# MONTHLY BOND LETTER

AlphaFixe Capital

OCTOBER 2020

## ECONOMIC EVENTS

- The Canadian economy added 378,000 jobs in September, bringing the unemployment rate to 9%, up from 10.2% in August. The majority of new jobs are for full-time positions (334,000) and in service industries (303,000). Among these industries, there were job gains in accommodation and food services (72,000) and information/culture/recreation (56,000). In contrast, employment slowed in October with a gain of 84,000. Statistics Canada also reported that the proportion of Canadians working from home stood at 25.6%, down slightly from the previous month (26.4%).

The survey used for the September statistics was carried out in the middle on the month, not taking into account new restrictions imposed by the Quebec government on restaurants and theatres. The impact of these measures resulted in the loss of nearly 48,000 jobs in restaurants and hotels the following month and 11,000 jobs in the culture and leisure industry.

- The U.S. economy grew at an annualized rate of 33.1% in the third quarter. This record rebound comes after a historic drop in the previous quarter (-33.2%). Nevertheless, the economy is still 3.5% below its level at the end of 2019. Consumption remains the driving force behind the recovery, with annualized growth of 40.7%. On the other hand, the pandemic has changed our lifestyles creating an uneven recovery. Consumption of goods is now surpassing pre-pandemic levels (+6.7%) while households are spending less on services (-7.7% compared to the end of 2019). Residential real estate has also benefited from the pandemic with a 5.1% gain since the beginning of the year.

This economic scorecard is a thing of the past. The increase in new Covid cases and the presidential election could disrupt growth in the fourth quarter. If power is shared in Congress, the President-elect will have less wiggle room to support the economy again. The long-awaited second stimulus package could be less generous if partisan ideology dominates.

- The International Monetary Fund (IMF) has revised upwards its economic forecast for the current year, forecasting a 4.4% contraction in world GDP instead of the -5.2% estimated last June. However, "growth is likely to be long, uneven, and uncertain," the IMF said, noting that prospects have deteriorated significantly in some developing countries where infections are rising rapidly.

Formerly an advocate of balanced budgets, the IMF is now encouraging industrialized countries to take advantage of historically low rates to raise debt and finance the recovery with infrastructure projects. This represents a major shift in thinking in the conduct of fiscal policies.

## RATE TRENDS

- Bank of Canada has announced that it is maintaining its policy rate at 0.25%, but is making changes to its quantitative easing program. The recovery has slowed recently and the increase in COVID-19 cases is expected to weigh on the economic outlook in many countries. Growth will continue to rely heavily on government support measures. The Bank therefore plans to keep the policy rate at the current low level until the economy's excess capacity is absorbed, which they expect to happen in 2023. The Bank also announced that it will reduce the size of its federal bonds purchases from $5 billion per week to $4 billion. It will also rebalance its program to focus more on longer-term bonds, which the Bank says to have a more direct influence on the most important borrowing rates for households and businesses.

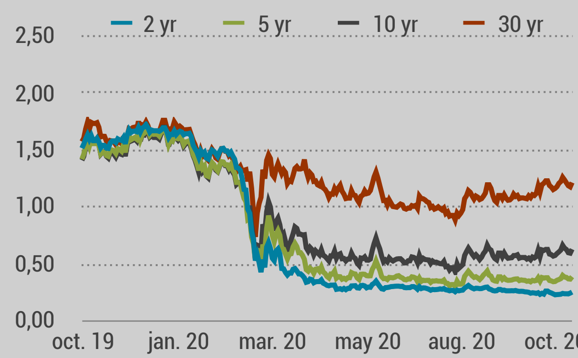
The Bank of Canada already holds 34% of the federal debt and the majority of the securities it holds mature in less than 2 years. Nevertheless, the current pace of purchases is worrisome. At what level of debt holding will the Bank disrupt market equilibrium? The Bank of Canada began its quantitative easing program only this year, while other central banks began after the 2008 financial crisis. Since mortgages make up the majority of household debt and have a maturity of less than 5 years, the Bank's interventions can be expected to be concentrated near that term.

## BOND RATES

| Oct. 30 2020 | | Monthly Change | Change 2020 | | Monthly Change | Change 2020 |
|---|---|---|---|---|---|---|
| Key Interest Rate | 0,25 % | 0,00 % | -1,50 % | 0,25 % | 0,00 % | -1,50 % |
| 3 months | 0,09 % | -0,03 % | -1,57 % | 0,09 % | -0,01 % | -1,46 % |
| 2 years | 0,26 % | 0,02 % | -1,44 % | 0,15 % | 0,03 % | -1,42 % |
| 5 years | 0,40 % | 0,05 % | -1,29 % | 0,38 % | 0,11 % | -1,31 % |
| 10 years | 0,66 % | 0,10 % | -1,04 % | 0,87 % | 0,19 % | -1,04 % |
| 30 years | 1,25 % | 0,14 % | -0,51 % | 1,66 % | 0,20 % | -0,73 % |
| RRB 30 years | -0,18 % | 0,02 % | -0,56 % | | | |

