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Bonds in a Post-Pandemic World

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Investment Background

Canada

- Monetary policy may in fact be too easy, especially if there is continued fiscal stimulus into 2021-22 and the vaccines are safe and effective

- A significant number of unknowns holding yields at extremely low levels are dissipating
- The size of income support programs has been a positive boost to GDP
- Housing (ex downtown condos) has been a beneficiary

						Delta Jan 2021 vs. Jan 2020	
Real GDP (% Annual Change)	2010 - 2019	2019	2020E	2021F	2022F	2020F	2021F
Canada	2.2	1.9	-3.9	4.3	4.3	-5.4	2.3
United States	2.3	2.2	-3.5	5.0	3.7	-5.2	3.2
United Kingdom	1.8	1.4	-11.1	5.2	4.1	-12.3	3.6
Eurozone	1.4	1.3	-7.5	4.8	3.3	-8.6	3.5
Japan	1.4	0.3	-4.9	3.0	1.0	-5.5	1.8
China	7.9	6.0	2.0	8.3	5.9	-4.0	2.5
India	7.2	4.8	-8.0	7.0	7.2	-14.2	-0.2
World	3.7	2.9	-3.9	5.4	4.2	-7.0	2.0

Source: Scotia Economics as of Jan. 12, 2021

Investment Background

United States

- Democratic sweep in the US changes the background to a dramatic monetary to fiscal handoff
- Does the rollout of vaccines make “September” the new “January”?

- Current recovery is “k-shaped”. There is definitely some weakness late in 2020, and early 2021 but financial markets are looking through the data as they would with a natural disaster
- Unemployment claims have rolled from the highest levels but remain elevated
- Surprise could be “higher than expected inflation” and “lower than expected growth” over the long-term as a cost of further debt expansion, especially since the Democrats have now gained control

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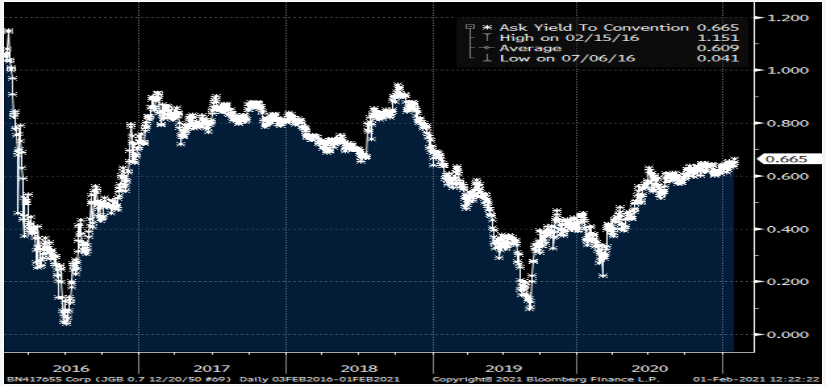
Investment Background

Global

- Long-term bond yields are beginning to rise globally, including in Japan (as shown below)

- Pace of economies re-opening and the depth of shutdown will dictate growth for 2021
- Structural impediments to growth (e.g. debt levels, demographics, low productivity) remain



Source: Bloomberg

Key Point for Bonds in a Post-Pandemic World

Was 2020 pandemic a tail-risk extension of secular bond bull market that would have ended in 2019?

Vaccines and fiscal hand-off could push yields significantly higher in US and Canada...

