RBC Global Asset Management

RBC Monthly Income Bond Fund

Commentary as at December 31, 2023

Canadian bonds posted gains in 2023, breaking a two-year losing streak. Fixed-income returns were bolstered, particularly in the fourth quarter, by signs that slowdowns in inflation and economic growth, especially in Canada and Europe, would give central banks the cover they needed to bring down their benchmark rates from the highest levels in two decades. In particular, the avoidance of a highly anticipated recession made the job of policymakers more difficult, as fears persisted that lower rates would rekindle inflation.

Slowing inflation and economic growth in the first half of 2023 allowed the Bank of Canada (the "BOC") to decrease the pace of interest-rate increases. The BOC increased interest rates three times during the period, compared with seven times in 2022, resulting in a benchmark rate of 5.0%. Canada's 10-year yield ended the year slightly lower at 3.11% but traded in a range between 2.72% and 4.24% – the highest since July 2007. The U.S. Federal Reserve (the "Fed"), meanwhile, continued raising its short-term benchmark rate, also at a reduced pace, bringing the benchmark rate to a peak of 5.25% to 5.50%. Government of Canada bonds outperformed their U.S. counterparts as investors bet the BOC would end rate hikes earlier and possibly ease more aggressively than the Fed.

Returns were bolstered by exposure to the Phillips, Hager & North Short Term Bond & Mortgage Fund, the Phillips, Hager & North Total Return Bond Fund and the RBC Bond Fund.

The portfolio manager believes the BOC has finished the current round of rate hikes and will start lowering rates in 2024 as the Canadian economy slows under the impact of tighter financial conditions. Given record-high levels of debt and high interest rates, Canadian households are cutting back their spending, and businesses are borrowing and investing less. The portfolio manager's view is that domestic bond yields will therefore continue to fall as the economy slows through the first half of 2024.

Over the longer term, bond yields may stay higher as the Canadian government will have to increase bond issuance to fund expanded social spending. Yields could also be supported by persistent inflation, which would force the BOC to hold policy rates at levels that might limit economic growth.

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