MONTHLY BOND LETTER

AlphaFixe Capital

JANUARY 2020

ECONOMIC EVENTS

- After a 1.1% decline in October, Canadian retail sales increased by 0.9% in November and 0.7% in volume terms. The increase in sales came largely from auto sales. Notwithstanding this industry, sales increased by 0.2% on a monthly basis with 70% of retailers posting gains. Stores were active in Quebec (1.4%), Ontario (1.6%) and British Columbia (1.1%), but conditions remained difficult in Alberta (-0.9%).

Household consumption is generally influenced by the strength of the labour market and real estate. The provincial difference in November retail sales reflects this reality. Real estate activity remains strong in Quebec and should continue to generate a steady flow at the malls. For the moment, Albertans are not as lucky.

- GDP growth in the United States reached 2.1% in the last quarter of the year, bringing the 2019 growth to 2.3%. Household spending slowed to 1.8% in the fourth quarter, but remained the growth engine in 2019 with a gain of 2.6%. Net exports made a strong contribution to GDP as exports grew by 1.4% while imports fell by 8.7% in response to the trade dispute. This uncertainty also affected business investment spending, which fell 1.5%. The GM strike and Boeing's cutbacks also undermined investment.

While Trump's fiscal stimulus has faded, the U.S. economy is returning to its natural growth rate of 2.0-2.5%. Some transitory factors have also dampened growth, including the trade dispute with China and the GM strike. These will have less influence in 2020, unless the coronavirus crisis deepens.

- The Chinese economy grew at a 6.1% rate in 2019 compared to 6.6% in the previous year. This is the slowest pace since 1990. This slowdown reflects the challenges China faced last year, namely the adoption of debt containment measures, the trade dispute with the United States and weak domestic demand.

The coronavirus crisis paralyzed economic activity at the beginning of the year. When the situation will stabilizes, the Chinese authorities will use all their fiscal and monetary powers to restart their economy.

RATE TRENDS

- The Bank of Canada kept its policy rate at 1.75% at its January meeting. The Bank expects growth to slow down in the fourth quarter as a result of the CN strike, difficult weather conditions and inventory adjustments. Geopolitical uncertainty also resurfaced early in the year following the conflict between Iran and the United States. In contrast, residential investment remains strong and household spending is expected to grow again, supported by the federal tax cut.

Investor expectations of a rate cut grew after the Bank withdrew its comment that the police rate was appropriate in this economic environment. However, Mr. Poloz explained at the press conference that they constantly modify the press release precisely to avoid this kind of interpretation and reiterated that the policy rate was appropriate.

- The Federal Reserve also renewed its monetary policy in January. The Fed says the labour market remains robust and economic activity is growing at a moderate pace, supported by consumer spending. However, business investment and exports remain weak. Therefore, the Committee judges that current policy remains appropriate and will allow inflation to return to the 2% symmetric target. Mr. Powell also indicated that Treasury bill purchases will continue to ensure an adequate level of reserves in the banking system, but that the pace will be reduced.

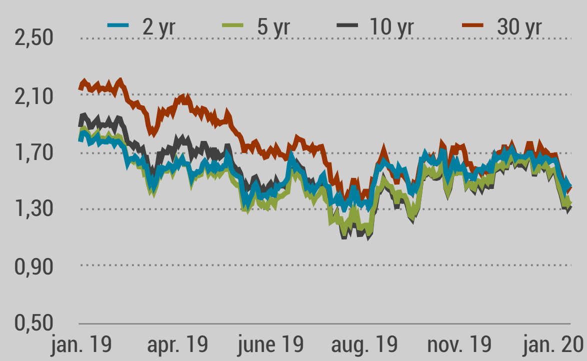
The Fed may indicate that it wants to slow the pace of its intervention in repo and money markets, but if investors push it, Mr. Powell will have no choice but to continue. Liquidity in the banking system is too important for the economy and the stability of financial markets.

BOND RATES

Jan. 31 2020		Monthly Change	Change 2020		Monthly Change	Change 2020
Key Interest Rate	1,75 %	0,00 %	0,00 %	1,75 %	0,00 %	0,00 %
3 months	1,64 %	-0,02 %	-0,02 %	1,54 %	-0,01 %	-0,01 %
2 years	1,43 %	-0,27 %	-0,27 %	1,31 %	-0,26 %	-0,26 %
5 years	1,28 %	-0,41 %	-0,41 %	1,31 %	-0,38 %	-0,38 %
10 years	1,27 %	-0,43 %	-0,43 %	1,51 %	-0,41 %	-0,41 %
30 years	1,43 %	-0,33 %	-0,33 %	2,00 %	-0,39 %	-0,39 %
RRB 30 years	0,11 %	-0,27 %	-0,27 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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CREDIT BOND SPREADS

