FIRST CAPITAL FINANCIAL

WORLDSOURCE FINANCIAL MANAGEMENT INC.
*Sponsoring Mutual Fund Dealer*

With equity markets dominating the headlines, mostly for going in the right direction -up, I thought I'd shift the conversation to fixed income investments for a change of pace. As you know, the onset of the global pandemic and its impact -even as an economic reopening takes place- has created challenges for fixed income investors. Bond markets have been highly volatility as spreads widened by over 600 basis basis points (100 basis points = 1 percent )and the high yield market plummeted by roughly 20%. The U.S. Federal Reserve's two-pronged approach of massive Quantitative Easing (QE) though the purchase of corporate bonds while slashing interest rates to zero helped stabilize bond markets, eventually leading to tighter spreads and a market recovery.

*"I sell bonds. Municipal bonds."*

Interest rates have been rising as of late, and the higher yields are generally bearish for bonds. However, we don't expect rates to rise significantly in the near term, given the high levels of debt currently outstanding in economies around the world. As the pandemic recovery continues amid mass vaccine rollout and economic reopening, the next move is likely further interest rate increases.

So what can bond holders expect in the face of higher interest rates, given their negative impact on bonds prices? Well, we expect a gradual rise in rates instead of a sharp one, an outcome that favours bonds with a shorter term duration. More, investment grade and non-investment grade bonds offer attractive yields and have largely replaced government bonds in our model portfolios. This positions our fixed income allocation to pick up yield and benefit from the ongoing and robust economic recovery. Coupled with floating rate loans (another debt instrument), our bond positions include a hedge against rising rates, while offering yield opportunities. Since loans are floating rate, they don't face the same headwinds that fixed rate does, and have shown historically that they can perform well in rising rate environments.

Since Covid-19 arrived, we have invested considerable time and research into how best to position our client's investment portfolios. This has resulted in a 10% to 15% increase in equity allocation, at the expense of bonds. Further, the remaining bond allocation is primarily corporate, including floating rate loans. An overweighting in bonds with shorter durations to maturity has also been a feature, with the combined effect of positioning clients for steady, predictable interest yields. So despite the headwinds of rising rates, we remain committed to a fixed-income weighting in our portfolios, where bonds serve to protect capital during periods of market volatility and market downside. As rates move higher, it gives our partners at Dimensional, EdgePoint, Guardian Capital and Mackenzie Investments an opportunity to capitalize on the higher yields through new bond issues. Bonds are boring -yes, but boring can be good. The upward trajectory of equity markets will at some point go the other way, and it will be fixed income's turn to grab newspaper headlines. For more on bond portfolio construction, click <here> to understand Mackenzie's Unconstrained Fixed Income fund.

Be safe, be well!

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