MONTHLY BOND LETTER

AlphaFixe Capital

SEPTEMBER 2024

ECONOMIC EVENTS

- Inflation in Canada has finally returned to the Bank of Canada's target. The consumer price index fell by 0.2% month-on-month in August, bringing annual growth to 2.0% from 2.5% the previous month. Lower food (-0.1%) and energy (-1.6%) prices contributed to this decline in inflation last month. Removing these volatile price components, core inflation also fell by 0.1% in August. Deflation affected several items in the index's consumer basket. In fact, 61% of the index's major components recorded price declines last month. Shelter remains a major source of inflation in the country. Prices associated with housing rose by 0.4% last month, and by 5.3% over 12 months. This component represents 29% of the CPI basket.
- After a few months of weakness over the summer, US employment picked up again in September. The economy added 254,000 new jobs, clearly surpassing investor expectations (+140,000). The July and August figures were also revised upwards, adding another 72,000 jobs to the economy. The private sector added 223,000 jobs, mainly in service industries (+202,000) such as restaurant and hotel services (+78,000), healthcare (+71,700) and retail trade (+15,600). The construction industry also added 25,000 jobs last month. Wages also rose. Average hourly earnings rose by 0.4% in September and by 4.0% over the past year, 0.1% more than in August.
- The news are multiplying, but not improving for the Chinese economy. Industrial production grew by 4.5% in the year to August, down from 5.1% in July. This pace reduces the likelihood of achieving the authorities' economic growth target of 5%. For this to happen, household consumption would have to be pick up the slack, and this is not the case. Chinese retail sales have grown by 2.1% over the past year, 0.6% less than in July.

RATE TRENDS

- The Federal Reserve surprised many investors by announcing an aggressive 0.50% cut in its policy rate to 5.0%. The Fed is increasingly confident of achieving its inflation target on a sustainable basis in the near future, and believes that the risks of achieving its inflation stability and full employment objectives are roughly balanced. However, the aggressive approach adopted should be interpreted as a commitment by the monetary authority to maintain full employment rather than a sign of economic weakness. The decision was not unanimous, as two committee members would have preferred a 0.25% cut. Monetary easing has begun and should continue this year. Committee members expect a 0.50% reduction in the key rate by the end of 2024, and a further 1% cut in 2025 to end the year at 3.5%.

Excluding housing, prices for the other components of the index have risen by just 0.6% over the past year. All in all, the balance of risks is shifting away from inflation towards a slowdown in economic activity and employment. This inflation report suggests that the Bank of Canada may accelerate its rate cuts in the near future. However, if the job market does not weaken, aggressive rate cuts could revive real estate bidding. The Bank is aware of this risk.

The job market is now the Federal Reserve's top priority, and every statistic relating to it will be closely scrutinized by investors. Admittedly, the pace of job creation is more moderate than last year, but gains are continuing. The increase in the working population is also reducing the pressure on wage gains. Before we see layoffs, corporate revenues and profit margins have to start falling, which is not yet the case from a macroeconomic point of view.

The economy therefore has excess production capacity in relation to domestic demand. China has often transferred its surplus production to the rest of the world through exports, but this time there are more obstacles. The various tariffs imposed on Chinese exports by U.S. allies make this transfer of surplus more difficult than before.

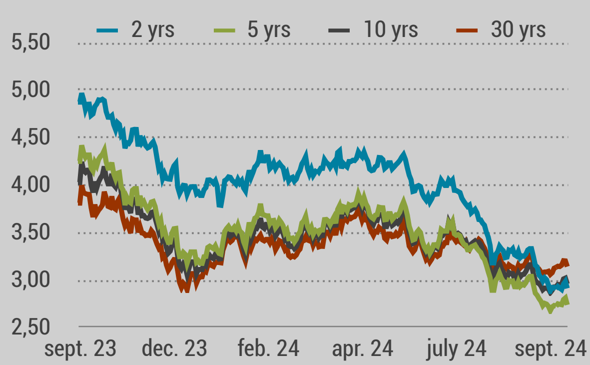
The Fed thus joins the ranks of other central banks on the path to monetary easing. However, it has been more aggressive than economic conditions require. After growing at an annualized rate of 3% in the second quarter, the economy is once again heading for above-potential growth over the summer. Employment is slowing, but there are no signs that companies are preparing for layoffs, while new jobless claims remain low. The 0.50% cut in the policy rate is more of an insurance policy that the Fed has purchased to achieve its goal of a soft landing for the economy.

