MONTHLY BOND LETTER

AlphaFixe Capital

MAY 2021

ECONOMIC EVENTS

- Real gross domestic product in Canada grew at an annualized rate of 5.6% in the first quarter. Despite the health constraints imposed during the quarter, the Canadian economy proved resilient as consumer spending grew at a higher rate than the previous quarter. Investment also grew at a faster pace, particularly residential real estate which grew at an annualized rate of 43.3% in the first quarter and 26.3% over the past year. Net exports also contributed to growth. On the other hand, businesses responded to higher demand by drawing down their inventories instead of producing more. This factor alone reduced growth by 1.4% in the first quarter.

Although real GDP fell short of economists' expectations, nominal GDP, which takes into account price growth, jumped a whopping 18.4% in the first quarter, surpassing its pre-pandemic level. This strong growth was driven by the GDP deflator, which jumped 12.2% in the last quarter. In contrast, the consumer price index is up only 3.4% in the past year. What is the correct reading of the price level in the Canadian economy?

- The U.S. consumer price index jumped 0.8% in April, bringing the annual change to 4.2%. Excluding volatile food and energy items, the core index jumped 0.9% in April and 3.0% over the past 12 months. This is the highest annual growth since 1995 and the highest monthly growth since September 1981. Semiconductor chip shortages have also propelled prices higher in the automotive sector. Declining production of new vehicles and concerns about the use of the public transit system pushed consumers into the used car market. Prices for used cars rose 10% in April, bringing the annual change to 27%.

Admittedly, prices fell at the start of the pandemic last year, forcing annual changes up in April. However, the annualized change in prices over the past three months is 6.6% for the all-items index and 5.6% for the core index, well above the Fed's target. Furthermore, when comparing the price level to February 2020, the all-items index shows an annualized increase of 2.2% and the core index shows an annualized increase of 1.9%, close to the Fed's target of 2%.

- The Markit index of European manufacturing activity rose to 62.9 in April, an all-time high. Production, new orders, and employment continue to rise while delivery times remain problematic, reaching an all-time high since the series began (June 1997). Purchasing managers also reported a sharp rise in input costs, the second highest in history.

Input costs are rising around the world. Businesses are increasingly able to pass on these increases to consumers, as certain imbalances between supply and demand for inputs will not be resolved in the short term, a recipe for inflation.

RATE TRENDS

- The Bank of England kept its policy rate at 0.10% and maintained the size of its bond-buying program at £895 billion. However, one member of the committee disagreed with the decision, preferring to reduce the size of the program by £50 billion, fearing inflationary pressures from the measures in place. The Bank also raised its economic outlook by 2.5%, now forecasting growth of 7.5% this year. This would be the highest rate of growth in more than 70 years if realized.
- According to the minutes of the last Federal Reserve meeting, some members suggested that it would be appropriate to begin discussions of a plan to reduce the bond purchase program at future meetings if the strong economic recovery continues.

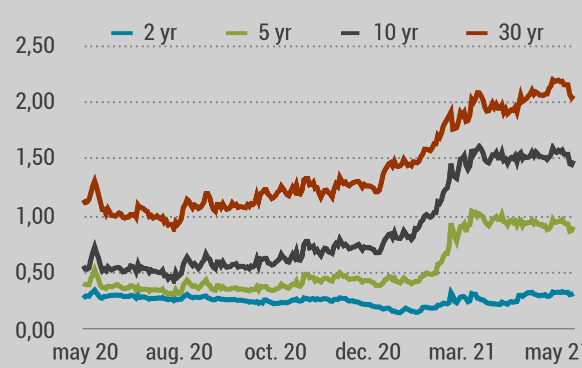
The fiscal and monetary measures in place since the pandemic have propelled the global economy and have raised fears of inflationary pressures everywhere. Central bankers all seem to be using the same supportive rhetoric as long as the health risks remain and the recovery is not established in an inclusive manner. Nevertheless, this approach brings its own inflationary risk that central banks are willing to bear. The longer they delay withdrawing support, the greater the chance that they will have to act quickly, forcefully and at higher rates to catch up.

BOND RATES

May 31, 2021	Canada	Monthly Change	Change 2021	United States	Monthly Change	Change 2021
Key Interest Rate	0,25 %	0,00 %	0,00 %	0,25 %	0,00 %	0,00 %
3 months	0,11 %	0,01 %	0,04 %	0,00 %	0,00 %	-0,06 %
2 years	0,32 %	0,02 %	0,12 %	0,14 %	-0,02 %	0,02 %
5 years	0,91 %	-0,03 %	0,51 %	0,80 %	-0,05 %	0,44 %
10 years	1,49 %	-0,06 %	0,81 %	1,59 %	-0,03 %	0,68 %
30 years	2,03 %	-0,05 %	0,82 %	2,28 %	-0,01 %	0,64 %
RRB 30 years	0,22 %	-0,18 %	0,52 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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CREDIT BOND RISK PREMIUMS

