

Monthly Money Trail

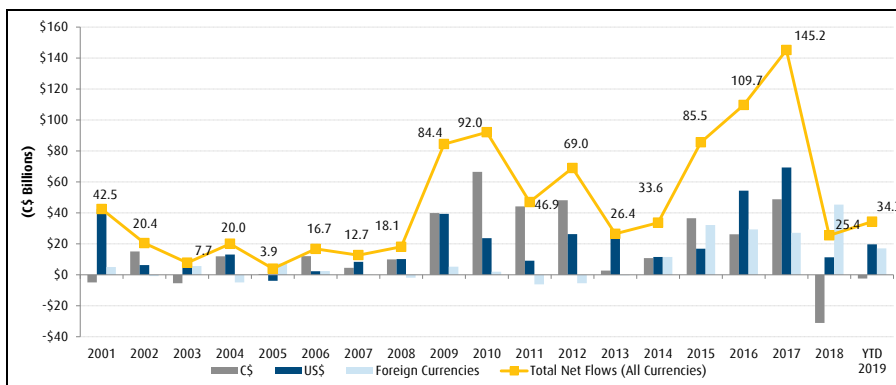
International Fund Flows

International investors continued to get their risk on in July, dumping a whack of GoC bonds and loading up on corporates. In fact, foreign portfolio managers doubled up the bleeding on Canada bonds in July versus June, divesting of nearly \$11 billion in GoC product as part of the general extension into risk that took place in the global markets during that month. We expect the reversal of fortune for risk appetite during August likely encouraged some international cash back into GoC bonds, but we will have to wait another month to see the final results. Year to date, the damage suffered in July sunk international purchases of Canadas into negative territory, with net divestitures of almost \$8 billion through the first seven months of 2019. Nonetheless, that dreary result is still better than the net selling of nearly \$28 billion which occurred over the same period in 2018 due to the decent amount of buying from earlier in 2019.

Global uncertainty has certainly ratcheted up a notch of late, driven by escalating geopolitical conflict in a number of unstable parts of the world. In addition, slowing economic conditions and an acceleration of accommodative monetary policy conditions are making positive yielding sovereigns something of a rarity in the capital markets these days, notionally putting GoC bonds in good stead. We believe any sustained improvement in global oil prices on the back of recent geopolitical events will bolster the Canadian dollar and hence international portfolio manager interest in bonds denominated in the loonie. At the same time, we recognize currently heightened uncertain times are making the direction of capital flows less predictable.

Unlike GoC bonds, international interest in Provie bonds was relatively neutral in July, with a modest net divestiture. Foreign investors have been disinterested in purchasing Provie bonds denominated in the loonie for quite some time now, leaving new issuance activity in currencies outside the Canadian dollar as the only real avenue pursued by global portfolio managers. And in that regard, the Provinces are in the driver's seat of when that international funding will take place. A very strong current funding position leaves the regions with the good fortune of being opportunistic in their primary market activity outside Canada. Through the first seven months of 2019 we witnessed \$4 billion in foreign net buying of Provie bonds, down a touch from the \$6 billion that took place during the same period in 2018. We note that swap spreads indicate international issuance is readily available to the regions in aggregate, so it is more a matter of when they decide to undertake a transaction.

International Investment in CDN. Debt Securities



Statistics Canada data presented on a 2 months delayed basis | Source: Statistics Canada. Table 36-10-0032-01 - International transactions in securities, portfolio transactions in Canadian bonds, by currency of issue and type of transaction, monthly; BMO Capital Markets.

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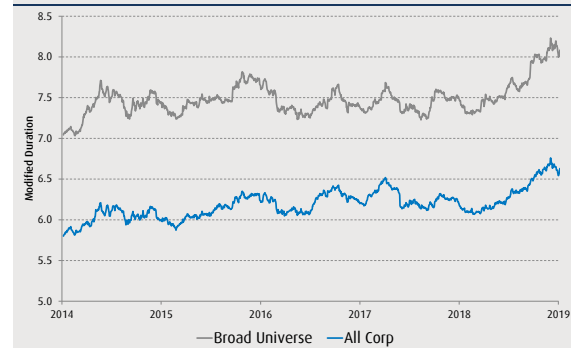
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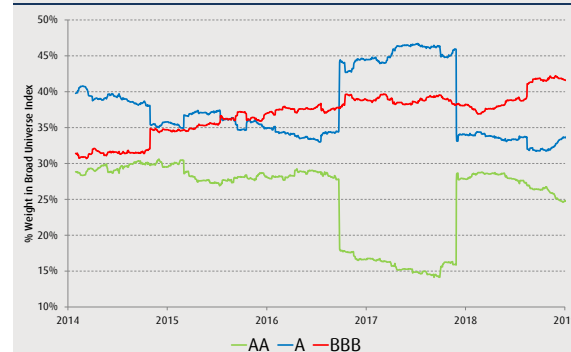
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Duration - FTSE TMX Broad Universe Index



