Beutel Goodman

Monthly Fixed Income Report

BEUTEL GOODMAN Investment Counsel

February 28, 2021

Market Snapshot

Canadian Rates	Current	Change (Basis Points)		
		Month	QTD	YTD
3 Month T-Bill Yield	0.13%	6	7	7
2 Year Bond Yield	0.33%	15	14	14
5 Year Bond Yield	1.01%	53	59	59
10 Year Bond Yield	1.42%	54	71	71
30 Year Bond Yield	1.83%	36	62	62

	Current	Change (Basis Points)		
		Month	QTD	YTD
3 Month U.S. T-Bill Yield	0.04%	-2	-5	-5
2 Year U.S. Bond Yield	0.14%	3	1	1
5 Year U.S. Bond Yield	0.75%	30	39	39
10 Year U.S. Bond Yield	1.44%	33	51	51
30 Year U.S. Bond Yield	2.17%	30	52	52

Currencies	Current	Change (%)		
		Month	QTD	YTD
CAD/USD	1.27	-0.9%	-0.6%	-0.6%
EURO/USD	0.82	0.1%	0.8%	0.8%
Trade Weighted USD	90.88	0.3%	1.0%	1.0%

Equity Indices	Current	Change in TR (%)		
	(Price Index)	Month	QTD	YTD
S&P 500	3811	2.8%	1.7%	1.7%
S&P/TSX	18060	4.4%	4.0%	4.0%

Credit Index OAS	Current	Change (Basis Points)		
		Month	QTD	YTD
Investment Grade	108	-6.0	-11.0	-11.0
High Yield	326	-36.0	-34.0	-34.0

Commodities	Current	Change (%)		
		Month	QTD	YTD
WTI Crude Oil (US$/bbl)	$61.50	17.8%	26.8%	26.8%
WCS Crude Oil (US$/bbl)	$50.68	29.7%	52.8%	52.8%
Gold (US$/ounce)	$1,734	-6.1%	-8.6%	-8.6%

Source: Macrobond, Bloomberg (for Credit Index OAS)
As of February 28, 2021

Market Commentary

February 2021 will be a month that the bond market will remember. While not as drastic and devastating as the 1994 sell off or the 2013 taper tantrum, interest rates did rise significantly in February, with the U.S. 10-year Treasury bond yield rising 33 basis points (bps) and the Canadian 10-year rising a whopping 54 bps. The bloodbath in the bond market was driven in part by the expectation of the end of the COVID-19 pandemic, via vaccines, and the next round of fiscal stimulus in the U.S.

When rates bottomed and began to rise last summer, the increase in rates was driven primarily by expectations for higher inflation. The sell-off in February 2021, however, was driven mostly by the real growth component and thus reflects more optimistic growth expectations.

GDP data for December came in stronger than expected for Canada (9.6% QoQ, annualized) and was 4.1% (QoQ, annualized) in the U.S. While GDP growth rates are strong, it is important to recognize that GDP in both countries remains below the peaks reached in 2019.

In an embarrassing moment for the Bank of Canada and Statistics Canada, their “new methodological change” for inflation had to be reversed as the adjustments for the pandemic led to atypical metrics for CPI-trim and CPI-median[1]. The final numbers show inflation tracking close to the 2.0% target, but headline inflation remains weak at 1.3%. The labour market is also slowly recovering but unemployment numbers continue to improve mostly due to the participation rate falling rather than employment rising. U.S. Federal Reserve (Fed) Chair Powell reiterated his view to the House Financial Services Committee on Wednesday February 24 2021, that the focus will remain on the labour market, not on inflation.

Provincial curves flattened in February as 10-year yields widened by 1 bp while 30-year spreads tightened by 3 bps. Domestic provincial bond supply decreased in the month to $7.8 billion versus $9.35 billion issued in January. Ontario’s Q3 budget update projected an unchanged deficit of $38.5 billion. Revenue was up $612.0 million, while expenses were up $2.6 billion from November’s budget. The province exhausted $2.0 billion of the $2.5 billion contingency reserve, which is why the deficit was unchanged. Quebec’s Finance Department estimates the province’s gross debt will be $220.8 billion by March 31, 2021, or 50.5% of GDP. However, Quebec’s auditor general, Guylaine Leclerc, says the province has underestimated its debt by $12.0 billion.

Overall, corporate spreads tightened marginally by 1 bp in February. For most of the month, corporate credit spreads tightened in on the back of strong corporate earnings, progress on the COVID-19 vaccine front and overall optimism for the economy. However, the sudden spike in interest rates during the last week of February caused spreads to soften on the increase in volatility.

[1] CPI-trim and CPI-median are statistical adjusted measures of inflation meant to remove and adjust the measure of inflation for volatile components.

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New corporate issuance was strong during February with $9.75 billion issued compared to $8.95 billion issued during the same period last year. We continue to expect new corporate issuance to remain below 2020 levels given the amount of prefunding corporations did last year. However, the recent backup in yields could bring potential issuances forward to earlier in the year.

There were a few credit rating changes during the month of February. In January, S&P revised their risk assessment on the oil and gas industry to “Moderately High Risk” from “Intermediate Risk” to reflect rising industry risks around energy transition, commodity price volatility, and pressure on profitability. Following this, the agency placed several oil and gas producers on CreditWatch Negative, including Canadian Natural Resources. In February, S&P subsequently downgraded Canadian Natural Resources (CNRL) to BBB- from BBB to reflect their revised industry risk assessment and expectation that the company’s cash flow and leverage metrics did not support the current rating. The downgrade on CNRL resulted in both Inter Pipeline (Corridor) Inc. and North West Redwater Partnership Inc. also being downgraded by one notch, as CNRL is a major counterparty to both issuers.

The FTSE Canada Universe Bond Index declined 2.52% in February. The Provincial and municipal sectors underperformed, returning -3.23% and -3.05%, respectively. The Federal and Corporate sectors' shorter duration helped them outperform, with returns of -2.14% and -1.95%, respectively, as yields rose.

Topic of the Month

365 Days Later

The COVID-19 pandemic is now entering its second year. The world has been in some form of lockdown for a year now. Worldwide almost 117 million people have contracted the virus as at March 8, 2021, and nearly 2.6 million have died. In this report, we look back on the economic transformation that has occurred over the last year, discuss the possible future of the pandemic and consider how assets should perform under different scenarios in the months ahead.

