

## Slippery seasonality in spreads

By Warren Lovely

For many in the Canadian bond market, the countdown is on. The first day of June—which initiates a truly outsized wave of bond market cash—is now less than 10 weekdays away. Go ahead a place a big, fat ‘X’ on your calendar if you must.

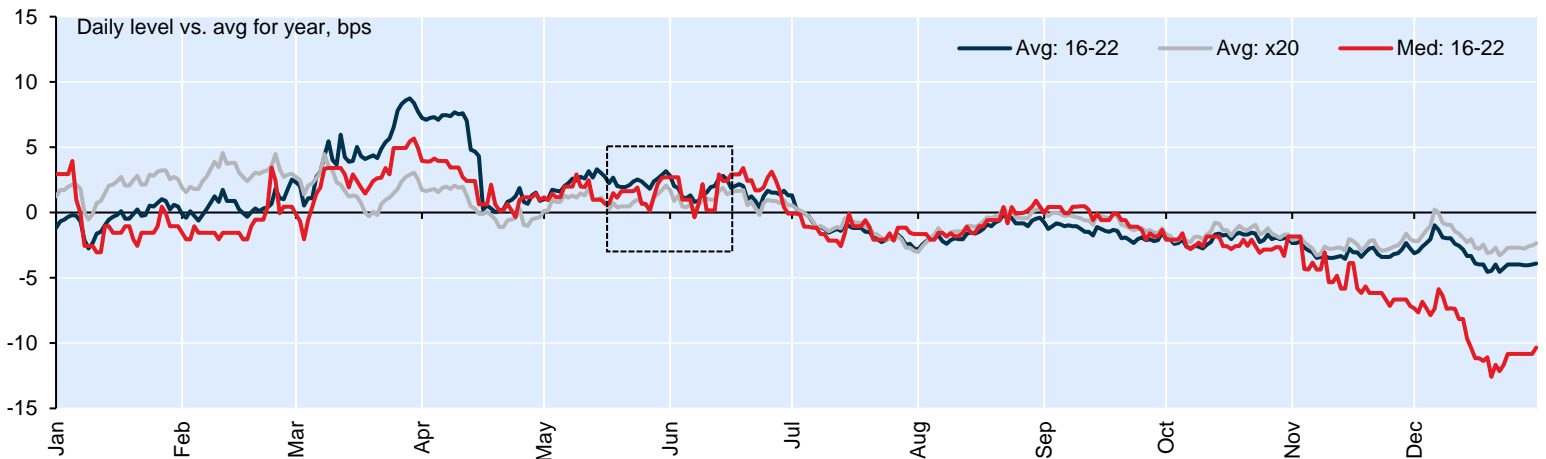
We’ve already put this year’s cash deluge in perspective ([Vol. VII, No. 39](#)). A supplemental piece went further, training a spotlight on absolute and relative rates market moves in/around June’s cash. That included testing/scoring a growing empirical sample against the intuitive/expected market direction ([Vol. VII, No. 40](#)).

Notwithstanding our thinly veiled disdain for seasonal trading bets (or perhaps because of it), this *Market View* report offers an updated take on seasonal tendencies in Canadian credit spreads. Spoiler: If you’re looking to blindly piggyback on June’s ample cash and are betting on a seasonal snuggling up of credit spreads, you might want to manage your expectations. Seasonals can be downright slippery (as in not terribly significant, nor stable) in credit markets. You might be better off focusing on overall market location and/or traditional RV indicators. Setting aside fundamental and technical considerations (of which there are many), it might be hard to dub provisos as ‘relatively cheap’ these days.

