MONTHLY BOND LETTER

AlphaFixe Capital

JANUARY 2018

ECONOMIC EVENTS

- National Bank's composite house price index rose 0.2% in December, bringing the annual change to 9.1%. Gains were recorded in Vancouver (1.3%), Winnipeg (1.9%) and Ottawa (0.4%), offsetting declines in six other cities, including Toronto, Calgary and Montreal. Despite a decline in the past 5 months, home prices in Toronto are still up 9.0% in 2017. However, Vancouver is the winner with a 16% year-over-year growth. Significant gains were also recorded in Montreal (7.0%).

It will be interesting to see how the new mortgage rules will affect prices and sales starting in January. However, as long as the mortgage debt service remains low and employment robust, households should fulfill their mortgage payments and prevent a housing meltdown.

- The US economy grew at an annualized rate of 2.6% in the last quarter of 2017, bringing the growth rate to 2.3% in 2017. Supported by a robust job market, consumer spending increased by 3.8%, mainly due to strong sales in durable goods. Corporate investments were also strong (6.8%), driven by significant gains in equipment expenditures (11.4%). In contrast, foreign trade weakened growth, but mainly because imports jumped 13.9%, doubling the growth of export (6.9%).

Although the first GDP reading has been below expectations, we should not worry too much, because the weakness lies mainly in increased imports, a sign that domestic demand is strong. Moreover, labour shortage seems to encourage companies to invest in equipment in order to meet growing demand.

- Europe's GDP grew by 2.3% on an annualized basis in the fourth quarter, a 19th straight quarter of gains. This brings 2017 growth to 2.5%, the strongest in 10 years, surpassing even US economy. On the other hand, Great Britain GDP grew by 1.8% in 2017, 0.1% less than in 2016.

The Eurozone is getting brighter while Brexit's uncertainty is hurting Great Britain's economy. Paradoxically, the Bank of England is tightening its monetary policy while the European Central Bank (ECB) continues to inject liquidity.

RATE TRENDS

- The Bank of Canada raised its policy rate by 0.25% to 1.25%. The Bank had already indicated that it would dictate its policy based on incoming economic data. However, strong job growth recently has forced the Bank to take note and recognize that the economy is nearing its potential level. On the other hand, uncertainty surrounding NAFTA renegotiations is weighing more and more on the outlook, forcing the Bank to foresee negative consequences for investments and exports.

The period of uncertainty with NAFTA could stretch. The Mexican presidential elections on July 1 and the mid-term congressional elections in November will put a hold on negotiations, unless Trump rejects NAFTA to galvanize its supporters in the fall.

- At the last meeting chaired by Janet Yellen, the Fed committee decided to keep the policy rate at 1.5%. Although the committee has highlighted employment strength, household spending and corporate investment, the status quo is justified by below-target inflation. Nevertheless, the Fed seems more and more confident to reach the target in the near future and still considers it appropriate to reduce monetary easing gradually.

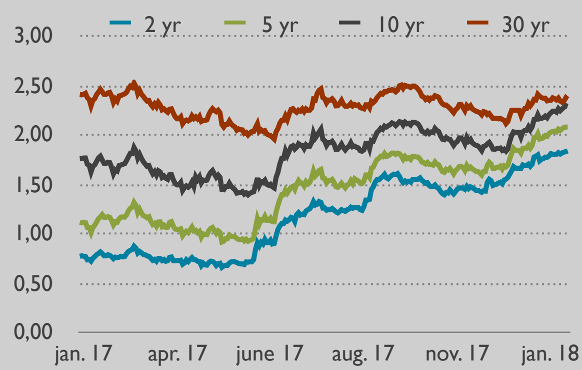
The Fed is more confident of reaching its inflation target, opening the door to a rate hike in the near future. Multiple company announcements of corporate tax savings redistribution to employees, in the form of bonuses or wage increases should further support demand and fuel inflation.

BOND RATES

Jan. 31 2018	Canada	Monthly Change	Change 2018	United States	Monthly Change	Change 2018
Key Interest Rate	1,25 %	0,25 %	0,25 %	1,50 %	0,00 %	0,00 %
3 months	1,20 %	0,14 %	0,14 %	1,46 %	0,08 %	0,08 %
2 years	1,84 %	0,15 %	0,15 %	2,14 %	0,26 %	0,26 %
5 years	2,08 %	0,21 %	0,21 %	2,51 %	0,31 %	0,31 %
10 years	2,29 %	0,24 %	0,24 %	2,71 %	0,30 %	0,30 %
30 years	2,36 %	0,09 %	0,09 %	2,93 %	0,19 %	0,19 %
RRB 30 years	0,59 %	0,02 %	0,02 %			

