FUND SPOTLIGHT

# Canadian Fixed Income Fund.

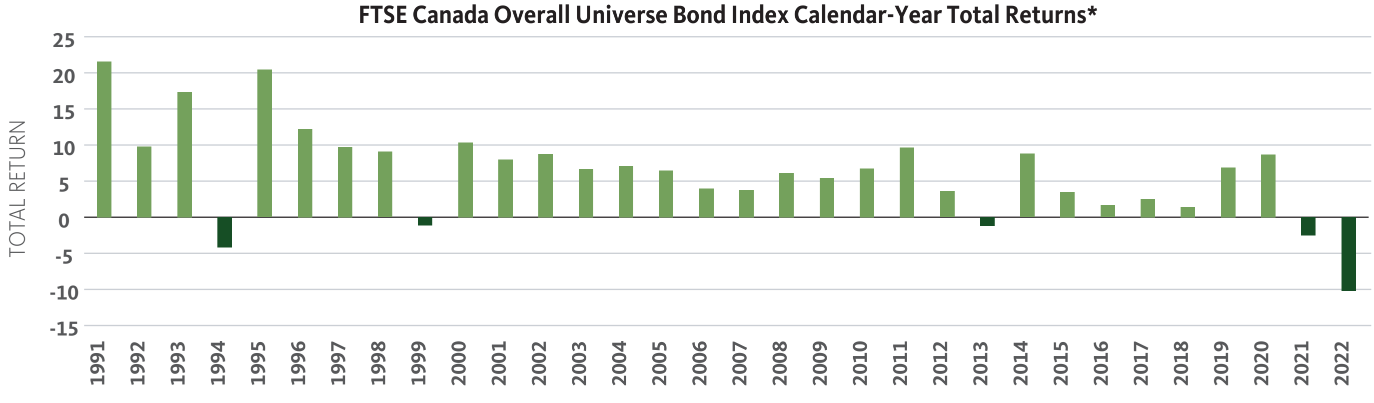
## Why Canadian fixed income?

Investors may question why they should allocate to investment-grade fixed income. Often, this comes down to the lower long-term return expectations of bonds versus equities. Stocks certainly have a higher expected long-term return, but our research shows Canadian stock market volatility has ranged between one and 10 times that of Canadian bond market volatility.[1] After adjusting for risk, those stock returns are not so flashy. Other times, it can come down to investors believing yields are too low or having concerns about rising interest rates or inflation.

These concerns, while certainly valid, do not take into account the strategic benefits of holding investment-grade bonds in a portfolio. Investment-grade fixed income is one of the few genuine diversifiers of equity risk that also generally delivers a risk premium in excess of cash. In the event of slower-than-expected economic growth (or any other development that impairs equity returns), investment-grade bonds can serve as a valuable stabilizer in a client's portfolio, providing a degree of buffer against equity losses. Since equities tend to be riskier than bonds over most time periods, it is important to note that even an apparently "balanced" portfolio such as one invested in 60% equities/40% bonds, will derive the vast majority of its risk from stocks. As such, bonds can serve as a crucial diversifier to the equity risk that overwhelmingly determines the outcomes of even optically balanced portfolios.

It's important to remember that markets are forward-looking. To the extent that inflation is expected to linger and interest rates remain higher, those expectations will already be factored into bond prices; the realization of those expectations will not in and of itself hurt bond returns. Rising rates erode short-term performance, but higher yields offer better potential future gains; over the long term, the vast majority of fixed-income returns are generated in the form of income. Therefore, investors may be well served to keep calm and clip their coupons—particularly as timing bond markets or interest rates is just as difficult as timing the stock market, which is notoriously challenging and often detrimental for investors. While we've seen an anomaly in fixed income over the past few years, we believe buying when bonds are "on sale" can be an effective strategy.

## Exhibit 1: The Generation of "Unprecedented"




Source: FTSE Canada, PCBond. Calendar year returns for period 1991 to 2022.
*Index returns are for illustrative purposes only, and do not represent actual performance of an SEI Fund. Index returns do not reflect any management fees, transaction costs, or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.

[1]Based on standard deviation of quarterly rolling 1-year Index returns between 1990 through December 31, 2022. Total return indices of S&P/TSX Composite vs. FTSE Canada Overall Universe Bond Index.

