MONTHLY FIXED INCOME UPDATE

Hank Cunningham

July 15, 2019

Interest Rate Summary	Jun-28-19	Dec-31-18	29-Dec-17	30-Dec-16	31-Dec-15	31-Dec-14	31-Dec-13
U.S.							
3-Month T-Bill	2.09%	2.36%	1.38%	0.50%	0.16%	0.04%	0.07%
2-Year Treasury	1.77%	2.49%	1.89%	1.19%	1.31%	0.47%	0.38%
10-Year Treasury	2.00%	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	1.47%	1.86%	1.69%	0.74%	0.48%	0.99%	1.14%
10-Year Canada	1.46%	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	6.52%	1.41%	2.52%	3.52%	3.52%	8.79%	-1.19%
DEX Federal Bond Index	4.04%	2.39%	0.13%	3.66%	3.66%	6.91%	-1.52%
DEX Provincial Bond Index	8.76%	0.66%	4.33%	4.14%	4.14%	12.18%	-2.70%
DEX All Corporate Index	6.82%	1.10%	3.38%	2.71%	2.71%	7.58%	0.84%
DEX "A" Corporate Index	8.28%	0.51%	4. 42%	2.62%	2.62%	9.10%	-0.16%
DEX Real Return Bonds	8.81%	-0.05%	0.72%	2.79%	2.79%	13.18%	-13.1%
DEX High Yield Bonds	4.91%	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:

Yields fell at all maturities in the U.S. in June. Three month treasury bills, two year treasurys and ten year notes fell 25, 17 and 7 basis points respectively, producing a modestly steeper yield curve. Contrast this with Canadian yields, which were mixed but with little change.

This divergent performance was a result of conspicuous slowing in economic growth in the U.S. while Canada continued to produce positive results in a number of important sectors.

A weak employment report at the beginning of June launched the market call for the Fed to loosen the monetary reins. Analysts cut growth forecasts and inflation, and U.S. exports remained weak. While the U.S. administration relented on the tariffs on Mexico, bond yields fell further; the market began to price in two rate cuts by the Fed.

