

Active and Strategic Fixed Income — Short Term

Third Quarter 2022

In the third quarter, inflation continued to be investors' main concern. In Canada, the inflation rate fell to 7.0% for the month of August after peaking at 8.1% in June. The decline is due mainly to lower gasoline prices. Core inflation, which excludes energy, is still high and causing concern for the Bank of Canada. During the quarter, the BoC raised its key rate by 1.50%. It is expected to raise the rate another 0.75% by the end of 2022.

In the coming months, rate hikes by central banks around the world are expected to affect aggregate demand and dampen growth gradually. The probability of a recession is rising.

Investors now expect Canada's key rate to be about 4.00% at the end of 2022. As a result, short-term bond yields rose sharply in the third quarter, with the yield on the 3-year Canada bond going from 3.13% to 3.72%.

During the quarter, we kept the duration slightly longer than that of the index, a decision that detracted from the portfolio's return.

The segment of the curve from 2 to 10 years is now inverted by 62 basis points (bps.). At the end of June, the slope was positive by 13 bps. In the third quarter, the segment from 2 to 5 years inverted by 47 bps. We kept a portion of the portfolio in maturities of more than 5 years. This decision was beneficial because the inversion of the curve was less pronounced for longer maturities.

Spreads on corporate securities with maturities of 5 to 10 years widened by 18 and 12 bps, respectively. Provincial bond spreads narrowed by 12 bps for 5-year bonds and widened by 8 bps for 10-year bonds. As for municipal spreads, they increased from 85 to 95 bps in relation to Quebec bonds. We increased our corporate holdings to a slightly overweight position. Our overweight in corporate and municipal securities at the expense of provincial notes detracted from the portfolio's return.

In the third quarter, the number of indicators signaling an economic slowdown increased. The accelerated inversion of the yield curve is one example. Given these risks and the current level of interest rates, we will keep the portfolio's duration longer than that of the index.