

January 12, 2021 - (Vol. V, No. 5)

Canada's 2020 fixed income trading awards go to...

By Warren Lovely

We've lost track of all the end-of-year awards variously handed out in recognition of 2020 performances. But the litany of accolades got us thinking: Why not hand out a few awards of our own, based on the year that was in Canada's fixed income markets. After all, we just received the final tranche of IIROC's MTRS 2.0 bond and money market secondary trading statistics for 2020. So here goes, a collection of trading/volume awards, presented with tongue planted in cheek. And no, we're not here to single out individual dealers, investors or traders. The great and influential ones know who they are. Rather, our awards are thematic and/or sector specific. The envelope please...

Money Market – When it comes to awards, this might be akin to the Emmy's. No disrespect intended; some of our favourite distractions are TV shows that have vied for Emmy statues over the years. And Canada traded ~C\$5 trillion in money market paper last year. That's no joke.

Go with the flow award: GoC T-bills | Fully one-third of money market trading was in GoC T-bills last year, up from ~25% in pre-virus days. Traders had a lot to keep track of in 2020, as bills were a vital funding source for a federal government rushing out virus supports. Operations increased (then decreased) in frequency, while tender sizes and BoC allocation percentages shifted significantly. A likely theme for 2021: terming out of the T-bill stock, leaving fewer bills o/s.

Gettin' busy award: Provincial T-bills | There were plenty of fireworks here too, with a special BoC purchase program earlier training a spotlight on some specific provincial liquidity pressures. But even after winding the PMMP program down, provincial T-bill volumes have remained healthy enough (+23% Y/Y as of Q4). Meanwhile, excess liquidity/strong investor demand has driven a major compression in yield (vs. GoC), which could well have some staying power.

Where'd you go award: Commercial/asset backed paper | CP liquidity went AWOL during the crisis, necessitating yet another BoC special program. Market stress has faded, but CP volumes haven't come back due to issuers not needing to borrow. There's nonetheless excess demand from clients for various CP names. Honourary mention: Bankers' Acceptances, where volumes were off 11% year-on-year as of Q4. Mind you, BAs still accounted for the largest share of money market trading in 2020 (41%), owing to the relatively short average term.

Bond Market – Think of this as the Oscars. Notional bond volumes were three-times larger than money market last year (approaching C\$15 trillion). It's here where the big duration bets get placed and where participants must contend with greater credit risk and pockets of illiquidity.

Busiest overall segment of the market: 3-10 year Canadas | The greatest action is consistently recorded in 'mid' Canadas—over 40% of all bond trading last year. This segment accounts for a disproportionate share of trading relative to outstandings. In other words, there's superior turnover vs. the long end but...

Biggest increase in GoC trading: Longer term Canadas, including RRBs | Trading activity followed issuance out the curve in 2020, as volumes in >10 year Canadas grew notably. RRBs accounted for less than 1% of total GoC trading vs. 9% of outstanding Canadas. Saying that, RRB volumes surged in 2020:Q4 vs. the prior year, setting a MTRS 2.0 record for the product. Activity was particularly brisk in December, as the first-ever rollout of a CANRRB from the index sparked some flow. More generally, investors on both sides of the border could increasingly vie for inflation protection as the recovery takes hold.

You're so special award: Any number of GoC bonds | The BoC's QE program still looks too big for the market. BoC holdings of many Canada bonds continue to accumulate and the Bank's overall ownership share is still marching higher. Tight conditions are already impacting credit spreads. To us, further moderation in BoC QE will be needed.

Turn me over award (excl. GoC): CMBs | Federal Crowns accounted for 25% of non-GoC bond trading last year, whereas provis were home to nearly half of such trading. But control for the stock of debt and it's clear that turnover in federal crown debt (most notably CMBs) remained superior (~3X based on full-year volumes relative to the stock of outstanding bonds).