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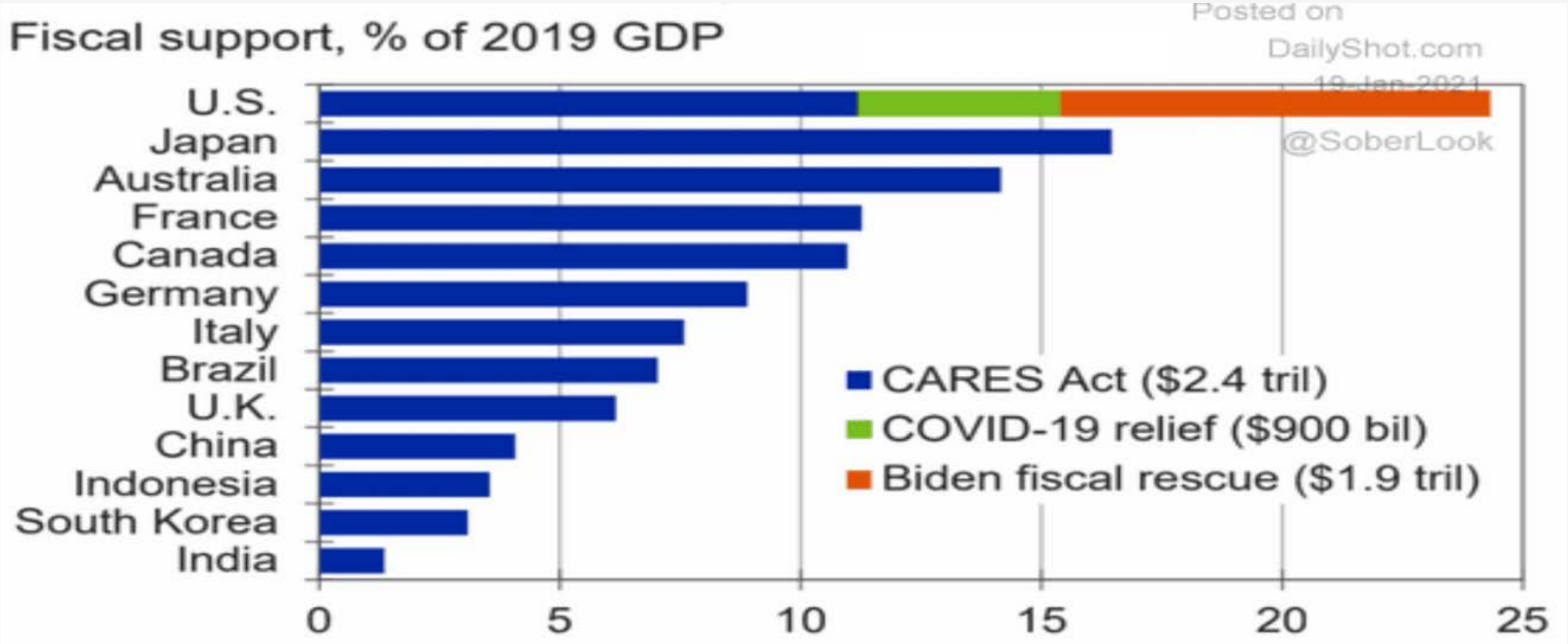
Biden Pumps Up Fiscal Policy

