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Monthly Fixed Income Update

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Interest Rate Summary	Oct-31-18	29-Dec-17	30-Dec-16	31-Dec-15	31-Dec-14	31-Dec-13	31-Dec-12
U.S.							
3-Month T-Bill	2.33%	1.38%	0.50%	0.16%	0.04%	0.07%	0.04%
2-Year Treasury	2.87%	1.89%	1.19%	1.31%	0.47%	0.38%	0.25%
10-Year Treasury	3.14%	2.41%	2.44%	2.27%	2.17%	3.03%	1.76%
Canada							
3-Month T-Bill	1.73%	1.05%	0.45%	0.51%	0.90%	0.92%	0.92%
2-Year Canada	2.34%	1.69%	0.74%	0.48%	0.99%	1.14%	1.14%
10-Year Canada	2.49%	2.04%	1.72%	1.39%	1.86%	2.76%	1.80%

Performance

	Oct-2018	2017	2016	2015	2014	2013	2012
DEX Universe Bond Index	-0.61%	2.52%	3.52%	3.52%	8.79%	-1.19%	2.65%
DEX Federal Bond Index	-0.33%	0.13%	3.66%	3.66%	6.91%	-1.52%	2.11%
DEX Provincial Bond Index	-0.90%	4.33%	4.14%	4.14%	12.18%	-2.70%	
DEX All Corporate Index	-0.62%	3.38%	2.71%	2.71%	7.58%	0.84%	6.22%
DEX “A” Corporate Index	-0.86%	4. 42%	2.62%	2.62%	9.10%	-0.16%	6.85%
DEX Real Return Bonds	-2.03%	0.72%	2.79%	2.79%	13.18%	-13.1%	
DEX High Yield Bonds	-0.53%	5.20%	13.79%	-5.58%	2.64%	6.87%	

All sectors produced negative returns in October. Of note was the negative return for high yield bonds, the first such monthly decline this year. Government bonds outperformed corporate bonds.

