CUMBERLAND
Private Wealth

FIXED INCOME

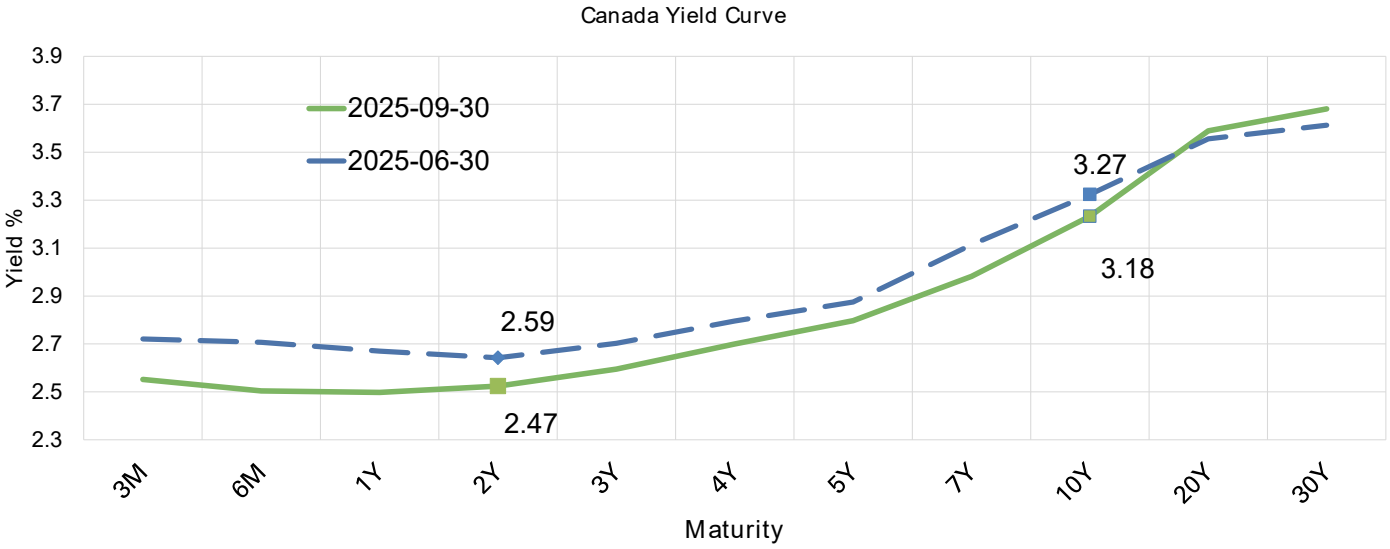
Third Quarter 2025

Fixed Income Markets Quarter in Review

The primary drivers of fixed income returns this past quarter were changes in yields, the shift in the shape of the yield curve and movements in corporate bond spreads. Frequent readers of this quarterly update will recognize these as familiar topics and themes from our prior comments.

Beginning with domestic bond yields and the shape of the curve, looking at Figure 1, below, during Q3 the Canadian yield curve steepened modestly. The terms from 1 month up to 10 years all shifted lower by approximately 10 bps, while the 20 and 30 year bond yields were flat or up a handful of basis points.

