MONTHLY BOND LETTER

AlphaFixe Capital

MARCH 2018

ECONOMIC EVENTS

- Canada's inflation rate has reached its highest level since October 2014 at 2.2 % YoY, following a monthly increase of 0.6 % in February. Over the past twelve months, prices for the eight major components of the index have risen, including energy prices, which have jumped 5.3 % since February 2017. Excluding changes in food and energy prices, inflation is 1.8% on an annual basis. Nevertheless, the Bank of Canada uses 3 core price measures (CPI-trim, CPI-median, and CPI-common), whose annual average change is at a six-year high, 2.03 % in February compared to 1.83 % from the previous month.
- The US economy added 313,000 jobs in February, the largest monthly change since the summer of 2016. Revisions were also made to the previous two months adding 54,000 jobs. However, the unemployment rate remained stable at 4.1 % for a fifth consecutive month. The average hourly wage increased by 0.1 % per month, bringing the annual change to 2.6 %. In January, annual wage growth reached 2.9 %, causing some panic about rising inflation risk.
- On March 13th, for the seventh time in 24 years, no 10-year Japan government bond was traded on the secondary market. With over $ 9 trillion in outstanding debt, Japan is the second largest bond market in the world after the United States. However, the Bank of Japan holds just over 40 % of this market through its asset purchase program, leaving little space for other investors to trade securities.

Core price index is rising, but uncertainties related to international trade and residential real estate are still likely to be of concern to the Bank of Canada. If it expects a NAFTA settlement before taking action, the Bank risks being forced to hike rates faster in the future, which could be of concern to the Canadian real estate market.

A slower wage increase in February is not worrisome, since the Fed also established its monetary policy based on anecdotal information. In this regard, most of the Fed's 12 districts have seen employers raise wages and provide additional benefits to attract workers.

Since September 2016, the Bank of Japan has been targeting the 10-year rate at 0 % instead of setting a monthly amount of asset purchases. Now that it holds nearly 40 % of the outstanding amount, the Bank of Japan no longer has to intervene to achieve its target as purchases are now lower than new government issuance, a first since 2013.

RATE TRENDS

- The Federal Reserve raised its Fed Funds rate by 25 bps to 1.75 % at its March meeting. The Fed's new president, Jerome Powell, has also presented new growth forecasts for the US economy boosted by fiscal stimulus. Fed members are now targeting a growth range of 2.6-3.0 % in 2018 and 2.2-2.6 % next year, up 0.4 % and 0.3 % this year and next year. The unemployment rate should reach 3.4-3.7 % in 2019 compared to 4.1 % today. On the other hand, inflation forecasts have barely changed and should stabilize around 2 %.
- Following its March 7th meeting, the Bank of Canada left its policy rate unchanged at 1.25 % despite strong economic growth in 2017. The Bank remains aware that the economic situation warrants a withdrawal from monetary easing, but still worries about NAFTA renegotiations and the real estate market.

Therefore, the Fed expects higher growth and employment without additional inflation, despite labor shortages and a possible trade war. If these previous two items intensify during the year, the Fed will be forced to be more aggressive than the current 2 rate hikes expected by year end.

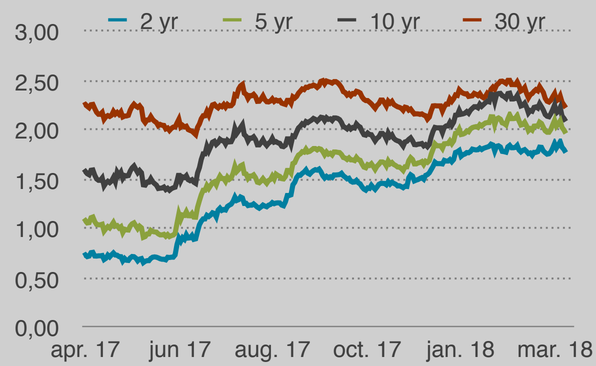
Now that the Fed has raised its policy rate, the gap between the Canadian and US key rates is -0.50 %. Since the early 2000's, this spread has reached a low of -1.00 %. The Bank should therefore follow in the Fed's footsteps soon, otherwise the loonie will depreciate, adding to an already rising inflation.

BOND RATES

March 31 2018		Monthly Change	Change 2018		Monthly Change	Change 2018
Key Interest Rate	1,25 %	0,00 %	0,25 %	1,75 %	0,25 %	0,25 %
3 months	1,10 %	-0,05 %	0,04 %	1,70 %	0,05 %	0,32 %
2 years	1,78 %	-0,01 %	0,09 %	2,27 %	0,02 %	0,38 %
5 years	1,97 %	-0,08 %	0,10 %	2,56 %	-0,08 %	0,36 %
10 years	2,09 %	-0,14 %	0,05 %	2,74 %	-0,12 %	0,33 %
30 years	2,23 %	-0,15 %	-0,04 %	2,97 %	-0,15 %	0,23 %
RRB 30 years	0,53 %	-0,07 %	-0,04 %			