Source: Bloomberg

## CANADIAN RATE TRENDS

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## CREDIT BOND RISK PREMIUMS

| Émetteurs | Credit Rating DBRS | Spread 5 yrs | Spread 10 yrs | Spread 30 yrs | Change 5 yrs month | Change 5 yrs 2020 | Change 10 yrs month | Change 10 yrs 2020 | Change 30 yrs month | Change 30 yrs 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| Royal Bank, Bail-in-debt | AA | 85 | 120 | 170 | -5 | 0 | 0 | 0 | 5 | 10 |
| Royal Bank, NVCC | A | 125 | 165 | 225 | -10 | 5 | -5 | -5 | 0 | 15 |
| Sun Life, subordinated debt | A | 115 | 155 | 210 | 5 | 15 | 10 | 10 | 20 | 25 |
| Hydro One | A high | 70 | 105 | 155 | -5 | 10 | -5 | 20 | 0 | 25 |
| Enbridge Inc | BBB high | 135 | 195 | 275 | 10 | 35 | 20 | 45 | 20 | 55 |
| Altalink LP | A | 65 | 100 | 150 | -5 | 10 | -5 | 20 | 0 | 30 |
| GTAA | A high | 90 | 130 | 180 | -5 | 35 | 0 | 50 | 5 | 70 |
| Bell Canada | BBB high | 105 | 160 | 230 | 0 | 5 | 5 | 10 | 5 | 25 |
| Rogers Communications | BBB | 105 | 160 | 230 | 5 | 10 | 10 | 15 | 10 | 25 |
| Loblaw | BBB high | 95 | 150 | 220 | 0 | -10 | 5 | -5 | 5 | 10 |
| Canadian Tire | BBB | 125 | 185 | 285 | -5 | 25 | 5 | 35 | 15 | 80 |
| Province Québec | AA low | 39 | 68 | 87 | 6 | 3 | 0 | 9 | 1 | 18 |
| Province Ontario | AA low | 42 | 72 | 88 | 4 | 4 | 1 | 10 | 1 | 15 |
| CMHC | AAA | 25 | 36 | --- | 2 | -4 | 0 | -2 | | |

Source: National Bank Financial

## CREDIT MARKET

- Canadian corporate bond new issuance reached $7.4 billion in October, down $3.4 billion from the previous month and $1.5 billion less than October 2019. Year-to-date bond financings totalled $98.3 billion, 19% higher than at the same time last year. Ontario Power Generation has completed a $400 million financing with a 5.5-year term. The issue rated AA(low) by DBRS attracted strong investor demand with an order book 8 times oversubscribed. The issuer is owned by Ontario, but the Province does not explicitly guarantee its debt. However, the Province indirectly provides a large portion of its financing needs through the Ontario Electricity Financial Corporation.

- Rogers Communications reported earnings of $512 million for the quarter ended September 30, 2010, down 13.7% from the same period last year. Although households have embraced teleworking and are using more data at home, Rogers has experienced an 8% decline in revenues over the past three quarters. This decline is due to lower roaming revenues that Rogers is reaping from international travel. The phased adoption of unlimited data rate plans has also reduced revenues from excess data usage. Nevertheless, free cash flow remains stable, which should provide some comfort to creditors.

- The Province of Ontario has tabled a budget update that forecasts a deficit of $38.5 billion for the current fiscal year, unchanged from the August update. This is a record deficit of 4.6% of GDP and is expected to decline slightly next year to $33.1 billion or 3.9% of GDP. Revenues for the current fiscal year are expected to reach $151.1 billion, of which 22.1% will come from federal transfers. Expenditures will total $187 billion with 35% of the expenditures allocated to healthcare this year. The budget also includes a contingency fund of $2.5 billion in addition to the $2.6 billion that was planned for last year but not used. As a result of this record deficit, the net debt to GDP ratio now stands at 47%, the second highest among the provinces after Newfoundland.

### FTSE TMX INDEX PERFORMANCE

| Sector | Weight | Oct. 2020 | 2020 |
|---|---|---|---|
| Universe | 100 % | -0,76 % | 7,18 % |
| Short Term | 42,0 % | 0,01 % | 4,80 % |
| Mid Term | 23,8 % | -0,47 % | 8,88 % |
| Long Term | 34,2 % | -1,87 % | 8,91 % |
| Federal | 33,4 % | -0,53 % | 6,97 % |
| Provincial | 37,8 % | -1,06 % | 8,04 % |
| Corporates | 26,7 % | -0,61 % | 6,17 % |
| RRB | | -0,77 % | 10,13 % |

Source: ftse.com

Rogers' hostile takeover bid to acquire Cogeco was categorically rejected by the Audet family, owner of the Quebec cable operator. Rogers could therefore divest itself of the interest it already holds in Cogeco, which is valued at $1.5 billion. Monetizing this asset could be attractive either to reduce indebtedness or to invest in its 5G infrastructure.

Although Ontario has given a forecast of deficits for the next few years, no plan to return to a balanced budget has been unveiled, which is understandable in these times of uncertainty and pandemic. In the meantime, it can still take advantage of the Bank of Canada's provincial bond purchase program to ensure a low cost of financing its debt.

## STRATEGIC POSITIONNING

U.S. voters rejected Donald Trump's abrasive and narcissistic personality for the presidency, but do not seem to be giving the Democratic Party carte blanche, preferring to keep the separation of power in Congress. Opinion polls suggested a big victory for Joe Biden as President, as well as for his Democratic colleagues in the Senate. Expectations of higher government expenditures to support the economy and finance various environmental projects seem to be fading as control of the Senate seems to remain in Republican hands. They have even made gains in the House of Representatives, reducing the Democratic majority. As a result, the likelihood of a major fiscal stimulus that would include significant assistance to states and municipalities to deal with the pandemic is also low. Republicans have a history of abandoning fiscal rectitude when one of their own is president in order to rediscover the virtues of fiscal balance when there is a Democrat in the White House. The emergence of the Tea Party in 2010 is proof of this. Biden's negotiating and convening skills will be put to the test if he wants to get some of his policies approved in the Republican Senate. Planned tax hikes for corporations and the wealthy will be set aside, which is viewed favourably by the stock market. Spending increases are not ruled out, but they must be translated into job creation, as is the case with infrastructure projects.