SLC INSIGHTS: GLOBAL OUTBREAKS ON THE RISE; RATES STAY LOW

June 19, 2020

A jump in new COVID-19 cases in Beijing in recent days has prompted school closings and flight cancellations as China looks to stem the threat of a second wave. The same reopening stress is apparent in the U.S., as infection rates rise in several states. While markets showed some initial concern, they have shrugged it off for now.

However, it is a reminder that diligence and social distancing are still necessary, which will keep consumers cautious. Some of that is evident in China's early recovery. While industrial activity has bounced back, retail sales have lagged. With the world economies in recession, trade is also weak.

This pattern of manufacturing recovering well ahead of a pickup in services is evident across most major economies. Even as supply capacity is restored, demand, while starting to improve, is still low.

During its rate setting meeting this week, the Bank of Canada made clear it has no intention to raise rates anytime soon. Governor Tiff Macklem reiterated that he wants to see Canada sustain an economic recovery before any rate increase. This suggests that rates will be on hold well into 2022. This is very similar to the U.S. Fed's guidance.

While the Bank of Canada has expanded its balance sheet to support asset purchases, Macklem was quick to assure that it still has significant capacity to do more if needed.

He noted that the early attempts to support and normalize markets appears to be paying off. While Macklem expects to see growth in the third quarter, he offered a sobering reminder that "even the good case is still pretty bad".

Bond market update

Our markets continue to be driven by central bank and fiscal policy announcements. Economic data and economic trends have become much less predictable in this time of upheaval. Economists have made some unprecedented forecasting errors, including the May employment reports in both Canada and the U.S.

The Bank of Canada has announced programs totaling over 20% of GDP, but some have been more active than others. On risk transfer programs, Canada bond and bill purchases of $260 billion have been the most active, while the provincial bond and corporate purchase programs have disappointed in size at $4 billion and $60 million respectively.

We have utilized the provincial program to sell some of our less liquid shorter-term provincial bonds at more reasonable prices than we would otherwise have received. The Bank of Canada has also provided support to the markets by increasing its repo assets by about $200 billion above normal levels.

Credit markets continue to be driven by the implied central bank put option and Canadian credit spreads have continued to tighten by about 20 basis points so far in June. That is 104 basis points tighter than March highs and 66 basis points higher than we finished in 2019. Interest rates in Canada continue to hover close to the low end of their recent range and, aside from 30 year bonds, are mostly close to record lows.

While fund flows have not been strong overall for fixed income, we have seen renewed increased competition for Canadian credit, notably from pension plans.

Sun Life Core Advantage Credit Private Pool[1]

The duration of the Core Advantage Pool has been neutral to slightly short. Over the past two weeks, we reduced our energy holdings to buy federals, reducing the strategy's spread duration. We remain underweight federals approximately 5%, with a larger underweight in provincials. We are overweight corporate bonds by approximately 27% which is largely driven by exposure to USD corporate securities.

As always, we remain focused on assisting our clients during these challenging times. If you have any questions about your portfolio or our business continuity procedures, please do not hesitate to contact us.

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