INVESTMENT FUNDS

BOND

MONTHLY COMMENTARY

October 31, 2020

What are some key risks/opportunities you anticipate for the next six months and how has this impacted your positioning?

One of the main risks is if governments impose more restrictions and more lockdowns that could slow the fragile economic recovery if the second wave of COVID-19 becomes out of control.

Another risk is the November 3rd U.S. election. The results could change the path for interest rates depending on the outcome. Social tensions or a contested result that drags on for several weeks are possibilities which could impact consumers and freeze risky assets.

The economic recovery has rebounded sharply thanks to government fiscal stimulus across the globe. In the U.S., the negotiations for a phase-4 package haven't provided positive results so far. A Democrat president could see a lot of resistance in achieving a meaningful fiscal package if his party is not in control of the Senate.

Finally, Brexit, possible geopolitical tensions in the Middle East and the U.S.-China trade war are still risks we must monitor constantly.

Central banks' large quantitative easing programs deployed to combat the economic impacts of COVID-19 significantly lowered the level of interest rates, and we find value in spread products. It is a way to enhance our total return and beat our benchmark. This strategy can provide additional return over a passive approach without taking undue risk.

Finally, the drugs making a difference in the battle against COVID-19 are now being identified. Progress is made and new data on COVID-19 is available daily. Hopefully, an efficient vaccine should be created in the coming months. It will be an opportunity to identify strategies that will act according to a positive economic scenario.

Share one or two recent investments or investment themes

A very powerful investment theme in recent months is the "search for yield" theme. Central banks around the world have cut their interest rates to record lows and implemented quantitative easing programs to support the economy and market functioning. As a result, yields on government securities have declined considerably, pushing investors further along the risk spectrum in order to boost yields. In our world, this translates into buying provincial bonds instead of federal government bonds because of the yield pickup. The "search for yield" theme has been prevalent for a few years already, but it has accelerated since the COVID-19 crisis as government securities yields have sunk to historical lows. The Bank of Canada's (BoC) quantitative easing program also includes the buying of provincial and corporate bonds, so this puts a credible backstop to any sustained increase in spreads. Our mandates also try to capitalize on this "search for yield" theme as we are overweight in provincial, municipal and corporate bonds and underweight in federal government securities. While we might move to an underweight position in credit bonds from time to time, over the long run, we expect to spend most time capitalizing on the "search for yield" theme.

Fund positioning and outlook

We still expect overnight rates to stay at their current level in Canada and in the U.S. So far, neither the Federal Reserve (Fed) nor the BoC has expressed its intention to lower it into negative territory as is the case in Europe and Japan. So, we expect the short-term portion of the yield curve to be anchored by central banks. Combined with the increasing amount of new issues in the long-term portion of the yield curve to finance big government deficits, we predict a continuation of the steepening of the yield curves in the coming months.

We remain constructive on corporate credit spreads because of the relentless investors' search for yield in a low interest rate universe. We may also see a sharp decrease in the amount of corporate new issues in 2021 that would help the asset class perform well in the coming months.

We like Canadian provincial credits. There is an important seasonality in the Canadian bond market happening at the beginning of December. A lot of money is being paid out in the form of coupon payments and maturities that must be reinvested in the market. Provincial credits tend to benefit from this situation. Provincial issuers also usually stop issuing a couple weeks before Christmas. So, a combination of fewer new issues in December and a lot of money to be invested in the segment help compress provincial spreads resulting in positive relative value performance.

We also like non-rated bonds from Quebec municipalities because of the good yield they provide while having a short maturity (usually less than five years).

As usual, we will remain agile in managing our portfolio's duration to take advantage of market opportunities especially in the context of the fast approaching U.S. election, which could bring volatility.

In conclusion, we think heavy issuance combined with positive news on a potential vaccine to combat COVID-19 could push yields higher in the coming months. But, if yields increase too fast, central bankers will be watching and may intervene to slow the pace. One thing is certain, yields will stay low on a historical basis. Remember that central banks will be involved in maintaining the lower part of the curve anchored. They should tolerate higher interest rates but to a certain level. Finally, keep in mind that an out-of-consensus outcome on November 3rd could drastically change these expectations.

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Main funds managed by the team

✓	Money Market
✓	Short Term Bond
✓	Bond
✓	IA Clarington Bond Fund
✓	IA Clarington Money Market Fund
✓	IA Clarington Real Return Bond Fund

iAIM snapshot

— Principal asset manager for iA Financial Group
— Major player in the asset management industry
— Manages $97 billion in general portfolios and segregated and mutual funds
— A team of 184 people, including 108 investment professionals (including 44 CFA charterholders)
— Composed of experienced managers who emphasize fundamental analysis, identification of value and long-term investing

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