**i) A narrower but cleaner sample based on NBF’s daily constant maturity spread indications**

**Chart 1: Gauging provincial spread tendencies over the calendar year (caution: you may need to squint)**

Relative deviation in Ontario 10-year constant maturity spread vs. GoC over course of calendar year

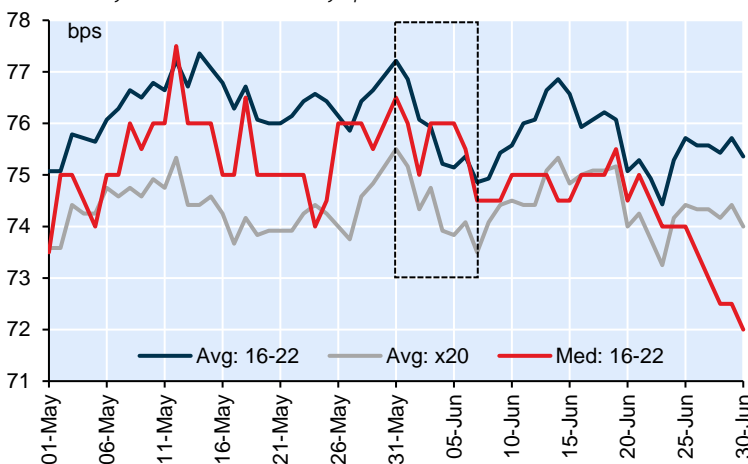


Source: NBF | Note: Based on daily constant maturity spreads from 2016-22; values >0 denote a period where spread is wider/higher than average for year; rising line denotes relative widening, falling line denotes relative tightening; average excluding 2020 presented in order to exclude particularly extreme spread re-pricing at onset of COVID-19 pandemic

We’re not suggesting the late May to early June window is a non-event for Canadian credit markets; primary market activity is typically lively. But for outright spread performance, the historic record in/around June’s jumbo cash flows isn’t exactly overwhelming. If you put stock in such things, seasonal tension looks more pronounced during peak summer and into year end.

**Chart 2: Some (modest and brief) support as cash flows?**

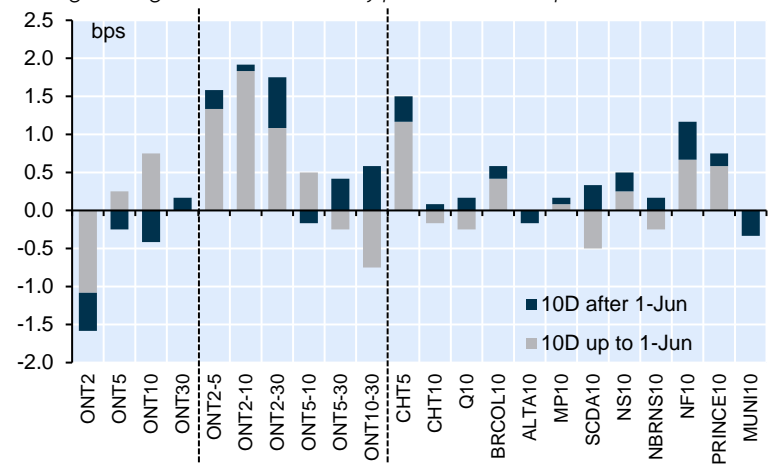
Ontario 10-year constant maturity spread vs. GoC centered on June 1<sup>st</sup>



Source: NBF | Note: Based on daily constant maturity spreads from 2016-22

**Chart 3: Of provincial credit curves & basis spreads**

Average change in constant maturity provincial credit spreads & curves



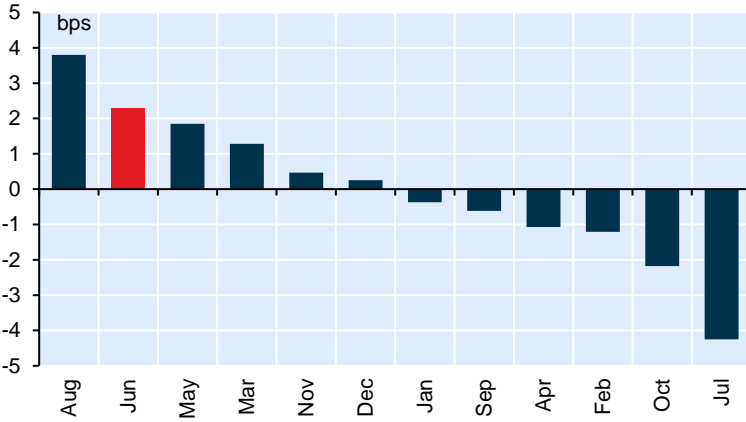
Source: NBF | Note: Based on daily constant maturity spreads from 2016-22

