Manulife Investment Management

Episode 79: Out of the hospital—three opportunities for fixed-income investors

Speaker 1:

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Macan Nia:

Take on risk. Really? You're supposed to be my backup singer, Kev, say, "Take on risk."

Kevin Headland:

I realize I can't sing, so I'm giving it up.

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Well, clearly I can't sing either. My family's been telling me that for years, no one wants to listen.

Investors are happy to move on from 2022, and for good reason. 2022 is the first year in financial history where US stocks and bonds were both down by more than 10%. There was nowhere to hide other than in cash. How did this happen? A once in a generational event in COVID led to unprecedented monetary and fiscal stimulus that led to levels of inflation not experienced in decades. In 2022 global central banks attempted to tackle inflation by raising interest rates aggressively over a short period of time. As bond prices are inversely correlated to interest rates, as interest rates increase bonds decline, bucking a historical trend of acting as a counterbalance to stock volatility and sold off along with stocks.

However, a tough 2022 has created a backdrop for 2023 that is likely to be more attractive for fixed income. Investors understand the tailwinds for bonds, but just buy bonds may be a simplistic approach. We believe there will be three unique phases for bond investing in 2023, with different types of bonds benefiting in each phase. We characterize the phases as phase one, the sweet spot. Phase two, duration is your friend. And phase three, take on risk. Bonds aren't dead. The patient has been given its medicine and is ready to leave the hospital. Listen on, this is Investments Unplugged.

Welcome to Investments Unplugged. I'm your co-host, Macan Nia, co-chief investment strategist at Manulife Investment Management. And I'm joined here with my partner in crime, Kevin Headland.

Kevin Headland:

Going on, Macan?

Macan Nia:

Not much, Kev, not much. Just waiting for this epic snowstorm to hit southern Ontario, but apparently it's supposed to hit from Saskatchewan all the way to, I think, out east, so should be fun.

Kevin Headland:

Lots of shoveling.

Macan Nia:

Yeah, great. So we are recording this on December 15th and it will be released in the first week of January, so we'll try to keep that in mind as we talk about bonds. We don't think much is going to change over the next couple of weeks. The points aren't going to be the exact same, but how do you feel, Kev? We're ending 2022. How are you feeling?

Kevin Headland:

I'm exhausted. Yeah, it's been a long year from a market perspective, from a work perspective. I'm looking forward to changing the page and I think 2023 is going to be a much better year than 2022 was.

Macan Nia:

Yeah, I think you're echoing the sentiment of investors across the world. It's been a really tough 2022, and I think a lot of it has to do with not necessarily with the equity downside because we're used to that, right? But as investors, typically when our equities sell off, our bonds are there to act as that countermeasure or that counterbalance, and that has not been the case this time around. And the Wall Street Journal has a great website, basically looks at the benchmarks from across the world in bonds. I'm looking at it right now. So if the year ended today, US government credits down 12%, you have the US ag down 11%, I think the DEX Universe, the Canadian Bond Universe, double digits down. I'm scrolling down this screen and there is nothing positive. And at minimum you're down mid single digits to really mid-teens.

So it's been a tough year for bonds. And in a nutshell, basically this is the result of, and Kev, correct me if you believe anything different or you want to add anything, is basically you had COVID, a once in a generational type of event. We were locked in our homes, governments were forced to support us. The US alone pumped $10 trillion into our economy. Surprise, surprise, led to high inflation that we have not seen in decades, which resulted in central banks, yes, they probably should have been raising rates earlier, but they were forced to catch up in 2022. And we've seen interest rates on the short end go from zero depending on where you are in the world, from Canada to US we're at 4.25%, 4.5%. All of this has led bond returns. For those that are newer to how the bond math works, basically as interest rates go up, bond prices come down. And as interest rates have come up this year, it had led to the bond prices that we see today. That's in the rear view mirror.

