The Best Time To Buy A Home | May 2021

"The best time to buy a home is always five years ago."
Ray Brown

This time last year, the Canadian Mortgage and Housing Corporation predicted that house prices would fall 9 - 18%. They got the magnitude about right, just the direction wrong.

Over the past year, strong demand for detached homes and ultra-low mortgage rates have driven home prices up 10 - 30% (depending on the region). The fact this occurred during a global pandemic and economic recession is nothing short of astounding.

It is so perplexing that concerns of a debt-driven bubble are starting to boil to the surface. Some Canadians are even calling on the central bank to raise interest rates before house prices and mortgage debt get out of control.

But should the Bank of Canada intervene in the housing market? And would they?

The Leaners v. Cleaners.

The long-standing debate on how central banks should approach bubbles can be described as 'lean versus clean.' That is, to lean into and pop the bubble before it gets out of control. Or to let it run its course and clean up the aftermath (i.e. Greenspan Puts).

The 'cleaners' argue that to lean into a bubble presupposes the ability to identify one. In the context of housing, why are a bunch of economists in Ottawa better at valuing homes than millions of Canadians operating in an open market.

Furthermore, the damage and costs associated with pre-emptively popping a bubble could be far greater than mopping up after it naturally bursts.

The 'leaners' would argue that bubbles need to be separated into those fueled by 'irrational exuberance' (i.e. dot com in the early 2000s) and those driven by debt and credit (i.e. US housing 2006-8).

The theory is that central banks have the necessary insights into lending practices and standards to identify credit bubbles. Furthermore, evidence suggests that credit bubbles are far more dangerous, given the potential damage to the financial system (Mishkin, 2010). As such, central banks should lean against them through monetary policy.

Monetary Policy.

But even if a debt-driven bubble can be identified, are rate hikes the best way to control it?

The problem with monetary policy is that it's a blunt instrument. Rate hikes can't target a specific market but impact the entire economy. It's difficult to understand how higher interest rates in the middle of a pandemic would have helped Canadians cope with the recession. Furthermore, the BoC's mandate is to ensure low and stable inflation (i.e. 2%), not control asset prices.

We, therefore, believe that the BoC leans towards the 'clean' doctrine. As such, they will not raise rates just to cool off the housing market and risk jeopardizing the nascent economic recovery. Instead, it will be inflation, employment, and the output gap that determine when the rate hikes begin.

This isn't to say that the central bankers aren't concerned about housing and the level of mortgage debt. They are well aware that higher mortgage rates and payments lead to less discretionary spending and economic activity.

Thus, while housing might not dictate when interest rates will rise, it could impact the pace of hikes and how high they can go. The last time around, the BoC managed to raise the overnight rate to 1.75% before there was a noticeable slowing of the economy. With even higher levels of consumer debt now, it's possible that after a few moves, the BoC takes a slight pause to assess the impact on consumer spending.

In the meantime, the debate surrounding a 'housing bubble' will continue unabated. The good news is that the commencement of a hiking cycle will be well telegraphed with sufficient warnings to lock in mortgage rates. And should the unthinkable happen, and house prices plunge, causing a recession, the BoC will be ready to use all the tools at their disposal to clean up the mess.

The Month of May.

Credit.

May saw a decline in volatility and the continuation of strong corporate earnings, with credit coasting along and spreads modestly tighter.

Generic Investment-Grade Credit Spreads:

- Canadian spreads tightened 3 bps to finish at 105 bps
- US spreads tightened 4 bps to finish at 84 bps

The 21 bps cross-border differential in spreads puts Canadian credit at its cheapest level relative to the US in 5 years. Furthermore, the indices continue to hide dispersion amongst issuers, with some sectors and names trading rich or cheap to the index average.

In terms of domestic supply, new issuance for May was below average but still a healthy $9 bn. Deals were well oversubscribed and generally performed well as cash remains available for corporate credit. Notable deals included a very strong offering from Sienna Senior Living as well as an inaugural barn burner from Hyundai Capital Canada. M&A-related issuance remains topical as Intact brought $1 bn to market in a multi-tranche deal.

In the US, we saw almost $140 bn come to market after recent earnings blackouts. Demand for new deals remained robust, as the US investment-grade market continues to see healthy cash inflows.

