MACKENZIE Investments

Q2 2025

Mackenzie Fixed Income Team

Quarterly report

Clarity is hard to come by in today's market. The overwhelming volume of red headlines and market volatility can be overwhelming, and the volume of noise is deafening.

Konstantin Boehmer
Head of Fixed Income,
Portfolio Manager

But for fixed income investors, clarity is not a luxury — it is a necessity. As we move through an increasingly politicized macro environment, the ability to tune out emotion and tune into structure, policy and predictable patterns becomes a decisive edge. However, in focusing on what matters most, sometimes we are brought much closer to home than we would expect.

Namely, discussions around the dinner table.

My eldest daughter is about to leave for university. She will be studying political science and international relations — in essence, skating to where the puck is going rather than where it has been. That choice feels especially poignant in our house, as I've witnessed a shared and growing interest in all things "global". For the past few months, dinner-table conversations have been a spirited mix of policy debates, macroeconomic forecasts and political theory. As she prepares to leave, I realize how much I will miss those debates — and how relevant they have become to the world of fixed income investing.

For much of modern market history, political analysis in developed markets was largely an academic pursuit — interesting, perhaps, but rarely investable. The pendulum would swing from fiscal conservatism to global expansionism, ebbing and flowing with the market. That era is over — today, politics is macro and ignoring it is no longer an option. The challenge now is not just staying informed but interpreting headlines with clear eyes and steady hands — especially when emotions are high.

Which brings us to Trump. Whether you love him or hate him, the goal remains the same: to understand his objectives, his motives and the resulting actions to follow. Understanding requires us to suspend bias — political, historical, personal — and evaluate the facts as they are, not as we wish them to be.

Trump is not the unpredictable wildcard many assume he is. While his style is chaotic, his strategy is not. His unpredictability is, in fact, part of the strategy. Trump's economic playbook is built around three core themes: economic sovereignty, reindustrialization and trade fairness. Tariffs, threats and social media outbursts are tools — not tantrums. His approach mirrors the principles in The Art of the Deal: escalate first, build leverage, then pivot to a pragmatic resolution. That creates volatility. It also creates opportunity. Our job is to cut through the noise and identify the signal. That cycle is repeated so consistently it becomes nearly predictable — if you are paying attention.

This is not a defense of policy. It is a defense of clarity, which is in short supply. Political narratives have become moral battlegrounds, making objectivity harder by the day. But that is precisely why it matters. As volatility rises and consensus fractures, the ability to think independently — and act decisively — becomes a true advantage.

Our team is built to do exactly that. We are not trying to win arguments online. We are trying to position portfolios for what is next — not just what is loudest. That means understanding the players, the strategies and the second- and third-order effects. There has never been a more important time to think clearly, communicate simply and invest with discipline.

And yes, I will miss those dinner-table debates. But I am grateful to work alongside a team that brings that same spirit of curiosity and challenge to every idea, every day.

Mackenzie Fixed Income Team views

	Significant underweight	Underweight	Neutral	Overweight	Significant overweight
Duration			● →	●	
CAD duration		○			
USD duration				○	
EUR duration			○		
Credit				○	
Investment grade credit				○	
High yield corporate			○		
Leverage loan			○		
Private credit				○	
Inflation linked bonds			○		
Emerging market local debt			○		
Currencies					
USD		●	← ●		
Emerging market currencies			○		

○ Indicates no change ← → Indicates change

Source: Mackenzie Investments. As at March 31, 2025.

Macro commentary

A US economic slowdown will affect Canada, though existing tariffs alone may not cause a recession. The Bank of Canada is ready to ease monetary policy, while the US Federal Reserve (Fed) remains cautious due to inflation risks. The second quarter will focus on bilateral trade negotiations and their impact on global bond markets.

Dustin Reid
Chief Fixed Income Strategist

The second quarter of 2025 is picking up right where Q1 left off — on a rollercoaster.

Heading into Inauguration Day on January 20, the so-called "Trump trades" — long USD, long equities, short duration and tighter credit — continued to perform well. But that momentum began to stall almost immediately. A flurry of executive orders surrounding the inauguration sent shockwaves through both the real economy and financial markets. While the initial tariff salvos were modest and largely aimed at China, the early focus quickly shifted toward Canada and Mexico, with headlines dominated by fentanyl, border security and bilateral trade. By early February and again in March, both Canada and Mexico narrowly escaped more extreme outcomes, but significant tariffs on steel, aluminum, autos and other sectors are already in place and having an impact.

