



Sujet: Sommaire sur l'environnement des  
taux d'intérêt et stratégie de durée.

Source : BMO Nesbitt Burns, avril 2004

## Bond Strategy

BMO Nesbitt Burns

### Highlights—April 2004

●The Fed is in a very delicate position. The U.S. job market sprang to life in March, as payrolls expanded by 308,000—the best employment report in almost four years—and consumer prices appear to have bottomed. As well, there is other evidence that the pricing environment is firming, and corporate pricing power is slowly returning. These trends suggest that the fed funds rate cannot stay at 1% indefinitely. A series of Fed speakers have been clearly laying the groundwork for the target rate to begin moving toward neutral territory, but there is no sense of urgency until there are consistent job gains. With U.S. consumer price inflation still quite low, the Fed can remain patient a little while longer.

●In Canada, the discussion revolves around the potential for further rate cuts, with the Bank of Canada expected to trim rates one more time this month, lowering the target for the overnight rate to 2.0%. Inflation poses little barrier to the Bank, with headline inflation at 0.7%, and core inflation at 1.1% in February, and even lower readings possible in March. As well, the drop in employment in February, and the 0.1% decline in GDP reported for January give the Bank room to manoeuvre. However, even in Canada the pricing environment has started to firm, and year-on-year consumer inflation readings will soon begin to turn upward.

●Corporate spreads, particularly for lower rated credit, have tightened sharply over recent months. We recommend a shift to underweight corporates in favour of provincials.

#### In the month ahead:

- The Bank of Canada's next rate setting date is April 13 and a 25 basis point rate cut is widely anticipated.
- The May 4 FOMC meeting will be of primary interest in the period ahead after payrolls finally popped in March.

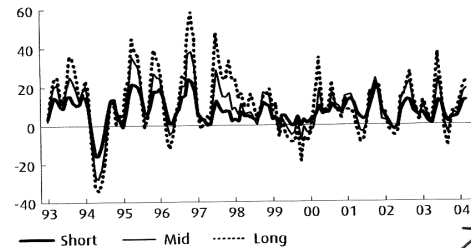
### Rate Forecast

	Forecast		Current 31-Mar-04	History 3-Month	History 12-Month		
	12-Month	3-Month			1-Month	12-Month	
Canada	Inflation (%)	1.7	0.7 (Feb.)	1.2	1.6	4.6	
	Overnight (%)	2.50	2.25	2.50	2.75	3.25	
	90-Day T-Bill (%)	2.60	2.05	2.00	2.12	3.15	
	10-Year Bond (%)	5.25	4.60	4.32	4.37	5.08	
	US\$/CS	78.0	76.0	76.3	74.9	77.0	68.2
U.S.	Inflation (%)	2.0	1.7 (Feb.)	2.0	2.1	3.0	
	Fed Funds (%)	1.75	1.00	1.00	1.00	1.25	
	90-Day Euros (%)	2.20	1.20	1.11	1.12	1.28	
	10-Year Note (%)	5.00	4.25	3.84	3.97	4.33	3.80

### Bond Strategy Committee

Dr. Sherry Cooper Chairperson	Christopher Norris Michael Herring Douglas Porter	Dr. Russell Sheldon Frank Van Veen Mark McMahon	David Watt Keith Edwards	Jason Parker Marisa Nicholishen
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### Government of Canada Bond Market (three-month percentage total return : a.r.)



### Total Return—One Year Forecast

(percent)	Coupon	+	Capital Gain (Loss)	=	Total Return	Duration
Cash	2.12	+	0.00	=	2.12	n.a.
Canada - Short	2.85	+	(2.26)	=	0.59	2.8
- Mid	3.99	+	(4.70)	=	(0.71)	5.8
- Long	4.94	+	(6.81)	=	(1.88)	12.1
- Universe	3.61	+	(3.90)	=	(0.29)	5.6
Provincial - Universe	4.35	+	(4.05)	=	0.30	7.4
Corporate - Universe	4.13	+	(4.08)	=	0.05	5.2
Total - Universe	3.94	+	(3.99)	=	(0.05)	6.0

### Selection

	Benchmark Weighting (%) *	Current Recommendation Weight (%)	Change (%)
Canadas - Total	47	48	0
- Short	24	29	0
- Mid	12	10	0
- Long	10	9	0
Provincial	26	26	1
Corporates/MBS	27	26	-1
Modified Duration	6.0	5.8	0.0

\* Only Canadian dollar domestic bonds with BBB credit rating or better.

*rendement prévu  
sur 12 mois  
Re-tourner  
à court terme*

*le 2.12% ne tient pas  
compte de la ↑ des taux  
sur un an - Erreur*