

What has June cash empirically meant for rates?

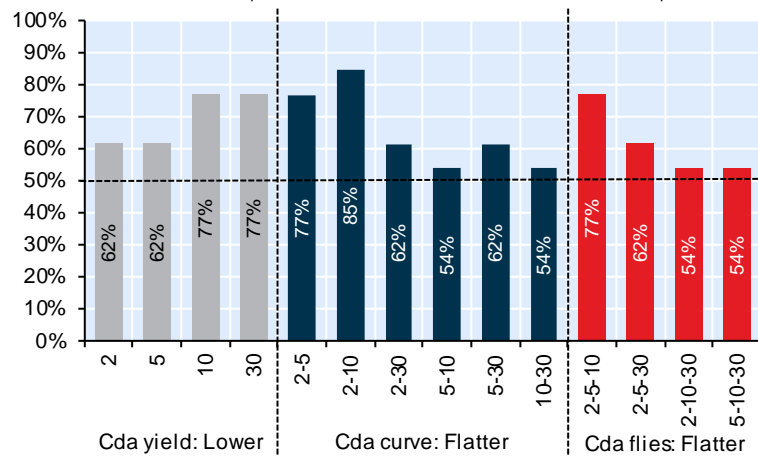
By Taylor Schleich & Warren Lovely

If April showers bring May flowers, then in Canada's fixed income market, May flowers bring June cash. No, that doesn't exactly roll off the tongue but with cash this concentrated, we figured the month deserves its own adage. This year a record \$15.5 billion in interest income (from bonds in the FTSE Canada Universe Bond Index) will be dispersed in June. The majority (over \$11 billion) will be delivered on the 1st and 2nd of the month. Of course, this will have large index effects with bonds rolling from bucket to bucket, duration of sub-indices subject to meaningful swings. That's a stone we've not left unturned, writing in detail on these considerations [yesterday](#). But here, our focus is on what it has historically meant for Canadian interest rates, on an absolute and relative basis.

Unfortunately, there's no 'perfect trade', one that replays itself each year without fail. There are, however, some compelling trends that have emerged over the past decade and change. Most frequently, you'll see the Canada curve flattening in the lead-up to June 1st, 5s and 10s performing versus 2s more than ¾ of the time. While the underlying steepness of the curve hasn't exhibited any correlation with the degree of flattening around 1-Jun, the curve has never been inverted—let alone *this* inverted—at this time of year (in our post-GFC sample). Canadas have also tended to outperform Treasuries as the key date approaches. Of course, cash isn't the only thing that matters as we were reminded last year when relative policy rate changes/expectations (and a BoC meeting right on 1-Jun) trumped interest payment impacts. Monetary policy today may not be stable, as BoC hike expectations rebuild, but it's calmer than this time last year. That combined with what looks to be extremely attractive Canada-US levels could see this trend of GoC outperformance resurface in 2023, notwithstanding a host of other risks.

Chart 1: Lead-up to 1-Jun supports curve flattener...

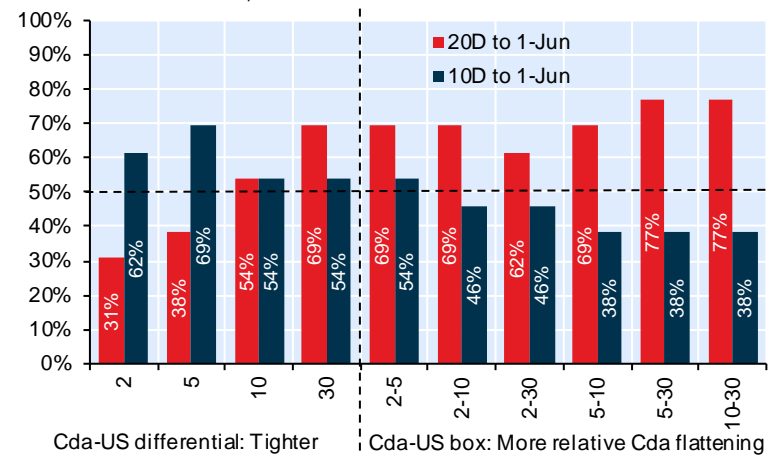
Past success rate vs. expected direction in Canadian rates 10D up to 1-Jun



