BOND

MONTHLY COMMENTARY

November 30, 2020

The search for yield in a situation of historically low interest rates has led us to prioritize an overweight in credit. We began December with a corporate credit weighting 1.6 times higher than the index with a slightly lower duration. Additionally, the Fund has a 1% exposure to U.S. high yield corporate bonds, 1.5% to regular U.S. corporate bonds, and approximately 2.7% to short-term U.S. corporate bonds. Provincial credit is also emphasized, mostly through an exposure to the duration of the holdings rather than by their weight. As for municipal securities, we favor short-term securities but in larger quantities. For the time being, duration management is evolving around that of the benchmark index, but as we close in to 2021, we should be encouraged to reduce our exposure. With respect to interest rate risk, the Fund holds call options that would be beneficial in the event of a drop in interest rates. Finally, we favor transactions that take advantage of a steeper yield curve, we are active in foreign exchange risk through our holdings in U.S. assets, and we actively trade interest rate risk through long or short-term views south of the border.

The first indicator that has caught our attention recently is not economic, but rather the surprisingly rapid and widespread increase in COVID-19 cases across North America. We fear that if the epidemic worsens, some leaders may decide to shut down portions of their economies, which would be negative for the economic recovery that has been underway since Q3 2020. We have seen a significant decline in economic activity in Europe following re-confinements imposed in some countries, due to the rapid growth of the epidemic in early fall. In fact, economic data has recently begun to weaken in North America. On the other hand, recent news about vaccine development has been very encouraging. It appears that mass vaccination will begin in the coming weeks, which should allow for a gradual reopening of the economy in the first few months of 2021 resulting in higher interest rates, an increase in the steepening of the yield curve and a narrowing of credit spreads.

The Fund is significantly overweight corporate bonds, which could be described as strategic rather than tactical allocation. Corporate bonds provide a more attractive yield than federal bonds and have a lower average duration, which partly protects against a possible rise in interest rates. In addition, the Bank of Canada currently has a program to purchase these bonds, which in turn supports the market and justifies relatively tight spreads. Although we do not anticipate any significant compression in credit spreads between now and the end of the year or in 2021, we believe that they should remain well supported.

The Fund is also overweight provincial bonds, but on a more tactical basis. Provincial bonds benefit from the "carry" effect, which causes investors to take on more risk to increase their returns in times of extremely low interest rates. This market is also supported by a purchase program from the Bank of Canada. Seasonality is favorable to provincial credit spreads at the end of the year. This overweight could be removed if credit spreads narrowed to too low a level, or if we decided to take a more defensive duration positioning. Indeed, provincial bonds have a fairly high average duration, and would therefore be impacted in the event of an increase in interest rates in 2021.

Overweight positions in corporate and provincial bonds are financed through a significant underweight position in federal government bonds. We believe that these should underperform in an economic recovery environment, where the risk on credit spreads is relatively moderate.

The Fund maintains a relatively low cash balance of 1% to 2%. This is the level we feel is appropriate to easily absorb daily cash inflows and outflows. We are not looking to build a cash "cushion". Even though interest rates further up the curve may rise, rates for shorter maturities are relatively well anchored and there are very short-term bonds with a more attractive yield than cash (examples: corporate bonds of less than 2 years, unlisted bonds from Quebec municipalities).

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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

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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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