CIBC Sustainable Canadian Core Plus Bond Strategy

Portfolio commentary as of December 2024

Overview

- With significant changes to government administrations around the globe, upcoming milestones for interim climate goals, and the continued maturation of the transition finance market, 2025 is shaping up to be a year of change and uncertainty for sustainable investing. Here are three key areas that we will be monitoring.
- Countries representing over half of the world's population went through an election in 2024, which resulted in several significant political regime shifts as incumbent parties struggled to maintain power – including the republican sweep in the USA. While we are not clear on which policies will be implemented, we will likely see regulatory rollbacks and a reduced focus on climate as the Trump administration takes office. However, the specifics around certain items like the IRA, nuclear energy, and corporate reporting requirements remains uncertain.
- The 10-year anniversary of the Paris agreement is set to occur this year. Most notably, this includes the requirement for countries involved to update their nationally-determined-contributions (NDCs) – the actions they're taking to limit greenhouse gas emissions. Most countries are currently behind their Net Zero goals and will need to decide which actions they will take moving forward – including whether to accelerate or decelerate their climate commitments and actions domestically. This could result in significant investment implications across markets.
- While the public sector grapples with how to proceed on climate change, private investments into transition finance assets continue to grow. One area of this market where we are seeing significant advancements in both technology and infrastructure is around carbon sequestration. This is an exciting development as this technology can be a key component of net zero strategies moving forward, making it easier to remove emissions from hard-to-abate sectors like industry, agriculture, and transport. This is a fast-growing market and will represent increasingly significant opportunities for investors.

Performance

- Several themes dominated markets in 2024, the first being rate cuts, where both the Bank of Canada and the US Federal Reserve (Fed) cut rates multiple times throughout the year as inflation continued to normalize. The second theme observed was yield curve steepening, as both the Canadian and US curves (defined here as the difference in yield between 2-year and 30-year government bonds) went from deeply inverted to positive. Finally, the third theme was strong performance from risk assets as credit spreads continued to tighten throughout the year.
- Looking ahead, futures markets are pricing in 2-3 cuts by the Bank of Canada in 2025, with one cut being fully priced in by the end of March (82% probability of a 0.25% rate cut in January). In the U.S., futures markets are pricing in 1-2 cuts by the Fed in 2025, with the first cut being fully priced in by mid-June. Markets are not expecting a rate cut by the Fed in January.
- One major observation has been the significant outperformance of the Canadian bond market relative to the U.S. in 2024, with the difference in yield between 10-year Canadian and U.S. government bonds reaching 1.34% in December compared to 0.77% at the end of 2023. This was particularly exacerbated in Q4, which saw the yield differential increase by more than 50 bps. This move is partially explained by weaker economic conditions in Canada relative to the U.S., uncertain trade policies surrounding Trump, higher risks of reaccelerating inflation in the U.S., and uncertainties surrounding the Federal leadership in Canada. Given both rates and this basis remain volatile, we continue to see cross market trade opportunities within our portfolios.
- While we have reduced risk within the portfolio by reducing our overweight in credit, particularly our position in high yield (now less than 5%), the portfolio remains overweight the corporate sector and is underweight the Government of Canada and Provincial sectors. The yield of the portfolio is above the benchmark, due to the sector allocation strategy and duration is neutral.

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1204 | 01/2025