MONTHLY BOND LETTER

AlphaFixe Capital

SEPTEMBER 2017

ECONOMIC EVENTS

- Finance Minister Bill Morneau announced a $ 17.8 billion deficit for the fiscal year 2016-2017, $ 5.2 billion less than expected compared to the original budget. This improvement is attributable to economic strength and deferral of certain infrastructure expenditures. Indeed, the federal government had planned to spend $ 3.7 billion more in infrastructure projects. With this deficit, the federal debt amounted to $ 631.9 billion or 31.2 % of GDP. The federal government still expects a deficit of $ 28.5 billion in 2017-18.

Unless the situation changes, this year's deficit is also expected to end below estimates. The Canadian economy recorded strong growth and job creation, adding to tax revenues. It should also be remembered that the forecast includes a $ 3 billion contingency fund.

- The Republican Party announced its tax reform which should reduce the burden for taxpayers and corporations. Income tax would be less progressive, moving from 7 tax brackets to 3 (12 %, 25 % and 35 %). On the other hand, the standard deduction would double to $ 12,000 for an individual and $ 24,000 for a family. Corporate tax would move from 35 % to 20 % and overseas profits would be taxed at a discount, but the rate is not set. This relief would be financed by eliminating the majority of allowable deductions, except for charitable donations and mortgage interest.

Will this plan be deficit-neutral? If it's the case, the economic impact will be weakened. Conservative Republicans will find it hard to support a deficit induced plan. Therefore, Democratic support will be required and they already qualified this reform as a gift for the wealthy paid by the middle class.

- Euro economic growth was 2.4 % in annualized terms in the second quarter, its highest rate since the sovereign debt crisis in 2012. Consumer and government spending increased each by 2 %, while corporate investment grew by 3.6 %. After contributing strongly at the beginning of the year, foreign trade subsided in the second quarter due to the euro strengthening.

This is Europe's 17th consecutive quarter of expansion and the third consecutive quarter with a growth rate of more than 2 %. The economy is strengthening and the source of growth is also diversifying, suggesting a lower asset purchase program.

RATE TRENDS

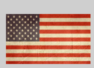
- The Federal Reserve kept its policy rate at 1.25%, but announced that they would begin reducing the balance sheet in October. In order to normalize its $ 4 500 billion balance sheet, the Fed will reduce its monthly reinvestments in Treasuries and MBS by $ 6 billion and $ 4 billion respectively. These amounts will be increased quarterly to reach $ 30 billion and $ 20 billion in October 2018. A rate hike is also expected in December by 12 of the 16 Committee members.

A December rate hike is taking shape. At the beginning of the month, investors estimated the probabilities of a rate hike at 28 %, but 64 % by the end of the month. Since the financial crisis, the Fed has never changed its policy rate without investors support because they fear disturbing financial markets.

- Bank of England Governor, Mark Carney, announced that the current monetary easing could be withdrawn to bring inflation back to the 2 % target. Since the Brexit vote, the inflation rate increased from 0.4 % to 2.9 % last August on the back of a lower currency and tightening of borders, which limits foreign workers and creates wage pressures, according to Carney.

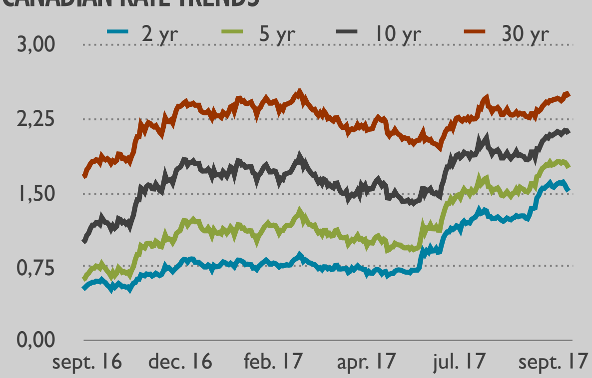
On the other hand, the Bank published its Financial Stability Report which states that consumer debt could inflict bank losses of up to £ 30 billion if the economy were to suffer a severe recession. In short, rates must be raised, but gradually.

BOND RATES

Sept. 30 2017		Monthly Change	Change 2017		Monthly Change	Change 2017
Key Interest Rate	1,00 %	0,25 %	0,50 %	1,25 %	0,00 %	0,50 %
3 months	1,00 %	0,22 %	0,55 %	1,04 %	0,05 %	0,54 %
2 years	1,52 %	0,24 %	0,77 %	1,48 %	0,16 %	0,29 %
5 years	1,75 %	0,22 %	0,64 %	1,94 %	0,23 %	0,01 %
10 years	2,10 %	0,25 %	0,38 %	2,33 %	0,22 %	-0,11 %
30 years	2,47 %	0,21 %	0,16 %	2,86 %	0,13 %	-0,21 %
RRB 30 years	0,85 %	0,18 %	0,36 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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CREDIT BOND RISK PREMIUMS

