Monthly Fixed Income Update

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March 17, 2022

Interest Rate Summary	Feb-28-22	Jan-31-22	Dec-31-21	Nov-30-21	Oct-29-21	Sep-29-21	Aug-31-21	Jul-30-21	Dec-31-20
U.S.									
3-Month T-Bill	0.31%	0.19%	0.04%	0.05%	0.05%	0.04%	0.04%	0.04%	0.08%
2-Year Treasury	1.43%	1.16%	0.73%	0.57%	0.50%	0.28%	0.21%	0.19%	0.12%
10-Year Treasury	1.83%	1.77%	1.51%	1.45%	1.56%	1.49%	1.31%	1.22%	0.92%
Canada									
3-Month T-Bill	0.57%	0.34%	0.17%	0.06%	0.15%	0.13%	0.16%	0.17%	0.06%
2-Year Canada	1.43%	1.25%	0.95%	0.98%	1.09%	0.53%	0.42%	0.45%	0.20%
10-Year Canada	1.81%	1.77%	1.42%	1.57%	1.72%	1.51%	1.21%	1.20%	0.68%

Performance	YTD	2021	2020	2019	2018	2017	2016
DEX Universe Bond Index	-4.10%	-2.54%	8.68%	6.87%	1.41%	2.52%	3.52%
DEX Federal Bond Index	-2.64%	-2.62%	7.28%	3.73%	2.39%	0.13%	3.66%
DEX Provincial Bond Index	-5.50%	-3.28%	9.86%	9.07%	0.66%	4.33%	4.14%
DEX All Corporate Index	-3.95%	-1.34%	8.74%	8.05%	1.10%	3.38%	2.71%
DEX "A" Corporate Index	-4.23%	-2.30%	8.98%	9.65%	0.51%	4.42%	2.62%
DEX Real Return Bonds	-6.96%	1.84%	13.02%	8.02%	-0.05%	0.72%	2.79%
DEX High Yield Bonds	-1.58%	6.18%	6.69%	8.48%	2.15%	5.20%	13.79%

Comments:

Bond yields rose at all maturities in January, February and thus far in March. The U.S. two-year note has jumped by 120 basis points, while the ten-year moved 70 basis points higher so far this year. Real Return bonds have suffered the most due to a rise in real yields.

Bond yields kept climbing in March, driven again by the twin forces of inflation and a hawkish Federal Reserve. The U.S. ten-year reached 2.24% before subsiding to its present level of 2.15%. This bond plummeted to 1.73% on separate occasions as the evolving geopolitical crisis motivated flights to quality.

