INVESTMENT FUNDS

Bonds

MONTHLY COMMENTARY

October 2023

Bonds yields hit multi-year highs in October

Supply weighs on the market

Fixed income was volatile in October, in large part because the higher-for-longer narrative emanating from the U.S. Fed, along with growing fiscal deficits, sparked a term premium along the curve and caused the 10-year Treasury yield to briefly eclipse 5%.

An ephemeral flight to quality took place in the middle of the month as a result of the dire situation in Israel, and again toward month's end as weakening consumer sentiment overshadowed higher-than-expected CPI and GDP data. By the time October closed, the 10-year was yielding 4.9%, as numerous pundits called 5% a good entry point and belief grew that the Fed was done hiking.

A weakening economy will provide a tailwind for bonds

Ongoing softening of economic data (labour market and sentiment specifically) brought the 10-year back down to 4.5% in the first few days of November, a development consistent with our continuing belief that the Fed's rapid escalation of policy rates will slow economic activity and possibly lead to a recession.

As a result, we think that the Fed is most likely done hiking and that deteriorating economic conditions in North America will cause central banks to begin easing monetary conditions in the second half of 2024, which will precipitate a steepening of the curve and a general decline in yields.

Performance analysis

We were underweight the strongly performing federal segment but offset the underweight by owning more long-term bonds. These bonds underperformed on a relative basis, as the yield curve steepened during the month. For the same reason, we lost on our provincial bonds because we were overweight longer-term tenors that also underperformed.

On the positive side, we gained on our option strategy, taking advantage of high volatility during the month to sell options with short expiries and collect good premiums.

iA Financial Group

#1 In net sales of segregated funds in Canada since 2016

Alexandre Morin, CFA

Senior Director, Portfolio Manager, Fixed Income

- Joined iA in 2015
- More than 25 years of investment experience
- Bachelor's degree in Business Administration, Université Laval

Overweight duration and high-quality credit

We were tactical with duration during October, given the yield volatility, albeit with a bias toward being slightly longer than our benchmark because we expect yields to recede as the effects of higher policy rates affect economic activity.

> "We increased our exposure to provincial bonds, moving from a slight underweight to neutral."

We remained overweight corporate investment-grade credits, adding to our position in the short end because of attractive spreads and all-ins. We continue to be overweight non-rated bonds issued by Quebec municipalities.

We will continue to look at value-added opportunities outside the Canadian bond market, especially relative value amongst various sovereign yields.

Key Takeaways

- October was a volatile month, with bond yields driven by supply, unexpectedly strong U.S. CPI and GDP data, Fed rhetoric and the Israeli-Hamas war.
- Given our pessimistic outlook on economic growth and with yields at levels not seen in more than 16 years, we think bonds offer a very attractive value proposition.
- We remain long duration and overweight credit.

About iAGAM

A magnet for top investment talent, iAGAM is one of Canada's largest asset managers, with over $100 billion under management across institutional and retail mandates. We help investors achieve their long-term wealth creation goals through innovative investment solutions designed for today's complex markets. We are building upon our historic success, supporting the growth of our core strengths and exploring innovative ways to meet investor needs. We are rooted in history and innovating for the future. Our experienced portfolio managers use a proprietary investment methodology, rooted in iAGAM's unifying commitment to strong risk management, analytical rigor and a disciplined, process-driven approach to asset allocation and security selection.

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