MONTHLY BOND LETTER

MARCH 2020

ECONOMIC EVENTS

- According to the latest data, 1.55 million Canadian workers applied for Employment Insurance between March 16 and 25, which would raise the number of unemployed to over 3 million and the unemployment rate to almost 15%. In response to this surge, the federal government has adopted a series of economic relief measures to assist employees and employers affected by the COVID-19 crisis. The federal government will subsidize 75% of company salaries up to a maximum of $847 per week as long as company revenues have fallen by more than 15%. For employees laid off or affected by COVID-19, the federal government will offer $2,000 per month for 4 months.
- Jobless claims also broke records in the U.S. with nearly 10 million claims in the last two weeks of the month. The lowest weekly mark prior to this crisis was 695,000 in 1982. The paralysis following the forced closure of businesses prompted Congress to adopt a $2.2 trillion (10% of GDP) relief plan to help taxpayers, SMEs, states, municipalities and hospitals, as well as providing loans to large corporations. Of this plan, $350 billion is offered in loans to SMEs, but would become a subsidy if employers keep their payrolls.
- After dropping as a result of the pandemic, China's manufacturing index jumped in March, from its sharpest contraction in February (35.7) to an expansion of activity (52.0) the following month. This reading shows that more than half of the companies surveyed have returned to work and production, but does not mean that the economy has returned to normal.

These are simply economic support measures to replace lost income from households and businesses. Economic stimulus plans will also be submitted shortly. These initiatives, combined with the decline in government revenues, will cause deficits to explode to over 20% of GDP in some countries. Canada must also find solutions to minimize the impact on real estate, the biggest financial risk in the country.

Jobless claims provide a good picture of the current employment situation. March's unemployment rate of 4.4% is not representative, as the survey was conducted during the week of March 12, before the explosion in claims. The extent of the damage to employment will not be known until April, as some of the measures adopted could provide an incentive to maintain employées in place.

For an economy with significant international trade, the resurgence of activity will be timid, since most of its foreign partners are currently in lockdown. Stimulus measures will have to target mainly domestic consumption and investment.

RATE TRENDS

- Monetary policy joined fiscal relief plans to support the economy. Thus, the Bank of Canada lowered its key rate twice, bringing it to 0.25% at the end of the month. In addition, the Bank launched various programs to support financial markets. It launched its first federal bond buyback program of $5 billion per week, in addition to programs to repurchase commercial paper, bankers' acceptances and provincial money market securities.
- The Federal Reserve also lowered its policy rate to 0.25% and re-launched its quantitative easing program. Initially set at $750 billion, the asset repurchase program quickly became unlimited and was extended to assets other than treasury bonds and mortgage-backed securities. In conjunction with the U.S. Treasury, the Fed can now purchase exchange-traded funds of corporate bonds and commercial paper. The Fed will also be able to lend directly to businesses.

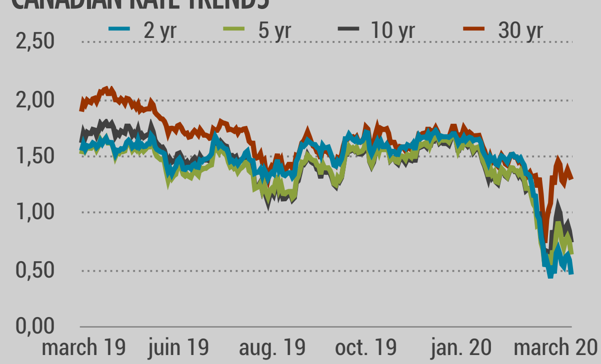
One of the objectives of central bankers around the world is to bring some order to the financial markets and ensure that they function properly. Central bank balance sheets are set to explode and will be used to finance the huge government deficits to come. Through these various measures, central banks want to free up commercial banks balance sheets to allow them to lend to households and businesses in financial difficulty. However, few banks will want to help a company on the verge of bankruptcy without external support. As a result, governments will again be called upon to step in and give financial institutions some form of guarantee for these loans.

BOND RATES

March 31, 2020		Monthly Change	Change 2020		Monthly Change	Change 2020
Key Interest Rate	0,25 %	-1,50 %	-1,50 %	0,25 %	-1,50 %	-1,50 %
3 months	0,26 %	-1,23 %	-1,40 %	0,06 %	-1,21 %	-1,48 %
2 years	0,43 %	-0,73 %	-1,27 %	0,25 %	-0,67 %	-1,32 %
5 years	0,59 %	-0,49 %	-1,10 %	0,38 %	-0,56 %	-1,31 %
10 years	0,70 %	-0,44 %	-1,01 %	0,67 %	-0,48 %	-1,25 %
30 years	1,30 %	-0,02 %	-0,46 %	1,32 %	-0,35 %	-1,07 %
RRB 30 years	0,31 %	0,25 %	-0,07 %			

