



MONTHLY FIXED INCOME UPDATE

Hank Cunningham

July 21, 2021

Interest Rate Summary	Jun-30-21	May-31-21	Apr-30-21	Mar-31-21	Feb-27-21	Jan-29-21	Dec-31-20	Dec-31-19
U.S.								
3-Month T-Bill	0.04%	0.01%	0.01%	0.02%	0.04%	0.05%	0.08%	1.55%
2-Year Treasury	0.25%	0.14%	0.16%	0.16%	0.13%	0.11%	0.12%	1.57%
10-Year Treasury	1.46%	1.60%	1.63%	1.74%	1.41%	1.07%	0.92%	1.92%
Canada								
3-Month T-Bill	0.14%	0.11%	0.10%	0.08%	0.06%	0.06%	0.06%	1.65%
2-Year Canada	0.45%	0.32%	0.30%	0.22%	0.15%	0.15%	0.20%	1.69%
10-Year Canada	1.39%	1.48%	1.54%	1.56%	1.35%	0.89%	0.68%	1.70%

Performance

	YTD	2020	2019	2018	2017	2016	2015
DEX Universe Bond Index	-3.46%	8.68%	6.87%	1.41%	2.52%	3.52%	3.52%
DEX Federal Bond Index	-2.94%	7.28%	3.73%	2.39%	0.13%	3.66%	3.66%
DEX Provincial Bond Index	-4.75%	9.86%	9.07%	0.66%	4.33%	4.14%	4.14%
DEX All Corporate Index	-2.26%	8.74%	8.05%	1.10%	3.38%	2.71%	2.71%
DEX "A" Corporate Index	-3.37%	8.98%	9.65%	0.51%	4.42%	2.62%	2.62%
DEX Real Return Bonds	-4.03%	13.02%	8.02%	-0.05%	0.72%	2.79%	2.79%
DEX High Yield Bonds	4.87%	6.69%	8.48%	2.15%	5.20%	13.79%	-5.58%

After experiencing rising yields in the first three months of the year and accompanying negative performance, the bond market turned in mostly positive performance in June. Government bonds showed mildly positive results, with most corporate bond sectors outperforming the government sector. Real Return bonds bounced back as well.

The U.S. ten-year yield fell by 14 basis points to 1.46% in June, and have fallen a further 20 basis points since month end. Year-to-date, this bond has added 34 basis points to yield 1.26%. With the two-year yield at 0.20%, the yield curve has flattened modestly to 106 basis points.

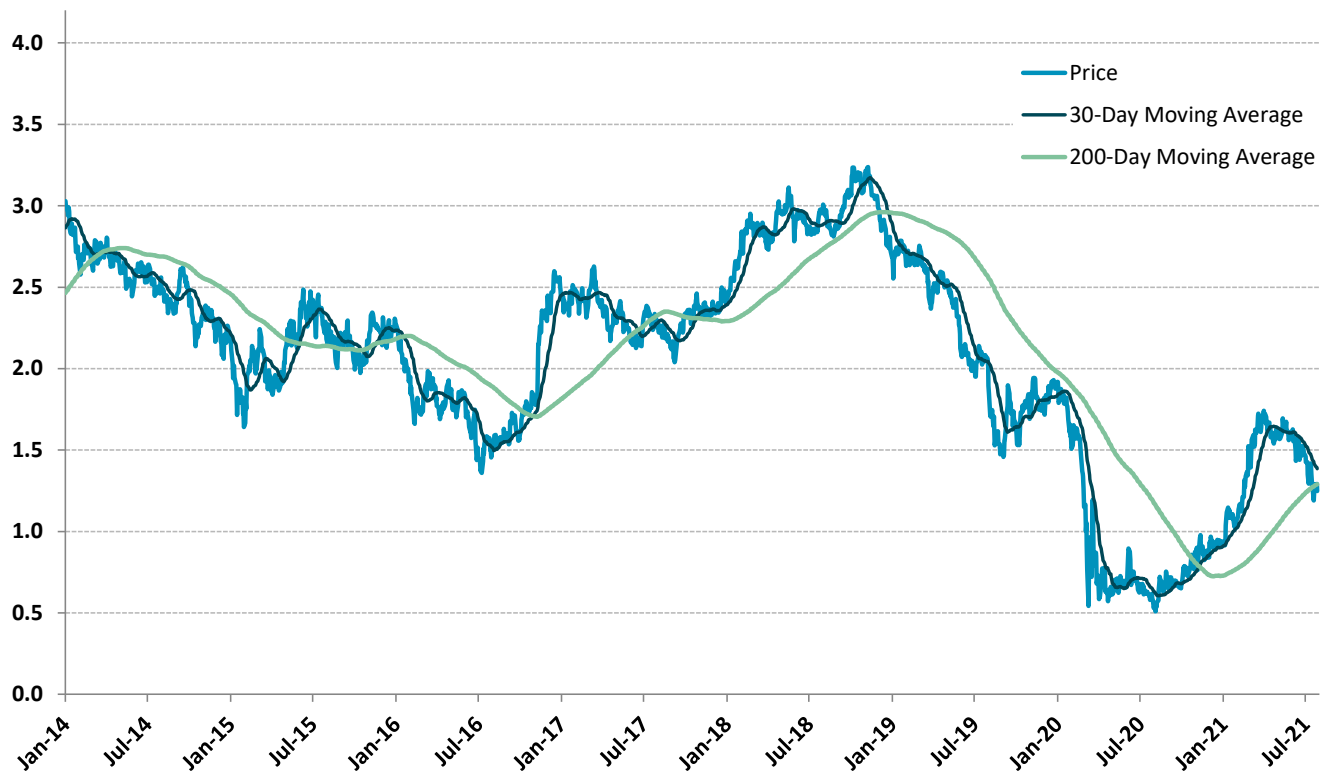
Chair Powell remained steadfast in the Fed's loose monetary stance, continuing to buy \$120 billion of bonds and mortgages per month, and stating repeatedly that he expects any run-up in inflation to be transitory. His views and stance have helped to calm the bond market. Meanwhile, the economic recovery continued, bringing with it tighter labour markets, a pickup in wage demands along with higher inflation.