For this analysis, we break down the scenarios into three discrete possible outcomes: the Good, the Bad and the Ugly.

Before we get into the scenarios, however, we note that the recovery is shaping up to be one unlike that of previous recessions. This recession has not been driven by asset bubbles, there has been no excess buildup of debt, and inflation remains well-behaved. The economy came to a dead stop based on a virus. As a result, the recovery could be very swift, with strong GDP growth unleashed by pent-up consumer spending fueled by excess stimulus. So really what we review below is the potential speed of the recovery, not the recovery itself. This is important, as it will likely determine whether stock and bond markets are ahead of themselves in what they expect to happen and when.

The term vaccine is derived from the Latin word vaccinus, meaning of, or derived from a cow. It got is name from the first vaccine, designed by Edward Jenner, who in 1798 inoculated an eight-year-old boy with matter from a cowpox sore on a milkmaid’s hand. Cowpox is a variant of the smallpox virus family, and consequently protected the boy from smallpox.

The Good – Vaccine and Herd Immunity by End of 2021 (High probability)

The most optimistic of our three cases is the one where vaccine roll out and a return to normal occurs by the end of 2021. We currently believe the probability of this outcome is the highest of the three.

At this time, the vaccine rollout is accelerating, and new types of vaccines continue to be approved. According to U.S. news, it will have enough supply to vaccinate the entire country by the end of May and will continue to administer them. Canada's vaccination program has been slowed by lack of supply and a patchwork of disjointed provincial government rollout plans; however, expectations are for vaccinations to ramp up quickly in the upcoming months.

As the COVID-19 vaccine rolls out globally, it is important to highlight that this is not the first time we have seen a global effort to eradicate a virus. The World Health Organization (WHO) in 1967 began a massive international search for smallpox outbreaks, and by 1980 smallpox was certified by the WHO to be eliminated. Polio, measles, tetanus, and mumps are also illnesses that have fallen victim to vaccines, and though not completely eradicated, remain well under control.

If the COVID-19 vaccines work as planned, we could reach herd immunity in the developed world by the end of 2021. This is mostly what the markets are pricing in as rates sold off dramatically in February, driven partially by expectations of excess fiscal stimulus in the U.S. and that a return to normal, sooner rather than later, would push forward economic growth.

If this scenario plays out, we could see interest rates continue to rise and the yield curve to eventually flatten, as expectations of higher overnight rates get pulled forward. In credit, sectors severely affected by COVID-19 should outperform as should cyclical assets.

The Bad – Slower rollout; Vaccine and Herd Immunity in 2022 (Medium-Low Probability)

A slightly less positive outcome is possible if the rollout takes longer than expected. Governments are not typically known for their ability to work efficiently.

We continue to monitor the rollout of vaccines and believe that this scenario would cause risk assets to sell off, interest rates to fall and the yield curve to steepen. If this were to occur, it would provide, in our opinion, a buying opportunity for risk assets and an opportunity to renew a short-duration position.

In this scenario, we would still reach herd immunity; however, the timing is extended further out, pushing economic liftoff into 2022.

The Ugly – Virus Variations; Vaccine and Herd Immunity Indefinite (Low Probability)

The worst scenario would be the emergence of a severe variant of the virus that is more transmittable and deadly and is resistant to the vaccines. While some variants are springing up, they appear thus far to be contained and manageable. Furthermore, the world is very attuned to these variants, and technology and systems continue to improve the monitoring of the outbreaks and plan to adjust the responsiveness of vaccines.

If this scenario were to occur, we would likely see the same response in markets that occurred during the first wave, where corporate spread widened, and Treasury yields rallied. However, we currently place a low probability on this scenario.

Portfolio Positioning

Our portfolios and current views are mostly aligned with the "good" outcome, though we have slightly reduced our exposure to risk assets and closed out our short-duration position as rates now appear to be stretched. We will look for any widening in spread products to increase our exposure in risk assets. We are also diligently debating and analysing the yield curve and may view any back-up in yields as an opportunity to re-initiate our short-duration position.

The Real Economy Over The Pandemic

The Canadian economy has seen some major transformations over the last year.

COVID by the Numbers		
Human cost		
Total Cases: Canada per 1M pop.	22,634	As of February 28 2021
Total Cases: U.S. per 1M pop.	85,433	As of February 28 2021
Mortality: Canada per 1M pop.	576	As of February 28 2021
Mortality: U.S. per 1M pop.	1,537	As of February 28 2021
Vaccines: Canada per 1M pop.	49,580	As of February 28 2021
Vaccines: U.S. per 1M pop.	228,132	As of February 28 2021
Stimulus		
Fiscal: Canada Net Debt Increase	20.5%	Net Debt, IMF Fiscal Monitor, Percent of GDP from Q4 2019 to Q4 2020
Fiscal: U.S. Net Debt Increase	22.7%	Net Debt, IMF Fiscal Monitor, Percent of GDP from Q4 2019 to Q4 2020
Monetary: Canada Chg in O/N Rate	-1.50%	From March 2020
Monetary: U.S. Chg in O/N Rate	-1.75%	From March 2020
Markets		
S&P/TSX	8.0%	YoY Percent Change (February 28 2021)
S&P 500 Return	30.2%	YoY Percent Change (February 28 2021)
Canada 10-year Bond Yield	+32 bps	YoY Change in yield (February 28 2021)
U.S. 10-year Bond Yield	+31 bps	YoY Change in yield (February 28 2021)
Economy		
Canada GDP from peak	-3.2%	Peak GDP to Q4 2020
U.S. GDP from peak	-2.4%	Peak GDP to Q4 2020
Canada Job Loss from peak	-858,300	Peak Employment to January 2021
U.S. job Loss from peak	-9,475,000	Peak Employment to February 2021
Canada: Appreciation of Housing	5.4%	YoY Percent Change (January 2021)

Source: Beutel, Goodman & Company Ltd., WHO, Our World in Data, Macrobond, StatCan, BLS, IMF, TMX, SPDJI, BoC, Fed, U.S. Department of Treasury

GROSS DOMESTIC PRODUCT (GDP)

GDP in Canada fell almost entirely due to Consumption. Historically, Consumption has remained stable through the economic cycle; typically Inventories and Fixed Capital have driven recessions. This time, lock-downs prevented people from consuming goods and services, making this recession unique. Looking forward, we expect Consumption to rebound as the economy begins to open and the excess savings that occurred in 2020 are released into the economy.

