MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

APRIL 2022

- The Canadian economy added 72,500 new jobs in March, bringing the unemployment rate to its lowest level ever recorded by Statistics Canada at 5.3%. In Quebec, the unemployment rate reached 4.1%, also an all-time low. In addition to hiring, businesses are demanding more from their employees. Hours worked increased by 1.3% in March, illustrating how much help is needed. What's more, all of the jobs are full-time (+93,000) while there was a slight decline in part-time jobs (-20,000). Recent easing of health measures have contributed to the increase in employment. Ontario (+35,000) and Quebec (+27,000) led in employment, but Covid restrictions were harsher.

Labour shortages has translated into a 3.4% increase in wages in the past year. However, this is lower than the increase observed in 2019 (+4.3%) when inflation was close to the Bank of Canada's target of 2%. Given that inflation is now at 6.7% and households are losing purchasing power, the wage recovery is not over. This process is slow, as labour contracts are not renegotiated every month.

- The U.S. economy contracted at an annualized rate of 1.4% in the first quarter of this year after growing by 6.9% in the previous quarter. The majority of the decline came from a depletion of inventories after a large build-up in the previous quarter. In fact, 75% of the growth in the fourth quarter was due to inventory accumulation. International trade also hurt growth early in the year, particularly in exports. Health restrictions have been stricter elsewhere in the world, affecting exports by U.S. companies. Excluding inventories and international trade, domestic final demand grew by 2.6%, driven by household consumption expenditures (+2.7%).

Interestingly, households increased their purchase of services but slightly reduced their consumption of goods, illustrating the rotation of preferences in the reopening phase of the economy. The pandemic and the war in Ukraine have highlighted the flaws of just-in-time inventory management for companies. It is therefore possible that we will return to a more traditional model of on-site inventory with the cyclical consequences and higher risks of having a recession.

- The eurozone economy grew at an annualized rate of 0.8% in the first quarter, down slightly from the previous quarter (1.2%). Growth in Spain (1.2%) and Germany (0.8%) more than offset the contraction in Italy, while the French economy stalled. International trade hurt growth in countries with energy dependence on foreign markets, such as Germany and Italy. On the other hand, French consumption declined, a sign of the loss of purchasing power linked to inflation.

Signs of stagflation are increasingly apparent. Inflation hit a new record high of 7.5% in April and 3.5% excluding food, energy, alcohol and tobacco. The European Central Bank (ECB) will eventually have to choose between growth and inflation, which is like choosing between the plague and cholera. The next few months will not be easy for the ECB.

RATE TRENDS

- As expected, the Bank of Canada announced a 0.50% increase in the policy rate to 1.0%. The last time an increase of this magnitude was voted was in May 2000. The Bank explained its decision by an increase in inflationary pressures resulting from the conflict in Ukraine and disruptions in global production chains. Domestic demand also strengthened as a result of a robust labour market. As a result, excess capacity has been absorbed and the economy is now in a phase of excess demand that requires a tighter monetary policy. The Bank also decided to end its program of reinvesting securities held on the balance sheet. As of April 25, maturing bonds on the balance sheet are no longer replaced, which will reduce the size of the balance sheet over time.

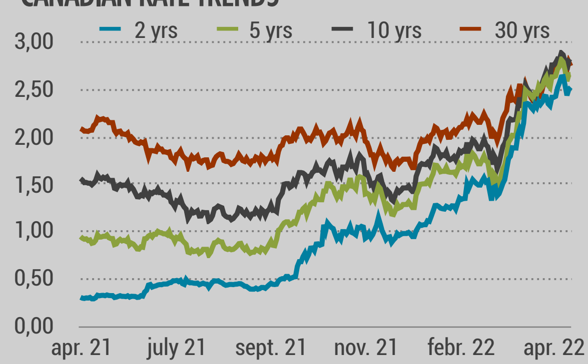
If the Bank wants to return to its 2% target by 2024, it will have to step up its pace and announce further 0.50% increases. However, a closer look at the Bank's balance sheet shows that it holds $85 billion in bonds that will mature in the 2022-23 federal government fiscal year. The government plans to issue a total of $212 billion in bonds during that fiscal year. Since the federal government will no longer be able to rely on the Bank of Canada to purchase a portion of its debt, the private sector will have to absorb all of the issuance. The last fiscal year that excluded the central bank as a buyer was in 2019-20 with $124 billion in issuance. This year, the private sector will have to buy 71% more than in 2019-20.