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 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+	95	120	170	5	5	0	5	5	5
Fortis Inc.	BBB high	BBB+	105	140	175	10	15	10	5	5	10
Hydro One	A high	A	75	95	135	10	10	5	10	5	5
Enbridge Inc	BBB high	BBB+	125	175	240	10	10	15	10	15	15
Encana Corp	BBB low	BBB	135	190	260	0	5	-5	0	-5	-5
GTAA	---	A+	60	85	100	5	10	10	15	5	15
Bell Canada	BBB high	BBB+	105	150	210	10	10	10	5	5	10
Rogers Communications	BBB	BBB+	95	140	205	10	5	5	0	5	5
Loblaw	BBB	BBB	105	155	210	0	10	5	10	0	10
Canadian Tire	BBB high	BBB+	110	160	220	0	10	5	10	5	15
Province of Québec	A high	AA-	43	62	75	3	7	2	7	1	10
Province of Ontario	AA low	A+	45	69	80	4	7	6	10	4	13
CMHC	AAA	AAA	31	40	---	3	4	2	5		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached $ 8.8 billion in March, up $ 2.8 billion from the previous month, but $ 817 million less than in March 2017. CIBC proceeded with its third issue of subordinated debt qualifying as a non-viability contingent capital (NVCC). Rated BBB in the FTSE TMX Index, the $ 1.5 billion bond was offered at a spread of 1.4 % for a 5-year term. Since February 7th, all outstanding NVCC issues in Canada are now included in the FTSE TMX Index. Their weight amounts to 4.3 % of corporate bonds with a total outstanding of $ 19.6 billion.

- The Québec government has announced additional spending of $ 848 million for the fiscal year ending March 31, 2018, reducing the surplus to $ 850 million. For the next fiscal year (2018-19) and the next five years, the government is counting on a balanced budget. In this election year, government revenues are expected to reach $ 109.6 billion (+ 2.2 %), while expenses will amount to $ 108.7 billion (+ 4.7 %), to which will also be added $ 2.5 billion in the Generations Fund. To offset the shortfall, the government will draw $ 1.6 billion from the Reserve Fund this year and $ 1.4 billion over the next two years. This reserve is currently at $ 5.4 billion. In addition, Québec intends to reduce its debt by $ 10 billion over the next five years by withdrawing $ 2 billion a year from the Generations Fund, which amounts to $ 12.8 billion as at March 31, 2018. As a result, the debt ratio should move from 49.6 % to 45 % in 5 years.

- The rating agency DBRS has revised Sobeys' credit rating outlook (BB high) from negative to stable. This change comes as the grocer stabilizes its market share and improves its same store sales growth closer to its competitors. As a result, the debt-to-EBITDA ratio improved from 4.0x to 3.4x. In order to achieve a positive rating action, Sobeys will need to further improve its same store sales at a rate similar to other grocers while increasing operating income at an annual rate of $ 1 billion.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	march-18	2018
Universe	100 %	0,75 %	0,10 %
Short Term	45,6 %	0,16 %	0,22 %
Mid Term	22,4 %	0,67 %	0,01 %
Long Term	32,1 %	1,65 %	-0,01 %
Federal	36,5 %	0,75 %	0,33 %
Provincial	33,5 %	0,96 %	-0,27 %
Corporates	28,1 %	0,51 %	0,28 %
RRB		1,49 %	1,38 %

Source: ftse.com

Despite a debt payment of $ 10 billion, the Generations Fund is expected to reach $ 17.8 billion in 2023 due to mandatory annual payments. Given the excellent performance of the Fund over the last 6 years (9.0 %), it was prudent to cash out a portion of the profits before the next recession reduces returns.

it's a good thing that the required improvement is not based on increased profitability, as Sobeys will have to grapple with additional labor costs. The grocer estimates that minimum wage increases in Ontario and Alberta will reduce profits by $ 25 and $ 70 million this year and next. These estimates do not even include changes to other wage brackets.

STRATEGIC POSITIONNING

After starting a NAFTA renegotiation and imposing tariffs on steel and aluminum imports in some countries, the Trump administration has once again tackled international trade, targeting China this time. The United States will impose tariffs of 25 % on some Chinese imports, which has earned them an immediate response from China, which in turn is taxing imports on 106 US products by 25 %. The Trump Administration's direct link between protectionism and trade deficit improvement is incorrect. For example, Brazil and India have average tariffs 5 and 3 times higher than the United States, but still record a trade deficit. In contrast, the average tariff in Germany (1.9 %) is lower than that of the United States (2.8 %), but the European country still has a large trade surplus. Changing the free trade agreements in place is also not a guarantee of success in reducing the deficit. In an attempt to ease US pressure on the trade deficit, Japan voluntarily reduced its auto exports in the 1980's and transferred some of its production to the United States. This agreement did not improve the trade balance for the United States. Thus, the tax reform announced at the beginning of the year risks aggravating the trade deficit by stimulating consumption and imports. Without reaching their goal, Trump's tariffs may just raise consumer prices and inflation even more.