Fastest growth in credit trading: Municipal bonds | Munis might not be the most actively traded product, and these bonds continue to comprise a relatively modest share of issuance and outstandings. But volumes perked up smartly in 2020, standing 34% higher in Q4 vs. the prior year. We'll resist handing out a *lifetime achievement award* in municipal bond trading, although it would have to go National Bank Financial. Instead, we'd tend to highlight growing depth and breadth in Canada's municipal bond market. That's a welcome development with C\$5.5-6.5 billion of gross municipal bond supply to distribute in calendar 2021.

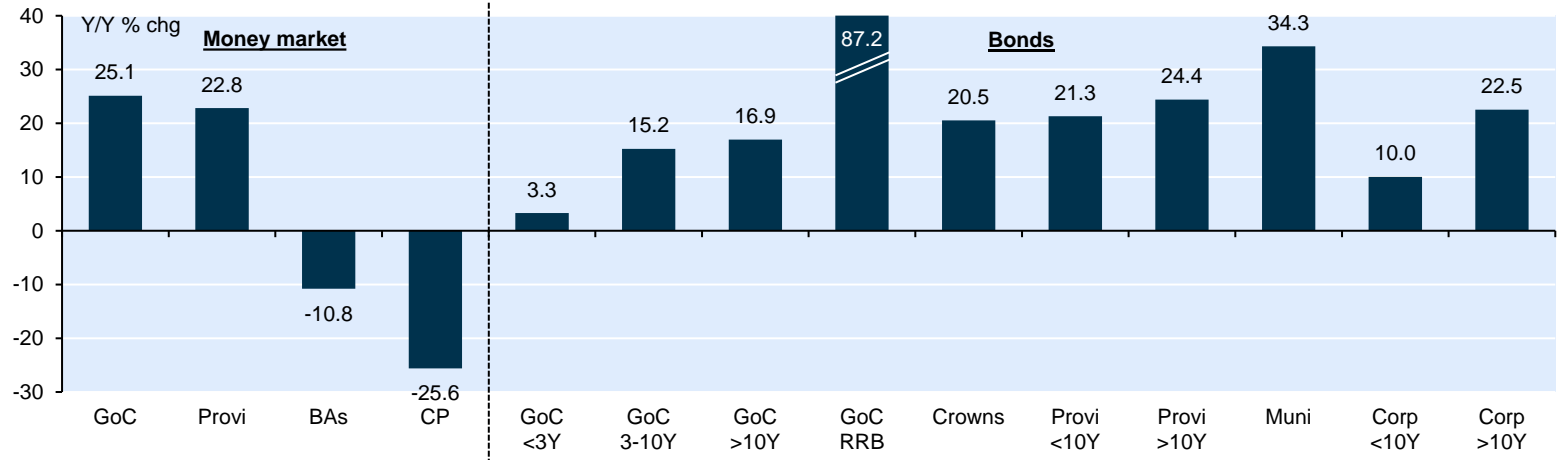
Consistently busy award + strip that down award: Provincial bonds | A couple awards here; provi volumes grew 23% in 2020. That included an extraordinary amount of trading in Q2, as a massive policy response (including the BoC's PBPPP) restored confidence and kicked off a surge in activity. There will be no shortage of opportunity in 2021, with issuance likely double the pre-virus trend and the hunt for yield still on. Trading in strips picked up in final quarter of 2020 led by provincials, which consistently account for the majority of strip bond trading.

Domestic investor choice award: Credit, not Canadas | We're not saying domestic investors are disinterested in GoC bonds, but they're increasingly scarce given the BoC's QE vacuum. Instead, the biggest increase in trading activity amongst domestic clients was reserved for federal crowns, provincials and corporates. Judging from spread compression, the prevailing trade was "offer wanted".

Non-resident investor choice award: Take your pick | Trading with non-resident investors was up across the board as 2020 drew to a close. The largest non-resident trading share belongs to Canada T-bills and bonds; both products saw a sharp pick-up in interest from international investors, in part due to a dramatic increase in net borrowing by Ottawa. Looking at Q4 vs. the prior year, non-res volumes more than doubled in corporate bonds (+125%) and were also notably higher in federal crown bonds (+83%) and provi bonds (+67%).

