MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

DECEMBER 2024

- Canadian real estate is showing signs of improvement. Housing starts jumped by almost 20,000 units to an annualized rate of 262,400 units in November. The monthly average for the first 11 months is 246,000, 5,000 more than last year. New single-family home construction rose by 2.6% on a monthly basis, while multiple-unit construction jumped by 10.2%. Home resales also rose by 2.8% in November, after jumping 7.7% in October. For the first 11 months of the year, sales are up 6.9% compared to the same period last year. The stock of unsold homes has been shrinking, so that at the current rate of sales, it would take 3.7 months to clear the inventory.

The cut in policy rate has given a boost to pent-up demand, which had been waiting for some financial respite before jumping into real estate. The new mortgage rules in effect since December 15 should also bolster demand. The ceiling for obtaining a CMHC-insured mortgage has been raised from $1 million to $1.5 million, while first-time buyers and those purchasing a new property will be able to amortize their mortgage over 30 years. The Bank of Canada will have to keep a close eye on real estate activity in early 2025 to avoid any further overbidding.

- The U.S. consumer price index rose by 0.3% in November, bringing the annual growth to 2.7%, up 0.1% from October (2.6%). Food prices climbed 0.4% in November, while energy prices rose 0.2%. Excluding these items, core inflation rose by 0.3% in November and 3.3% year-on-year. A number of factors contributed to monthly price growth last month. These included housing (+0.3%), health care (+0.4%), as well as new (+0.6%) and used (+2.0%) vehicles. This is the second monthly reading of over 2% for second-hand vehicles.

Inflation remains uncomfortably persistent for a central bank. Annual core inflation rate has remained at 3.3% for the past three months, and the progress made at the start of the year has stagnated recently. As the market awaits Trump's expansionary economic measures, the key rate could halt at a higher-than-expected level to ease inflationary pressures in an economy already in excess demand.

- For the first time since the pandemic, the British economy posted two consecutive months of contraction. After declining by 0.1% in September, GDP fell by a further 0.1% in October. Goods production and construction contracted, while service industries stagnated. The British economy was therefore showing signs of weakness before the new government tabled its budget on October 30th. The budget called for increased government spending and investment, partly financed by a rise in employers' social security contributions.

Despite this economic slowdown, the Bank of England remained on the sidelines in December, keeping its key rate at 4.75% at its meeting. The economy is fragile, but services inflation is out of control (+5.0%) under the influence of persistently high wage increases (+5.2%). The Bank also does not know how companies will react to tax increases. Will they pass them on to customers, or absorb them into their margins?

RATE TRENDS

- The Bank of Canada did not want to disappoint investors' expectations, and lowered its key rate by 0.50% to 3.25% at the end of its December meeting. At its current level, the policy rate has returned to the neutral rate range estimated by the Bank (2.25% to 3.25%). The Bank listed several factors justifying its decision. Economic growth in the third quarter was weaker than expected, the unemployment rate climbed to 6.8% in November, and the federal government's new immigration policy should slow GDP growth next year compared with the Bank's forecasts. Tariff risks also cloud the economic outlook, but do not appear to be a decisive factor. On the other hand, the Bank acknowledges that its monetary easing is beginning to stimulate household spending and real estate activity.

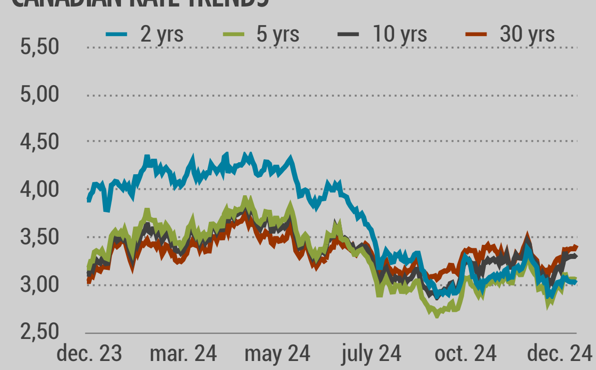
From here on in, monetary policy is no longer on a predetermined course. Indeed, the Bank has indicated that it will assess the need for further cuts one meeting at a time. Several factors could alter the direction of policy. Tariffs on Canadian exports to the U.S. are certainly a disruptive factor for the Canadian economy, and would force further aggressive cuts. On the other hand, the rapid reduction in the key rate this year and the new mortgage rules that came into effect on December 15 could stimulate the real estate market and rekindle bidding wars.