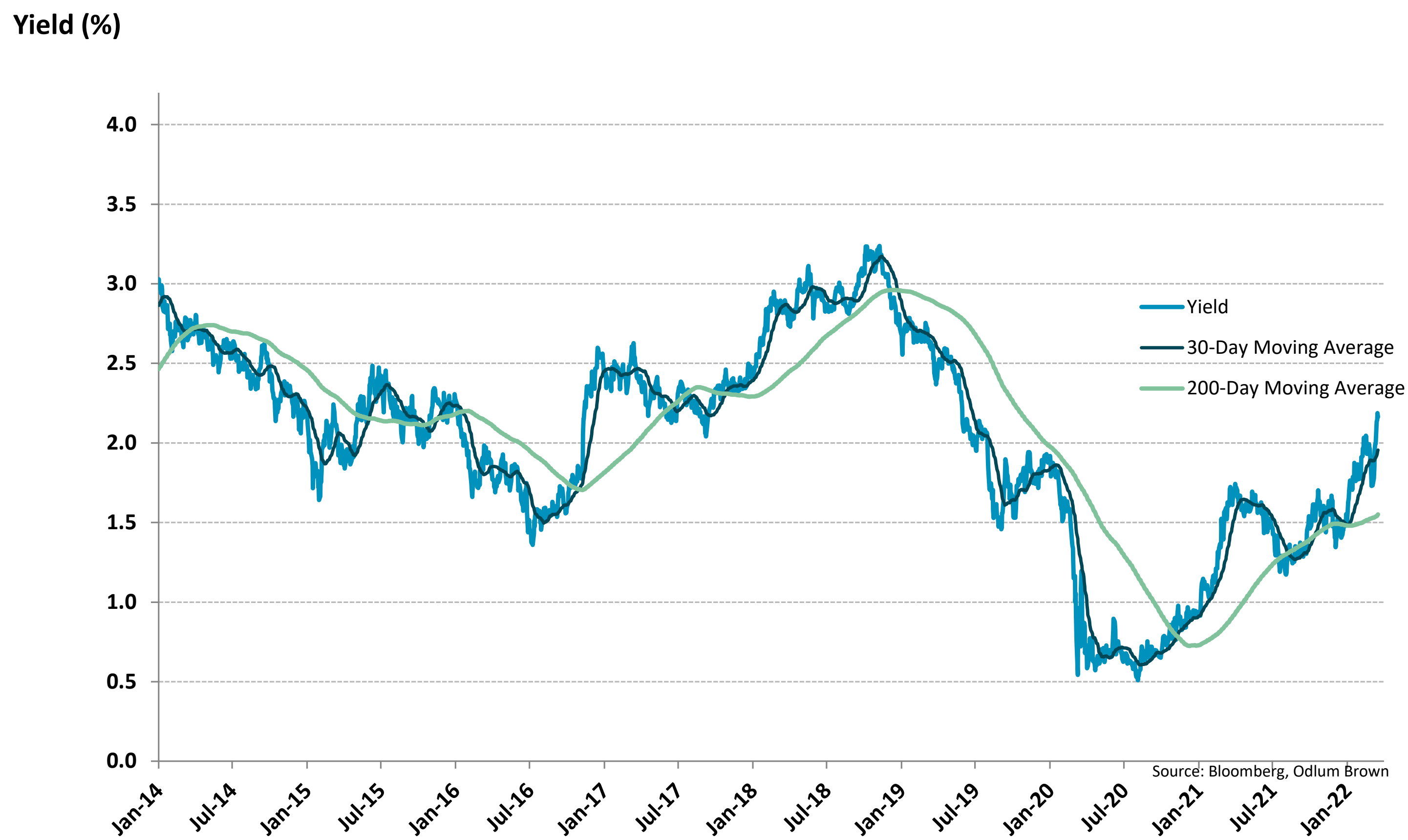
The yield curve flattened significantly with the spread between two-year and ten-year bond yields at a narrow 25 basis points. Inflation has been the key statistic this year. The February Consumer Price Index (CPI) reading was 7.9% on a year-over-year basis, the highest since 1982. More importantly, it shows no signs of slowing.

At the same time, the labour market remained taut with the unemployment rate hitting 3.8% and wage pressures evident. There are 11 million job openings in America, more than the number of unemployed by approximately two million.

