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INVESTMENT RESEARCH

# Monthly Fixed Income Update

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**March 10, 2020**

| Interest Rate Summary | Feb 28-20 | Dec-31-19 | Nov-29-19 | Dec-31-18 | 29-Dec-17 | 30-Dec-16 | 31-Dec-15 |
|---|---|---|---|---|---|---|---|
| **U.S.** | | | | | | | |
| 3-Month T-Bill | 1.28% | 1.55% | 1.58% | 2.36% | 1.38% | 0.50% | 0.16% |
| 2-Year Treasury | 0.92% | 1.57% | 1.53% | 2.49% | 1.89% | 1.19% | 1.31% |
| 10-Year Treasury | 1.15% | 1.92% | 1.78% | 2.69% | 2.41% | 2.44% | 2.27% |
| **Canada** | | | | | | | |
| 3-Month T-Bill | 1.48% | 1.65% | 1.65% | 1.64% | 1.05% | 0.45% | 0.51% |
| 2-Year Canada | 1.15% | 1.69% | 1.58% | 1.86% | 1.69% | 0.74% | 0.48% |
| 10-Year Canada | 1.13% | 1.70% | 1.46% | 1.97% | 2.04% | 1.72% | 1.39% |

**Performance**

| | YTD | 2019 | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|---|---|
| DEX Universe Bond Index | 3.64% | 6.87% | 1.41% | 2.52% | 3.52% | 3.52% | 8.79% |
| DEX Federal Bond Index | 3.45% | 3.73% | 2.39% | 0.13% | 3.66% | 3.66% | 6.91% |
| DEX Provincial Bond Index | 4.23% | 9.07% | 0.66% | 4.33% | 4.14% | 4.14% | 12.18% |
| DEX All Corporate Index | 3.10% | 8.05% | 1.10% | 3.38% | 2.71% | 2.71% | 7.58% |
| DEX “A” Corporate Index | 3.50% | 9.65% | 0.51% | 4.42% | 2.62% | 2.62% | 9.10% |
| DEX Real Return Bonds | 5.23% | 8.02% | -0.05% | 0.72% | 2.79% | 2.79% | 13.18% |
| DEX High Yield Bonds | 1.58% | 8.48% | 2.15% | 5.20% | 13.79% | -5.58% | 2.64% |

All sectors produced positive returns in February with long-term government bonds producing the best returns. Corporate bond returns lagged those of government bonds. The high yield sector lagged for the fourth consecutive month.

