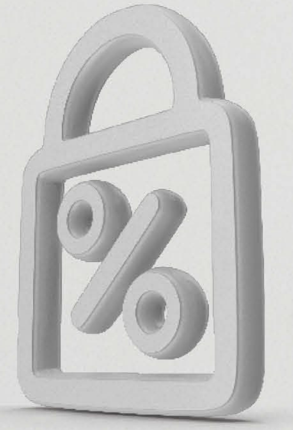
GUARDIAN CAPITAL | GuardBonds

Is it time to lock in rates?



With the Bank of Canada (BoC) finally relenting on nearly three years of interest rate hikes, which led to generationally high interest rates, is it time for fixed income investors to consider "locking-in" these high rates before they potentially decline?

The 0.25% rate cut delivered by the BoC on June 5, 2024, marked a shift in monetary policy from the previous historical tightening cycle. Further easing could spell the end of the inverted yield curve (i.e. short-term rates higher than long-term rates), which would reduce the relative value of cash and cash alternatives, which for the last two years have generated very high yields compared to the rest of the fixed income yield curve. With the potential for further declining interest rates, cash and cash alternative investment vehicles could return to their traditional roles as a "safe haven" rather than a source of attractive income.
The "big six" Canadian banks were the primary beneficiaries of approximately C$350B of pandemic-era savings, most of which found their way into GICs, earning around 5% interest[1]. High Interest Savings Account (HISA) ETFs also benefited from combined net flows of over $18B in 2022 and 2023, with yields peaking above 5%[2]. Lenders may find it challenging to continue paying attractive rates if the BoC continues to cut rates, as it may lower their profit margins. The big banks already took bold cost-cutting steps last year to preserve profits even as loan loss provisions rose[3], so their appetite to continue subsidizing HISA ETFs may dissipate. Data provided by the BoC[4].

For HISA ETFs, the rate cut cycle represents a second headwind to yields – recall that as of January 31, 2024, new liquidity requirements from the Office of the Superintendent of Financial Institutions (OSFI) took effect, which reclassified deposits from HISA ETFs as unsecured wholesale funding with 100% run-off on bank balance sheets[5]. This OSFI ruling, along with the BoC rate cut, means lower rates earned on deposits from HISA ETFs.