Both secondary spreads and primary indications hint at a tendency for provinces to cheapen up in May, followed by a tendency to tighten (modestly and only briefly) once the cash starts to really flow. Despite seasonal duration extension, long provincials have registered historic underperformance on the credit curve. Meanwhile, basis spreads have favoured Ontario vs. most provincial peers.

ii) A broader & longer sample of Bloomberg's aggregate bond indices (+ supply considerations)

**Chart 4: June not supportive for provi spreads longer term**

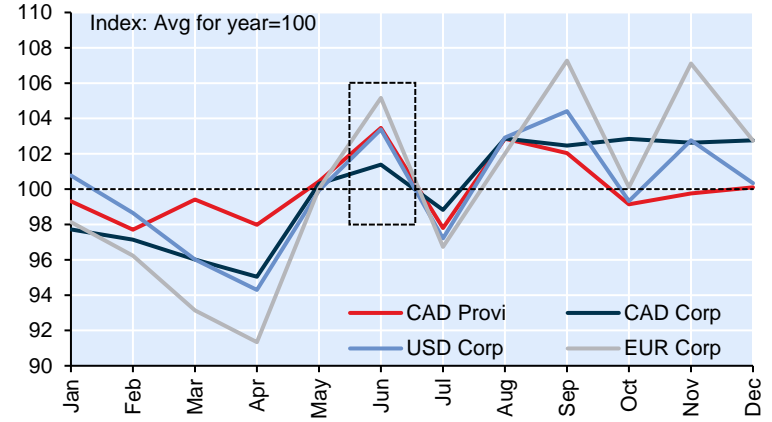
Average change in CAD provi aggregate index spread by month



Source: NBF, BBG | Note: Avg chg in monthly closes for post-GFC period (x2020)

**Chart 5: ... although it's not best month for credit generally**

Average relative deviation in aggregate index spread over calendar year

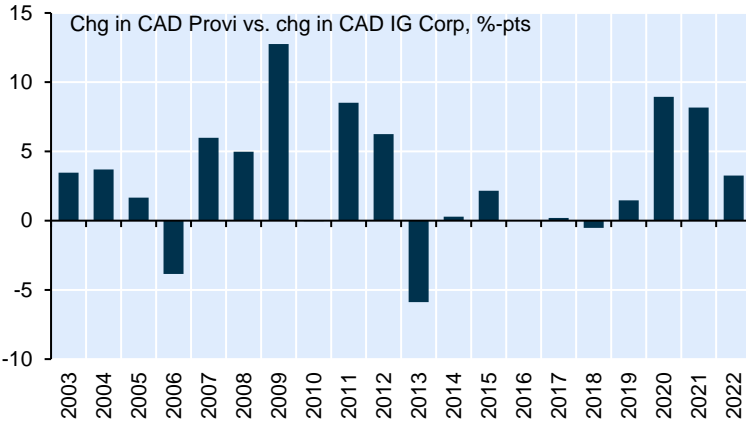


Source: NBF, BBG | Note: Based on avg monthly closes for post-GFC period (x2020)

Extending our look-back period, you'd be hard-pressed to find a month that has, on average, generated poorer results for aggregate provincial bond index spreads than June. Provi total returns for the month of June also look sub-par (vs. other months) longer term. To be fair, aggregate index spreads for corporates (be they in CAD, USD and EUR) have also betrayed an historical June wobble.

**Chart 6: Proportionate underperformance of provis vs. corps**

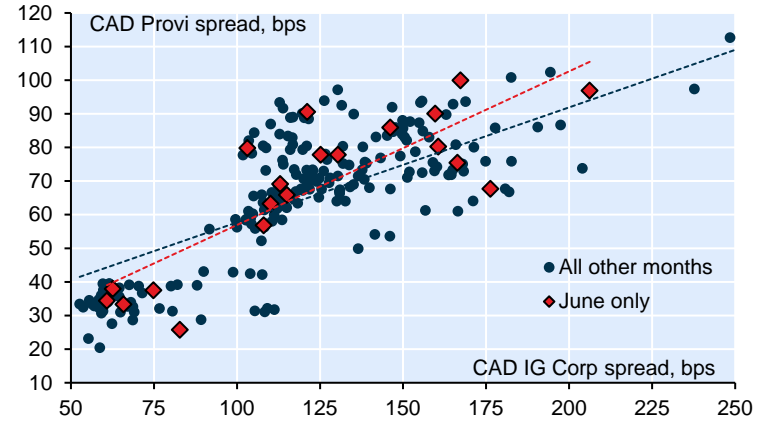
Relative change in CAD Provi vs. CAD IG Corp aggregate index spread: June