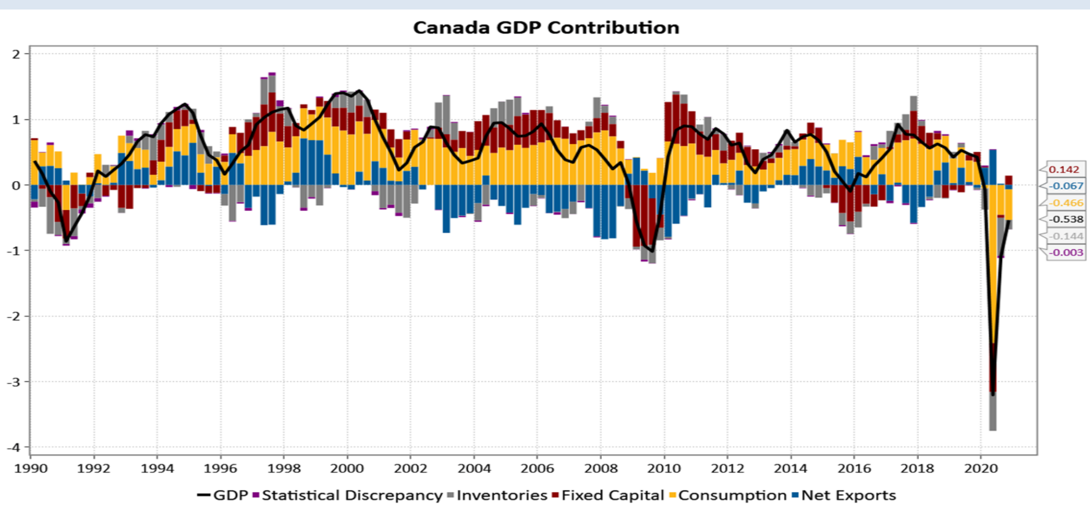

Figure 1 depicts the nominal GDP quarterly contributions by sector to annual growth (smoothed) for Canada. Unlike prior recessions, the COVID-19 recession was driven by a drop in consumption.

LABOUR MARKET

The sectors of the Canadian labour market that were hit hardest over the last year were those most affected by the lock-downs, such as Trade and Accommodation & Food Services.

While employment fell over the year, the fiscal stimulus measures were net positive. Household disposable income and net worth increased to new highs for all income and age groups as a result of the stimulus cheques. We believe this increase in wealth and income should help accelerate growth in 2021 and bring back output to pre-pandemic levels.

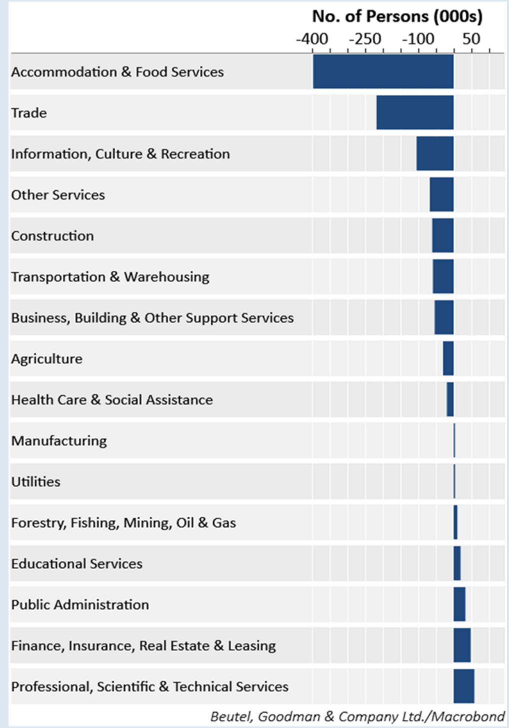

Figure 2 depicts the employment changes of the different sectors of the Canadian economy over the pandemic year. The sectors most affected by lock-down measures were more severely hit. Accommodation & Food Services and Trade saw the largest negative changes over the year, while Professional, Scientific & Technical Services and Finance, Insurance, Real Estate & Leasing saw the largest positive changes.

INFLATION

The consumer price index (CPI) inflation measure in Canada fell over the year, due to decreasing inflation in most sectors, but in large part due to the highly cyclical transportation costs and to a lesser degree to the Clothing and Recreation sectors, where demand fell due to the lock-down. We expect these sectors to rebound with the recovery and do not expect inflation to rise too aggressively as overall GDP production remains below potential.

