# MONTHLY BOND LETTER

AlphaFixe Capital

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## ECONOMIC EVENTS

- The Canadian economy grew at an annualized rate of 1.3% in the third quarter, compared to 3.5% in the previous quarter. This deceleration is partly attributable to a decline in exports (-1.5%) following a lofty 12.9% gain in the second quarter. Household consumption expenditures accelerated from 0.5% to 1.6% influenced by strong durable goods orders, particularly auto sales. Business investments also jumped 9.5%, while residential real estate recorded a 13.3% increase, the strongest quarterly growth in 7 years.

This national accounts reading further demonstrates the resilience of the Canadian economy. Even business investment has increased despite global economic uncertainty. At the same time, the GDP calculation using income approach shows a 5.1% increase in Canadian wages and 7.2% in Quebec, thus supporting consumer spending.

- New home sales in the United States reached 733,000 on an annualized basis in October compared to 738,000 in the previous month, which was the highest sales rate since 2007 and a 20% increase from last year's average sales. Existing home sales, housing starts and building permits have also posted gains since the beginning of the year. The drop in the 30-year mortgage rate from 4.94% last November to 3.66% recently partly explains this surge in the real estate sector.

This is an encouraging sign that the Federal Reserve is not facing a liquidity trap that makes monetary policy ineffective. Thus, rate cuts this year should further stimulate economic activity in the coming months, unless Trump further disrupts the economy with his trade disputes.

- GDP growth in Germany reached 0.4% in annualized terms in the third quarter, avoiding a technical recession defined as two consecutive quarters of contraction. Government, household and foreign trade expenditures contributed to growth. Business investment, on the other hand, fell, reflecting the pessimism of business leaders facing trade tensions.

In addition to trade disputes, the German economy also suffers from its monetary policy. Instead of encouraging investment and consumption, negative interest rates have forced households to save more. Germans have long perceived savings as a virtue.

## RATE TRENDS

- In her first speech as President of the European Central Bank (ECB), Christine Lagarde called for a new mix of monetary and fiscal policy to enable the euro area to achieve its growth and employment potential. Trade tensions and geopolitical uncertainties have slowed world trade growth of which Europe is heavily dependent. This new policy mix would allow the European economy to reduce its dependence on exports by focusing more on domestic demand.

A career politician, Christine Lagarde may be able to convince the various governments to help boost the European economy. This call for fiscal stimulus shows that the ECB is looking for ammunition to stimulate the economy. Quantitative easing served to stabilize the area in 2015, but has not demonstrated its effectiveness in creating growth.

- Federal Reserve Chairman Jerome Powell mentioned in a speech that monetary policy seems appropriate at the moment and that the stimulating effects of rate cuts have already begun to help consumers and businesses. "At this stage of the economic cycle, I see the glass more than half full," the president said. "With the right policies, we can go further". The Fed also reiterated its firm objective of achieving the 2% inflation target, a sign that monetary policy will remain dovish.

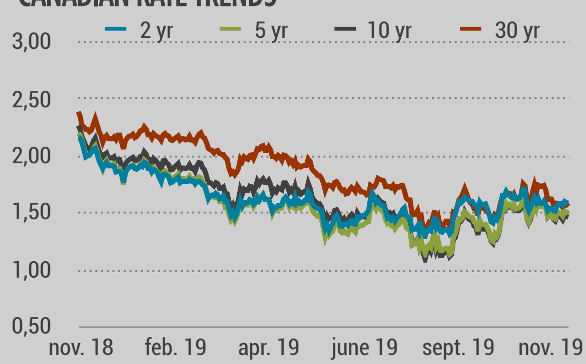
The Fed's message is clear: we have intervened to offset the negative effects of trade disputes and we will remain patient before resuming a restrictive monetary policy. Nevertheless, President Trump will have to implement good trade policies if he wants the economy to run at full capacity.

## BOND RATES

| Nov. 30 2019 | Canada | Monthly Change | Change 2019 | United States | Monthly Change | Change 2019 |
|---|---|---|---|---|---|---|
| Key Interest Rate | 1,75 % | 0,00 % | 0,00 % | 1,75 % | 0,00 % | -0,75 % |
| 3 months | 1,66 % | -0,01 % | 0,00 % | 1,57 % | 0,04 % | -0,79 % |
| 2 years | 1,59 % | 0,07 % | -0,28 % | 1,61 % | 0,09 % | -0,88 % |
| 5 years | 1,49 % | 0,07 % | -0,40 % | 1,63 % | 0,11 % | -0,89 % |
| 10 years | 1,46 % | 0,05 % | -0,50 % | 1,78 % | 0,08 % | -0,91 % |
| 30 years | 1,56 % | -0,02 % | -0,63 % | 2,21 % | 0,03 % | -0,81 % |
| RRB 30 years | 0,27 % | -0,07 % | -0,50 % | | | |

