MONTHLY FIXED INCOME UPDATE

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Interest Rate Summary	Aug-31-19	Dec-31-18	29-Dec-17	30-Dec-16	31-Dec-15	31-Dec-14	31-Dec-13
U.S.							
3-Month T-Bill	1.98%	2.36%	1.38%	0.50%	0.16%	0.04%	0.07%
2-Year Treasury	1.51%	2.49%	1.89%	1.19%	1.31%	0.47%	0.38%
10-Year Treasury	1.50%	2.69%	2.41%	2.44%	2.27%	2.17%	3.03%
Canada							
3-Month T-Bill	1.62%	1.64%	1.05%	0.45%	0.51%	0.90%	0.92%
2-Year Canada	1.35%	1.86%	1.69%	0.74%	0.48%	0.99%	1.14%
10-Year Canada	1.16%	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	8.70%	1.41%	2.52%	3.52%	3.52%	8.79%	-1.19%
DEX Federal Bond Index	5.81%	2.39%	0.13%	3.66%	3.66%	6.91%	-1.52%
DEX Provincial Bond Index	11.67%	0.66%	4.33%	4.14%	4.14%	12.18%	-2.70%
DEX All Corporate Index	8.57%	1.10%	3.38%	2.71%	2.71%	7.58%	0.84%
DEX "A" Corporate Index	10.64%	0.51%	4. 42%	2.62%	2.62%	9.10%	-0.16%
DEX Real Return Bonds	11.27%	-0.05%	0.72%	2.79%	2.79%	13.18%	-13.1%
DEX High Yield Bonds	6.43%	2.15%	5.20%	13.79%	-5.58%	2.64%	6.87%

All sectors produced positive returns in August with long-term government bonds leading the way by a wide margin. This is typical when the yield curve flattens with long-term yields falling faster than short-term yields.

Interestingly, high yield bonds continued to lag the investment grade sectors for a second consecutive month.

Comments:

August was a tumultuous month for bond markets. U.S. bond yields fell dramatically – down 36 basis points for the 2-year and 52 basis points for the 10-year. This decline was in response to growing global recession fears, exacerbated by an escalation in trade tensions. There has been clear weakness in manufacturing as is evident from the various global PMIs and Fed districts.

Thus far, the consumer is contributing to positive growth in confidence levels, and growth in personal income and consumption.

At the same time, inflation, as measured by the Core PCE, remains muted; although, it is showing modest upticks in other inflation measures as well as in wage growth.

