



## MONTHLY FIXED INCOME UPDATE

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October 14, 2022

Interest Rate Summary	Sep-29-22	Aug-31-22	Jul-29-22	Jun-30-22	May-31-22	Apr-29-22	Mar-31-22	Dec-31-21	Dec-31-20
<b>U.S.</b>									
3-Month T-Bill	3.30%	2.93%	2.36%	1.67%	1.06%	0.83%	0.50%	0.04%	0.08%
2-Year Treasury	4.28%	3.50%	2.89%	2.96%	2.56%	2.72%	2.34%	0.73%	0.12%
10-Year Treasury	3.83%	3.20%	2.65%	3.02%	2.85%	2.94%	2.34%	1.51%	0.92%
<b>Canada</b>									
3-Month T-Bill	3.78%	3.23%	2.65%	2.09%	1.47%	1.44%	0.73%	0.17%	0.06%
2-Year Canada	3.79%	3.65%	2.96%	3.09%	2.66%	2.62%	2.29%	0.95%	0.20%
10-Year Canada	3.17%	3.12%	2.61%	3.22%	2.89%	2.86%	2.40%	1.42%	0.68%

Performance	YTD	2021	2020	2019	2018	2017	2016
DEX Universe Bond Index	-11.78%	-2.54%	8.68%	6.87%	1.41%	2.52%	3.52%
DEX Federal Bond Index	-9.23%	-2.62%	7.28%	3.73%	2.39%	0.13%	3.66%
DEX Provincial Bond Index	-14.79%	-3.28%	9.86%	9.07%	0.66%	4.33%	4.14%
DEX All Corporate Index	-10.76%	-1.34%	8.74%	8.05%	1.10%	3.38%	2.71%
DEX "A" Corporate Index	-11.58%	-2.30%	8.98%	9.65%	0.51%	4.42%	2.62%
DEX Real Return Bonds	-16.66%	1.84%	13.02%	8.02%	-0.05%	0.72%	2.79%
DEX High Yield Bonds	-7.37%	6.18%	6.69%	8.48%	2.15%	5.20%	13.79%

### Comments

Heavily influenced by inflation both domestically and globally, administered interest rates and bond yields have pushed higher. The Fed Funds Rate stands at 3.00%, up from 0% at year end. Two-year and 10-year U.S. Treasuries have advanced by 367 basis points and 235 basis points to 4.39% and 3.86%, respectively. Year-to-date performance of bond indices are the worst in recorded history.

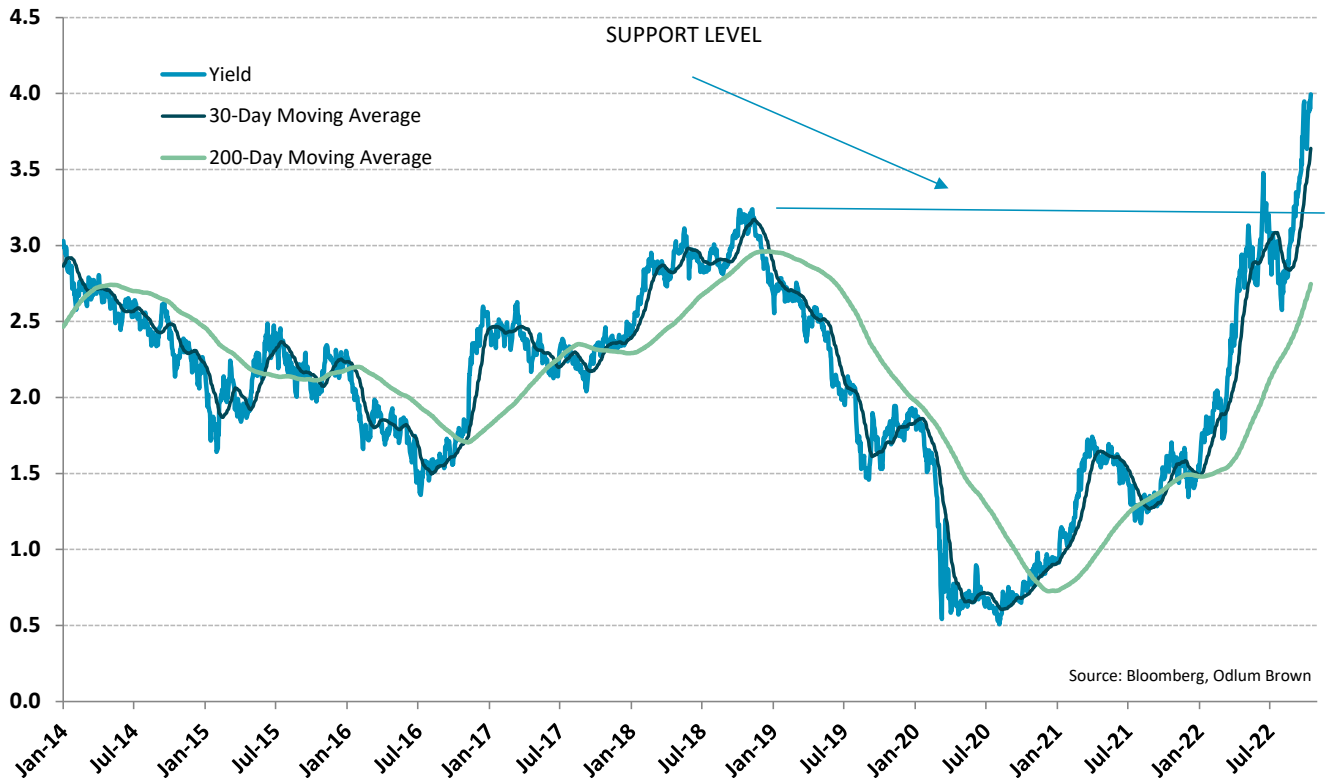
The Fed threw cold water on widespread predictions of a U.S. recession at the Jackson Hole Conference, signaling further substantial hikes in the Fed Fund Rate. In fact, the U.S. economy has proved to be quite resilient with the employment market remaining firm along with consumer spending. The unemployment rate fell to 3.5% amid rising wage pressures. At the same time, there are over 10 million jobs available. The real estate market, however, is reeling under the weight of successive increases in mortgage rates, spawned by the Fed's tightening.

