TD Asset Management

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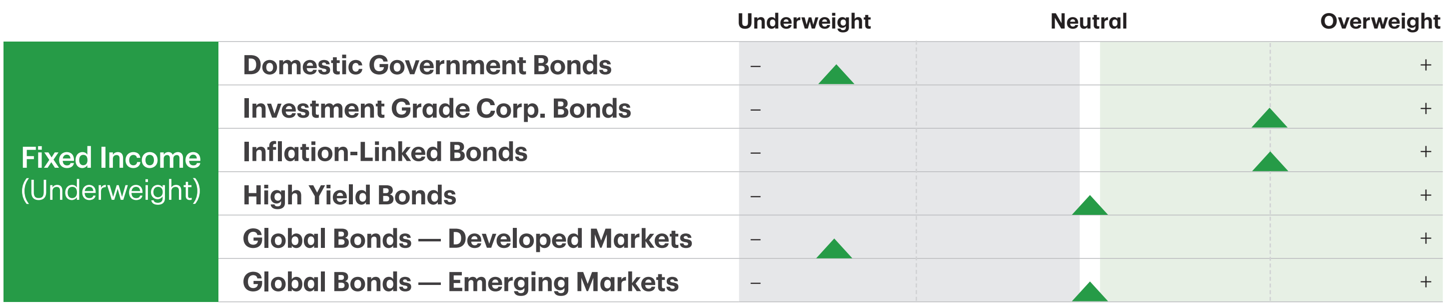
Fixed Income Forecast | 2021

The TD Wealth Asset Allocation Committee ("WAAC," "we") is modest underweight fixed income as an asset class. Entering 2021, we expect bond markets to be subject to some volatility from an uneven economic recovery and the length of time for widespread vaccination to be achieved. Interest rates should remain low for the foreseeable future as the U.S. Federal Reserve (the Fed) and central banks maintain an accommodative stance with respect to rates and their balance sheets.



Domestic Government Bonds
(Maximum underweight)

- We maintain a maximum underweight view for government bonds as we believe yields will remain range bound near record low levels for the extended term.

Investment Grade Corporate Bonds
(Modest overweight)

- Despite significant spread narrowing, investment grade corporate bonds continue to offer a relative yield advantage over government debt.

Inflation-Linked Bonds
(Modest overweight)

- While a significant surge in inflation is not in the Committee's forecast, inflation insurance is inexpensive for those looking to protect against a rise in rates driven by a shift in expectations.

High Yield Bonds
(Neutral)

- High yield spreads have narrowed considerably from late March 2020, but there may be room for further tightening, particularly if the economic rebound gains steam in 2021.

Global Bonds - Developed Markets
(Maximum underweight)

- Low or negative nominal and real yields globally, are not compelling from a risk-reward perspective.

Global Bonds - Emerging Markets
(Neutral)

- Select opportunities offering incremental real yields do exist, but we remain highly selective due to continued economic uncertainty.

Part of the WAAC's mandate is to highlight risks and opportunities on the horizon. Below are some of the factors we will be watching in 2021.

↑ Opportunity ↔ Neutral ↓ Risk

What We're Monitoring	Potential Implications
Inflation	↔ A notable theme to emerge in 2020 was the updated policy framework from the Fed. The Fed unveiled a shift in inflation targeting, with the new policy allowing inflation to overshoot targets for a period of time, after an economic downturn. The shift indicates that the Fed will maintain ultra-accommodative policy indefinitely, with its own projections implying no rate increases through to the end of 2023. Given that other central banks may adopt a similar approach to policy, including the Bank of Canada, yields and rates will likely remain range bound near record low levels for the extended term.
Policy Action	↑ As economic conditions worsened in 2020, global governments and central banks responded with aggressive and coordinated measures to effectively prevent further hemorrhaging of economies, while maintaining liquidity in credit markets. We expect further stimulus measures to be taken in 2021 to keep economies and markets afloat.
Yield Curve	↔ Global fiscal and monetary responses to the COVID-19 pandemic have helped ameliorate the negative impacts to the economy and accelerate the recovery during the latter part of 2020. We expect a modest yield curve steepening as the economic recovery gains momentum in 2021.
Corporate Credit	↑ From a corporate credit perspective, the shutdowns and stay-at-home orders initially caused downward adjustments to most future corporate sector earnings, which negatively impacted credit fundamentals in the short to intermediate term. Swift policy action helped to stabilize markets which have rebounded substantially since March. Despite the significant tightening, and with investment grade corporate bond spreads reverting to their longer-term averages, we retain a modest overweight to corporate credit due to their relative yield advantage over government debt. Given the spread compression in corporate bond markets, we remain active in seeking to unlock relative value opportunities which we believe will still exist in 2021.