

## North American Fixed Income

The ongoing credit crisis that has ravaged Wall Street since the summer of 2007 intensified in the fourth quarter of 2008. The Bank of Canada (BOC) began to buy mortgages from the nation's chartered banks to improve capital ratios and bolster liquidity. Initially targeting C\$25 billion in purchases, the BOC has since increased the program to \$75 billion. Given that the federal government can finance these instruments at much preferred interest rates, some analysts expect Ottawa could pocket roughly \$1 billion per year as this program progresses. As a result, housing trust issuance was significantly stronger in the fourth quarter and should continue to be so in early 2009.

U.S. Treasury yields headed lower over the quarter, while yield curves flattened and risk premiums ballooned. Long-dated Treasuries outperformed shorter-dated issues as deflation concerns mounted. At the same time, investment-grade and high-yield corporate credit spreads mushroomed to record highs.

Canadian bond markets were not immune to the storm, as credit markets seized and signs emerged indicating the domestic economy is in recession.

Canadian yield curves were much steeper in the fourth quarter, as yields at the short end fell at twice the pace of those at the long end. Canadian corporate credit spreads also grew significantly wider.

Despite all the doom and gloom, a strengthening of Canada's economy is expected later in 2009. Recent weakness at the gas pumps should extend through the summer and should free up some discretionary income for households. Home sales and sale prices are cooling, but at least some of this weakness reflects the fact earlier price gains were likely overdone. One of the darker spots on the horizon remains the manufacturing sectors of Québec and Ontario, and continued weakness in the auto and auto parts spaces is expected, as the Big Three automakers spend most of 2009 realigning production schedules and slashing costs.

Bond yields are expected to remain range-bound this year, with a slight upward bias materializing as issuance picks up. All said, with 2008 finally at a close 2009 should be a better year for investors.

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