

# "Will Real Return Bonds live up to their Name"

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Director of Fixed Income

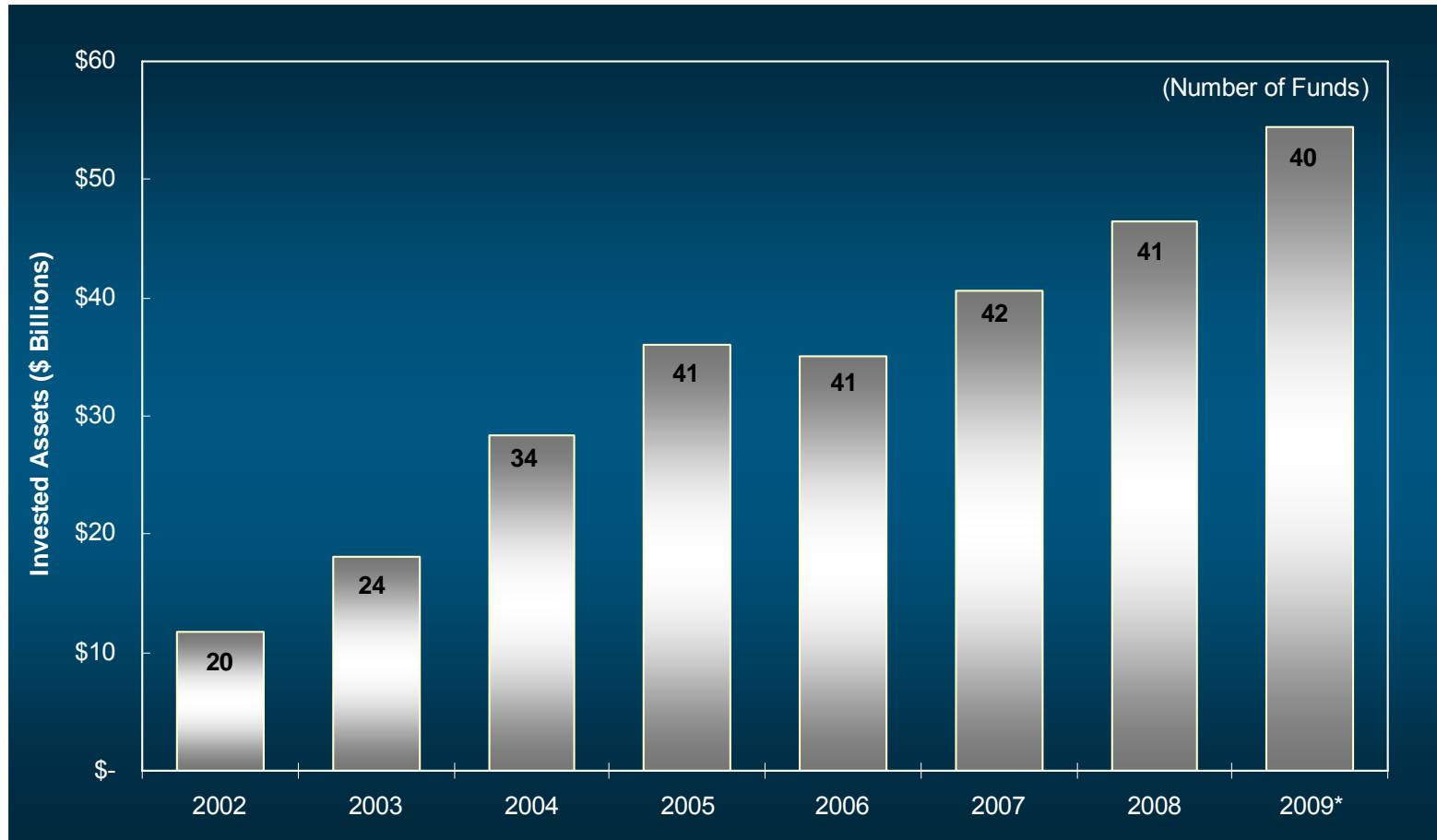
**Brent Joyce**  
Vice President, Managed Accounts

# Definitions

- **Real Yield:** The rate of return, in absence of inflation expectations that clears the market of borrowers and lenders for a particular term and level of risk.
- **Inflation Expectation:** The expected rate of inflation (CPI) over a particular term.
- **Nominal Yield:** The sum of the real yield and inflation expectation for a particular term.
- **Yield Curve:** The curve connecting yields of government bonds with terms to maturity, typically of 1 to 30 years; There is a different yield curve for Real Return Bonds and nominal bonds.
- **Inflation Breakeven:** The difference between the yields on nominal and Real Return Bonds for a similar term. It is generally understood to represent inflation expectations, except that there may be other factors besides inflation that distort the relationship between nominal and real yields.