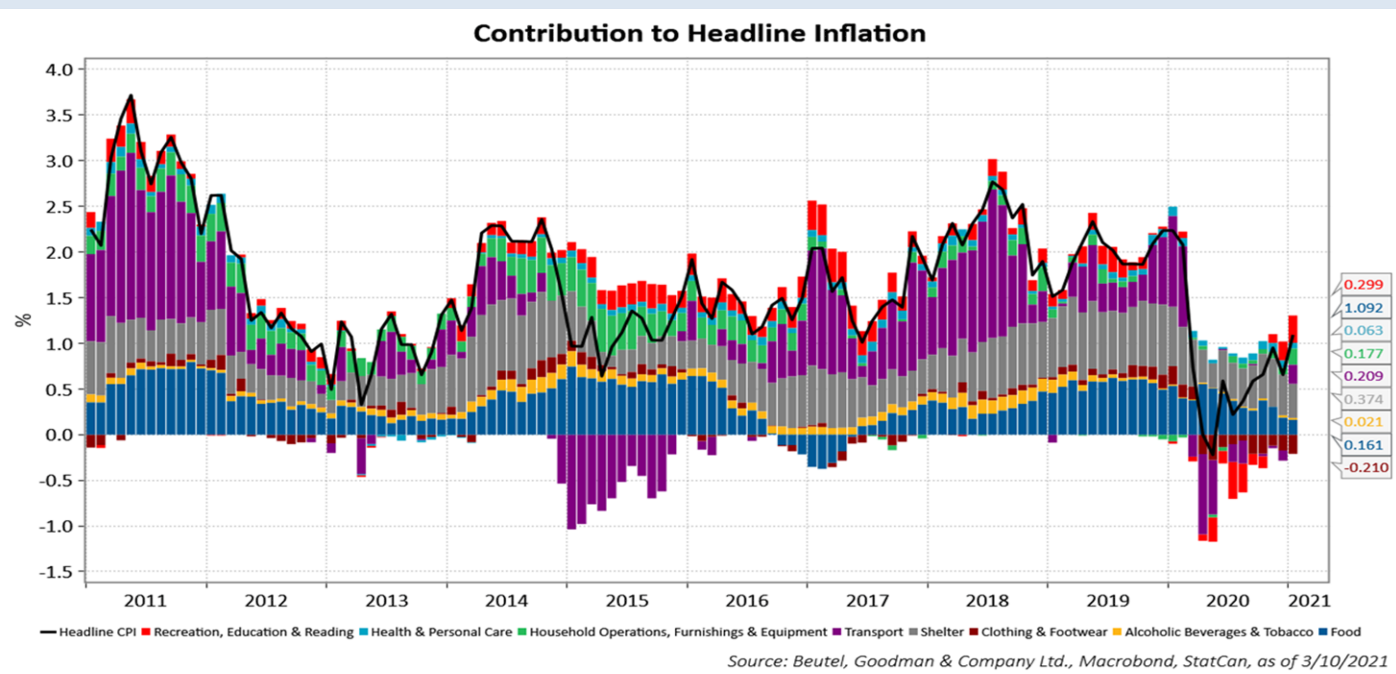

Figure 3 depicts the contribution to Canadian headline inflation by sector. The graph shows that Transportation was the primary driver of weaker inflation over the pandemic year followed by clothing & footwear and Recreation, Education & Reading.

YIELD CURVE

Prior to the pandemic, the yield curve was flat as the Bank of Canada (BoC) was in a tightening cycle and the economy was near full capacity. Once the pandemic arrived and put the economy on pause, the BoC reduced rates to near zero and began buying bonds (quantitative easing) to provide stimulus. This caused yields along the entire yield curve to fall. Since then, the long end of the curve, which is less determined by the BoC and more driven by inflation and growth potential, has returned to pre-pandemic levels, while the front end of the curve remains pinned to the BoC, which is still in easing mode.

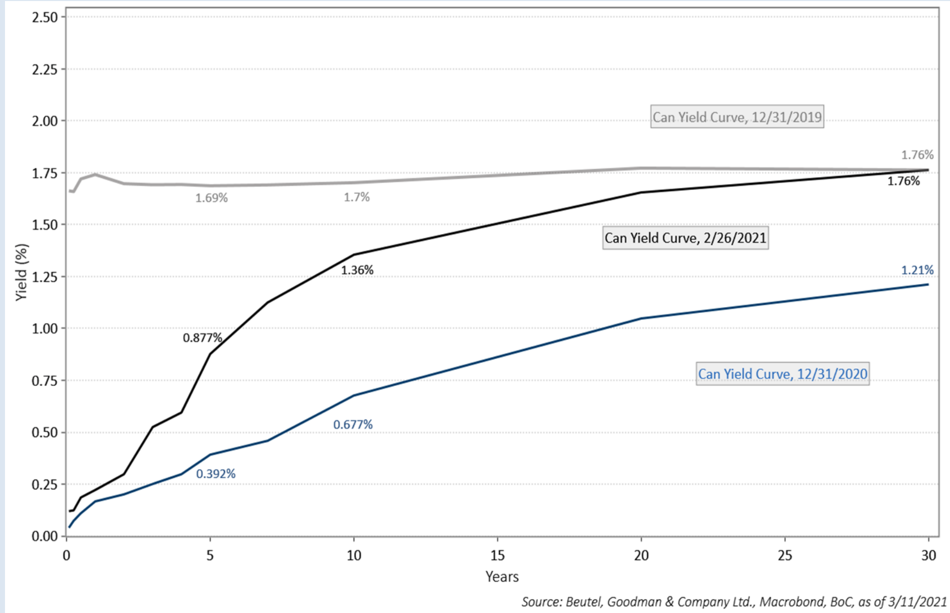

Figure 4 is a line graph that depicting the yield curve in Canada at various points in time. The graph shows that the long end of the curve has returned to pre-COVID-19 levels of about 1.76% (from 1.21% on December 31, 2020), as expectations of inflation and real growth return.

CREDIT SPREADS

Credit spreads in Canada and globally widened in response to pandemic fears and global lock-down measures in the most significant credit-spread-widening event since the Global Financial Crisis. The indiscriminate credit-spread widening presented an opportunity to initiate positions in credit securities that our deep research and analysis found attractive, but that had previously been fully valued. We were also able to put our contrarian hats on and initiate positions in strong companies in depressed and unloved sectors such as Energy and Airlines. As central banks and governments turned on the fiscal and monetary taps in unprecedented fashion, credit spreads rallied into year-end. In most sectors, credit spreads are back to or through pre-pandemic levels. We believe the background for credit remains constructive, with the economy poised to re-accelerate. However, we remain wary of Merger & Acquisition risk and companies that may have over-levered in a low-interest-rate environment.

