

MONTHLY BOND LETTER

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ECONOMIC EVENTS

- Employment in Canada rose by 81,000 in August, to 471,000 over the past 12 months and 304,000 in 2019. This is the best labour market performance since 2002. With an increase in the labour force, the unemployment rate remained unchanged at 5.7%. Employment in August was driven mainly from Ontario (58,000) and Québec (20,000). Québec's performance in this area was impressive, with a gain of 112,000 (+2.6%) year over year and the lowest unemployment rate in its history and in the country at 4.7%. Robust employment has forced wages up 3.7% since August 2018.
- The US Manufacturing Purchasing Manager Index fell below the 50 in August, indicating a contraction (49.1), a first in 3 years. New orders fell to 47.2 from 50.8 previously, on par with 2012 as the lowest level since the financial crisis. In contrast, the non-manufacturing sector index rose to 56.4, driven by new orders, which rose to 61.5, a 6 months high. Out of the 18 industries surveyed, 16 showed growth.
- The German government has announced a green plan to reduce, by 2030, its greenhouse gas emissions by 55% compared to their 1990's level. A budget of €54 billion has been adopted to encourage companies and households to reduce their emissions. These expenses will be financed by a carbon tax imposed on companies that produce and sell fossil fuels.

RATE TRENDS

- For a second time this year, the Federal Reserve reduced its Funds rate by 0.25% to 2.00%. The Fed calls the labour market and consumer spending strong, but points out that exports and investments are being disrupted by trade uncertainty. The Fed justified its decision by the "implications of global developments for the economic outlook as well as muted inflation pressures". Three members opposed, two preferring the status quo while the third voted for a 0.50% cut.
- At his last meeting as President of the European Central Bank (ECB), Mario Draghi delivered a new monetary stimulus plan. The ECB lowered its key interest rate from -0.40% to -0.50% and introduced a new QE program, buying €20 billion of bonds a month as long as necessary. These measures are intended to counter the stronger-than-expected economic slowdown resulting from ongoing trade disputes. Mr Draghi also appealed to the European political class, inviting countries with budget flexibility to support growth with fiscal spending.

SEPTEMBER 2019

While trade disputes remain a concern for the Bank of Canada, as for all other central banks, the strength of employment in Canada does not support additional monetary stimulus. Furthermore, the real estate market is recovering and Hong Kong protests may encourage some of the 300,000 residents who hold Canadian passports to settle in Canada.



The influence of the manufacturing sector is declining. Its share of GDP fell from 34% in 1997 to 26% last year, while employment in this sector fell from 19% to 14% over the same period. For the time being, trade disputes only affect the manufacturing sector, without much contagion on the service sector and consumer confidence.

This is a step in the right direction. However, Germany could both revive its economy and achieve carbon neutrality more quickly if it used part of its budget surplus (€58 billion or 1.7% of GDP), the highest since its reunification in 1989.

The Fed's message is simple. The U.S. economy would be stronger if trade tensions that undermine investment decisions were reduced. At the press conference, Jerome Powell mentioned trade-related risks 20 times and Brexit only once. Global development risks are therefore quite clear.

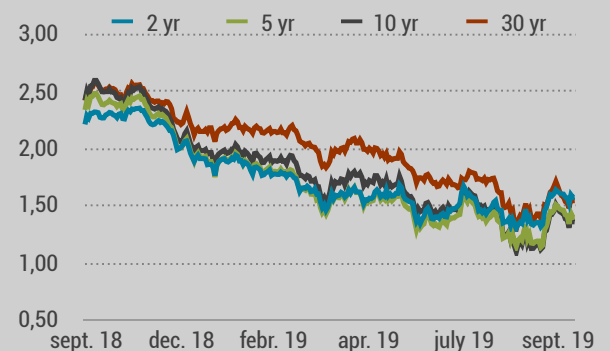
The ECB adds its name to 19 other central banks that have reduced their policy rates as a preemptive measure to ease trade tensions. Despite negative rates in Europe, the economic situation is not improving, proof that monetary policy is ineffective. The bond market currently offers an incentive to borrow, but governments are not listening.

BOND RATES

		Monthly Change	Change 2019		Monthly Change	Change 2019
Sept. 30 2019						
Key Interest Rate	1,75 %	0,00 %	0,00 %	2,00 %	-0,25 %	-0,50 %
3 months	1,66 %	0,03 %	0,00 %	1,81 %	-0,16 %	-0,54 %
2 years	1,58 %	0,23 %	-0,28 %	1,62 %	0,12 %	-0,86 %
5 years	1,40 %	0,21 %	-0,49 %	1,55 %	0,16 %	-0,97 %
10 years	1,36 %	0,20 %	-0,60 %	1,67 %	0,17 %	-1,02 %
30 years	1,53 %	0,10 %	-0,66 %	2,11 %	0,15 %	-0,90 %
RRB 30 years	0,26 %	0,07 %	-0,50 %			