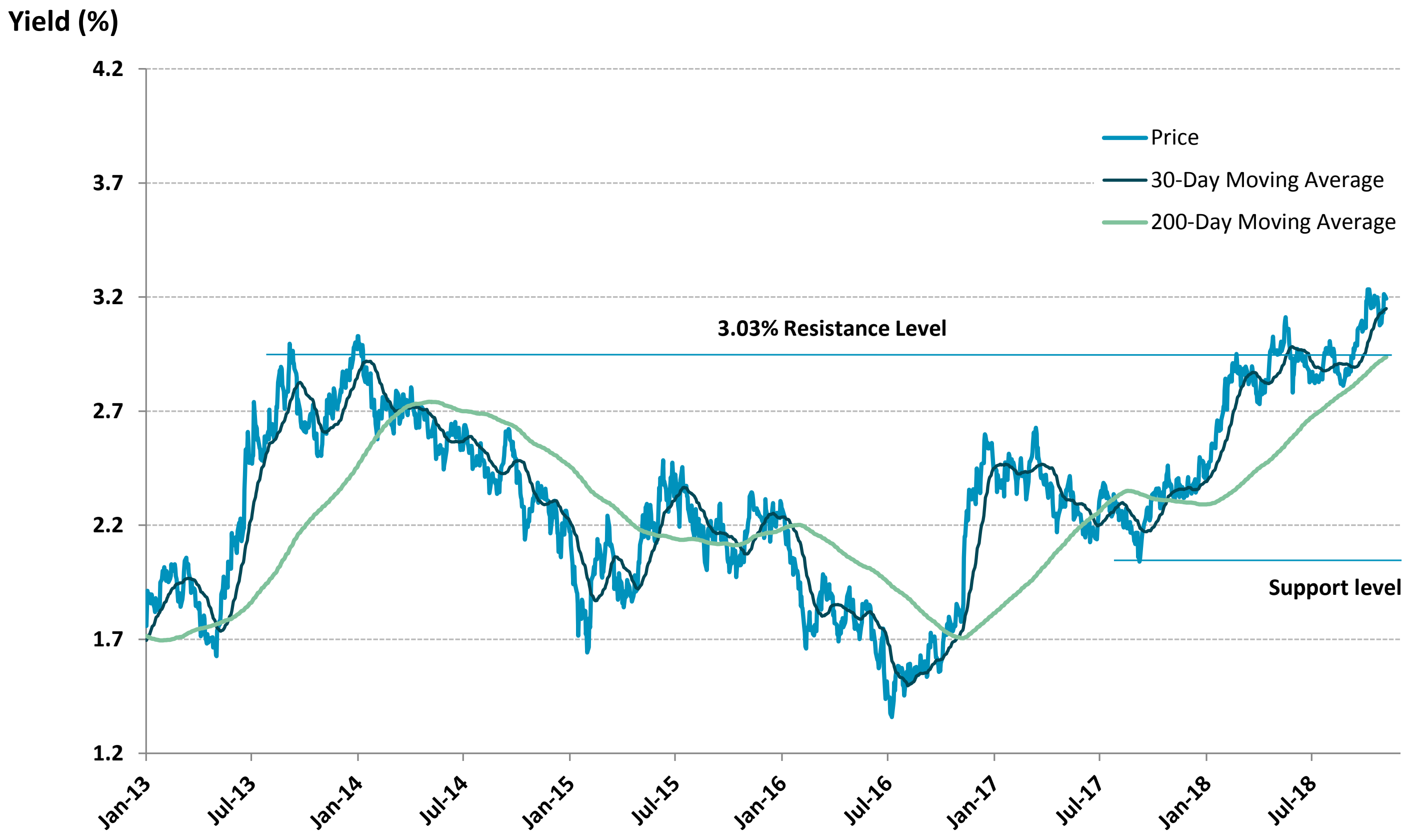
Comments

Bond yields continued to press higher in October and in early November. Not surprisingly, the 20-basis-point surge in yields in late September was partially reversed with the bellwether U.S. ten-year note falling to 3.06% in early October. Since then, bond yields rebounded to 3.20% as the fundamentals arguing for higher bond yields, namely above-trend GDP growth, tight labour markets, rising wages, elevated consumer spending and confidence, and manufacturing, remained in place. The only sign of possible weakness emanated from the housing market, which may be a result of higher mortgage yields. Credit markets showed some strain as high yield bonds produced negative returns. The U.S. Treasury announced record quarterly debt sales of $83 billion. The Federal Reserve raised the Fed Funds rate again, leaving little doubt that it would hike again in December.

The Bank of Canada raised its key lending rate, partly following the Fed, but also in reaction to a rosier economic outlook for Canada. The Bank accompanied this hike with a hawkish statement, paving the way for further normalization of interest rates. This helped the loonie only temporarily as the U.S. dollar remained strong and as oil prices sagged.