Inflation reports disappointed those who had forecasted meaningful improvement in consumer prices. The September CPI result in the U.S. displayed a 40-year high for the core rate at 6.6%, while the headline print was 8.2%. Both of these numbers exceeded consensus.

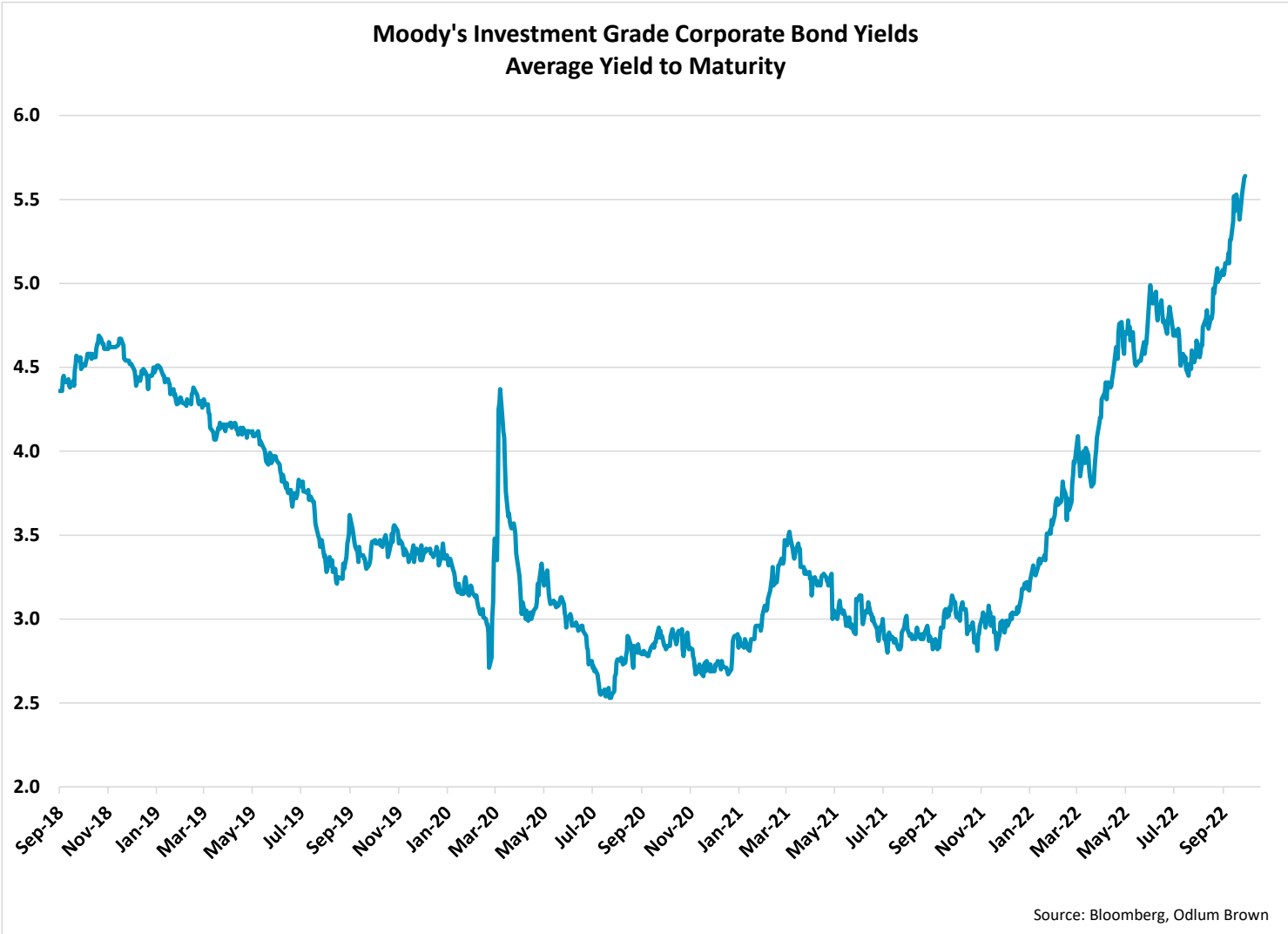
Canada's economy has also been relatively firm. Along with a friendlier-than-expected CPI print, the Canadian bond market significantly outperformed the U.S., to the extent that the Canadian 10-year is a full 50 basis points lower than its U.S. counterpart.

