

## Rate Hikes? | March 2026

“The four most dangerous words in investing are: this time is different.”  
Sir John Templeton

First and foremost, our thoughts go out to those impacted and affected by the war. One of our most basic human desires is for safety and security, and with that in mind, we hope for a quick and peaceful resolution to the conflict.

Typically, during wartime and geopolitical turmoil, investors seek safety in government bonds. On this occasion, it seems safe to utter the four dangerous words: this time is different.

This time, government bonds felt the brunt of the pain, with interest rates following oil sharply higher. At their peak, Canadian 2-year yields were 81 bps higher, as the bond market priced in three Bank of Canada rate hikes in 2026. Towards month-end, de-escalation optimism unwound some of that move, with yields implying just under two hikes by year-end. That still has many Canadians scratching their heads.

### Ghosts of inflation past.

The bond market’s logic is straightforward: oil up, inflation up, central banks hike. To be fair to the bond market, it has historical precedent on its side. The 1970s oil shocks sent inflation into double digits and forced central banks into some of the most aggressive tightening cycles in modern history.

The market reaction is reinforced by the 2021-22 episode, which made “transitory” the most expensive word in central banking, and is further exacerbated by recent hawkish comments from the ECB and the Bank of England.

But as we are constantly reminded in this industry, past performance is not indicative of future results. Oil’s share of global GDP is considerably smaller than it was fifty years ago. Oil consumption relative to global economic output has declined 62% since the 1970s, and oil production is more geographically diversified.

Another important difference is our starting point. Canadian CPI was sitting comfortably at target, and inflation expectations were well-anchored. Growth was sluggish, weighed down by lingering uncertainty over CUSMA and cautious business investment. This is not a picture of an economy running hot, but one that could use some warming up.

### Through the looking through glass.

At their March 18<sup>th</sup> meeting, members of BoC stated that they would look through the immediate effect on inflation of the oil price shock. They also acknowledged that they had some flexibility because CPI was close to target and core measures suggested limited upward pressures.

Yes, inflation is heading higher, but the Bank is not focused on the headline print itself, but on whether higher energy prices begin to impact long-term inflation expectations. The mechanism that transforms a supply shock into a structural problem. For now, those expectations remain anchored. And oil futures imply that crude prices will be closer to \$70 than \$100 by year-end. Since oil was trading in the low \$60s pre-war, that trajectory would meaningfully reduce pressure on inflation expectations over the coming months.

### Traders gonna trade.

Before the war, bond traders had already been flirting with the idea of BoC rate hikes, but for growth, not inflation, reasons. The theory ran something like this: federal infrastructure spending, the tailwind from

previous rate cuts, and a constructive resolution to CUSMA negotiations would collectively lift Canadian GDP enough to justify a modest tightening cycle.

It appears that, in addition to these factors, the market is now considering the possibility that elevated energy prices could push GDP even higher. This, coupled with the inflationary pressure of higher oil prices, has led traders to expect 2 hikes later this year.

#### The case for cuts.

But with higher energy prices, there is also the potential for demand destruction. The more people pay at the pump, the less they have for discretionary spending. And classical economic theory would suggest that this puts downward pressure on inflation and increases unemployment. This is why there is a camp that believes central bankers should cut interest rates amid an oil price shock. The Canadian case for additional monetary stimulus is further supported by a weak housing market.

#### The fog of war.

For now, we have uncertainty piled on top of uncertainty. Accordingly, we expect the BoC to be cautious and deliberate, and do not anticipate them to be moving rates anytime soon. And even if hikes materialize later this year or next, we expect a mild increase of 50-75 bps, from the bottom end of the neutral range (2.25%-3.25%) towards the middle. So for those still scarred by 2022, rest assured, in a world littered with sequels, we do not see one coming in the bond markets.

#### The Month of March.

##### Credit.

Relative to rates, credit markets showed surprising resilience. Investment-grade spreads generically widened a modest 5 bps on both sides of the border. For context, IG spreads were 11 bps wider in February amid concerns about AI, private credit, and geopolitical uncertainty.

The surge in interest rates provided support for the corporate bond market. As rates spiked, all-in yields enticed buyers and acted as a buffer against the spread widening one would typically expect following a geopolitical shock of this magnitude.