Kevin Headland:

Yeah, I think it's important also to understand that it was almost like there was nowhere to hide. The announcement came so quickly in terms of the Fed pivot to raising rates, immediately the market started pricing in and moving higher yields. And it's not about the quality of the investment or the quality of the bond you hold. As you said, it's mathematics, right? When yields go up, prices go down. When there's price volatility, I think it's important to understand that it's not a mistake of investors or portfolio managers, it's just what happened. And I think a lot of the move in the Federal Reserve caught the market by surprise.

And as we've walked through, when we go back to early this year, I think the expectation was Federal funds rates to 1.5%, then through the summer, "Well, maybe it's going to 3%." And we're like, "Oh, it's never going to get to 5%." And lo and behold, here we are and the market expectations are for early next year to get to 5% federal funds rates. So as we moved through the year and inflation remained stickier, the target of federal funds rates kept moving higher and therefore yield moved higher and therefore the bond returns kept decreasing.

Macan Nia:

And Kev, I think it's important to recognize or appreciate that narratives can change very quickly. So we were beginning the year Jan, and the markets are pricing in, it was kind of cute. We were pricing in in Jan that the US Federal Reserve would raise rates maybe two to three times, to your point, maybe getting the terminal rate up to 1.25%. And we've seen how that's unfolded. The reason I bring that up is, there's a narrative in the markets today and that can change very quickly. And it's important not to be looking in the rear view mirror at these bond returns and extrapolating them forward, expecting that to continue or to some degree continue the negativity. And I think our view, is as we enter 2023 we're pretty confident and optimistic about bond returns. I think the visibility is much better.

Let's start with inflation. So where we will be wrong or where we can be wrong is if we're wrong on inflation. And we've seen inflation peak at 9.1%, it's come down to 7.1%, still high. I know we've been applauding, hit 7.1%, markets hooray, but still it's 7.1%, it's too high. But all the measures that we're looking at in terms of our inflation indicators see inflation trending down towards 4% by the summer of next year, and that will provide the Fed with flexibility in terms of not raising rates and really not having to go more than what the markets, and we'll talk to what the markets are pricing in in terms of next year, which haven't changed that much actually after yesterday's announcement. But you know what, let's talk about yesterday's announcement. So today's December 15th, we had that 7.1% print, then we had the Fed meeting the day after, which was yesterday. They raised rates by 50 BPs, and the markets took Federal Reserve Powell's comments as hawkish, the market sold off. What did you take away from that meeting?

Kevin Headland:

I've been saying since I think August, before Jackson Hole when the meetings were coming out, and the market kept anticipating prior to the Fed meetings and minutes and press conference that there would be a change of tone. Little less hawkishness, I don't want to say dovishness, but little less hawkishness. And every time the market expected that change in tone, it didn't come. The Federal Reserve has not become more hawkish. They've remained on message the entire time. Yet the market keeps expecting something that doesn't come. Instead of just saying, "Okay, they haven't changed their tone, this is great," it hasn't gotten more hawkish. I compare it to that petulant child having a tantrum in the grocery store because their parents won't give them the candy they want. The parent hasn't changed. They keep saying no, but the kid keeps having a temper tantrum, and I don't understand it.

If the Federal Reserve was more hawkish, I can understand the negativity. But the CPI print came out, the expectation was, it was great, the markets rallied very strongly pre-market, early market. As the day unfolded, that positive tone in the market came out and it became neutral because they focused back on the Federal Reserve. And then when the Federal Reserve announcement came out, as I said yesterday, again, back to that negativity because Jerome Powell hadn't changed his tone. And I find just interesting how we keep expecting something that hasn't changed, yet we keep expecting something different.

Macan Nia:

I think, let's be honest here, the Fed doesn't want the markets to rally too strongly, too quickly. That in itself is inflationary, right? If the markets go up, the wealth effect, I think we all can personally draw parallels to that. We all probably feel a little bit less rich this year. And I think the Fed saw that in June when the markets perceived their comments as being hawkish, markets rallied 10%+, and he came out and I think they don't want that to happen. They want it to be gradual. So to your point, where I think a colleague of ours said at best yesterday, texted us, giving a shout out to Corey Gifford, one of our colleagues out in Manitoba. And he says, as I've said, peacocking. Are they just putting on a show without actual any change? And the interest rate probabilities would suggest that.

