

Active and Strategic Fixed Income - Short Term

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STRATEGY OVERVIEW

Our investment philosophy relies on a multi-strategy approach whereby duration management, portfolio positioning on the yield curve, sector selection, and the active management of corporate bonds all constitute opportunities for adding value versus the benchmark. Our corporate bond approach is conservative and focuses on high quality securities.

The objective is to outperform the benchmark, to a reasonable extent, at every stage of the credit cycle. Long-term returns are therefore generated through a combination of interest income and a moderate capital gain.

QUARTERLY COMMENTARY

Government authorities and central banks continued their support measures in the third quarter. To that end, the Federal Reserve said it planned to keep its key interest rate near zero through 2023. Investors responded by acquiring slightly riskier securities in their search for yield. As a result, even though bond yields changed very little in the third quarter, provincial and corporate spreads continued to narrow. Solid job creation, rising stock markets and central-bank buying of securities gave investors the confidence to assume more risk. This is typical of an economic recovery.

Bond yields fell slightly during the quarter, with the 3-year Government of Canada bond yield going from 0.31% to 0.26%.

We kept the duration slightly shorter than that of the index during the quarter. This strategy did not contribute to the return.

We kept our investments within maturities of 1 to 5 years. During the quarter, the slope of the segment from 2 to 10 years steepened by 8 basis points (bps). More specifically, the segment from 2 to 5 years steepened by 3 bps, while the segment from 5 to 10 years increased by 5 bps. All the Bank of Canada's bond-buying programs are reflected in market valuations. The BoC will not change its monetary policy until the Canadian economy exceeds its potential growth rate, something that could take several years. We are therefore entering a period of stability. Our positioning strategy did not provide any observable advantage.

During the quarter, corporate spreads narrowed by 36 bps. and provincial spreads by 7 bps. As for municipal spreads, they narrowed from 63 bps to 47 bps in relation to Quebec bonds. We maintained our overweights in provincial and corporate securities by taking part in new issues. We also increased our weighting of municipal bonds. This strategy contributed significantly to the portfolio's return and was the main source of value added.

As long as central banks continue their bond-buying programs, interest rates are expected to remain low, especially for short-term maturities. Even so, we do not think they will go into negative territory. Unlike corporations, the Canadian provinces should continue to rely heavily on bond issuance to finance their deficits. Having taken profits generated by our positioning on the curve, we will maintain a position quite close to the neutral point. We will keep the duration short, but close to that of the index. Finally, as long as the stock market trend stays positive, we will continue to overweight provincial and corporate securities.