PORTFOLIO DASHBOARD:

BONDS: TOO MUCH NEGATIVITY?

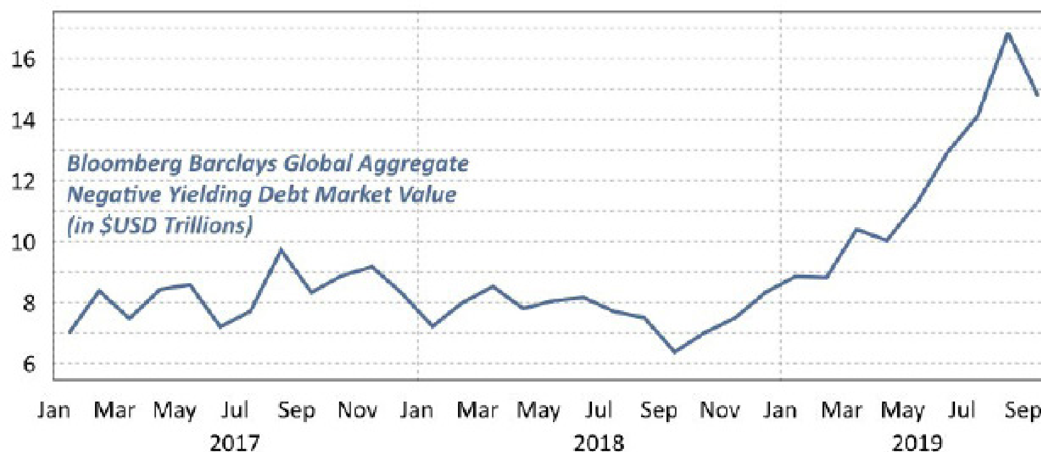
Bonds play a vital role in portfolio construction. Allocations to high quality debt provide a stable source of income, decrease volatility and broaden exposure to additional factors which drive returns. This ultimately creates a more resilient portfolio. For this reason, even Forstrong's most equity-oriented strategies, designed to have higher growth potential, will still maintain some fixed income exposure.

With that gushing preamble out of the way, our view on bonds (and for that matter all other asset classes) fluctuates over time. Generally speaking, fixed income assets tend to be most attractive in times of steady or weakening growth, where longer-term yields are stable or falling. This has certainly been the case of late, as a struggling global manufacturing sector has put a dampener on the world economy. So we should all be loading up on bonds…right?

We would caution against jumping on the bond bandwagon. Before even considering the economic outlook (we'll get there), the debt market is showing signs of extremes. Consider that bond funds have seen record inflows this year and are a consensus overweight amongst global fund managers. Long-term bond yields have rapidly collapsed, leading to inverted yield curves in numerous economies. Per the chart below, approximately 15 trillion USD in investment grade global issuance now carries a negative yield. Bond bulls are effectively betting that the asset class marches further into subterranean territory.

The deceleration in global growth warranted a fall in bond yields, but it is critical to look at the magnitude of the move and delineate what the current price is telling us about the market's expectations. Moves in the widely tracked 10 year US treasury and German bund provide a helpful illustration, having fallen significantly (approximately 175 and 120 basis points respectively) from their highs in the fourth quarter of 2018. Currently near the 1.5% level, the US 10 year has a negative real yield, while its German counterpart incredibly has a negative nominal yield near -0.6%. These are clearly not prices that concur with Forstrong's expectation that bottoming leading indicators, dovish central bank policy and the prospect of meaningful fiscal stimulus foreshadow an impending economic stabilization.

Is the bond market a bubble? Not by the classic definition, but there is definitely a bubble in fear. Investors are charging every notorious corner of global debt markets. Nevermind the swelling amounts sunk into negative-yielding debt. Stand in wonder of the more freakish fixed income issues. For example, the Republic of Austria recently brought back its "century bond" — riddled with interest rate risk — at a whopping 1.2%. Regardless, bond exposure still serves an important diversifying role in portfolios; the current environment just necessitates a greater degree of selectivity. We prefer exposures such as emerging market sovereign bonds which have positive real yields, upside currency potential and a credit element that would benefit from firming global growth.



Sources: Bloomberg, Macrobond, Forstrong Global Asset Management

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GLOBAL STRATEGY OVERVIEW

CASH

With longer-term global bonds looking increasingly vulnerable, we have modestly raised portfolio cash levels to offset equity risk and dampen volatility.

BONDS

The path of least resisitance for short-term bond yields should be lower, as accomodative central bank policy worldwide should suppress upwards pressure. Against this backdrop, short-term fixed rate debt should outperform floating rate notes. We have sold Canadian and US investment grade floaters and redirected the proceeds into short-term corporate bonds.

EQUITIES

The vast majority of countries now have a higher dividend yield than 10 year sovereign bond yield. Ironically, equities have become the predominant source of portfolio income. We continue to tilt client portfolios further towards equities, which in addition to their superior yield, better align with our view of a return to slow, stable global growth.

OPPORTUNITIES

A steepening US yield curve would be a favourable environment for US mortgage REITs, allowing for a larger spread between short-term borrowing costs and long-term mortgage investment portfolios. With a dividend yield currently over 10%, we have added exposure to the asset class to boost income and position for a reversal in long-dated bond yields.

Portfolio	Inception Date	1 Month	Year to Date	1 Year	3 Year	5 Year	10 Year	Since Inception
CORE SERIES								
Core Income	Jul 1, 2008	0.89%	6.73%	7.22%	4.17%	5.65%	6.73%	7.08%
Core Balanced	Jul 1, 2003	0.94%	8.80%	5.45%	5.25%	6.47%	6.76%	7.21%
Core Growth	Jul 1, 2003	1.52%	11.04%	4.53%	6.60%	7.02%	7.63%	8.00%
GLOBAL SERIES								
Global Income	Jul 1, 2008	0.59%	4.73%	6.43%	4.36%	7.11%	7.65%	8.54%
Global Balanced	Jul 1, 2003	0.96%	6.69%	4.10%	5.71%	7.73%	7.71%	7.21%
Global Growth	Jul 1, 2003	1.67%	9.19%	3.15%	7.54%	8.64%	8.98%	8.17%
FOCUS SERIES								
Special Opportunities Focus	Jan 1, 2014	1.78%	4.55%	2.10%	4.98%	6.21%	N/A	7.04%
Emerging Markets Opportunities Focus	Feb 1, 2019	0.76%	N/A	N/A	N/A	N/A	N/A	N/A

Gross-of-fees performance ($CAD) as of September 30, 2019. Returns for periods greater than 1 year are annualized.

Performance statistics for ETF Managed Portfolios are calculated from documented actual investment strategies as set by Forstrong's Investment Committee and applied to its portfolios mandates, and are intended to provide an approximation of composite results for separately managed accounts. Actual performance of individual separate accounts may vary with average gross "composite" performance statistics presented here due to client-specific portfolio differences with respect to size, inflow/outflow history, and inception dates, as well as intra-day market volatilities versus daily closing prices. Performance numbers are net of total ETF expense ratios and custody fees, but before withholding taxes, transaction costs and other investment management and advisor fees. Past performance is no indication of future results. A rate of return for one year or less is not annualized.