# IA Wealth Core Bond Pool

## Fixed Income Commentary: June 2021

### ESG and green bonds

Designed to fund environmental or climate change mitigation projects, green bonds are becoming increasingly popular. It is possible to observe that the illiquidity discount formerly seen in the green bond market has become a scarcity premium mainly due to the popularity and low issuance of this type of bond. Being already invested in this market, we believe that these bonds will continue to perform in the months/years to come. We are increasing our allocation based on available opportunities. The second quarter began with the highest level of the U.S. rate since the beginning of the year, with the overly optimistic tone that was present in the first quarter.

However, that sentiment faded this quarter as all the good news was very well priced in. We saw the U.S. rate market consolidate and volatility subside. Even though the vaccine campaign in Canada still has very good traction and the stimulus continued to be rolled out, the rate market peaked.

The market now seems to be concerned about the future withdrawal of support measures by governments and central banks while carefully monitoring new variants of COVID-19 that make some countries return with restraint measures. At the Fed, more and more people believe that the overnight rate should be raised next year, and that quantitative easing should be reduced sooner rather than later. In June, this new paradigm resulted in a flattening of the curve with a significant sell-off in the front end of the curve.

However, economic data shows that consumers are spending their money and are confident about the future. The media has even reported that some workers now prefer to leave their current jobs rather than physically return to work - they would rather find another job that allows them to work remotely. Such a high “quit rate” is generally associated with a healthy economy. In addition, businesses have continued to face bottleneck effects, with low inventories and a high backlog. This should allow for better growth with an acceleration of industrial production to replenish inventories.

Outside our borders, the market is also highlighting China’s measures to control credit borrowing as well as some measures to stop commodity speculation. Overall this quarter, market participants were torn between, on one hand, the risk of a potential slowdown caused by China or new COVID-19 variants, and, on the other hand, the rather good data from the U.S. economy - meaning a greater likelihood of rate hikes next year and balance sheet reduction this year for the U.S. economy.

### Yields, corporate sector, and duration

We still see corporate credits as an attractive overweight holding in our portfolios as they offer good carry and the demand for new issues is still strong. However, corporate credit spreads tightened strongly last year and in the first quarter of 2021, leaving little to no room for further tightening at the levels that we were at the end of the first quarter. In fact, Canadian corporate spreads were slightly tighter for the quarter. We still like this market, but the risks are more balanced than they were. The overweight remains relevant, but to a lesser extent. We have a bias to own securities in the short and mid part of the corporate bond curve.

As always, we stay nimble and opportunistic on duration. With the quick rise in interest rates seen in the first quarter, we didn't witness the same trend in the last quarter. Nonetheless, with strong economic data to come, immunization campaigns that are well underway, the amount of new issuance funding large budgetary deficits and a potential for less accommodative central banks, we could see rates move higher as the economy continues to recover. As a result, it will pay to deviate from our benchmark's duration to capitalize on those moves.

### Inflation expectations

With tax packages in place, aggressive central banks maintaining loose financial conditions, and economies reopening, opportunities have emerged in real yields/break-evens as inflation has jumped to levels not seen in years. Even though the new policy framework put in place by the Fed at its September 2020 meeting would allow inflation to exceed the 2% target, the market has pushed inflation expectations very high. There will be opportunities related to inflation-protected bonds, but the risks of seeing a very large increase in inflation expectations are now balanced.

### Yield curves

The massive fiscal stimulus programs put in place by governments to support their economies will increase the level of issuance in some parts of the curve, presumably in the long term while overnight rates will be kept at the zero-lower bound for some time. In addition, very strong economic data, the pace of vaccinations and the Federal Reserve's change in tone following the June meeting could largely influence market expectations of future central bank rate hikes. The mention of a taper and an increase in expected rate hikes in 2023 by the Federal Reserve should flatten the curve while increased issuance and strong inflation expectations should do the opposite. This should then create curve and relative value opportunities between the U.S. and Canada.

### COVID-19

There still are many uncertainties about the duration of this pandemic and economic recovery. There is growing concern about new variants of COVID-19 (Delta, Lambda) and the resurgence of cases around the world, leading some countries to return with restrictive measures and of course, making headlines in the media.

### Optimism and economic data

Vaccination campaigns around the world and the reopening of economies have created a lot of optimism in the markets. In this environment, economic data must meet expectations and have little to no room for error. We now seem to be at the "peak of optimism" and the market will focus on any negative news that could derail ongoing economic recovery. If economic data or corporate earnings fail to meet high expectations next quarter, volatility in risk assets and rates is likely to rise.

### Portfolio performance & characteristics

| Fund, benchmark and index performance | 1 Month | 3 Months | YTD | 1 year | 3 years | 5 years | 10 years | Since inception[1] |
|---|---|---|---|---|---|---|---|---|
| IA Wealth Core Bond Pool – Series F | 0.9% | 1.6% | -3.2% | -2.1% | 4.0% | 2.7% | 3.8% | 4.1% |
| Benchmark[2] | 1.0% | 1.7% | -3.5% | -2.4% | 4.2% | 2.6% | 3.9% | 4.4% |

Source: iA Clarington, Morningstar, as at June 30, 2021.

| Portfolio characteristics | |
|---|---|
| Modified duration (years) | 8.1 |
| Fund size ($million) | 346.0 |
| No. of holdings | 352 |
| Average credit quality | AA |
| Portfolio yield | 2.4% |

Source: iA Clarington, as at June 30, 2021.

**Dealer use only.** The name change was effective June 29, 2020. [1]IA Wealth Core Bond Pool Series F inception date is October 2, 2006. On or about July 24, 2020, Series F was merged into Series FX and Series FX was renamed Series F. [2]The Fund's benchmark is FTSE Canada Universe Bond Index.

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