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INVESTMENT RESEARCH

Monthly Fixed Income Update

Hank Cunningham

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Interest Rate Summary	May-29-20	Dec-31-19	Dec-31-18	29-Dec-17	30-Dec-16	31-Dec-15
U.S.						
3-Month T-Bill	0.14%	1.55%	2.36%	1.38%	0.50%	0.16%
2-Year Treasury	0.16%	1.57%	2.49%	1.89%	1.19%	1.31%
10-Year Treasury	0.65%	1.92%	2.69%	2.41%	2.44%	2.27%
Canada						
3-Month T-Bill	0.18%	1.65%	1.64%	1.05%	0.45%	0.51%
2-Year Canada	0.28%	1.69%	1.86%	1.69%	0.74%	0.48%
10-Year Canada	0.53%	1.70%	1.97%	2.04%	1.72%	1.39%

Performance

	YTD	2019	2018	2017	2016	2015	2014
DEX Universe Bond Index	5.74%	6.87%	1.41%	2.52%	3.52%	3.52%	8.79%
DEX Federal Bond Index	6.99%	3.73%	2.39%	0.13%	3.66%	3.66%	6.91%
DEX Provincial Bond Index	6.80%	9.07%	0.66%	4.33%	4.14%	4.14%	12.18%
DEX All Corporate Index	2.76%	8.05%	1.10%	3.38%	2.71%	2.71%	7.58%
DEX “A” Corporate Index	3.07%	9.65%	0.51%	4.42%	2.62%	2.62%	9.10%
DEX Real Return Bonds	3.78%	8.02%	-0.05%	0.72%	2.79%	2.79%	13.18%
DEX High Yield Bonds	-5.27%	8.48%	2.15%	5.20%	13.79%	-5.58%	2.64%

All sectors produced positive performance in April. Corporate bonds, both investment grade and high yield, outperformed governments for the second consecutive month. The backstopping of the corporate bond market by the Federal Reserve and the Bank of Canada has restored confidence and has led to record issuance of new issues.

Comments:

	May-29-20	Apr-30-20	Mar-31-20	Feb-28-20	Jan-31-20	Dec-31-19
U.S. 3-month Treasury Bills	0.14%	0.10%	0.09%	1.28%	1.55%	1.55%
U.S. 2-year bonds	0.16%	0.20%	0.25%	0.92%	1.32%	1.57%
U.S. 10-year bonds	0.65%	0.61%	0.67%	1.15%	1.51%	1.92%

For the second straight month, there was little net change in government bond yields. However, credit markets continued to resuscitate, with both investment-grade and high-yield spreads narrowing steadily, accompanied by record amounts of new corporate bonds.

