MONTHLY FIXED INCOME UPDATE

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November 7, 2017

Interest Rate Summary	31-Oct-17	30-Dec-16	31-Dec-15	31-Dec-14	31-Dec-13	31-Dec-12
U.S.						
3-Month T-Bill	1.13%	0.50%	0.16%	0.04%	0.07%	0.04%
2-Year Treasury	1.60%	1.19%	1.31%	0.47%	0.38%	0.25%
10-Year Treasury	2.38%	2.44%	2.27%	2.17%	3.03%	1.76%
Canada						
3-Month T-Bill	0.87%	0.45%	0.51%	0.90%	0.92%	0.92%
2-Year Canada	1.39%	0.74%	0.48%	0.99%	1.14%	1.14%
10-Year Canada	1.95%	1.72%	1.39%	1.86%	2.76%	1.80%

Performance

	Oct-2017	Year-to-Date	2016	2015	2014	2013	2012
DEX Universe Bond Index	1.64%	2.13%	3.52%	3.52%	8.79%	-1.19%	2.65%
DEX Federal Bond Index	1.07%	0.33%	3.66%	3.66%	6.91%	-1.52%	2.11%
DEX Provincial Bond Index	2.33%	3.27%	4.14%	4.14%	12.18%	-2.70%	
DEX All Corporate Index	1.55%	3.06%	2.71%	2.71%	7.58%	0.84%	6.22%
DEX “A” Corporate Index	1.79%	3.97%	2.62%	2.62%	9.10%	-0.16%	6.85%
DEX Real Return Bonds	2.26%	-0.75%	2.79%	2.79%	13.18%	-13.1%	
DEX High Yield Bonds	1.08%	8.54%					

Comments:

Performance was positive in all sectors of the bond market in October with investment grade corporates outperforming high yield bonds. All sectors have displayed positive returns for the year with the exception of real return bonds.

While U.S. yields rose for the month, Canadian yields fell, reversing part of September’s trend.

	U.S.	Canada	Net Difference
Three month Treasury Bills	+5 basis points	-13 basis points	-18 basis points
Two-year bond yields	+11 basis points	-13 basis points	-24 basis points
Ten-year bond yields	+5 basis points	-15 basis points	-20 basis points

The table above shows how Canadian yields fell in October compared to their U.S. counterparts.

Early in the month, the U.S. ten-year bond was approaching 2.50% as a result of further evidence of synchronized global growth and some signs of a pick up in inflation.. Further, market participants believed that ECB head Mario Draghi would make meaningful steps to begin to withdraw monetary stimulus.

Most bonds in the Euro zone are trading at yields well below those in the United States and this serves to limit increases in U.S. bond yields. Instead, inflation readings remained benign, running at a year-over-year pace of 1.7% in the U.S, and Draghi took only a baby step towards normalization. Thus, U.S. bond yields subsided to 2.38%, up a mere 5 basis points for the month. They have fallen further, to 2.32% since month end. The market also was split regarding the appointment of the next Fed chairman; the appointment of Powell was a victory for those favouring the continuance of moderation in monetary policy.

The most recent employment report fell short of street expectations and, importantly, displayed zero wage growth.

Turning to Canada, the economy cooled over the summer as the U.S economy picked up steam. Bond yields fell sharply and so did the Loonie. The Bank of Canada has now assumed a wait and see stance and is unlikely to raise the Bank Rate in December.

This bond approached but did not break above 2.50%. It continues to be locked in a narrow trading range with an upward yield bias.