The primary market paused briefly amid the conflict but finished the month with a robust \$14.35 bn in new domestic issuance, slightly above last March and heavily concentrated in high-quality issuers. Banks led with \$7.4 bn, with Cable/Telecom/Media printing 4.25 bn, together accounting for nearly 80% of supply. Deals that did price traded flat to wider on the break, with issuers offering marginal concessions to get transactions across the line.

Unsurprisingly, energy/mining outperformed, tightening across the curve as the oil shock supported commodity-linked credits. It was the only sector that was tighter both on the month and YTD. On the other side of the ledger, Credit Unions and Mid-Cap Banks, Autos, REITs, and Power Generation all underperformed.

Investment-grade credit spreads:

- Canadian spreads widened 5 bps to 94 bps.



- U.S. spreads widened 5 bps to 89 bps.

### Interest Rates.

In Canada, the pivot in expectations through March was remarkable. At the end of February, the bond market was pricing nearly half a cut by year-end. At the peak of the sell-off, traders had swung to pricing over three hikes. By month-end, de-escalation optimism unwound a portion of the move, with the market settling at pricing just under two hikes by year-end, still a notable shift from where we began the month. The Bank of Canada held rates steady at its March 18<sup>th</sup> meeting, opting to look through the immediate inflationary impulse of the oil shock, citing sluggish growth, on-target inflation, and well-anchored expectations.

South of the border, the Fed also held rates steady last month. Meanwhile, the market shifted from pricing two and a half cuts in 2026 to flat by month-end, implying no moves from the Fed for the foreseeable future.

- Canadian 2y finished at 2.82% (+43 bps) and the 10y at 3.47% (+35 bps)
- US 2y finished at 3.80% (+42 bps) and the 10y at 4.32% (+38 bps)

### The Funds.

#### Algonquin Debt Strategies Fund.

While the widening of credit spreads offset the yield earned, the main driver of the monthly return was the move in interest rates. Despite our low duration exposure, the magnitude of the move in government yields led to a 74 bps loss.

#### Portfolio Metrics:

- 4.5-5.0% yield
- Average credit rating: BBB+
- Average maturity: 1.9
- IR Duration: 1.4y

	1M	3M	6M	YTD	1Y	3Y	5Y	10y	SI
X Class	-0.74%	0.14%	1.17%	0.14%	4.24%	8.77%	5.44%	6.56%	7.92%
F Class	-0.74%	0.02%	0.86%	0.02%	3.49%	7.75%	4.60%	NA	NA

\* As of March 31<sup>st</sup>, 2026

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 1<sup>st</sup>, 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

The combo of wider spreads and higher interest rates made for a difficult month. While active management and trading offset some of the losses from the market moves, the net result was a loss of -1.6%. After reducing duration at the end of February, we used the spike in yields to add some exposure.



#### Portfolio Metrics:

- 4.0-4.5% yield
- Average credit rating: A-
- Average maturity: 2.7y
- IR Duration: 4.4y

	1M	3M	6M	YTD	1Y	2y	3y	5y	SI
F Class	-1.60%	-0.11%	0.47%	-0.11%	3.89%	6.65%	7.23%	4.13%	4.84%

\* As of March 31<sup>st</sup>, 2026

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.

We are now several weeks into the war, with little clarity on the terms under which hostilities will end. Both sides have tabled maximalist demands, and while we suspect there is room to moderate their ‘asks’, there is still a great deal of ‘wood to chop’ before reaching a final deal.

The interest rate market is becoming increasingly interesting to us. After nearly six years of counselling investors to avoid long-duration bonds, a period in which we saw very little upside, we find ourselves warming up to the idea. In particular, if Canadian 10-year yields approach 3.75%, we think that represents a compelling entry point to add duration to diversified portfolios. We have not yet seen that level, but we are watching closely. Conversely, given our view that the Bank of Canada's next move is more likely to be a hike than a cut, we would be sellers of short-duration exposure on rallies.

On the surface, credit spreads were generally well-behaved, but generic spread moves obscure dispersion. Beneath the headline numbers, issuers with high exposure to private credit, communications and software saw much wider spread moves than suggested by the ‘average’.

While spreads cannot be described as cheap, the widening over the past two months has us leaning toward incrementally adding exposure. That said, we will continue to manage our overall positioning from a defensive posture.

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