The Bank of Canada, facing strong data, tapered its bond purchases for the second time, leaving it as the only Central Bank in the developed world to tighten.

There has been some easing in commodity prices and inflation expectations, however, and the housing market has shown uneven conditions. Also, the U.S. consumer has cooled.

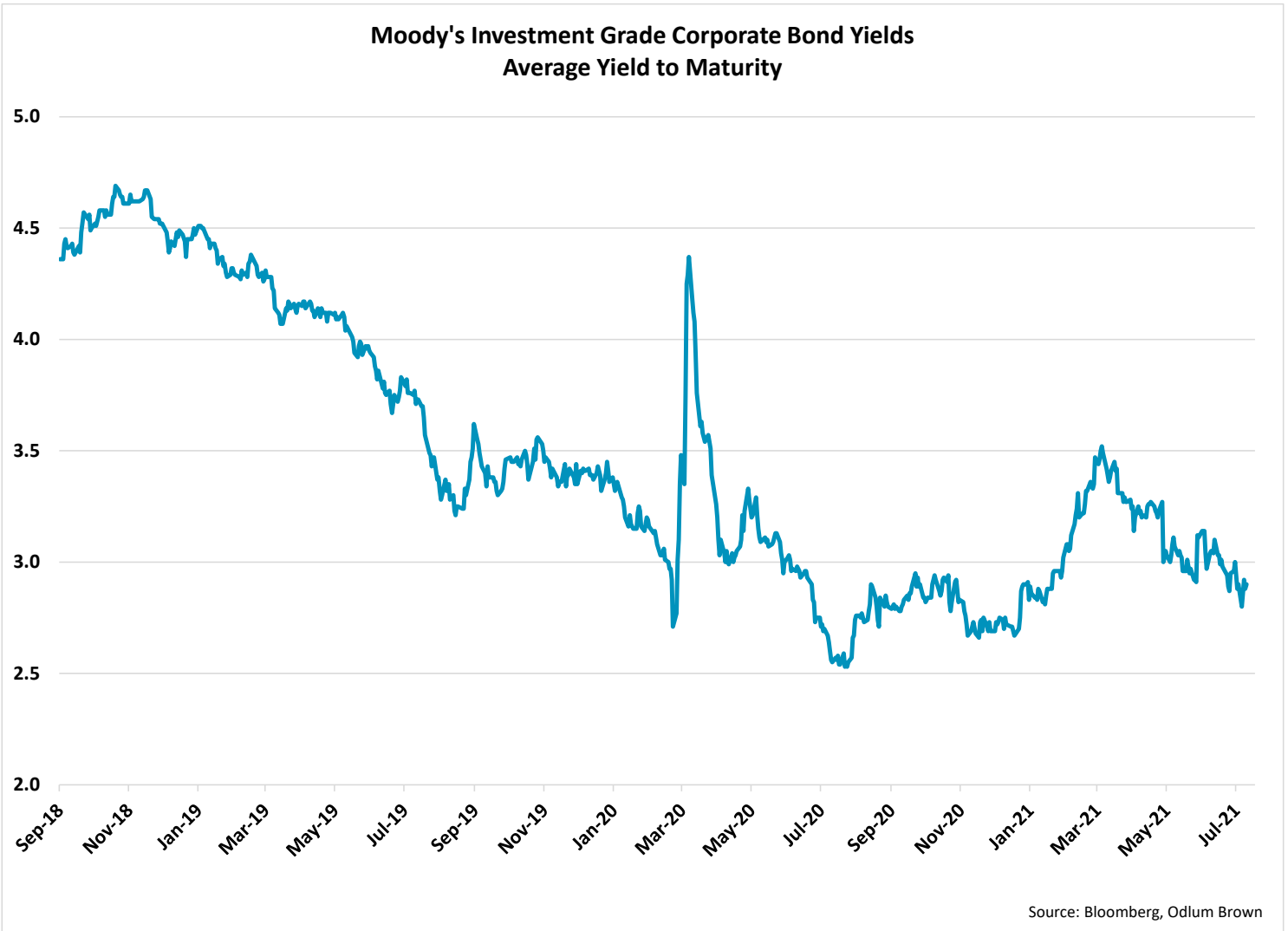
U.S. 10-Year Treasury

Yield (%)