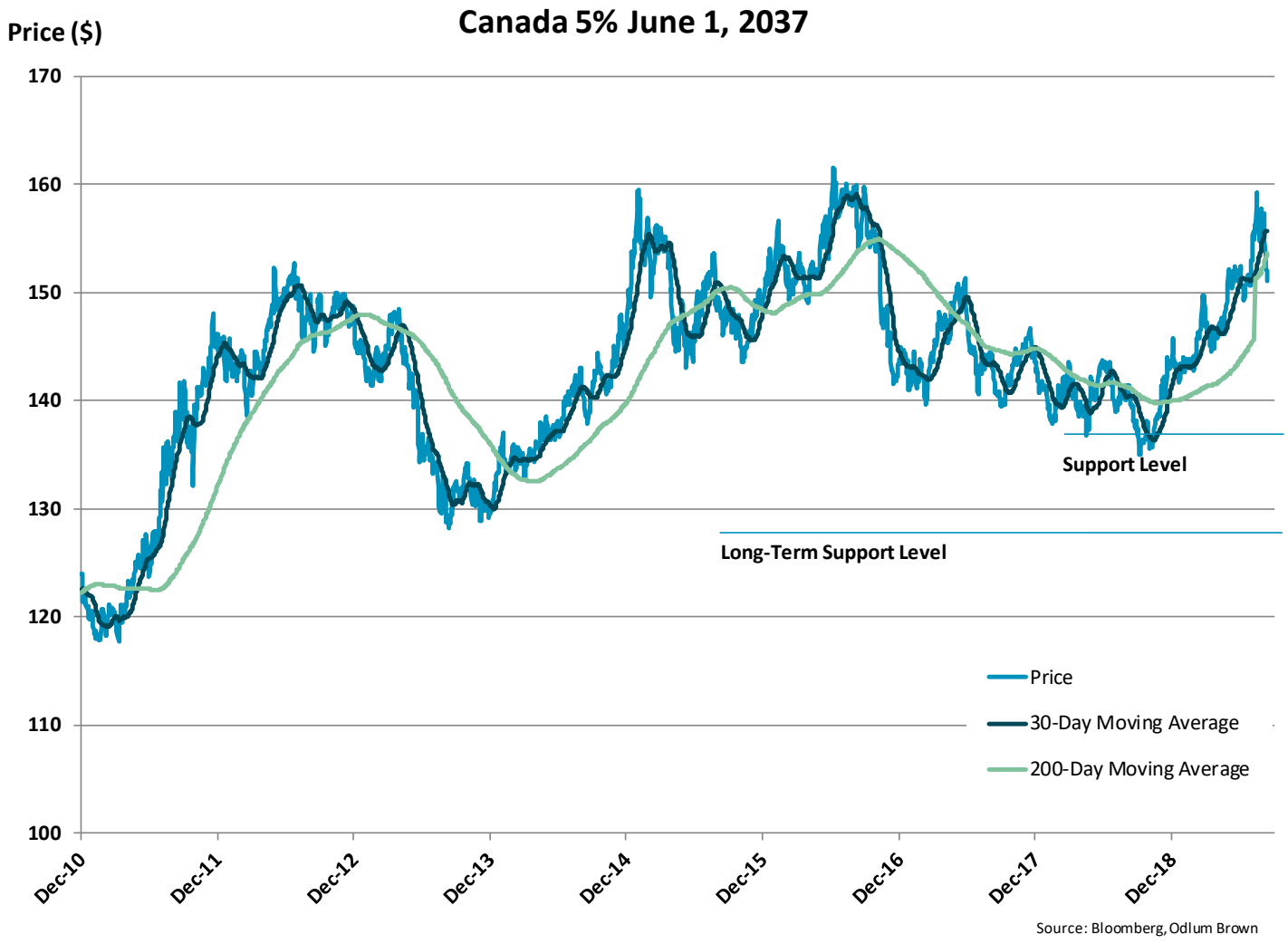
The gathering recession gloom sparked an increased focus on monetary and fiscal stimulus. Several central banks, including the U.S. Fed, eased and plan to ease further. China is stimulating fiscally and Germany, long the bastion of balanced budgets, is openly discussing fiscal stimulus.

Of late, economic data has been encouraging from Europe. The U.S. employment picture is still encouraging and the housing market is clipping along at a decent pace. Growth estimates are in the 2% region for the U.S. economy.

