Quarterly Commentary

Multi-Strategy High Yield

The Canadian FTSE TMX Universe Bond Index lost 0.8% in the fourth quarter of 2019 but was up 6.9% for the year. The Bank of Canada has kept its benchmark interest rate steady at 1.75%. The rate remains at its highest level since December 2008. In the U.S. the Federal Reserve cut its benchmark interest rate at the end of October to a range of between 1.5% and 1.75%.

The Bank of Canada kept its key interest rate unchanged for its final rate decision of 2019 citing signs of a stabilizing global economy and the resilience of Canadian consumers. The central bank's target for the overnight rate remains at 1.75%, where it has stood since October 2018. The bank continues to hold rates steady despite a wave of cuts at other central banks around the world in the face of slowing growth and the uncertainty surrounding the U.S. / China trade war. The central bank said that Canada's inflation rate continues to remain near the bank's 2% target which is "consistent with an economy operating near capacity".

Canada's policy rate is now the highest of the countries to which it is usually compared. Canada's relatively high overnight rate mainly reflects the central bank's success in achieving its 2% inflation target. Inflation has been at 1.9% or above since March 2019 and most recently has risen to 2.2% compared with a year ago. Inflation heated up in November as gasoline prices posted their first year-over-year increase since October 2018 and the closely watched core inflation number, considered a better gauge of underlying inflation, was 2.2% compared with a revised figure of 2.1% for October. What this means is that real short term interest rates (adjusted for inflation) in these other countries are much closer to their Canadian equivalent than can be seen by only considering nominal short term rates.

In the U.S., the Federal Reserve cut short term rates three times in 2019, ending the year with a range of between 1.5% and 1.75%. Speaking to Congress' Joint Economic Committee in mid-November, Chairman Jerome Powell said that the Fed is likely to keep its benchmark short term interest rate unchanged in the coming months. "Looking ahead, my colleagues and I see a sustained expansion of economic activity, a strong labour market, and inflation near our symmetric 2% objective as most likely". By lowering borrowing costs on mortgages and other loans, the rate cuts have spurred home sales and boosted the economy. The Committee questioned Powell about negative interest rates, which President Trump also called for, and he responded that they "would certainly not be appropriate in the current environment." Negative rates occur "at times when growth is quite low, and inflation is quite low, and you really don't see that here," Despite President Trump's attacks, both Republican and Democrat lawmakers took a largely respectful approach to Powell. Several complimented him for the "Fed Listens" events the central bank has held around the country, which have sought input from a range of groups, including unions and non-profits, on ways the Fed could update its monetary policy framework.

Recent U.S. data suggests that growth remains healthy as the economy expanded 2.1% in the third quarter despite being down from 3.1% in the first three months of the year. The unemployment rate is at a historic low and hiring is strong enough to potentially push the rate even lower. A problem has been that many businesses have delayed or cut back on their spending on large equipment but a partial resolution of the trade war may help revive business investment.

Fixed income volatility increased considerably in recent months as yields rose sharply in early September and have since retreated lower. Markets appear to be struggling with clear signs of slowing global growth which may be challenging for central banks to counterbalance. Ten year U.S. Treasuries are trading at an extremely low yield, which has historically been consistent with economic distress, but the U.S. remains a sea of calm as unemployment is at an historic low. Corporate leverage has grown, but so have corporate earnings, As a result default rates are running below their historical long term average and default forecasts from bond rating firms remain low.

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www.provisus.ca

18 King Street East, Suite 303
Toronto, ON M5C 1C4

Phone: 416-933-1111
Toll Free: 1-877-768-4787