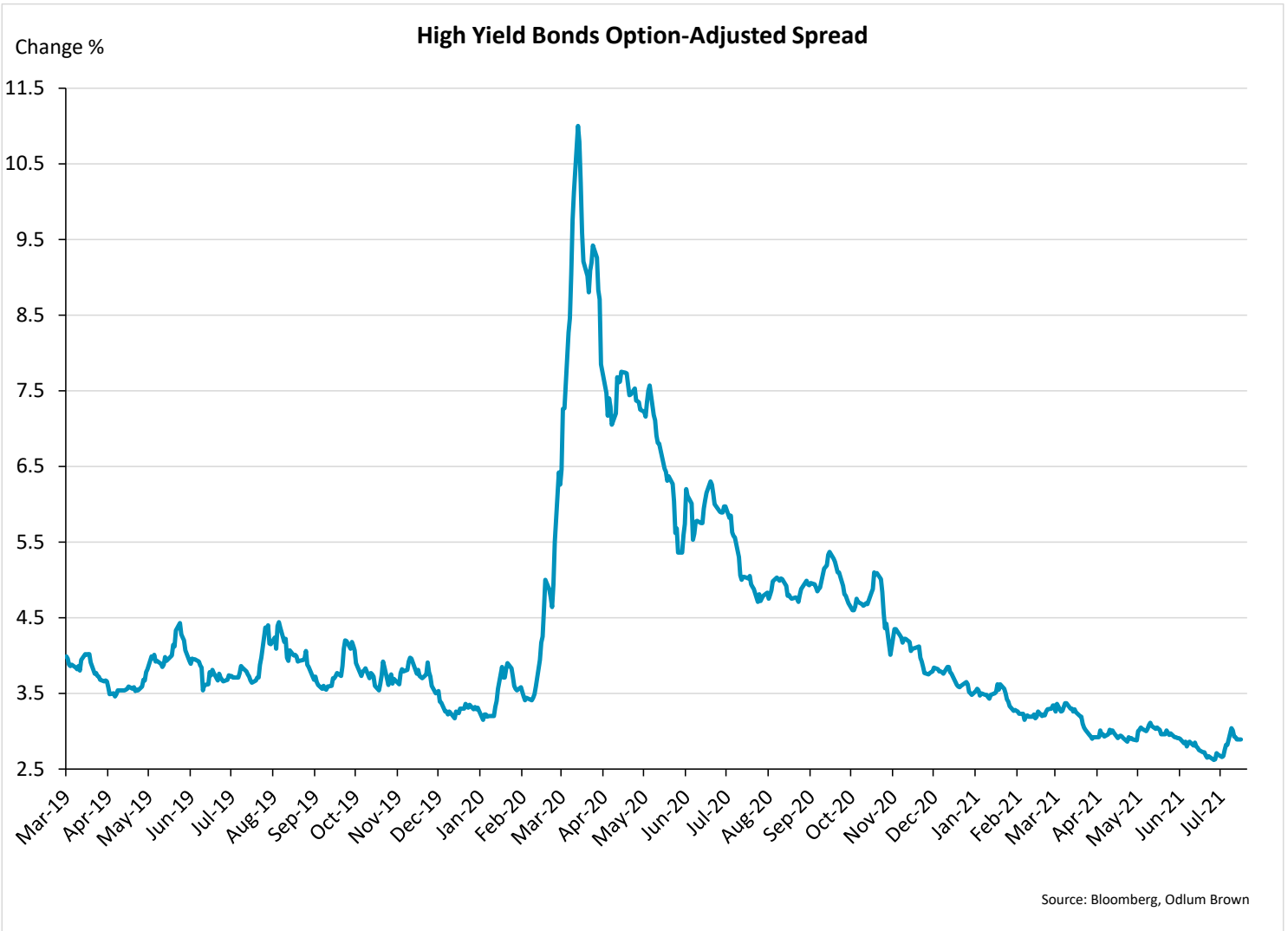


Source: Bloomberg, Odium Brown

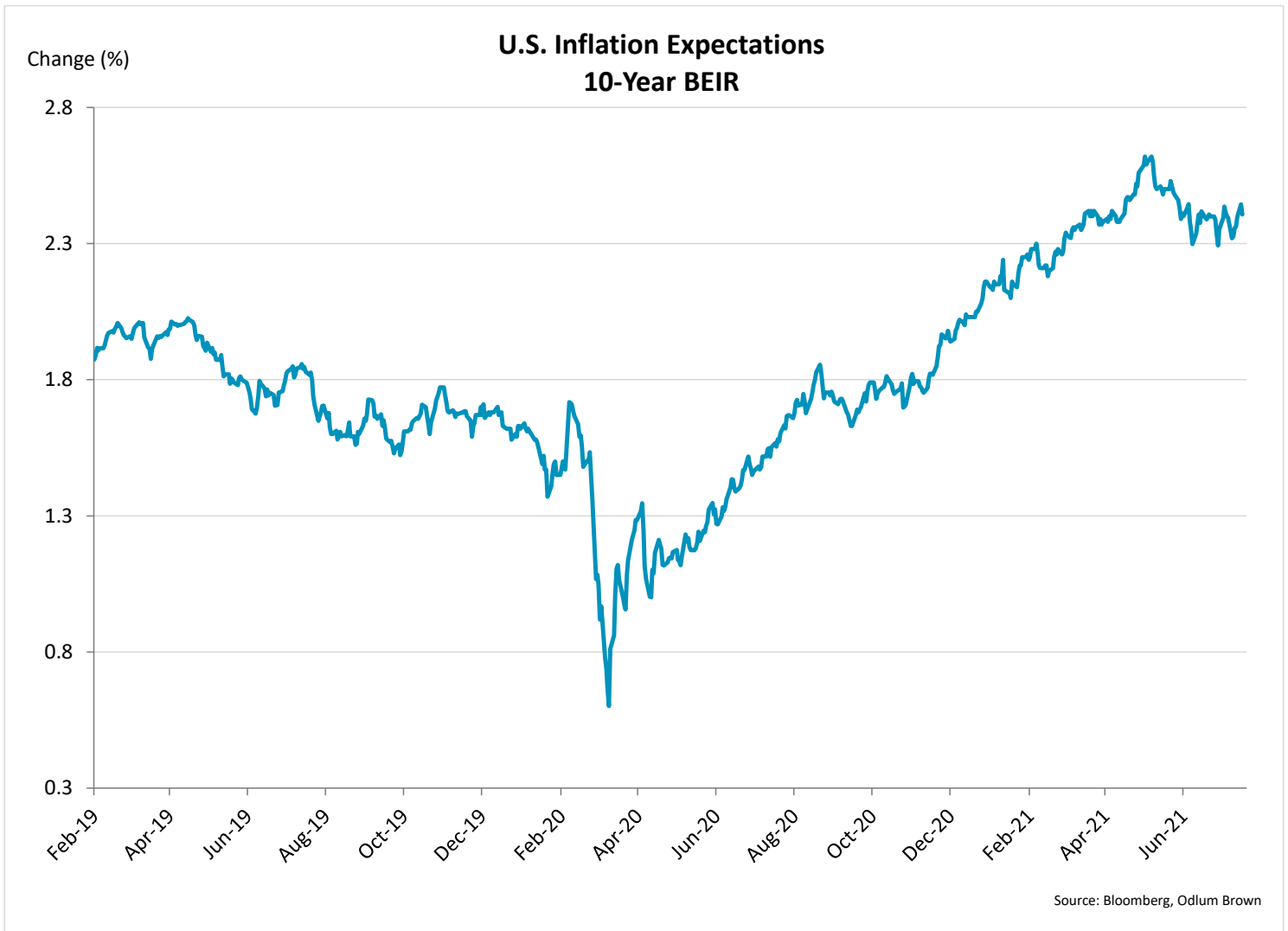
This global bellwether moved decisively higher in yield during the first three months of 2021, but has moved sharply lower since.