So before the announcements, and I'm going to use the US as the example, they were basically 100% priced in that they were going to go 50 BPs yesterday and then, or 100% chance of a 25 BP increase in Feb, and then a 50% chance of a 25 BP increase in March. That hasn't changed that much, Kev. When you look at the interest rate probabilities right now, it's still basically 100% chance of 25 BPs in Feb and then it's gone up slightly, Kev, it's gone from 50% to 70% chance of a 25 BP increase in March. But the way the markets initially reacted yesterday, I think it was a little bit quick of a reaction. We're seeing it today, yields are down. So our narrative has not changed. We see and follow our inflation measures, they're all rolling over.

This will provide the Fed the opportunity to go another couple times early next year. But the pause. Now, what this might be different and we've talked about this, Kev, before, is the Fed's probably not going to be as quick to be cutting rates as they've done in previous cycles. Typically when they pause they start cutting eight months afterwards. That's not going to be the case this time, because inflation is still, even by the summer it's 4%, it's going to be trending lower, it's still above the 2% target. So we're going to be at this pause level for longer. But that's going to be supportive for not only equities, but for the conversation of today, the bond market.

Kevin Headland:

I think you're 4% target by summer, and it's almost like the end of summer. And that's a fairly optimistic scenario. We're going to continue to track the data, but that's almost like a base to a best case scenario, almost. I don't think it's going to get any slower than that, and that's probably the good news story. So it's coming down, but unlikely to hit anywhere near the target that the Federal Reserve has for the 2% inflation levels before the end of next year. They might start decreasing rates a little bit by end of next year depending on data, but that would be a normalization. That won't be like we're trying to stimulate the economy, we're just going to bring it back down slowly, very slowly, slower than the way they raise it back to a normal level.

If inflation's under control, if employment is still at full employment, that doesn't mean at current levels but full employment, somewhere in the 5% range, I think that's when the Federal Reserve decides to do that. But the market expecting them to go from a rate hike to a rate cut and pivot real quickly, that is probably not going to be likely for most of next year, I'd say.

Macan Nia:

And I think a positive thing going into 2023 is, financial conditions have tightened. There is no doubt about that with the yields going up to the degree they've had. So basically the US 10-year has gone up from 1.5% to, I think it was 4.25% at its peak in I think October-ish, and it's come down to 3.5%. So despite rates going up a couple more times early next year, financial conditions are actually easing from what we were at probably in the fall of this year. That's going to be a supportive thing for the US economy. So today's conversation is about bonds. And I think given how [inaudible 00:12:58] have performed this year, we need to relearn or reeducate ourselves in terms of why we own bonds.

So from a very simplistic perspective, you own bonds because of, one, income, and number two, it provides downside protection when equities sell off. So typically when equities have sold off, your bond prices have done well. And that's helped the balanced investor. And that has been the case, that's why we own bonds. One can argue since the great financial crisis our income has decreased for the amount of risk we have to take on, that whole reaching for yield. Again, going back to how quickly narratives change, Kev, a couple years ago or two, three years ago, everyone was reaching for yield, right? "Oh, high yield at 4%, you've got to reach for yield." Well, we don't have to do that today. So the income component is actually even more attractive today than it was at the beginning of the year. And then second, the downside, it wasn't there, the COVID thing happened, and once in a generational type of event, inflation went up.

