



# Global X Active Ultra-Short Term Investment Grade Bond ETF (HFR)

## 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 the quarter 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, short-term Provincial spreads declined four basis points to 26 bps and short-term corporate spreads on average narrowed nine basis points to 97 bps.

## Quarter in Review

HFR maintains a very low duration between 0 and 1 year. Canadian short-term rates fell considerably during the quarter as inflation cooled, economic data weakened, and the BoC cut rates a total of 50 bps, putting pressure on interest rates particularly those at the short end of the curve. This volatility allowed us to add value over the quarter as we entered the quarter with a duration of 0.85 years, close to the upper end of the range. At the end of Q3, the portfolio's duration stood at 0.60 years.

With respect to transaction activity, HFR took profits from several expensive corporate names that had performed well and made selective purchases in the primary market to take advantage of new issue concessions.

During the quarter, HFR bought Bank of Montreal, Bank of Nova Scotia, Chip Mortgage Trust, Desjardins, George Weston Ltd., Manulife Bank, RioCan, Royal Bank Non-Viability Contingent Capital (NVCC), and Smart REIT. Our security selection in Bank, Energy, and Real Estate issues also provided added value for the quarter.

## Outlook and Positioning

The BoC began the process of loosening monetary policy in June, and Fiera Capital Corporation (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 do not fall into a recession, inflation trends towards the target and the BoC cuts to neutral over the period. The Sub-Advisor has a modest overweight and will look for attractive opportunities to add to this position, but at the same time, if spreads tighten significantly, it will look to take profits. The Sub-Advisor's focus will remain on 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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