INVESTMENT FUNDS

Bonds

MONTHLY COMMENTARY

May 2023

Debt-ceiling crisis averted, but yields remain on the rise

Inflation concerns take centre stage again

May started out by shaking off the hangover from the U.S. regional bank crisis. Even so, the lower yields associated with the flight to quality quickly gave way to mounting concerns over a potential debt-ceiling impasse and persistent inflation, pushing bond yields higher.

In the credit market, spreads took all the reverberations in governments yields in stride, with IG coming down 10 basis points in May and HY plunging 30. Risk investors seem to have overlooked the potential consequences of a pending recession, at least for one month.

Long bond yields won't retest the highs reached last fall

As the Fed says, monetary policy acts with long and variable lags. The current cycle started in March 2022; therefore, the economic impact of past actions should start being felt soon. This explains why we don't see long bond yields touching the highs reached last fall in this cycle.

Performance Analysis

Our overweight position in the corporate segment, which had the best total return for the period, was positive in a rising-yield environment because of its shorter duration. For the same reasons, our municipal bonds were a tailwind as well.

Our security selection in the federal and provincial segments was detrimental because we had to offset our underweights with longer-term bonds that performed poorly on a relative basis in the rising-yield environment. Finally, our exposure to the U.S. yield market negatively affected performance because bond yields evolved in a fashion similar to those in Canada.

iA Financial Group

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

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— Joined iAGAM in 2015
— More than 20 years of investment experience
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Long duration and overweights in corporate and municipal credit

Monetary policies have been tightened in a very expedited manner since March 2022. Their impacts on the economy should be felt soon. Therefore, we have maintained our bias toward a longer-duration position. At the same time, we are prepared to take advantage of the persistent volatility in the bond market.

> "We are maintaining our overweight in quality credits, although we are closely monitoring the onset of any recession-related widening."

We continue to overweight non-rated bonds issued by Quebec municipalities because of their excellent carry and low interest rate risk.

Key Takeaways

- After March's regional banking turmoil, the markets braced for the debt-ceiling showdown.
- The impacts of the Fed's past actions are yet to be felt in the economy. Long-bond yields won't return to the highs reached last fall.
- We maintain a longer duration than that of our benchmark, coupled with overweights in corporate and municipal credit.

About iAGAM