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Trump v The Bond Market | October 2024

"I used to think if there was reincarnation,
I wanted to come back as the President or the pope or a .400 baseball hitter.
But now I want to come back as the bond market. You can intimidate everybody."
James Carville

The result was expected to be close, delayed, and potentially even contested. But in the end, the Americans rather decisively returned Donald J. Trump to the White House as the nation's 47th President.

Not only did the Republicans regain the Oval Office, but the 'red wave' also took the Senate and is en route to a majority in the House. As the results rolled in, markets frantically repriced assets in anticipation of Trump's proposed policies.

But there is a big difference between saying and doing, between campaign promises and what is and can be implemented. So, for now, there are still many more unknowns than knowns. But when it comes to the bond markets, we think there are some simple takeaways for investors.

At a high level, the Republicans are priming the economic pump with an expansionary and pro-growth agenda. The consensus is that these policies are inflationary at a time when the economy is strong, and inflation is still running hot. The natural conclusion is that this could influence the Federal Reserve's decision-making.

However, which policies will be implemented is still unknown, and those that are enacted will not have a material impact until later in 2025. Furthermore, the Fed is not in the habit of jumping to conclusions and will want to assess the impact of any fiscal plans on growth, inflation, and the labour market. Thus, we could see further adjustments to the policy rate later next year and into 2026.

In the meantime, we expect the Fed to continue cutting rates into 2025, albeit with a more measured approach. With core CPI still elevated and the risk of it re-accelerating, we feel the pace could be slower and the terminal rate higher. Thus, instead of cutting policy rates down to 2-3%, a 3-4% range is the more likely outcome.

On our side of the border, the story is somewhat different. The potential for tariffs and a trade war puts a cloud of uncertainty over the Canadian economy. This could lead to reduced business investment, hiring, and growth, similar to what we saw in 2016 when NAFTA was being renegotiated. With economic growth below forecast and CPI at 1.6%, this additional drag could pressure the Bank of Canada to cut faster and deeper.

Moving out the yield curve into longer-dated rates, the focus shifts to deficits. The Committee for a Responsible Federal Budget estimates the Trump administration will increase the deficit by 7.75 trillion over the next decade. We have seen estimates ranging from 1.5 to 15 trillion depending on which fiscal policies are implemented.

The bottom line is the deficit is expected to increase and, with it, the supply of government bonds. This, combined with the spectre of inflation reigniting, puts upward pressure on the term premium. Investors worried about inflation and deficits will want sufficient compensation to leave cash and short-term investments to buy 10-year treasuries.

As for the Canadian 10y, the US long-end is the dog that wags the tail. While the BoC can control the short-end, longer-dated rates are at the mercy of the market (barring central bank intervention). Thus, even if the Bank is forced to cut more aggressively, 10y rates could be dragged higher by the States.

For the past year, we have warned clients about extending duration. We remain skeptical of value in the long end, even though the US 10y has moved 70 bps higher since the Fed's 50 bps 'jumbo cut'. As while President-Elect Trump has defeated his political rivals, there could be a new foe on the horizon with the return of the bond vigilantes.

The Month of October.

Credit.

With the rate-cutting cycle in full swing and investors still attracted by all-in yields, money continues to flow into fixed income. The strong demand for corporate bonds led to a narrowing of credit despite robust supply.

With Canadian bank spreads tightening towards US levels, the domestic market once again became attractive for bank funding. This led to solid issuance from the 'big 6' and a surprisingly busy month for new deals, with a total of $15 bn in new supply.

New Issue Notables.

- TLAC (Total Loss Absorbing Capacity) friendly 6y and 11y bonds from TD, BNS, and RBC, with 'no call to final year' features.
- National Bank went shorter, with a 3y non-call for 2y deal.
- Gibson Energy issued $350mm of 7y paper with proceeds earmarked to refinance a high coupon callable bond.
- The REITs were also busy, with First Capital issuing a $200mm 5.6y bond, Chartwell a $150mm 5y deal, and Dream Summit and Crombie also getting in on the action.
- Enmax came to market with a $400m 10y issue.
- Three high-yield issuers also took advantage of lower funding levels and a receptive market, with Kruger, Empire Communities, and Go Easy printing deals.

