MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

NOVEMBER 2022

- The pace of growth in the Canadian economy slowed slightly over the summer, from an annualized 3.3% in the second quarter to 2.9% in the third. This headline looks good, but the details are less telling. Household consumption expenditures declined by 1.0% over the summer. With disposable income up 3.3% during this period, households increased their savings levels to build a precautionary cushion in the event of a recession. Residential real estate weakened further, falling 15.4% over the summer. In contrast, non-residential real estate jumped 12.0% in the third quarter. International trade was a major contributor to growth due to increased exports of oil and agricultural products. Government spending and inventories also contributed to growth.

Statistics Canada has also revised the national accounts for the past few years, adding 0.5% to growth last year, so Canadian GDP is now higher than the Bank of Canada estimated and therefore excess demand is also greater. While the economy is showing signs of the slowdown that the Bank of Canada wants to see, they may have to raise the policy rate higher in order to shrink this inflationary excess demand. The state of the job market remains the key factor in their decision.

- U.S. employment growth continued with a gain of 261,000 jobs in October, mostly in the private sector (233,000). Employment was also revised upward in September, a gain of 315,000 instead of 263,000. All industries listed showed an increase in employment. The most notable gains were in health care (+53,000), professional and technical services (+43,000), leisure and hospitality (+35,000) and manufacturing (+32,000) industries. In fact, since the beginning of the year, this last industry has added 367,000 workers. There are now 12.922 million manufacturing workers in the U.S., the highest number since November 2008.

Have companies started to secure their production lines by reshoring jobs after two years of disruption? Is it possible that some industries have shifted production from Europe to the U.S. to reduce energy costs? This resurgence in U.S. manufacturing is welcomed by households, but complicates the Federal Reserve's task. How can demand be reduced if employment remains so robust?

- Inflation in the U.K. jumped 2% in October and 11.1% yera-over-year, its fastest pace in 41 years. This growth was to be expected as the body that regulates energy rates was planning an increase in October. However, the British government has introduced a new support program that caps household energy bills at £2,500 per year for the next six months. Without this support, inflation would have reached 13.8%. In addition to utilities, food prices jumped by 2% in October and 16.2% in the past year. This is the highest increase in 45 years.

After the Truss mini-budget fiasco in October, the new Sunak government has done a U-turn by announcing £55 billion in spending cuts and tax increases despite an economy already in recession, according to the finance minister. Monetary and fiscal policies are now working together to curb activity and inflation. Will this prompt the Bank of England to reduce its rate hikes?

RATE TRENDS

- Like the Federal Reserve earlier this month, the Bank of England also raised its key rate by 0.75% to 3.00%. In announcing its largest rate hike since 1989, the bank indicated that further increases will be required, but that the final rate should be below what the market was expecting at the end of October (5.25%). The lower terminal rate is explained by weaker growth outlook. New Zealand's central bank also raised its policy rate by 0.75% to 4.2%, its highest level since January 2009 and its largest increase in history. After five consecutive 0.50% hikes, the bank believes that more aggressive tightening was required to keep inflation under control. In the land of the kiwi and the All Blacks, inflation reached 7.2% in the third quarter.

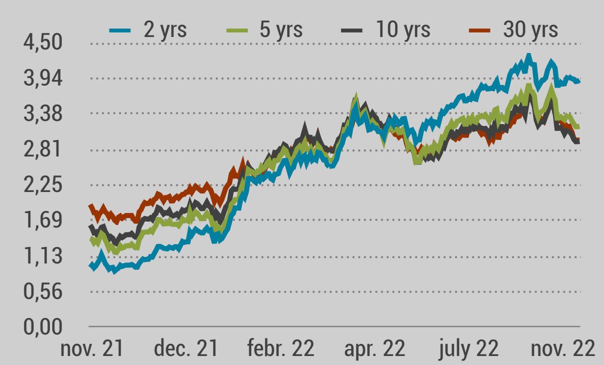
The aggressive hike in New Zealand is surprising, as it was one of the first central banks to tighten monetary policy in October 2021. Nevertheless, the majority of aggressive rate hikes by central banks appear to be behind us and monetary policies are now entering a fine-tuning mode. They will certainly slow down the pace of hikes next year to assess the effect of the latest hikes on growth and inflation. Some banks are already forecasting a significant slowdown next year, or even a recession, but they believe that this is the price to pay to regain control over inflation and avoid long-term costs.

