Monthly Fixed Income Update

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Interest Rate Summary	Feb-27-21	Jan-29-21	Dec-31-20	Dec-31-19	Dec-31-18	29-Dec-17
U.S.						
3-Month T-Bill	0.04%	0.05%	0.08%	1.55%	2.36%	1.38%
2-Year Treasury	0.13%	0.11%	0.12%	1.57%	2.49%	1.89%
10-Year Treasury	1.41%	1.07%	0.92%	1.92%	2.69%	2.41%
Canada						
3-Month T-Bill	0.12%	0.06%	0.06%	1.65%	1.64%	1.05%
2-Year Canada	0.30%	0.15%	0.20%	1.69%	1.86%	1.69%
10-Year Canada	1.35%	0.89%	0.68%	1.70%	1.97%	2.04%

Performance

	YTD	2020	2019	2018	2017	2016	2015
DEX Universe Bond Index	-3.60%	8.68%	6.87%	1.41%	2.52%	3.52%	3.52%
DEX Federal Bond Index	-2.97%	7.28%	3.73%	2.39%	0.13%	3.66%	3.66%
DEX Provincial Bond Index	-4.93%	9.86%	9.07%	0.66%	4.33%	4.14%	4.14%
DEX All Corporate Index	-2.48%	8.74%	8.05%	1.10%	3.38%	2.71%	2.71%
DEX "A" Corporate Index	-3.27%	8.98%	9.65%	0.51%	4.42%	2.62%	2.62%
DEX Real Return Bonds	-5.91%	13.02%	8.02%	-0.05%	0.72%	2.79%	2.79%
DEX High Yield Bonds	2.02%	6.69%	8.48%	2.15%	5.20%	13.79%	-5.58%

All sectors produced sharply negative performance in February with the exception of high yield bonds.

Longer-term bond yields rose significantly last month with the bellwether U.S. 10-year note tacking on 34 basis points. The Canadian 10-year bond added 46 basis points. This trend has continued into March with the U.S. 10-year bond tacking on a further 15 basis points since month end. For the year-to-date, the U.S. 10-year yield has gained a full 70 basis points.

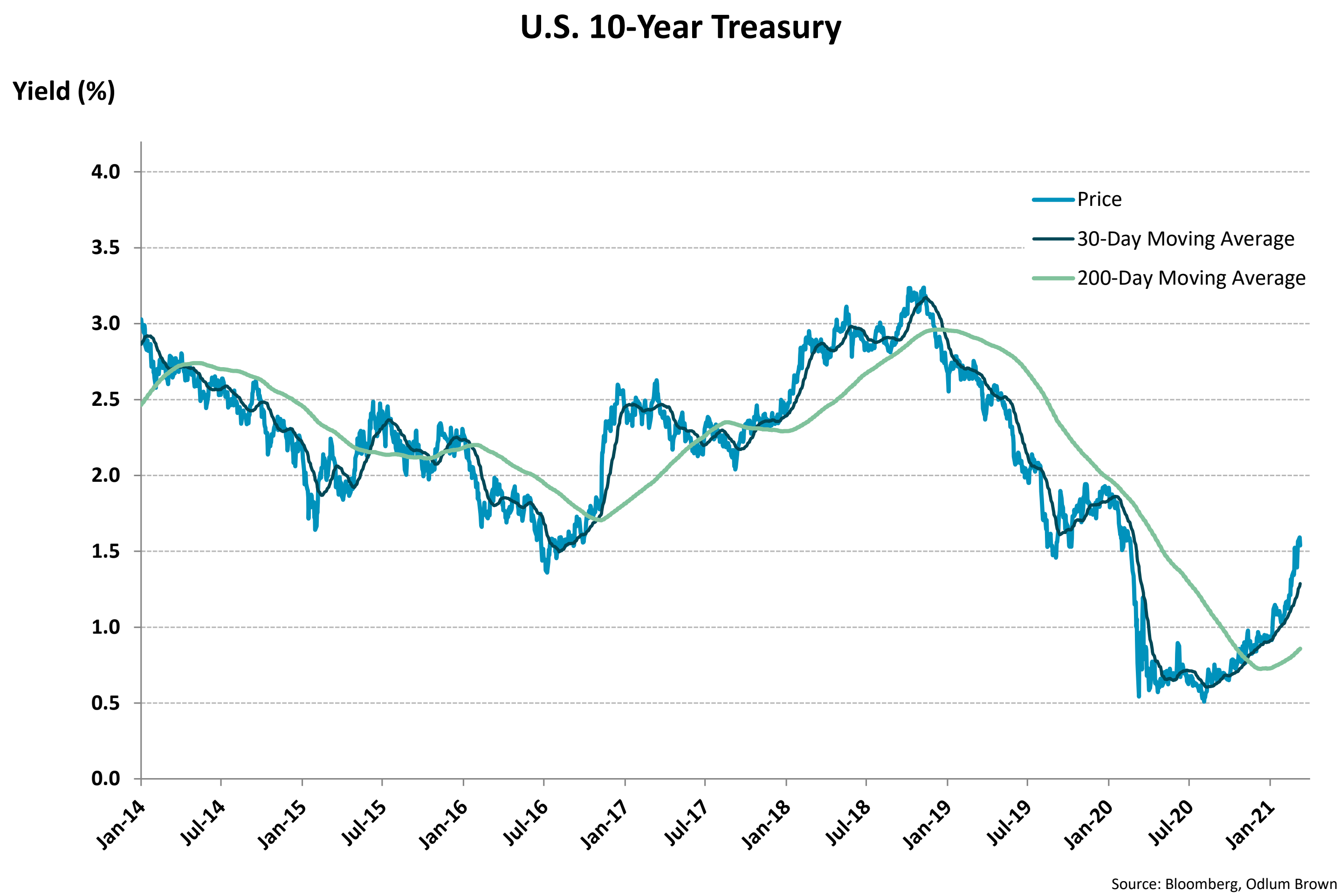
Thus far, the Federal Reserve has displayed no concern over this sharp increase in market yields, continuing to aver its preference for lower and longer monetary ease.