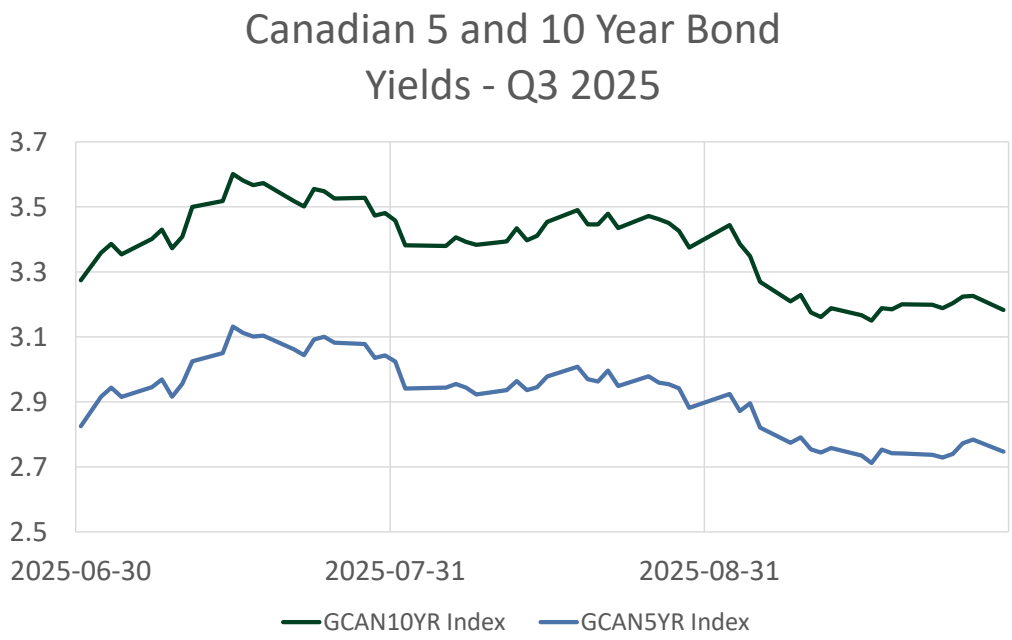
1. Canadian Yield Curve



Source: Bloomberg

However, there was movement within the quarter. Interest rates moved higher initially, peaking in mid July and then subsided later in the quarter (see Figure 2 below).

2. Canadian Bond Yields

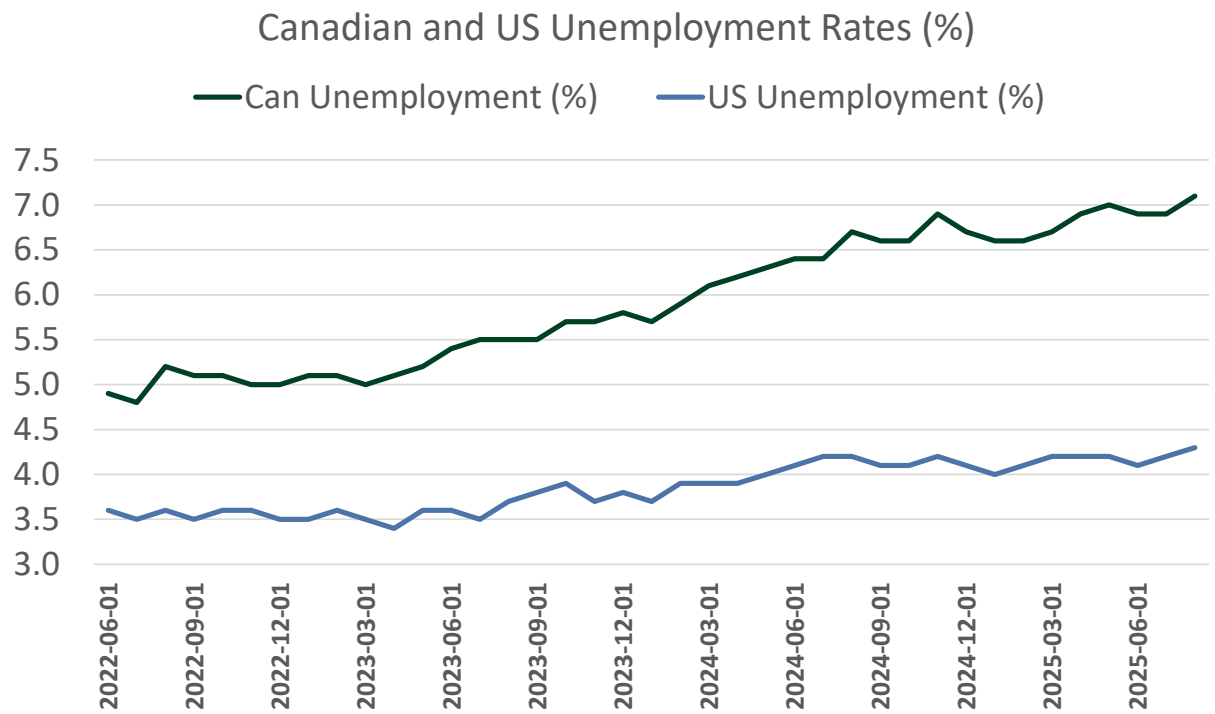


Source: Bloomberg

The driver of the higher rates in early Q3 was President Trump's announcement of 25%-50% levies on Japan, South Korea, Brazil, South Africa, Indonesia, Thailand and most importantly from our perspective Canada (Canada faced an increase to 35%). In addition, concerns grew over mounting projected deficits by the Canadian government. Elevated fiscal debt levels raise fears that higher interest rates will result, as the country's creditworthiness is perceived to have worsened. Finally, core inflation remained elevated in comparison to the CPI measure.

