The New Year Edition | December 2024

"Every new beginning comes from some other beginning's end."
Seneca

With the start of the new year comes the annual tradition of making predictions and prognostications for the year ahead. One only needs to look back at the forecasts from previous years to realize just how difficult this exercise is. The market always seems to find a way to humble those who make predictions, especially about the future.

Having endured such humbling experiences over our careers, we prefer to concentrate on where we are and how we got here. With that in mind, we offer a bond market synopsis of the year that was and the setup as we begin 2025.

The lookback.

Interest rates.

2024 was the year of the interest rate cuts. The Bank of Canada (BoC) began in June by delivering three consecutive 25 bps cuts before ramping up to finish the year with two 50 bps moves. South of the border, the Federal Reserve (Fed) began its campaign in September with a 50 bps cut before slowing the pace with two 25 bps reductions to close out 2025.

Despite the cuts, longer-dated yields moved higher as curves steepened (uninverted). Counterintuitively, 10y rates sold off dramatically after the Fed's first cut. This trend continues unbroken as inflation and deficit concerns have markets rethinking term premiums.

	Dec. 31, 2023	Dec. 31, 2024	YoY
CAD Overnight	5.00%	3.25%	-1.75%
CAD 2y	3.89%	2.93%	-0.96%
CAD 10y	3.11%	3.23%	0.12%
US Fed Funds	5.38%	4.38%	-1.00%
US 2y	4.25%	4.24%	-0.01%
US 10y	3.88%	4.57%	0.69%

Source: Bloomberg

Credit.

In the land of credit, corporate issuance exceeded expectations, with the domestic and US markets seeing CAD 147 billion and USD 1.6 trillion of new deals. The higher-than-expected supply was met with higher-than-expected demand, leading to spreads grinding tighter through the year, with Canadian credit outperforming and closing the gap with the US.

	Dec. 31, 2023	Dec. 31, 2024	YoY
CAD IG	132 bps	99 bps	-33 bps
US IG	99 bps	80 bps	-19 bps
US HY	346 bps	313 bps	-33 bps

Source: Bloomberg

Fixed income returns.

As for fixed-income returns, 2024 saw a wide dispersion depending on the type of exposure. Longer-duration products underperformed, while Canadian and high-yield markets outperformed.

	2024 Total Return
FTSE Canada Universe Bond Index	4.23%
FTSE Canada All Corporate Bond Index	6.97%
FTSE Canada Long-Term Overall Bond Index	1.35%
Bloomberg US Aggregate Bond Index	1.25%
ICE US Treasury 20y+ Index	-7.71%
Markit iBoxx USD Liquid High Yield Index	7.95%

Source: iShares

The funds.

Algonquin Debt Strategies.

The Fund posted its second consecutive double-digit year with a net return of 11.19%. The main drivers of performance:

- Maintaining a high exposure to credit and an overweight in the banking sector.
- Active rotation of credit positions to maximize spread compression.
- Tactical rate trading, in particular a Canadian yield curve steepener (i.e., long 2y, short 10y).

	2024 Total Return
Algonquin Debt Strategies Fund (F Class)	11.19%

The Algonquin Debt Strategies Fund LP was launched on February 2, 2015. Returns are shown on "Series 1 F Class' , and are based on NAVs in Canadian dollars as calculated by SGGG Fund Services Inc. net of all fees and expenses. For periods greater than one year, returns are annualized. .

Algonquin Fixed Income 2.0.

The Fund continued its run of outperformance, capping off a strong 5 years since its inception. The primary factors underlying the outperformance in 2024:

- Overweight Canadian investment-grade credit.
- Concentrated interest rate exposure in the short end of the Canadian yield curve.
- Capitalizing on the volatility in bond markets.

	2024 Total Return
Algonquin Fixed Income 2.0 (F Class)	9.84%

The setup for the new year.

The tale of two countries.

It was the best of times; it was the worst of times. Okay, perhaps it is not that dramatic, but one of the key themes as we enter 2025 is the divergence in the US and Canadian economies.

North of the border, inflation is at target, unemployment is elevated, and growth is anemic. Lower rates could support growth, but slower immigration is a headwind, with GDP per capita declining for six consecutive quarters.

Accordingly, the market expects the BoC to continue cutting rates, with the base case being one more in 2025. We agree that the Bank isn't done cutting, but it's too early to know how many are left. The obvious wildcard is tariffs. We have seen estimates that 25% broad-based tariffs would cause a 2-5% negative impact on domestic GDP. This would plunge Canada into a recession and force the BoC to continue cutting aggressively.

South of the border, the economic picture is very different. The US economy is strong, with stable growth, low unemployment, and inflation above target. Furthermore, the Republicans are priming the economic pump with policies which, on the surface, appear expansionary and inflationary.

As such, the market expects the Fed to be on hold for the first part of the year before delivering one cut in the second half. Interestingly, after the latest payroll numbers, Bank of America changed its forecast to no more cuts and the potential for hikes. Our view is that there is far too much uncertainty to have any conviction on what the Fed might or might not do.

The uncertain optimists.

While uncertainty is always a market storyline, the year ahead looks murkier than usual because President-elect Trump seems to like it that way. Although most economists acknowledge the high degree of uncertainty, their 'calls' are relatively optimistic, with positive returns from equities and fixed-income.

The underlying theme behind the optimism is that the President-elect's talk of tariffs and deportations is mainly bluster and negotiation tactics. We worry that people are underestimating Donald J. Trump. He has been called many names, but 'quitter' isn't one of them. As such, he may attempt to implement an aggressive tariff and deportation plan, which could result in upending markets.

As such, we find it impossible to have much conviction, except that the BoC will continue to cut rates this year, and markets will be more volatile than expected. Accordingly, we have reduced exposure to credit and rates and are positioned to capitalize on market dislocations when they occur.

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