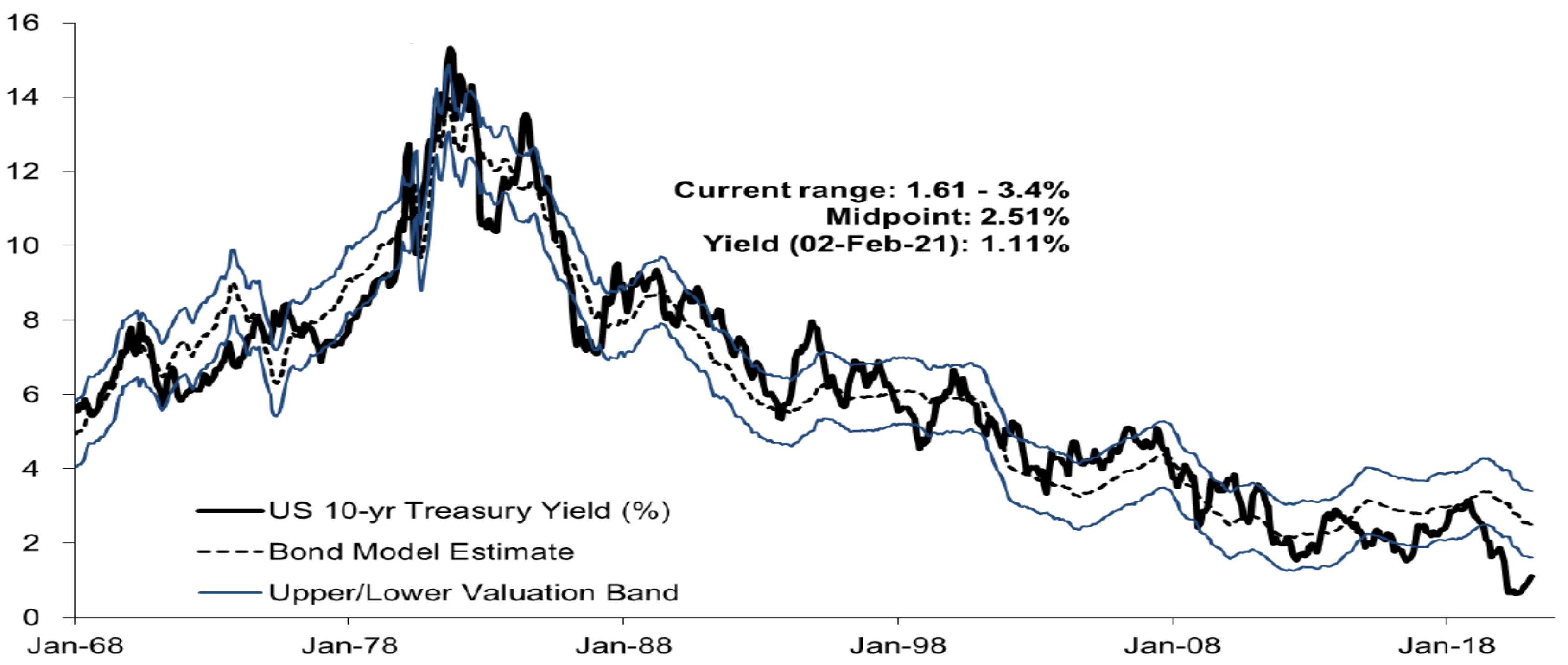


Source: Moody's Analytics

Is the Secular Decline in Yields Over?

Source: PC Bond

Bond Model Estimate



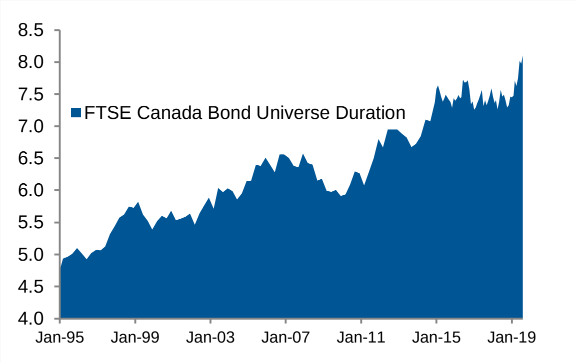
Source: 1832 Asset Mgmt, FRB, BLS

Fixed Income Team Response

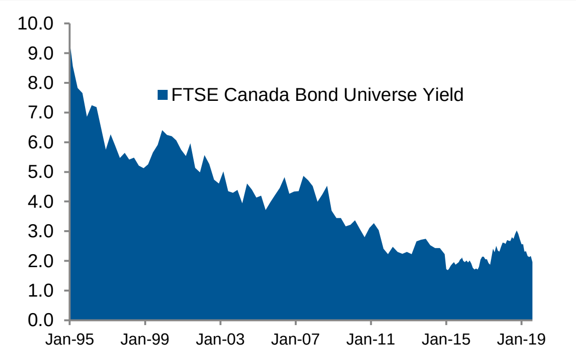
- “Go to where the data takes us”.
- Moved quickly to dynamically adjust duration during 2020.
- We are looking to reduce duration on bond price rallies.
- We are beginning to take yield curve steepeners off.
- As the year develops we will look at investing in inflation protection, floating rate notes, more barbell-like structures.
- Set up to take advantage of credit dislocations. Our experienced credit research team is a significant advantage.