The bigger issue has been volatility in policy communication. The constant back-and-forth from the Trump administration over tariff baselines and scope created substantial uncertainty. US business and consumer sentiment, long buoyed by the narrative of economic exceptionalism, began to wobble. "Soft" survey data started to roll over in February, and by March markets were pricing out US growth exceptionalism. Stagflation-lite began to take hold as the new underlying narrative.

It wasn't just economics. Geopolitics had a hand on the wheel, too. The much-publicized Oval Office meeting between President Donald Trump, Vice President J.D. Vance and Ukrainian President Volodymyr Zelenskyy was widely seen as a diplomatic misfire. The fallout accelerated Europe's push for greater self-reliance, particularly on defense. Germany moved with surprising speed, suspending its debt brake and unveiling a €1 trillion fiscal package focused on defense and infrastructure. German Bund yields repriced almost overnight, reflecting both a stronger growth outlook and rekindled inflation risks in the eurozone.

Now in early Q2, market volatility remains high. Trump's latest move, a 90-day pause on reciprocal tariffs for non-retaliatory nations, while increasing tariffs on China to 125%, has temporarily lifted risk sentiment in North America. For now, it's a pause, not a pivot. And for companies, it's still likely a holding pattern: capex is delayed, hiring plans frozen and inventory restocking put on hold. The danger is that a stall in "soft data" could turn into something more real if this uncertainty persists and we see it appear in the hard data throughout the second quarter.

If the US does have a material economic slowdown, Canada won't be immune. The existing tariffs on Canadian exports are meaningful, but likely not enough to push the country into recession on their own. However, a weaker US consumer, hit by triple-digit tariffs on Chinese goods, could dampen Canadian business investment and consumer demand. The Bank of Canada remains poised to ease policy and has signaled it would tolerate a temporary rise in inflation if driven by one-time price adjustments. Barring a left-tail shock, we expect one to two more cuts this year, broadly in line with market pricing.

The Fed, in contrast, may remain stickier. Inflation dynamics in the US carry more upside risk, particularly with the 125% China tariffs. That alone could add 100 bps to headline personal consumption expenditures (PCE) inflation. With US growth still outpacing peers and nominal GDP holding firm, rate cuts are not imminent unless markets become exceptionally unruly.

Looking ahead, Q2 was already setting up to be all about bilateral trade negotiations, and the 90-day pause only heightens the stakes. As trade flows become more politicized, monetary and fiscal policy will increasingly be deployed on a country-by-country basis. This fragmentation is likely to feed into bond markets, with US duration continuing to drive global yields. But with European yields rebounding, potentially on the back of fiscal expansion, global bond leadership may not be as unipolar as it has been in recent quarters.

Global fixed income

The initial optimism of Q1 2025 faded due to volatility in policy communication, heightened geopolitical tensions and rising US recession risks, leading to a broader reassessment across global bond markets. The macro environment remains fluid, with fiscal and monetary policy signals crucial for shaping bond market direction in Q2.

Hadiza Djataou
Portfolio Manager

The first quarter of 2025 began with strong momentum behind the so-called "Trump trades," as markets reacted to the new US administration's assertive stance on fiscal and trade policy. However, that initial optimism faded as the quarter progressed. Volatility in policy communication, heightened geopolitical tensions and rising US recession risks prompted a broader reassessment across global bond markets.

By quarter-end, investors were confronting a new reality — characterized by fragmented trade relationships, diverging fiscal approaches across regions and inflation that no longer appears as well-anchored as in prior quarters.

US Treasuries saw significant volatility but ultimately rallied across the curve. The curve steepened as markets struggled to balance persistent inflation with increasing downside risks to growth.

In Europe, the US policy backdrop acted as a catalyst for a notable fiscal shift. The European Commission proposed close to €800 billion in defense-related spending, combining €150 billion in new EU-level issuance with €650 billion in national fiscal space. Germany's announcement in March marked a significant turning point. Easing its constitutional debt brake to fund defense and unveiling a €500 billion infrastructure plan, the country delivered a €1 trillion fiscal package that surprised markets. Bund yields jumped more than 30 bps in a single day, and borrowing costs rose across the eurozone as investors began pricing in stronger domestic demand and a potential resurgence in inflation.

