Market View
Economics and Strategy

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Op-ed: The bonds must go through!

By Warren Lovely

"Neither vol nor strain nor gloom nor widening of spread stays this issuer from the timely (and successful) completion of the appointed bond program."

*– NBF's take on the apparent creed of the **Canada Mortgage Bond** program administrators, modeled on the 'neither snow nor rain nor heat nor gloom of night' motto often associated (unofficially) with the U.S. Postal Service*

As with the U.S. Postal Service, it's not clear that the Canada Mortgage and Housing Corporation (CMHC) has an official motto. But at least in one corner of the organization, specifically those responsible for the Canada Mortgage Bond program (Bloomberg ticker "CANHOU"), the tongue-in-cheek creed we've offered at top might just ring true.

After all, the overseers of the CMB program recently braved turbulent market conditions to successfully place a C$5 billion 5-year fixed offering (CANHOU 3.1% 6/15/2028) into a diverse investor base at reasonably tight spreads (all things considered). It came as the SVB headlines were sparking off and marked the second offering of calendar 2023, en route to another year of C$40 billion in gross supply for this sovereign-guaranteed (and thus gold-plated) program. Annual CMB issuance, like overall mortgage insurance-in-force is capped by federal legislation.

For those less familiar with the program, CMHC (as administrator of the Canada Housing Trust No. 1, which is the vehicle that technically sells all Canada Mortgage Bonds) has long favoured an uber-predictable approach for its high profile (and highly liquid) CMB deals. Currently, that means accessing the domestic bond market eight times a year: quarterly 5-year fixed-rate offerings (in March, June, September, December), offset at regular/steady intervals by quarterly 10-year fixed-rate + 5-year FRN offerings (in February, May, August, November). Compared to more opportunistic issuers, where taking advantage of favourable market conditions might be a chief (in some cases sole) motivation, investors can essentially adjust their watches (or more appropriately their calendars) to the CMB program.

Theoretically, committing to issuing at a given/consistent time of year, no matter underlying market tone, can leave this issuer vulnerable to bouts of market turbulence that less creditworthy, less established and/or less liquid names might blanch at. But CMHC has demonstrated time and again that top-rated CMBs regularly attract a dedicated/hard-core following irrespective of market volatility. Indeed, March 2023 was hardly the first time a CMB offering had to contend with underlying market turbulence and elevated vol. We'd invite you to reflect on some of the more tumultuous periods in recent memory:

- March 2023: U.S. bank failure(s) followed by government-led consolidation of Swiss banking giants with banking system noise lingering;
- 2022: Global central bank rate hike frenzy, which kicked off in March in North America and which by September had many braced for the proverbial 'hard landing';
- 2020-21: The initial COVID-19 outbreak, large-scale shut down and resulting market panic in March 2020, followed by successive waves of variants, renewed yet temporary restrictions and bouts of economic/financial stress;
- 2018: Another FOMC rate hike cycle complete with a liquidity draining QT programme, which culminated in a serious growth scare in December;
- Further back there was a sovereign debt crisis that raged widely and intermittently during the early 2010s and even an equity market flash crash in May 2010;
- Truly, the granddaddy of all semi-recent stress events was the Global Financial Crisis, which torched financial markets most savagely in the fall of 2008. Put a big, fat 'X' on September 15, 2008, when Lehman Brothers went down. And yet within days of this historic collapse there was CMHC securing vital and cost-effective term financing for participating Canadian mortgage underwriters (the real end users of the CMB program) via a scheduled CMB deal. Not two months removed from the Lehman letdown, when the days were still pretty dark based on our memory of the time, CMHC successfully branched out its CMB program, bringing an inaugural 10-year fixed-rate offering. Not too many issuers would have the ability to broaden and diversify a debt program (establishing a tranche characterized by extra duration/risk) in the midst of a financial crisis, but again, that's what makes CMBs unique/special.

We could go on but the point is perhaps clear. There have been bouts of financial stress aplenty but in no instance did it deter, dissuade or derail a scheduled CMB offering.

