MONTHLY BOND LETTER

AlphaFixe Capital

JUNE 2024

ECONOMIC EVENTS

- Canada's consumer price index rose by 0.6% in May, bringing annual growth to 2.9% from 2.7% in April. Gasoline was less expensive in May, pushing energy prices down by 1.1% last month. However, this was offset by a 0.9% rise in food prices. Excluding these two volatile items, the core inflation index also posted a 0.6% rise in May. This growth is mainly attributable to services prices, which jumped by 1% in May and 4.6% over the past year. Housing continues to be a major source of inflation, with an annual rise of 6.4%, mainly due to rental prices (+8.9%). Other major contributors to index growth last month were tour package prices (+10.4%), airline tickets (+16%) and restaurant bills (+0.6%).

Admittedly, there is a seasonal effect behind the demand for travel and airfares heading into the summer vacations, but most of these items constitute discretionary household spending and reflect households' relative comfort with their budgets. For the Bank of Canada, these data do not point in the right direction. The two indices the Bank tracks, the median and trimmed-mean CPI also showed an acceleration. These figures show that the road to sustainable inflation at 2% will be fraught with difficulties, and that we need to proceed with caution.

- The real estate market has been going through a rough patch recently. New home sales fell by 11.3% in May to an annualized rate of 619,000 units. However, this decline was amplified by a sharp upward revision of sales in April. Instead of 634,000, April sales now stand at 698,000, accounting for a large portion of the decline in May. Nevertheless, activity has slowed of late, and building contractors are finding themselves with a growing stock of unsold homes. At the end of May, there were 481,000 homes in inventory, compared with 426,000 at the same time last year. Based on the pace of sales, contractors could have cleared their inventory of homes in 7 months last year, but now they have to wait 9.3 months.

This increase in unsold homes means fewer building permits issued (-2.8% in May) and fewer housing starts (-5.5% in May). Demand for housing still seems to be there, but households are surely waiting for more affordable financial conditions to buy a home, as was the case at the end of last year. The slowdown in new construction activity could therefore slow GDP growth in the second quarter.

- Like Canada, inflation has not said its last word in Australia. The consumer price index now shows annual growth of 4% in May, compared with 3.6% in April. This is the third consecutive month of accelerating inflation. What's more, several items in the basket recorded higher rates of price growth. These included housing (5.2% vs. 4.9% in April) and, more specifically, electricity rates (6.5% vs. 4.2%). Prices also accelerated for clothing and transport.

This pace is double the central bank's target. At the end of its last meeting, the Central Bank of Australia did not rule out any option, even further monetary tightening, given the risks associated with rising inflation. The possibility of a rate hike will certainly be on the agenda at the August 6 meeting.

RATE TRENDS

- Not surprising, the Federal Reserve kept its policy rate again at its June meeting. The Fed acknowledged that inflation is improving, calling the progress modest rather than insufficient. The consumer price index shows that inflation slowed in May, rising by 3.3% year-on-year instead of 3.4%. Core inflation also fell by 0.3% to 3.4% year-on-year. The decision to keep the policy rate at 5.5% came as no surprise, but the monetary policy projections for the current year did. Fed members now expect to have to cut the key rate only once in 2024, compared with 3 cuts forecast when the summary of economic projections was last published in March.

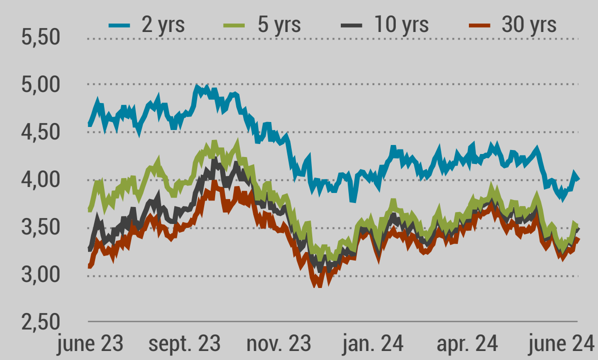
The Federal Reserve is giving itself a few more months to accumulate evidence of a sustainable deceleration in inflation before easing monetary policy. Of course, disinflation is timid, but the Fed also needs to keep an eye on the state of the labor market. In this respect, employment appears to be more balanced than before. Continuing jobless claims is still rising and have recently reached their highest level since November 2021. It is therefore taking longer for the unemployed to return to the job market. A sluggish job market will give the Fed more conviction to initiate rate cuts.