In other news, Rogers announced a structured equity deal, allowing it to delever quicker than expected. The announcement of the agreement, somewhat akin to a sale and leaseback arrangement, led to a rally in both their unsecured and hybrid bonds.

Investment grade credit spreads:

- Canadian spreads tightened 6 bps to 110 bps.
- US spreads tightened 5 bps to 84 bps.

Interest Rates.

Bond traders were gripped by sober second thoughts. The euphoria of the jumbo rate cut was replaced by fears that a too-aggressive Federal Reserve would trigger a rebound in inflation. As a result, yields surged higher to reflect a more measured cutting cycle with a terminal rate of about 3.5% rather than 2.9%.

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The big move in US rates proved irresistible for domestic yields, which also increased. However, unlike the parallel shift across rates in the States, the Canadian curve underwent a steepening, with 2y bonds putting up a better resistance than 10y. We believe that the move to an upward-sloping curve still has room to run, especially since governments show little interest in curbing fiscal deficits.

Sovereign yields:

- Canadian 2y finished at 3.07% (+16 bps), and the 10y at 3.22% (+26 bps)
- US 2y finished at 4.17% (+53 bps), and the 10y at 4.29% (+50 bps)

The Funds.

Algonquin Debt Strategies Fund.

The Fund had another strong month with a return of 0.92%, benefitting from an overweight in financials, a yield curve steepener, and tactical trading.

Portfolio Metrics:

- 5-7% yield
- Average credit rating: A-
- Average maturity: 3y
- IR Duration: 0.6y

	1M	3M	6M	YTD	1Y	3Y	5Y	SI
X Class	1.02%	2.87%	5.85%	10.80%	15.29%	6.31%	5.77%	8.46%
F Class	0.92%	2.58%	5.21%	9.65%	13.73%	5.41%	4.90%	NA

* As of October 31st, 2024

The Algonquin Debt Strategies Fund LP was launched on February 2, 2015. Returns are shown on 'Series 1 X Founder's Class' since inception and for 'Series 1 F Class' since May 1st, 2016, 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

With a return of +0.13%, the Fund significantly outperformed fixed-income markets, with most products down -1 to -1.5% in October. The losses from the rise in interest rates were minimized due to our curve positioning and more than offset by the gains from credit and the portfolio yield.

Portfolio Metrics:

- 5-7% yield
- Average credit rating: A-
- Average maturity: 3.6y
- IR Duration: 3y

	1M	3M	6M	YTD	1Y	2023	2022	2021	2020
F Class	0.13%	2.69%	7.28%	7.98%	15.94%	9.75%	-6.15%	2.42%	10.53%

* As of October 31st, 2024

Algonquin Fixed Income 2.0 Fund is an Alternative Mutual Fund and was launched on December 9, 2019. Returns are shown for Class F since inception and are based on NAVs in Canadian dollars as calculated by SGGG Fund Services Inc., net of all fees and expenses. Investors should read the Simplified Prospectus, Annual Information Form, and Fund Facts Documents and consult their registered investment dealer before making an investment decision. Commissions, trailing commissions, management fees, and operating expenses all may be associated with mutual fund investments. An Alternative Mutual Fund is not guaranteed, its value changes frequently and its past performance is not indicative of future performance and may not be repeated. Payment of quarterly distributions is not guaranteed and paid at the discretion of the manager; therefore, it may vary from period to period and does not infer fund performance or rate of return.

Looking Ahead.

The policy of 'American Exceptionalism' implies one should consider a broad range of economic outcomes. The potent mix of tax cuts, tariffs, and a steep curbing of immigration will impact economic growth and inflation in ways that are difficult to predict. As a result, we expect markets to be volatile as election rhetoric turns into economic policy.

Since it will be many months before we get policy announcements, we expect the Federal Reserve to remain on a steady albeit cautious cutting path. The Bank of Canada has a more challenging task, as the uncertainty of US trade policy will likely put a chill on domestic business investment. With GDP already weaker than forecast, the Bank could cut more aggressively than envisioned a few weeks ago. As a result, we continue to concentrate our duration exposure on the short end of the Canadian yield curve with a steepening bias.

Credit spreads continue to grind narrower. With most companies getting issuance out of the way before the US election, we expect the new issue calendar to be light into early 2025. Less supply coupled with central banks continuing to lower rates means the trend to tighter spreads remains intact.

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