But we ask ourselves, Kev, okay, will bonds go back to the relationship with equities, that inverse relationship post-COVID, or are we in a new structure where the correlations are one? When stocks sell off, bonds sell off. And the reality is, that's not going to be the case. When stocks sell off, yields have been coming down, you see it now, we're going back to that pre-COVID period where again, like I mentioned, when stocks sell off, the expectations for growth come down, yields come down on the long end, bond prices go up. And for anyone, all of us own bonds, look at the performance over the last month. It's coming back more into reality. So as we enter 2023, I know everyone on this call, and we've talked to thousands of advisors, the message from every one of these shops, sell side shops, is buy bonds. I think there's nuances to it. So we have characterized 2023 as a three-phase approach to bond investing. It's not all going to be the same, the opportunities are going to be different, but we've looked at it from three phases.

Kevin Headland:

Yeah, I think it's important to understand that you need to be flexible in fixed income. So when we look at our three phases, the first phase is the sweet spot, the second phase is to embrace duration, and the third phase is take on risk. So we look at-

Macan Nia:

Kev, I'm surprised you didn't include the songs for that. We've been taking about whether you wanted to ... We wrote about this recently, we've attached songs. So what's the song that you attach with the sweet spot? "Hit me with the ..." Come on, Kev, you're not going to just hold me out like this. Wasn't that, "Hit me with your best spot"?

Kevin Headland:

Hit me with your best shot?

Macan Nia:

Yeah, that's the song.

Kevin Headland:

[inaudible 00:15:39], yeah.

Macan Nia:

Okay, great. Now this is just going downhill very quickly. What was our duration is your friend song? Or did we have one?

Kevin Headland:

Maybe, "You've got a friend in me." What is that from?

Macan Nia:

That's from Toy Story, you know that.

Kevin Headland:

There we go. There we go.

Macan Nia:

Well, the take on risk one, phase three.

Kevin Headland:

The take on risk one was where me ...

Macan Nia:

That was aha. Take on risk.

Kevin Headland:

That's aha, yeah.

Macan Nia:

Take on risk. Okay, so basically half the people listening to this podcast, they cut off.

Kevin Headland:

We should not quit our day jobs to become singers, that's for sure.

Macan Nia:

It is way too early to be recording this. Okay, so phase one, the sweet spot.

Kevin Headland:

Yeah, so that's really where we are right now. You mentioned yields are much more attractive but than they were early this year. Of course they have been over the past quite some time. Across different fixing asset classes we've seen yields have doubled if not tripled from the beginning of this year. And the sweet spot for us is really, invest in grade corporate credit. Whether it's Canada or US, we favor the US right now, but good quality fixed income, very low default risk if at all, because they're triple B+ rated bonds. Companies that we're very familiar with and most of investors are very familiar with, company names that they know. But providing a really attractive income in the 5%+ range, that is very attractive because you're getting those incomes being paid. And these are income levels we haven't seen since before the financial crisis. So it's been quite some time, we're going back almost 15 years now that we actually haven't seen yields at these levels.

So when you mentioned, Macan, that we don't have to reach for yield any more, that is the case. Income and yield is here to have. And I think it's important for investors to understand that this current phase is about the income. We're being paid to wait. Take that income opportunity, that's attractive. If yields move down in the future, even fixed income, or even as they come to maturity, we're actually investing in fixed income bonds in investment grade corporate space that are less than par. Meaning that as they mature, they go from below par to par. That is also income, but also capital gain. So if we hold those investments to maturity, we eventually get paid back our par value, our principal, as long as they don't default, which again is very low, that becomes capital gain. So there's two components to fixed income that we have to make sure we remember. One is income, the yield, but there also is capital gain opportunity as well that we have to pay attention to.

Macan Nia:

Yeah, and very few investors actually hold the bond to maturity. The bond actually moves up to its core value in advance of its maturity date. So it's not like you have to wait the 10-year period before you get it, and it moves in advance. So just to give some ideas, Canadian credit paying you 5%, at the beginning of the year it was 2.5%. And then we always implore, we go, "Mr. And Mrs. Advisor," imagine I came into your office, the 2008 version of yourself, and I said, "I have investment grade credit," whether in Canada or in the US, yielding you 5%. What would you say? And you'd probably tell me to leave your office because you'd think I was lying. But that's the opportunity today in terms of the bond environment. So I think it's important. And we'll get to the GIC argument at the end, because at minimum I think my bonds are giving me the income that GICs can, if not a little bit more. You might say, yeah, there's more downside. But I think at this point in the interest rate cycle, a lot of that's been priced in.

