INVESTMENT FUNDS

BOND

QUARTERLY COMMENTARY

December 31, 2021

Market and Portfolio Update

The final months of 2021 saw the bond market undertake a valiant effort to reverse the damage done to total returns earlier in the year. Several important pieces of news were the foundation of these moves. For starters, the Bank of Canada's (BoC) asset purchase program came to an end, while the U.S. Federal Reserve announced on November 3 the start of its tapering program. In addition, the December update of its policy rate forecast reinforced its change in tone, demonstrating a willingness to quickly address rising inflation. Finally, we entered December with a new COVID variant causing renewed concern that a new set of protective measures would be put in place to mitigate its transmission, but the emerging rhetoric about the reduced severity of the disease quickly dissipated this market concern.

The high level of market influencers persists, with investors dismissing any significant impact from the Omicron variant from the outset, choosing instead to focus on perceived central bank tightening. Thus, the market has already incorporated many of the BoC's moves in 2022 into bond price. In addition, the possibility that investors may reduce their expectations for bank rate hikes could create opportunities to position the portfolio against a steepening yield curve in Canada, while the U.S. yield curve could continue to flatten.

We expect to own bonds with shorter duration than our benchmark to begin 2022, given the current upward pressure on yields. Nonetheless, we will remain flexible and may change our duration stance should we see the opportunity. Canadian bond yields have seen a lot of movement in recent months and we believe the recent volatility could continue, opening doors to opportunities to modify our duration stance.

We expect to be overweight in corporate credit. Their spreads and shorter duration offer some degree of protection over government bonds in an environment of upward pressure on yields. Admittedly, spreads are fairly tight at current levels and offer little relative value but the general improvement in corporate credit quality as well as the search for yield offer some comfort. For the provincial segment, we do not expect their credit quality to deteriorate as the economic impact of recent closures does not appear to be too great. In the meantime, the new issue market is very active, and issuers are looking to secure the still low funding rates ahead of any potential moves by the BoC. Any near-term credit spread weakness on new issuance may provide investment opportunities, all things being equal.

For the next year, we believe that central banks will be the main market drivers. Worried about persistent inflation, we expect central bankers in North America to start their hiking cycle soon. Also, they will start passively reducing their massive balance sheets (quantitative tightening). This should affect both yield levels and the shape of the yield curve. If central banks act too aggressively, there is a risk that their economies will be hampered. Economic uncertainty remains high as governments around the world take fiscal measures to reopen their economies, while negatively impacting their overall credit profile. With respect to hopes for economic recovery, risk assets are currently priced for strong and consistent performance, putting them at risk if growth does not unfold as expected. Investors will be looking for signs that companies can sustain profit growth despite rising risks.

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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

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