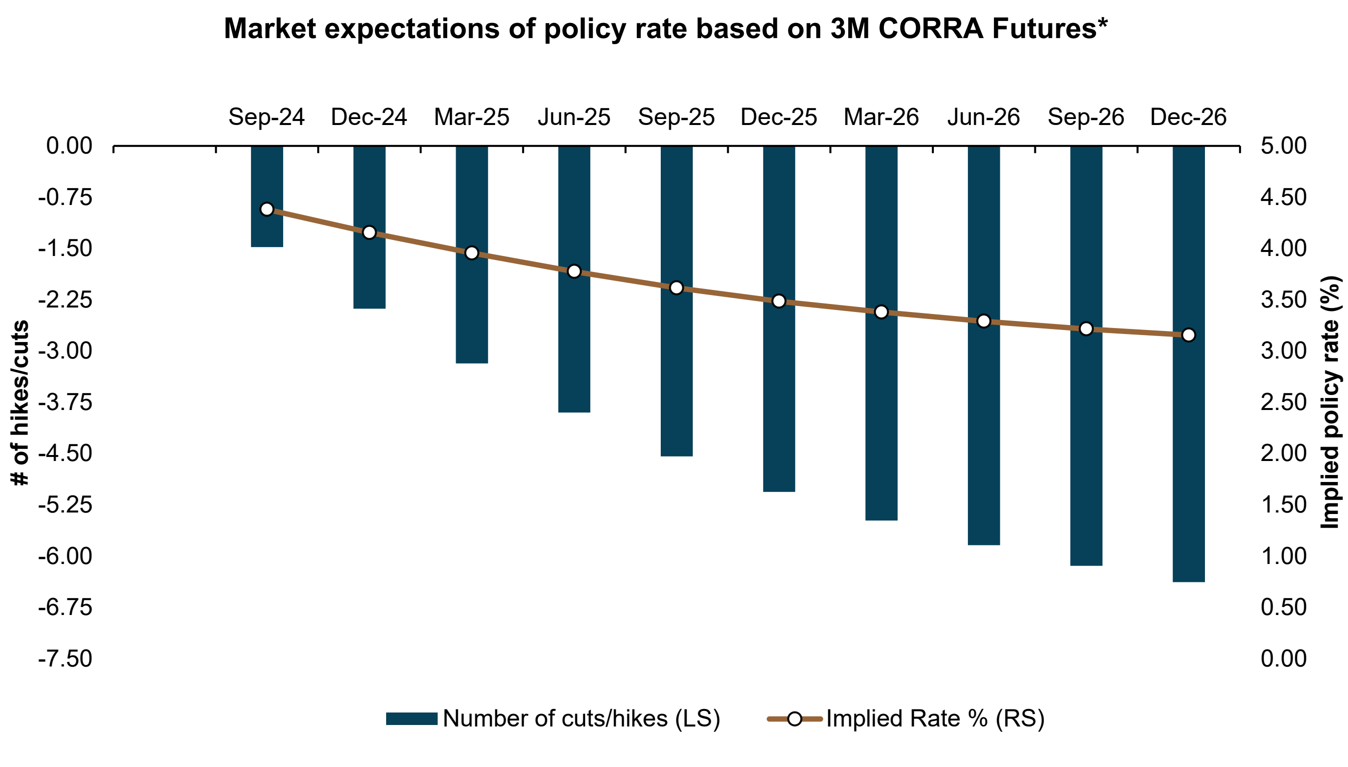
[1] Reuters, *Battle for Canadian bank deposits seen heating up as rate cuts loom*, Rates & Bonds, published March 21, 2024. https://www.reuters.com/markets/rates-bonds/battle-canadian-bank-deposits-seen-heating-up-rate-cuts-loom-2024-03-21/
[2] National Bank of Canada, *Canadian ETF Flows*, Financial Markets, ETF Research & Strategy, published May 2, 2024 https://cetfa.ca/wp-content/uploads/2024/05/April-Canadian-Flows.pdf
[3] CBC News, Big banks announce layoffs and more bad loans as TD, Royal and CIBC post quarterly results, Business, November 20, 2023. https://www.cbc.ca/news/business/bank-earnings-1.7044654
[4] Bank of Canada, *Interest rates posted for selected products by the major chartered banks, Statistics, published June 12, 2024.* https://www.bankofcanada.ca/rates/banking-and-financial-statistics/posted-interest-rates-offered-by-chartered-banks/#download
[5] Investment Executive, H*ISA ETFs adjust to new era as OSFI liquidity rules take effect*, New, published January 14, 2024. https://www.investmentexecutive.com/news/products/hisa-etfs-adjust-to-new-era-as-osfi-liquidity-rules-take-effect/

Summary of rate cut effects among cash products

Name	Ticker	Pre-BoC Rate Cut Gross Yield (as of May 31, 2024)	Post-BoC Rate Cut Gross Yield (as of June 14, 2024)	Change
Global X High Interest Savings ETF	Cash	4.98%	4.67%	-0.31%
CI High Interest Savings ETF	CSAV	4.95%	4.73%	-0.22%
Evolve High Interest Savings Account Fund	HISA	5.18%	4.73%	-0.45%
Canadian Chartered Banks Avg. 1yr GIC	n/a	4.40%	4.00%	-0.40%

Source of ETF Yield: Publicly available records from Global X Investments Canada, CI Investments Inc., and Evolve Funds Group Inc. websites. ETFs shown are amongst the largest HISA ETFs in Canada.
Source of GIC Yield: Bank of Canada, Statistics posted June 12, 2024.

