Focused Corporate Bond

November 2022

Market Highlights

Credit rallied in November as investors interpreted the data and Fed communication as indicative of a more imminent pivot in policy and reversal of interest rates. The reduced upward pressure on yields, coincided with attractive corporate bond yields and better-than-expected earnings reports, caused domestic corporate yield spreads to narrow by 14 basis points over the month. Given improved investor sentiment, primary issuance was robust at $13.3 B versus the 5Y average of $9.5 B, with deals well oversubscribed and with diminished new issue concessions. Amidst this backdrop, lower-rated, higher-beta debt outperformed with long-end outperformance driven by the bid for duration.

For the month, short, mid and long-term credit spreads narrowed by 14, 15 and 13 bps, respectively. Absolute returns were augmented by the rally in sovereign yields as 2, 5, 10 and 30-year Government of Canada yields fell by 2, 25, 31 and 29 bps, respectively. The bull flattening of the domestic sovereign yield curve was notable as the 2-30 yield curve inversion of 88 bps marked the largest inversion since the early 1990's and was 30 bps more inverted than the US Treasury yield curve.

Domestic banks made headlines as RBC announced its intention to acquire HSBC Canada for $13.5 B. On the back of the announcement, HSBC Canada yield spreads outperformed, narrowing by over 30 bps and placing HSBC Canada issues as top performers. Outside of M&A news, initial Q4 bank earnings highlighted the impact of the higher rate environment on profitability and growth. While rising rates have been a tailwind for net interest income and margins, the associated volatility and macro uncertainty have pressured capital market division margins, provisions for credit losses, and loan growth outlooks. Given capital levels well above regulatory minimums and cheaper pricing in the US market, Canadian domestic issuance looks set to slow, which will be supportive of bank credit spreads going forward.

Across the credit curve, the best performing issues were predominately lower-rated, higher-yielding and higher beta issues. Telecom was the top performing industry as it serves as a liquid BBB-rated corporate proxy and well received issuance by BCE reduced supply pressures. Similarly, Enbridge's $2B and Inter Pipelines' $1.5B multi-tranche deals, reduced near-term pipeline issuance concerns. Beta compression aided other BBB-rated sectors such as real estate, retail and media. More defensive, high-rated issues in infrastructure, pensions, securitization, power generation and utilities underperformed. The latter was impacted by S&P's two notch credit rating downgrade of Nova Scotia Power to BBB- following government intervention to cap power-rate increases. Finally, financial services lagged as S&P revised CI Financial's BBB- rating outlook to negative on heightened leverage, increasing the likelihood of a fall into high yield.

Outlook & Strategy

Risk assets are still vulnerable to higher interest rates, reduced liquidity and more importantly a recession. The risk has been felt most acutely in the speculative grade markets which have seen risk premiums rise as issuance has struggled on lower demand, unfavorable growth outlooks, and weakened fundamentals due to margin pressures. In the Canadian market, which is dominated by investment grade credits, leverage and debt servicing metrics, even for the lowest rated credits, are healthy and refinancing risk is not a near-term threat.

Given the macro backdrop and event risks, we anticipate that investors will cautiously look to credit as a source of attractive yield carry. Given the rapid increase in rates, persistent inflation and macroeconomic downside risks, corporate yields may prove more volatile this tightening cycle than prior episodes. We therefore expect to see less momentum driven trade and greater differentiation of spread performance amongst lower rated, higher-beta and illiquid credits. The portfolio has good liquidity and is well positioned to capitalize on relative value and yield enhancement opportunities.

LORICA

Focused Corporate Bond

November 2022

Disclaimer

This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The information contained in this document has been compiled by Cidel Asset Management Inc. from sources believed to be reliable, but no representations or warranty, express or implied, are made by Cidel Asset Management Inc. as to its accuracy, completeness or correctness. The opinions expressed are as of the date of this publication and may change without notice and are provided in good faith, but without legal responsibility. Lorica Investment Strategies is a trade name of Cidel Asset Management Inc. Cidel Asset Management Inc., carrying on business as Cidel ("Cidel" is a registered trademark) is registered as a portfolio manager, investment fund manager and exempt market dealer in Ontario. Cidel is also registered as a portfolio manager and exempt market dealer in the provinces of Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland and Labrador, Nova Scotia, Prince Edward Island and Saskatchewan. In Quebec, Cidel is registered as a portfolio manager, investment fund manager and exempt market dealer. This document may not be reproduced, distributed or published by any recipient hereof for any purpose.

Cidel
Asset Management