MONTHLY BOND LETTER

AlphaFixe Capital

MARCH 2025

ECONOMIC EVENTS

- Canada's consumer price index jumped by 1.1% in February, pushing the annual inflation rate to 2.6%, compared with 1.9% in January. This acceleration was anticipated due to the end of the temporary GST break in mid-February. However, its impact was not limited to items directly affected by the tax break: all the main aggregates in the index recorded price increases. Among the components that contributed most to this inflation were food (+1.9% month-on-month), leisure, education and reading (+3.4%), alcoholic beverages (+1.5%) and clothing and footwear (+1.6%). Price rises were equally widespread between goods (+0.8%) and services (+1.2%). The inflationary effect of the end of the GST holiday is expected to continue into March, as the exemption was only in place for half of February.

Beyond the one-off effect of the end of the GST break, inflationary pressures were already present in Canadian production chains. In January, the Producer Price Index was up 5.8% year-on-year, largely due to the depreciation of the Canadian dollar. Producers therefore appear to be passing on part of the increase in input costs to their customers. What's more, Canada's response to US tariffs on steel and aluminum in March could eventually translate into higher prices for consumers.

- According to a preliminary reading, the US goods trade deficit fell by $7.7 billion between January and February, to $147.9 billion. Although this represents a slight improvement against a backdrop of trade tensions, the deficit is still higher than investors' expectations of $134 billion. In February, only China was subject to 10% tariffs, while Canada and Mexico were granted a reprieve. U.S. companies took advantage of this tariff-free window to build up inventories before new restrictions came into force. The situation could turn around starting April 2, when the Trump administration plans to apply new 25% tariffs on all vehicle imports into the US and reciprocal tariffs.

At present, 66% of imports from Canada are used as inputs for American companies, and only 34% as consumer products. In the case of China it's the opposite. The integration of North American chains complicates the situation for companies in the United States, as it is more difficult for them to find a substitute product in their production. Not impossible, but more difficult. As a result, the impact of tariffs on Canadian products hurts U.S. producers, and the transmission of costs to U.S. consumers is more likely.

- China returned to deflation in February with a 0.7% year-on-year drop in its consumer price index (CPI), the first price decline in thirteen months. This deflation is attributed to cautious household consumption, as households are preoccupied with employment and income. Growth in food prices has fallen the most in 13 months, while non-food prices are deflating. At the same time, the producer price index fell by 2.2%, the 29th consecutive month of decline.

To return to the 5% growth target for 2025, the government has given itself greater fiscal leeway by raising the deficit target from 3% to 4% of GDP. Faced with the tariffs imposed by the Trump administration, the authorities need to strengthen domestic demand and restore consumer confidence.

RATE TRENDS

- In line with investor expectations, the Bank of Canada cut its key rate by 0.25% to 2.75%. This decision reflects a direct response to the uncertainty caused by the U.S. administration's tariff threats. The Bank of Canada acknowledges that the Canadian economy rebounded in the second half of 2024, and that growth was maintained in January. However, trade tensions with the U.S. have altered the environment, risking a slowdown in economic activity while increasing inflationary pressures in Canada. The Bank also reiterates its delicate position with regard to this trade conflict. "Monetary policy cannot neutralize the repercussions of a trade war. But it can, and must, prevent price rises from fuelling inflation in the long term".

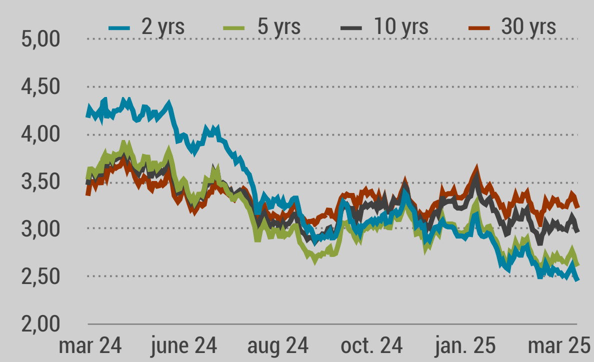
The Bank of Canada has clearly reaffirmed that its priority is to keep inflation under control. However, the Bank will be cautious in conducting its monetary policy. It will want to assess whether the downward pressure on inflation from a weakening economy outweighs the upward pressure from costs, or vice versa. In anticipation of the tariffs, domestic economic activity accelerated at the start of the year, borrowing from future growth. Moreover, economic uncertainty will not only hamper growth, but also generate additional costs in the form of high inventories and research to circumvent tariffs. These costs could be passed on to customers.