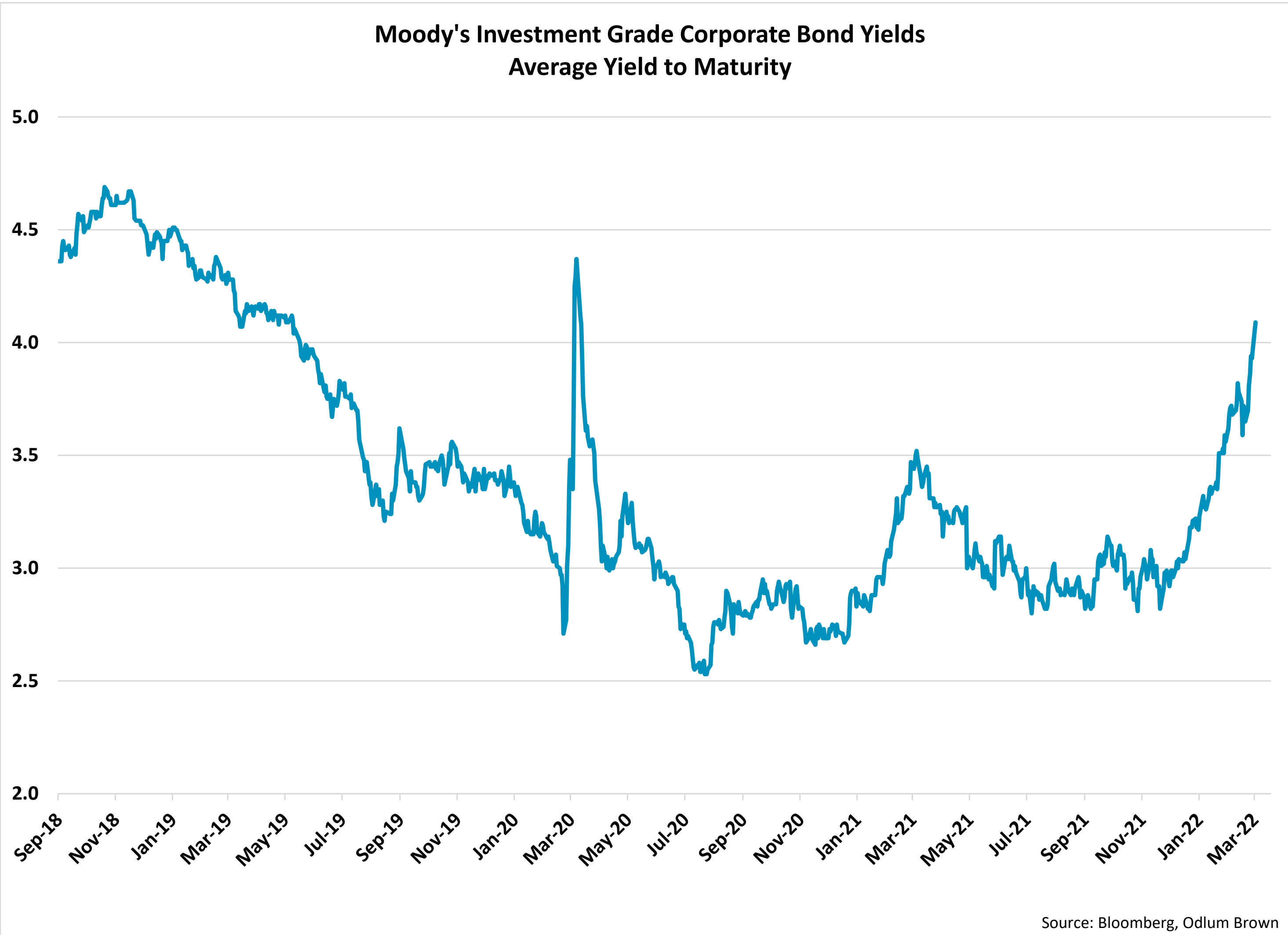
The Federal Reserve raised its Fed Funds Rate by 25 basis points on March 16, signaling another six hikes before the end of the year. In addition, the Fed is likely to begin reducing its balance sheet in May.

Canada has also enjoyed buoyant economic times with a record trade surplus and a blowout employment report. The Bank of Canada followed through on its rate hike forecast by raising its key rate by 25 basis points on March 2.