## Why SEI Canadian fixed income?

### Manager of managers

Manager-of-managers strategies combine multiple third-party strategies into a single mutual fund with the expectation that specialization should benefit performance. Given there are varying ways to analyze an opportunity set, SEI seeks specialists with unique expertise to work collectively under our watch to harvest opportunities. In the investment-grade bond space, this allows us to diversify by alpha sources—or, in more common terms, drivers of excess return.

### Alpha sources

We believe our alpha-source framework differentiates SEI from our competitors. Within fixed income, we have four primary alpha sources—and we diversify our sub-advisors by alpha source.

**Macro:** The investment manager seeks to benefit from directional positioning by means of active duration, yield curve, and spread beta. Differing market expectations regarding economic and corporate fundamentals, central bank policy, political and regulatory frameworks, and technical factors provide the opportunity for active and trend following opportunities.

**Risk-adjusted yield:** The investment manager seeks to maintain a long-term buy-and-hold strategy based on acquiring assets with superior yield per unit of risk.

**Value:** The investment manager seeks to benefit from market mispricing and mean reversion in underlying sectors, industries, and currencies, which manifest due to market overreactions and aversion to losses.

**Selection:** The investment manager seeks to uncover idiosyncratic opportunities at the issue and issuer level that have been mispriced by other market participants.

## Active management

Historically, active management has been quite successful in fixed income.[2] Through the use of our identified alpha sources (macro, credit, and selection), many active managers have outperformed investment-grade fixed-income benchmarks. Active management has a greater degree of flexibility in managing liquidity, volatility, and credit risks compared to fully passive strategies that seek to mimic an index; passive strategies may need to hold a significant number of illiquid securities as they seek to optimize performance against a benchmark index that may not be fully replicated.

## Exhibit 2: SEI's Manager of Managers Alpha Sources Cover the Market


For illustrative purposes only.
Source: SEI

**Domestic Macro**

- Connor, Clark & Lunn Investment Management Ltd.
- Beutel, Goodman & Company Ltd.

**Global Macro (Government)**

- PIMCO Canada

**Investment Grade Credit**

- J. Zechner Associates Inc.
- Addenda Capital Inc.
- Aviva Investors Canada Inc.

[2]Based on data from eVestment Analytics, Canadian Core Bond Universe, rolling calendar years of 3-year annualized periods between 1990 and 2022 showed 30 of 32 periods where the median manager outperformed the FTSE Canada Overall Universe Bond Index returns, gross of fees.

# Suggested implementation

## Investment-grade fixed income has a place in most portfolios

From a diversification and risk-reduction viewpoint, investment-grade fixed income has a place in most portfolios. The proportion of fixed income exposure within an individual's overall portfolio often depends on their personal risk tolerance and goals. Investors with a higher risk tolerance or long-term goals would generally have lower allocations to investment-grade fixed income. Conversely, risk-averse investors or those with shorter-term goals and a more immediate need for a stable source of income would typically be expected to have higher allocations to investment-grade fixed income.

## Match your currencies

Many investors diversify their portfolios across different countries and regions, which can bring additional currency risk to any portfolio. Within equities, currency risk is generally modest compared to the overall risk of the asset class. However, in fixed income, the currency risks can become a more prominent driver of volatility and in some cases can dominate or even exceed the volatility of investment-grade bonds themselves. Therefore, in most cases, it would be prudent for most fixed-income investors to match the currency of their fixed-income investment to their home-country currency. This could involve currency hedging when it comes to foreign bonds, which may be a difficult or expensive proposition depending on the types of bonds and currencies being hedged. With this in mind, we suggest Canadian investors allocate the majority of their bond allocation to actively-managed, investment-grade Canadian fixed income where currency exposures are fully hedge back to Canadian dollars.

## To learn how to add SEI's Canadian Fixed Income Fund to your clients' portfolios, contact your Relationship Manager.

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There are risks involved with investing, including loss of principal. Diversification may not protect against market risk. There may be other holdings which are not discussed that may have additional specific risks. In addition to the normal risks associated with investing, international investments may involve risk of capital loss from unfavourable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. Bonds and bond funds will decrease in value as interest rates rise.

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