Source: FTSE TMX Debt Capital Markets Inc., BMO Capital Markets

Ratings Weight - FTSE TMX All Corporate Index



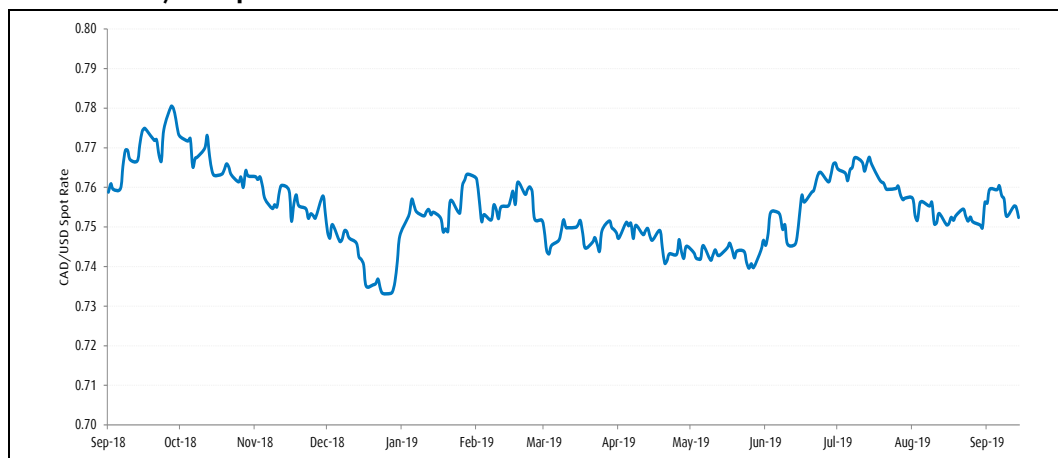
Source: FTSE TMX Debt Capital Markets Inc., BMO Capital Markets

Exhibit 1: Canada's International Transactions in Securities

<i>(C\$ millions)</i>	May 2019	June 2019	July 2019	January to July 2018	January to July 2019
Foreign Investment in Canadian Securities	10,319	(4,064)	(1,171)	64,993	31,311
Debt securities	14,898	(2,882)	(3,120)	55,005	28,718
Money market instruments	2,038	2,243	(4,633)	9,603	(5,575)
Governments	(1,005)	(2,800)	(693)	(1,432)	(6,397)
Federal government	(1,297)	(4,195)	(188)	(3,011)	(2,922)
Other governments	292	1,395	(506)	1,581	(3,476)
Corporations	3,043	5,044	(3,940)	11,033	823
Government business enterprises	(28)	386	(748)	2,411	(2,512)
Private corporations	3,072	4,658	(3,191)	8,623	3,337
Bonds	12,860	(5,126)	1,513	45,403	34,293
Governments	8,172	(5,529)	(10,802)	(21,623)	(3,500)
Federal government	8,828	(5,425)	(10,669)	(27,719)	(7,835)
Other governments	(656)	(104)	(134)	6,096	4,334
Corporations	4,688	403	12,315	67,024	37,792
Government business enterprises	3,856	(5,479)	2,015	6,648	3,920
Private corporations	831	5,882	10,300	60,376	33,870
Equity and investment fund shares	(4,579)	(1,181)	1,949	9,986	2,594
Canadian investment in foreign securities	4,122	6,605	12,451	40,907	20,833
Debt securities	5,975	3,046	6,572	39,720	26,429
Money market instruments	(1,448)	(754)	1,208	1,401	(1,472)
Bonds	7,423	3,800	5,364	38,320	27,900
Equity and investment fund shares	(1,854)	3,559	5,880	1,189	(5,596)

Source: Statistics Canada. Table 36-10-0028-01 - International transactions in securities, portfolio transactions in Canadian and foreign securities, by type of instrument and issuer, monthly; BMO Capital Markets.

Exhibit 2: CAD/USD Spot Rate



Source: BMO Capital Markets, Bloomberg.

