MONTHLY FIXED INCOME UPDATE

Hank Cunningham **April 13, 2021**

Interest Rate Summary	Mar- 31-21	Feb-27-21	Jan-29-21	Dec-31-20	Dec-31-19	Dec-31-18
U.S.						
3-Month T-Bill	0.02%	0.04%	0.05%	0.08%	1.55%	2.36%
2-Year Treasury	0.16%	0.13%	0.11%	0.12%	1.57%	2.49%
10-Year Treasury	1.74%	1.41%	1.07%	0.92%	1.92%	2.69%
Canada						
3-Month T-Bill	0.08%	0.12%	0.06%	0.06%	1.65%	1.64%
2-Year Canada	0.22%	0.30%	0.15%	0.20%	1.69%	1.86%
10-Year Canada	1.56%	1.35%	0.89%	0.68%	1.70%	1.97%

Performance

	YTD	2020	2019	2018	2017	2016	2015
DEX Universe Bond Index	-5.04%	8.68%	6.87%	1.41%	2.52%	3.52%	3.52%
DEX Federal Bond Index	-3.72%	7.28%	3.73%	2.39%	0.13%	3.66%	3.66%
DEX Provincial Bond Index	-7.23%	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	-3.50%	8.98%	9.65%	0.51%	4.42%	2.62%	2.62%
DEX Real Return Bonds	-7.30%	13.02%	8.02%	-0.05%	0.72%	2.79%	2.79%
DEX High Yield Bonds	2.22%	6.69%	8.48%	2.15%	5.20%	13.79%	-5.58%

All sectors produced sharply negative performance in March with the exception of high yield bonds; this is the third consecutive month of poor performance. Corporate bonds outperformed Government bonds while Real Return Bonds were the worst-performing sector again.

Bond yields rose for the third consecutive month in March. The U.S. ten-year bellwether note's yield advanced 33 basis points, bringing the year-to-date cumulative increase to 82 basis points. With the U.S. two-year anchored near 16 basis points, the yield curve steepened to a cyclical high of 158 basis points.

Thus far this year, the Federal Reserve has displayed no concern over this sharp increase in market yields, continuing to aver its preference for accommodative monetary policy. Fed Chair Powell maintained his dovish stance during March, reiterating his message that the economy had a long way to go.

