From the
Bond Desk

Don't Fight the Fed

At some point in their career, all active portfolio managers will inevitably ask themselves if they are being too active. After all, they are paid to generate additional returns beyond those of the market, and thus they may fear that being positioned too close to the index is doing their client a disservice. But humble fund managers must also accept the need to choose one's battles, and to know when they're outmatched.

There are three major sources of value add for active bond managers: duration; curve positioning; and credit exposure. Historically, our team has taken a contrarian approach to the markets, so we're used to be having significant deviations from our benchmark on those fronts. However, the Bank of Canada and the Federal Reserve have made their intentions crystal clear in the near term – they have anchored short-term yields lower to bolster the economy; they are buying long-term issues in order to keep a flatter yield curve (to help finance their governments' huge stimulus measures); and they are buying corporate – and, in the case of the BoC, provincial – bonds to provide liquidity to the bond market and support credit products. Given this, we're of the belief that going up against these two financial behemoths is not a battle worth fighting.

	BANK OF CANADA	FEDERAL RESERVE
Duration	Pledged to "hold the policy interest rate at the effective lower bound until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved."	"We're not thinking about raising rates. We're not even thinking about thinking about raising rates," Fed Chairman Jerome Powell said. "What we're thinking about is providing support for the economy. We think this is going to take some time."
Yield Curve	Both recently went down the yield curve control path, pledging to buy enough long-term bonds to keep the rate from rising above targets	
Credit	Launched a $50-billion Provincial Bond Purchase Program and a $10-billion Corporate Bond Purchase Program.	Said it will buy up to US$750 billion of corporate bonds and exchange-traded funds made up of corporate bonds.

> "If you choose not to decide, you still have made a choice."
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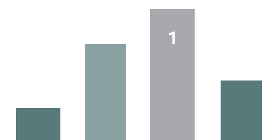
> – Rush, *Freewill*

Thus, as it stands, we find ourselves uncharacteristically deviating only slightly from the market, as these central banks' actions are mainly dictating ours. As highly active managers, this should feel uncomfortable but it doesn't, as we truly feel that being positioned this way offers the best risk/reward for our clients. Why? At the moment, we are preparing for both a risk-on and risk-off environment; there are simply too many unknowns and "ifs" driving the market: will there be a second wave of COVID-19?; if there is, will the economy go back into lockdown?; if it does, do corporate bonds fall (due to a flight to safety) or rally (on hopes of increased fiscal stimulus and central bank programs)?

In truth, no fund manager can predict the future or answer these questions with certainty, but one thing is for sure: the central banks' programs will continue to be one of, if not the, primary drivers of bond markets. Our job is to properly price the risks facing our clients and decide if a bet is worth taking. If this means having to deviate somewhat from our traditional management style and be more in-line with the universe on some aspects than we would normally be, so be it. Better that than to go toe-to-toe with two of the most powerful financial agents in the world.

Jean-Guy Mérette
Vice President and Portfolio Manager
Active and Strategic Fixed Income Team



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