INVESTMENT FUNDS

BOND

MONTHLY COMMENTARY

May 31, 2021

ESG and green bonds

Designed to finance environmental or climate change mitigation projects, green bonds are becoming increasingly popular with investors. The global green bond market has grown by 60% annually, from $100B in 2015 to over $1T in 2020[1]. In addition, 2020 has seen a record amount of new green bond issuance at $270B, driven in part by the growing popularity of the product as well as the desire for a greener and more egalitarian post-COVID economic recovery[2] . While green bonds are the most well-known, ESG bonds also include, for example, social bonds.

We believe that ESG bonds will continue to perform well in the coming months/years. We continue to increase our allocation when opportunities arise. For example, we recently participated in several new ESG bond issues, such as the province of Quebec's ten-year green bond and the Asian Development Bank's seven-year gender equity bond. In addition, we recently acquired municipal bonds from Quebec City's Réseau de Transport de la Capitale (RTC), a public transit company. Although this issuer is not officially classified as "green", we believe it meets the ESG criteria given its field of activity.

As has been the case since the beginning of the year, we were significantly underweight in federal government bonds in May, which allowed us to overweight various asset classes such as corporate credits, unrated municipal credits with maturities of less than five years, and various exchange-traded fund positions that provide access to short-dated USD corporate credit products. Despite the fact that credit spreads are at historically low levels, the search for yield is driving investors into risky assets. Combined with our bearish view on interest rates, we believe that these asset classes should outperform our benchmark over the next few months. However, we have started to reduce our exposure to long corporate bonds as we believe that credit spreads at current levels leave little room for negative economic surprises or a change in tone in the Federal Reserve's speech that would indicate that it intends to reduce its quantitative easing.

Also, the duration of our portfolio remains lower than our benchmark and positioned for a steepening of the Canadian yield curve. On the other hand, we believe that interest rates with a five-to-ten-year maturity are the most likely to rise in the United States as the Federal Reserve may signal its intention to reduce its quantitative easing in the coming months. As a result, we closed our position that was expecting the U.S. yield curve to steepen.

Finally, our active positions include exposure to the U.S. dollar as well as a long position in real return bonds, which provides protection in the event of a rise in Canadian inflation.

iA Financial Group

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

iA Investment Management

Duration, inflation, and yield curve

We remain agile and opportunistic on duration, as usual. With the rapid rise in interest rates seen in the first quarter, we doubt we will see the same trend in the coming months. Nevertheless, with the potential for higher inflation in the near term, the large-scale rollout of vaccination campaigns and the amount of new issuance funding large budget deficits, we could see rates rise as the economy continues to recover. It will therefore pay to move out of the duration of our benchmark to take advantage of these movements and opportunities could emerge in real return securities as inflation could rise once the economy recovers from the pandemic.

Moreover, the fact that governments are committed to supporting people and businesses, coupled with corporate profits above the most optimistic expectations, holds promise for economic recovery and the hiring of workers in the coming months. These massive fiscal stimulus programs will increase the level of issuance in some parts of the curve, likely over the long term, while overnight rates will be kept low for a long time, likely until 2023 according to the latest projections released by the U.S. central bank. Curve and relative value opportunities between the U.S. and Canada will therefore be possible in this environment.

Pandemic and economic strength

There are still many uncertainties about the duration of this pandemic and economic recovery, as variants are spreading rapidly around the world and many countries are, or have been, experiencing a third wave of infections. We are closely monitoring data related to COVID-19: the sharp decline in vaccination rates, particularly in the U.S., may delay the achievement of herd immunity.

In addition, following the rapid rollout of the Biden administration's tax plan and increasing vaccination in the developed world, particularly in Canada, there is a lot of optimism in the markets. Economic data must meet expectations and have little or no margin for error in this environment. However, if economic data were to be even stronger than expected, the risk associated with a change in tone from the currently very accommodative U.S. Federal Reserve would grow and could be detrimental to risky assets. For its part, the Bank of Canada, having already begun to reduce its balance sheet last April, could find itself continuing or slowing the pace of balance sheet tapering depending on the strength of future economic data.

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ALEXANDRE MORIN, CFA

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

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

1 https://www.climatebonds.net/2021/01/record-2695bn-green-issuance-2020-late-surge-sees-pandemic-year-pip-2019-total-3bn
2 https://www.climatebonds.net/2021/01/record-2695bn-green-issuance-2020-late-surge-sees-pandemic-year-pip-2019-total-3bn

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