Chart 1: Assessing growth in latest quarterly trading volumes across Canada's fixed income market

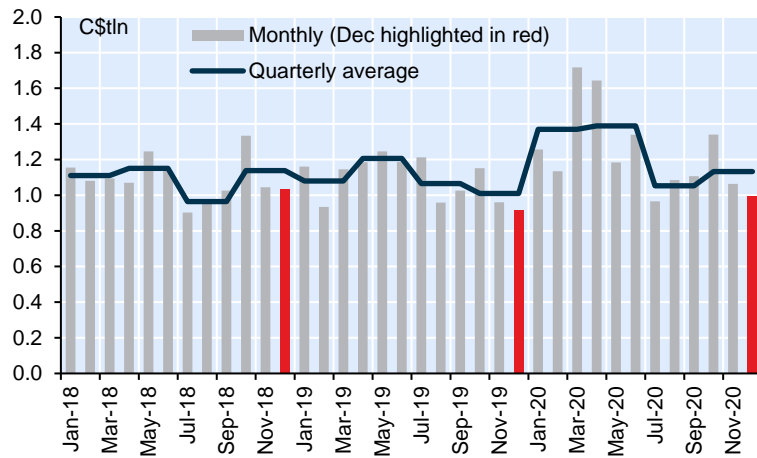
Year-over-year growth in total Canadian secondary bond & money market trading by major sector/tenor: 2020:Q4



Source: NBF, IIROC | Note: Change in total trading, 2020:Q4 vs. 2019:Q4; chg in GoC RRB trading exceeds top-most vertical axis value

Chart 2: Monthly bond volumes in MTRS 2.0 reporting regime

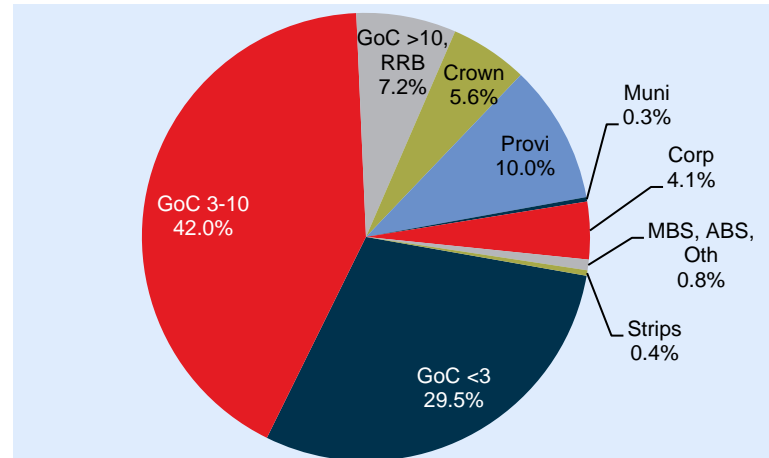
Canada secondary bond trading: Monthly (with quarterly averages)



Source: NBF, IIROC | Note: Total 2020 bond trading (all sectors) +13% vs. prior year

Chart 3: Bond volume dissection

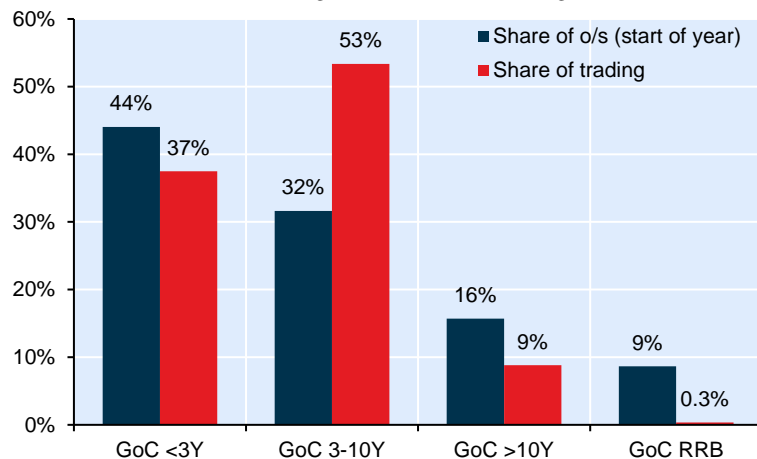
Share of Canada secondary bond trading by major sector/term: 2020



