MONTHLY BOND LETTER

AlphaFixe Capital

FEBRUARY 2020

ECONOMIC EVENTS

- The Canadian economy grew at an annualized rate of 0.3% in the fourth quarter, up from 1.1% in the previous quarter. This brings the annual growth rate to 1.6% in 2019, down 0.4% from 2018. A combination of factors explains this slowdown. While the rail strike was the main factor, the interruption of oil pipeline services, unfavourable crops and the impact of the GM workers strike in the United States also contributed to the slowdown. As a result, investments fell 6.3% after a 5.6% gain in the previous quarter. In contrast, consumer spending grew 2.0%, supported by residential real estate (1.1%) and employment.

Rail transport paralysis by Aboriginal protesters in February will undermine growth in the first quarter, as will the supply shock resulting from the coronavirus crisis. Elements in favour of monetary easing are adding up, but they also carry a host of consequences, including fueling an already heated housing market.

- The first reading of the Markit index of purchasing managers in the U.S. service industry reached 49.4 in February, below the threshold of 50 that marks the expansion from a contraction. This is the weakest reading in 76 months and the first decline in service activity in four years. According to Markit, the weakness reflects concerns about the global economic slowdown and the COVID-19 epidemic that is disrupting tourism and hospitality industry. Manufacturing is still expanding (50.8), but the pace has slowed from January.

Following the Sino-US trade war, manufacturing is now facing a supply chain shock. Manufacturers are forced to shut down production to prevent the spread of the virus or due to a lack of inputs. Is it time to revisit the globalization model of the past 30 years?

- As a direct result of the sales tax hike on October 1st, Japan's economy contracted by 6.3% in annualized terms in the last quarter of 2019. This is the worst GDP decline since the first quarter of 2014, when the government also raised the sale tax. The 11.5% drop in consumer spending last fall is the main source of the contraction.

This decline is happening even before the coronavirus affected more than 250 people in Japan. The worst news for Japan would be the postponing the Olympic Games this summer if the epidemic is not controlled.

RATE TRENDS

- In an effort to ease the economic impact of COVID-19, the Federal Reserve lowered its policy rate by 0.50 % to 1.25 % on March 3, the first intra-meeting decision since 2008. In a press conference, Powell said he was confident that the US economy fundamentals remain strong, but he said he is closely monitoring the impact of the coronavirus on the economy. According to the Fed, financial conditions easing will boost consumer confidence.

As always, investors have been pushing the Fed to help them, but this time the tool is ineffective. In 2008, the crisis was financial and the cure had to be financial as well. This gesture created panic instead of reassuring investors. Today, the economy needs a vaccine, not lower rates. A 0.50% cut in the policy rate will not drive people to the malls.

- The Bank of Canada followed its U.S. counterpart by also announcing a 0.50% cut in its policy rate the next day. COVID-19 represents a substantial negative shock to the Canadian and global outlook, and monetary and fiscal authorities are responding. The disruption in global supply chains will reduce activity and commodity prices. In addition, rail blockade in February will hurt first-quarter growth. The Bank has also indicated its willingness to intervene again if necessary.

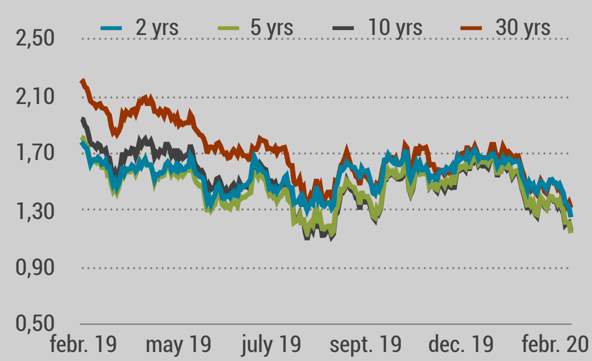
The bank is taking a big gamble. It believes that the economic risk of COVID-19 outweighs the risk of an overheated housing market. Home sales in Toronto have increased by 46% annually in February pushing the average price up by 17%. If the spread of the virus stabilizes, the Bank will have exacerbated the financial risks associated with indebtedness.

BOND RATES

Feb. 29, 2020	Canada	Monthly Change	Change 2020	U.S.	Monthly Change	Change 2020
Key Interest Rate	1,75 %	0,00 %	0,00 %	1,75 %	0,00 %	0,00 %
3 months	1,49 %	-0,16 %	-0,17 %	1,27 %	-0,27 %	-0,28 %
2 years	1,16 %	-0,28 %	-0,54 %	0,91 %	-0,40 %	-0,66 %
5 years	1,08 %	-0,20 %	-0,61 %	0,94 %	-0,38 %	-0,76 %
10 years	1,13 %	-0,14 %	-0,57 %	1,15 %	-0,36 %	-0,77 %
30 years	1,32 %	-0,11 %	-0,44 %	1,68 %	-0,32 %	-0,71 %
RRB 30 years	0,05 %	-0,06 %	-0,33 %			

