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Canada's bond market cash bombs: 'Fat lady' and 'little girl'

By Warren Lovely

It's June and across Canada's domestic bond market cash bombs are falling. The real 'nuclear' event came a couple weeks back, on June 3rd, when two of the biggest individual cash flow days of the year (June 1st and June 2nd) were concentrated together (Chart 1). Once ignited, related coupon and duration effects exploded over our rates and credit markets. It was something to behold.

Another cash bomb lands today, June 17th, although the related fallout is likely to be much less significant than two weeks' prior. For context, some \$2 billion of FTSE Canada Universe Bond Index cash will be paid out today, the bulk of that really a delayed fuse from June 15th (which landed on a Saturday this year). Compare that with the nearly \$14 billion of Index-related cash that lit up the sky on June 3rd.

As for security rolls, mid-June adjustments have traditionally keyed on Canada Housing Trust/Canada Mortgage Bonds. This year is no different. One large CMB issue rolls out of the Index on Monday (CANHOU 0.95% 06/15/2025; net holdings \$11.26 billion). Another CMB rolls over from the 'Mid' to the 'Short' bucket of the Universe (CANHOU 3.7% 06/15/2029; net holdings \$4 billion). A small cluster of other bonds will supplement these CMB rolls, including a \$1.4 billion PSP Capital

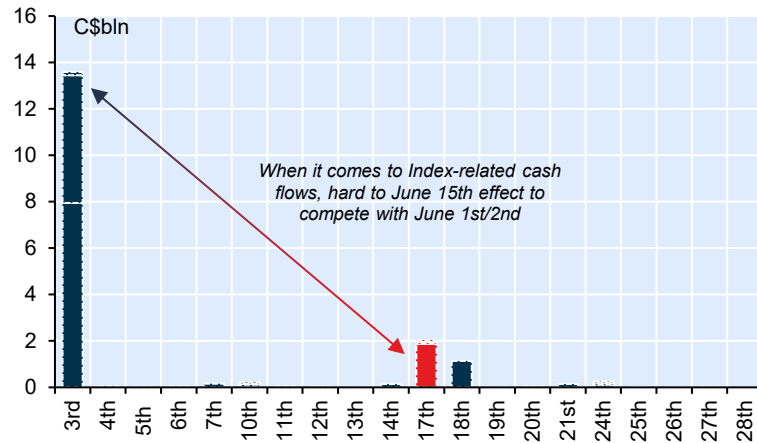
2029 bond that is also rolling from 'Mid' to 'Short' (Chart 2). Generally speaking, few(er) securities roll from 'Long' to 'Mid' in/around June 15th. This year, you won't find a single bond dropping down into the 'Mid' bucket. Isolated/simulated modified duration impacts are thus concentrated in the 'Short' and 'Mid' buckets.

Based on Friday's closing levels and Index constituents, we estimate a ~0.04 year increase in the modified duration of the FTSE Canada Universe Bond Index today, all else equal. While non-trivial, that's nothing compared to the earlier-observed June 3rd duration bomb. This year's June 15th effect also looks to be more contained/modest than prior years (Chart 3). (Note: There are June 18th cash/duration impacts to watch for, primarily focused on provis.)

Finally, if the concussive wave from today's Index-related cash flows fails to knock you off your feet maybe valuations will. Relative to OIS, 5-year CMB spreads currently reside some 2½ standard deviations above the recent averages (Chart 4)—a compelling set-up for fresh supply. Credit is even cheaper in 10s, where CMB and Ontario spreads vs. OIS are at least 3+ standard deviations cheap to recent averages.

