Market Recap – 3rd Quarter 2021

Key issues faced by the bond market

FIERA CAPITAL

Q3 2021

- **Risk assets took a pause** in the third quarter after rallying significantly in the first half of the year
- **Fear over a fourth wave caused by the Delta variant** and related potential lockdowns weighted on the global tone in the third quarter. However, infections appeared to be stabilizing, setting the stage for a boost in confidence in the later part of the quarter.
- **Inflation in North American has picked up** substantially and **continued to be high in Q3**, although Central Bankers are trying to convince investors that the **recent spike is transitory and should be contained.**
- Late in the quarter, **bond yields reversed course and moved marginally higher** and the yield curve steepened after the Federal Reserve hinted at **tapering their bond purchase program before year end** and **even opened the door for a rate hike by the end of 2022.**
- This news surprised the market late in September as the Fed had been very dovish in previous communications.
- This led investors to price more adequately a shift in Central Bankers' tone, with the market now currently expecting 1 rate hikes by the Fed in 2022 and close to 2 rate hikes by the BoC.
- All these developments **caused the 10-year Canada yield to increase 14bps to 1.52%** and for the yield curve to steepen. In this environment Mid-term Provincial and Corporate spreads were on average unchanged at 49 bps and 118 bps respectively.

Source: Bloomberg

Credit Markets Recap

As of September 30th, 2021

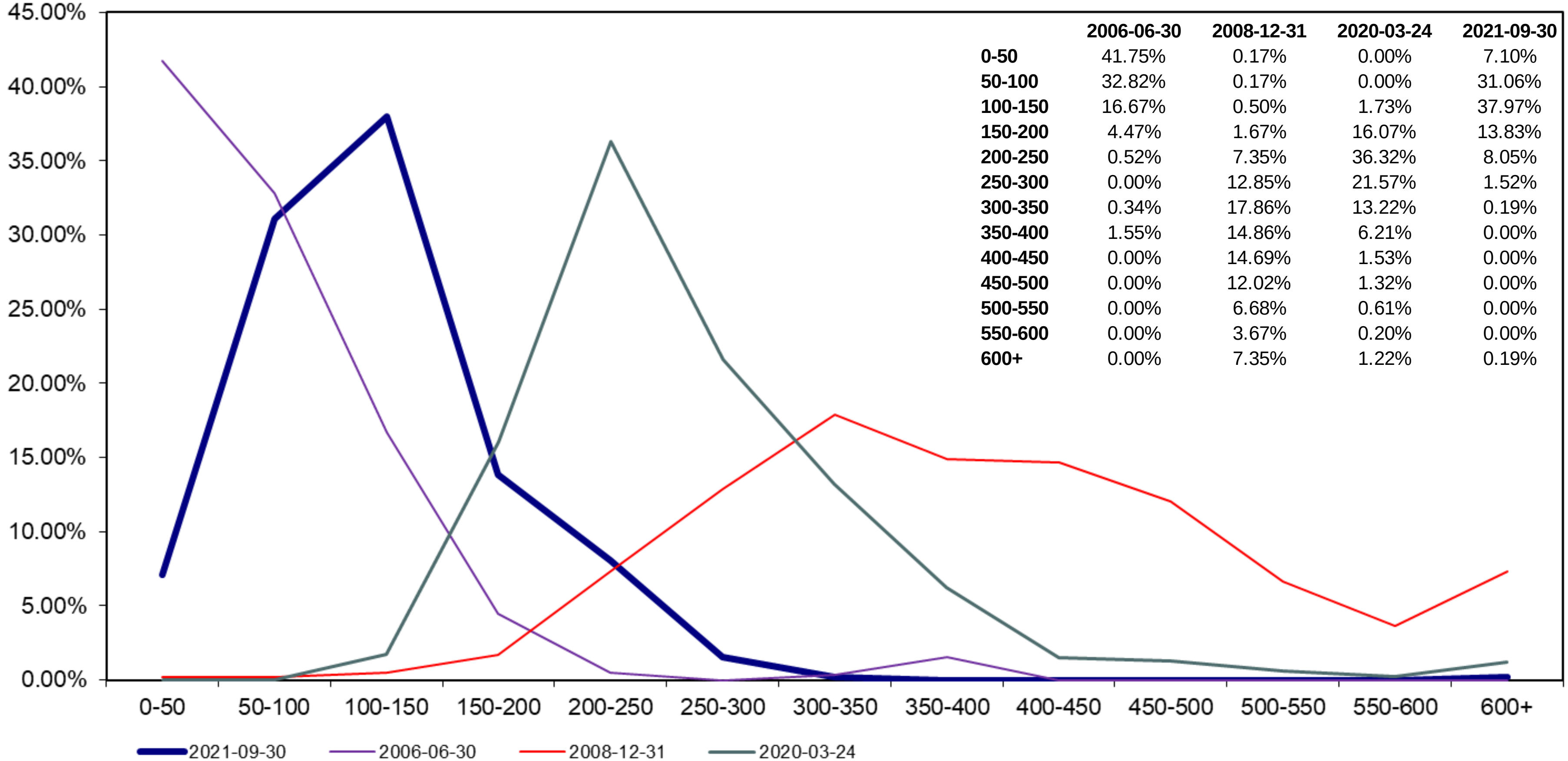
Spread Change	2015 Change	2016 Change	2017 Change	2018 Change	2019 Change	2020 Change	2021 YTD Change	Q3 2021 Change
Canada								
Agencies	+7	-16	-16	+6	-15	-9	-2	0
Provincials:	+11	-17	-28	+23	-26	+4	-7	+2
Corporates:	+33	-40	-35	+36	-51	+13	-7	+1
Short	+28	-40	-36	+31	-59	-4	-3	0
Mid	+35	-43	-33	+42	-58	+10	-13	+1
Long	+41	-32	-31	+41	-33	+37	-10	+3
U.S.								
Corporates:	+29	-43	-31	+60	-58	+1	-13	+5
Short	+22	-25	-35	+53	-53	-2	-12	+3
Mid	+30	-53	-31	+72	-73	-4	-11	+7
Long	+44	-62	-31	+61	-61	-2	-15	+8
High Yield	+191	-273	-59	+170	-173	+26	-71	+11