Interest Rates.

As seems to be the habit in bond markets, big moves happen in a few weeks, followed by periods of consolidation as rates trade sideways. This trend continued in May as government yields remained within a narrow range. The market continues to wait for greater clarity on the employment picture. Thus far, job creation has been below expectations, keeping rates well anchored.

Interest rates:

- Canadian 5y finished at 0.90% (-3 bps) and the 10y at 1.48% (-6 bps)
- US 5y finished at 0.80% (-5 bps) and the 10y at 1.59% (-3 bps)

The Funds.

Given the lack of volatility, the month was largely a 'carry' month, with a few wins on the security selection side, and a little extra through some tactical trading.

Of note was our purchase of Shaw preferred shares below par (in both funds). As part of the proposed merger, Rogers could direct Shaw to call their preferred shares to have a clean capital structure. Rogers even promised Shaw an additional $120 mm to subsidize the take-out (this is unheard of and suggested that these shares would be called). Several hours after the Shaw meeting, Rogers exercised this option, and the prefs traded up about $1.50 to $25.00.

Algonquin Debt Strategies Fund

	1M	3M	6M	YTD	1Y	3Y	5Y	SI
X Class	0.46%	0.90%	3.53%	2.24%	17.91%	5.15%	7.04%	9.87%
F Class	0.39%	0.72%	3.06%	1.90%	16.92%	4.33%	6.09%	NA

As of May 31st, 2021

The Algonquin Debt Strategies Fund LP was launched on February 2, 2015. Returns are shown on 'Series 1 X Founder's Class' since inception and for 'Series 1 F Class' since May 1st, 2016 and are based on NAVs in Canadian dollars as calculated by SGGG Fund Services Inc. net of all fees and expenses. For periods greater than one year, returns are annualized.

Algonquin Fixed Income 2.0

	1M	3M	6M	YTD	1Y	2020
F Class	0.77%	1.40%	2.64%	1.18%	14.19%	10.53%

As of May 31st, 2021

Algonquin Fixed Income 2.0 Fund is an Alternative Mutual Fund and was launched on December 9, 2019. Returns are shown for Class F since inception and are based on NAVs in Canadian dollars as calculated by SGGG Fund Services Inc., net of all fees and expenses. Investors should read the Simplified Prospectus, Annual Information Form, and Fund Facts Documents and consult their registered investment dealer before making an investment decision. Commissions, trailing commissions, management fees and operating expenses all may be associated with mutual fund investments. An Alternative Mutual Fund is not guaranteed, its value changes frequently and its past performance is not indicative of future performance and may not be repeated. Payment of quarterly distributions is not guaranteed and paid at the discretion of the manager, therefore, it may vary from period to period and does not infer fund performance or rate of return

Looking Ahead.

Most people are looking forward to the summer months with the promise of socializing with friends and family, eating at restaurants, and getting haircuts. Bond nerds, on the other hand, are checking out the issuance calendar and getting a handle on whether the seasonal credit spread narrowing pattern will work this year.

So far, the primary calendar for the next couple of months appears very manageable, which should be supportive for spreads. With vaccination rates rapidly improving 'pandemic' affected names should remain in vogue.

The improving economy coupled with flush balance sheets is supportive for debt-fueled M&A activity, which is something we keep in mind when selecting our credits. This selection can be about avoiding certain credits where debt-financed M&A could lead to credit deterioration (we have no current exposure to railroads and limited exposure to Rogers) but also about taking advantage of dislocations.

The Federal Reserve's unwinding of the Secondary Market Credit Facility (SMCF) is much ado about nothing. The facility holds about $5 bn in corporate bonds and $9 bn in ETFs. We think the market can easily absorb this inventory, as we expect the Fed to sell the holdings in an orderly manner.

Rates have traded in a narrow range for several months, undoubtedly aided by a slower than expected US job recovery. Much of the disappointment is being blamed on generous stimulus cheques. With a couple more months before these payments end, we think rates will move sideways into the fall when stronger employment numbers will pose upward pressure.

Barring unexpected developments that derail the global economic recovery, we expect that a lower volatility summer is in store.

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