MONTHLY BOND LETTER

AlphaFixe Capital

ECONOMIC EVENTS

JULY 2024

- Employment in Canada contracted for the second month in a row. After losing 1,400 jobs in June, the Canadian economy shed 2,800 workers in July. This is the first consecutive drop in employment since August and September 2022. However, the details of the survey are more mixed than the headline suggests. The Canadian economy lost part-time jobs (-41,900) but gained full-time employment, which means more hours worked and more income. Wage growth remains robust and persistent (+5.2%), which does not please the Bank of Canada. On the other hand, new jobs were created in the public sector (+40,800), at the expense of the private sector (-41,900), indicating weak activity. Service industries shed 14,800 jobs, notably in wholesale and retail trade (-44,100), finance (-15,000) and hotels and restaurants (-9,700).

These industries are linked to the business cycle and point to a slowdown in activity. The details of this labour force survey show that there will be more hours and income in the economy in July, but that these are not coming from robust private economic activity. For the Bank of Canada, which somehow telegraphed another decline in September, this survey does not provide them with the evidence to remain inactive.

- The US economy recovered in the second quarter, with annualized quarterly growth of 2.8%, double that of the first quarter. Consumers returned to the malls with a 2.3% increase in household spending. After a contraction at the start of the year, consumption of goods accelerated (+2.5%), particularly for vehicles. Business investment also contributed (+5.2%), especially for machinery and equipment (11.6%), while investment in fixed assets fell (-3.3%). Government spending again supported growth (+3.1%), but residential real estate contracted (-1.4%) for the first time in a year.

Nevertheless, it is encouraging to see a recovery in spending on durable goods that are generally financed, such as vehicles. This reflects a degree of confidence on the part of households in managing their budgets. However, the pace of consumption growth is likely to weaken in the future, as households will no longer be able to rely as much on the excess savings accumulated during the pandemic. This is evaporating rapidly, and consumption growth will keep pace with employment income.

- China's consumer price index recorded a monthly gain of 0.5% in July, erasing the previous month's price decline (-0.2%). This increase was driven by food prices in July (+1.2%) following the passage of typhoon Gaemi, which disrupted agricultural production. The price index excluding food and energy rose by 0.4% year-on-year. This represents a slowdown on June's reading (+0.6%) and reflects a flagging economy where demand remains fragile.

In July, the People's Bank of China cut its key rate by 0.10% to support the economy. Growth fell from 6.1% annualized quarter-on-quarter in the first quarter to 2.8% in the second. Household spending is weakened by real estate risks and falling house prices. Geopolitical tensions and the global slowdown are also hurting exporters.

RATE TRENDS

- The Bank of Canada continued its monetary easing, cutting its policy rate by 0.25% to 4.50%. The Bank also left the door wide open to further cuts in the cost of borrowing. Although the Canadian economy is growing faster than the Bank's expectations, population growth is faster, accentuating growth potential and excess supply in the economy. This excess supply should ease inflationary pressures. In a press conference, the Governor was very dovish. "With the inflation target in sight and increased excess supply, downside risks to inflation are taking on increasing weight in our monetary policy deliberations. We need growth to accelerate so that inflation doesn't fall too far," he said.

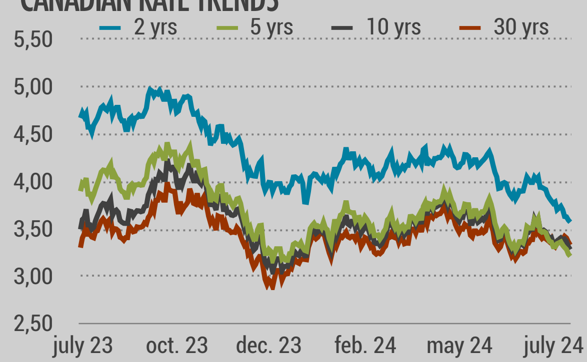
With this comment, it looks like we'll have to find arguments between now and the next meeting to convince the Governor not to cut rates at the next meeting. There's also every reason to believe that the Federal Reserve will begin its monetary easing in September, which means that the spread between U.S. and Canadian key rates could remain at 1%. This is an acceptable level for the Bank of Canada, and should not further weaken the Canadian currency. This assumption suggests a 0.25% cut in the US rate. Some investors are (wrongly) calling for a more aggressive cut, given the exaggerated risks of imminent recession in the US.