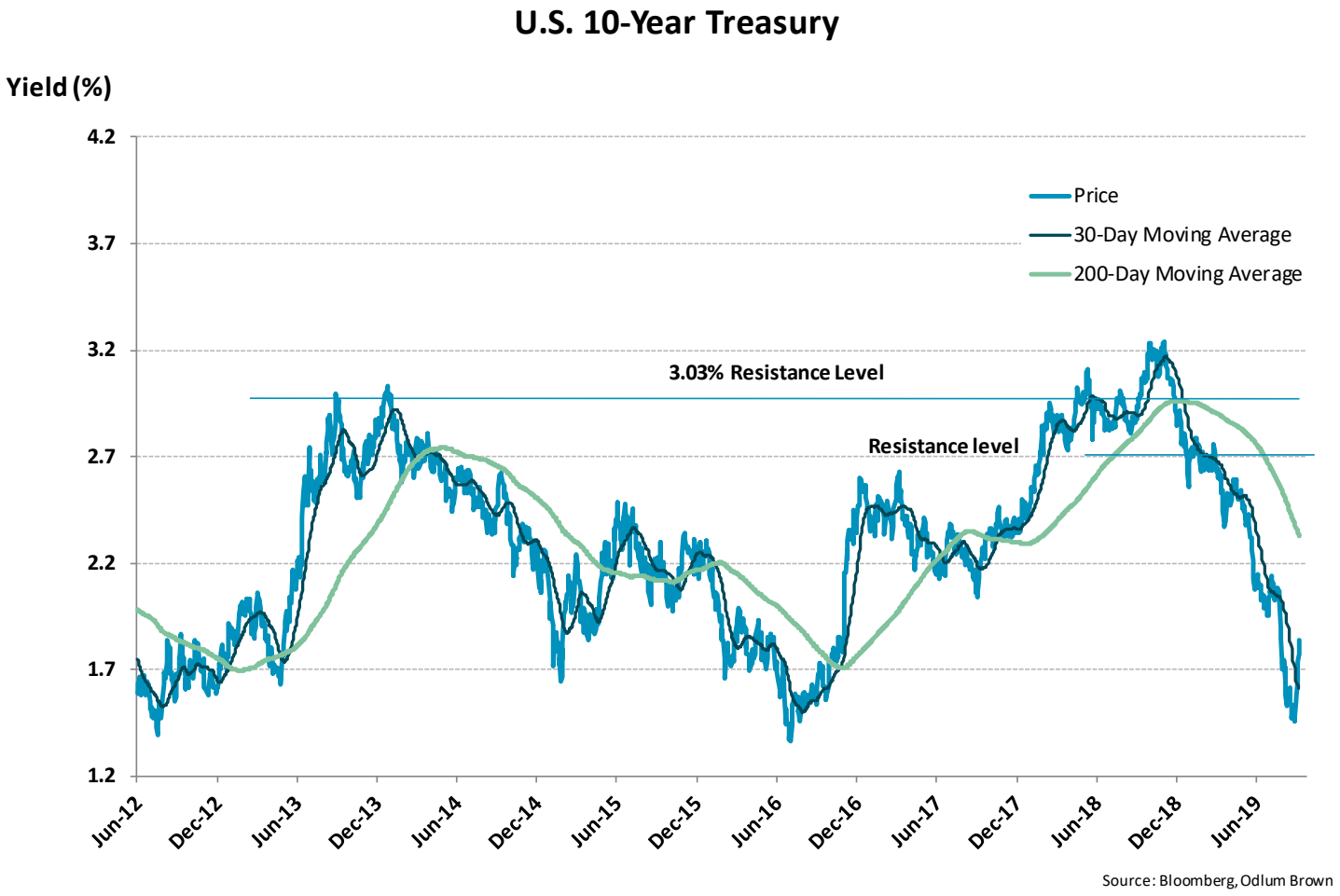
Post-Labour Day, corporations pounced on record low borrowing costs and issued an all-time high of $ 74 billion in new issues in one week!

Coincidentally, and in tandem with the palpable easing of trade tensions, bond yields jumped from a low of 1.46% for the U.S. 10-year to 1.83% today. The 2-year/10-year yield curve inverted briefly but is now at a positive nine basis points.

