MONTHLY BOND LETTER

AlphaFixe Capital

JULY 2021

ECONOMIC EVENTS

- Employment in Canada increased by 324,700 over the past two months, bringing the unemployment rate to 7.5%, down 0.7%. Looser health restrictions in Ontario, Quebec and British Columbia had a direct impact on employment. These three provinces accounted for most of the job creation (+308,100). However, many of the jobs were for part-time positions (+230,700) targeting the youth aged 15 to 24 (+226,200) in service industries affected by the pandemic. For example, the hospitality and food services industry added 136,100 employees while 91,000 workers found jobs in retail trade.

There are still 246,300 jobs to be recovered to pre-pandemic levels compared to 5.7 million in the United States. The job gains are the result of a successful vaccination campaign in Canada that allowed authorities to lift several restrictions. As long as the new variant does not cause an increase in hospitalizations, the economy should continue to grow, especially as the use of the vaccine passport prevents further closures.

- The U.S. economy grew at an annualized rate of 6.5% in the second quarter, a slight acceleration from the previous quarter's 6.3%. Consumer spending (11.8%) propelled the economy as the easing of health measures encouraged Americans to travel, return to dining out and engage in previously restricted activities. Business investment in equipment also contributed to growth (13.0%). On the other hand, businesses invested less in fixed assets and drew on inventories to meet demand. Residential real estate also hurt growth (-9.8%) as soaring prices made homes less affordable and slowed activity.

The U.S. economy has returned to pre-pandemic levels, but disruptions in supply chains and labor shortages have dampened its momentum. Consumers are still sitting on a stockpile of savings, but the fourth wave could lead to a slowdown. However, companies will need to replenish their inventory, which should contribute to growth in the coming quarters.

- China's economy grew at an annualized rate of 5.3% in the second quarter and 7.9% in the past 12 months. "China's economy has experienced a steady recovery," the statistics bureau said in a statement. Retail sales rose 12.1% in June from a year ago while industrial production rose 8.3% over the same period.

China's economy is on track to meet its 6% growth target for 2021. However, the outbreak of the delta variant in China could be an obstacle. Authorities are not shy about shutting down an industry to stop the spread of the virus.

RATE TRENDS

- The Governing Council of the European Central Bank (ECB) has approved a new monetary policy framework that includes a symmetric inflation target of 2% over the medium term. This is in contrast to the previous strategy, which targeted inflation close to, but below, 2%. This level is no longer a ceiling, as the Bank will tolerate a transitional period of overshooting if the ECB fails to meet its inflation target despite low rates.

- The Federal Reserve reiterated its monetary policy stance at its last meeting, while indicating that progress has been made since December in achieving the goals of full employment and 2% average inflation over the long term. Progress, yes, but not enough to change the path of monetary policy, especially with the risk of a fourth wave.

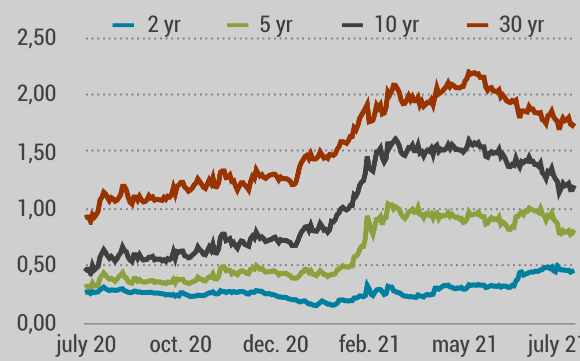
The ECB has joined the Federal Reserve with a more responsive monetary policy framework that favors inflation. By accepting more inflation to benefit employment, central banks are slowly unveiling their exit strategy plan. The labor market must be inclusive and return to full employment, while inflation must be at a steady 2%. So there is no reason to intervene now, as some central bankers believe that the price increase is temporary. No bank wants to make the mistake of acting hastily in the face of the ever-present pandemic risk with the variant delta.

