MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

OCTOBER 2018

- Canadian retail sales fell 0.1% in August as 7 of the 11 sub-sectors showed declines. Exclusing price changes, retail sales volume decreased by 0.3% month over month. On an annual basis, however, sales increased by 3.6% and 0.7% in volume. The decline in sales in August was due to lower gazoline sales, as well as clothing, building materials and furniture. In contrast, new car sales increased by 1.3% on a monthly basis in August, bringing annual growth to 0.4%.

Car and furniture purchases are often made using credit and some are concerned that their recent weakness is linked to monetary tightening. However, the policy rate is far from being restrictive, while the strength of the labour market should still be supporting consumer spending.

- The US economy grew at an annualized rate of 3.5% in the third quarter, a deceleration from the previous quarter (4.2%). Consumer spending remained robust (4.0%), driven by employment and Trump's tax reform. Companies also replenished their inventories in the last quarter, adding to growth. On the other hand, international trade was harmful, with imports rising sharply (9.1%) while exports fell (-3.5%). Net exports therefore substracted 1.9% from the growth rate, the worst trade performance in 33 years.

Anticipating new tariffs, U.S. companies appear to have rebuilt their inventory of foreign products for the holiday season. The United States' tax and trade policies are contradictory. It becomes difficult to eliminate the trade deficit when you stimulate the consumption of goods, often imported from China, at a time when the economy is already operating at full capacity.

- China's annual growth rate reached 6.5% in the third quarter, down 0.2% from the second quarter. Although growth is equal to the government's target rate for 2018, this is the lowest rate since 2009. A portion of this deceleration is domestic as infrastructure spending has slowed while auto sales continued to decline and may show a first annual decline since 1990.

Given the strong will of Chinese leaders to tackle excessive debt and dismantling the shadow banking system, it would be unlikely that China would adopt further credit expansion measures without losing any credibility. Government spending therefore seems more appropriate to counter the impact of the trade dispute with the United States.

RATE TRENDS

- The Bank of Canada raised its policy rate in October from 1.50% to 1.75%. The economy continues to grow close to its potential, as the uncertainty about international trade is now resolved with the new USMCA agreement. Business investments could therefore accelerate future growth. Nevertheless, the Bank points out that the trade dispute between the United States and China poses as a risk to the global economy and commodity prices. All in all, the Bank still paints a bright picture of the Canadian economy allowing it to abandon the gradual approach to normalizing monetary policy towards its neutral rate (2.5% to 3.5%). At a press conference, the Governor admitted that this change opens the door to a rate hike at each meeting, but the pace will always depend on the strength of the economic data and global conditions.

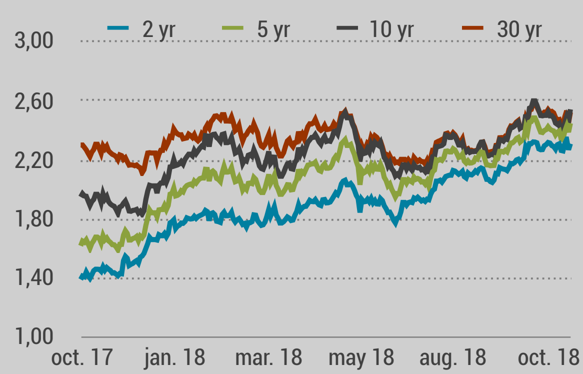
The Bank has made it clear that at this point in the economic cycle, the Canadian economy no longer needs an accomodative policy and it's therefore appropriate to return to a neutral rate (+/- 3%) to contain inflation. Especially since the number of companies reporting labour shortages is close to a historic level according to the Bank's Business Outlook Survey. By indicating that a rate hike may occur at each meeting, markets may be more volatile. Significant changes in some indicators could be interpreted as a change in monetary policy.

