MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

MARCH 2019

- Recession fears were alleviated early in the year as Canadian GDP posted a solid 0.3 % MoM growth rate in January. Expansion occurred in 18 of the 20 sectors listed, marking the most extensive growth since last May. Lower oil production in Alberta was detrimental early in the year, resulting in a 3.1% decline in the mining and oil and gas extraction industry, a fifth consecutive month of decline. In contrast, the construction industry recorded its first gain in 7 months, up 1.9% in January. This is the most significant monthly increase in construction since July 2013.
- The U.S. economy added 20,000 employees to payrolls last February, the lowest monthly job creation since September 2017 when Hurricane Irma hit the United States. This drop in employment can be explained by various factors, including government paralysis, trade war with China and the harsh weather in February. The unemployment rate still fell to 3.8%, down 0.1%. Despite modest employment, average hourly wages have increased by 3.4% over the past 12 months compared to 3.1% in the previous month.
- Manufacturing Purchasing Manager Index in the German reached its lowest level in six years in March, at 44.7 compared to 47.6 in February. A reading below 50 means a contraction in manufacturing activity. New orders and exports fell. Uncertainty related to Brexit and international trade dispute has had an impact on some sectors, particularly the automotive industry.

RATE TRENDS

- The Federal Reserve announced that it would maintain its policy rate at 2.5% in its March meeting. Committee members now expect to keep this rate unchanged for all 2019, contrary to last December when two increases were anticipated. The Fed justifies this extended patience by the fragile global economic situation and softening inflation. Members also expect lower growth this year (1.9 to 2.2%), a significant decrease from the last forecast (2.3-2.5%).
- Contraction in Europe and China manufacturing industries, combined with the Fed's dovish speech pushed investors to priced in a rate cut in the future, forcing an inversion of the yield curve. The spread between the 10-year and 3-month rates in the United States fell from 28 bps at the end of February to -5 bps in March.

Like the global economy, Canada is going through a slow patch, not to be confused with a recession. Although it was raised last year, the policy rate remains below the neutral rate, meaning that monetary policy remains expansionary. In addition, the federal budget should also promote growth, especially with the CMHC program that provides down payment support for new home buyers.

Besides from affection the economy, the government's shutdown early in the year may have also worsened the quality of economic statistics. In this regard, several economic data have been recently revised considerably.

The Purchasing Manager Index is often a gauge of international trade. However, trade link between China and Europe is important, which explains the drop in the index. On the other hand, the stimulus measures adopted in China earlier this year should have a positive impact on Germany in the second half of the year.

In his press conference, Jerome Powell announced that the 2% inflation target has still not been met symmetrically and convincingly, 10 years after the start of this expansion. By aiming for symmetry, the Fed announces that it could let inflation rise without intervening in order to obtain an average rate of 2% over the business cycle.

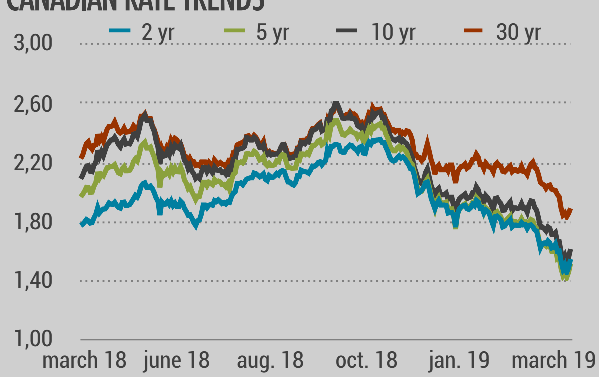
The yield curve inversion is generally a leading indicator of a recession. On the other hand, the majority of other financial assets are not pointing in this direction. These have posted strong gains, reflecting a growing economy.

BOND RATES

March 2019	Canada	Monthly Change	Change 2019	United States	Monthly Change	Change 2019
Key Interest Rate	1,75 %	0,00 %	0,00 %	2,50 %	0,00 %	0,00 %
3 months	1,67 %	-0,00 %	0,02 %	2,38 %	-0,05 %	0,03 %
2 years	1,55 %	-0,23 %	-0,31 %	2,26 %	-0,25 %	-0,23 %
5 years	1,52 %	-0,30 %	-0,37 %	2,23 %	-0,28 %	-0,28 %
10 years	1,62 %	-0,33 %	-0,35 %	2,41 %	-0,31 %	-0,28 %
30 years	1,89 %	-0,30 %	-0,29 %	2,81 %	-0,27 %	-0,20 %
RRB 30 years	0,44 %	-0,26 %	-0,32 %			