So that's phase one, Kev. So as you said, the sweet spot, where you are paid to wait, you don't necessarily have to take on, whether it's duration risk, credit risk, liquidity risk. Even think about for those advisors on the call, when you make your financial plans for your clients, what's the return expectations you plug in for bonds? 3%, 4%? And you can get 5% today. So if anything, yes, it's been a tough 2022, but the odds of our clients reaching their financial goals now are probably better because of the better opportunities in the bond space moving forward. So we transition to phase two at some point next year, again, talking about the importance of having a mandate that's flexible, that can maneuver quickly, and this is the one where we'd characterize it as, duration is your friend.

And as we transition in the first half of next year, we believe that the global economy continues to weaken, the global economy continues to absorb the interest rate increases that we have seen this year. It takes roughly a year, year and a half for interest rate increases to go through the broader economy. If we started in March of last year, we haven't fully absorbed this. We think the odds of a recession have increased. It's interesting to me, Kev, a couple weeks ago I would have thought that everyone was calling for recession next year. And that's not the case. It's a mixed bag. Some believe it is, some believe there's not. Actually different opinions within shops as well. Our view is, we don't think it's a question of, it's going to happen. When we look at LEIs, when we look at the yield curve, when we look at housing starts, we go through the list, we believe we're going to get a recession at some point early next year.

It's going to be mild, employment remains resilient, yes, the unemployment rate's going to go up, but is it going to go up to high single digits? We don't think so. Corporate balance sheets are still strong. Personal balance sheets, yes, we're using our savings, but we have savings. That's a strong personal balance sheet. So we think the recession's going to be mild, but during recessions yields fall. And this goes back since the dawn of bonds and the economy. We don't think that this time is going to be any different, and that will be good, because as your interest rates come down or yields come down, duration becomes your friend.

Kevin Headland:

I think it's important to understand that headwind we faced early this year when yields went up, as I said, you couldn't hide, yield go up, price go down. Well, guess what? The opposite is true as well. When yield come down, prices go up, it's the bond math. And what happens is, the longer duration you have, the more sensitive your bond price is than moving yields. So if yields are going to move down, you want to actually have longer duration. Now, actually we calculated this and looked at the moving that 10-year treasury yield just during periods of inflation, just when the month is indicative of recession. In just those periods, the average drop in the 10-year yield is 1/3. That is very attractive when you look at even where we are today, call it 3/5%, we drop by another 1% during recessions, that's an attractive price appreciation. Plus the extra yield you're already receiving, that ends up being a nice total return.

So we want to take advantage of that. The other thing what happens also, as we said, if we believe that, fixing this back to that protection for your portfolio, if we do get a recession, if we do get another repricing lower in equities or more volatility, again, having longer duration, higher quality treasury like investments, that should also protect your portfolio this time around on the downside.

Macan Nia:

And let's talk again, not to keep harboring this point, but let's go through that bond math. Because that's the question that advisor are asking. The question, we're going to look at it through a Canadian lens right now. There's also the equivalence that's in the US, we call it GICs, there's equivalence in the US, but it's guaranteed. And you can be getting these for 4% to 5% one year, five years it can be gaining 5% as well. So why not just invest in these GICs? It's risk free versus bonds. And the initial argument makes sense for one-year time horizon, but many are not looking at it from just a one year. So going through that bond math, if my yield, let's just say at a Canadian investment grade is 5%. So my income from my GICs is equivalent to the yield of basically my bonds.