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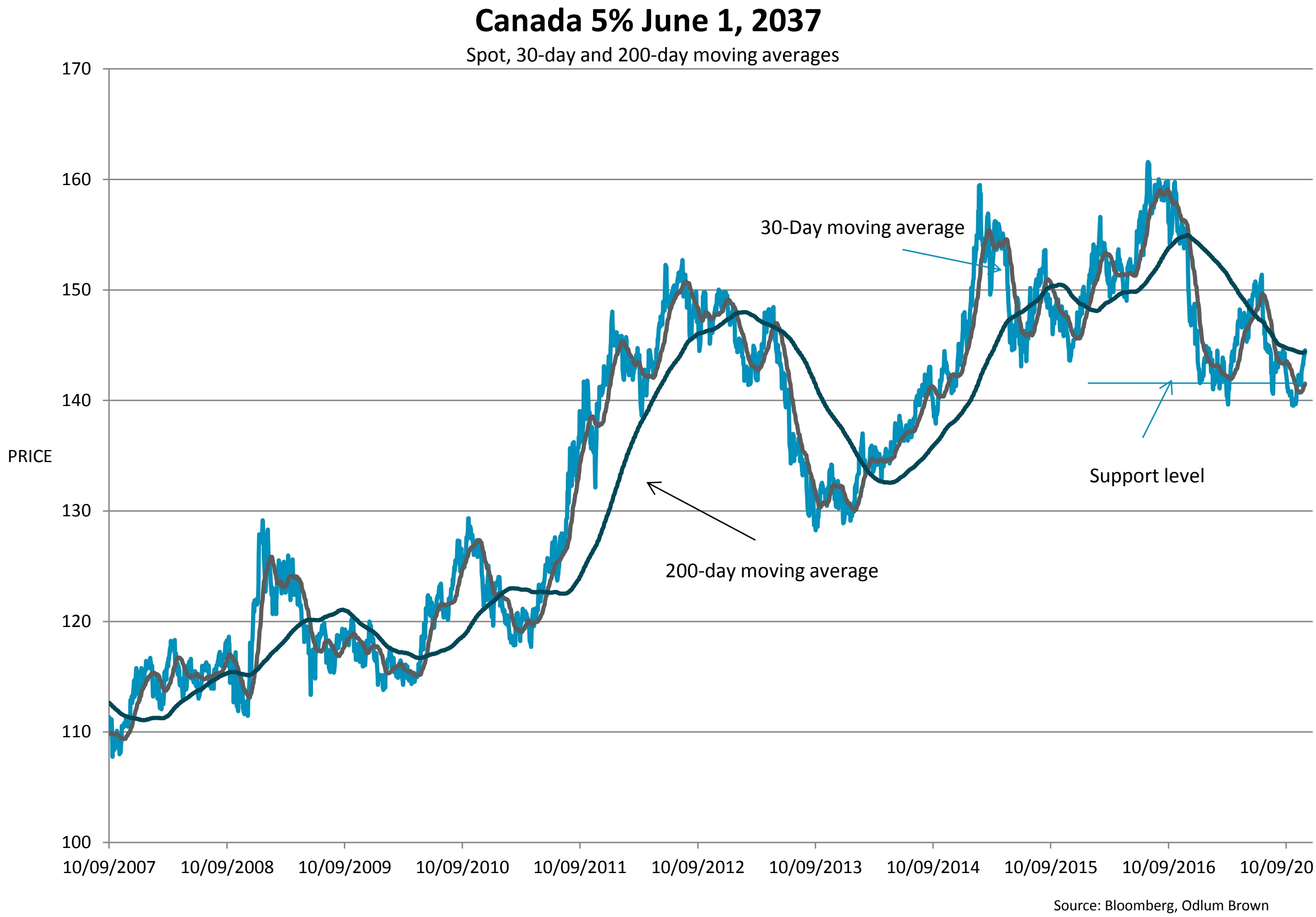

The price of this long-term Canada bond has rallied sharply and is touching the 200 day moving average.

