The Fortnighter

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We have a new "quote system" at RBC DS – and one of the default settings for the new program is to display the year-to-date price change for the securities I follow.

As I went through my list this morning, one year-to-date change jumped out at me. **Up 140%.** Since January 1st of this year(!) Can you guess? Tesla? GameStop? Bitcoin?? Nope – the yield on the Government of Canada 5-year bond!

Granted, as I write this the 5-year Canada was still only yielding 93 bps - less than one percent. But that's a pretty dramatic change in just 8 weeks. And if you don't think that's a big deal, try substituting "5-year mortgage rate" into the above sentence - got your attention now?

Rates appear to be going up. And that ties in to the discussion in the last issue of the Fortnighter (#70) on inflation expectations. Economies seem to be recovering, prices are rising and that is sending yields on fixed-income securities higher.

For investors (as opposed to savers), higher rates can be problematic. More expensive borrowing costs for corporations can mean lower profits. Rising <u>yields</u> on bonds (like those 5-year Canada's cited above) mean declining <u>prices</u> for bond investors. And higher rates in general mean investors may be inclined to sell stocks and switch to bonds.

The big question here is whether rising rates represent a fundamental shift in the market place and whether it warrants a change in investment strategy. I don't think so (yet).

First of all, we've seen this before! Bond yields have been declining pretty steadily for 25 years and every so often there's a "head fake" higher. We still have a ways to go before that long downward trend emphatically reverses itself.

And rates are still low historically – that 5-year bond yield is below the current rate of inflation – so holders are still losing money in real terms. Rates don't seem (so much) to be spiking higher due to a dramatic pickup in economic activity – as much as they are simply getting back to something more reasonable.

And equities can continue appreciating in the face of rising interest rates – after all, those rate increases are really a reflection of a recovering economy. Long term, economic growth should be good for stocks.

My opinion on the current situation is that we are not going to see dramatically higher inflation and interest rates in the years ahead. After the last recession, central banks kept the "taps open" for years – and both economic growth and inflation never really picked up. Stocks did fine.

There are differences with this recovery, of course. And we should expect uncertainty as we transition forward. I continue to see fundamentals supportive of our current investment model. As always, happy to discuss!