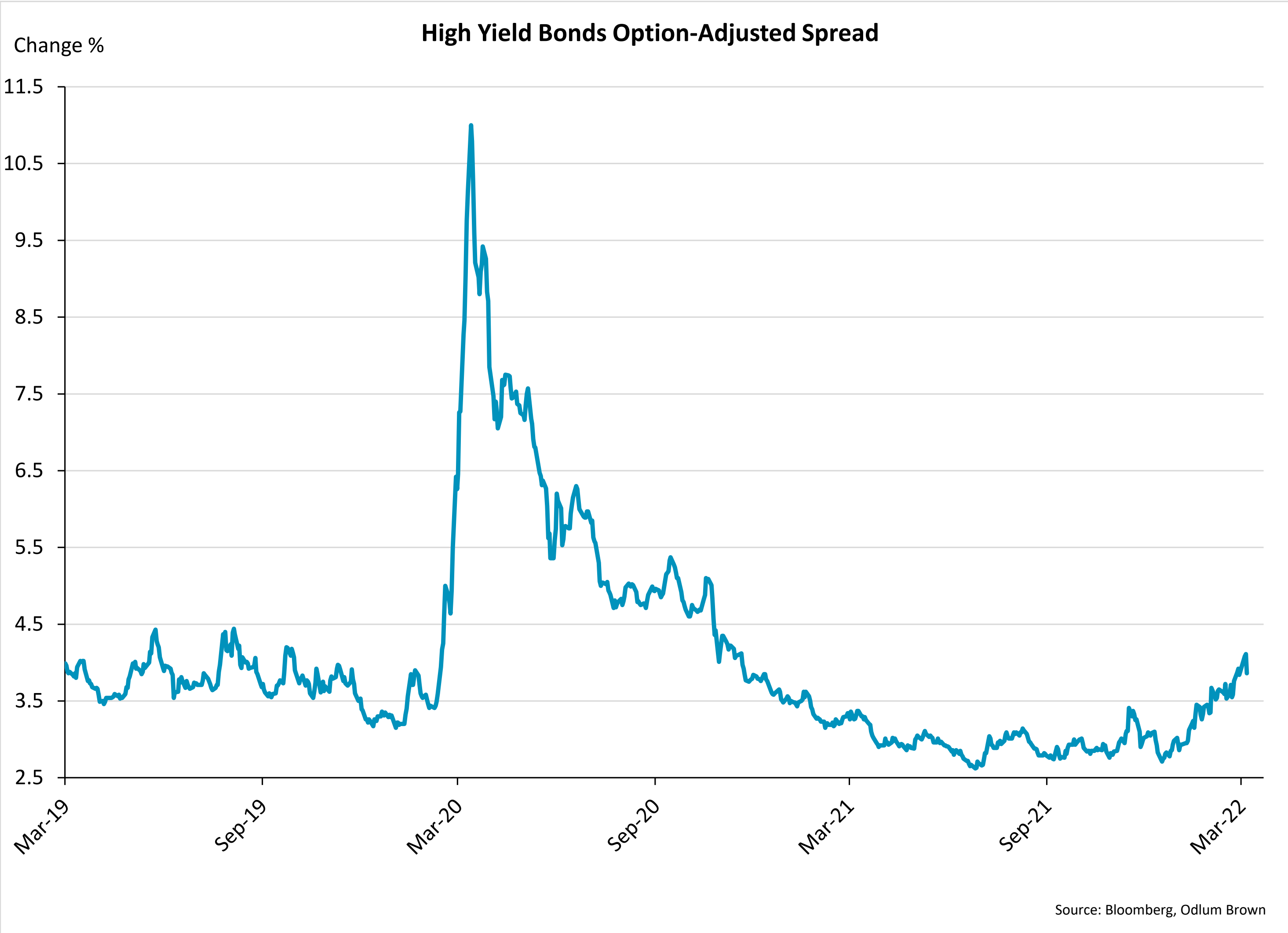
U.S. 10-Year Treasury



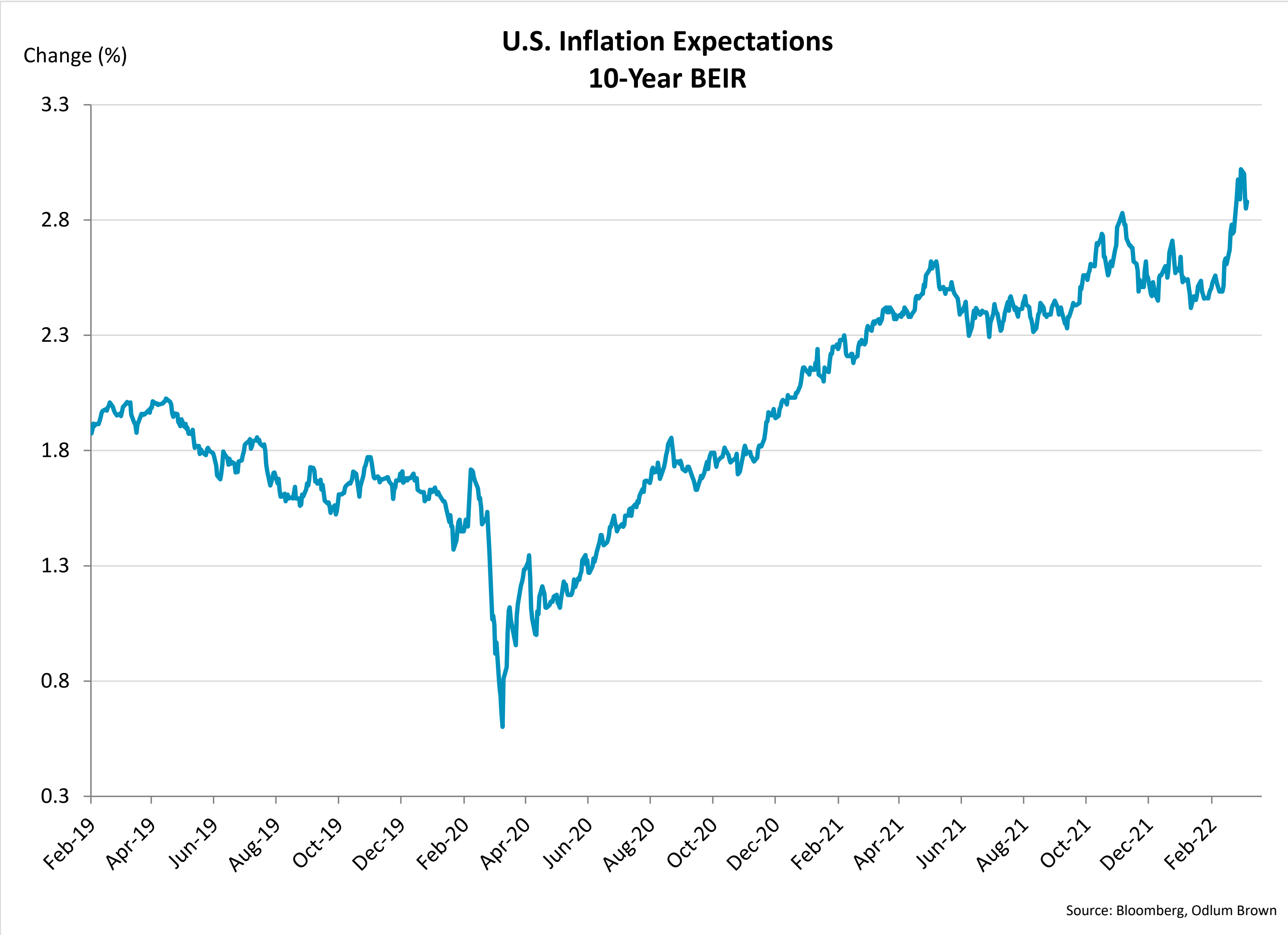
This bellwether's yield has soared despite being interrupted by a couple of significant flights to quality. Inflation, a tight employment situation and a hawkish Federal Reserve have all contributed to this rise in bond yields.



