MONTHLY BOND LETTER

AlphaFixe Capital

MAY 2018

ECONOMIC EVENTS

- Canadian GDP grew by 1.3 % in annualized terms in the first quarter, compared to 1.7 % in the previous quarter. This deceleration is attributable to a slowdown in consumer spending and a decline in international trade. Exports of non-energy products fell while imports showed good growth. As mortgage measures came into effect in January, residential real estate fell sharply (-7.2 %) after generating a strong gain (13.5 %) in the previous quarter. Corporate investments continue to grow, with a significant annualized increase of 10.9 % in the first quarter.

The weakness in consumer spending may be due to the real estate market adjusting to new mortgage measures. Growth this year should still be supported by government spending and corporate investments, which, like US companies, are investing in their production facility due to labor shortage.

- According to the US Bureau of Labor Statistics, the number of job vacancies has increased by 472,000 reaching a record high of 6.6 million. Employment opportunities have increased in a number of industries, including professional and business services (112,000) and construction (68,000). However, the number of unemployed people surveyed by the Bureau amounted to 6.3 million in April.

This is the first time that the number of job vacancies has surpassed that of the unemployed, illustrating employment strength in the United States, but also a shortage of skilled labor. To fill these positions, CEO's will have to offer more competitive compensation.

- Political instability in Italy has led to turmoil in the country's bond market. This financial instability came about right after the Five Star Movement and the League political party presented a government project to the Italian President with a Eurosceptic finance minister, which was rejected by President Matarella. The coalition has also juggled with the idea of issuing mini-BOTS, the equivalent of an I.O.U interest-free and non-maturing, which is close to the characteristics of a currency. However, on the evening of May 31st, a new project, with a non-Europhobe finance minister was presented and accepted by the President.

The 2-year Italian government bond yield went from -0.33 % at the beginning of the month to 2.64 % in the midst of the crisis, while the 30-year bond rate increased by 78 % to reach 3.65 %. The uncertainty about the a Euro break-up is palpable, but it is rather the idea of issuing a quasi-currency to pay suppliers that has scared the bondholders in Italy.

RATE TRENDS

- The Bank of Canada kept its key rate again at 1.25 % at their May. Global and Canadian economic conditions remain favorable with economic growth strengthening at the end of the first quarter in Canada. Inflation is also expected to rise above 2 % due to rising gas prices. The Bank concluded that a rate hike would be warranted to keep inflation on target while removing concerns about economic sensitivity to interest rate movements.

The Bank of Canada has opened the door for a rate hike at their next meeting in July. Two elements that previously worried the bank have been mitigated. The economic sensitivity to rates comment was removed from the press release, while real estate should now be supported by strong employment income growth.

- In response to the political instability in the Italian bond market and the return of US tariffs on steel and aluminum, investors turned to government bonds for safety. As a result, Canada10-year bond rates fell 28 bps between its year high level on May 17th (2.52 %) and the end of the month.

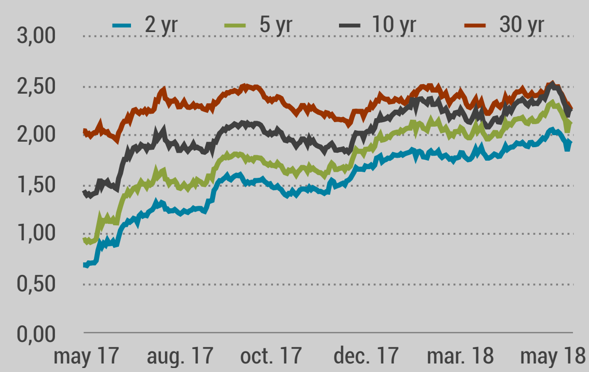
Several investors have used the short sale strategy to guard against rising interest rates. Thus, the market reaction may be due in part to a reversal of thesenstrategies rather than widespread fear.

BOND RATES

May 31 2018	Canada	Monthly Change	Change 2018	US	Monthly Change	Change 2018
Key Interest Rate	1,25 %	0,00 %	0,25 %	1,75 %	0,00 %	0,25 %
3 months	1,29 %	0,10 %	0,23 %	1,89 %	0,10 %	0,52 %
2 years	1,92 %	0,03 %	0,23 %	2,43 %	-0,06 %	0,54 %
5 years	2,11 %	-0,01 %	0,25 %	2,70 %	-0,10 %	0,49 %
10 years	2,24 %	-0,06 %	0,20 %	2,86 %	-0,09 %	0,45 %
30 years	2,26 %	-0,14 %	-0,00 %	3,03 %	-0,10 %	0,29 %
RRB 30 years	0,52 %	-0,11 %	-0,06 %			