Japan was a notable underperformer within G10 rates. Japanese government bonds underperformed meaningfully as domestic inflation pressures built, and speculation increased around potential Bank of Japan (BoJ) policy normalization.

One of the more prominent themes during the quarter was a repricing of inflation expectations. While realized inflation remained relatively stable in many markets, forward measures began to rise. In the US, short-dated TIPS breakevens widened in response to concerns around the inflationary impact of tariffs and supply chain disruptions.

Emerging markets delivered mixed results. Real yields remained attractive in several regions, and inflation trends continued to improve. However, the external environment — marked by volatile trade headlines and shifting global risk appetite — introduced dispersion across countries and asset classes. Brazil stood out as a top performer, benefiting from attractive carry, supportive policy and light investor positioning. In contrast, many Asian markets saw more muted rate moves but experienced pressure on currencies, particularly as China's trade outlook deteriorated.

Outlook

Looking ahead to the second quarter, the macro environment remains highly fluid. The US administration's 90-day pause on tariffs has temporarily eased tensions but has not resolved the underlying uncertainty. Fiscal and monetary policy signals will play a critical role in shaping bond market direction in the months ahead.

In Europe, markets will be watching closely to see whether Germany's pivot signals a broader fiscal reacceleration. If that materializes, Bunds could continue to underperform, while peripheral spreads may tighten.

Emerging markets continue to offer selective opportunities — particularly in higher-carry stories with credible policy frameworks and disinflationary momentum. However, this is not a market that rewards broad-based exposure. As macro drivers become increasingly fragmented and desynchronized, local factors, real yield differentials and FX dynamics will remain central to performance in emerging markets.

The second quarter is shaping up to be about adaptation. Fiscal policy, geopolitics and trade have re-emerged as dominant forces. For fixed income investors, this means greater volatility — but for us, greater opportunity to take advantage of dispersion and structural shifts globally.

Canadian investment grade fixed income

The first quarter saw increased volatility across asset classes due to policy uncertainty. Canadian and US government bond yields fell, and credit spreads widened as markets priced in the risk of US tariff policies. While risk appetite is low and market volatility is high, the widening of credit spreads presents opportunities for long-term investments at attractive prices. The market's fragility could lead to pockets of illiquidity, but an orderly market risk-off could support fixed income markets in the long run.

Mark Hamlin
Portfolio Manager

Felix Wong
Portfolio Manager

The first quarter of 2025 was marked by the transition in the US from the end of the Biden administration to the beginning of the Trump administration. Understandably there was some trepidation in markets ahead of this, due to months of threats around immigration policies and pending "Day 1" tariffs. The new administration didn't disappoint, with the president signing more executive orders in his first one hundred days than any president in history. Most concerning for markets is the threat of tariffs and what that can lead to — inflation, economic slowdown, dysfunctional supply chains and unemployment. And of course, most concerning to us is the threat of tariffs on Canada. In the end, the threat was largely toothless, with 25% tariffs being implemented not once but twice and then immediately paused. This left the threat of future tariffs hanging over Canada and the world. That type of news flow and uncertainty is not without consequences with investors getting cautious on risk — both equities and corporate bonds — in favour of government bonds.

In Canada yields on 2-year, 5-year, 10-year and 30-year government bonds fell by 47 bps, 35 bps, 26 bps and 11 bps, respectively, significantly bull-steepening the curve. Similarly in the US these same tenors fell 36 bps, 43 bps, 36 bps and 21 bps. In terms of credit, the US CDX Investment Grade Index — which had stubbornly refused to widen despite Trump's electoral success and threats of disruption — finally gave up, widening from sub-50 to over 60. Similarly, the CDX High Yield Index — which traded at a low of 290 bps in the middle of the quarter ended March 31 — rose to 380 bps, which is still tight from a historical perspective, but reflects increased concern from market participants. Another sign of concern over pending policies in the US was the widening of shorter end inflation breakeven rates with 2-year breakeven rates widening a whopping 74 bps and 5-year breakeven rates by 23 bps.

The main effect on markets during the first quarter was the effect on cross asset volatility. Uncertainty can lead to illiquidity which can lead to outsized moves — or volatility. We saw volatility increase across asset classes — rates, equities, credit and FX. As accounts (including us) implemented long-volatility strategies to hedge against tail risks, both volatility and vol skew (higher volatility for lower delta options) increased. A good example of this was the price action in the Canadian dollar, which oscillated several times between weak and strong as tariffs were threatened, implemented and paused.

