MONTHLY BOND LETTER

SEPTEMBER 2023

ECONOMIC EVENTS

- Canada's annual inflation rate climbed for the second consecutive month, rising from 3.3% in July to 4.0% in August. The acceleration in the rate of growth is largely attributable to higher gasoline prices. Excluding gasoline, the CPI posted annual growth of 4.1% in August, unchanged from July. Apart from gasoline, mortgage interest costs (+30.9% year-on-year) and rents (+6.5%) also contributed to price pressure. On the other hand, food prices fell by 0.1% in August, bringing the annual variation from 7.8% in July to 6.8% the following month. Excluding food and energy, core CPI has risen by 3.6% over the past year, a slight acceleration on July (+3.4%). The same is true of the average of the 3 core inflation measures, which stands at 4.3%, 0.2% higher than July's average.

Households build their inflation expectations around items they have to pay for frequently, such as gas, food and housing. Although they've had a respite lately on the grocery bill, the other two items are still rising at a high rate. In fact, over 50% of the consumer price index basket is still showing annual growth of over 5%. The acceleration in the annual rate of inflation may not be over, as prices could rise faster this year than last. This complicates the Bank of Canada's task of preventing high inflation from taking root in Canadians expectations.

- While many fear a slowdown in the US labor market, the latest job vacancy figures have shown diffirently. The number of job vacancies rose by 690,000 in August to 9.6 million. Vacancies rose in professional and business services (+507,000), public education (+76,000) and manufacturing (+95,000), among others. What's even more telling is that all regions of the country recorded an increase in job applications. There are now 1.5 vacancies for every unemployed person, which is a step towards a more balanced job market. At its peak last year, this ratio was over 2 vacancies per unemployed person.

This rise in vacancies, combined with the recent drop in new jobless claims, indicates a labor market that remains tight despite the aggressive rate hike. This reinforces the Federal Reserve's message that it will need to keep rates higher for longer to weaken demand and force a rebalancing of the labor market.

- Europe's annual inflation rate fell by 0.9% in September to 4.3%, its slowest pace since October 2021. The deceleration was equally evident in services, non-energy industrial goods and food. Excluding food and energy prices, core inflation index reached 4.5%, its lowest level since August 2022. Among the zone's major economies, inflation slowed markedly in Germany, with annual growth of 4.3% in September, compared with 6.4% in August.

The European Central Bank should welcome this news. Monetary tightening had weakened the economy recently without any clear sign of easing inflationary pressures. GDP is struggling to grow (+0.4% in Q2) and retail sales, calculated as a year-on-year change, have weakened over the last 11 months.

RATE TRENDS

- Like the Bank of Canada, the Federal Reserve decided to maintain its policy rate at 5.5% at its September meeting. However, the updated summary of economic projections indicates that committee members expect to raise the rate one more time before the end of the year. Next year's expected rate cuts by committee members are also less pronounced. By the end of 2024, the projected easing totals 0.50%, half of what was forecast in June. On the other hand, the ECB preferred to raise its key rate by 0.25% to 4.0%, while making it clear that it is now on pause. Rates have reached high levels which, if maintained for a sufficiently long period, will make a substantial contribution to the rapid return of inflation to target.

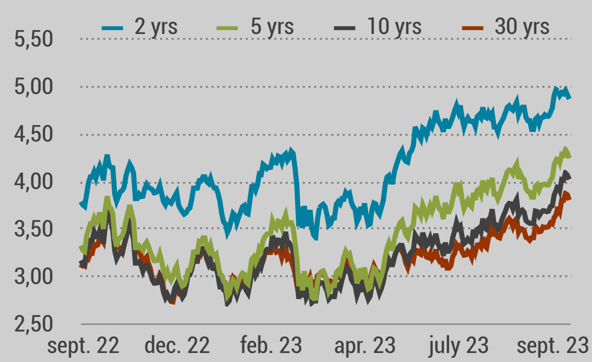
Central banks have two options: raise rates or keep them high for an extended period. Some opted for the latter. Although central bankers repeated that they would not be cutting rates anytime soon, investors remained skeptical about the possibility. History, however, is proving investors right. Central banks have frequently done 180 degrees in their monetary policy stance once they perceive a slowdown. Now, however, the economic climate is different from that of recent decades, and investors can no longer apply their old way of thinking.

BOND RATES

Sept. 30, 2023	Canada	Monthly Change	Change 2023	United States	Monthly Change	Change 2023
Key Interest Rate	5,00 %	0,00 %	1,75 %	5,50 %	0,00 %	2,25 %
3 months	5,13 %	-0,01 %	0,87 %	5,45 %	0,01 %	1,10 %
2 years	4,87 %	0,23 %	0,82 %	5,04 %	0,18 %	0,62 %
5 years	4,25 %	0,36 %	0,84 %	4,61 %	0,36 %	0,61 %
10 years	4,03 %	0,47 %	0,73 %	4,57 %	0,46 %	0,70 %
30 years	3,81 %	0,42 %	0,53 %	4,70 %	0,49 %	0,74 %
RRB 30 years	1,95 %	0,35 %	0,76 %			