Current market expectations forecast an additional two rate cuts from the BoC before the end of 2024. That means that the current interest rates earned on GICs and HISA ETFs are likely to continue to trend lower.

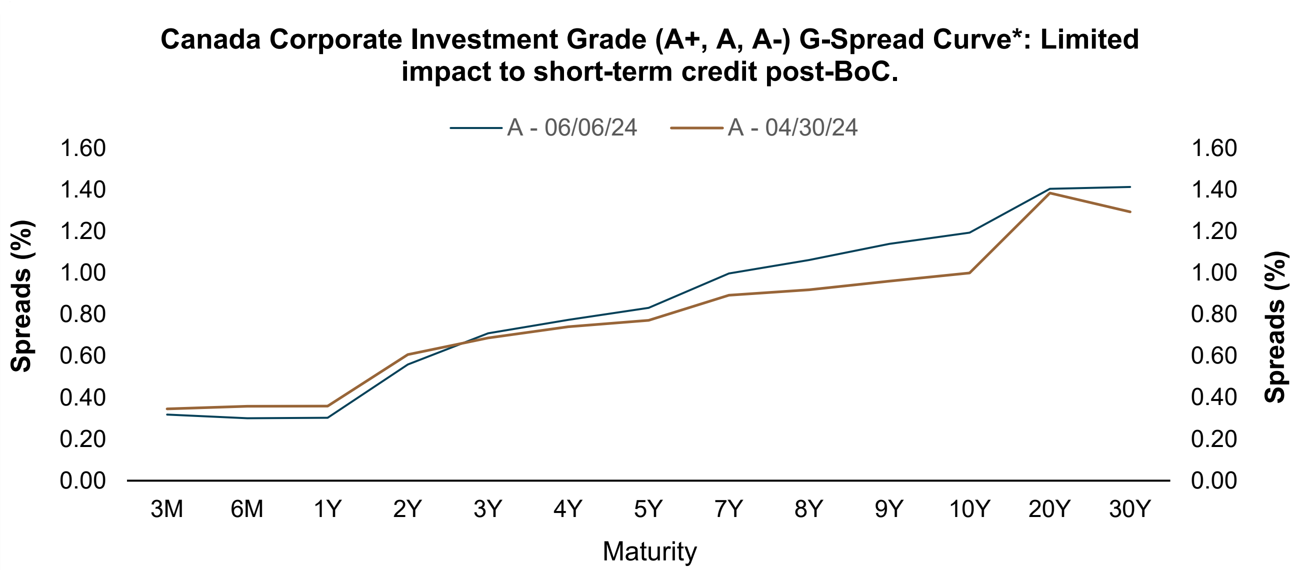


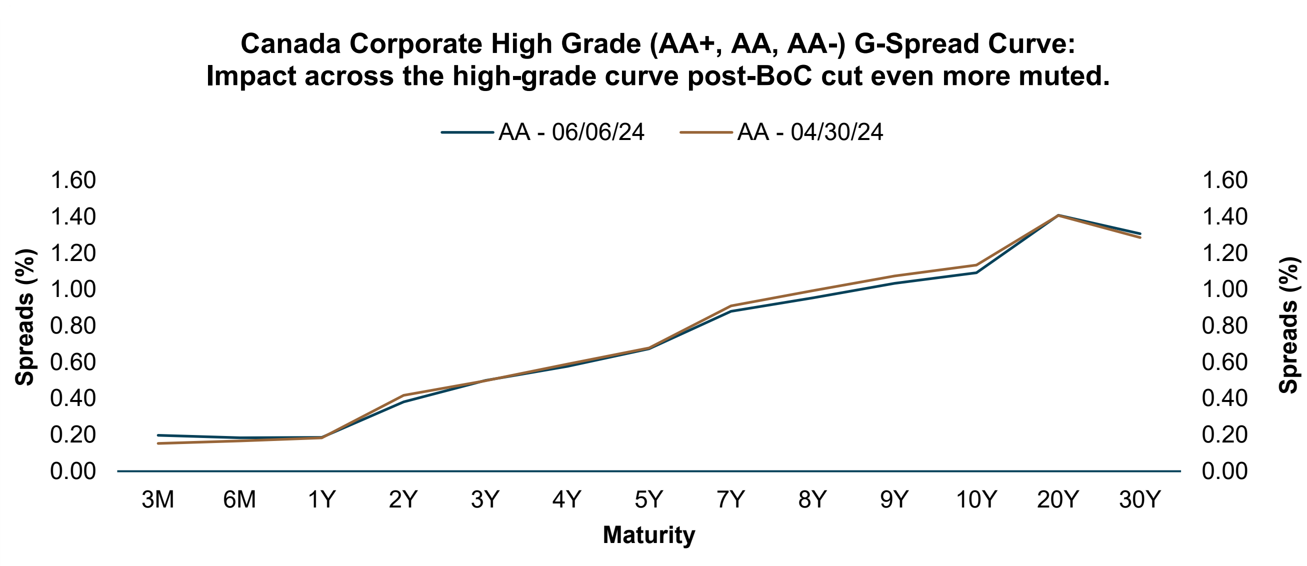
Source: Guardian Capital LP based on data from Bloomberg as of 06/12/2024
* Canadian Overnight Repo Rate Average (CORRA) measures the cost of overnight general collateral funding in CAD using Government of Canada treasury bills and bonds as collateral for repurchase transactions. CORRA futures allow investors to speculate on the future cost of overnight general collateral funding – serving as a proxy for the future expected policy rate.

So, if rates drift lower as expected, how can investors best “lock in” at today’s rates?