We commented last quarter that the corporate bond spread market was expensive. Increasingly, corporations issuing bonds in the market were required to pay marginally higher spread premium to attract investors. The increasing threat of the US tariff policy and the uncertain consequences to the North American economy have started to move bond spreads wider during the quarter as the market began to price this risk in. For the quarter, Canadian and US corporate bond index spread rose 6 bps and 12 bps respectively.

With yields falling, it was, overall, a positive month for fixed income. The FTSE Canada Universe Bond Index posted a positive total return for the quarter of 2%, with the US corporate index returning 2.2%.

Outlook

As at the end of the quarter — with the threat of global tariffs and a pending trade war looming — the outlook can only be described as uncertain. The US administration has suggested various reasons for tariffs — border security, reciprocity, to reduce trade imbalances — and so what policies will be implemented and how they can be mitigated remains unclear. Risk appetite therefore remains low generally in the market and volatility remains high. Overall, the market remains fragile, and a fragile market can lead to pockets of illiquidity.

However, this doesn't imply a lack of opportunity. For the better part of two years, credit spreads have been languishing at historically tight levels and credit spread volatility at or near all-time lows. Any continued resetting of wider credit spreads may be an opportunity to accumulate excellent long-term investments at attractive prices. Any orderly risk-off market should be supportive for fixed income markets in the longer run generally, as it will help bring valuation to a more reasonable level.

We remain cautious of what is currently unclear and continue to consider multiple possible future paths. In particular, should tariffs be implemented and should this be the beginning of either a short-term or longer-term trade war, what will the outcome be for inflation. While tariffs are generally thought to be inflationary — at least in the short term — will the over-riding reaction be demand destruction and a global slowdown? The second quarter promises to be equally interesting.

High yield corporate fixed income

Despite risks, high yield bonds offer attractive yields and capital gains opportunities. There are opportunities in higher-quality high yield exposure and other fixed income markets, such as private credit and hybrid/limited recourse capital notes (LRCN) markets. Credit selection will be crucial given elevated volatility from President Trump's policies.

Dan Cooper
Head of Credit, Portfolio Manager

Ken Yip
Portfolio Manager

The US high yield bond market started the year on a strong note with the ICE BofA US High Yield Index returning 0.95% in the first quarter. Weakness was evident in March however, as high yield fell 1.1% due to the escalating trade war between the US and the rest of the world, resulting in the worst month for returns since October 2023. After a very strong 18.18% return in 2024, CCCs have lagged year to date, and are responsible for a large part of the high yield segment's underperformance in March, falling -2.31% and underperforming Bs (-1.36%) and BBs (-0.57%). Given the volatility, the new issue market also slowed meaningfully year-over-year, with $68.3 billion of new deals compared to $87.6 billion (-22%) for the same period in 2024.

As at March 31, the high yield market spread of 351 bps is meaningfully elevated compared to 290 bps at the end of 2024, reflecting significant anxiety over President Trump's trade war and its impact on both individual business fundamentals and broader inflation. Despite these risks, we see opportunity in the space with relatively attractive all-in yield-to-maturity at 7.81% providing reasonably good compensation even in a market downturn, with the exception of certain CCC-rated credits that may have difficulty raising new capital and servicing their debt. High yield bonds are also supported by the following factors:

- The yield on the high yield market has risen from the low of 4.3% on December 31, 2021, to 7.81% on March 31, 2025. The current yield represents an attractive source of income after a long period of low yields (and even negative yields in some areas of the market), with a more significant buffer from rising rates than provided by other areas of fixed income.
- The average price of a high yield bond has declined from $103.31 in 2022 to a current price of $94.97. The majority of these bonds will continue to make their coupon payments and mature in the future at a price of $100, representing an attractive capital gains opportunity for investors who are willing and able to do the deeper analysis required in the high yield market.

- The overall quality of the issuers in the index is higher than at almost any other time in history, with over 50% rated BB as a large portion of the index is represented by companies that were previously investment grade before being downgraded to the high yield market (known as fallen angels).
- The high yield market issuer fundamentals are strong, as companies were able to refinance debt and extend maturities at attractive yield levels prior to the beginning of the rate hiking cycle. With reasonable leverage and record high interest coverage ratios, we see limited risks related to covenants, liquidity or refinancing needs for the majority of the index.
- The high yield default rate last peaked in 2020 at 6.8% and traded as low as 1% in the post-COVID period. The default rate has since increased from those record lows and currently sits at 1.3%, with the stress caused by the interest rate hiking cycle moderated by the Fed shifting to a rate cutting cycle. We do expect defaults to increase from these historically low levels but stay well below prior cycle peaks, given the relatively short timeframe since the last default wave, the high quality of the index and the strong overall fundamentals of the issuers.

