MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

DECEMBER 2016

- Canadian employment reported strong growth of 54,000 in December, bringing the unemployment rate to 6.9 %. Full-time jobs jumped by 81,000 while part-time jobs fell by 27,000. Throughout 2016, Canada created 214,000 jobs, mainly part-time (+ 153 700) and mostly during the second half. Quebec stood out in 2016 with 89,000 full-time jobs, which brought unemployment rate to an all-time low of 6.2 % in November. However, Alberta has continued to lose jobs during the year (-19,000), bringing its unemployment rate to 8.5 % compared to 4.8 % just two years ago.

More jobs were created in the past 12 months than in the previous year, but the quality has deteriorated. In 2015, full-time employment (+ 147 000) greatly surpassed part-time jobs (+ 8 000). On a more positive note, more than half of the employees chose to work part-time in 2016 for education reasons and very few invoked economic reasons or inability to find a full-time position.

- The U.S. dollar continues to rise against other major currencies. The dollar index reached its highest level since 2002 at 103.3, an increase of 29 % in three years and 5.6 % since the presidential election. The strength of the greenback is a problem to foreign companies having contracted U.S. dollar-denominated debt. According to the Bank of International Settlements, debt in US dollars of non-financial companies in developing countries rose from 60 % of their combined GDP in 2006 to more than 110 % at the end of 2015.

Investors search for yield has helped emerging countries to avoid capital flight. However, today's higher yield on the North American bond markets could adversely affect those countries.

- The Treasury Department announced that China reduced US Government bond holdings by $ 41.3 billion in October to $ 1 120 billion, its lowest level in 6 years. Sale proceeds helped support the falling Chinese currency. As such, Japan has become the largest foreign creditor of the United States with $ 1 130 billion in Treasury securities.

Since 2015, foreign US Treasury holdings have reached a plateau, similar to international trade volumes. If protectionism is growing, who will replace foreign investors to help finance the expected deficits in Trump's fiscal policy?

RATE TRENDS

- As expected by investors, the Federal Reserve voted unanimously to raise its key rate by 25 bps to 0.75 %. The Fed said that they were encouraged by labour market strength and the increase of household expenditures. Committee members predict three rate hikes in 2017 and two in 2018. In contrast, at its last meeting, the Fed had expected two rate hikes in 2017. In the long term, the median forecast for the Fed fund's rate is at 3.0%, compared to 2.875% previously.

During the press conference, Janet Yellen said that few Committee members had taken into account the upcoming potential fiscal stimulus. Since the economic effect of these measures will be felt later, it is possible that rate hikes in 2018 will also be increased.

- The BCE extended its asset purchase program deadline from March 2017 to December 2017, but reduced the monthly amount from € 80 to 60 billion starting in April 2017. This decision is justified by lower deflationary risks. However, if the situation requires, the BCE could increase its purchases or buy securities whose yields are below the benchmark rate (-0.40 %).

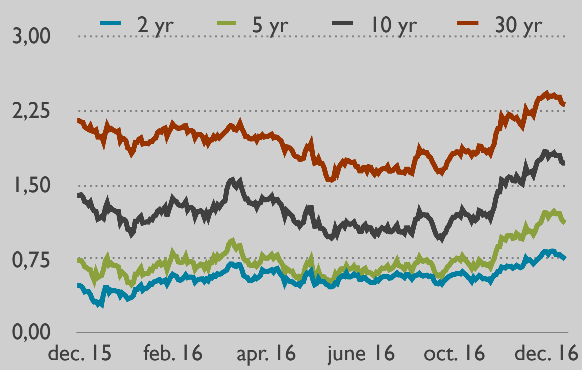
Non-conventional monetary policy has lost support in Europe. The Bank of Sweden, birthplace of negative rates, has extended its asset purchase program, but the Governor had to use his tie-breaking vote.

