MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

MAY 2024

- The pace of growth in the Canadian economy was slower than expected. GDP grew at an annualized rate of 1.7% in the first quarter, 0.6% below expectations. The economy started the year on a strong footing, but the pace slowed towards the end of the quarter as the economy stalled in March. However, the details are brighter than the GDP reading would suggest. Household consumption expenditure rose by 3.0%, supported by a 7.4% increase in disposable income. Businesses also increased investment (+3.5%) after two consecutive quarters of sharp decline. Even investment in residential buildings contributed (+1.3%). International trade also added marginally to growth. On the other hand, companies reduced the pace of inventory accumulation, cutting growth by 1.5%.

In fact, if we look at final domestic demand, which takes GDP excluding international trade and inventories, it shows growth of 2.9%, its fastest pace since the first quarter of 2022. Growth will also continue in April, with Statistics Canada forecasting a monthly increase of 0.3%. Nevertheless, the economy has grown by 0.5% over the past year, well below the population growth rate (3%). The labor market is also in oversupply. Monetary policy could therefore lend a helping hand to the economy.

- The U.S. consumer price index (CPI) rose by 0.3% in April, very close to investors' expectations of a more robust rise. Year-on-year, inflation now stands at 3.4%, a tenth below the March reading. Excluding food (0.0%) and energy (1.1%), core inflation is up 0.3% month-on-month and 3.6% year-on-year. Again, this represents a slight decline on March, but still above the Fed's target range. Transportation services (+0.9%) helped boost the index last month, thanks to a 22.6% jump in auto insurance premiums over the past year.

Although inflation eased slightly in April, the pace is still too persistant to justify a 180-degree turn in monetary policy. Progress in slowing inflation has evaporated since the start of the year, as aggregate demand still exceeds supply. It will probably take more timid inflation readings in the coming months to sway Fed members' opinion that inflation is moving convincingly towards the 2% target.

- After treading water in the last quarter of the year, Japan's economy contracted by an annualized 2.0% in the first three months of the year. Private consumption contracted (-2.8%) for the fourth quarter running, while business investment fell by 3.2% in the first quarter. International trade also weighed on GDP, as exports fell by more than imports. Only public spending contributed to growth in the first quarter.

Japan's economy is difficult to follow due to the multiple revisions made to the national accounts recently. Nevertheless, with two declines in the last 3 quarters, Japan's economy is fragile, which should encourage the Bank of Japan to maintain an accommodating monetary policy for some time to come.

RATE TRENDS

- The Bank of Canada has announced a 0.25% cut in its policy rate to 4.75%. It is the first G7 central bank to ease monetary policy. Progress in slowing inflation has been convincing enough to reinforce the Bank's confidence that it will make a sustainable return to the 2% target. The Canadian economy grew at a slower pace (1.7%) than the Bank expected (2.8%) in the first quarter, held back by weaker inventory investment. The labor market is still expanding, but at a slower pace than population growth. As a result, the Canadian economy is once again in excess supply, easing pressure on consumer prices. Monetary policy therefore no longer needs to be as restrictive as before.

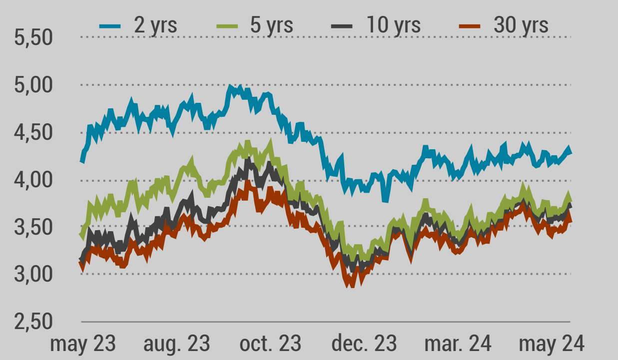
Canadians expecting successive aggressive rate cuts may be disappointed. The Bank has indicated that there are still risks surrounding the inflation outlook. The road to rate normalization will be fraught with pitfalls. Firstly, the Bank is aware that a rapid rate cut could rekindle overbidding in the real estate market, given the country's housing shortage. The effect on the currency of an aggressive cut in Canada without a U.S. response is also a consideration. The Bank does not seem overly concerned about the inflationary impact of a depreciating loonie, given the country's oversupply.