BOND RATES

Dec. 31, 2024	Canada	Monthly Change	Change 2024	U.S.	Monthly Change	Change 2024
Key Interest Rate	3,25 %	-0,50 %	-1,75 %	4,50 %	-0,25 %	-1,00 %
3 months	3,14 %	-0,28 %	-1,91 %	4,31 %	-0,18 %	-1,02 %
2 years	2,93 %	-0,11 %	-0,96 %	4,24 %	0,09 %	-0,01 %
5 years	2,97 %	0,02 %	-0,21 %	4,38 %	0,33 %	0,53 %
10 years	3,23 %	0,14 %	0,12 %	4,57 %	0,40 %	0,69 %
30 years	3,33 %	0,20 %	0,30 %	4,78 %	0,42 %	0,75 %
RRB 30 years	1,45 %	0,10 %	0,15 %			

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	80	105	140	-5	-50	-5	-60	-5	-55
Royal Bank, NVCC	A	125	160	205	0	-60	0	-70	0	-65
Sun Life, subordinated debt	A	95	135	175	-5	-70	-5	-70	-5	-60
Hydro One	A high	60	90	120	0	-25	0	-25	0	-20
Enbridge Inc	A low	90	125	175	0	-40	-5	-50	-5	-45
Altalink LP	A	60	90	120	0	-25	0	-25	0	-20
GTAA	A high	55	85	115	0	-25	0	-25	0	-15
Bell Canada	BBB high	100	145	190	-5	-25	0	-20	-5	-10
Rogers Communications	BBBL	105	150	190	-5	-40	0	-35	-5	-40
Loblaw	BBB high	75	115	160	-5	-30	-5	-25	-5	-15
Canadian Tire	BBB	105	145	195	-5	-15	-5	-15	-5	-10
Province Québec	AA low	24	65	90	-1	-14	0	-1	3	2
Province Ontario	AA low	24	62	86	-3	-16	-2	-6	2	-4
CMHC	AAA	13	36	---	-5	-15	-3	-8		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bonds new issuance totaled $11.6 billion in December, up $8.3 billion on the previous month and $3.9 billion more than in December 2023. For the year 2024, bond financing totals $126.3 billion, a new annual record in terms of new issues. This represents an increase of 33% on 2023, and 6% more than the previous record set in 2021. Investor demand did not dry up in December. Yield spreads on corporate bonds continued to tightened, enabling corps to produce the best sectoral performance at each part of the yield curve in 2024.

- Moody's has rewarded National Bank for its sound management by upgrading its credit rating from Baa1 to A3. This upgrade means that the Limited Recourse Capital Notes (LRCN) move from the High Yield Bond category (Ba1) to the Investment Grade category (Baa3). Moody's justifies this decision by "National Bank's strong and stable profitability supported by a disciplined growth strategy, the high quality of its assets and capital position, and the healthy levels of funding and liquidity that protect it against market shocks". National Bank's activities are also well diversified, making the bank's sales less dependent on volatile capital market revenues. This sound management has enabled National Bank to report financial results superior to those of its Canadian peers.

- Economic updates continued in December with British Columbia. Halfway through its fiscal year, the western province reported a slightly higher deficit than budgeted. The province's revenues were in line with budget forecasts ($81.4 billion vs. $81.5 billion), but expenses increased by $1.5 billion to $90.9 billion. The deficit now stands at $9.4 billion, or 2.2% of the province's GDP. The increase in spending is largely attributable to health care and other services offered to the population. The province's debt has also risen, from 18.4% of GDP at the end of the last fiscal year to 22.3% at the time of this update. In this respect, only Alberta (8%) and Saskatchewan (14%) fare better.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Dec. 2024	2024
Universe	100 %	-0,69 %	4,23 %
Short Term	41,2 %	0,38 %	5,70 %
Mid Term	31,1 %	-0,28 %	4,65 %
Long Term	27,8 %	-2,68 %	1,35 %
Federal	40,5 %	-0,43 %	3,48 %
Provincial	32,7 %	-1,42 %	3,10 %
Corporates	25,0 %	-0,14 %	6,97 %
RRB		-0,76 %	3,73 %

Source: ftse.com

Despite a difficult economic environment in 2024, the National Bank has managed to pull through with flying colors. With the key interest rate cut by 1.75% in 2024, we can't rule out the possibility of a recovery in the real estate market in 2025, which would improve the bank's financial results. On the other hand, the risks of a trade war with the United States would be an issue for all Canadian banks.

The province's debt ratio is low, but fiscal discipline is still the appropriate course of action given the risks to public finances. Whether it's lower population growth, future mortgage refinancings, tariffs or climate change causing forest fires, the province must continue its sound management of public finances.

STRATEGIC POSITIONNING

Several central banks continued their monetary easing in December, but the pace could slow in coming months. Following the lead of the Bank of Canada, the European Central Bank and the Federal Reserve eased monetary policy, each cutting its key rate by 0.25% in December. The Fed decision was widely expected, but investors turned their attention to the summary of economic projections. This shows that the Federal Reserve will adopt a cautious approach at its next meetings. Instead of lowering the cost of money by 1.0% in 2025, as planned in September, committee members now expect two cuts for a total of 0.50%. In his speech, the Fed Chairman mentioned that the policy rate is now close to neutral and that monetary policy is still somewhat restrictive. Committee members expect growth to accelerate in 2025 and inflation to remain persistent. Without having clearly identified it, the members seem to have taken into account the various economic policies of the next Trump administration in their economic assessments. Excess demand in the economy will be further stimulated by the measures put forward by Trump, while tariffs could accentuate the inflationary pressures already present. The bulk of the monetary easing in the US seems to be behind us, with only fine-tuning left to do.