# Indexed Bond Mutual Funds - U.S.

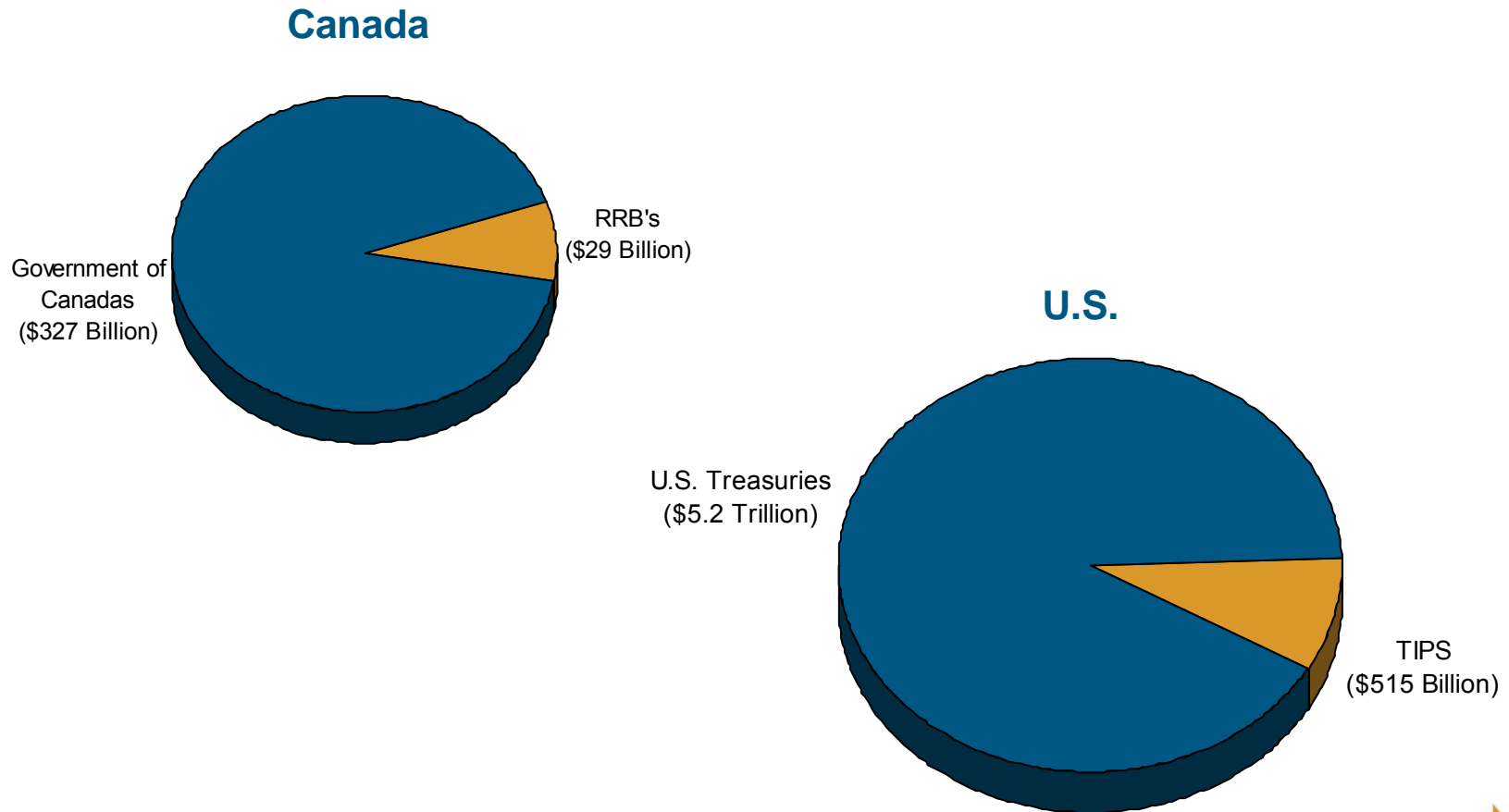
- Interest in ILB's has risen appreciably over the last five years.