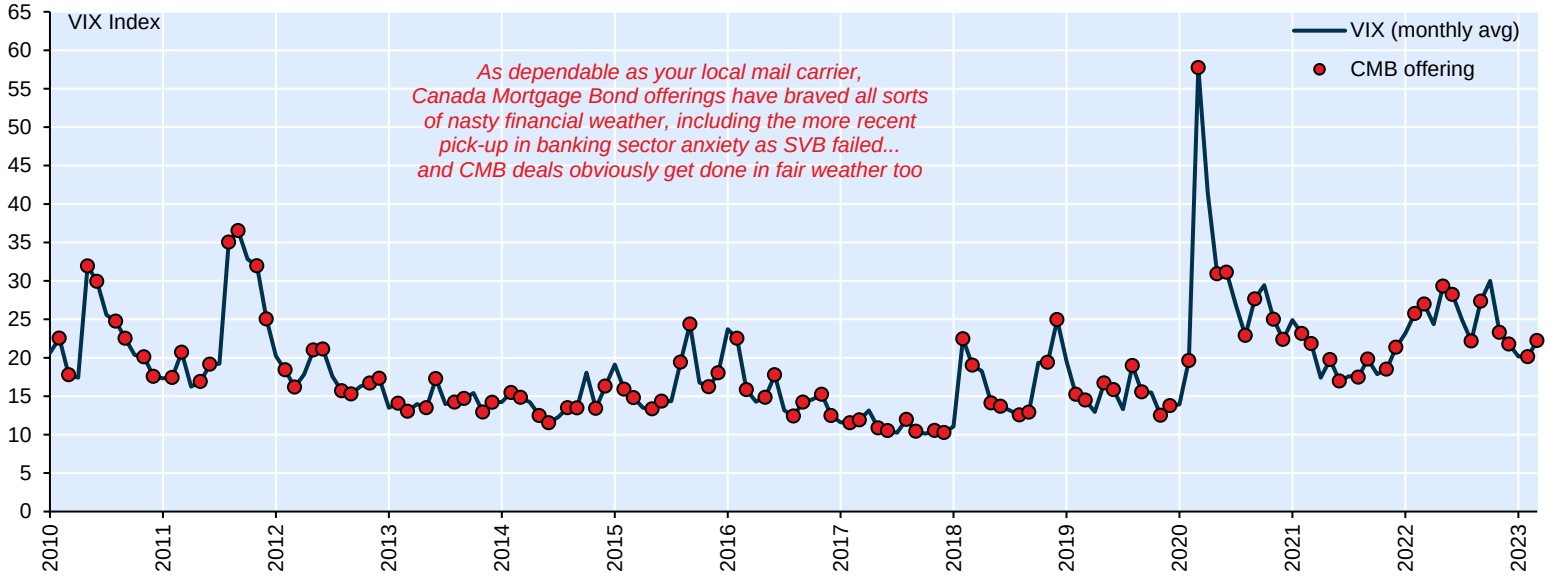
Just to be clear, we are not arguing that CMB spreads are impervious to the business cycle, shifting investor attitudes and/or overall risk sentiment. Notwithstanding the iron-clad timely payment guarantee of Canada's sovereign government (rated: S&P AAA, Moody's Aaa, Fitch AA+, DBRS AAA) CMBs have always traded at a spread to the risk-free GoC curve. Moreover, these securities tend to widen as stress levels are ratcheted up, the credit curve typically steepening in destabilized environments. But if you're looking for a bond to file under the 'low beta' section of your debt securities handbook, you might consider inserting a Canada Mortgage Bond. And as we've seen in recent sessions, low(er) beta bonds certainly have utility when financial markets are getting turned upside down.

As those working for the postal service might say, the mail must go through. Well, in this case the Canada Mortgage Bonds must be issued, ensuring a predictable (some might say vital) and wholly cost-effective means of pooling and securitizing insured mortgages in this country. Is there a financial condition this program can't handle? We haven't seen it yet.

Note: We offered a complementary Op-ed focused on the soundness of Canada's banking sector. You can check it out here.

Chart 1: CMB program provides financial sector vital financing/liquidity during all types of weather… be it calm or extreme

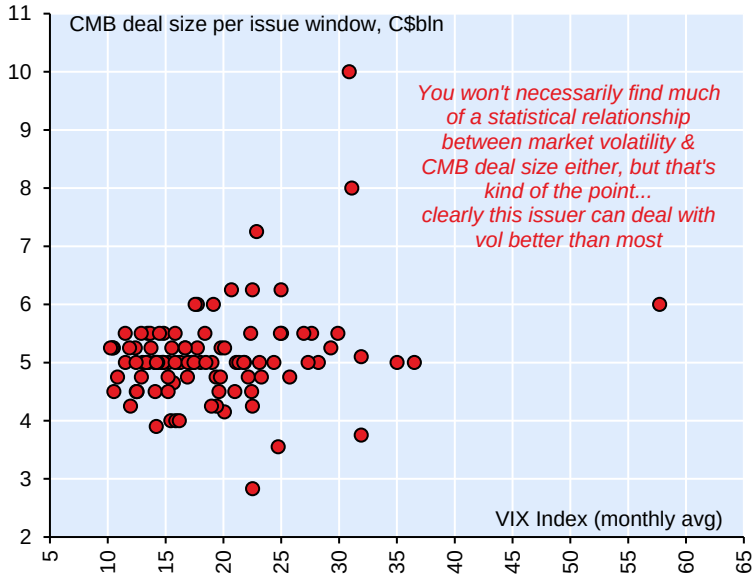
CMB issuance timing vs. common proxy for market volatility (VIX)



