MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

AUGUST 2021

- Against all expectations, the Canadian economy contracted at an annualized rate of 1.1% in the second quarter. Statistics Canada made significant revisions to the April and May GDP readings, indicating a more pronounced decline in the economy in the third wave of Covid. The contraction was due to sharp declines in home resale activities as well as exports. Increases in government spending, business inventories and investment in machinery were not enough to offset the above declines. Household spending was unchanged quarter-over-quarter, but its composition was not. Households reduced spending on goods and increased spending on services after the authorities eased some health restrictions.

The third quarter is off to a rocky start with Statistics Canada forecasting a 0.4% decline in activity in July. Manufacturing, construction and retail trade are reported to have declined. Supply problems are preventing manufacturers from meeting high consumer demand given the plethora savings. This contraction is more supply than demand related.

- The U.S. economy added 235,000 jobs in August, including 243,000 in the private sector. This slowed the pace of hiring from the previous 2 months when an average of more than 1 million workers were hired per month. Retail trade saw a loss of 29,000 positions, while the leisure and hospitality industry did not add employees during the month, reflecting a slowdown related to the surge in Delta cases. On the other hand, labor shortages are being felt in hourly wages, which rose 0.6% in the last month and 4.3% year over year.

Two new factors could dampen the job market in September: the global reduction in auto production by some manufacturers and the impact of Hurricane Ida. On the other hand, the Pandemic Unemployment Benefit program ended in more than two dozen states on September 6th and could prompt some to return to work and fill the labor shortage.

- The number of Delta variant Covid infections jumped during August in Asia. The Vietnamese government imposed a widespread lockdown of the city of Ho Chi Minh, which is home to several clothing and footwear manufacturing plants. China also closed the Meishan terminal at the port of Ningbo-Zhoushan, the world's third busiest port, after a worker was infected with Covid.

The highly contagious Delta variant shows the importance of having a global vaccination strategy that includes all emerging countries. These countries are integrated in the global supply chains and their zero tolerance approach exacerbates shortage problems.

RATE TRENDS

- Federal Reserve Chairman Jerome Powell delivered an anticipated speech at the annual central bankers' symposium in Jackson Hole, Wyoming. Powell indicated that the Fed will likely begin tapering its asset purchases by the end of the year, but that decision is not directly related to the decision to raise the policy rate, which has more stringent conditions to meet. Powell did not want to restrict himself to a fixed timetable for initiating the tapering, preferring to gather more evidence that the U.S. economy is not overly disturbed by the rise in the Delta variant cases, particularly with respect to employment. Inflation is running above the Fed's target, but Powell is maintaining his temporary effect on prices position. Inflation should ease when the global supply chains will function more normally according to the Fed.

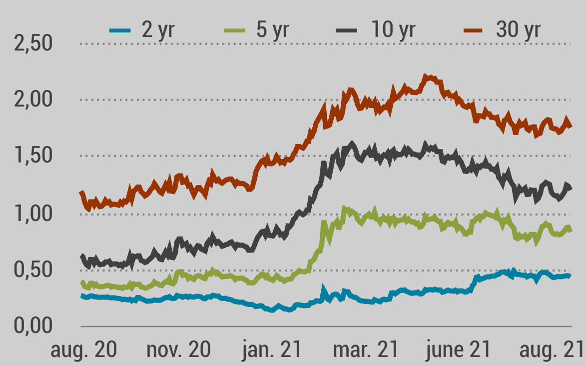
The killer question: does the slowdown in hiring seen in August cast doubt on the substantial progress in employment so desired by the Fed to reduce its asset purchase program in September? At worst, it delays the decision by a few months. In its assessment, the Fed must recognize that its expansionary policy is effective in stimulating demand, but cannot address the global supply problems and labor shortages that have been holding back activity recently. On the other hand, the asset purchase program is artificially inflating the value of some assets.

