MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

MAY 2020

- The Canadian economy contracted at an annualized rate of 8.2% in the first quarter of the year. Social distancing and confinement measures at the end of March had a direct impact on household consumer spending, which fell 8.9%, the largest decline on record. This decline was due to job losses and the closure of non-essential stores, particularly of durable goods (-23.2%). On the other hand, spending on non-durable goods increased 13% as consumers stockpiled certain products. Covid-19 and railroad blockades disrupted supply chains, forcing firms to reduce inventories instead of production.

This contraction occurred with only two weeks of confinement. The Canadian economy was put in an artificial coma for at least 6 weeks with a gradual and slow recovery. A 30 to 40% drop in GDP in the second quarter is therefore not impossible, but the stock markets seem to be banking on a rapid recovery supported by the central bankers. The gap is widening between the economy and the stock market, which is ignoring all the risk factors that have emerged recently.

- Personal consumer spending fell 13.6% in April in the United States, the largest drop since 1959. No industry was spared. Durable goods (-17.3%), non-durable goods (-16.2%) and services (-12.2%) all experienced significant declines. Personal income, on the other hand, increased by 10.5% compared to the forecast of -5.9%. This unexpected increase was due to an rise in government social benefits, which more than offset the decrease in other sources of personal income.

Wage losses were partly offset by higher unemployment benefits for affected workers. Thus, the majority of the increase in personal income comes from the one-time $1,200 payment to support households during the pandemic. We can therefore expect a drop in income next month.

- To support its economy disrupted by the pandemic, the Japanese government announced a second economic stimulus package of ¥117 trillion in May. This includes rent subsidies for individuals and SMEs as well as a lump-sum allowance for frontline medical workers. Including the first program of an equivalent amount announced in April, the stimulus in place totals 40% of GDP.

This is by far the largest support program ever deployed during this pandemic, and this for a country already heavily in debt. The Bank of Japan has indicated that it will not allow rates to rise after this announcement. Debt monetization in Japan's is well under way.

RATE TRENDS

- Jerome Powell, Chairman of the Federal Reserve, and Andrew Bailey, Governor of the Bank of England, both ruled out the possibility of cutting policy rates in negative territory, as is the case in Japan and Europe. Negative rates rumours were fuelled by the issuance of a U.K. government bond with a negative yield to maturity (-0.003%). Both bankers believe that this monetary tool has hurt the European and Japanese banking systems.

- In its Financial System Review, the Bank of Canada believes that the measures it has implemented will help the banking system through the crisis. While the government has put in place support measures for businesses and households, the Bank is concerned that the crisis could create a solvency problem for those whose incomes are significantly affected. High household indebtedness is expected to increase again as a result of the pandemic.

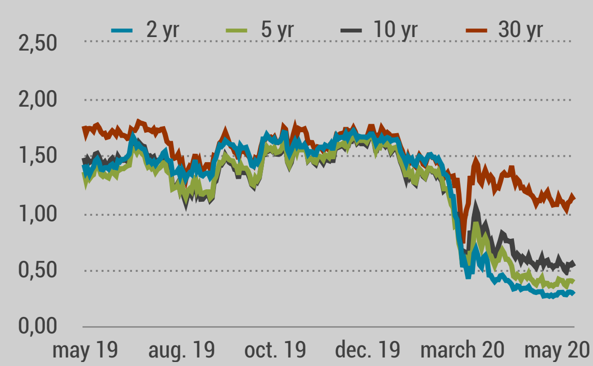
Central banks have always indicated that negative rates are one of the tools available, but surely the last to come out of the toolbox. As it has been the case in Europe, this policy would reduce profits and limit the banks ability to absorb the wave of loan losses related to the pandemic. Governments around the world have deployed support measures to enable households and businesses to survive in times of crisis. These measures would never have had the same impact without a strong banking system, as indicated by the Bank of Canada. Negative interest rate policy only weakens banks when they are needed. Why take this policy risk if the benefits are limited?

BOND RATES

May 29, 2020		Monthly Change	Change 2020		Monthly Change	Change 2020
Key Interest Rate	0,25 %	0,00 %	-1,50 %	0,25 %	0,00 %	-1,50 %
3 months	0,19 %	-0,07 %	-1,47 %	0,12 %	0,05 %	-1,42 %
2 years	0,29 %	-0,02 %	-1,41 %	0,16 %	-0,04 %	-1,41 %
5 years	0,40 %	0,01 %	-1,29 %	0,30 %	-0,06 %	-1,39 %
10 years	0,53 %	-0,01 %	-1,17 %	0,65 %	0,01 %	-1,26 %
30 years	1,12 %	-0,01 %	-0,65 %	1,41 %	0,12 %	-0,98 %
RRB 30 years	0,10 %	-0,06 %	-0,27 %			

