MONTHLY BOND LETTER

AlphaFixe Capital

MARCH 2023

ECONOMIC EVENTS

- The Canadian economy has started the year strong. GDP grew by 0.5% in January and is expected to continue to grow by 0.3% the following month according to a preliminary estimate by Statistics Canada. Growth in January was widespread with 17 out of 20 industries showing output growth. Goods-producing industries grew by 0.4%, including construction (+0.7%) and manufacturing (+0.5%). Home improvement and vehicle manufacturing contributed to growth in January. Service industries also grew in January, up 0.6% month-over-month. Notable gains were recorded in retail trade (+1.0%), arts and entertainment (+2.1%), and food and hospitality (+4.0%).

In fact, several industries related to household discretionary spending did well in January. Consider restaurants, entertainment and retail trade. Assuming the economy grows by 0.3% in February and does a stand still in March, GDP would grow at an annualized rate of 2.9% in the first quarter, well ahead of the Bank of Canada's forecast of +0.5%. To reach the Bank's forecast, the economy would have to contract by 1.8% in March, which is unlikely.

- The failure of the US Bank Silicon Valley Bank (SVB) caused a stir in the financial markets in March. The bank was taken by storm by an acceleration of withdrawals after suffering a $1.8 billion loss on the sale of $21 billion of its bond portfolio. To prevent a panic in the banking system, the government announced that it would guarantee all deposits at the bank, not just those under $250,000. In addition, the Federal Reserve has offered the regional banks financing using the bonds they hold as collateral. The loan will be at the face value of the bond ($100), instead of the market value which is often at a discount these days.

The first reaction of investors is to draw parallels with the 2008 financial crisis when banks' balance sheets brought the financial system to the brink. However, this comparison is inappropriate. It is not yet a problem of asset quality, but rather a mismanagement of a bank that did not properly match its liabilities (deposits) with its assets (government bonds).

- As expected, inflation is decelerating rapidly in Europe. According to a preliminary reading, the price index rose 0.9% in March and 6.9% in the past year. This is a sharp deceleration from February's 8.5%. The slower pace is attributable to energy prices, which have now fallen 0.9% in the past 12 months compared to a 13.7% increase in February. Excluding energy and food, core inflation now stands at a new high of 5.7 percent.

Core inflation is closely monitored by the European Central Bank (ECB) as a barometer for its monetary policy. Financial stability is still a concern for policymakers, but inflation is accelerating and is not yet under control. If the banking situation stabilizes, the ECB will continue its monetary tightening, but at a more moderate pace.

RATE TRENDS

- Despite the events that shook the financial markets during the month, the Federal Reserve continued its fight against inflation by raising its policy rate by 0.25% to 5.0%. The Fed was not alone in continuing its monetary tightening. The European Central Bank, the Bank of England and the Swiss National Bank all raised their policy rates for the same inflationary reasons. They also each reiterated their confidence in their respective banking systems, indicating that they are resilient and well capitalized to weather the turbulence. The outlook was toned down, however. The commitment to continue raising rates to fight inflation is now less firm. Central banks want to assess the economic effects of tighter economic conditions before tightening further.

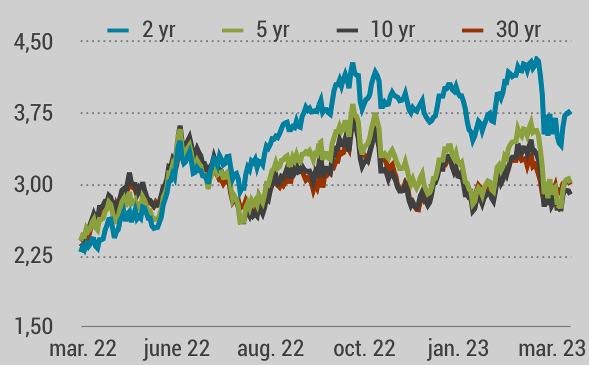
Concerns about the banking system are more related to the liquidity of banks than to their solvency. In an effort to alleviate these concerns, central banks have been working together this month to announce coordinated liquidity measures. However, this does not rule out the economic consequences of this crisis. If regional banks were to tighten credit conditions, economic growth would be limited, which would hurt the labor market. It is still too early to assess the economic consequences, but for now, the latest surveys show that consumer confidence is improving.

BOND RATES

Mar. 31, 2023		Monthly Change	Change 2023		Monthly Change	Change 2023
Key Interest Rate	4,50 %	0,00 %	4,00 %	5,00 %	0,25 %	4,50 %
3 months	4,40 %	-0,12 %	0,14 %	4,69 %	-0,08 %	0,35 %
2 years	3,74 %	-0,47 %	-0,32 %	4,03 %	-0,79 %	-0,40 %
5 years	3,02 %	-0,50 %	-0,39 %	3,57 %	-0,61 %	-0,43 %
10 years	2,90 %	-0,43 %	-0,40 %	3,47 %	-0,45 %	-0,41 %
30 years	3,00 %	-0,20 %	-0,28 %	3,65 %	-0,27 %	-0,31 %
RRB 30 years	1,26 %	0,01 %	0,07 %			

