CIBC ASSET MANAGEMENT

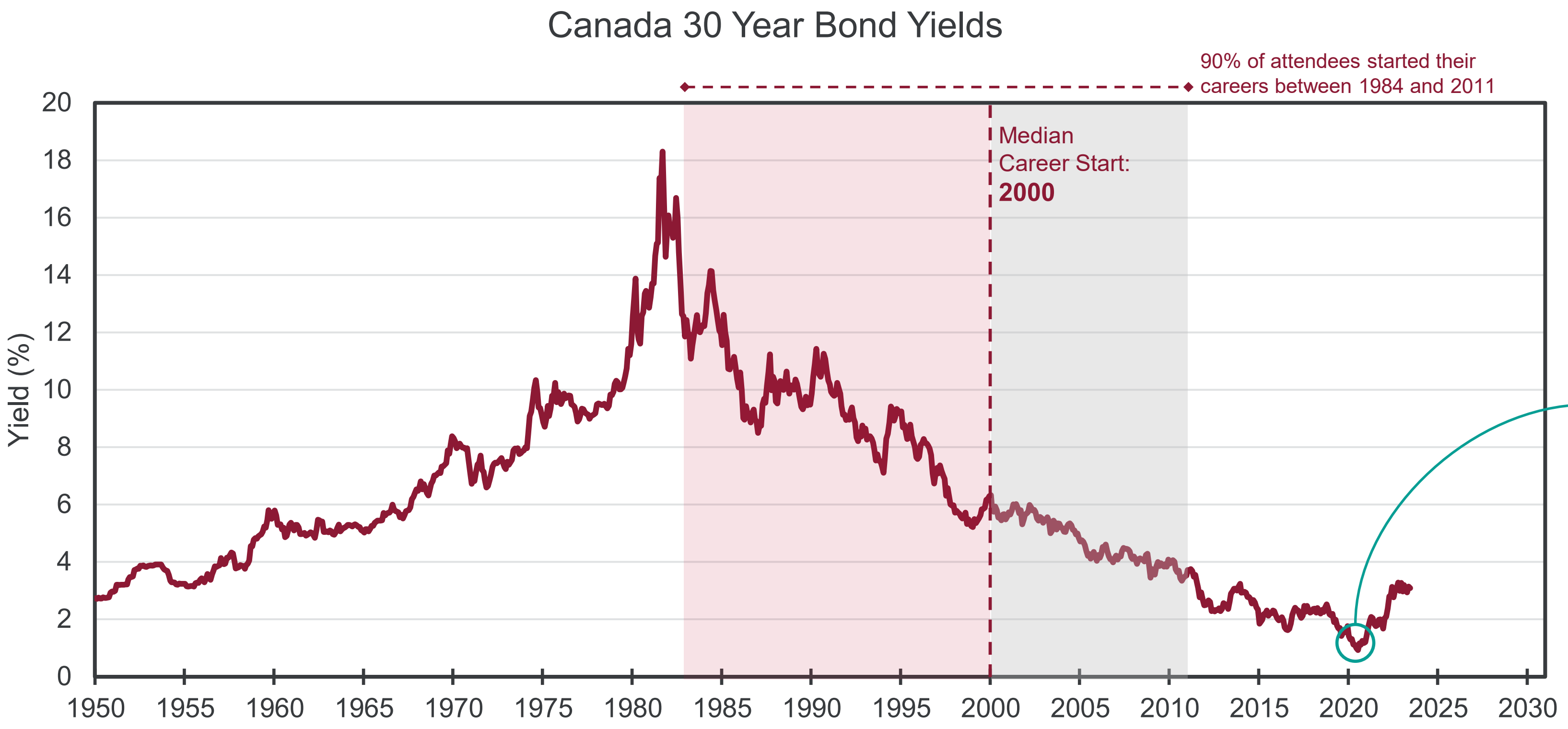
INSTITUTIONAL

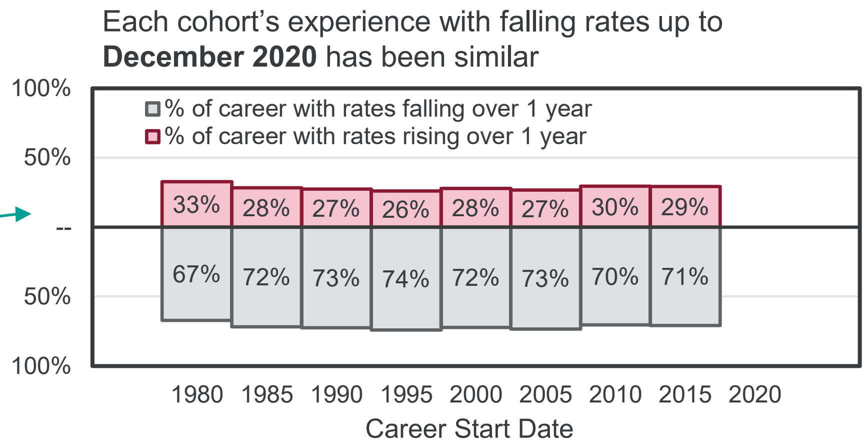
# REIMAGINING INTEREST RATE RISK AND STRATEGIES

Understanding the impact of range-bound yields

August 2023

# Canadian Interest Rates: A Common Thread

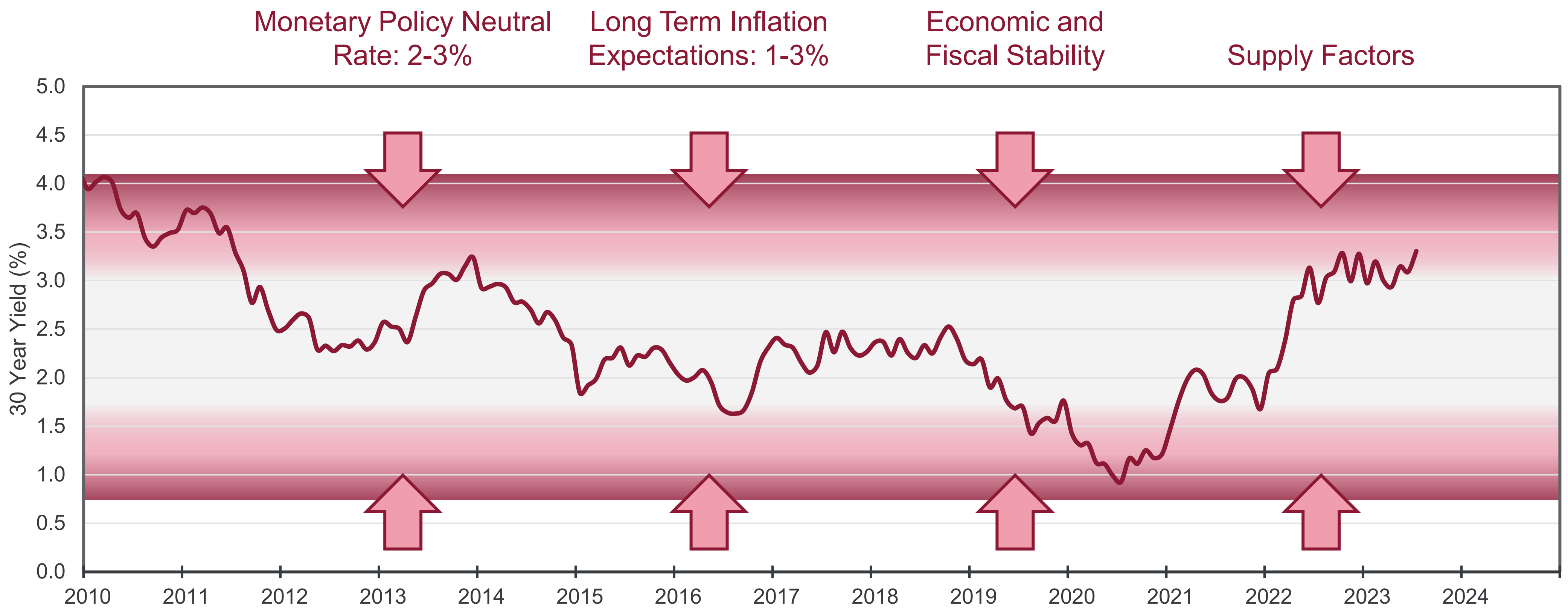



Consistently falling rates has had profound impact on decision making for Canadians and has serious implications on decision making

Source: FTSE Global Debt Capital Markets Inc., CIBC AM Inc. Data to July 2023.

# Pressures Keeping Long Term Interest Rates Contained




Effective risk management and investment strategies involve:

1. Precise risk assessment with accurate “range” modelling
2. Taking action to adjust portfolios in a timely manner

Today’s environment is going to mean a greater need to actively manage interest rate risk, expand investing tool kits and educate key stakeholders

Source: FTSE Global Debt Capital Markets Inc., CIBC AM Inc. Data to July 2023.

# Setting Our Upper Range

- Define our time horizon (Short term, 1 year, 5 years etc…)
- Define the factor to forecast (Overnight rates, 10-year, 30-year)
- Review past data and economic forecasts
- Determine signal levels
- Seek counterarguments to challenge our beliefs