ISSUER	Credit rating		Spread			Change 5 yrs		Change 10 yrs		Change 30 yrs	
	DBRS	S&P	5 yrs	10 yrs	30 yrs	month	2017	month	2017	month	2017
Royal Bank, deposit notes	AA	AA-	75	95	140	-5	-20	-5	-15	-5	-15
Manulife, Senior debt	A high	A+	90	125	170	-10	-25	-5	-10	-5	-15
Fortis Inc.	BBB high	BBB+	100	145	180	5	-20	5	-20	0	-45
Hydro One	A high	A	70	90	140	0	-10	0	-15	0	-10
Enbridge Inc	BBB high	BBB+	120	170	235	0	-10	-5	-10	-5	-5
Encana Corp	BBB low	BBB	155	210	295	-20	-60	-15	-75	-15	-50
GTAA	---	A+	50	75	90	-5	-20	0	-20	-5	-45
Bell Canada	BBB high	BBB+	100	150	210	0	-15	5	-15	-5	-15
Rogers Communications	BBB	BBB+	95	145	210	0	-20	5	-20	-5	-25
Loblaw	BBB	BBB	105	155	215	0	-15	5	-15	5	-10
Canadian Tire	BBB high	BBB+	105	160	215	0	-20	5	-15	0	-15
Province of Québec	A high	A+	47	68	80	-1	-8	-1	-10	-2	-12
Province of Ontario	AA low	A+	49	69	80	-1	-7	-2	-10	-2	-9
CMHC	AAA	AAA	35	46	---	-1	-3	0	-2		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached $ 13.6 billion in September, up $ 8.3 billion from the previous month and $ 6.6 billion more than in September 2016. Since the beginning of the year, corporate bond issuance amounted to $ 79.3 billion, 23.6% more than at the same date last year. Among borrowing companies, McDonald's made its first $ 1 billion Maple bond financing. The bond, rated BBB+ by S&P and Moody's, offered a premium of 120 bps more than a federal bond for an 8-year term. Similar to Apple last month, McDonald's added a covenant that allows them to redeem the security at par ($ 100) for tax reasons such as a reduction in the corporate income tax rate.

- Grocery store chain Metro announced the acquisition of Jean Coutu pharmacies for $ 4.5 billion. Metro would pay 75 % of this amount in cash and the rest in shares. Thus, the 419 Jean Coutu pharmacies will be added to the 258 Brunet pharmacy locations, therefore offering economies of scale. According to some analysts, the debt ratio would reach, at worst, 4X EBITDA. On the other hand, Metro could divest its $ 2 billion stake in Alimentation Couche-Tard, which would significantly reduce the debt ratio (2.7X). This transaction is similar to Loblaws and Shoppers Drug Mart in 2013 and is part of a consolidation trend in the pharmaceutical industry to compete with US giants Walmart and Costco. Following this transaction, S&P and DBRS indicated that there would be no change in the credit rating.

- Moody's has downgraded HSBC by one notch, from Aa2 to Aa3. Moody's said that the overall corporate and household debt in key markets where HSBC operates, poses a risk to the bank's assets quality in case of a negative shock. The United Kingdom and Hong Kong are identified as markets that need to be monitored due to Brexit and the Asian real estate market. The agency also lists Mexico and Canada as a result of the NAFTA renegotiations and Canadians overall household debt.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Sept. 2017	2016
Universe	100 %	-1,32 %	0,48 %
Short Term	45,6 %	-0,45 %	-0,20 %
Mid Term	23,2 %	-1,30 %	-0,16 %
Long Term	31,2 %	-2,59 %	1,73 %
Federal	37,0 %	-1,18 %	-0,73 %
Provincial	33,7 %	-1,66 %	0,92 %
Corporates	27,4 %	-1,09 %	1,49 %
RRB		-1,99 %	-2,96 %

Source: ftse.com

This transaction will allow Jean Coutu to expand their distribution and create synergies ahead of Quebec new law on generic drugs. This law will allow the Quebec government to issue tenders for the public drug insurance plan, directly affecting pharmacist income.

Unlike other Canadian banks, HSBC Canada's credit rating is strongly influenced by HSBC Holding support in case of difficulty. On the other hand, global events beyond Canadian control may weaken the parent company and therefore the Canadian franchise without any domestic justification.

STRATEGIC POSITIONNING

Although hurricanes Harvey and Irma will weaken the US economy momentarily due to lower production, strong fundamentals remain. The labor market is strong, consumer confidence remains close to the peak since the last recession and companies want to set up investment projects. In fact, the NFIB survey conducted in August showed that 32% of US small businesses were planning capital expenditures in the next 3-6 months, the highest level since 2006. At the same time, the Trump administration seeks to further stimulate the economy with a tax plan that should be financed through economic expansion according to its proponents. Will Congress support this plan? If it accentuates the deficit in the long term, tax cuts would be considered permanent and would require a vote of at least 60 senators out of 100. However, Republicans could use the budget reconciliation process that require a simple majority in the Senate if the reform is only temporary (10 years). Fiscal stimulus policy could be partially offset by restrictive monetary policy and central bank balance sheet reduction, all of which creates an environment in favour of higher rates.