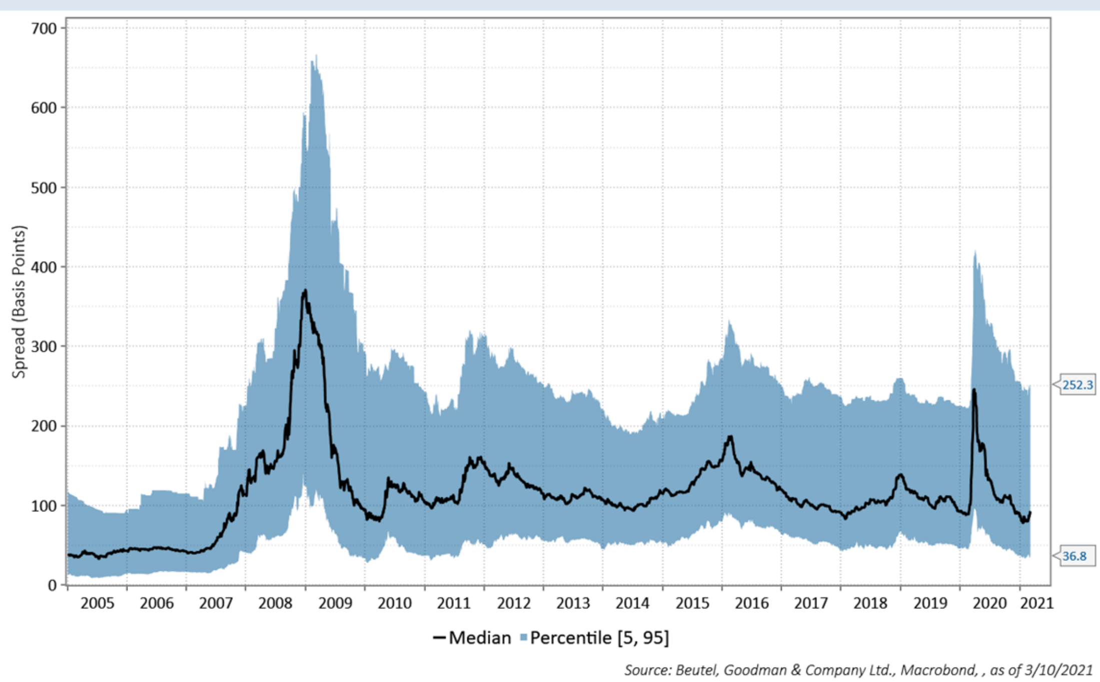

Figure 5 is a graph depicting Canadian 5-year corporate bond spreads and dispersion of issuers. The graph shows corporate spreads have returned to pre-COVID-19 levels, but dispersion is still wide as certain sectors and issuers future risk remains in question.

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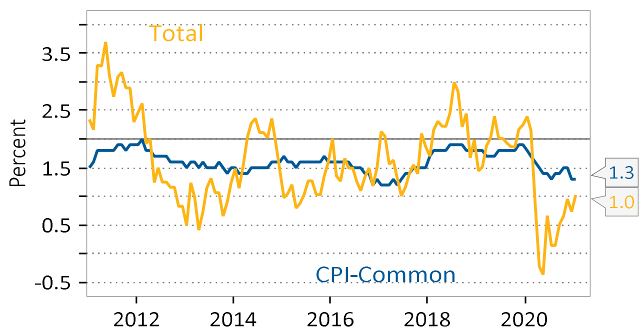
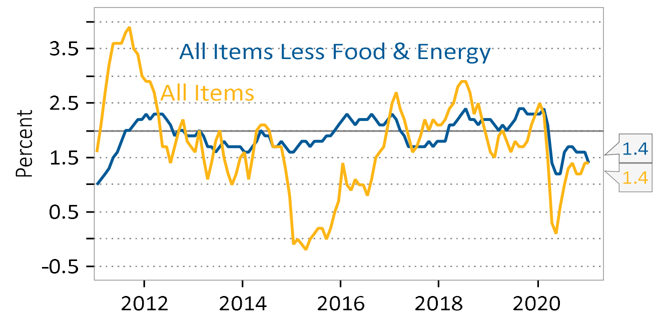
Macro Economic Charts (As at February 28, 2021)