Source: U.S. Government Accountability Office

# Real & Nominal Bonds Outstanding - Canada & U.S.

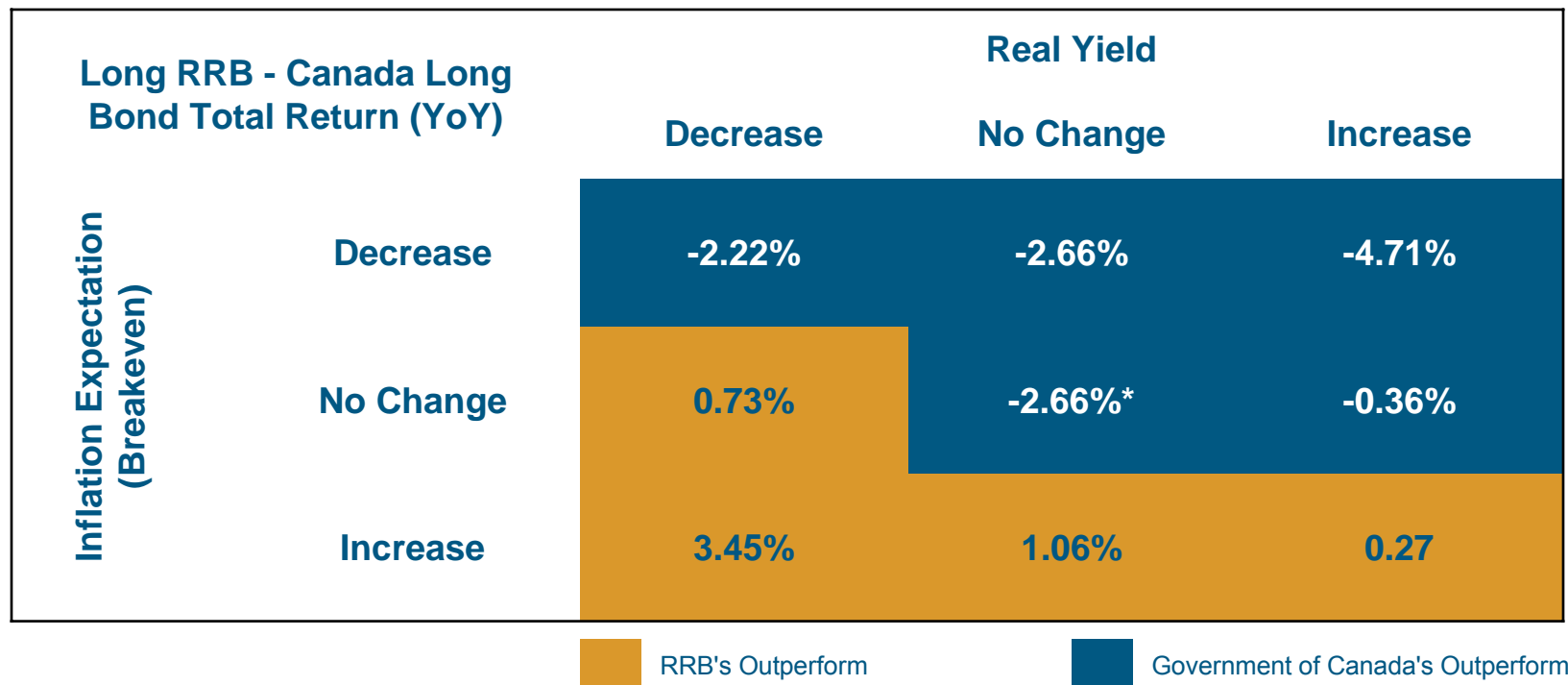
- Indexed linked bonds account for only 10% of sovereign debt outstanding in North America.



Source: Bloomberg & Laketon Investment Management

# Long RRB vs. Long Canada Performance – Last 10 Years

- Long RRB's outperform Canada Long Bonds significantly only when inflation expectations increase and there is a decrease or no change to real yields.