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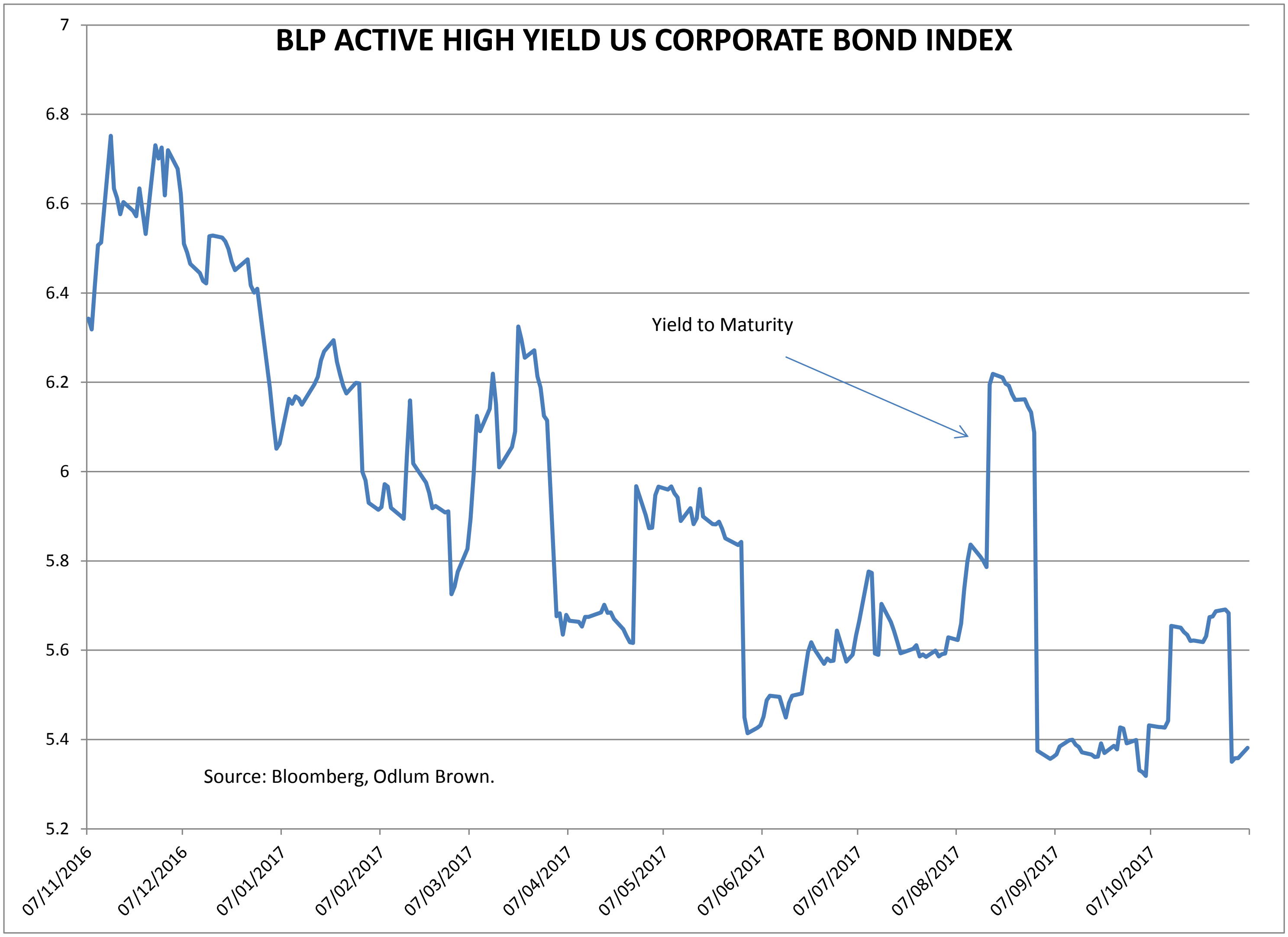