How Dynamic is Different
Traditional bond indices are poorly constructed

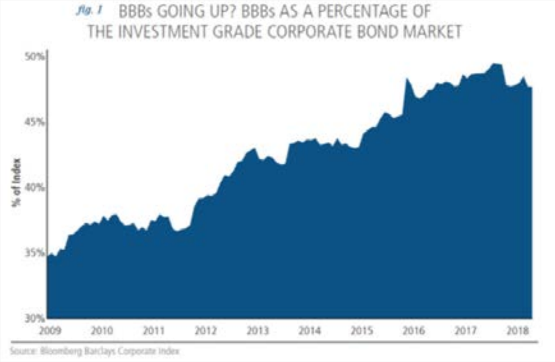
DURATION AT HIGHS



YIELDS AT LOWS



COMPOSITION CHANGING

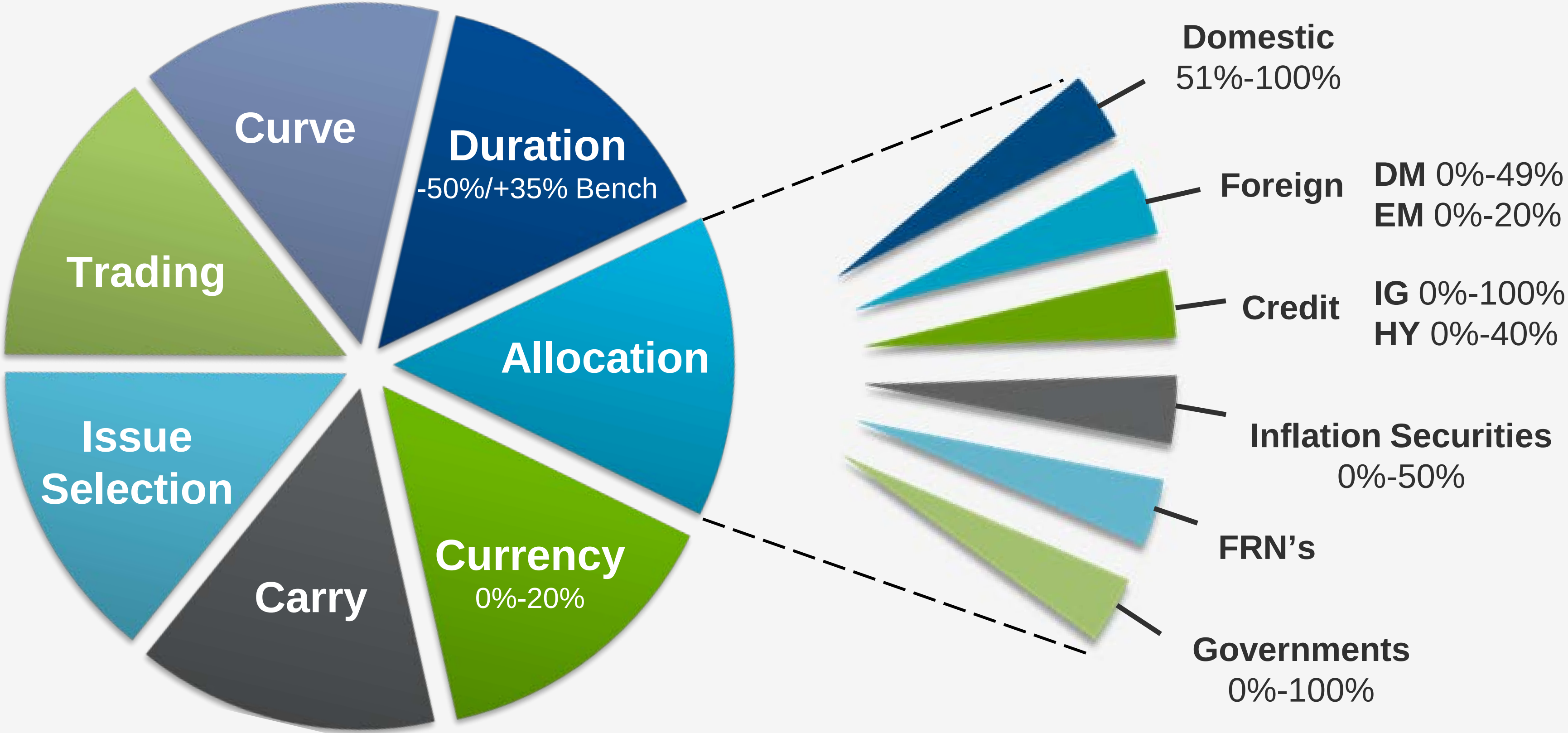


Source: PC Bond, Bloomberg

- Integrated team with access to **global resources**
- **True active management** that aims to enhance risk/return
- **Strategic conviction** with dynamic positioning
- **Broad set of instruments** to protect downside and enhance return

Proactive versus reactive risk management

Process Levers



Macro Summary

- COVID-19 outbreak gave the central banks and governments the greenlight for massive monetary and fiscal stimulus.
- There is risk that long term rates back up into 2021 with the introduction of COVID-19 vaccines, the monetary-to-fiscal hand-off and the potential for inflation pressures.

