Monthly Fixed Income Update

Hank Cunningham

May 11, 2018

Interest Rate Summary	30-Apr-18	29-Dec-17	30-Dec-16	31-Dec-15	31-Dec-14	31-Dec-13	31-Dec-12
U.S.							
3-Month T-Bill	1.80%	1.38%	0.50%	0.16%	0.04%	0.07%	0.04%
2-Year Treasury	2.49%	1.89%	1.19%	1.31%	0.47%	0.38%	0.25%
10-Year Treasury	2.95%	2.41%	2.44%	2.27%	2.17%	3.03%	1.76%
Canada							
3-Month T-Bill	1.19%	1.05%	0.45%	0.51%	0.90%	0.92%	0.92%
2-Year Canada	1.89%	1.69%	0.74%	0.48%	0.99%	1.14%	1.14%
10-Year Canada	2.30%	2.04%	1.72%	1.39%	1.86%	2.76%	1.80%

Performance

	Apr-2018	2017	2016	2015	2014	2013	2012
DEX Universe Bond Index	-0.86%	2.52%	3.52%	3.52%	8.79%	-1.19%	2.65%
DEX Federal Bond Index	-0.70%	0.13%	3.66%	3.66%	6.91%	-1.52%	2.11%
DEX Provincial Bond Index	-1.26%	4.33%	4.14%	4.14%	12.18%	-2.70%	
DEX All Corporate Index	-0.55%	3.38%	2.71%	2.71%	7.58%	0.84%	6.22%
DEX “A” Corporate Index	-0.71%	4. 42%	2.62%	2.62%	9.10%	-0.16%	6.85%
DEX Real Return Bonds	-0.83%	0.72%	2.79%	2.79%	13.18%	-13.1%	
XHY ETF High Yield Bonds	0.63%	5.20%	13.79%	-5.58%	2.64%	6.87%	

Comments

Bond yields rose at all maturities in April with the yield on the bellwether U.S. ten-year note adding twenty basis points to reach 2.95%. The U.S. two-year note reached 2.50%, the highest since 2008 and its yield now exceeds the dividend yield for the Dow Jones Industrial Average.

