# Global X Active Canadian Bond ETF (HAD)

## 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 we have not seen in over two years.

The Bank of Canada (BoC) continued to reduce its target for the overnight rate during the quarter to 4.25%. They have now cut rates by 75 basis points (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 the year, 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 U.S. Federal Reserve. 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

Duration helped returns over Q3 as Fiera Capital Corporation (the Sub-Advisor) was expecting lower rates, but curve positioning was negative as the Sub-Advisor was set up for a flatter curve. HAD's credit overweight was positive and came from security selection, yield carry in the portfolio, and sector allocation. However, our selection of Federal and Provincial bonds subtracted from performance.

Sector allocation to Financial and Real Estate were positive contributors to corporate performance. Security selection also helped and came from HAD's positioning within the Financial, Energy and Infrastructure sectors.

Weighted duration deviation (WDD) on corporate bonds increased slightly from 0.44 years to 0.46 years as the probability of the soft landing increased. With respect to transaction activity, HAD took profits from several expensive corporate names that had performed well and bought some that were still attractive. The Sub-Advisor made selective purchases in the primary market to take advantage of new issue concessions. During Q3, HAD bought Bank of Montreal, Bank of Nova Scotia, Chip Mortgage Trust, CU Inc., Desjardins, George Weston Ltd., RioCan, and Smart REIT.

At the end of the quarter, the portfolio had a duration of 7.17 years relative to the benchmark duration of 7.34 years.

## Outlook and Positioning

The BoC began the process of loosening monetary policy in June, and the Sub-Advisor expects this to continue in 2024 and 2025. The Sub-Advisor believes the BoC will reduce rates over this period to a neutral level of approximately 2.75%. This does not mean a cut of 25 bps every meeting – the BoC could skip a meeting or even cut by 50 bps. The economy is soft, and inflation has moved lower, but we are not falling off a cliff. The Sub-Advisor's base case is for the BoC to achieve a soft landing next year, but the Sub-Advisor is anticipating volatility and opportunities through this easing cycle. Currently, investors have priced in an overly aggressive BoC making the market vulnerable to a sell-off. The U.S. economy has been more resilient than Canada, but they have also started cutting rates with a goal to get to a neutral level in two years. Restrictive policy is working in both countries but there are long and variable lags. Elevated bond supply and geopolitical events will also contribute to this environment.

Investment grade credit spreads are reflective of a soft landing scenario, where Canadian growth operates below potential but does not fall into a recession, inflation trends towards the target and the BoC cuts to neutral over this period. The Sub-Advisor's focus will remain on the short end of the curve and in high-quality sectors or in names where it believes there is value.

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

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