Source: NBF, Bloomberg | Note: Success rates based on 13Y period from 2010-22

Chart 2: ...with (slightly) more frequent Canada outperformance

Past success rate vs. expected direction in Cda-US rates 10D & 20D to 1-Jun

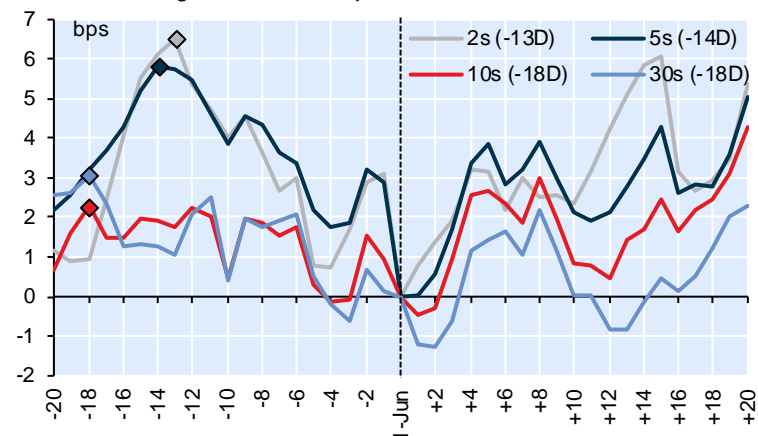


Source: NBF, Bloomberg | Note: Success rates based on 13Y period from 2010-22

No relationship is perfect, though some trends play out more often. The empirical record supports a flatter curve and outperformance of Canadas vs. USTs in the lead-up to 1-Jun. In recent years, curve flattening has remained successful, modestly so in 2022. Canada-US hasn't. The BoC led the Fed on hikes early on this hiking cycle, leading to GoCs underperforming for the 2nd straight year.

Chart 3: The 'average' path for Canada-US in 1-Jun lead-up

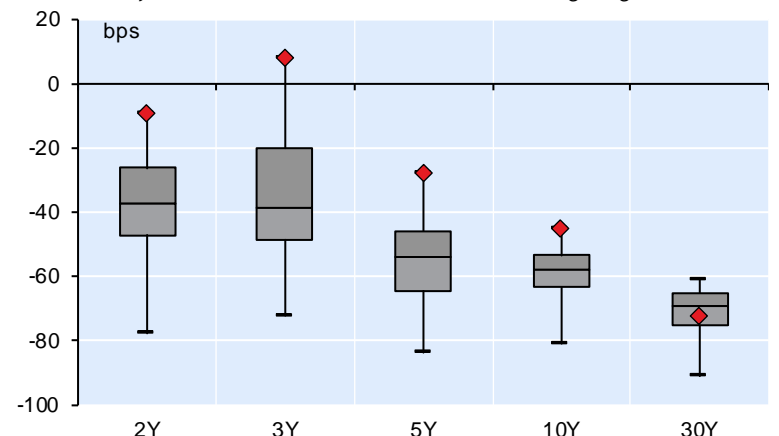
Cumulative change in Canada-US yield differentials relative to 1-Jun



Source: NBF, Bloomberg | Note: Avg change based on 13Y period from 2010-22

Chart 4: By many measures, Canadas are very cheap

Canada-US yield differentials: Current & 3-month trading range

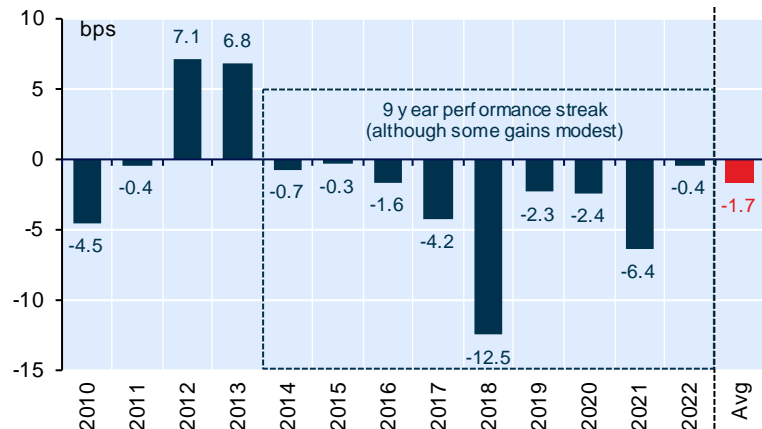


Source: NBF, Bloomberg | Note: Grey bars represent 25th to 75th percentile trading range