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	Spread 5 yrs	Spread 10 yrs	Spread 30 yrs	Change 5 yrs month	Change 5 yrs 2020	Change 10 yrs month	Change 10 yrs 2020	Change 30 yrs month	Change 30 yrs 2020
Royal Bank, bail-in Debt	AA	100	135	175	15	15	15	15	15	15
Royal Bank, NVCC	A	140	190	230	20	20	20	20	20	20
Sun Life, Subordinated Debt	A	105	150	190	5	5	5	5	5	5
Hydro One	A high	70	105	150	5	10	10	20	10	20
Enbridge Inc	BBB high	115	170	245	10	15	15	20	20	25
Altalink LP	A	70	100	140	5	15	10	20	10	20
GTAA	A high	70	100	140	10	15	15	20	20	30
Bell Canada	BBB high	110	165	230	10	10	15	15	20	25
Rogers Communications	BBB	105	160	225	10	10	15	15	15	20
Loblaw	BBB	115	170	225	10	10	15	15	15	15
Canadian Tire	BBB high	115	170	225	15	15	20	20	20	20
Province Québec	AA low	48	74	86	6	12	11	15	11	17
Province Ontario	AA low	49	77	89	6	11	11	15	11	16
SCHL	AAA	37	49	---	5	8	9	11		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bond new issuance reached $7.5 billion in February, down $800 million from February, but $3.2 billion more than in February 2019. Since the beginning of the year, the total bond financing reached $15.8 billion, or 61% more than the previous year. Credit market activity was divided into two different parts in the month of February. The first three weeks were active with sustained demand for investors. Risk aversion has built up during the last week as investors reacted to the risk of a pandemic which produced the fastest stock market correction in history.

- Alberta's Finance Minister announced a $6.8 billion budget shortfall (1.9% of GDP) for fiscal year 2020-21, a slight improvement over the previous budget ($7.5 billion deficit). The province still expects to return to a balanced budget in fiscal year 2022-23 with a barrel of oil hovering near $58 (WTI) this year and rising to $63 in 2022-23. The province's reliance on oil royalties is expected to increase in the coming years, rising from 10.2% of revenues this year to 14.7% in FY 2022-23. Revenues are expected to reach $50 billion this year, down 1.9%, while expenditures would total $56.8 billion, including an allocation of $750 million to the province's contingency fund. Given the projected deficit and of capital spending, the debt is expected to reach 12.1% of GDP this year.

- DBRS has upgraded Rogers Communication's credit rating from BBB to BBB(high) while returning its outlook to stable. The upgrade underlines the sustainable improvement in operating earnings, revenue diversification, increased ability to generate free cash flow and debt reduction initiated two years ago. DBRS still believes that Rogers operates in a competitive environment in Canada. The company is facing regulatory changes and new customer consumption habits that will undermine Rogers' cable and telephone operations. Despite capital expenditures for the construction of the 5G network, DBRS expects the debt ratio to decrease due to EBITDA increase over time.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Feb 2020	2020
Universe	100 %	0,71 %	3,64 %
Short Term	41,7 %	0,65 %	1,70 %
Mid Term	23,0 %	0,84 %	3,75 %
Long Term	35,3 %	0,69 %	5,99 %
Federal	34,9 %	1,05 %	3,45 %
Provincial	35,7 %	0,61 %	4,23 %
Corporates	27,3 %	0,42 %	3,10 %
RRB		1,06 %	5,23 %

Source: ftse.com

In light of the risks of a coronavirus-related economic slowdown, indigenous protests against pipeline projects and the oil price war that Russia and Saudi Arabia may unleash, the province's oil forecast is very optimistic. What is worrying is the growing dependence on oil revenues to balance the budget.

This rating upgrade is only a realignment with other rating agencies, so the impact on credit spreads is marginal. However, the industry does face some political risks. The Liberals want to reduce the cell phone bill for taxpayers by 25% by increasing competition with smaller providers.

STRATEGIC POSITIONNING

The increasing spread of COVID-19 beyond China's borders quickly changed investors' perception of risk and prompted economic authorities to react. However, monetary policy is more effective in addressing a decline in demand than a supply disruption, as is the case with COVID-19. The economic risk comes from the absence of a treatment that an interest rate cannot solve. In 2008, central bankers intervened to save banks that were too big to fail. Today, they are intervening to support a stock market that is too lofty to fall. So why have a president at the Fed or a governor at the Bank of Canada if the market dictates monetary policy? Instead of lowering the cost of money, economic authorities should explore more targeted solutions. Free COVID screening and hospitalization, tax holidays and loans to affected businesses as long as they keep their employees or even an employment insurance bonus for employees who were laid-off. This public health crisis also demonstrates the flaws in the current global economic order. Supply chain disruptions reinforce the idea of de-globalization to secure and control production by bringing it back close to headquarters. This crisis could translate into more expensive inputs, a return of inflation, exploding government deficits and an end to the 30-year decline in rates.