

MONTHLY BOND LETTER

AlphaFixe
Capital

ECONOMIC EVENTS

August 2017

- The Canadian economy grew at an annualized rate of 4.5 % in the second quarter, following an excellent growth of 3.7 % in the first quarter. Apart from residential construction, which declined by 4.7 %, all other GDP components rose in the spring. Consumer spending increased by 4.8 %, due to a 6.6 % increase in real disposable income. Companies also continue investing, but at a slower pace than in the first quarter, while foreign trade contributed to growth despite the strength of the dollar at the end of the quarter.
- The US economy added 345,000 new jobs to the payroll in July and August. The unemployment rate stood at 4.4 % in August, while average hourly earnings remained flat at 2.5% since last April. The US economy created more than 1.3 million jobs so far this year, but only 64,000 for workers aged 25 to 54. Young adults (16-24 years old) found 258,000 jobs and about a million jobs for those aged 55 and over.
- Japan's GDP recorded an annualized growth of 4 % in the second quarter; its sixth consecutive increase, the longest stretch of gain in a decade. Consumer spending and corporate investment contributed to growth, while exports fell for the first time in four quarters. The upcoming Olympics along with low unemployment rate encourage both public and private investments.

Growth in the first half of the year has been the highest since 2002, supported by strong job creation in the past year. The pace may decline in the second half of the year due to a slowdown in real estate in some parts of Canada, which could slowdown consumer spending on durable goods.

Low job creation for the prime-age workers (25-54 years), may partly explain low wage increase. The pool of available workers aged 55 and over is higher with an employment ratio of 39 % against 78 % for those aged 25-54.



Higher consumer spending is a result of a favorable labor market. On the other hand, this improvement is not reflected on wages, which fell by 0.4 % annually in June. Without inflation, the Bank of Japan could maintain its asset purchase program.

RATE TRENDS

- The Bank of Canada raised its key rate by 0.25 % to 1.00 % on September 6th, a second straight increase this year. This hike surprised investors who given the publication of the Monetary Policy Report. Given the strength of recent economic data, Canadian growth is more widespread and autonomous in the eyes of the Bank and the global economy is also strengthening. However, the Bank also identified possible areas of turbulence. Among other things, the housing sector appears to be cooling, while geopolitical risks and uncertainties related to international trade persist. The appreciation of the dollar in recent months has also been raised, but reflects the strength of the Canadian economy more than a rise in commodity prices, which appears to be less disruptive to the Bank.

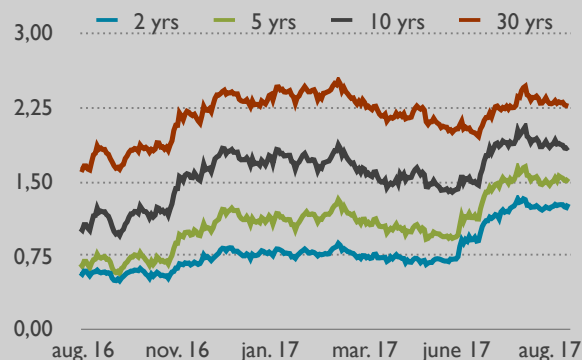
Whether an increase occurs in September or in October, it was highly still expected. What is important is if there will be another one this year? The Bank still considers to have considerable monetary stimulus in place, suggesting further tightening as the economy approaches full employment. The US monetary policy also needs to be considered. Currently, the US policy rate is at 1.25 %, an indication of a Fed hike would open the door for the Bank to a third increase in 2017. Nevertheless, rate hikes will not be aggressive as the Bank wants to assess its impact on household debt.

BOND RATES

August 31 2017		Monthly Change	Change 2017		Monthly Change	Change 2017
Key Interest Rate	0,75 %	0,00 %	0,25 %	1,25 %	0,00 %	0,50 %
3 months	0,78 %	0,04 %	0,32 %	0,99 %	-0,08 %	0,49 %
2 years	1,28 %	-0,04 %	0,53 %	1,33 %	-0,02 %	0,14 %
5 years	1,53 %	-0,12 %	0,42 %	1,70 %	-0,13 %	-0,23 %
10 years	1,85 %	-0,21 %	0,13 %	2,12 %	-0,18 %	-0,33 %
30 years	2,26 %	-0,20 %	-0,05 %	2,73 %	-0,17 %	-0,34 %
RRB 30 years	0,68 %	-0,14 %	0,18 %			

