MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

APRIL 2019

- After three consecutive monthly declines, sales by Canadian retailers rose 0.8% in February. General merchandise stores and car dealerships contribued to sales growth. Excluding vehicles, sales increased by 0.6% in February after dropping 0.6% the previous month. Notwithstanding price changes, retail sales volume increased by 0.2 %. Quebec and Ontario experienced strong sales growth with gains of 1.6% and 1.5% respectively, while British Columbia experienced a decline (-1.9%).

Since the end of the third quarter of 2018, retail sales volume has been down 0.5%, confirming that the Canadian economy is going through an rough patch. However, the largest drop occurred in grocery stores (-2.1%) while car sales increased by 0.3%. The 3.1% increase in food prices during the same period may explain the decrease in sales.

- The U.S. economy grew at an annualized rate of 3.2% in the first quarter of the year. Accelerating government spending and increasing corporate inventories contributed to growth, as did international trade due to lower imports. On the other hand, residential real estate contracted for the fifth consecutive quarter. Households also spent moderately this winter, increasing by only 1.2% with a sharp drop in durable goods. The uncertainty associated with the government shutdown at the beginning of the year forced households to put more aside, with the savings rate jumping to 7 % of disposable income.

Some of the contributing factors in the first quarter could reverse in the second, such as business inventory build-up. On the other hand, consumer spending could recover. Government shutdown undermined household confidence in January, while bad weather in February delayed some spending. These factors will ease in the second quarter.

- The annual growth rate of the Chinese economy remained unchanged in the first quarter of 2019 at 6.4%. The stimulus programs which were implemented in recent months are beginning to be profitable. Industrial production recovered, up 8.5% from 5.7% in the previous quarter. Retail sales also accelerated with a year-over-year gain of 8.7%, up 0.5% from December.

Although growth is identical to the previous quarter, China's economic conditions are improving as a result of the stimulus. Industrial production (8.5%) reached a peak not seen since 2014, while the manufacturing sector activity index expanded in March after three months of contraction.

RATE TRENDS

- The Bank of Canada maintained its key policy rate at 1.75% in April. The Bank expects that the Canadian economy will be disrupted in the first half of the year by residential real estate, lower oil production in Alberta and uncertainty related to international trade. However, economic activity should recover in the second half of the year. As a result, the Bank has lowered its 2019 growth forecast from 1.7% to 1.2%. The bias towards future rate increases was replaced by a more balanced message.

The three disruptive elements should reverse in the second half of the year. Canadian oil prices has recovered, discussions between China and the United States should lead to an agreement while Canadian real estate will get a boost from CMHC with the new down payment assistance program.

- U.S. monetary policy has also remained unchanged. The committee made a positive assessment of the economy with robust labour market conditions. On the other hand, the Fed pointed out that inflation was unusually low due to transitional factors. Once these elements are resolved, inflation is expected to return to the 2 % target. The Fed therefore believes that patience is required to assess the appropriate adjustments for the future.

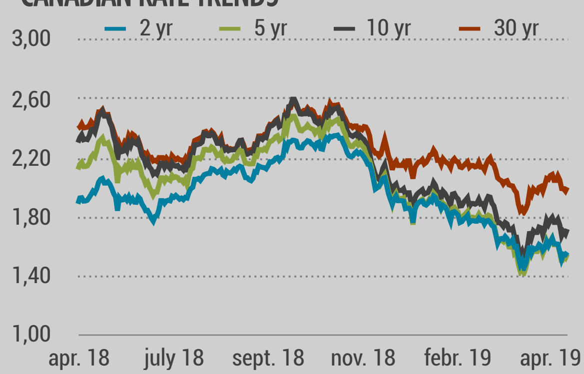
Jerome Powell ignored President Trump's recommendations for a 1% cut in the Fed Funds rate and more quantitative easing. Who could remind the President that these measures are exceptional and only used in times of crisis?

BOND RATES

April 30, 2019	Canada	Monthly Change	Change 2019	United States	Monthly Change	Change 2019
Key Interest Rate	1,75 %	0,00 %	0,00 %	2,50 %	0,00 %	0,00 %
3 months	1,68 %	0,01 %	0,02 %	2,41 %	0,03 %	0,06 %
2 years	1,56 %	0,01 %	-0,30 %	2,27 %	0,01 %	-0,22 %
5 years	1,54 %	0,02 %	-0,35 %	2,28 %	0,05 %	-0,23 %
10 years	1,71 %	0,10 %	-0,26 %	2,50 %	0,10 %	-0,18 %
30 years	1,99 %	0,10 %	-0,19 %	2,93 %	0,11 %	-0,09 %
RRB 30 years	0,49 %	0,05 %	-0,27 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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CREDIT BOND RISK PREMIUMS