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-	85	105	145	10	10	10	15	10	15
Manulife, Senior debt	A high	A+	100	125	170	10	10	5	10	5	5
Fortis Inc.	BBB high	BBB+	100	140	180	0	10	0	5	10	15
Hydro One	A high	A	70	95	135	0	5	5	10	5	5
Enbridge Inc	BBB high	BBB+	120	170	230	-10	5	-10	5	-10	5
Encana Corp	BBB low	BBB-	135	185	255	5	5	0	-5	0	-10
GTAA	---	A+	60	85	115	0	10	5	15	10	30
Bell Canada	BBB high	BBB+	105	150	210	5	10	5	5	10	10
Rogers Communications	BBB	BBB+	100	140	210	5	10	5	0	10	10
Loblaw	BBB	BBB	105	155	210	5	10	5	10	5	10
Canadian Tire	BBB high	BBB+	105	155	215	0	5	0	5	0	10
Province of Québec	A high	A+	40	62	72	-2	4	-1	7	-3	7
Province of Ontario	AA low	A+	43	67	77	-1	5	0	8	-1	10
CMHC	AAA	AAA	32	40	---	2	5	1	5		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached $ 10.3 billion in May, up $ 2.8 billion from the previous month, but $ 3.6 billion lower than in May 2017. Since the beginning of the year, corporate bond issuance totaled $ 39.0 billion, 11 % less than at the same time last year. Among borrowers, Manulife has issued its first green bond issue in Canada. The product of this debenture will be used to fund assets eligible in the Manulife Green Bond Framework which encourages renewable energy projects, eco-buildings, clean transportation and sustainable water and forest management.

- The federal government has announced that it will acquire the Trans Mountain Pipeline and all of Kinder Morgan's core assets for $ 4.5 billion. The US company will continue to build the pipeline over the summer until the deal is completed. Thereafter, the federal government will complete the project to eventually resell these assets at an appropriate time. Kinder Morgan had set a May 31st deadline to resolve this controversial project in British Columbia. Export Development Canada will fund this transaction while the Alberta Government will pay for unexpected construction costs. Approved in 2016, this project is considered essential to the country's economic growth, says the Trudeau government who are looking for international buyers for its Canadian oil.

- Canadian Tire announced that they will acquire the Norwegian clothing company Helly Hansen, which is controlled by the Ontario Teachers' Pension Plan, for $ 985 million. Canadian Tire will also take on the $ 50 million debt. Strategically, this acquisition fits with Canadian Tire's product offering, who also owns Sports Experts and Atmosphere. Canadian Tire intends to finance this transaction with cash and credit lines. Once the transaction is concluded, the debt to EBITDA ratio would be 2.4X compared to 1.9X at the end of last year. Since the company expects to repay its debt quickly using its cash flow, the credit rating agencies have confirmed their ratings with stable outlook.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	may 2018	2018
Universe	100 %	0,80 %	0,04 %
Short Term	44,5 %	0,15 %	0,31 %
Mid Term	44,5 %	0,15 %	0,31 %
Long Term	32,8 %	1,96 %	-0,08 %
Federal	36,1 %	0,59 %	0,21 %
Provincial	34,1 %	1,22 %	-0,33 %
Corporates	27,9 %	0,56 %	0,29 %
RRB		1,70 %	2,25 %

Source: ftse.com

The aspect of finding a new investor quickly seems unreal, as the legal dispute with British Columbia could drag on. The federal government chose to bail-out a US company project that did not have all the required government permits and approvals. Trans-Canada Pipeline was not so lucky in the United States with Keystone.

Although Canadian Tire has the ability to fund this transaction internally, it is highly likely that it will take advantage of current favorable conditions to borrow on the bond market. This would be the first issue since 2009 for the Canadian retailer with only 3 outstanding issues totaling $ 550 million.

STRATEGIC POSITIONNING

The European crisis spectrum and intensification trade war with the United States overshadowed the financial markets in the last week of May. Will these events disrupt the global economy and force central bankers to revert from normalizing their monetary policies? Not at the moment. Currently, polls show a slight support of Italians in favor of the Eurozone and the 5-star movement and the League political parties have won support in March election on anti-austerity platforms, not against the Union. If the coalition government does not succeed in stimulating the economy fiscally and an election were to reoccur this year, the stake could however lead to a referendum of the European Union. In addition, Mr. Trump protectionism has returned by lifting the exemption granted to Canada, Mexico and the European Union on steel and aluminum import tariffs. The next day, Canada announced tariff countermeasures for more than 100 US imported products, targeting regions where mid-term election looks tight. If trade tensions escalate, the immediate impact will be felt by consumers, as the idea of imposing tariffs to repatriate production is unrealistic. All in all, these events should not jeopardize the growth and inflationary environments that should force tighter monetary policies, unless the politicians mess it all up.