

Quick Hit – Keep your eyes on the Crown (the 10-year one that is)

A nice orderly new issue calendar might call for a 10-year CMB re-opening this week and it is to say that this inaugural fixed deal to ring in the New Year is arriving in timely fashion. As such, the recent risk-off market sentiment led the way to a major equity bear market, the S&P 500 having even plunged 4.1% on February 5th, representing the largest decline since August 2011 (Chart 1). This hints for a return to more defensive investment strategies in which CMB certainly hold a place of choice.

CMB spreads have shown decent resilience - as would be expected - throughout the latest bout of provincial credit spread widening that occurred in early January. Prior to that widening, both the 5-year and 10-year Ontario vs CMB relationships were sitting at the tightest level on the range since 2010 (with similar tights observed in February 2015, Chart 2), prompting many investors to turn the switch on significant CMB reallocation out of provincials. That trend somewhat faltered later in the month and into February, as CMB spreads outperformed - at the margin - relative to provincials'. Nonetheless, the Ontario vs CMB relationship currently stands right about the average since 2017. Also noteworthy would be that provinces have accumulated some amount of pre-funding, leaving them with no urgent need to tap the market with overwhelming supply that could in turn pressure the aforementioned relationship.

On an absolute basis, CMB spreads have appreciated a fair bit since February 2016. As an aside, this trend was extensively shared with other provincial and corporate credits alike, as they started to recoup the significant widening endured from a weakening crude - which strengthened back around February 2016.

Now, CMB spreads likely appear slightly rich when reverted back to an asset swap basis. As such, Canadian swap spreads have widened in general since the beginning of the year, resulting from a mix of factors that would include:

- The massive 30yr/10yr Canada curve flattening (~17bps in January) which brought about paying interest in the sector on the swap curve, with flows and yield levels also influencing the 10-year sector;
- New issues in the U.S. that were swapped back in Canadian dollars;
- Institutional accounts having put into place rate locks; and
- Slower natural receiving flow from insurers over the last few weeks/months.

All in all, it is fair to say that the generally tighter CMB spread environment of late - notwithstanding last week's credit spread widening - not only reflects an overall credit appreciation, but also a strong demand for high quality credit. The latter has oftentimes proven more stable in the face of adversity (and prosperity, for that matter), a characteristic that certainly has some merit in the current uncertain environment.

Chart 1: Equities dive to late 2017 levels

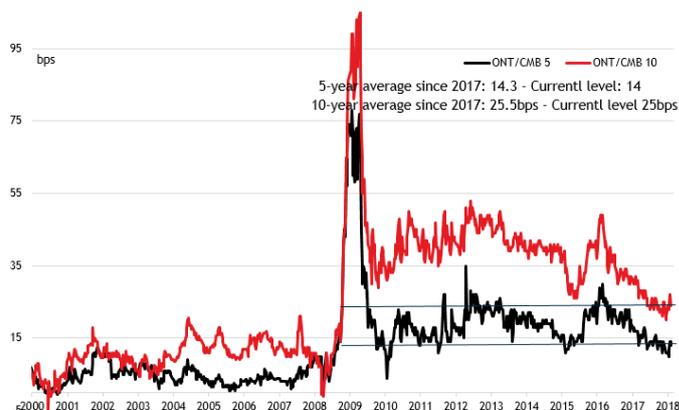
S&P 500 Index



Source: NBF, Bloomberg

Chart 2: CMB spreads relatively attractive

5-year and 10-year Ontario vs relationships



Source: NBF

Fixed Income Trading Desk Strategy

Public Sector Strategy

Warren Lovely

+1 416-869-8598 | Warren.Lovely@nbc.ca

Catherine Maltais

+1 514-879-8598 | Catherine.Maltais@nbc.ca

Taylor Schleich

+1 416-869-6480 | Taylor.Schleich@nbc.ca

Corporate Credit

Connor Sedgewick

+1 514-879-3182 | Connor.Sedgewick@nbc.ca

Pete Metzger

+1 416-869-8607 | Pete.Metzger@nbc.ca

Relative Value Models

Drew Lloyd

+44 (0)20-7488-9379 | Drew.Lloyd@nbc.ca

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