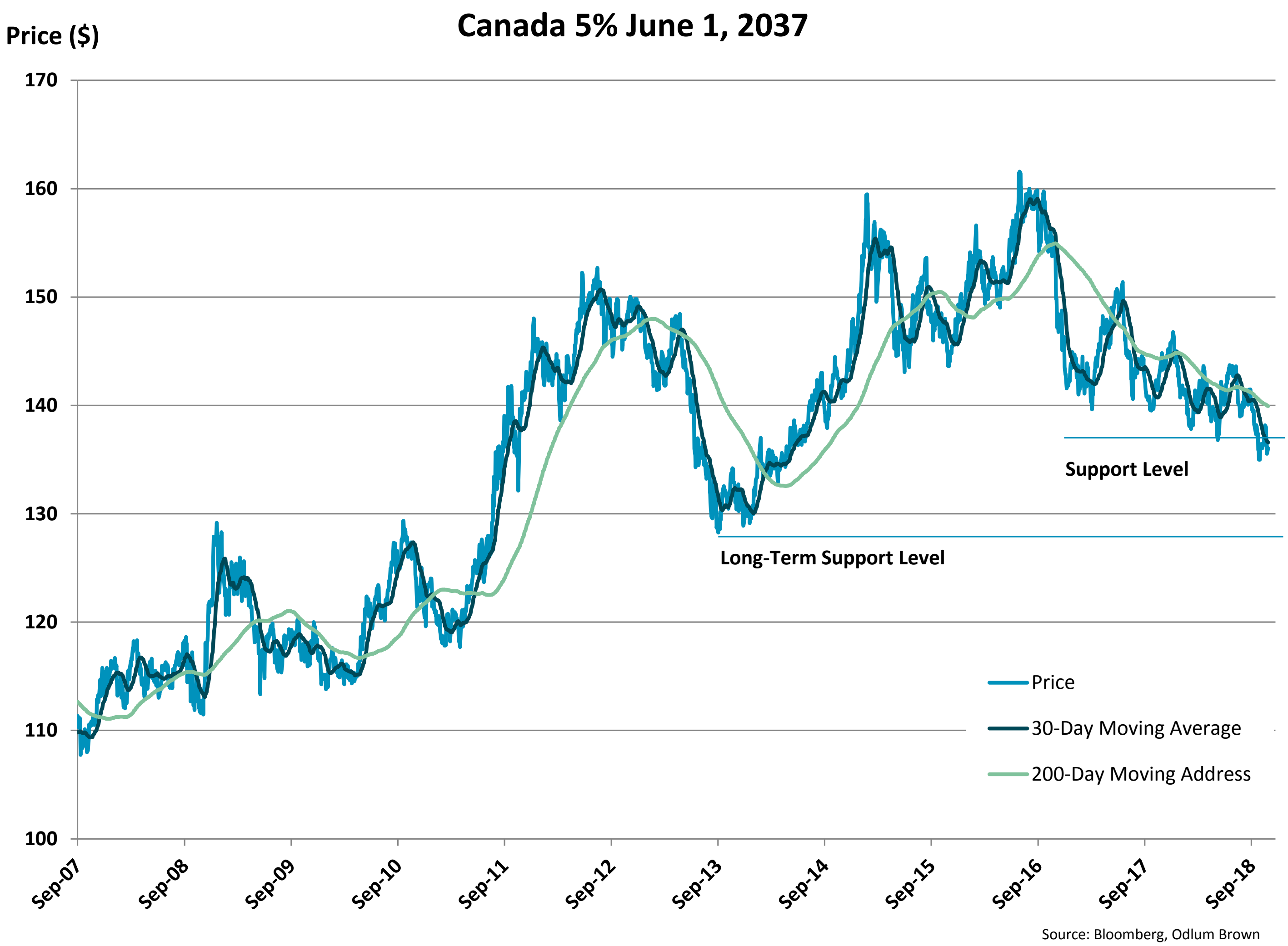
Globally, growth estimates have been pared to 3.5%. The ECB will end its QE program at year end but is monitoring the Italian markets closely.