However, as the month progressed, tariff fears subsided somewhat with the announcement of US trade deals with the EU and the UK. In addition, the market turned an increasing focus on the worsening employment data, particularly in the US. Looking at Figure 3 below, the Canadian unemployment rate has steadily risen from a post-covid low of 4.8% in July 2022 to 7.1% as of August 2025. US interest rates have also risen, albeit to a smaller degree, from 3.5% in September 2022 to a recent high of 4.3% in August 2025. The rising US unemployment rate garnered the most attention and scrutiny, however.

3. Canadian and US Unemployment Rates (%)



Source: Bloomberg

Correspondingly, domestic GDP data also weakened, with the Canadian y-o-y GDP declining to 0.9% 12-month growth rate as of July 2025. This is down from the 2.4% figure posted in January 2025. In addition, the Bank of Canada estimated that the domestic economy contracted by approximately 1.5% in the second quarter (as of this writing the Q3 GDP data has not been released).

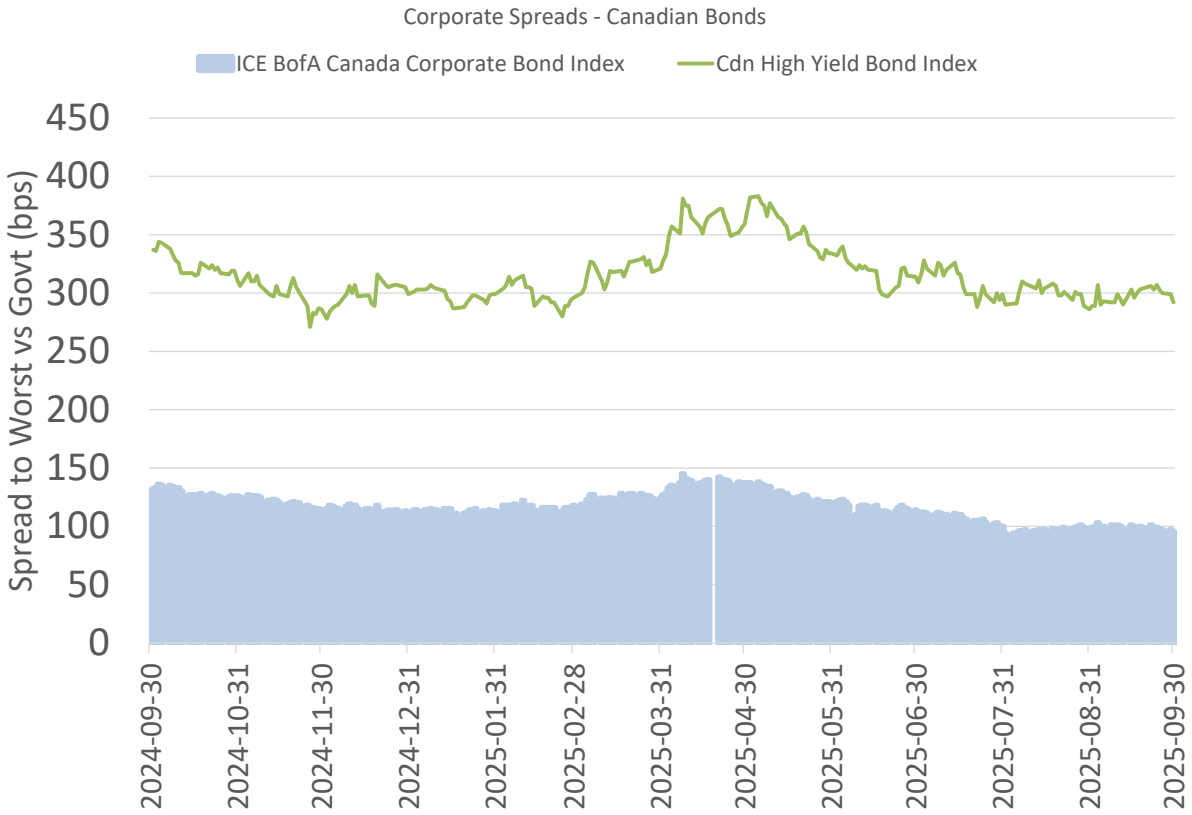
As a result of the fragile Canadian economy, and with inflation remaining within acceptable parameters (Canadian inflation measured 1.9% as of the end of August, slightly below the 2.0% target set by the Bank of Canada), the central bank lowered its Overnight Lending Rate by 25 bps to 2.50% on September 17th. This marked the first rate cut following several meetings with no change.