## U.S. 10-Year Treasury

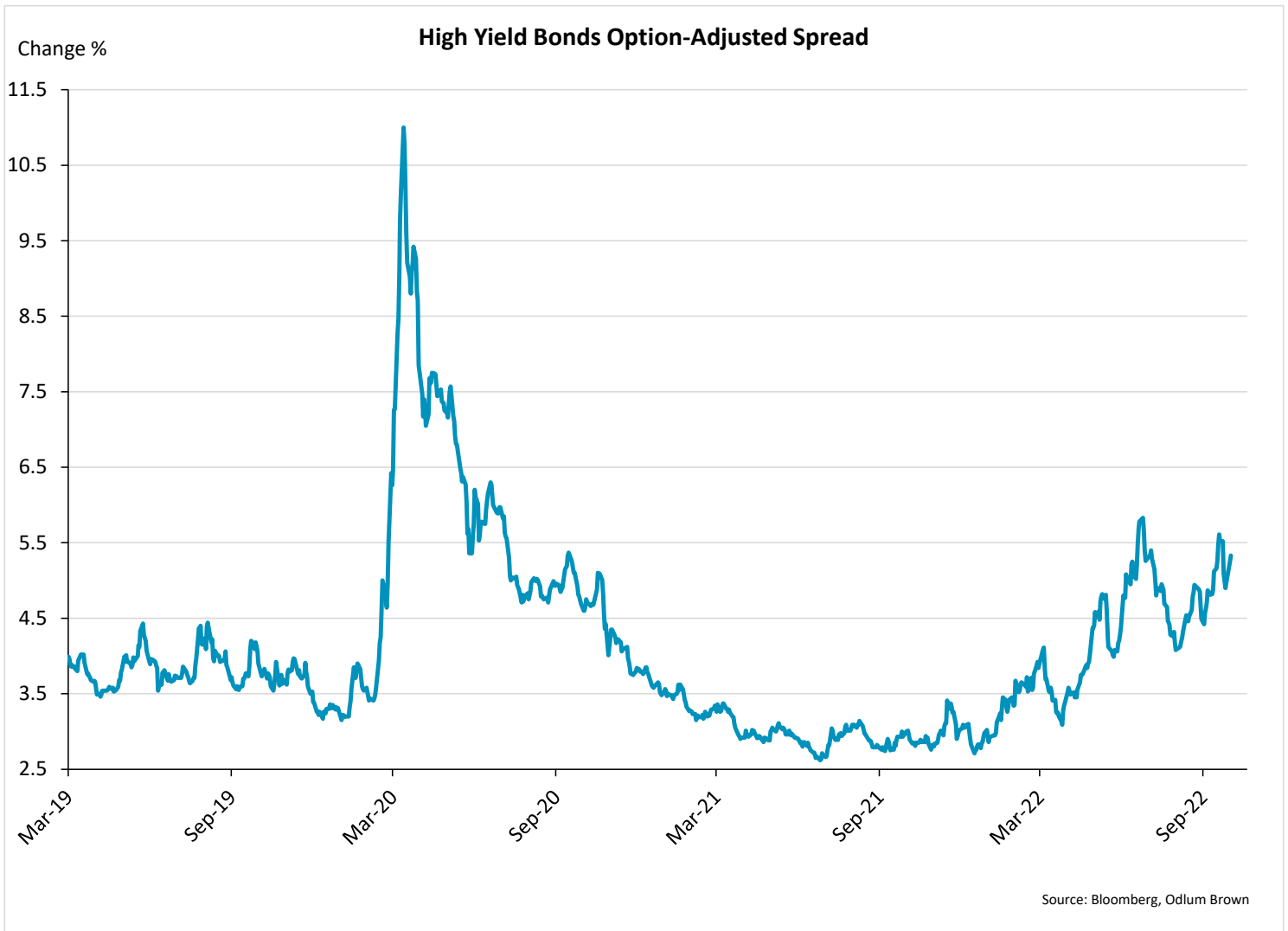
Yield (%)



