

Markets

Best Canada Bond Fund Awaits Trump-Driven Junk Opportunities

by Allison McNeely
March 28, 2017

- ▶ Renaissance Corporate Bond Fund has returned 2.1% this year
- ▶ Would add high-yield holdings again if spreads widen

Can Donald Trump deliver? That's the question Canada's best-performing bond fund this year is asking as it seeks to extend its advantage in a low-yield world.

The Renaissance Corporate Bond Fund, managed by Canadian Imperial Bank of Commerce's CIBC Asset Management unit, has returned 2.1 percent year to date, the best result for the first quarter among 36 funds focused on Canadian bonds, according to data compiled by Bloomberg. The average return is 1.1 percent. The C\$1.2 billion (\$900 million) Renaissance fund has a one-year total return of 7.1 percent, compared with a 2.3 percent average return for the group.

The fund's managers are keeping an eye out for opportunities to profit from widening credit spreads as the new U.S. president's ability to carry out his election promises is very much in question after last week's health-care defeat.

"The big picture really hasn't changed," Patrick O'Toole, one of the fund's managers, said by phone from Toronto. "We've been expecting this year to have not as fruitful a year in corporates as last year, whether they're investment grade or high yield, but we do still expect them to beat government bonds."

The Phillips Hager & North Long Bond Pension

Trust ranked second, with a total return of 1.8 percent, and the RBC Private Corporate Bond Pool had the third-best returns of the group at 1.7 percent, according to data compiled by Bloomberg.

Market Expectations

Expectations for corporate-bond returns are decidedly more modest following a year in which high yield returned 17 percent. This year they've returned 1.8 percent, as rising government bond yields since the U.S. election erode spreads.

Credit spreads can be expected to remain tight and government-bond yields will continue to drift higher, with the Canada 10-year note expected to reach around 2 percent this year from 1.59 percent, said Joey Mack, director of fixed income at GMP Securities LP in Toronto.

"Maybe the Fed is not going to hike that fast, and maybe Trump is not going to get as much done as we previously thought," he said. "This is probably going to be a better year for active managers versus the indexes, because the indexes can't fight the tape. They've got to ride the yield up."

Oil Drops

Credit spreads have widened since hitting a low in early March as the price of oil dropped below \$50 a barrel and investors began to peel off some of the Trump-euphoria trade, CIBC's O'Toole said. The portfolio has a high-yield weighting of 21 percent. If spreads were to widen out about another 150 basis points, or 1.5 percentage points, from around 400 basis points currently, the fund would look to

selectively increase the weight by another 1 percentage point to 2 percentage points in the portfolio, O'Toole said.

CIBC's view of economic growth in Canada and the U.S. is below consensus because it doesn't see capital expenditure being particularly strong, O'Toole said. He's not holding his breath for any instant boost from Trump policies, either, he said.

"The market, since Trump won, has sort of priced in that he's going to be able to do everything quick, and you come to the realization that he might get some of these things done, but it won't be as quick as we all think," he said. "The boost to corporate profits from lower taxes might not be a 2017 phenomenon, maybe it'll be 2018 or a 2019 phenomenon."

CIBC is waiting for potential opportunities in names that are sensitive to capital expenditure needs, such as construction and construction equipment, he said. The fund is overweight investment-grade and high-yield telecom; industrials; and investment-grade real estate investment trusts, O'Toole said.

The price of oil isn't making them "all that nervous," O'Toole said, and CIBC expects it to trade between \$45 and \$60 this year. It will be tougher for oil-producing nations to stick to their production-cut targets, he said, and if oil moves below \$45, it could also present investing opportunities, he said.

"The hardest thing to get right is if you try to time things like increasing the weight in high yield, or reducing the weight in high yield," he said. "If you're getting two-thirds of the move right, you're doing pretty well."

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