

MONTHLY BOND LETTER

AlphaFixe
Capital

April 2021

ECONOMIC EVENTS

- The Government of Canada has presented its first budget in 25 months. Nearly 200 measures are proposed in a three-year, \$101 billion economic stimulus package with almost half of which (\$49 billion) will be spent in the current fiscal year. The deficit will fall from \$354 billion (16.1% of GDP) last year to \$154.7 billion this year (6.4% of GDP). There is no plan to return to a balanced budget, while the federal government still expects a \$30.7 billion deficit in 2025-26. The flagship measure of the economic stimulus plan is the introduction of a national \$10 child care program. Modelled on the Quebec program, the child care system will increase women's labour force participation and support economic growth.
- The U.S. economy grew at an annualized rate of 6.4% in the first quarter, an improvement over the previous quarter's 4.3%. Consumer spending contributed strongly to this growth with a 10.7% gain, propelled by stimulus checks distributed during the quarter (\$2,000 in total). Business investment (9.9%), residential real estate (10.8%) and government spending (6.3%) also contributed to growth. This high demand meant that businesses drew down their inventories and the U.S. had to import more goods than it exported. As a result, both of these items slowed growth in the first quarter.
- After posting its worst contraction in decades in the first quarter last year, China's economy has grown 18.3% over the past 12 months. The recovery was initially orchestrated by the authorities with a boost to industrial production. However, consumers have recently recovered, with retail sales jumping 34.2% in the past year and industrial production growing 14.1% over the same period.

In sum, governments do not want to repeat the mistakes of past crises by withdrawing support too early in a return to balanced budgets. However, the federal government is counting on strong economic growth and low interest rates to stabilize public finances, two elements that are beyond their control. In fact, the Parliamentary Budget Officer has said that the government is overestimating the economic impact of the \$101 billion stimulus package, as only \$69 billion is real stimulus spending.

As the vaccination campaign progresses, households will be able to deploy the savings they have accumulated since the beginning of the pandemic. This pent-up demand will support the economy in the coming quarters. Infrastructure investment programs (\$4.1 trillion in total) will also boost government spending and GDP in the coming years.



These annual numbers are impressive, but looking at the quarterly changes paints a different picture. China's economy fell 9.3% quarter-over-quarter in March 2020 and then ended the year in positive territory. However, growth in the first quarter of 2021 is only 0.6%, the slowest pace in recent years.

Given the 25% reduction in the federal deficit, the Bank had no choice but to reduce its purchases. By closing the output gap more quickly, the Bank seemed to be indicating that it would begin its rate hikes sooner than anticipated. However, Tiff Macklem emphasized that future hikes must be result-based given the uncertainties around the forecast. Since there is a lag of about a year before the rate hike has any effect on the economy, waiting for the results means that the Bank will be behind the curve and will have to act more quickly to slowdown the economy.

RATE TRENDS

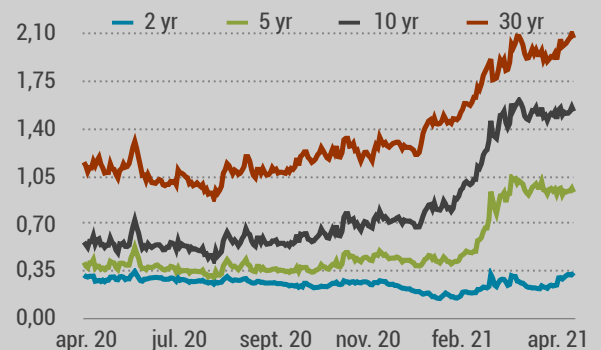
- The Bank of Canada kept its key interest rate unchanged at its April meeting while reducing the size of its weekly federal bond purchases from \$4 billion to \$3 billion as planned. However, the Bank did not mention where on the curve they will reduce their purchases. The Bank drew an optimistic picture of the global and Canadian economy. "The outlook for the global and Canadian economies has improved. Business has proven to be more resilient than expected in the face of the Covid-19 pandemic, and vaccine deployment is progressing." As a result, it expects growth of 6.5% this year, up 2.5% from its last forecast. The strength of the recovery means that excess capacity in Canada should be filled in the second half of next year instead of 2023.

BOND RATES

		Monthly Change	Change 2021		Monthly Change	Change 2021
Apr. 30 2021						
Key Interest Rate	0,25 %	0,00 %	0,00 %	0,25 %	0,00 %	0,00 %
3 months	0,10 %	0,01 %	0,03 %	0,00 %	-0,01 %	-0,06 %
2 years	0,30 %	0,08 %	0,10 %	0,16 %	-0,00 %	0,04 %
5 years	0,93 %	-0,06 %	0,54 %	0,85 %	-0,09 %	0,49 %
10 years	1,55 %	-0,01 %	0,87 %	1,63 %	-0,11 %	0,71 %
30 years	2,08 %	0,10 %	0,87 %	2,30 %	-0,11 %	0,65 %
RRB 30 years	0,40 %	0,16 %	0,70 %			

