MONTHLY BOND LETTER

AlphaFixe Capital

JULY 2018

ECONOMIC EVENTS

- Housing starts in Canada grew at an annualized rate of 248,100 in June, 54,000 more than in the previous month. This gain is due in particular to a strong increase in multiple housing projects (172,800 units, +46%), while single-family homes fell slightly (56,000, -4%). Geographically, Ontario and Quebec recorded significant growth in the new housing market, an 88.4 % jump for our neighbors (104,400 units) and 44.9 % for Quebec (59,900 units). Strong housing demand is also reflected in the value of building permits for the residential sector, which rose 7.7 % in May to $ 5.5 billion, the second highest value ever recorded.

The stabilizing housing market following the implementation of new mortgage rules allowed the Bank of Canada to mitigate this risk into the Canadian economy and to continue to raise rates. Demographic factors also influence the results of these data. The demand for multiple dwellings is often associated with immigration, millennials and baby boomers, the two largest cohorts in the country.

- Driven by consumer spending, investments and international trade, US GDP jumped by an annualized rate of 4.1 % in the second quarter compared to 2.2 % in the first. This is the highest growth rate since the third quarter of 2014. Trump's tax reform fueled consumer spending, which grew 4.0 %, specially durable goods such as cars. Businesses also benefited from a lower tax rates, enabling them to increase investments by 7.3 % during the quarter. Foreign trade also boosted growth with a 9.3 % jump in exports in the spring.

A portion of the growth may be attributable to fiscal stimulus, but protectionist rhetoric has also contributed. Having anticipated further rétorsion measures, US trading partners may have replenished their inventory of US goods. Tariffs on steel and aluminum also reportedly forced some consumers to pre-empt purchasing cars. Growth could therefore weaken if these factors diminish.

- Concerned about the economic impact of the trade conflict with the United States, China has announced a series of measures to support its economy. These were provided in the form of a tax relief for research and development expenditures and special bond issues to finance infrastructure projects. According to Moody's, the additional burden of these measures in relation to GDP and budget spending in 2018 will be weaker.

Indebtedness and risks to the financial system have been relegated to the sidelines in China. The United States and the European Union have agreed to reform the World Trade Organization to fight against unfair trade practices, especially those practiced by China.

RATE TRENDS

- The Bank of Canada has announced a 0.25 % increase in its key rate to 1.50 % as well as warning Canadians of further incrrate hikes eases to keep inflation on target. However, this approach will be gradual and guided by economic data. The Bank's decision is based on a strong US economy, the weaker Canadian dollar and a tight labor market that will force some companies to invest more. The economic impact of tariffs on steel and aluminum is expected to be modest, according to the Bank, but it will be different if the trade conflict with the United States moves into the auto industry. As a result, the risks associated with trade tensions are now considered more important and could hinder rate normalization.

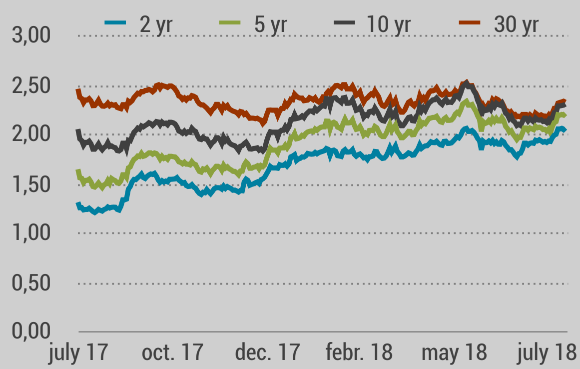
The Bank's comment regarding the weakness of the currency is interesting. Two factors explain this depreciation: the trade dispute with the United States and rate hike expectations in the United States. Unless disaster strikes, the Bank will have to follow its US counterparts in raising the cost of money. A high rate differential between the two countries would further weaken the loonie, pushing up import prices and therefore inflation.

BOND RATES

July 31 2018	Canada	Monthly Change	Change 2018	United States	Monthly Change	Change 2018
Key Interest Rate	1,50 %	0,25 %	0,50 %	2,00 %	0,00 %	0,50 %
3 months	1,45 %	0,19 %	0,39 %	2,02 %	0,11 %	0,64 %
2 years	2,07 %	0,16 %	0,38 %	2,67 %	0,14 %	0,79 %
5 years	2,22 %	0,15 %	0,35 %	2,85 %	0,11 %	0,64 %
10 years	2,31 %	0,14 %	0,27 %	2,96 %	0,10 %	0,55 %
30 years	2,33 %	0,12 %	0,06 %	3,08 %	0,09 %	0,34 %
RRB 30 years	0,59 %	0,13 %	0,02 %			