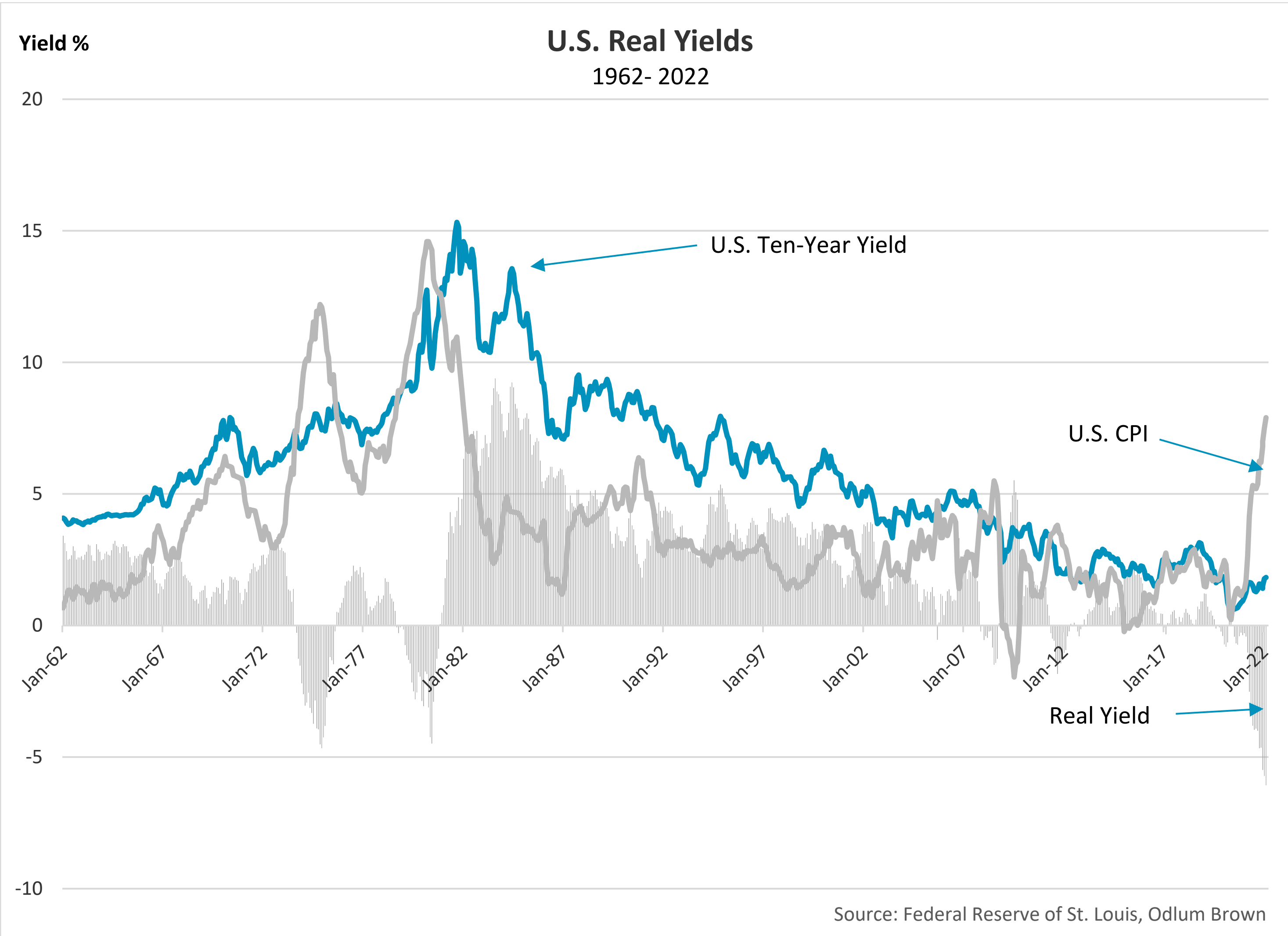
Investment-grade corporate bond yields have risen, along with an increase in government bond yields and a widening of corporate yield spreads.



Demand for high yield bonds has eased considerably and spreads are widening from their lows earlier this year.



After peaking in November 2021, inflation expectations reached new highs in February 2022. They have declined slighted since.



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

Outlook

The Federal Reserve and the Bank of Canada have begun to remove monetary accommodation and there is more tightening to come. To date, there has been little impact on economic data nor has the geopolitical conflict fed into the mix. Indeed, the Fed has maintained a positive economic outlook and is forecasting the inflation rate to average out at 4.3% for 2022. Many central banks, including the Bank of Canada, the Bank of England and the ECB, will join the Fed in tightening.

It is reasonable, however, to acknowledge that growth, both domestic and global, will suffer somewhat. Consumer sentiment has ebbed but retail sales have held up. A major concern is whether capital spending is reduced or delayed. At the same time, the geopolitical landscape has produced wide-spread uncertainty, and even more inflationary pressure.

Real yields are improving but remain deeply negative. A combination of further increases in bond yields, plus some easing in inflation will result in less negative real yields. But, this has not happened yet.

Thus, we expect yields at all maturities to gain further with a 2.5% target for the bellwether ten-year U.S. note. Corporate bond yields will move up in at least a similar fashion and possibly widen further from Treasury yields.

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 eventually and help ease inflation. Overall, inflation will be slow to subside, with most forecasts estimating it to land between 4-5% this year.

It is likely that the Fed will be flexible in its monetary policy, owing to the uncertainty surrounding growth and the geopolitical conflict. Already, the market has discounted several rate hikes and thus markets are not likely to react in a knee-jerk fashion.

The significant flattening of the yield curve has given rise to recession fears. Bond market returns will thus continue to be disappointing.

Strategy

This continues to be a time to defend principal 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. Also, we recommend individual floating-rate bonds.

We have adopted the use of outside bond investment managers to augment returns. 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.