

Cash is king (with much more of it to flow in 2023)

By Warren Lovely

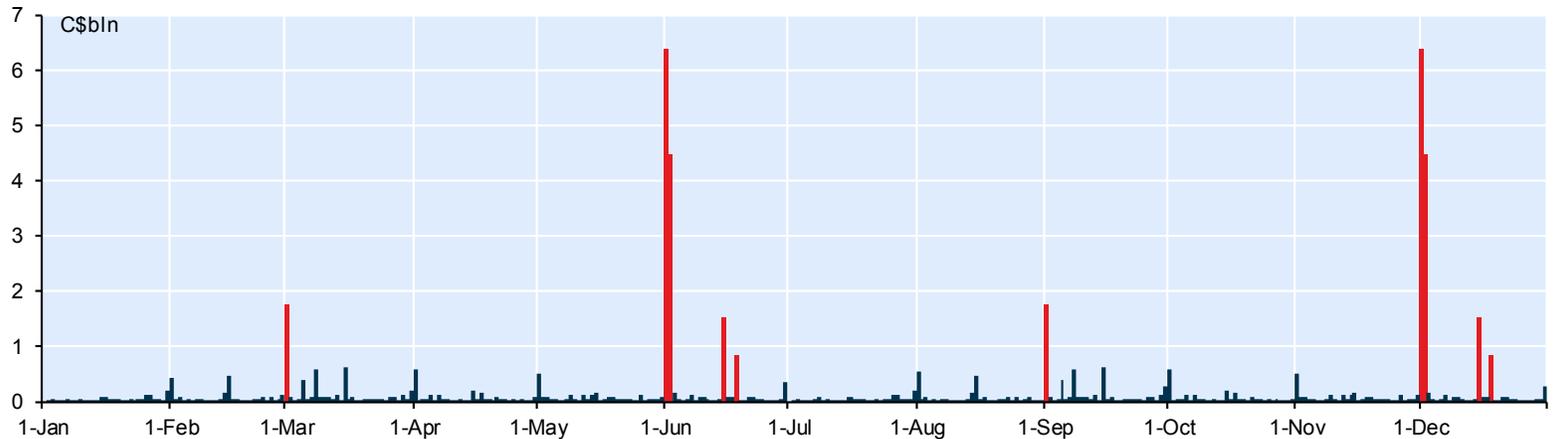
Before tacking any new calendar to the wall, it's customary to pencil in particularly notable days. For fixed income investors, dealers or strategists, many of the most vital days coincide with major economic data releases, monetary policy decisions/communications, budgets/funding announcements and assorted other geopolitical events. For Canada's domestic bond market, however, there are always a handful of additional days that are worth prepping for: those characterized by distinctly outsized cash flows.

Canada's heavy concentration of bond maturities and the resulting lumpiness in fixed income cash flows are nothing new. In a sense, consistently chunky cash flows have produced something of a normal sinus rhythm for our bond market. Historically, hefty cash flows, index roll outs/roll overs and associated portfolio adjustments have coloured absolute and relative performance in Canadian rates and credit markets. After all, when you have over 50% of a year's cash paid out on just 10 days (comprising less than 3% of the calendar) it pays to sit up and take notice. Of course, as we've seen more than once (including in 2022), markets must account for (contend with) more than mere cash flows.

What makes 2023 potentially notable/special is the larger amount of cash due to be paid out. Based on current FTSE Canada Universe Bond Index constituents, we estimate C\$58.4 billion in total index cash flows for calendar 2023 (a figure that will ultimately change as more issues arrive). That's almost 15% more cash than the past couple of years and is more like 25% higher than what flowed half a decade ago. We'll be previewing Canada's particularly noteworthy cash flow days as they get closer. For now, this *Market View* may prove handy when marking up your calendar. Some of these days are simply too important to miss.

Chart 1: Distinctly lumpy cash flows produce normal sinus rhythm for Canada's domestic bond market

Projected daily FTSE Canada Universe Bond Index cash flows: 2023

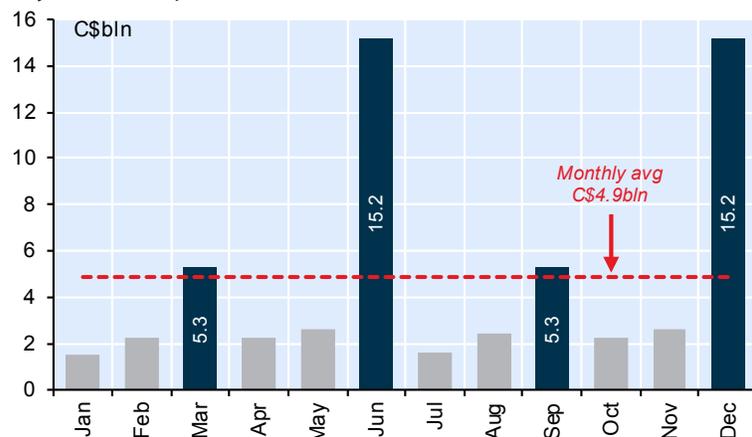


Source: NBF, FTSE Russell | Note: For all charts, estimates/analysis based on Index constituents/pricing captured at end of each year (e.g., 2023 cash flows estimated end of Dec-22)

This is how 2023's \$58.4bn of index cash shakes out. Chunky? No question. There won't be a whole lot to key on in either January or February, with the first major day of note coming March 1st. Things get *really* interesting in June, where the 1st, 2nd, 15th and 18th are all important days. Then, of course, there's the six-month echo effect in September (1st) and December (1st, 2nd, 15th, 18th).

