

MONTHLY BOND LETTER

AlphaFixe
Capital

ECONOMIC EVENTS

FEBRUARY 2021

- The Canadian economy grew at an annualized rate of 9.6% in the fourth quarter, bringing the contraction in GDP for the year to 5.4%, the steepest annual decline since data collection began in 1961. Nearly 75% of this quarterly growth came from an increase in business inventories. Government spending and business investment also drove growth, while household consumption was largely unchanged. Household disposable income jumped 10% in 2020, the strongest growth in 4 decades. The household savings rate as a share of disposable income was 12.7% in the fourth quarter.
- Americans' personal income jumped 10% in one month in January, boosted by the most recent \$900 billion support package passed last December. This is the second highest monthly growth in history after April 2020 (12.4%). In fact, more than all of the increase in income (\$1,954 billion) came from government transfers (\$1,977 billion) in the form of a cheque sent to taxpayers or an increase in the employment insurance program. Personal spending also increased, but at a slower pace, up 2.4% in January. As a result, the household savings rate climbed to 20.5 per cent of disposable income, up from 13.4% last December.
- The U.K. economy grew by 1% between the third and fourth quarters of 2020. Increases in government spending and business investment propelled growth. Consumption dipped slightly (-0.2%) due to health measures adopted in November. For the year 2020, the economy fell 9.9%, the worst decline since the Great Freeze of 1709, also eclipsing the 9.7% decline in 1921 after World War I.

In 2020, Canadians have saved an amount comparable to the last seven years combined, almost \$200 billion or 9% of GDP. Once vaccination picks up and life returns to normal, households will have significant amounts of money to deploy in the economy. If shortages in supply chains do not improve, consumers could face significant price increases for some goods.

The distribution of \$600 checks included in the \$900 billion support plan propelled retail sales by 5.3% in January, the 4th largest monthly increase in history. What will happen to consumption when Congress passes a \$1.9 trillion plan that includes a \$1400 check? A family of 4 earning less than \$150,000 a year will receive \$5,600. Investors may well fear overheating.



The finance minister has announced £65 billion in additional measures over the next two years to boost the economy, but he is already preparing for the post-Covid era with tax hikes for corporations in 2023. Is austerity the right way to reduce debt or would it be better to accept more inflation to reduce the debt-to-GDP ratio?

What is worrisome is not the rise or the level of rates, but the speed at which this rise has occurred. Before the Covid crisis, the all-time low for U.S. 10-year bonds was 1.47% in 2016. Today, there is concern when rates return to that old mark. The Fed may say it's not worried, but if rising rates disrupt financial markets and force investors to revise valuations of certain assets, it will respond as it always has. Growth will be there this year and inflationary pressures will emerge, so the direction of rates is up, just watch the speed.

RATE TRENDS

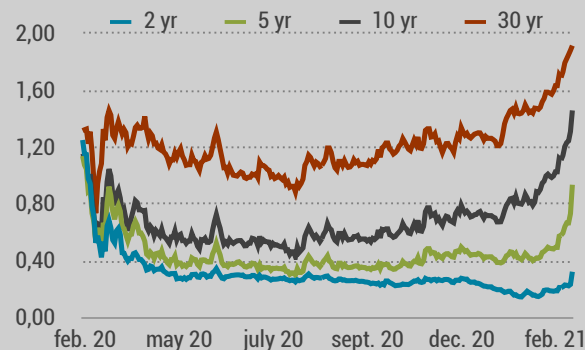
- Global bond yields jumped in 2021 and primarily in February. For example, 10-year bond rates in the U.S. and Canada rose by 34 and 47 basis points (bps) in February. Inflation expectations drove rates early in the year, but more recently, rates have responded more to the favorable growth outlook for 2021. Indeed, 10-year real return bond yields rose 29 bps in the U.S. in February, reflecting stronger growth. Central bankers say they are not worried, citing ongoing vaccination campaigns, lower hospitalizations and hopes for a return to more normal conditions later this year as reasons for the recent rise. Inflationary pressures are not alarming, according to the Fed, as inflation expectations remain anchored and do not suddenly change after decades of low and controlled inflation.

BOND RATES

		Monthly Change	Change 2021		Monthly Change	Change 2021
Feb. 26 2021						
Key Interest Rate	0,25 %	0,00 %	0,00 %	0,25 %	0,00 %	0,00 %
3 months	0,12 %	0,06 %	0,05 %	0,03 %	-0,02 %	-0,03 %
2 years	0,30 %	0,14 %	0,10 %	0,13 %	0,02 %	0,01 %
5 years	0,88 %	0,45 %	0,49 %	0,73 %	0,31 %	0,37 %
10 years	1,36 %	0,47 %	0,68 %	1,40 %	0,34 %	0,49 %
30 years	1,76 %	0,29 %	0,55 %	2,15 %	0,32 %	0,51 %
RRB 30 years	0,11 %	0,22 %	0,41 %			

