INVESTMENT FUNDS

Bonds

QUARTERLY COMMENTARY

December 2022

Another quarter with high bond-yield volatility

Trading range close to 100 basis points

The bond market rally that took place for much of the fourth quarter faded at year-end on concerns that the central banks would remain vigilant in combatting persistent, albeit receding, inflation. In this context, 10-year GoC yields ended the year close to where they started the fourth quarter. That being said, the trading range was quite wide, with yields ranging from 2.75% to 3.70%.

On the spread markets, credit performed well as the US Fed and the BoC slowed the pace of their rate hikes, overlooking any fears of a recession.

Expecting another quarter of high volatility

Economic data, especially those related to inflation, will need to slow meaningfully for central banks to continue reducing the pace of their rate hikes. Otherwise, the first quarter of 2023 could be difficult for the asset class as the market would need to reassess its view of central banks' reducing the overnight rate in the second half of 2023. In other words, the volatility should continue in the first quarter of 2023 because the central banks have not yet finished raising their rates.

Performance analysis

The first contributor to performance was our overweight in corporate bonds, an asset class that outperformed the benchmark. The second contributor was our use of derivatives in the US rates market. In essence, we sold options on interest rate futures and collected good premiums as the volatility in the bond markets continued unabated in the last quarter. We intend to continue using this strategy as long as volatility stays high.

The main detractor was our position in provincial bonds. We were underweight this segment but owned bonds with longer maturities in a context where 30-year Canada yields ended the quarter higher than where they had started.

iA Financial Group

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

Alexandre Morin, CFA

Senior Director, Portfolio Manager, Fixed Income

- Joined iAIM in 2015
- More than 20 years of investment experience
- Bachelor's degree in Business Administration, Université Laval

Positioning: short duration and long credits

Consistent with our modus operandi, we will stay nimble because we expect bond-yield volatility to offer multiple opportunities this winter to position our portfolio on short and long durations alike.

"We started 2023 with a shorter duration than our benchmark because we think economic data, especially inflation, will force investors to reassess their view that North American central banks will start to cut rates in the second half."

We currently favour corporate credits, although their spreads did well in the fourth quarter of 2022, because they offer a much better carry proposition than a year ago. Nonetheless, we will monitor for any signs of economic recession, which could start to weigh on spread levels.

Finally, we started the year underweight provincial credits as we expect heavy new issuance in January.

Key Takeaways

- Bond-yield volatility was again high during the fourth quarter.
- The first quarter of 2023 could also be highly volatile because the central banks have not yet finished raising their overnight rates.
- We are starting the year short duration and overweight credits.

About iAIM

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