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December 1st index extension: History in the making

By Warren Lovely

As we routinely telegraph (e.g., [here](#) and [here](#)), there are a couple of particularly noteworthy days in Canada's domestic bond market each year. December 1st (along with the six-month echo on June 1st) certainly qualifies as special. If anything, bond index adjustments this December 1st might just be the most extraordinary ever, at least in the 'Long' bucket (i.e., >10Y) of the index.

First off, there's plenty of coupon-related cash set to flow this December, not just on the 1st but also again on the 4th (since the 2nd is a weekend) and at mid-month too (the 15th delivering notable CMB cash flows). As the BoC has worked down its holdings of GoC bonds (via QT), the amount of Canadas held by end investors has stepped up. This helps explain the increase in index-related cash, which we see as 13% higher this December vs. the year-earlier period.

Coupons are one thing, but as far as December 1st index duration effects are concerned, security rollovers are much more material. To be clear, no bonds are set to roll out of the Universe on December 1st. Nonetheless, the rolling over from the 'Long' to 'Mid' bucket of the

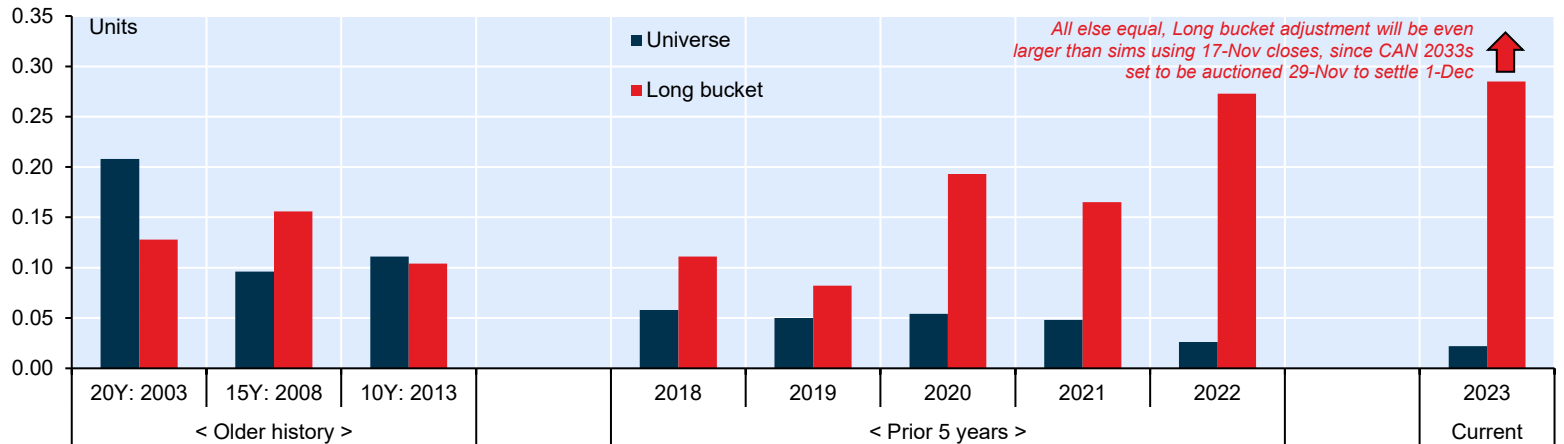
CAN 3.25% 1-Dec-2033s will help key a major duration increase in the 'Long' component of the index. (An Alberta bond also rolls down.)

Based on detailed index simulations (using constituents and closing prices from November 17th), the 'Long' bucket of the FTSE Canada Universe Bond Index is set lengthen by ~0.3 units on December 1st. The actual duration extension will quite likely be even larger, closing in on 0.35 units, given that the CAN 2033s will be auctioned once more before dropping down into the 'Mid' bucket.