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



The high yield market remains close to record low spreads.



Inflation expectations have moved steadily lower, but remain well above 2%.

The employment market remained buoyant in North America as the U.S. economy added 850,000 jobs with rising wage costs evident. Meanwhile, Canada reported a blowout increase of 231,000 jobs in June.

On the inflation front, both wholesale and retail price inflation in the U.S. out-paced estimates. U.S. CPI is now running at 4.5% year-over-year.

Outlook

This is a challenging environment for fixed income investors. Despite a dramatic economic recovery, rising inflation and tight labour markets, we have seen bond yields fall a full 50 basis points since the end of March. Markets have decided that inflation will be transitory. Already, we have seen corrections in commodity prices and inflation expectations. In the background remain two fundamentals that act as long-term constraints on bond yields, namely demographics and technology. Further,

the U.S. is increasingly perceived to be in a debt trap where there is no apparent way out as any fiscal or monetary restraint would be counterproductive.

The period of lower-for-longer bond yields is likely to persist as the path out of the pandemic is clarified. Could yields go lower? Yes they could, with 1% being a realistic target. They could also move higher, with 2% as a logical level, given the poor fundamentals for bonds, namely negative real yields. Thus, the environment for fixed income investors will remain challenging and it is likely that returns will continue to be modest.

Strategy

The normal approach in such an environment, where real yields are negative 3%, is to reach for yield. That implies investing in long-term, low-quality corporate bonds. We do not counsel such an approach as long-term, low-quality bonds offer the attendant risks of price and capital loss. Instead, we recommend high-quality corporate bonds of relatively short-term duration. This approach will produce low single-digit returns and protect principal.

Specifically, we recommend a ladder 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 for more details and to discuss this strategy.

Please read our Odlum Brown Limited Disclaimer and Disclosure - It is important!

Odlum Brown Limited is an independent, full-service investment firm focused on providing professional investment advice and objective research. We respect your right to be informed of relationships with the issuers or strategies referred to in this report which might reasonably be expected to indicate potential conflicts of interest with respect to the securities or any investment strategies discussed or recommended in this report. We do not act as a market maker in any securities and do not provide investment banking or advisory services to, or hold positions in, the issuers covered by our research. Analysts and their associates may, from time to time, hold securities of issuers discussed or recommended in this report because they personally have the conviction to follow their own research, but we have implemented internal policies that impose restrictions on when and how an Analyst may buy or sell securities they cover and any such interest will be disclosed in our report in accordance with regulatory policy. Our Analysts receive no direct compensation based on revenue from investment banking services. We describe our research policies in greater detail, including a description of our rating system and how we disseminate our research, on the Odlum Brown Limited website.

This report has been prepared by Odlum Brown Limited and is intended only for persons resident and located in all the provinces and territories of Canada, where Odlum Brown Limited's services and products may lawfully be offered for sale, and therein only to clients of Odlum Brown Limited. This report is not intended for distribution to, or use by, any person or entity in any jurisdiction or country including the United States, where such distribution or use would be contrary to law or regulation or which would subject Odlum Brown Limited to any registration requirement within such jurisdiction or country. As no regard has been made as to the specific investment objectives, financial situation, and other particular circumstances of any person who may receive this report, clients should seek the advice of a registered investment advisor and other professional advisors, as applicable, regarding the appropriateness of investing in any securities or any investment strategies discussed or recommended in this report.

This report is for information purposes only and is neither a solicitation for the purchase of securities nor an offer of securities. The information contained in this report has been compiled from sources we believe to be reliable, however, we make no guarantee, representation or warranty, expressed or implied, as to such information's accuracy or completeness. All opinions and estimates contained in this report, whether or not our own, are based on assumptions we believe to be reasonable as of the date of the report and are subject to change without notice.

Please note that, as at the date of this report, the Research Analyst responsible for the recommendations herein, associates of such Analyst and/or other individuals directly involved in the preparation of this report hold securities of some of the issuer(s) referred to directly or through derivatives.

No part of this publication may be reproduced without the express written consent of Odlum Brown Limited. Odlum Brown Limited is a Member of the Canadian Investor Protection Fund.