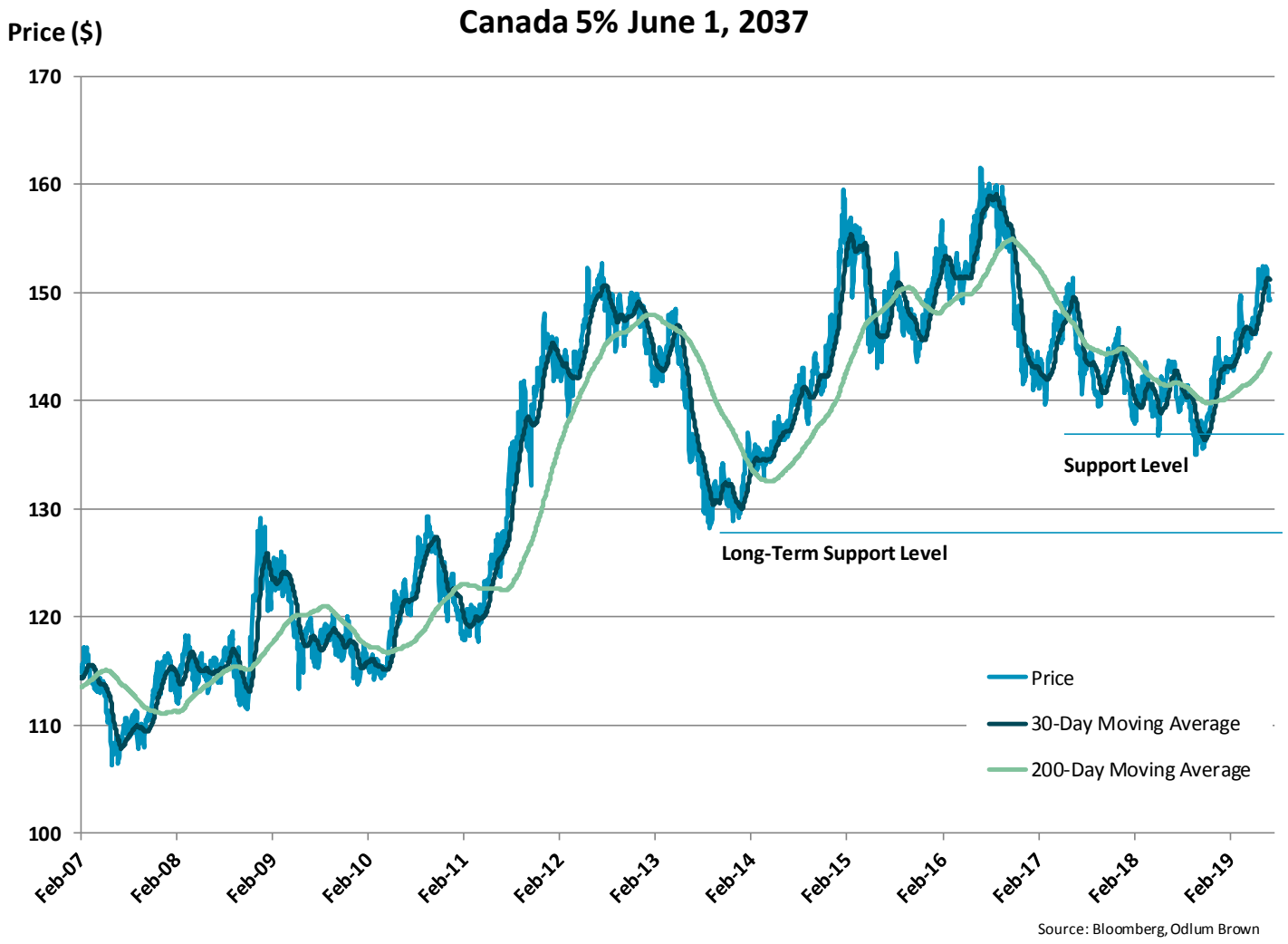
Powell, in fact, signalled at least one rate cut was coming. This was in response to a series of weak data such as manufacturing, durable goods and capital goods.

This served to add further strength to the loonie, as Canada reported a trade surplus, oil prices were firm, GDP prints were positive and our CPI exceeded not only estimates but the Bank of Canada's target as inflation rose above 2%.