This occurred after a steady stream of economic data exceeded expectations, including housing starts, home sales (prices were the highest since 2006), durable goods orders, capital goods orders and various PMIs. This series of positive news culminated in a robust employment report, pushing the U.S. unemployment rate lower to 6.2%.

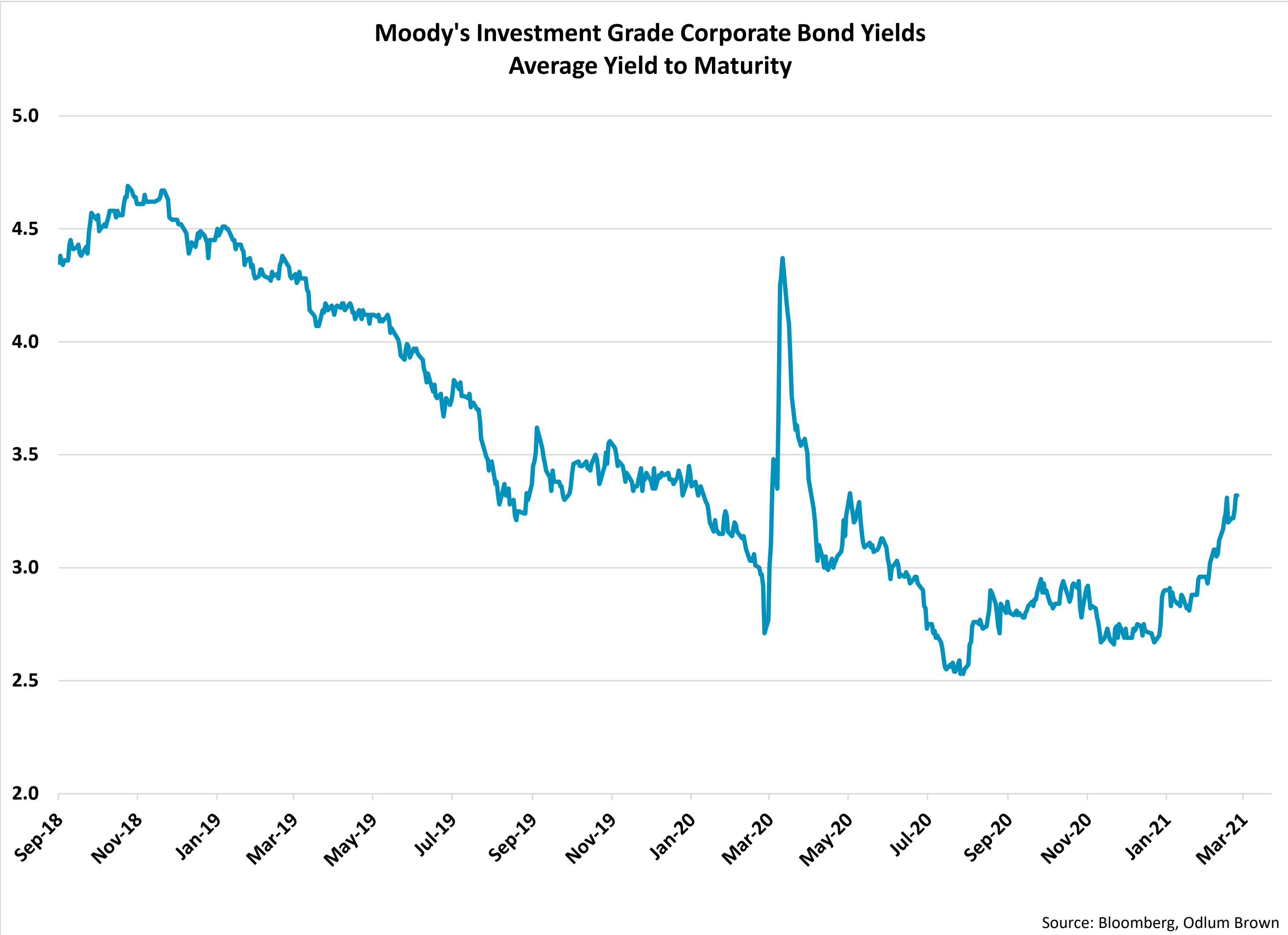
Further, inflation expectations soared over 2% and the broad rally in commodity prices continued.