Source: Bloomberg

CANADIAN RATE TRENDS



CREDIT BOND RISK PREMIUMS

ISSUER	Credit rating DBRS	Credit rating S&P	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2018	Change 10 yrs month	Change 10 yrs 2018	Change 30 yrs month	Change 30 yrs 2018
Royal Bank, deposit notes	AA	AA-	65	85	125	-10	-10	-5	-5	-5	-5
Manulife, Senior debt	A high	A+	80	105	150	-10	-10	-10	-10	-15	-15
Fortis Inc.	BBB high	BBB+	80	120	155	-10	-10	-15	-15	-10	-10
Hydro One	A high	A	60	80	125	-5	-5	-5	-5	-5	-5
Enbridge Inc	BBB high	BBB+	100	145	210	-15	-15	-20	-20	-15	-15
Encana Corp	BBB low	BBB	120	180	245	-10	-10	-10	-10	-20	-20
GTAA	---	A+	50	70	85	0	0	0	0	0	0
Bell Canada	BBB high	BBB+	90	140	200	-5	-5	-5	-5	0	0
Rogers Communications	BBB	BBB+	80	130	195	-10	-10	-10	-10	-5	-5
Loblaw	BBB	BBB	90	140	195	-5	-5	-5	-5	-5	-5
Canadian Tire	BBB high	BBB+	95	145	200	-5	-5	-5	-5	-5	-5
Province of Québec	A high	A+	35	55	67	-1	-1	0	0	2	2
Province of Ontario	AA low	A+	38	58	69	0	0	-1	-1	2	2
CMHC	AAA	AAA	25	34	---	-2	-2	-1	-1		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached $ 6.4 billion in January, an increase of $ 2.9 billion compared to the previous month, but $ 1.3 billion less than in January 2017. Companies also carried out several floating rate financings. In fact, there was a total of $ 5.2 billion in floating-rate debt issues in January alone, $ 600 million less than all 2017. We must go back to the third quarter of 2013, when the Fed had just indicated that it would reduce the pace of its asset purchases, to see such enthusiasm for floating rate products. At that time, Canadian companies had issued $ 5.7 billion of floating rate securities in one quarter, primarily due to strong investor demand.
- The Province of Ontario has presented an innovative solution to fund the 25% decline in electricity rates put in place in 2017. Instead of widening the deficit of the province by this shortfall, the Liberal government has created a financing vehicle called Fair Hydro Trust with the objective of borrowing a total of $ 20 billion, including $ 10 billion through capital markets. Fair Hydro Trust's debt will be repaid with higher electricity bill rates for Ontarians starting in 2021. Given the structure, Fair Hydro Trust will be included in the corporate bond index, despite its taxation power of Ontario's electricity consumers.
- Thomson Reuters, a Canadian company, announced that it would divest 55% of its Financial and Risk division to BlackStone Group LP for $ 17 billion. Thomson plans to use nearly $ 3 billion of the proceeds to pay down debt, invest $ 1 to $ 3 billion in its Legal and Accounting units and deploy $ 9 to $ 11 billion in a share buyback program. As a result of this announcement, Moody's and S&P rating agencies placed their respective credit ratings under review with negative outlook. The agencies are concerned about a 50% decline in Thomson's revenue and concentration in two divisions - Legal (63%) and Accounting and Tax units (27%).

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Jan. 2018	2018
Universe	100 %	-0,80 %	-0,80 %
Short Term	45,6 %	-0,22 %	-0,22 %
Mid Term	22,1 %	-1,13 %	-1,13 %
Long Term	32,3 %	-1,37 %	-1,37 %
Federal	37,0 %	-0,77 %	-0,77 %
Provincial	33,9 %	-1,26 %	-1,26 %
Corporates	27,2 %	-0,24 %	-0,24 %
RRB		-0,42 %	-0,42 %

Source: ftse.com

In recent years, electricity rates have risen because of the higher cost of clean energy production. The government has decided to help taxpayers today and then spread these rates to future generations, plus additional financing cost from 2021.

Even though the amount allocated to repay debt will allow Thomson Reuters to maintain a debt ratio close to 2.5 times EBITDA, the reduction in business diversification still raises the level of risk for lenders. The rating may be downgraded, but should remain investment grade.

STRATEGIC POSITIONNING

The US economy is strengthening and Trump's tax plan adds fuel at a time when the economic situation does not require it. Tax cuts, mainly for corporations and the wealthy, will ultimately affect the middle class. Several companies like Apple, AT & T, Boeing and Comcast have announced that they will use tax-saved money to distribute bonuses and increase employee's wages. In recent years, this tax savings would have been distributed to shareholders in the form of share buybacks or special dividends. The difference today is the strength of the labor market, which creates a shortage of skilled labor, could lead companies to take steps to retain their employees. The 2.9% annual wage growth in January is evidence of a strong labor market that could be passed on to consumers and force the Fed to tighten monetary policy further. The stock market drop in the beginning of February is a reflection of this reality. Higher wages reduce corporate profit margins and point to a higher policy rate, two factors that investors fear. Stock market volatility therefore illustrates a market adjustment towards a robust economy without monetary crutch rather than the fear of a recession.