MONTHLY BOND LETTER

AlphaFixe Capital

MAY 2023

ECONOMIC EVENTS

- The Canadian economy got off to a flying start this year. GDP grew at an annualized rate of 3.1% in the first quarter, after declining (-0.1%) in the previous quarter. Consumer spending was up 5.7%, particularly on durable goods (+13.9%) such as vehicles. Households also purchased services (+5.3%) such as travel and dining out. Business investment rose slightly, while investment in residential property (-14.6%) fell for the fourth consecutive quarter under the weight of rising mortgage rates. International trade also made a major contribution to growth at the start of the year.
- Personal consumer spending in the US jumped by 0.8% in April, following slight gains of 0.1% in the previous two months. Spending on goods rose by 1.1%, propelled by vehicle sales as supply chains return to normal. Households also increased their spending on services (+0.4%). On the price front, the Personal Consumption Expenditure price index rose by 0.4% month-on-month. The core PCE index, which excludes energy and food, also rose by 0.4% in April, and by 4.7% year-on-year. This represents an acceleration compared with March (+4.6%), in the opposite direction to what members of the Federal Reserve want in terms of inflation.
- Finally, some good news on the European inflation front. According to a preliminary reading, the consumer price index for the euro zone stalled in May. As a result, the annual variation fell from 7% in April to 6.1% the following month. This deceleration was largely due to the 1.7% year-on-year fall in energy prices. Prices of other products also showed a deceleration in annual variation, but remain high and irreconcilable with the 2% inflation target.

The Canadian economy is more resilient than some had anticipated. Despite monetary tightening, consumers are purchasing items that require financing, such as vehicles. Real estate also seems to be picking up after a difficult year, which is a testament to the confidence of households who are benefiting from a robust job market. And that's not all. Statistics Canada forecasts GDP growth of 0.2% in April, despite the public service strike and the ice storm that paralyzed part of the province.

A robust labour market and excess savings continue to underpin economic growth, making inflation more persistent and difficult to control. The resilience of the economy complicates the Fed's task. In fact, the current expansion is driven more by income than debt. Household debt now stands at 100% of disposable income, compared with over 130% in 2008. This deleveraging since 2008 means that monetary policy is less effective at slowing the economy.

Inflation is still 3 times above target. What's more, the labor market is still buoyant, as evidenced by an all-time low unemployment rate of 6.5% in April. These favorable conditions for workers are influencing the costs of companies operating in the service industries, making the situation too inflationary for the ECB.

RATE TRENDS

- Several major central banks continued their monetary tightening in May. The Federal Reserve, the European Central Bank, the Bank of England and the central banks of Australia and New Zealand each raised their policy rates by 0.25%. For some, the peak has been reached or appears to have been reached, but for others, the road to the 2% inflation target requires further work to slow the economy. This is particularly the case in the euro zone and in the UK, where inflation is proving more difficult to control and is fuelled by wage increases. These two banks have made it clear that the risk of inflation becoming entrenched requires them to raise the policy rate again at the next meeting. In the UK, the annual inflation rate (8.7%) is 4 times the 2% target.

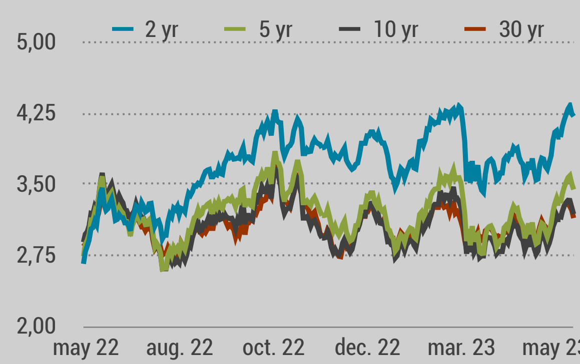
After raising rates aggressively over the past year, central banks now seem to be calibrating their response to persistent inflation. Some central banks, such as Australia's and even the Bank of Canada, have preferred to take a pause to assess the extent of the work they've done, but that doesn't mean the tightening is complete. For example, Australia resumed monetary tightening with 2 hikes after a one-meeting pause. The Bank of Canada followed suit on June 7, announcing a 0.25% increase in its key rate after a pause of 2 meetings. In short, a pause is not a synonym of future cut.