Source: NBF, IIROC | Note: Share of C\$14.83 trillion in total bond trading in 2020

Chart 4: Relatively brisk turnover in 'mid' Canadas

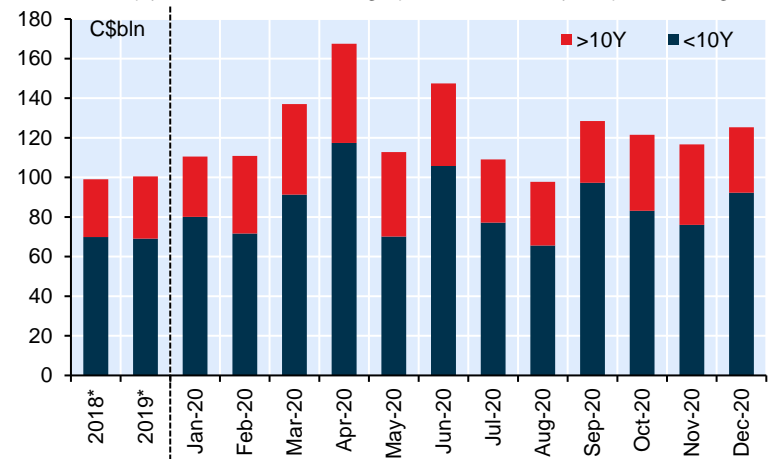
Share of total GoC bond trading vs. share of outstanding bonds: 2020



Source: NBF, IIROC, Bank of Canada | Note: GoC outstanding bonds as at 1-Jan-2020; share of GoC trading based on full-year total

Chart 5: Provincial bond trading surged across curve

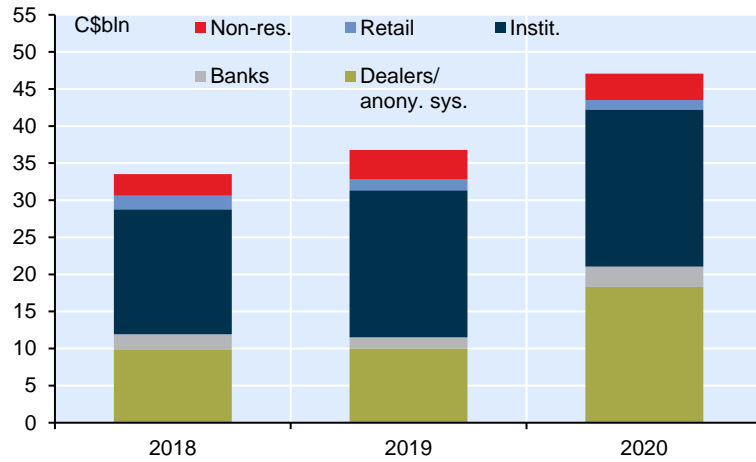
Total monthly provincial bond trading by tenor: 2020 vs. prior year averages



Source: NBF, IIROC | Note: Figures for 2018 & 2019 represent monthly averages for year; total 2020 provincial bond trading +23% vs. prior year

