MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

DECEMBER 2022

- Canadian retailers saw their sales increase by 1.4% in October. Subtracting sales at dealerships and gas stations, sales at other retailers showed a gain of 0.9%. In fact, most of the growth in retail sales in October came from gas stations (+6.8%) and grocers (+2.2%). Sales are up, but that's because consumers are paying more without increasing the volume of their purchases. In fact, in terms of volume, sales were flat in October. For November, Statistics Canada is forecasting a 0.5% decline in sales. The decline in gasoline prices could be the cause.

After the frenzy related to the easing of health restrictions in the first half of the year, retailer sales volume was weaker in the second half of the year. Loss of purchasing power and economic uncertainty have dampened consumer momentum since June. However, consumers also changed their spending habits over the summer by reducing purchases of goods in favor of services such as travel. This substitution is less visible in retailers' sales.

- The Consumer Price Index (CPI) rose by 0.1% in November in the United States, bringing the annual change to 7.1% from 7.7% the previous month. Lower energy prices (-1.6%) were a major contributor to the deceleration in inflation last month. Food prices continue to rise (+0.5%), but the pace has moderated compared to last month. Food still costs 10.6% more than a year ago. Excluding these two volatile items, the core index is up 0.2% last month and 6.0% year-over-year. Housing (+0.6%) remains a source of pressure on the price index, as do communications (+1.0%) and leisure (+0.5%). In contrast, improving supply chain impediments in the auto sector mean that demand for used vehicles has weakened and prices fell 2.9% last month.

Most of the increase in the price of services is related to housing, which represents nearly 33% of this index. However, data for rents are collected every 6 months (January and July) with monthly adjustments thereafter. This methodology was appropriate in the past as rental prices were fairly stable, but the pandemic changed things. Rents exploded in 2021 and early 2022, but have been declining recently. This decline should therefore appear in the new January data and contribute to a deceleration in the CPI in 2023.

- The U.K. consumer price index rose 0.4% in November, bringing the annual change to 10.7%. However, this is a deceleration from the previous month's 11.1% increase, which was the highest since 1981. As elsewhere in the world, energy prices fell in November, especially gasoline, which posted an annual increase of 17.2% compared to 22.2% the previous month. In contrast, food continued to rise, up 1.1% in November and 16.5% year-over-year. This is the 16th consecutive monthly increase and the highest annual change in food prices since 1977.

As the British economy gradually moves into recession and inflation decelerates, the Bank of England should be less aggressive. However, the job is not done. The labour market remains robust with unemployment at 3.7% and private sector wage growth at 6.9%, more than three times the 2% inflation target. Additional increases will be required in 2023.

RATE TRENDS

- Monetary tightening continued in December as both the Bank of Canada and the Federal Reserve announced a 0.50% increase in their policy rates. For the Bank of Canada, this is the second increase of this magnitude, but for the Fed it is more of a deceleration from the four 0.75% increases. Although inflation has eased in both countries from the highs seen over the summer, the acceleration in prices remains at an uncomfortable pace. Both central banks recognize that the lagged effect of the monetary tightening in place will slow growth in 2023, justifying more moderate hikes than before. The labor market imbalance in both countries remains a source of fuel for inflation that justifies further tightening early in the year.

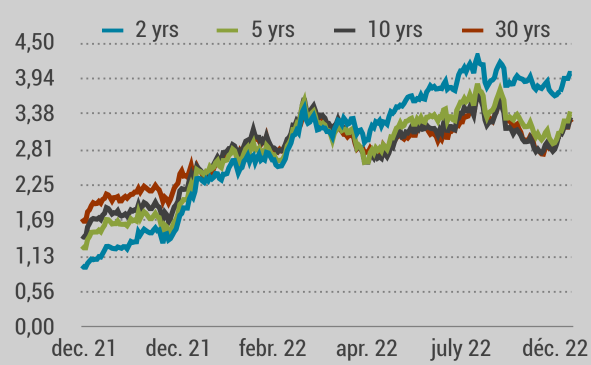
After raising policy rates aggressively throughout the year, central banks are starting 2023 on the path of caution. Hikes of more than 4% in a year are very rare and should dampen economic momentum in 2023, especially where activity is tied to debt. However, central bankers are struggling to solve the employment puzzle and are suggesting a structural shift that may be causing companies to keep employees on the payroll despite a slowdown in sales. The tightening cycle is coming to an end, but policy rates will be higher for a longer period than some investors currently expect.

BOND RATES

Dec. 31, 2022	Canada	Monthly Change	Change 2022	United States	Monthly Change	Change 2022
Key Interest Rate	4,25 %	0,50 %	4,00 %	4,50 %	0,50 %	4,25 %
3 months	4,26 %	0,25 %	4,08 %	4,34 %	0,02 %	4,31 %
2 years	4,05 %	0,18 %	3,10 %	4,43 %	0,12 %	3,69 %
5 years	3,41 %	0,25 %	2,15 %	4,00 %	0,27 %	2,74 %
10 years	3,30 %	0,36 %	1,87 %	3,87 %	0,27 %	2,36 %
30 years	3,28 %	0,28 %	1,60 %	3,96 %	0,23 %	2,06 %
RRB 30 years	1,20 %	0,08 %	1,32 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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CREDIT BOND RISK PREMIUMS