BOND RATES

June 30, 2024	Canada	Monthly Change	Change 2024	United States	Monthly Change	Change 2024
Key Interest Rate	4,75 %	-0,25 %	0,00 %	5,50 %	0,00 %	0,25 %
3 months	4,66 %	-0,14 %	-0,40 %	5,35 %	-0,05 %	0,02 %
2 years	4,00 %	-0,18 %	0,11 %	4,75 %	-0,12 %	0,50 %
5 years	3,51 %	-0,17 %	0,34 %	4,38 %	-0,13 %	0,53 %
10 years	3,50 %	-0,13 %	0,39 %	4,40 %	-0,10 %	0,52 %
30 years	3,39 %	-0,09 %	0,36 %	4,56 %	-0,09 %	0,53 %
RRB 30 years	1,49 %	-0,07 %	0,19 %			

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 2022	Change 10 yrs month	Change 10 yrs 2022	Change 30 yrs month	Change 30 yrs 2022
Royal Bank, Bail-in-debt	AA	110	145	175	0	-20	0	-20	0	-20
Royal Bank, NVCC	A	150	195	235	0	-35	0	-35	0	-35
Sun Life, subordinated debt	A	130	170	205	5	-35	5	-35	5	-30
Hydro One	A high	85	115	145	5	0	5	0	5	5
Enbridge Inc	A low	120	160	210	0	-10	0	-15	0	-10
Altalink LP	A	85	115	140	5	0	5	0	0	0
GTAA	A high	75	105	135	0	-5	0	-5	0	5
Bell Canada	BBB high	125	165	210	5	0	5	0	5	10
Rogers Communications	BBBL	130	175	220	0	-15	5	-10	5	-10
Loblaw	BBB high	105	145	180	0	0	0	5	0	5
Canadian Tire	BBB	130	175	220	0	10	0	15	0	15
Province Québec	AA low	37	70	94	0	-1	-2	4	0	6
Province Ontario	AA low	38	69	92	0	-2	-1	1	1	2
CMHC	AAA	26	41	---	-4	-2	0	-3		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bonds new issuance totalled $19.5 billion in June, up $7.5 billion on the previous month and $10.5 billion more than in June 2023. Year-to-date, bond financing totals $60.6 billion, up 31% on the same period last year. This is the second busiest month in history for new corporate bond issuance. Among the contributing issuers was the inaugural financing of Coastal Gaslink Pipeline, with $7.1 billion of debt spread over 11 different bonds with maturities ranging from 2027 to 2049.

- Bank consolidation in Canada continued in June. After Royal Bank's purchase of HSBC Canada last year, it was now National Bank's turn to announce plans to acquire Canadian Western Bank (CWB) for $5 billion. This amount represents a 110% premium over the market value of this Alberta-based bank. CWB has total assets of $42.3 billion, including a loan portfolio of $37 billion. The acquisition is attractive for National Bank, as it enables it to expand its portfolio in under-exploited markets such as equipment financing. CWB also has an interesting wealth management division. The two banks' assets do not cannibalize each other, and National Bank will be able to benefit from synergies in cost structure. CWB customers will also be able to benefit from the capital markets services offered by National Bank.

- Last year's slowdown in the Canadian economy appears to be disrupting the final tally of some provincial budgets for the 2023-2024 fiscal year. Alberta's surplus reached $4.3 billion, compared with $5.2 billion when the budget was tabled in March. This decline is mainly attributable to a downward revision of approximately $1 billion in provincial revenues. A similar observation applies to the budget for the province of Quebec. For the 2023-24 fiscal year, the province's deficit totals $5.4 billion, an increase of $1.2 billion compared to the forecast announced last March. Here too, the downturn is due to a drop in revenues compared with the Finance Minister's expectations.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	June 2024	2024
Universe	100 %	1,13 %	-0,38 %
Short Term	42,0 %	0,75 %	1,57 %
Mid Term	30,3 %	1,19 %	-0,30 %
Long Term	27,8 %	1,60 %	-3,39 %
Federal	40,2 %	1,03 %	-0,37 %
Provincial	33,0 %	1,35 %	-1,50 %
Corporates	25,0 %	0,96 %	1,16 %
RRB		1,60 %	-0,78 %

Source: ftse.com

Although the transaction still requires the approval of CWB shareholders and regulatory authorities, it is unlikely to be blocked by the authorities. The latter gave the green light to the deal that married HSBC and Royal Bank last year. All eyes now turn to Laurentian Bank, which was the subject of acquisition rumours last year.

More precarious public finances in Quebec than in Ontario are at the root of the widening bond yield spreads between the two provinces. Economic growth for the current fiscal year (2024-25) will also be slower, mainly due to lower population growth in Quebec than in Ontario, which attracts temporary immigration.

STRATEGIC POSITIONNING

There seems to be a shift in the direction of monetary policy in industrialized countries. On the one hand, the Bank of Canada and the European Central Bank have begun their monetary easing with respective 0.25% cuts in their key rates. On the other hand, the Federal Reserve continues to postpone the date on which it deems that monetary easing will be required, given the risks associated with a resurgence in inflation. Whereas it had previously expected to cut its key rate 3 times when the economy was in excess demand, the Fed now anticipates a single cut in 2024, when economic activity is showing signs of exhaustion. Excess savings have all but run out, while restrictive financial conditions are weakening demand for credit consumption. In the future, household spending will evolve more in line with labour market income. The job market is gradually coming back into balance, which weakens pressure on wages and could reduce the pace of spending. On the other hand, wage growth in Canada is still brisk. The unionization rate in Canada is 29.4%, compared with 10.3% for our neighbors to the south. As a result, wage adjustments are slower to take effect in Canada, as collective bargaining agreements spanning several years are not all renegotiated. This could complicate the Bank of Canada's task of controlling services inflation, and dampen its intentions to ease monetary policy.