

### Market Overview

North American bond yields were much higher over the last three months especially longer-term bonds as the curve steepened on the theme of higher-for-longer interest rates.

Positive economic surprises at the start of the quarter and signs of an easing of inflationary pressures gave investors hope that the U.S. Federal Reserve (Fed) may achieve price stability without tipping the economy into a recession. Meanwhile, the Bank of Canada (BoC) increased rates by 25 basis points (bps) in July to 5% as economic growth had been stronger than expected led by consumer spending. Housing was improving, the labour market remained resilient, and immigration was helping to stimulate the economy. Inflation had fallen but remained more persistent than expected. In August, Canadian data was mixed with headline inflation higher, but with growth and employment lower. Participants priced in a 60% probability of another rate hike by December.

In September, rates moved materially higher as both headline and core inflation came in much hotter than expected. Markets moved immediately to price in a full 25 bps increase by the BoC by year-end and removed rate cuts built in for 2024. The economy slowed down in Q3 but not fast enough to bring inflation to the 2% target. Population growth, employment and pent-up demand have prevented the economy from going into a recession. The job market had been showing signs of cooling after a blistering start to the year, however, the latest report surprised to the upside. The unemployment rate remains low at 5.5% and hourly wages are high at 5.2%. Key measures of core inflation are elevated at 4%. In the U.S. the economy is not slowing very quickly driven by consumer savings, pent-up demand, and a powerful fiscal stimulus. The Fed has hinted they may still need to increase rates again in this cycle but then it will be necessary to hold rates high for a long period to bring inflation down to 2%. The repricing of rate cuts drove bond yields higher and steepened the curve.

In this environment, short-term Provincial spreads decreased 2 bps to 35 bps and corporate spreads narrowed 9 bps to 137 bps.

### Quarter in Review

The very low total duration kept generally between 0 and 1 year in the quarter limited rate impact on the quarter. Corporates, yielding on average 6.16% did provide stable carry once again in the quarter while also benefiting from spread compression in the quarter.

We took profits from several expensive corporates that had performed well. We were also very selective in the primary market to take advantage of new issue concessions. These names included TD bail-in, CIBC bail-in, National Bank bail-in, Rogers Communication, Coast Capital, West Edmonton Mall, and Enbridge Hybrid. In the quarter, our selection in Pipelines, Banks, and real estate issuers provided value added.

### Outlook and Positioning

We were surprised by the uptick in the core measures of inflation in September after trending lower for most of the year. If this is repeated with the next reading, the BoC will likely increase rates. This outcome is already reflected in the market. The Fed is also getting close to finishing its tightening campaign.

We believe monetary policy is restrictive and over time the economy will slow and lower inflation. Our base case is for an economic slowdown in 2024 that will eventually lead to interest rate cuts, but this is getting pushed further and further out as inflation remains sticky. Investors are now looking for the first interest rate cut from the Bank at the end of the first quarter of 2025.

# HFR Quarterly Commentary

Horizons Active Ultra-Short Term Investment Grade Bond ETF

Q3 2023

Portfolio duration ended Q3 around 1.03 years. Although corporate spreads generally reflect our base case, we did take profits in the quarter as some names got very expensive on the back of strong investor appetite. If corporate spreads tighten more, we could look to take further profits or if they widen to reflect a significant slowdown, we could increase our exposure. We continue to closely monitor issuers that are more sensitive to higher interest rates factoring in the higher-for-longer backdrop. The yield at quarter end is approximately 6.34%, which makes it quite attractive as we approach the peak of the hiking cycle.



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