# Monthly Fixed Income Update

**Hank Cunningham**

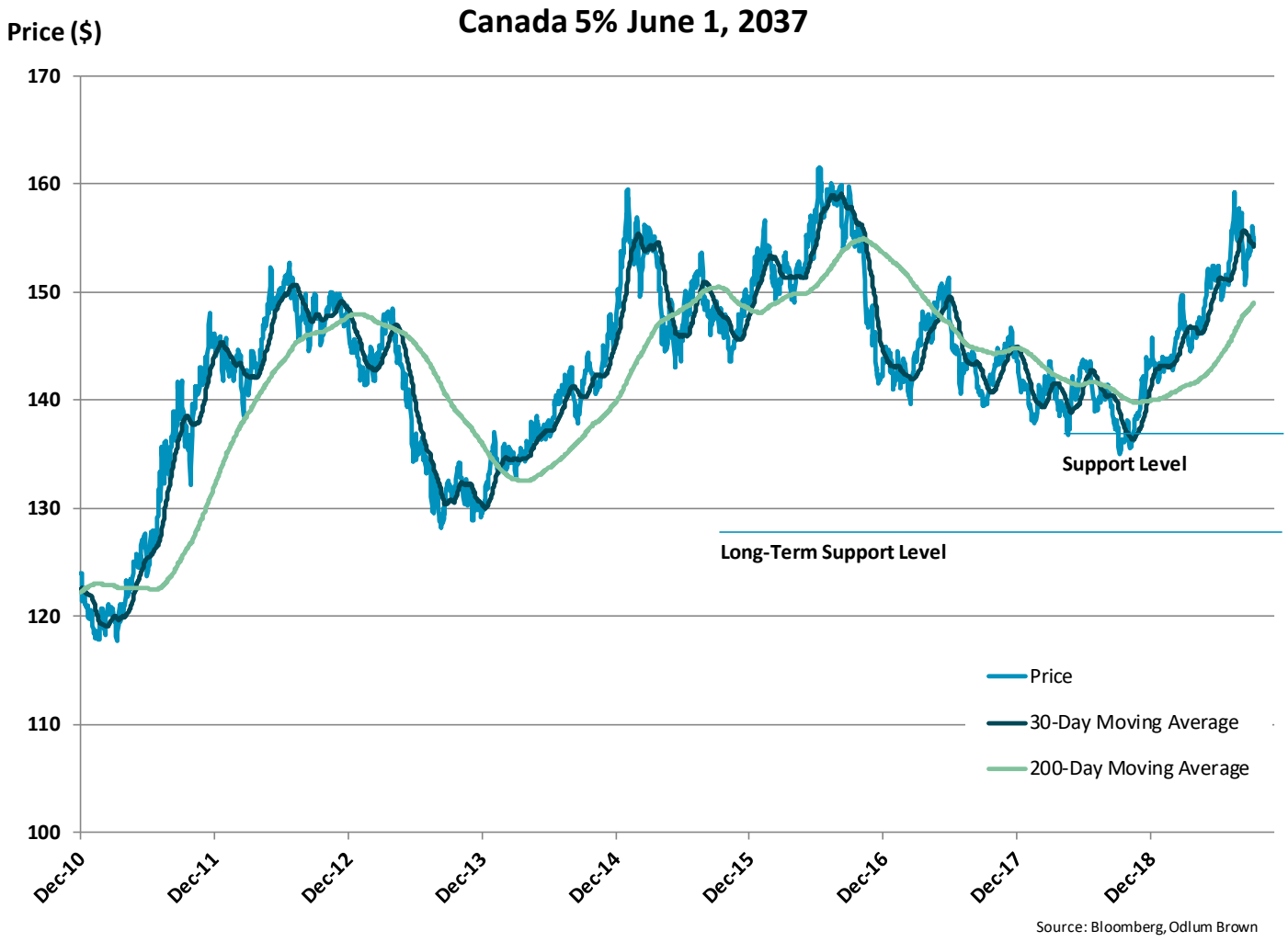
**October 9, 2019**

| Interest Rate Summary | Sep-30-19 | Dec-31-18 | 29-Dec-17 | 30-Dec-16 | 31-Dec-15 | 31-Dec-14 | 31-Dec-13 |
|---|---|---|---|---|---|---|---|
| **U.S.** | | | | | | | |
| 3-Month T-Bill | 1.78% | 2.36% | 1.38% | 0.50% | 0.16% | 0.04% | 0.07% |
| 2-Year Treasury | 1.62% | 2.49% | 1.89% | 1.19% | 1.31% | 0.47% | 0.38% |
| 10-Year Treasury | 1.67% | 2.69% | 2.41% | 2.44% | 2.27% | 2.17% | 3.03% |
| **Canada** | | | | | | | |
| 3-Month T-Bill | 1.65% | 1.64% | 1.05% | 0.45% | 0.51% | 0.90% | 0.92% |
| 2-Year Canada | 1.58% | 1.86% | 1.69% | 0.74% | 0.48% | 0.99% | 1.14% |
| 10-Year Canada | 1.36% | 1.97% | 2.04% | 1.72% | 1.39% | 1.86% | 2.76% |