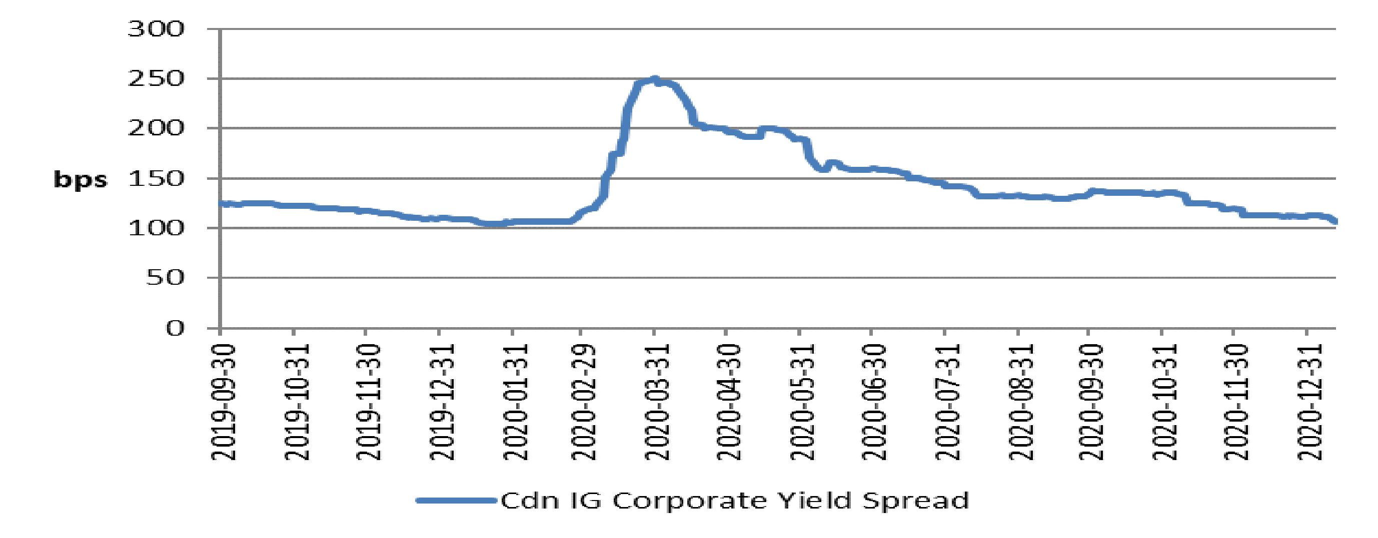
- We warned for a year that interest rate lows for the cycle had not been seen if we have a recession but are now concerned that 2020 was an “pandemic” extension of the secular bond bull market.
- 2021 could lead to a “cat and mouse” situation where the bond market attempts to take yields up but ultimately the degree of the move could be muted by central banks.
- New era of “Bigger Government” may be back.
- Risks of “Japanification” of North America remains (large debt levels, huge central bank balance sheets, low secular growth “stagnation”) including negative rates and buying of equity ETFs.

Credit Market Outlook

A Smoother Ride from Here?

Credit Market Outlook
2020’s wild, strange ride

Sharp deterioration in credit and macro fundamentals offset by bigger-than-ever “Fed Put” led to an “inverted V-shaped” roller coaster ride in risk premiums

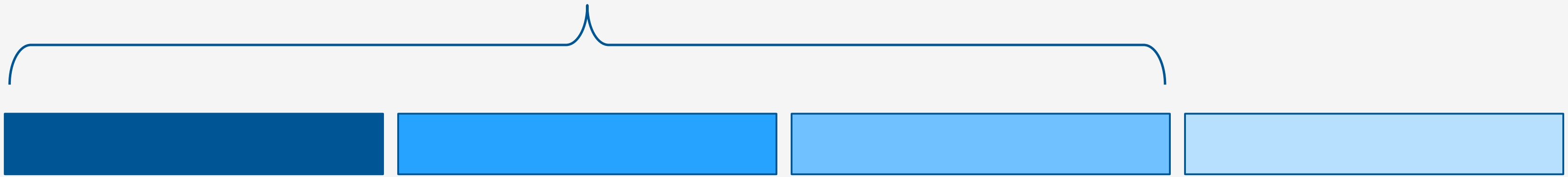


Source: ICE/BofAML, Bloomberg

Credit Market Outlook
When should you own credit?

In 3 out of 4 generalized market environments, credit will generate excess returns