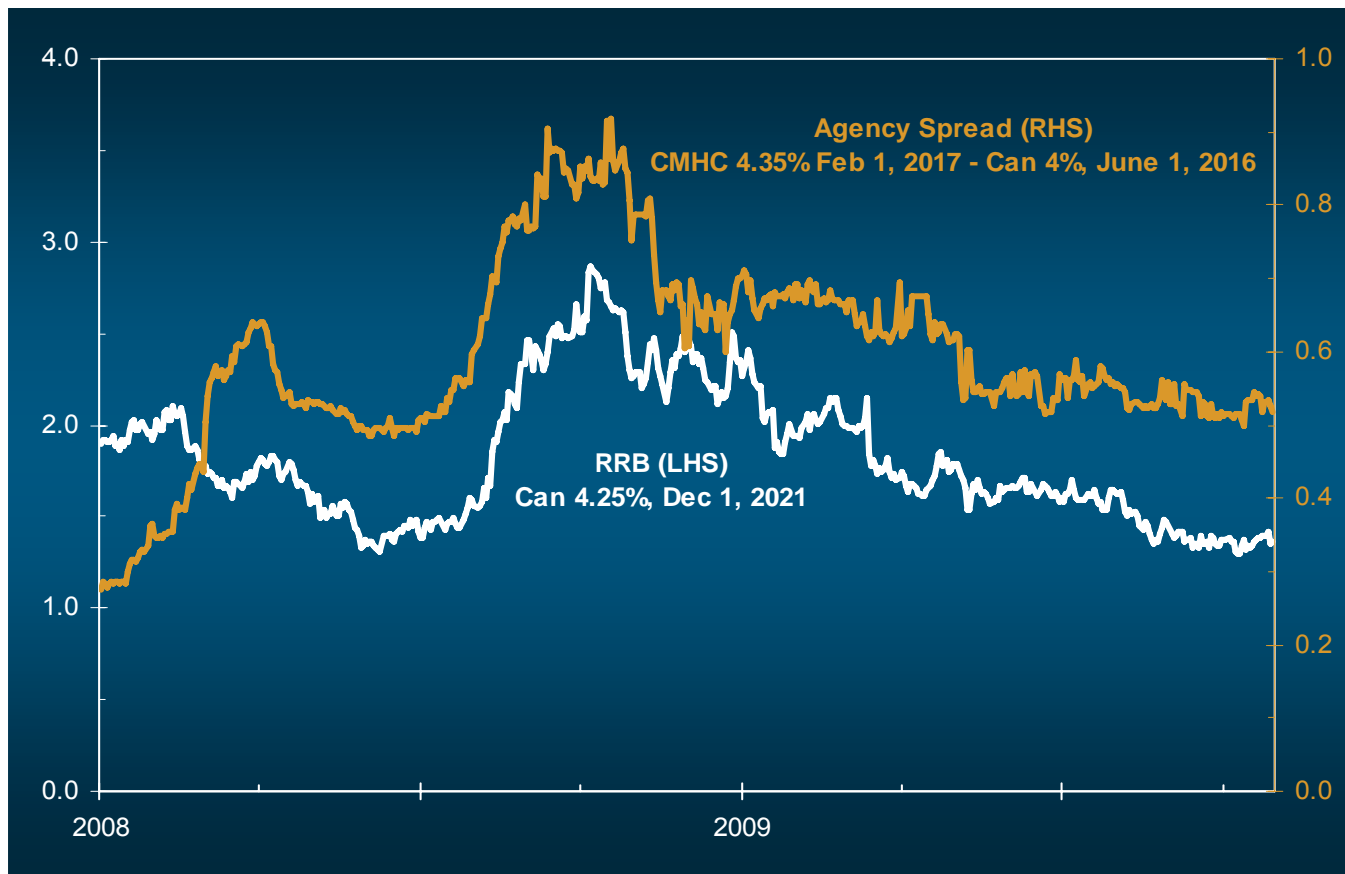


- Long RRB's Long Canada - Constant maturity series : Laketon & Bloomberg
- Total return based on monthly yoy calculations from January 2000 to December 2009.
- No change defined when Breakeven or real yield change by less than  $\pm 5$  bps.