Chart 6: Trend in municipal bond trading has been up

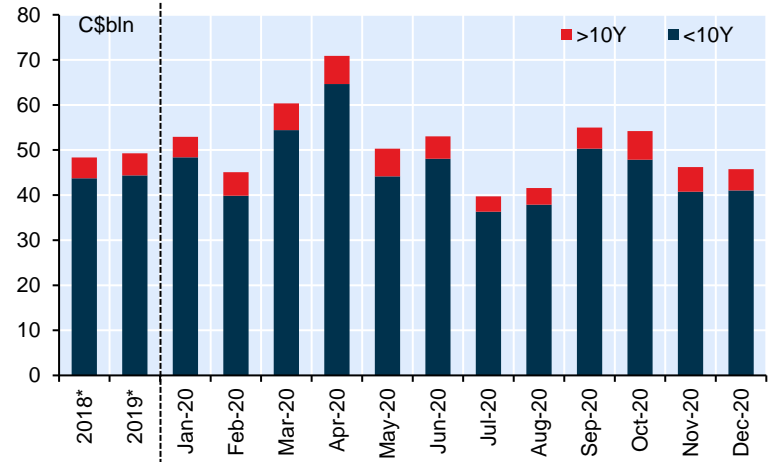
Total annual municipal bond trading by counterparty type



Source: NBF, IIROC | Note: Total 2020 municipal bond trading +29% vs. prior year

Chart 7: Less growth in corporate bond trading last year

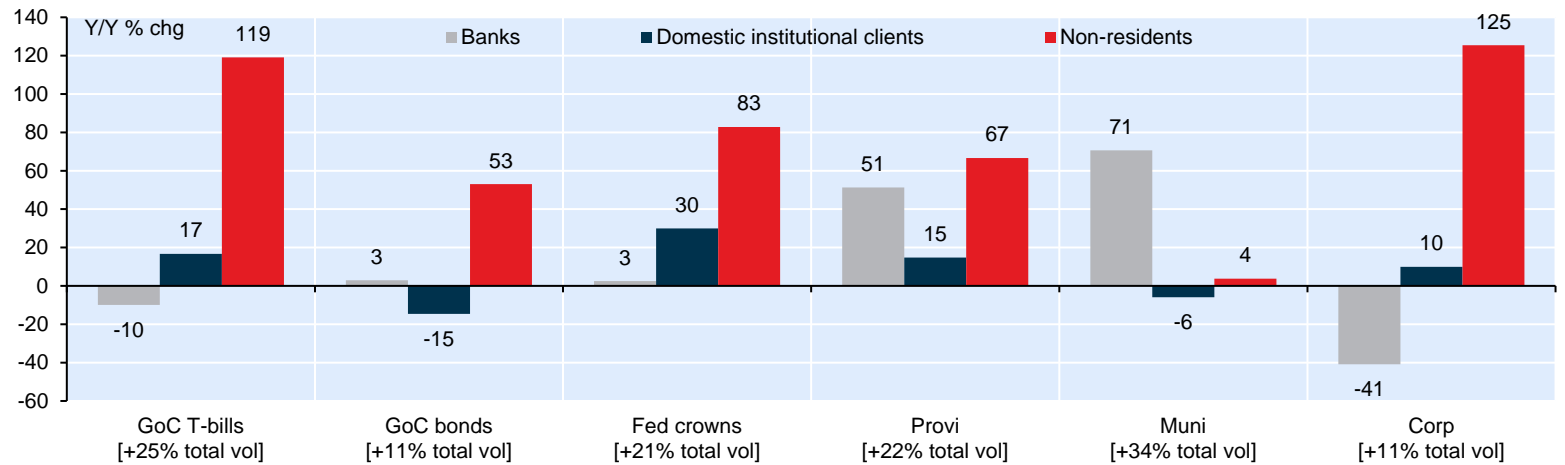
Total monthly corporate bond trading by tenor: 2020 vs. prior year averages



Source: NBF, IIROC | Note: Figures for 2018 & 2019 represent monthly averages for year; total 2020 corporate bond trading +4% vs. prior year

