GUARDIAN CAPITAL

# GUARDIAN CANADIAN BOND FUND Q1 2024 REVIEW AND OUTLOOK

APRIL 2024

## Market Review

Bond markets corrected during Q1 2024, following one of the best absolute performance quarters since the mid 1980's, in Q4 2023. The continued resiliency of most economic data into the New Year, particularly firmer than anticipated readings of underlying inflationary pressures, and recognition that central banks may not be as aggressive as expected in moving toward a more "neutral" policy setting, were material contributors to driving yields higher during the quarter.

The net result was a broad move higher in market interest rates across the curve that weighed on fixed income performance over the three months ended March. The domestic benchmark, FTSE Canada Universe Index, declined 1.2% in Q1, while the more rate-sensitive segments of the market, such as longer duration (FTSE Canada Long Term Overall Index -3.6%) and government bonds (FTSE Canada All Government Bond Index -1.7%), underperformed other areas, such as shorter term (FTSE Canada Short Term Overall Index +0.3%) and corporate (FTSE Canada All Corporate Bond Index +0.1%) bonds.

Note, however, these moves only amounted to a partial retracement of the outsized ones recorded late last year as, rather than a complete rethink in the direction of policy such as the one that triggered the selloff last summer (from looming cuts to "higher for longer"), the shift in Q1 largely just reflected a delay in the timing. Indeed, central banks globally have signaled that no further rate hikes are expected and that their focus has shifted to the appropriate timing of cuts — so it remains the case that the path of least resistance for rates is lower, just not as quickly as previously assumed.

The Canadian dollar (CAD) depreciated relative to the US dollar (USD) during the quarter. Relative to the US dollar, the cross (exchange rate) began the quarter at 1.319 CAD per USD and ended the quarter at 1.353 per USD.

**TREASURY YIELDS**

| 10-YEAR YIELDS | END OF Q1 2024 | QTD CHANGE (BPS) | 1 YEAR CHANGE (BPS) |
|---|---|---|---|
| Canada | 3.47% | 36 | 57 |
| US | 4.20% | 32 | 73 |
| Germany | 2.30% | 27 | 1 |
| UK | 3.93% | 40 | 44 |
| Japan | 0.72% | 11 | 39 |

*Source: Guardian Capital, Bloomberg. As of March 31, 2024. 100 bps is equal to 1.0%.*

## Performance Attribution and Positioning

The Fund's portfolio outperformed its benchmark (the FTSE Canada Universe Bond Index) in the first quarter of 2024, driven by sector allocation and security selection effects.

In order to acquire the duration of the portfolio, relative to the benchmark, the portfolio has significant overweight exposure in the 7- and 10-year nodes compared to an underweight in long bonds. Relative value metrics dictate long-term curve exposure is expensive relative to mid-term tenors. In an eventuality where the difference between long-term bond yields relative to mid-term bond yields steepens, the middle of the curve is expected to outperform adjusted for duration. At the end of the first quarter, the portfolio holdings of the Fund had an average yield to maturity that was in-line with the benchmark's at 4.2%.

The Fund's portfolio continues to overweight corporate bond issues generally, and those in the Financials sector, which positively contributed to relative returns. Strong credit selection in mid-term bank and insurance bonds also added value. The Fund exited bond positions in TransCanada Pipelines and Province of Saskatchewan in favour of TD Bank, Desjardins, Province of Ontario, and Royal Bank bonds.

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

## Outlook

Looking forward, the adjustment of expectations over the last three months brings the market more closely aligned with the views of central banks (and our own), which leads to a better balance of risks than prevailed three months ago. While the base case is that low-but-positive growth combined with continued progress on inflation will leave policymakers positioned to begin gradually moving away from their restrictive policy stances around the middle of the year in a boon for bond market investors, there is the potential that continued underlying economic verve could give a cause for a more extended pause that would limit near-term downside for rates and weigh on performance.

Taken together, this backdrop would suggest that rates may remain rangebound over the coming months, while also being subject to continued volatility as markets react to the incoming dataflow and weigh its implications for the policy outlook.

Any moves higher in yields from their current levels, however, may represent opportunities to selectively add duration as rates are ultimately expected to drift lower with the easing cycle — the Manager views the belly of the curve (5- to 10-year maturity band) as providing a compelling risk/reward profile, with absolute yields providing the best income on offer in decades and an ample cushion against near-term volatility, while also offering among the best potential for capital gains.

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