Source: Fiera Capital, PC Bond Analytics*

The information on the above chart is based on a sample of average spread change of securities in the DEX Universe Index.

Credit Recap

Credit Spread Dispersion – September 30th, 2021



	2006-06-30	2008-12-31	2020-03-24	2021-09-30
0-50	41.75%	0.17%	0.00%	7.10%
50-100	32.82%	0.17%	0.00%	31.06%
100-150	16.67%	0.50%	1.73%	37.97%
150-200	4.47%	1.67%	16.07%	13.83%
200-250	0.52%	7.35%	36.32%	8.05%
250-300	0.00%	12.85%	21.57%	1.52%
300-350	0.34%	17.86%	13.22%	0.19%
350-400	1.55%	14.86%	6.21%	0.00%
400-450	0.00%	14.69%	1.53%	0.00%
450-500	0.00%	12.02%	1.32%	0.00%
500-550	0.00%	6.68%	0.61%	0.00%
550-600	0.00%	3.67%	0.20%	0.00%
600+	0.00%	7.35%	1.22%	0.19%

Market Backdrop – Start of Q4 2021 (Fiera IFI Team)

Key issues faced by the bond market

Key factors impacting the backdrop for North America

- **Economic Growth: Ongoing economic recovery, albeit at slower pace as pandemic is lingering on**
  - Earlier this year, we were seeing risks of quicker spending by consumers and elevated risks of much stronger growth then we see now.
  - Although growth remains much above potential and continues to recover from the slowdown in 2020, we are now entering a phase of sustained growth combined with more persistent inflation than expected.
- **Employment: Unemployment levels still elevated, but labor shortages increasing**
  - Participation rate has dropped materially during the pandemic and has not fully recovered. Uncertain how many people have left the labor market and/or are still to return, but we expect gradual return to full employment.
  - North American job openings are at very high levels, supporting wage growth.
- **Inflation: Transitory factors staying elevated for longer and inflation expectations on the rise**
  - Strong consumer demand, global supply chains remaining fragile and bottlenecks are more persistent than previously assumed.
  - Continued positive outlook for wage growth as well as increases in sticky inflation components such as shelter and food are helping to keep inflation expectations elevated.
- **Central Bank Policy (BoC and Fed): Expect QE to be scaled back and backdrop to allow for first rate hikes in late 2022**
  - BoC has already started to reduce asset purchases, the Fed will likely follow in Q4 2021.
  - In general, developed market central bank policy will be less accommodative going forward and we expect net supply of government bonds to the market to increase in the 2022/23 period.

IFI – Factors Impacting Rates

Pro Higher Rates	Con Higher Rates
Inflationary pressures rising and coordinated global move for decreasing monetary stimulus (inc. less QE and bias to increasing rates) ↑	Continued economic impact from Covid-19 due to lockdowns and other restrictions, incl. risk that pandemic will drag on for longer than currently expected.
Impact of Covid-19 vaccination and expected gradual reopening of the economy in 2021 ↓	Desire to keep accommodative central banks (incl. QE) and general low-rate environment around the world ↓
Extremely stimulative financial conditions in North America/Developed Markets (Monetary & Fiscal stimulus)	Increased valuations of risk assets (i.e. bubble risk)
Strong pent-up demand amongst consumers following 2020 restrictions and lockdowns	Phasing out of Covid-19 related government support programs and payment deferral programs at banks (i.e. deferral cliff) ↓
US/CAN budget deficit and government bond supply ↑	Structural demand for North American rates from central banks, commercial banks, insurance, various foreign investors, etc.
	Geopolitical risks (e.g. China, Iran, Afghanistan, Taiwan, etc.) ↑
	Higher debt levels with consumers and corporations in the aftermath of the pandemic, potentially causing solvency issues/insolvencies

Credit Outlook – Q3 2021

Outlook for Macro Factors

- **Spread valuations are at the lower end of the range / through pre-pandemic levels in many sectors.**
- **The outlook for spreads remains slightly positive as the economy continues to recover and technicals remain favorable.**
- **Over the medium term, risks of spreads going through periods of spreads widening have increased.**

Macro Factor		Outlook		Spread Impact
Economic				
Growth (NA / Global)	⇒	Strong	⇒	Positive
Inflation (Canada)	⇒	Elevated	⇒	Negative
Inflation (Global)	⇒	Elevated	⇒	Negative
Monetary Policy	⇒	Extremely accommodative, but decreasing	⇒	Neutral
Real Interest Rates	⇒	Low	⇒	Positive
Dollar	⇒	Strengthening (USD)	⇒	Neutral
		Strengthening (CAD)		Neutral
Current Account (U.S.)	⇒	Large Deficit	⇒	Negative
Credit				
Corporate Earnings	⇒	Stable to Improving	⇒	Neutral
Event Risk	⇒	Elevated	⇒	Negative
M&A Activity	⇒	High	⇒	Negative
Corporate Leverage	⇒	Stable	⇒	Neutral
Upgrades / Downgrade	⇒	Stabilizing	⇒	Neutral
Technicals				
Supply (CAD)	⇒	Reducing from elevated	⇒	Positive
Demand (CND Corporates)	⇒	Strong	⇒	Positive
Asset Allocation	⇒	Inflows Credit/Fixed Income	⇒	Positive
Equity Markets	⇒	Increasing vol	⇒	Negative
Liquidity (Corporate Bonds)	⇒	Solid	⇒	Positive
Swap Spreads	⇒	Increasing (CAD)	⇒	Negative
Current Valuations				
Spread levels	⇒	Lower End of Range	⇒	Neutral
Market sentiment	⇒	Supportive	⇒	Positive

Source: Fiera Capital