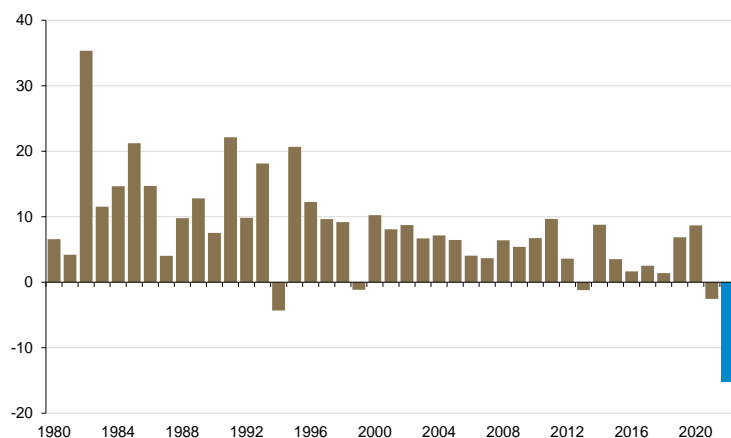


## Putting the “income” back into “fixed income”\*

October was yet another challenging month in what has been a historically difficult year for bond investors. The FTSE Canada Universe Bond Index, a broad gauge of the performance of the Canadian bond market, fell a further 1% bringing the year-to-date decline to -13%. This is by far the worst year in the broad Canadian bond market benchmark’s 43-year existence (runner-up is the mere -4% drawdown in 1994) and 2022 alone has included five of the 20 worst single months in the index’s history.

### Head and shoulders (and torso and knees) below the rest...

(FTSE Canada Universe Bond Index calendar year total return; percent)



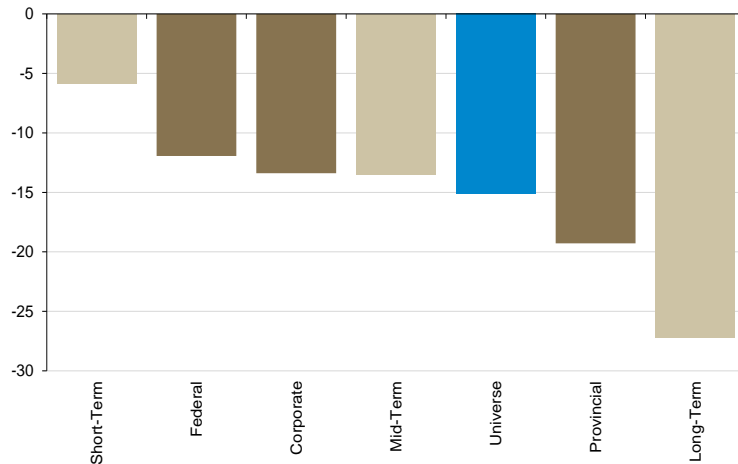
Source: Guardian Capital based on data from Bloomberg and FTSE, 2022 is year-to-October 21

What has made this weakness particularly difficult for investors is that no segments of the fixed income market have been spared from the carnage — corporate (-12%), provincial (-16%) and Federal government (-12%) bonds are all down on the year, as are those with long (-23%), medium (-11%) and short durations (-5%) according to bond performance data compiled by FTSE.

\*This commentary was authored by Guardian Capital LP, an affiliate of Guardian Partners Inc., and is being provided with permission from the author.

### Nowhere to hide

(FTSE Canada Universe Bond Index year-to-date total return; percent)



Source: Guardian Capital based on data from Bloomberg and FTSE to October 21, 2022

All in, it has been a terrible year for an asset class that has been generally viewed as “risk-free” and is supposed to serve as an insurance policy for balanced portfolios when stocks take a dive (which they have this year, with the S&P/TSX down 6% through October and the MSCI World Index down 14% in Canadian dollar terms).

But, as is almost always the case, the chaos this year has created opportunity. The terrible, horrible, no good, very bad year has been the result of a much-needed reset in the bond market that puts investors on a much better track for the future and limits the likelihood of seeing a repeat performance soon.

One of the appeals of owning bonds is that they offer regular, fixed income flows (interest payments from the borrower to compensate for what is a loan to a government or corporation) — these income flows typically provide a buffer for total return should interest rates rise and cause the market price of the bond to fall (yields and price move inversely).

Thanks to more than a decade of historically low-interest rates due to the ultra-loose monetary policy, not only did those payments almost entirely evaporate (just a year ago, one-quarter of bonds traded with a negative yield!) but there was also effectively no buffer against an adverse move in rates — the absence of protection combined with the jump in market yields as global central bankers reversed course in response to elevated inflationary pressures has resulted in this year’s broad-based rout.

### Started from the bottom, now we're here

(10-year Government of Canada Treasury note yields; percent)



Source: Guardian Capital based on data from Bloomberg and FTSE to October 21; shaded regions represent periods of US recession

Looking forward, however, the performance outlook has improved markedly relative to what it was 10 months ago. Bond yields now sit at levels that provide investors with a degree of cash flow not seen in more than a decade that represents some actual compensation for the risk of changes in market rates as well as the erosion in purchasing power that comes from inflation (the yield on real return bonds, for example, has turned positive this year for the first time since 2011). As an example of putting the “income” back into “fixed income,” Canadian short-term investment grade corporate bonds (represented by the FTSE Canada Short Term Corporate Bond Index), now currently offer a yield of 5.4%, far more compelling than the paltry yields available in recent memory.

Of course, this does not mean that the asset class has regained its “risk-free” status — especially in the near term. There is the potential for interest rates to move higher as markets continue to re-assess the path for monetary policy, while the rising possibility of an economic downturn would negatively impact credit, particularly for those bond issuers at the lower end of the quality spectrum.

The risk/reward profile for the asset class as a whole, however, is undeniably better now than it has been over much of the last decade, providing a fairly compelling opportunity for active investors with longer investment horizons to explore adding positions in fixed income assets (particularly those higher quality bonds and those with less sensitivity to changes in rates) that have been neglected from their portfolios in recent years.

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