INVESTMENT FUNDS

Bond (iA)

MONTHLY COMMENTARY

November 2023

Strong bond bull market in November

Improved sentiment supported by softening economic data

After peaking at 5% in October, 10-year U.S. Treasury yields dropped another 40 basis points in November to end the month under 4.4%. This stellar month for fixed income squarely moved year-to-date total returns into positive territory.

A confluence of factors drove the enthusiasm for bonds, accentuated by a growing consensus among pundits, including members of the central bank itself, that the U.S. Fed had most likely finished its hiking cycle. Economic releases in the month supported that notion, such as softening inflation and labour data, along with smaller-than-expected auction size increases in the United States.

Bearish economic view, bullish bond view

Along with the building market sentiment, we continue to think central banks have probably completed their current hiking cycles, as the lagged effects of unprecedented monetary tightening manifest themselves with greater consistency. What’s more, weakening labour conditions, slowing economic growth (with Canada most likely already in recession) and a concomitant taming of inflation all suggest central banks will begin easing by mid-2024 or even earlier.

At the same time, we are concerned that the “bad is good” mindset driving risk assets will eventually turn sour as corporate profits are buffeted even more, and labour softness slows consumer demand.

Performance analysis

The tailwinds for our performance were as follows: 1) We underweighted the federal segment, which underperformed by a wide margin, and, to compensate, we owned longer-term bonds, which overperformed in an environment of falling yields; and 2) we had an underweight position in provincial bonds, which we also offset by owning longer-term bonds that overperformed.

The headwinds were as follows: 1) We were overweight municipal bonds, which overperformed the index, but also owned a lot of non-rated bonds with a low duration; and 2) in the corporate segment, value added came from positive security selection in high-beta sectors in the long end, but a portion of the portfolio was invested in shorter maturities that did not perform well on a relative basis.

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 are maintaining a longer duration because we expect bond yields to go down in the coming months.

> "That being said, nimbleness will be key to provide value added for our clients because volatility is still historically high."

We are overweight investment-grade corporate credits, which outperformed their sub-investment-grade counterparts and should continue doing so as the economy slows. We are modestly overweight provincial bonds because we expect this asset class to continue doing well as all-in buyers take advantage of still-elevated bond yields. Finally, we continue to overweight non-rated bonds issued by Quebec municipalities because they provide an excellent carry.

Key Takeaways

- Bonds rallied in November, producing one of the best monthly total returns in decades.
- Given the current level of yields and our pessimistic outlook for economic growth, 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.

SRM607A-1(23-12) ACC