Canada also reported some strong data, such as a blowout retail sales print, plus a robust 0.7% increase in the November GDP. Combined with the biggest trade surplus since 2014 and a concomitant narrowing of the current account deficit, the Canadian dollar appreciated. Now, with the vaccine rollout underway and the economic skies brightening, consumer confidence has reached a three-year high.

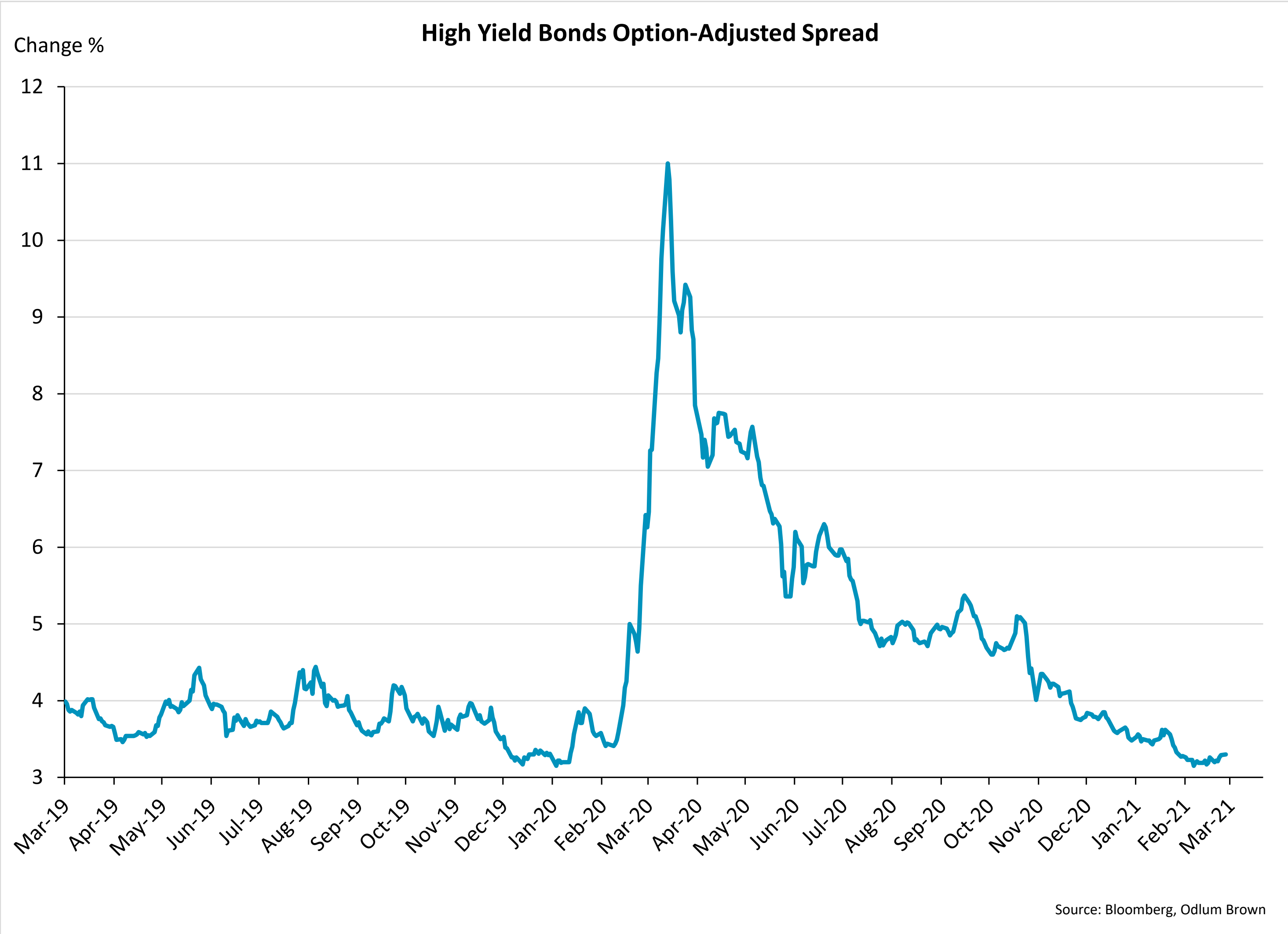
Globally, prospects have brightened, with all developed world nations reporting upswings in economic activity.



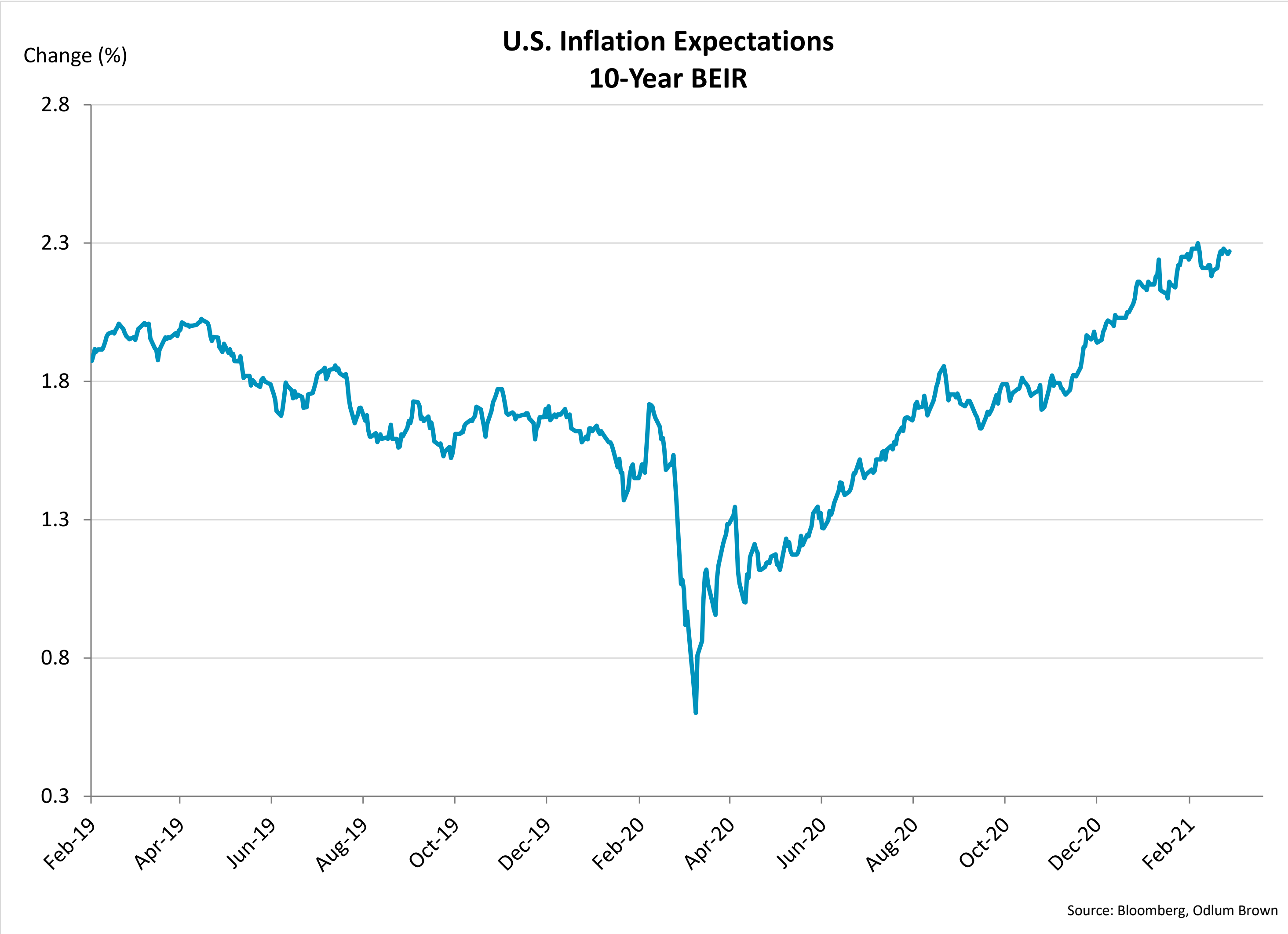
This global bellwether moved decisively higher in yield.