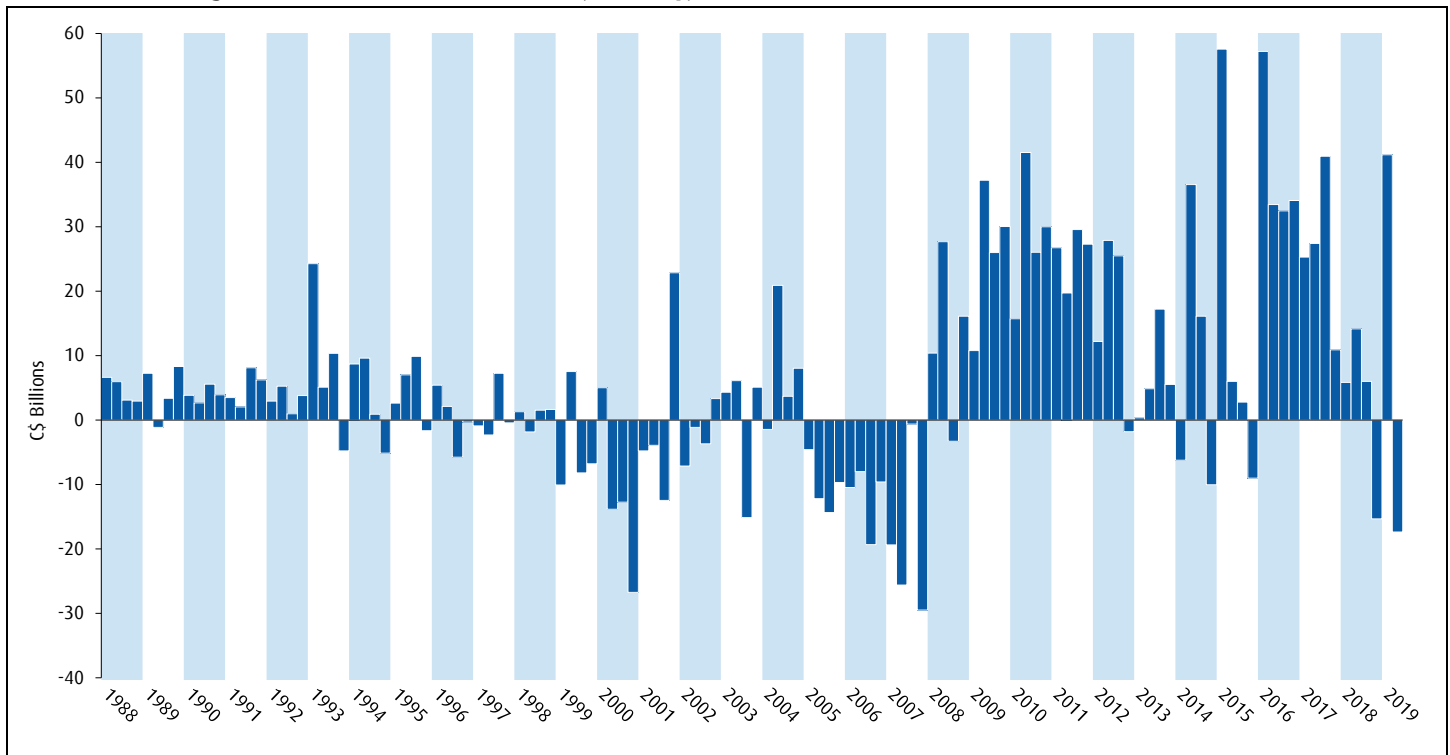
We have maintained for some time that global portfolio managers are enamoured by the strong sovereign backdrop, punctuated by stable political and financial systems, in which the Provinces operate. Layer on a growing spate of negative yielding sovereigns and the investment appeal of Canada's regions outside the country is that much more attractive. We expect foreign investors to continue scooping up Provie bonds in currencies other than the loonie for the foreseeable future and believe that activity will remain the source of ongoing demand-supply disequilibrium in the domestic market. As a result, we remain constructive on the Provinces. Recently augmented geopolitical risk in

the Middle East and its effect on the price of oil will certainly augment that demand, especially for Alberta bonds. We may even see more interest in Canadian dollar Provincial bonds should the loonie meaningfully benefit from the recent strength of oil prices.

