Global X Active Corporate Bond ETF (HAB)

Market Overview

North American bond yields declined significantly over the third quarter (Q3), and yield curves adjusted from being inverted to positively sloped, an environment which has not been seen in over two years. The U. S. Federal Reserve (Fed) started its interest rate-cutting cycle in September by lowering rates by 50 basis points (bps) which surprised some investors looking for a smaller 25-bps reduction. The Fed forecasted it will lower yields from the current restrictive level to a neutral rate over the next two years, ending at 2.875%. However, the market is well on its way to pricing in this yield level over the next year. The unemployment rate continued to nudge higher and inflation made further progress towards the Fed's 2% inflation target. Core inflation, although still elevated, has declined from 4% at the beginning of the year to 3.2% at the end of September. The Fed's rate-setting Federal Open Market Committee (FOMC) has a dual mandate to support maximum employment and return inflation to its target. Over the last several years, the Fed has been more concerned about inflation, but today it judges that the risks to achieving these two goals as now roughly balanced.

The Bank of Canada (BoC) continued to reduce its target for the overnight rate during the quarter to 4.25%. It has now cut rates by 75 bps since early June. The economy continued to operate in excess supply, allowing inflation to move lower which gave the BoC more confidence it would be able to achieve its 2% inflation target over time. Since the start of 2024, headline inflation declined from 3.4% to 2%, and core inflation on average fell 110 bps to 2.4%. The market is now expecting the BoC to cut rates another 170 bps over the next year to end at 2.6%.

Although Q3 saw some turmoil related to fears of a recession, the risk-off tone was brief due to the dovish pivot from the BoC and Fed. In this environment, mid-term Provincial spreads declined four bps to 52 bps and corporate spreads on average narrowed nine bps to 139 bps.

Quarter in Review

The strategy rose by 0.6% in the third quarter (Q3), led by long exposures to equities, bonds, metals and softs. The alpha component delivered positive returns, while the risk parity core was slightly downThe duration was a positive contributor to performance as the fund was positioned for lower rates, but curve positioning was a detractor as Fiera Capital Corporation (the Sub-Advisor) was expecting a flatter curve. Security selection was favourable within the Financial and Real Estate sectors, particularly from names within the Banking, Insurance, and REIT sub-sectors.

Weighted duration deviation (WDD) on corporate bonds remained at -0.06 over the quarter as the Sub-Advisor remained cautious on the level of spread compensation in the face of a potential economic slowdown. The portfolio carry was 20 bps at the end of the quarter.

In the secondary market, HAB sold several names across the curve that had performed well and bought some that were still attractive. In the primary market, HAB made selective purchases to take advantage of new issue concessions – HAB bought Bank of Montreal, Bank of Nova Scotia, CHIP Mortgage Trust, CU Inc., George Weston Ltd., Hydro One, Manulife Bank, RioCan Real Estate Trust, Royal Bank Non-Viability Contingent Capital (NVCC), Smart REIT, and TELUS.

Source: Fiera Capital Corporation as at September 30, 2024.

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