The curve is almost fully upward sloping, meaning the shorter term bonds yield less than the longer term bonds, which is 'normal'. Investors expect higher yields for longer-term investments. In addition, the shorter term bonds are influenced heavily by expectations for monetary policy (in this case, likely anticipating more accommodative policy), while the longer-term issues are subject to longer term fiscal and macroeconomic factors (expectations of government borrowing needs, economic growth and inflation).

Lower yields are a tailwind for fixed income performance, and this was the case during the quarter, although as noted the decrease in yields was modest.

In corporate bonds, tighter bond spreads accompanied the lower yields during the quarter. Looking at figure 4 below, high yield bond spreads (the grey line at the top) tightened from 309 bps at the end of Q2 2025 to 285 bps on September 30th. This indicates that investors judged that the riskiness of non-investment grade bonds decreased over the quarter. Accordingly, spreads of investment-grade bonds also tightened, from 109 bps to 96 bps. As spreads narrow, bond prices increase, and this had a modest positive impact on corporate bond prices in the quarter. It bears noting that spreads of 285 bps and 96 bps for high yield and investment grade bonds respectively are below historical averages and still not at levels indicating concerns over a broader recession or any credit quality concerns.

4. Canada Bond Indices Spread Over Government Bonds



Source: Bloomberg

Although much of the economic data here in Canada was weak, fixed income securities enjoyed a positive performance in the third quarter, and on a year-to-date basis. This was driven by the move lower in interest rates in Q3 and so far in 2025 due to the anticipation of Bank of Canada cuts, weakening growth, and lower yields in global markets, offset to a large degree by inflation worries, and possible fiscal risk. Credit-sensitive issues such as corporate bond performance have benefited further due to the higher coupons they typically offer versus government bonds (corporate bond spreads are relatively flat on a year-to-date basis) and from the spread compression noted above.

Figure 5 summarizes fixed income markets returns below.

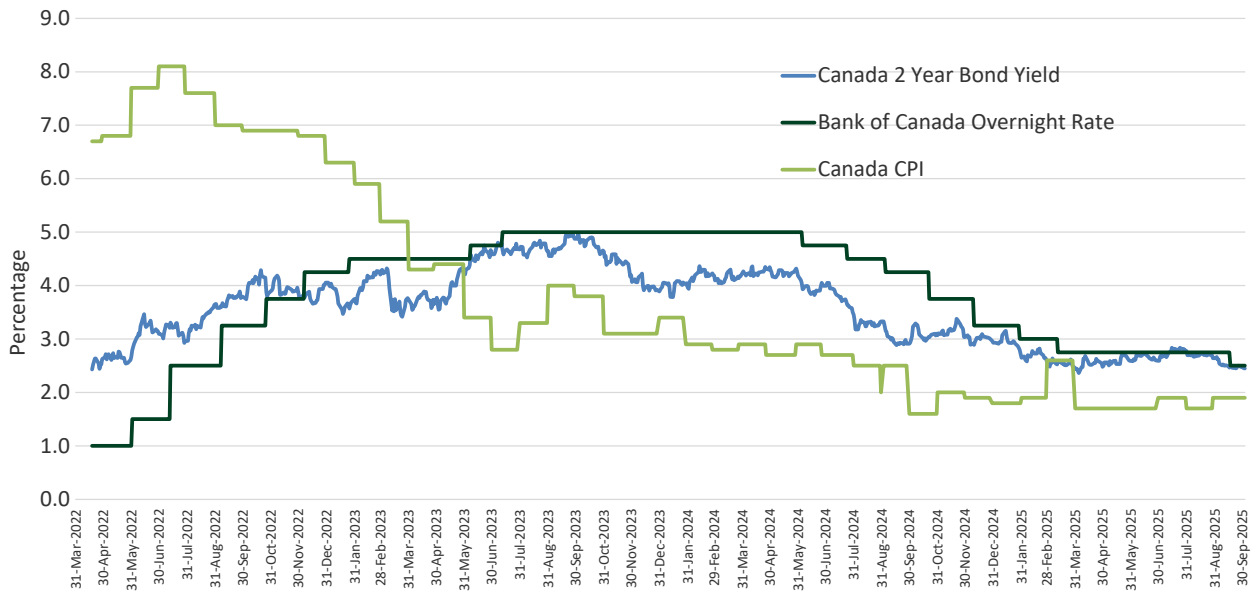
5. Returns for Fixed Income Asset Classes