But I have a lot of upside opportunity in bonds. And to your point, if you do that math, there's a very easy case where income is five. Just from duration or yields coming down, I can make another 4% to 5%. And then look at credit upgrades, currency, and all the other things. We can make a thesis or an argument and back it up where, you know what? Bonds in one year, realistically and with confidence you could say they're up high single digits with risk to the upside. That's, I think, the thing that, yes, I think what is happening now is we're looking in the rear view mirror, we're seeing that cash was the only asset class that did well this year. You're looking at bonds being down 10%, and we're taking that view and we're looking forward, where we know that typically in Canada, for example, bonds outperform GICs 80% of the time. We're just so happy to be in that 20% period. But again, investing is a probability based decision. Probability states that bonds are likely to outperform GICs next year.

Kevin Headland:

Also important, investors look at GICs, of course they're not marked to market, so the actual price doesn't move. But if you're locking in your money for one, two, three, five years, typically most GICs have a penalty if you take money out beforehand. So I think it's important when we're looking at an investment decision on a relative basis that we give the same timeframe to our fixed income. So if I'm going to think of three-year GIC, I should not look at my returns of fixed income for those three years. And I think as you said, if we're here three years from now and look back and look at the total return, I have a very high degree of comfort, I would say, in saying that my bonds are going to outperform my GICs. My GIC is going to give the yield every year, but my bonds give the yield which is very similar and the total return. And I think that's important to understand. We have to look at the same timeframe and look at this as an apples to apples comparison, not apples to oranges. And let's go to phase three.

Macan Nia:

Yeah, so let's just put in a nutshell, just conclude phase two. So phase two is, duration's your friend. And basically by increasing duration and the quality while transitioning to maybe longer dated government bonds, you're mitigating risk, potentially increasing your return. Then we transition to phase three. And phase three is, take on risk. Really? You're supposed to be my backup singer, Kev. You're supposed to say, "Take on risk."

Kevin Headland:

I realized I can't sing, so I'm giving it up.

Macan Nia:

Well, clearly I can't sing either. My family's been telling me that for years, no one wants to listen. But phase three is taking on risk, and this is the final phase in the opportunity in the fixed income set, where you want to be taking on risk, where the recession has been fully priced in and where you recognize it being fully priced in or in spreads, whether it's investment grade spreads or high yield spreads. But we're going to talk to high yield spreads in terms of taking on risk. At this point in the cycle you want to be increasing your high yield exposure in a very material manner. Because at this point this is like the bottoming of the market as well in a sense, where when you look at one-year forward returns from this bottoming period, high yield almost acts like equities.

So very equity-like, this is when you want to be taking it. We are clearly not there yet. The benchmark we use always is 800 basis points with high yield spreads, is typically when that happens in markets you close your eyes and you just buy the forward returns. When you go back, let's say to the mid-'90s, and I'm going to use median 'cause I like a median over average. But when it's above 800 basis points, the one-year forward return going back to history is 20%. So it's very meaningful, it's very powerful. Today we're at 550, so we're not quite there yet. But this is the phase that you want to be taking on credit risk.

Kevin Headland:

Yeah, I think it's important there as well as, you say close your eyes, but you can do well there. But even if you're an active manager, even better, where you can truly take on those companies that really show dislocation. Because what happens during recessions, during weak economic periods, is the market starts pricing in high levels of default risk amongst high yield bonds. Sometimes it's almost like they just think everything less than investment grade is going to default. And prices fall materially, as you said, spreads widen out over similar government bonds, which is the incremental yield premium you need to receive to take on that default risk. But almost all the time those default levels are never achieved, meaning that some bonds that are being priced for default never hit default. And then eventually you need to rally back to hard value as you get close to maturity. And this is where it's such an attractive opportunity to invest in fixed income. Right now spreads are even tighter now. They're down to almost 440 for high yield over government. So very, very low, tight.

Macan Nia:

Wow, down 550 to 440?