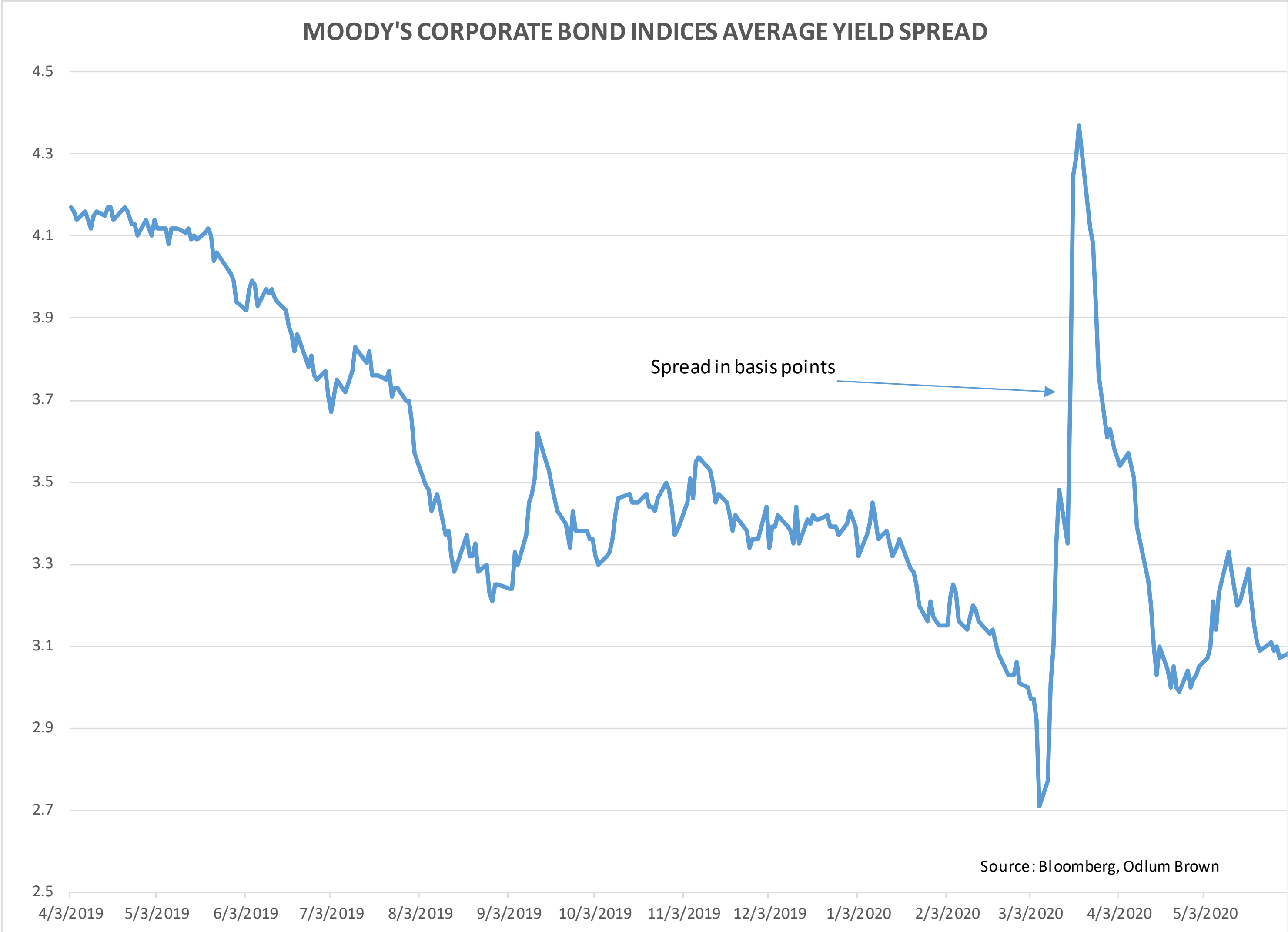
After the stunningly strong employment report on June 5, it appears that the massive and unprecedented monetary and fiscal stimulus not only in North America but also globally, has fended off the worst-case economic scenario. Indeed, heralded by the improvement in the labour market and other signs of recovery, some respected economists believe the recession in North

America is over. We believe the pandemic is likely rear its head again and there may be significant adjustments to the recent economic data.

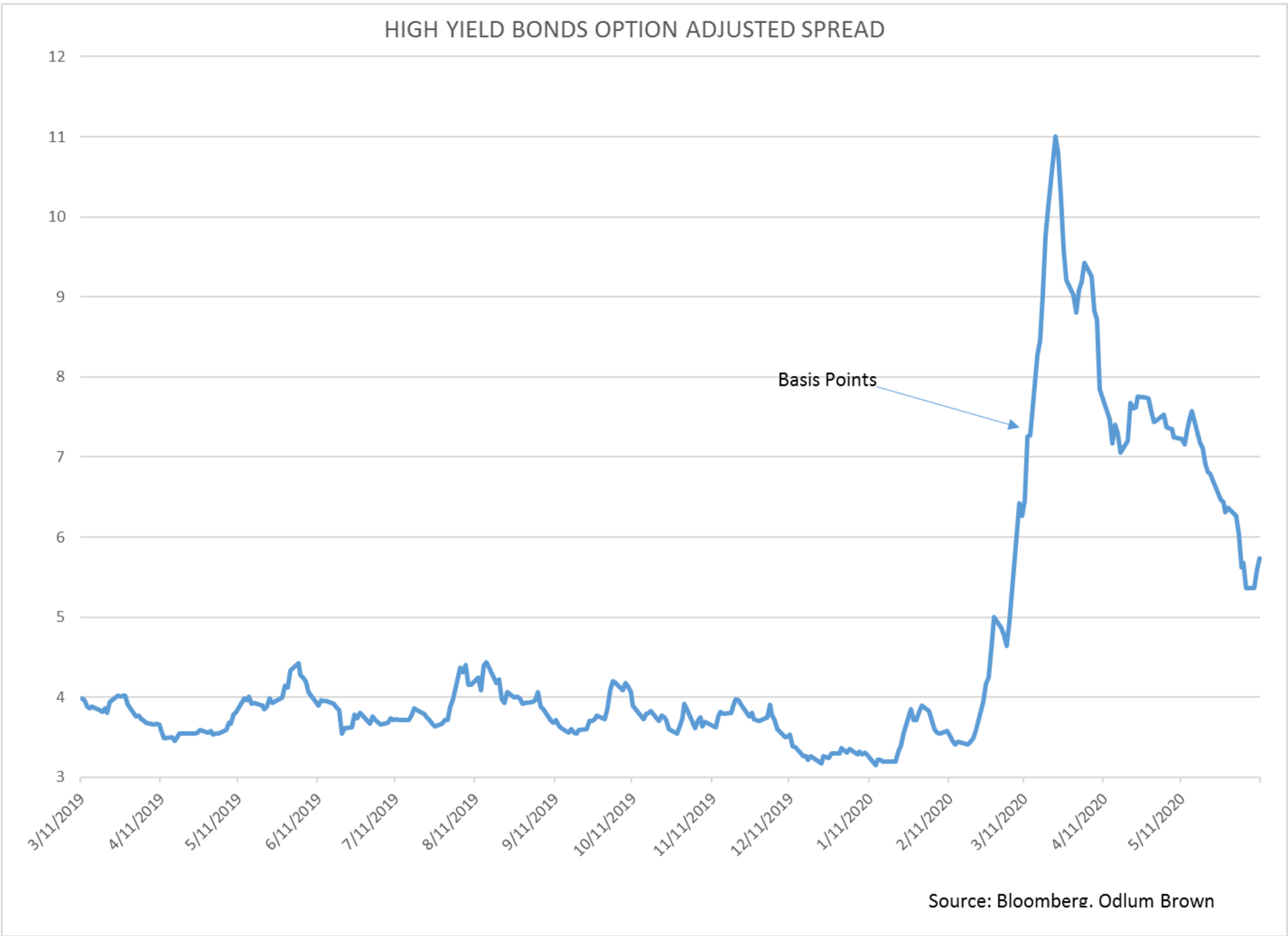
Forecasts for a "V" shaped recovery have become more common. As an example of what may be in store, China, the first country to open fully from the pandemic restrictions, is experiencing such a recovery.