In stark contrast to the heavy net divestiture of Canadas in July, international investors scooped up over \$10 billion of Canadian corporate bonds during the month, mostly through primary market transactions in currencies outside the loonie, as has been the case for the past few years. Similar to the Provie market, ongoing issuance by Canadian corporates (i.e., predominantly by the Big 6) in other jurisdictions is causing demand-supply at home and underpins our favourable view on corporates over the near to medium term. Through the first seven months of 2019 foreign buyers purchased almost \$34 billion of Canadian corporates, putting downward pressure on the domestic primary market as well as spreads. Although considerably less than the \$60 billion that was bought during the same period last year, the amount of foreign buying action this year is still having a pronounced impact relative to the overall size of the Canadian corporate bond market, part of which is the lowering of credit quality in the corporate part of the index. Also of note, international investors termed out some of their exposure to Canadian corporates by selling \$3.2 billion in money market instruments.

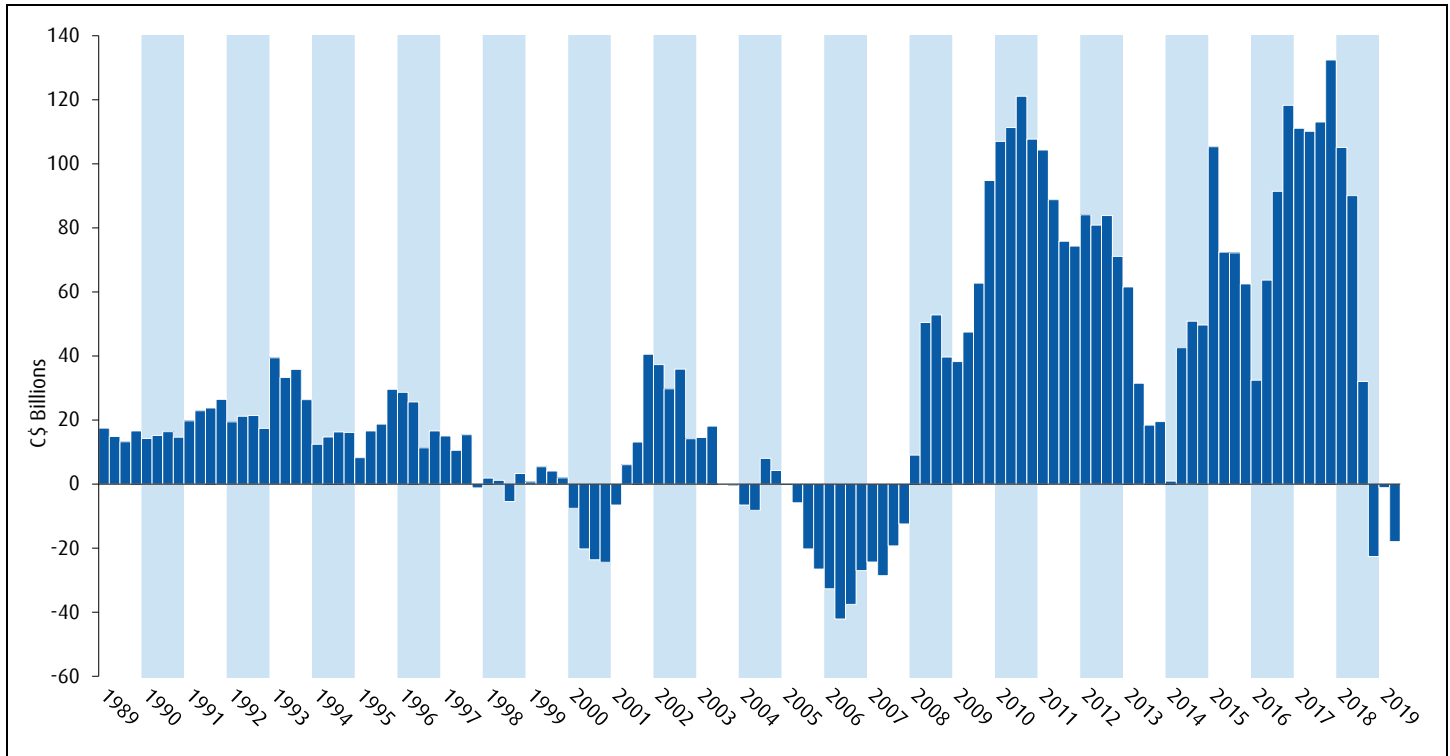
Finally, agency bonds similarly enjoyed net buying from international investors in July, although nowhere near to the same degree as corporates. At \$2 billion, the activity in July doubled the year-to-date amount to \$4 billion, down a tad from \$6.6 billion during the same period in 2018. We maintain our belief foreign (and domestic) buyers are looking to add yield anywhere they can find it and agency bonds provide an ideal opportunity for that incremental pickup. We expect foreign buyers to continue adding exposure to Canadian agency bonds over the near to medium term.