The high-yield bond market remains stable in the region of 5.50%

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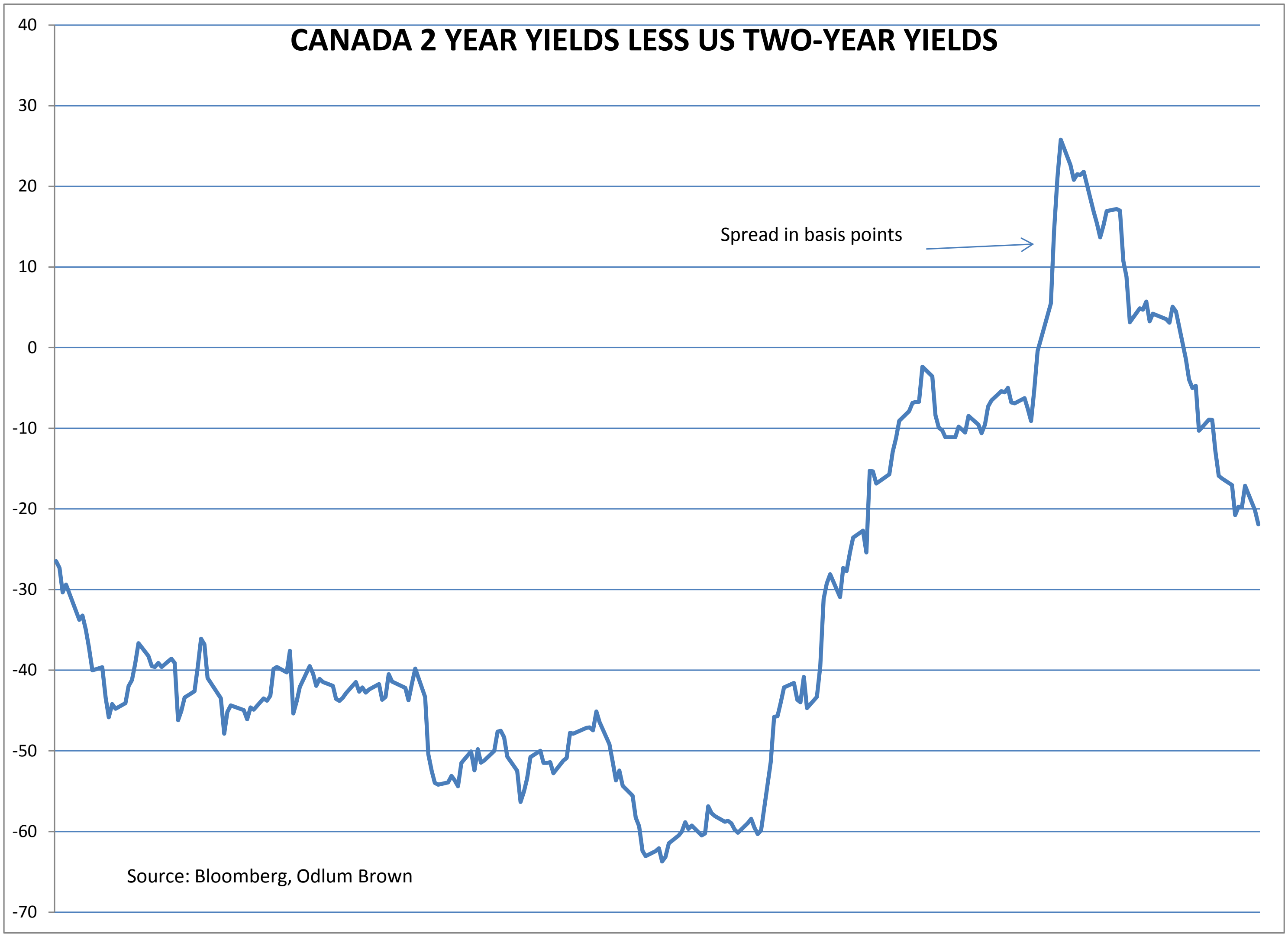

This chart displays the dramatic swing in the yield of the Canada two-year bond versus the US two-year bond.

Outlook

The appointment of Jerome Powell to replace Janet Yellen as Fed Chair means that, in all likelihood, US monetary policy will remain on a steady course of normalization. All signs point to an increase in the Fed Funds Rate in December. Bond yields in the U.S. will be held down by the lower yields in Europe. ECB head Draghi's tepid move recently has done little to change this.

At the margin, we believe that bond yields will inch higher. The global synchronized economic recovery continues apace but, as yet, unaccompanied by any acceleration in inflation, despite a tight labour market.

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The Canadian economy has softened in the summer months, resulting in a decline in market bond yields and the adoption of a dovish stance by the Bank of Canada. Thus, there is little chance of a hike in the Canadian Bank Rate in the short term.

Strategy

There is no reason to alter our stance of maintaining high quality, laddered corporate portfolios with a short duration. For those investors with the appropriate risk profile, high yield bonds deserve a presence in fixed income portfolios. Continued investment in corporate bonds will result in positive, albeit small, returns.

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