MONTHLY FIXED INCOME UPDATE

Hank Cunningham

August 13, 2019

Interest Rate Summary	Jul-31-19	Dec-31-18	29-Dec-17	30-Dec-16	31-Dec-15	31-Dec-14	31-Dec-13
U.S.							
3-Month T-Bill	2.07%	2.36%	1.38%	0.50%	0.16%	0.04%	0.07%
2-Year Treasury	1.87%	2.49%	1.89%	1.19%	1.31%	0.47%	0.38%
10-Year Treasury	2.02%	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	1.54%	1.86%	1.69%	0.74%	0.48%	0.99%	1.14%
10-Year Canada	1.48%	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	6.70%	1.41%	2.52%	3.52%	3.52%	8.79%	-1.19%
DEX Federal Bond Index	3.95%	2.39%	0.13%	3.66%	3.66%	6.91%	-1.52%
DEX Provincial Bond Index	9.00%	0.66%	4.33%	4.14%	4.14%	12.18%	-2.70%
DEX All Corporate Index	7.27%	1.10%	3.38%	2.71%	2.71%	7.58%	0.84%
DEX "A" Corporate Index	8.82%	0.51%	4. 42%	2.62%	2.62%	9.10%	-0.16%
DEX Real Return Bonds	9.30%	-0.05%	0.72%	2.79%	2.79%	13.18%	-13.1%
DEX High Yield Bonds	6.17%	2.15%	5.20%	13.79%	-5.58%	2.64%	6.87%

