MONTHLY BOND LETTER

AlphaFixe Capital

DECEMBER 2019

ECONOMIC EVENTS

- The Canadian economy lost 71,000 jobs in November, the worst monthly labour market downturn since the financial crisis. As a result, the unemployment rate rose 0.4% to 5.9%. Job losses were recorded in both good-producing (-26,600) and service-producing (-44,400) industries. In contrast, annual wage growth remained unchanged at 4.4%. Quebec took the hardest hit, with 45,000 jobs lost, particularly in the manufacturing, accommodation and food service industries. Employment also fell by 18,000 in Alberta and British Columbia, but rose by 15,000 in Ontario.

After recording sustained growth, employment in Quebec has fallen drastically. Is this a reflection of an economic downturn or is it data volatility? Based on the number of job vacancies, employment is still in good shape. In the third quarter, there were 562,910 jobs available in Canada, including 137,530 in Quebec alone. This represents a 16% year-over-year increase in job availability in Quebec.

- The U.S. labour market remains strong, with 266,000 new jobs created in November, bringing the unemployment rate to 3.5%, a 50-year low. This is the 21st consecutive month with the unemployment rate below 4%. With the exception of wholesale trade, employment increased in all other industries. Manufacturing added 54,000 jobs after a decline of 43,000 in the previous month. This gain was mainly due to GM workers returning to work at the end of October after a strike that started September 16th. Wages rose 3.1% on a 12-month basis.

The robust labour market has created pressure on wages, but not necessarily on consumer prices. The strong U.S. dollar and President Trump's tax cut in 2018 have allowed corporations to absorb these wage increases. These elements could dissipate next year.

- The Japanese government announced a fiscal stimulus of ¥13.2 trillion, equivalent to $159 billion or 1.9% of GDP. This spending program, the largest since the financial crisis, will be spread over 15 months and will help counter the effects of a weaker global economy, the recent sales tax hike and the risk of a slowdown after this summer's Olympic Games.

Fiscal stimulus is increasingly being used to stimulate economies, indicating that monetary policy has reached its limits. An increase in government spending also allows for a better redistribution of wealth.

RATE TRENDS

- After three consecutive rate cuts, the Federal Reserve announced a pause in its monetary policy, justifying that the current level was appropriate to support economic activity, full employment and the 2% inflation target. To deviate from the status quo, the Fed indicated that it would like to see a significant and persistent increase in inflation or a deterioration in global economic conditions, particularly with respect to international trade.

With this decision, the Fed is signalling an asymmetry in its monetary policy, preferring to keep its foot closer to the gas pedal rather than the brakes. If inflation occurs and the Fed is patient before intervening, then the bond market will react with rising long-term rates and a steeper yield curve.

- The Swedish Central Bank (Riksbank) has decided to raise its key policy rate by 0.25% to bring it to 0%, ending nearly 5 years of negative rates. The Riksbank expects inflation to remain close to the 2% target, but believes that the overheated housing market and growing household debt must be contained by higher borrowing costs. The monetary authority does not expect to raise rates by 2022, but reserves the right to lower them again if economic conditions deteriorate.

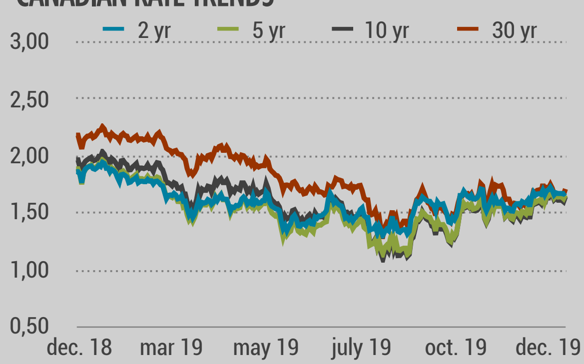
This change in policy will be closely examined by the European Central Bank, which is beginning to worry about the impact of negative rates. This policy would create an incentive to invest in riskier assets while at the same time reducing banks' profit margins, thereby threatening financial stability.

BOND RATES

Dec. 31, 2019	Canada	Monthly Change	Change 2019	United States	Monthly Change	Change 2019
Key Interest Rate	1,75 %	0,00 %	0,00 %	1,75 %	0,00 %	0,00 %
3 months	1,66 %	0,00 %	0,00 %	1,54 %	-0,02 %	0,00 %
2 years	1,70 %	0,11 %	0,00 %	1,57 %	-0,04 %	0,00 %
5 years	1,69 %	0,20 %	0,00 %	1,69 %	0,07 %	0,00 %
10 years	1,70 %	0,24 %	0,00 %	1,92 %	0,14 %	0,00 %
30 years	1,76 %	0,21 %	0,00 %	2,39 %	0,18 %	0,00 %
RRB 30 years	0,38 %	0,11 %	0,00 %			