BOND RATES

Sept. 30, 2024	Canada	Monthly Change	Change 2024	United States	Monthly Change	Change 2024
Key Interest Rate	4,25 %	-0,25 %	-0,75 %	5,00 %	-0,50 %	-0,50 %
3 months	4,22 %	0,05 %	-0,84 %	4,62 %	-0,49 %	-0,72 %
2 years	2,91 %	-0,42 %	-0,98 %	3,64 %	-0,28 %	-0,61 %
5 years	2,74 %	-0,30 %	-0,44 %	3,56 %	-0,14 %	-0,29 %
10 years	2,96 %	-0,20 %	-0,15 %	3,78 %	-0,12 %	-0,10 %
30 years	3,14 %	-0,13 %	0,11 %	4,12 %	-0,08 %	0,09 %
RRB 30 years	1,44 %	-0,02 %	0,14 %			

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	95	130	160	-10	-35	-10	-35	-10	-35
Royal Bank, NVCC	A	140	185	225	-15	-45	-15	-45	-15	-45
Sun Life, subordinated debt	A	115	155	190	-15	-50	-15	-50	-15	-45
Hydro One	A high	70	105	135	-10	-15	-10	-10	-10	-5
Enbridge Inc	A low	110	155	205	-10	-20	-10	-20	-10	-15
Altalink LP	A	70	105	135	-10	-15	-10	-10	-10	-5
GTAA	A high	65	100	130	-10	-15	-5	-10	-5	0
Bell Canada	BBB high	110	150	195	-15	-15	-15	-15	-15	-5
Rogers Communications	BBBL	125	165	210	-10	-20	-10	-20	-10	-20
Loblaw	BBB high	95	135	175	-10	-10	-10	-5	-5	0
Canadian Tire	BBB	125	170	215	-10	5	-5	10	-5	10
Province Québec	AA low	31	72	97	-4	-7	0	6	0	9
Province Ontario	AA low	32	71	94	-3	-8	0	3	0	4
CMHC	AAA	18	41	---	-4	-10	-2	-3		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate bonds new issuance totalled $12.5 billion in September, up $3.8 billion on the previous month, but $2.5 billion less than in September 2023. Year-to-date, bond financing totals $98.1 billion, up 32% on the same period last year. The return of the summer vacations is synonymous with a resumption of financing activity, and this month was no exception. In all, there were 26 new issues, of which only two were by Canadian banks: Scotiabank ($1.25 billion) and the Fédération des caisses Desjardins du Québec ($1.25 billion).

- Allied Properties REIT completed a $250 million financing with a 4-year term, offering a yield spread of 2.8% over a federal bond of the same maturity. This real estate investment trust invests mainly in office properties (82% of the portfolio) located in major Canadian cities. The pandemic has changed the way companies work, leaving Allied with a vacancy rate of almost 15% of the entire portfolio. To reflect the risk in this business sector, Moody's downgraded Allied's credit rating below investment grade. DBRS, however, retains a BBB rating, so the outstanding bonds have been downgraded to the high yield category by FTSE. However, this new bond is rated solely by DBRS and meets the investment-grade criteria of the index, as there is only one agency.

- Ontario's Minister of Finance has presented the final public accounts for the 2023/24 fiscal year ending March 31. Instead of a $3 billion shortfall as presented in the budget, Ontario is left with a $600 million deficit. Total revenues were boosted by $1.6 billion due to higher tuition revenues from international students. On the other hand, spending was $600 million lower than budgeted. Health care and education cost more than expected, but debt servicing was reduced by $1.4 billion to $11.4 billion, or 5.5% of provincial revenues. The near-balancing of the budget appears to be temporary, as the province is still forecasting a $9.8 billion deficit for the current fiscal year.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	Sept. 2024	2024
Universe	100 %	1,90 %	4,27 %
Short Term	41,4 %	1,31 %	5,02 %
Mid Term	29,5 %	1,97 %	5,09 %
Long Term	29,1 %	2,70 %	2,16 %
Federal	40,5 %	1,63 %	3,94 %
Provincial	32,9 %	2,07 %	3,47 %
Corporates	24,8 %	2,12 %	5,88 %
RRB		-1,19 %	1,44 %

Source: ftse.com

Dumping rating agencies whose opinion seems unfavorable to companies seems to be becoming an increasingly common practice. Including Allied, 9 companies in the last two years have dumped a rating agency in order to improve their credit rating and obtain cheaper financing.

Ontario's economy will face a number of obstacles in 2024. Rising interest rates have weakened real estate activity, while significant population growth is putting pressure on public services. Employment and tax revenues are rising, but cannot keep pace with population growth, creating a budgetary imbalance.

STRATEGIC POSITIONNING

The Federal Reserve has finally joined the other central bankers in the monetary easing. However, it made a stunning entrance by announcing a 0.50% cut in its key rate. No other bank has dared to act so aggressively in this cycle of easing. However, the message is similar across all central banks. Inflation is no longer enemy number one, and the risks to economic growth and employment are greater if policy is kept too long in restrictive territory. To ensure price stability and avoid recession, the start of the rate-cutting cycle is required, but how far will rates go? The Federal Reserve has raised its forecast for the equilibrium policy rate each quarter this year, to 2.875% from 2.5% last year. Various structural changes are currently taking place in the economy, justifying this increase. In Canada, the situation is different. Monetary policy is having a faster impact on the budgets of households refinancing their mortgages. The equilibrium rate could therefore be lower than in the United States, but we will no longer be returning to the extremely low rates of the last decade. With Canada's 2-year rate approaching the equilibrium rate, the bond market seems to have already discounted much of the Bank's work. The risk, which no one is talking about, is that inflationary pressures could increase in response to the monetary easing that is taking hold. This is not to be dismissed.