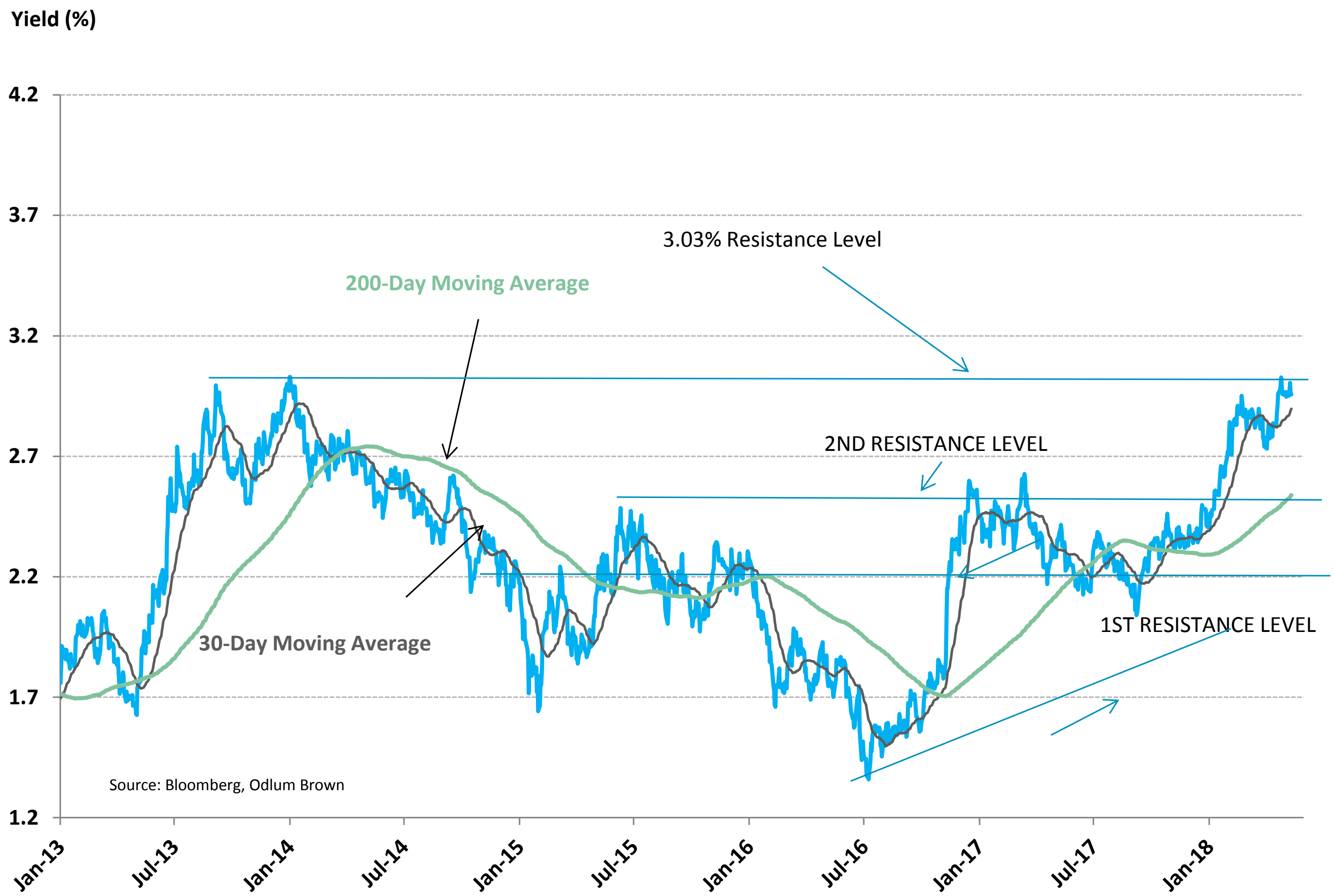
Thus, performance was negative in most sectors of the bond market in April. It was notable that Government bonds underperformed corporate bonds by a healthy margin as credit spreads stabilized and government yields rose. The high yield market was stable and produced positive returns.

The yield curve was slightly steeper for the month but the flattening trend has resumed in May.

