IA Clarington Inhance Bond SRI Fund

Manager commentary – Q3 2024

Global bond yields (the interest earned on a fixed-income security) ended September broadly lower as multiple developed-market central banks began lowering their policy interest rates amid moderating inflation pressures.

In June, the Bank of Canada (BoC) cut its policy interest rate by 25 basis points (bps), from 5.00% to 4.75%. This made the BoC the third developed-market central bank to begin easing (lowering interest rates) this cycle (following Switzerland and Sweden) and the first of the G7 central banks, although it was followed closely by the European Central Bank, which cut its policy interest rate the next day. The BoC subsequently made 25-bps cuts at both its July and September meetings, with the policy interest rate ending the period at 4.25%.

The U.S. Federal Reserve (the Fed) commenced its policy easing with a 50-bps cut in September, taking the upper bound (higher end) of its policy interest rate down to 5.0% while signalling further interest rate cuts to come.

U.S. Treasury bond yields (the interest earned on a U.S. government fixed-income security) ended September down 22 to 98 bps across the yield curve (graphical illustration of yields and maturities of bonds of similar credit quality), with the largest declines seen in the front-end (short maturities) of the curve as markets priced in more aggressive Fed interest-rate cuts.

Government of Canada bond yields (interest earned on Canadian government fixed-income security) ended the period down anywhere from 21 to 126 bps across the yield curve, with the front-end of the curve outperforming as markets priced-in more aggressive BoC interest-rate cuts amid signs of a weakening labour market. With short-term rates significantly outperforming, the yield curve steepened significantly (long-term bonds were offering higher yields than short-term bonds). The difference between the 10-year yield and the 2-year yield “un-inverted” (10-year yield offering a higher rate then the 2 year yield) for the first time in more than two years near the end of September, ending the period (April 1 – September 30) at 5 bps, up from -70 bps at the start of the period. The benchmark Government of Canada 10-year yield ended the period at 2.96%, about 51 bps lower from where it started.

Reflecting the sharp drop in underlying bond yields, all sectors of the Canadian investment-grade (a high-quality debt security with a low risk of default. Ratings for investment grade instruments are BBB and above) fixed-income market generated positive total returns (an investment return that includes any interest, capital gains, dividends and distributions). Corporate bonds were the strongest-performing sector given higher yield and modestly tighter credit spreads (the difference in yield between debt instruments with similar terms, but different credit ratings). Meanwhile, federal bonds were the weakest performers, but they still generated strong absolute returns given the sharp decline in bond yields.

The Fund's allocation to preferred shares (A type of share ownership in a corporation. Preferred stock dividends are typically paid out before common share dividends. Preferred shareholders are also paid before common shareholders in the event of bankruptcy. Unlike common shares, preferred shares do not generally come with voting rights), which are not held in the benchmark index, contributed strongly to performance as preferred shares outperformed bonds significantly. The Fund's overweight allocation to corporate bonds and underweight allocation to federal bonds also contributed, as the corporate sector outperformed the federal sector within the index. The Fund’s duration positioning (sensitivity to interest rates) contributed as well. The Fund entered the period with a slightly short duration versus the index before taking a long-duration position in late April after a significant back-up in yields. The Fund maintained this positioning until mid-September, ending the period relatively neutral versus the index. Individual contributors included The Toronto-Dominion Bank (5.75%, PERP), an institutional preferred share that was the largest individual contributor to the Fund's performance. The position benefited from strong credit spread tightening and a growing probability of being called at the next call date (a day on which the issuer has the right to redeem the issue at a par, or at a small premium to par). The Fund's position in Province of Manitoba (2.85%, 05/09/2046), a long maturity bond, was initiated in late April as part of a relative value (higher yield relative to a peer group) trade, just as long-dated bond yields reached their year-to-date highs.

The Fund's bias toward higher-quality corporate holdings detracted slightly from performance as BBB-rated corporate bonds outperformed higher-rated corporate bonds. Short-dated bonds underperformed mid- and long-dated bonds owing to their lower duration and the significant drop in interest rates during the period. As a result, the Fund's largest individual detractors were all short-dated corporate bonds that had rolled out of the index for becoming under one-year maturity, including Bank of Montreal (2.37%, 03/02/2025), Bank of Nova Scotia (1.95%, 10/01/2025), Canadian Imperial Bank of Commerce (2.75%, 03/07/2025) and Rogers Communications Inc. (3.1%, 15/04/2025).