Source: NBF, BBG | Note: Relative chg in monthly closes for June only

**Chart 7: Further isolating June's relative moves in CAD credit**

CAD Provi vs. CAD IG Corp aggregate index spread (monthly)

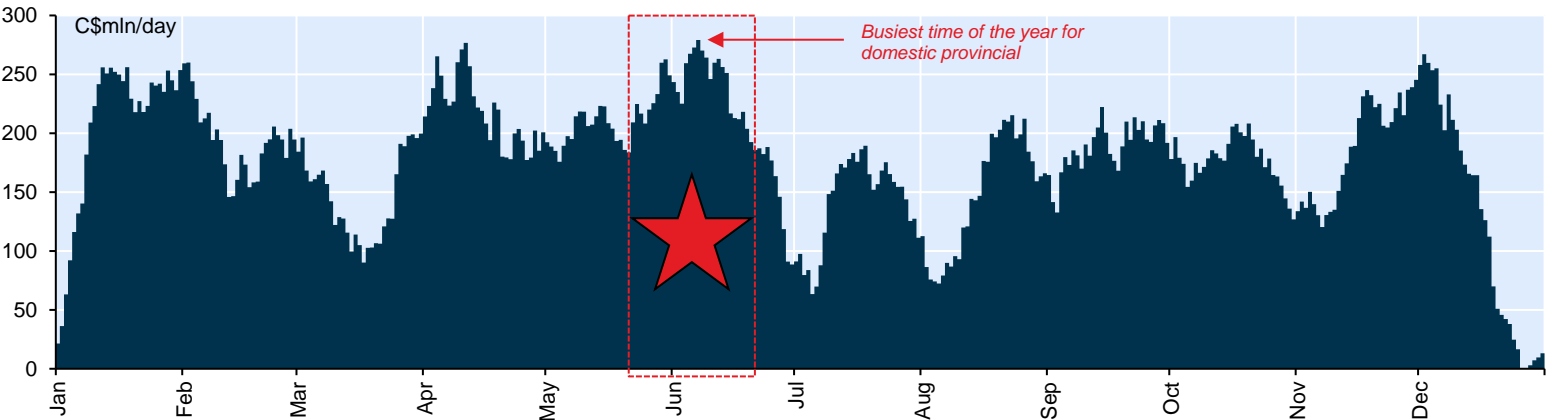


Source: NBF, BBG | Note: Monthly closes from 2003-22

So do provincials suffer from relative underperformance in June? Two decades of bond index spread and total return data hint at 'yes'. On a proportionate basis, it's common for provi spreads to widen more (or tighten less) than CAD corporate spreads in June. Average total returns for provis in June have likewise fallen relatively short of CAD corps based on a 1, 2, 5, 10 or 20 year sample.

**Chart 8: Provincial supply backdrop surely a consideration, as issuers generally get busy in/around June cash**

Average daily CAD gross provincial bond issuance over the course of a 'typical' calendar year



