MONTHLY BOND LETTER

AlphaFixe Capital

JULY 2022

ECONOMIC EVENTS

- The Canadian economy lost 43,200 jobs last month, but this is not such bad news. Firstly, hours worked increased by 1.3% in June, offsetting some of the job losses. Second, much of the decline (-59,000) occurred among self-employed part-time workers. With the lifting of health restrictions, one can think that drivers for Uber Eats or DoorDash of this world becoming less popular. In addition, Statistics Canada reports that a portion of those who were self-employed in May became employed in June. The high number of job vacancies and the increase in wages are now becoming an incentive to leave self-employment. In fact, the average hourly wage increased by 5.2% in June compared to 3.9% in May.

Wages are adjusting quickly to inflation, which should be a concern for the Bank of Canada. The unemployment rate is at a new historic low of 4.9% due to the decline in the labour force, especially among those aged 55 and over. The latter may have left the labour market to take advantage of the summer period. In short, there is nothing in this survey that will cause the Bank of Canada to deviate from its monetary tightening. Before slowing down rate hikes, central banks will want to see a slowdown in the job market.

- U.S. GDP fell by an annualized 0.9% in the second quarter after a 1.6% decline during winter, the definition of a technical recession. Household consumption spending slowed, rising only 1.0%. Business investment dipped slightly (-0.1%) while residential investment fell at an annualized rate of 14% in the quarter. Inventory reduction was the largest contributor to the decline in GDP, subtracting 2.0% from growth in the quarter. Companies are struggling with high inventory levels as they over-order in anticipation of supply shortages and continued strong demand.

So is this a recession? Not by any real definition, as employment and incomes remain robust. Yes, there is a slowdown in activity, but that was the Federal Reserve's objective in order to curb inflation. Before calling for a recession, we will have to see an increase in the unemployment rate, which currently stands at 3.6%. Recall that the contraction in the first quarter was the result of a drop in international trade in a context of pandemic restrictions and war.

- Sanitary measures in China to contain the spread of Covid have had a significant economic impact. China's GDP contracted by 2.6% between the first and second quarters, compared to 1.4% growth in the previous quarter. On a year-over-year basis, the economy grew by a modest 0.4%, the second worst performance of the Chinese economy after the contraction at the start of the pandemic in 2020. The impact is concentrated in affected regions such as Shanghai and Beijing, where GDP has fallen by 13.7% and 2.9% respectively in the past year.

The national statistics office also points out that tightening monetary policy abroad has contributed to the slowdown. Central banks have accelerated rate hikes because they are facing a supply shock due to health measures in China. In sum, with growth of 2.5% in the first half of the year, the Chinese economy will struggle to meet its 5.5% target.

RATE TRENDS

- Several central banks tightened credit availability by announcing significant increases in their key interest rates. The Bank of Canada surprised many with a 1.0% increase, while the Federal Reserve and the European Central Bank (ECB) raised their rates by 0.75% and 0.50% respectively. This is the first hike for the ECB since 2011, ending the era of negative rates introduced in 2014. The message conveyed, however, is the same. We need to act to prevent high inflation from taking root and spiraling into inflation. Excess demand has been building in Canada recently and one of the ways this is manifesting itself is through labour shortages that are creating upward pressure on wages. Strong demand also allows companies to pass on rising costs directly to consumers.

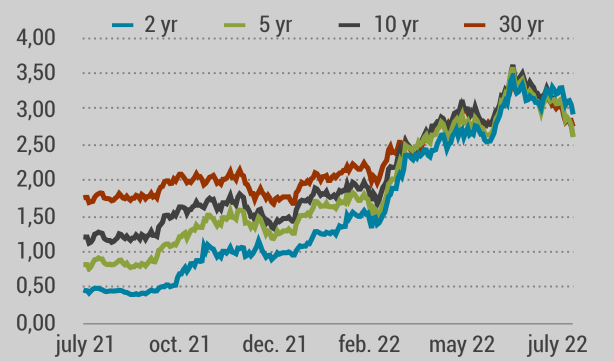
Of course, inflation must be controlled, but central banks must also consider the impact of the increases announced since the beginning of the year. Canada's key interest rate was raised by 2.25% in just four months, something that has not been seen since 1995. The consequences of these increases will not be felt for another 6 to 12 months. Central banks would like to orchestrate a soft landing for the economy, believing that they can only curb excess demand. However, their misjudgments of inflation are now forcing them to act more quickly and more forcefully, which is significantly reducing the runway.

BOND RATES

July 31, 2022	Canada	Monthly Change	Change 2022	United States	Monthly Change	Change 2022
Key Interest Rate	2,50 %	1,00 %	2,25 %	2,50 %	0,75 %	2,25 %
3 months	2,67 %	0,56 %	2,49 %	2,32 %	0,69 %	2,29 %
2 years	2,96 %	-0,13 %	2,01 %	2,88 %	-0,07 %	2,15 %
5 years	2,62 %	-0,49 %	1,36 %	2,68 %	-0,36 %	1,41 %
10 years	2,61 %	-0,61 %	1,18 %	2,65 %	-0,36 %	1,14 %
30 years	2,77 %	-0,36 %	1,10 %	3,01 %	-0,17 %	1,11 %
RRB 30 years	0,94 %	-0,42 %	1,07 %			