ISSUER	Credit rating DBRS	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2020	Change 10 yrs month	Change 10 yrs 2020	Change 30 yrs month	Change 30 yrs 2020
Royal Bank Bail-in Debt	AA	85	120	160	0	0	0	0	0	0
Royal Bank NVCC	A	120	170	210	0	0	0	0	0	0
Sun Life, dette subordonnée	A	100	145	185	0	0	0	0	0	0
Hydro One	A high	65	95	140	5	5	10	10	10	10
Enbridge Inc	BBB high	105	155	225	5	5	5	5	5	5
Altalink LP	A	65	90	130	10	10	10	10	10	10
GTAA	A high	60	85	120	5	5	5	5	10	10
Bell Canada	BBB high	100	150	210	0	0	0	0	5	5
Rogers Communications	BBB	95	145	210	0	0	0	0	5	5
Loblaw	BBB	105	155	210	0	0	0	0	0	0
Canadian Tire	BBB high	100	150	205	0	0	0	0	0	0
Province Québec	AA low	42	63	75	6	6	4	4	6	6
Province Ontario	AA low	43	66	78	5	5	4	4	5	5
SCHL	AAA	32	40	---	3	3	2	2		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached $8.3 billion in January, down $2.5 billion from the previous month, but $2.8 billion more than in January 2019. This was the best month of January in terms of volume since 2013 when it reached $9.9 billion. The Canadian banking industry again attracted attention in January with a total of $6.3 billion divided among 5 issuers. These were mainly bank bail-in debt. Although the issues were large in size, investors gobbled them up despite the uncertainty surrounding Iran and the United States and the coronavirus.
- Difficulties in the automotive industry continue to weigh on automaker's financial performance and their ratings outlook. This time, Toyota saw its long-term credit outlook downgraded from stable to negative by Moody's. While the rating remains high at Aa3, Moody's believes that this change reflects the challenges associated with the underlying trends in the global auto industry. Increased competition, electric vehicles and stricter environmental standards "would require higher levels of profitability to temper the uncertainties associated with these transitions». Toyota announced a 3.2% reduction in operating income in the third quarter of its fiscal year. The manufacturer's cost reduction efforts were unable to offset unfavorable exchange rate fluctuations and lower sales.
- The weight of BBB-rated corporate bonds in the United States reached 50% of investment grade corporate bonds in 2019, a first in the index's history according to Bank of America Securities. In addition, only 0.3% of investment grade bonds were downgraded in the high-yield category, also a record. In Canada, BBB-rated corporate securities in the FTSE Canada Corporate Index increased from 22 % in 2009 to 41% by the end of 2019. This weight rises to 62% in the mid-term index (5 to 10 years), compared to 29% in 2009. Some issuers have been downgraded to the BBB category over the past 10 years, but the increase in weight is also due to the arrival of new Canadian issuers and new bank debt structures.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Jan. 2020	2020
Universe	100 %	2,91 %	2,91 %
Short Term	41,9 %	1,04 %	1,04 %
Mid Term	23,1 %	2,89 %	2,89 %
Long Term	35,1 %	5,26 %	5,26 %
Federal	34,8 %	2,37 %	2,37 %
Provincial	35,5 %	3,60 %	3,60 %
Corporates	27,6 %	2,68 %	2,68 %
RRB		4,12 %	4,12 %

Source: ftse.com

The 7.5% drop in auto sales in China last year hurt Japanese automakers. Trade tensions with the United States, the adoption of stricter emission standards, and reduced subsidies for new-energy vehicles account for this decline. While some factors will dissipate, the change in the industry is real, costly, and requires effective management.

While weight has increased over the past 10 years, issues are not necessarily of poor quality. The weight of BBB- rated securities is only 6%, while that of BBB+ is 24%. In addition, some major Canadian banks issued non-viable contingent capital securities rated BBB. These must comply with new bank capital requirement that make them less risky.

STRATEGIC POSITIONNING

The geopolitical risks that threatened the global economy last year dissipated at the beginning of the year. The partial agreement between China and the United States combined with monetary easing by 28 central banks in 2019 and fiscal stimulus in some countries are paving the way for a global recovery in 2020. This was before the coronavirus came along and blurred the picture. Certainly, this epidemic will slow growth in China, where several regions have been paralyzed for weeks. If the situation does not stabilize in the coming months, this epidemic could lead the world economy into recession given the importance of China in the global economy today. Currently, there are more than 40,000 people infected worldwide, but only 590 outside China. Thus, the risks of a pandemic are limited for the time being and the rate of new cases is slowing daily. The virus is spreading rapidly, but its less deadly (2% of infected) than SARS (10%) that troubled the world in 2003. Criticized in the management of this crisis, the Chinese authorities will deploy all the tools for an economic recovery. In 2003, China had stimulated its economy considerably once the epidemic had been brought under control. The global economy will therefore suffer a temporary shock, but the backdrop remains positive in 2020 and financial assets will later price in higher growth rate...unless the epidemic persists.