

MONTHLY BOND LETTER

AlphaFixe
Capital

ECONOMIC EVENTS

DECEMBER 2020

- The annual inflation rate in Canada rose from 0.7% in October to 1.0% in November. Although well below the Bank of Canada's target (2%), this is the highest reading since the beginning of the pandemic. Upward pressure came from clothing and footwear, recreation/reading, housing and durable goods such as furniture (2.8% year-over-year) and appliances (2.9% year-over-year). In contrast, gasoline prices fell 1.5% in November and 11.9% over the past 12 months. In terms of geography, Alberta (1.3%) and British Columbia (1.1%) recorded the largest price increases, while Prince Edward Island (-0.5%) and New Brunswick (-0.4%) are in deflationary territory.
- The U.S. Congress adopted a \$900 billion financial support plan, the second since the beginning of the Covid crisis. This plan offers a \$600 cheque to each adult earning less than \$75,000, a \$300 increase in Employment Insurance benefits for 11 weeks, until March 14, 2021, and an envelope for SMEs through the wage protection plan. Funding will also include assistance for schools and vaccine distribution.
- The United Kingdom and the European Union finally reached a trade agreement just days before the deadline. The deal was crucial for the British economy, as exports to the unified zone totalled £294 billion (43 % of total exports) while the UK imports £374 billion worth of goods and services from the Union (more than 50 % of total imports). The agreement focuses more on goods and less on services.

The new lockdown measures imposed in various provinces (Quebec and Ontario) should reduce pressure on consumer prices at the beginning of the year. However, with the arrival of vaccines in 2021, economic activity in the second half of the year can be viewed with more optimism. Financial markets perceive the inflationary risk ahead. The break-even inflation rate implied in the 30-year Real Return Bonds closed the year at 1.51% compared to 1.32% in September.

This financial support will allow household income to grow in the first quarter of 2021. However, the odds of the stimulus cheque being raised to \$2,000 has increased since the election in Georgia on January 5th giving Democrats control of the Senate for the next two years.

This saga, which will have lasted more than 4 years, removes a risk factor for the British economy at a time when the authorities must fight against a new, more virulent strain of Covid. A third general lockdown has been announced and government assistance (£4.6 billion) has been enhanced to help affected businesses in the retail and catering sectors.

RATE TRENDS

- The European Central Bank (ECB) left its key interest rate unchanged, but increased the size of its emergency bond purchase program by €500 billion to €1,850 billion. The purchase period has been extended by 9 months to March 2022 and maturities will be reinvested until the end of 2023. The ECB has also increased the amount that banks can borrow at negative rates as long as they maintain the flow of credit to households and businesses. It has also extended the period when these favourable conditions will apply by 12 months to June 2022.
- Not surprisingly, the Federal Reserve left its monetary policy unchanged. As a result, the Fed will continue to buy Treasury securities at a rate of at least \$80 billion per month until substantial progress has been made on employment and price stability. Committee members also raised their economic forecast, but still plan to keep the policy rate at the floor until the end of 2023.

Since the beginning of the crisis, central bankers have clearly indicated their intention to have an dovish monetary policy for several years. Even more so if the political environment makes the use of fiscal stimulus difficult, as is the case in Europe. The senatorial election in Georgia could give the Fed some breathing space in 2021. The Biden administration's generous program of government support and spending is expected to help the economy while we wait for the large-scale vaccination program to be implemented. Political disagreements in Congress recently have tarnished the economic climate at the end of the year, 2021 could be more favourable.

BOND RATES

		Monthly Change	Change 2020		Monthly Change	Change 2020
Dec. 31 2020						
Key Interest Rate	0,25 %	0,00 %	-1,50 %	0,25 %	0,00 %	-1,50 %
3 months	0,07 %	-0,04 %	-1,59 %	0,06 %	-0,01 %	-1,49 %
2 years	0,20 %	-0,05 %	-1,50 %	0,12 %	-0,03 %	-1,45 %
5 years	0,39 %	-0,04 %	-1,30 %	0,36 %	0,00 %	-1,33 %
10 years	0,68 %	0,01 %	-1,03 %	0,91 %	0,07 %	-1,00 %
30 years	1,21 %	0,05 %	-0,55 %	1,64 %	0,08 %	-0,74 %
RRB 30 years	-0,30 %	0,05 %	-0,67 %			