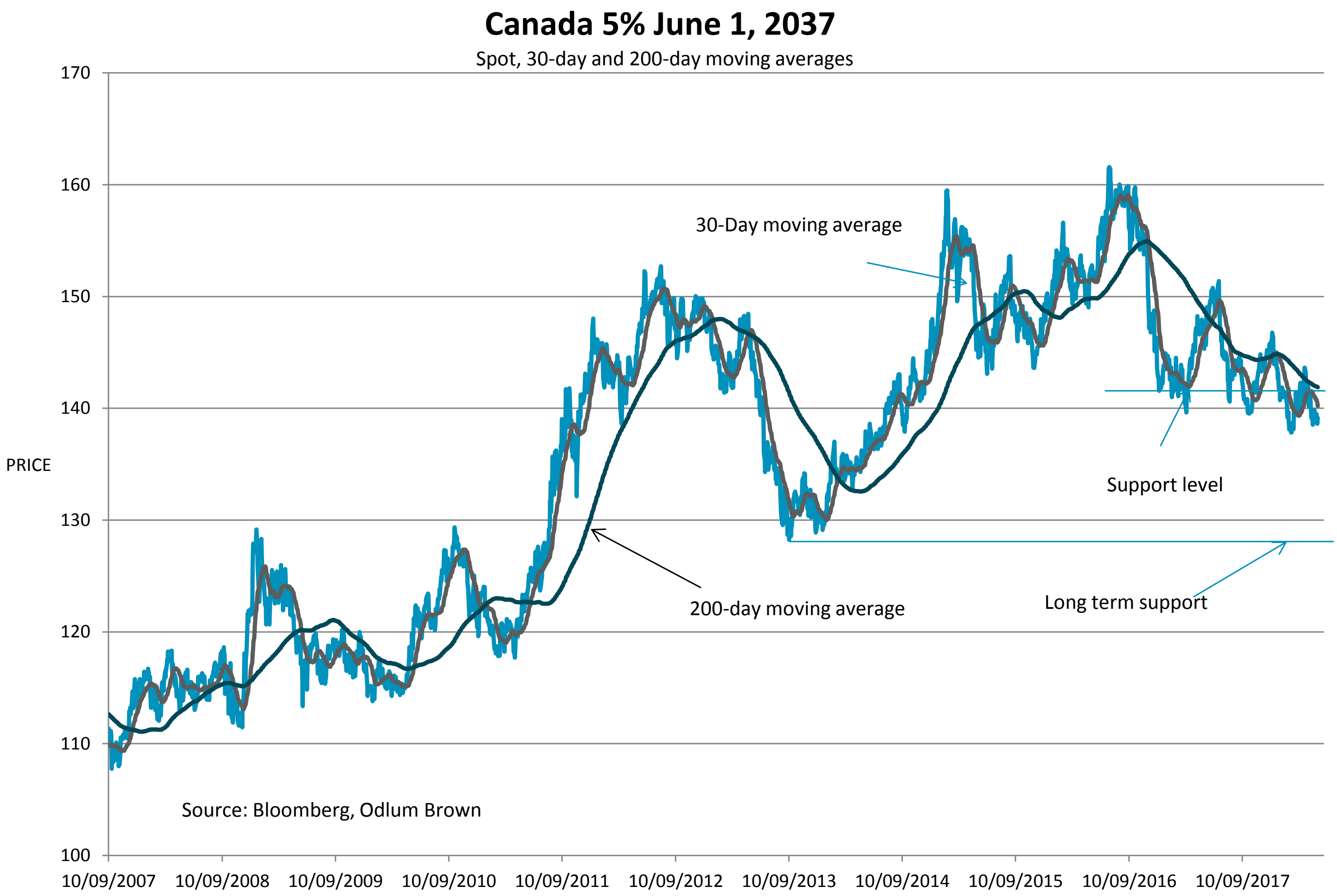
It was noteworthy in Canada that the Government five-year yield reached its highest level in five years and gave rise to hikes in mortgage rates. The Bank of Canada did not raise the Bank Rate and adopted a neutral tone as the Canadian economy experienced some headwinds.

Elsewhere, there was no change in the monetary accommodation by the European Central Bank or the Bank of Japan.