Source: Bloomberg

CANADIAN RATE TRENDS



1800 Ave. McGill College | Suite 2420 | Montréal (PQ) | H3A 3J6 514-861-3493 www.alphafixe.com info@alphafixe.com

CREDIT BOND RISK PREMIUMS

ISSUER	Credit rating DBRS S&P	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2020	Change 10 yrs month	Change 10 yrs 2020	Change 30 yrs month	Change 30 yrs 2020
Royal Bank, Bail-in Debt	AA	150	185	225	-5	65	0	65	5	65
Royal Bank, NVCC	A	215	250	290	-10	95	-5	80	0	80
Sun Life, Subordinated debt	A	185	225	260	-20	85	-10	80	-10	75
Hydro One	A high	110	135	175	-10	50	-10	50	0	45
Enbridge Inc	BBB high	200	245	295	-40	100	-30	95	-15	75
Altalink LP	A	105	130	170	-10	50	-10	50	0	50
GTAA	A high	130	160	190	0	75	10	80	10	80
Bell Canada	BBB high	155	195	255	0	55	10	45	15	50
Rogers Communications	BBB	150	190	250	0	55	10	45	15	45
Loblaw	BBB	145	185	245	0	40	10	30	15	35
Canadian Tire	BBB high	220	260	320	10	120	20	110	25	115
Province Québec	AA low	58	84	96	0	22	3	25	2	27
Province Ontario	AA low	60	87	99	0	22	3	25	2	26
SCHL	AAA	36	43	---	-4	7	-5	5		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached $17.6 billion in May, down $900 million from the previous month and $11.6 billion more than in May 2019. This is the second largest month for new issuance after April 2020. Since the beginning of the year, bond financings totalled $62.7 billion, up 77.6% from last year. Companies that need to secure debt to get through this pandemic are also noticeable in the United States. Investment grade new issues reached $262.2 billion in May, the second highest month on record after April 2020. The year-to-date total is therefore $1,069.7 billion, a new record and 95% higher than last year.

- The Bank of Canada has unveiled the terms of its $10 billion corporate bond buyback program. Canadian incorporated companies are targeted by this program, with the exception of deposit-taking institutions. Their credit ratings must be at least BBB as of April 15 to be eligible and BBB low if the rating is downgraded after that date. Consequently, any issuer rated below investment grade will not be eligible in the Bank's repurchase program. The maturity of the securities must be five years or less and the Bank may not hold more than 10% of the total face value of eligible bonds of any one issuer. The Bank did two operations in May, each valued at $100 million and targeting 61 different securities. The reality was quite different. In the end, the Bank purchased $21.5 million in four securities from the dealer banks.

- The economic consequences of the pandemic tarnished the second quarter's financial results of Canadian banks. In total, the six major banks increased their loan loss provisions by $8.5 billion over last year to $10.9 billion this year. Nonetheless, Canadian banks maintained their dividends and reported earnings of $5.8 billion, down 50% from the same period in 2019. The situation was different for Laurentian Bank, which had to reduce its dividend from $0.67 to $0.40 per share as a result of a 76% drop in earnings to $11.9 million in the second quarter. Loan loss provisions jumped from $9.2 million to $54.9 million.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	May 2020	2020
Universe	100 %	0,31 %	5,74 %
Short Term	40,3 %	0,28 %	3,49 %
Mid Term	23,6 %	0,40 %	7,16 %
Long Term	36,1 %	0,30 %	7,56 %
Federal	34,1 %	0,21 %	6,99 %
Provincial	37,1 %	0,22 %	6,80 %
Corporates	26,7 %	0,60 %	2,76 %
RRB		0,16 %	3,78 %

Source: ftse.com

We welcome the Bank's décision to exclude high-yield securities from its program in order to avoid any moral hazard risk. However, the program has not been as successful as expected, mainly because market conditions were improving even before its implementation. If conditions deteriorate, this safety net will already be in place.

Like everyone else, the banks are navigating in troubled waters with their eyes closed. The pandemic will disrupt employment and the solvency of some businesses, but the extent is still unknown. Government support measures are helping to get through the crisis, but they will not last forever. Will the banks be able to keep their sacrosanct dividend intact after the programmes have expired?

STRATEGIC POSITIONNING

As confinement measures are lifted and life slowly resumes, there appears to be a significant gap between the stock market outlook and the post-Covid economic reality. By the end of May, the S&P 500 had recovered 70% of its decline since the beginning of the pandemic, despite the current weak economy. Admittedly, the financial markets are not looking at today's situation, but tomorrow's. However, it seems that several risk factors have been left out of the stock market equation. Relations between China and the United States are deteriorating by the day. Although Phase 1 of the trade agreement between the two superpowers is not yet in jeopardy, this possibility cannot be ruled out as Mr. Trump is worried about his re-election and decides to toughen his position against China, which he accuses of having caused the Covid crisis. A second wave of the pandemic must also be considered, especially in light of the historic protests that have taken place across the United States. As a result, the stock market is expecting unhindered perfection, ignoring the permanent job losses and insolvency that lie ahead. This perfection stems from the monetary injection by central bankers, necessary to stabilize markets and to finance the huge government deficits put in place to stimulate the economy. Debt monetization and deglobalization, two inflationary factors not to be neglected.