MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

OCTOBER 2023

- Canadian GDP was flat for the second month running in August. The goods-producing sector contracted by 0.2%, while manufacturing (-0.6%) and agriculture, forestry, hunting and fishing (-3.2%) weighed on growth. Forest fires during the summer had a negative impact on economic activity. The service industries recorded a 0.1% growth, driven by wholesale trade (+2.3%), transport and warehousing (+0.8%) and finance (+0.4%). On the other hand, retail trade (-0.7%) and hotels and restaurants (-1.8%) contracted. Statistics Canada also forecasts that the economic paralysis will continue into September, bringing to 3 the number of consecutive months of zero growth.

If September's forecast proves correct, the economy would have been sluggish over the last two quarters. The loss of purchasing power due to inflation and monetary tightening is cutting into household budgets. The decline in discretionary spending, such as eating out, is a sign of weakness. The economy therefore has little room for manoeuvre to avoid sliding into recession. It is highly likely that the Bank of Canada has completed its tightening, but it is too early to speak of a rate cut.

- The US economy has demonstrated its strength. GDP grew at an annualized quarterly rate of 4.9% in Q3, the fastest pace since Q4 2021, despite a 5.25% increase in policy rate since then. Several factors contributed to this rise. Household consumption spending recovered, rising by 4.0% compared with 0.8% in the previous quarter. Business investment rose slightly (+0.8%), but companies also replenished their inventories, adding 1.3% to GDP. Residential real estate was also positive after 9 consecutive quarters of contraction. International trade and government spending also boosted growth.

Household consumption is underpinned by annual income growth (4.8%) outstripping inflation (3.7%), a debt-to-income ratio that has fallen sharply over the past 10 years, and accumulated savings that remain strong. However, households dipped into their savings this quarter to support their spending. This rate of growth will not be repeated in the next quarter, but still points to an economy that is more resilient to monetary tightening than before.

- Economic growth in China has accelerated. China's GDP grew by 1.3% quarter-on-quarter in September, bringing the annual increase to 4.9% from 6.3% in the second quarter. However, the second-quarter figures were biased upwards due to the economy's sharp contraction last year. Since the start of the year, the economy has grown by 5.2%, just exceeding the Chinese authorities' growth target of 5%. The quarter ended on a high note. Retail sales rose by 5.5% year-on-year in September, an acceleration on last month's 4.6%.

The Chinese economy's contribution to growth in industrialized countries is not what it used to be. Over the past year, China has reduced its exports to the United States (-9.3%), the Eurozone (-11.6%) and Japan (-6.4%), while Russia has gained (+21.0%). The engine of the global economy has therefore lost some of its horsepower, and its torque is no longer able to drive global growth as much as it once did.

RATE TRENDS

- The strategies of the major central banks have synchronized of late. It's time to pause and evaluate the lagged effect of the aggressive monetary tightening begun last year. These include the Bank of Canada, the Federal Reserve, the ECB and the Bank of England. In Canada, the key rate was maintained at 5.0%. The Canadian economy is showing signs of slowing as a result of previous rate hikes. Demand has weakened for durable goods, real estate and services. The job market and retail sales volumes have failed to keep pace with the significant population growth of recent quarters, a sign that the economy is running out of steam. However, vigilance is still called for, as inflation expectations and wage growth remain high.

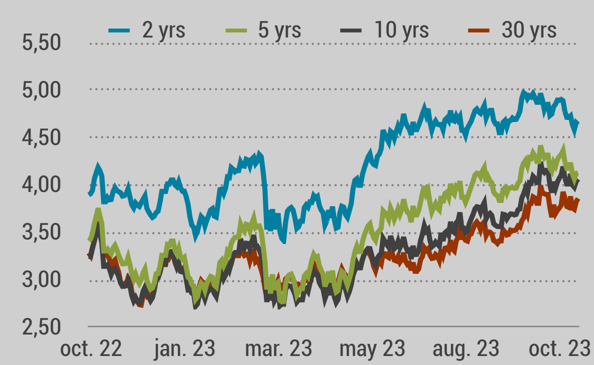
Investors will have to make a thorough analysis of the economic situation. A pause to assess the economic consequences of the aggressive tightening now underway is not a call for an imminent rate cut. After the Federal Reserve's announcement, investors moved ahead of their expectations for a first rate cut. The structural forces that make inflation more persistent are still in place and complicate the achievement of the 2.0% target. The central banks' shared commitment to keeping rates high for an extended period does not therefore seem to be shared by all investors.

