MONTHLY BOND LETTER

AlphaFixe Capital

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ECONOMIC EVENTS

- For the third consecutive month, the Canadian economy shed jobs in August, a decline of 39,700, bringing the total to 113,500 since May. As a result, the unemployment rate rose by 0.5% to 5.4%, the first increase in 7 months. A portion of this increase in the unemployment rate is attributable to an increase in the labor force with new workers looking for work. Among workers who lost their jobs, there was a drop of 25,000 positions for those aged 15 to 24, a normal situation in August as they prepare to return to school. By industry, 28,000 workers lost their jobs in the construction industry due to the housing downturn. Meanwhile, employment in the education industry fell by 50,000 last month and by 81,700 since May, accounting for 72% of all jobs lost in the past 3 months.

Should we fear an imminent recession? Some economists are concerned about the deterioration of the job market, noting that 3 straight months of declines are observable only during a recession. However, the decline is concentrated in education, perhaps related to a retirement wave as there has been a decline in jobs for older workers. Given the teacher shortages that everyone has been pointing out recently, it is quite possible that we will see a pickup in education in the coming months.

- The U.S. consumer price index (CPI) rose 0.1% in August, bringing annual growth from 8.5% in July to 8.3% the following month. This deceleration in inflation was largely due to a 5.0% drop in energy prices, including a 10.6% drop in gasoline. On the other hand, households had to pay 0.8% more in August for food and 11.4% more in the past year. Thus, the core index, which excludes energy and food prices, shows a jump of 0.6% in August and 6.3% over the past year, with services prices rising 6.8% in the past year.

In sum, while the overall index is decelerating from its peak earlier this year, core inflation has accelerated and is helping to entrench inflation. Services prices are often tied to wages and labor shortages, which do not appear to be easing quickly. The Federal Reserve will therefore need to continue its aggressive monetary restraint to curb inflation at its upcoming meetings.

- The British government has launched a major fiscal offensive with a support package of nearly £150 billion over two years. In addition to the previously announced cap on electricity tariffs for households and businesses, the new Chancellor of the Exchequer has set his sights on tax cuts that will deprive the state of £45 billion in revenue by 2026-27. The minimum tax rate will be cut from 20 per cent to 19%, while the planned increase in the tax rate from 40 per cent to 45% for taxpayers earning more than £150,000 has been scrapped. The increase in the corporate tax rate has also been cancelled. The government will finance the plan by issuing an additional £72 billion in bonds this fiscal year, 45% more than the £161 billion originally planned.

Financial markets reacted violently to this inflationary stimulus plan. The British pound hit an all-time low and bond yields jumped, forcing the Bank of England to restart a £65 billion bond-buying program to stabilize financial markets. Although the government has reversed itself by allowing taxes to rise for the wealthy, the situation is unsustainable in the long term. The Bank of England cannot be seen as the money printer that pays the government's bills, because it will never be able to stem inflation and will lose investor's confidence.

RATE TRENDS

- Central banks continued their aggressive monetary tightening to curb inflation. The Bank of Canada (+0.75%), the Federal Reserve (+0.75%), the ECB (+0.75%), the Bank of England (+0.50%), the Riksbank of Sweden (+0.75%), and the central banks of Switzerland (+0.75%) and Norway (+0.50%) raised their policy rates while indicating that further increases will be appropriate to combat inflation. In the case of Canada, the evolution of economic statistics will determine the magnitude of the next increase in October. By clearly identifying services inflation, the Bank of Canada is indicating that even an improvement in supply problems would be insufficient to achieve the inflation target soon.

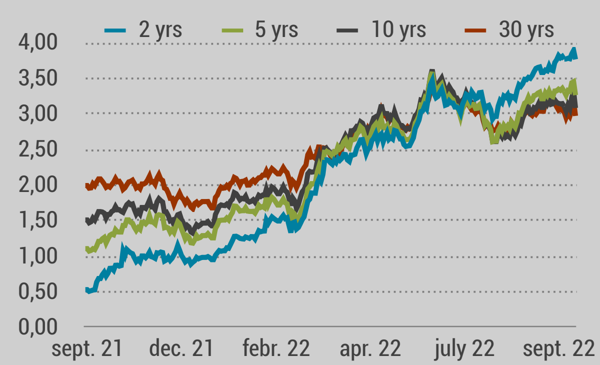
Services price growth has accelerated in several countries in recent months as health measures have been relaxed, releasing a pent-up demand in certain industries such as tourism. Services inflation is linked to the labor shortage that is a structural factor arising from the aging population and will persist despite rising rates. Central banks must realize that the pandemic and the war in Ukraine have changed the global economy. The era of cheap labor, cheap goods and cheap energy is over.