New positions included Province of Manitoba (2.85%, 05/09/2046) in late April as part of a relative value trade out of a shorter-dated long-maturity Ontario bond as the basis between Manitoba credit spreads and Ontario credit spreads had widened significantly. Additionally, interest rates were sitting near year-to-date highs, so the fund manager extended the Fund’s duration at that time.

Increased positions included the Fund’s non-bank corporate exposure, such as the addition of Videotron Ltd. (4.65%, 15/07/2029).

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Decreased positions included the Fund’s overweight exposure to bonds with medium-length maturities. With a steeper yield curve (longer-term yields are higher than short term yields) and bonds in the middle of the yield curve outperforming, the fund manager decreased the Fund’s exposure to the middle of the curve and increased its short- and long-dated exposures.

Eliminated positions included preferred shares issued by Sun Life Financial Inc. Preferred shares had rallied significantly since late 2023, and this issue in particular appeared expensive versus comparable issues from peers.

With inflation now in its targeted range, the BoC's focus can shift to the strength of the economy.

The BoC's 4.25% policy interest rate remains quite restrictive relative to current and expected inflation levels, as well as to its own neutral (sustainable interest-rate estimate of 2.25% to 3.25%. Weak productivity (The ability to produce greater quantities of goods and services in better and faster ways), high consumer debt and a wave of mortgage renewals set to significantly increase mortgage payments should encourage the BoC to swiftly reduce its policy interest rate to neutral levels.

The Fund’s duration and yield curve positions are close to neutral versus the index. With considerably lower bond yields and significant central bank interest-rate cuts already priced into the market, the fund manager expects bond yields to be range-bound (trade within a specific range) with a downward bias, and will tactically adjust duration accordingly. Yield curves steepened sharply during the period, but certain segments of the curve remain inverted (short-term yields are greater than long-term yields), presenting potential opportunities to shift further exposure out of medium-length maturities and into short- and long-dated maturities.

The Fund maintains an overweight position in corporate bonds but with a bias towards higher credit quality and shorter maturities, which continue to offer attractive yield relative to underlying federal bonds. Credit spreads are not far from their tightest levels in the past two years, which warranted some caution in the near term but are at more reasonable valuations when considering longer horizons. The Fund continues to hold preferred shares as a yield enhancer.

Fund and benchmark performance as at September 30, 2024	1-year	3-year	5-year	Since inception (Dec. 2016)
IA Clarington Inhance Bond SRI Fund – Series B	12.7%	-1.1%	-0.1%	0.8%
FTSE Canada Universe Bond Index	12.9%	-0.1%	0.6%	1.9%

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Non-traditional fixed income asset classes may carry higher risk, but generally provide higher yield than traditional fixed income asset classes. A mutual fund's "yield" refers to income generated by securities held in the fund's portfolio and does not represent the return of or level of income paid out by the fund. For definitions of technical terms in this piece, please visit iaclarington.com/glossary and speak with your financial advisor.

The performance data comparison presented is intended to illustrate the Fund's historical performance as compared with historical performance of widely quoted market indices. There are various important differences that may exist between the Fund and the stated indices that may affect the performance of each. The Fund's benchmark is the FTSE Canada Universe Bond Index, which is comprised of Canadian investment grade bonds and has significantly different portfolio duration characteristics. The FTSE Canada Universe Bond Index consists of a broadly diversified selection of investment-grade Government of Canada, provincial, corporate and municipal bonds issued domestically in Canada. The Fund's geographic, sector and credit quality exposure may differ from that of the benchmark. The Fund may hold cash while the benchmark does not. It is not possible to invest directly in market indices. The performance comparison is for illustrative purposes only and does not imply future performance.

Indicated mutual fund rates of return include changes in share or unit value and reinvestment of all dividends or distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Returns are historical annual compounded total returns.

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