Credit Outperforms



Credit spreads narrow materially

Credit spreads narrow modestly

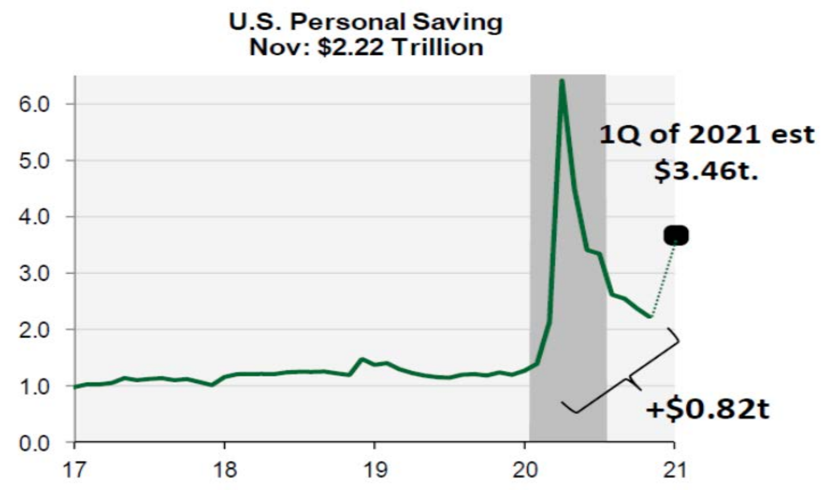
Credit spreads widen modestly

Credit spreads widen materially

Credit Market Outlook
Improving fundamentals

While credit and macro fundamentals are still weaker than pre-pandemic levels, their improvement looks set to continue

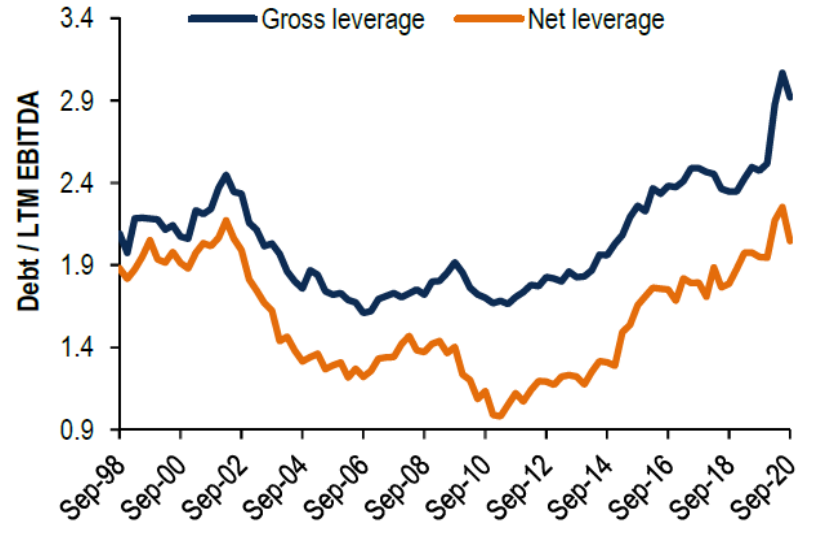
Macro Fundamentals: Vaccine-enabled reopening & stimulus-driven excess savings will drive a pent up demand fueled economic rebound in H2, 2021

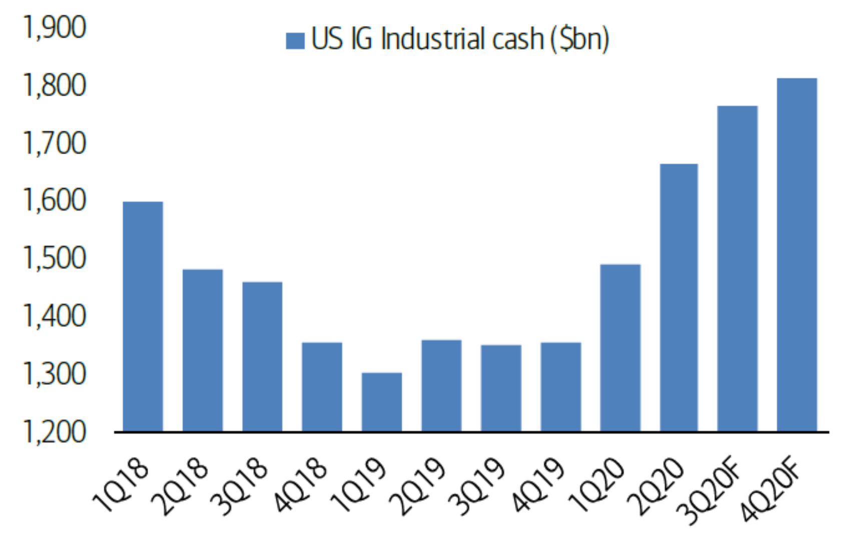


Source: CSM, Haver Analytics, 1832 Asset Mgmt

Credit Market Outlook
Improving fundamentals

Credit Fundamentals: Management teams are focused on balance sheet repair, liquidity is high and earnings are rising