Source: Bloomberg

CANADIAN RATE TRENDS



CREDIT BOND RISK PREMIUMS

Issuers	Credit Rating DBRS	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2023	Change 10 yrs month	Change 10 yrs 2023	Change 30 yrs month	Change 30 yrs 2023
Royal Bank, Bail-in-debt	AA	155	185	215	5	-10	0	-15	0	-15
Royal Bank, NVCC	A	215	255	295	5	-10	0	-15	0	-15
Sun Life, subordinated debt	A	195	235	265	10	-5	10	-5	10	-5
Hydro One	A high	100	130	150	5	-10	5	-10	5	-10
Enbridge Inc	BBB high	155	200	245	5	-20	0	-15	5	-15
Altalink LP	A	100	130	150	5	-5	5	-5	5	-5
GTAA	A high	95	125	145	5	-10	5	-10	5	-10
Bell Canada	BBB high	140	195	225	-5	-20	5	0	5	0
Rogers Communications	BBBL	170	225	260	-5	-10	0	0	0	-10
Loblaw	BBB high	125	165	195	0	-25	0	-20	0	-15
Canadian Tire	BBB	135	180	220	-10	-35	-15	-30	-20	-35
Province Québec	AA low	44	73	94	-1	-2	2	1	3	0
Province Ontario	AA low	46	74	95	-1	-2	2	0	3	0
CMHC	AAA	35	48	---	0	-1	3	2		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bonds new issuance totalled $15.1 billion in September, up $10.9 billion on the previous month and $6.6 billion more than in September 2022. Year-to-date, bond financing totals $74.6 billion, down 12% from the same period last year. After a summer break in August, the new issue market returned with a vengeance in September, with 29 bonds issued by 21 different companies. Of particular note was a $3 billion financing spread over 4 maturities from Rogers Communications. The proceeds of this debt will be used to finance the acquisition of Shaw Communications, for which approval was obtained in March after a lengthy regulatory battle.

- The saga of Laurentian Bank continued in September. After launching a review of its strategic options, the bank's management decided to rule out the option of selling the institution. According to management, shareholder value would be optimized by allocating capital and resources to its most profitable business units and specialized products. However, it was a computer breakdown that paralyzed part of the bank's operations for several days that caused concern among investors and forced changes in the institution's management. Rating agency DBRS has expressed concern about the latest events at Laurentian Bank, and will initiate a full review of the bank in the coming weeks, which could lead to a downgrade of its credit rating.

- The province of British Columbia has released an economic update on its public finances following the first quarter of its fiscal year. The budget deficit for fiscal 2023-24 is expected to reach $6.7 billion, $2.5 billion higher than when the budget was tabled last February. The revenue forecast is down, mainly due to lower natural gas prices, which are dragging down resource royalties. The $1 billion increase in expenses over the initial budget is attributable to the cost of fighting forest fires. For the following fiscal year (2024-25), the deficit forecast was reduced by $700 million to $3.1 billion. This improvement is due to growth in government revenues.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Sept. 2023	2023
Universe	100 %	-2,62 %	-1,46 %
Short Term	44,4 %	-0,40 %	0,88 %
Mid Term	28,1 %	-2,58 %	-1,96 %
Long Term	27,5 %	-6,04 %	-4,62 %
Federal	39,3 %	-2,07 %	-1,69 %
Provincial	33,0 %	-3,85 %	-2,82 %
Corporates	25,8 %	-1,77 %	0,69 %
RRB		-3,59 %	-7,70 %

Source: ftse.com

The new management team will have an exhaustive list of tasks to complete. In addition to consolidating IT systems, the new president will have to reassure customers. Let's not forget that the banking system relies on the bond of trust with its depositors. If this bond is broken, and withdrawals flood in, the bank could face difficult times, even if its capitalization ratios are currently in line.

The outlook for fiscal 2024-25 looks very optimistic. The Finance Ministry expects rising interest rates to hurt the real estate market this year, but anticipates 13.5% growth in sales next year. In the absence of a recession this year, the Bank of Canada could keep its key rate high for an extended period. Is a real estate recovery in 2024 utopian?

STRATEGIC POSITIONNING

Since the pandemic, the message from central banks has become more consistent. Faced with galloping inflation, they made it clear that they were going to tighten monetary conditions aggressively to bring inflation back within the target range of 1% to 3%. They subsequently toned down their message by mentioning that they would take occasional pauses to assess the lagged effect of the cumulative hikes on the economy. As the tightening cycle draws to an end, the message has been reinforced. If they are to avoid the long-term economic costs of letting inflation take root, they will have to leave rates high for an extended period. Although this message had been mentioned before, investors didn't believe it. Over the past 30 years, disinflation and, in a few cases, even deflation have proved to be the biggest risk facing central bankers. As a result, the conduct of monetary policy was biased towards easing conditions rather than tightening. Economic conditions have changed, and the structural underpinnings of the economy militate in favor of higher and more volatile long-term inflation. Investors who have applied their model of the last 30 years and predicted a rapid u-turn inpolicy rates are not taking these structural changes into account. Rates will remain high until they buckle under the weight of a recession.