INVESTMENT FUNDS

BOND

MONTHLY COMMENTARY

June 30, 2020

The main contributor to our fund performance during the quarter was our underweight Canadian government bonds as they were the laggards in terms of performance in the second quarter. The Canadian government bonds lagged because credit markets became very well supported in April by actions from the Bank of Canada promising to buy up to CA$50B in provincial bonds as well as up to $10B in corporate bonds until April 2021.

The second main contributor to our performance was our overweight corporate bonds. We took advantage of the widening of their spreads to add to our corporate bonds exposure in order to increase the yield of our portfolio in a low interest rate environment. To hedge some of our corporate bond risks, we decided to be underweight provincial bonds, since we forecast provincial governments will need to issue a lot of debt to pay for the costs associated with the pandemic.

Skillful security selection in the Provincial segment was our third contributor. We were overweight in peripheral provincial bonds such as Manitoba, Nova Scotia and Saskatchewan that performed better than the benchmark province of Ontario.

Finally, the only segment that was detrimental to our performance was our security selection in the municipal complex. We like one- to five-year non-rated municipal bonds issued by municipalities in the province of Quebec since they provide good carry for a small interest rate risk. Their spread tightened a lot in April but since they have a short maturity, they performed poorly against our benchmark on a total return basis.

Opportunities and risks going forward

Corporate sector

After an unprecedented first quarter, the second quarter witnessed stabilization in the bond market. Although the recovery in economic data and fiscal stimulus should help rates to recover, continued central bank asset purchases, fears of a second wave of COVID-19 and risks of a slower recovery are expected to keep rates low for some time. In this context, credit spreads, while staying wider than pre-COVID-19 levels, should continue to tighten in the coming months due to the search for yield from investors and the support from central banks.

Duration and curve positioning

As always, we stay nimble and opportunistic on duration. The current interest rate level looks low compared to historical levels, but we are in the middle of an exceptional crisis and central banks are extremely accommodative, so low rates are justified. Nonetheless, we could still see slightly higher rates in the coming months as the economy starts to recover. As a result, it will pay to deviate from the benchmark duration to capitalize on those moves. Also, all countries are not synchronized in terms of recession/recovery, so this could create some opportunities in foreign fixed-income markets. In addition, governments have announced massive fiscal programs to support their economies and more are expected. These programs will increase issuance in some parts of the curve, presumably in the long term. For their part, quantitative easing programs will be mainly concentrated in the short term of the curve while overnight rates for central banks will be kept at the zero-lower bond for a long time. This will likely create some curve opportunities and relative value trades.

Inflation

The current recession is deflationary and breakevens have collapsed during the market turmoil. With the fiscal packages in place, aggressive central banks and the reopening of economies taking place, opportunities could appear in real yields as inflation may arise once the economy recovers. We are closely monitoring real return bonds and Treasury inflation-protected securities (TIPS) values.

COVID-19

The COVID-19 health crisis has pushed the world into its first recession since the global financial crisis in 2008. There are many uncertainties regarding the depth and length of this recession. Until a vaccine is developed, another sharp rise in COVID-19 infections could trigger selling in risk assets and inflows into bond markets. A second forced economic lockdown would be painful for economic activity and; therefore, the U.S. expressed their willingness to keep the economy open even if there were a spike of cases.

U.S. presidential election

Another risk is the upcoming U.S. presidential election on November 3, 2020. The next quarter will be marked by election headlines as both parties attempt to win the White House. With his approval ratings plummeting since the beginning of the pandemic, Donald Trump may be inclined to act in very intense and unpredictable ways. The risk of a democratic sweep is building and could be detrimental to risky assets since Joe Biden has promised to push for higher corporate taxes and more regulations.

International

A major global theme over the past years, protectionism is still an important risk in the next quarter. Indeed, the possibility of renewed U.S.-China trade tensions, Hong Kong protests and the ongoing post-Brexit economic negotiations between the UK and Europe are risks that we will closely monitor. Finally, we are closely monitoring opportunities in the U.S. and keep the flexibility as whether to hedge or not our U.S. dollar exposure.

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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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