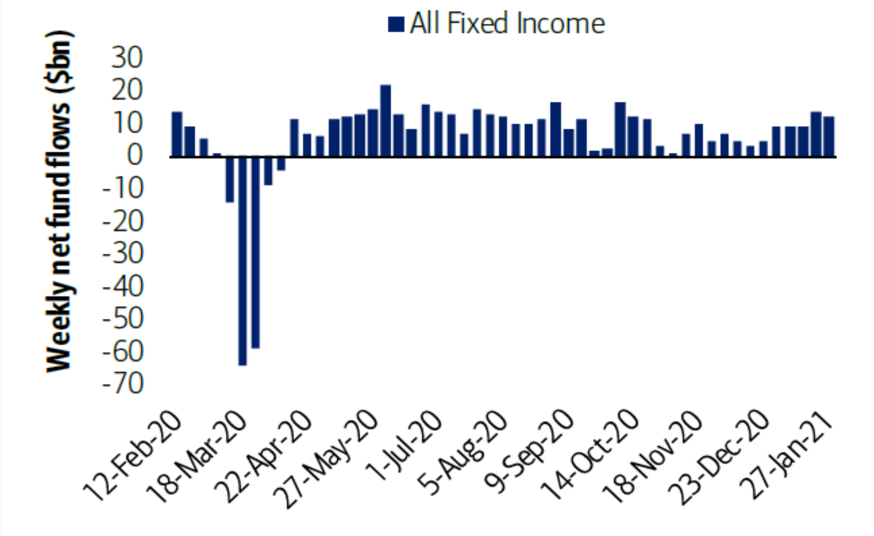


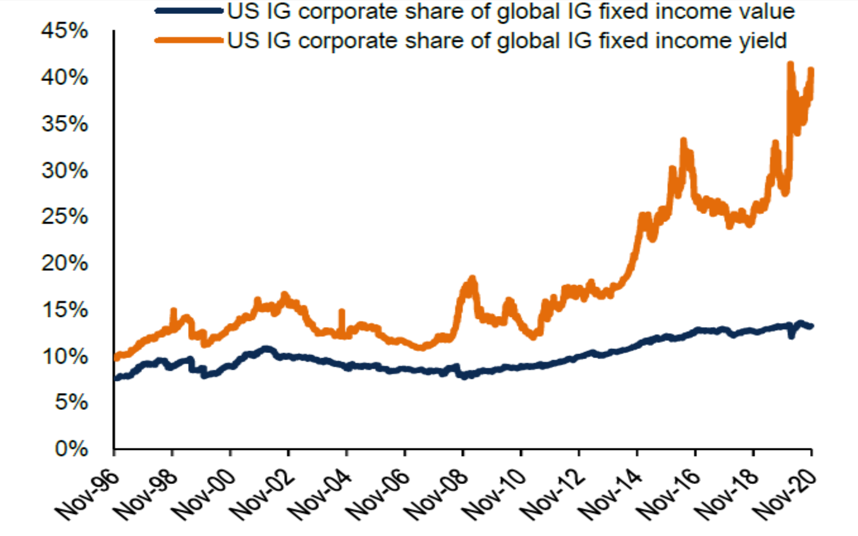
Source: BofA, Bloomberg

Credit Market Outlook
Technical tailwinds

Demand/supply imbalance providing a tailwind to credit spreads

Strong investor inflows fueled in part by limited alternatives



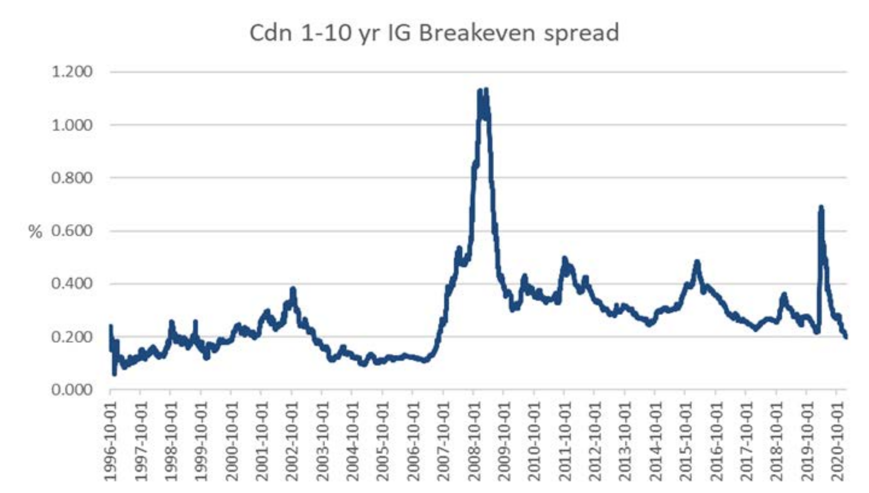


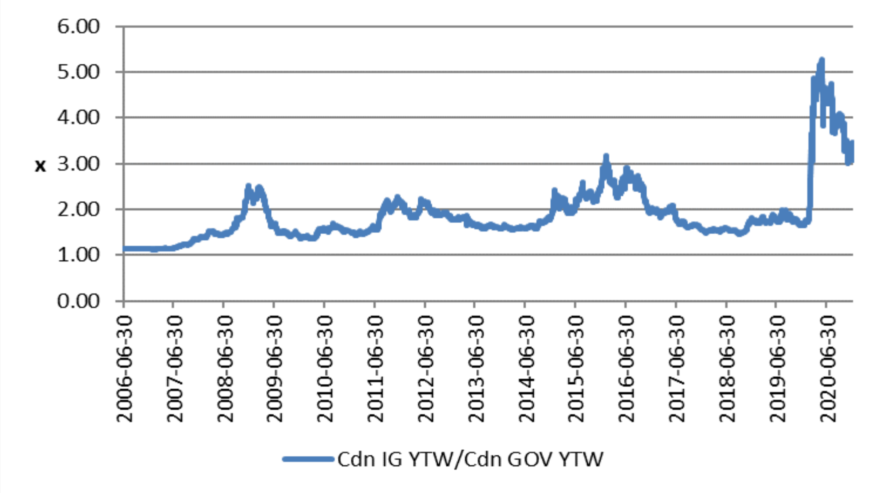
Source: EPFR Global, BofA, ICE

Credit Market Outlook
Mixed valuations

