MONTHLY BOND LETTER

AlphaFixe Capital

FEBRUARY 2025

ECONOMIC EVENTS

- Canadian GDP ended the year on a strong note, up 2.6% quarter-on-quarter on an annualized basis. This follows a revised GDP growth of 2.2% in the previous quarter (originally 1.0%). Household consumer spending (+5.6%) propelled the economy, particularly vehicle purchases, as households sought to secure the full subsidy for electric vehicles. Monetary easing also helped the residential real estate sector, which posted a second-quarter gain with growth of 16.5%, the highest pace in 4 years. Businesses also contributed, increasing investment by 8% in the quarter. However, they cut back sharply on inventory, which subtracted 3.3% from fourth-quarter GDP. Tariff threats also boosted growth. Exports jumped by 7.4%, or 2.0% more than imports.

As a result, final domestic demand, which excludes changes in inventories and international trade, jumped 5.6% last quarter, the most robust growth since 2017, excluding the pandemic of course. And the good news doesn't stop there. According to initial estimates from Statistics Canada, GDP was also up 0.3% in January. This increase may be attributable to exports to the United States and a build-up of inventories. This economic impetus will be beneficial, but the imposition of 25% tariffs on our exports could quickly put the brakes on growth.

- A sense of mistrust is setting amongst American consumers since the president's inauguration, according to the Conference Board. The Conference Board's consumer confidence index fell 7 points in February to 98.3. After Donald Trump's election in November, the same indicator had jumped to 112.8. This is the biggest monthly drop in confidence since August 2021. There is little change in household perceptions of current conditions, rather it's the outlook for the next 6-12 months that Americans are worried about. Consumers are also worried about inflation. Inflation expectations for the coming year have risen from 5.2% in January to 6.0% a month later.

The Trump administration's confrontational trade policy is of great concern to consumers, who perceive a risk of stagflation. Instead of initially emphasizing his pro-growth policies (tax cuts and deregulation), the new tenant of the White House prefers to embark on various trade conflicts with even his most loyal partners. With this administration, geopolitical factors will have a major impact on economic activity and the direction of financial markets.

- According to a preliminary reading, inflation in Europe rose by 0.5% in February and by 2.4% year-on-year. Energy prices rose less rapidly (0.2% vs. 1.9% in January), while food inflation accelerated (3.1% year-on-year vs. 1.4% in January). Excluding these volatile elements, core inflation is up by 2.6% year-on-year, or 0.1% less than in January. This disinflation is attributable to services prices, which rose by 3.7% year-on-year in February, compared with 3.9% the previous month.

This disinflation should encourage the ECB to continue its monetary easing this year. However, several events could derail investors' outlook. How will the war in Ukraine evolve? Will the US impose tariffs? Will Germany allow large deficits? These are all questions that will change the course of the economy and monetary policy in 2025.

RATE TRENDS

- With no statutory central bank meetings during the month of February, the bond market moved in step with concerns about the trade wars being waged by the USA against its various business partners. Although Canada and Mexico benefited from a reprieve during February, the uncertainty still reduced household confidence while raising inflation expectations. As a result, bond yields have adjusted to this new reality of uncertainty, which will slow economic growth. Moreover, the Bank of Canada has indicated that its monetary policy toolbox is limited when it comes to tariffs. Tariffs will slow economic growth, while raising inflation on imported and tariffed products. The Bank cannot act on these two opposing forces.

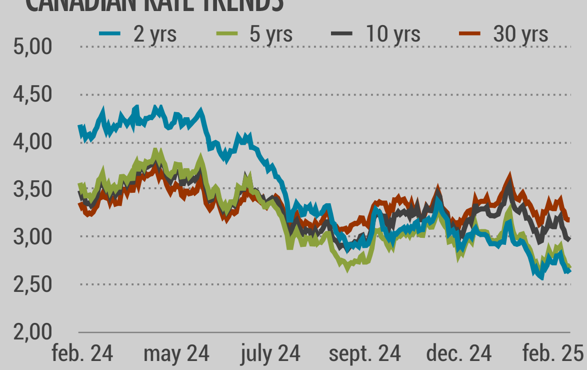
The Bank of Canada is likely to use a moderate and patient approach in conducting its monetary policy in response to the US tariffs. Before aggressively stimulating the economy with sharply lower rates, the Bank will want to assess how long this conflict will last (and Trump changes his mind quickly) and the governments' fiscal response to this unjustified war. A colossal spending program coupled with a very expansionary monetary policy could lead to another episode of inflation if the conflict is resolved quickly. The Bank would not want to make a U-turn with its monetary policy to limit uncertainty.

