HAB Quarterly Commentary

March 2019

Market/Economic Update

Bond markets were strong in the opening quarter of the year. Weakening global economic growth caused markets to remove the risk of further rate hikes by monetary authorities and pushed longer term yields lower. Ten-year Canada yields ended the quarter (Q1, the first three months ending march 31, 2019) at 1.62%, down 35 basis points from the start of the year, and below the Bank of Canada's over-night target rate of 1.75%.

Sector spreads also performed well in the quarter, reversing some of the risk-off spread widening that occurred at the end of 2018. As term yields fell, investors saw greater value in higher yielding corporate and provincial bonds. This was supported by more dovish messaging coming from central banks on the future path of policy rates – which encouraged greater risk-taking and improved market liquidity.

Spreads on provincial bonds narrowed by 12 basis points on average in the quarter, while investment grade corporate spreads narrowed by 22 basis points. Lower-quality BBB-rated securities outperformed. The average yield advantage of owning a BBB-rated mid-term corporate bond narrowed by 30 basis points and finished the quarter at 187 basis points.

Portfolio performance and positioning

Our security selection within the Communication and Energy sectors contributed positively to the fund. Our underweight position in securitization was beneficial as that sector underperformed this quarter.

Security selection in the real estate dragged on the performance of the fund. Our overweight position in the real estate sector and our underweight position in the infrastructure sector detracted from performance.

To start the second quarter of the year, we are slightly below benchmark duration. We favour bonds in the Real Estate and Infrastructure sectors, at the expense – albeit slightly – of the Communication sector.

Outlook

Bond market sentiment has swung dramatically over the past several months in response to a slowing global expansion, led by weaker Chinese consumer demand and a post-tax reform letdown in the U.S. This has been exacerbated in Canada by home-grown headwinds facing Canadian households and business spending. We have lowered our expectations for growth and pushed out our expectations for further rate hikes in North America.

In our view, the timely recognition by policy makers of the weaker backdrop combined with still moderate inflation pressure has reduced the risk of a policy mistake coming from rate hikes. Other potential shocks are more worrisome, such as an escalation in trade frictions.

For now, we remain moderately short duration versus our performance benchmark as we believe markets have swung too far into the bearish camp. We also believe the lower rate environment will support a continued overweight in higher yielding quality corporate bonds.