All sectors produced positive returns with provincial bonds again leading the way. Of interest is that high yield bonds continued to lag the investment grade sectors.

Comments:

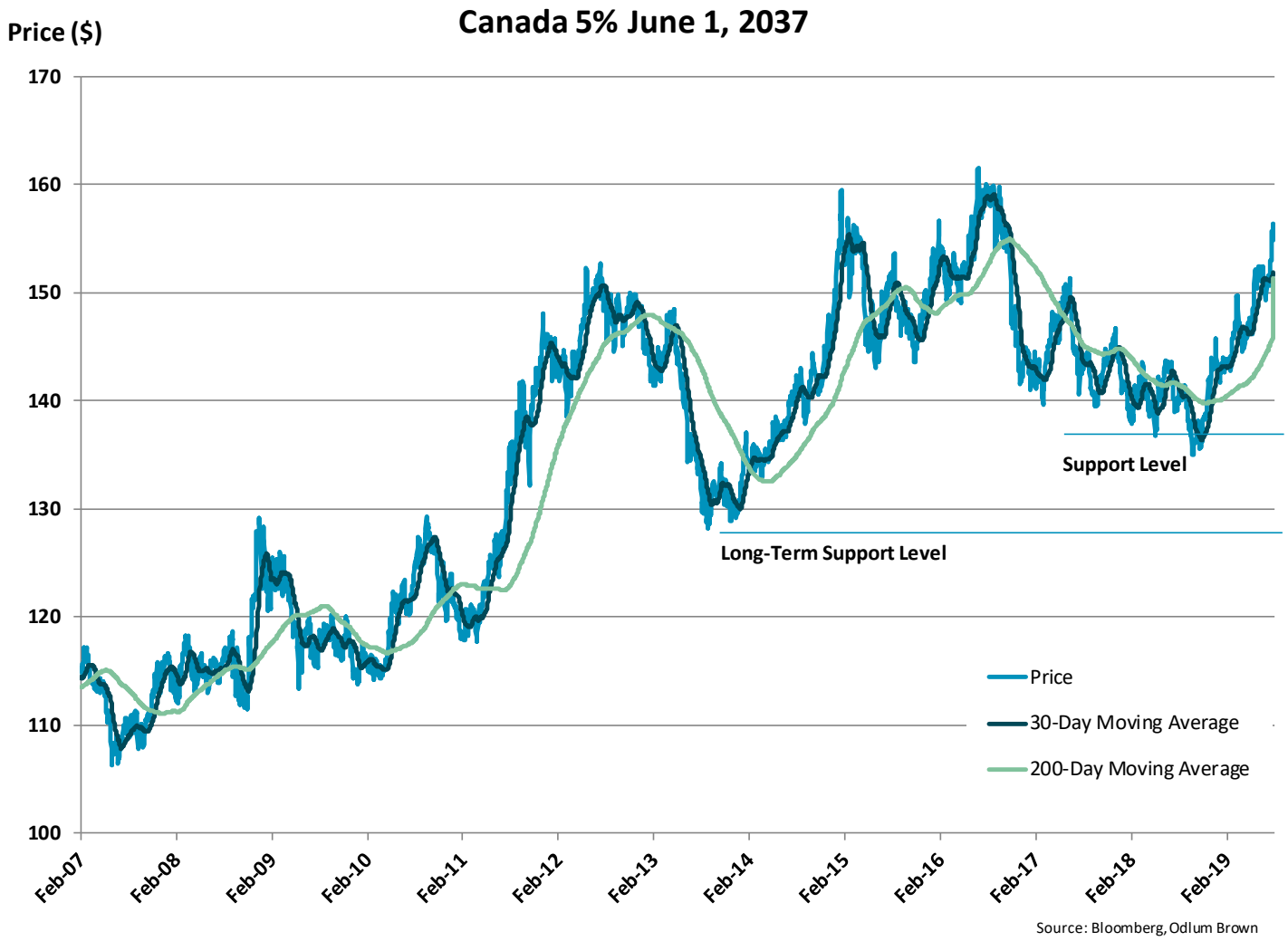
July produced mixed results for bond markets. Yields on U.S. two-and ten-year bonds actually rose as did their Canadian counterparts. At one point, the U.S. ten-year reached 2.15% after trading early in the month at 1.95%. The U.S. economy continued to throw off positive numbers as retail sales and consumer confidence remained strong. ISMs continued to be above the important 50 level but manufacturing slowed perceptibly. The U.S. employment market remained tight as non-farm payrolls grew but at a slower pace than in the previous twelve months. As to Canada, it reported a weak employment result but also a second consecutive trade surplus and a plunge in retail sales.

