Active and Strategic Fixed Income — Short Term

Second Quarter 2022

In the second quarter of 2022, the widespread rise in prices continued around the world. In Canada, the inflation rate climbed to 7.7%. As their purchasing power erodes, consumers must make choices and reduce their spending accordingly. Even though the inflation is largely caused by exogenous factors that are restricting the supply of a number of products, the Bank of Canada seems determined to apply a restrictive monetary policy to slow demand. The tightening of monetary policy by the central banks has also affected the stock markets, causing high volatility and a widespread decline in prices.

Investors now expect the key rate to be about 3.50% at the end of 2022. As a result, short-term bond yields rose sharply in the second quarter. The yield on a 3-year Canada bond increased from 2.28% to 3.13% after touching a high of 3.46%.

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

In the second quarter, the slope of the segment from 2 to 10 years was unchanged. The segment from 2 to 5 years flattened by 12 basis points (bps), while the segment from 5 to 10 years steepened by 12 bps. Even though we kept a portion of the portfolio in maturities of more than 5 years, this strategy contributed to the portfolio's quarterly return.

Spreads on corporate securities with maturities of 5 and 10 years widened by 34 and 23 bps, respectively. For the same maturities, provincial bond spreads widened by 2 and 7 bps, respectively. As for municipal bond spreads, they increased from 61 to 85 bps in relation to Quebec bonds. Our overweight in corporate and municipal notes was the main negative component of the portfolio's return.

The yield curve is completely flat and the market is waiting for the next interest rate cycle. Rates could continue to rise, in order to combat inflation, or they could go down, to avoid a recession. We will keep the portfolio's duration longer than that of the index because we think the rate hikes are behind us.

We think persistent inflation could cause the economy to slow. Consequently, we will be cautious about our exposure to corporate bonds and will maintain an underweight in provincial bonds until further notice.