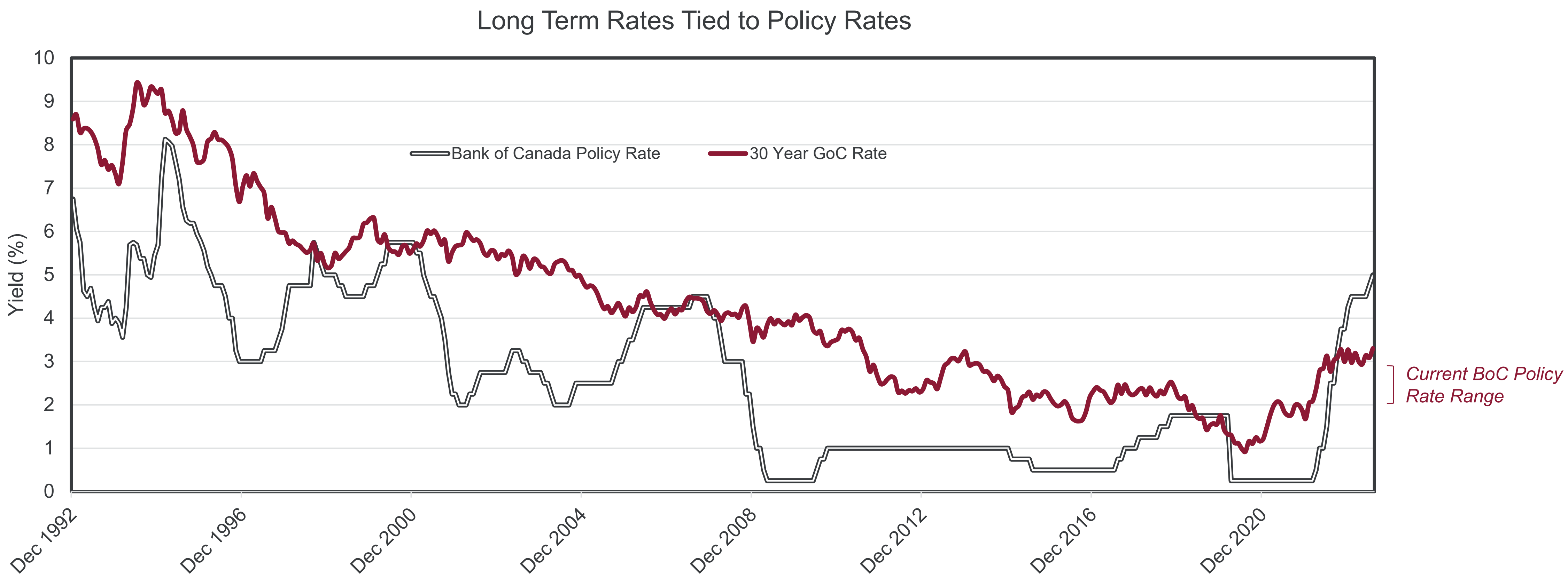
| Question | Rationale | Upper Bound Expectations | Outcome | |
|---|---|---|---|---|
| Over 5 years 30 year interest rates would have a hard time staying **above** ___% because: | 1. Central Bank Policy Rates are limited by a rate sensitive economy. Expect return to high end of the range over time. | 3% long term policy rate | 3.0% | Early signal |
| | 2. Long term inflation expectations have been stable despite the highest inflation spikes seen since the 1980s | 2.5% long term inflation | 3.5% | Conviction level |
| | 3. Factors limiting long term GDP growth are limiting upside to future economic forces | 2% (real) | | |

These ranges serve as a guide to help us identify if risks are higher than usual and if there are opportunities to seize.

Sources: CIBC Asset Management Inc.

# Key Drivers of Long-Term Interest Rates: Monetary Policy

## Monetary policy expectations anchor the yield curve limiting how high, and low, long term rates trade

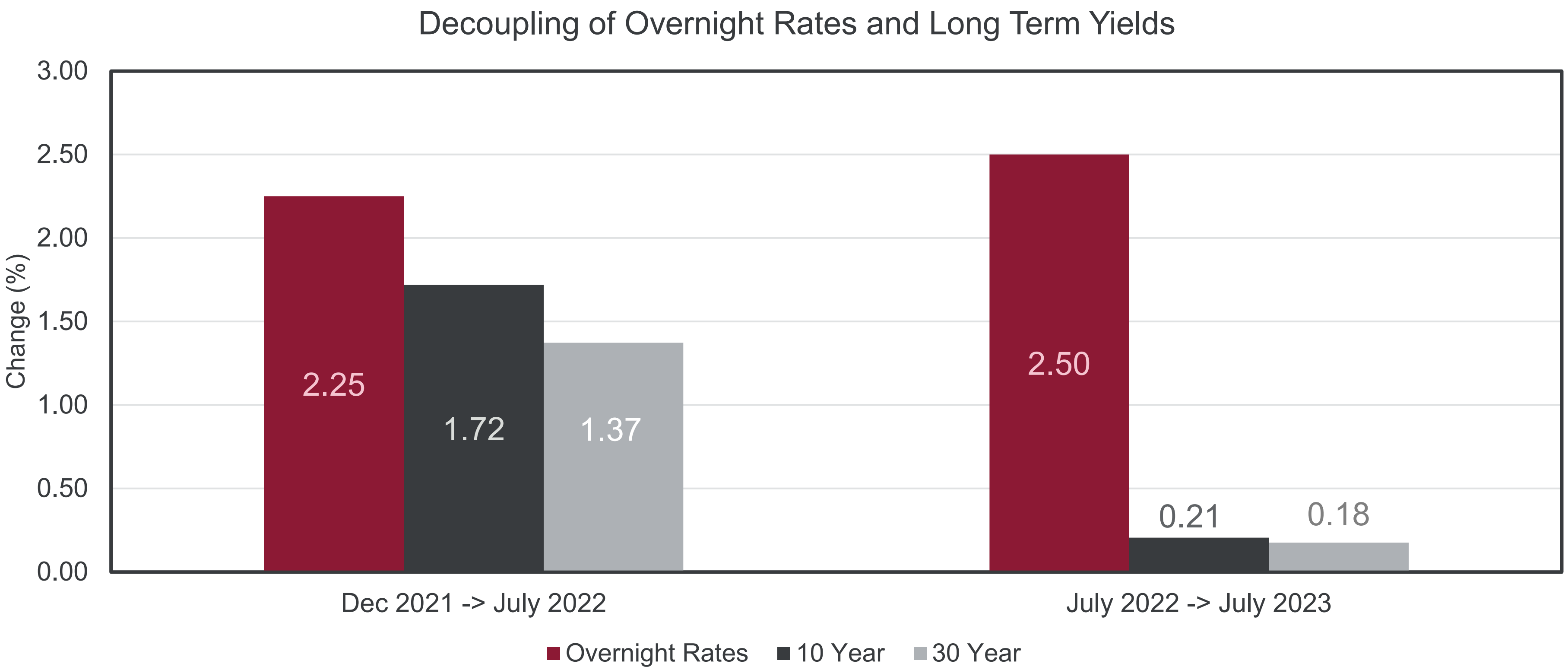



30 year rates represent the expected long term average for shorter term rates.

