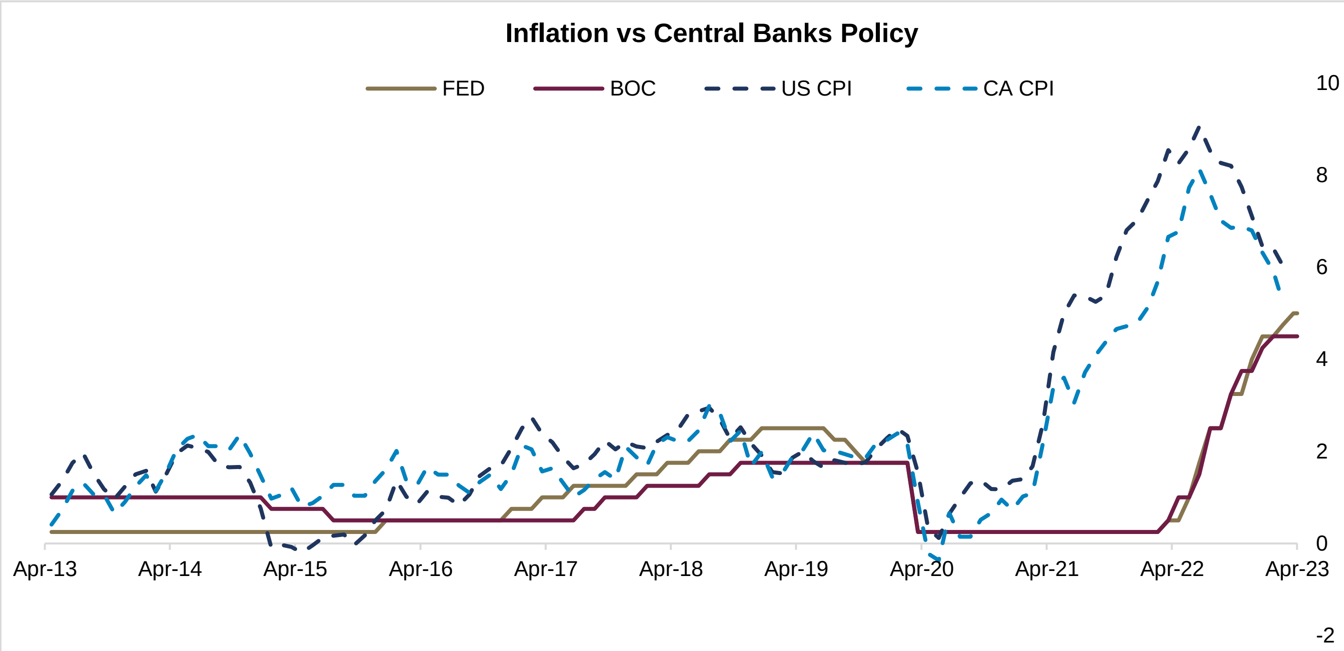
GUARDIAN CANADIAN BOND FUND Q1 2023 REVIEW AND OUTLOOK

Market Review

First quarter of 2023 witnessed a strong rebound for bonds as markets priced in a dovish central bank for the remainder of the year. The Bank of Canada (BoC) raised its key policy rate by 25bps in its first meeting of the year. The central bank opted for a pause there after as it evaluates the impact of its most aggressive hiking cycle on the Canadian economy. In the US, the Federal Reserve (Fed) raised its target range for the Fed Funds rate by 50 basis points cumulatively (25bps hike each in January and March meeting) to 5.00% (upper bound). While inflation remains high compared to central banks' target range of 2%, we are seeing signs of central banks reaching an inflection point when it comes to their future rate trajectory.

Chart: Reaching an inflection point



Source: Guardian Capital LP based on data from Bloomberg as of March 31, 2023..
FED: Federal Reserve Policy Rate (%), BOC: Bank of Canada Policy Rate (%), US CPI: US Consumer Price Index (%), CA CPI: Canada Consumer Price Index (%).

As the market priced in future rate cuts yields dropped, benefitting longer duration bonds the most during the first quarter. The difference between the long-term and short-term yields, as noted by 30-year and 5-year spread, steepened by the end of first quarter. We have witnessed significant flattening and inversion in most of the yield curve relationships in 2022, as central banks opted for one of the most aggressive hiking cycles in decades. While still too early to conclude, we might witness a move towards mean reversal in some of these relationships.

Credit spreads tightened significantly in the first quarter amid an overall risk-on sentiment. However, by the end of the first quarter spreads widened and ended the quarter unchanged as a banking crisis unfolded in the US and Europe. Canadian investment grade spreads are still wide relative to history suggesting that there already is a reasonable amount of risk premium priced in, even more so now with the widening seen during the US/EU liquidity crisis in March.

