PORTFOLIO CONSTRUCTION

CI ASSANTE WEALTH MANAGEMENT

Fixed Income Commentary

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The battle between slowing overall economic activity and stubborn inflation continues to rage in most geographies. Central banks in these regions have increased short rates very sharply over the past year. Generally, the results have been positive as headline inflation has fallen and interest rate sensitive sectors of the economy are in decline. However, the resilience of the economy as a whole has led policymakers to remain active and vigilant.

Specifically, in Canada, the increase in job creation remains too strong for a meaningful pullback in wage growth. The upward trend in household income has thwarted the Bank of Canada's efforts to create a sustained downward tilt to core inflation. The Bank has taken overnight rates to 4.5% and has indicated a preference for pausing to assess the lagged impacts of its tightening cycle. The over-levered household sector weighs on the mind of policymakers and is the primary rationale for the difference in rates between Canada and the U.S.

In the U.S., the Federal Reserve is likely to raise rates at least 50bps more in early 2023. Consumption of services, tight labour markets, good capital expenditures and strong rental markets have combined to keep core inflation well above the Federal Reserve's comfort level. Hence, more hikes to come.

In Europe, government subsidies have somewhat sheltered the consumer from dramatically higher energy prices to date. Therefore, as price caps are being raised, this will add to headline consumer inflation. The European Central Bank began its hiking cycle much later than its global counterparts and still has at least 100bps more to do in the first half of this year.

In the United Kingdom, a combination of lingering BREXIT issues, low labour supply and the highest level of strike activity in 40 years has greatly reduced the country's growth potential. Thus, the risk of spiraling wage push inflation is very high in England. The Bank of England has indicated that they are close to a plateau in short-term rates, but the markets have priced in another 75bps-100bps of hikes.

A new governor of the Bank of Japan begins his tenure in April. The BoJ has run an ultra-loose monetary policy for the past 7+ years. Currently, the BoJ caps 10-year yields at 0.5% (after having raised this cap from 0.25% in December 2022). This is called yield curve control and it has become untenable as the BoJ is spending enormous amounts of money to keep 10-year yields below 0.5%. There is a strong expectation that the new governor will end yield curve control, which would bring about major changes in capital flows globally. Foreign pools of capital which have shunned Japanese bonds for years will recalibrate their strategies, and Japanese-based pools of capital will look to repatriate some of their holdings of foreign bonds.

Our portfolios started the year short of benchmark duration and have only recently added purchases of government bonds. Our CI Global Bond fund (mutual fund) and the Global Fixed Income pool fund is still underweight U.K. and European sovereign bonds due to their less attractive real yield profile. These funds increased their overweight position in North American debt, with the fund overall being short of benchmark duration. Our domestic-focused funds have just recently extended duration beyond the benchmark as 10-year yields in the U.S. went above 4% and approached 3.5% in Canada. Our curve positioning has favoured a flattening bias, but our purchases were in the 7- to 10-year sector so our flattening bias is less pronounced.

Our view on credit is somewhat cautious and we are managing this sector more tactically. The technical backdrop is good for credit. Supply and demand dynamics are in equilibrium and are expected to remain so. All-in yields on both investment grade and high yield bonds are at attractive levels on a risk-adjusted basis. Our concern stems from the decline in fundamentals that we expect to build throughout 2023. As economic activity declines, earnings and cash flow generation will weaken, and credit metrics will suffer. Right now, we feel we are being reasonably compensated for this risk, but we intend to sell into any significant spread narrowing. We did exactly this in early January as we trimmed some bonds issued in the financial sector.

Top 15 Holdings as of February 28, 2023

1. Canadian Natural Resources Limited 2. Suncor Energy Inc. 3. Royal Bank of Canada 4. Toronto-Dominion Bank 5. Microsoft Corporation	6. Brookfield Corporation 7. Alphabet Inc. Class A 8. WSP Global Inc. 9. Prologis, Inc. 10. Element Fleet Management Corporation	11. Amazon.com, Inc. 12. Tencent Holdings Inc. 13. Enbridge Inc. 14. Canadian Pacific Railway Limited 15. Alibaba Group Holding Limited

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