Source: Bloomberg

## CANADIAN RATE TRENDS

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## CREDIT BOND RISK PREMIUMS

| ISSUER | Credit rating DBRS | S&P | Spread 5 yrs | 10 yrs | 30 yrs | Change 5 yrs month | 5 yrs 2019 | 10 yrs month | 10 yrs 2019 | 30 yrs month | 30 yrs 2019 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Royal Bank, deposit notes | AA | | 90 | 125 | 165 | -10 | -45 | -10 | -35 | -10 | -35 |
| Royal Bank, Senior debt | A | | 125 | 175 | 215 | -15 | -60 | -15 | -45 | -15 | -45 |
| Fortis Inc. | BBB high | | 80 | 130 | 190 | -15 | -60 | -10 | -55 | -10 | -45 |
| Hydro One | A high | | 65 | 90 | 135 | -10 | -50 | -20 | -50 | -20 | -45 |
| Enbridge Inc | BBB high | | 110 | 160 | 230 | -10 | -50 | -10 | -50 | -5 | -45 |
| Encana Corp | A low | | 90 | 135 | 185 | -10 | -45 | -10 | -40 | -10 | -35 |
| GTAA | --- | | 60 | 85 | 115 | -5 | -25 | -5 | -20 | -5 | -25 |
| Bell Canada | BBB high | | 105 | 155 | 215 | -5 | -50 | -10 | -45 | -15 | -45 |
| Rogers Communications | BBB | | 100 | 150 | 215 | -5 | -50 | -10 | -45 | -10 | -45 |
| Loblaw | BBB | | 110 | 160 | 215 | -5 | -55 | -10 | -55 | -10 | -55 |
| Canadian Tire | BBB high | | 105 | 155 | 210 | -5 | -55 | -10 | -55 | -10 | -60 |
| Province of Québec | A high | | 37 | 60 | 72 | -4 | -22 | -4 | -24 | -5 | -24 |
| Province of Ontario | AA low | | 39 | 65 | 76 | -4 | -24 | -4 | -24 | -5 | -25 |
| CMHC | AAA | | 28 | 38 | --- | -3 | -15 | -2 | -18 | | |

Source: National Bank Financial

## CREDIT MARKET

- Canadian corporate bond new issuance totalled $6.2 billion in November, down $2.6 billion from the previous month, but $1 billion higher than in November 2018. Since the beginning of the year, the total bond financing amounted to $88.8 billion, up 11.5% from the same date last year. Auto finance companies have been active with four issues totalling $1.55 billion from three different manufacturers, General Motors, Ford Canada and BMW. Global trade uncertainty and household debt are affecting Canadian sales. More than half of the purchases are financed for periods of 84 months or more, while 80% of leases are for more than 48 months according to LMC Automotive.

- The CAQ government has updated its public finances, which now projects a surplus of $4.1 billion for the current fiscal year (2019-20), an increase of $2.5 billion over the budget tabled last March. The previous year surplus also increased by $2.7 billion to $8.3 billion. The better-than-expected results in 2018-19 were due to higher revenues (4.7%) from personal income taxes and higher revenues from government business enterprises. Spending also declined (-2.0%) mainly due to lower debt service because of lower interest rates and accelerated debt repayment. These enviable financial results prompted DBRS to upgrade the Province's credit rating from A(high) to AA(low).

- Moody's upgraded Hydro One's credit rating from Baa1 to A3 with a stable outlook. This action follows a decision by the company to remain exclusively focused on its Ontario operations for at least five years. According to the agency, "this upgrade reflects the vision of an increased likelihood of extraordinary government support ». Moody's had previously downgraded Hydro One's rating after it announced its intention to acquire Avista, a regulated utility in the United States, on the grounds that the company was no longer perceived as a government related issuer. Since this transaction failed and Hydro One is refocusing on its Ontario operations, Moody's has re-established its government relationship in the rating.

### FTSE TMX INDEX PERFORMANCE

| Sector | Weight | Nov. 2019 | 2019 |
|---|---|---|---|
| Universe | 100 % | 0,52 % | 8,16 % |
| Short Term | 42,7 % | 0,07 % | 3,25 % |
| Mid Term | 22,8 % | 0,11 % | 6,90 % |
| Long Term | 34,5 % | 1,34 % | 15,65 % |
| Federal | 34,8 % | 0,05 % | 4,85 % |
| Provincial | 35,8 % | 0,86 % | 11,07 % |
| Corporates | 27,3 % | 0,65 % | 8,64 % |
| RRB | | 0,77 % | 9,70 % |

Source: ftse.com

Sound public finance management in Quebec will allow the province to achieve its target of 45% debt to GDP in the current fiscal year, 6 years in advance. In 2016, Quebec's debt ratio was 14.3% higher than Ontario's. It will be soon lower than that of their neighbor, whose budget will not be balanced until 2024.

At the beginning of the year, Hydro One estimated its financing needs between $1.5 and $2.0 billion. Having already reached the minimum of this range, the company could take advantage of low interest rates and tight long-term credit spreads to accelerate its borrowing program, especially now that the credit rating cloud has disappeared.

## STRATEGIC POSITIONNING

The global economy is showing signs of stabilization as some manufacturing activity indicators have stopped falling and are showing signs of recovery. Monetary stimulus initiated by several central banks have also reduced fears of a global recession and their lagging effects are expected to show early next year. In fact, if we combine monetary stimulus, fiscal thrust in China and Japan and the possibility of a trade agreement between the US and China, the result could be positive for economic growth next year. President Trump has an incentive to resolve this conflict, as no president has been re-elected for a second term in the midst of a recession. Why wait until the last minute? Because any agreement will not improve the U.S. trade deficit with China, as he promised to his constituents. The presence of a fiscal and trade deficit means that the United States is consuming much more than it produces, a reality that will not change any time soon. One of the greatest risks in 2020 is that trade uncertainty has persisted for too long, undermining business and consumer confidence to the point of no return. In such a case, Trump's belligerent attitude towards China may ramp up, believing that the way to victory is through protectionism and not growth. However, confidence is still high, supported by a robust job market and a bullish stock market.