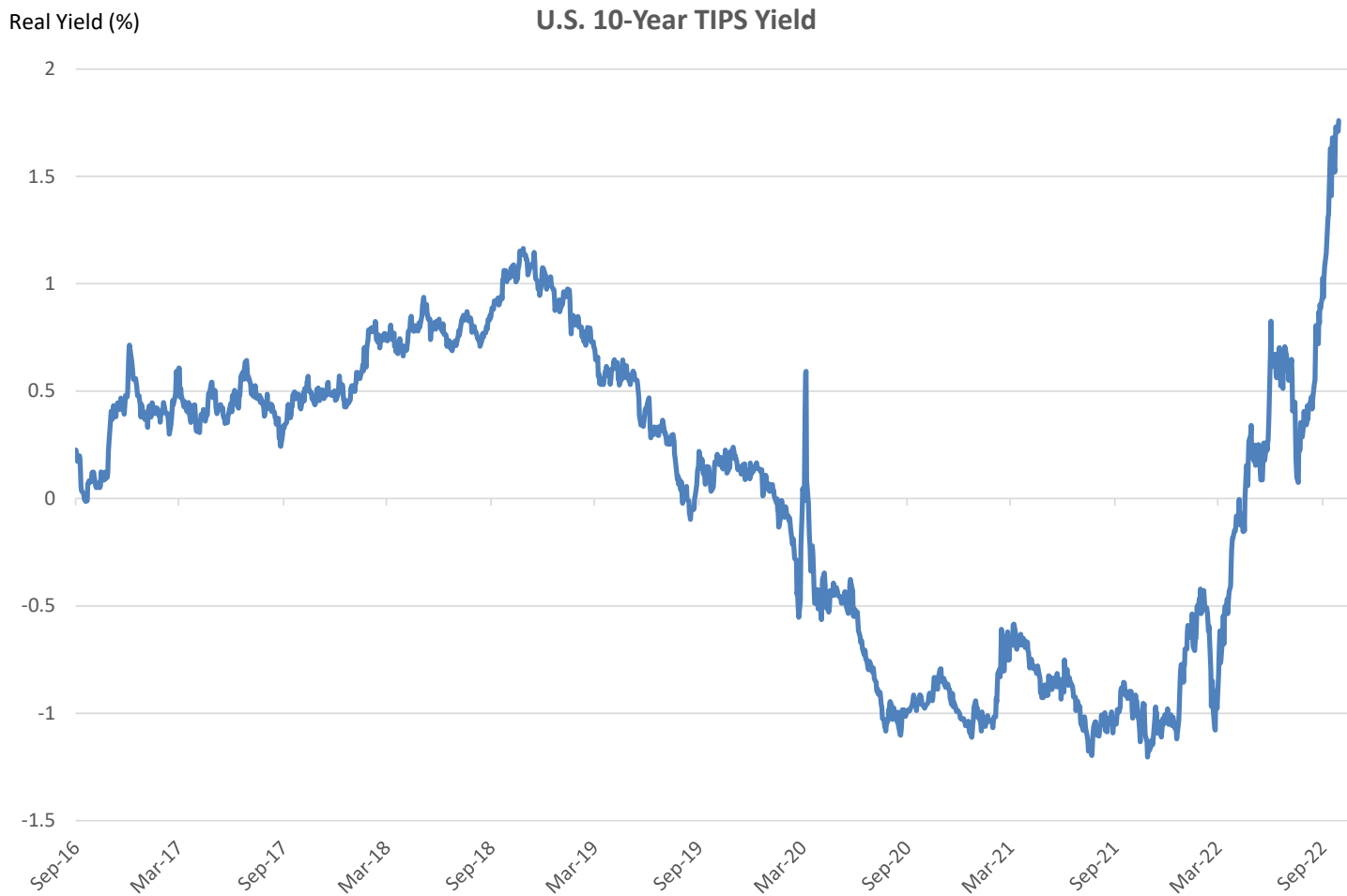
This bellwether's yield has been volatile reaching 4%, which is well above the previous resistance point of 3.25%. This bond is 50 basis points lower in yield than the two-year note. With more Fed tightening to come, further upward pressure on bond yields is likely.