BOND RATES

Dec. 30 2016	Canada	Monthly Change	Change 2016	United States	Monthly Change	Change 2016
Key Interest Rate	0,50 %	0,00 %	0,00 %	0,75 %	0,25 %	0,25 %
3 months	0,46 %	-0,06 %	-0,06 %	0,50 %	0,02 %	0,33 %
2 years	0,75 %	0,04 %	0,27 %	1,19 %	0,08 %	0,14 %
5 years	1,11 %	0,10 %	0,38 %	1,93 %	0,09 %	0,17 %
10 years	1,72 %	0,14 %	0,33 %	2,44 %	0,06 %	0,17 %
30 years	2,31 %	0,15 %	0,16 %	3,07 %	0,03 %	0,05 %
RRB 30 years	0,49 %	0,13 %	-0,15 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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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 2016	Change 10 yrs month	Change 10 yrs 2016	Change 30 yrs month	Change 30 yrs 2016
Royal Bank, deposit notes	AA	AA-	95	110	155	0	-40	5	-45	5	-35
Manulife, Senior debt	A high	A+	115	135	185	0	-30	0	-35	0	-25
Fortis Inc.	BBB high	BBB+	120	165	225	-10	-15	-10	0	-10	10
Hydro One	A high	A	80	105	150	0	-30	-5	-30	0	-35
Enbridge Inc	BBB high	BBB+	130	180	240	-5	-130	-5	-135	-5	-105
Encana Corp	BBB low	BBB	215	285	345	-50	-185	-50	-190	-50	-205
GTAA	---	A+	70	95	135	0	-20	-5	-25	0	-30
Bell Canada	BBB high	BBB+	115	165	225	0	-55	0	-55	0	-55
Rogers Communications	BBB	BBB+	115	165	235	0	-65	0	-65	0	-60
Loblaw	BBB	BBB	120	170	225	-5	-45	-5	-40	0	-40
Canadian Tire	BBB high	BBB+	125	175	230	0	-35	0	-30	0	-30
Province of Québec	A high	A+	55	78	92	-2	-13	-5	-19	-5	-18
Province of Ontario	AA low	A+	56	79	89	-3	-12	-5	-17	-5	-17
CMHC	AAA	AAA	38	48	---	-4	-11	-6	-11		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached $ 4.6 billion in December, a decline of $ 5 billion compared to the previous month, but $ 600 million more than in December 2015. Thus, in 2016, corporate issuance reached $ 83.3 billion, or 2.6 % less than in 2015. This decrease is due to lower issue volume in securitization, communications and public-private partnership projects. However, higher volume in financial and utilities industries was not enough to compensate. Among new issues in the month of December, we should outline a 10-year $ 450 million from Fairfax Financial, issued only 6 days before they announced their intentions to make a major acquisition, $ 4.9 billion for AlliedWorld.
- Canadian grocery chain Sobeys has been downgraded by S&P to BB+. This announcement comes after the publication of their second quarter financial results which showed a drop of more than 50 % in profit ($ 33.1 million) compared to the same period last year ($ 68.5 million). Same store sales have also declined by 2.8 % during the quarter and 5.1 % in Western provinces. The integration of Canada Safeway, that was acquired in 2013 for $ 5.8 billion, is still problematic and S&P estimates that the restructuring plan and cost efficiencies that should reduce the debt ratio will take longer than expected. Furthermore, DBRS said that they would announce a downgrade below investment grade if financial results do not stabilize in the coming quarter.
- Canadian company Fairfax Financial filed a bid of $ 4.9 billion to acquire the Swiss insurer AlliedWorld. The latter offers casualty, property and specialty insurance and reinsurance products through an established worldwide network. If they accept, AlliedWorld shareholders will receive $ 54 per share, or a premium of 18 %. This offer consists of a portion in cash ($ 10) and Fairfax's shares ($ 44). The Canadian company has also an option to increase the cash portion of the offer to $ 30 if a partner wishes to participate in this acquisition. Rating agencies have all confirmed their credit ratings as a result of this announcement.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Dec. 2016	2016
Universe	100 %	-0,50 %	1,66 %
Short Term	44,1 %	-0,05 %	1,01 %
Mid Term	24,4 %	-0,34 %	1,61 %
Long Term	31,5 %	-1,26 %	2,47 %
Federal	36,8 %	-0,62 %	0,00 %
Provincial	34,2 %	-0,64 %	1,76 %
Corporates	27,1 %	-0,16 %	3,73 %
RRB		-2.08	5.23

Source: ftse.com

It will be difficult for Sobeys to make a u-turn. The chain does not have a discount banner like its competitors to serve less fortunate clients. In addition, it seems that Sobeys has lost the confidence of a portion of Canada Safeway's customers. This could be very difficult to regain.

Although the announcement of this acquisition does not increase the debt burden, it remains vitally important. Creditors should have been aware of it prior to the new debt issuance earlier this month. The case of Sobeys demonstrates that an integration risk can also turn into credit risk.

STRATEGIC POSITIONNING

Investor's behavior since the US election shows high expectations in regards to Mr. Trump's policies. Many hope that fiscal policies put forward during the campaign will accelerate the economic growth, increase company profit margins, increase inflation and force the Federal Reserve to hike its key rate. His views on immigration control and protectionism are also long term inflationary elements that bond investors fear. Inflationary risks explain in large part why the FTSE TMX long-term index fell 7.54 % in the last quarter, ending the year with a return of only 2.47 %. However, Mr. Trump will have to deal with Congress to pass his election platform. Although mostly composed of Republicans, Congress doesn't completely agree with Trump's policies and it is very likely that the scope of its measures will be diluted by the two chambers. Given the uncertainty, investors have perhaps anticipated too much. In the short term, it is possible that reason prevails and that investors will reassess the risks. However, longer term economic measures will have to be more egalitarian otherwise populism will expand, which closes economic borders and increases inflation.