Empirically, optimal entry for a long Canada, short UST position is T-18 to T-13 weekdays prior to June 1st... which is now behind us. But as we caution, this trade isn't like clockwork and long Canada positions put on in recently haven't been profitable. Saying that, Canadas now appear well positioned. By most RV screens, GoCs are flashing cheap, particularly in the short-end and belly. Still, one must be mindful of risks, of which there are many. A BoC decision on 7-Jun, the FOMC a week later and debt ceiling anxiety can drastically disrupt the technical support offered by June's wall of cash.

Chart 5: A 9-year 'hot streak' for 2s-10s flatteners on the line...

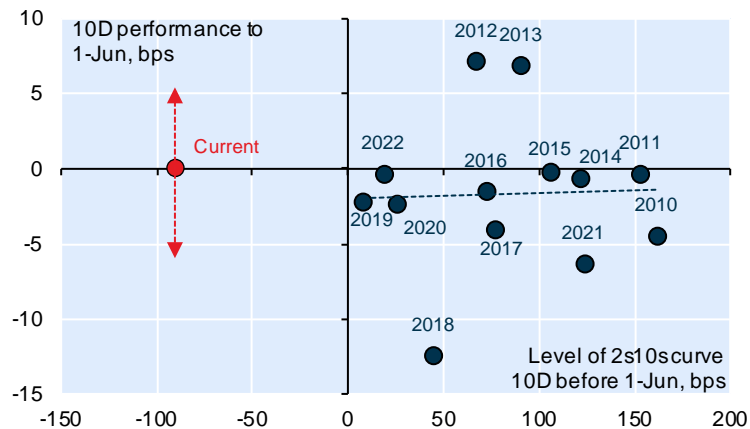
Net change in Canada 2s10s curve in 10D leading up to 1-Jun



Source: NBF, Bloomberg

Chart 6: ... fortunately, starting location hasn't really mattered

Net change in 2s10s curve in 10D lead-up to 1-Jun vs. level of 2s10s 10D prior



Source: NBF, Bloomberg | Note: Current refers to 17-May

There's been success playing the curve flattener into June 1st, the historical success rate most impressive for 2s10s (followed by 2s5s). A nine-year performance streak for 2s10s is on the line as the key date approaches. Of course, the curve today is **much** flatter than around any other recent 1-Jun. Fortunately, starting location hasn't tended to matter for this particular variable (not true for others).

Table 1: Examining past performance in/around June 1st

Average move (net) & success rates in Canada interest rates (yields, curves, butterflies, vs. US) & provincial credit in days before/after 1-Jun (based on 2010-22)

	Canada Outright				Canada Curves						Canada Flies			
	2-year	5-year	10-year	30-year	2s-5s	2s-10s	2s-30s	5s-10s	5s-30s	10s-30s	2s-5s-10s	2s-5s-30s	2s-10s-30s	5s-10s-30s
Days before / after 1-Jun														
-20	-5.9	-10.6	-10.1	-10.4	-4.8	-4.3	-4.5	0.4	0.3	-0.2	-5.2	-5.0	-4.1	0.6
-10	-7.5	-9.5	-8.9	-9.0	-2.0	-1.7	-1.5	0.4	0.5	0.2	-2.4	-2.6	-1.9	0.2
-5	-2.5	-3.7	-3.6	-4.2	-1.2	-1.2	-1.7	0.0	-0.5	-0.5	-1.2	-0.7	-0.7	0.5
-3	-3.0	-3.5	-2.7	-2.6	-0.5	0.3	0.4	0.8	0.9	0.1	-1.3	-1.4	0.2	0.7
-1	-2.6	-2.6	-1.6	-1.2	-0.1	1.0	1.4	1.0	1.4	0.4	-1.1	-1.5	0.6	0.6
+0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
+1	2.1	2.8	2.9	2.4	0.7	0.8	0.3	0.1	-0.4	-0.5	0.6	1.2	1.4	0.6
+3	2.6	3.8	5.0	5.1	1.3	2.5	2.6	1.3	1.3	0.0	0.0	0.0	2.5	1.2
+5	5.0	7.2	8.1	7.7	2.3	3.1	2.7	0.9	0.4	-0.4	1.4	1.8	3.6	1.3
+10	7.0	6.3	5.5	3.7	-0.6	-1.8	-3.3	-1.1	-2.7	-1.5	0.5	2.1	-0.2	0.4
+20	8.1	7.9	7.1	2.9	-0.2	-2.1	-5.1	-1.9	-5.0	-3.0	1.7	4.8	0.9	1.1
Success rate (%)														
-20	54%	85%	85%	77%	92%	77%	62%	69%	62%	46%	62%	69%	77%	62%
-10	62%	62%	77%	77%	77%	85%	62%	54%	62%	54%	77%	62%	54%	54%
-5	54%	62%	62%	69%	69%	54%	69%	54%	54%	54%	46%	54%	77%	62%
+5	23%	38%	23%	23%	23%	31%	46%	46%	46%	62%	54%	38%	31%	31%
+10	31%	38%	38%	46%	54%	62%	62%	62%	69%	77%	54%	46%	38%	38%
+20	38%	38%	38%	54%	62%	77%	69%	54%	62%	54%	46%	46%	62%	54%
Criteria	Lower yield				Flatter yield curve						Belly performance			