Exhibit 3: Net Foreign Investment in Canadian Bonds (Quarterly)



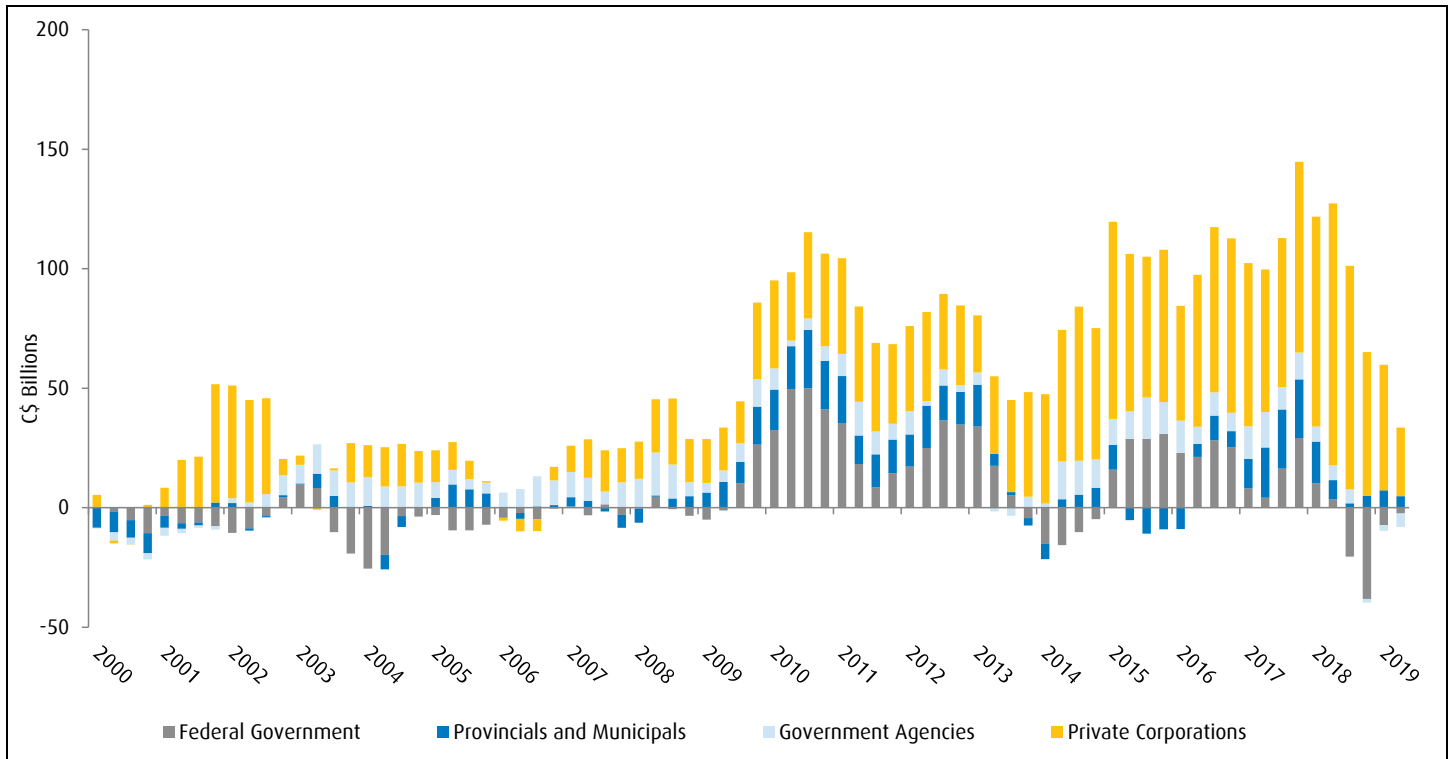
Source: Statistics Canada. Table 36-10-0029-01 - International transactions in securities, portfolio transactions in Canadian and foreign securities, by type of instrument and issuer, quarterly; BMO Capital Markets.