Then, it all changed. Another threat by the U.S. for more tariff increases on Chinese goods was followed by a cut in the Fed Funds Rate by a dovish U.S. Federal Reserve Board.

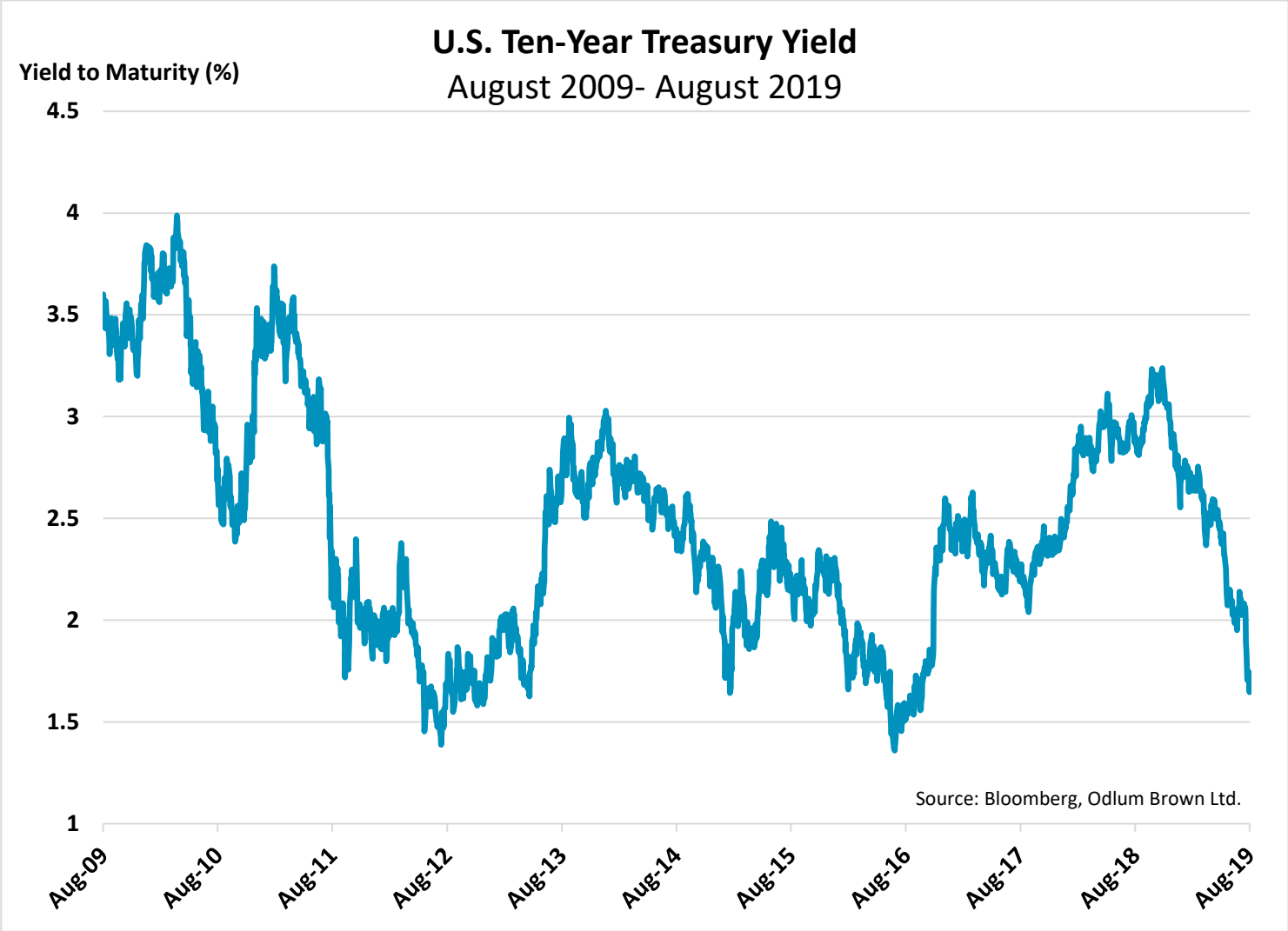
Bond yields plunged. On July 31, the U.S. ten-year bellwether fell to 1.64% from 2.02%. The market is pricing in three more rate cuts by the Fed. Thus far, the Bank of Canada has remained on the sidelines but after three more foreign central banks cut rates, its hand may be forced.

The high yield market suffered as recession fears eroded investor confidence. Investment grade corporates followed Treasury yields lower for the most part, with a slight widening of the yield spread.

