MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

FEBRUARY 2023

- The Canadian economy stalled in the last quarter of the year after growing by 2.3% in the previous quarter. Consumer spending grew by 2.0% after declining by 0.4% in the third quarter. Government spending continued to grow, but at a slower pace, while international trade again contributed to growth due to lower imports. On the other hand, residential real estate posted a third straight quarter of decline and businesses also cut back on investment, especially in machinery and equipment. They also drew down inventories to meet demand rather than produce more. This sharp reduction in inventories was the biggest contributor to the GDP deceleration.

Here is a perfect example where the headline can be misleading, as the details speak louder than the header suggests. Looking at final domestic demand, which strips out international trade and inventory changes, it grew by 1.2% in the fourth quarter, in contrast to a 0.8% contraction in the previous quarter. All in all, monetary policy has had a rapid impact on the cost-sensitive housing market, but does not appear to be dampening consumer appetite.

- Inflation in the U.S. appears to be more difficult to control than investors had anticipated. Indeed, the consumer price index rose by 0.5% in January, driven by energy (2.0%) and food (+0.5%) prices, bringing the annual change to 6.4%, down 0.1% from December. However, excluding these two volatile items, the core index was up 0.4% month-over-month and 5.6% year-over-year. Moreover, the last 3 month annualized inflation rate adds up to 4,6 %, far from the Federal Reserve's 2% target. Prices for services excluding housing and energy are up 6.1% year-over-year, triple the inflation target.

Armed with a huge savings reserve from the pandemic and propelled by a strong job market, consumers are still flocking to shopping malls, helping to keep pressure on prices. Retail sales rose 3% month-over-month in January, led by a 5.9% jump in sales at dealerships. Strong demand for financed goods signals that monetary policy is not yet tight enough.

- The Chinese government is reaping the economic rewards after abandonning its zero-Covid restrictions late last year. The national manufacturing activity index rebounded in February, climbing to 52.6, up 2.5 points from January. This is the highest reading since April 2012. The expansion is seen in production as well as new orders, employment and exports. The situation is similar for service industries. The activity index rose from 54.4 in January to 56.3 the following month with expansions in all industries.

However, care must be taken in interpreting these statistics. This is a survey and when an executive is asked if they have seen a contraction, stability or expansion in their business, it is normal for them to mention an expansion after a lockdown. This does not mean that the level of production and activity is back to normal and similar to 2021.

RATE TRENDS

- The Federal Reserve raised its policy rate on February 1st, setting the stage for other central banks to follow suit during the month. The Riksbank in Sweden continued its monetary tightening by raising its key rate by 0.50% to 3.0%. And that's not all. The central bank also announced that it will sell government bonds starting in April to reduce its assets at a faster pace. In Oceania, the Bank of New Zealand raised its policy rate by 0.50% to 4.75%. This is the 10th consecutive hike for a total of 4.50% since October 2021, the most aggressive tightening since 1999. Australia also raised its policy rate, but at a slower pace, jumping 0.25% to 3.35%. The latter two banks have indicated that further increases will occur over the course of the year.

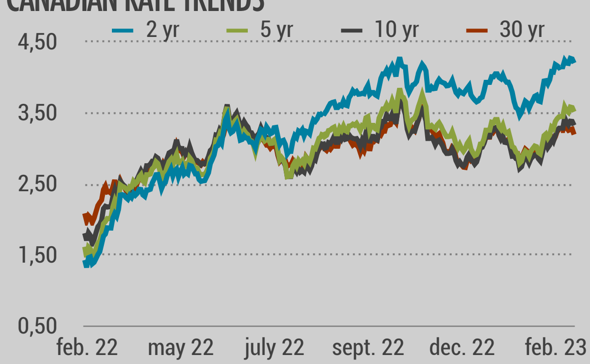
Annual inflation rates around the world are expected to decelerate in the coming months as a result of the base effect. Does this mean central banks should let their guard down? On the contrary. To ensure a sustained return to the 2% target, monetary policies will have to be restrictive for a longer period of time. Skeptical about this possibility, investors have had to resign themselves to the idea that there will be no rate cuts this year. This change in outlook stems primarily from an economy that appears more resilient than expected, but also from the tougher rhetoric of central banks that do not want to repeat the mistake of the 1970s.

