INVESTMENT FUNDS

BOND

QUARTERLY COMMENTARY

December 31, 2020

The main macro drivers over the last quarter of 2020 included the U.S. elections and fiscal stimulus negotiations on one side, and the increase in COVID-19 cases and vaccine progress on the other.

The month of October was negative for North American fixed income, with rates increasing and yield curves steepening. The market was mostly driven by hope in the U.S. that Republicans and Democrats would finally agree on a fiscal stimulus package which would result in higher growth and inflation, and by decreasing uncertainty regarding the November U.S. presidential elections. Several polls showed a strong lead by Joe Biden and a potential "blue wave" that would give the new administration the ability to pass ambitious stimulus measures. Canadian rates mostly followed their U.S. peers during the month.

The U.S. presidential election led to some disappointment in the markets. The "blue-wave" that had been priced prior to the election did not materialize. Rates dropped and yield curves flattened, as the prospect of a democratic House of Representatives and a republican Senate lowered the potential for big fiscal stimulus.

On November 9th, the first COVID vaccine test result by a big pharmaceutical company was disclosed, markets were pleased by the high efficacy ratio, and U.S. 10-year yield jumped by 10 bps on that day. December thus started on a risk-on tone, but an increase in new infections continued worldwide and the discovery of a new strain of the virus during the second half of the month led to more lockdowns and restrictions on business activities, leading economists to revise lower their growth forecasts for the first quarter of 2021.

Going forward, the gradual vaccination of the population against COVID-19 will be a huge catalyst to ease restrictions and enable a robust economic recovery. The vaccination campaign has started more slowly than anticipated, but issues should be sorted out throughout the first quarter of 2021.

The main contributor to the fund's performance during the quarter was an underweight position in federal government bonds as they returned 88 bps less than the overall index during the fourth quarter. Despite the introduction of new lockdowns, approval and distribution of new vaccines have allowed risky assets to continue to rise with the ongoing search for yield. Combined with the fact that governments must issue more debt to pay for the costs of the pandemic, it is no surprise that the federal segment was the laggard last quarter.

The second contributor to performance was the use of derivatives and ETFs. We use them opportunistically to manage duration exposure or for the relative value proposition between Canadian and U.S. rates. In the fourth quarter, we sold the fund's U.S. dollar exposure purchased through ETFs. As the Canadian dollar had appreciated in comparison to the U.S. dollar throughout the fourth quarter, this was a profitable trade.

The last contributor to performance was an overweight exposure to corporate bonds, as the search for yield continued unabated. As has been the case since last April, credit markets are well supported by actions taken by the Bank of Canada, the latter promising to buy up to CAD$50B in provincial bonds and up to CAD$10B in corporate bonds until April 2021. Seeing that the rally in risk assets markets kept going, we decided to increase our exposure to corporates. Exposure to some higher-yielding securities, such as high-yield corporate bonds and bank loans, was also added through the purchase of ETFs.

In the context of low interest rates and an ongoing economic recovery, we believe that credit spreads should continue to tighten in the coming months due to the search for yield from investors, the support from central banks and the fiscal stimulus offered by governments.

As always, we stay nimble and opportunistic on duration. The potential for inflation to rise in the coming months, the rollout of immunization campaigns and the amount of new issuance funding large budgetary deficits could bring about higher rates as the economy continues to recover. As a result, it will pay to deviate from the benchmark duration to capitalize on these moves.

Finally, increased issuance, accommodative central banks and rising inflation, expectations will likely create curve opportunities and relative value trades going forward, and we are watching out for these opportunities.

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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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