

# DYNAMIC LIVE

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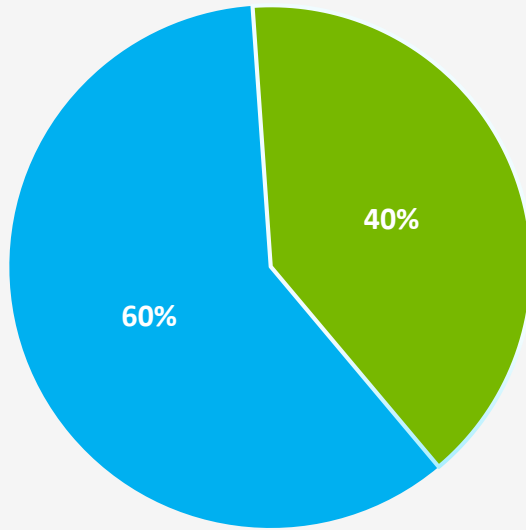
# Time to Diversify Your Fixed Income

**Marc-André Gaudreau**

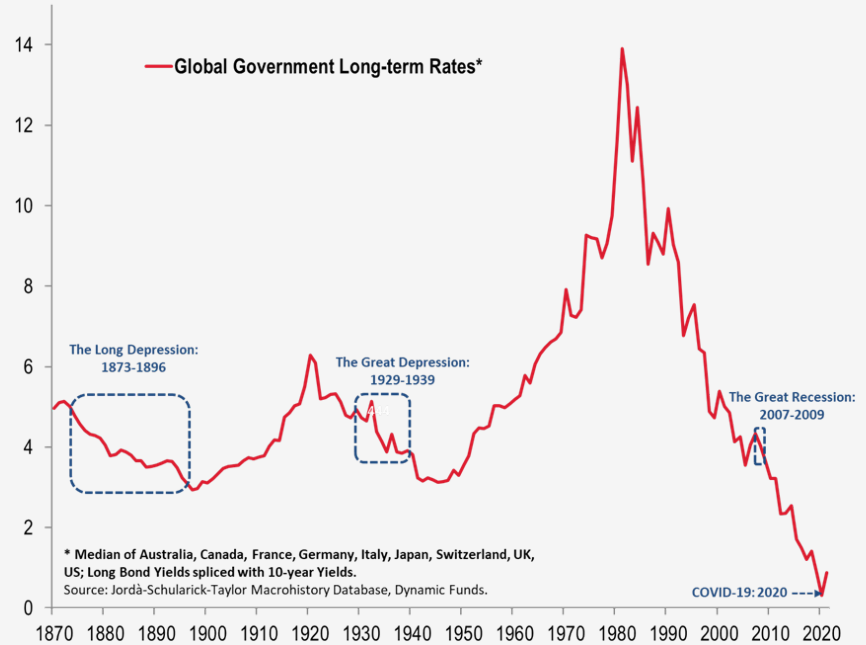
Vice-President & Senior Portfolio Manager

