

## Season's greetings from an active provi bond market

By Warren Lovely

Another day, another provincial bond trade. In this case, it was the latest re-opening of the Ontario 2054s. 'Tis the season. We are now in one of the busier windows for primary bond supply, loosely defined as mid-November to mid-December. Just how do spreads tend to cope with all this supply? Reasonably well if history is any guide.

In fairness, the empirical track record for provincial spreads going into December 1<sup>st</sup> isn't exactly out-of-this-world. Plenty of times spreads moved sideways (or even a bit wider) as outsized coupon payments met with hyper-elevated primary supply. But making considerable progress against borrowing plans without causing legitimate spread indigestion might be deemed a victory in its own right.

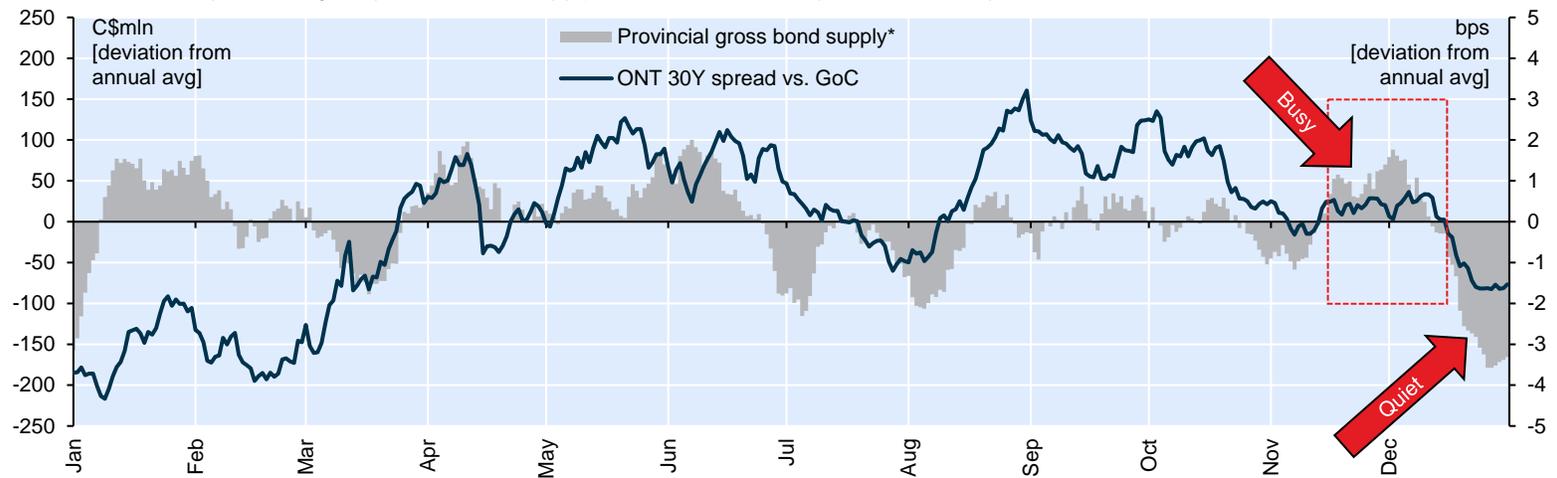
And once the supply valve is shut off—as is generally the case in the back half of December—we often witness serious credit spread compression. Looking at the net change in Ontario cash spreads from the first of December through the end of the month, 10s have widened only once in the past 13 years. Granted, the one misstep was back in 2018 as tighter monetary policy was biting. Foreshadowing?

On its face, the historical record might leave one axed to buy any material back-up in provincial spreads (on a cash or ASW basis). Given current valuations, we could get behind this sentiment, at least as a short-term, tactical view. At ~75bps, Ontario 10-year constant maturity spreads are wider than where we've been the prior half-dozen years (high 60s). A simple RV screen vs. US IG CDX notionally flags provi spreads as modestly 'cheap'. Meantime, for all-in buyers, 10-year yields, at ~4.45%, are roughly 50 bps north of the prior-year level and essentially double what we had in late 2021. As for relative bond returns (e.g., long-term provis vs. long-term federal), December performance record stands out quite positively after controlling for underlying risk sentiment (proxied by US equity returns).

All this to say: Expect a relatively steady/heavy dose of provincial supply over the coming handful of weeks. But don't underestimate the domestic bond market's ability to digest prospective deals. There's no shortage of market catalysts to control for, but should provi credit wobble here, we'd generally favour establishing long positions to be held through calendar year-end.

### Chart 1: Traditionally, mid-November to mid-December a relatively busy time for provincial bond supply

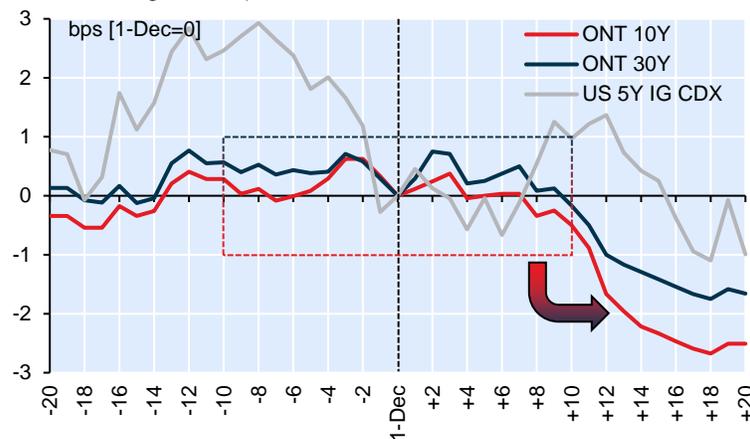
Traditional seasonal pattern of gross provincial bond supply & bellwether (Ontario) provincial credit spread: Domestic (CAD) market



Source: NBF, BBG | Note: Daily pattern, showing deviation from annual avg; daily domestic (CAD) bond supply is smoothed +/- 5D; based on 13Y sample covering 2010-22

### Chart 2: Visualizing the seasonal pattern in spreads

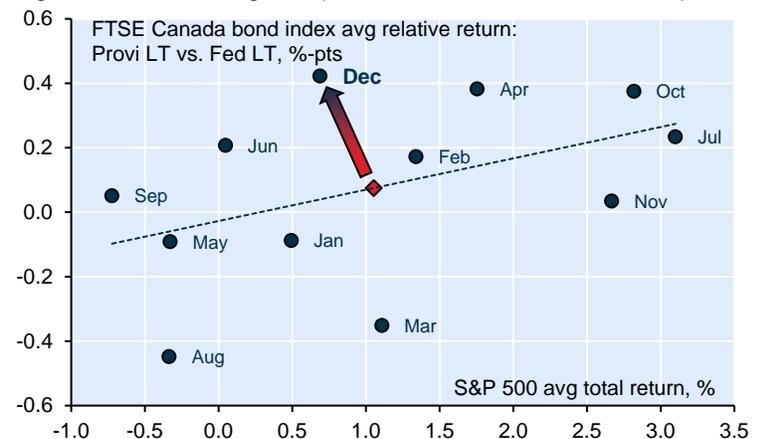
Cumulative chg in ONT spreads vs. GoC & US IG CDX relative to 1-Dec



Source: NBF, BBG | Note: Based on avg chg in generic benchmark/index from 2011-22

### Chart 3: December generally a good month for long provis

Avg relative return of long-term provi index vs. S&P 500 total return by month



Source: NBF, BBG, FTSE Russell | Note: Based on avg total returns from 2010-22



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