Source: Bloomberg

CANADIAN RATE TRENDS



CREDIT BOND RISK PREMIUMS

Émetteurs	Credit Rating DBRS	Change								
		Spread			5 yrs		10 yrs		30 yrs	
		5 yrs	10 yrs	30 yrs	month	2021	month	2021	month	2021
Royal Bank, Bail-in-debt	AA	65	100	150	5	0	5	-5	5	-5
Royal Bank, NVCC	A	95	135	190	5	-5	5	-5	5	-5
Sun Life, subordinated debt	A	80	120	175	0	-10	0	-10	0	-10
Hydro One	A high	55	85	125	5	5	5	0	0	-5
Enbridge Inc	BBB high	90	140	215	0	-5	-5	-10	0	-20
Altalink LP	A	55	80	120	5	5	5	0	0	-5
GTAA	A high	60	90	130	5	10	5	5	0	0
Bell Canada	BBB high	75	120	190	0	-5	-5	-10	-5	-10
Rogers Communications	BBB	75	120	190	0	-5	-5	-10	-5	-10
Loblaw	BBB high	70	115	185	0	-5	-5	-10	-5	-10
Canadian Tire	BBB	90	140	240	0	-5	-5	-15	-5	-15
Province Québec	AA low	30	54	73	1	0	0	-3	-5	-6
Province Ontario	AA low	35	59	74	2	0	0	-3	-5	-7
CMHC	AAA	23	35	---	3	2	4	3		

Source: National Bank Financial

CREDIT MARKET

● New domestic corporate bond issuance totaled \$9.5 billion in February, up \$2.6 billion from the previous month and \$2 billion more than in February 2020. Year-to-date, bond financings totaled \$16.3 billion, up 3% from last year. Low rates on government bonds have encouraged investors to take on more risk. For the first time in its history, the current yield on the Bloomberg Barclay's U.S. High Yield Bond Index fell below 4%. Cineplex also completed a \$250 million bond issue with a 7.5% coupon. The issue was five times oversubscribed for an issuer that has no credit rating and whose industry is severely impacted by the crisis.

● Collectively, the six major Canadian banks reported first quarter earnings of \$13.9 billion, up 11.5% from the same period last year. Provisions for credit losses totaled \$1.57 billion, down 47% from the first quarter of 2020 and 52% lower than the previous quarter. Wealth management and mortgage lending activities contributed to earnings growth. In contrast, the pandemic made it more difficult to grow certain commercial, credit card, and auto lending businesses. Increased disposable income allowed households to reduce their credit card balances.

● According to Alberta's Finance Minister, the deficit will reach \$20.2 billion for the fiscal year ending March 31, or 6.6% of GDP. This is a slight improvement from the revised forecast of \$21.3 billion issued last November. The deficit next year is expected to reach \$18.2 billion, including \$1 billion for oil-by-rail and an additional \$1.1 billion to combat Covid. This forecast assumes an average oil price (WTI) of \$46 per barrel compared to the current level of nearly \$60. The spread between the price of Texas oil (WTI) and Canadian oil (WCS) is expected to be close to \$14.60, according to the province. A one-dollar increase in oil prices or a one-dollar narrowing of the spread would bring almost \$200 million in additional revenue to the province.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Feb. 2021	2021
Universe	100 %	-2,52 %	-3,60 %
Short Term	41,8 %	-0,80 %	-0,68 %
Mid Term	25,0 %	-3,11 %	-3,58 %
Long Term	33,1 %	-4,19 %	-7,11 %
Federal	34,1 %	-2,14 %	-2,97 %
Provincial	37,3 %	-3,23 %	-4,93 %
Corporates	26,6 %	-1,95 %	-2,48 %
RRB		-3,70 %	-5,91 %

Source: ftse.com

The vaccination-driven economic recovery will boost bank returns over the course of the year. With the Bank of Canada looking to keep its policy rate at the floor for a few years, banks will also benefit from a steeper yield curve. Bank assets are generally longer term.

This is a conservative approach given the recent rise in oil prices as the global economy opens up. Provinces will have to manage more cautiously as the Bank of Canada appears to be ending its provincial bond purchase program. Nevertheless, Alberta's debt-to-GDP ratio remains low compared to other provinces.

STRATEGIC POSITIONNING

The sudden rise in bond yields can be interpreted as a sign of increased market confidence in global growth prospects. This confidence is also expressed in the market for commodities such as oil, copper and lumber, which continues to reach record highs. Vaccines and their efficiency also point to a reopening of the economy earlier this year. A third \$1.9 trillion U.S. support plan will also stimulate demand at a time when global supply chains are under pressure from rising costs and delays. The bond market has therefore adjusted to this new reality of high growth, but the impact has been felt more on 5 to 10-year rates than elsewhere on the curve. This upward adjustment of 5-year rates should not please central bankers since this is the financing term that has the most impact on economic growth, particularly in the mortgage market. Instead of depleting ammunition to keep long-term rates low, central bankers should focus their efforts on shorter-term rates if the objective is to stimulate the economy and return to full employment. If inflationary pressures emerge, will central bankers quickly tighten monetary policy or are we in a new environment where inflation is tolerated in order to reduce government debt ratios?