Investment-grade corporate bond yields have begun to move higher with U.S. Treasury yields.



The high yield market resumed its rally. Spreads reached all-time lows but have gradually moved up.



Inflation expectations moved sharply above the important 2% level and have levelled off at six-year highs near 2.25%.

Outlook

Last month, we detailed the factors in place that would produce higher yields. These factors remain and thus, we conclude that bond yields should continue to climb. While the bond market may stabilize around current yield levels, the trend higher in real yields is likely to continue; our target for the U.S. 10-year is in the 1.75 - 2.00% range.

Fundamentals include:

- Massive federal deficits
- Soaring Money Supply; up 25% year-over-year, but turnover is still low
- Monetary accommodation; the Federal Reserve favours inflation running higher than its 2% target
- Fiscal stimulus: another $1.9 trillion
- Commodity prices are up 13% in the last 12 months

- A weaker U.S. dollar
- Inflation expectations are at a six-year high
- Record borrowing needs by the U.S. Government

The Federal Reserve has shown no inclination to either taper its bond purchases or interfere with the long-term bond market. It is a distinct possibility that record borrowing by the U.S. Treasury may cause occasional disruptions in the bond market.

CPI estimates are for a 2.2% increase in 2021, perhaps reaching 3% at its highest. One school of thought has this as a temporary phenomenon with inflation easing back as the year progresses.

Corporate bond yields will compress further with government yields but will not fall in nominal terms. Therefore, we continue to expect corporate bond returns to outpace those of government bonds but those returns will be modest at best.

Strategy

With an outlook for gradually rising bond yields, the number one theme for fixed income investors is preservation of capital. We continue to stress the importance of including high-quality, fixed income securities of relatively short durations in client portfolios. In this environment, we favour non-cyclical corporate bonds of maturities less than five years, such as those issued by utilities, banks, telecommunications and recurring-revenue businesses. Corporate bonds will generate only modest returns at best this year but will outperform government bonds. We have long recommended a laddered approach to fixed income investing. We continue to do so as a one- to five-year ladder has a short duration.

For several years, we have had an approved list of outside fund managers. At present, in order to augment returns and benefit from their expertise in credit markets, we recommend two of these managers in particular, who are well positioned for this market environment. For further discussion, please speak to your Portfolio Manager or Investment Advisor.