Source: Bloomberg

CANADIAN RATE TRENDS



CREDIT BOND RISK PREMIUMS

Issuer	Credit Rating DBRS	Spread 5 yr	Spread 10 yrs	Spread 30 yr	CHANGE 5 yr month	CHANGE 5 yr 2020	CHANGE 10 yr month	CHANGE 10 yr 2020	CHANGE 30 yr month	CHANGE 30 yr 2020
Royal Bank, Debt Recapitalization Interne	AA	245	270	300	145	160	135	150	125	140
Royal Bank, Subordinated Debt NVCC	A	330	355	385	190	210	165	185	155	175
Sun Life, dette subordonnée	A	310	335	365	205	210	185	190	175	180
Hydro One	A high	175	195	215	105	115	90	110	65	85
Enbridge Inc	BBB high	330	365	415	215	230	195	215	170	195
Altalink LP	A	170	190	210	100	115	90	110	70	90
GTAA	A high	185	210	235	115	130	110	130	95	125
Bell Canada	BBB high	255	280	320	145	155	115	130	90	115
Rogers Communications	BBB	250	275	315	145	155	115	130	90	110
Loblaw	BBB	260	285	325	145	155	115	130	100	115
Canadian Tire	BBB high	265	290	330	150	165	120	140	105	125
Province of Quebec	AA low	87	116	120	39	51	42	57	34	51
Province of Ontario	AA low	88	118	123	39	50	41	56	34	50
CMHC	AAA	50	65	---	13	21	16	27		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached $10.9 billion in the month of March, up $3.4 billion from the previous month but $1.4 billion less than in March 2019. Since the beginning of the year, total bond financings reached $26.7 billion, 20% more than at the first quarter last year, despite the crisis. Faced with significant liquidity needs to get through this pandemic, American companies have proceeded with record financings in the last month. US investment grade issuers raised $ 260.7 billion in bond financing in March, bringing the first quarter to an unprecedented $ 509.7 billion record.

- The COVID-19 crisis quickly had an impact on the corporate bond market. The credit rating of car manufacturer Ford was downgraded from BBB- to BB+ by S&P. Moody's, which already classified the company as a high-yield bond, also downgraded its rating by one notch, from Ba1 to Ba2. As a result, Ford's outstanding debt (US$36 billion) falls below investment grade in U.S. bond indices. The COVID-19 is hurting both Ford's assembly line and demand. The company has had to close its plants to protect its employees, while lockdown orders have led to a drastic drop in auto sales in the U.S. (-35% year-over-year) and Canada (-47% year-over-year). Ford's downgrade comes on top of those of Kraft Heinz, Macy's and Occidental Petroleum, all under investment grade now.

- Provincial issuers have not been spared by this flight to quality. Long-term credit spreads on provincial bonds closed the month at 138 bps according to the FTSE Canada index, an increase of 43 bps during the month and 60 bps since the start of the year. As a result, this sector generated a return of -5.59% in March. All the provinces will soon be deploying support measures. Ontario has already budgeted $17 billion in its 2020-21 budget to combat the consequences of COVID-19. Quebec was banking on a balanced budget earlier this month, but will have to revise its figures soon. Budget deficits are expected to explode soon, especially for oil-producing provinces such as Alberta and Newfoundland.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	March 2020	2020
Universe	100 %	-2,00 %	1,56 %
Short Term	42,8 %	0,14 %	1,85 %
Mid Term	22,7 %	-0,43 %	3,31 %
Long Term	34,5 %	-5,50 %	0,16 %
Federal	35,7 %	1,63 %	5,13 %
Provincial	36,1 %	-2,83 %	1,28 %
Corporates	26,1 %	-5,41 %	-2,48 %
RRB		-4,93 %	0,04 %

Source: ftse.com

Corporate bonds rated BBB represented 50% of the U.S. investment grade index at the end of 2019 or $3.4 trillion. This crisis could push many issuers into the high-yield category. With $1.2 trillion outstanding, will the high yield bond market be able to absorb as many new issuers?

Oil-producing provinces also had to deal with the side effects of a crude oil price war between Russia and Saudi Arabia. Newfoundland even came close to the financial abyss. Its unsuccessful attempts to borrow demonstrate the risks of refinancing in times of crisis. The Bank of Canada's provincial treasury bill purchase program avoided the worst.

STRATEGIC POSITIONNING

In an effort to reduce the spread of the virus and its impact on public health, the majority of governments around the world have adopted containment measures that are putting the global economy into an induced coma. Currently, governments are administering economic support programs that allow households and businesses to survive during this period of income paralysis. Already, government spending will reach almost 10% of GDP, not counting the negative impact on tax revenues that will cause deficits to swell. Governments will have to put in place stimulus plans that will be as important as those of support. Governments will be able to count on central bankers to finance a large portion of the coming wave of indebtedness. However, the consequences of quantitative easing programs are different from those of 2008. During the financial crisis, central banks injected liquidity into the financial system, driving up asset prices. This time, money is being injected into both the financial markets and the real economy. Central banks hope to be able to withdraw the monetary support before inflation occurs, but financial markets always find a way to penalize central banks when they run out of liquidity. So the post COVID-19 world will be different, and inflation becomes an underestimated long-term risk given the short-term doldrums we all experience.