BOND RATES

Apr. 30, 2022	Canada	Monthly Change	Change 2022	United States	Monthly Change	Change 2022
Key Interest Rate	1,00 %	0,50 %	0,75 %	0,50 %	0,00 %	0,25 %
3 months	1,46 %	0,71 %	1,28 %	0,82 %	0,34 %	0,79 %
2 years	2,62 %	0,33 %	1,67 %	2,71 %	0,38 %	1,98 %
5 years	2,75 %	0,34 %	1,49 %	2,95 %	0,50 %	1,69 %
10 years	2,87 %	0,46 %	1,44 %	2,93 %	0,60 %	1,42 %
30 years	2,80 %	0,42 %	1,12 %	3,00 %	0,55 %	1,09 %
RRB 30 years	0,94 %	0,36 %	1,06 %			

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	145	175	210	25	60	25	60	25	55
Royal Bank, NVCC	A	190	240	285	25	80	30	90	35	85
Sun Life, subordinated debt	A	170	220	260	20	70	25	80	25	70
Hydro One	A high	110	140	170	15	45	10	40	20	35
Enbridge Inc	BBB high	165	215	285	25	55	30	60	30	55
Altalink LP	A	110	135	165	15	45	5	35	15	30
GTAA	A high	110	140	170	15	40	15	40	25	40
Bell Canada	BBB high	150	195	250	20	50	20	50	20	45
Rogers Communications	BBB high	170	220	295	15	40	15	45	20	60
Loblaw	BBB high	145	190	230	20	55	20	55	20	40
Canadian Tire	BBB	155	205	280	20	60	20	60	20	50
Province Québec	AA low	45	71	92	2	12	6	15	6	18
Province Ontario	AA low	49	75	95	3	12	8	14	7	17
CMHC	AAA	36	50	---	-2	5	0	9		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance totaled $4.7 billion in April, down $24 billion from the previous month and $5.5 billion less than in April 2021. Year-to-date, bond financings totaled $48.9 billion, up 11% from this time last year. This is the lowest issuance volume since 2015 for an April and well below the $7.3 billion average of the past 10 years. Weak equity markets dampened investor enthusiasm. Demand for corporate bonds is still there, but investors are prioritizing quality assets.

- The Ontario Finance Minister presented his budget for the 2022-23 fiscal year. The Ford government expects the province's deficit to increase from $13.5 billion in the previous fiscal year (2021-22) to $19.9 billion this year, including a $1 billion provision, which represents 1.9% of GDP. Economic growth is expected to generate a 3.7% increase in provincial revenues to $179.8 billion. On the other hand, in this election year, the government is counting on spending to increase by 6.2% to $198.6 billion. Instead of offering a cheque to fight inflation, the government is offering a 5.7 cent tax rebate on gasoline for the next six months. The Department of Finance plans to borrow $41.5 billion this year, essentially unchanged from last year ($41.4 billion). However, the province is already ahead of the curve, taking advantage of favourable conditions and pre-funded $10 billion in the past year.

- Moody's has maintained Saputo's credit rating at Baa1, but has changed the outlook from stable to negative. This change reflects the challenges the company will face in the coming years. Saputo is facing inflation in its operating costs, labor shortages at its U.S. facilities and supply chain disruptions. If these challenges continue, Saputo may find it difficult to meet its debt reduction targets of 3x EBITDA within the next 12 months. The company is still trying to defend its profit margins by streamlining costs and increasing prices to consumers.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Apr. 2022	2022
Universe	100 %	-3,49 %	-10,22 %
Short Term	42,3 %	-0,92 %	-3,87 %
Mid Term	26,9 %	-2,97 %	-9,60 %
Long Term	30,7 %	-7,25 %	-18,13 %
Federal	35,7 %	-2,52 %	-7,93 %
Provincial	35,4 %	-4,61 %	-12,79 %
Corporates	26,7 %	-3,20 %	-9,44 %
RRB		-4,84 %	-13,72 %

Source: ftse.com

Unlike other provinces, Ontario is announcing an increase in the deficit this year. Definitely, elections influence the budget. Although there will be no cheque distribution like in Quebec, the gas rebate will be used to help taxpayers with inflation. This measure is still not fair, as the wealthy benefit as much as low-income families who are more affected by inflation.

Saputo is not the only company facing rising input costs, labour shortages and compressed profit margins. The frequency of adjustment of consumer prices is lower than that of inputs, which are often traded on the financial markets. Saputo will not be the only one to face a rating review.

STRATEGIC POSITIONNING

The Bank of Canada is the first monetary authority in the industrialized world to raise its policy rate by 0.50% during this period of monetary tightening, but it will not be the only one, nor will it be the last. The economy is entering a phase of excess demand, but the inflationary pressures we are currently experiencing are the result of a combination of strong demand and supply disruptions. In this regard, rate hikes will not affect the ability to unclog global production lines, or lower energy prices that are heavily influenced by geopolitical developments. Banks can, however, mitigate the demand side. The risk is that central banks will have to overcompensate for their inaction in tackling inflation earlier. Policy rates could be raised above their neutral point without inflation even returning to a reasonable level due to supply shocks. If they wait for inflation to return within their target range before stopping the tightening, it is possible that the cost of money will be too high, significantly weakening demand and pushing the economy into recession. Nevertheless, this risk is not imminent, as the real policy rate is still deeply negative, the labor market is still robust and household savings are high. Watch out for the next few years, though.