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 2022	Change 10 yrs month	Change 10 yrs 2022	Change 30 yrs month	Change 30 yrs 2022
Royal Bank, Bail-in-debt	AA	160	195	220	-5	75	0	80	-5	65
Royal Bank, NVCC	A	215	265	305	0	105	0	115	-5	105
Sun Life, subordinated debt	A	185	230	270	0	85	-5	90	-5	80
Hydro One	A high	100	135	160	-5	35	0	35	-5	25
Enbridge Inc	BBB high	170	215	270	-5	60	-5	60	-10	40
Altalink LP	A	95	130	155	-10	30	0	30	-5	20
GTAA	A high	100	135	160	-5	30	0	35	-5	30
Bell Canada	BBB high	155	195	235	-5	55	-10	50	-15	30
Rogers Communications	BBB	170	215	275	-5	40	-5	40	-10	40
Loblaw	BBB high	150	190	220	-5	60	-10	55	-15	30
Canadian Tire	BBB	160	205	270	-5	65	-10	60	-15	40
Province Québec	AA low	46	72	94	-1	13	-3	16	-4	20
Province Ontario	AA low	49	77	96	-1	12	-3	16	-5	18
CMHC	AAA	35	44	---	-2	4	-3	3		

Source: National Bank Financial

CREDIT MARKET

- New Canadian corporate bond new issuance totaled $4.9 billion in July, down $2.5 billion from the previous month and $5.7 billion less than in July 2021. Year-to-date, bond financings totaled $70.6 billion, down 4.6% from this time last year. The banking industry again drove new issuance in July. However, Ontario Power Generation issued a green bond maturing in 2032. This is the 3rd green bond issue for a company in the Canadian market in 2022, but the provinces and the federal government have taken up the slack this year.

- The soap opera of Rogers Communications' acquisition of Shaw Communications continued again this month. In its financial results, Rogers said the deadline was extended to Dec. 31, 2022, with the option to extend it to Jan. 31, 2023. In early July, Rogers and Shaw announced that initial mediation efforts with the Competition Bureau had not resulted in a resolution. As a result, the Competition Bureau found Quebecor's proposal to purchase Freedom to be inadequate. Nevertheless, Rogers reported satisfactory results with revenues up 8% to $3.87 billion and adjusted EBITDA of $1.6 billion, a 16% jump over last year. The debt-to-equity ratio declined from 3.4X EBITDA at the end of 2021 to 3.2X in the second quarter of this year. If the transaction is approved, this ratio will increase to 4.9X EBITDA.

- Loblaw reported its second quarter financial results. Sales were $12.85 billion, up 2.9% from the same period last year. Sales were up only 0.9% in the food sector, while its retail pharmacy division reported a 5.6% increase in sales. Sales of cough and cold products boosted pharmacy revenues, courtesy of Covid's latest wave. EBITDA was $1.5 billion, up 9% year over year, reflecting the ability to pass on higher costs to consumers and a sales mix favoring higher-margin products. However, the company says it is concerned about the effect of the loss of household purchasing power on its general merchandise sales. There was a noticeable decline during the quarter, Galen Weston said.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	July 2022	2022
Universe	100 %	3,90 %	-8,81 %
Short Term	43,0 %	1,21 %	-3,23 %
Mid Term	26,4 %	4,63 %	-7,24 %
Long Term	30,6 %	7,27 %	-16,47 %
Federal	36,8 %	3,15 %	-6,62 %
Provincial	35,0 %	5,18 %	-11,24 %
Corporates	26,0 %	3,22 %	-8,10 %
RRB		8,09 %	-10,71 %

Source: ftse.com

In addition to running counter to the government's desire to increase competition in the telephone industry, this transaction faces another hurdle; the major outage that disrupted Rogers' services in early July. The Competition Bureau may well question whether the lack of competition in this sector exposes consumers to vulnerabilities in network robustness.

Loblaw has managed to increase its revenues by 2.9% in the past year while inflation in food is 8.8% in the past year and 3.9% in health and personal care. While inflation is disrupting its general merchandise sales, it appears that sales volume in its primary business has also been affected.

STRATEGIC POSITIONNING

The war on inflation is being waged around the world. Central banks are raising interest rates at the fastest pace in decades. This sudden increase is raising fears of a recession, especially in the U.S., where the economy has recorded two consecutive quarters of contraction. As long as the job market remains robust, the economy cannot be considered to be in recession and the Fed should not deviate from its objective. However, it is possible that the pace of future hikes will be less aggressive. Without deviating from its inflation objective, the Fed will prefer to analyze the day-to-day economic data before making its next decision. This is where the task becomes more complicated for the Fed. If it continues its aggressive tightening, it will succeed in controlling inflation at the cost of a recession. On the other hand, if it takes its foot off the brake, it will allow the expansion to continue, but will fail to control inflation in the long run. Certainly, the disruptions to production lines appear to have created a high inventory problem at a time when demand is falling. A downward adjustment in some prices may be required to clear this excess inventory. However, housing and labor shortages are demographics that are expected to persist and fuel inflation over the longer term. In sum, the economy may go through a short period of downward adjustment in some prices, but if the Fed believes it has achieved its goal on inflation, it will only shift the problem and find itself behind the curve again.