Source: Bloomberg

CANADIAN RATE TRENDS



1800 Ave. McGill College | Suite 2420 | Montréal (PQ) | H3A 3J6
514-861-3493
www.alphafixe.com
info@alphafixe.com

CREDIT BOND SPREADS

ISSUER	Credit rating DBRS	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2019	Change 10 yrs month	Change 10 yrs 2019	Change 30 yrs month	Change 30 yrs 2019
Royal Bank Bail-in Debt	AA low	110	145	185	5	-25	5	-15	5	-15
Royal Bank NVCC sub debt	A low	160	205	245	10	-25	10	-15	10	-15
Fortis Inc.	BBB high	115	160	215	0	-25	-5	-25	0	-20
Hydro One	A high	95	130	165	5	-20	10	-10	5	-15
Enbridge Inc	BBB high	130	180	235	-5	-30	5	-30	5	-40
Encana Corp	BBB	175	240	295	0	-30	0	-30	0	-30
GTAA	---	75	100	130	5	-10	10	-5	5	-10
Bell Canada	BBB high	125	170	230	0	-30	0	-30	5	-30
Rogers Communications	BBB	120	165	225	0	-30	0	-30	5	-35
Loblaw	BBB	130	180	235	0	-35	0	-35	5	-35
Canadian Tire	BBB high	125	175	240	0	-35	0	-35	5	-30
Province of Quebec	A high	49	72	81	3	-10	2	-12	0	-15
Province of Ontario	AA low	53	77	86	3	-10	2	-12	0	-15
CMHC	AAA	38	47	---	3	-5	1	-9		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached 12.3 billion in March, an increase of $7.7 billion over the month and $3.5 billion more than in March 2018. Since the beginning of the year, corporate bond issuance amounted to $22.1 billion, or 4.8% more than at this time last year. Investor's risk appetite revived in the first quarter. Corporate bond spreads contracted over the last 3 months, from 150 bps at the end of 2018 to 130 bps in March. The situation is similar at the provincial level, where long-term bond yield spreads declined by 12 bps to close the first quarter at 92 bps.
- Sun Life Insurance Company has published a framework for issuing sustainable bonds. The bond's proceeds will be used to finance or refinance, in whole or in part, green or social assets on Sun Life's general fund balance sheet. Eligible assets will have to meet pre-established criteria listed in 6 main categories: renewable energy, energy efficiency, sustainable buildings, clean transportation, sustainable water management and access to essential services. Therefore, a green bond can meet 5 of the 6 major sustainable asset categories. Given the growing global demand for this type of bond, Sun Life believes it can diversify its funding sources.
- The CAQ's first budget proposed a financial framework targetting a balanced budget for a fourth consecutive year. For the year ending March 31, 2019, the Government of Quebec's operating surplus was $5.6 billion, up $1.1 billion from December. The government will use $3.1 billion of the surplus for the Generations Fund and $2.5 billion will be allocated to the stabilization reserve, a fund available in the event of an emergency. For the following fiscal year (2019-20), the government plans to increase spending by 4.7% while revenues should be up 1.8%. As a result, the operating surplus will fall to $2.5 billion and will be transfer in full into the Generations Fund. For the next 4 years, annual expenditure growth is expected to reach 3.0% and income 3.2%. Under this plan, the province's gross debt is expected to fall from 46.1% of GDP in 2019 to 42.3% in 2024.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	March-19	2019
Universe	100 %	2,35 %	3,91 %
Short Term	43,7 %	0,85 %	1,74 %
Mid Term	22,2 %	2,13 %	3,77 %
Long Term	34,1 %	4,50 %	6,94 %
Federal	35,1 %	1,85 %	2,50 %
Provincial	35,4 %	3,12 %	5,24 %
Corporates	27,6 %	1,99 %	4,03 %
RRB		4,03 %	5,13 %

Source: ftse.com

As a result, Sun Life can be expected to issue a green bond in the near future, so will National Bank, which also filed a sustainable bond framework last October. Issuers appreciate the geographical diversity of investors while the latter are seeking an impact investment solution without sacrificing return.

With this year's payment, the stabilization reserve has now reached a record level of $9.7 billion. This safety net provides the government with significant flexibility to deal with a possible economic slowdown or a recession without compromising the balanced budget.

STRATEGIC POSITIONNING

Financial markets are sending diametrically opposite signals. On the one hand, the Fed's dovish speech pushed bond rates down so that the 3-month rate is now above the 10-year rate. The inversion of the yield curve has raised fears of a recession in the near future. On the other hand, all other risky assets are pointing in the opposite direction, particularly credit spreads, which have been narrowing steadily since the beginning of the year. New corporate bond issuance are attracting a record number of investors with very large purchase orders. How can a bond manager worry about a recession while at the same time adding credit risk? While the global economy is softening, recession risks are is premature. The stimulus measures adopted in China in the first quarter will pay off in the spring and drive Europe up in the second half. In their trade negotiation strategy with the US, China must display a strong and resilient economy towards Trump's tarif threats. In addition, Trump also wants to run a re-election campaign with a strong economic report card, which implies a trade agreement with Xi Jinping. China's recovery combined with a trade agreement and continued accommodative global monetary policies will support economic growth and higher risk assets for some time to come.