Issuers	Credit Rating DBRS	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2022	Change 10 yrs month	Change 10 yrs 2022	Change 30 yrs month	Change 30 yrs 2022
Royal Bank, Bail-in-debt	AA	165	200	230	0	80	0	85	0	75
Royal Bank, NVCC	A	225	270	310	-10	115	-10	120	-10	110
Sun Life, subordinated debt	A	200	240	270	-25	100	-25	100	-25	80
Hydro One	A high	110	140	160	5	45	5	40	0	25
Enbridge Inc	BBB high	175	215	260	-5	65	-5	60	-5	30
Altalink LP	A	105	135	155	5	40	5	35	0	20
GTAA	A high	105	135	155	0	35	0	35	0	25
Bell Canada	BBB high	160	195	225	0	60	-5	50	-5	20
Rogers Communications	BBB	180	225	270	0	50	-5	50	-5	35
Loblaw	BBB high	150	185	210	0	60	-5	50	-5	20
Canadian Tire	BBB	170	210	255	-5	75	-15	65	-15	25
Province Québec	AA low	46	72	94	2	13	-5	16	-1	20
Province Ontario	AA low	48	74	95	2	11	-5	13	-2	17
CMHC	AAA	36	46	---	1	5	-4	5		

Source: National Bank Financial

CREDIT MARKET

- Corporate bond new issuance reached $8.1 billion in December, down $5.2 billion from the previous month, but $1.1 billion more than in December 2021. For the year 2022, bond financing totaled $115.4 billion, down 3% from 2021, which was a record year. This is still the second best year for issuance in Canadian history. Certainly, the financial industry monopolized a large portion of the primary market with 60% of new issues, a proportion higher than its weight in the index at the beginning of the year (35.5%). Corporate executives showed a clear preference for short-term financing. The proportion of new issues with a maturity of 5 years or less was 57% in 2022, compared to 36% last year when rates were lower.
- Canadian banks were very active in the new issue market in Canada in 2022, but were even more active outside of Canada. Overall, the 6 major Canadian banks issued $242 billion, with only 25.6% of that amount issued in Canada. This is a 74% increase from the previous record in 2018. Increased loan growth during the year, M&A financing and pre-funding in the face of the risk of higher policy rates would explain this abundance of issuance in 2022. The bulk of the issuance was completed in the United States ($102 billion or 42%). Covered bond issues ($88 billion) were mainly sold abroad.
- Quebec's Finance Minister presented an economic update, the highlight of which is the anti-inflation shield. In addition to the $400 to $600 cheques distributed to many taxpayers, this inflation relief plan includes an increase in the tax credit for the support of seniors from $411 to $2,000. In addition, the increase in certain government tariffs has been capped at 3% while the indexation of the main parameters of the personal tax system and social assistance programs has been set at 6.44%. The adoption of this shield will therefore increase the deficit for the current fiscal year to $5.2 billion from the $1.5 billion forecast last August. For next year, the deficit will increase by $1 billion to $2.3 billion. Nevertheless, the goal of a balanced budget in 2027-28 is not in question.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Dec. 2022	2022
Universe	100 %	-1,65 %	-11,69 %
Short Term	43,1 %	-0,15 %	-4,04 %
Mid Term	27,7 %	-1,88 %	-10,29 %
Long Term	29,2 %	-3,63 %	-21,76 %
Federal	37,3 %	-1,46 %	-9,34 %
Provincial	34,3 %	-2,31 %	-15,05 %
Corporates	26,3 %	-1,03 %	-9,87 %
RRB		-0,62 %	-14,32 %

Source: ftse.com

Excluding financing in Canada, our 6 major banks have issued $180 billion abroad, which is 1.5 times the total new corporate issuance in 2022 in the FTSE index. With the acquisition of HSBC Canada by RBC and First Horizon by TD Bank in 2022, funding requirements will remain high. This makes our banks look too big for the Canadian bond market.

We are going to repeat ourselves, but this shield only fuels inflation since it affects the majority of taxpayers. With this second assistance program, Quebec wins the provincial gold medal for anti-inflation measures, 70% more than the second place in percentage of GDP. It would have been preferable to offer more to the poorest and to keep some ammunition to fight against a possible pronounced slowdown.

STRATEGIC POSITIONNING

Like the Bank of Canada and the Federal Reserve, the ECB and the Bank of England also raised their key rates by 0.50% in December. Even the Bank of Japan has changed its tune. Granted, there is no rate hike in the near future, but it has widened its 10-year rate band from +/-0.25% to +/-0.50%. So this is a gradual withdrawal from their yield curve control as inflation reached 3.8%. After an aggressive rate hike in 2022, central bankers are expected to slow the pace of increases in early 2023 leading to a pause during the year. Inflation rates should begin to ease in the first half of 2023 as the effects on prices from the pandemic and the invasion in Ukraine are gradually removed from the calculations of annual change. This reduction in inflationary pressures is expected, but investors anticipate a rate cut in the second half of the year in response to an expected economic slowdown. Since the Canadian and U.S. economies appear to be more resilient than expected despite the announced rate hikes, is investor apprehension justified? The evolution of the job market is a reference point for this question. Given the difficulty companies have had in filling vacancies over the past year, they may be less likely to lay off staff in the face of an economic downturn. A high policy rate over a long period of time therefore seems appropriate.