# Times Have Changed...

## Rethinking the role of traditional fixed income

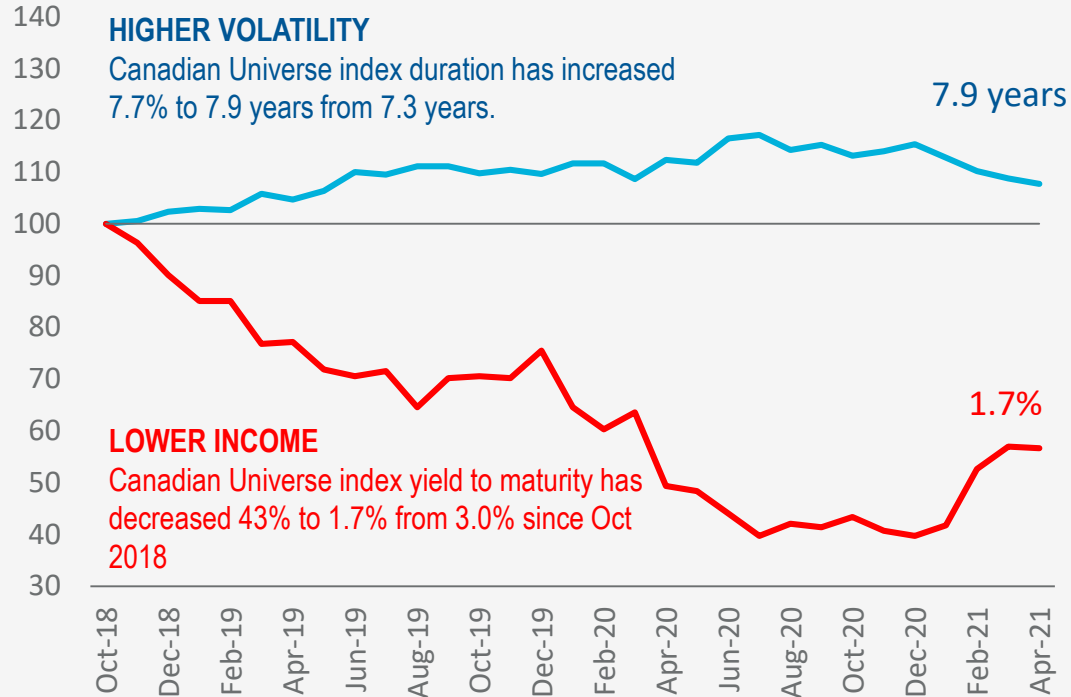


■ Equities ■ Fixed Income



# Traditional Fixed Income Investor Dilemma

## Riskier and lower-returning than it used to be



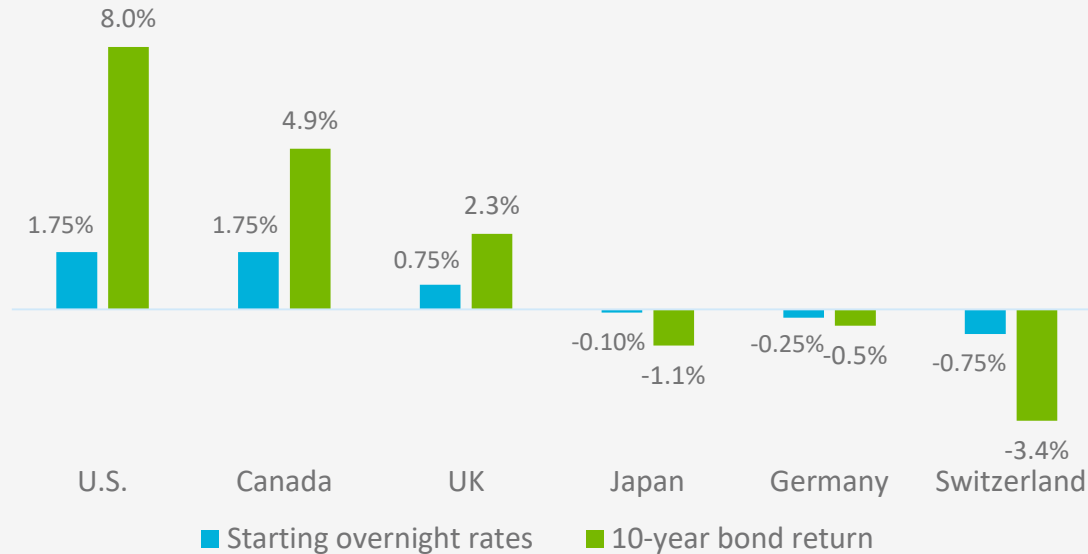
An instantaneous 1% increase in yield leads to a ~8% loss

Source: Bloomberg, FTSE Canada Universe Bond Index from Oct 2018 to Apr 2021.