Source: Bloomberg

CANADIAN RATE TRENDS



CREDIT BOND RISK PREMIUMS

Issuer	Credit Rating DBRS	Change								
		Spread			5 yrs		10 yrs		30 yrs	
		5 yrs	10 yrs	30 yrs	month	2021	month	2021	month	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	-5	-10	-5	-10	-5	-15
Hydro One	A high	65	90	130	5	15	5	5	5	0
Enbridge Inc	BBB high	95	145	220	0	0	0	-5	0	-15
Altalink LP	A	65	85	125	5	15	5	5	5	0
GTAA	A high	65	95	135	0	15	0	10	0	5
Bell Canada	BBB high	90	135	200	5	10	0	5	0	0
Rogers Communications	BBB	100	150	225	0	20	0	20	0	25
Loblaw	BBB high	85	130	190	5	10	5	5	0	-5
Canadian Tire	BBB	100	150	245	5	5	0	-5	5	-10
Province Québec	AA low	31	60	75	-2	1	1	3	-4	-4
Province Ontario	AA low	35	65	78	-2	0	0	3	-3	-3
CMHC	AAA	24	37	---	-1	3	-1	5		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance totaled \$10.2 billion in April, down \$3.6 billion from the previous month and \$8.2 billion less than in April. Year-to-date, bond financings totaled \$40.4 billion, down 10% from last year. Among the issuers in April was Aéroports de Montréal (ADM), which completed a \$400 million financing with a 30-year term. The proceeds of this issue will be used to finance ADM's general operations, as well as its capital program. In April, the federal and provincial governments reached an agreement on a financing package that will allow for the construction of a REM station at Pierre Elliott Trudeau International Airport.
- The Province of British Columbia has presented its budget for the 2021-2022 fiscal year. The province anticipates a deficit of \$9.7 billion (3.1% of GDP) due to the combined effect of lower revenues (-3.3%), higher spending (4.5%) and a pandemic contingency fund totalling \$4.25 billion. A return to a balanced budget is not expected for another 7 to 9 years. Revenues are declining due to lower federal transfers and tax revenues, specifically corporate taxes. Health care spending will increase during the pandemic, including spending on vaccinations, personal protective equipment and testing. The province also wants to boost the economy with \$3.5 billion in infrastructure spending over the next three years. Debt to GDP is expected to rise from 15% before the pandemic to a peak of 26.9% in 2023-24.
- Canada's two major railroads, CN and CP, competed to acquire Kansas City Southern (KCS), a U.S. railroad that provides access to ports on the Pacific Ocean and Gulf of Mexico, as well as routes to Mexican auto plants. Initially, CP submitted an offer totalling \$25.2 billion, which was approved by the KCS board of directors. However, CN followed up with an offer of US\$33.7 billion in cash and stock. This offer gives KCS shareholders twice the cash portion of CP's offer, reducing uncertainty for shareholders. Canadian Pacific may soon increase its offer to compete with CN.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Apr. 2021	2021
Universe	100 %	0,06 %	-4,98 %
Short Term	42,2 %	0,18 %	-0,40 %
Mid Term	25,2 %	0,55 %	-4,00 %
Long Term	32,6 %	-0,50 %	-11,14 %
Federal	34,5 %	-0,01 %	-3,73 %
Provincial	37,2 %	0,15 %	-7,09 %
Corporates	26,2 %	0,01 %	-3,48 %
RRB		-1,79 %	-8,96 %

Source: ftse.com

The province has delivered a fairly conservative budget, with almost 44% of the deficit coming from the Covid Contingency Fund, the cushion in case of problems. In addition, the province is counting on GDP growth of 4.4% this year, which is far below the Canadian economy's growth forecast of over 6% in 2021.

Should CP match CN's offer? CN's offer, while higher, could be blocked by U.S. regulators given the overlapping routes between the two entities, creating the 3rd largest railroad in North America. CP must therefore assess the risk of its Canadian competitor's failure before the competition bureau before raising its price.

STRATEGIC POSITIONNING

The debate has been launched. Will the inflation we are seeing everywhere be transitory or are we in the midst of a structural change that will raise prices over the longer term? Central bankers are arguing that there will be a transitory rise in inflation due to the base effect from last's year weak prices. In addition, the shortages experienced due to disruptions in global supply chains should also be resolved as the pent-up demand from the pandemic runs out. Production will adjust and inflation will return to control. But what if the shortages continue? Semiconductor chip industry executives have indicated that the imbalance could last a few years, illustrating the concentration of production lines in Asia. Repatriation of some production lines is therefore becoming a priority to ensure independence and prevent shortages of essential goods. The environmental costs will also have to be taken into consideration in the future. Central bankers are on a slippery slope, hoping that inflation expectations will remain anchored. Consumers have not faced product shortages in decades and their perception of prices may change if they want to secure their purchases. The recovery is taking hold quickly and the inflationary signs typically seen at the end of the cycle could manifest themselves more quickly this time around.