Chart 1: Counting June cash (flows)

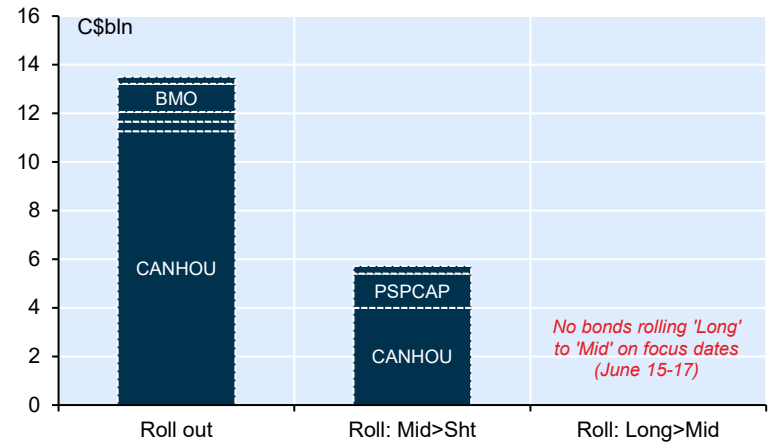
FTSE Canada Universe Bond Index: Jun-24 cash flows by business day



Source: NBF, FTSE Russell | Note: Est. end of May-24; Sat/Sun cash captured Mon

Chart 2: CMB rolls generally the main focus mid-month

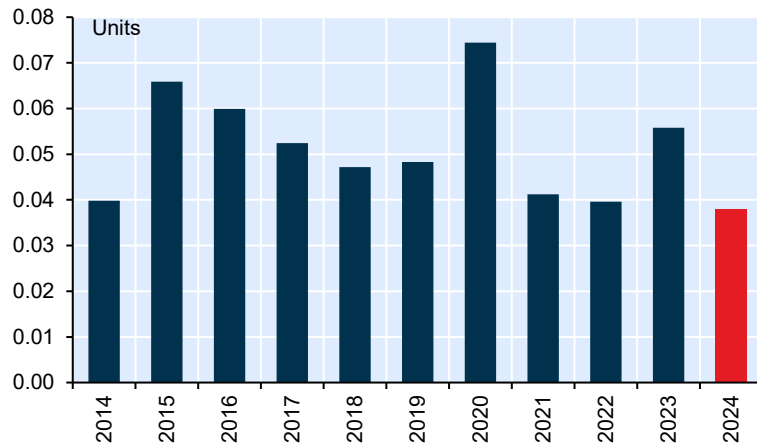
FTSE Canada Universe Bond Index: Securities rolling out/over on 17-Jun-24



Source: NBF, FTSE Russell | Note: Height represents combined holdings of bonds rolling

Chart 3: A relatively smaller duration impact vs. prior years

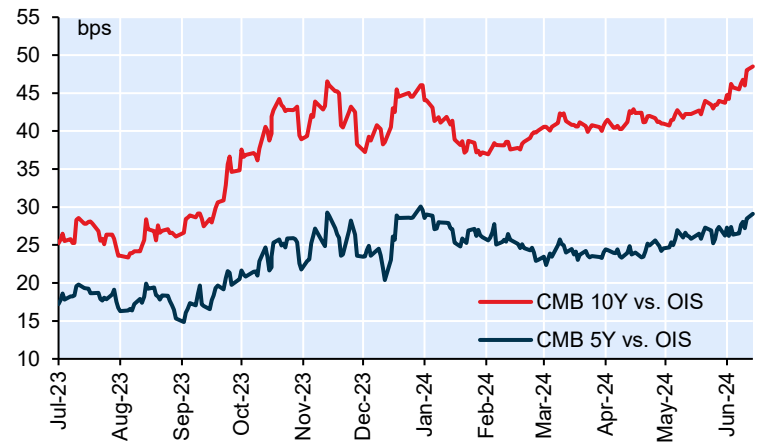
FTSE Canada Universe Bond Index: Est. change in duration on 15-Jun*



Source: NBF, FTSE Russell | Note: NBF simulations using prices & constituents from 14-Jun (or latest); where 15-Jun falls on weekend, duration impact delayed (e.g., to 17-Jun-24)

Chart 4: Asset swap valuations increasingly striking

CMB constant maturity spreads vs. OIS



Source: NBF | Note: Based on NBF's daily new issue, constant maturity spread indications; latest data point refers to 17-Jun-24



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