Monthly Fixed Income Update

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Interest Rate Summary	Dec-31-21	Nov-30-21	Oct-29-21	Sep-29-21	Aug-31-21	Jul-30-21	Jun-30-21	Dec-31-20
U.S.								
3-Month T-Bill	0.04%	0.05%	0.05%	0.04%	0.04%	0.04%	0.04%	0.08%
2-Year Treasury	0.73%	0.57%	0.50%	0.28%	0.21%	0.19%	0.25%	0.12%
10-Year Treasury	1.51%	1.45%	1.56%	1.49%	1.31%	1.22%	1.46%	0.92%
Canada								
3-Month T-Bill	0.17%	0.06%	0.15%	0.13%	0.16%	0.17%	0.14%	0.06%
2-Year Canada	0.95%	0.98%	1.09%	0.53%	0.42%	0.45%	0.45%	0.20%
10-Year Canada	1.42%	1.57%	1.72%	1.51%	1.21%	1.20%	1.39%	0.68%

Performance

	2021	2020	2019	2018	2017	2016	2015
DEX Universe Bond Index	-2.54%	8.68%	6.87%	1.41%	2.52%	3.52%	3.52%
DEX Federal Bond Index	-2.62%	7.28%	3.73%	2.39%	0.13%	3.66%	3.66%
DEX Provincial Bond Index	-3.28%	9.86%	9.07%	0.66%	4.33%	4.14%	4.14%
DEX All Corporate Index	-1.34%	8.74%	8.05%	1.10%	3.38%	2.71%	2.71%
DEX "A" Corporate Index	-2.30%	8.98%	9.65%	0.51%	4.42%	2.62%	2.62%
DEX Real Return Bonds	1.84%	13.02%	8.02%	-0.05%	0.72%	2.79%	2.79%
DEX High Yield Bonds	6.18%	6.69%	8.48%	2.15%	5.20%	13.79%	-5.58%

Comments:

The year ended with bond yields on the rise, after they fell earlier in December, as the Omicron variant took hold and led to a flight-to-quality bid in the bond market.

