MONTHLY BOND LETTER

AlphaFixe Capital

JANUARY 2019

ECONOMIC EVENTS

- The unemployment rate ended 2018 at its lowest level since January 1976 at 5.6%, down 0.2% from the end of last year. Employment therefore increased by 163,000 during the year or 0.9%, which represents a decrease in pace compared to 2017 (2.3%). Full-time jobs increased over the year (185,000) while part-time jobs declined (-22,000). The provinces of Ontario (+78,000), British Columbia (+44,000) and Alberta (+22,000) created 88% of the country's jobs. After growing by 91,000 in 2017, employment in Quebec remained essentially unchanged in 2018.

It is normal for the job creation to slow down when the unemployment rate reaches historic lows. However, it is reassuring to see strong job creation in the provinces where real estate is at risk, namely Toronto and Vancouver. Now that the Bank of Canada has announced a break and employment remains robust, it is less likely that a real estate crisis will emerge.

- The ISM manufacturing index in the United States recovered in January (56.6) after dropping 4.5 points in December (53.4). Recall that a reading above 50 indicates an expansion while a decline occurs below 50. The new orders sub-index jumped to 58.2 from 51.3 in December. The labour market sub-index (55.5) remains in expansionary territory for the 28th consecutive month. Over the past 12 months, the economy has added 261,000 new manufacturing jobs, up 68,000 from the previous 12 months.

The new manufacturing orders provide a positive outlook on the economy's direction. The sharp decline in December was worrisome, but more so a risk on the financial markets than of an economic slowdown.

- The Chinese economy grew at an annualized rate of 6.4% in the fourth quarter, bringing growth to 6.6% in 2018, the slowest pace in 28 years. Although the trade surplus with the rest of the world is at its lowest level since 2013, the surplus with the United States increased by 17% in 2018 to reach US$323 billion, a peak since 2006. China has announced that it wants to eliminate this surplus by 2024 in order to ease tensions with the United States.

China's problem is that it produces more than it consumes. As a result, it accumulates savings of up to 45% of GDP. This production surplus can therefore be recycled into exports or credit accessible to the economy. China must therefore promote domestic consumption to mitigate this problem, hence the decrease in the effective tax rate since the beginning of the year.

RATE TRENDS

- The Bank of Canada announced that it was maintaining its policy rate at 1.75% at its January meeting. The Bank has placed considerable emphasis on the decline of oil prices worldwide, which will have a negative impact on the Canadian economy, thus a reason for its decision, while citing the risk of a trade dispute between the United States and China. In light of this decline, the Bank has revised its growth forecast from 2.1% to 1.7% for 2019. The objective of normalizing rates remains, but it is a matter of the strength of economic statistics.

If you want to forecast the Bank's next rate hike, look at the evolution of oil prices. Yet the downward impact of the oil industry on the Canadian economy will be less than in 2015. Investments in this industry had fallen by 50% at that time and have remained low ever since.

- The Federal Reserve has indicated that it is putting its monetary policy on hold for an indefinite period of time while remaining flexible in managing its balance sheet. The decline in financial markets, the weakness of the global economy, trade tensions with China and moderate inflationary pressures are the reasons behind the Fed's decision.

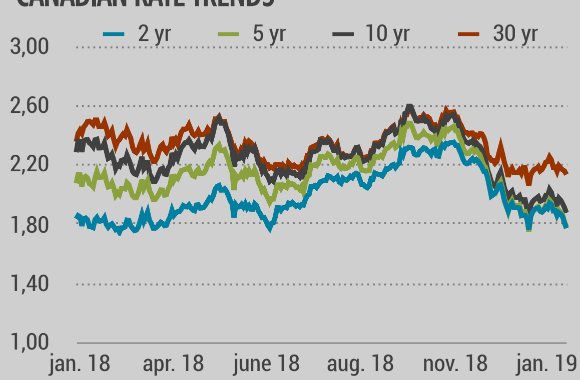
The investors finally made the Fed cry uncle. Over the past 30 years, they have dictated the pace of monetary tightening and according to them, the Fed was moving too fast given the current geopolitical risks.

BOND RATES

Jan. 31 2019		Monthly Change	Change 2019		Monthly Change	Change 2019
Key Interest Rate	1,75 %	0,00 %	0,00 %	2,50 %	0,00 %	0,00 %
3 months	1,66 %	0,00 %	0,00 %	2,38 %	0,03 %	0,03 %
2 years	1,78 %	-0,09 %	-0,09 %	2,46 %	-0,03 %	-0,03 %
5 years	1,79 %	-0,10 %	-0,10 %	2,44 %	-0,07 %	-0,07 %
10 years	1,88 %	-0,09 %	-0,09 %	2,63 %	-0,05 %	-0,05 %
30 years	2,14 %	-0,05 %	-0,05 %	3,00 %	-0,02 %	-0,02 %
RRB 30 years	0,68 %	-0,09 %	-0,09 %			

