MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

SEPTEMBER 2020

- Canadian existing home sales increased 6.2% in August after a huge 26% jump in July. This has put the year over year increase at 33.5%. New listings also jumped in August, with a 10.6% increase in one month. This is the first time that listings are outpacing sales since the resal estate market reopening after the lockdown. Excess demand in recent months has propelled the average transaction price up 18.5% in the past year across the country. In Montreal, sales grew by 38.8% year-over-year, forcing prices up 21% over the same period.

Part of this increase is the result of pent-up demand following the market's closure for almost 3 months in the peak season. On the other hand, certain factors of robustness persist. Mortgage rates are at historic lows, millenials demographic demand remains present, and household disposable income is rising, thanks to government programs. In contrast, the outlook for commercial real estate with its office space is bleaker.

- The U.S. budget deficit reached $200.1 billion in August, bringing the cumulative deficit to $3,007 billion with only one month left in the fiscal year (ending September 30, 2020). At this time last year, the deficit stood at $1,067 billion. Spending in the first 11 months of the fiscal year reached $6,054 billion compared to $4,155 billion last year, an increase of 45.7%. Revenues were virtually unchanged at $3,046 billion compared to $3,088 billion in 2019.

The deficit as a percentage of GDP is expected to be the highest since the Second World War. However, the nearly $2 trillion increase in the deficit was financed entirely by the Federal Reserve, which purchased $2.1 trillion in Treasury bonds this year. Modern monetary theory in application.

- The annual inflation rate in the euro zone reached -0.3% in September, a second consecutive month of deflation and a 4-year low. Core inflation, which subtracts the prices of volatile items such as food, energy and tobacco, reached an all-time low of 0.2% in annual change. The absence of inflation opens the door to an increase in the European Central Bank's bond purchase program by the end of the year.

The pandemic has changed household consumption patterns. Travel has been replaced by swimming pools, electric bicycles or home renovation. Since the pandemic has changed the consumer basket, is the one used in the inflation calculation still adequate?

RATE TRENDS

- As expected, the Federal Reserve kept its policy rate at 0.25% following its September meeting. This rate will remain unchanged until labour market conditions have reached levels consistent with the committee's assessments of maximum employment. Inflation will also be expected to remain moderately above 2% for some time. Committee members forecast that the policy rate will remain at this low level until 2023.

- The European Central Bank (ECB) left its policy rate and asset repurchase program unchanged following its monetary policy meeting. However, at a press conference, Christine Lagarde stressed the strength of the euro against the U.S. dollar recently. Although the euro's nearly 10% appreciation against the U.S. dollar is not yet a burden to European exporters, the trend is worrisome in the eyes of the ECB.

The idea of a 2% average inflation target is gaining traction among central bankers. Christine Lagarde indicated that the ECB is studying this proposal. With this approach, monetary policy will remain accommodative even when the output gap is closed. It will take an unemployment rate below 4% and an inflation rate above 2% or the Fed to start raising its policy interest rate. The Fed is the first central bank to adopt this new monetary framework, but others will follow. This is a major change in the conduct of monetary policy. Instead of acting preventively to control inflation, the Fed will now be reactive to inflationary factors.

BOND RATES

Sept. 30, 2020	Canada	Monthly Change	Change 2020	U.S.	Monthly Change	Change 2020
Key Interest Rate	0,25 %	0,00 %	-1,50 %	0,25 %	0,00 %	-1,50 %
3 months	0,12 %	-0,02 %	-1,54 %	0,09 %	-0,00 %	-1,45 %
2 years	0,25 %	-0,03 %	-1,45 %	0,13 %	-0,00 %	-1,44 %
5 years	0,36 %	-0,04 %	-1,33 %	0,28 %	0,01 %	-1,41 %
10 years	0,56 %	-0,06 %	-1,14 %	0,68 %	-0,02 %	-1,23 %
30 years	1,11 %	-0,06 %	-0,65 %	1,46 %	-0,02 %	-0,93 %
RRB 30 years	-0,20 %	-0,03 %	-0,58 %			

