iA Investment Management

INVESTMENT FUNDS

Market and Funds Update

Fund name: Bond Fund

Portfolio Manager: Alexandre Morin, CFA, Principal Portfolio Manager, Fixed Income

March 20, 2020

As of March 19th, 2020, the Bond Fund was underperforming its benchmark. It is to be noted that the Fund's performance over the past few weeks has been very volatile due to extremely high volatility in interest rates.

At the start of 2020, we believed that the tentative global economic recovery started in late 2019 following the signature of the Phase 1 deal between China and the USA would continue, meaning that the "search for yield" investment theme would continue to benefit municipal, provincial and corporate bonds. We did not expect major central banks movements but acknowledged that risks were tilted to the downside.

The main factor contributing to the underperformance of the Fund is its overweight in credit. Our overweight in corporate bonds compared to the Fund's benchmark was about 6% (33% vs 27% for the FTSE Canada Bond Index). In addition to this, we had close to 10% short term corporate bonds (maturities of 12 months and less). We owned them waiting for better opportunities to put that money into longer corporate bonds. We were also overweight municipal bonds, mainly invested in 4 years and less non-rated Quebec municipal bonds. Provincials spreads were too tight as we ended 2019, so our positioning there was mostly underweight / neutral. The Fund's main underweight was in federal government bonds, as they offered a low yield and the curve was extremely flat.

As the COVID-19 pandemic started to expand outside of China, liquidity rapidly dried up in the corporate bond market. We were still able to sell some of our short-term corporate bonds to position the Fund for a steeper curve in the Federal segment. Our performance was still affected by spreads widening in corporate and municipal bonds, as well as our underweight in federal government securities.

We also had some small positions in international bonds that contributed to the Fund's underperformance. North American rates greatly outperformed other developed markets rates during the crisis as the Fed and BoC had more leeway to drastically cut rates compared to central banks in the European Union, UK and Australia.

Our underweight in provincials panned out well as spreads have widened significantly, and we have now moved to benchmark weight. We intend to gradually build a long position in provincials as well as in corporate bonds in the coming weeks / months.

Our fund is still underweight federal government bonds and we expect that position to contribute positively to the Fund's performance in the coming months as spread compression in credits should lead to higher returns in provincials, municipals and corporate bonds when the COVID-19 crisis ends.

The huge amount of monetary and fiscal stimulus that is being provided will eventually help the economy to recover from the COVID-19 shock, but weakness might persist for several months before we get there. Monetary accommodation will likely be kept for several quarters after the recovery, so interest rates should settle at levels below those that were prevailing before the crisis and be a lot less volatile. Curves should also stay steeper than they were at the end of 2019.

Alexandre Morin, CFA,
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