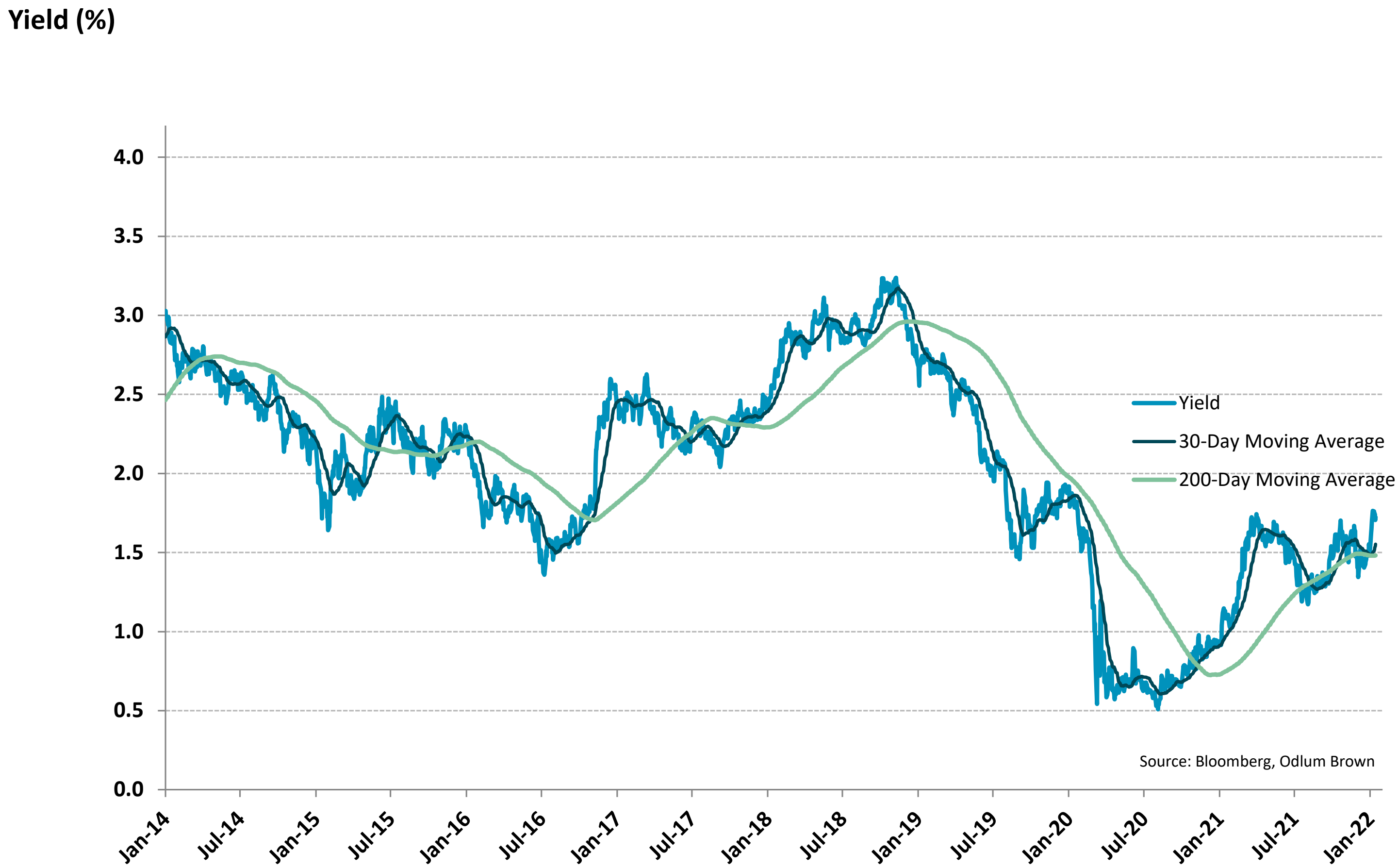
The beginning of 2022 brought a major surprise. Federal Reserve minutes indicated that, not only was the Fed ready to rapidly end its quantitative easing and raise the Federal Funds Rate, but they also revealed for the first time this cycle that the Fed was preparing to reduce its swollen balance sheet. This shocked the bond market; the bellwether ten-year note tacked on an immediate 25 basis points, touching 1.80% before plateauing. Corporate issuers stampeded to borrow money and a flurry of new bond issues appeared in the first week of the year.

Inflation was the key statistic for December, with CPI reaching its highest level since 1983. A more recent reading saw CPI rise 7% year-over-year, accompanied by signs that the worst was over. Wholesale inflation came close to a 10% yearly gain.

