MONTHLY BOND LETTER

AlphaFixe Capital

JULY 2017

ECONOMIC EVENTS

- According to the Canadian Real Estate Association, the housing resale market has decreased by 6.6 % monthly in June reaching 39,979 units. It is the largest monthly decline in seven years. The two cities most at risk, Vancouver and Toronto, decreased by 4.0 % and 15.1 %, respectively. Based on current sales, it would take 5.1 months to liquidate the inventory of listed homes, one month more compared to last March. For the Greater Region of Toronto, this ratio stood at 2.5 months in June against 0.8 month in March.

Two factors contributing to the real estate slowdown in June are rising rates, in response to the Bank of Canada's statements, and the new property taxes for foreigners buying in Ontario. However, it's too early to draw conclusions. More than a third of the Canadian population lives in Toronto, Vancouver and Montreal. This concentration somehow supports demand.

- The US economy growth rate increased from 1.2 % in annualized terms in the first quarter to 2.6 % in the second quarter. Household consumption spending continues to rise (+ 2.8 %), supported by a strong labor market. Corporate investment, net exports and government spending contributed to growth while residential real estate had an downward effect. Inventories remained stable despite the downturn in the first quarter, suggesting that they should be replenished in coming quarters.

GDP numbers show us again that growth during the first quarter was an outlier, as it was the case during the last three years. Household expenditure average growth rate over three years was 3.1 % and 3.3 %, if the first quarters are excluded. The economy is doing well and can be removed from the Fed's artificial respirator.

- The Chinese economy grew at an annualized rate of 6.9 % in the second quarter, similar to the first quarter, but above the government target (6.5 %). Boosted by credit availability, China has also released stronger than expected data on retail sales, industrial production and capital investment. Authorities, who recently announced the implementation of a new Financial Stability Committee, are still worried about debt.

Although President Xi Jinping promised to fight against systemic risks, little effort will be made at the dawn of the Communist Congress Party. The president will have to solidify his political base before implementing his structural reforms, because 5 of the 7 Committee members will retire this fall.

RATE TRENDS

- The Bank of Canada raised its key rate by 0.25 % to 0.75 %, the first hike in 7 years. The Bank believes that the economy is growing at a faster pace than expected, thus reducing excess capacity by the end of the year, 6 months earlier than initially expected. Recognizing the time lag between monetary policy and inflation, the Bank has considered it appropriate to act now, even if inflation is low temporarily.

If the Canadian economy is close to potential by the end of the year, the Bank should adjust its policy rate again to move away from a monetary crisis policy. However, will the Bank soften its tone following the soaring loonie (which reached 80 ¢ US in July), evoking its effect on the economy and exports?

- The Federal Reserve has chosen to maintain its key rate at 1.25 % in the month of July. The Committee reiterated that the monetary tightening will continue gradually and that the balance sheet reduction plan will begin shortly. Nevertheless, the Fed has raised some concern about the low level of inflation. Having always been confident of reaching the 2 % target in the near term, members will be watching prices closely.

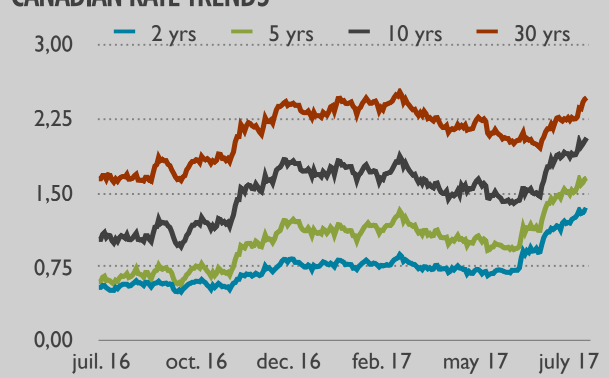
While inflation is held back due to temporary factors, monetary policy remains accomodative and economic expansion is ageing. The Fed will have to build ammunition if it wants to fight off the next downturn.

BOND RATES

July 31 2017		Monthly Change	Change 2017		Monthly Change	Change 2017
Key Interest Rate	0,75 %	0,25 %	0,25 %	1,25 %	0,00 %	0,50 %
3 months	0,74 %	0,03 %	0,28 %	1,07 %	0,06 %	0,58 %
2 years	1,32 %	0,21 %	0,57 %	1,35 %	-0,03 %	0,16 %
5 years	1,65 %	0,26 %	0,54 %	1,84 %	-0,05 %	-0,09 %
10 years	2,06 %	0,30 %	0,34 %	2,29 %	-0,01 %	-0,15 %
30 years	2,47 %	0,32 %	0,15 %	2,90 %	0,07 %	-0,17 %
RRB 30 years	0,81 %	0,22 %	0,32 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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CREDIT BOND RISK PREMIUMS

