MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

FEBRUARY 2024

- Canadian GDP grew at an annualized rate of 1.0% in the fourth quarter, following a contraction in the previous quarter (-0.5%). Our exports surged by 5.7%, notably oil and crude bitumen exports. Imports were down over the period (-1.6%), so international trade made a significant contribution to economic expansion. Household consumption expenditure accelerated (+0.8%) compared with the previous quarter (+0.4%), propelled by purchases of vehicles and sport utility vehicles, reflecting improved supply problems. Residential construction investment declined despite the housing shortage across the country, while business investment posted its sixth quarterly decline in the last 7 quarters.

All in all, final domestic demand, which excludes international trade and changes in inventories, contracted (-0.7%), reflecting an economy weakened by monetary policy. For example, households increased their consumption, but the population grew at a higher rate, so that per capita consumption was down for the third consecutive quarter. Growth looks set to pick up in January, when the resolution of the Front Commun labour dispute in Quebec will allow the economy to rebound.

- The US consumer price index rose by 0.3% in January, bringing the annual change to 3.1% from 3.4% in December. Excluding food (+0.4%) and energy (+0.5%), core inflation rose by 0.4% in January and by 3.9% over 12 months, i.e. 0.2% more than in December. This acceleration was driven by service prices, notably those excluding energy (+0.7%). Additional price pressures on housing (+0.6%), medical services (+0.7%) and transportation services (+1.0%) explain the growth in services inflation. What's more, prices for services excluding food, energy and housing rose by 0.85% in January, and by 4.3% over the past year. This is a higher rate than last December (3.9%).

The battle against inflation is not over. Instead of falling towards 2%, some core inflation measures are accelerating. The Federal Reserve would like to see a sustained and convincing decline in inflation towards its 2% target. Considering that investors are still expecting monetary easing to begin in early summer, this doesn't leave much time for the Fed to be convinced.

- The UK consumer price index fell by 0.6% in January, but the annual inflation rate still remained at 4%, as prices had also fallen in January 2023. Excluding changes in food and energy prices, core inflation also remained unchanged at 5.1%. This stability should be encouraging for the Bank of England, but inflation is still too high, especially for service prices (6.5%), which have been on the rise for the past 2 months.

Certainly, continued high wage growth (6.2%) is fuelling inflation in the service industries, where the wage bill is an important component of costs. Although the British economy has been faltering of late, inflation is too high and sustained to prompt the Bank to ease financial conditions.

RATE TRENDS

- Investors have toned down their enthusiasm for monetary easing since the start of the year. At the end of 2023, U.S. policy rate futures were expecting 6 cuts over the course of the year, which would have brought the policy rate to 4% by December 2024. On the Canadian side, investors were expecting the Bank of Canada to cut its rate 4 times, bringing it to 4% by the end of the year. The persistence of inflation and the strength of certain economic indicators over the past 2 months have changed investors' outlooks. At the end of February, 4 cuts of 0.25% were expected in the U.S. and 3 in Canada. Investors who were betting on a hard landing for the US economy are now expecting a soft landing, or perhaps none at all.

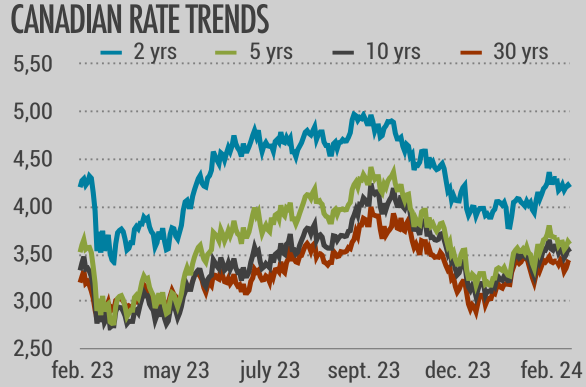
While the outlook for monetary policy easing at the end of 2023 seemed overly optimistic given the robustness of the U.S. economy, what is more surprising is the timidity of the anticipated cuts in Canada compared to our neighbors. Monetary tightening in Canada put the brakes on the Canadian economy in 2023, but this was not the case in the United States. On the contrary, the economy grec strongly last year. If U.S. inflation comes down convincingly without slowing the economy, the Fed could cut its key rate slightly, but there's no reason why the Bank of Canada shouldn't be more aggressive in its monetary easing.