# Do government bonds have anything left to give?

## Lost their ability to hedge when risky assets go down

Covid-19 crisis bond returns and starting short rates

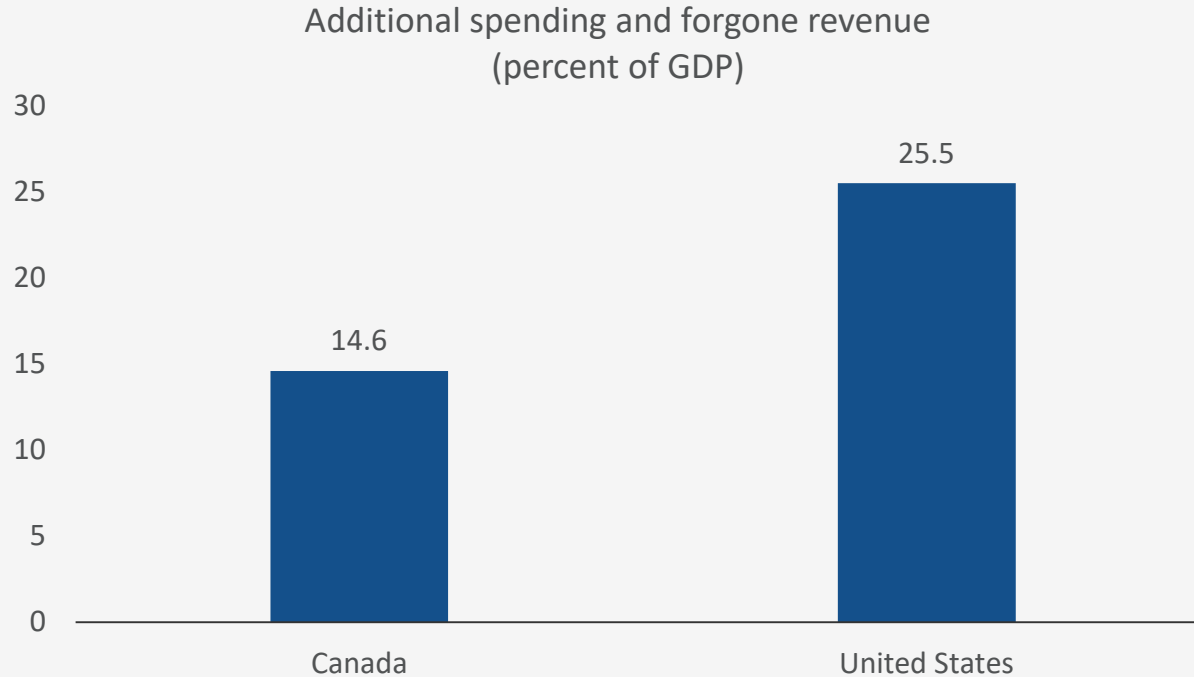


**Overnight rates in the U.S. and Canada are at 0.25% down from 1.75% before the pandemic**

Source: GMO Quarterly Letter 2Q 2020

# Magnitude of Fiscal support

## Never been this much support outside of wartime

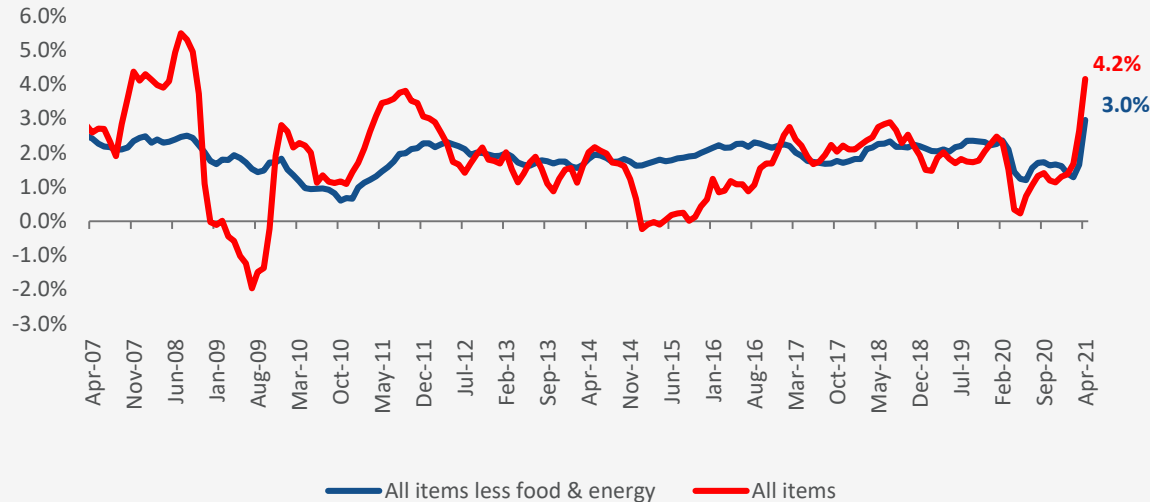


<https://www.imf.org/en/Topics/imf-and-covid19/Fiscal-Policies-Database-in-Response-to-COVID-19>

