MONTHLY BOND LETTER

AlphaFixe Capital

JULY 2023

ECONOMIC EVENTS

- For the first time since March 2021, the annual inflation rate has returned to the Bank of Canada's target range of 1-3%. The consumer price index rose by 0.1% in June, and by 2.8% over the past 12 months. Prices for hotels (+11.6%), airline tickets (+8.2%), gasoline (+1.9%) and mortgage interest (+1.6%) rose rapidly last month, while those for clothing (-1.7%), telephony (-5.8%) and travel packages (-11.5%) fell. The base effect explains most of the annual decline in inflation. On the other hand, the Bank of Canada's preferred measures of underlying inflation, which exclude volatile elements, are decelerating less rapidly. The average annual rate for these two indicators was 3.8% in June, compared with 3.9% the previous month.

We knew that the annual inflation rate would fall rapidly in the first half of the year, as prices rose by an average of 1% per month in the first 6 months of 2022. For the next six months, the monthly average last year was close to 0%. Consequently, if prices continue to rise at a rate of 0.2% per month for the rest of 2023, the CPI will reach 3.9% by the end of the year, which is almost double the inflation target of 2.0% set by the Bank of Canada.

- The US economy is once again showing signs of resilience. Despite rate hikes over the past year, US GDP grew at an annualized rate of 2.4% in the second quarter, exceeding economists' expectations (+1.8%). Consumers were still on board, but spending growth was less vigorous than in the previous quarter (+1.6% in spring, versus 4.2% in Q1). Businesses also invested more (+7.7%), particularly in machinery (+10.8%). They also replenished their inventories during the quarter. Government spending also contributed to growth, while international trade dampened it.

Overall, the economy is progressing better than expected. Rising business investment is a sign of management's confidence in the outlook, and the rise of machinery spending can be interpreted as a response to labour shortages. The Inflation Reduction Act that was passed last year is also a factor supporting investment. Household deleveraging over the past decade has also made monetary policy less effective at slowing the economy than it used to be.

- The European economy regained momentum in the spring. GDP in the unified zone grew by 0.3% between the first and second quarters, after stagnating during the winter. The recovery in demand was probably underpinned by a moderation in inflationary pressures, while rising interest rates acted as a brake on growth. Growth also varied from country to country. France (+0.5%) and Spain (+0.4%) recorded higher growth rates, while the German economy stagnated in the spring and Italy saw its economy contract (-0.3%).

Declining global demand for consumer goods is hurting some European countries. This is particularly the case in Germany, where manufacturing and international trade account for a large part of the economy. Nonetheless, the European economy is set to maintain its momentum over the summer, propelled by a recovery in tourism. On the other hand, record-breaking heatwaves could slow activity.

RATE TRENDS

- The Bank of Canada has decided to fight inflation head on by raising its policy rate by 0.25% to 5.0%. This monetary tightening is a response to a stronger-than-expected Canadian economy. Household spending is vigorous despite the rise in financing rates. The real estate market has also strengthened as a result of the significant increase in Canada's population over the past year. Demographic expansion is also rebalancing the labour market and easing pressure on wages, but it is also stimulating consumer spending and accentuating excess demand in the economy. The Bank acknowledges that the decline in inflation is likely to slow in the near future. However, core inflation remains high and persistent, which justifies this rate hike.

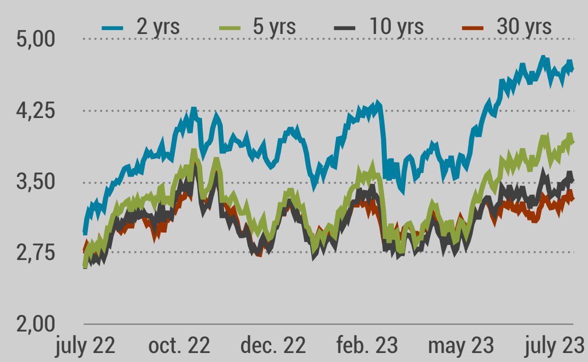
Like several other central banks, the Bank of Canada has distanced itself from its forward guidance strategy, preferring to base its next decisions on economic data. Having each raised their key rates by 0.25% this month, the Federal Reserve and the European Central Bank have also adopted this approach, letting themselves be guided by economic conditions and inflation momentum. As a result, financial markets will navigate more in the fog and react more forcefully to economic releases. This approach could bring higher volatility to the various asset classes in the months ahead.