BOND RATES

Aug. 31 2021	Canada	Monthly Change	Change 2021	U.S.	Monthly Change	Change 2021
Key Interest Rate	0,25 %	0,00 %	0,00 %	0,25 %	0,00 %	0,00 %
3 months	0,17 %	-0,00 %	0,09 %	0,04 %	-0,01 %	-0,02 %
2 years	0,43 %	-0,03 %	0,22 %	0,21 %	0,03 %	0,09 %
5 years	0,84 %	0,02 %	0,45 %	0,78 %	0,09 %	0,42 %
10 years	1,22 %	0,01 %	0,54 %	1,31 %	0,09 %	0,40 %
30 years	1,78 %	0,02 %	0,56 %	1,93 %	0,04 %	0,29 %
RRB 30 years	0,12 %	0,04 %	0,41 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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	75	105	150	5	10	5	0	5	-5
Royal Bank, NVCC	A	105	145	195	5	5	5	5	5	0
Sun Life, subordinated debt	A	90	130	180	5	0	5	0	5	-5
Hydro One	A high	65	95	130	5	15	5	10	0	0
Enbridge Inc	BBB high	100	145	225	5	5	5	-5	5	-10
Altalink LP	A	65	90	125	5	15	5	10	0	0
GTAA	A high	65	95	130	5	15	5	10	0	0
Bell Canada	BBB high	95	140	205	-5	15	-5	10	-5	5
Rogers Communications	BBB high	115	160	230	-5	35	-5	30	-5	30
Loblaw	BBB high	85	130	190	5	10	5	5	5	-5
Canadian Tire	BBB	95	145	235	0	0	0	-10	0	-20
Province Québec	AA low	26	55	77	1	-4	1	-2	-1	-2
Province Ontario	AA low	29	61	81	-1	-6	1	-1	-1	0
CMHC	AAA	21	37	---	-1	0	3	5		

Source: National Bank Financial

CREDIT MARKET

- New Canadian corporate bond issuance totaled $3.8 billion in August, down $6.8 billion from the previous month and $1 billion less than in August 2020. Year-to-date, bond financings totaled $77.8 billion, down 3% from last year. There were only 7 issues during August, including 2 green bond issues by Real Estate Investment Trusts (REITs), Allied Properties REIT and Granite REIT. These trusts intend to use the proceeds of these issues to finance or refinance expenditures associated with eligible green projects as described in their respective green bond frameworks.

- The big six Canadian banks reported $15.2 billion in earnings in the third quarter of their fiscal year, an increase of $5.4 billion or 55% over the same period last year. In the middle of the pandemic last year, banks had increased their provisions for credit losses by a total of $6.2 billion, significantly affecting their bottom line. As conditions improved, the banks reduced their provisions by $409 million in the last quarter, accounting for most of the increase in profits. These strong results prompted the Liberal Party to announce during the election campaign that they would like to increase the tax rate for Canadian banks from 15% to 18% on profits over $1 billion and establish a special dividend to make them pay more.

- Rising oil prices have allowed the province of Alberta to revise its budget projections for the current year. Instead of an $18.3 billion deficit, the province is now projecting a $7.8 billion shortfall. In his initial budget, the Minister of Finance was cautious in assuming a U.S. oil price of US$46 per barrel (WTI). However, between April and August, oil averaged US$68 per barrel. In addition to oil royalties, personal and corporate tax revenues also boosted the province's revenues as the economic recovery was stronger than expected. Expenditures were largely unchanged from the forecast.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Aug. 2021	2021
Universe	100 %	-0,12 %	-2,59 %
Short Term	40,4 %	0,06 %	-0,09 %
Mid Term	26,4 %	-0,05 %	-1,66 %
Long Term	33,2 %	-0,41 %	-6,33 %
Federal	34,3 %	-0,07 %	-2,18 %
Provincial	37,4 %	-0,26 %	-3,82 %
Corporates	26,2 %	0,01 %	-1,35 %
RRB		-0,38 %	-2,86 %

Source: ftse.com

These promises could generate $2.5 billion a year over four years in federal revenus and would be used to pay some of the pandemic measures. However, many industries have benefited from federal largesse during this crisis, so why target only one successful industry? Why not apply it to other industries?

With seven months left in the fiscal year, revenues should remain strong unless oil drops to an average of $30 by the end of the year, which is unlikely. However, the fourth wave of Covid is hitting Alberta hard and could worsen health care spending and the deficit in this province where the vaccination rate is below the Canadian average

STRATEGIC POSITIONNING

Central bankers are increasingly beginning to recognize the limits of their ultra-expansionary monetary policy. Even as the Delta variant continues to take its toll around the world, some banks are talking about scaling back the asset purchase program soon, and even the central bank of Australia announced in September that it was reducing its weekly bond purchases from AU$5 billion to AU$4 billion despite a sharp rise in Covid cases. In South Korea, the central bank raised its policy rate by 0.25% to 0.75% to limit the risks of financial instability associated with the current monetary policy. The same is true of some members of the Federal Reserve. While a rate hike is off the table for now, some members want to reduce the quantitative easing program. The program is effective in stimulating demand, but the economy doesn't have a demand problem, it has a supply problem and shortages. So the program is no longer relevant in the eyes of some members and is causing more collateral damage such as rising asset prices linked to low rates. Unfortunately, the supply problem is more difficult to solve, as the integration of global production chains means that the local economy is dependent on government decisions elsewhere in the world. Shortages will not end soon, which means continued high prices.