# Erosion of Purchasing Power

## Transitory or not? CPI jumped 4.2% in April

12-month percent change in CPI for all urban consumers (CPI-U), not seasonally adj. April 2020 to April 2021



Consumer prices surged in April by the most in any 12-month period since 2008

<https://www.bls.gov/news.release/pdf/cpi.pdf>

# Credit Strategies Favor

## Consider diversifying beyond traditional fixed income

- **Asset Mix:**
  - Target credit strategies that reduce interest rate sensitivity
  - Traditional fixed income will not protect capital in a taper tantrum scenario
- **Credit Selection:**
  - Upside exposure to economy re-opening
  - COVID-impacted sectors with “survive and thrive” characteristics
  - Beneficiaries from an inflationary environment
- **Risk/Reward:**
  - Earn a real return!
  - Enhance real returns without amplifying default risk



# Dynamic Funds Solutions

Enhancing asset class through active management

		DCARF DCARFII	DXO	DHYBF	DPYC
	<b>Traditional Fixed Income</b>	<b>Liquid Alternatives / OM funds</b>	<b>Crossover Bonds</b>	<b>High Yield Bonds and Loans</b>	<b>Preferred Shares</b>
<b>Interest Rate Sensitivity</b>	High	Minimal	Medium	Low	Negative
<b>Income</b>	Low	High	Medium	High	High
<b>Default Risk</b>	Minimal	Low	Low	Declining	Low
<b>Correlation to Equities</b>	Low or High?	Low	Medium	High	High

Source: Bloomberg

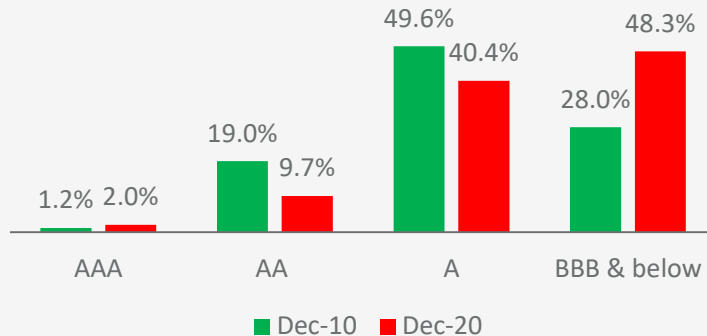
# Dynamic High Yield Bond Fund

## Asset classes have changed

### INVESTMENT GRADE

- Since 2010, the YTM from IG has **decreased 42.9% to 2.7% from 4.8%** while duration has **increased 28.9% to 9.2 years from 7.1 years**.
- Quality of the asset class has gone down since December 2010

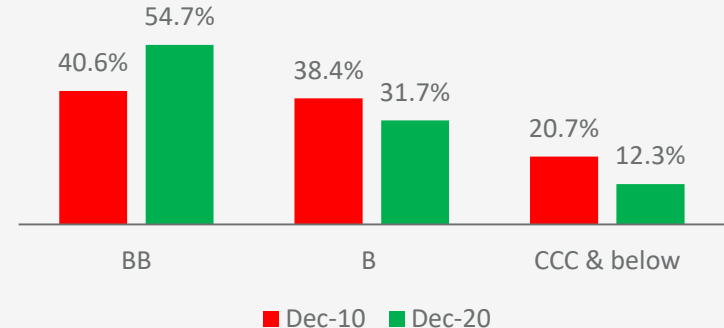
Weighting by rating



### HIGH YIELD

- Since 2010, the YTM from HY has **decreased 34.9% to 5.8% from 8.8%** while duration has **increased 15% to 2.9 years from 2.5 years**.
- Quality of the asset class has improved since December 2010

Weighting by rating



Source: Morningstar Direct, Investment Grade: iShares iBoxx \$ Investment Grade Corp Bd ETF, High Yield: iShares iBoxx \$ High Yield Corp Bd ETF

# Dynamic High Yield Bond Fund

Still pockets of opportunities

- Active management opportunities



Source: Bloomberg, US High Yield Index in US dollars from 12/31/1996 to 5/13/2021.

