INVESTMENT FUNDS

Bonds

QUARTERLY COMMENTARY

June 2023

Bond yields rose during the period

Markets priced in renewed central bank hawkishness

Easing of concerns around the U.S. regional banking system in the second quarter allowed the market to refocus on inflation and the Fed’s determination to bring it back down to target.

For its part, the Fed stepped up the rhetoric of higher for longer during the quarter, despite the pause at its June meeting. As a result, 10-year Treasuries added 40 basis points in the quarter to close at about 4%, where they were before several U.S. regional banks went belly up.

The damage was more pronounced in 2s, which added 90 basis points and headed toward 5% again, ushering the 2s-10s inversion back to -100 basis points and rekindling talks of the early 1980s, when such a situation was last observed.

The economy should slow with ongoing interest rate hikes

With the Fed saying that two hikes are most likely left in the current cycle, a more pronounced slowing of economic conditions in North America seems inevitable, even though risk assets are not really pricing in such an outcome, as tech and the rise of AI keep driving levels higher.

Even so, we expect the disconnection between risk assets and tighter monetary conditions to reconcile eventually. We also think bond yields are near the highs of the current hiking cycle and will begin to recede in the coming months, while the curve will re-steepen

Performance analysis

The main positive contribution to performance during the quarter was our underweight in the federal segment, which performed poorly in a rising-yield environment. Also, to compensate for our underweight, we held bonds with long maturities that performed better because of the flattening yield curve. Additionally, we were overweight long-term provincial bonds, which also did well because of the yield-curve flattening. Our overweight in corporate bonds also added value because they outperformed owing to their shorter duration. Finally, our position in non-rated municipals did well; their short maturities helped them outperform in a market that saw bond yields go up.

iA Financial Group

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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

A long duration and an overweight in quality credit it

> "We think bond yields are near the high end of their present range and therefore have maintained a duration that is longer than that of our benchmark."

Given our expectation that the current round of central bank rate hikes will result in slowing economic conditions for several quarters.

Notwithstanding, we are overweight quality credit because we think investor enthusiasm for risk assets will remain robust in the near term, barring any unforeseen consequences of monetary tightening, such as what happened earlier this year with U.S. regional banks. We think risk investors are awaiting clearer signs of slowing economic conditions in what has thus far been a very resilient labour market**.**

Key Takeaways

- Bond yields sell off on central bank repricing in the wake of regional bank turmoil and stronger economic data.
- The impact of past interest rate hikes will be felt in the economy and will be favourable for bonds.
- The portfolio has a longer duration than its benchmark and an overweight in quality credit.

About iAGAM

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