Most of the credit spread widening has been retraced, albeit with some notable industry dispersion

Breakeven spreads have declined but relative yields are still historically high

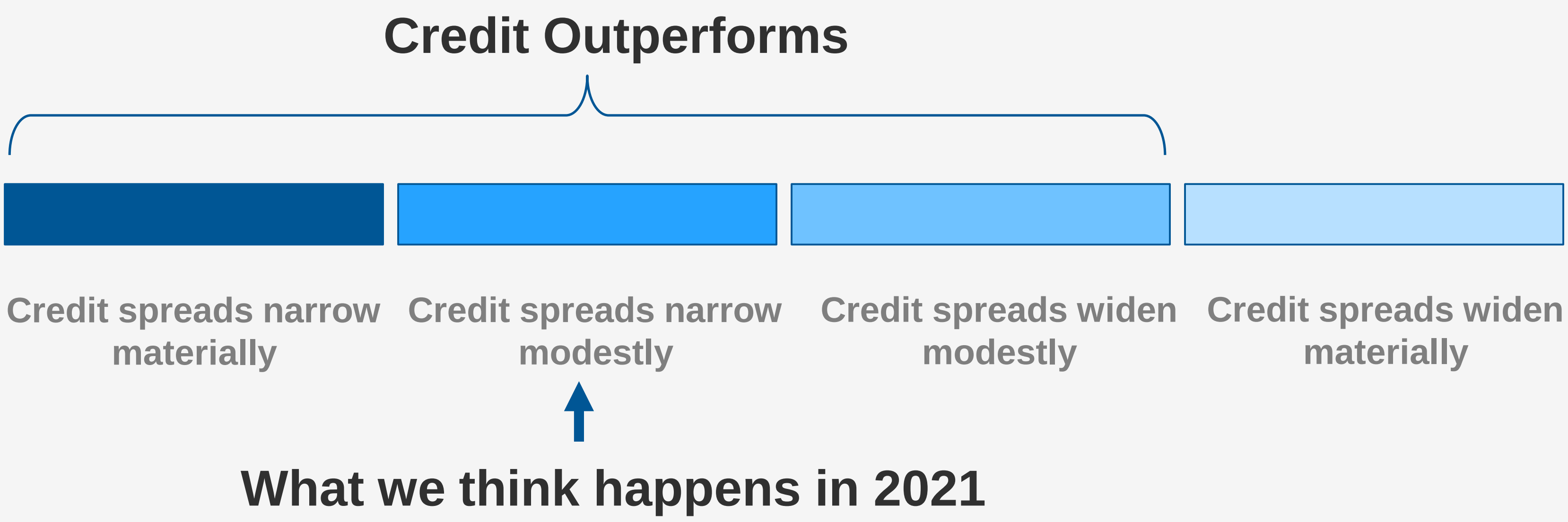




Source: ICE/BAML, Bloomberg

Credit Market Outlook
So where are we now?

If risk premiums widen less than 20 bps over the next year, credit will generate excess returns



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