Chart 8: A closer look at what some key investor types were trading

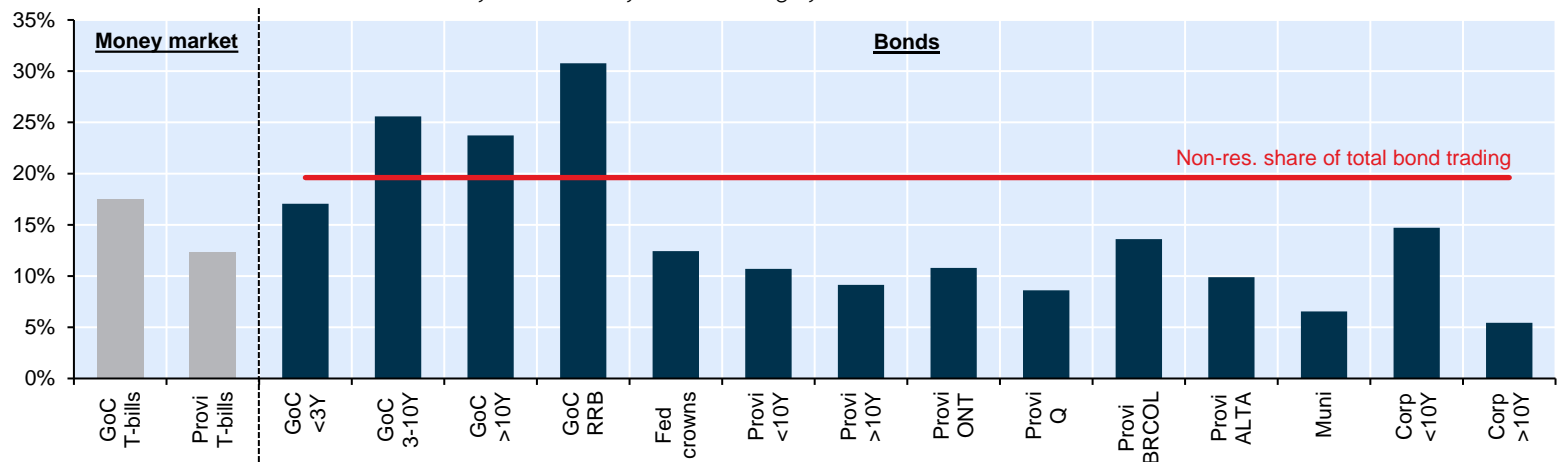
Year-over-year growth in Canadian secondary bond & money market trading by select investor type & sector: 2020:Q4



Source: NBF, IIROC | Note: 2020:Q4 vs. 2019:Q4; figures in [] under each sector label refer to year-over-year change in secondary trading across all counterparties

Chart 9: What share of trading have non-residents recently accounted for?

Non-resident share of total Canadian secondary bond & money market trading by select sector: 2020:Q4



Source: NBF, IIROC | Note: Shares for individual provinces reflect total for all tenors; provinces listed by BBG ticker



Economics and Strategy

Montreal Office 514-879-2529

Stéfane Marion

Chief Economist and Strategist
stefane.marion@nbc.ca

Paul-André Pinsonnault

Senior Economist
paulandre.pinsonnault@nbc.ca

Daren King

Economist
daren.king@nbc.ca

Matthieu Arseneau

Deputy Chief Economist
matthieu.arseneau@nbc.ca

Angelo Katsoras

Geopolitical Analyst
angelo.katsoras@nbc.ca

Jocelyn Paquet

Economist
jocelyn.paquet@nbc.ca

Kyle Dahms

Economist
kyle.dahms@nbc.ca

Camille Baillargeon

Intern Economist
camille.baillargeon@nbc.ca

Toronto Office 416-869-8598

Warren Lovely

Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich

Rates Strategist
taylor.schleich@nbc.ca

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.

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.

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

With respect to the distribution of this report in the United States of America, National Bank of Canada Financial Inc. ("NBCFI") which is regulated by the Financial Industry Regulatory Authority (FINRA) and a member of the Securities Investor Protection Corporation (SIPC), an affiliate of NBF, accepts responsibility for its contents, subject to any terms set out above. To make further inquiry related to this report, or to effect any transaction, United States residents should contact their NBCFI registered representative.

This report is not a research report and is intended for Major U.S. Institutional Investors only.

This report is not subject to U.S. independence and disclosure standards applicable to research reports.

HK Residents

With respect to the distribution of this report 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) and Type 3 (leveraged foreign exchange trading) regulated activities, the contents of this report 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 report 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 National Bank of Canada and National Bank Financial Inc, 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.