MAY 2022

MONTHLY UPDATE

Evolve Active Core Fixed Income Fund

FIXD invests primarily in domestic and international high quality fixed income securities, and to a lesser extent, adding yield or enhancing returns on the portfolio by opportunistically investing in international fixed income securities, emerging market debt, preferred shares, convertible bonds and non-investment grade bonds.

NEO

FIXD

ETF TICKER: FIXD (UNHEDGED)
MUTUAL FUND FUNDSERV CODE: EVF110 (CLASS F); EVF111 (CLASS A)
SUB-ADVISOR: ADDENDA CAPITAL

ADDENDA CAPITAL

Active management in Fixed Income continues to be an attractive investment opportunity. Addenda Capital is one of Canada's largest multi-asset investment firms, with over $38.1 billion in assets under management, including $26.1 billion in fixed income and over $1.2 billion in preferred shares.

Source: Addenda Capital, as at December 31, 2021. *Excludes $1,533 million in Advisory assets and $354 million in Overlay assets.

Market and Portfolio Review

Markets sold off for most of the month, with similar themes continuing to weigh on performance including the ongoing conflict in Ukraine, rising interest rates, recession fears, and rising input costs. Weak earnings results from large US retailers reinforced concerns that high inflation will force consumers to pull back on spending. Markets saw a rebound towards the end of the month as CPI suggested that price increases might be slowing but clearly, we are not out of the woods yet.

May continued to be a challenging month for most investment markets apart from the Energy sector. The Canadian equity market, as measured by the S&P/TSX Index, returned 0.1% during the month as a result of a rally in Energy stocks which increased 8.9% as inventory levels of oil, natural gas, and refined products are at multi-year lows and projected to move lower, despite a shift lower in global GDP in 2022. Similarly, the S&P 500 Index ($CAD) declined -0.9% with the Energy sector being the best performing sector returning close to 15%. The Canadian fixed income market was relatively flat with the FTSE Canada Universe Index declining -0.1%, with short-term bonds outperforming long-term bonds. Foreign bonds were modestly positive in local currency terms but negative for Canadian investors due to the appreciation of the Canadian dollar. One of the lone bright spots during the month was the S&P/TSX Preferred Shares Index which rose 5.01%, but is still modestly negative over the year-to-date period.

The Evolve Active Core Fixed Income Fund (FIXD) portfolio modestly declined alongside the bond market during the month of May. Underperformance during the month was attributable to the off-benchmark allocation Global and High Yield bonds which declined more than Canadian bonds; although this was partially offset by the allocation to Preferred Shares which outperformed the broader bond market. The underlying Core Bonds component of the FIXD strategy also had a negative impact on relative performance due the portfolio's longer than benchmark duration; however, the overall FIXD portfolio has a shorter-than-benchmark duration.

Outlook

Heading into the first few weeks of June, bond prices now reflect a scenario where the Bank of Canada is hiking 75 bps per meeting until reaching a terminal rate of 3.5%. Financial conditions are becoming increasingly more punitive and will continue to play into the slowing growth theme we have already observed symptoms of. Furthermore, the Bank of Canada highlighted their concern about household debt in the face of rising rates in the most recent financial stability report. As a result, we are forecasting a yield reversal in the second half of the year as the growth picture comes under pressure and market expectations remove the more aggressive pricing expectations.

Global growth slows but remains above longer-term trends supported by fiscal stimulus and a historically high savings rate. We expect that growth will be primarily driven by the consumer and government sectors, although supported but positive business investment. Unemployment will continue to fall and dislocations in the labour force should work their way out as the participation rate rises.

Inflation pressure should peak in 2022 but remain above central bank targets due to supply chain issues, elevated commodity prices, and increasing labour costs. Significant dislocations in the labour markets with more job openings than available workers put upward pressure on wages. Structural forces (aging demographics, technology advancements, and a growing debt overhang) will continue as headwinds to long term inflation.

2022 will be a transition year as central banks raise administered monetary policy rates and start to reverse bond purchase programs.

Global monetary policy evolves at different speeds as some central banks move to tighten while others maintain extraordinary easy policy. Above target price inflation will be the primary focus of central banks.

Fiscal stimulus via direct consumer programs has mostly finished but infrastructure spending will continue to contribute positively to growth.

Risks

Future details surrounding how central banks reduce the size of their bond purchase programs and the pace/ amount of policy tightening contribute to market volatility.

The path of inflation proves more persistent causing central banks to move aggressively to combat price increases and negatively impact economic momentum in the process.

- Pandemic related lockdowns should diminish, although uncertainties continue throughout 2022.
- Longer term risk from significant U.S. fiscal deficits may result in higher personal and corporate taxes which would be negative for economic growth.

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