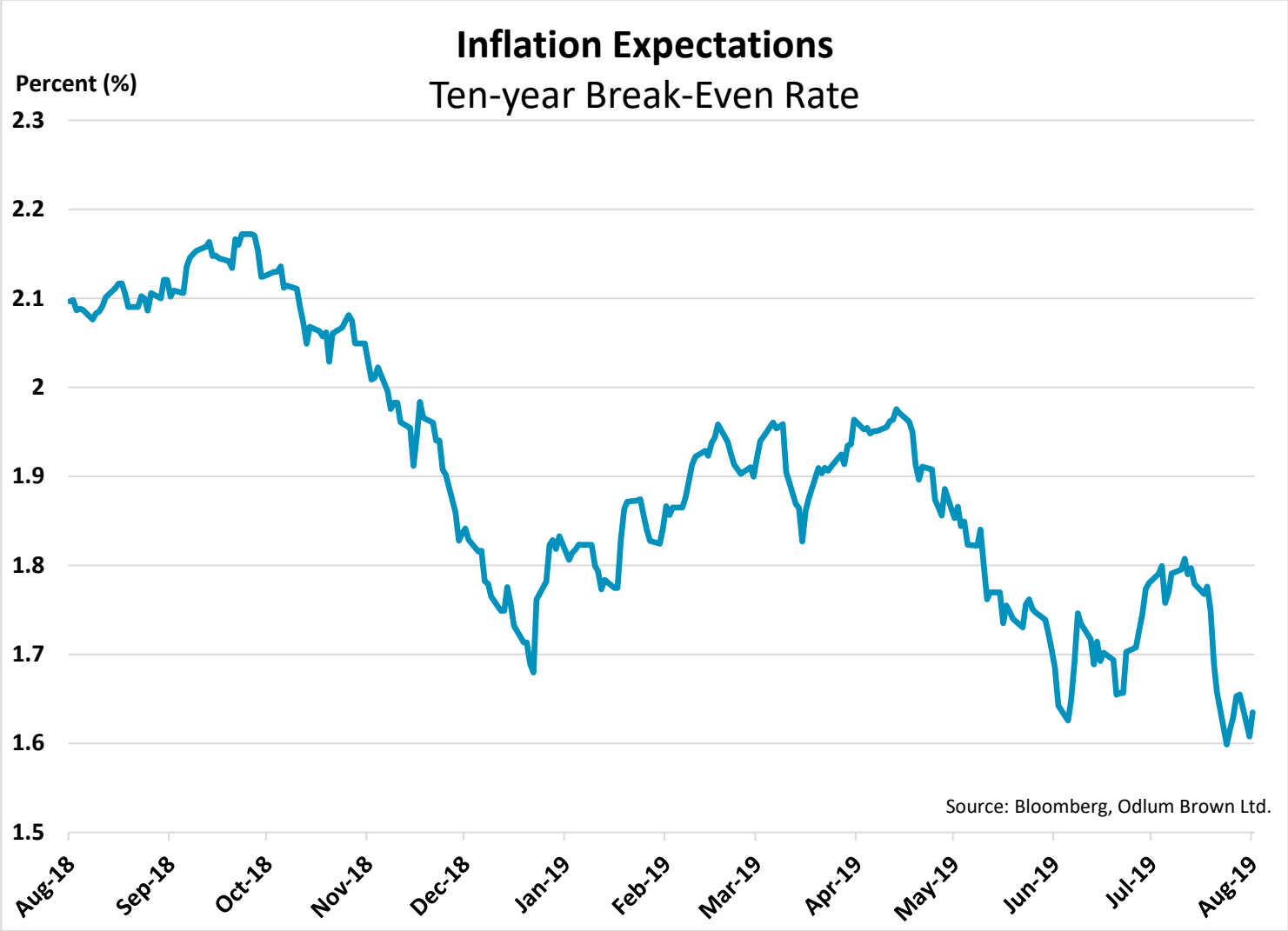
Abroad, yields fell further with there now being $15 trillion in sovereign bonds having a negative yield. Canada's ten-year Government yield stands at a paltry 1.20% with three-month treasury bills at 1.64%.



This long-term bond is approaching its all-time high but its momentum has reached overbought levels.



This global bellwether bond's yield has fallen sharply. Further declines are possible but this bond is technically overbought. This chart displays the yield history over the past ten years.



This chart depicts the slide in inflation expectations.

Outlook

Where do we go from here? How low can bond yields go?

The ongoing trade feud will disrupt markets further. On the surface, GDP growth is positive in the U.S. and Canada, albeit at a slower pace.

While U.S. consumers and businesses remain confident, retail sales are strong and the employment market remains taut, investors' eyes are focused on the growing global recession risk. Investors in negative-yield markets are snapping up U.S. (and Canadian) bonds at a torrid clip.

We conclude that bond yields may go lower, even as they touch all-time lows. Strategists are now pondering whether U.S. interest rates will also go to zero. A reversal in this bond yield decline will require a détente in the trade war and evidence that global growth, while slowing, remains positive with some stirring of inflation.

Strategy

By most standards, bonds are overvalued. Therefore, 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.