Kevin Headland:

Yeah, they're 440 right now, yeah. Just showing that the bond market is not pricing in that recession just yet, not pricing the default risk. As we see economic weakness continue, it will eventually start pricing in more default risk and spreads will widen. And then again, as you said, that's when we take on that phase three approach. That is when we start to reallocate our fixed income from high quality, government treasuries, protection, duration to move into a fixed income. And it's going to be a measured pace. You don't whipsaw it, you take a measured approach. But there will be definitely an opportunity next year if we think things play out the way we do with a recession. Mild or not, we should see spread widening and you want to take advantage of the high yield, because when spreads hit, as you said, 800 base points, 900 base points, you're looking at double-digit one-year returns. And if they get to 1,000 base points, you're in the 20%+ returns on average one year out based on history since inception.

Macan Nia:

Well, let's not hope we get to 1,000. That would be structural thing to, when you get that high it's a great financial crisis, type of thing. Let's just hit 800, typical recession.

Kevin Headland:

In the great financial crisis we hit 2,000 basis point spreads.

Macan Nia:

Yeah. When you're up above 1,000 ...

Kevin Headland:

It was wild.

Macan Nia:

COVID was also wild, but again, it could have been a massive shock to the system. Yeah, Kev, I'm looking at my Bloomberg, wow, things quickly changed in a week. We were at mid-fives and then now, wow, well, that gets on the back of the inflation data, makes sense. But interesting enough, spreads aren't moving that much over the past couple days based on what the Fed said. So just to wrap this up is, it's not as simple I think for 2023. I think we're doing ourselves a disservice as investors when we just say buy bonds. Yes, it is buy bonds, but it's buying the right bonds for the right opportunities, and there's going to be different opportunities in 2023 because we're going through a transition where we're pivoting into a recession. We'll be pivoting out of a recession and different bonds do well in those different environments.

So phase one is the one we're in today, where you want to be taking on risk. And then as we go into phase two ... Sorry, sweet spot, I'm going backwards, Kev, we really need a vacation. But phase one, the sweet spot, you're just being paid to wait, clipping that coupon, that's very attractive. Then we transition to phase two, which is, duration's your friend. When we start pricing in a recession, yields drop, those bonds do well. And as we pivot out of a recession, is taking on risk. So you want to be taking on credit, high yield in this example. But that's a lot to do and a lot of listeners, as advisors, investment management is just one aspect of the job. There's estate planning, there's taxes, there's building your book of business. So it's a lot to take on.

Again, so if you're going to be buying a solution, you want to be buying a solution that is extremely flexible, that has the ability to transition to these different asset classes, and more importantly, they've shown a history of doing it. So look back at history, during the great financial crisis, other selloffs, see whether these solutions have been able to navigate those periods, because that's important. Because experience, we lived through the great financial crisis, so on and so forth, we've gained experiences from both. So I think that's important that they've had a history, experience navigating these periods.

Kevin Headland:

Yeah, I think that key word is flexible. I think that's the word that keeps coming back to me when I look at the fixed income environment going forward, is being flexible, being able to manage those periods. And as you said, history, there's a lot of funds there that actually haven't even been around. So the great financial crisis. It's important how the portfolios navigate that environment. And of course returns are not going to necessarily be the same. But was there change? Was there movements in the portfolio to adapt to different scenarios? It's important that the managers realize the movements, how the capabilities and the flexibilities, as you said, to move those opportunities. And I think that's important to understand, and it's important to remember that and remember the opportunities that exist as we go forward.

And as you said. I think also the key is, as humans we have a recency bias. It's been a very tough year for fixed income. Don't count it out. It remains an important part of a well-balanced portfolio. And for the long term, this is also just not a one-year fixed income opportunity. This is going forward, and we think there remains a good opportunity and remains a key piece of a portfolio. And by all means, bonds are not dead. They're alive and well. And this is actually one of the most attractive opportunities for fixed income we've seen, again, since before the financial crisis.