After an initial move higher following Trump's election win, risk sentiment significantly moderated in 2025. Concerns over the US's ability to maintain growth exceptionalism, inflationary/recessionary fears tied to the escalating trade war and significant government spending cuts directed by DOGE, made US Treasuries one of the top performing assets for the quarter, as equities came off and credit spreads widened. Our team will continue to monitor the trajectory of the interest rates in the face of competing pressures of a potential growth slowdown and tariff-driven inflation. Given a high degree of market uncertainty, which would create a particularly difficult backdrop for highly leveraged companies to refinance their existing debt, our team prefers higher-quality high yield exposure that has cheapened in this selloff. We're also finding attractive opportunities in other areas of the fixed income market that we feel may offer attractive risk-return characteristic and diversification opportunities for our mandates, such as private credit, the US cannabis debt market and the hybrid/LRCN markets. We do expect that credit selection will grow in importance through the year, given elevated volatility from President Trump's policies.

Leveraged loans

Despite the slowdown in leveraged credit issuance, we continue to see new issuance of collateralized loan obligations (CLOs), highlighting the resilience of the CLO market even amid broader market challenges.

Movin Mokbel
Portfolio Manager

The market outlook depends on resolving trade wars and avoiding a US recession. Loans offer attractive returns in the absence of a severe recession, and high-quality loans and AAA CLO portfolios are recommended for investors anticipating economic downturns.

The market dynamics currently feel overly negative and very fluid. We are experiencing significant risk-off markets due to escalating trade wars and weakening consumer confidence, both in the US and globally. While loan returns were positive in Q1, with a gain of 0.48%, they have turned negative in the first trading week of April, now down over 1.5% year-to-date. Loan prices have dropped below 95, decreasing a couple of points since March 31.

Primary market issuance for leveraged credit has slowed across all types of deals as issuers and investors await more clarity on the macroeconomic picture, causing companies to temporarily step back. Despite the lack of panic in credit markets so far, this could change quickly, depending on investor sentiment and the broader economic backdrop.

On a brighter note, new issue CLOs are still coming to market. Tier 1 managers are pricing new issues in the 140+ bps range for AAA, up from 115-120 bps in February. The secondary market has widened accordingly, with AAA widening by approximately 35 bps, which translates to about one point on a price basis. CLOs continue to price in the market despite a major pullback in new loans and high-yield issuance, highlighting the resilience of the CLO market.

Outlook

The outlook for the market is highly dependent on the resolution of ongoing trade wars and whether the US economy can avoid a recession. Macro risks have resurfaced dramatically, now centered on potential recessions triggered by trade conflicts. Inflation concerns, which never fully dissipated, are becoming more prominent. This instability could lead to reduced consumer demand and corporate spending.

We believe a recession would prompt the Fed to cut rates, which could be beneficial for credit markets, including loans. Markets are currently pricing in aggressive rate cuts by the end of 2025. Rate cuts are not necessarily negative for loans; if they stimulate the economy and boost risky assets, loans will generally follow suit.

Over the past three years, loans have outperformed on a risk-adjusted basis for two main reasons: high rates provided substantial coupons for investors; and the economy was performing well with strong employment, keeping credit fundamentals stable. However, defaults in the loan market have been rising. If the current macro backdrop leads to significantly higher defaults, loans may underperform. It's worth noting that most default candidates are already marked down in price, which could mitigate losses should actual defaults occur.

In the absence of a severe recession, loans offer an attractive return opportunity given their yield of over 9% and prices below 95, with no direct rate risk. We believe a deep recession can be avoided and US growth will resume. The current trade wars are politically driven and can be resolved if politicians choose to address global affairs constructively. We remain generally positive on the loan asset class and view the current sell-off as a buying opportunity.

For investors who anticipate a US recession, we recommend high-quality loans and AAA CLO portfolios, which carry less credit risk and no rate risk. For those expecting a deep US recession that forces the Fed to cut rates aggressively, we suggest high-quality investment-grade portfolios.

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