Chart 2: June & December remain most important months...

Projected monthly FTSE Canada Universe Bond Index cash flows: 2023

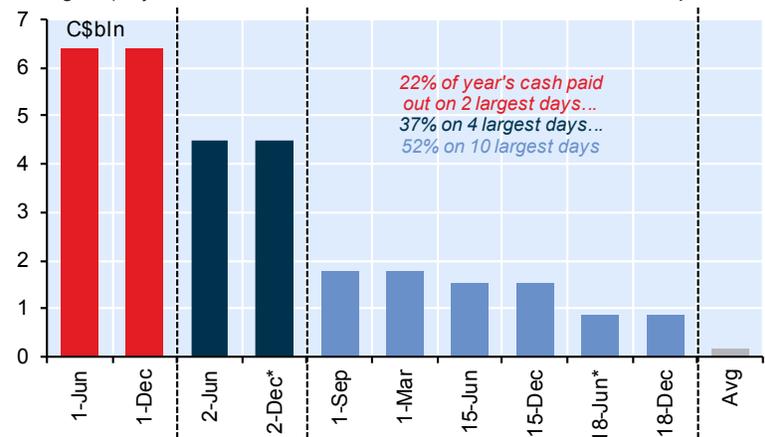


Source: NBF, FTSE Russell

Further to Chart 1, June/December and March/September are the real focal months when it comes to Canada's bond market cash. It has long been thus.

Chart 3: ... with cash heavily concentrated into a few days

10 largest projected FTSE Canada Universe Bond Index cash flow days: 2023

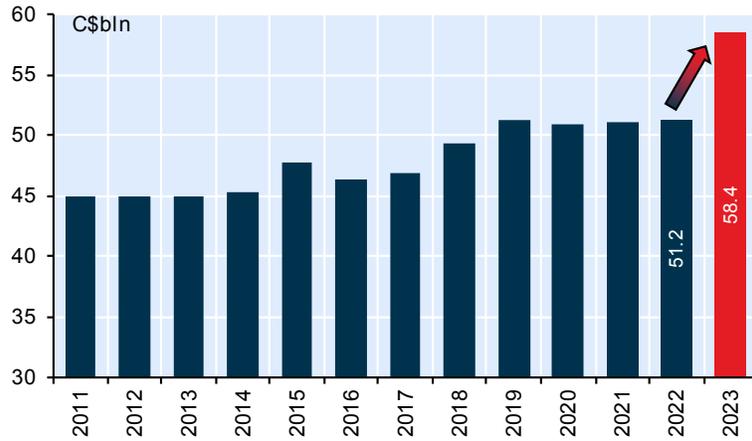


Source: NBF, FTSE Russell | Note: Asterisk denotes a day that falls on weekend in 2023

June 1st/2nd (and December 1st/2nd) are about as striking as they come, standing 7-11 standard deviations above the daily average. In all, 52% of this year's cash will flow on just 10 days.

Chart 4: Almost 15% more cash in 2023

Projected FTSE Canada Universe Bond Index cash flows: 2023 vs. trend

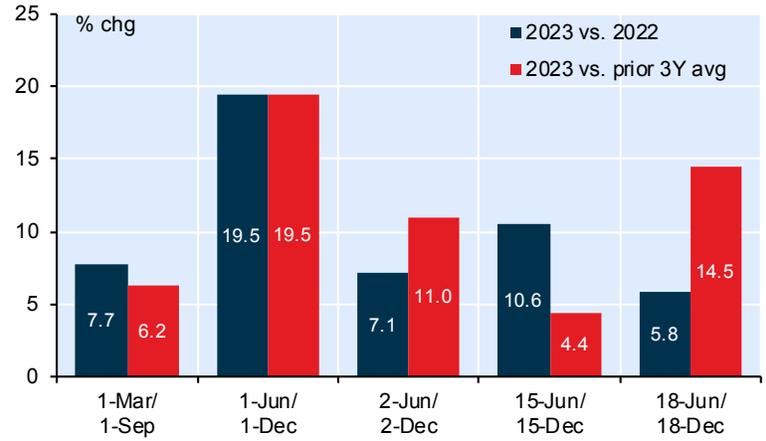


Source: NBF, FTSE Russell

The seasonal pattern of cash flows may not be all that different, but this year's total index cash is stepping up notably. We estimate ~15% more index cash in 2023 vs. the prior year.