Source: Bloomberg LP., CIBC AM Inc. Data to July 2023.

# Key Drivers of Long-Term Interest Rates: Monetary Policy

## Long term interest rates include the expected path of short-term interest rates and expect limited ability to remain above 3%



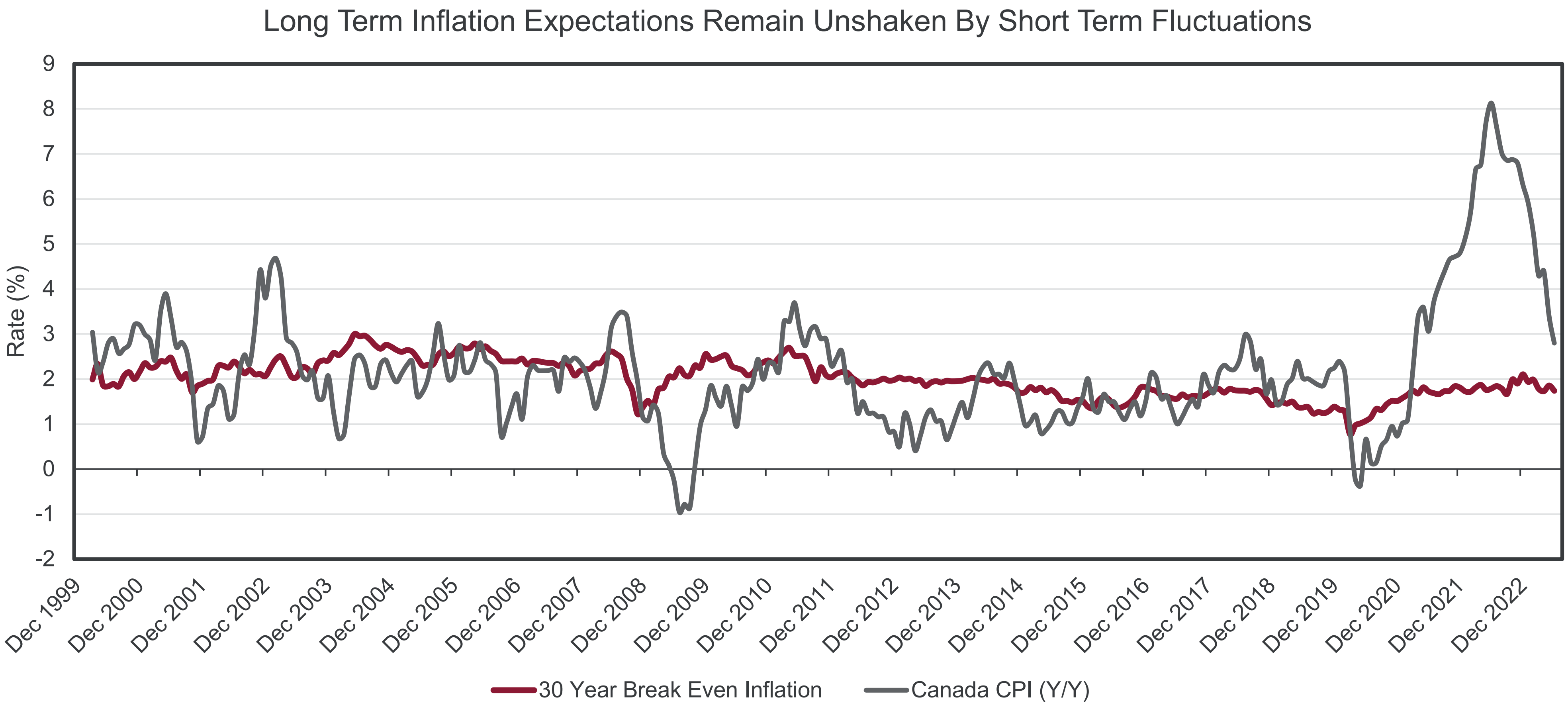

Initial rate hiking caused bond yields to rise…

…but after the BoC reached their long term neutral rate, 10 and 30 year bond yields haven't reacted to additional monetary tightening

Source: Bloomberg LP., CIBC AM Inc. Data to July 2023.