Canada CPI, YoY



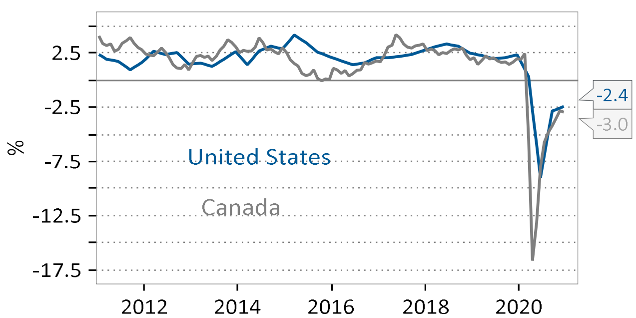
Source: StatCan, BLS, BEA

US CPI, YoY



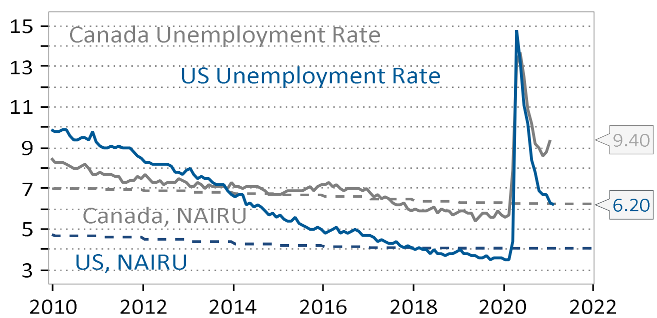
Source: StatCan, BLS, BEA

Real GDP, SA, YoY



Source: StatCan, BLS, BEA

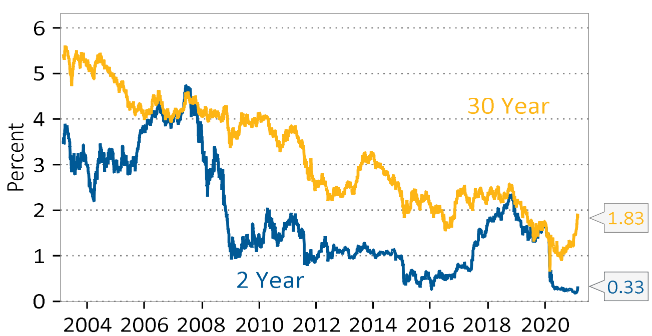
Unemployment Rate, SA



Source: StatCan, BLS, BEA

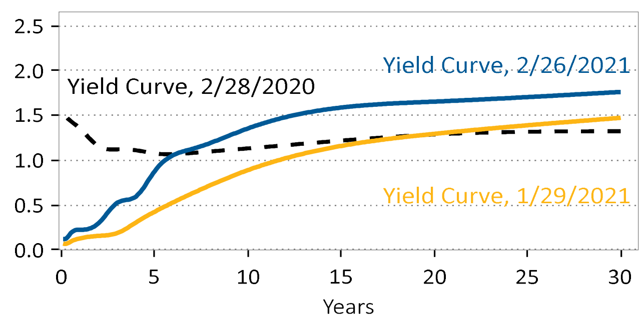
Rates Charts

Benchmark Canada Yields



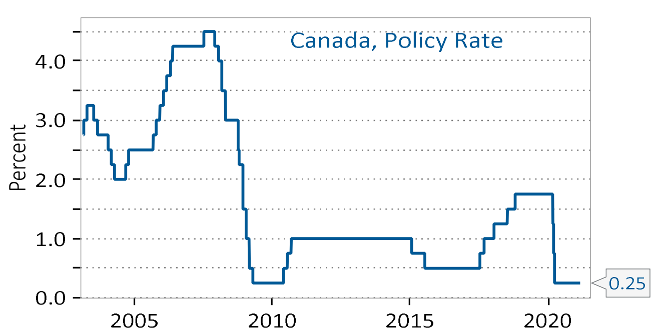
Source: BoC, Macrobond

Canada Yield Curves



Source: BoC

Bank of Canada Overnight Rate



Source: BoC, Macrobond

Sovereign Yields

Country	Overnight Rate	2 Year	10 Year
Canada	0.25%	0.33%	1.42%
United States	0.25%	0.14%	1.44%
United Kingdom	0.10%	0.13%	0.80%
Germany	-0.50%	-0.66%	-0.25%
Italy	-0.50%	-0.25%	0.75%
Spain	-0.50%	-0.45%	0.41%
Japan	-0.10%	-0.10%	0.16%

Source: Macrobond

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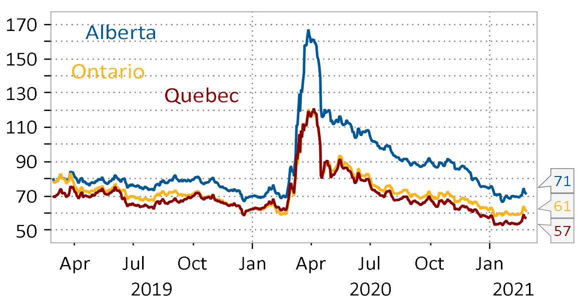
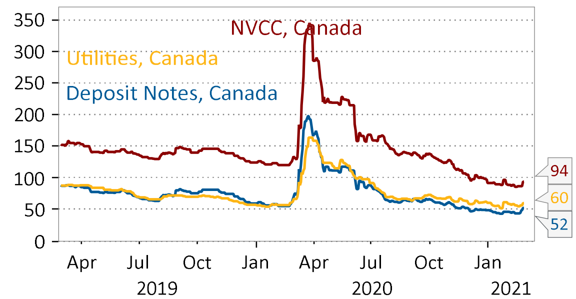
Credit Charts (As at February 28, 2021)

Provincial Spreads, 10 Year



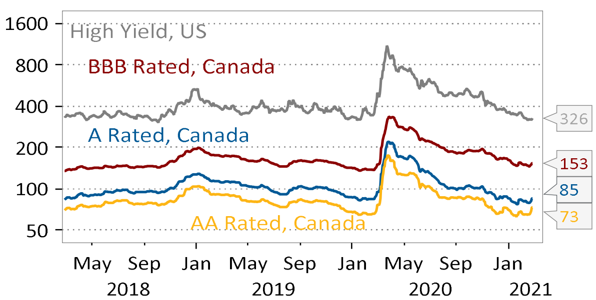
Source: Beutel Goodman, Macrobond

Corporate Credit Spreads



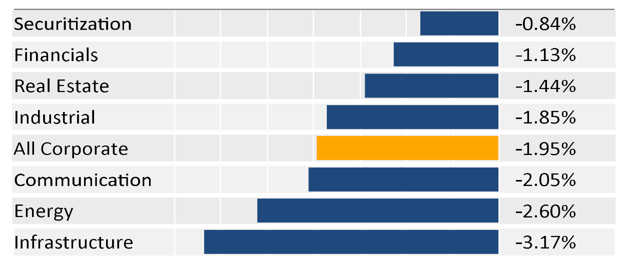
Source: Beutel Goodman, Macrobond

Corporate Spreads by Rating



Source: Beutel Goodman, Bloomberg

FTSE Corporate Sectors Total Return



Source: FTSE Global Debt Capital Markets Inc.

Corporate Event Risk Monitor

Overall Credit Attractiveness
Funding Availability
IG Credit Spreads
HY Credit Spreads
Financial Institution Credit
Volatility
Liquidity
Leveraged Buyouts
M&A
Share Buybacks
Dividend Increases
Stock Market
Economy

Source: Beutel Goodman

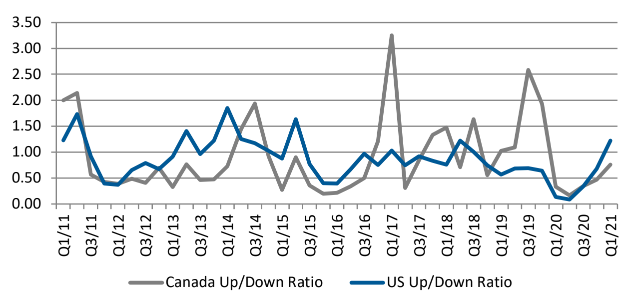
New Corporate Issues in the Canadian Market

Issuer	Maturity	Sz ($mm)	Spread
OPG	21-Feb-51	$500	146.0
Winnipeg Airports Authority	3-Feb-51	$100	155.0
Allied Properties REIT	12-Feb-26	$600	117.5
BMW Canada Inc.	20-Sep-22	$175	20.3
BMW Canada Inc.	20-Sep-23	$125	30.6
BMW Canada Inc.	20-Apr-24	$100	49.2
Empire Life Insurance	17-Apr-26	$200	307.0
Alectra Inc.	11-Feb-31	$300	75.0
TMX Group Limitied	12-Feb-31	$250	101.0
Manulife Financial	19-Jun-26	$2,000	284.4
Toyota Credit Canada	23-Feb-26	$400	55.9
H&R REIT	19-Feb-27	$300	189.1
Honda Canada Finance Inc. (FRN)	26-Feb-24	$250	9.0
Honda Canada	25-Feb-28	$600	79.4
Cineplex Inc.	24-Feb-26	$250	685.4
Manulife Bank of Canada	26-Feb-26	$500	56.8
Goldman Sachs Group Inc.	28-Feb-28	$1,000	104.1
Fairfax Financial Holdings Limited	3-Mar-31	$850	261.6
Canadian Imperial Bank of Commerce	24-Mar-24	$1,250	46.0

