MONTHLY BOND LETTER

AlphaFixe Capital

SEPTEMBER 2018

ECONOMIC EVENTS

- The Consumer Price Index (CPI) in Canada rose 2.8% on a year-over-year basis in August compared to 3% in July. This deceleration is mainly due to lower prices at the pump for drivers. In the last twelve months, consumer goods prices rose 2.5% while services were up 3.1%. Prices rose in all major components of the CPI, especially transportation (7.1%). The Bank of Canada's inflation index was 2.2%, 0.2% above its target and the highest level since 2009.

Oil prices eased slightly towards the end of the summer, but the situation could be temporary. Indeed, the US sanctions against Iranian oil should come into effect in early November, which could cause a market imbalance. Higher prices at the pump could be transmitted indirectly to consumers, as workers now have greater wage power.

- The United States follow through on their threat by imposing a 10 % tariff on $ 200 billion worth of imported products from China. This measure forced China to add $ 60 billion of US imports on its tariff list. This conflict is intensifying as the US trade deficit with the rest of the world reached $ 50 billion in July and $ 337 billion since the beginning of the year. This is an increase of 7% over the first seven months of 2017. Last year, the trade deficit increased by 10% to reach $ 552 billion, after being stable in 2015 and 2016.

Trump built his campaign on the premise that a trade deficit is bad for the country. However, the increase in the deficit is not the result of bad trade deals with its partners, but from the fact that the United States consumes more than it produces. The drop in taxes this year has exacerbated the situation by further stimulating consumption and imports.

- The Turkish lira has fallen by 37% since the beginning of the year against the US dollar, forcing the central bank to defend its currency by raising its key rate by 6.25% in September to 24%. The country has major structural problems, inflation reached 17.9% last August, corporate debt in US dollars exploded in the recent years, as did the current account deficit of the country. Turkey is therefore dependent on foreign money, particularly in dollars.

Fed rate hikes, coupled with Trump's tax reform, propelled the dollar higher. This situation is causing problems for emerging markets where dollar denominated debt are near their peak at 12% of GDP. Debt in dollars, revenues in local currency and high interest rates create a difficult mix for companies.

RATE TRENDS

- The Federal Reserve raised its key rate by 0.25% to 2.25% while leaving the door wide open for another increase by the end of the year. This decision is based on an optimistic view of the labor market which continues to strengthen along with an economy growing at a steady clip. In its statement, the Fed no longer qualifies the current policy as accommodating, but expects that the key rate will reach 3.50% in 2020, 1.25% more than it is currently.

By removing the "accommodating" part from the statement, the Fed does not mean it's holding back on rate hikes. The economy is strongly stimulated by tax reform, neutralizing the impact of rate hikes this year. Therefore, the Fed will have to do more to slow down the economy,.

- Bank of Canada's Senior Deputy Governor, Carolyn Wilkins, said the committee questioned whether the gradual approach to rate hike was still appropriate given that the economy has been running at full capacity for the past year. Although the trade dispute with the United States brings uncertainty in exports and investments, Wilkins also outlined the inflationary risks from protectionist measures.

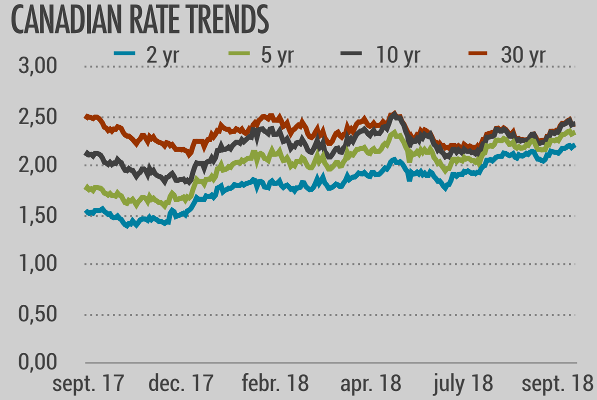
Now that the US-Mexico-Canada Agreement is in place, the Bank could speed up rate hikes. It has recently eased its concerns over real estate and household debt, saying the employment strength will allow families to adjust their budgets.

BOND RATES

Sept. 30 2018	Canada	Monthly Change	Change 2018	United States	Monthly Change	Change 2018
Key Interest Rate	1,50 %	0,00 %	0,50 %	2,25 %	0,25 %	0,75 %
3 months	1,58 %	0,05 %	0,53 %	2,20 %	0,10 %	0,82 %
2 years	2,21 %	0,14 %	0,53 %	2,82 %	0,19 %	0,94 %
5 years	2,34 %	0,17 %	0,48 %	2,95 %	0,21 %	0,75 %
10 years	2,43 %	0,20 %	0,38 %	3,06 %	0,20 %	0,66 %
30 years	2,42 %	0,17 %	0,16 %	3,21 %	0,19 %	0,47 %
RRB 30 years	0,66 %	0,13 %	0,09 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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CREDIT BOND RISK PREMIUMS

