McMURTRY INVESTMENT REPORT™
Investment Advice for Everyone

Fixed Income – How to manage in a period of rising interest rates
November 2021

TOTAL RETURNS – End of October 2021

	1M	**3M**	**YTD**	**1 Year**
CBO 1-5 year Corporate Ladder	N/A	N/A	-1.39	-0.82
CLF 1-5 year Government Ladder	-1.25	-1.71	-2.00	-1.82
XSB Short Term Gov't	-1.11	-1.42	-1.63	-1.21
XHY US High Yield	-0.44	0.02	2.74	8.02
CHB US High Yield	-0.45	0.03	2.96	8.50
TIP US Real Return	1.16	0.32	4.35	6.45
XRB CDN Real Return	-1.76	-4.20	-6.26	-4.61
XBB CDN Bond Universe	-1.08	-2.72	-5.08	-4.02
EQ Bank High Interest Savings *	0.10	0.30	1.00	1.25
HPR Preferreds	2.95	5.26	25.63	37.92

*Returns interpolated based on annual rate of 1.25%

As you can see from the above table, investment returns in the fixed income area have been all over the place.

Starting with real return bonds, the major difference in performance between Canada and the US is that the portfolio duration in Canada's real return ETF is very long term, while the US Tip is a much shorter duration one. In Canada the benefits from higher inflation have been more than offset by the longer duration.

The returns from Canadian preferreds have been very strong propelled by the expectation of higher rates. It is very important to keep in mind that preferred shares are a form of equity and are not really fixed income. Secondly preferred shares should only be held in a rising rate environment and should be sold once the economy is about to go into another recession.

Investment grade corporate bond 1-5 year ladder has outperformed the 1-5 year government ladder. This is because corporate bond spreads over Government of Canada bonds continue to shrink.

Short term government bonds have not performed nearly as well as EQ Bank's High Interest Savings Account. This is principally a result of much higher fees for the XSB.

Both the US High Yield corporate bond ETF's registered strong performances. These ETF's are Canadian dollar hedged which has helped. In addition, as mentioned above, corporate bond spreads over both Canada and US Treasury bonds continue to tighten.

Recommendation

In a period of rising interest rates and inflationary expectations, it is important to do the following:

Maintain a sufficient cash reserve

Shorten portfolio duration

Maintain exposure to US High Yield Corporates provided the ETF's are Canadian dollar hedged

Maintain Canadian Investment grade corporate bonds as long as duration is relatively short

Maintain exposure to US Real Return bonds through the US ETF TIP.

Continue to avoid Canadian Real Return bonds

Continue to invest in Canadian preferreds as long as interest rates are in a rising trend. Use an actively run ETF like HPR to properly diversify.