Source: Bloomberg

CANADIAN RATE TRENDS



CREDIT BOND SPREADS

ISSUER	Credit rating DBRS	Credit rating S&P	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2019	Change 10 yrs month	Change 10 yrs 2019	Change 30 yrs month	Change 30 yrs 2019
Royal Bank, deposit notes	AA		85	120	160	-5	-50	-5	-40	-5	-40
Manulife, Senior debt	A		120	170	210	-5	-65	-5	-50	-5	-50
Fortis Inc.	A		100	145	185	-5	-50	-5	-45	-5	-45
Hydro One	A high		60	85	130	-5	-55	-5	-55	-5	-50
Enbridge Inc	BBB high		100	150	220	-10	-60	-10	-60	-10	-55
Encana Corp	A		55	80	120	-5	-45	-5	-40	-5	-45
GTAA	A high		55	80	110	-5	-30	-5	-25	-5	-30
Bell Canada	BBB high		100	150	205	-5	-55	-5	-50	-10	-55
Rogers Communications	BBB		95	145	205	-5	-55	-5	-50	-10	-55
Loblaw	BBB		105	155	210	-5	-60	-5	-60	-5	-60
Canadian Tire	BBB high		100	150	205	-5	-60	-5	-60	-5	-65
Province of Québec	AA Low		36	59	69	-1	-23	-1	-25	-3	-27
Province of Ontario	AA low		38	62	73	-1	-25	-3	-27	-3	-28
CMHC	AAA		29	38	---	1	-14	0	-18		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bonds new issuance reached $10.8 billion in December, up $4.6 billion from the previous month and $9.8 billion higher than in December 2018. Total bond financings amounted to $99.6 billion in 2019, an increase of 23.4% over last year and the second strongest year in history in terms of volume. The banking industry set a record in terms of new issuance volume with $39.4 billion as well as utilities ($18.9 billion). This increase in bank debt is explained by an increase in non-viable contingent capital (NVCC) debt.
- Credit bonds recorded an excellent performance in 2019. Corporate bonds return was 8.05% while provincial securities returned 9.07%. However, the duration of provincial bonds (10.9 years) is much higher than that of corporate bonds (6.6 years). Focusing only on the mid-term part of the curve, corporate bonds (8.43%) outperformed provinces (5.77%) and federal bonds (3.83%). Investors' search for yield resulted in the outperformance of BBB rated corporate bonds relative to others. Their performance in the mid-term index was 9.24% in 2019, particularly due to energy bonds.
- The Office of the Superintendent of Financial Institutions (OSFI) has advised the six major Canadian banks that it is raising the domestic stability buffer threshold by 0.25 % to 2.25 % of the total risk-weighted assets. This measure is designed to protect systemically important banks from certain risk factors, including high levels of consumer indebtedness and global trade tensions. Given the low interest rate environment and economic stability, OSFI believes that an additional degree of strictness is required. The domestic stability buffer is one of four capital requirements for Canadian banks. Combined, these requirements total 10.25 %, a level that banks already meet.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Dec. 2019	2019
Universe	100 %	-1,19 %	6,87 %
Short Term	43,0 %	-0,15 %	3,10 %
Mid Term	22,7 %	-1,07 %	5,75 %
Long Term	34,3 %	-2,55 %	12,71 %
Federal	34,6 %	-1,06 %	3,73 %
Provincial	35,3 %	-1,80 %	9,07 %
Corporates	28,0 %	-0,54 %	8,05 %
RRB		-1,53 %	8,02 %

Source: ftse.com

The outperformance of lower-quality bonds reflects investor confidence in the economy. High-yield bonds in the United States also posted an excellent performance, while spreads narrowed by 169 bps in 2019 to end the year at 280 bps. Why lend to a risky company if the chance of a recession is high?

With this announcement, OSFI is telling us that it is concerned about the high levels of household debt due to an overheated Canadian real estate market. Why did the Bank of Canada add fuel on fire with a speech about lowering rates that could jumpstart mortgage debt once again?

STRATEGIC POSITIONNING

Financial markets welcomed the news of a partial agreement between the United States and China which, according to President Trump, will be signed on January 15th. In addition, the election of a majority government in the United Kingdom now allows Boris Johnson to ratify an agreement with the European Union and avert the risks of a disorderly withdrawal which is feared by investors. On the other hand, certain risk factors cannot be completely ruled out and escalating tensions with Iran is economically worrying because of its effects on oil prices. The sharp rise in crude oil has already been a factor behind previous recessions, as has an overly restrictive monetary policy. However, the last three recessions in the United States have been caused by bursting asset bubbles. Real estate in 2008, technology stocks at the beginning of the millennium and the savings and loans crisis in the 1990's. At present, it is difficult to identify a large enough financial asset in speculative territory that would tip the economy into recession and cause a crisis. Moreover, the combination of monetary easing around the world, expansionary fiscal policies and easing trade conflicts should sustain global growth and push investors towards risky assets in 2020. A less risky global environment also means a less robust U.S. dollar and therefore a higher rate structure. However, caution is always called for, and a tweet can quickly change things around.