MONTHLY BOND LETTER

AlphaFixe Capital

OCTOBER 2022

ECONOMIC EVENTS

- After losing 113,500 jobs between June and August, employment in Canada has increased by 129,400 over the past two months, including 108,300 in October alone. All of the new jobs are full-time (119,000), further confirming the strength of the labour market. Employment increased in several industries in october, including manufacturing (+23,800), construction (+24,600), and accommodation and food services (18,300), but fell in wholesale and retail trade (-20,200), and natural resources (-6,800). Employment in education increased in October (+5,300), but there are still 30,400 jobs to be recovered from those lost over the summer. In healthcare, employment grew by 6,700.

In addition to the jobs to be recovered in education, the health care industry is in dire need. In fact, as of August, the number of healthcare job vacancies stood at 152,000. After increasing 1.0% in July, 0.75% in September, and 0.50% in October, some technical analysts with their rule expected the policy rate to be raised by 0.25% in December. This labor survey may change their minds. Slowing the pace of increases doesn't necessarily mean they can't do another 0.50% hike if market conditions require it.

- Our neighbors to the south have returned to growth. After two consecutive quarters of contraction, the U.S. economy grew at an annualized rate of 2.6% in the third quarter. International trade contributed strongly to this gain. Oil, non-automotive capital goods and financial services drove exports up 14.4% while imports fell 6.9% over the summer. Business investment also rose 3.7%, but residential real estate fell 26.4 percent, the sixth consecutive quarter of decline. Personal consumption expenditures grew by 1.4% in the last quarter, a deceleration from the spring.

Year-to-date, the average increase in consumer spending is 1.6%, a sharp slowdown from last year, but also from 2019 (2.2%). While growth is back, the details show a slowing economy. With the global slowdown, the U.S. economy will not be able to benefit as much from international trade, especially with such a strong currency. Inflation and real estate are also headwinds for household spending.

- China's economy grew 3.9% quarter-over-quarter in September, the fastest growth since the second quarter of 2020 at the start of the pandemic. Year-over-year growth was also 3.9%, up from 0.4% in the previous quarter. The lifting of some Covid lockdowns over the summer contributed to growth. The economy was buoyed by an increase in industrial production and international trade. On the other hand, retail sales remain weak, up 2.5% over the past year, but only 0.7% for the first nine months of the year compared to the same period last year.

The outlook for the Chinese economy is not bright. The real estate sector is going through a tumultuous period while the zero-tolerance policy on Covid is hurting household consumption spending, especially on convenience services. The global economic slowdown is also a headwind for Chinese exports. Growth no longer seems to be at the top of the leadership's agenda.

RATE TRENDS

- Financial markets had given their blessing to a 0.75% increase, but the Bank of Canada preferred to slow down the pace with a 0.50% hike to set the key rate at 3.75%. The bank acknowledges that previous hikes are slowing the economy. "Slower domestic and foreign demand, lower commodity prices and a reduced impact of global supply disruptions should ease price pressures," the bank says. The global economy is expected to grow by 1.6% next year (down from 2.0%), while Canadian GDP is expected to fall from 3.25% this year to 0.9% next year. The economy is even expected to stall over the next 3 quarters. The Bank is also concerned about the tightening of financial conditions and its impact on the markets.

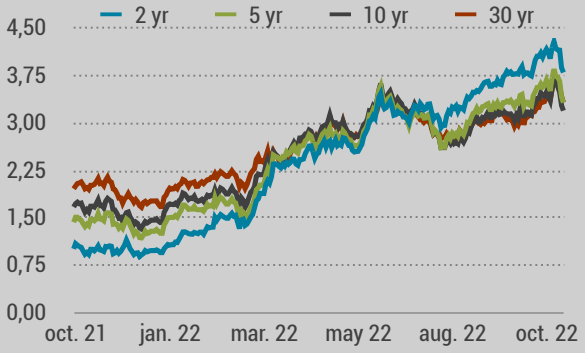
The Bank of Canada's work is not done as "future rate hikes will be influenced" by economic conditions and the evolution of inflation and inflation expectations. What is important here is the use of the plural. So the bank expects to have to act in the next two meetings, raising the policy rate to a minimum of 4.25%. It should be noted, however, that a 0.50% increase is normally considered aggressive. The tightening this year is extraordinary and cannot be sustained indefinitely. The bank's approach therefore seems appropriate and could avoid unexpected accidents.

BOND RATES

Oct. 31, 2022		Monthly Change	Change 2022		Monthly Change	Change 2022
Key Interest Rate	3,75 %	0,50 %	3,50 %	3,25 %	0,00 %	3,00 %
3 months	3,87 %	0,26 %	3,69 %	4,06 %	0,78 %	4,03 %
2 years	3,90 %	0,11 %	2,95 %	4,48 %	0,29 %	3,75 %
5 years	3,41 %	0,09 %	2,16 %	4,23 %	0,21 %	2,97 %
10 years	3,25 %	0,08 %	1,83 %	4,05 %	0,26 %	2,54 %
30 years	3,29 %	0,19 %	1,61 %	4,16 %	0,44 %	2,26 %
RRB 30 years	1,32 %	-0,13 %	1,44 %			