# Key Drivers of Long-Term Interest Rates: Inflation

## Inflation expectations have been unaffected by recent headline inflation numbers

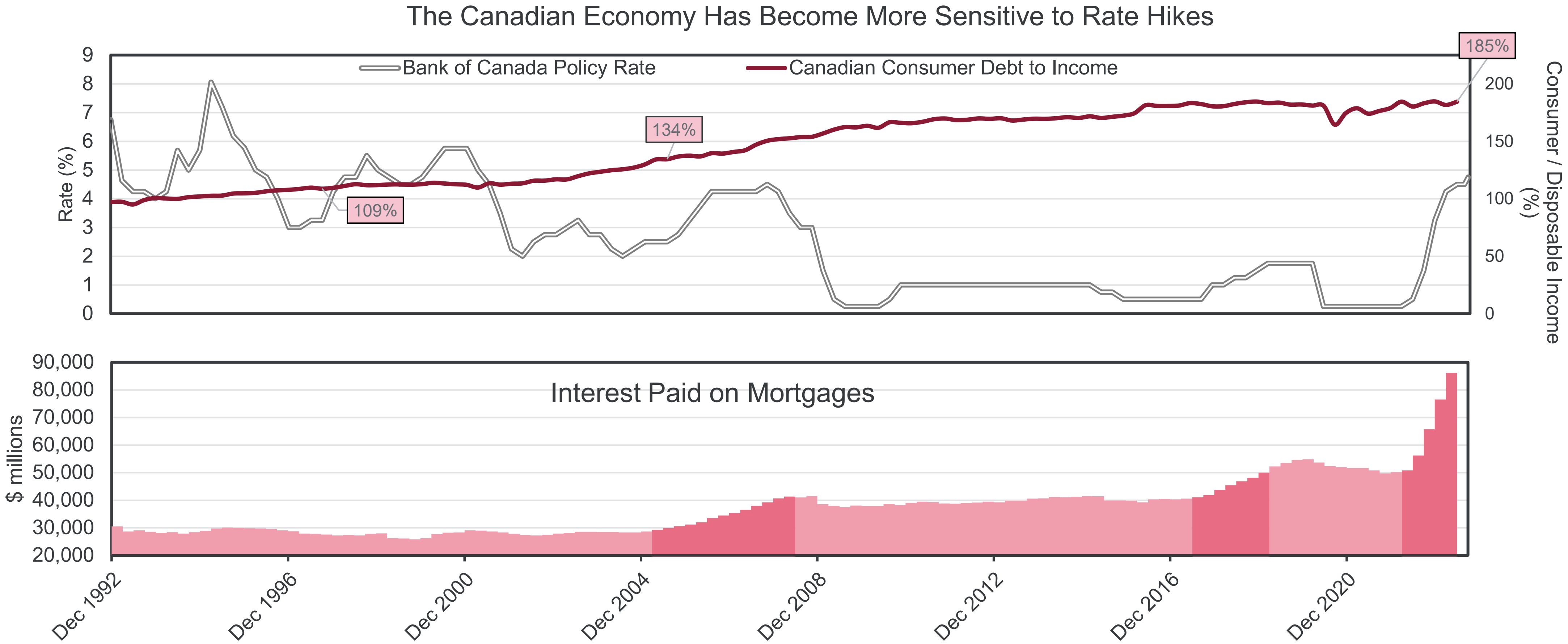



Long term expectations are not as volatile as headline CPI numbers

Source: Bloomberg LP., CIBC AM Inc. Data to July 2023.

# Headwinds for Higher Rates: Fiscal & Economic Stability

## Interest rate hikes have a greater impact today than in the past because the increase in Canadian Consumer debt limiting the tolerance the Canadian economy has for high interest rates

