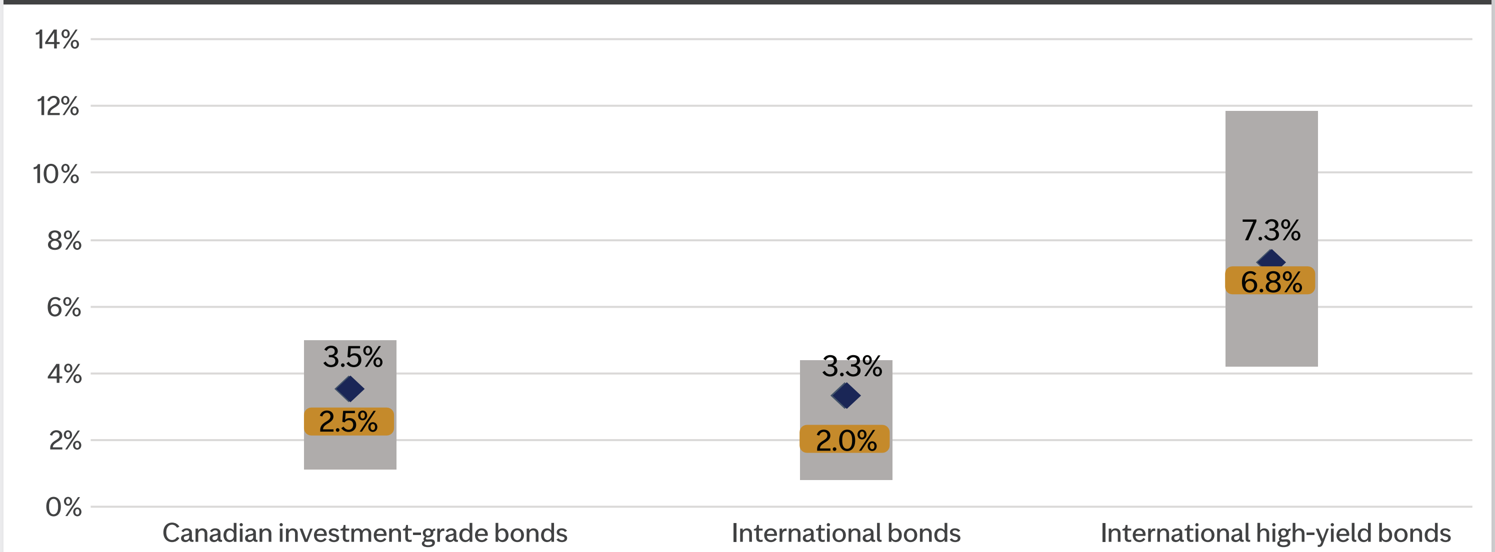
Fixed-income outlook

Bond yields remain above 10-year averages



Source: FactSet and Edward Jones.

The Bank of Canada (BoC) continued cutting its policy rate in recent months as inflation has moderated. Bond yields remain above their averages over the past decade, despite pulling back from recent peaks, potentially setting the stage for stronger returns ahead. Extending duration with intermediate- and long-term bonds and bond funds can help lock in yields for longer, ahead of likely additional BoC rate cuts.

Higher bond yields offer potential for stronger returns — Bond yields rose over the past few years as the BoC hiked interest rates to fight inflation. As shown in the chart above, yields for the major fixed-income asset classes remain above their averages over the past decade. This is despite pulling back from their recent peaks as inflation moderated and markets priced in expectations for BoC rate cuts. Higher yields mean bonds generate more income because income is a key driver of bond returns, it also potentially sets the stage for stronger returns ahead.

Extending duration can help lock in yields for longer — Short-term yields could fall further as the BoC continues cutting rates. This will likely steepen the yield curve and raise reinvestment risk for short-term bonds and GICs. We see value in intermediate- and long-term bonds and bond funds, which can help lock in yields for longer. Additionally, bond prices typically rise when interest rates fall, and vice versa, offering the potential for higher values. Maturing or called bonds and GICs could be a source of funds to extend duration.

The BoC appears poised to continue cutting rates — Since starting its easing cycle in June, BoC recently noted that broad inflationary pressures are easing, with excess supply in the economy putting downward pressure on inflation, while price increases in shelter and some other services partially offset. With inflation moderating toward the middle of the target range, monetary policy can likely be less restrictive, potentially allowing the BoC to continue cutting rates.

▶ Action for investors

Bond yields remain above their 10-year average, offering the potential for stronger returns ahead. Intermediate- and long-term bonds and bond funds can help you lock in rates for longer. Maturing or called bonds and GICs could be a source of funds to extend duration or to reallocate to underrepresented asset classes.

Before investing in bonds, you should understand the risks involved, including credit risk and market risk. Bond investments are also subject to interest rate risk such that when interest rates rise, the prices of bonds can decrease, and the investor can lose principal value if the investment is sold prior to maturity.