Source: Bloomberg

CANADIAN RATE TRENDS



1800 Ave. McGill College | Suite 2420 | Montréal (PQ) | H3A 3J6 514-861-3493 www.alphafixe.com info@alphafixe.com

CREDIT BOND RISK PREMIUMS

Issuers	Credit Rating DBRS	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2022	Change 10 yrs month	Change 10 yrs 2022	Change 30 yrs month	Change 30 yrs 2022
Royal Bank, Bail-in-debt	AA	185	220	250	10	100	10	105	10	95
Royal Bank, NVCC	A	255	300	340	20	145	20	150	20	140
Sun Life, subordinated debt	A	235	270	300	25	135	15	130	10	110
Hydro One	A high	120	150	175	5	55	0	50	0	40
Enbridge Inc	BBB high	195	235	285	5	85	5	80	0	55
Altalink LP	A	115	145	170	5	50	0	45	0	35
GTAA	A high	120	150	170	5	50	0	50	0	40
Bell Canada	BBB high	180	220	250	5	80	0	75	-5	45
Rogers Communications	BBB	195	245	295	5	65	5	70	-5	60
Loblaw	BBB high	170	210	235	5	80	0	75	-5	45
Canadian Tire	BBB	190	240	280	15	95	15	95	10	50
Province Québec	AA low	42	75	96	0	9	1	19	-1	22
Province Ontario	AA low	45	78	98	1	8	2	17	-1	20
CMHC	AAA	32	44	---	0	1	-1	3		

Source: National Bank Financial

CREDIT MARKET

- Canadian new corporate bonds issuance totaled $8.8 billion in October, up $1.2 billion from the previous month, but $1.2 billion less than in October 2021. Year-to-date, bond financings totaled $93.2 billion, down 5% from this time last year. Canadian banks have once again monopolized the market with $6.3 billion in issuance. With generous government programs and quantitative easing by central banks during the pandemic, banks saw their deposits jump and also extended lines of credit to businesses. Two years later, inflation is eating into banks' deposits and businesses are using their lines of credit instead of borrowing on a term basis. Banks are therefore in need of funding, which would explain the large amount of issuance this year.

- Telus continues its diversification strategy by announcing the acquisition of mobile strategy service provider WillowTree for US$1.225 billion through its Telus International division. This amount also includes US$210 million in debt. WillowTree has operations in several markets, including the U.S., Canada, Brazil, Portugal and Spain, and generated US$140 million in revenue last year with high profit margins. Following this news, S&P placed Telus' rating on credit watch for a for possible a one-step downgrade. Currently, S&P rates Telus BBB+. After the acquisition, Telus' debt-to-EBITDA ratio is expected to be close to 3.5x and is expected to remain above 3.25x by the end of next year, a threshold for a lower rating according to S&P.

- British bank HSBC is currently reviewing the possibility of selling its Canadian subsidiary, which is valued at almost US$9 billion, according to the Financial Times. The review comes as major shareholder Ping An seeks to split the bank's Asian and Western businesses. HSBC is reportedly targeting its Canadian operations as less profitable in order to focus its efforts on Asian and European markets. The streamlining of operations has already begun. HSBC sold its French operations to Cerberus last year, is exiting Greece and has notified clients in South Africa that it will focus on international clients rather than domestic banking.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Oct. 2022	2022
Universe	100 %	-1,00 %	-12,66 %
Short Term	43,7 %	-0,06 %	-4,74 %
Mid Term	26,4 %	-0,40 %	-10,96 %
Long Term	30,0 %	-2,83 %	-23,19 %
Federal	37,8 %	-0,67 %	-9,84 %
Provincial	34,3 %	-1,45 %	-16,02 %
Corporates	25,8 %	-0,87 %	-11,54 %
RRB		0,61 %	-16,15 %

Source: ftse.com

Since 2019, Telus has made a variety of acquisitions that have moved it further and further away from its regulated telecom operations. These transactions have also raised the company's debt level. This expansion plan also brings its share of business integration risk that can eat into cash flow and monopolize management attention.

This is not the first time HSBC Canada has considered selling its Canadian assets. If a sale were to take place, it would surely involve one of Canada's six major banks and would require both OSFI and federal government approval. In the Shaw/Rogers merger, the feds are criticizing the reduction of competition, will they apply the same line of thinking to the banking industry?

STRATEGIC POSITIONNING

After announcing several significant rate hikes, central banks are moving towards a more cautious approach of their monetary policy. The Bank of Canada and the Reserve Bank of Australia have already reduced the pace of increases, indicating that the lagged effect of previous hikes should slow economic activity soon and price pressures from excess demand. The Federal Reserve preferred to follow up with a fourth consecutive 0.75% hike on November 2, but is opening the door to a less aggressive pace at future meetings. Is this really a change in attitude that signals the end of monetary tightening? Not really. What the banks are telling us is that the odds of a crash rise quickly when you are driving at 75 for a long time in a 25 zone. The final policy rate could even be higher than expected, it's just that they will take longer to get there. Rates could also be kept high for some time as the labor shortage complicates the demand reduction job that central banks are trying to achieve. Unfortunately, history has taught us that such aggressive monetary tightening usually ends badly. Banks are likely to raise rates until they break something. They will then try to fix what they broke by lowering rates. You be the judge, will they break the economy through a recession or financial markets?