BOND RATES

May 31, 2023	Canada	Monthly Change	Change 2023	US	Monthly Change	Change 2023
Key Interest Rate	4,50 %	0,00 %	3,50 %	5,25 %	0,25 %	4,25 %
3 months	4,65 %	0,20 %	0,39 %	5,39 %	0,36 %	1,05 %
2 years	4,22 %	0,56 %	0,16 %	4,40 %	0,39 %	-0,02 %
5 years	3,45 %	0,48 %	0,04 %	3,75 %	0,27 %	-0,25 %
10 years	3,19 %	0,35 %	-0,11 %	3,64 %	0,22 %	-0,23 %
30 years	3,15 %	0,21 %	-0,13 %	3,86 %	0,19 %	-0,10 %
RRB 30 years	1,32 %	0,07 %	0,12 %			

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	155	190	220	5	-10	5	-10	5	-10
Royal Bank, NVCC	A	215	260	300	0	-10	0	-10	0	-10
Sun Life, subordinated debt	A	195	230	255	-5	-5	-5	-10	-5	-15
Hydro One	A high	100	130	150	-5	-10	-5	-10	-5	-10
Enbridge Inc	BBB high	155	205	245	-10	-20	-5	-10	-5	-15
Altalink LP	A	100	130	150	-5	-5	-5	-5	-5	-5
GTAA	A high	95	125	145	-5	-10	-5	-10	-5	-10
Bell Canada	BBB high	145	185	215	-5	-15	-10	-10	-10	-10
Rogers Communications	BBBL	175	220	260	-5	-5	-5	-5	-5	-10
Loblaw	BBB high	135	170	195	-10	-15	-10	-15	-10	-15
Canadian Tire	BBB	155	195	240	-10	-15	-10	-15	-10	-15
Province Québec	AA low	48	72	93	2	2	-3	0	-4	-1
Province Ontario	AA low	49	73	92	1	1	-3	-1	-4	-3
CMHC	AAA	38	44	---	2	2	-2	-2		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bonds new issuance totaled $8.7 billion in May, up $4.2 billion on the previous month, but $775 million less than in May 2022. Year-to-date, bond financing totals $35.6 billion, down 39% on the same period last year. The list of new issues includes several new issuers, such as Sagen MI Canada and Électricité de France, but also includes companies not frequently seen on the primary market, such as Energir and Canadian National Railway. The railway industry benefits from strong demand from American investors, which thighten spreads to less attractive levels for a Canadian investor.
- The six major Canadian banks released their financial results for the second quarter of the current year. Collectively, they reported earnings of $12.9 billion, down 28% on the same period last year. Revenues rose by $3.8 billion to $51.4 billion, but costs also increased. Apart from the narrowing gap between the banks' cost of funds and the rates offered to customers, the banks also recorded a significant increase in non-interest expenses. These totalled $29.2 billion for all 6 banks, up 18% from the second quarter of last year. Significant expenses included salary increases to retain or attract employees.
- The Ford government's recent budgetary discipline has paid off. S&P changed the outlook on Ontario's credit rating (A+) from stable to positive. The strong economic recovery, combined with inflation, has replenished government coffers faster than expected. A return to balanced budgets is expected in 2026, 3 years earlier than last year's forecast. Although the pace of economic growth is expected to slow in the current fiscal year, population growth through immigration and announced investments by automakers and suppliers of electronic vehicle batteries are all factors militating in favor of more robust long-term growth.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Mai 2023	2023
Universe	100 %	-1,69 %	2,47 %
Short Term	42,8 %	-0,90 %	1,35 %
Mid Term	26,7 %	-2,17 %	2,34 %
Long Term	30,5 %	-2,38 %	4,26 %
Federal	38,0 %	-1,77 %	1,73 %
Provincial	34,6 %	-1,84 %	3,02 %
Corporates	25,4 %	-1,37 %	2,76 %
RRB		-1,06 %	-0,36 %

Source: ftse.com

Here's an example of companies in the service industry bearing the brunt of the labor shortage. Despite squeezed profit margins, the capitalization and liquidity ratios of Canadian banks are solid, and they are beginning to increase provisions for losses. The solidity of our banking system and its conservative management are assets that enable us to avoid crises.

On the cusp of a likely recession, Ontario has made responsible fiscal choices, preferring to balance the budget rather than fulfill socially inequitable election promises to help households fight inflation. Immigration is also a factor in Ontario's favor. Quebec has raised its immigration threshold to 60,000, but this seems insufficient to halt the decline in its weight within the federation.

STRATEGIC POSITIONNING

On January 25, the Bank of Canada announced a 0.25% increase in its policy rate, and told Canadians that it would be taking a break to assess the economic impact of the cumulative tightening announced (+4.25%). The pause lasted 133 days, and the Bank came to the conclusion that financial conditions were not restrictive enough to allow them to confidently achieve their 2% inflation target. Thus, on June 7, the Bank announced that a further 0.25% tightening was required as the Canadian economy proved more resilient than expected, with a robust job market and rising consumption of financed items such as vehicles. Canadian real estate has also rebounded from a year of uncertainty and correction in real estate values, which were inflated by the pandemic and discount financing. The recent population growth is also a factor stimulating demand. Is this the end of rate hikes? Not necessarily. The economy is still in excess demand, making it difficult to achieve the 2% inflation target. This is particularly true in the labor market, where wages are rising at a strong pace (4-5%) without any productivity gains, which is incompatible with inflation control. The Bank is therefore leaving the door open to further increases if the economic situation so requires. Note to investors: in this inflationary environment, pauses are no guarantee of a rate cut in the near future.