With monetary policy at extreme ease, focus has shifted to fiscal stimulus. Germany announced a second round of stimulus, for an additional EUR 110 billion. The U.S. is also considering another round of fiscal stimulus, although Congress has paused, as it assesses the nascent recovery.

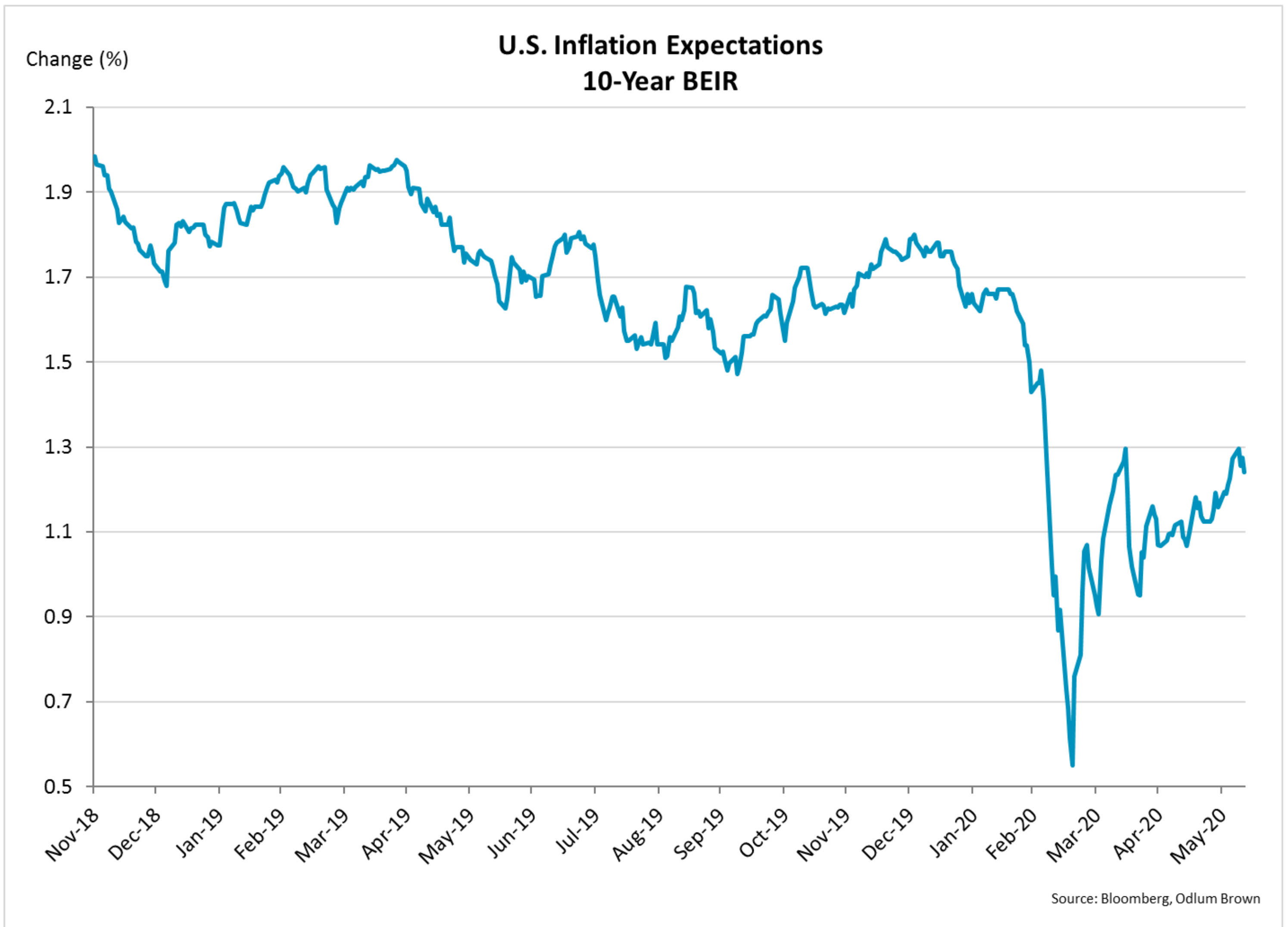
This global bellwether issue has traded in a narrow range following its earlier steep plunge.