Émetteurs	Credit Rating DBRS	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2021	Change 10 yrs month	Change 10 yrs 2021	Change 30 yrs month	Change 30 yrs 2021
Royal Bank, Bail-in-debt	AA	65	100	145	0	0	0	-5	0	-10
Royal Bank, NVCC	A	95	135	185	0	-5	0	-5	0	-10
Sun Life, subordinated debt	A	80	120	170	0	-10	0	-10	0	-15
Hydro One	A high	60	90	125	-5	10	0	5	-5	-5
Enbridge Inc	BBB high	95	145	225	0	0	0	-5	5	-10
Altalink LP	A	60	85	120	-5	10	0	5	-5	-5
GTAA	A high	65	95	135	0	15	0	10	0	5
Bell Canada	BBB high	90	135	200	0	10	0	5	0	0
Rogers Communications	BBB high	105	150	220	5	25	0	20	-5	20
Loblaw	BBB high	85	130	190	0	10	0	5	0	-5
Canadian Tire	BBB	100	150	240	0	5	0	-5	-5	-15
Province Québec	AA low	28	55	72	-3	-2	-5	-2	-3	-7
Province Ontario	AA low	33	61	76	-2	-2	-4	-1	-2	-5
CMHC	AAA	23	31	---	-1	2	-6	-1		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate new bond issuance totaled $7.3 billion in May, down $2.9 billion from the previous month and $10.3 billion less than in May 2020. Year-to-date, bond financings totaled $47.7 billion, down 24% from last year. Of the total issued in May, $500 million came from Bell Canada in its first sustainable bond issue maturing in 2028. With a coupon rate of 2.20%, the bond is part of the company's new sustainable financing framework that requires Bell Canada to provide allocation and impact reports until the proceeds of the issue are allocated to green or social projects. The issue attracted 85 buyers, reflecting the growing popularity of sustainability or green bonds.

- S&P downgraded the Province of Alberta's credit rating from A+ to A with a stable outlook. In justifying its decision, S&P cited the fact that the province has experienced two powerful economic shocks in the past six years. Prior to the pandemic, Alberta had to deal with the collapse of oil prices in late 2014 that weakened public finances. Subsequently, measures adopted to control the pandemic inflated health care spending while reducing tax revenues. As a result, the province's fiscal position deteriorated and the tax-borne debt burden increased by a greater proportion than is the case for other Canadian provinces.

- Pembina Pipeline Corporation reached an agreement to acquire Inter Pipeline Ltd. (IPL) in an all-stock deal that values IPL at $8.3 billion. This is a 17.8% premium to the hostile offer that was filed by Brookfield Infrastructure Partners in February. "The transaction will create one of the largest energy infrastructure companies in Canada, with a pro forma enterprise value of $53 billion and a highly connected and complementary asset base." Since the transaction is being done on an equity basis, debt to EBITDA ratios are not expected to change or at best improve if the estimated $150-200 million in synergies are applied to the combined business.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	May 2021	2021
Universe	100 %	0,63 %	-4,38 %
Short Term	41,4 %	0,09 %	-0,31 %
Mid Term	25,3 %	0,54 %	-3,49 %
Long Term	33,3 %	1,39 %	-9,90 %
Federal	34,3 %	0,30 %	-3,45 %
Provincial	37,4 %	1,02 %	-6,14 %
Corporates	26,2 %	0,49 %	-3,01 %
RRB		3,69 %	-5,60 %

Source: ftse.com

This downgrade reflects the lack of diversification of the economy and the fiscal choices of elected officials. Alberta has a lower rating than Quebec despite a lower debt ratio. Alberta has the flexibility to raise tax rates or introduce a sales tax that would reduce the debt burden, but lacks the political will to do so.

The battle for IPL is not over, however, as Brookfield has upped its bid by offering 4.4% more than Pembina, of which nearly three-quarters would be paid in cash and only 26% in share exchange. Brookfield intends to directly court IPL shareholders to accept the offer, going above the board of directors that approved Pembina's offer, an unusual practice.

STRATEGIC POSITIONNING

"We have supply problems", "there are delivery delays" or "this product is out of stock", these are some of the phrases we hear recently during our trips to the malls. But here is a new shortage; workers. The number of job openings in April increased by 1 million from the previous month to a record 9.3 million in the United States. Clearly, there is a major imbalance in the labor market between supply and demand, as exactly the same number of people were unemployed in May. Businesses are constantly facing the same obstacles in finding qualified workers. Some schools still teach remotely, leaving families without childcare options. In addition, businesses must compete with enhanced employment insurance support programs that delay the appetite of the unemployed to return to the workforce. This competition is even more pronounced in low-income, high physical proximity industries such as food service and leisure. There were 1.34 million job openings in food service, up 349,000 over the month. This means business leaders must attract workers with higher wages or bonuses. These labor cost increases are in addition to other input price increases that will have to be passed on to consumers or absorbed by profit margins or a combination of both.