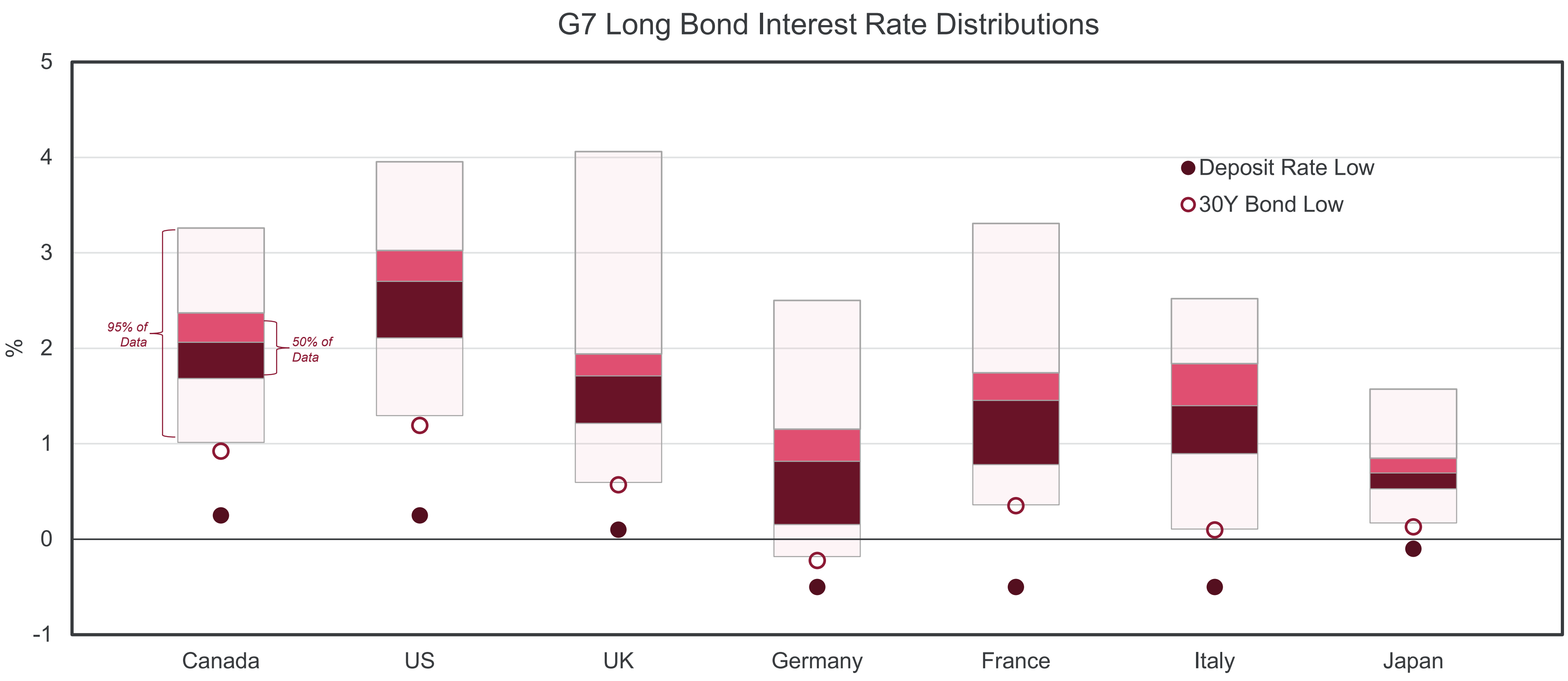



The impact from higher rates its just starting to be felt in the Canadian economy and has become a more effective weapon for the BoC to slow demand than in the past

Source: Statistics Canada, CIBC AM Inc. Data to July 2023.

# How Low Did They Go?

## Overnight Policy and Deposit rates went near, and in a few cases below, 0% but despite pessimistic economic and long-term inflation expectations, long bond yields remained higher than short term rates



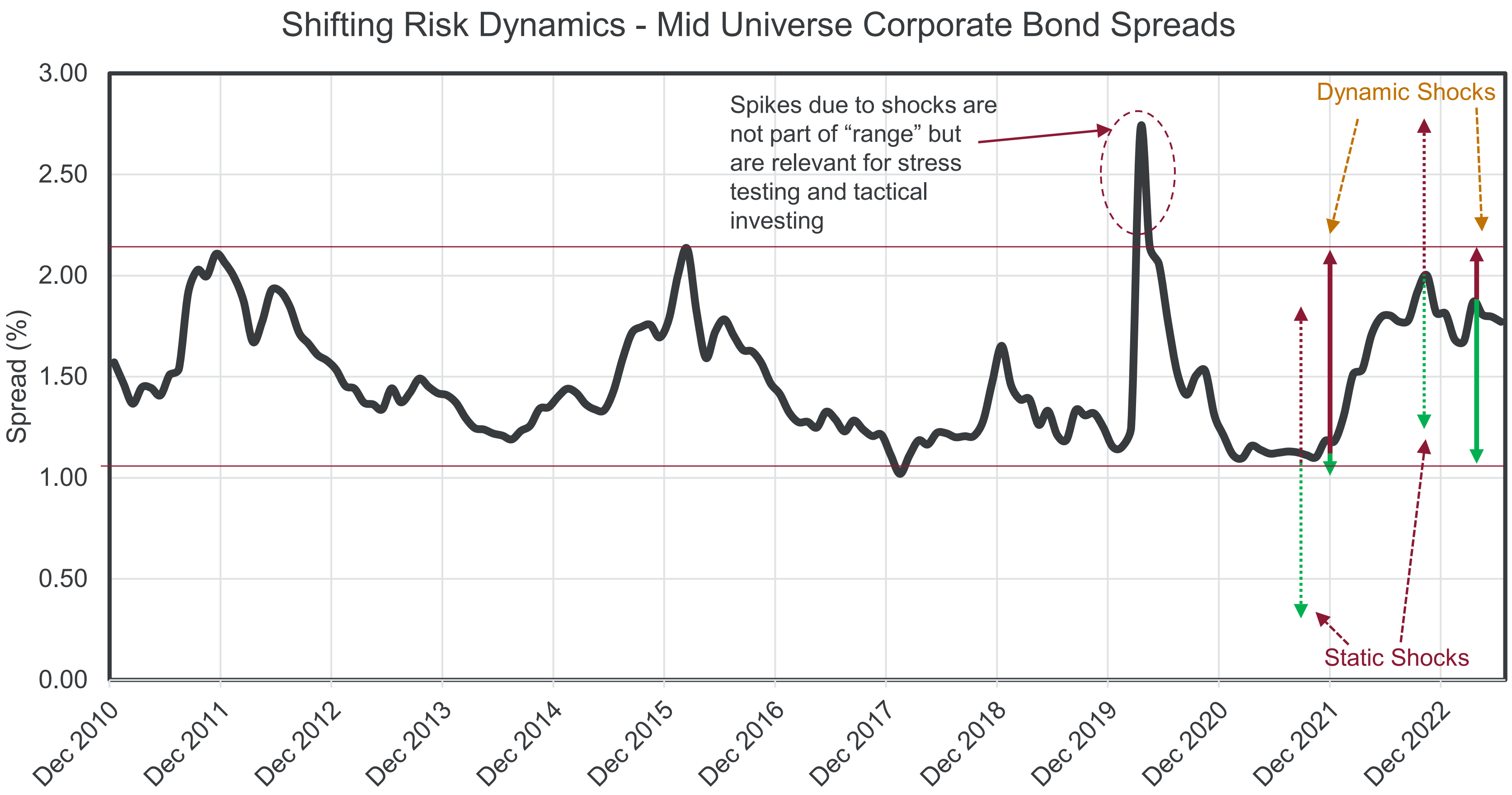

There are limits to how low central banks can push overnight rates and drag down long term bond yields providing support to a lower end of a range

Source: Bloomberg LP., CIBC AM Inc. Data from December 2008. As of July 2023.