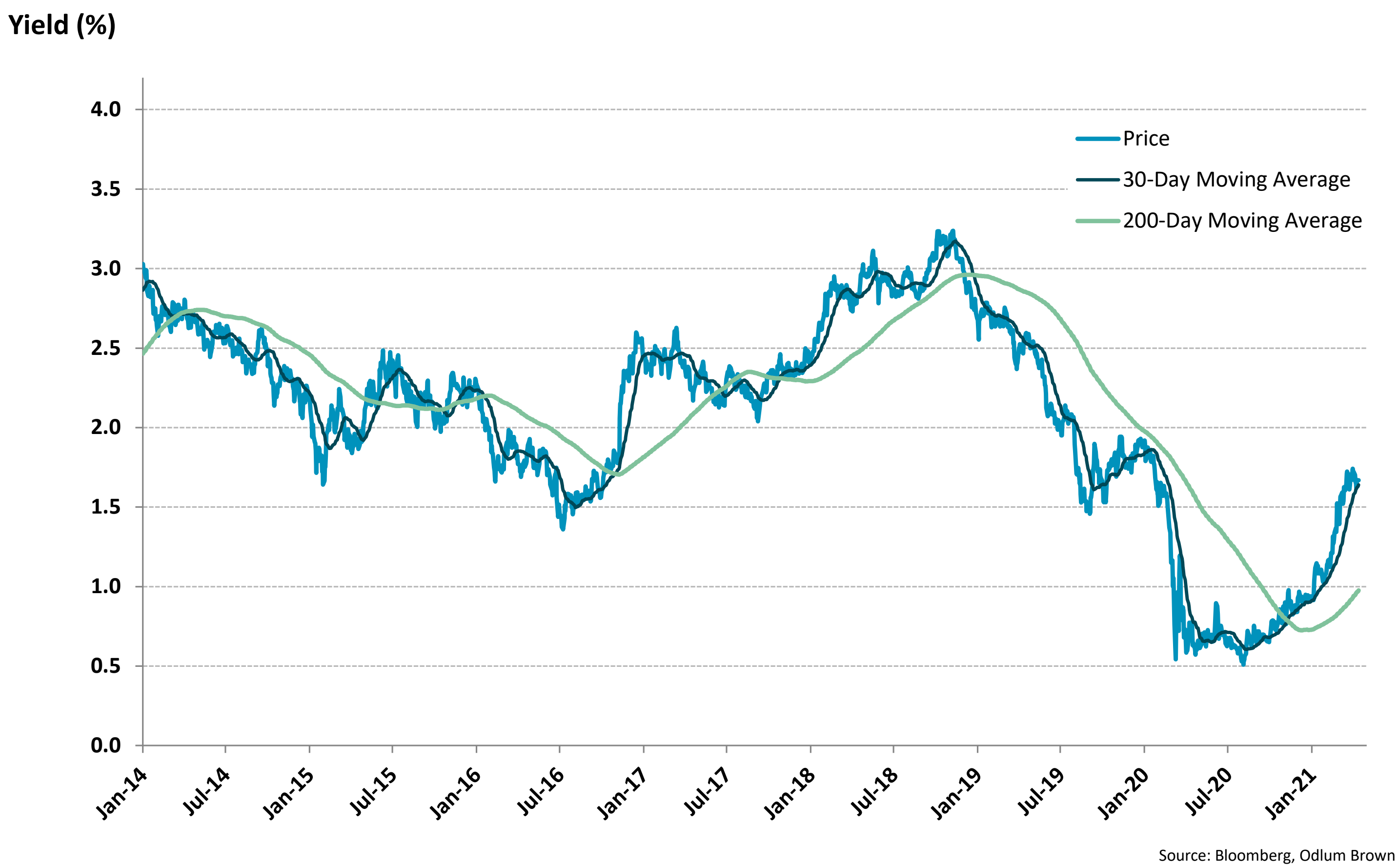
This occurred after a steady stream of economic data exceeded expectations, including housing starts, home sales (prices were the highest since 2006), durable goods orders, and capital goods orders. Several manufacturing reports registered impressive gains as well, notably the Philadelphia Fed Index, the Chicago PMI (best since 2008) and the ISM report recorded the highest level ever! On top of this was a blockbuster employment report with almost one million new jobs added. Inflation began to rise too as wholesale prices jumped well above consensus levels, as did consumer prices. Amidst this, inflation expectations increased further. Ominously, the latest wholesale inflation release displayed the first solid evidence that inflation is taking hold and this was validated by the latest CPI print.

This positive news was not confined to the U.S.; Canada reported two blockbuster employment reports, the second straight monthly trade surplus and an all-time high in consumer sentiment.