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 RISK PREMIUMS

Issuers	Credit Rating DBRS	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2023	Change 10 yrs month	Change 10 yrs 2023	Change 30 yrs month	Change 30 yrs 2023
Royal Bank, Bail-in-debt	AA	165	200	230	25	0	25	0	25	0
Royal Bank, NVCC	A	240	285	325	50	15	50	15	50	15
Sun Life, subordinated debt	A	210	250	275	35	10	35	10	30	5
Hydro One	A high	110	140	165	10	0	10	0	10	5
Enbridge Inc	BBB high	175	220	265	15	0	15	5	15	5
Altalink LP	A	110	140	165	10	5	10	5	10	10
GTAA	A high	105	130	155	10	0	10	-5	10	0
Bell Canada	BBB high	155	200	230	15	-5	15	5	10	5
Rogers Communications	BBB	180	225	270	15	0	5	0	10	0
Loblaw	BBB high	150	190	210	20	0	20	5	15	0
Canadian Tire	BBB	170	215	255	20	0	20	5	15	0
Province Québec	AA low	44	74	97	9	-2	9	2	8	3
Province Ontario	AA low	45	74	97	8	-3	7	0	7	2
CMHC	AAA	32	42	---	7	-4	2	-4		

Source: National Bank Financial

CREDIT MARKET

- New Canadian corporate bond issuance reached $7.4 billion in March, up $2.1 billion from the previous month, but $21.3 billion less than in March 2022. Year-to-date, bond financing totals $22.5 billion, down 49% from the same period last year. This compares to a record $44.2 billion in new issuance in the first quarter of last year. However, there was more activity in green bonds this quarter with 7 issues for a total of $2.6 billion. Despite last year's record high issuance, there were only 2 green bond issues in the first 3 months for a total of $600 million.

- Swiss authorities orchestrated the merger of UBS and Credit Suisse after investors and depositors recently lost confidence in the latter. The transaction is valued at US$3.25 billion in equity and forced the complete write-off of the value of the Additional Tier 1 (AT1) capital bonds. For investors in these bonds, this is a loss valued at US$17 billion, while shareholders, who are junior to creditors, reap a portion of this transaction. The decision came as a surprise to Credit Suisse's creditors. The bonds had contractual triggers that allowed the regulator to write off the value of the bonds completely if the bank's Tier 1 capital ratio fell below 7%. Write-offs were also possible if the bank was deemed unsustainable by the regulator or if the government provided financial support to the bank. The regulator ruled that as a result of the extraordinary government support in this merger, these securities could be wiped-out.

- March is provincial budget time. In Quebec, the Legault government presented a 2023-24 budget that assumes 1.8% revenue growth despite a one percent tax rate reduction for each of the first two tax brackets. Expenditures will increase by 0.7%, bringing the deficit for the 2023-24 fiscal year to $4 billion, including the $2.4 billion payment to the Generations Fund. The budget should be balanced in fiscal year 2027-28. The good news is that the government has set an objective of reducing the province's debt ratio to 30% of GDP, close to the average of other provinces.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Mar. 2023	2023
Universe	100 %	2,16 %	3,22 %
Short Term	43,3 %	1,22 %	1,82 %
Mid Term	27,1 %	3,16 %	3,85 %
Long Term	29,6 %	2,61 %	4,72 %
Federal	38,0 %	2,47 %	2,95 %
Provincial	34,4 %	2,42 %	3,79 %
Corporates	25,5 %	1,33 %	2,79 %
RRB		0,69 %	-0,23 %

Source: ftse.com

This situation would not apply under the Canadian regulatory framework. The Canadian banks' Limited Recourse Capital Notes do not force a write-off. Rather, the Canadian framework provides a mechanism for converting the amount invested into common shares at pre-determined multiples. This would leave creditors as shareholders rather than losing their investment completely.

In times of economic uncertainty and continued inflation, the political decision to cut taxes is questionable. By comparison, Ontario is projecting a deficit of $1.3 billion, including a $1 billion contingency reserve. Ontario has achieved a balanced budget for the current fiscal year.

STRATEGIC POSITIONNING

It's amazing what a week can bring in the financial markets these days. On March 7, the Federal Reserve Chairman mentioned that if economic statistics remain robust, the Fed should raise its policy rate forecast for the current year by accelerating future hikes. Three days later, the SVB was seized and all scenarios were thrown out the window. After stabilizing the situation with special supplementary liquidity programs for U.S. banks, the Federal Reserve still raised its key rate by 0.25% on March 22, subject to conditions for further monetary tightening in the future. It is difficult and still too early to assess the consequences of this banking crisis on the evolution of the economy. Fed officials expect another rate hike this year and slower growth due to tighter credit conditions. The labor market is also expected to take a hit with a 1 percent increase in the unemployment rate, equivalent to a loss of 1.6 million jobs. Despite this decline in employment, the Fed does not expect to reduce the cost of money until 2024. This scenario is not shared by investors, who are now betting on a rate cut of nearly 1% in the second half of the year. Although banks could tighten credit conditions, the drop in bond rates this month could support growth. The direction of the financial markets is therefore in the hands of the regional banks.