INVESTMENT FUNDS

BOND

MONTHLY COMMENTARY

January 31, 2022

Market and Portfolio Update

2022 started off with a dizzying amount of activity in the global capital markets during January, and fixed income was no exception. In Canada, 10-year government bonds backed up close to 35 basis points, finishing the month just under 1.77% as investors started baking in more hawkish overtures emanating from central bank policymakers both at home and abroad. The story was much the same in the U.S. as 10-year treasuries began the year just over 1.5% and closed out at nearly 1.8% after meaningfully breaching that level a couple of times throughout the month.

There was no shortage of storylines buffeting the markets in January, but when things finally ended it was central bank positioning over policy rates on both sides of the border that ultimately drove the narrative on bonds. Growing trepidation surrounding a potential military conflict between Russia and Ukraine, for example, sent equity markets scurrying at points and periodically put a bid into bonds, but remained more the fodder of the media than the markets. Meanwhile, ballooning market volatility also became a topic of concern, with intraday volatility leaving investors' heads spinning and spurring much contemplation about where such wild price swings put us in historical context and what that says about the future market direction. Yet the rhetoric about volatility seemingly had more to do with a change in the equity market narrative towards value over growth, itself prompted by building central bank hawkishness, than it did with underlying fundamentals.

On the economic front, inflation remained the key focus and with prints in Canada and the U.S. reaching nearly 5% and 7%, respectively, therein was the fuel for monetary policy supplanting all else as the principal issue of the month. Extremely tight labour conditions in the U.S. and to a much lesser degree Canada further propelled worries about inflation and encouraged policymakers to become more vocal about taking active steps to reduce the threat of higher costs on the economy. As a result, the markets jostled their way towards the January 26 central bank meetings in both countries. And investors did not come away disappointed. A more hawkish tone overall was reaffirmed, albeit with no need for immediate action since both policymakers stood pat while signalling a liftoff primed for March and orderly movements thereafter (possibly two successive hikes to start). Even the messaging on quantitative tightening allayed market fears of aggressive monetary policy action since the Fed and BoC intimated a measured approach to unwinding their balance sheets, likely to be commenced in the summer after the initial increases in rates and not to be the primary driver of monetary conditions. A stated desire by central bankers to not surprise the markets as monetary conditions are tightened did not, however, discourage some forecasters from predicting 7+ rate hikes this year or possibly even a 50 basis point move in either country at their next respective meetings.

As for bond market performance, the desire of central bank policymakers to talk yields higher meant losses for bonds across the board, with ensuing volatility and poor liquidity being unwelcomed byproducts. The FTSE TMX Canada Universe Bond Index lost 3.4% in January 2022, paced to the downside by longer duration segments like Provincials (-4.66%) and the Infrastructure segment of the corporates (-4.79%). The Federal segment outperformed in January, registering a loss of 2.34%, as weakening spreads also weighed on corporates, which lost 2.94%. Oddly, corporate spreads in Canada were slow to respond to the risk off sentiment pervading the markets in January, but heavy new issuance in the U.S. and worries about rising rates producing slowing economic activity eventually pushed levels out roughly 10 basis points. Provincial spreads also faced some spread pressure in January as they widened 6 basis points. High yield in the U.S. took it on the chin during the month as three successive weeks of $2 billion+ in associated ETF outflows temporarily surged spreads up by roughly 50 basis points, although levels recovered somewhat into February. And in that regard, we see opportunity to selectively add some exposure to high yield should momentum shift back towards that asset class following such a sharp correction in January.

Volatility was also present in the evolution of yield curves. The 2s-10s curve in the U.S., for instance, plunged 20 basis points in January to finish around 60 basis points as the short end bore the brunt of market angst over the potential of the U.S. Fed increasing policy rates and bear flattening the curve. By comparison, in Canada 2s-10s rose a touch to roughly 50 basis points by the time January ended as the market here was already pricing in tightening action by the BoC. But that expectation did not stop the curve from temporarily bear flattening by over 15 basis points in the first half of the month before settling down as it became less likely the Bank would move at its January meeting.

Despite all the volatility in January, our overall view remains biased towards shorter duration given the backdrop of higher rates going forward. We believe most of the heavy lifting for upward pressure on yields has already been priced into the market but expect levels to generally drift higher. At the same time, we will remain nimble to take advantage of anticipated ongoing volatility as the markets continue to figure out a new narrative, while the spectre of mounting geopolitical risks persists. In addition, we remain overweight corporates as a modestly softer spread environment presents opportunity to selectively pick away at that asset class.

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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

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- 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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