BOND RATES

Feb. 29, 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 %	0,75 %
3 months	4,97 %	-0,05 %	-0,08 %	5,38 %	0,02 %	0,05 %
2 years	4,18 %	0,21 %	0,29 %	4,62 %	0,41 %	0,37 %
5 years	3,57 %	0,17 %	0,40 %	4,24 %	0,40 %	0,40 %
10 years	3,49 %	0,17 %	0,38 %	4,25 %	0,34 %	0,37 %
30 years	3,36 %	0,11 %	0,33 %	4,38 %	0,21 %	0,35 %
RRB 30 years	1,52 %	0,01 %	0,22 %			

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	-10	-20	-10	-20	-10	-20
Royal Bank, NVCC	A	160	205	245	-10	-25	-10	-25	-10	-25
Sun Life, subordinated debt	A	140	180	210	-5	-25	-5	-25	-5	-25
Hydro One	A high	70	105	130	-10	-15	-5	-10	-10	-10
Enbridge Inc	BBB high	125	165	215	-5	-5	-5	-10	-5	-5
Altalink LP	A	70	105	130	-10	-15	-5	-10	-10	-10
GTAA	A high	65	100	125	-5	-15	0	-10	0	-5
Bell Canada	BBB high	115	155	195	-5	-10	-5	-10	-5	-5
Rogers Communications	BBBL	130	170	215	-5	-15	-5	-15	-5	-15
Loblaw	BBB high	105	145	175	0	0	5	5	-5	0
Canadian Tire	BBB	125	170	210	5	5	10	10	0	5
Province Québec	AA low	38	70	90	-1	0	2	4	2	2
Province Ontario	AA low	39	69	89	-2	-1	-1	1	0	-1
CMHC	AAA	27	41	---	-2	-1	1	-3		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance totalled $10 billion in February, down $2.6 billion on the previous month, but $4.7 billion more than in February 2023. Year-to-date, bond financing totals $22.6 billion, up 49% on the same period last year. As Canadian banks went in black-out mode awaiting financial results announcements, they did not participate in the new issue calendar in February. On the other hand, automotive finance companies were active. GM Financial of Canada, Ford Credit Canada and Honda Canada Finance collectively borrowed $2 billion during the month.

- Canada's six major banks have announced their financial results for the first quarter of their fiscal year. Bank revenues reached $52.2 billion, an increase of 5% over the same period last year. This increase slightly outpaced nominal GDP growth in Canada last year (4.0%). They also increased provisions for credit losses to $4.1 billion from $2.5 billion last year. Despite this prudent credit management, five of the six major Canadian banks reported better-than-expected results. Collectively, first-quarter earnings totalled $12.5 billion, up 17% on the same period last year. Operating expenses rose by 3% over the same period, but tax expenses were significantly lower (-46%) than last year.

- Provincial budget season is underway. British Columbia expects to increase its deficit from $5.9 billion in the current fiscal year to $7.9 billion in fiscal 2024-25. A return to balanced budgets is not expected for the next few years. Revenues are expected to grow as the population increases, but the pace of spending will be higher to help families with the rising cost of living. Meanwhile, Alberta has announced that its budget surplus will fall from $5.2 billion for the fiscal year ending at the end of March to $367 million for fiscal 2024-25. This decrease is attributable to lower oil royalties and increased spending to provide more health and education services to a population growing through immigration.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Feb. 2024	2024
Universe	100 %	-0,34 %	-1,71 %
Short Term	42,1 %	0,03 %	-0,15 %
Mid Term	29,2 %	-0,59 %	-1,80 %
Long Term	28,7 %	-0,65 %	-3,91 %
Federal	39,7 %	-0,47 %	-1,67 %
Provincial	33,3 %	-0,60 %	-2,63 %
Corporates	25,2 %	0,21 %	-0,47 %
RRB		-0,30 %	-3,24 %

Source: ftse.com

The increase in profits is largely attributable to lower taxes. Last year, the banks had to take a one-off tax called the Canadian Recovery Dividend, as the government felt that the banks benefited from a faster and more vigorous recovery than other sectors after Covid. Notwithstanding the tax, the results still testify to a banking sector in good financial health.

Finance ministers are taking a cautious approach to public finances in anticipation of an economic slowdown in 2024. On the other hand, they are also dealing with a growing population, which increases the spending envelope for essential public services. In the case of British Columbia, however, the government wanted to be more generous in this election year.

STRATEGIC POSITIONNING

In the last three months of last year, bond yields fell rapidly as investors banked on aggressive rate cuts throughout the year. These rate cuts were not an admission of a likely recession, as these same investors pushed stock market values to new highs while investing in high-yield corporate bonds. True, inflation is slowing, but the progress is not convincing enough to justify an aggressive rate cut. The U.S. economy is robust and growing faster than its production capacity. Excess demand in the labor market is persistent, but less pronounced than in 2022. This economic strength is delaying the achievement of the inflation target and justifies the maintenance of a restrictive monetary policy for some time to come. On the other hand, economic conditions in Canada are more fragile. GDP per capita is down for the third quarter running, and demand continues to grow more slowly than potential output, creating excess supply. This excess supply reduces pressure on certain prices in the economy, except in the case of housing, which is structurally in deficit. As a result, the Canadian economy needs a monetary stimulus over and above that of the United States. While investor enthusiasm for the upcoming cuts in the U.S. has faded over the past two months, the expected cuts in Canada are illogically smaller.