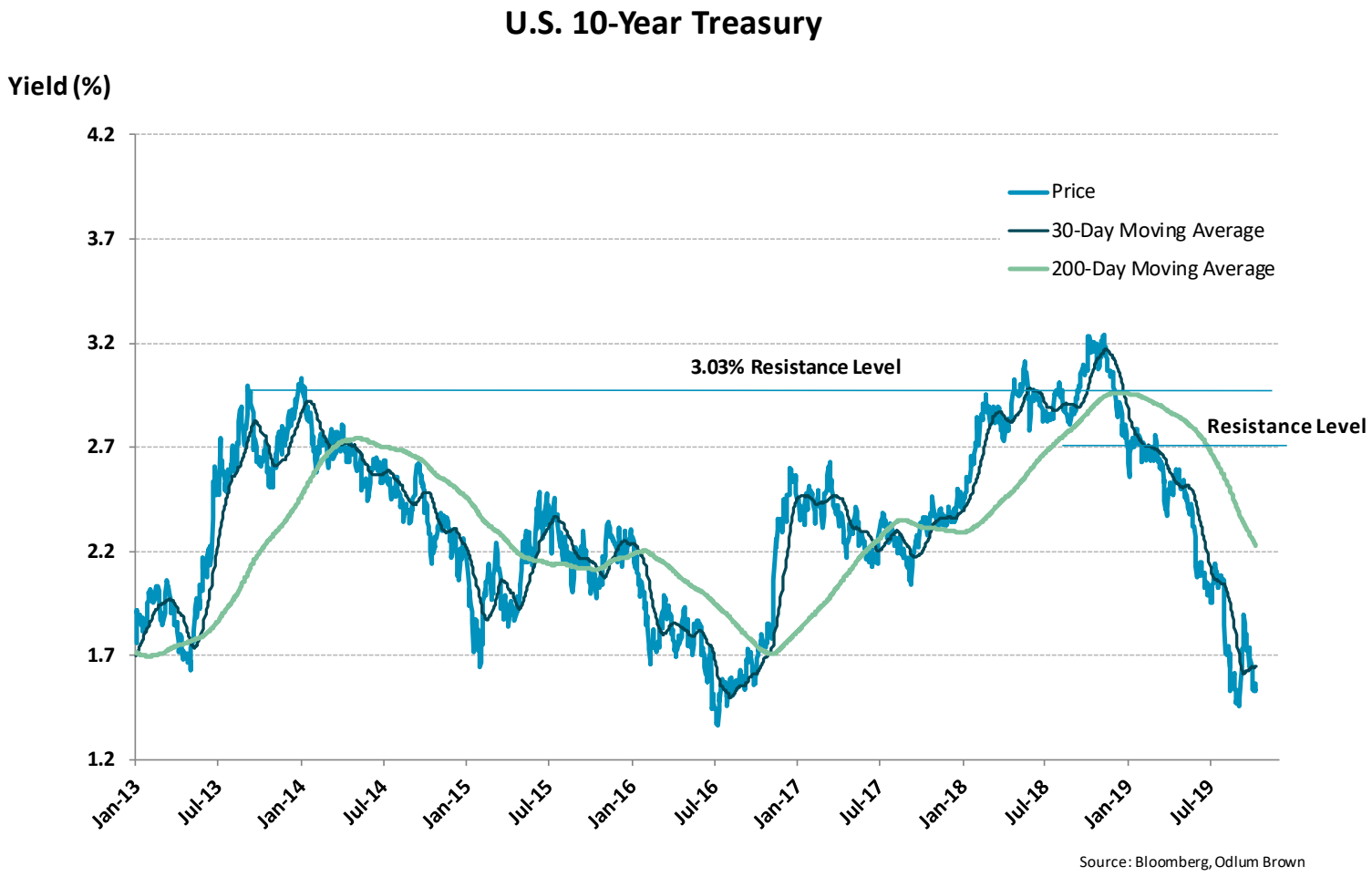
**Performance**

| | 2019 YTD | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
|---|---|---|---|---|---|---|---|
| DEX Universe Bond Index | 7.79% | 1.41% | 2.52% | 3.52% | 3.52% | 8.79% | -1.19% |
| DEX Federal Bond Index | 4.48% | 2.39% | 0.13% | 3.66% | 3.66% | 6.91% | -1.52% |
| DEX Provincial Bond Index | 10.53% | 0.66% | 4.33% | 4.14% | 4.14% | 12.18% | -2.70% |
| DEX All Corporate Index | 7.98% | 1.10% | 3.38% | 2.71% | 2.71% | 7.58% | 0.84% |
| DEX "A" Corporate Index | 9.89% | 0.51% | 4. 42% | 2.62% | 2.62% | 9.10% | -0.16% |