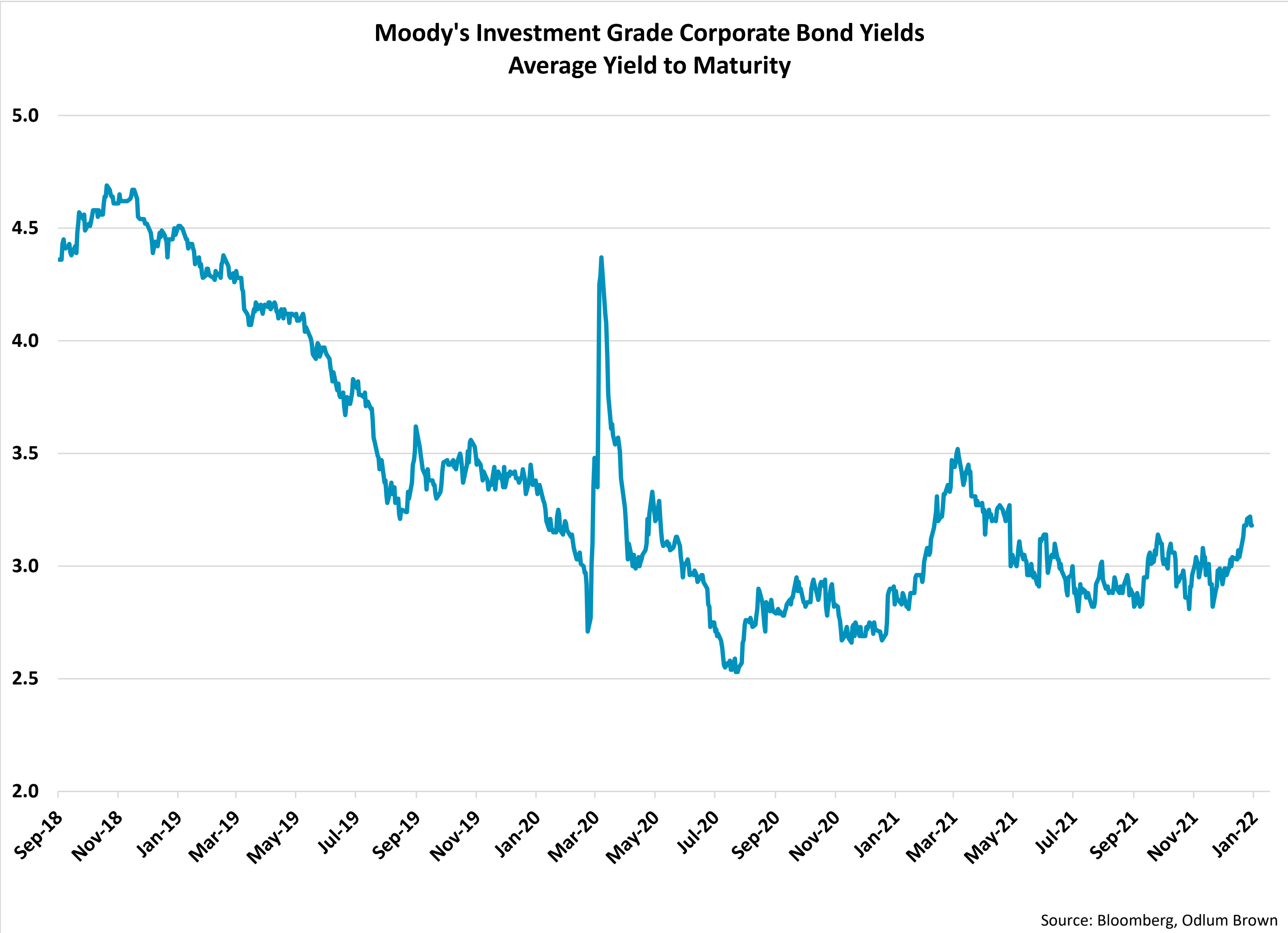
At the same time, the labour market remained taut with the unemployment rate hitting 3.9% and wage pressures evident. There are 11 million job openings in America.

Canada has also enjoyed buoyant economic times with a record trade surplus and a blowout employment report. The Bank of Canada has taken note and has warned of imminent tightening.