BOND RATES

May 31, 2024	Canada	Monthly Change	Change 2024	United States	Monthly Change	Change 2024
Key Interest Rate	5,00 %	0,00 %	0,50 %	5,50 %	0,00 %	0,25 %
3 months	4,80 %	-0,14 %	-0,25 %	5,40 %	0,01 %	0,07 %
2 years	4,18 %	-0,16 %	0,29 %	4,87 %	-0,16 %	0,62 %
5 years	3,68 %	-0,18 %	0,51 %	4,51 %	-0,21 %	0,66 %
10 years	3,63 %	-0,19 %	0,52 %	4,50 %	-0,18 %	0,62 %
30 years	3,48 %	-0,19 %	0,45 %	4,65 %	-0,14 %	0,62 %
RRB 30 years	1,56 %	-0,15 %	0,26 %			

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 2024	Change 10 yrs month	Change 10 yrs 2024	Change 30 yrs month	Change 30 yrs 2024
Royal Bank, Bail-in-debt	AA	110	145	175	5	-20	5	-20	5	-20
Royal Bank, NVCC	A	150	195	235	0	-35	0	-35	0	-35
Sun Life, subordinated debt	A	125	165	200	0	-40	0	-40	0	-35
Hydro One	A high	80	110	140	5	-5	5	-5	5	0
Enbridge Inc	BBB high	120	160	210	5	-10	0	-15	0	-10
Altalink LP	A	80	110	140	5	-5	5	-5	5	0
GTAA	A high	75	105	135	5	-5	5	-5	5	5
Bell Canada	BBB high	120	160	205	5	-5	5	-5	5	5
Rogers Communications	BBBL	130	170	215	5	-15	5	-15	5	-15
Loblaw	BBB high	105	145	180	5	0	5	5	5	5
Canadian Tire	BBB	130	175	220	5	10	5	15	5	15
Province Québec	AA low	37	72	94	-2	-1	0	6	-2	6
Province Ontario	AA low	38	70	91	-2	-2	-1	2	-3	1
CMHC	AAA	30	41	---	0	2	-1	-3		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bonds new issuance totalled $12 billion in May, up $6.2 billion on the previous month and $3 billion more than in May 2023. Year-to-date, bond financings total $50.1 billion, up 39% on the same period last year. The primary market was particularly active, with 27 different issues during the month, an average of more than one issue per business day.

- S&P has announced that it has upgraded Videotron's credit rating from BB+ to BBB-, bringing the Quebec-based telecom company's unsecured bonds into investment-grade territory for the agency. This rating change applies to both the issuer and the company's unsecured bonds. The rating agency justifies its decision by the decrease in the debt ratio, which should reach 3.2X EBITDA within 12 to 18 months, in line with a rating in the BBB category. "We expect the company to manage earnings and generate substantial cash flow in the face of increasing market competitiveness as it continues to grow its domestic wireless business, while protecting the profitability of its existing Quebec operations," S&P stated. Moody's followed suit later in May, also upgrading its rating for Videotron from Ba2 to Baa3 with a stable outlook. The Quebec cable operator is now investment grade.

- In early June, Coastal Gaslink completed the largest bond financing in Canadian corporate bond history. Coastal GasLink's 670 km pipeline project will feed shale natural gas from the Montney region of Western Canada to the Shell-led LNG Canada terminal on the West Coast. From there, it will be converted into liquefied natural gas and exported, mainly to Asia. This major project was completed last year, and the bond issue will be used to repay financing already in place. The company will have to borrow $7.1 billion in bonds, which will be divided into 11 tranches with maturities ranging from 2027 to 2049. Some aboriginal leaders are asking investors not to buy the bond, citing aboriginal rights violations, environmental and regulatory concerns, and financial risks.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	May 2024	2024
Universe	100 %	1,77 %	-1,49 %
Short Term	42,1 %	0,89 %	0,81 %
Mid Term	28,9 %	1,64 %	-1,47 %
Long Term	29,1 %	3,24 %	-4,92 %
Federal	40,1 %	1,48 %	-1,39 %
Provincial	33,7 %	2,37 %	-2,81 %
Corporates	24,4 %	1,39 %	0,20 %
RRB		3,05 %	-2,35 %

Source: ftse.com

Credit agency telecom ratings are converging towards BBB. Although Vidéotron has managed to improve its financial ratios of late, it will face the same challenges as other companies in this sector. Canadian immigration policy in recent years has made it easier to sell packages to new customers. The decrease in temporary immigration will complicate the task for future sales.

Although this is the largest corporate bond issue in Canadian history, information about this issuer is difficult to obtain. The agencies have assigned a credit rating to the company (A low), but these are difficult to access, as they are not public. This opacity should be a source of discomfort for creditors, who find it difficult to carry out a due diligence analysis.

STRATEGIC POSITIONNING

After two years of tightening financial conditions to fight inflation, it's time for some central banks to turn back the clock. This is particularly true of the Bank of Canada and the European Central Bank, which have each announced a 0.25% reduction in their key rates. Inflationary pressures have eased in these two regions due to excess supply in the economy. This is not yet the case in the United States, where demand still exceeds supply in various spheres of the economy, notably employment. However, the labor market seems to be rebalancing further as the ratio of vacancies per unemployed person has returned to its pre-pandemic level. It is becoming increasingly important to monitor the evolution of the labor market, as households can no longer use the accumulated savings from the pandemic for shopping. According to the latest available statistics, this excess savings will soon run out, forcing consumers to rely more on their employment income for spending. High interest rates and more restrictive loan underwriting criteria are also weakening consumer demand for financed items. In short, if the job market rebalances and wage pressure eases, household demand should slow from the pace of recent years. This could open the door for the Federal Reserve to ease monetary policy, but there are still months to go before this becomes a reality.