| DEX Real Return Bonds | 10.22% | -0.05% | 0.72% | 2.79% | 2.79% | 13.18% | -13.1% |
| DEX High Yield Bonds | 7.01% | 2.15% | 5.20% | 13.79% | -5.58% | 2.64% | 6.87% |

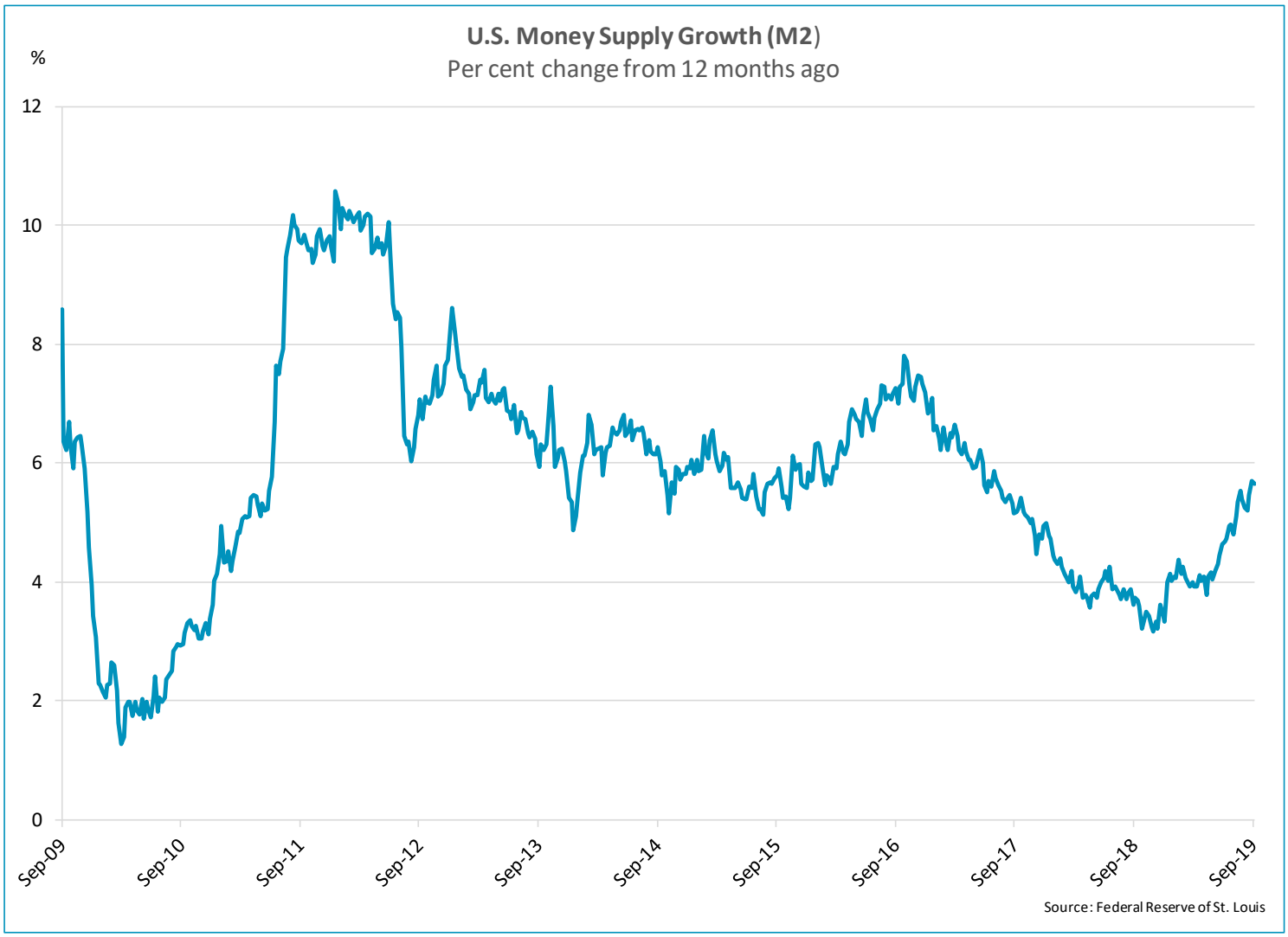
All sectors produced negative returns in September, save for high yield bonds, with long-term government bonds performing the worst, despite a late month rally. The yield curve steepened slightly as long-term yields rose faster than did two-year yields. Of interest is that real return bonds have outperformed all other sectors thus far this year.