BG Approved List Corporate Credit Rating Actions

Issuer	Date	Rating Agency	Former	New
Inter Pipeline (Corridor Inc.)	02-12-2021	S&P	BBB	BBB-
Canadian Natural Resources	02-11-2021	S&P	BBB	BBB-
Canadian Tire Corp.	02-26-2021	S&P	BBB (Neg)	BBB (Stable)
Toyota Credit Canada	02-22-2021	S&P	A+ (Neg)	A+ (Stable)
North West Redwater	02-17-2021	S&P	BBB+ (Neg)	BBB (Stable)
SNC-Lavalin Group Inc.	02-10-2021	DBRS	BBH (Stable)	BBH (Neg)

Credit Rating Upgrade/Downgrade Ratio



*as of February 28, 2021 *Sources: S&P, Moody's, Fitch, DBRS*

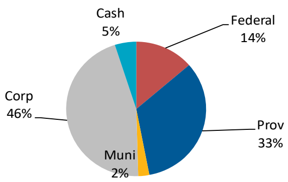
Factsheets (As at February 28, 2021)

Beutel Goodman Income Fund

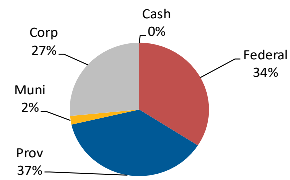
Modified Duration Risk

	Federal	Provincial	Municipal	Corporate	Total
Portfolio	8.26	12.40	9.54	5.40	7.98
Benchmark*	6.09	10.66	9.68	6.71	8.03
Net	2.17	1.74	-0.14	-1.31	-0.05

Portfolio Sectors

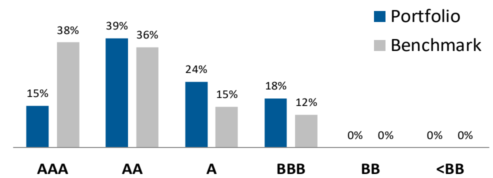


Benchmark Sectors



Benchmark: FTSE Canada Universe Bond Index

Ratings Breakdown



Yield to Maturity by Rating

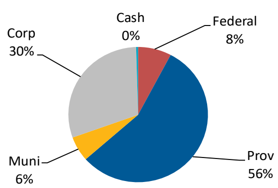
	AAA	AA	A	BBB	BB	<BB	YTM
Portfolio	0.92%	1.93%	1.54%	2.41%	0.00%	0.00%	1.68%
Benchmark*	0.99%	1.76%	2.02%	2.43%	0.00%	0.00%	1.59%

Beutel Goodman Long Bond Fund

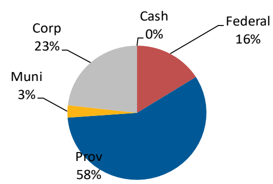
Modified Duration Risk

	Federal	Provincial	Municipal	Corporate	Total
Portfolio	17.93	16.57	13.55	13.62	15.68
Benchmark*	17.44	16.11	14.68	13.59	15.70
Net	0.49	0.46	-1.14	0.03	-0.02

Portfolio Sectors

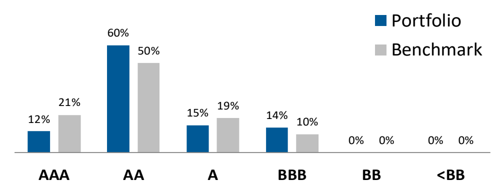


Benchmark Sectors



Benchmark: FTSE Canada Long Term Bond Index

Ratings Breakdown



Yield to Maturity by Rating

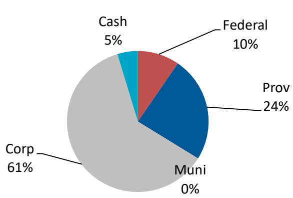
	AAA	AA	A	BBB	BB	<BB	YTM
Portfolio	1.81%	2.45%	2.95%	3.40%	0.00%	0.00%	2.59%
Benchmark*	1.88%	2.46%	2.88%	3.63%	0.00%	0.00%	2.54%

Beutel Goodman Core Plus Bond Fund

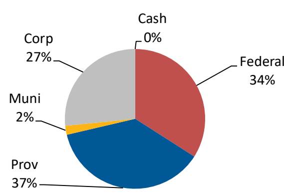
Modified Duration Risk

	Federal	Provincial	Municipal	Corporate	Total
Portfolio	13.69	15.10	-	4.85	7.96
Benchmark*	6.09	10.66	9.68	6.71	8.03
Net	7.61	4.44	-	-1.86	-0.07

Portfolio Sectors

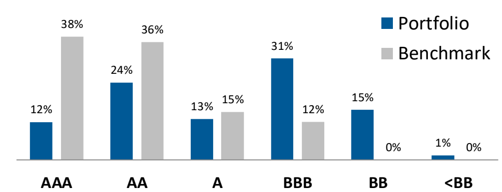


Benchmark Sectors



Benchmark: FTSE Canada Universe Bond Index

Ratings Breakdown



Yield to Maturity by Rating

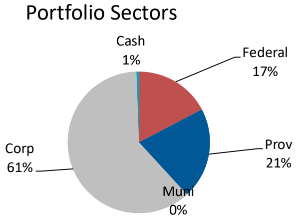
	AAA	AA	A	BBB	BB	<BB	YTM
Portfolio	1.52%	2.09%	1.84%	2.50%	3.69%	1.67%	2.27%
Benchmark*	0.99%	1.76%	2.02%	2.43%	0.00%	0.00%	1.59%

Beutel Goodman Short Term Bond Fund

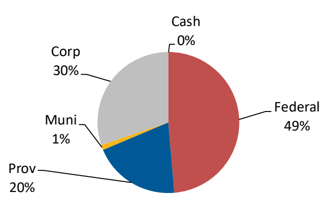
Modified Duration Risk

	Federal	Provincial	Municipal	Corporate	Total
Portfolio	1.82	3.12	2.09	2.68	2.61
Benchmark*	2.63	2.84	3.12	2.76	2.72
Net	-0.81	0.28	-1.03	-0.08	-0.11

Portfolio Sectors

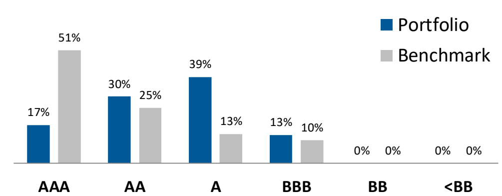


Benchmark Sectors



Benchmark: FTSE Canada Short Term Bond Index

Ratings Breakdown



Yield to Maturity by Rating

	AAA	AA	A	BBB	BB	<BB	YTM
Portfolio	0.46%	0.75%	1.13%	1.78%	0.00%	0.00%	0.98%
Benchmark*	0.55%	0.76%	1.10%	1.43%	0.00%	0.00%	0.77%

source: FTSE Global Debt Capital Markets Inc.