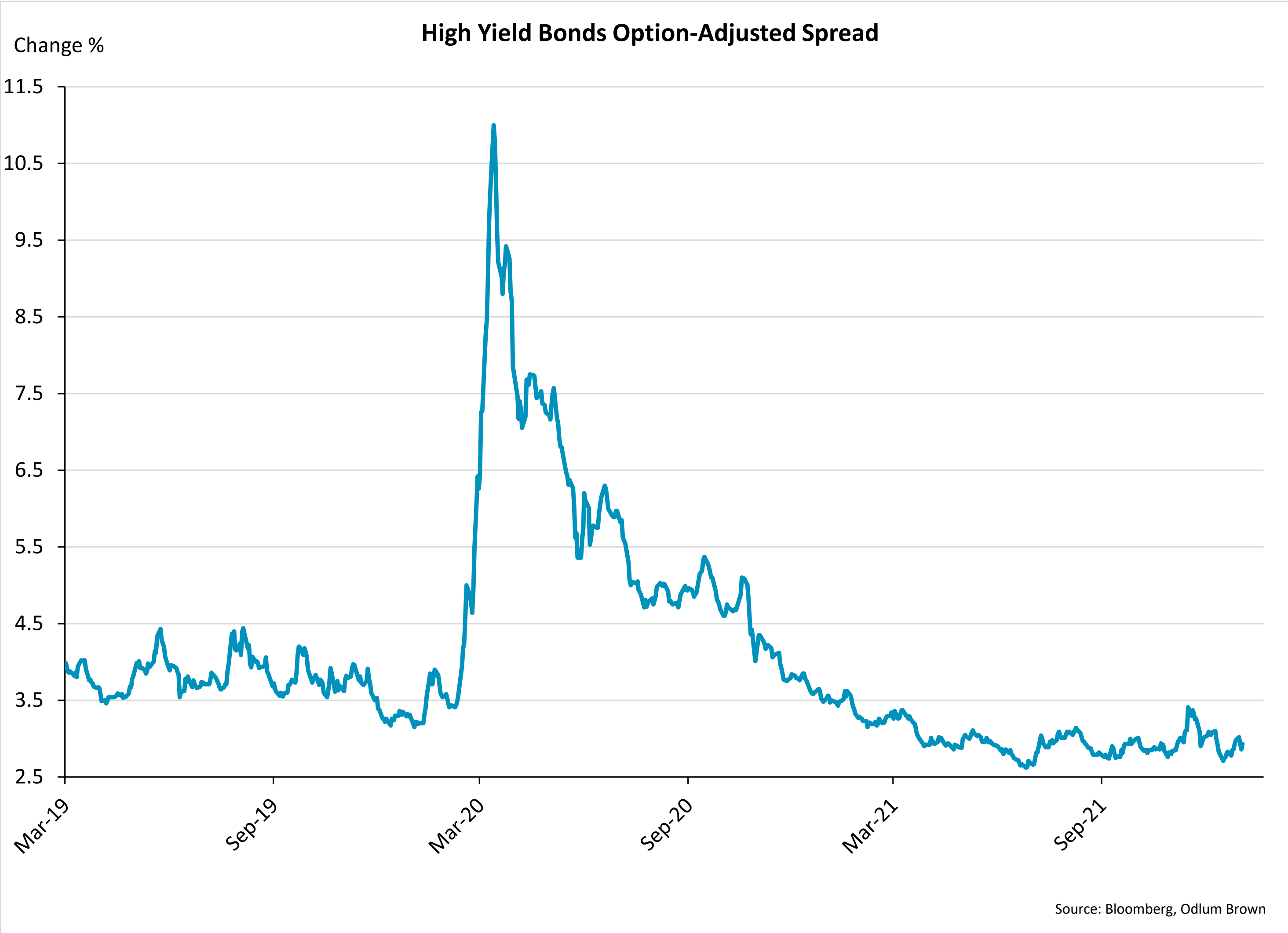
U.S. 10-Year Treasury



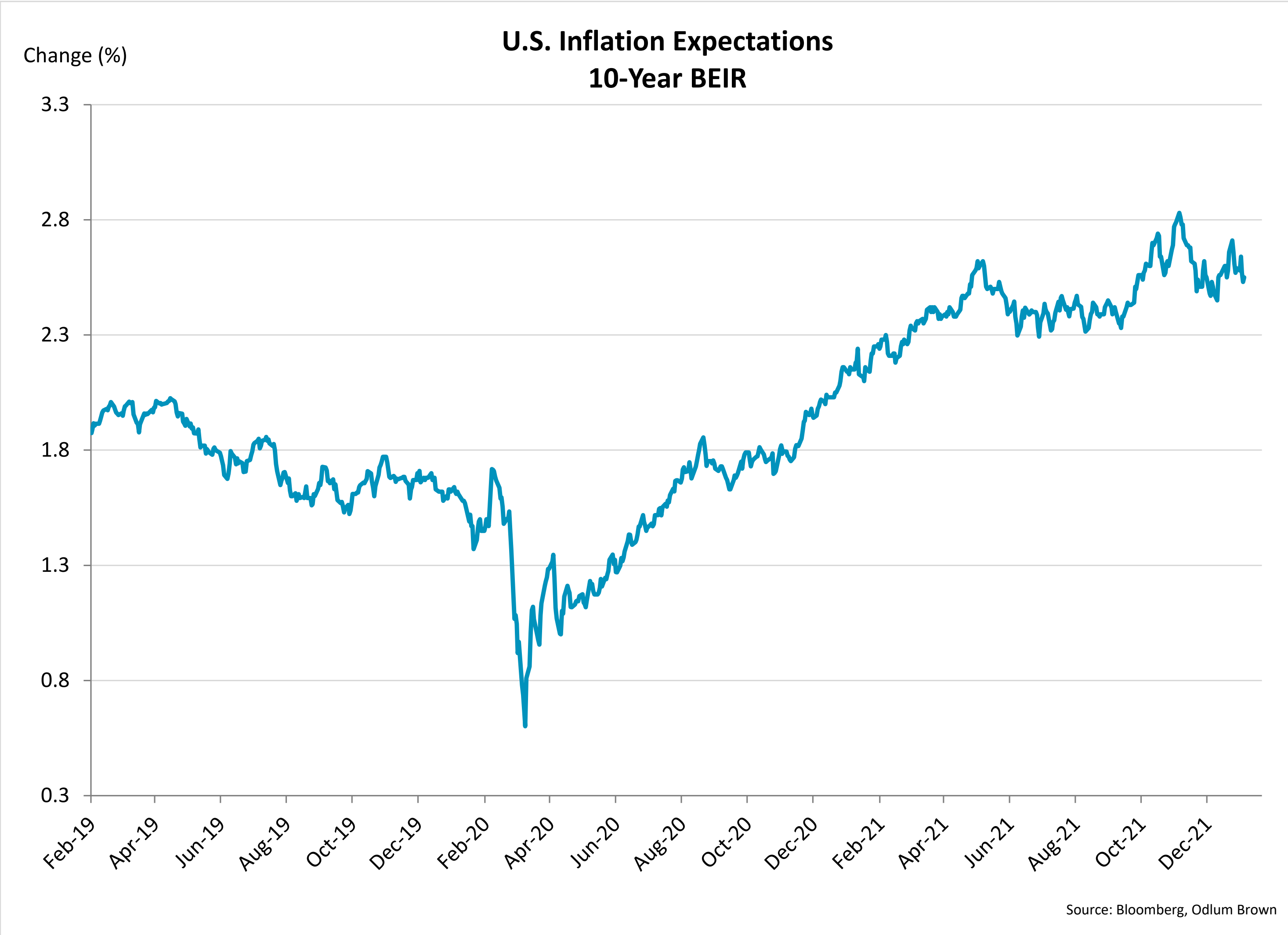
This benchmark's yield soared in early 2022 after the Fed indicated it would begin to reduce its balance sheet once quantitative easing was finished.