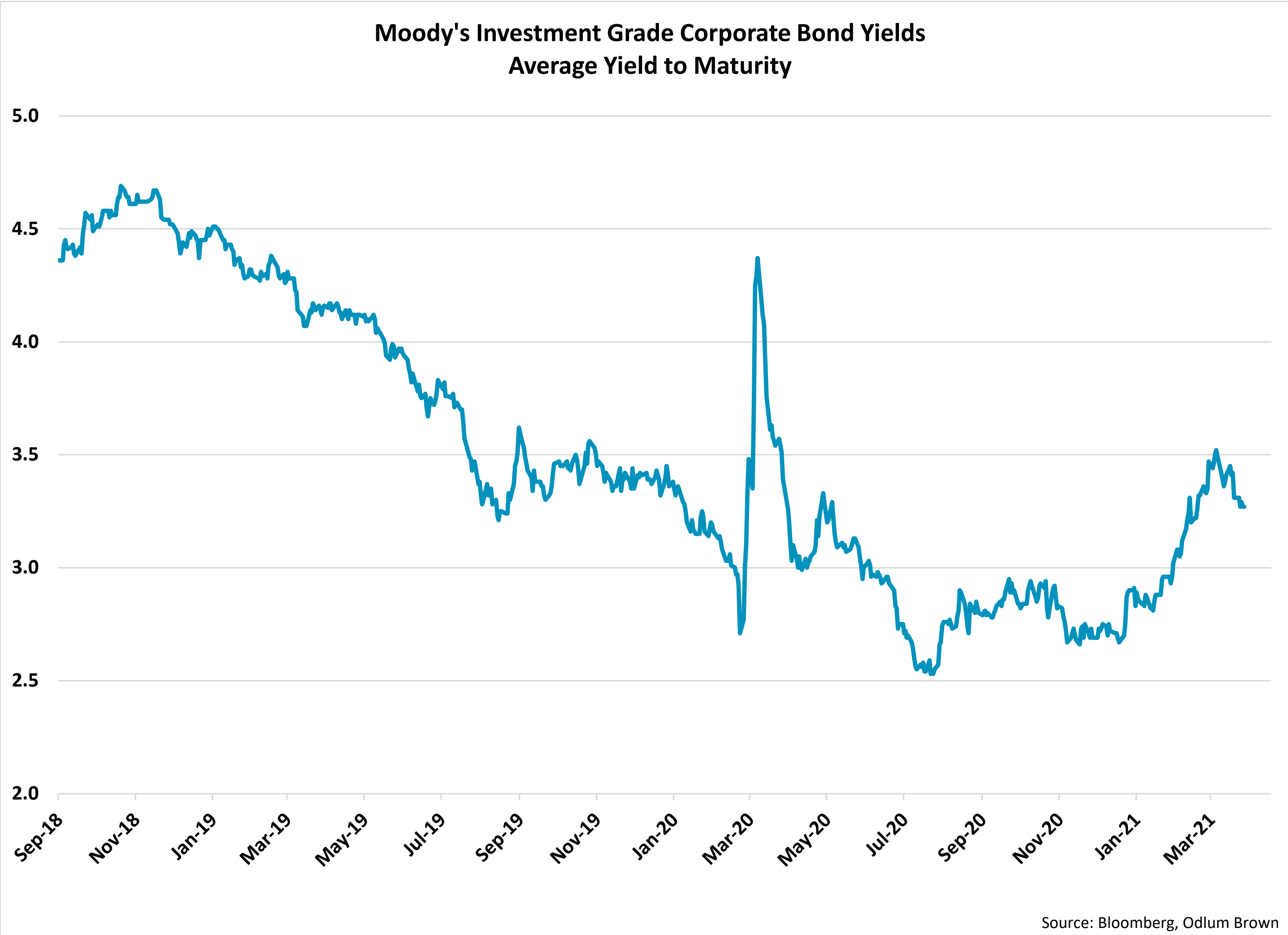
Globally, prospects have brightened, with all developed nations reporting upswings in economic activity. In particular, Euro PMIs reached their best level since 1997.

The IMF upgraded its global 2021 growth estimate to 6%, upgrading the forecasts for the U.S. and Canada in the process.

