MONTHLY BOND LETTER

AlphaFixe Capital

DECEMBER 2018

ECONOMIC EVENTS

- The business outlook survey fell slightly in December, but remains strong according to the Bank of Canada. Sales are expected to stabilize in 2019 following strong growth in the prior year. Labor shortages are still an issue for managers. Hiring intentions remain strong and a majority of respondents believe they would have difficulty meeting a surge in demand. In order to overcome this production constraint, managers plan to use technology and automation. In this regard, for most companies, the survey indicates that it is still easy to obtain credit despite the recent tightening of conditions.

This survey is a good illustration of the Canadian situation. Economic activity is still robust, provoking labor shortages which is a headache for business leaders. What is interesting about this survey is that credit conditions remain favorable to businesses. Evidence that the current rate structure is not restrictive and that the turmoil in financial markets is not due to monetary policy.

- The U.S. economy added 312,000 workers to payrolls in December, including 301,000 in the private sector. In addition, the figures for the last two months have been revised, adding 58,000 new jobs. Despite this gain, the unemployment rate still increased by 0.2% to 3.9%. The robustness of the labor market in December is also widespread, while 70% of industries reported a higher number of employees. The labor shortage also resulted in a 0.4% increase in wages in one month and a 3.2% increase over one year.

Labor market conditions show that the economy is not yet on the brink of collapse as some investors seem to think. However, it must be taken into account that some leading indicators, such as new orders from the manufacturing industry, declined sharply and could point to a slowdown.

- Britain's economy grew by 2.4% in annualized terms in the third quarter, the fastest pace since the last quarter of 2016. The service industry remains the driving force of the British economy, contributing the most to GDP. The construction industry and consumer spending also contributed to growth. On the other hand, business investment contracted for a third consecutive quarter.

Brexit risks weighted on business confidence this year. This uncertainty increased at the end of the year and will still be present in 2019 as the vote in parliament was postponed by the Prime Minister. Thus, the economy could decelerate while households will also adopt a prudent approach to spending.

RATE TRENDS

- The Federal Reserve raised its key policy rate by 0.25% for a fourth time in 2018, bringing it to 2.50%, in a much anticipated decision by investors in December. The Fed painted a bright picture of the economy, but revised its outlook from 3 to 2 rate hikes next year due to a deceleration in global growth and financial markets turbulence. Mr. Powell also indicated that he is studying a wide range of indicators to determine his policy, including economic, financial and political.

The data indicates that the economy is doing well while the markets seem to be worried about an impending recession, here is the Fed's puzzle. Powell had no choice but to raise rates, otherwise he would have lost all his credibility and independence, being perceived as Trump's puppet who keeps criticizing him.

- The Swedish Central Bank (Riskbank) also raised its key rate by 0.25% to -0.25% in December. Since inflation and inflation expectations are close to the bank's 2 % target, the need to maintain an ultra-expansionary monetary policy has declined slightly, said the monetary authority.

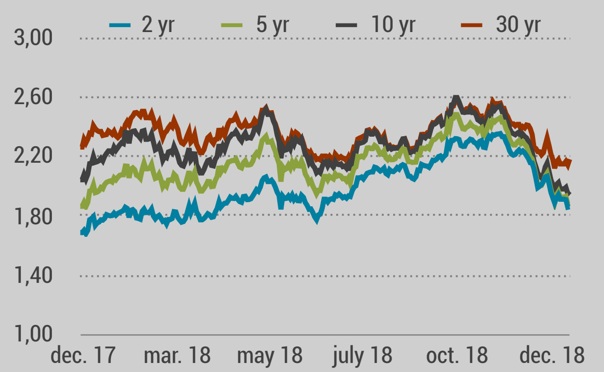
Riskbank faces the same dilemma as some central bankers, namely using monetary policy to tackle the labor shortages that raise wages, without offending investors eager for discount financing.