Source: NBF, Bloomberg, CMHC | Note: Monthly data; final data point refers to Mar-23, with VIX avg based on month-to-date

Chart 2: CMB program hardly shrinks away from market vol

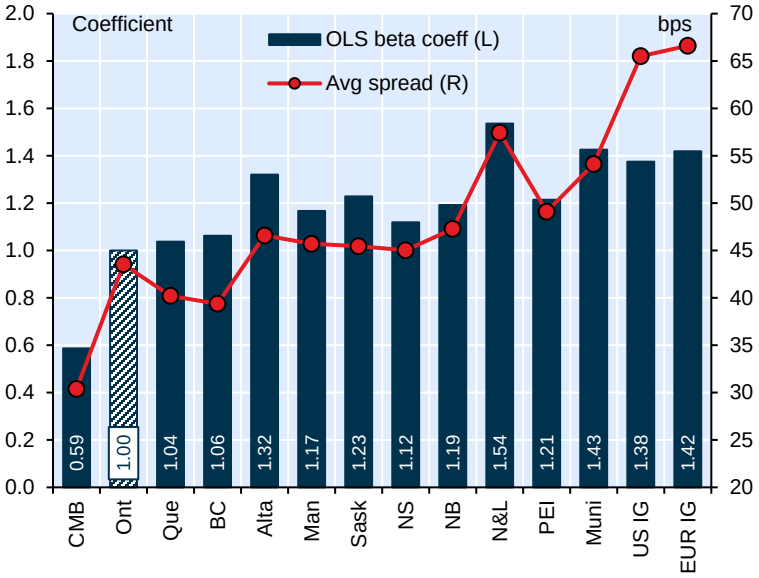
CMB deal size (all tranches) vs. common proxy for market volatility (VIX)



Source: NBF, Bloomberg, CMHC | Note: Monthly data from 2010; CMB issuance 8X/year; months with no CMB issuance not shown

Chart 3: CMB the very definition of 'low beta'

Beta coefficient & average spread: 5Y tenor (1000 days to 22-Mar-23)



Source: NBF, Bloomberg | Note: OLS testing of daily data; constant maturity spreads vs. GoC curve for CMB/provinces, CDX indices for US/EUR IG corporates

Table: A finer look at relative spread noise in CMB vs. provincial/corporate credit

Credit spread characteristics: 5Y tenor (based on 1000 trading days up to & including 22-Mar-23)

	5Y	CMB	Ont	Que	BC	Alta	Man	Sask	NS	NB	N&L	PEI	Muni	US IG	EUR IG
	Latest (bps)	33.5	46.5	46.0	44.5	46.5	48.5	47.0	48.5	49.0	61.0	53.0	51.5	80.5	88.8
1000 days	Average (bps)	30.4	43.5	40.2	39.4	46.6	45.7	45.5	45.0	47.3	57.4	49.1	54.1	65.5	66.6
	Std Dev (bps)	6.3	9.5	9.9	10.1	13.3	11.1	11.9	10.6	11.4	16.7	11.7	13.9	17.2	22.5
	Coeff Var (SD/avg)	21%	22%	25%	26%	29%	24%	26%	24%	24%	29%	24%	26%	26%	34%
	OLS beta vs. Ont	0.59	1.00	1.04	1.06	1.32	1.17	1.23	1.12	1.19	1.54	1.21	1.43	1.38	1.42

Source: NBF, Bloomberg | Note: Data refers to 5Y tenor only; latest spread as at 9:30ET 22-Mar-23 & includes NBF indications; constant maturity spreads vs. GoC curve for CMB/provinces, CDX indices for US/EUR IG corporates; beta coefficients are relative to Ontario (Ont=1) & are estimated via OLS regression analysis; 1000 day sample is meant to capture longer-term trend, as 1000 trading days currently covers Jan-19 to Mar-23 & thus spans pre-, peak- & post-pandemic period

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