

Quick Hit – Trade From Away

We trade more than our fair share of bonds at National Bank Financial. So I don't necessarily hear "traded away" all that often on the desk. But "trade from away"—that is, buying and selling interest originating from non-residents—well that's another story entirely.

We were served up Q3 domestic bond trading stats the other day, and as always, there were plenty of interesting nuggets if you went digging. Let's start at the highest possible level: total trading volumes (industry wide, covering all sectors, and including exchanges between all dealers, brokers and clients... be they domestic or international). During the third quarter of 2017, \$3.08 trillion of Canadian bonds traded hands. That works out to an average daily volume of just under \$50 billion. So ya, our market is fairly liquid.

Strictly speaking, total quarterly volumes were off some 7% vs Q2. That was, however, a much smaller drop-off than what one would typically expect to see during the summer quarter, when concentrated holidays and a related slowdown in primary supply tends to result in double-digit declines in secondary flow. Fact is, third quarter volumes easily surpassed the max Q3 level established during the prior decade. When we control for established/stable seasonal patterns in the data, our estimate of seasonally adjusted total trading volumes stands a healthy 9% above the prior quarter... bringing to seven the number of consecutive quarters where seasonally adjusted volumes expanded. Refer to Chart 1 for an illustration of raw and seasonally adjusted trading volumes.

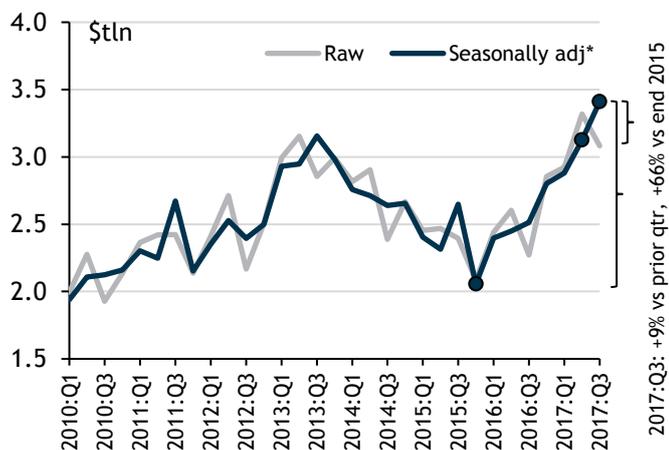
What of the non-resident trading volumes? Well, their contribution was easy enough to see in Q3. Bucking the broader trend, non-resident volumes (across all sectors) actually edged a bit higher vs Q2, setting a new high-water mark for a third quarter. At \$542 billion, trading in Canadian bonds by non-residents accounted for 17.6% of total trading in Q3. But here again, the underlying story is even more compelling. Strip out the considerable amount of trading that gets done via broker systems, between dealers or within a given bank and you're left with a much better measure of client business. And it's here when the non-resident influence is hard to ignore, accounting for roughly one-third of secondary market business (our estimate for the industry as a whole).

Trade with internationals has long been concentrated in Canadas and Q3 was no exception; 0-10 year GoC bonds accounted for 85% of non-res volumes last quarter. Fair to say that record sovereign supply (linked, in part, to federal deficits) and a noted re-pricing of Canadian rates (as the Bank of Canada delivered a couple of rate hikes during the quarter) has spurred greater turnover, regardless of where a counterparty resides. Here's a stat for you: non-resident trading of GoC bonds in Q3 eclipsed the combined amount of trade in provincial, municipal, financial, corporate, ABS and maple bonds that was carried out *industry wide*. Notwithstanding this noted GoC concentration, non-residents are becoming more and more important players in other segments of the market. You can see this on new issue buyer lists and you can likewise observe it in secondary trading stats (Chart 2). The non-resident share of trading in federal crown bonds (notably CMB) jumped in Q3, with internationals likewise more active traders of provincial and corporate paper during the quarter. In our municipal bond market, non-residents have also become much more active; their Q3 trade in munis was more than double the corresponding 2016:Q3 tally, with year-to-date volumes spiking some 40% higher.

Suffice it to say, more and more of our bond market counterparties tend to be located in faraway corners of the globe (or least beyond our national borders). And in much the same way that a community or an economy draws strength from diversity, so too might our bond market benefit from the incremental breadth and depth of distribution, additional sources of liquidity and more efficient price discovery that an engaged non-resident investor base provides... particularly if they're willing and able to lend out their growing mountain of bonds!

