DECEMBER 2016

Debt Market Monitor

National Debt Capital Markets Services

Is it time for the "Big Rotation"?

Shortly after the U.S. presidential election, market investors took to heart what the president-elect had notionally offered up in the way of a big fiscal stimulus plan, a cut in taxes, reduced regulations and a promise to revisit trade agreements – all to assert economic growth. Globally, investors saw more than $1 trillion eroded from bond markets in anticipation of the proposed stimulus plan, higher interest rates and inflation. Bond yields moved up dramatically, reflecting the exodus from bonds. This exodus is a worldwide bet that there will be gains in the U.S. economy, at least in the near term, inflation at or beyond the current target of 2% will be achieved and, of course, interest rates will rise sooner rather than later.

Some experts sense that a sentiment shift in the bond market has already started. Following the election, the stampede from bonds has driven 30-year U.S. treasury yields to their largest weekly increase since January 2009. Is this the early warning of even higher yields around the corner? Not if you believe the Relative Strength Index ("RSI"), which provides an indicator of whether or not a security is overbought/oversold. The RSI indicator a week after the presidential election reported at 83 versus a threshold index of 70. A higher number signals that a security is oversold. Selling a volume of bonds above market equilibrium (i.e. when there are more sellers than buyers) results in lower bid-offer prices, thus increasing yields. Bondholders want more yield and to pay less to hold a bond when there is an overabundance of supply. For a real impact example, consider that the holder of a 10-year maturing bond experiences a pricing compression that results in a yield increase of 2%. In this instance, the value of the bond drops immediately by 20%. Now, magnify that value onto the estimated $100-trillion-plus global bond market that has issuance as long as 99 years in some cases and an estimated 20% that is subject to negative yields. The longer the bond maturity, the greater the loss in value when prices fall.

Regardless of whether the "Big Rotation" (bonds to stocks) has already started or is about to start, it will need support from a stronger global economy and from central banks to stop the accommodation process and, possibly, start removing stimulus. Experts have touted the current series of events as the beginning of the end of the 35-year bull market in bonds.

What do lower price bonds potentially translate into for all types of lending? Higher rates, tougher underwriting and more scrutiny of the sponsorship. Hence, 2017 may bring a more solid economic underfoot; however, the year will not be without impact, as we have seen from bond yields. Higher inflation and interest rates could very well be the theme for 2017 and beyond. Watch for multiple rate hikes during 2017 by the Federal Reserve so long as economic indicators remain positive.

Fiscal Snapshot

Bank of Canada Rate

	BoC Rate	Bank Prime Lending
November 2016	0.75	2.70
One month ago	0.75	2.70
One year ago	0.75	2.70

Government of Canada Benchmark Bond Yields

	5-Year	10-Year	Long
November 2016	1.00	1.58	2.16
One month ago	0.69	1.20	1.85
One year ago	0.91	1.57	2.29

Indicative Commercial Mortgage Spreads* Over Government of Canada Bond Yields

Conventional	5-Year	10-Year
November 2016	1.70 - 2.00	1.85 - 2.35
One year ago	1.75 - 2.00	1.90 - 2.30
Insured	**5-Year**	**10-Year**
November 2016	0.95 – 1.10	1.00 – 1.20
One year ago	0.90 - 1.25	0.95 - 1.40

*Spreads are indicative of high quality real estate in major Canadian markets.

Highlighted Transaction

Asset Type	Two property manufacturing portfolio
Location	Secondary Canadian city
Facility Details	A non-recourse, senior conventional debt facility for equity repatriation purposes, in the amount of $12.5M, for a 5 year term, 25 year amortization at a very competitive rate of interest.

Intelligent Debt Financing Solutions

The Avison Young National Debt Capital Markets dedicated team is focused on providing innovative North American-wide debt and equity solutions to accomplish goals. We originate debt and equity for all types of real estate and all types of clients. Debt origination includes fixed and floating rate structures, permanent and construction financing, structured finance, bridge and mezzanine debt and insured agency financing - CMHC and Fannie Mae / Freddie Mac.

Our years of combined debt/equity capital markets experience has created meaningful relationships that we can put to work for you.

Please contact our National Debt Capital Markets team for more details related to debt financings or real estate transactions.

Norm Arychuk, Broker*
416.673.4006
norman.arychuk@avisonyoung.com

Michael Ho, Mortgage Agent**
416.673.4012
michael.ho@avisonyoung.com

*Licence #: M09002260
Brokerage Licence #10637

**Licence: # M15000834
Brokerage Licence #10637

Avison Young is the world's fastest-growing commercial real estate services firm. Headquartered in Toronto, Canada, Avison Young is a collaborative, global firm owned and operated by its principals. Founded in 1978, the company comprises over 2,200 real estate professionals in 77 offices providing value-added, client-centric investment sales, leasing, advisory, management, financing and debt placement services to owners and occupiers of all property types.

U.S. Capital Markets Offices Atlanta | Houston | Boston | Los Angeles | Orange County | Nashville | South Florida | Chicago | Raleigh-Durham | Washington, D.C. | New York
Canadian Capital Markets Offices Calgary | Edmonton | Montreal | Toronto | Vancouver
European Capital Markets Offices Frankfurt | Dusseldorf | Munich | London

AVISON YOUNG Intelligent Real Estate Solutions

avisonyoung.com

Avison Young Commercial Real Estate (Ontario) Inc., Brokerage
18 York Street, Suite 400
Mailbox # 4
Toronto, Ontario, Canada M5J 2T8
416.955.0000

CANADA'S BEST MANAGED COMPANIES