Asset Class Returns	Q3 2025	Q2 2025	Q1 2025	Q4 2024	2024	2023
Morningstar Canada Core Bond Index	1.39%	-0.72%	2.01%	-0.17%	3.92%	6.32%
Morningstar Canada Corporate Bond GR CAD	1.66%	0.33%	1.80%	1.07%	6.60%	8.52%
Morningstar Canada Corporate Bond GR CAD	2.66%	1.61%	1.52%	2.05%	11.48%	10.00%

Source: Bloomberg

Outlook

6. Canada Bond Indices Spread Over Government Bonds



Source: Bloomberg

The chart above (Figure 6) illustrates the relationship between inflation, the Bank of Canada's overnight rate, and the yield on the Government of Canada's 2-year bond. While the inflation rate and the overnight rate tend to move in a similar direction, they are not perfectly aligned, and periods of divergence and fluctuation are common. The 2-year bond yield serves as a useful indicator of market expectations regarding the future path of the overnight interest rate.

As shown above, inflation as measured by Consumer Prices (CPI) remain below the Bank of Canada's 2.0% target (CPI in August measured 1.9% and has remained below 2% for the most recent five monthly reports). The 2-year bond yield decreased moderately over the third quarter, from 2.59% to 2.47%. The Bank of Canada, as mentioned above, cut the overnight rate by 25 bps to 2.50% on September 17th.

The 2-year bond yield and the Bank of Canada overnight rate are within 10 bps of one another, suggesting limited scope for further interest rate cuts. However, Inflation (CPI) is approximately a full percentage point below them, hinting there may be room for the Bank of Canada to cut. Indeed, we do believe that the Bank of Canada will cut rates before year-end, likely a single cut, given the weak economy.

The ongoing uncertainty caused by trade and political considerations continue to weigh on the economy and markets. Resolution of these issues in some form would provide the biggest uplift or boost to both (economy and to fixed income markets) in our view, however expectations remain modest, and the timing of such an event is uncertain.

The size of the Canadian government's deficit should it continue to grow will put pressure on mid and longer-term yields over time in our view and therefore is likely to continue causing the yield curve to steepen.

With regards to the investment positioning of the Cumberland Income Fund, we do not anticipate extending the portfolio's duration, reflecting our assessment of mid- to long-term yield dynamics and our expectation for a modest decline in near-term interest rates. Although the recent tightening in corporate credit spreads has been a positive development, we do not hold a high degree of conviction that this trend will persist given the prevailing softness in domestic economic conditions. Accordingly, we remain cautious and do not intend to increase the fund's allocation to corporate credit at this time.

Our preference is to maintain the portfolio's current positioning which includes a balance of defensive / short to mid duration holdings and some selected higher beta bonds to bolster returns. We remain cautiously constructive on the fixed income market over the near term.

Warm regards,
Owen Morgan
Portfolio Manager, Cumberland Income Fund

*Cumberland Private Wealth refers to Cumberland Private Wealth Management Inc. (CPWM) and Cumberland Investment Counsel Inc. (CIC). Owen Morgan (a Portfolio Manager at CIC) is the lead portfolio manager for the Cumberland Income Fund. NCM Asset Management Ltd. (NCM) is the Investment Fund Manager to the Kipling Strategic Income Fund. CPWM, CIC and NCM are under the common ownership of Cumberland Partners Ltd.