

## Market News

Although the economy continued to suffer in the first quarter, fixed income markets showed some signs of stability, as bond yields traded in a steady range, and corporate bond spreads tightened. The 10-year U.S. Treasury yield increased 45 basis points (bps) to 2.66%, and the 10-year Canada bond yield rose 10 bps to 2.78%. The rise in North American bond yields reflects the reservations of investors to the flight to quality bid that occurred during the fourth quarter of 2008.

Despite the continued barrage of poor economic headlines and the recent memory of credit defaults and spread widening, North American investors have begun 2009 by investing cash built up during 2008. Investors are re-entering the credit markets and buying corporate bonds at all-time cheap valuation levels. While the economic forecast consensus is that things are likely to get worse before they get better, the market is willing to bet that economic conditions will turn later this year. Corporate bond spreads performed well in the first quarter, tightening by approximately 37 and 20 bps in Canada and the U.S. respectively, while provincial spreads tightened nine bps, and municipal spreads widen two bps.

Because the Fed funds rate already sits at 0-.25%, the U.S. Federal Reserve (the Fed) was not in a position to add more monetary stimulus, but the Fed did initiate a policy of quantitative easing in the first quarter. The Fed was active in buying longer-dated U.S. Treasuries in an effort to further lower rates across the yield curve. The Bank of Canada also was active in the first quarter, lowering the overnight rate a total of 100 bps, to an all time low of 0.50%. While there is debate about whether the Bank of Canada will ease rates further and eventually follow the Fed in quantitative easing, it is widely agreed that both central banks will leave their short-term rates at their all-time lows for the rest of 2009.

## Outlook

Our outlook calls for economic readings to remain weak in the near term, but to improve during the second half of 2009, and we expect credit spreads to tighten through the end of 2009. Governments and central banks around the world continue to devote their financial resources to reversing the global crisis. We believe this will provide the basis for positive economic growth in late 2009 or early 2010.

It is important to note that, despite the unprecedented amount of capital being used to fight the credit crisis, markets rarely travel in a straight line toward recovery. The globally coordinated government programs, monetary policy and fiscal stimulus recently established are only just beginning to garner traction, and markets are likely to see some volatility as corporate earnings remain weak and investors express their doubts and fears in future economic direction. We see current spread levels and any back-up in credit as an excellent opportunity to continue adding exposure to high-quality spread products. We expect the collective global monetary and fiscal stimulus to allow corporate bonds and provincials to outperform in 2009. This is consistent with historical trends of credit spreads typically leading a fundamental recovery by about nine months.