Corporate bond markets remain relatively calm. Investment-grade corporate yields have tracked higher along with government bond yields, with some modest widening of yield spreads.



**After a strong rally, high yield bonds have risen and their spreads have widened from government yields. Credit conditions remain relatively stable.**



Source: Bloomberg, Odium Brown

**After being mired in negative territory, real yields have responded to monetary tightening by moving higher to almost 2%.**

## Outlook

Inflation is a global issue. In Europe, consumer prices are above 10% with no sign of relief. There has also been extra turbulence caused by extraordinary developments in the UK. There is little doubt that short-term interest rates and market bond yields are headed higher. The U.S. Federal Reserve has signaled at least two more hikes before year end, which would produce a Fed Funds Rate of 4.5%. Others believe the Fed will tighten further, with the Fed Funds Rate peaking next year.

As to market yields, the U.S. two-year yield, currently at 4.4%, could reach 5% with further tightening and the 10-year appears to be headed for 4.5%. There have been few signs of strains in credit markets but vigilance is required. Given the extent of the bond market selloff, it is likely there will be rallies from time to time.

The Fed has stated that it needs to see several consecutive monthly improvements in inflation statistics before reconsidering its policy stance. There is growing evidence of an acceleration in wage demands, which will act as a floor for inflation.

The Bank of Canada has little choice but to follow the Fed as the Canadian economy has also proved to be resilient. In addition, the Canadian dollar has suffered at the hands of a strong U.S. dollar; the weaker Loonie will exacerbate inflation trends in Canada as import prices add to domestic price pressures.

In summary, global credit markets have discounted the next rounds of interest rate hikes by central banks. This removes the surprise factor and should result in few knee-jerk reactions. There remains the possibility that several central banks may reduce their bloated balance sheets via bond sales.

The big question remains: when will we see inflation turn? Thus far, inflation has been slow to respond to tightening and, in fact, has accelerated somewhat. There is a six to nine month lag before monetary tightening takes effect, so it is possible markets will see some improvement on the inflation front in the first or second quarter of next year.

## Strategy

Inflation is the enemy of bond investors and will remain a major negative for the foreseeable future. Thus, this continues to be a time to defend principal as long-term bonds continue to carry significant potential for capital loss if interest rates rise further. We counsel investors not to reach for yield, but instead to invest in short-term, high-quality corporate bonds. This approach will defend principal while producing modest returns. Floating-rate bonds offer the promise of higher returns with minimal risk to principal as short-term yields continue to climb.

The increase in corporate yields this year has resulted in a host of bonds, issued at lower yields, trading at significant discounts from their par values, thus creating positive after-tax opportunities. We have created the **Odlum Brown Discount Corporate Ladder** portfolio to take advantage of this opportunity.

We also continue to recommend a laddered approach using the **Odlum Brown Corporate Bond Ladder**, which features more in the way of current coupon bonds. Also, we recommend individual floating-rate bonds. The **Odlum Brown Model Portfolio** is also well positioned for this market environment with a short duration and floating-rate debentures included.

We have adopted the use of outside bond investment managers to augment returns. Our top recommended funds are:

- **Picton Mahoney Liquid Alt Fund.** This is a well-managed long/short fund and is available as an ETF.
- **Canso Short-Term and Floating-Rate Fund.** This fund protects principal and takes advantage of opportunities in the floating-rate market.
- **Canso Corporate Value Fund.** This is a well-managed, long-only corporate bond fund.

Please consult your Investment Advisor or Portfolio Manager for more details and to discuss this strategy.

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