# Range Bound Risk Management In Action

## Looking to Credit Markets

# Range Bound Management In Action: Credit Markets




Effective management needs to take the current level into consideration to understand potential risks

**Lower bound supported by:**

- Spreads on corporate bonds should be positive;
- Comparing index to previous bull markets;
- Outlook on issuance consistent with previous periods

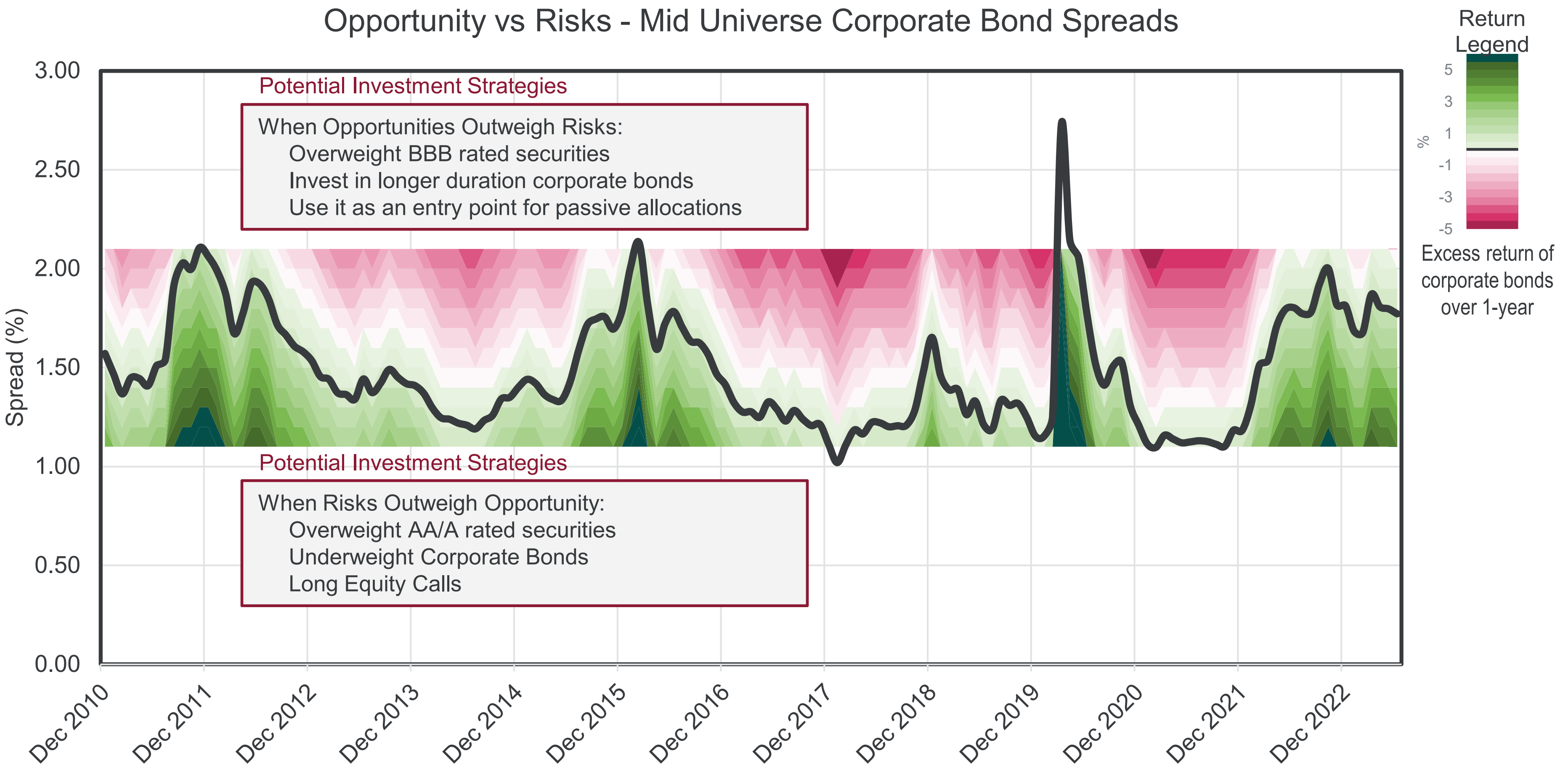
**Upper bound supported by:**

- Risk appetite
- Credit fundamentals
- Long term economic expectations

Risks are dynamic. Understanding where a range is provides guidance about how risk shift over economic cycles

Source: Bloomberg LP., CIBC AM Inc. Data to July 2023.

