Global X Active Ultra-Short Term Investment Grade Bond ETF – HFR
Quarterly Commentary: Q2 2025

Market Review

The second quarter began with significant market volatility as the US administration unveiled their plan for reciprocal tariffs in early April, causing US equity indices to fall and credit spreads to widen in both Canada and the US. Markets gradually settled during the quarter after a series of tariff deadline extensions, walk-backs, and a general cooling in the tariff rhetoric. By the end of June, equity indices had regained their highs, and credit spreads finished the quarter tighter than where they started the year. Geopolitical risk remained at the forefront as conflict broke out between Israel and Iran, but the market reaction was muted, other than a brief spike in the price of oil which subsequently reversed following a ceasefire agreement.

The Federal Reserve remained on hold in Q2 despite vocal calls from the President to cut rates. With employment stable and inflation cooling (but still elevated), the fear of tariff-induced price increases in the back half of the year kept the Fed on the sidelines. The market is looking for the Fed to cut rates 65 basis points for the rest of the year, down from early April when investors had priced in over 100 basis points of cuts.

In Canada, bond yields moved higher across the curve, led by the long end, while the yield picture in the US was more mixed. The long end of the US curve sold off on the prospect of higher sustained fiscal deficits while short and mid-term rates fell.

After cutting 50 basis points in the first quarter, the Bank of Canada held its policy rate at 2.75% in Q2, keeping the policy rate in the middle of its estimated neutral range of 2.25% - 3.25% and electing to take a wait-and-see approach with respect to the impacts of tariffs. Economic data in Canada was mixed, with the unemployment rate higher, Q1 GDP surprising to the upside, and core inflation sticky at 3%. At the end of the quarter, markets were looking for the Bank to cut rates a further 35 basis points in 2025, down from the 70 basis points that were priced in early April. The Canadian dollar appreciated vs. the USD during the quarter, rising almost 6% to 0.73 from 0.69.

Spreads in Canada narrowed during the quarter despite the April tariff volatility. Short-term provincial spreads narrowed by 3 basis points to 15 basis points and are in by 8 basis points year-to-date, while short-term corporate spreads narrowed by 16 basis points to 83 basis points and are in by 4 basis points year-to-date.

Portfolio Performance and Positioning

The fund returned 1.09% net of fees for the quarter vs 0.64% for the benchmark, generating added value of 45 basis points. While a typical short-term benchmark portfolio generated a gross return of 0.49% and a typical universe benchmark portfolio delivered -0.57% gross, HFR maintains a very low duration between 0 and 1 year. The fund benefitted from its corporate exposure during the quarter as spreads narrowed, more than offsetting the negative impact from rising rates.

During the quarter, we took profits on several names that had performed well and were active in the primary market, where we bought new bail-in issues from TD, BMO, CIBC, and National Bank, as well as issues from CP Rail, Dollarama, and ABS from Canvas, Ford, BMW, and CNHC.

At the end of the quarter, the portfolio's duration was 0.86 and was yielding 3.60%.

Outlook

We expect the Canadian economy to be soft over the next 12 to 18 months but to avoid a severe recession, with growth trending in the 1% area. We expect inflation to slow gradually, allowing the Bank to cut further towards the bottom of the neutral range at 2.25%. Trade tensions with the US will remain elevated in the near term but should ease gradually through negotiation; however, impacts on sentiment and global growth may be more pronounced, and weigh further on the Canadian economy. Fiscal spending and potential benefits of a comparatively lower tariff rate on Canadian goods will partially offset some of the headwinds.

While tariffs should continue to play a significant role in determining Canadian monetary and fiscal policy, the rhetoric has eased notably, and other uncertain aspects of US policy, such as the Big Beautiful Bill, have come to the forefront. The net stimulative nature of the bill and the prospect of higher government bond supply in both countries could pressure long-term rates higher. We expect the Bank of Canada and the Fed to cut rates moderately to offset any weakness, but their decisions must also weigh the trade-off between soft growth and sticky inflation which may be exacerbated by increased spending and tariffs.

We are currently positioned for lower rates at the front end of the curve and are long duration overall. Short rates will be pulled in the direction of the Bank of Canada, but longer rates will be driven by inflation, bond supply, fiscal policy, and global growth/yields. We expect market volatility to remain elevated which will present us with opportunities to go both long and short duration.

We increased our corporate exposure over the quarter will continue to look for attractive opportunities to add to this position but remain cautious as spreads have narrowed and are at the low end of the historic range. Our focus remains on short-dated bonds, high quality sectors, and names in which we believe there is value.