Over the quarter, in Canada, long-term Provincial, Federal and corporate bonds outperformed their mid- and short-term counterparts. Overall, long-term Federal bonds outperformed the rest of the index. The Canadian yield curve (30-year versus 5-year) remained volatile during the first quarter of 2023. By the of February, the curve inverted as persistent economic data weighed heavily on the yield curve. However, the banking crisis in the US prompted market to quickly readjust its expectations resulting in a steeper yield curve along with repricing of future central bank policies.

The Canadian dollar (CAD) slightly appreciated relative to the US dollar (USD) over the first quarter. Relative to the US dollar, the cross (exchange rate) began the quarter at 1.355 CAD per USD and ended the quarter at 1.351 CAD per USD.

TREASURY YIELDS

10-YEAR YIELDS	END OF Q1 2023	QTD CHANGE (BPS)	YTD CHANGE (BPS)	1 YEAR CHANGE (BPS)
Canada	2.90%	-40	-40	49
US	3.47%	-41	-41	113
Germany	2.29%	-28	-28	174
UK	3.49%	-18	-18	188
Japan	0.33%	-9	-9	12

Source: Guardian Capital based on data from Bloomberg as of March 31, 2023. 100 bps is equal to 1.0%.

Performance Attribution and Positioning

Shorter Canada yield curve relationships (10-year vs 2-year) continued the flattening trend in the first quarter. However, the difference between the long-term and short-term yields, as noted by 30-year and 5-year spread, steepened by the end of first quarter. The steepening in the yield curve occurred in March as the banking crisis unfolded in the US and Europe.

The Fund's portfolio has transitioned from a barbell structure to a bullet structure (concentrated on the 5-, 7- and 10-year segment of the yield curve) in the past few quarters as different curve relationships flattened. Our current yield curve positioning contributed to performance as our overweight positioning in 5- to 10-year nodes performed better, duration-adjusted, relative to shorter tenors. Mid-term yields fell the most during the quarter compared to longer-term yields, which benefitted portfolio's bullet structure. An eventuality of re-steepening Canada yield curve relationships, represents another source of unlocked relative value and we expect it to contribute to the relative performance in the future. Compared to the benchmark, the portfolio has slightly longer duration, which contributed to performance as overall rates fell during the first quarter.

Over the course of last 12 months, the Fund has added to its credit risk positioning by increasing the contribution to duration and duration times spread as credit spreads widened significantly. Within corporates, shorter-term financial spreads widened by a significantly greater extent relative to other comparable term sectors. The Fund increased its exposure to credit by moving down the capital structure of major Canadian financial institutions to take advantage of widening spread relationships within these corporate entities. The Fund's overweight positioning in the corporate sector contributed positively to portfolio performance as higher beta issues outperformed lower beta issues in the last three months.

The Fund's portfolio has an overweight exposure to Provincial bonds in market value and contribution to duration basis. Overall, positioning in selected Provincial issues contributed to relative performance as longer-term Provincial issues outperformed longer-term corporates, while underperforming longer-term federal bonds in the first quarter of 2023. Within long-term Provincials, the overweight position in Province of British Columbia and Ontario issues contributed to performance. The portfolio does not own any Province of Quebec issues, which detracted from relative performance. Over the quarter, the Fudn sold some of its high beta corporate bonds and moved to a combination of Canada Housing Trust issues and a lower beta corporate issue. Later in the quarter, the Fund sold the lower beta corporate to purchase back the higher beta issue, due to this spread relationship widening.

The Fund is higher quality, liquid, and provides a higher yield carry relative to the benchmark. The Manager continues to actively seek attractive opportunities to enhance portfolio structure and relative total returns.

Outlook

Central banks across the globe, particularly in North America, have been aggressive with their interest rate policies, driving interest rates higher. This resulted in yield curve inversions in shorter tenors not seen in decades. With global monetary policy tightening throughout the last calendar year, the material adjustment to higher yields, wider credit spreads, and extremes in many yield curve relationships provide relative value opportunities going forward.

As rates rose aggressively in the past twelve months, inflation remained persistent. We are starting to see the impact of one of the most aggressive hiking cycles in decades on the latest inflation data. While pricing pressures are broadly easing, core prices remain stick and it remains critical to determine how much of this is driven via demand vs supply. We expect BoC to remain on hold through the end of the year as its focus shifts to a potential for economic contraction in the second half of the year.

This macroeconomic backdrop of continued decline in inflation and growth slowdown supports curve steepener, which is best expressed in our portfolio as a bullet structure (higher concentration in the middle end of the yield curve relative short- and long-end). We also believe a modest overweight duration exposure may benefit the portfolio from the lagged effects of monetary tightening. We are currently maintaining an overweight position in the credit risk as credit spreads remain near historical highs. However, we are cognizant of the downside risk in the credit market and actively monitoring current macroeconomic and business cycle.

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