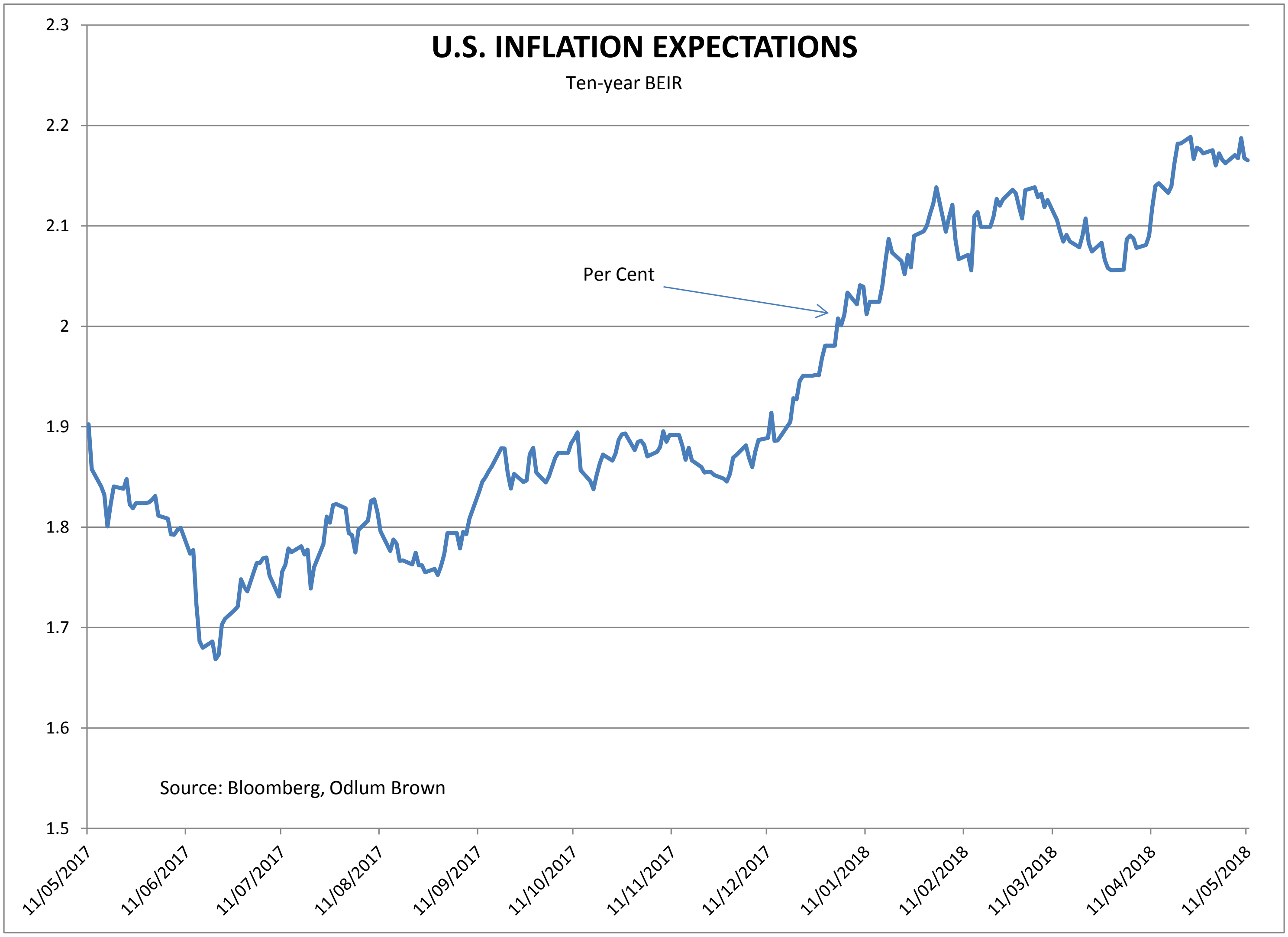
U.S. 10-Year Treasury



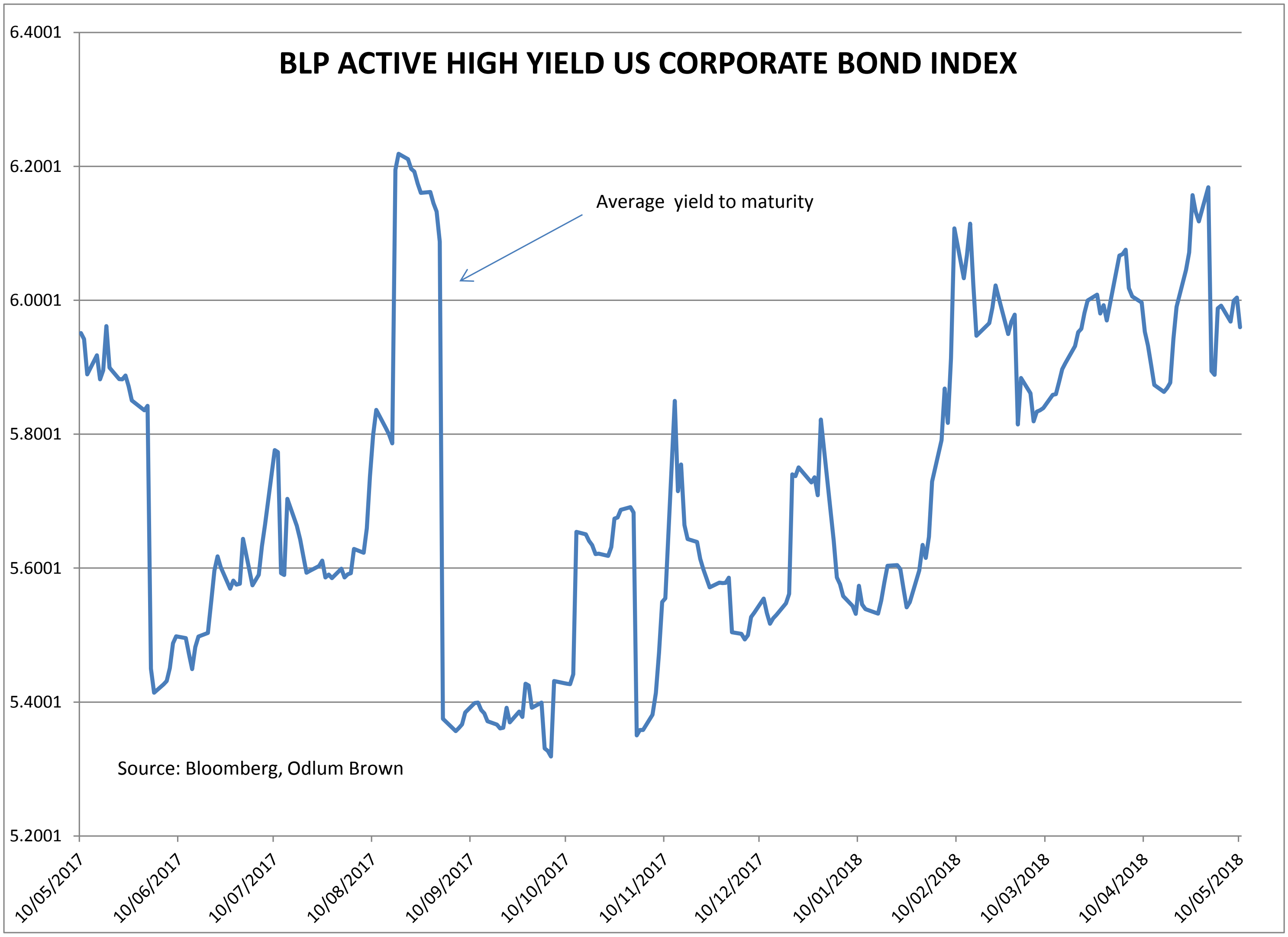
The yield on this bellwether bond has stabilized just below the psychologically important 3% level. The support level is at 2.63%.