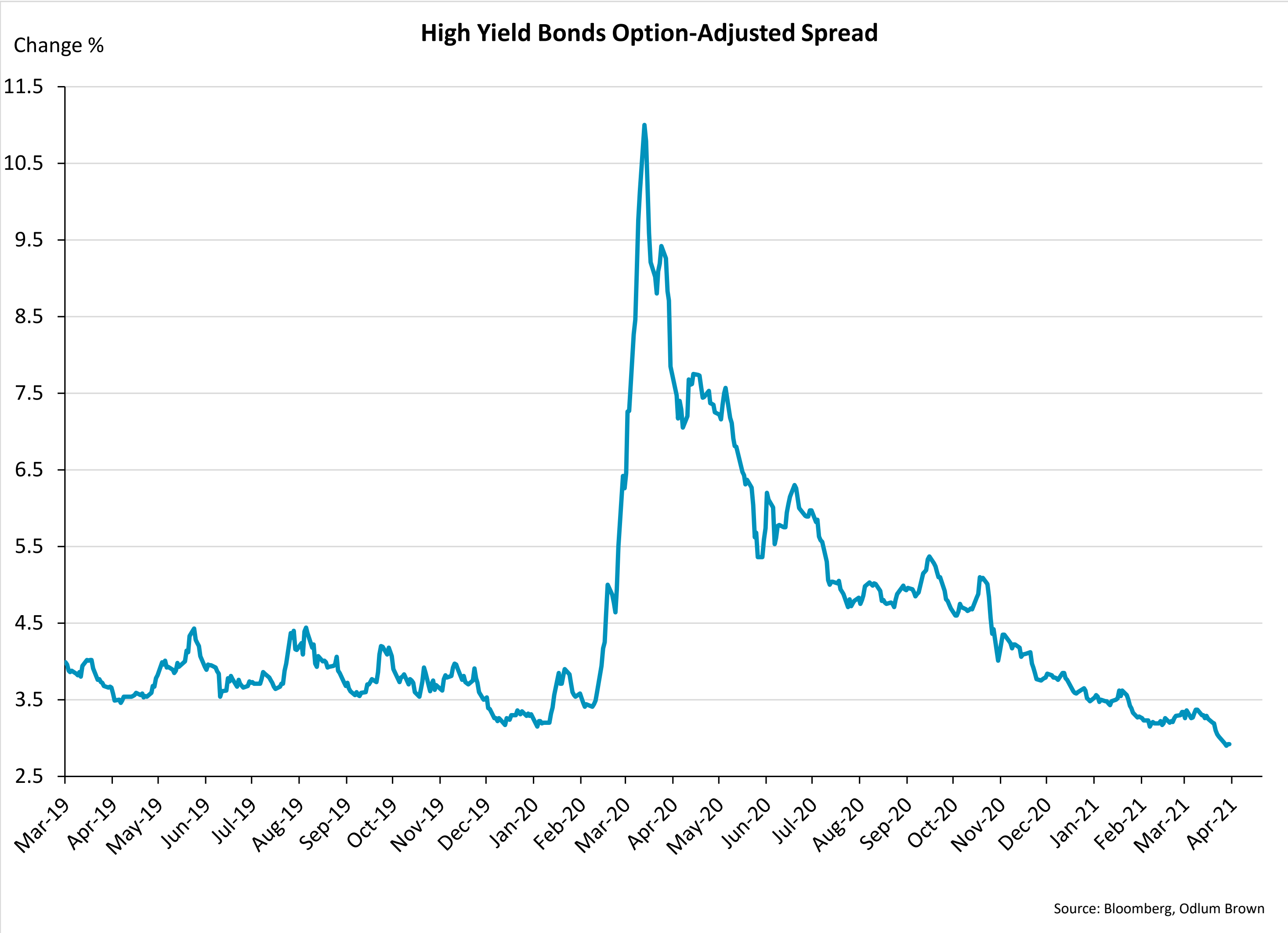
U.S. 10-Year Treasury



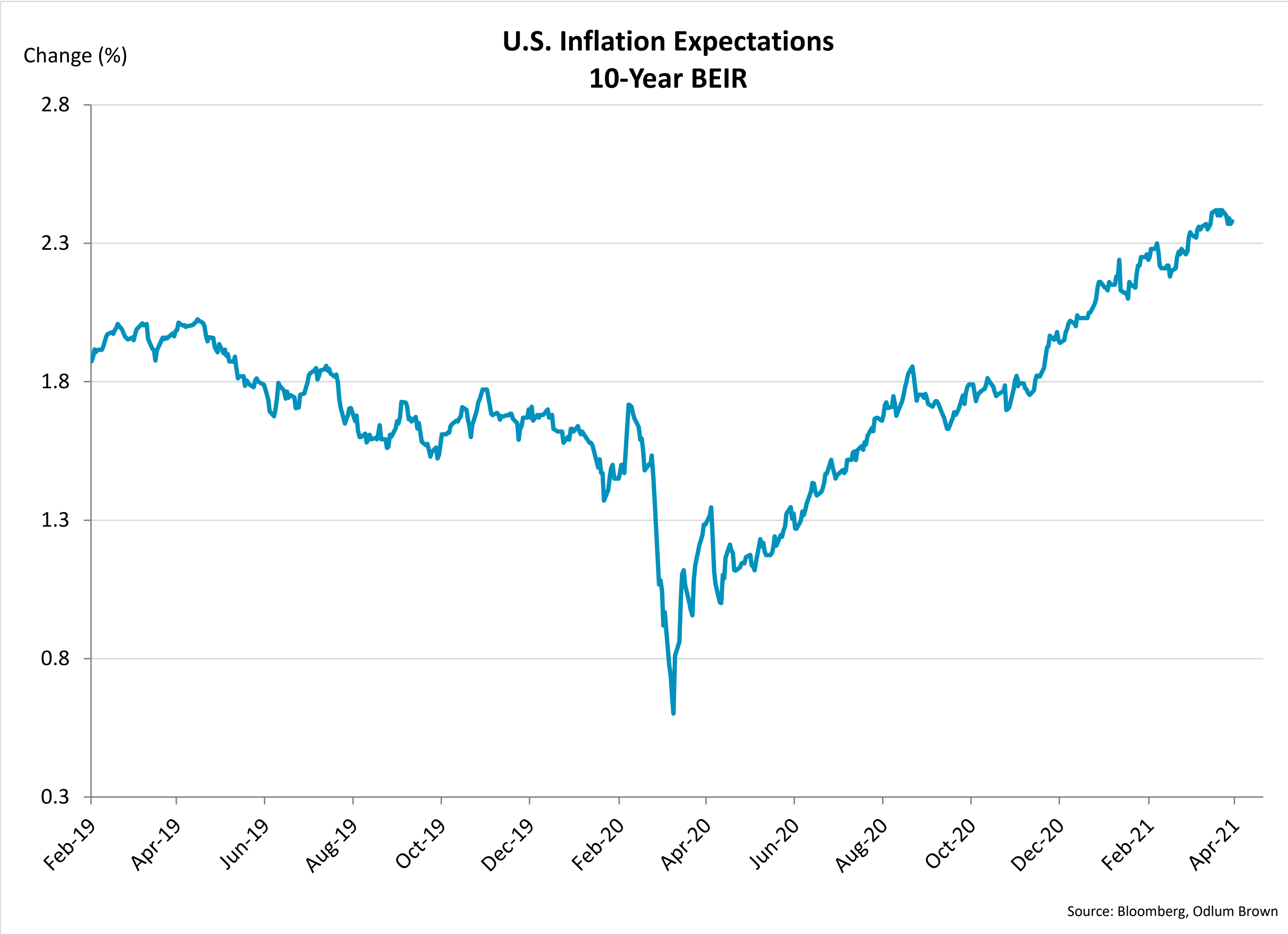
This global bellwether moved decisively higher in yield last month but has stabilized thus far in April.



Investment-grade corporate bond yields began to move higher with U.S. Treasury yields and are tracking them as Treasury yields consolidate.



The high yield market resumed its rally. After moving up briefly, spreads moved to new record lows.



Inflation expectations moved sharply above the important 2% level and have levelled off at six-year highs near 2.35%.

Outlook

Higher yields likely lie ahead for bonds; the near-term target is 2% for the ten-year U.S. Treasury and 2.25% later this year.

The factors that led to recent upticks in yields remain in place, principally massive fiscal and monetary stimuli. Consensus had expected that the recovery would return North American economies to pre-pandemic growth rates. This no longer appears to be the case, as the recovery is gaining strength, producing new record highs in key statistics and, importantly, is producing an uptick in inflation, which may not be just transitory. The massive fiscal and monetary stimuli should continue to feed into growth; the Fed has stated its willingness to allow inflation to exceed its 2% target for an uncertain amount of time before taking action to rein in monetary stimulus.

The result will likely be higher bond yields. Corporate yield spreads will remain compressed but corporate bond yields will push higher with the rising government yields.

Thus, fixed income performance will be modest at best.

Strategy

With an outlook for further increases in bond yields, the number-one theme for fixed income investors remains 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.