BOND RATES

Oct. 31 2018	Canada	Monthly Change	Change 2018	United States	Monthly Change	Change 2018
Key Interest Rate	1,75 %	0,25 %	0,75 %	2,25 %	0,00 %	0,75 %
3 months	1,74 %	0,16 %	0,68 %	2,33 %	0,13 %	0,95 %
2 years	2,34 %	0,12 %	0,65 %	2,87 %	0,05 %	0,98 %
5 years	2,43 %	0,09 %	0,56 %	2,97 %	0,02 %	0,77 %
10 years	2,49 %	0,07 %	0,45 %	3,14 %	0,08 %	0,74 %
30 years	2,53 %	0,11 %	0,27 %	3,39 %	0,19 %	0,65 %
RRB 30 years	0,82 %	0,16 %	0,24 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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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 2018	Change 10 yrs month	Change 10 yrs 2018	Change 30 yrs month	Change 30 yrs 2018
Royal Bank, deposit notes	AA	AA-	80	100	140	5	5	5	10	5	10
Manulife, Senior debt	A high	A+	105	130	170	10	15	10	15	10	5
Fortis Inc.	BBB high	BBB+	110	155	205	0	20	0	20	0	40
Hydro One	A high	A-	90	115	155	5	25	5	30	5	25
Enbridge Inc	BBB high	BBB+	130	170	235	15	15	10	5	15	10
Encana Corp	BBB low	BBB-	155	215	270	10	25	15	25	10	5
GTAA	---	A+	65	85	115	5	15	5	15	5	30
Bell Canada	BBB high	BBB+	120	165	225	10	25	10	20	10	25
Rogers Communications	BBB	BBB+	115	160	225	15	25	15	20	10	25
Loblaw	BBB	BBB	125	170	220	10	30	10	25	5	20
Canadian Tire	BBB high	BBB+	120	165	230	10	20	10	15	5	25
Province of Québec	A high	A+	40	60	76	0	4	-2	5	-1	11
Province of Ontario	AA low	A+	43	64	80	1	5	-1	5	0	13
CMHC	AAA	AAA	29	38	---	0	2	0	3		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance has reached $3.7 billion in October, down $6.1 billion from the previous month and $4.1 billion lower than in October 2017. Since the beginning of the year, corporate bond issuance amounted to $74.5 billion, 14.5% lower than at the same date last year. Atco, the principal shareholder of Canadian Utilities and CU Inc., issued a $200 million hybrid subordinated debt maturing in 2078, but redeemable in 2028 at the issuer's option. Rated BBB and with a coupon of 5.50%, the issue combines the characteristics of a bond since it has a maturity date, as well as those of a stock given the possibility of deferring coupon payments (such as a dividend) without triggering a default event.

- Western Canadian oil prices fell 41.8% in October to close at 22.31, $43 less than its Texan counterparts. During the month, this differential reached a historic low of US$ 50. Canadian oil production continued to rise, but exports were facing bottlenecks. The pipeline network is saturated and rail transport is not sufficient. However, the drop in prices was exacerbated by BP's refinery temporary shut down in Indiana, Canada's largest oil buyer, for the maintenance purposes. Refining is expected to resume in November. This price decrease could have an impact on Alberta's budget balance as the province assumes a discount of $24 for 2018-19 fiscal year. At the current discount level, the deficit will increase.

- Moody's downgraded GE and GE Capital's credit rating by two notches to Baa1 with a stable outlook. This decision comes following the release of their financial results, which shows a record loss of $22.8 billion in the third quarter and a second drop in dividends within the year. According to Moody's, the decreasing performance in the energy division will lead to a decline in the company's cash flow for some time to come. The weaker performance of this division is due to lower demand, increased competition, misjudgment of financial perspects and operational missteps. S&P had already downgraded its rating to BBB+, moving GE to BBB category in the index. The long-term spreads (2037) have widened by 100 bps since this announcement.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Oct. 2018	2018
Universe	100 %	-0,61 %	-0,96 %
Short Term	46,4 %	-0,10 %	0,44 %
Mid Term	21,2 %	-0,36 %	-0,87 %
Long Term	32,4 %	-1,51 %	-3,02 %
Federal	36,0 %	-0,33 %	-0,48 %
Provincial	34,2 %	-0,90 %	-1,91 %
Corporates	27,9 %	-0,62 %	-0,39 %
RRB		-2,03 %	-0,97 %

Source: ftse.com

The Alberta long-term spreads increased by 5 bps compared to Ontario's in response to this situation exacerbated by certain temporary factors. Exports to BP's plant in Indiana will resume shortly while government's decision to removed oil from the list of dangerous materials in rail transport should increase volume.

The impact on the index is negligible, as there are only two GE Capital bonds outstanding in Canada. After being (too) generous with its shareholders by redistributing nearly $25 billion in form of share buybacks in 2016-17, GE now sees itself forced to protect its creditors, its balance sheet, its cash flows and credit rating.

STRATEGIC POSITIONNING

Financial markets were volatile in October as the stock market drop after a rapid rise in the third quarter. Some events during the month intensified investors' sense of uncertainty. In early October, the Federal Reserve Chairman tightened his stance by indicating that he wanted to conduct a monetary policy in line with the long-term objective of price stability, but said he was prepared to act with authority if inflationary expectations rise or fall. The Trump administration has also increased its attacks on China, accusing them of human rights violations, interference in the mid-term elections and the constant threat of additional tariffs. Although volatility is increasing, the fundamental economic picture remains unchanged. Monetary policies in Canada and the United States are still expansionary, with key rates at 75-100 bps below their neutral points. In addition, Trump's tax reform has boosted consumer spending this year and is expected to boost GDP by more than 1% next year. The current rate levels are therefore not high enough to turn the economy into a recession. Trade disputes are therefore the most disruptive element in today's markets and the outcome of the mid-term election in the United States will determine the strength of Trump's message in the future.