Chart 5: Extra cash on most days, including all the biggies

Change in projected FTSE Canada Universe Bond Index cash: Key days

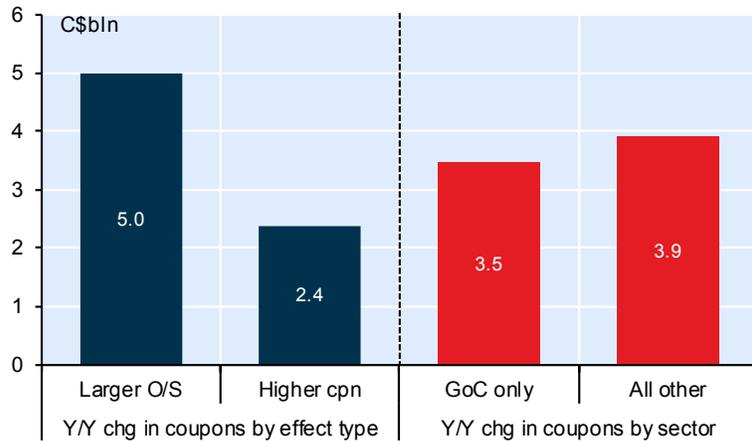


Source: NBF, FTSE Russell

A clear majority of days will be characterized by more cash in 2023 than the recent trend. That's true for all 10 of the largest cash flow days. There will be an extra 20% on June/December 1st.

Chart 6: More bonds x higher coupon = much more cash

Nature of change in FTSE Canada Universe Bond Index coupons: 2023 vs. 2022



Source: NBF, FTSE Russell | Note: Total coupon payments +\$7.4bln year-over-year

We attribute the largest share of 2023's index cash flow increase to the larger stock of bonds now held by end investors (exacerbated by a BoC QT programme that started up Apr-22).

Chart 7: Bond holdings expand (although market value suffered)

Total holdings & market value of FTSE Canada Universe Bond Index

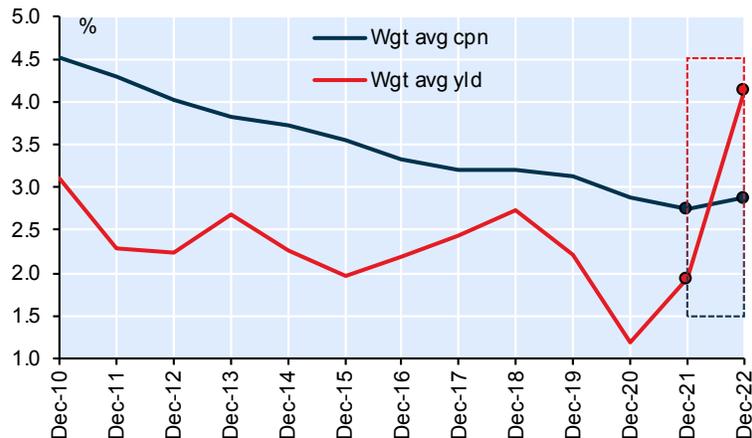


Source: NBF, FTSE Russell | Note: End of year sum of all Index securities; GoC excl. BoC

The par value of index bond holdings (excl. BoC), expanded \$173bln in 2022—a larger increase than in 2020 or 2021, when BoC QE neutralized much of the sovereign's net bond supply.

Chart 8: Average coupon edged up in 2022 (with more to come)

Average coupon/yield of FTSE Canada Universe Bond Index

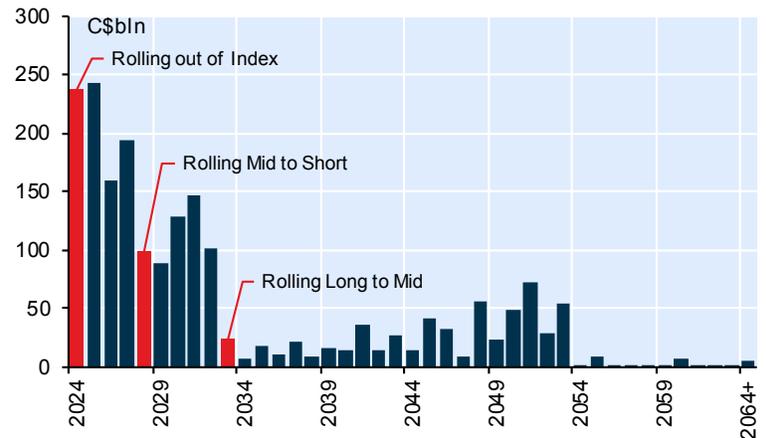


Source: NBF, FTSE Russell | Note: End of year weighted average of all Index securities

We estimate that the weighted average coupon of the FTSE Canada Universe Bond Index rose 13 bps in 2022 (with more coming in 2023). This explains some of the extra cash set to flow.

Chart 9: Roll outs/roll overs will trigger duration adjustments

Maturity profile of FTSE Canada Universe Bond Index, highlighting bond rolls



Source: NBF, FTSE Russell | Note: Red bars denote total current holdings rolling in 2023

Finally, we'd highlight the non-trivial duration adjustments that accrue as bonds either roll out or roll over. Some \$360bln of current holdings (or 19% of the Universe) will be impacted in 2023.



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