

MONTHLY BOND LETTER

AlphaFixe
Capital

ECONOMIC EVENTS

NOVEMBER 2020

- The Canadian economy grew at an annualized rate of 40.6% in the third quarter, following a 38.1% drop in the previous quarter. Nevertheless, economic activity is still 5.3% below the level at the end of 2019. Household spending was a major contributor to growth, especially spending on durable goods such as vehicles. Residential real estate has also been an engine of growth. Compared to the fourth quarter of 2019, residential investment increased by 10.3%. Strong household demand caused imports to grow at a faster pace than exports, so international trade was a drag on growth. Firms also drew on inventories to meet demand.
- US personal income fell 0.7% in October, the fourth monthly decline in 6 months. Nevertheless, over the past year personal income is still up 5.5%, thanks to government support. Since the Employment Insurance (EI) enhancement ended on July 31, income from government transfers fell 6.2%. On the other hand, wages and salaries, which make up more than 50% of revenues, increased by 0.7%. Personal expenditures increased, but at a slower pace, up 0.5% in October compared to 1.2% in September.
- Japan's economy grew by 5% between July and September, corresponding to annualized growth of 21.4%. However, economic activity remains 5.8% below the level recorded in the same period last year. Household consumer spending and international trade drove activity up while business investment declined in the third quarter.

All in all, the economy has recovered, but the next quarter will be more difficult due to the new partial lockdown measures announced in various provinces. The impact will be less than in the spring. For example, in Quebec, only 5% of the economy is closed compared to 40% in the spring. Many companies have also adapted their business model to survive in pandemic mode using e-commerce and food delivery services.

In the first nine months, household savings increased by \$1,655 billion due to a rise in government transfers that increased household disposable income by more than \$1,200 billion. Thus, households have ammunition to spend even if Congress is slow to agree on a second economic support plan.


The increase in Covid cases worldwide and new lockdown measures in some countries could disrupt Japanese exports. However, Japan is benefiting from China's economic boom which may be the only country to record GDP growth in 2020.

RATE TRENDS

- The U.S. Treasury Department has decided to end 9 support programs that were created in collaboration with the Federal Reserve at the beginning of the pandemic. The two corporate bond purchase programs will therefore be closed at the end of the year. According to the Treasury Secretary, these programs have been very little used and have distorted asset values. This decision will free up nearly US\$455 billion that can be used otherwise by Congress.
- Sweden's central bank decided to keep its policy rate at 0%, but increased the size of its quantitative easing program from SEK 500 billion (\$58.7 billion) to SEK 700 billion (\$82 billion). The purchase period of the program was also extended by 6 months to extend it to the end of 2021. The governor said a rate cut is not the right response to the current crisis, preferring instead to ensure financial market stability.

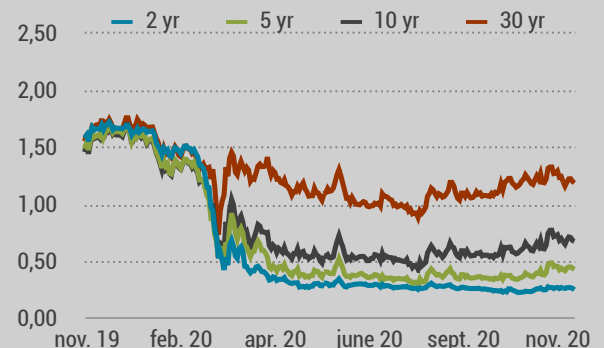
Central banks around the world have implemented quantitative easing programs aimed primarily at restoring liquidity in financial markets. Nine months after their implementation, some of these programs have lost their purpose since financial markets have regained the balance needed to operate properly. The Treasury's decision is therefore consistent with the initial objective of these programs. In Canada, the Bank of Canada has only purchased \$180 million in corporate bonds out of a \$10 billion program and credit spreads have narrowed anyway. Is it still necessary to maintain this program?

BOND RATES

		Monthly Change	Change 2020		Monthly Change	Change 2020
Nov. 30 2020						
Key Interest Rate	0,25 %	0,00 %	-1,50 %	0,25 %	0,00 %	-1,50 %
3 months	0,12 %	0,02 %	-1,54 %	0,07 %	-0,02 %	-1,47 %
2 years	0,25 %	-0,01 %	-1,45 %	0,15 %	-0,00 %	-1,42 %
5 years	0,43 %	0,03 %	-1,26 %	0,36 %	-0,02 %	-1,33 %
10 years	0,67 %	0,01 %	-1,03 %	0,84 %	-0,03 %	-1,08 %
30 years	1,17 %	-0,09 %	-0,60 %	1,57 %	-0,09 %	-0,82 %
RRB 30 years	-0,35 %	-0,16 %	-0,72 %			