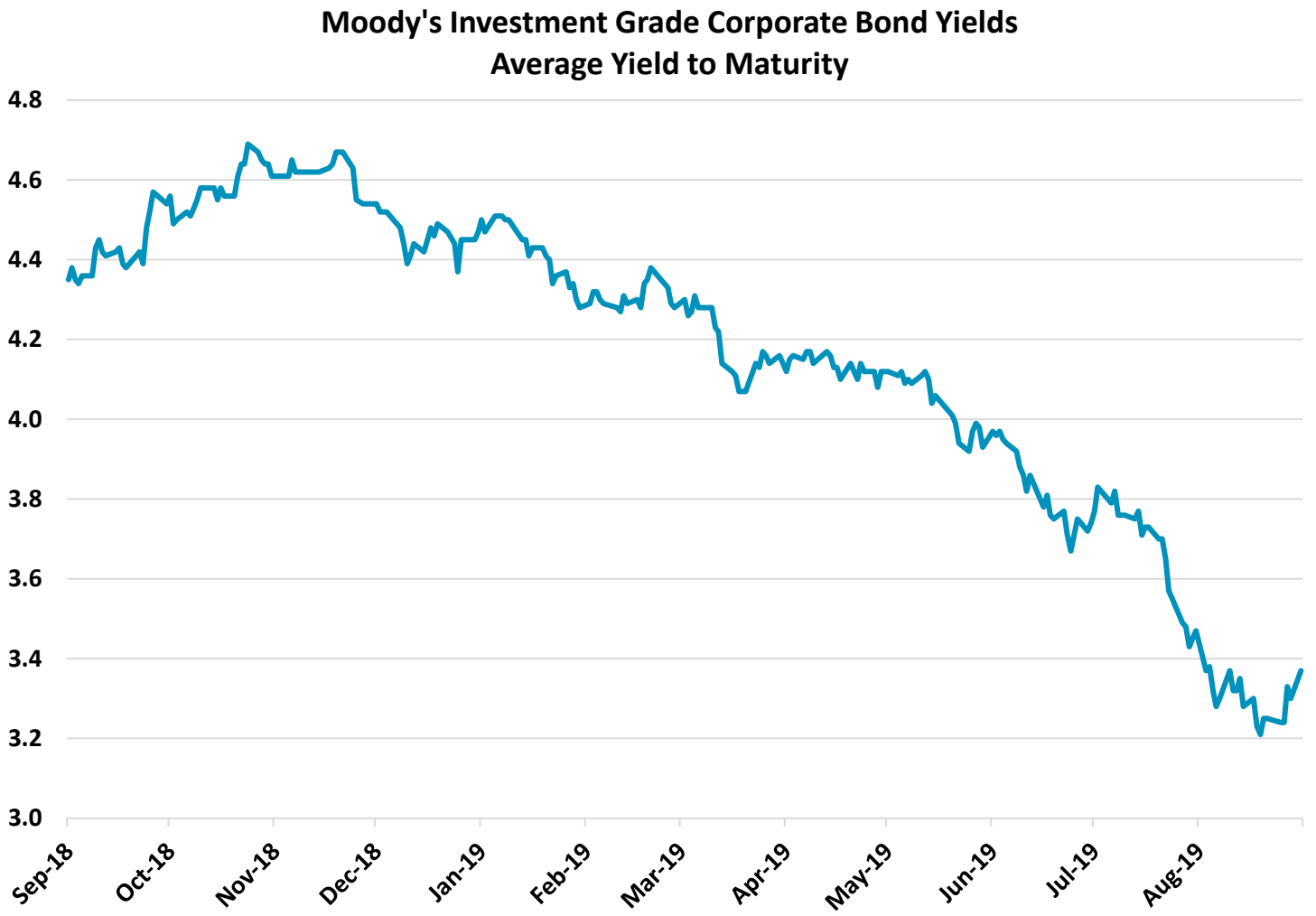
Canada continued to produce a string of solid economic data, sufficient to keep the Bank of Canada on the sidelines while most central banks eased. Exports surged, the employment picture is robust and the housing market bounced back. In the wake of this trend-bucking performance, Canadian bond yields rose by more than their U.S. counterparts with the 2-year and 10-year bonds yielding just four and 27 basis points respectively below their U.S. counterparts.



After spiking to multi-year highs, this bond retreated sharply.



This global bellwether bond's yield fell sharply in August but its yield rebounded in early September.



Source: Bloomberg, Odlum Brown

Corporate bonds followed treaury yields lower, prompting an onslaught of new bond issues.

Outlook

Now what? Was this turnaround in bond yields an important inflection point or was it merely a typical reaction to an overdone situation?

It is likely a combination of the two. Recession fears have been partly assuaged by the revived monetary stimulus occurring globally, accompanied by fiscal stimulus.

While manufacturing has weakened perceptibly, GDP growth remains positive in North America with recent evidence that growth in Europe may have ticked up.

Inflation remains subdued but is stirring sufficiently to attract the markets' attention. The giant wildcard is trade, as it remains the chief potential disruptor to markets and economic confidence. Its impact is yet to be determined. We conclude that bond yields went too low, too fast and that the current rebound was to be expected. Nevertheless, recession fears have abated somewhat with renewed monetary and fiscal stimulus becoming more prevalent. Therefore, we may not witness yields falling back to their recent lows in the near term.

Arguing against a sustained climb in yields is the subdued inflation picture and slow growth.

Strategy

By most standards, bonds are overvalued. Therefore, we counsel a high-quality, short duration approach to bond investments. We have long advocated the laddered approach when constructing a fixed income portfolio. There is no reason to alter this strategy as it removes the guesswork from fixed income investing.

Therefore, a ladder composed of high-quality corporate bonds and GICs will continue to produce positive returns while preserving principal.

For further discussion, please speak to your investment advisor.