This is historic stuff for the 'Long' bucket, even if the expected adjustment in the Universe looks to be relatively modest. Investors should presumably be able to see this coming right? While we wouldn't necessarily fight the 'efficient markets hypothesis', the sheer magnitude of this year's index adjustments could keep a relative bid to long Canadas vs. USTs in/around the start of the month. All else equal, related positioning might likewise lend marginal support to a curve flattener (at least temporarily and for outsized technical reasons). There's much to control for and other important days on the calendar, but history looks to be in the making this December 1st.

Chart 1: Simulations point to record duration increase for 'Long' bucket of FTSE Canada Universe Bond Index on December 1st

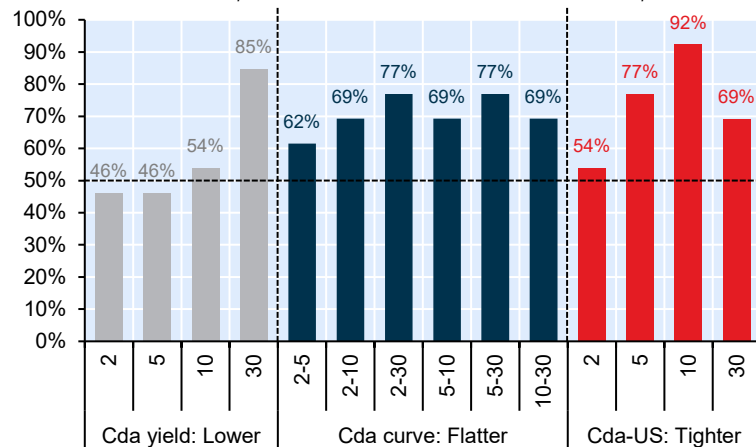
Projected 1-day change in modified duration of FTSE Canada Universe Bond Index & 'Long' (i.e., >10Y) bucket: 30-November to 1-December



Source: NBF, FTSE Russell | Note: Figures represents NBF simulations of select years; in all cases, sims based on index composition & closing prices as at 17-Nov (or most recent) for each period in question; figures are presented for illustrative purposes; simulated changes in duration can differ from actual/reported duration changes, owing to shifts in yields/curves & issuance from simulation date to 1-Dec; in some cases, 1-Dec would have landed on a weekend, with associated index adjustments thus captured on next good business day

Chart 2: Historic extension may aid certain seasonal trades

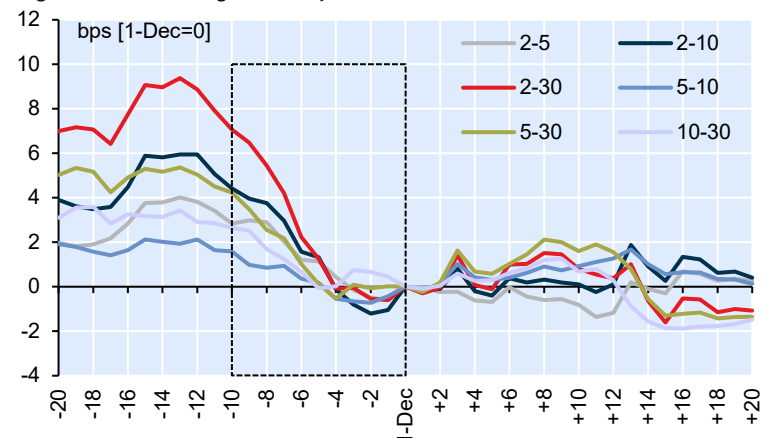
13Y success rates vs. expected direction in Canadian rates 10D up to 1-Dec



Source: NBF, BBG | Note: Success based on chg over 10 weekdays; 13Y sample (2010-22)

Chart 3: Seasonals tend to support flattener into December 1st

Avg cumulative change in GoC yield curves relative to 1-Dec (13Y, 2010-22)



Source: NBF, BBG | Note: Cumulative chg in generic BMs; horiz axis is weekdays vs. 1-Dec



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