MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

JUNE 2022

- The consumer price index rose 1.4% last month in Canada and 7.7% year-over-year. This is the fastest pace since January 1983. A 12% increase in gasoline prices in the last month was a major contributor to the jump in the index. In the past year, motorists have had to pay 48% more for a liter of gasoline. Food also increased by 0.5% in the last month and 8.8% over 12 months. But inflationary pressures are also evident elsewhere. Prices for household furnishings and equipment rose 1.3% in May, bringing the annual change to 5.5%. Higher transportation and input costs explain this increase. Lower health restrictions also unleashed the pent-up demand for recreation and culture, with prices rising 1.9% last month and 5.4% year-over-year.

Inflation is becoming more prevalent in the economy and the Bank of Canada should not be monitoring just its core measures as it has in the past. The focus should be on the all-items index (+7.7%), as this is the measure that Canadians use to set their inflation expectations. Food and gasoline are purchased more often than furniture or clothing. With a strong labour market and high inflation, the Bank of Canada could easily justify a 0.75% increase in the policy rate at its July meeting.

- The University of Michigan's U.S. consumer confidence index fell to an all-time low in May (50). Confidence related to current conditions is at its lowest level in history (53.8) while the outlook for the next 6 months fell to a low not seen since May 1980 (47.5). Nearly 50% of respondents cited inflation as their primary concern. In this regard, inflation expectations in the next year stand at 5.4%. Moreover, inflation expectations for the next 5 years have risen slightly from 3.0% in April to 3.1%.

This rise in long-term inflation expectations has prompted the Federal Reserve to be more aggressive in raising its policy rate by 0.75%. The Fed is trying to prevent high inflation from being entrenched and must act more forcefully or risk a recession. Currently, a few indicators are showing signs of weakness, but overall, the economy is doing well. As long as employment does not fall significantly, the Fed will maintain its anti-inflation rhetoric.

- The British economy is decelerating rapidly. After growing by 0.7% in January, the British economy stalled in February, fell by 0.1% in March and now the decline is accelerating in April, down 0.3%. Service industries fell 0.3%, reflecting a 5.6% decline in the health industry due to a significant reduction in Covid-related screening activity. Output fell 0.6%, due to a 1.0% decline in manufacturing. Construction also fell 0.4%, following strong growth in March.

Supply chain disruptions, rising production costs and the Brexit continue to dampen activity, but demand is also being affected by rising prices. Last April, the cap on regulated electricity tariffs was raised by 54%, reducing household demand for non-essential goods. A second increase in the cap is expected in October.

RATE TRENDS

- For the first time since 1994, the Federal Reserve raised its policy rate by 0.75% to 1.75%. The hike came as no surprise to investors on the heels of the recent inflation reading and the increase in long-term household inflation expectations from the University of Michigan's consumer confidence survey. Investors' attention was more focused on the summary of economic projection from the FOMC members. The policy rate is expected to reach 3.50% by the end of the year and 3.75% in 2023, causing an economic slowdown. Indeed, the Fed expects GDP to grow by 1.7% in both 2022 and 2023, down from 2.8% and 2.2% in its last forecast in March. Inflation is expected to remain high this year at 5.2%, but fall to 2.6% in 2023.

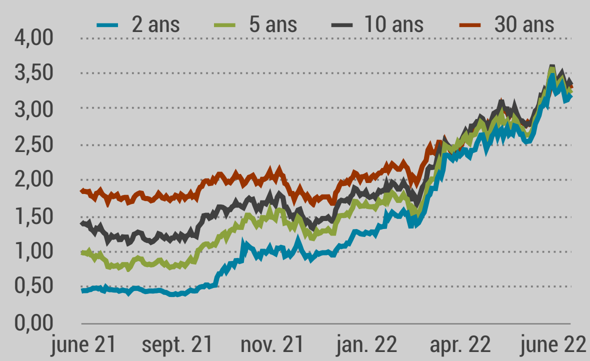
How to interpret the Federal Reserve's message? They have decided to bring out the big guns to fight inflationary pressures, while leaving the door open for a second 0.75% increase in July. Central banks will be forced to choose between containing inflation at the cost of a potential recession or protecting the recovery, the economy and financial markets by allowing more inflation and taking the risk that households will change their long-term outlook on inflation. There is no right choice, but the Fed seems to be accepting the risk of a recession because the economic cost unanchored inflation and reliving the 1970s seems too high.