BOND RATES

Feb, 28, 2025	Canada	Monthly Change	Change 2025	USA	Monthly Change	Change 2025
Key Interest Rate	3,00 %	0,00 %	-2,00 %	4,50 %	0,00 %	-1,00 %
3 months	2,83 %	-0,03 %	-0,31 %	4,29 %	0,01 %	-0,02 %
2 years	2,57 %	-0,08 %	-0,36 %	3,99 %	-0,21 %	-0,25 %
5 years	2,61 %	-0,12 %	-0,36 %	4,02 %	-0,31 %	-0,36 %
10 years	2,90 %	-0,17 %	-0,33 %	4,21 %	-0,33 %	-0,36 %
30 years	3,12 %	-0,12 %	-0,21 %	4,49 %	-0,30 %	-0,29 %
RRB 30 years	1,23 %	-0,06 %	-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 2025	Change 10 yrs month	Change 10 yrs 2025	Change 30 yrs month	Change 30 yrs 2025
Royal Bank, Bail-in-debt	AA	85	110	145	0	5	0	5	0	5
Royal Bank, NVCC	A	135	170	215	5	10	5	10	5	10
Sun Life, subordinated debt	A	115	150	190	10	20	5	15	5	15
Hydro One	A high	65	100	130	0	5	0	10	5	10
Enbridge Inc	A low	110	150	195	5	20	10	25	10	20
Altalink LP	A	65	100	130	0	5	0	10	5	10
GTAA	A high	60	95	120	0	5	0	10	0	5
Bell Canada	BBB high	115	155	195	5	15	0	10	-5	5
Rogers Communications	BBBL	115	155	195	0	10	-5	5	-5	5
Loblaw	BBB high	90	130	170	5	15	0	15	0	10
Canadian Tire	BBB	115	155	200	0	10	-5	10	-5	5
Province Québec	AA low	27	65	95	1	3	-1	0	1	5
Province Ontario	AA low	28	63	92	0	4	-1	1	0	6
CMHC	AAA	16	36	---	-1	3	-3	0		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bonds new issuance totalled $11.1 billion in February, down $600 million on the previous month, but $1.1 billion more than in February 2024. Year-to-date, bond financing totals $22.8 billion, up 1% on the same date last year. The energy industry has been busy on the primary market, with TransCanada Pipeline and Enbridge raising $2.8 billion. Both companies will use the proceeds of these new bonds to refinance existing debt, for general corporate purposes and to finance capital projects in the case of Enbridge.
- Tariff threats from the USA are having major financial consequences for the North American automotive industry, especially for Michigan's big 3 manufacturers. Among these, Stellantis, owner of Dodge, Ram and Chrysler among others, has had its credit rating downgraded from BBB+ to BBB by S&P. In its report, the agency indicated that it does not expect Stellantis to absorb the cost of the tariffs, but rather to pass it on to customers and transfer part of its assembly to the USA. The automaker had already announced cautious sales forecasts for 2025 after a drop in activity last year. Trump's tariffs complicate the implementation of the price-cutting strategy adopted by the automaker at the end of last year to boost sales. S&P is therefore concerned about the outlook for the manufacturer's profit margins.
- The uncertainty caused by the trade dispute with the United States was reflected in the new provincial budgets. Assuming a 15% tariff on Canadian exports to the U.S. and a 10% tariff on energy products, the province of Alberta has presented a $5.2 billion budget deficit for fiscal 2025-26. This represents a reversal of $11 billion between last year's surplus and this year's projected shortfall. In addition to tariffs, new immigration rules are also expected to dampen economic growth in 2025 and next year. Of the projected deficit, $4 billion is a provision for contingencies, not direct spending. Revenues are expected to fall by 8.1% over the period, while spending is set to rise by 0.6%.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Feb. 2025	2025
Universe	100 %	1,10 %	2,31 %
Short Term	39,6 %	0,46 %	1,35 %
Mid Term	31,8 %	1,24 %	2,71 %
Long Term	28,5 %	1,86 %	3,24 %
Federal	40,8 %	1,06 %	2,32 %
Provincial	32,7 %	1,37 %	2,62 %
Corporates	24,7 %	0,79 %	1,86 %
RRB		1,20 %	3,82 %

Source: ftse.com

Stellantis is the lame duck of the 3 American manufacturers, but they all face the same problems and the same political pressure. The complex integration of assembly lines in North America is a headache for manufacturers who want to cut costs. Building a new plant will take time and increase selling prices. Ultimately, consumers will bear the price.

The government is banking on an oil price of US$68 (WTI) this year, surely too high in the eyes of the new American president, who is seeking to mitigate the inflationary impact of his policies. The Alberta government has considerable leeway to support its economy. The province's debt-to-GDP ratio would be 8.7% after the fiscal 2025-26 deficit.

STRATEGIC POSITIONNING

This is it. We've been dreading it for weeks, and now it's finally here. The Trump administration has made good on its threat by launching an unjustified trade war against the Canadian economy. We all know that the justification for fentanyl and immigration doesn't hold water. The real pretext is that he wants companies to move and produce in the U.S. to avoid tariffs. The only problem is that they don't have enough manpower to repatriate all manufacturing production, especially if he adopts immigrant deportation measures. The argument that a trade deficit means its trading partners are taking advantage of the U.S. is false. The U.S. has recorded a trade deficit every year since 1982, while Germany and Japan have recorded surpluses. Nevertheless, economic growth in the US has far outstripped that of these two countries over this period. If a country runs a trade deficit, it's because it consumes far more than it can produce. This consumption must be financed by foreign capital. So a deficit on the trade account must be offset by a surplus on the financial account. In other words, foreigners buy more American assets than the other way around. These investments have enabled US stock markets to soar over the past 30 years, and interest rates to fall. Bringing international trade back into balance therefore means lower consumption, more savings and, potentially, revalued financial assets.