BOND RATES

Nov. 30, 2022	Canada	Monthly Change	Change 2022	U.S.	Monthly Change	Change 2022
Key Interest Rate	3,75 %	0,00 %	3,50 %	4,00 %	0,75 %	3,75 %
3 months	4,01 %	0,14 %	3,83 %	4,32 %	0,26 %	4,29 %
2 years	3,88 %	-0,02 %	2,92 %	4,31 %	-0,17 %	3,58 %
5 years	3,16 %	-0,25 %	1,90 %	3,74 %	-0,49 %	2,47 %
10 years	2,94 %	-0,31 %	1,51 %	3,61 %	-0,44 %	2,10 %
30 years	3,00 %	-0,29 %	1,32 %	3,74 %	-0,43 %	1,83 %
RRB 30 years	1,12 %	-0,20 %	1,24 %			

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	165	200	230	-20	80	-20	85	-20	75
Royal Bank, NVCC	A	235	280	320	-20	125	-20	130	-20	120
Sun Life, subordinated debt	A	225	265	295	-10	125	-5	125	-5	105
Hydro One	A high	105	135	160	-15	40	-15	35	-15	25
Enbridge Inc	BBB high	180	220	265	-15	70	-15	65	-20	35
Altalink LP	A	100	130	155	-15	35	-15	30	-15	20
GTAA	A high	105	135	155	-15	35	-15	35	-15	25
Bell Canada	BBB high	160	200	230	-20	60	-20	55	-20	25
Rogers Communications	BBB	180	230	275	-15	50	-15	55	-20	40
Loblaw	BBB high	150	190	215	-20	60	-20	55	-20	25
Canadian Tire	BBB	175	225	270	-15	80	-15	80	-10	40
Province Québec	AA low	44	77	95	2	11	2	21	-1	21
Province Ontario	AA low	46	79	97	1	9	1	18	-1	19
CMHC	AAA	35	50	---	3	4	6	9		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance totalled $13.3 billion in November, up $4.5 billion from the previous month but $600 million less than in November 2021. Year-to-date, bond financings totaled $106.5 billion, down 4.9% from this time last year. With one month of funding activity to complete, new issue volume is only $1.6 billion away from reaching the second highest annual funding position in history after 2021 ($119 billion). The more moderate pace of upcoming policy rate hikes has prompted investors to take on more risk, translating into tighter spreads over the month. Risk appetite also explains the 26 new issues during the month.

- Royal Bank of Canada (RBC) announced that it was acquiring the Canadian operations of HSBC for $13.5 billion in cash for 100% of the share capital of HSBC Canada. With this acquisition, RBC will run all of HSBC Canada's profits beginning June 30, 2022. Once synergies are realized, it is estimated that earnings would be C$1.4 billion in 2024. Synergies would represent a significant portion of non-interest expenses, 55%. With respect to the Canadian bank capitalization regime, HSBC Canada's risk-weighted assets were C$44 billion as of September 30, 2022, which would require new funding by RBC of almost C$5 billion and C$1.5 billion in bail-in debt and subordinated debt (including LRCN) respectively.

- Midway through its 2022-23 fiscal year, the Province of Alberta provided an economic update that now projects a budget surplus of $12.3 billion, down $1 billion since the last revision. This is still a significant improvement over the $511 million surplus presented in the original budget. This increase in the surplus since the budget was tabled is mainly due to higher oil revenues this year. Spending has also jumped by $2.5 billion from the original budget. Alberta Premier Danielle Smith announced plans to provide $600 over six months for each child under 18 and each senior to families with annual incomes under $180,000. The program will cost $2.4 billion.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Nov. 2022	2022
Universe	100 %	2,81 %	-10,20 %
Short Term	42,2 %	0,88 %	-3,90 %
Mid Term	26,9 %	2,67 %	-8,58 %
Long Term	30,9 %	5,71 %	-18,80 %
Federal	37,2 %	2,04 %	-7,99 %
Provincial	34,8 %	3,55 %	-13,04 %
Corporates	25,9 %	2,95 %	-8,93 %
RRB		2,82 %	-13,79 %

Source: ftse.com

The Competition Bureau will review the transaction, but the Canadian Ministry of Finance has stated that it will have the final say on the transaction after receiving OSFI's recommendations. Hopefully this time the Royal Bank has learned a lesson from the 1998 failed berger with BMO and has made some political moves before announcing this transaction.

As was the case for Quebec this month, we denounce the distribution of cheques to taxpayers, as it will only fuel inflationary pressures. More support for families in real need seems more appropriate. In the case of Alberta, this announcement is purely eletoral, as Albertans head to the polls in the spring. For Quebec, it was all about keeping an election promise.

STRATEGIC POSITIONNING

This year, central bankers have realized that they have been lagging behind in fighting inflationary pressures and have stepped up their efforts. After an aggressive tightening not seen since the 1980s, it is now time to slow down and assess the impact of the latest hikes on the economy. Is this a sign that the tightening is over and that the banks will soon cut rates? Far from it. From a central banker's perspective, causing a recession by tightening monetary policy is commonplace, but making a monetary policy mistake that lets inflation take hold is a case study to be taught later. No one wants their name associated with a fiasco like the inflation of the 1970s. If inflation is purely cyclical, price adjustment will happen quickly. However, if inflation stems from structural changes such as an aging population, the securitization of production chains, the decarbonization of the economy, and the development of block trade after the war in Ukraine, inflationary pressures could be more persistent and may require high rates for longer. As former U.S. Treasury Secretary Larry Summers once said, fighting inflation with rate hikes in an environment of structural change is like fighting an infection with antibiotics. If you stop taking the medication before the doctor prescribes, the infection may quickly return.