Macan Nia:

And just to put into context how challenging of a year 2022 has been, is really if the year ended today on December 15th, 10-year treasury returns have never been this bad since 1929. And if the year ended today, there has been no other year where stocks measured by the S&P 500 and the US bond market have been down more than 10%. So this has been a very, very unique year, because there's been nowhere to hide and there's been carnage everywhere. So a lot of us are feeling exhausted, but bear markets, they happen. They're rare, thankfully. And we believe not that we're at the cusp of a bull market starting January, we still think we have to work through some things, especially on the equity side. We've got to work through negative earnings, but we are much, much closer to that bottom today. And there's much, much more visibility in terms of inflation, in terms of interest rate probabilities, or the path of interest rates, in terms of China's zero COVID policy.

So a lot of the headwinds that we were facing in 2022, there are more likely to be tailwinds in 2023. So put your feet to the fire, because we get the question too, Kev, especially in this phase, is, do you want Canadian investment grade credit or US? Our view is, I think you're picking hairs. We would maybe side more to the US side because it's more diversified, less focused on the financials, but the spreads in both are very similar. Yields are also very similar. I think you're just picking hairs. It's just, you should be in them. Now, again, putting your feet to the fire, end of year 2023, what has, let's say, investment grade credit done? If you were an advisor and they have to put in return profile, what would you be comfortable with?

Kevin Headland:

I'm comfortable with high single digits in the 7%+ range. I think it's very, very possible if things play out the way they are for investment credit to reach that level. And as you said, reverse the upside. Again, I think this is one, when we talk to our fixed income managers, fixed income managers don't get excited very often. They're excited about the opportunity. When you're investing in fixed income of good quality, fixed income that is trading below par and sometimes meaningfully below par, this is a return opportunity that hasn't existed in quite some time in some portfolio managers' careers. When they go back 15, 20 years, they've never seen this opportunity. So it's actually an exciting time for fixed income that we haven't seen.

Macan Nia:

Yeah, I think I would be comfortable saying 8%, being conservative. Let's just start with the yield at 5%. You talked about the duration math, you add 3% to 4% there, and without even including credit upgrades within the portfolio, currency, and other things, I think at minimum 8%. So let's end there, Kev, I think we've rambled enough. So at this time I think we want to thank everyone on the call who listens to us. We just got numbers in terms of subscribers to Investments Unplugged, and every time Jocelyn, who's our marketing manager, tells us, I don't believe her. But what did she say yesterday, Kev, in terms of how many people active listeners?

Kevin Headland:

26,000.

Macan Nia:

Active listeners.

Kevin Headland:

Listeners.

Macan Nia:

And downloads went from 20,000 at the beginning of the year to 60,000, just roughly.

Kevin Headland:

I think the beginning of the numbers were a bit skewed, but we're up to roughly 60,000 downloads total for our podcast since we started.

Macan Nia:

Yeah, which just blows our mind. And we just wanted to thank everyone, and when you come up to us when we're on the road and tell us that you listen to us, our first response is, "Why?" And then we're like, "Oh, that's nice." But we want to thank everyone on the podcast listening to us. It does mean a lot to us getting those numbers. It's not that we're just talking to a black hole, but there's a human on the other side and we really appreciate your support. And without your support Kevin and I wouldn't have jobs. So thank you very much. I also want to thank everyone, I especially want for the podcast because of the success, this podcast could not be done without the main man behind it, is Peter, Peter Ward.

He's a little upset. He's English, his team got kicked out by the French, so he is a little bit upset about that. But he is also a massive- Yeah, don't worry about it, he's also a massive Newcastle fan. So I guess that balances it out 'cause they're doing really well. But Pete, we thank you so much. This podcast would be a shell of it without your guidance, your editing, everything. So thank you for that. Kevin, any last talks as we go into 2023?

Kevin Headland:

No, by the time this podcast has been distributed, the holiday season will be over, we'll be back to work. But I hope everyone had spent a great time getting refreshed and ready for what we expect a much better 2023.

Macan Nia:

Yeah, really well said. So hoping everyone had a happy holidays, enjoyed it with their friends and family, and we look forward to 2023 and seeing everyone in person again. So thank you so much.

Speaker 4:

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