	Canada-US Differential				Canada-US Boxes					
	2-year	5-year	10-year	30-year	2s-5s	2s-10s	2s-30s	5s-10s	5s-30s	10s-30s
Days before / after 1-Jun										
-20	-1.1	-2.2	-0.7	-2.6	-1.1	0.5	-1.4	1.5	-0.3	-1.9
-10	-4.0	-3.9	-0.5	-0.4	0.2	3.6	3.6	3.4	3.5	0.1
-5	-0.8	-2.2	-0.3	-0.5	-1.4	0.5	0.3	1.9	1.7	-0.2
-3	-1.7	-1.9	0.1	0.6	-0.2	1.8	2.3	1.9	2.5	0.6
-1	-3.1	-2.9	-0.9	-0.2	0.2	2.2	3.0	2.0	2.8	0.8
+0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
+1	0.8	0.0	-0.5	-1.2	-0.8	-1.3	-2.0	-0.5	-1.2	-0.8
+3	1.9	1.7	0.9	-0.6	-0.2	-1.0	-2.5	-0.8	-2.3	-1.5
+5	3.2	3.8	2.7	1.4	0.7	-0.5	-1.7	-1.1	-2.4	-1.2
+10	2.3	2.2	0.9	0.0	-0.2	-1.5	-2.3	-1.3	-2.1	-0.8
+20	5.4	5.0	4.3	2.3	-0.4	-1.1	-3.1	-0.8	-2.7	-2.0
Success rate (%)										
-20	31%	38%	54%	69%	69%	69%	62%	69%	77%	77%
-10	62%	69%	54%	54%	54%	46%	46%	38%	38%	38%
-5	62%	46%	54%	54%	54%	54%	54%	54%	54%	46%
+5	46%	31%	31%	54%	46%	69%	62%	54%	62%	62%
+10	38%	46%	46%	54%	54%	69%	69%	62%	62%	54%
+20	31%	54%	38%	54%	62%	62%	62%	38%	46%	62%
Criteria	Relatively tighter yield vs. US				Relatively flatter yield curve vs. US					

Summary of Key Empirical Findings

- No rate/curve/box/differential has performed the same every year, but some trends tend to occur more frequently than others.
- 5s and 10s have tended to perform best and most often in the lead-up to 1-Jun cash. 30s have rallied by a similar amount but less frequently.
- The Canada curve often flattens in the weeks before 1-Jun. 2s-5s and 5s-10s have seen the most significant performance with the highest success rates.
- GoCs tend to outperform USTs, mostly in 2s and 5s, albeit not recently
- In the week after 1-Jun, we tend to see rates sell off, curves steepen and Canadas underperform USTs. However, 10-20 days after 1-Jun, the curve has more often than not been flatter than in was on 1-Jun.

Source: NBF, Bloomberg | Note: Based on week days; success rates calculated over 13Y period, covering 2010-22; success rates reflect the percentage of time the expected direction of trade held in pre- & post-cash period; examples of the 'a priori' direction of trade include: Canada outright = lower yield; Canada curves = flatter; Canada-US yield differentials = tighter/narrower; refer to "Criteria" for nature of tests & expected direction



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