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# North American Preferred Shares

## Market drivers

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### 1) Subordination risk (general risk appetite)

- Accounted for by corporate credit spreads

### 2) Interest rates

- Impact on income
  - Canadian 5-year (resets), 3-month (floating) in contrast to 30-year (perpetuals)
- Relative value between risk free rates vs risky assets (including preferred shares)
  - CDN + US treasury yields

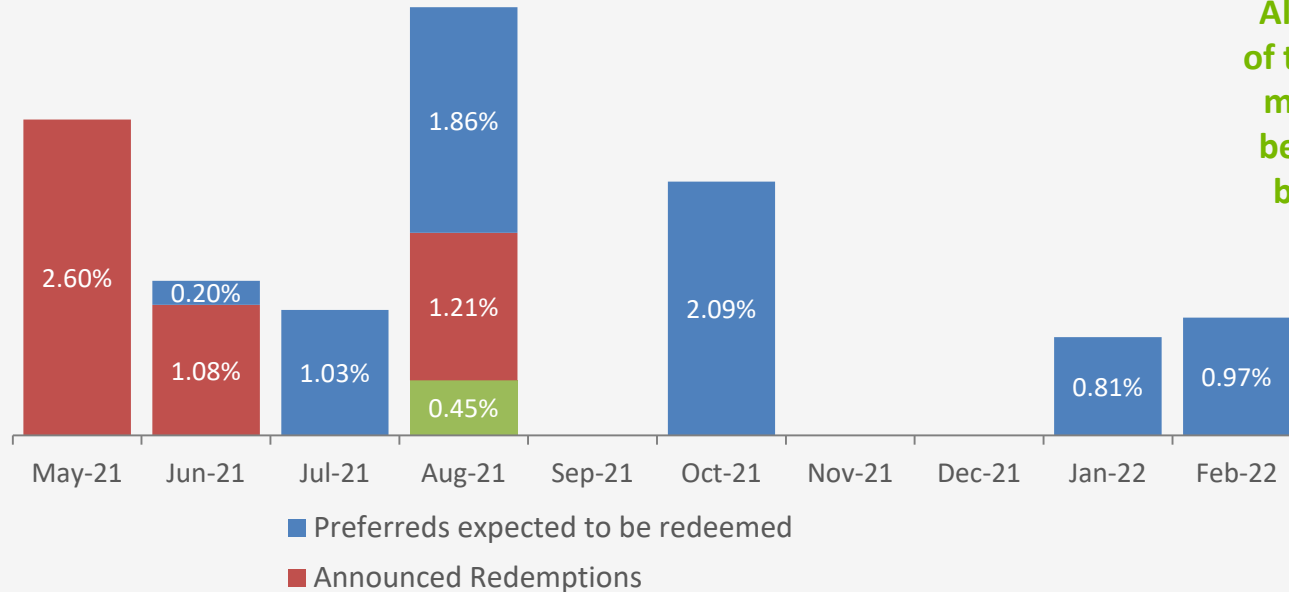
### 3) Market technicals

- Net supply (new issuance – redemptions)
- Fund flows (between passive-active, tax-loss selling/switching)

# Dynamic Preferred Yield Class

## Reduction in Net Supply is upon us

Percent of Canadian Preferred Share Market by Month



Almost 11.1%  
of the Canadian  
market could  
be Redeemed  
by February  
2022

# Conclusion

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- Traditional fixed income investor dilemma: low income and high interest rate sensitivity
- Economic re-opening could spur growth and pressure rates
- Need to think about diversifying your fixed income exposure into alternative strategies that can use leverage and/or non-investment grade credit
- Active credit strategy solutions can enhance the risk / reward potential

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