\*Scenario results affected by too few data points.

# RRB Yields vs. Federal Agency Yield Spreads - Canada

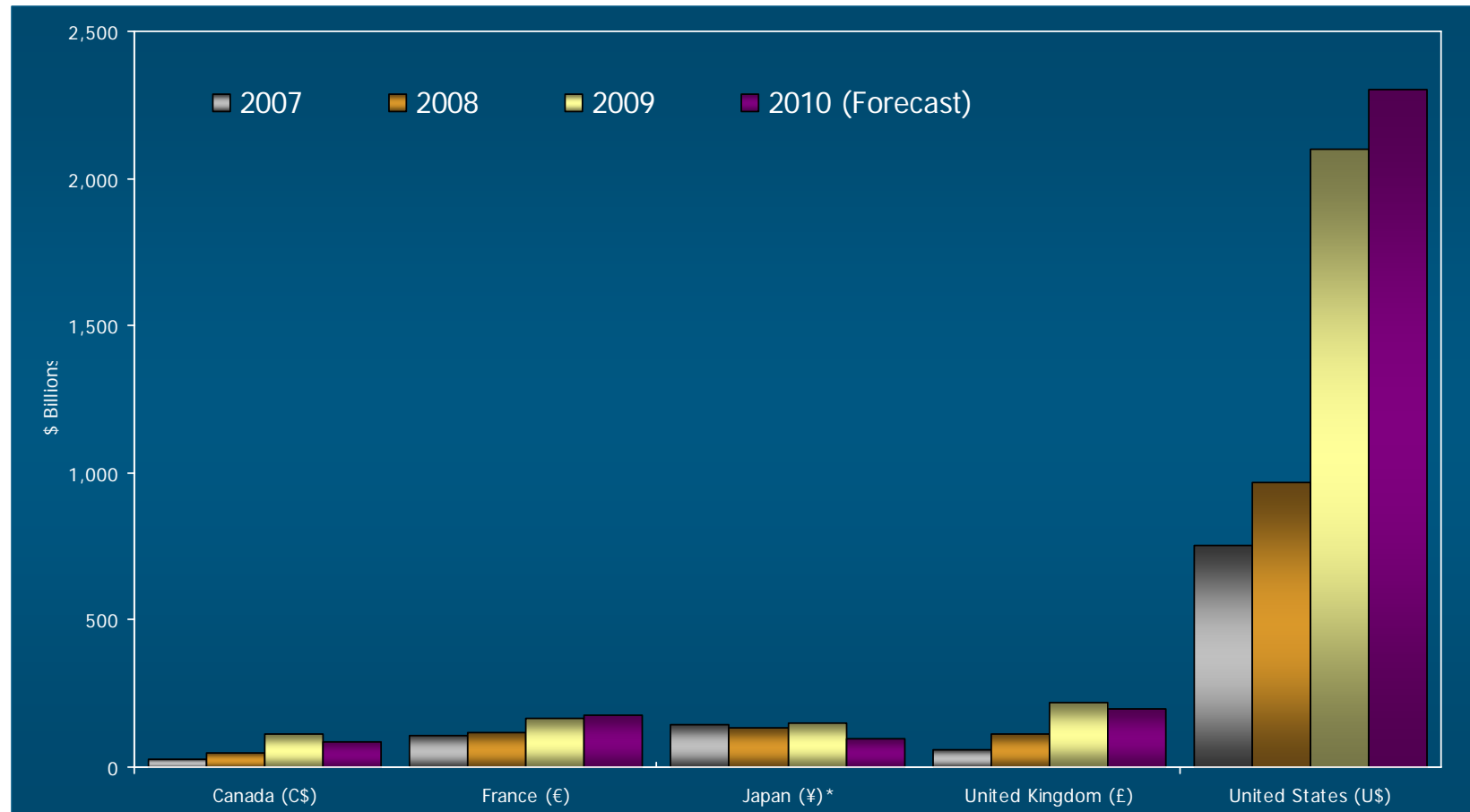
- RRB yields tracked credit yield spreads during the credit crisis performing like spread product due to the liquidity premium placed only on sovereign nominal bonds.



