PHILLIPS, HAGER & NORTH
Investment Management®

July 2017

We have been receiving inquiries from clients given the recent move in yields and negative performance for the month of June in their fixed income portfolios. We wanted to take this opportunity to provide some context and commentary around recent market developments.

What happened?

Canadian interest rates took a sharp turn higher in the second half of June after having stayed relatively steady since the beginning of the year. This move higher was kicked off by a speech mid-June from Bank of Canada (BoC) Senior Deputy Governor Wilkins in which she alluded to a potential policy rate hike coming sooner than markets had previously anticipated. It was further spurred by comments from BoC Governor Poloz in the last week of June where he acknowledged that the economic drag from the oil shock was now largely behind us, commenting that the low policy rate had "done its job."

All said, Canadian interest rates moved higher in June by roughly 10 basis points in the longest maturities, and upwards of 40 basis points in shorter maturities. This resulted in bonds of all maturities posting negative returns for June, with longer term (i.e. higher sensitivity to changes in interest rates) portfolios underperforming shorter term portfolios. For context, the MFA Bond Fund (~3 year average term to maturity) returned -0.84% for the month while the MFA Intermediate Fund (~1 year average term to maturity, and less sensitive to changes in interest rates) returned -0.15%. It is because of this additional interest rate risk that longer maturity bonds pay a higher compensation (by way of a higher yield) than shorter maturity bonds.

Context and upside

While a move of this magnitude can be uncommon, it is not unheard of. We have experienced similar moves in recent memory: e.g. the very recent U.S. election resulting in a Trump presidency, and the 2013 "Taper Tantrum" marking the end of U.S. quantitative easing. As investors, it is important that we look beyond the initial sticker shock of a decline in prices and remind ourselves of what we are cheering for: if very low interest rates have been a heavy burden borne by fixed income investors globally over the last many years, an increase in yields will ultimately help our portfolio returns over time. We just need to look well beyond a one month move in price to appreciate this.