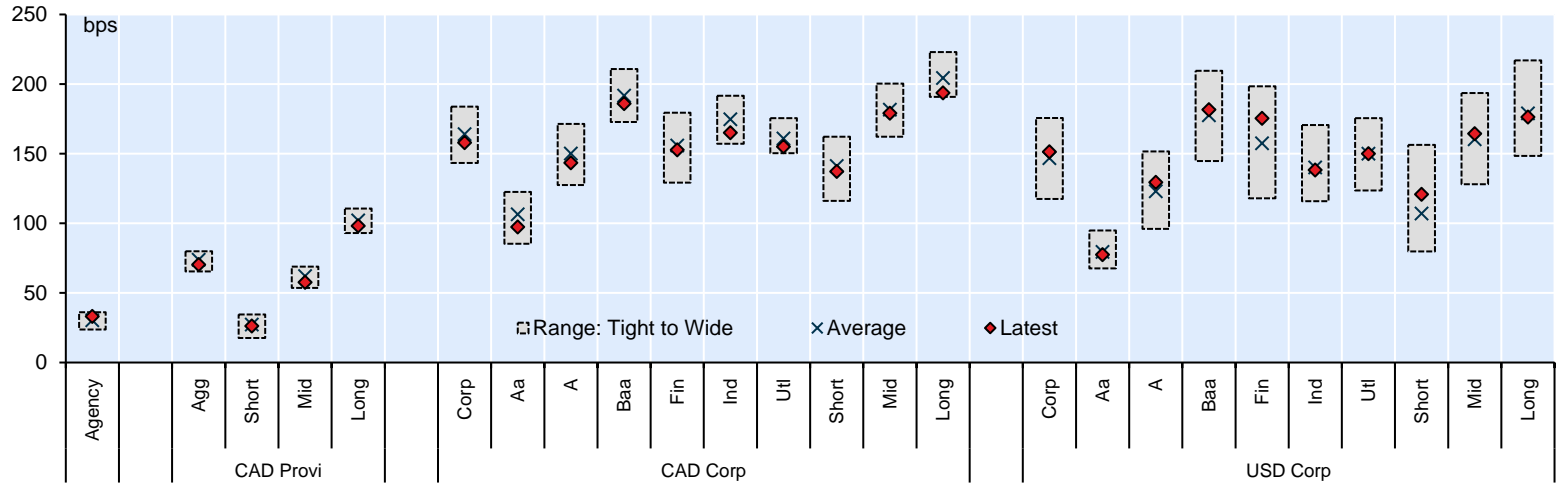
Source: NBF, BBG | Note: Based on marketable provincial bond issuance over 13Y period (2010-22); levels smoothed +/- 5 days to more clearly identify underlying tendencies

We caution that the above-noted tendencies observed in historic bond spreads and/or total returns are not iron-clad. But that's kind of the point isn't it. Seasonals simply can't be relied on blindly. And if you're looking to understand the apparent underperformance of provincials vs. corporates, spare a thought for the provi bond supply often served up this time of year. 'Scarcity' hardly applies here.

iii) Supplemental RV screens based on Bloomberg bond indices

**Chart 9: Provi spreads at tighter end of range... less so for corps, where financial concerns still evident**

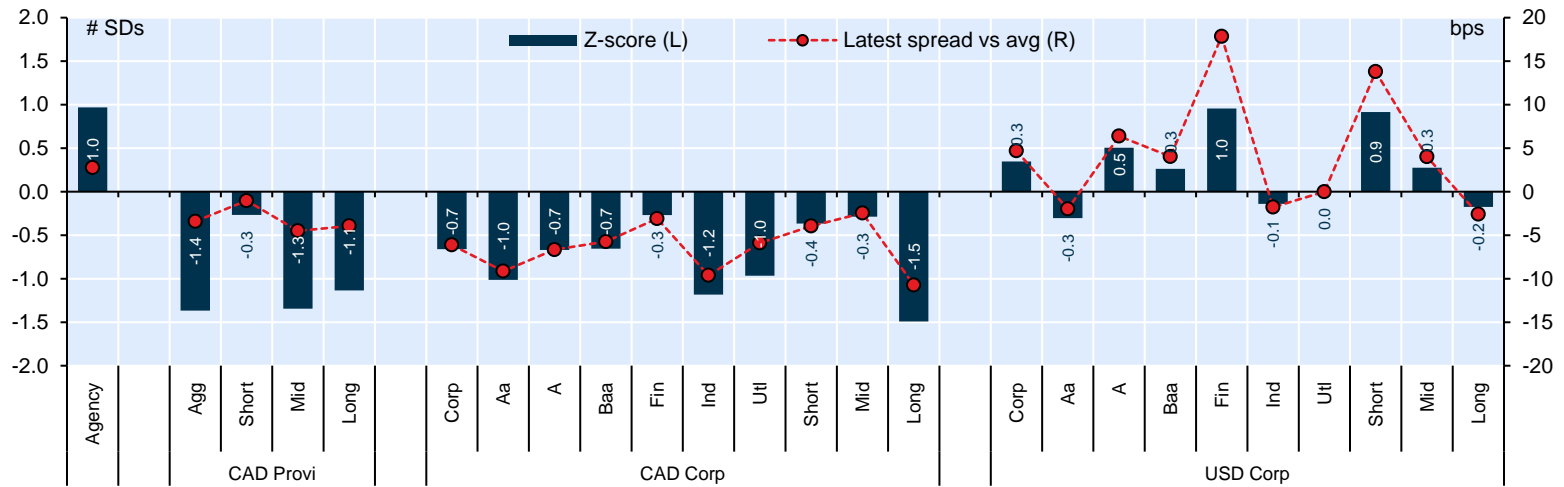
Bloomberg bond index spread: Latest vs. 1-year average/trading range | Focal period [1 year, daily data]: 18-May-2022 to 18-May-2023