Chart 1: Seasonally adjusted volumes on the rise

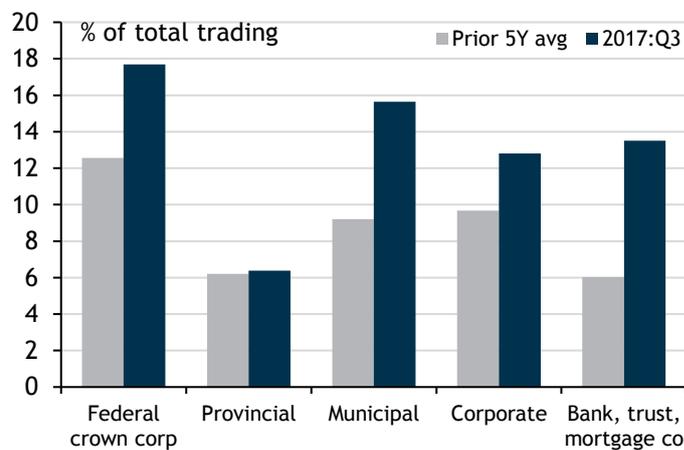
Canada domestic bond trading volumes: Raw & seasonally adjusted



Source: NBF, Bank of Canada | Note: NBF seasonal adj using X-12 process

Chart 2: Beyond GoC, non-res trading share rises

Non-resident share of total domestic bond trading (non-GoC sectors)



Source: NBF, Bank of Canada

PLEASE SEE END OF DOCUMENT FOR IMPORTANT DISCLOSURES

Fixed Income Trading Desk Research

Public Sector Research

Warren Lovely

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

Catherine Maltais

+1 514-879-2270 | Catherine.Maltais@nbc.ca

Corporate Credit

Connor Sedgewick

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

Relative Value Models

Drew Lloyd

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

Important Disclosures

General

This Report was prepared by National Bank Financial, Inc. (NBF), (a Canadian investment dealer, member of IIROC), an indirect wholly owned subsidiary of National Bank of Canada. National Bank of Canada is a public company listed on the Toronto Stock Exchange.

The particulars contained herein were obtained from sources which we believe to be reliable but are not guaranteed by us and may be incomplete and may be subject to change without notice. The information is current as of the date of this document. Neither the author nor NBF assumes any obligation to update the information or advise on further developments relating to the topics or securities discussed. The opinions expressed are based upon the author(s) analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein, and nothing in this Report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances. In all cases, investors should conduct their own investigation and analysis of such information before taking or omitting to take any action in relation to securities or markets that are analyzed in this Report. The Report alone is not intended to form the basis for an investment decision, or to replace any due diligence or analytical work required by you in making an investment decision.

Any opinions expressed herein reflect a trading perspective. NBF, or its affiliates may publish fundamental research on the subject issuer(s), which may reflect a different opinion. This Report is not produced by the NBF Research Department and has not been reviewed by the NBF Research Department.

This Report is for distribution only under such circumstances as may be permitted by applicable law. This Report is not directed at you if NBF or any affiliate distributing this Report is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that NBF is permitted to provide this Report to you under relevant legislation and regulations.

National Bank of Canada Financial Markets is a trade name used by National Bank Financial and National Bank of Canada Financial Inc.

National Bank Financial Inc. or an affiliate thereof, owns or controls an equity interest in TMX Group Limited ("TMX Group") and has a nominee director serving on the TMX Group's board of directors. As such, each such investment dealer may be considered to have an economic interest in the listing of securities on any exchange owned or operated by TMX Group, including the Toronto Stock Exchange, the TSX Venture Exchange and the Alpha Exchange. No person or company is required to obtain products or services from TMX Group or its affiliates as a condition of any such dealer supplying or continuing to supply a product or service.

Canadian Residents

NBF or its affiliates may engage in any trading strategies described herein for their own account or on a discretionary basis on behalf of certain clients and as market conditions change, may amend or change investment strategy including full and complete divestment. The trading interests of NBF and its affiliates may also be contrary to any opinions expressed in this Report.

NBF or its affiliates often act as financial advisor, agent or underwriter for certain issuers mentioned herein and may receive remuneration for its services. As well NBF and its affiliates and/or their officers, directors, representatives, associates, may have a position in the securities mentioned herein and may make purchases and/or sales of these securities from time to time in the open market or otherwise. NBF and its affiliates may make a market in securities mentioned in this Report. This Report may not be independent of the proprietary interests of NBF and its affiliates.

This Report is not considered a research product under Canadian law and regulation, and consequently is not governed by Canadian rules applicable to the publication and distribution of research Reports, including relevant restrictions or disclosures required to be included in research Reports.

