RBC Global Asset Management

RBC $U.S. Core Bond Pool

Commentary as at December 31, 2022

In January 2022, interest rates were near record lows and monetary stimulus was unprecedented, helping to lift U.S. stocks to record levels as much of the Western world tried to move on from the pandemic. But Russia's invasion of Ukraine in February helped propel rapidly rising inflation to its highest level in four decades. The response to inflation – a rapid rise in global interest rates – led to the worst year for a U.S. balanced portfolio since 1937 and marked the first time since at least 1872 that both U.S. stocks and U.S. bonds had double-digit declines. Meanwhile, Chinese President Xi's appointment to an unprecedented third term made him the country's most powerful political leader since the 1970s, amplifying geopolitical tensions.

Bonds issued by governments of developed countries declined, posting their worst returns since 1985, as major central banks aggressively raised short-term interest rates to fight inflation running at its highest level in 40 years. In 2022 alone, the U.S. Federal Reserve (the "Fed") raised its short-term benchmark rate seven times, lifting the fed funds rate to a range of 4.25% to 4.50% from near zero. The Bank of England increased its policy rate eight times to 3.5%, and the European Central Bank four times to 2%, the highest level since 2008. Then, in December, the Bank of Japan surprised investors by adjusting monetary policy in a way that allowed yields to move higher. Generally speaking, yields on short-maturity bonds rose more than those on long-maturity issues, reflecting expectations that higher rates would hinder economic growth.

The Fund's returns were negatively affected by holdings in the $U.S. Global Bond Fund, the BlueBay $U.S. Global Investment Grade Corporate Bond Fund (Canada) and the RBC $U.S. Investment Grade Corporate Bond Fund.

The portfolio manager expects the 2022 interest-rate hikes to start holding back economic growth significantly in 2023, raising the likelihood that North America and Europe will fall into recession. A recession marked by rising unemployment would relieve pressure on central bankers to continue hiking interest rates and would indicate, at a minimum, that an end to the tightening cycle is coming. Canadian and European corporate bonds are pricing in a mild to moderate recession, while U.S. corporate bonds suggest that growth will hold up better. In all cases, the portfolio manager stands ready to accumulate attractively priced assets in the event of further declines in bond prices.