Source: Bloomberg

CANADIAN RATE TRENDS



CREDIT BOND SPREADS

ISSUER	Credit rating DBRS	CHANGE								
		Spread			5 yrs		10 yrs		30 yrs	
		5 yrs	10 yrs	30 yrs	month	2019	month	2019	month	2019
Royal Bank, bail-in debt	AA	100	135	175	-5	-35	-5	-25	-5	-25
Manulife, sub debt NVCC	A	145	195	235	-10	-40	-5	-25	-5	-25
Fortis Inc.	BBB high	100	140	205	-5	-40	-5	-45	0	-30
Hydro One	A high	80	110	155	-5	-35	-5	-30	-5	-25
Enbridge Inc	BBB high	120	170	240	-5	-40	-5	-40	-5	-35
Encana Corp	BBB	185	245	315	0	-20	0	-25	0	-10
GTAA	---	65	90	120	-5	-20	-5	-15	-5	-20
Bell Canada	BBB high	110	160	225	-10	-45	-10	-40	-5	-35
Rogers Communications	BBB	105	155	225	-10	-45	-5	-40	0	-35
Loblaw	BBB	115	165	225	-10	-50	-5	-50	-5	-45
Canadian Tire	BBB high	110	160	220	-10	-50	-5	-50	-5	-50
Province of Québec	A high	43	66	78	-3	-16	-3	-18	-4	-18
Province of Ontario	AA low	44	70	82	-4	-19	-3	-19	-4	-19
CMHC	AAA	31	41	---	-3	-12	-3	-15		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached a monthly record of \$14.4 billion in September, up \$9.4 billion from the previous month and \$4.6 billion higher than in September 2018. Corporate bond spreads closed the third quarter at 123 bps, an increase of 6 bps compared to the previous quarter. Among the issuers, Videotron (BB) issued \$800 million for a five-year term, the largest high-yield bond issue in Canadian history. With a 4.50% coupon rate, this senior unsecured bond attracted significant demand from 63 buyers. The Québec cable operator plans to use the proceeds of this bond to repay bank debt.
- European banks have obtained some relief from the European Central Bank. In order to cushion the financial impact on the banking system after the latest rate cut, the ECB has introduced a two-tier system whereby banks will not have to pay interest on their excess reserves with the ECB, up to 6 times their requirement reserves. Last year, banks had to pay €7.2 billion in interest for their deposits at the central bank according to the Association of German Banks. The new measure should reduce the interest costs to €5 billion annually. Currently, no European bank charges interest on retail deposits. However, in Switzerland, UBS and Credit Suisse have begun to charge their wealthier clients for deposits.
- DBRS has upgraded the credit rating of the Province of Prince Edward Island (PEI) from A (low) to A with a stable outlook. According to the agency, "improved operating results and stronger economic growth have contributed to reduced borrowing requirements and a lower debt-to-GDP ratio". The measures put forward to increase population have stimulated economic activity and allowed the province to balance its public finances over the past three fiscal years. In the second quarter, population growth was 2.2% annually, the strongest of the 10 Canadian provinces. Driven by international immigration, employment income grew by 4.6% in 2019, also the fastest growth among the provinces.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Sept. 2019	2019
Universe	100 %	-0,84 %	7,79 %
Short Term	43,2 %	-0,38 %	2,95 %
Mid Term	22,3 %	-1,05 %	6,91 %
Long Term	34,5 %	-1,26 %	14,92 %
Federal	34,6 %	-0,89 %	4,88 %
Provincial	35,8 %	-1,02 %	10,53 %
Corporates	27,6 %	-0,54 %	7,98 %
RRB		-0,94 %	10,22 %

Source: ftse.com

If the economy is the engine, the banking system is the oil that keeps it running. Negative monetary policy reduces the profitability of the European banking system, thereby encouraging strict risk management that undermines economic growth. A period of restructuring and cost reduction could therefore occur.

Since the spring elections this year, the Conservative Party has formed a minority government and has indicated that it wants to work with the opposition (Green Party) to pursue these positive economic policies. Lets hope that the collective benefits of these economic measures will take precedence over the political interests of the parties.

STRATEGIC POSITIONNING

The global economic slowdown is mainly affecting the manufacturing sector, while the service sector continues to expand. For the time being, trade disputes have not yet spread to other areas. Employment and consumer spending remain strong while lower mortgage rates stimulate real estate transactions. As a preemptive measure, some central bankers have decided to support their economies by reducing policy rates. On the other hand, the marginal effect of the monetary stimulus is fading, as evidenced by the weak economic growth in Europe despite negative rates in several countries. Fiscal stimulus measures would produce better results, but some governments face obstacles to achieve them. A trade agreement between China and the United States would avoid the contagion effect. In this regard, the resignation of John Bolton, National Security Advisor in the United States, is encouraging. The latter was considered a hawk in China's negotiations. Trump's re-election depends on a strong US economy and a bullish stock market. A trade war with China runs against these objectives. The stock market bullish trend this year is an indication of a trade resolution, while declining bond rates points to a recession risk. In our opinion, the bond market is the outlier.