March 2010

Dynamic Fixed Income Commentary

Outlook (3-12 month investment horizon)

- G7 central banks remain focused on disinflationary pressures linked to weak economic recovery and high unemployment.
- Weak US economic conditions will lead to a gradual withdrawal of liquidity by the fed and an increase in the interest rate on excess reserves before a modest increase in the fed funds rate sometime in the second half of 2010.
- Bank of Canada to increase overnight rate moderately from 0.25% beginning third quarter of 2010.
- High unemployment, low income growth and low consumer inflation will keep shorter-term government yields low and limit increase in longer-term yields.
- Canadian yield curve to gradually flatten as the year progresses.
- Canadian yield curve flatter than US with US short- to mid-term yields below Canadian reflecting weaker US credit conditions and economy.
- Corporate bond spreads to stabilize following rally. Demand for income to support corporate bond yield spreads limiting increases. Dominant themes for investment grade corporate bonds are credit quality (strength of balance sheet, free cash flow and credit trends) and liquidity. Continue to avoid the risks associated with excessive financial leverage, opaque balance sheets, impaired access to capital, dependence on wholesale funding and the absence of visibility of underlying collateral in structured credit. Sector selection and relative valuations important going forward.
- Bond yields remain in mature phase of a long-term secular bull market supported by low inflation global expansion, global overcapacity, surplus global savings, demographic trends adding to structural demand for longer duration assets, and extended by a low growth recovery from recent economic contraction. Supportive factors to moderate gradually over the next 2 to 4 years due to improving global demand led by the developing economies. Rising government debt a long-term risk.
- Canadian breakeven (B/E) spreads (long-term government nominal bond yield less real yield) expensive around 2.60%. Valuations supported by expectations of an eventual return of inflationary pressures and investor demand. B/E better value around 2.20%. Own 5-year provincial real return bonds (RRBs) and floating rate notes (FRNs) to preserve capital when real yields rise or breakeven spread declines.

Strategy (3-month investment horizon)

Duration

- Reduce when Canada 10-year yields near 3.30%, add above 3.80%
- Shift to short-term federal bonds or government FRNs when reducing duration

Yield Curve

- Relative value in the 4- and 7-year term due to steepness of yield curve and credit curve

Sectors

- Overweight – federal bonds
- Neutral – corporate bonds
- Underweight – provincial bonds, RRBs (increase on weakness in B/E spreads near 200 bps)

Corporates

- Industry overweight – communication (favour cable companies), energy and infrastructure
- Industry underweight – financials, industrials (especially consumer sector) and ABS
- Industry neutral – real estate (selected issuers and seasoned AAA CMBS)

Dynamic Funds™
Invest with Advice.

FIXED INCOME FUND PERFORMANCE (as of February 28, 2010)

Fund Name	Inception Date	1-Year Return	3-Year Return	5-Year Return	10-Year Return	Since Inception Return
Dynamic Advantage Bond Class	Feb-08	14.2%	-	-	-	5.3%
Dynamic Advantage Bond Fund	Nov-00	16.0%	3.4%	3.9%	-	1.9%
Dynamic Canadian Bond Fund	Aug-79	10.0%	4.8%	4.4%	5.8%	8.9%
Dynamic Real Return Bond Fund	Oct-04	13.4%	1.4%	3.3%	-	3.5%

08DWD007_DFI_Commentary_EN_0310_V1