BOND RATES

Oct. 31, 2023	Canada	Monthly Change	Change 2023	United States	Monthly Change	Change 2023
Key Interest Rate	5,00 %	0,00 %	1,25 %	5,50 %	0,00 %	2,25 %
3 months	5,04 %	-0,09 %	0,78 %	5,46 %	0,01 %	1,12 %
2 years	4,64 %	-0,23 %	0,58 %	5,09 %	0,05 %	0,66 %
5 years	4,13 %	-0,12 %	0,72 %	4,85 %	0,24 %	0,85 %
10 years	4,06 %	0,03 %	0,76 %	4,93 %	0,36 %	1,06 %
30 years	3,86 %	0,05 %	0,58 %	5,09 %	0,39 %	1,13 %
RRB 30 years	2,01 %	0,06 %	0,81 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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CREDIT BOND RISK PREMIUMS

Issuers	Credit Rating DBRS	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2023	Change 10 yrs month	Change 10 yrs 2023	Change 30 yrs month	Change 30 yrs 2023
Royal Bank, Bail-in-debt	AA	160	190	220	5	-5	5	-10	5	-10
Royal Bank, NVCC	A	225	265	305	10	0	10	-5	10	-5
Sun Life, subordinated debt	A	200	240	270	5	0	5	0	5	0
Hydro One	A high	100	130	150	0	-10	0	-10	0	-10
Enbridge Inc	BBB high	165	210	250	10	-10	10	-5	5	-10
Altalink LP	A	100	130	150	0	-5	0	-5	0	-5
GTAA	A high	95	125	145	0	-10	0	-10	0	-10
Bell Canada	BBB high	150	200	225	10	-10	5	5	0	0
Rogers Communications	BBBL	175	225	255	5	-5	0	0	-5	-15
Loblaw	BBB high	130	170	195	5	-20	5	-15	0	-15
Canadian Tire	BBB	140	185	220	5	-30	5	-25	0	-35
Province Québec	AA low	45	75	95	1	-1	2	3	1	1
Province Ontario	AA low	47	77	96	1	-1	3	3	1	1
CMHC	AAA	33	52	---	-2	-3	4	6		

Source: National Bank Financial

CREDIT MARKET

- Canadian new corporate bonds issuance totalled $2.5 billion in October, down $12.6 billion on the previous month and $6.3 billion less than in October 2022. Year-to-date, bond financing totals $77.1 billion, down 18% on the same period last year. One month follows another and no two months are alike.. While there were 29 bonds issued by 21 different companies in September, only 5 issuers carried out bond financing in October. The total issued by these 5 companies represents the lowest monthly sum since December 2018.

- Rating agency S&P has upgraded the credit rating of Ford Motor Company and Ford Motor Credit from BB+ to BBB- and changed the rating outlook from positive to stable. As a result, Ford Credit Canada bonds will move out of the High Yield Bond Index and into the FTSE Canada Universe Index, as the new rating joins those of Fitch and DBRS in the investment-grade category. Although the company has reached an agreement with the United Auto Workers (UAW) conceding a 25% wage increase over 4 years, S&P believes that the cost-cutting program already underway will more than compensate for the wage increases. Management is already focusing on reducing complexity and controlling spending on engineering and manufacturing logistics. Ford also has $51 billion in cash on hand, providing financial flexibility.

- It's Ontario's turn to update its public finances. The projected deficit for the 2023-24 fiscal year has risen from $1.3 billion when the budget was published to $5.6 billion. The expected surplus for 2024-25 has also been erased, becoming a shortfall of $5.3 billion. Revenues have been cut by $2.6 billion this year, as the government now expects an economic slowdown and weaker job creation. Expenditures jumped by $1.7 billion due to an increase in the contingency fund. Negotiations with the public service union are fast approaching, and the government is expecting a hefty bill. Borrowing requirements for the current fiscal year increased from $27.5 billion to $34.7 billion.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Oct. 2023	2023
Universe	100 %	0,37 %	-1,09 %
Short Term	44,3 %	0,78 %	1,66 %
Mid Term	28,3 %	0,36 %	-1,61 %
Long Term	27,4 %	-0,29 %	-4,90 %
Federal	39,4 %	0,48 %	-1,22 %
Provincial	33,0 %	0,22 %	-2,60 %
Corporates	25,7 %	0,40 %	1,09 %
RRB		-0,23 %	-7,92 %

Source: ftse.com

Ford's financial situation is improving according to S&P, but the automotive industry is changing and will have to overcome multiple challenges that call for caution on the part of investors. The energy transition requires massive investment in research and development, which delays the profitability of electric vehicle sales. Where would the demand for these vehicles be without government support?

The period of improvement in provincial public finances is drawing to a close. Ministers are forecasting tougher days ahead by lowering revenue projections. At the same time, infrastructure investment needs are pressing. The energy transition and social housing will require particular attention in the coming years. Provincial borrowing programs are likely to be high.

STRATEGIC POSITIONNING

The Bank of Canada and the Federal Reserve are using the same rhetoric of high policy rates over an extended period of time, but their respective economic conditions are different. The Canadian economy has been stagnating for the past 6 months, despite a significant increase in population, which is boosting demand. Employment is growing at a slower pace than population growth, while retail sales volumes have been falling for 3 months. Household debt ratios are high, and mortgage refinancing is taking place within 5 years. As a result, monetary tightening is having a faster impact on Canadian household budgets. The situation is different in the United States. The economy is robust and sustained by consumer spending. Households have been deleveraging over the past decade, and their mortgage financing takes place over a 30-year term. Homeowners with mortgages taken out before 2022 will not see an increase in their mortgage payments for years. U.S. monetary policy is therefore less effective than before in slowing the economy. Despite these differences, inflationary pressures are not abating at the pace desired by central banks, forcing them to maintain a combative stance on inflation. We are approaching the end of rate hikes, but it has not yet been declared. However, the difference in economic conditions between Canada and the United States is reflected in a higher policy rate in our neighboring country. The more direct effect of Canadian monetary policy suggests that the peak has been reached.