ISSUER	Credit rating DBRS	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2019	Change 10 yrs month	Change 10 yrs 2019	Change 30 yrs month	Change 30 yrs 2019
Royal Bank, bail-in debt	AA low	100	135	175	-10	-35	-10	-25	-10	-25
Royal Bank, sub debt NVCC	A low	145	190	230	-15	-40	-15	-30	-15	-30
Fortis Inc.	BBB high	110	150	200	-5	-30	-10	-35	-15	-35
Hydro One	A high	90	130	165	-5	-25	0	-10	0	-15
Enbridge Inc	BBB high	120	170	230	-10	-40	-10	-40	-5	-45
Encana Corp	BBB	160	225	280	-15	-45	-15	-45	-15	-45
GTAA	---	70	95	120	-5	-15	-5	-10	-10	-20
Bell Canada	BBB high	115	155	220	-10	-40	-15	-45	-10	-40
Rogers Communications	BBB	110	150	220	-10	-40	-15	-45	-5	-40
Loblaw	BBB	120	170	225	-10	-45	-10	-45	-10	-45
Canadian Tire	BBB high	115	165	230	-10	-45	-10	-45	-10	-40
Province of Québec	A high	44	69	81	-5	-15	-3	-15	0	-15
Province of Ontario	AA low	48	74	85	-5	-15	-3	-15	-1	-16
CMHC	AAA	33	46	---	-5	-10	-1	-10		

Source: National Bank Financial

CREDIT MARKET

- New Canadian corporate bond issues reached $7.1 billion in April, a decrease of $5.2 billion from the previous month and 400 million less than in April 2018. Since the beginning of the year, corporate bond financing amounted to $29.2 billion, an increase of 2.1% from the same period last year. Unlike April 2018, when 59% of issues were from Canadian banks, no financial institutions in Canada were included in the new issue list in April 2019. Issuers and industry diversity illustrates investor's appetite for credit products. In April, corporate spreads narrowed by 8 bps. to close the month at 122 bps. according to the FTSE Canada Index.

- Doug Ford's government released its first budget, which aims at returning Ontario to a balanced budget in fiscal year 2023-24. In the meantime, Ontario will face a deficit of $11.7 billion for the year ending March 31st and $10.3 billion in 2019-20, or 1.2% of GDP. Over the next four years, total annual deficits are expected to reach $26.2 billion. As a result, the debt ratio is expected to peak next year at 40.7% of GDP and then fall below 40% from 2022-23 onwards. In its projections for the current fiscal year (2019-20), the Minister of Finance is forecasting economic growth of 1.7%, which would translate into a 2.3% increase in revenues. On the other hand, expenditure is expected to increase by 0.5%. Higher spending on health and education would be offset by reductions in other sectors.

- SNC-Lavalin announced that it is selling to OMERS (Ontario Municipal Employees Retirement Fund) 10.01% of its shares in the 407 Highway located in the Toronto area. OMERS will pay $3 billion at closing with a balance of $250 million to be paid over a 10-year period. SNC will still maintain a 6.76% interest in the highway once the transaction is completed. The proceeds in this sale will be used to reduce SNC's debt level. As a result, DBRS confirmed the credit rating to BBB while removing its review for a possible downgrade. Changes made to improve risk management and governance also influenced DBRS' decision.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Apr. 2019	2019
Universe	100 %	-0,10 %	3,80 %
Short Term	43,5 %	0,26 %	2,00 %
Mid Term	22,3 %	0,14 %	3,92 %
Long Term	34,2 %	-0,73 %	6,16 %
Federal	35,3 %	-0,19 %	2,30 %
Provincial	35,2 %	-0,32 %	4,90 %
Corporates	27,5 %	0,30 %	4,33 %
RRB		0,17 %	5,32 %

Source: ftse.com

By 2024, the province could encounter headwinds usually seen at the end of the economic cycle which would impact tax revenues. Controlling expenses is therefore essential. Currently, Quebec and Ontario have debt ratios similar at nearly 40%, except that Quebec has surplus that justifies a tighter spread for several years to come.

Based on the transaction metrics, 407 Highway's market value is $32.5 billion for a company that generated $539 million in earnings last year. Thus, the P/E ratio is 60x. High growth must therefore be present to justify such a value. Last year, revenues increased by 9.7% and earnings by 14,7 %.

STRATEGIC POSITIONNING

Occasionally, investors should step back and take a look at the bigger picture instead of being glued to their screens. The U.S. economy grew at a rate of 3.2% in the first quarter and is now three months close to beating the longest expansion in history under the Clinton administration. In addition, the U.S. unemployment rate is now at 3.6%, a low not been seen since December 1969, as the stock market is close to its all-time high. The Chinese economy is stabilizing and the stimulus measures will have a greater impact in the second half of the year. Nevertheless, investors are still anticipating rate cuts in the U.S., as evidenced by the yield curve inversion. However, these expectations seem premature. Inflation has decelerated recently, but due to temporary factors. The economy will have to weaken significantly before the Fed reduces its key policy rate. Financial conditions remain looser than on average according to the Chicago Federal Reserve Index, which should provide further stimulus to the economy. The Fed is sending out more and more signals on inflation symmetry. Minneapolis Fed President Neel Kashkari has already mentioned that due to the low level of inflation since 2009, the Fed could accept a rate of 2.3% for several years without concern. How will the bond market react if the Fed no longer fights inflation?