CIBC ASSET MANAGEMENT

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Opportunities in fixed income investments

It's an exciting time to be a fixed income investor

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Based on the last decade, few investors would think "fixed income" and "exciting" could be used together in the same sentence. Negative yielding bonds and ultra-low interest rates have made fixed income the antithesis of exciting. However, having now lived through the most aggressive monetary policy tightening cycle in decades, fixed income offers investors something they aren't used to. Given their attractive income and upside potential, your bond allocation could be the most exciting part of your portfolio in 2024.

The Bank of Canada (BoC) has paused rate hikes and cuts are likely later this year. That sets the stage for fixed income to generate strong risk-adjusted returns, with upside potential that would get anyone excited. History confirms this view.

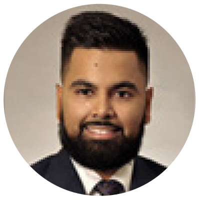
On average, as of January 2024, Canadian bonds delivered investors a 7.7% return the year after the BoC made its last rate hike (going back to 1998). That compares to an average of 8.2% for Canadian equities. The key difference? The lowest return for Canadian bonds was 5% following the BoC's last hike in 1998, Canadian equities returned negative 14% a year after the BoC stopped hiking in May 2000.

Strong risk-adjusted returns

If the BoC is nearing that inflection point, fixed income should be high on the radar of investors looking for strong risk-adjusted returns. Indeed, the high-flying returns generated by fixed income after peaks in interest rates is a global phenomenon. An investor in global bonds who added fixed income holdings after local highs in interest rates would have generated an average three year cumulative return of 27%.

But timing re-entry into fixed income can be difficult. Predicting the future path of interest rates and central bank decisions isn't easy. 2023 was a prime example. Market participants expected significant rate cuts from the US Federal Reserve in 2023—this didn't happen. In fact, we saw four rate hikes. Trying to perfectly time your investment with peaks in interest rates is near impossible. Consider the latest peak in Canadian interest rates experienced in October 2023. Canadian bonds produced an 8% return over November and December. If you had waited until December to invest, you missed out on 5% of that return. So why invest now? Investors are getting paid to wait for a reversal in interest rates with a yield in Canadian fixed income that is the highest since 2009.

These are the types of fixed income backdrops we should all get excited about.



Finding unique investment solutions in target maturity bond funds

By Ebad Saif
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In today's current environment of attractive fixed income yields, many investors are turning to buying individual bonds, guaranteed investment certificates (GICs) or other term-to-maturity securities to satisfy future, short-term cash flow needs. These investments provide certainty of maturity, return of capital and defined maturity dates that can be aligned with future life events when cash outflows are required such as a vacation or buying a home. But these investments also miss out on some of the advantages offered by traditional bond mutual funds such as diversity and active management.

The unique opportunity with target maturity bonds

So how do investors get the best of both worlds? We believe the answer is target maturity bond funds. These investments offer a unique opportunity to own a diversified, professionally managed, yield enhancing bond portfolio. Target maturity funds also offer pre-designated term to maturity dates that give investors the same certainty in return of capital as owning an individual bond or GIC.

An added benefit is that target maturity strategies also offer advantageous characteristics of traditional bond funds such as diversification by investing in a variety of corporate and government issuers to avoid concentration risk as well as the active management by portfolio managers and credit research teams. With target maturity bonds, investors benefit from active security selection decisions where portfolio managers find the best individual bonds to invest in from a risk-reward standpoint as well as the institutionalized structure that comes with a large fixed income platform including execution, portfolio analytics and team experience.

Investing in discount bonds

As part of a well-balanced investment strategy, investors should also look for mutual funds and portfolio managers that prioritize buying discount bonds. A discount bond is a bond that offers a lower coupon than the prevailing market rate and therefore trades below its par value. For taxable investors, the return profile of discount bonds can offer a significant tax advantage when compared to GICs because a larger portion of the total return is derived from capital gains which receive lower tax treatment than interest income.

This is important because the current backdrop offers a unique opportunity for investors to buy both government and corporate bonds that are currently trading at a discount to their par value—a phenomenon that hasn't been seen since the 1980s.

Overall, we think now is a unique and exciting time to explore new ways to drive outcomes for investors and target maturity bonds can play a key role in the fixed income portion of a well-balanced investment portfolio.

About CIBC Asset Management

At CIBC Asset Management, we believe that every customized investment solution begins with research and rigour. We specialize in a variety of investment solutions such as equities, fixed income, currency management, liability-driven investments, asset allocation, and responsible investments.

Across a spectrum of investment solutions, we commit to best-in-class research. Dedicated sector and regional analysts focus on industry research and security-specific idea generation. Our investment professionals leverage deep and diverse expertise by sharing proprietary research across asset-class teams. By sharing insights across asset class teams, we maximize opportunities to add value to our client portfolios.

We provide our clients with our research insights and expertise on industry issues and themes that matter most to them.

Contact us any time

To learn more about CIBC Asset Management and our investment solutions, please contact your advisor or your CIBC representative. For more insights, connect with us on LinkedIn and Twitter.

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