Guardian Capital LP offers a suite of target maturity bond funds, GuardBonds™, that are available in mutual fund and ETF units and are designed to provide income over a pre-determined time horizon by investing in a portfolio consisting primarily of investment-grade bonds with effective maturities in successive years from 2024 to 2027, and which are hand-picked by the Fixed Income team at Guardian Capital LP.

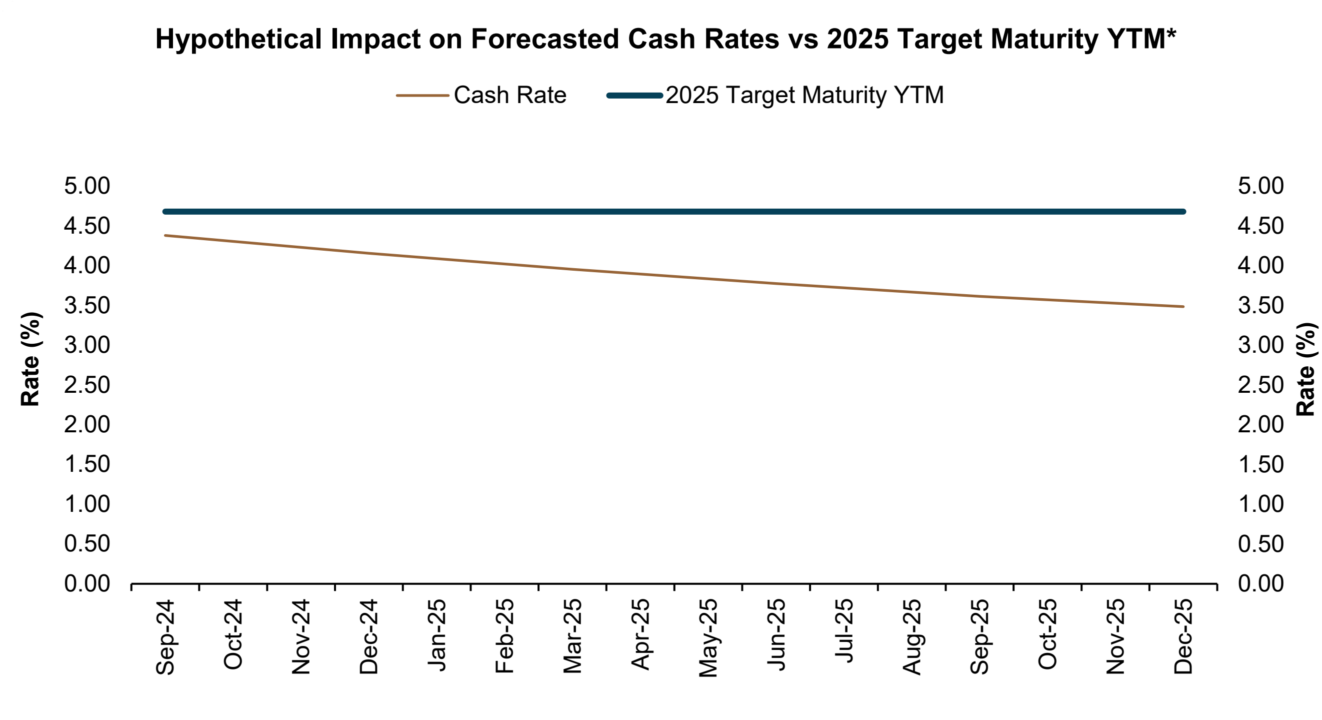
The two charts below show that the impact of interest rate cuts on A and AA-rated investment grade fixed income, generally issuances rated A or above, has been relatively muted. The spread on corporate bonds – that is the difference in yield between an A or AA rated bond and an equivalent government bond – has not declined much at all. On A rated bonds it has declined less than 20 bps after the recent BoC cut and is virtually unchanged in the AA segment.





