INVESTMENT FUNDS

Bond (iA)

QUARTERLY COMMENTARY

September 2023

Bond yields hit multiyear highs in the third quarter

Recession scenario loses many of its supporters

For the second consecutive summer, bond investors resigned themselves to the growing likelihood of higher-for-longer policy rates, which took 10-year Treasury yields 80 bps higher. The resteepening of the yield curve was a major theme as well. There was no shortage of factors contributing to weakening sentiment, such as ballooning U.S. deficits, sticky inflation and hawkish Fed commentary. Admittedly, there were points in July and August when ephemeral rallies were sparked by softening economic indicators, but yields took off in September and didn't look back. Of note, risk assets started to feel the pain of rapidly increasing bond yields.

We still expect a slowing economy to provide a tailwind for the bond market

We expect bond yields to decline over the next 12 months as the impacts of the significant interest rate hikes by central banks make their way through the global economy. We are beginning to see some cracks emerging in the economic data.

Also, risk assets are now reflecting the pain induced by higher yields; the S&P has given back half of its year-to-date gains, and yield spreads have risen by 50 basis points in the past couple of weeks. Finally, we think the development of a bullish trend in North American bond yields will not be linear, so nimbleness is key in such highly volatile markets.

Performance analysis

Duration is the prime reason why our portfolio underperformed in the third quarter. Specifically, we lost on our federal segment because we were underweight that sector, and we compensated by owning longer-term bonds that underperformed as yields went up sharply and the curve steepened. Our underweight in provincial bonds paid off, because they underperformed the benchmark significantly. But again, we compensated by owning longer-term bonds. Our corporate exposure was positive because of its shorter duration. Finally, the same can be said of our municipal bonds, which outperformed because of their shorter duration.

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 IG credit

At the end of the quarter, we were overweight duration, and we intend to maintain that posture because we expect bond yields to go down in the coming months, although nimbleness will be key to provide value added for our clients.

"Volatility is still present, so we will be tactical in our duration management."

We were overweight corporate investment-grade credit, which outperformed. Even so, we modestly reduced our exposure to corporate bonds during the quarter because we expect a slowing economy to push credit spreads wider. We continued to overweight non-rated bonds issued by Quebec municipalities.

Key Takeaways

- Bond yields moved materially higher in the third quarter, fuelled by the higher-for-longer interest rate narrative.
- With yields at levels not seen in more than 15 years, we think bonds offer a very attractive value proposition, given our pessimistic outlook on economic growth.
- We remain long duration and overweight credit, although we reduced our exposure to credit slightly during the quarter, given our expectation of slowing economic conditions.

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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