

What is the bond market telling us?

It has been quite the ride for bond investors over the past two years. After enduring the scepticism of many during the equity bull market, bond investing has become the flavour again. Whether from weary investors tired of the volatility in the equity markets or pension fund managers re-evaluating their asset mix strategy after experiencing another year of losses, bonds are popular.

Index	1 year %	5 year %	10 year %
DEX Bond Universe	5.5	5.4	6.1
S&P/TSX Composite	-30.7	5.0	5.0

As the above table shows, bonds provided steady positive returns over the past decade without experiencing the type of price fluctuations as equities. Short-term federal government bonds provided the highest return over the past two years as a result of rising risk aversion, and the effect of a 4% drop in central bank policy rates. These strong price moves prompted our shift into holding more corporate bonds in December.

The demand for bonds quickly shifted to the corporate bond market as higher yields and new issuance activity enticed investors. The portfolios benefited from our early shift into corporate bonds. The demand for these higher yield issues reached a fever pitch in April as most issues were virtually sold out as soon as the details were announced. Income yields are falling quickly in the corporate bond market because of the demand. This type of frenzy is a symptom of an over-heated market, and we have halted our purchases at this time in response.

The policy settings by central banks in response to the credit crisis have prompted vigorous discussions relating to the long term effects of their actions. Policy makers have favoured countering rapidly falling asset prices and negative growth rates with stimulus in the form of extremely low interest rates, increased spending, and bond repurchases to promote lending and liquidity. The risks to the economy if this stimulus is not carefully managed are much higher rates of inflation and higher interest rates, and sharply lower bond prices.

The bond market is considered a great predictor of the future direction of the markets. The bond market shifted course in April as long-term government bond yields started to rise quickly in response to heightened inflation fears. Appetite for risk is gaining strength as investors responded positively last month to reports that

Pooled Fund – Month End Unit Values[^]

Unit Values	Dec-08 [*]	Mar-09 [*]	Apr-09
Cdn Income Fund CI D	10.42	10.52	10.58
Cdn Balanced CI A	12.27	11.97	12.33
Cdn Equity Fund CI A	8.22	7.56	7.98
Cdn Small Cap CI A	15.92	14.30	15.92
Global Equity Fund CI A	7.95	7.32	7.44

[^] Fund NAVs reflect "full-fee" class * Post distribution

show early signs of stabilising, though not improving, levels of economic activity. Prices for riskier assets have moved sharply higher. The riskier the asset, the higher return in the month as evidenced by the 4.3 % return in the month for the DEX High Yield Bond Index and the 14.1% return in BMO Small Cap Index. Returning confidence has increased the risk of inflation as the fiscal and monetary stimulus now begins to work its way through the economy. Central Banks are focused on keeping interest rates down to aid in the recovery of the financial system. They have introduced programmes to purchase bonds in an attempt keep longer term-yields low. Their control has been limited as yields continue to rise. Bond investors have also moved beyond 2009 and see the negative consequences of rising budget deficits and money printing.

We continue to hold our terms to maturity short to protect against this higher risk to inflation. While our equity funds benefited from returning confidence, our performance was slightly weaker than the respective benchmarks as the more speculative stocks garnered the most attention. We will continue to buy stocks at discounted values. We will not chase securities as they move by excessive enthusiasm in the market.

Total Return – Capital Gains plus Income (%)

To Apr 30 '09	1 Mo	3 Mo	1Yr	3 Yr	5 Yr	10 Yr
QV Pooled	%	%	%	%	%	%
Cdn. Income	1.0	2.2	5.7	5.7	5.2	5.5 [^]
Cdn. Balanced	3.3	2.0	-7.2	1.4	5.3	8.8
Cdn. Equity [*]	5.6	-0.8	-21.3	-3.9	7.0	13.2
Cdn. Small Cap	11.1	1.0	-24.6	-6.7	5.7	13.1
Global Equity	2.1	1.2	-10.7	-	-	-

^{*} Historic equity returns from the Cdn. Balanced Fund [^]6 years

Benchmarks:

DEX Bond Univ.	0.0	2.5	5.5	5.7	5.5	6.1
Balanced Fund	3.4	4.9	-13.7	-0.1	5.7	5.8
S&P/TSX Comp	7.3	8.3	-30.7	-5.9	5.0	5.0
BMO Small _{unwtd}	14.1	15.5	-36.1	-15.9	-3.1	3.2
MSCI World _(SCA)	5.1	2.8	-30.0	-11.5	-5.6	-5.1

⁻ Pooled fund returns are gross of management and custodial fees. Returns over one year are annualized.

⁻ The Balanced Fund Index reflects the total rates of return earned by the DEX 91-Day T-Bill Index (5%), the DEX Bond Universe (45%), the S&P/TSX Composite Index (40%), and the MSCI World Index (CS) (10%)