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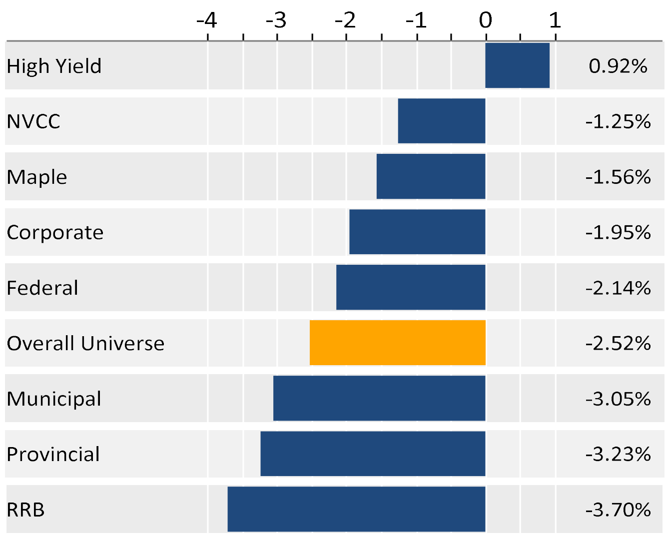
BEUTEL GOODMAN Investment Counsel

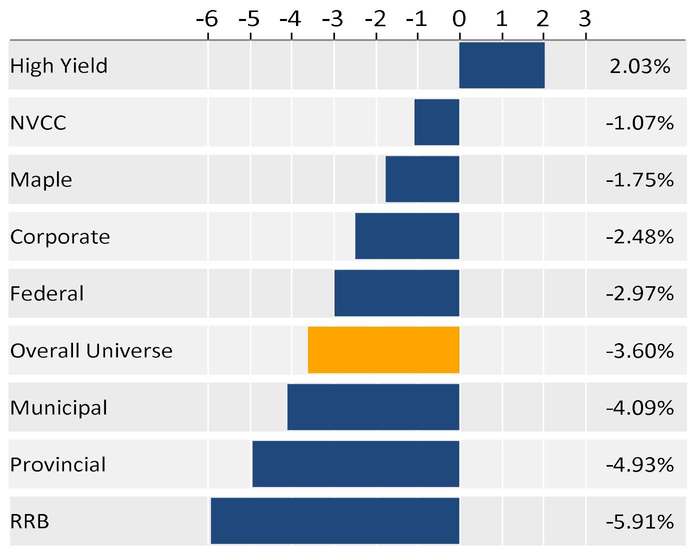
Index Returns

FTSE Canada Universe Bond Index

MoM Return

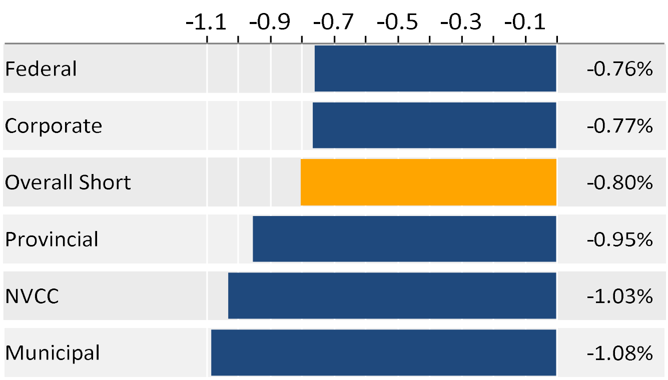


YTD Return

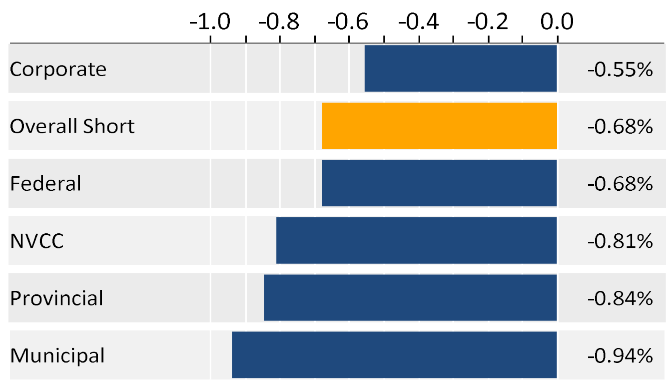


FTSE Canada Short Term Bond Index

MoM Return

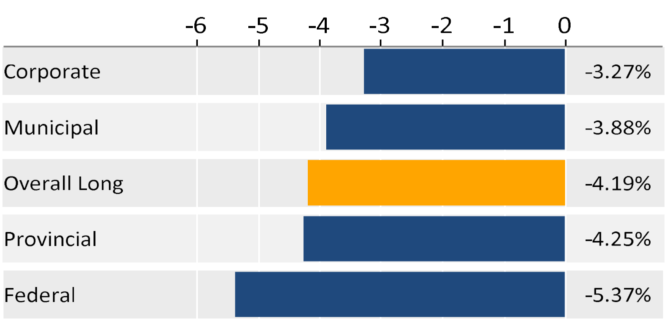


YTD Return

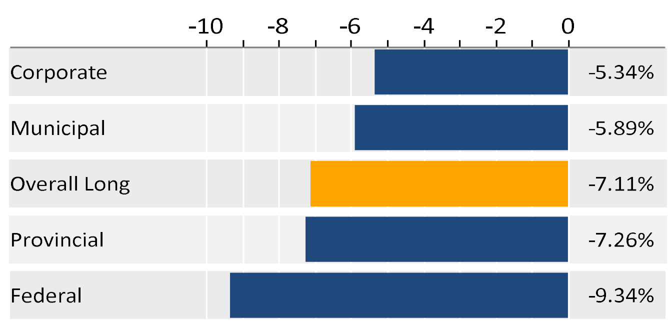


FTSE Canada Long Term Bond Index

MoM Return



YTD Return



Source: FTSE Global Debt Capital Markets Inc.

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