**Comments:**

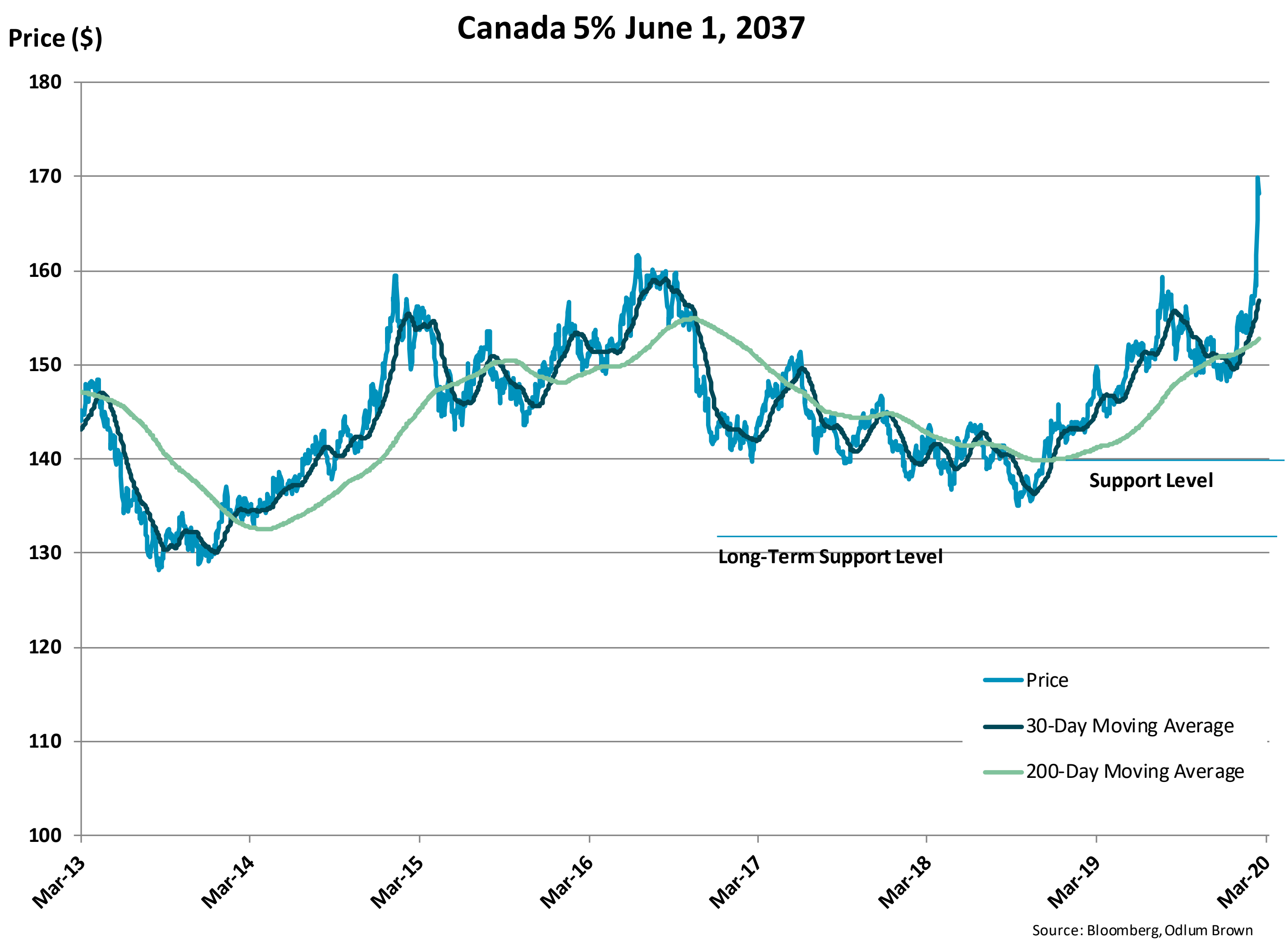
This has been an extraordinary time in the bond markets. Bond yields have plummeted as a result of the Covid-19 outbreak and the attendant global recession fears. There has been a stampede into government bonds:

| | Dec.31/19 | Jan. 31/20 | Feb. 28/20 | Current |
|---|---|---|---|---|
| **U.S. 3-month Treasury Bills** | 1.55% | 1.55% | 1.28% | 0.39% |
| **U.S. 2-year bonds** | 1.57% | 1.32% | 0.92% | 0.42% |
| **U.S. 10-year bonds** | 1.92% | 1.51% | 1.15% | 0.63% |

At the same time, corporate credit markets have been rattled as default fears have risen. All of this market action has taken place after most economic data has been constructive.

In a move seldom seen and that some observers think to be somewhat panicky, the Federal Reserve lowered the Fed Funds Rate by a full 50 basis points between regularly scheduled FOMC meetings. The market is discounting a similar move at the March meeting. Most other central banks, including the Bank of Canada, have followed suit.

Recognizing that monetary policy can only do so much, there is much discussion of fiscal stimulus thought to be necessary to stave off recession. Inflation expectations have fallen significantly also.