BOND RATES

Feb. 28, 2023	Canada	Monthly Change	Change 2023	U.S.	Monthly Change	Change 2023
Key Interest Rate	4,50 %	0,00 %	4,25 %	4,75 %	0,25 %	4,50 %
3 months	4,52 %	0,10 %	0,26 %	4,77 %	0,13 %	0,43 %
2 years	4,21 %	0,45 %	0,15 %	4,82 %	0,61 %	0,39 %
5 years	3,52 %	0,49 %	0,11 %	4,18 %	0,56 %	0,18 %
10 years	3,33 %	0,41 %	0,03 %	3,92 %	0,41 %	0,05 %
30 years	3,20 %	0,23 %	-0,08 %	3,92 %	0,28 %	-0,05 %
RRB 30 years	1,25 %	0,18 %	0,05 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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	140	175	205	5	-25	5	-25	5	-25
Royal Bank, NVCC	A	190	235	275	5	-35	5	-35	5	-35
Sun Life, subordinated debt	A	175	215	245	10	-25	10	-25	10	-25
Hydro One	A high	100	130	155	5	-10	5	-10	10	-5
Enbridge Inc	BBB high	160	205	250	10	-15	10	-10	10	-10
Altalink LP	A	100	130	155	5	-5	5	-5	10	0
GTAA	A high	95	120	145	0	-10	0	-15	5	-10
Bell Canada	BBB high	140	185	220	10	-20	15	-10	15	-5
Rogers Communications	BBB	165	220	260	10	-15	15	-5	10	-10
Loblaw	BBB high	130	170	195	5	-20	5	-15	5	-15
Canadian Tire	BBB	150	195	240	5	-20	5	-15	5	-15
Province Québec	AA low	35	65	89	-2	-11	-4	-7	-3	-5
Province Ontario	AA low	37	67	90	-2	-11	-4	-7	-3	-5
CMHC	AAA	25	40	---	-1	-11	-1	-6		

Source: National Bank Financial

CREDIT MARKET

- New Canadian corporate bond issuance reached $5.3 billion in February, down $4.5 billion from the previous month and $300 million less than in February 2022. Year-to-date, bond financings total $15.2 billion, down 2% from the same period last year. Investors have regained their appetite for credit securities at the beginning of the year. In the first two months of the year, corporate bonds have returned 1.44%, 0.97% more than federal bonds. The situation is similar for the U.S. high-yield bond market, where spreads have narrowed by 0.60% in two months to close February at 4.21%.

- Moody's announced that it was downgrading Telus' credit rating from Baa1 to Baa2. As a result of this decision, the outlook was changed from negative to stable. Moody's justifies that this change was necessary to reflect a riskier profile of the company following recent acquisitions. "The downgrade reflects the company's willingness to tolerate high financial leverage through a number of debt-financed acquisitions and spectrum purchases," Moody's said. In addition, Telus has shown no commitment to de-leveraging the company in the coming quarters. Nonetheless, Moody's believes that being the second largest telecom provider strengthens Telus' business profile, while diversifying into other areas of the business is an asset.

- Alberta and British Columbia have each presented their budgets for the 2023-24 fiscal year. In the case of Alberta, the financial surplus is reduced from $10.4 billion (2022-23) to $2.4 billion including a $1.5 billion contingency fund. Revenues are expected to decline by 7% due to an economic slowdown and a lower oil price ($79 per barrel versus $90.50 in 2022-23). On the other hand, spending is up 3.9 per cent, especially on health care. In British Columbia, the budget balance moves from a surplus of $3.6 billion in 2022-23 to a deficit of $4.2 billion in 2023-24. Again, the projected economic downturn is expected to reduce the province's tax revenues, but the province plans to increase spending by 7.8%. Health care and housing affordability remain spending priorities.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Feb. 2023	2023
Universe	100 %	-1,99 %	1,04 %
Short Term	42,5 %	-0,76 %	0,59 %
Mid Term	27,7 %	-2,53 %	0,67 %
Long Term	29,7 %	-3,22 %	2,06 %
Federal	37,5 %	-1,96 %	0,47 %
Provincial	34,4 %	-2,39 %	1,34 %
Corporates	26,1 %	-1,50 %	1,44 %
RRB		-2,59 %	-0,92 %

Source: ftse.com

Financing new spectrum with debt is a common practice for a telecom provider. What is more worrisome is the additional debt for complementary activities that brings integration risk. In addition, the rank of this new debt is structurally higher than the existing debt, a worrisome trend that we are monitoring closely.

As the economy enters a downturn, provincial finance ministers want to continue to support growth through significant spending expansion. This fiscal stimulus is not expected to affect credit in these provinces, which still have very low debt ratios. On the other hand, the spring election in Alberta could change the financial picture during the year.

STRATEGIC POSITIONNING

Last month, investors were anticipating that the Federal Reserve would raise its policy rate to 5% in the first half of the year and then cut it by 0.50% in the last six months of the year in response to the economic slowdown. A month later, the outlook has changed. The economy is stronger than expected, the job market shows no signs of slowing and inflation is more persistent. As a result, the scenario of a more aggressive policy rate hike held for a longer period of time is gaining support. At the end of February, the forecast for the policy rate this year was now 5.5%. In Canada, the central bank has signaled a pause, but the next change in the policy rate may well be an increase. While annual inflation rates will decelerate soon, a return to the 2% target is a more difficult project to achieve. The excess savings from the pandemic are still with us, and businesses are still struggling to attract workers to their facilities. Last year, high inflation was eating into personal purchasing power. This year, inflation is decelerating, but wages are still rising. This could lead to a situation where real wages are positive and contributing to growth. Getting inflation back to 2% will require an easing of labour market conditions, which could lead to a recession. A recession is not imminent, but it will be difficult to avoid.