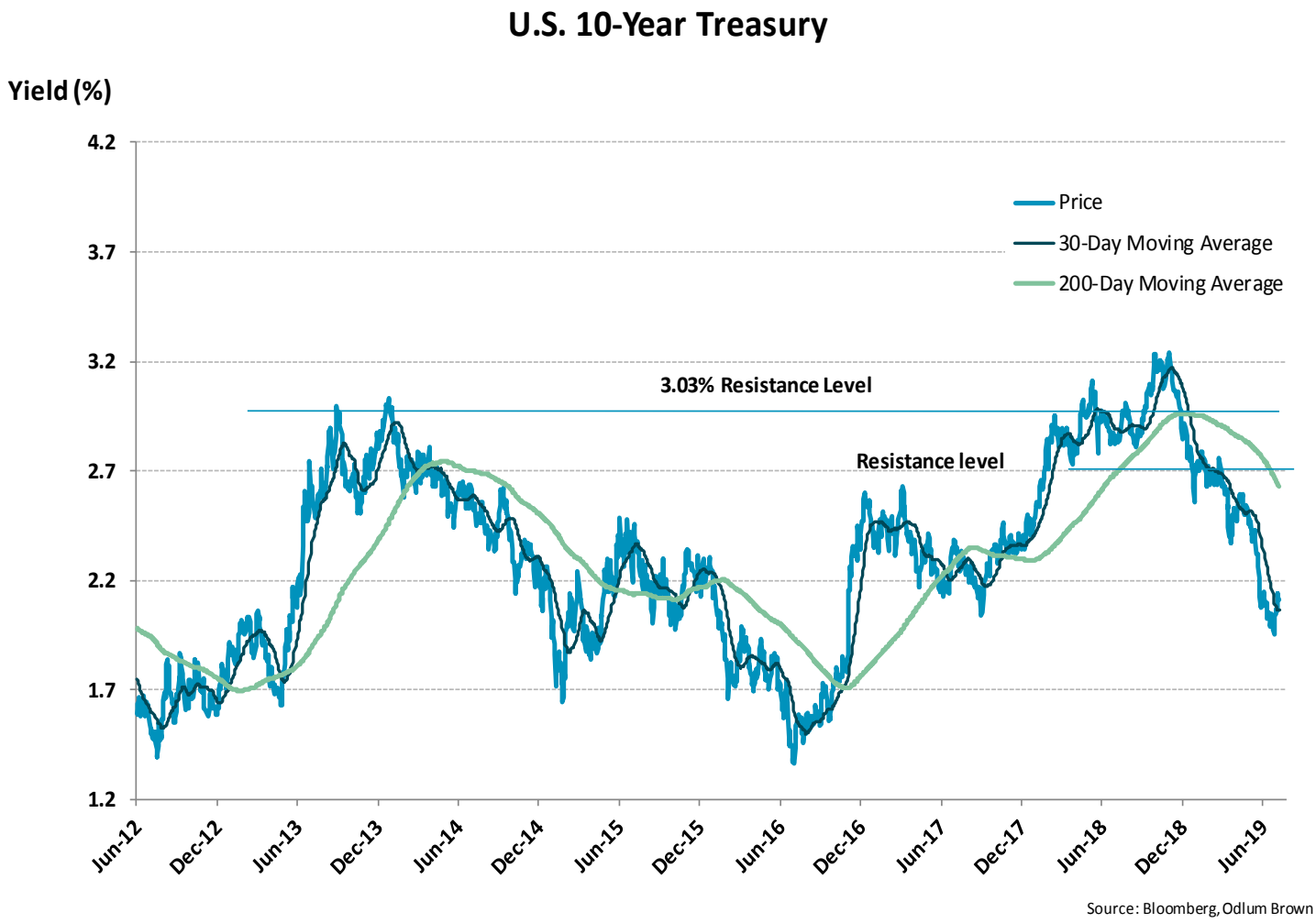
This led to no change by the Bank of Canada, signalling that it was moving to the sidelines. Some analysts favour a hike in the Bank Rate.

Since month end, the U.S. ten-year note touched 1.95%, but the yield has since risen to 2.10% on this bellwether. Contributing to this turnaround was the surprise increase in both wholesale and retail inflation, along with a strong employment report.