Source: Bloomberg

CANADIAN RATE TRENDS



1800 Ave. McGill College | Suite 2420 | Montréal (PQ) | H3A 3J6 514-861-3493 www.alphafixe.com info@alphafixe.com

CREDIT BOND RISK PREMIUMS

ISSUER	Credit rating DBRS	Credit rating S&P	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2018	Change 10 yrs month	Change 10 yrs 2018	Change 30 yrs month	Change 30 yrs 2018
Royal Bank, deposit notes	AA	AA-	85	105	145	0	10	0	15	0	15
Manulife, Senior debt	A high	A+	95	120	170	0	5	-5	5	0	5
Fortis Inc.	BBB high	BBB+	110	150	185	0	20	-5	15	-15	20
Hydro One	A high	A	80	105	140	0	15	0	20	-5	10
Enbridge Inc	BBB high	BBB+	125	175	240	10	10	10	10	10	15
Encana Corp	BBB low	BBB-	140	190	260	-5	10	-10	0	-5	-5
GTAA	---	A+	65	85	110	0	15	0	15	0	25
Bell Canada	BBB high	BBB+	110	155	215	5	15	5	10	0	15
Rogers Communications	BBB	BBB+	105	145	215	5	15	5	5	0	15
Loblaw	BBB	BBB	110	160	215	5	15	5	15	5	15
Canadian Tire	BBB high	BBB+	105	155	215	0	5	0	5	-5	10
Province of Québec	A high	A+	42	64	75	2	6	1	9	0	10
Province of Ontario	AA low	A+	45	69	80	2	7	2	10	1	13
CMHC	AAA	AAA	30	40	---	0	3	0	5		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached $ 4.9 billion in July, down $ 6.2 billion from the previous month and $ 2.7 billion lower than July 2017. Since the beginning of the year, corporate bond issuance totaled $ 50.0 billion, 9.0 % less than at the same time last year. Among the borrowers, CIBC issued a $ 1.5 billion deposit note for a 5-year term. Since the beginning of the year, the total amount of deposit notes issued by Canadian banks was $ 20.1 billion, up $ 2.5 billion from the first 7 months of last year. This increase may be due to the new rules coming into effect on September 28th, which require deposit notes to be subject to internal bail-in regulations.
- In the second half of the year, Loblaws, Canada's largest grocer, has announced that it will have to increase price of certain items accordingly as retaliatory tariffs on US imports come into effect. These tariffs adds to rising transportation costs, wages and the weak Canadian dollar, which combined will reduce the company's profit margin. Sobeys CEO also announced this possibility in late June. Although, he indicated that he was looking for ways to avoid increasing prices, some suppliers have no other alternatives given the low margins in the food industry.
- Enbridge has entered into an agreement with Brookfield Infrastructure Partners to sell gas assets in Western Canada for $ 4.3 billion. The agreement includes assets that collect natural gas from drillers in Alberta and British Columbia with a daily capacity of 3.3 billion cubic feet. This transaction is part of Enbridge's strategic debt reduction plan that has been moving away from non-core assets since its acquisition of Spectra Energy last year. Since the beginning of the year, Enbridge has divested $ 7.5 billion in assets, more than double its target of $ 3 billion in 2018, which quickly brings it closer to the long-term target of $ 10 billion.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	July 2018	2018
Universe	100 %	-0,74 %	-0,13 %
Short Term	45,3 %	-0,13 %	0,40 %
Mid Term	22,1 %	-0,60 %	-0,35 %
Long Term	32,6 %	-1,66 %	-0,76 %
Federal	36,0 %	-0,63 %	0,04 %
Provincial	34,0 %	-1,04 %	-0,56 %
Corporates	28,2 %	-0,49 %	0,21 %
RRB		-1,86 %	1,44 %

Source: ftse.com

Companies often tend to delay price increases, chosing to reduce their margins instead of losing market share. However, this situation is not viable for investors in the long run. Especially since today, with the wage pressures, consumers have more room to maneuver in their budget.

Enbridge's asset sale program acceleration could have a positive impact on its credit rating. The new business plan proposes a debt reduction and a simplification of its structure with a concentration on regulated assets, which improves the predictability of cash flow and comforts creditors.

STRATEGIC POSITIONNING

The US economy generated excellent growth in the second quarter, propelled by consumers and exports. However, this rate can't be expected to continue as some of this growth was precipitated before Trump's tariffs came into effect in July. In addition, the economy is running at full potential and will soon be constrained to further expand production capacity. There are now more job openings (6.6 million) than registered unemployed (6.3 million) while the number of people out of the labor force wanting a job is near a historic low. These human capital constraints force some firms to invest in machinery in order to increase production, but the effect will be noticeable later. Meanwhile, economic demand remains strong and supported by ever-expanding monetary policies. The real policy rate in Canada, the United States, Japan and several European countries is still in negative territory. Strong demand in an economy at its potential is inflationary. Trade disputes between the US and its multiple partners remain the only cloud on the horizon, but does not pose a recession risk in the short term. Trump's approach is to threaten by parking loudly to force renegotiations but not to pull the US out of free-trade. His flip flop with Europe and Jean-Claude Juncker is an example, with kisses in support.