MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

MAY 2022

- Despite Omicron and new health measures early in the year, the Canadian economy grew at an annualized rate of 3.1% in the first quarter. Consumer spending continues to be a major driver of growth (+3.4%), particularly spending on durable goods (+10.8%). Investment also contributed strongly to growth. Residential investment had another strong quarter (+18.1%), driven by renovation. Businesses also increased investment (+9.0%), especially in the energy sector in response to the war in Ukraine. International trade hurt growth early in the year due to supply problems in global production chains. Exports (-9.4%) fell more than imports (-2.4%).

The performance is more remarkable when looking at nominal growth. Taking into account the change in prices, GDP grew at an annualized rate of 15.7% in the first quarter. Apart from the last 2 years, which were outliers, such growth has not been seen since the 1980s. Labour income also increased by 15.6% in the first 3 months of the year and households took advantage of this to increase their savings. This gives them a better cushion to absorb the rising cost of living.

- U.S. new home sales fell 16.6% month-over-month in May to an annualized 591,000. This was the fourth monthly decline and the lowest level since April 2020 in the midst of the pandemic. However, the average sales price was US$570,300, up 31% from a year ago. Several factors may account for the decline in sales. Labour shortages, rising material prices and supply chain disruptions are hurting contractors. On the other hand, rising mortgage rates and higher real estate values are weighing on home affordability and eating into a growing portion of household budgets.

As an example, the monthly mortgage payment on a $570,300 new home with a 20% down payment and a 5.25% mortgage rate for 30 years is $2,519. A year ago, the payment was $1,514 due to the 3.25% rate and a 31% lower price ($434,800). That's $1,000 a month more to afford a new property. Rising mortgage rates are also cooling down existing home sales which fell 2.4% in April, their lowest level since June 2020.

- The U.K. consumer price index rose 2.5% in April, bringing the annual rate of inflation from 7% in March to 9% in April, its fastest pace since 1982. The war in Ukraine is beginning to impact the British grocery basket with a 1.1% increase in food in April. Energy jumped 25.3% last month, propelled by a 49.9% increase in electricity costs following a price cap increase by the regulator. A second increase is expected in October.

Inflation could reach more than 10% this year despite a slowing economy. Growth was 0.8% in January, flat in February and down 0.1% in March. Both wholesale and retail trade recorded a sharp decline in activity, indicating that inflation is beginning to affect household spending as they make consumer choices.

RATE TRENDS

- Several central banks are firmly committed to fighting inflation and rate hikes are being announced across the industrialized world. The Bank of England and the Bank of Australia have each announced a 0.25% increase in the key rate, while the Federal Reserve and the Reserve Bank of New Zealand have increased rates by 0.50%. The Bank of Canada also announced a 0.50% increase on June 1st, but warned Canadians that it could be more aggressive if necessary. "The Governing Council is prepared to act more forcefully if necessary to meet its commitment to the two per cent inflation target," the bank said in its release. The door is therefore open for a 0.75% hike in future meetings if conditions warrant.

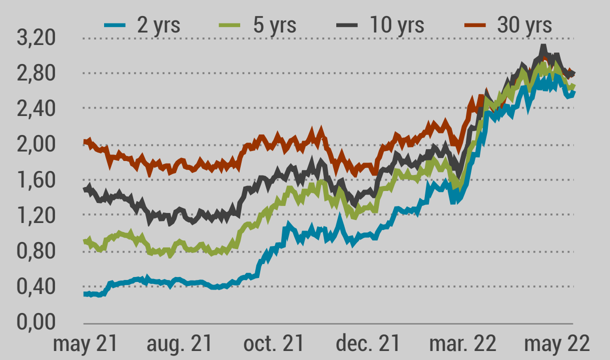
After dismissing inflationary risks altogether at the beginning of 2021 and calling them transitory afterwards, central banks have capitulated this year, admitting that inflation is very problematic and that monetary policy needs to be tightened faster than a DeWalt can do it. According to an analysis by the Financial Times, central bankers in 55 countries surveyed have announced more than 60 policy rate increases in the past three months, the most since early 2000. Canada was the first industrialized country to raise its rate by 0.50% this year, will it also be the first to do 0.75%?