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

Émetteurs	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	90	120	165	0	5	0	0	5	5
Royal Bank, NVCC	A	135	170	225	-5	15	-5	0	0	15
Sun Life, subordinated debt	A	110	145	190	5	10	5	0	0	5
Hydro One	A high	75	110	155	5	15	10	25	10	25
Enbridge Inc	BBB high	125	175	255	5	25	15	25	10	35
Altalink LP	A	70	105	150	5	15	10	25	10	30
GTAA	A high	95	130	175	0	40	0	50	10	65
Bell Canada	BBB high	105	155	225	5	5	10	5	15	20
Rogers Communications	BBB	100	150	220	5	5	10	5	15	15
Loblaw	BBB high	95	145	215	0	-10	5	-10	10	5
Canadian Tire	BBB	130	180	270	0	30	-10	30	0	65
Province Québec	AA low	33	68	86	-7	-3	-1	9	3	17
Province Ontario	AA low	38	71	87	-5	0	-2	9	2	14
CMHC	AAA	23	36	---	-2	-6	-3	-2		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached $10.8 billion in September, up $5.9 billion from the previous month, but $3.6 billion less than in September 2019. Year-to-date bond financing totalled $91 billion, up 23% from the same time last year. Like Royal Bank earlier this year, three other Canadian banks (National Bank, Bank of Montreal and CIBC) have issued limited recourse capital notes. The 4 issues outstanding this year total $4.25 billion. It should be noted that this note has a 60-year maturity, but redeemable at the issuer's option after 5 years. The banks simultaneously issue preferred shares that are placed in trust and serve as collateral for the note in the event of a bank default.
- The Province of British Columbia has revised its budget accounts for the 2019/20 fiscal year from a surplus of $203 million estimated in the February budget to a modest deficit of $321 million (0.1% of nominal GDP). However, the deficit is expected to explode in the current fiscal year due to the pandemic. The province is projecting a deficit of $12.5 billion (5% of GDP) compared to a surplus of $300 million projected in last February's budget. The province's long-term borrowing requirement for 2020/21 is now estimated at $21.1 billion compared to $8.3 billion before the pandemic. The province has already completed 73% of its financing program. The majority of borrowing has been completed in the Canadian market.
- According to Dealogic, new U.S. corporate bond issues in the third quarter totalled $386 billion, including $119 billion in high-yield bonds. This is a record amount of issuance for a third quarter. Year-to-date bond financing reached $1,457 billion, surpassing the previous mark set in 2017 ($898 billion). The Federal Reserve's corporate bond buyback program contributed to this surge. As of September 30, the Fed had purchased $45 billion in corporate bonds this year. This intervention allowed investment-grade corporate bond spreads to tightened from 3.73% in March to 1.36% at the end of September.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Sept. 2020	2020
Universe	100 %	0,32 %	8,00 %
Short Term	42,0 %	0,16 %	4,80 %
Mid Term	23,8 %	0,44 %	9,40 %
Long Term	34,2 %	0,41 %	10,99 %
Federal	33,4 %	0,41 %	7,55 %
Provincial	37,8 %	0,43 %	9,20 %
Corporates	26,7 %	0,01 %	6,82 %
RRB		0,03 %	10,99 %

Source: ftse.com

Canadian provinces are facing deficits in the current fiscal year that surpass those of the 2008-2009 financial crisis. Declines in revenues, increased spending (especially in health care) and growth in borrowing are likely to affect credit ratings. In this regard, British Columbia's credit rating remains AAA , but two agencies have a negative outlook.

The Fed's support program for the corporate bond market stimulated investor demand, allowing borrowers to protect their balance sheets from the effects of the pandemic. The Fed's interventions have improved liquidity in the market, but will not be able to protect investors from the solvency risk resulting from the pandemic.

STRATEGIC POSITIONNING

Since the beginning of the pandemic, the financial markets have been supported by central bankers intervention programs, which have gone beyond the limits imposed during the financial crisis to purchase increasingly risky assets. This support to the markets combined with the generosity of government assistance programs has allowed for a rapid recovery of the economy. Nevertheless, the presidential elections could darken the picture for investors in October. President Trump's insistence on ballot rigging and widespread electoral fraud clearly raised the spectre of a constitutional crisis from November 3, especially if he loses narrowly. If that happens, we may not know the outcome of this election for weeks, if not months. Certainly, a legal challenge would bring uncertainty to the financial markets at the same time that Covid is intensifying. Polls giving a clear lead to one party in the 6 key states would be less damaging to financial markets. The probability of a blue wave (Democrats) is not negligible. If the Democrats regain control of the Presidency and Congress, economic stimulus measures will be easier to adopt. Their economic plan relies on increased spending, especially on infrastructure. This fiscal stimulus, coupled with the new, less precautionary monetary policy framework, could fuel inflation, which is currently out of line with long-term rates.