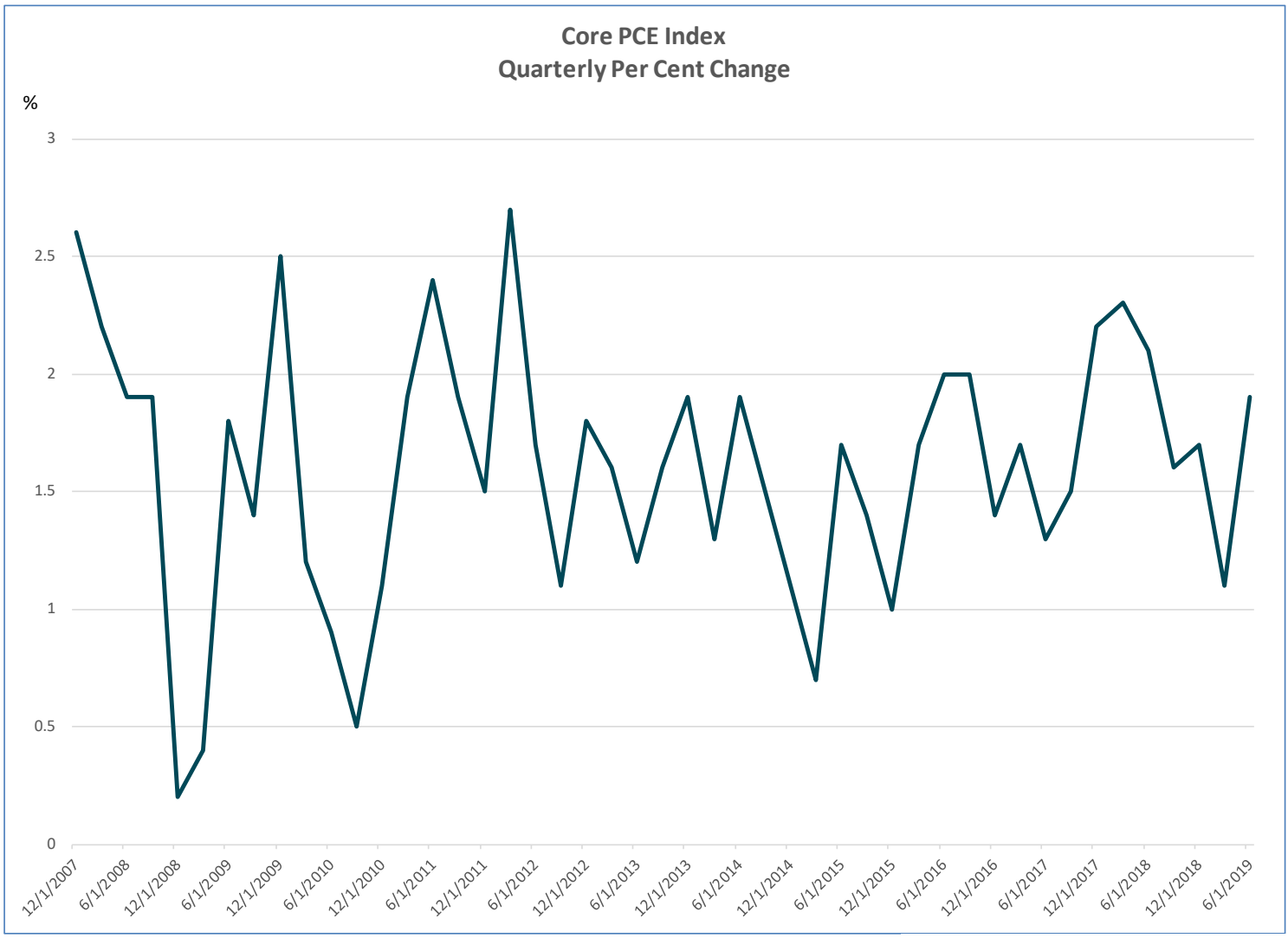

**This bond has rallied and is above its moving averages.**




**This global bellwether bond's yield has fallen below its moving averages.**

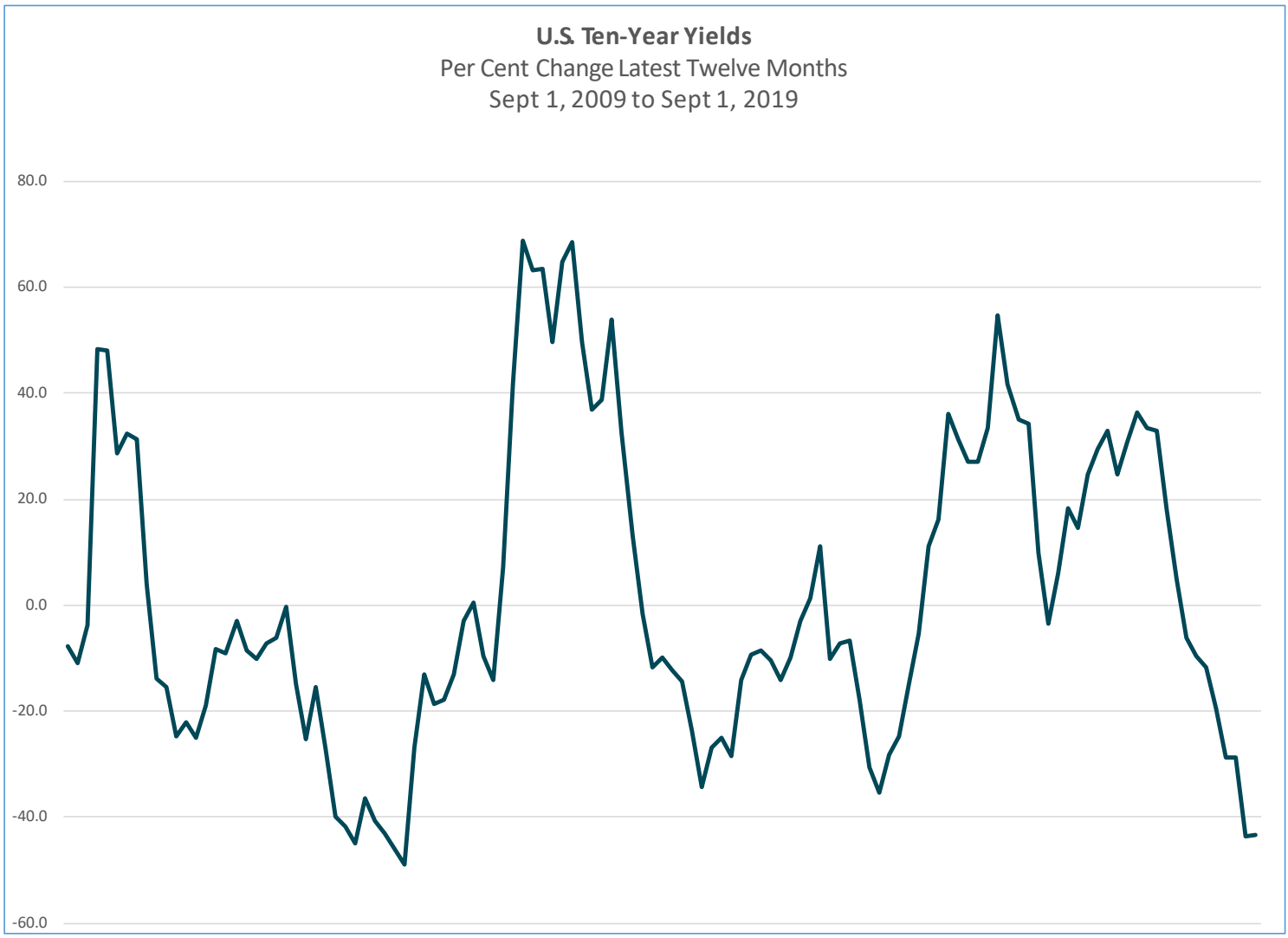



**This important variable has accelerated in the past year after a decade of decline.**




Source: St. Louis Federal Reserve

**This key measure of inflation, is showing signs of moving over 2%.**




Source: Bloomberg, Odlum Brown Limited

**This chart shows the rate of change for the ten-year benchmark. It has reached extreme levels.**

**Comments:**

September produced more volatility in the wake of August's dramatic developments. For the month, two-year and ten-year U.S. bonds rose by a net 11 and 17 basis points respectively. At one point, the ten-year note hit a high of 1.90% before settling at 1.78% at month end and 1.56% currently. Canada's bonds performed similarly, but rose more on a net basis.

The closely watched yield curve, as measured by the yield spread between two- and ten–year bonds, returned to positive at plus five basis points at month-end, and 14 basis points currently.