Source: NBF, BBG | Note: Latest refers to 18-May-23 closing levels

**Chart 10: Counting Zs... provi spreads relatively tight(er) in 'mid' section of curve, with long CAD corp spreads relatively snug**

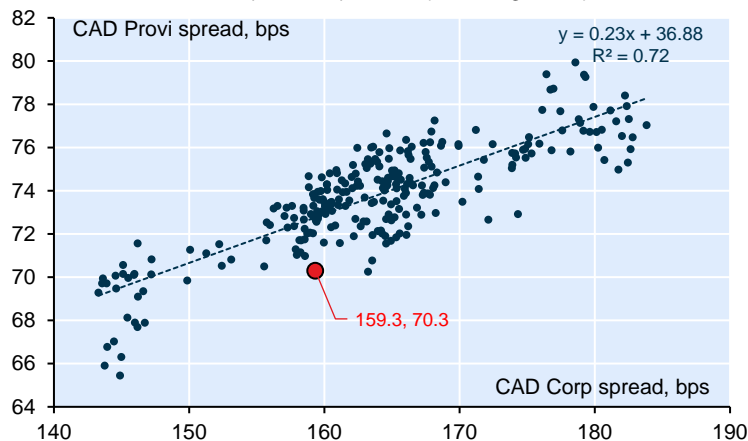
Bloomberg bond index spread deviation from 1-year average & resulting Z-score | Focal period [1 year, daily data]: 18-May-2022 to 18-May-2023



Source: NBF, BBG | Note: Z-score calculated as: (Latest - Mean) / Standard Deviation; latest refers to 18-May-23 closing levels

**Chart 11: Low(er) beta provis not exactly 'cheap' vs. corps...**

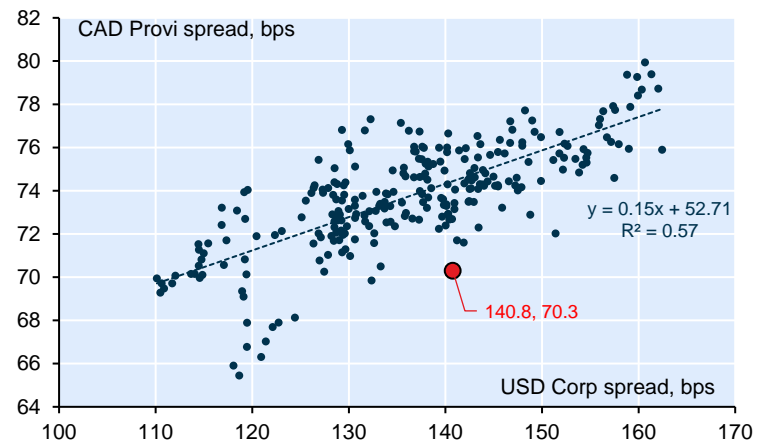
CAD Provi vs. CAD IG Corp index spread: 1-year range (daily)



Source: NBF, BBG | Note: Latest (red dot) refers to 18-May-23 closing level

**Chart 12: ... and even tighter (relatively speaking) vs. USD IG**

CAD Provi vs. USD IG Corp index spread: 1-year range (daily)



Source: NBF, BBG | Note: Latest (red dot) refers to 18-May-23 closing level



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