BOND RATES

Dec. 31 2018		Monthly Change	Change 2018		Monthly Change	Change 2018
Key Interest Rate	1,75 %	0,00 %	0,75 %	2,50 %	0,25 %	1,00 %
3 months	1,65 %	-0,05 %	0,59 %	2,35 %	0,01 %	0,98 %
2 years	1,86 %	-0,30 %	0,17 %	2,49 %	-0,30 %	0,60 %
5 years	1,89 %	-0,31 %	0,02 %	2,51 %	-0,30 %	0,30 %
10 years	1,97 %	-0,30 %	-0,08 %	2,68 %	-0,30 %	0,28 %
30 years	2,18 %	-0,21 %	-0,08 %	3,01 %	-0,28 %	0,27 %
RRB 30 years	0,76 %	-0,06 %	0,19 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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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 2018	Change 10 yrs month	Change 10 yrs 2018	Change 30 yrs month	Change 30 yrs 2018
Royal Bank, deposit notes	AA	AA-	105	125	165	15	30	15	35	15	35
Manulife, Senior debt	A high	A+	130	155	195	15	40	15	40	15	30
Fortis Inc.	BBB high	BBB+	140	185	235	15	50	15	50	15	70
Hydro One	A high	A-	115	140	180	15	50	15	55	15	50
Enbridge Inc	BBB high	BBB+	160	210	275	10	45	10	45	10	50
Encana Corp	BBB low	BBB-	205	270	325	20	75	20	80	20	60
GTAA	---	A+	85	105	140	10	35	10	35	15	55
Bell Canada	BBB high	BBB+	155	200	260	15	60	15	55	15	60
Rogers Communications	BBB	BBB+	150	195	260	15	60	15	55	15	60
Loblaw	BBB	BBB	165	215	270	10	70	5	70	10	70
Canadian Tire	BBB high	BBB+	160	210	270	15	60	5	60	10	65
Province of Québec	A high	A+	59	84	96	13	23	15	29	15	31
Province of Ontario	AA low	A+	63	89	101	14	25	16	30	17	34
CMHC	AAA	AAA	43	56	---	9	16	10	21		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond issuance reached $1 billion in December, down $4.2 billion from the previous month and $2.8 billion lower than in December 2017. This is the least active month since August 2015. For 2018, corporate bond issuance amounted to $80.7 billion, 22.4% lower than in 2017. Financial market nervousness continued in December as the S&P500 Index recorded its worst monthly performance since February 2009. At the same time, corporate bond spreads widened by 16 basis points according to the FTSE Canada Universe Index and by 14 bps for long-term corporate bonds. Provincial spreads were not spared with a 16 bps increase in the long-term.
- Enbridge has been able to stand out in this hostile environment for risky assets. Indeed, Moody's has placed Enbridge's Inc. credit rating (Baa3) on review for a possible upgrade. This upgrade reflects the significant steps taken by Enbridge to simplify its corporate structure and reduce its structural subordination, including the announcement of a cross-guarantee agreement between Enbridge Inc. and its operating companies. As a result, Enbridge Inc. will guarantee Spectra's senior loans and Enbridge Energy Partners while the latters will provide guarantees for Enbridge Inc. Moody's indicated that these efforts, combined with a reduction in debt, could result in a multi notch credit rating upgrade.
- Moody's also announced that it is lowering the Province of Ontario's credit rating from Aa2 to Aa3 with a stable outlook. This downgrade reflects the fiscal challenges faced by the province along with a projection of a $14.5 billion deficit for the current fiscal year (2018-19), or 9.8% of projected revenues. Given the size of this deficit, Moody's does not expect the province to return to a balanced budget for several years, thereby lowering its financial ratios. Moody's therefore expects the province's debt to reach 240% of revenues this year, while the burden of interest costs is also expected to increase rapidly to reach 9.0% of revenues by 2020.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Dec. 2018	2018
Universe	100 %	1,36 %	1,41 %
Short Term	45,4 %	0,87 %	1,91 %
Mid Term	21,8 %	1,60 %	1,91 %
Long Term	32,7 %	1,86 %	0,31 %
Federal	36,3 %	1,67 %	2,39 %
Provincial	34,0 %	1,28 %	0,66 %
Corporates	27,7 %	1,06 %	1,10 %
RRB		1,46 %	-0,05 %

Source: ftse.com

Enbridge has made the bet that it is preferable for its shareholders to follow the path of financial stability provided by the activities operating within a regulatory framework. In this volatile period, investors gave them a thumbs up with their share price remaining unchanged in the fourth quarter while the S&P TSX fell 10.9%.

Despite this downgrade, the province still remains in the AA category since S&P is the only agency with an A rating. On the other hand, Fitch's rating (AA-) has a negative outlook due to a lack of a concrete plan to return to equilibrium. A downgrade would bring the province into A Category with its negative consequences.

STRATEGIC POSITIONNING

Investor opinion turned around in the fourth quarter due to a cascade of events. The arrival of the Democrats in the House of Representatives at the beginning of November and the ongoing budget conflict with the President brought upon a partial government shutdown. As we approach the halfway point of Donald Trump's presidential term, investors realize that the deregulation and tax cuts are coming are losing steam. Especially since the new Congress is likely to curb any new tax cut measures and the White House seems to have a shortage of adults due to the "forced" departures of John Kelly and Jim Mattis. Slower growth in China and the trade dispute with the United States are also of concern to investors. Apple has warned investors that sales in China will hurt next quarter's results. Since these events are beyond investor's control, they have turned to the institution they have most often influenced, the Fed. Despite a dovish speech from the Fed after the December rate hike, investors continued to exert pressure on the markets to obtain a counterweight to Trump's negative policies. Over the past 30 years, Greenspan, Bernanke and Yellen have all bowed to market pressures, Powell will not be any different in the eyes of investors.