UK Residents

This Report is a marketing document. This Report has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. In respect of the distribution of this Report to UK residents, NBF has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). This Report is for information purposes only and does not constitute a personal recommendation, or investment, legal or tax advice. NBF and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant investments or related investments discussed in this Report, or may act or have acted as investment and/or commercial banker with respect hereto. The value of investments, and the income derived from them, can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance. If an investment is denominated in a foreign currency, rates of exchange may have an adverse effect on the value of the investment. Investments which are illiquid may be difficult to sell or realise; it may also be difficult to obtain reliable information about their value or the extent of the risks to which they are exposed. Certain transactions, including those involving futures, swaps, and other derivatives, give rise to substantial risk and are not suitable for all investors. The investments contained in this Report are not available to retail customers and this Report is not for distribution to retail clients (within the meaning of the rules of the Financial Conduct Authority). Persons who are retail clients should not act or rely upon the information in this Report. This Report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

This information is only for distribution to Eligible Counterparties and Professional Clients in the United Kingdom within the meaning of the rules of the Financial Conduct Authority. NBF is authorised and regulated by the Financial Conduct Authority and has its registered office at 71 Fenchurch Street, London, EC3M 4HD.

NBF is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom.

U.S. Residents

National Bank of Canada Financial Inc. (NBCFI), a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of the Financial Industry Regulatory Authority (FINRA), and a member of the Securities Investor Protection Corporation (SIPC), is distributing this Report in the United States. NBCFI operates pursuant to a 15 a-6 Agreement with its Canadian affiliate, NBF Inc.

This Report has been prepared in whole or in part by personnel employed by non-US affiliates of NBCFI that are not registered as broker/dealers in the US. These non-US personnel are not registered as associated persons of NBCFI and are not licensed or qualified as research analysts with FINRA or any other US regulatory authority and, accordingly, may not be subject (among

other things) to FINRA restrictions regarding communications by a research analyst with the subject company, public appearances by research analysts and trading securities held in a research analyst account.

The author(s) who prepared these Reports certify that this Report accurately reflects his or her personal opinions and views about the subject company or companies and its or their securities, and that no part of his/her compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this Report as to the securities or companies.

NBF compensates the authors of this Report from a variety of sources, and such compensation is funded by the business activities of NBF including, Institutional Equity and Fixed Income Sales and Trading, Retail Sales, the correspondent clearing business and Corporate and Investment Banking.

Because the views of its personnel may differ, members of the National Bank Financial Group may have or may in the future issue Reports that are inconsistent with this Report, or that reach conclusions different from those in this Report. To make further inquiry related to this Report, United States residents should contact their NBCFI registered representative.

This document is intended for institutional investors and is not subject to all of the independence and disclosure standards under FINRA rules applicable to debt research Reports prepared for retail investors. This Report may not be independent of the proprietary interests of NBF, NBCFI, or their affiliates. NBF, NBCFI, or their affiliates may trade the securities covered in this Report for their own account and on a discretionary basis on behalf of certain clients. Such trading interests may be contrary to the recommendation(s) offered in this Report.

HK Residents

With respect to the distribution of this email in Hong Kong by NBC Financial Markets Asia Limited ("NBCFMA") which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 (dealing in securities) regulated activity, the contents of this email are solely for informational purposes. It has not been approved by, reviewed by, verified by or filed with any regulator in Hong Kong. Nothing herein is a recommendation, advice, offer or solicitation to buy or sell a product or service, nor an official confirmation of any transaction. None of the products issuers, NBCFMA or its affiliates or other persons or entities named herein are obliged to notify you of changes to any information and none of the foregoing assume any loss suffered by you in reliance of such information.

The content of this email may contain information about investment products which are not authorized by SFC for offering to the public in Hong Kong and such information will only be available to, those persons who are Professional Investors (as defined in the Securities and Futures Ordinance of Hong Kong ("SFO")). If you are in any doubt as to your status you should consult a financial adviser or contact us. This material is not meant to be marketing materials and is not intended for public distribution. Please note that neither this material nor the product referred to is authorized for sale by SFC. Please refer to product prospectus for full details.

There may be conflicts of interest relating to NBCFMA or its affiliates' businesses. These activities and interests include potential multiple advisory, transactional and financial and other interests in securities and instruments that may be purchased or sold by NBCFMA or its affiliates, or in other investment vehicles which are managed by NBCFMA or its affiliates that may purchase or sell such securities and instruments. No other entity within the National Bank of Canada group, including NBF, is licensed or registered with the SFC. Accordingly, such entities and their employees are not permitted and do not intend to: (i) carry on a business in any regulated activity in Hong Kong; (ii) hold themselves out as carrying on a business in any regulated activity in Hong Kong; or (iii) actively market their services to the Hong Kong public

Copyright

This Report may not be reproduced in whole or in part, or further distributed or published or referred to in any manner whatsoever, nor may the information, opinions or conclusions contained in it be referred to without in each case the prior express written consent of NBF.