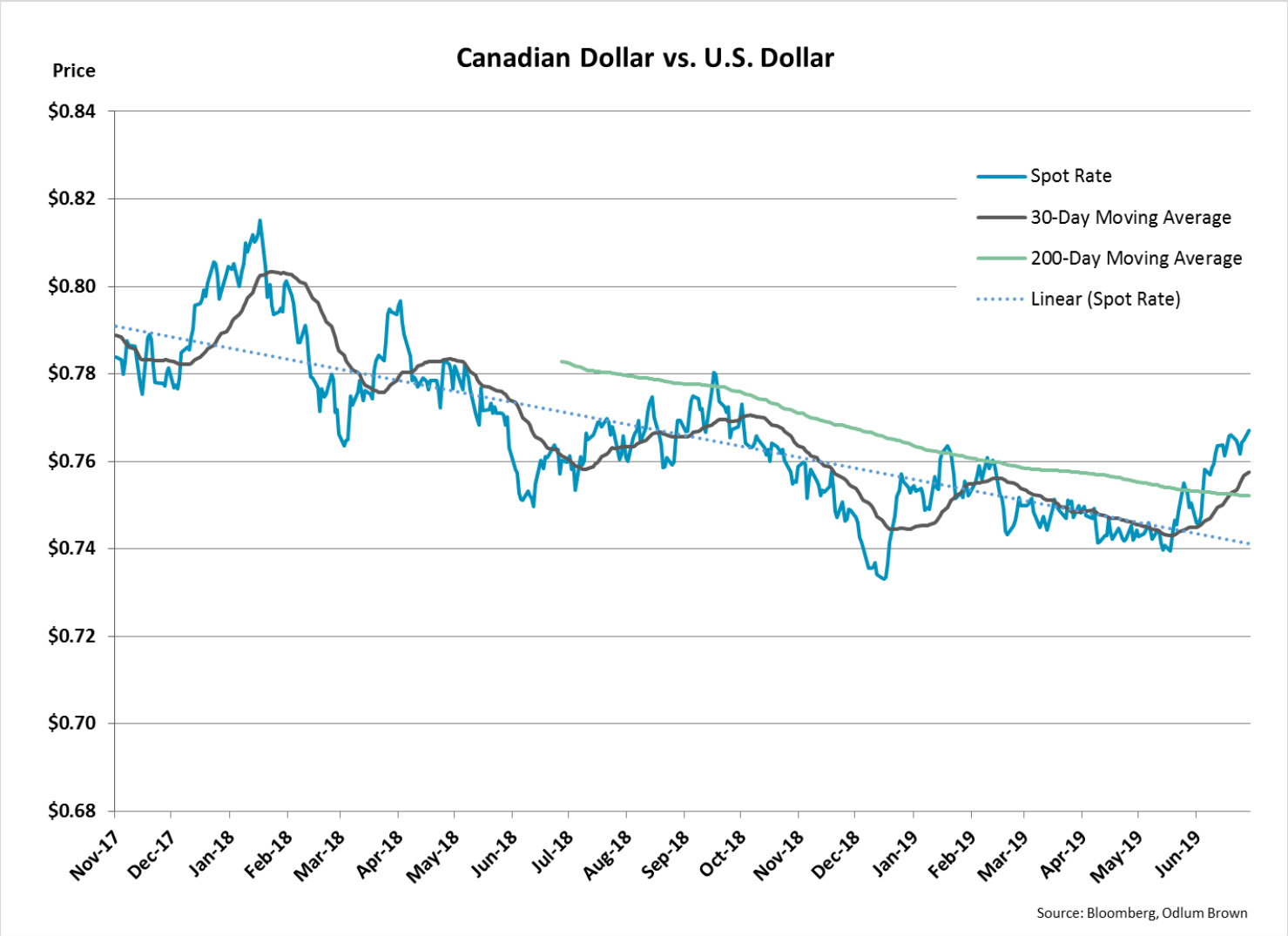
The high yield market was healthy, with an active new issue calendar and spreads over Treasurys tightening modestly.