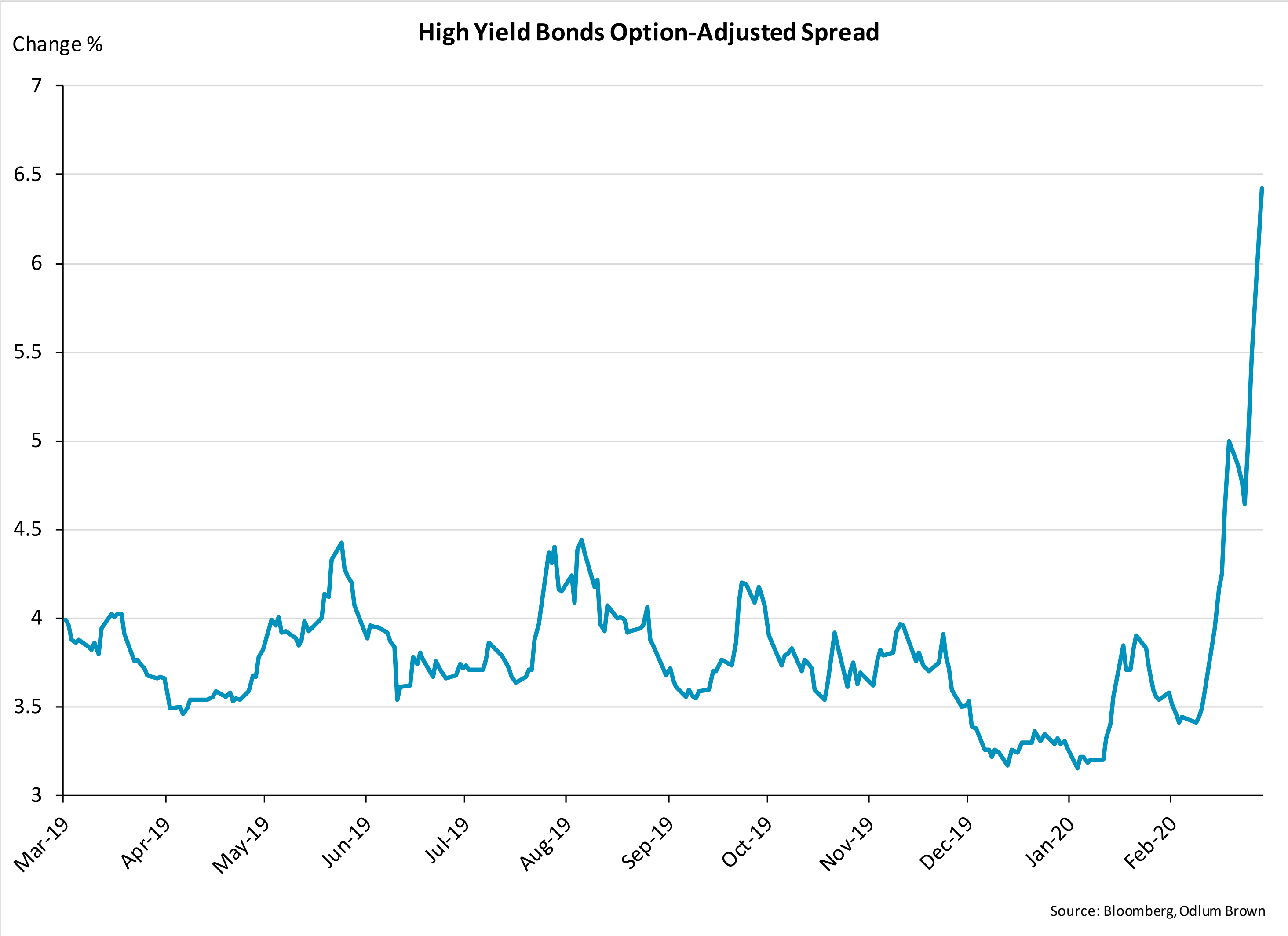



**This bond climbed sharply and has reached all-time highs.**

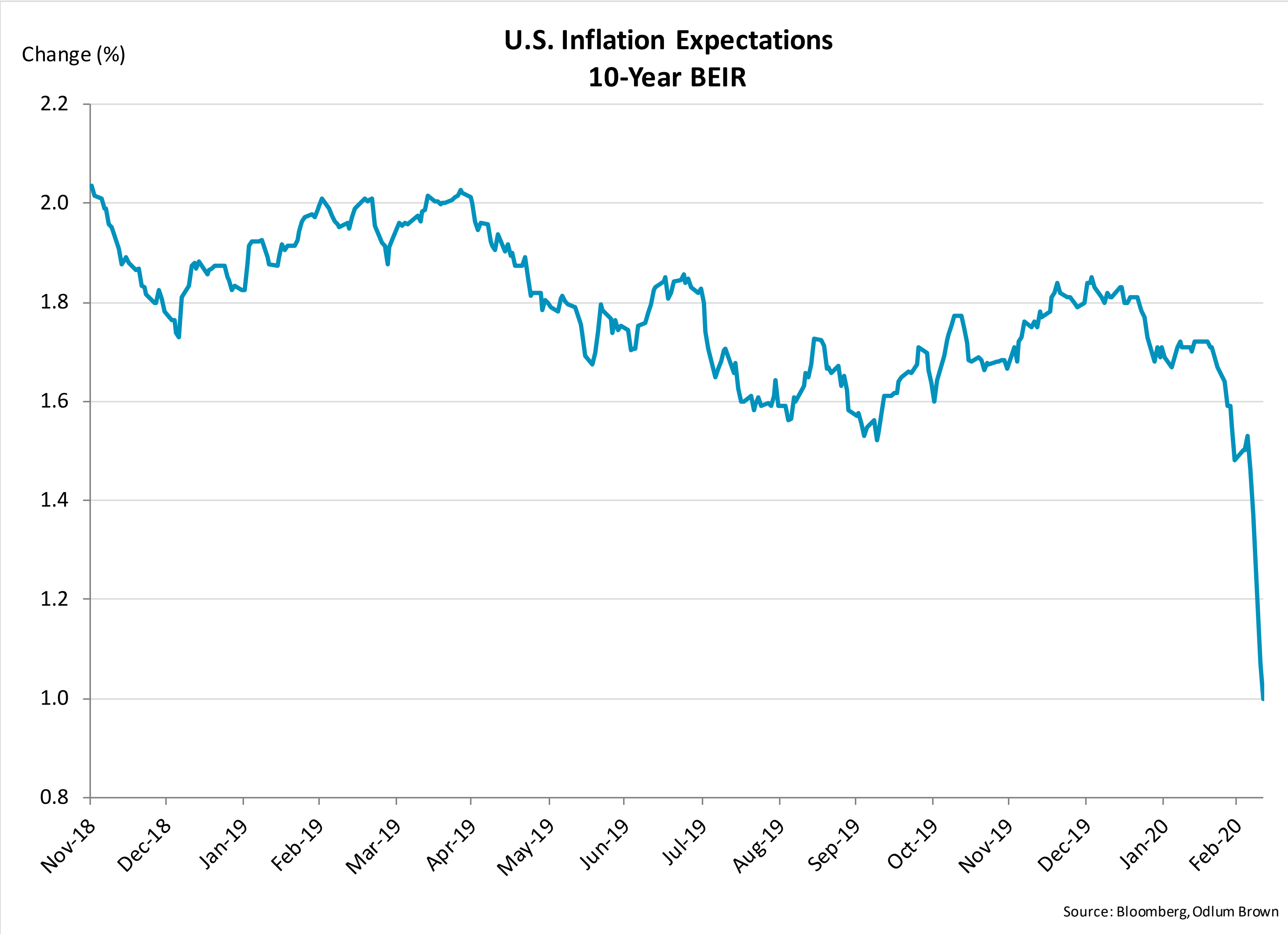
## U.S. 10-Year Treasury


Source: Bloomberg, Odlum Brown

**This global bellwether bond's yield fell sharply to record lows.**




**The high yield market has witnessed sharply wider yield spreads from government bonds.**




**Inflation expectations have moved sharply lower.**

**Outlook**

Fixed income investors have gone through a dramatic turn of events. Government yields in North America have plunged and are approaching zero. At the same time, corporate credit markets have witnessed a significant widening of bond yields. High yield energy bonds, in particular, have been battered.

Central banks everywhere have loosened monetary policy again. As they do not have much left in the way of ammunition, the focus has shifted to fiscal stimulus. Several countries have announced, or are about to announce, such stimulus in an attempt to stabilize their economies and fend off a recession. Substantial fiscal stimulus will provide some cushion as will sharply lower energy prices. In the meantime, there is no evidence of Covid-19 peaking and thus, economic activity will be constrained.

Wider yield spreads for corporate bonds, both investment-grade and high yield, will be a feature of the markets in the near future. The spread for investment-grade corporates has already blown out to 200 basis points over U.S. Treasury notes. Some pundits believe this spread could widen further, to 400 basis points.

**Strategy**

Quality is the keyword for fixed income investors. In this environment, we favour non-cyclical corporate bonds, such as those issued by utilities, banks and recurring revenue businesses such as 407 ETR. We also favour GICs.

Energy bonds have come under pressure and have little liquidity.

We have long recommended the laddered approach to fixed income investing. We continue to do so and, in addition to GICs, investors may wish to consider short-term provincial bonds.

For further discussion, please speak to your Portfolio Manager or Investment Advisor.