ISSUER	Credit rating		Spread			Change					
						5 yrs		10 yrs		30 yrs	
	DBRS	S&P	5 yrs	10 yrs	30 yrs	month	2018	month	2018	month	2018
Royal Bank, deposit notes	AA	AA-	75	95	135	-10	0	-5	5	-5	5
Manulife, Senior debt	A high	A+	95	120	160	0	5	0	5	0	-5
Fortis Inc.	BBB high	BBB+	110	155	205	5	20	5	20	5	40
Hydro One	A high	A-	85	110	150	10	20	10	25	10	20
Enbridge Inc	BBB high	BBB+	115	160	220	0	0	0	-5	-5	-5
Encana Corp	BBB low	BBB-	145	200	260	0	15	0	10	-5	-5
GTAA	---	A+	60	80	110	0	10	0	10	0	25
Bell Canada	BBB high	BBB+	110	155	215	5	15	0	10	0	15
Rogers Communications	BBB	BBB+	100	145	215	0	10	0	5	0	15
Loblaw	BBB	BBB	115	160	215	5	20	0	15	5	15
Canadian Tire	BBB high	BBB+	110	155	225	5	10	0	5	5	20
Province of Québec	A high	A+	40	62	77	-2	4	-3	7	-3	12
Province of Ontario	AA low	A+	42	65	80	-3	4	-4	6	-4	13
CMHC	AAA	AAA	29	38	---	-3	2	-2	3		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance has reached $ 9.8 billion in September, up $ 3.8 billion from the previous month, but $ 3.7 billion less than in September 2017. Since the beginning of the year, corporate bond issuance amounted to $ 70.8 billion, 10.7% less than at this time last year. Among the issuers, note the presence of Sysco who distributes food products to restaurants, health and education institutions as well as hotels. The 3.65% coupon bond will mature in April 2025 and will be structurally subordinated to the US debt according to the offering memorandum. The Canadian debt is guaranteed by Sysco EU II, a Luxembourg company where exercising creditor right is difficult according to Sysco's Offering Memorandum.

- Canadian bank bond issuance evolved in September when Royal Bank issued the first senior note eligible for non-viability contingent capital (bail-in). This debenture was offered with a spread of 0.95% more than a federal bond or 0.15% more than a traditional deposit note. For its part, CIBC issued a $ 1 billion deposit note which proceeds will be used exclusively to fund businesses engaged in the promotion of women in management positions. For a company to be eligible, women must represent at least 30% of senior executives or board members or the company must be a signatory of the Catalyst Agreement 2022, a movement to accelerate the advancement of women in business.

- The S&P rating agency lowered Hydro One's credit rating by one notch to A- while maintaining a negative outlook. According to S&P, « Hydro One's management and governance structure, which has weakened following the government of Ontario's decision to exert its influence on the utility's compensation structure through, potentially promoting the interests and priorities of one owner over those of other stakeholders ». Doug Ford has sharply criticized Hydro One's CEO compensation which he links to rising electricity rates. The Ontario Energy Board Act has already been amended to exclude executive compensation from customer rates.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Sept. 2018	2018
Universe	100 %	-0,97 %	-0,35 %
Short Term	46,5 %	-0,20 %	0,54 %
Mid Term	21,0 %	-0,93 %	-0,51 %
Long Term	32,5 %	-2,05 %	-1,53 %
Federal	35,6 %	-0,83 %	-0,15 %
Provincial	34,0 %	-1,25 %	-1,01 %
Corporates	28,5 %	-0,79 %	0,23 %
RRB		-1,47 %	1,08 %

Source: ftse.com

Environmental, social and governance (ESG) issues are attracting more and more attention from fixed income investors. Moody's also announced that it would change its methodology to improve the risk transparency associated with these factors, which, according to the agency, are already taken into account while evaluating the ratings.

Two elements stand out:
1. The growing importance of ESG factors in a company's risk assessment.
2. The negative outlook could be related to the acquisition of Avista. Once this transaction is completed, S&P may lower the rating again, bringing it in the BBB category of the index.

STRATEGIC POSITIONNING

The greatest threat to the Canadian economy was removed in the last hour of the quarter. Trump has finally done what he does best, divide and conquer. In an attempt to force Canada to sign the US-Mexico-Canada Agreement (USMCA), he initially isolated Canada by signing an agreement with Mexico in the summer and then creating a division within Canada by forcing Trudeau to choose between the Quebec dairy industry and Ontario's auto industry. Now that he has two North American allies and Europe, he will seek to exert pressure on China to change their unfair trade practices. In fact, the USMCA includes a clause requiring signatories to give notice if they decide to negotiate an agreement with a non-market country. This wording is addressed directly to China. Nevertheless, the greatest quality of this agreement is to mitigate the uncertainties for companies and economic decision-makers. In fact, the Bank of Canada had lowered its growth outlook three times in the past year due to the effects of trade uncertainty on investment and exports. Faced with a shortage of manpower, business leaders can now be more confident in investing to automate certain tasks. With a key rate of 1.50%, a historically low unemployment rate, an inflation rate close to 3% and a trade deal, the Bank of Canada now lacks arguments not to raise rates in October.