Investment-grade corporate bonds have retraced approximately two-thirds of their earlier widening.



The high-yield market has also continued to improve.



Inflation expectations have bounced up from extremely low levels.

Outlook

Fed Chair Jerome Powell delivered a sobering assessment of the current and projected economic landscape. The Fed will leave its Fed Funds Rate unchanged until 2022. While the Fed cannot directly control bond yields, it can exert considerable influence over them. Indeed, market observers believe the Fed may resort to some measure of yield curve control should yields rise more than the Fed would like.

There is a recovery underway, as witnessed by the stunning employment report and the strength in equity markets. Thanks to the Fed's actions, liquidity has been restored to credit markets. Not only have yield spreads between corporate and government bonds narrowed, but there have been record numbers of new corporate bonds issued.

Government bond yields jumped twenty basis points after the June employment report but they retreated by the same amount after Chair Powell's gloomy assessment of economic conditions. While not announcing any new measures, the Fed has made it clear that there is "no limit" to the tools it has at its disposal. Once again, the market has learned to "not fight the Fed."

The consensus view is that, as the full effect of this unprecedented stimulus hits global economies, inflation will rear its head. It is not difficult to see sharp price increases ultimately in important items such as food, restaurants, air fares, hotels and wages. That moment is, however, far into the future as global economies struggle with the forces of deflation for the foreseeable future.

Thus far, the gigantic increase in the U.S. budget deficit has mostly been absorbed by the Fed's balance sheet, which has ballooned by some $5 trillion dollars with no apparent ceiling. It is on its way to $10 trillion this year. With the Fed monetizing this deficit, one outcome has been a weak U.S. dollar. Our conclusion is that the yield curve will steepen further and that we have seen the lows in long-term government bond yields.

Along with a rebound in energy prices, this weakness in the U.S. dollar has led to a steady rise in the Canadian dollar.

As to bond yields, the Fed has anchored short-term yields close to zero. The yield curve has steepened, in recognition of not only the long-term implications of record issuance of Government bonds but also the ultimate increase in inflation.

Strategy

We continue to stress the importance of including high-quality fixed income securities for client portfolios. In this environment, we favour non-cyclical corporate bonds, such as those issued by utilities, banks, telecommunications and recurring revenue businesses.

Conditions have improved in the secondary bond market and there has been some retracement of the widening in corporate bond yield spreads, both investment grade and high yield. Primary issuance of investment-grade corporate bonds and high-yield bonds reached record levels in May.

We have long recommended the laddered approach to fixed income investing. We continue to do so and, in addition to high-quality corporate credits, investors may wish to consider short-term provincial bonds.

Eventually, we will turn our attention to inflation-protected bonds. It is premature to do so given the likelihood of benign inflation for the next couple of years.

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.

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