Source: Bloomberg

CANADIAN RATE TRENDS



CREDIT BOND RISK PREMIUMS

Émetteurs	Credit Rating DBRS	Change								
		Spread			5 yrs		10 yrs		30 yrs	
		5 yrs	10 yrs	30 yrs	month	2020	month	2020	month	2020
Royal Bank, Bail-in-debt	AA	65	105	155	-5	-20	-5	-15	-5	-5
Royal Bank, NVCC	A	100	140	195	-5	-20	-5	-30	-10	-15
Sun Life, subordinated debt	A	90	130	185	-5	-10	-10	-15	-15	0
Hydro One	A high	50	85	130	-5	-10	-5	0	-10	0
Enbridge Inc	BBB high	95	150	235	-10	-5	-10	0	-15	15
Altalink LP	A	50	80	125	-5	-5	-5	0	-10	5
GTAA	A high	50	85	130	-5	-5	-5	5	-10	20
Bell Canada	BBB high	80	130	200	-5	-20	-5	-20	-10	-5
Rogers Communications	BBB	80	130	200	-5	-15	-5	-15	-10	-5
Loblaw	BBB high	75	125	195	-5	-30	0	-30	-5	-15
Canadian Tire	BBB	95	155	255	-15	-5	-15	5	-10	50
Province Québec	AA low	30	57	79	-4	-6	-6	-2	-5	10
Province Ontario	AA low	35	62	81	-3	-3	-6	0	-4	8
CMHC	AAA	21	32	---	-2	-8	0	-6		

Source: National Bank Financial

CREDIT MARKET

- New Canadian corporate bonds reached \$5.9 billion in December, up \$2 billion from the previous month, but \$4.9 billion less than in December 2019. Bond financings set a record in 2020 with a total of \$108.1 billion, 8.5% higher than last year and 4% higher than the previous mark set in 2017. The real estate industry was very active in December with 9 transactions for a record \$2.65 billion. It is also an annual record with a total of \$10.2 billion in 2020, \$3 billion more than in 2014. Real estate investment trusts contributed to this record year, taking advantage of affordable and less restrictive financing conditions in the markets compared to commercial mortgages.
- Dollarama, Quebec's \$1 store chain recorded net income of \$161.9 million in the third quarter of 2020, up 16.8% over the same period last year. Sales jumped 12.3% over the same period despite a drop in traffic. This increase is partly explained by the growth in the total number of stores over the past 12 months. In addition, same-store sales increased by 7.1% due to the combined effect of a 26.3% increase in the average transaction amount and a 15.2% decrease in the number of transactions. Dollarama recognized the dedication of its employees during the pandemic period with a \$300 bonus for full-time employees and \$200 for part-time employees.
- U.S. investment-grade corporate bond issuance reached a record \$1,856 billion in 2020, a 54% jump over 2019 and 33% higher than the previous record of \$1,396 billion set in 2017. April (\$297 billion), May (\$262 billion), March (\$261 billion) and June (\$177 billion) became the most active 4 months on record. High yield bond issuance jumped 425% year-over-year in 2020 to a record \$432.5 billion. The Fed's intervention in this market allowed yield spreads for these riskier securities to contract by 7.01% between the peak in the middle of the pandemic (10.87%) and the end of the year (3.86%). Several companies took advantage of the Fed's support to hoard large amounts of money.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Dec. 2020	2020
Universe	100 %	0,37 %	8,68 %
Short Term	41,1 %	0,23 %	5,29 %
Mid Term	24,7 %	0,60 %	10,08 %
Long Term	34,2 %	0,37 %	11,90 %
Federal	33,9 %	0,04 %	7,28 %
Provincial	37,5 %	0,40 %	9,86 %
Corporates	26,6 %	0,73 %	8,74 %
RRB		0,34 %	13,02 %

Source: ftse.com

These excellent financial results highlight the resilience of the Quebec retailer's business model through various economic cycles. We also applaud the decision to reward front-line employees who put their health at risk for a modest salary. Canadian grocers should follow through.

Given the record amounts borrowed in 2020, new corporate debt issuance is expected to decline in 2021. Up more than 50% from 2019, record issuance will allow companies to weather the challenging economic environment in the coming months. On the other hand, some companies will find it difficult to survive despite the vaccine and currency printing.

STRATEGIC POSITIONNING

The risks associated with the U.S. presidential election and Brexit are now over, but the sky is not completely clear. The insurrection at the Capitol on January 6th shows that trumpism is still alive and could disrupt the political life of the new administration. Although the Senate is Democratic, the margin is narrow, leaving less room for elected officials to push the entire Democratic program through. The second wave of Covid will also have a serious impact on economic activity in the first quarter in Europe and Canada. Quebec and Ontario, the country's two largest economic provinces, have announced tough lockdown measures for January and possibly beyond. The Canadian economy is expected to contract in the first quarter, possibly prompting the Bank of Canada to further enhance its economic support. Having recently reduced its pace of government bond purchases from \$5 to \$4 billion per week, the Bank is unlikely to reverse its decision. In fact, at a monthly rate of \$17.3 billion, the Bank's program is twice as aggressive as the Fed's in proportion to its economy. In addition, the Bank is concerned about the effects on our exporters of a rising Canadian dollar in recent months at a time when economic activity of our trading partners is slowing down. Therefore, a 0.15% cut in the policy rate at the January 20th meeting should not be ruled out, even if its economic impact is negligible.