BOND RATES

March 31, 2025	Canada	Monthly Change	Change 2025	United States	Monthly Change	Change 2025
Key Interest Rate	2,75 %	-0,25 %	-2,25 %	4,50 %	0,00 %	-1,00 %
3 months	2,64 %	-0,20 %	-0,51 %	4,29 %	-0,00 %	-0,02 %
2 years	2,46 %	-0,11 %	-0,47 %	3,88 %	-0,11 %	-0,36 %
5 years	2,61 %	0,01 %	-0,35 %	3,95 %	-0,07 %	-0,43 %
10 years	2,97 %	0,07 %	-0,26 %	4,21 %	-0,00 %	-0,36 %
30 years	3,23 %	0,10 %	-0,11 %	4,57 %	0,08 %	-0,21 %
RRB 30 years	1,33 %	0,10 %	-0,12 %			

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 2025	Change 10 yrs month	Change 10 yrs 2025	Change 30 yrs month	Change 30 yrs 2025
Royal Bank, Bail-in-debt	AA	95	120	155	10	15	10	15	10	15
Royal Bank, NVCC	A	145	180	225	10	20	10	20	10	20
Sun Life, subordinated debt	A	125	160	200	10	30	10	25	10	25
Hydro One	A high	70	100	125	5	10	0	10	-5	5
Enbridge Inc	A low	110	150	190	0	20	0	25	-5	15
Altalink LP	A	70	100	125	5	10	0	10	-5	5
GTAA	A high	65	95	120	5	10	0	10	0	5
Bell Canada	BBB high	115	150	185	0	15	-5	5	-10	-5
Rogers Communications	BBBL	120	155	190	5	15	0	5	-5	0
Loblaw	BBB high	95	130	165	5	20	0	15	-5	5
Canadian Tire	BBB	120	155	195	5	15	0	10	-5	0
Province Québec	AA low	29	68	99	2	5	3	3	4	9
Province Ontario	AA low	30	66	95	2	6	3	4	3	9
CMHC	AAA	16	37	---	0	3	1	1		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bonds new issuance totaled $9 billion in March, down $2.1 billion on the previous month, and $725 million less than in March 2024. First-quarter bond financing totaled $31.6 billion, 2% less than at the same time last year. Despite an uncertain environment for Canadian companies in the wake of the trade dispute with the United States, corporate bond spreads still performed relatively well. Since the beginning of the year, the yield premium has risen by 14 basis points to 1.16% at the end of March.

- During March, three corporate bond issuers launched new bond financing transactions - Allied Properties, CI Financial and Russel Metals - and used credit rating arbitrage strategies to qualify for the index as investment-grade bonds. This enables them to lower their cost of funding, while offering the possibility of increasing bond size and liquidity. The index's credit rating methodology stipulates that unsolicited ratings are not taken into account. Allied is rated BBB by DBRS-Morningstar, while its unsolicited Moody's rating is Ba1. In the case of Russel Metals, rated at issuer level by DBRS-Morningstar (BBB low) and S&P (BB+), the company has chosen to have its new issue rated at issue level by DBRS-Morningstar only, so that the issue meets the index eligibility criteria.

- Quebec Finance Minister Éric Girard has published his budget for fiscal year 2025-26, forecasting a record deficit of $13.6 billion due to the uncertain economic context. This amount includes a $2.2 billion payment to the Generations Fund to reduce the debt and a $2 billion provision for economic contingencies. The Minister forecasts growth of 1.1% for 2025, including the impact of the 10% customs duties expected over the next two years. To return to a balanced budget by 2029-2030, the CAQ government forecasts average annual spending growth of 1.9% over five years, against an estimated 3.2% increase in revenues over the same period.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	March 25	2025
Universe	100 %	-0,28 %	2,02 %
Short Term	40,8 %	0,34 %	1,69 %
Mid Term	31,0 %	-0,05 %	2,65 %
Long Term	28,2 %	-1,41 %	1,79 %
Federal	41,1 %	-0,06 %	2,25 %
Provincial	32,5 %	-0,71 %	1,89 %
Corporates	24,6 %	-0,05 %	1,81 %
RRB		-0,35 %	3,45 %

Source: ftse.com

This corporate strategy reduces the quality of the index by including bonds that would normally have been classified in the high yield category. The loss of agency coverage also reduces the level of independent monitoring and analysis of a company. That said, many investment policies already require an issuer to have 2 credit ratings to qualify.

These are relatively optimistic growth assumptions in a context of high uncertainty this year. In his defense, the Finance Minister is not alone in his optimism: the majority of provincial budget forecasts anticipate a slight slowdown in growth in 2025 compared to 2024, rather than a real downturn. For 2024 as a whole, Quebec's GDP grew by 1.4%.

STRATEGIC POSITIONNING

We are entering a new economic era in which cooperation with Western allies is a thing of the past, at least from the USA's point of view. The announcement of reciprocal tariffs is expected to push the effective tariff rate up to 24%, compared with 12% for Iran and 14% for Venezuela, the two other most protectionist countries. These tariffs could push up the annual inflation rate by just over 1.5%, to between 4% and 5%. However, the objective of these policies remains unclear. Repatriating industries to U.S. soil would require time, manpower and energy. The last two elements are currently in short supply in the U.S., especially if there is a massive deportation of immigrants. Some Republican politicians have raised the possibility that the revenues generated by these tariffs could be used to finance promised tax cuts. As a result, the economy could well enter a period of stagflation. These changes will also have financial consequences. A rebalancing of the current account also means a reduction in foreign investment in the United States, including the purchase of Treasury bonds. With the budget deficit at 6.2% of GDP, the government will have to borrow a considerable amount this year, relying increasingly on domestic savings. The uncertainty caused by reciprocal tariffs is currently benefiting safe havens such as bonds, but in the medium term, the trade conflict will reduce the pool of foreign lenders for the United States.