BOND RATES

July 31, 2023	Canada	Monthly Change	Change 2023	United States	Monthly Change	Change 2023
Key Interest Rate	5,00 %	0,25 %	2,50 %	5,50 %	0,25 %	3,00 %
3 months	5,06 %	0,13 %	0,80 %	5,40 %	0,12 %	1,06 %
2 years	4,68 %	0,09 %	0,62 %	4,88 %	-0,02 %	0,45 %
5 years	3,90 %	0,22 %	0,49 %	4,18 %	0,02 %	0,17 %
10 years	3,50 %	0,23 %	0,20 %	3,96 %	0,12 %	0,08 %
30 years	3,31 %	0,21 %	0,03 %	4,01 %	0,15 %	0,05 %
RRB 30 years	1,55 %	0,18 %	0,35 %			

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	140	175	205	-15	-25	-15	-25	-15	-25
Royal Bank, NVCC	A	200	245	285	-15	-25	-15	-25	-15	-25
Sun Life, subordinated debt	A	180	225	250	-10	-20	0	-15	0	-20
Hydro One	A high	95	125	145	-5	-15	-5	-15	-5	-15
Enbridge Inc	BBB high	145	195	235	-10	-30	-10	-20	-10	-25
Altalink LP	A	95	125	145	-5	-10	-5	-10	-5	-10
GTAA	A high	90	120	140	0	-15	0	-15	0	-15
Bell Canada	BBB high	145	185	215	0	-15	0	-10	0	-10
Rogers Communications	BBBL	175	225	255	0	-5	0	0	-5	-15
Loblaw	BBB high	130	165	190	-5	-20	-5	-20	-5	-20
Canadian Tire	BBB	150	190	230	-5	-20	-5	-20	-5	-25
Province Québec	AA low	48	69	89	0	2	-1	-3	-1	-5
Province Ontario	AA low	49	71	90	-1	1	0	-3	-1	-5
CMHC	AAA	40	45	---	-2	4	-1	-1		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bonds new issuance totalled $6.3 billion in July, down $6.3 billion on the previous month, but $1.4 billion more than in July 2022. Year-to-date, bond financing totals $49 billion, down 22% on the same period last year. Canada's banks have ended their blackout period, which prevents them from issuing new debt prior to the disclosure of financial results. They therefore issued a total of $4 billion in July, equivalent to 63% of all new issues. Since the beginning of the year, the sum of new bank bonds totals $21.9 billion, far behind last year's exceptional pace ($70.9 billion in 2022), but in line with the average of recent years.
- TC Energy, formerly TransCanada Pipeline, has announced that it will split the company into two separate companies. On one side, TC Energy will combine its liquids pipeline activities, including the renowned Keystone pipeline, in a new company to be listed on the stock exchange. On the other hand, TC Energy will concentrate its efforts on operating its natural gas and nuclear infrastructures, as well as hydroelectric storage solutions and the development of new, greener energy solutions. Prior to this announcement, TC Energy had announced that it was selling 40% of its interest in Columbia Gas and Columbia Gulf for $5.2 billion. These assets were deemed non-core to TC Energy's operations, and the proceeds will be used in part to pay down debt.
- Laurentian Bank has placed a for sale sign in front of its branches. In a press release, the Bank indicated that it had hired JP Morgan to assist in a strategic review process that could lead to the sale of the financial institution. The number of potential buyers has narrowed, as Scotiabank and TD Bank have decided not to submit bids. Royal Bank is already awaiting regulatory approval for its acquisition of HSBC Bank last year. It has therefore been out of the race since the beginning. The other Canadian banks have not made their intentions known, but Bank of Montreal seems intent on focusing its growth on the US market.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	July 2023	2023
Universe	100 %	-1,11 %	1,37 %
Short Term	42,9 %	-0,09 %	0,91 %
Mid Term	28,4 %	-1,12 %	0,71 %
Long Term	28,7 %	-2,59 %	2,66 %
Federal	38,4 %	-1,02 %	0,39 %
Provincial	34,1 %	-1,74 %	1,53 %
Corporates	25,6 %	-0,36 %	2,60 %
RRB		-2,68 %	-2,95 %

Source: ftse.com

With this decision, TC Energy clearly wants to dissociate its petroleum and polluting activities from those perceived as being more favourable to the environment. The company believes that the future of energy does not lie in oil, and therefore wants to ensure that the prospects of oil-related decline do not tarnish TC Energy's valuation in the future.

Laurentian Bank's balance sheet is not the brightest. Profits fell by 17% last quarter, and its asset portfolio contains many commercial mortgages whose values have depreciated since the pandemic and work from home. These factors are hampering its growth and could also make it less attractive to competitors. However, its capitalization is robust.

STRATEGIC POSITIONNING

The famous recession everyone was expecting in 2023 keeps being postponed. This feeling of pessimism is fuelled by the cumulative and rapid rate hikes across industrialized countries to bring inflation back on target. Typically, such severe monetary tightening ends in recession or major disruption to financial markets. Although some policy rates are now above the level of inflation, this positive real rate environment is recent and must normally be maintained for some time before the moderating effect on the economy is realized. Until recently, the annual rate of inflation outpaced wage growth, boosting corporate profit margins, which may explain why the recession has not yet manifested itself. Household balance sheets are healthy, with deleveraging over the past decade, robust income growth and excess savings all supporting household consumption spending. Consequently, expectations of a rate cut early next year seem premature. The annual inflation rate came down rapidly in the first half of the year, but the road to the 2% target is much more arduous. The central bank tightening cycle is nearing an end, but the real policy rate needs to be positive for some time to come, in order to weaken the economy and inflation. The banks will therefore be patient before making a U-turn and lowering their rates.