# Using Range Bound Risk Management With Credit




## When markets are near the edges of a range investors should:

1. Revisit their rationale for their range, make sure key assumptions are still valid
2. Develop an investing strategy appropriate for the market conditions
3. Stress test portfolios to safeguard against financial market instability

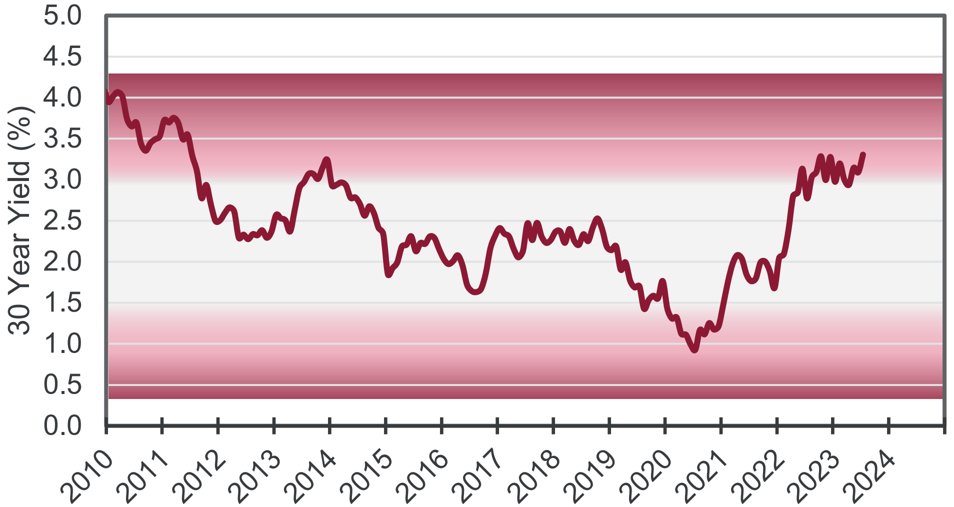
Source: Bloomberg LP., CIBC AM Inc. Data to July 2023. Determining appropriate investment strategies will vary by individual client based on their own situation. The potential investment strategies listed above is not intended to be advice.

# What To Do Today For Interest Rates

# What to do in today's environment

The rise in rates provided a boost to pension plans' funded status but these tailwinds are now threats.

1. **Review your risk management approach to interest rate risk**
   Potential moves one direction may be larger than in the opposite direction – are you prepared for this dynamic?




Work with internal and external experts to develop your own understanding of where ranges are:

- Define your time horizon (Short term, 1 year, 5 years etc…)
- Define the relevant factor to forecast (Overnight rates, 10-year, 30-year, real yields)
- Review past data and economic forecasts
- Determine signal levels
- Seek counterarguments to challenge your beliefs

Over ___ years ___ interest rates will have a hard time staying above/below ___%

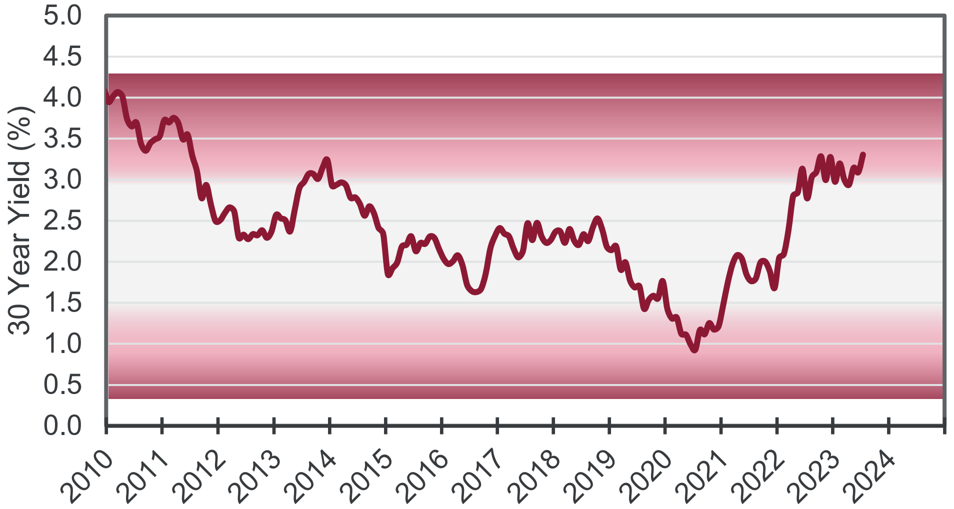
Sources: FTSE Global Debt Capital Markets Inc. and CIBC Asset Management Inc. Data to July 2023.

# What to do in today's environment

The rise in rates provided a boost to pension plans' funded status but the risks they pose are quite different.

1. Review your risk management approach to interest rate risk
   Potential moves one direction may be larger than in the opposite direction – are you prepared for this dynamic?

2. **Evaluate alternative interest rate hedging strategies and impact on overall portfolio's expected returns**




The most important thing is to take action. A broader tool kit and robust governance plan will help facilitate implementation and improve outcomes in this new environment of dynamic interest rate risk

Strategies to manage interest rate risk

- Extending Portfolio Duration
- Managing Asset Allocation
- Overlays
- Using Signals as an Entry points
- Dynamic Hedge Ratios

Sources: FTSE Global Debt Capital Markets Inc. and CIBC Asset Management Inc.

# Questions?

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