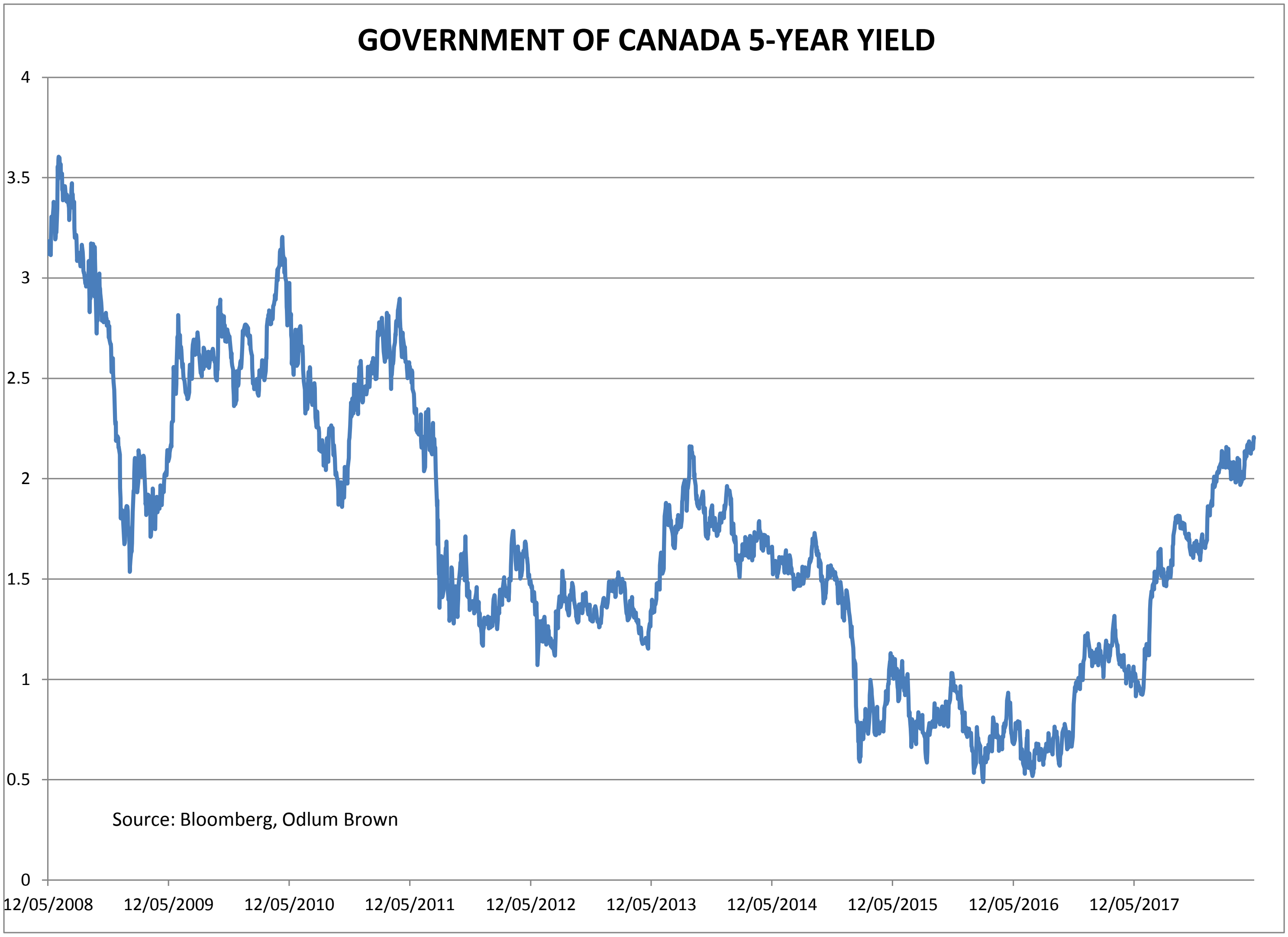
The price of this long-term Canada bond has slumped in the past month and is below the major resistance line but well above long-term support.



Inflation expectations remain solidly over 2%.



The high yield market has stabilized near its high yield mark for the year. Spreads remain near historically narrow levels.



This ten-year chart of the Canada five-year yield depicts the sharp increase over the past year and it portends further upward pressure on mortgage rates in Canada.

Outlook

We believe that the uptrend in bond yields will continue and this means an unattractive risk/reward for longer dated bonds. The rising trend in short-term yields in North America, following increases in administered rates by the Federal Reserve and the Bank of Canada, has reduced the penalty for staying in short-dated bonds.

The U.S. economy may experience 3% real GDP growth this year. The employment market is taut and inflation has approached or passed the Central Bank targets. The housing market remains healthy, industrial production continues to pick up and consumer confidence is high. Inflation, while firming, is not an immediate threat to markets.

With this outlook as a backdrop, the Fed will continue to normalize short-term interest rates with at least two more increases in the Fed Funds Rate expected this year. The Bank of Canada has moved to a neutral position as it monitors the various headwinds affecting the Canadian economy. It will raise rates but will lag the U.S. Fed.