Source: Bloomberg, PC Bond and Laketon Investment Management

# Sovereign Government New Debt Issuance

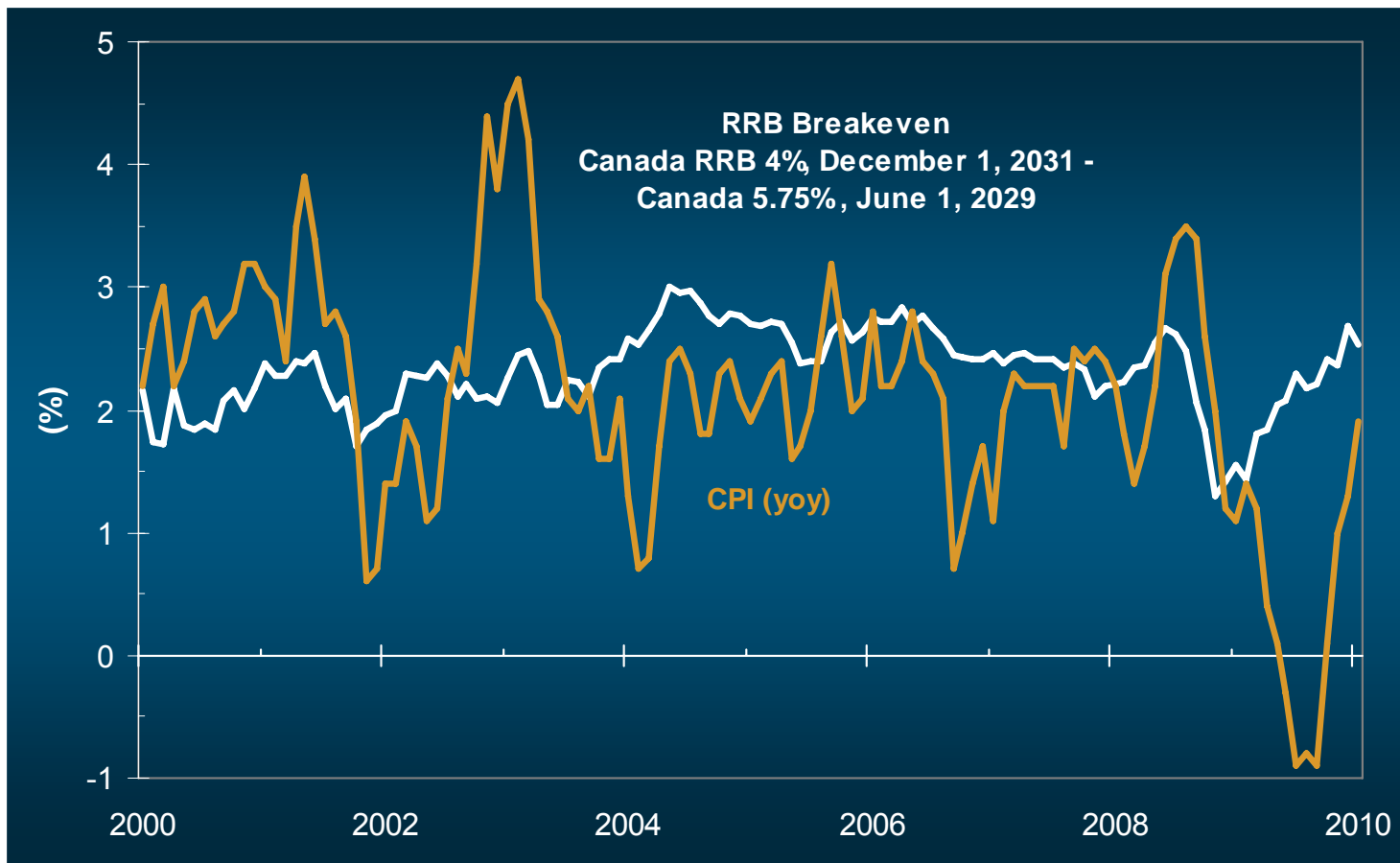
- Excessive sovereign debt issuance will eventually result in higher real yields.