BOND RATES

June 30, 2022	Canada	Monthly Change	Change 2022	United States	Monthly Change	Change 2022
Key Interest Rate	1,50 %	0,50 %	1,25 %	1,75 %	0,75 %	1,50 %
3 months	2,11 %	0,62 %	1,93 %	1,63 %	0,59 %	1,60 %
2 years	3,10 %	0,43 %	2,14 %	2,95 %	0,40 %	2,22 %
5 years	3,11 %	0,37 %	1,85 %	3,04 %	0,22 %	1,77 %
10 years	3,22 %	0,33 %	1,80 %	3,01 %	0,17 %	1,50 %
30 years	3,14 %	0,29 %	1,46 %	3,18 %	0,14 %	1,28 %
RRB 30 years	1,37 %	0,27 %	1,49 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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CREDIT BOND RISK PREMIUMS

Issuers	Credit Rating DBRS	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2022	Change 10 yrs month	Change 10 yrs 2022	Change 30 yrs month	Change 30 yrs 2022
Royal Bank, Bail-in-debt	AA	165	195	225	5	80	5	80	0	70
Royal Bank, NVCC	A	215	265	310	5	105	5	115	5	110
Sun Life, subordinated debt	A	185	235	275	0	85	0	95	0	85
Hydro One	A high	105	135	165	-5	40	-5	35	-5	30
Enbridge Inc	BBB high	175	220	280	-5	65	-5	65	-10	50
Altalink LP	A	105	130	160	-5	40	-5	30	-5	25
GTAA	A high	105	135	165	-5	35	-5	35	-5	35
Bell Canada	BBB high	160	205	250	0	60	0	60	-5	45
Rogers Communications	BBB high	175	220	285	0	45	-5	45	-10	50
Loblaw	BBB high	155	200	235	0	65	0	65	0	45
Canadian Tire	BBB	165	215	285	0	70	0	70	0	55
Province Québec	AA low	47	75	98	1	14	4	19	5	24
Province Ontario	AA low	50	80	101	0	13	5	19	5	23
CMHC	AAA	37	47	---	1	6	-1	6		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bonds new issuance totaled $7.4 billion in June, down $2 billion from the previous month and $8.3 billion below June 2021. Year-to-date, bond financings totaled $65.7 billion, up 3.6% from this time last year. Once again, the financial industry has dominated the new issue calendar with a total of $5.7 billion and 3 issues of Limited Recourse Capital Notes (LRCN). These are subordinated bank debt that will be converted into preferred shares of the bank in the event of a default on interest or principal payments.

- Sales at discount retailer Dollarama jumped 12.4% in the past year due to an increase in the number of stores (63 more) and a 7.3% increase in same-store sales. Dollarama's net income reached $145.5 million in the quarter ending May 1, a 28% gain over the same period last year. Inflation means it's getting harder to offer $1 products. The company had previously announced that it would begin selling $5 products, the first increase in the price cap at its stores since 2015 when $4 items made their debut. Dollarama is effectively managing its costs as operating income increased 24.4% to $220.0 million, or 20.5% of sales, compared to 18.5% in the same period last year.

- The saga of Rogers' acquisition of Shaw is not over. In order for the deal to get approval from the Canadian Competition Bureau, Rogers and Shaw sold Freedom Mobile to Quebecor for $2.85 billion. This is an acquisition price equivalent to 6.8X EBITDA, which is considered a bargain. This transaction also requires regulatory approval. Freedom Mobile has approximately 1.3 million subscribers with operations in Ontario, Alberta and British Columbia. This acquisition allows Quebecor to expand its wireless operations in the rest of Canada and offers greater growth potential through economies of scale. Quebecor will finance this transaction through new debt that will increase the debt to EBITDA ratio from 3.2X to 3.7X.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	June 2022	2022
Universe	100 %	-2,18 %	-12,23 %
Short Term	44,3 %	-0,79 %	-4,39 %
Mid Term	26,0 %	-1,94 %	-11,34 %
Long Term	29,7 %	-4,35 %	-22,13 %
Federal	36,6 %	-1,75 %	-9,47 %
Provincial	34,7 %	-3,10 %	-15,62 %
Corporates	26,5 %	-1,53 %	-10,97 %
RRB		-3,56 %	-17,40 %

Source: ftse.com

Here is a sign of the effects of inflation on household consumption patterns. Before households begin to cut back on their overall consumption, they initially look for solutions that allow them to keep up with the cost of living. Discount retailers and big box stores like Walmart and Costco are becoming a solution for consumers.

It should be noted that Quebecor is rated below investment grade by the agencies and that the size of the issues planned for the coming year could have a widening effect on yield spreads. High-yield bonds lose their appeal during a recession. However, in the longer term, this transaction brings several positive elements to Videotron.

STRATEGIC POSITIONNING

We often hear that 50 is the new 40, but in the case of central banks, it is more like 0.50% is the new 0.25%. Indeed, the list of central banks that have announced a 0.50% rate hike in recent months is growing, and some, like the Federal Reserve, want to accelerate the tightening with a 0.75% increase. The Bank of Canada is expected to follow in the footsteps of its U.S. counterpart at its July meeting as businesses struggle to meet strong demand due to labor shortages and supply chain bottlenecks. This accelerated normalization of interest rates is raising fears of a slowdown that is beginning to show up in some industries such as real estate where the effect of rate hikes is direct. Consumer sentiment is also down, with inflation eroding some of the purchasing power of households. Is this enough to calm the momentum of central banks in their monetary tightening? Not quite. The labor market remains robust and companies are still complaining about a lack of personnel. As long as employment does not fall significantly, central banks will not deviate from their goal of controlling inflation. The cost of this inflation fight is likely to be a recession next year, as central banks adjust policy based on the path of this lagging indicator. Once inflation will come down, the recession will already be upon us.