There is no change likely in the quantitative easing by either the European Central Bank or the Bank of Japan. Therefore, U.S. bond yields will stand out in global markets and attract foreign investors. While this will likely put a cap on bond yields (the 3% level on the ten-year has become a significant barrier), the heavy supply of new U.S. Treasury offerings plus the ongoing reduction in the Fed's balance sheet will exert upward pressure on bond yields.

The recent sustained strength in commodity prices will also contribute to higher bond yields as inflation will inevitably accelerate to some degree.

With the odds of a recession occurring in the next two years being low, credit markets, both investment-grade and high-yield, are healthy and we do not anticipate any significant deterioration in corporate credit health.

Strategy

Against this backdrop, it is difficult to foresee anything but modest or negative returns in fixed income portfolios. Thus, preservation of capital should be the main theme for fixed income investors. At the core of bond portfolios, therefore, we counsel fixed income investors to have high-quality, short-duration corporate bonds. This core could be augmented by a representation in the high yield market, as even with the expected rise in government yields their total returns should still exceed returns from the government sector. At present, the credit markets are showing only modest signs of strain and yield spreads remain relatively narrow. Should we perceive any possible significant weakness in credit markets, we may advise including selected provincial bonds in clients' portfolios. There is a case to be made for selected investment in funds of certain investment management firms. We endorse a number of those that have added value to clients' portfolios. For more information, please speak to your advisor.

Please read our Odlum Brown Limited Disclaimer and Disclosure - It is important!

Odlum Brown Limited is an independent, full-service investment firm focused on providing professional investment advice and objective research. We respect your right to be informed of relationships with the issuers or strategies referred to in this report which might reasonably be expected to indicate potential conflicts of interest with respect to the securities or any investment strategies discussed or recommended in this report. We do not act as a market maker in any securities and do not provide investment banking or advisory services to, or hold positions in, the issuers covered by our research. Analysts and their associates may, from time to time, hold securities of issuers discussed or recommended in this report because they personally have the conviction to follow their own research, but we have implemented internal policies that impose restrictions on when and how an Analyst may buy or sell securities they cover and any such interest will be disclosed in our report in accordance with regulatory policy. Our Analysts receive no direct compensation based on revenue from investment banking services. We describe our research policies in greater detail, including a description of our rating system and how we disseminate our research, on the Odlum Brown Limited website www.odlumbrown.com.

This report has been prepared by Odlum Brown Limited and is intended only for persons resident and located in all the provinces and territories of Canada, where Odlum Brown Limited's services and products may lawfully be offered for sale, and therein only to clients of Odlum Brown Limited. This report is not intended for distribution to, or use by, any person or entity in any jurisdiction or country including the United States, where such distribution or use would be contrary to law or regulation or which would subject Odlum Brown Limited to any registration requirement within such jurisdiction or country. As no regard has been made as to the specific investment objectives, financial situation, and other particular circumstances of any person who may receive this report, clients should seek the advice of a registered investment advisor and other professional advisors, as applicable, regarding the appropriateness of investing in any securities or any investment strategies discussed or recommended in this report.

This report is for information purposes only and is neither a solicitation for the purchase of securities nor an offer of securities. The information contained in this report has been compiled from sources we believe to be reliable, however, we make no guarantee, representation or warranty, expressed or implied, as to such information's accuracy or completeness. All opinions and estimates contained in this report, whether or not our own, are based on assumptions we believe to be reasonable as of the date of the report and are subject to change without notice.

Please note that, as at the date of this report, the Research Analyst responsible for the recommendations herein, associates of such Analyst and/or other individuals directly involved in the preparation of this report hold securities of the issuer(s) referred to directly or through derivatives.

No part of this publication may be reproduced without the express written consent of Odlum Brown Limited. Odlum Brown Limited is a Member of the Canadian Investor Protection Fund.