Source: Bloomberg

CANADIAN RATE TRENDS



CREDIT BOND RISK PREMIUMS

Issuers	Credit Rating DBRS	Spread			Change					
					5 yrs		10 yrs		30 yrs	
		5 yrs	10 yrs	30 yrs	month	2020	month	2020	month	2020
Royal Bank, Bail-in-debt	AA	70	110	160	-15	-15	-10	-10	-10	0
Royal Bank, NVCC	A	105	145	205	-20	-15	-20	-25	-20	-5
Sun Life, subordinated debt	A	95	140	200	-20	-5	-15	-5	-10	15
Hydro One	A high	55	90	140	-15	-5	-15	5	-15	10
Enbridge Inc	BBB high	105	160	250	-30	5	-35	10	-25	30
Altalink LP	A	55	85	135	-10	0	-15	5	-15	15
GTAA	A high	55	90	140	-35	0	-40	10	-40	30
Bell Canada	BBB high	85	135	210	-20	-15	-25	-15	-20	5
Rogers Communications	BBB	85	135	210	-20	-10	-25	-10	-20	5
Loblaw	BBB high	80	125	200	-15	-25	-25	-30	-20	-10
Canadian Tire	BBB	110	170	265	-15	10	-15	20	-20	60
Province Québec	AA low	34	63	84	-5	-2	-5	4	-3	15
Province Ontario	AA low	38	68	85	-4	0	-4	6	-3	12
CMHC	AAA	23	32	---	-2	-6	-4	-6		

Source: National Bank Financial

CREDIT MARKET

Canadian corporate bond new issuance totalled \$3.9 billion in November, down \$3.5 billion from the previous month and \$2.3 billion less than November 2019. Year-to-date bond financing totalled \$102.2 billion, 15% higher than at the same time last year. Ford Credit Canada, which is now rated BB+ with a negative outlook, has completed a three-year financing totalling \$600 million. With a 3.5% coupon, the bond attracted several investors, prompting the finance company to increase the size of its issue from \$400 million to \$600 million. This issuer's negative outlook is related to its dependence on the U.S. automaker in terms of sales and market share.

Québec's deficit for the current fiscal year (2020-21) is expected to reach \$15 billion. Deficits of \$8.3 billion and \$7.5 billion are also projected for the next two years. A contingency fund of \$4 billion this year and \$3 billion next year is included in the estimated deficit. As economic conditions are improving compared to previous studies, the government has decided to release \$1.8 billion in additional measures to stimulate the economy and accelerate the recovery. As a result of this deficit, the province's gross debt will reach 50.5% in March 2021, up from 43.3% last March. The Finance Minister still expects to achieve a balanced budget within 5 years, which contrasts with the majority of other governments that do not dare to announce a return to a balanced budget.

Canadian Tire Corporation reported net income of \$326 million in the third quarter of 2020, up 43% from the same period last year. Revenues grew by 10% over the past year to nearly \$4 billion. Strong sales growth at Canadian Tire (+28%) and Mark's (+7%) was partially offset by declines at SportChek (-2%), Helly Hansen (-3%) and gasoline (-26%). Earnings before interest, taxes, depreciation and amortization (EBITDA) amounted to \$684 million, a 24% jump in the past year. This improvement reduced the debt-to-EBITDA ratio from 3.5x in the second quarter to 3.1x this quarter.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Nov. 2020	2020
Universe	100 %	1,03 %	8,29 %
Short Term	41,2 %	0,23 %	5,05 %
Mid Term	24,0 %	0,49 %	9,42 %
Long Term	34,8 %	2,37 %	11,49 %
Federal	33,9 %	0,25 %	7,24 %
Provincial	37,7 %	1,28 %	9,42 %
Corporates	26,3 %	1,68 %	7,95 %
RRB		2,28 %	12,64 %

Source: ftse.com

The International Monetary Fund and the World Bank have even put forward the idea of additional debt to support the recovery. These organizations are advocating for infrastructure spending that will help jobs recovery. With the second wave of Covid now emerging, Quebec's contingency fund could be used.

E-commerce sales have reached \$1 billion year-to-date, an increase of \$700 million or 211% over 2019. This performance illustrates the adaptation efforts of Canadian retailers to navigate through this pandemic. Online sales will help the economy better weather the second wave of Covid.

STRATEGIC POSITIONNING

Some risk factors are slowly dispersing in the financial landscape. While Trump continues his judicial hunt, claiming loudly that there was electoral fraud without hard evidence, the outcome of the presidential election will not change. The new vaccines with high efficacy rates allow investors to look forward to 2021 with more enthusiasm and pockets full of government transfers to invade restaurants once the restrictions are lifted. In fact, Canadian household disposable income has increased by 10.6% in the past year, which has been marked by a recession that is anything but normal. Generous government support programs have allowed Canadians to accumulate a savings cushion of \$207 billion by the end of the third quarter, a 10-fold increase over a year ago. Against this backdrop, investors are looking to the future with greater enthusiasm, justifying increases in stock market indexes and tighter credit spreads. The federal government has also demonstrated its intention to support the Canadian economy, recording one of the highest deficits in the industrialized world in 2020, with no plan to return to balanced budgets within the next five years. In the face of this optimistic momentum, is it necessary to keep all the central bankers' quantitative easing programs or is it time to reassess their usefulness or the size of the interventions? To this question, the U.S. Treasury has responded by withdrawing some support.