Once again, markets were roiled by the ongoing trade tensions. On the economic front, global slowing continued. The OECD downgraded global GDP to a 2.9% forecast. The dichotomy between manufacturing and the consumer continued. Purchasers Managers Indices (PMIs), including the important U.S. index, fell, as they did in Germany and Japan. This, of course, made for louder recession forecasts. As a result, the market is pricing in a cut in the Fed Funds Rate on October 30.

However, there was also a steady stream of positive economic news, led by the consumer who remains confident and whose earnings and spending remain firm. The employment market remains tight, although wage gains are disappointing. The housing market, by all measurements, continues to rebound. Interestingly, industrial production jumped sharply.

Inflation remains subdued but, importantly, the Fed's favourite inflation measure, the Core PCE, moved up to 1.9%. Most central banks have moved to an accommodative monetary stance. They have been joined by fiscal stimulus from China, India, Netherlands, Finland and Italy to date.

As to Canada, our GDP stalled over the summer and seems headed for 1.5% GDP growth for the year. Retail sales remained firm, the employment and housing markets displayed strength and our trade deficit narrowed. The Bank of Canada will be watching the Fed's actions closely.

**Outlook**

Recession forecasts are commonplace and are based on evidence of slowing growth generally and manufacturing specifically. Uncertainty regarding the trade outcome is also troublesome.

Central banks have responded with renewed monetary accommodation and that is being accompanied by fiscal stimulus in China, India and a few Euro countries. All eyes are on Germany, long the bastion of balanced budgets. They are musing publicly about a 50 billion Euro stimulus package. Such a move, in concert with the other monetary and fiscal stimuli already announced should, with a lag, be sufficient to fend off a recession and could result in a pickup in growth, at the margin.

The Fed is poised to cut the Fed Funds Rate on October 30 and has announced an expansion to its balance sheet. It may cut rates a second time before year-end. One result of this will be a steeper yield curve as short-term yields fall, while long-term yields may actually rise.

**Strategy**

By most standards, bonds are overvalued. We counsel a high-quality, short duration approach to bond investments. We have long advocated the laddered approach when constructing a fixed income portfolio. There is no reason to alter this strategy as it removes the guesswork from fixed income investing. Therefore, a ladder composed of high-quality corporate bonds and GICs will continue to produce positive returns while preserving principal.

For further discussion, please speak to your investment advisor.