Source: Bloomberg

CANADIAN RATE TRENDS



CREDIT BOND RISK PREMIUMS

ISSUER	Credit rating		Spread			Change					
	DBRS	S&P	5 yrs	10 yrs	30 yrs	5 yrs		10 yrs		30 yrs	
						month	2017	month	2017	month	2017
Royal Bank, deposit notes	AA	AA-	80	100	145	5	-15	0	-10	10	-10
Manulife, Senior debt	A high	A+	100	130	175	5	-15	5	-5	5	-10
Fortis Inc.	BBB high	BBB+	95	140	180	0	-25	0	-25	0	-45
Hydro One	A high	A	70	90	140	5	-10	0	-15	10	-10
Enbridge Inc	BBB high	BBB+	120	175	240	5	-10	10	-5	10	0
Encana Corp	BBB low	BBB	175	225	310	15	-40	5	-60	10	-35
GTAA	---	A+	55	75	95	0	-15	0	-20	5	-40
Bell Canada	BBB high	BBB+	100	145	215	5	-15	5	-20	10	-10
Rogers Communications	BBB	BBB+	95	140	215	0	-20	5	-25	10	-20
Loblaw	BBB	BBB	105	150	210	5	-15	0	-20	5	-15
Canadian Tire	BBB high	BBB+	105	155	215	0	-20	0	-20	5	-15
Province of Québec	A high	A+	48	69	82	2	-7	3	-9	4	-10
Province of Ontario	AA low	A+	50	71	82	3	-6	2	-8	3	-7
CMHC	AAA	AAA	36	46	---	2	-2	1	-2		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached \$ 5.3 billion in August, down \$ 2.3 billion from the previous month and \$ 2.1 billion lower than in August 2016. Since the beginning of the year, corporate bond issuance reached \$ 65.7 billion, 15 % more than at the same time last year. Among borrowing companies, Export Development Canada (EDC), a federal guaranteed Crown corporation, issued a green bond in August. This is EDC's first green bond issue in Canadian dollars, but the fourth in its history. The bond proceeds will be used to finance projects such as companies who focus on protecting and sanitizing water or air, as well as those producing renewable energy.
- Apple also completed their first Maple bond issuance in the Canadian market. Taking advantage of strong demand, Apple has issued \$ 2.5 billion for a 7-year term bond. This is the biggest corporate bond issuance in the Canadian market, tied with TD Bank and Royal Bank. The AA+ bond offered a yield premium of 80 bps, which is 5 bps less than a bank deposit note for the same term. Apple plans to use the proceeds for general purposes, like common shares buyback and dividend payments. On the other hand, Apple has added a covenant to the prospectus that allows it to repurchase the current issue at par (\$ 100) for tax reasons. This decision could come about as a result of new legislation or an amendment to the law.
- Tesla, manufacturer of electric vehicles, issued their first high-yield bond totalling US \$ 1.8 billion for an 8-year term. The debt proceeds will be used, among other things, to increase production capacity with the launch of the new Model 3 in sight, with pre-orders already reaching 455,000 units. Moody's assigned a B3 rating to the bond under the assumption that the manufacturer will be able to produce 300,000 units in 2018 with profit margins of 25 %. On the other hand, the agency recognizes that Tesla's brand and its physical assets represent a value for its competitors in case Tesla encounters serious financial problems.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Aug. 2017 (%)	2017 (%)
Universe	100 %	1,41	1,83
Short Term	45,2 %	0,42	0,25
Mid Term	23,3 %	1,36	1,16
Long Term	31,5 %	2,91	4,43
Federal	36,9 %	1,19	0,45
Provincial	34,2 %	1,84	2,63
Corporates	27,0 %	1,14	2,61
RRB		2,26	-0,99

Source: ftse.com

Since Trump's economic plan includes a tax rebate on overseas corporate profits, it is possible that this bond will be bought back if the plan is approved by Congress. We remain cautious when a company borrows money in order to transfer to shareholders.

This is a unsecured bond for a company with negative cash flows in an embryonic but growing market segment. Eventually, the company could use certain assets such as its giga-plant batteries as collateral for new debt, relegating bond investors at the bottom of the scale

STRATEGIC POSITIONNING

Yet again, the financial market seems to be influenced by political events. Donald Trump's reaction to Charlottesville's violence could influence the country's economic situation. With a small majority in the Senate, the Republicans could lose political support towards adopting fiscal reform put forward during the presidential campaign. In addition, the President could lose support from Jewish members in his economic team, including Gary Cohn, the Chief Economic Advisor to the President, and Steven Mnuchin, the Treasury Secretary. The military escalation between the United States and North Korea also weighed on the market's direction at the end of the month. Furthermore, hurricanes Harvey and Irma will have economic consequences by the end of the third quarter. We can expect more timid employment figures in September, especially if Irma strikes Florida in full force. It should be noted that the surveys calculating employment take place in the week including the 12th of the month, which is right after hurricane Irma, if it does reach Florida. These combined events could squander the Fed's message by the end of the year, forcing a more passive tone by the time the storm passes, but basically the goal remains to remove the accommodation in place.