

## 2025 Market and Economic Outlook: Q&A with Adam Ditkofsky

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*Adam Ditkofsky, Senior Portfolio Manager, Fixed Income*

**Moderator:** Adam, you opened a recent call by saying 2025 is “one of the more interesting years we’ve had in a long time.” What, specifically, makes this year so unusual?

**Adam:** It’s the remarkable convergence of macro shocks. We’ve got tariffs making a comeback, geopolitical tensions heating up, and President Trump back in the mix—all amplifying headline noise and volatility. Yet beneath that noise, there’s a real split in the data between what I call “soft” versus “hard” signals. Soft indicators—like surveys and sentiment—collapsed almost immediately after tariff headlines, but hard data, such as US retail sales and employment, stayed surprisingly resilient. That divergence is unusual and forces investors to dig deeper than headlines before making allocation calls.

**Moderator:** Let’s separate the US and Canadian pictures. How would you grade the US economy right now?

**Adam:** The US still looks solid. The American consumer is showing only modest signs of weakness, if any; June retail sales, for instance, came in stronger than expected. The hard indicators haven’t rolled over. We’re just now starting to see the first real uptick in tariff revenue collections, so the impact on corporate margins is still taking shape. Could growth soften? Sure, but it would be from a position of relative strength. That explains why the market is only pricing in 1-2 Fed cuts for the second half of 2025, even though we’re projecting closer to 100 basis points over the next twelve months.

**Moderator:** Contrast that with Canada—your tone there is more cautious.

**Adam:** Very much so. I flagged three pressure points:

1. **Unemployment:** Canada’s unemployment rate has climbed to roughly 7 percent and continues to edge higher, even after the recent “positive” jobs report. Most of the job gains were in part-time positions. With about three job seekers for every available role, persistent slack in the labour market remains a major economic concern—and it could push the Bank of Canada toward additional rate cuts.
2. **Merchandise trade:** Tariffs have triggered what I’d call a collapse in our trade balance with the US. Two consecutive months of record deficits suggest Canada is, at the margin, more of an importing than an exporting nation right now. If that trend doesn’t reverse, it becomes a sustained drag on the economy.
3. **Real estate:** It’s not a crash, but stagnant prices aren’t providing the wealth effect Canadians rely on—remember, about 40% of average household wealth is tied to housing, and it’s even more for lower-income groups.

Put those together, and you get higher risks of a recession, which was recently assigned a 35% probability in our Q2 forecast.

**Moderator:** Given that backdrop, what do you expect from the Bank of Canada versus the Fed?

**Adam:** The BoC is on hold right now. Markets have backed out additional cuts because inflation is under control, and the latest jobs report has bought them time. But with headline inflation below 2% and real growth wobbling, I think the bank will ultimately need to ease—just not in a straight line.

In the US, we foresee two formal cuts priced in, but we think a full percentage point of easing over the next 12 months is plausible, particularly once President Trump appoints a new Fed chair after Jerome Powell's term ends in May. In short: Canada pauses, then cuts; the U.S. cuts more steadily, albeit from a higher starting point.

**Moderator:** How is the shape of the yield curve informing your bond strategy?

**Adam:** The inversion that dominated 2023 and early 2024 is gone. We're back to a normal, upward-sloping curve, meaning investors finally get paid to extend duration. Five-year Canada bonds yield more than two-year paper; seven- and ten-year bonds offer even better compensation. That re-steepening unlocks two opportunities:

- **Front-end mispricing:** Markets are not fully discounting the probability of rate cuts, so yields inside five years look 15–30 bps too high by our estimates.
- **Duration premium:** Because the curve is steeper, adding term not only boosts yield but also sets up capital appreciation if central banks follow through on easing.

**Moderator:** Some investors still view duration as the enemy after 2022. Is that fear misplaced now?

**Adam:** It is. In 2022, we faced 8–9% inflation and zero policy rates—bonds couldn't compete. Today, headline inflation is below 2% in Canada and around 3% in the US. Ten-year government bond yields are approximately 3.5% in Canada and 4.25% in the US. Bonds are once again generating real returns. With policy rates likely heading lower, holding duration is no longer a high-risk trade; it's insurance against an economic slowdown or equity drawdown.

**Moderator:** Credit spreads have ground tighter. How are you balancing yield pickup versus valuation risk?

**Adam:** We're decidedly defensive in long credit, but new supply is scarce, so long corporate spreads have been performing well. Although valuations look expensive from our perspective. Across our portfolios, we're underweight long corporates and prefer front-end IG positions or floating-rate assets like CLO tranches embedded in the CIBC Income Advantage Fund.

**Moderator:** You co-designed the CIBC 2025 Investment Grade Bond Fund. With its bonds rolling to par, what should advisors do with maturing capital?

**Adam:** First step: clarify the client's investment horizon. If they have a known liability in 2026 or 2027—tuition, cottage purchase—then laddering into the 2026 or 2027 Target Maturity Funds makes sense. You maintain certainty, sidestep reinvestment risk, and pick up roughly 3.8% to 4.1% on a GIC-equivalent basis. If the money is truly long-term, I'd pivot to our perpetual active solutions—the CIBC Canadian Bond Fund or the CIBC Fixed Income Pools—because they combine higher yields (around 4.5%) with duration that benefits when rates fall.

**Moderator:** For advisors with USD-denominated cash, does the strategy differ?

**Adam:** Yes, the calculus changes because unhedged U.S. short-term IG funds still yield north of 6%. If the client has natural USD liabilities—Florida property taxes, tuition at a U.S. school—parking money in a USD Investment-Grade Bond Fund is compelling. You avoid hedge costs and pick up a meaningful yield premium. But the same reinvestment risk applies: those yields will compress if the Fed cuts, so it's better to lock in paper maturing in 2027 rather than rolling three-month T-bills indefinitely.

**Moderator:** Let's close on risk management. What keeps you up at night?

**Adam:** Two tail risks. First, a policy mistake—if tariffs spiral into a broader trade war, inflation could spike even as growth stalls, forcing central banks into a difficult corner. Second, credit complacency: leverage looks comfortable at current spreads, but if margins compress on the back of tariffs or weaker demand, downgrades could cascade. That's why liquidity and quality screens in our portfolios are tight. The good news is that the bond market now compensates you for taking measured duration risk, so you no longer have to stretch for the last nickel in credit to meet client income targets.

**Moderator:** And the single biggest opportunity?

**Adam:** It's exactly the flip side: locking in medium-term yields before the easing cycle gains traction. We haven't seen bond funds with yields above 4.5% for most of the past decade. Investors can secure higher "risk-free" government bond rates today and potentially benefit from capital gains when the Bank of Canada and the Fed eventually move to lower policy rates. Maturing 2025 fund capital offers a timely opportunity to take advantage of this window.

**Moderator:** Adam, insightful as always. Thanks for sharing your views.

**Adam:** My pleasure. Always happy to chat about markets.

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