INVESTMENT FUNDS

Bond (iA)

QUARTERLY COMMENTARY

December 2023

Bonds rally substantially in the fourth quarter

Driven by expectations that the next move by central banks is lower

After peaking at 5% in October, the 10-year U.S. Treasury yield fell more than 100 basis points to end the year under 4%, capping a stellar quarter that moved year-to-date total fixed income returns squarely into positive territory. A confluence of factors underpinned the enthusiasm for bonds, amid a growing consensus among pundits, including members of the central bank itself, that the U.S. Fed had most likely completed its hiking cycle. Economic releases supported that notion, particularly softening inflation and labour data, along with smaller-than-expected auction sizes in the United States.

Bearish economic view, bullish bond view

We still expect bond yields to decline over the next 12 months as the impact of significant and rapid interest rate hikes by central banks makes its way through the economy. In the short term, we expect continued volatility in the bond market – especially because we think the market is too aggressive in pricing in the timing and magnitude of rate cuts over the next 12 months. Nimbleness is key in such volatile markets, and we will continue to be tactical and actively manage the portfolio's interest rate risk.

Performance analysis

During the quarter, we were underweight the federal segment, which underperformed by a wide margin. To offset the underweight, we had exposure to longer-term bonds that overperformed in an environment of rapidly declining yields.

We were also underweight the provincial segment, which outperformed, but we owned bonds with longer maturities that performed even better because of declining yields. On net, our provincial exposure was positive for the portfolio.

Finally, our municipal and corporate bonds were detrimental to our performance because, on average, they have a shorter maturity, which caused them to underperform during the period.

iA Financial Group

#1 in net sales of segregated funds in Canada since 2016

Alexandre Morin, CFA

Senior Director, Portfolio Manager, Fixed Income

- Joined iA in 2015
- More than 25 years of investment experience
- Bachelor's degree in Business Administration, Université Laval

Modestly overweight duration and high-quality IG credit

We were tactical with duration in the fourth quarter, adding when yields rose and taking some profits as they fell. By quarter-end, however, we were modestly overweight duration because we thought the market was too aggressive in pricing in the timing and magnitude of rate cuts by central banks over the next 12 months.

"Notwithstanding, nimbleness will be key to provide value added for our clients, as we expect volatility in the bond market."

We are overweight investment-grade corporate credits, which noticeably outperformed higher-yield bonds, and we have a neutral position in provincial bonds, which similarly tightened during the quarter. We continue to overweight non-rated bonds issued by Quebec municipalities.

Key Takeaways

- Bond yields moved materially lower in the fourth quarter amid softer inflation, a smaller-than-expected government bond supply and signs that central bank rate hikes were over.
- We remain long duration and overweight credit, although we reduced our duration as rates rallied and trimmed our position in credit over the quarter.
- We will continue to actively manage our exposure to rates, curve and credit, and also look outside Canada for opportunities to add value.

About iAGAM

A magnet for top investment talent, iAGAM is one of Canada's largest asset managers, with over $100 billion under management across institutional and retail mandates. We help investors achieve their long-term wealth creation goals through innovative investment solutions designed for today's complex markets. We are building upon our historic success, supporting the growth of our core strengths and exploring innovative ways to meet investor needs. We are rooted in history and innovating for the future. Our experienced portfolio managers use a proprietary investment methodology, rooted in iAGAM's unifying commitment to strong risk management, analytical rigor and a disciplined, process-driven approach to asset allocation and security selection.

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