MONTHLY BOND LETTER

AlphaFixe Capital

JULY 2020

ECONOMIC EVENTS

- Canada's gross domestic product grew by 4.5% in May. Despite this increase, economic activity in Canada is still 15% below the level observed in February. All 11 sub-sectors posted gains in May. Construction led the way with 17.6% growth in activity. This sector accounted for over 26% of the economic growth recorded in the country. Statistics Canada also gave a preliminary reading in June, pointing to a 5% gain. Despite this increase, GDP in the second quarter would still fall by 40% on an annualized basis.

Real estate has regained all the ground lost during the lockdown as sales jumped 15.2% year-over-year in June and prices rose 6.5% over the same period. This increase can be explained by a low level of properties for sale, deferred mortgage payments for struggling homeowners and a change in lifestyle. The home is now becoming a workplace.

- As expected, the U.S. economy collapsed in the second quarter, falling 32.9% on an annualized basis. This was the worst contraction in GDP since the Great Depression (-38.2% in the third quarter of 1932). The majority of items posted declines, including consumer spending (-34.6%), business investment (-27%) and residential real estate (-38.7%). In contrast, federal government spending (+17.4%) contributed to growth, but this was partially offset by a 5.6% decline in state and municipal spending.

The increase in new Covid cases in July is expected to slow the long-awaited economic recovery. Some southern states have had to shut down industries to control the spread of the virus. In the spring, several workers lost their jobs temporarily. The longer the health crisis continues, the more permanent the job losses will become.

- The 27 members of the European Union finally reached an agreement on a support plan that includes €390 billion in grants and €360 billion in loans. Obtaining financial aid is also tied to respect for the rule of law. The members also adopted a long-term budget of €1,074 billion covering the period 2021-2027. Of the total amount approved, 30% is to be dedicated to climate protection and all expenditure is to contribute to the EU's emission reduction.

This financial agreement was essential for the eurozone survival. The countries finally agreed to socialize their debts. Even during the sovereign debt crisis, this concept was rejected. However, the increase in cases in Spain suggests that a unified health policy should also be put forward, otherwise frugal countries will no longer want to help negligent countries.

RATE TRENDS

- The Federal Reserve maintained its monetary policy unchanged while reiterating its willingness to use all the tools at its disposal to support the economic recovery. As evidence of this intention, the Fed extended swap agreements with certain central banks until March 31st, 2021 to allow them easy access to the U.S. dollar. The Fed also announced the extension until the end of 2020 of its various credit access and asset repurchase programs.

- Minister Morneau presented an economic update on federal public finances. For the current fiscal year (2020-21), the deficit is expected to reach $343 billion or 15% of Canada's GDP. As a result, the federal debt will reach $1.2 trillion at the end of the fiscal year in March 2021. The federal government has also released its debt management strategy, which calls for a total of $409 billion in new Canada Bond issues.

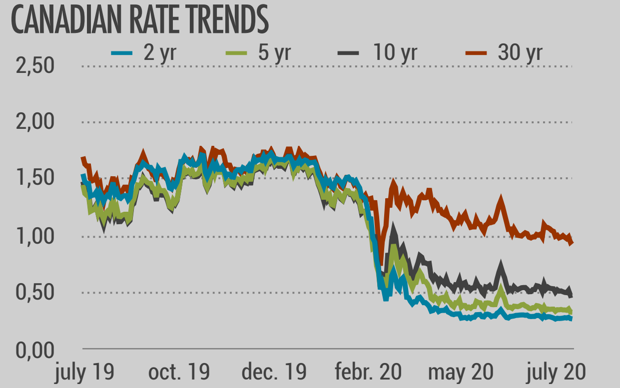
Central banks work with governments to fund their support programs. In the U.S., the Treasury plans to borrow a total of $4.5 trillion this year compared to $1.28 trillion last year. In contrast, the Federal Reserve will buy nearly $2.3 trillion in Treasury securities this year. In Canada, the borrowing program is $409 billion this year, up 229% from last year. The Bank of Canada will purchase the equivalent of $260 billion annually in federal bonds, leaving $149 billion to be absorbed by the capital market, only 20% more than last year. The modern monetary theory advocated by some Democrats is already at our doorstep.

BOND RATES

July 31, 2020	Canada	Monthly Change	Change 2020	U.S.	Monthly Change	Change 2020
Key Interest Rate	0,25 %	0,00 %	-1,50 %	0,25 %	0,00 %	-1,50 %
3 months	0,17 %	-0,04 %	-1,49 %	0,08 %	-0,05 %	-1,46 %
2 years	0,27 %	-0,02 %	-1,43 %	0,11 %	-0,04 %	-1,46 %
5 years	0,32 %	-0,05 %	-1,37 %	0,20 %	-0,08 %	-1,49 %
10 years	0,47 %	-0,06 %	-1,24 %	0,53 %	-0,13 %	-1,39 %
30 years	0,93 %	-0,06 %	-0,84 %	1,19 %	-0,22 %	-1,20 %
RRB 30 years	-0,22 %	-0,15 %	-0,60 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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CREDIT BOND RISK PREMIUMS