BOND RATES

May 31, 2022	Canada	Monthly Change	Change 2022	U.S.	Monthly Change	Change 2022
Key Interest Rate	1,00 %	0,00 %	0,75 %	1,00 %	0,50 %	0,75 %
3 months	1,49 %	0,03 %	1,31 %	1,04 %	0,22 %	1,01 %
2 years	2,66 %	0,04 %	1,71 %	2,56 %	-0,16 %	1,82 %
5 years	2,74 %	-0,01 %	1,48 %	2,82 %	-0,14 %	1,55 %
10 years	2,89 %	0,03 %	1,47 %	2,84 %	-0,09 %	1,33 %
30 years	2,85 %	0,05 %	1,17 %	3,05 %	0,05 %	1,14 %
RRB 30 years	1,10 %	0,16 %	1,22 %			

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	160	190	225	15	75	15	75	15	70
Royal Bank, NVCC	A	210	260	305	20	100	20	110	20	105
Sun Life, subordinated debt	A	185	235	275	15	85	15	95	15	85
Hydro One	A high	110	140	170	0	45	0	40	0	35
Enbridge Inc	BBB high	180	225	290	15	70	10	70	5	60
Altalink LP	A	110	135	165	0	45	0	35	0	30
GTAA	A high	110	140	170	0	40	0	40	0	40
Bell Canada	BBB high	160	205	255	10	60	10	60	5	50
Rogers Communications	BBB high	175	225	295	5	45	5	50	0	60
Loblaw	BBB high	155	200	235	10	65	10	65	5	45
Canadian Tire	BBB	165	215	285	10	70	10	70	5	55
Province Québec	AA low	46	71	93	1	13	0	15	1	19
Province Ontario	AA low	50	75	96	1	13	0	14	1	18
CMHC	AAA	36	48	---	0	5	-2	7		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance totaled $9.4 billion in May, up $4.7 billion from the previous month and $2.1 billion higher than May 2021. Year-to-date, bond financings totaled $58.3 billion, 22% higher than at this time last year. The majority of new debt has come from companies in the financial industry ($6.5 billion), primarily banks ($6.3 billion). In just 5 months, Canadian banks have issued a total of $39.7 billion, surpassing the annual record set in 2019 ($39.4 billion).

- All six Canadian banks reported their fiscal second quarter results, with profits totaling $18 billion, up 29% from the same period last year. The vast majority (85%) of the earnings growth was attributable to a significant increase in net income at Bank of Montreal (BMO), up $3.5 billion from a year ago. Accounting actions related to revenues associated with BMO's pending acquisition of Bank of the West boosted net income this quarter. Banks benefited from favourable conditions in their personal and commercial divisions while some banks, notably RBC, also reduced their loan loss provisions. Loan portfolios are growing, both in real estate and in loans to companies seeking to improve productivity or enhance supply chains.

- Almost a year to the day after announcing a credit downgrade, S&P has gone back to the drawing board and upgraded Alberta's credit rating from A to A+. The upgrade is the result of improved economic conditions over the past year related to rising oil prices that have bolstered government revenues. S&P also noted that the stable outlook reflects the strong likelihood that the robust growth anticipated over the next two years "will lead to continued improvement in Alberta's fiscal performance and limit the increase in the tax-financed debt burden". The province's oil price forecast presented at the time of the budget is conservative and suggests a more favourable fiscal outcome than expected for the current fiscal year.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	May 2022	2022
Universe	100 %	-0,07 %	-10,28 %
Short Term	41,7 %	0,24 %	-3,64 %
Mid Term	27,1 %	0,02 %	-9,59 %
Long Term	31,2 %	-0,57 %	-18,59 %
Federal	36,1 %	0,08 %	-7,86 %
Provincial	35,5 %	-0,15 %	-12,92 %
Corporates	26,3 %	-0,15 %	-9,58 %
RRB		-0,74 %	-14,35 %

Source: ftse.com

These quarterly results cover the period ending April 30. The impact of the last two Bank of Canada rate hikes has not yet been felt. The economy remains robust and in excess demand, but Canadian banks will have to be cautious in the face of the economic uncertainty that is emerging. In this regard, why reduce loss provisions if risks are increasing?

The geopolitical chessboard has also changed this year. Countries are looking to secure energy supplies in countries where the rule of law is respected. Alberta is therefore a partner of choice in this regard for several countries. The environmental challenges remain, however. Inflation also increases government revenues and will also improve the province's fiscal performance.

STRATEGIC POSITIONNING

The Bank of Canada has made a second 0.50% increase in its key interest rate, but is warning Canadians that it could reach 3% in the near future with more aggressive rate hikes. Inflation is a key concern for central bankers, who fear that it will become entrenched and change people's long-term expectations. Acknowledging that monetary policy has little effect in correcting the supply shocks we see today, the Bank of Canada mentioned that the start of the rate hikes in April was to rebalance the excess demand in the economy at that time. One has to wonder why the bank waited until there was excess demand before starting to raise rates? Our high school economics courses teach us that excess demand causes inflation. Wouldn't it have been better if the rate had been close to neutral (2-3%) when the economy was approaching the excess demand cycle? This situation applies to most central banks. By delaying monetary policy normalization, central banks will have to do more and faster to fight inflationary pressures. The same logic applies in reverse. Will they wait for inflation to decline before stopping monetary tightening? Since inflation is a lagging indicator, it might be too late and the economy may already be contracting.