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

ISSUER	Credit rating DBRS	Credit rating S&P	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, deposit notes	AA low		115	145	185	-20	-20	-15	-15	-15	-15
Manulife, Senior debt	A high	A+	110	140	180	-20	-20	-15	-15	-15	-15
Fortis Inc.	BBB high	BBB+	120	165	215	-20	-20	-20	-20	-20	-20
Hydro One	A high	A-	95	120	155	-20	-20	-20	-20	-25	-25
Enbridge Inc	BBB high	BBB+	140	185	235	-20	-20	-25	-25	-40	-40
Encana Corp	BBB low	BBB-	175	240	295	-30	-30	-30	-30	-30	-30
GTAA	---	A+	75	95	125	-10	-10	-10	-10	-15	-15
Bell Canada	BBB high	BBB+	130	175	230	-25	-25	-25	-25	-30	-30
Rogers Communications	BBB	BBB+	125	170	230	-25	-25	-25	-25	-30	-30
Loblaw	BBB	BBB	140	190	240	-25	-25	-25	-25	-30	-30
Canadian Tire	BBB high	BBB+	135	185	245	-25	-25	-25	-25	-25	-25
Province of Québec	A high	A+	47	72	85	-12	-12	-12	-12	-11	-11
Province of Ontario	AA low	A+	51	76	89	-12	-12	-13	-13	-12	-12
CMHC	AAA	AAA	35	47	---	-8	-8	-9	-9		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond issuance reached $ 5.5 billion in January, an increase of $4.5 billion over the month but $800 million less than in January 2018. Among the 9 new issues in January, 2 were green bonds, Ontario Power Generation and Algonquin Power, a first for the latter. Algonquin's will be used to finance or refinance investments in renewable and clean energy production technologies. The majority of the production (86%) is sold under long-term power purchase agreements with a term of about 14 years old. These contracts exceed the maturity of the green bond (2029) and reduce cash flow volatility.

- Canadian provinces took advantage of more favorable capital market conditions in January to accelerate their financing programs. Collectively, they raised $13.7 billion in bond financing in the last month, the fourth most active month in history. However, Canadian issues totalled only $4.7 billion, while $9 billion was issued on foreign markets, particularly in the United States and Europe. This is by far a record for foreign issues in a single month, the last time was $6.4 billion in April 2017. As a result, some provinces have already completed their funding requirements for the current fiscal year, 8 weeks ahead of schedule. This is the case in Quebec, Ontario and Alberta.

- Hydro One and Avista announced that they were cancelling their merger after Washington State and Idaho regulators refused to approve the transaction. As a result, Hydro One will now have to pay Avista a cancellation fee of $103 million as stipulated in the terms of the contract. Regulatory agencies have indicated that Avista's customers are not sufficiently protected from the whims of the Ontario government, the majority shareholder of Hydro One. It should be recalled that the Ford administration had forced the former CEO of Hydro One to retire on the pretext that high electricity rates were linked to the high salaries for its senior executives. For American agencies, this type of interference demonstrates that the province is willing to put its political interests ahead of those of shareholders.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Jan. 2019	2019
Universe	100 %	1,34 %	1,34 %
Short Term	44,9 %	0,67 %	0,67 %
Mid Term	22,0 %	1,44 %	1,44 %
Long Term	33,1 %	2,19 %	2,19 %
Federal	36,3 %	0,69 %	0,69 %
Provincial	34,3 %	1,74 %	1,74 %
Corporates	27,5 %	1,68 %	1,68 %
RRB		1,34 %	1,34 %

Source: ftse.com

The opening of foreign markets to provincial bonds reduces the amount of bonds to be issued in Canada and has resulted in a significant narrowing of spreads in one month. With only $2 billion in financing to be completed for all provinces and 2 months to go, the environment is favourable for the provincial credit.

Cancelling the transaction means lower debt levels for Hydro One, maintaining its credit rating and narrowing spreads. However, the company's directors now face challenges. How to move Hydro One forward with Doug Ford as Prime Minister considering that the option of an acquisition

STRATEGIC POSITIONNING

The king is dead, long live the king! Today we can say December has passed, long live January! Indeed, there is no better proof that January's asset returns to illustrate that December's volatility was temporary and reflected a change in investors' perception of risk. The fundamentals of the economy are the same as last November. Real estate is doing well, household consumption spending is supported by a robust labour market, a high savings rate and a record high for net assets. Consumer and business confidence is also high, as is the manufacturing industry. What changed in December was investors' perception of risk facing geopolitical events beyond their control. These events were also compounded by restrictive rhetoric from the Federal Reserve without a break in sight. However, the monetary policy path changed on January 4th following Jerome Powell's speech, providing much-needed relief to investors and improving their perception of risk in the markets. Given that monetary policy is on hold, that the market does not anticipate any increase in the coming year and that the economy continues to grow beyond its production capacity, inflationary pressures could be more pronounced in the longer-term, with a steepening of the yield curve.