ISSUER	Credit rating DBRS	Credit rating S&P	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2017	Change 10 yrs month	Change 10 yrs 2017	Change 30 yrs month	Change 30 yrs 2017
Royal Bank, deposit notes	AA	AA-	75	100	135	-5	-20	0	-10	-5	-20
Manulife, Senior debt	A high	A+	95	125	170	0	-20	0	-10	0	-15
Fortis Inc.	BBB high	BBB+	95	140	180	-5	-25	-5	-25	0	-45
Hydro One	A high	A	65	90	130	-5	-15	0	-15	0	-20
Enbridge Inc	BBB high	BBB+	115	165	230	-10	-15	-10	-15	0	-10
Encana Corp	BBB low	BBB	160	220	300	-10	-55	-5	-65	0	-45
GTAA	---	A+	55	75	90	-5	-15	-5	-20	-10	-45
Bell Canada	BBB high	BBB+	95	140	205	0	-20	-5	-25	0	-20
Rogers Communications	BBB	BBB+	95	135	205	0	-20	-5	-30	0	-30
Loblaw	BBB	BBB	100	150	205	-5	-20	0	-20	5	-20
Canadian Tire	BBB high	BBB+	105	155	210	0	-20	0	-20	5	-20
Province of Québec	A high	A+	46	66	78	-3	-9	-3	-12	-2	-14
Province of Ontario	AA low	A+	47	69	79	-3	-9	-2	-10	-2	-10
CMHC	AAA	AAA	34	45	---	-2	-4	-3	-3		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached $ 7.7 billion in July, down $ 1.3 billion from the previous month and $ 2.3 billion lower than in July 2016. Since the beginning of the year, corporate issuance reached $ 60.1 billion, 20.8 % more than at the same date last year. Among the borrowing companies in July, Alimentation Couche-Tard issued a $ 700 million 7-year term bond to finalize its acquisition of CST Brands, who received the green light from the Canadian Competition Bureau. In addition, Couche-Tard also announced that it had signed an agreement to purchase Holiday Station Stores for an undetermined amount. Holiday operates 522 convenience stores and service stations in 10 states.

- Hydro One, the largest electricity distributor in Ontario, announced the acquisition of US-based Company Avista, who supplies electricity and natural gas to the northwest region of the United States. As a result of this transaction, which amounted to $ 6.7 billion, the merged company will have combined assets of more than $ 32 billion. Credit rating agencies S&P (A) and Moody's (A3) kept their credit ratings but downgraded the company's outlook. S&P believes that the acquisition alters the company's risk profile whose activities were previously concentrated in Ontario through a regulatory framework. The likely government support reduction was also a detrimental factor amongst agencies. To finance this acquisition, Hydro One will issue 5, 10 and 30-year bonds in the United States for a total of $ 3.4 billion.

- FTSE Russel, which compiles data from the Canadian Bond FTSE-TMX Index, has announced that all eligible subordinated bank debt in the event of non-viability will become part of the universal index as of February 7th 2018. As of July 1st, 2017, only new NVCC are included in the index, but the process was still pending for previously issued debts. Canadian banks have already issued 15 NVCC securities for a total of $ 15.8 billion, 8 of which were rated BBB representing half of NVCC securities at market value. These additions will increase the weight of corporate bonds in the index by approximately 0.8 %, but especially those rated BBB.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	July 2017	2017
Universe	100 %	-1,90 %	0,42 %
Short Term	46,1 %	-0,41 %	-0,17 %
Mid Term	22,9 %	-1,52 %	-0,20 %
Long Term	31,0 %	-4,32 %	1,49 %
Federal	36,8 %	-1,56 %	-0,73 %
Provincial	34,0 %	-2,67 %	0,77 %
Corporates	27,3 %	-1,38 %	1,45 %
RRB		-3,24 %	-3,17 %

Source: ftse.com

By adopting a growth strategy in the United States, the Ontario government will have difficulty defending financial support in front of voters. Creditors will therefore have to exclude the government support premium from the securities value. However, Avista regulatory framework reduces financial risks.

The weight of BBB rated corporate bonds has grown steadily over the last 10 years, from 18.7 % in 2007 to 39.1 % in June 2017. Although certain issuers have been downgraded, the main source is new issuers like NVCC securities. The latter has an interesting relative value given the regulatory framework of banking activities.

STRATEGIC POSITIONNING

Last month, bond yields rose on monetary policy speeches by several central bankers, including Bank of Canada. The latter has kept its promise by withdrawing one of the two rate cuts put in place during the collapsing oil prices. The Bank of Canada is expected to continue its monetary tightening in 2017, but the loonie appreciation of more than 8 % over two months should cool it off. Short-term rates rose last month in response to the Bank of Canada's statements based on policy developments. This month, it is the long-term segment of the index that adjusted to monetary policy, with a decline of 4.32 % over a month, thereby eliminating almost all gains from the first half of the year. The short and mid term yields in Canada have approached those of United States in the last two months, however 30-year rates are still 41 bps lower, justifying an upward adjustment. The bond markets are adapting to the new economic reality, namely a synchronized recovery across countries and central bankers who are pushing for monetary tightening and a reduction in the quantitative easing programs. Since the recovery has been often disappointing, there are skeptics who are hard to convince. This time it seems different and skeptics could be confused.