*G-Spread is the difference between the yield on government bonds and the yield on corporate bonds of the same maturity.
Source: Guardian Capital LP based on data from Bloomberg as of 06/12/2024.

The GuardBonds™ strategies aim to achieve a potentially better risk-reward profile where investors "lock in" a higher yield by investing today in target maturity funds that hold corporate bonds to their maturity date. "Locked-in" in the sense that it is possible to achieve the current level of yield by purchasing one of these target maturity GuardBonds™ now and hold to maturity, even if the current yield-to-maturity of these strategies varies slightly over time.



Simulated Example – For Illustrative Purposes Only.

***Use of Simulated Model Examples - The forecast model has been prepared for illustrative purposes only, to help show the potential impact of interest rate declines and potential investment outcomes.** Simulated returns are not the returns of any particular investor, account or portfolio and there is no guarantee that these same results will be achieved by investors. The reliance on hypothetical, simulated returns come with inherent risks and limitations. There are frequently material differences between hypothetical results and the actual results achieved by a particular investment strategy. Hypothetical performance calculations cannot account for the impact of certain financial or market risks on actual holdings or trading. There are numerous other factors related to the markets in general, and the implementation of any specific investment strategy, which cannot be fully accounted for the in the preparation of hypothetical results; all of which can adversely affect actual results. Hypothetical, simulated performance is not indicative of future results, and no representation is being made that any investor will, or is likely, to achieve gains, losses or outcomes similar to those illustrated. Please consider these and other factors carefully and do not place undue reliance on modeled or forward-looking information. This illustration is not intended to represent the investment experience of any particular investor.

Key considerations and benefits of the GuardBonds™ target maturity funds:

Held to maturity, just like a bond

Greater certainty of income

Tax-efficient

Comparison	GuardBonds™	GICs	HISAs	Other Target Date Funds
Defined Maturity	✓	✓	✓	✓
Ability to Bulk Trade	✓	X	✓	✓
Monthly Income	✓	X	✓	✓
Ease of Execution	✓	✓	✓	✓
Diversification	✓	X	X	✓
Tax-Efficiency	✓	X	X	X

Speak with your Financial Advisor about how GuardBonds™ may be incorporated into your broader investment portfolio or visit guardbonds.com to learn more.

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