U.S. 10-Year Treasury

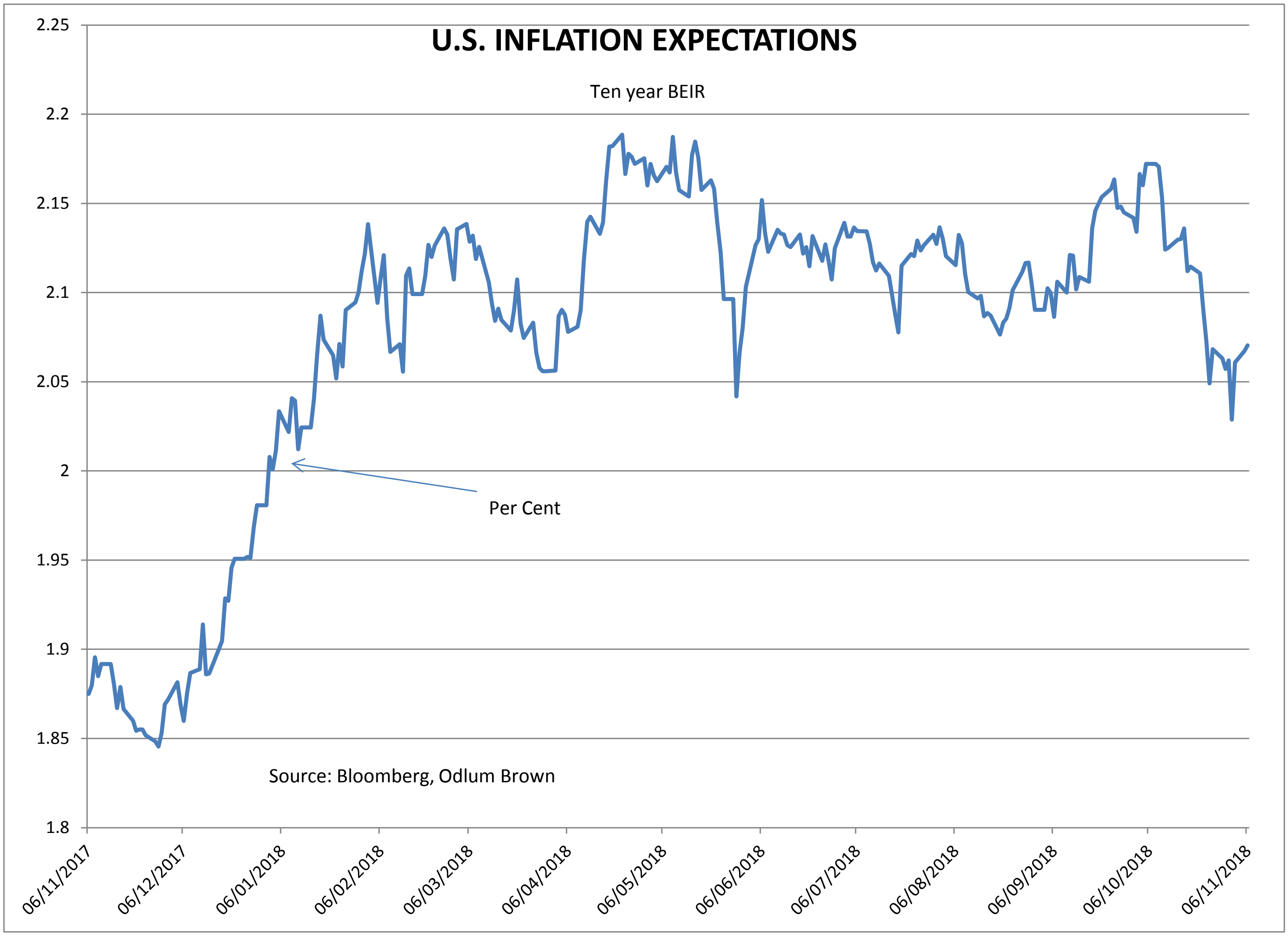


Source: Bloomberg, Odlum Brown

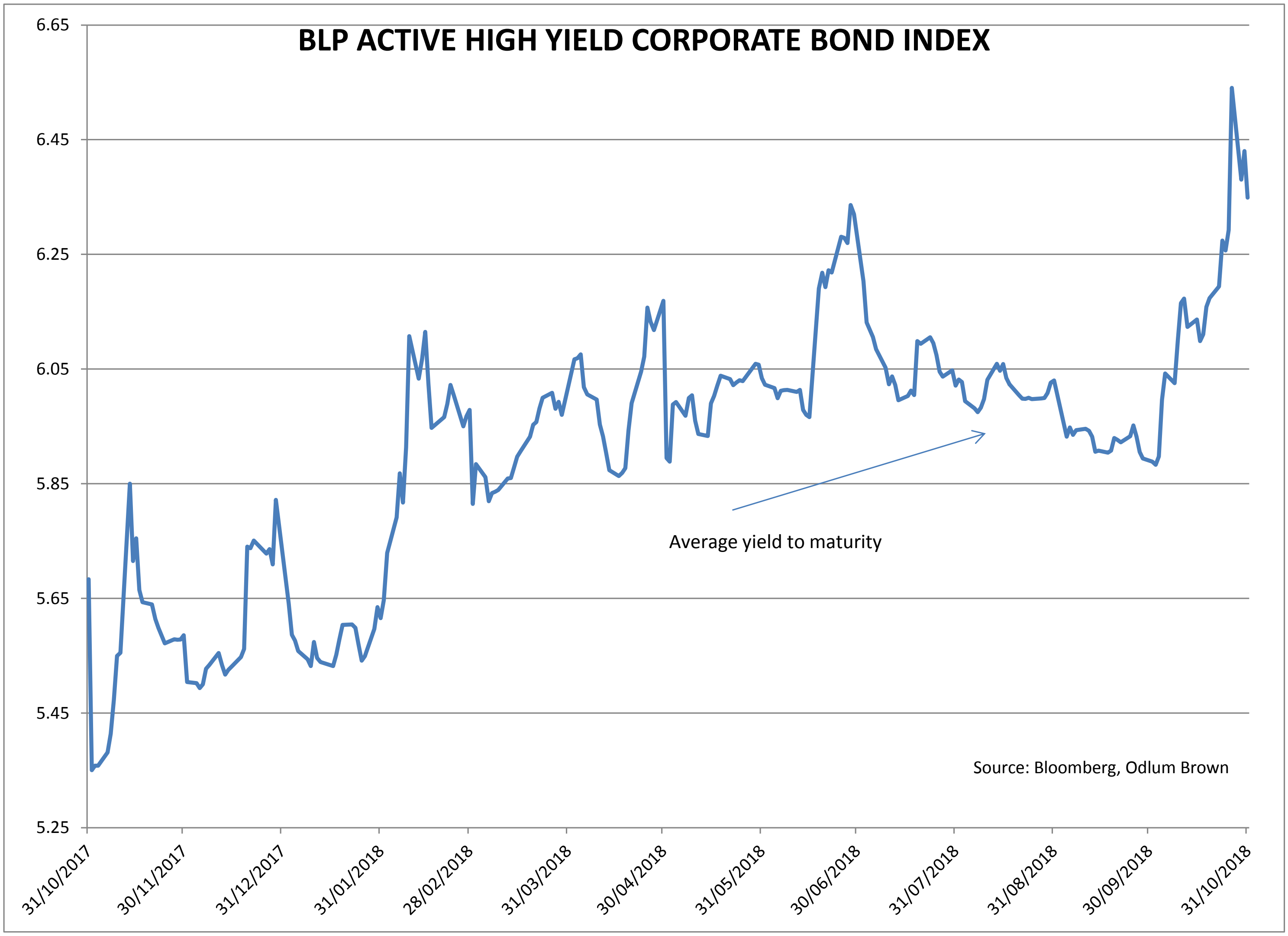
The yield on this bellwether bond has breached an important resistance point. The next threshold is 3.25%



The price of this long-term Canada bond has broken below a key support level.



Inflation expectations rebounded sharply.



The high yield market had a major correction but has rallied from its worst levels.

Outlook

The U.S. ten-year yield reached our year-end target of 3.25% briefly and has fallen modestly. All signs point to higher yields at all maturities. The Federal Reserve and the Bank of Canada are clear in their goal of "normalizing" interest rates, likely leading to a further increase of 100 basis points in administered rates during the next twelve months.

As for market yields, they are heading higher as the employment market remains strong with the unemployment rate at 3.7%, seven million unfilled jobs, and wage growth kicking in above 3%. Besides this, the U.S. Treasury increased its debt sales to $83 billion per quarter and the Fed continues to unwind its balance sheet.

Corporate bonds, both investment grade and high yield, suffered in October but remain at relatively narrow spreads from government bonds.

In short, we believe bond yields will continue to grind higher with a target of 3.5% to 4% for the bellwether U.S. ten-year.

Strategy

We continue to recommend maintaining high-quality, short duration portfolios of corporate bonds. As short- and mid-term yields rise, these portfolios will generate additional income as maturities are reinvested, while preserving capital at the same time. In this fashion, we expect modest positive returns and increased income over the medium term

We still counsel that clients maintain a modest exposure to the high yield market as, with credit conditions stable, this will enhance the returns from government and investment-grade corporates.

We also advocate investment in floating rate debentures, which will benefit from rising short-term yields while having a short duration.

We remain in favour of selected investment in funds of certain investment management firms which have been successful at generating positive returns with short duration portfolios.

For more information, please speak to your advisor.