Source: BIS, U.S. Treasury, Agence France Tresor, Office on National Statistics (U.K.), Banca D'Italia, Statistics Canada, Bank of Japan. As at December 31, 2009

# Long RRB Breakeven (Nominal-Real Yields) VS. Current Inflation - Canada

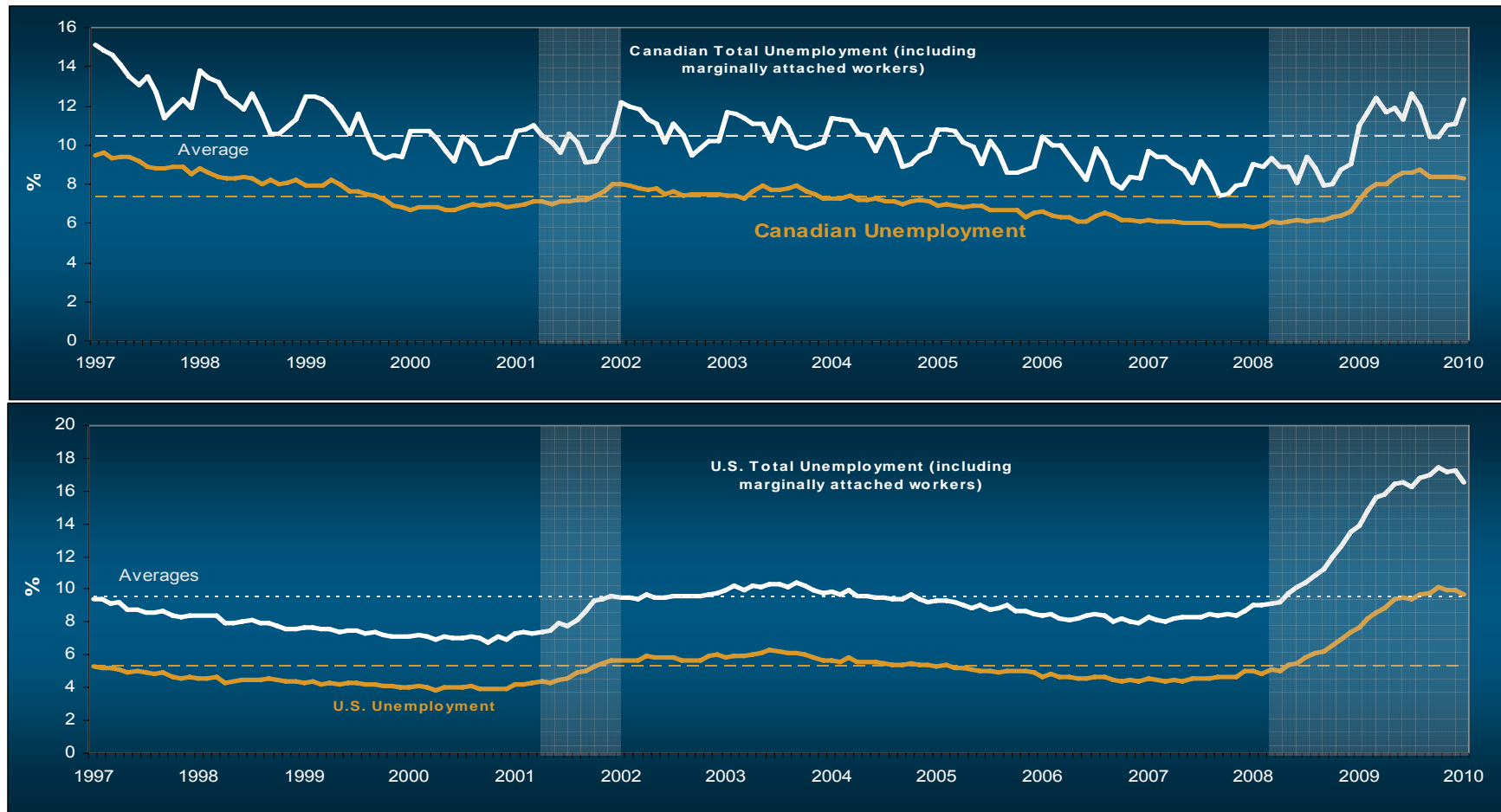
- Inflation breakevens move with expected inflation not current CPI.



Source: PC-Bond and StatsCan. As at January 31, 2010

# Unemployment Rates - Canada & U.S.

- Significant excess labour capacity in North America limits medium-term inflation pressures.



Source: Bureau of Labor Statistics and StatsCan. As at January 31, 2010

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