BOND RATES

Sept. 30, 2022	Canada	Monthly Change	Change 2022	United States	Monthly Change	Change 2022
Key Interest Rate	3,25 %	0,75 %	3,00 %	3,25 %	0,75 %	3,00 %
3 months	3,61 %	0,36 %	3,43 %	3,28 %	0,38 %	3,25 %
2 years	3,79 %	0,14 %	2,84 %	4,19 %	0,70 %	3,46 %
5 years	3,33 %	0,04 %	2,07 %	4,02 %	0,67 %	2,75 %
10 years	3,17 %	0,06 %	1,75 %	3,79 %	0,59 %	2,28 %
30 years	3,10 %	0,07 %	1,42 %	3,72 %	0,43 %	1,82 %
RRB 30 years	1,45 %	0,19 %	1,57 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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CREDIT BOND RISK PREMIUMS

Issuers	Credit Rating DBRS	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2022	Change 10 yrs month	Change 10 yrs 2022	Change 30 yrs month	Change 30 yrs 2022
Royal Bank, Bail-in-debt	AA	175	210	240	15	90	15	95	15	85
Royal Bank, NVCC	A	235	280	320	20	125	20	130	25	120
Sun Life, subordinated debt	A	210	255	290	20	110	20	115	15	100
Hydro One	A high	115	150	175	15	50	20	50	20	40
Enbridge Inc	BBB high	190	230	285	20	80	20	75	20	55
Altalink LP	A	110	145	170	15	45	20	45	20	35
GTAA	A high	115	150	170	15	45	25	50	20	40
Bell Canada	BBB high	175	220	255	15	75	25	75	20	50
Rogers Communications	BBB	190	240	300	15	60	25	65	25	65
Loblaw	BBB high	165	210	240	10	75	20	75	15	50
Canadian Tire	BBB	175	225	270	10	80	20	80	15	40
Province Québec	AA low	42	74	97	-6	9	0	18	4	23
Province Ontario	AA low	44	76	99	-6	7	-1	15	3	21
CMHC	AAA	32	45	---	-3	1	-2	4		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate new bonds totaled $7.6 billion in September, up $1.4 billion from the previous month, but $2.8 billion less than in September 2021. Year-to-date, bond financings totaled $84.4 billion, down 4.3% from this time last year. Among the issuers, Telus Corporaton completed a $2 billion bond financing with three different terms: 7 years ($350 million), 10 years ($1.1 billion) and 30 years ($550 million). The proceeds of this debt will be used in part to finance the purchase of Lifeworks, a digital health provider acquired this summer for $2.3 billion.
- At the halfway point in its fiscal year, BC reported a greatly improved budget balance. For the 2022-23 fiscal year, the province now anticipates a surplus of $706 million, a significant improvement from the $5.5 billion deficit projected at the time of the budget earlier this year. The previous fiscal year was also revised from a deficit of $483 million to a surplus of $1.3 billion. In both cases, the province is benefiting from a significant increase in revenues over the forecast, coming from both personal and corporate tax as well as resource revenues. Nevertheless, the budget surplus will be achieved in a less robust economic environment. The province is expecting economic growth of 3.2% in 2022, down from 4.0% previously. As a result, the government is relying on inflation to replenish revenues as nominal GDP growth in 2022 has been doubled to 11.6% from 5.8%.
- Corporate bond spreads continued widening in September. According to the FTSE Canada Index, corporate bonds offered a yield to maturity of 5.20%, 1.8% higher than Government of Canada bonds. The previous month, that spread was 1.63%. Year-to-date, spreads have widened by an average of 0.61%. The situation is less alarming for provincial bonds. Spreads on 5-year bonds have narrowed while spreads on long-term bonds have widened by only 0.04%. The reduction in provincial budget deficits means that they no longer have as much need for financing.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Sept. 2022	2022
Universe	100 %	-0,53 %	-11,78 %
Short Term	42,9 %	-0,07 %	-4,69 %
Mid Term	26,5 %	-0,17 %	-10,60 %
Long Term	30,6 %	-1,49 %	-20,96 %
Federal	37,1 %	-0,17 %	-9,23 %
Provincial	34,8 %	-0,57 %	-14,79 %
Corporates	26,0 %	-0,97 %	-10,76 %
RRB		-2,46 %	-16,66 %

Source: ftse.com

In inflationary times when households are struggling to make ends meet, the popular reaction of governments is to redistribute the surplus in the form of a cheque to help maintain purchasing power. If the measures are well targeted to low-income and needy people, they are applauded. However, they will have to be offset by spending cuts.

If we look at the performance of corporate bonds this year (-10.76%), we see that it is close to that of federal bonds (-9.23%). The decline in the bond markets is therefore not a credit event as we have been accustomed to in recent decades, but an interest rate event. On the other hand, if a recession occurs, yield premiums could rise.

STRATEGIC POSITIONNING

As Hurricane Ian demonstrated, it is only a few days after a storm has passed that the extent of the damage becomes apparent. For the United Kingdom, the consequences of the storm on the financial markets following the mini-budget were quickly apparent. The sharp rise in long-term bond yields forced the Bank of England to make a U-turn by announcing a bond-buying program (£65 billion) just days after announcing that it would reduce its balance sheet by £80 billion in the next year. But why the sudden change? To ensure the stability of financial markets, the bank says. Because of low rates and low volatility in recent years, many pension funds have used leveraged liability-driven investment strategies. When rates jumped, investors faced margin calls that exacerbated bond sales to replenish collateral. What we see is that after the 2008 financial crisis, some of the risk in the financial system was shifted off the balance sheet of banks to other investors such as large pension funds or hedge funds. As is often the case, it is the use of excess leverage in what are considered low-risk assets that ends up surprising and destabilizing the markets. By keeping policy rates too low for too long, central banks have also encouraged the use of excess leverage.