# Global X Active Canadian Municipal Bond ETF (HMP)

## Market Overview

North American bond yields were generally higher and the yield curve steepened over the second quarter. The Bank of Canada (BoC) reduced its overnight rate to 4.75% from 5.00% in June. The Canadian economy has been operating in excess supply and inflation continued to move lower, giving the BoC more confidence it would be able to achieve its 2% inflation target over time. As a result, the BoC's Governing Council said monetary policy no longer needed to be as restrictive and cut 25 basis points (bps). Inflation has come down from the highs in 2022 and the breadth of price increases has narrowed. Since the start of the year, headline inflation declined from 3.5% to 2.9% and core inflation on average fell by 70 bps to 2.9%. However, investors were disappointed in June with the latest inflation print as it bounced slightly higher after falling for four consecutive months. The market is now only expecting the Bank to cut rates twice in 2024 to 4.25%, with the next move anticipated in September. At one-point investors were looking for an additional 75 bps in cuts before year-end.

In this environment, short-term provincial spreads declined by 4 bps to 27 bps and corporate spreads narrowed by 4 bps to 104 bps.

Short-term rated municipal spreads performed in line with provincials, tightening by 4 bps. However, non-rated municipal spreads narrowed by an additional 10 bps, outperforming even corporates.

## Quarter in Review

Duration strategy helped as HMP was set up for lower rates, but curve positioning was negative as HMP was anticipating a flatter curve. The portfolio generated 7 bps of carry and 3 bps from duration/curve, with the remainder primarily driven by non-rated municipal and provincial spread compression. Non-rated municipal spreads in the five-year term were approximately 68 bps relative to provincials.

## Outlook and Positioning

The BoC has begun the process of loosening monetary policy and the Sub-Advisor expects this to continue in 2024 and into 2025. It will not be a straightforward exercise where the BoC cuts at every meeting until it gets to a neutral level. The Sub-Advisor expects stops and starts as the economy is not falling off a cliff and there are still risks to the inflation outlook. The U.S. economy has been more resilient than Canada, but it is also starting to show signs of weakening which will eventually lead to an interest rate cut from the Fed. Restrictive policy is working in both countries but there are long and variable lags. We expect a heightened level of interest rate volatility as the market transitions to lower rates, which will provide HMP with trading opportunities. Elevated bond supply and geopolitical events will also contribute to this environment.

Investment grade credit spreads (and in turn, non-rated municipal spreads) are relatively attractive despite various headwinds coming our way in the next 12 to 18 months. While spreads are not as wide as they have been recently and thus not fully compensating for a hard landing, general risk compensation in the 5-year and under remains decent. The Sub-Advisor will remain active in the non-rated sector as opportunities present themselves and add or reduce exposure as conditions warrant. In the quarter, the yield carry from HMP's overweight in non-rated municipals has declined to the high 20s bps from the high 30s bps.


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