BOND RATES

July 31, 2024	Canada	Monthly Change	Change 2024	United States	Monthly Change	Change 2024
Key Interest Rate	4,50 %	-0,25 %	-0,50 %	5,50 %	0,00 %	0,00 %
3 months	4,42 %	-0,24 %	-0,64 %	5,28 %	-0,07 %	-0,05 %
2 years	3,45 %	-0,55 %	-0,44 %	4,26 %	-0,49 %	0,01 %
5 years	3,09 %	-0,42 %	-0,09 %	3,91 %	-0,47 %	0,07 %
10 years	3,16 %	-0,34 %	0,05 %	4,03 %	-0,37 %	0,15 %
30 years	3,21 %	-0,18 %	0,18 %	4,30 %	-0,26 %	0,27 %
RRB 30 years	1,33 %	-0,16 %	0,03 %			

Source: Bloomberg

CANADIAN RATE TRENDS



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	110	145	175	0	-20	0	-20	0	-20
Royal Bank, NVCC	A	155	200	240	5	-30	5	-30	5	-30
Sun Life, subordinated debt	A	130	170	205	0	-35	0	-35	0	-30
Hydro One	A high	80	115	145	-5	-5	0	0	0	5
Enbridge Inc	A low	130	170	220	10	0	10	-5	10	0
Altalink LP	A	80	115	140	-5	-5	0	0	0	0
GTAA	A high	75	105	135	0	-5	0	-5	0	5
Bell Canada	BBB high	130	170	215	5	5	5	5	5	15
Rogers Communications	BBBL	135	180	225	5	-10	5	-5	5	-5
Loblaw	BBB high	110	150	185	5	5	5	10	5	10
Canadian Tire	BBB	135	180	225	5	15	5	20	5	20
Province Québec	AA low	40	73	99	3	2	3	7	5	11
Province Ontario	AA low	40	72	97	2	0	3	4	5	7
CMHC	AAA	26	41	---	0	-2	0	-3		

Source: National Bank Financial

CREDIT MARKET

- Canadian corporate new bond issuance totaled $7.3 billion in July, down $12.2 billion on the previous month, but $5 billion more than in July 2023. Year-to-date, bond financing totals $76.9 billion, up 39% on the same period last year. The summer vacation period justifies this monthly decline, but the sum of issues in July is still higher than the average for the last 13 years ($6.6 billion). Of the 14 issues in July, 3 were green bonds: Brookfield Renewable Partners LLC, Hyundai Capital Canada and BCI QuadReal Realty.

- Last April, the FTSE Russel Group launched a consultation to determine the eligibility of Maple bonds for inclusion in the FTSE Canada Universe Index. Following discussions with various stakeholders, FTSE Russel concluded that these Canadian-dollar bonds from foreign issuers make up a growing and significant proportion of the Canadian bond universe, and should be included in the universal index in view of the index's representative objective. The inclusion of Canadian bonds in the universal index allows for better diversification of issuers according to the FTSE, and broadens the range of possible investments for bond index managers. The same universal index eligibility criteria will be applied to Maple bonds, and their inclusion will take effect on January 1, 2025. FTSE Russell will also publish a universal index excluding Maple.

- Collectively, Canadian provinces borrowed $9.8 billion in July, all currencies combined. This is a more moderate pace than in previous months, which is normal for the summer period. Since the beginning of 2024, the provinces have borrowed a total of $114 billion, which is a new record, surpassing the previous mark set in 2020 when governments put in place various support programs in response to the pandemic. The Canadian market absorbed 80% of new issues in July, compared with 60% in the previous 4 months. With only 3 months remaining in their fiscal year, which began on April 1, the provinces have already completed 57% of their financing requirements.

FTSE TMX INDEX PERFORMANCE

Sector	Weight	July 2024	2024
Universe	100 %	2,37 %	1,99 %
Short Term	41,3 %	1,54 %	3,13 %
Mid Term	30,5 %	2,84 %	2,53 %
Long Term	28,2 %	3,10 %	-0,40 %
Federal	40,3 %	2,25 %	1,87 %
Provincial	33,1 %	2,62 %	1,08 %
Corporates	24,6 %	2,23 %	3,41 %
RRB		3,48 %	2,66 %

Source: ftse.com

This change will have an impact on the investment policies of various investors. These bonds were frequently subject to constraints and holding limits. Consideration will need to be given to the level of investor comfort with these issuers, which are nonetheless investment-grade.

This advance in the financing schedule gives them some breathing room in case things get tough. The brief episode of volatility on financial markets at the beginning of August shows that the window of opportunity to borrow on financial markets can close quickly. Given this year's significant needs, the provinces must remain proactive.

STRATEGIC POSITIONNING

The end of the world has been foretold by certain prophets for decades, and this was once again the case at the beginning of August. Investors woke up on August 5 to a dramatic 12% fall in Japan's Nikkei 225 stock index, foreshadowing carnage on the US markets. Some analysts attributed the stock market crash to the risk of a US recession following the release of weaker employment figures. Admittedly, the job market has been less vigorous, but the end of the world is not just around the corner. Last time I checked, our neighbors were still creating jobs. The U.S. economic slowdown is therefore broad-based, and we should direct our explanations more towards the Bank of Japan's monetary policy and the carry trades it has generated. Several years of expansionary monetary conditions encouraged investors to borrow in yen at low rates to invest in various higher-yielding markets. Now that the Bank of Japan has decided to tighten its financial conditions and the Federal Reserve is preparing to ease its own, investors have reassessed these transactions. The Nikkei's fall is more the result of a reversal in carry trades than of a US economy on the brink of collapse. We are therefore experiencing the consequences of an excessively easy monetary policy for too long, in which risk was not properly assessed due to central bank support.