RBC Canadian Short-Term Income Fund

Commentary as at December 31, 2023

Canadian short-term bonds recorded solid gains in 2023, with the bulk of the returns coming in the fourth quarter of the year, as falling inflation boosted expectations that central banks would be able to start rolling back two years of interest-rate hikes.

The recovery, part of a broader surge in fixed-income assets, came after tighter monetary policy through the first three quarters of 2023, started to slow economic growth and reduce inflation. By the fourth quarter, a weaker economic landscape and falling inflation suggested to investors that central-bank-set policy rates would come down in 2023, triggering a rally in the broad bond market. The Bank of Canada (the “BOC”) lifted its benchmark rate to 5% during the period from 4.25% as inflation remained above the central bank’s 2% target.

The Fund’s relative returns benefited from an above-benchmark allocation to corporate bonds, which outperformed comparable-maturity Government of Canada securities. Performance was also aided by a lower sensitivity to changes in interest rates than the Fund’s benchmark.

The extra premium earned on corporate bonds, above the yield on government bonds, ended the year at its lowest level in almost two years. Valuations at these levels leave investors with less protection against the impact of a deep economic downturn or a re-acceleration of inflation if the BOC is forced to keep rates higher. The Fund remains overweight in corporate bonds as they remain attractively valued on a historical basis. Default rates remain relatively low and corporate balance sheets relatively healthy.

The Fund’s sensitivity to changes in interest rates was brought in line with the benchmark in late 2023 due to expectations that the BOC will begin to lower rates sometime in 2024.