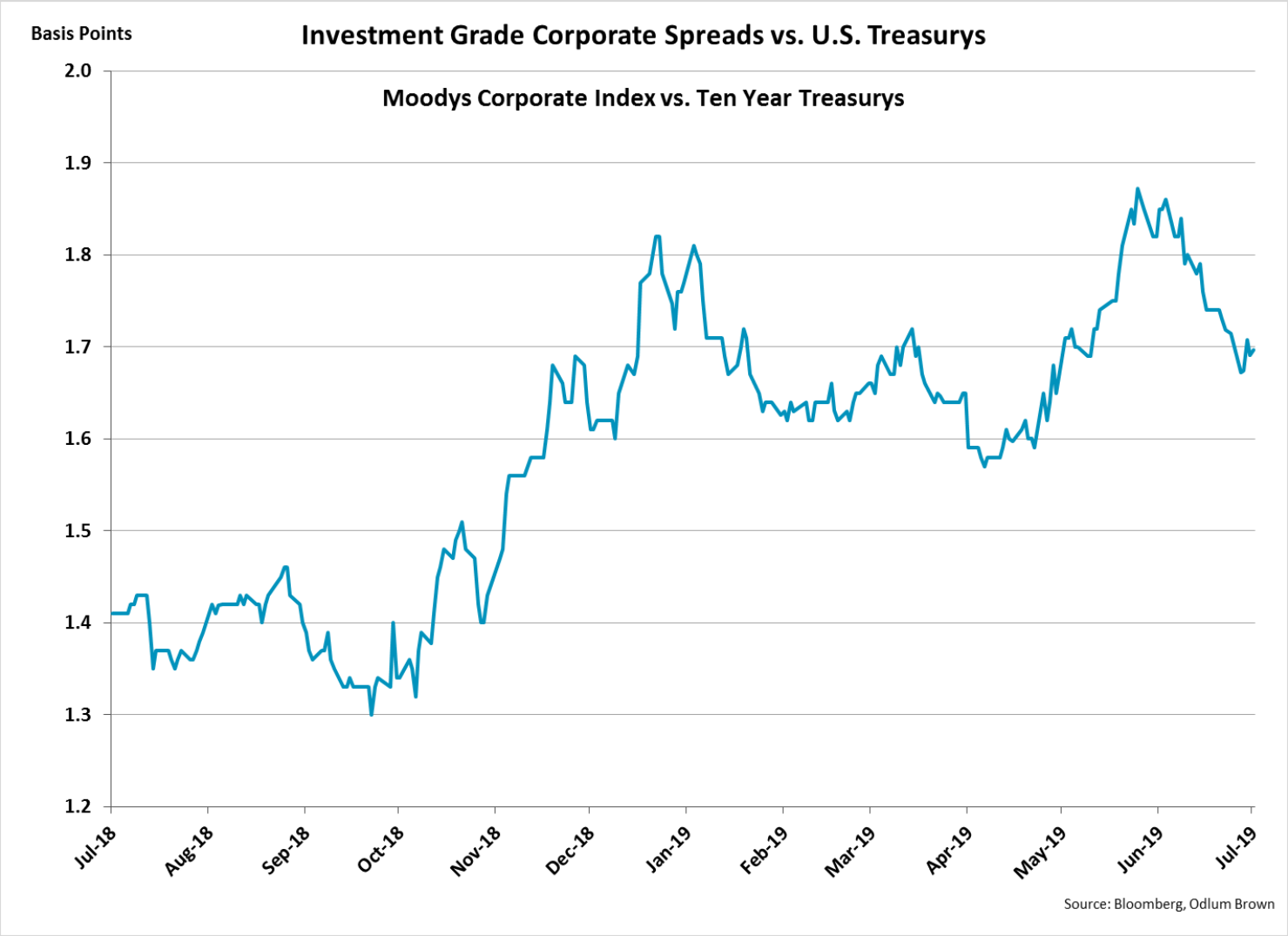
The price of this long-term Canada bond has sold off and is displaying technical weakness.



This global bellwether bond sunk to 1.95% but its yield moved up to 2.10%. It remains technically bullish.



This chart shows the Canadian dollar in a bull market.



After rising steadily, corporate yield spreads narrowed after the Fed signaled monetary easing.

Outlook

Where does the market go from here? There are clear signs of slowing in global and American growth. Canada is an exception to this, with its economy performing well.

Monetary ease, in an attempt to forestall further weakness has returned everywhere but Canada. Bond yields, primarily in Europe, have fallen deeper into negative territory. It is premature to fear a recession in the near term, but GDP growth should abate somewhat.

The U.S. consumer remains confident and employment remains strong, while inflation actually stirred to everyone's surprise. It is likely that bond yields will stay suppressed indefinitely, but we believe that a modest uptrend in yields may take place, especially if inflation continues to tick up.

Of course, global trade concerns are of major importance but it is difficult to predict the outcome or impact. Thus, they are the wild card and could lead to market disruption.

Canada is enjoying a period of positive economic results which should leave the Bank of Canada on the sidelines. The strength in the loonie will act as a *de facto* tightening, which should continue as the Fed contemplates lowering rates and weakening the U.S. dollar as a result.

Strategy

Returns for fixed income investors have exceeded most estimates for the total year in just six months. Duplicating this in the second half of 2019 would produce total returns of 14% for the full year. This is unlikely. Thus we recommend a continued focus on short duration, high-quality corporate bonds.

For further discussion, please speak to your investment advisor.