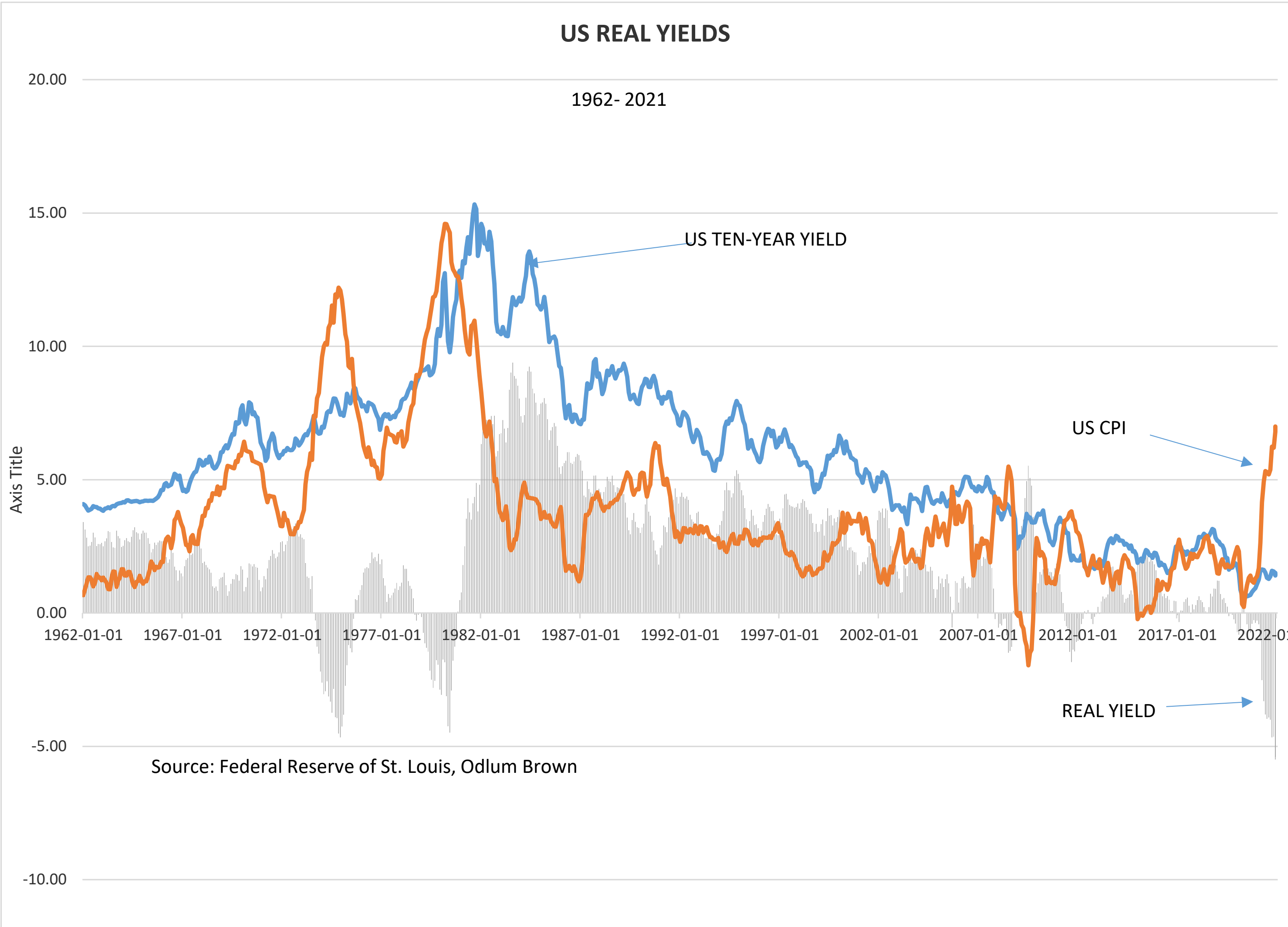
Investment-grade corporate bond yields have risen along with the increase in government bond yields.



Demand for high yield bonds remains robust although spreads have widened modestly from record lows.



Inflation expectations peaked in mid-November. They have slid more than 25 basis points, but remain at elevated levels.



This chart displays the trend in real yields for the past 60 years. There have been several periods of negative yields, but the current negative yields are at their most extreme. The average for this period is positive 2.2%.

Outlook

This year is shaping up to be the year of "the Hike." Central banks have come to realize that they are behind the curve and are moving to rein in excessive monetary accommodation. At present, the Bank of Canada may move first. The first increase in the Fed Funds Rate could take place in March, when quantitative easing is slated to end. The markets anticipate three or four yield hikes, which would put the Fed Funds Rate over 1% by year end.

Real yields (bond yields minus inflation) are at extremely negative levels. As inflation ameliorates and nominal bond yields rise, real yields will improve (i.e. become less negative).

Wage pressures are escalating and may prevent the inflation rate from falling back to the 2% level. Commodity prices have soared of late too. Long-term deflationary pressures, such as demographics and technology, will re-emerge and help ease inflation. Overall, inflation will be slow to subside, with most forecasts estimating it to land between 3-4%.

The runoff in the Fed's balance sheet plus the massive increase in corporate borrowing should add to upward pressure on bond yields. The ten-year U.S. note should grind higher to 2% or more. The key question is whether the economy reacts poorly to this tightening. The Fed must act gingerly and could act more slowly than consensus.

Strategy

This continues to be a time to defend principal in the bond market as investing in long-term bonds, which, while offering higher nominal yields than shorter-term bonds, carry significant potential for capital loss if interest rates rise. Thus, 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.

Specifically, we recommend a laddered approach using the **Odlum Brown Corporate Bond Ladder**. GICs could be used in the ladder as well. In addition, we adopted the use of outside bond investment managers to augment returns. We continue to do so. 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.