AVISON YOUNG

AUGUST 2018

Debt Market Monitor

Debt Capital Markets Services

Large bond funds bet on interest rates going up soon

The gurus of the bond world have placed an aggressive bet, staking their claims to higher yields being driven by growth. This wager comes in the form of positioning their bond funds to a negative duration – less than zero term remaining. In other words, these funds are very significantly weighted to take advantage of rising interest rates – soon. Morningstar Inc. reports that six major bond funds have taken an aggregate negative-duration position totaling more than US$100 billion. The thought is that a global economy growing sustainably would, in turn, enhance government bond yields in the west and boost emerging market credits. All said, this is a major wager that interest rates are headed north. Of course, the longer that it takes for this strategy to gain real-life traction, the greater the cost and loss of profit.

Unfortunately, these bond funds have encountered stronger headwinds than their managers anticipated. Core inflation rates have remained sedate and unyielding haven flows continue to bolster bond prices and have kept longer dated developing market yields depressed. Additionally, trade war worries and a stronger U.S. dollar have virtually stopped the emerging market rally. Some of these funds with negative duration have been in a holding pattern for nearly two years. How do you position a negative duration? – well, Franklin Templeton Investments has partly used interest-rate swaps.

Janus Henderson Global Unconstrained Bond Fund has placed its chips on a bet that the German bund yields will start to catch up with U.S. treasury yields. Recently, the spread between the two yields was the widest in almost three decades, with bunds anchored by rising political risks and a downward-looking assessment of a European Central Bank rate hike.

None of these bond fund managers are throwing in the towel; in fact, there remains a strong likelihood that the markets will return to where they were at the beginning of 2018. The IMF has predicted that, in 2018 and 2019, the global economy will grow 3.9% – a level that would be the fastest pace since 2011.

Fiscal Snapshot

Bank of Canada

	Bank Rate	Bank Prime Lending Rate
July 2018	1.75	3.70
One month ago	1.50	3.45
One year ago	1.00	2.95

Government of Canada Benchmark Bond Yields

	5-Year	10-Year	Long
July 2018	2.22	2.31	2.33
One month ago	2.06	2.17	2.20
One year ago	1.65	2.06	2.47

Indicative Commercial Mortgage Spreads* Over Government of Canada Bond Yields

Conventional	5-Year	10-Year
July 2018	1.50 - 2.20	1.60 - 2.20
One year ago	1.70 - 2.35	1.85 - 2.40
Insured	**5-Year**	**10-Year**
July 2018	0.80 - 1.10	0.80 - 1.10
One year ago	0.95 - 1.15	0.95 - 1.25

*Spreads are indicative of high quality real estate in major Canadian markets.

Highlighted Transaction

Asset Type	Single tenanted industrial building
Location	Major Canadian city
Facility Details	A $10M senior charge, utilized to assist with the acquisition of the asset and to provide working capital. Terms included a 25-year amortization, a 5-year term, limited recourse and 70% leverage, at a competitive rate of interest.

Intelligent Debt Financing Solutions

The Avison Young Debt Capital Markets dedicated team is focused on providing innovative North American-wide debt and equity solutions to accomplish goals. We originate debt and equity for all types of real estate and all types of clients. Debt origination includes fixed and floating rate structures, permanent and construction financing, structured finance, bridge and mezzanine debt and insured agency financing - CMHC and Fannie Mae / Freddie Mac.

Our years of combined debt/equity capital markets experience has created meaningful relationships that we can put to work for you.

Please contact our Debt Capital Markets team for more details related to debt financings or real estate transactions.

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