Election Frenzy

Notes from the Trading Desk - Q2 2024

July 8, 2024

Central banks officially began loosening monetary policy this past quarter, with the Bank of Canada and the European Central Bank leading the charge with 25-point rate cuts. In Canada, as underlying inflation continues to ease, the Governing Council feels confident that the 2% target can be achievable over time. South of the border, where disinflation has been slow due to a resilient economy, the US Fed has held rates amid concerns of reigniting inflation.

Overall, a soft landing still appears within reach. Growth remains positive but is beginning to moderate. Meanwhile, consumer data remains mixed as retailers experience continued pressure from bargain-hunting consumers despite income data coming in strong.

Politics occupied centre stage toward the end of Q2, particularly in Europe with the UK election and a surprise election in France. The win for the Labour Party in the UK was as expected, but the French election was notably impactful as Europe took a bruising in the markets immediately following the election announcement. The leftist coalition, New Popular Front, had an unexpected victory, likely resulting in a hung government. This means the region will remain volatile in the short-term as France and the Eurozone navigate political instability – though supportive monetary policy and demand for fixed income remain relative tailwinds.

In the world of US politics, the presidential debate, while entertaining, was widely seen as a disastrous start for the Democrats in the Trump vs. Biden sequel. In our view, US political risk is arguably more concerning than what we saw in Europe over the past quarter. Aging candidates, potentially massive tariffs, and the risk of fiscal dominance due to reckless spending from both parties are all factors we are closely monitoring as we inch closer to the US election.

From a holdings perspective, in early June, we made a sizeable investment in Coastal GasLink's (CGL) new issue, the largest bond deal in Canadian history at $7.1 billion. Spreads on the bonds tightened persistently in the days and weeks following the bond deal, making CGL a top contributor across several strategies. Outside of Canada, European Financials have been a great source of alpha generation. Notably, banks such as UBS and Barclays have seen substantial spread compression across the maturity spectrum, which contributed greatly to the portfolio's outperformance compared to the broader market.

Positioning-wise, we continue to opportunistically rotate out of Europe and into North America, where there is less volatility in the near-term. Investment grade fund inflows have picked up significantly, and as liquidity returns to all markets, we seek to identify outliers and tactically capture relative value. We are conscious of the need to find a balance between the supportive technical backdrop and the rising risks, so we aim to operate at a lower headline risk level as we anticipate further economic weakness, particularly in Canada. Overall, significant dislocations persist under the surface, which we are able to capitalize on through active management.

As central banks begin to cut overnight interest rates, the rates available to cash allocations will begin to decline, providing strong incentive to lock in attractive yields and return streams now. Amid the volatile economic and political backdrop that darkens this process, we believe investors should start to redeploy cash into active fixed income solutions that can provide both return generation and risk management.

For more updates on the credit market, read our **Credit Market Themes in 5 Charts** article for this quarter.