Issuer	Credit rating DBRS	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2020	Change 10 yrs month	Change 10 yrs 2020	Change 30 yrs month	Change 30 yrs 2020
Banque Royale, Bail-in Debt	AA	90	120	160	-20	5	-20	0	-20	0
Banque Royale, NVCC	A	140	175	225	-25	20	-25	5	-15	15
Sun Life, Subordinated debt	A	110	145	195	-40	10	-40	0	-30	10
Hydro One	A high	70	105	145	-20	10	-15	20	-10	15
Enbridge Inc	BBB high	135	175	255	-20	35	-20	25	-10	35
Altalink LP	A	65	100	140	-20	10	-15	20	-5	20
GTAA	A high	90	125	160	-5	35	0	45	0	50
Bell Canada	BBB high	115	150	215	-10	15	-10	0	-10	10
Rogers Communications	BBB	110	145	210	-10	15	-10	0	-10	5
Loblaw	BBB	105	140	205	-15	0	-10	-15	-10	-5
Canadian Tire	BBB	155	205	280	-40	55	-40	55	-25	75
Province Québec	AA low	43	72	84	-4	7	-2	13	-1	15
Province Ontario	AA low	46	75	87	-3	8	-2	13	0	14
SCHL	AAA	32	40	---	-1	3	1	2		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached $5 billion in July, down $2.7 billion from the previous month and $1 billion less than in July 2019. Since the beginning of the year, bond financings totalled $75.3 billion, 48% higher than at the same time last year. The Royal Bank has completed a $1.75 billion financing using a new bank debt structure called a Limited Recourse Capital Note. This bond has a 60-year maturity and offers a 4.5% coupon for the first 5 years. Thereafter, it will be adjusted to the 5-year Canada bond rate plus 4.137%. At the same time, the bank has issued preferred shares that will be held in trust and will serve as collateral for this note. In the event of a default, the investors would receive the preferred shares held in collateral.

- The Greater Toronto Airport Authority (GTAA) will reduce its workforce by 27% in response to the drop in air traffic since the beginning of the pandemic. A total of 500 positions will be removed, including 200 unfilled positions that will eventually be eliminated. As a result, 300 workers will be affected by this decision. These measures have been adopted to offset the effects of the lockdown on air activity. Last April, GTAA revenues fell 53.4% year-over-year while passenger volumes declined 98% over the same period. In the first quarter, passenger volumes declined 17.4% year-over-year. Despite Covid's disastrous impact on airport operations, DBRS has reaffirmed GTAA's credit rating to A(high) with a stable outlook due to its abundant liquidity reserve to weather the crisis.

- Provincial credit spreads have continued to tighten over the past month, particularly for shorter-term securities that are close to their pre-pandemic levels. The performance of provincial securities was achieved in a difficult economic environment. Combined, provincial deficits are expected to reach more than $78 billion for the current fiscal year, a six-fold increase over last year. In fact, British Columbia's economic update now projects a $12.5 billion deficit instead of the $227 million surplus projected before the pandemic. The total provincial borrowing requirement this year totals a record $157 billion with just over $41 billion (29%) to be completed only.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	July 2020	2020
Universe	100 %	1,27 %	8,89 %
Short Term	40,4 %	0,48 %	4,53 %
Mid Term	24,3 %	1,03 %	9,37 %
Long Term	35,3 %	2,36 %	13,98 %
Federal	33,0 %	0,53 %	8,08 %
Provincial	37,9 %	1,48 %	10,67 %
Corporates	27,0 %	1,85 %	7,36 %
RRB		3,45 %	9,95 %

Source: ftse.com

The federal government has helped Canada's airports by ceasing rent until December 2020. Since this is an essential service, financial support can be expected beyond the end of the year if the crisis persists or a second wave occurs. GTAA has no maturity to refinance before 2022.

Last year, the provinces issued a total of $85 billion in bonds, or 54% of this year's volume. Clearly, the provinces have benefited from the Bank of Canada's buyback program. Although the Bank of Canada has only purchased $6.6 billion in provincial securities this year, the support provided by this program is sufficient to push investors into the provincial sector.

STRATEGIC POSITIONNING

Risk factors continue to increase, but the financial markets are turning their backs. The explosion of new Covid cases in the southern United States is delaying the opening of the economy and jeopardizing the long-awaited V-shaped recovery. With this delay, temporary layoffs become increasingly permanent and create long-term scars in the economy. The risks of a second wave are materializing. Spain, Japan and Australia all recorded a marked increase in new cases after a lull in May and June. The economic logic of a cold war between the United States and China is taking shape with the formation of trade blocs in each of the poles. But why worry, governments have made it clear that they will help households and businesses with the support of central bankers. So modern monetary theory is at our doorstep. Supported by former Democratic candidate Bernie Sanders, this theory reverses the thinking of finance and economics. Instead of letting central banks control inflation with their monetary tools, the supporters of modern monetary theory prefer to modulate inflation through fiscal policy, raising taxes to slow down the economy in case of inflation. There is therefore no budgetary constraint for a country that can print money to pay the bills. Isn't that the current situation? Leaving inflation control in the hands of elected officials is a disastrous recipe. Putting the brakes on the economy is a politically unpopular decision.