Exhibit 4: Net Foreign Investment in Canadian Bonds (Rolling 12-Month by Quarter)



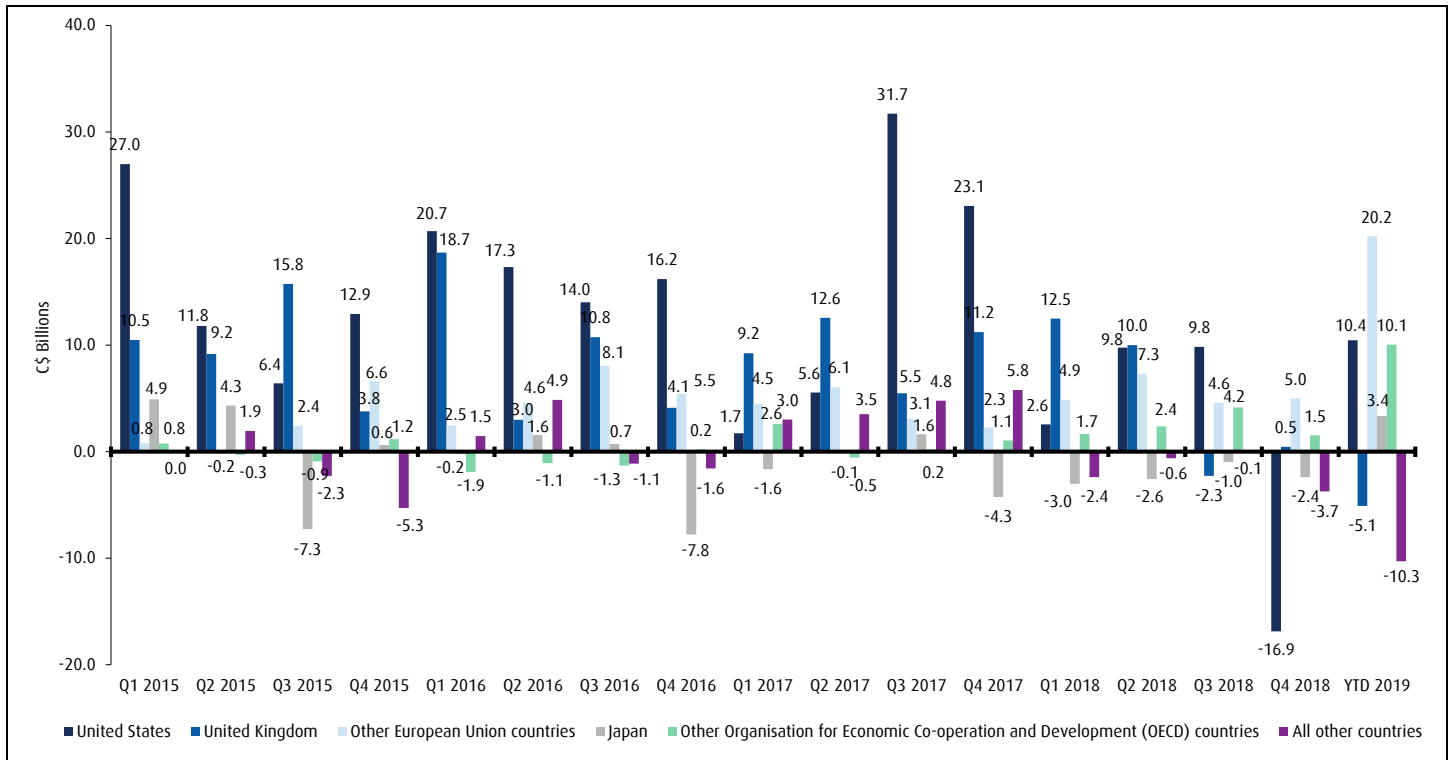
Source: Statistics Canada. Table 36-10-0029-01 - International transactions in securities, portfolio transactions in Canadian and foreign securities, by type of instrument and issuer, quarterly; BMO Capital Markets.

Exhibit 5: Foreign Investment in Canadian Government and Corporate Bonds (Rolling 12-Month by Quarter)



Source: Statistics Canada. Table 36-10-0029-01 - International transactions in securities, portfolio transactions in Canadian and foreign securities, by type of instrument and issuer, quarterly; BMO Capital Markets.

Exhibit 6: Foreign Investment in Canadian Debt Securities by Geography (Quarterly)



Source: Statistics Canada. Table 36-10-0030-01 - International transactions in securities, portfolio transactions in Canadian and foreign securities, by geographic area, monthly; BMO Capital Markets.

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sector perform = Forecast to provide an appropriate risk/reward and/or total return is expected to be in line with the sector average

underperform = Forecast to provide an inferior risk/reward and/or total return is expected to be below the sector average

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underperform = Forecast to provide an inferior risk/reward and/or total return is expected to be below the average of the index

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