BOND RATES

July 30, 2021		Monthly Change	Change 2021		Monthly Change	Change 2021
Key Interest Rate	0,25 %	0,00 %	0,00 %	0,25 %	0,00 %	0,00 %
3 months	0,17 %	0,03 %	0,10 %	0,04 %	0,00 %	-0,02 %
2 years	0,45 %	0,00 %	0,25 %	0,18 %	-0,06 %	0,06 %
5 years	0,82 %	-0,16 %	0,42 %	0,69 %	-0,20 %	0,33 %
10 years	1,20 %	-0,19 %	0,53 %	1,22 %	-0,25 %	0,31 %
30 years	1,76 %	-0,08 %	0,55 %	1,89 %	-0,19 %	0,25 %
RRB 30 years	0,08 %	-0,04 %	0,38 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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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	70	100	145	0	5	0	-5	0	-10
Royal Bank, NVCC	A	100	140	190	0	0	0	0	0	-5
Sun Life, subordinated debt	A	85	125	175	0	-5	0	-5	0	-10
Hydro One	A high	60	90	130	0	10	0	5	0	0
Enbridge Inc	BBB high	95	140	220	0	0	-5	-10	-5	-15
Altalink LP	A	60	85	125	0	10	0	5	0	0
GTAA	A high	60	90	130	0	10	0	5	0	0
Bell Canada	BBB high	100	145	210	10	20	10	15	10	10
Rogers Communications	BBB high	120	165	235	15	40	15	35	15	35
Loblaw	BBB high	80	125	185	0	5	0	0	0	-10
Canadian Tire	BBB	95	145	235	0	0	0	-10	0	-20
Province Québec	AA low	25	54	78	-1	-5	0	-3	2	-1
Province Ontario	AA low	30	60	82	-1	-5	0	-2	2	1
CMHC	AAA	22	34	---	-1	1	3	2		

Source: National Bank Financial

CREDIT MARKET

- New domestic corporate bond issuance totaled $10.6 billion in July, down $5.1 billion from the previous month and $5.6 billion higher than in July. Year-to-date, bond financings totaled $74 billion, down 1.7% from last year. Canadian banks have been particularly active with 5 issues totaling $5.2 billion. Air Canada also issued $2 billion maturing in 2029. A total of 70 investors participated in this issue, which was rated BB by the rating agencies, some of which have a negative outlook on the rating. Investors' appetite for high yielding product (4.625% coupon) continues despite the risks associated with this industry during a pandemic.

- S&P downgraded the province of British Columbia's credit rating from AAA to AA+. Canada's third-largest province will run a deficit this fiscal year that is "significantly larger" than expected at the start of the pandemic, likely extending the time to return to fiscal balance, S&P said. In total, the province's fiscal debt is expected to reach $102 billion, or 172% of operating revenues by next March, and will reach 195% by 2024. These ratios are no longer comparable to those of AAA rated peers. Previously, Fitch also downgraded the province's rating from AAA to AA+ for the same reasons. The actual budget includes $13 billion in additional operating expenditures, of which $8.7 billion will be ongoing.

- Fitch also downgraded Canada's operating environment from AA to AA- because of the high level of private and public sector debt that will hurt business, especially for Canadian banks. This downgrade means that no Canadian bank can be rated higher than AA-, forcing the agency to downgrade RBC Bank from AA to AA-. The downgrade means that RBC, TD, Bank of Montreal, Scotiabank and CIBC are now all rated the same (AA-), while National Bank is rated A+. The outlook is stable, except for Bank of Montreal and Scotiabank, the latter having more activities in South American countries.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	July. 2021	2021
Universe	100 %	1,03 %	-2,47 %
Short Term	40,8 %	0,37 %	-0,15 %
Mid Term	26,1 %	1,43 %	-1,61 %
Long Term	33,1 %	1,53 %	-5,95 %
Federal	34,2 %	0,85 %	-2,11 %
Provincial	37,4 %	1,24 %	-3,57 %
Corporates	26,3 %	0,92 %	-1,36 %
RRB		1,60 %	-2,49 %

Source: ftse.com

The downgrade of British Columbia's rating means that there are no AAA rated provinces left in Canada. Ongoing spending surely influenced S&P's decision. Nevertheless, the western province still has the lowest debt to GDP ratio in Canada and a favourable risk profile.

This downgrade does not represent a disavowal of the Canadian banking system or a deterioration in financial metrics, but rather an acknowledgement that high levels of household debt will impede future growth in lending activity. Loan underwriting criteria are robust in Canada, which limits the risk of losses for banks.

STRATEGIC POSITIONNING

More and more central bankers are concerned about inflationary pressures and are beginning to prepare financial markets for a reduction in monetary support. Federal Reserve Vice Chairman Richard Clarida recently mentioned that the economy is progressing toward full employment and average inflation at 2%, also reiterating his forecast for a rate hike in 2023. If progress continues, he said, an announcement could be made later this year, contrasting Jerome Powell's more patient approach. The Reserve Bank of Australia will begin tapering its asset purchase program next month, while the Bank of England believes that modest monetary policy tightening is likely to be needed over the next two years to keep inflation in check. On the other hand, the rise of the delta variant around the world could disrupt these plans. The number of cases is rising rapidly in Asia, particularly in Vietnam, where the outbreak has forced the closure of apparel and shoe factories. Cases are also on the rise in China, and Chinese officials have always acted proactively, not hesitating to close factories, ports or cities at the slightest risk of an outbreak. This variant could cause a slowdown in global economic activity, but also further disrupt supply chains. An economic slowdown with by inflation, a headache for central bankers in tapering mode.