Global X Active CDN Municipal Bond ETF – HMP Quarterly Commentary: Q3 2025

Market Review

The third quarter of 2025 saw a moderation in economic momentum in North America, prompting central banks to resume easing after lengthy periods on hold. While inflation concerns remain, softening labour markets have shifted the policy focus from combating inflation to supporting growth and employment. Despite lingering fiscal and macro uncertainty, the market tone in Q3 was decidedly risk-on as credit and equity markets performed well in anticipation of Fed rate cuts.

In Canada, the yield curve steepened modestly, led by a lower front end. After holding rates at its previous three meetings, the BoC cut its overnight rate by 25 basis points to 2.50% in September, citing deteriorating labour market conditions and easing inflation pressures. Economic data was weak as Q2 GDP contracted by 1.6% due to a large decrease in exports, and the unemployment rate hit a new cycle high at 7.1%. While headline inflation was 1.9% in August, preferred measures of core inflation remained around 3%; however, Governor Macklem stated that the upward inflation momentum seen earlier in the year has dissipated and that the Bank sees underlying inflation closer to 2.5%. He also emphasized that the Bank will be looking shorter term than usual to respond to any sudden further weakness. At the end of the quarter, markets were pricing the BoC to cut an additional 25 basis points by year-end.

U.S. rates outperformed Canada during the quarter as yields fell across the curve in a broadly parallel shift; however, the short end has rallied significantly year-to-date while long rates are little changed amidst fiscal deficit and inflation concerns, as well as questions concerning the future of Fed independence. The Fed delivered a 25 basis points rate cut at its September meeting, the first of 2025, lowering the target for the fed funds rate to 4.00-4.25%. The move followed a tick up in the unemployment rate to 4.3% and a series of substantial downward revisions to employment numbers for the 12-month period ending March 2025; however, Q2 GDP was revised higher to 3.8%, the latest testament to the resilience of the world's largest economy. Although U.S. inflation remains sticky with core PCE near 3%, Chair Powell stated that the balance of risks has shifted, and that the downside risks to employment now outweigh the upside risks to inflation. As of the end of Q3, market expectations reflected another one-to-two cuts by the Fed in 2025.

Amidst this backdrop, short-term provincial spreads narrowed by 3 basis points to 13 basis points during the quarter (11 basis points year-to-date), while short-term spreads of rated Municipal issuers narrowed by 4 basis points to 17 basis points (11 basis points year-to-date). Short-term spreads of non-rated Municipal issues narrowed by approximately 9 basis points, outperforming their rated counterparts and provincial issues. For the quarter, short-term corporate spreads moved in by 14 basis points to 72 basis points and are in 18 basis points year-to-date.

Portfolio Performance and Positioning

The fund returned 1.42% net of fees for the quarter vs 1.30% for the benchmark, generating added valued of 12 basis points. Contributions from duration and curve positioning were positive, and we benefitted from the carry in the portfolio, security selection, and sector allocation, including our overweight to non-rated Municipal bonds which outperformed rated Munis and Provis. With respect to security selection, we added value through our selection of non-rated Municipal and Provincial securities, which was partially offset by our selection of rated Municipal bonds.

At the end of the quarter, the fund was yielding 3.03% and had duration of 3.12 years. The fund's carry was 30 basis points, unchanged from Q2.

Outlook

We expect the Canadian economy to grow below potential over the next 12 to 18 months but to avoid a recession, growth will be challenged in the near term but should gradually return towards 1%. We expect core inflation to slow gradually, allowing the Bank to cut further towards 2%.

Although trade-related risks remain, global growth has been more resilient than anticipated in 2025. Canada currently enjoys a comparatively lower tariff rate than global competitors due to exemptions under CUSMA, but there is lack of clarity concerning the upcoming renewal in 2026 which could see Canada's tariff rate materially increase; further, the

US imposed tariffs on Canadian soft-wood lumber at the end of the quarter, suggesting that trade tensions have not abated. Significant spending on Canadian infrastructure projects should support long-term investments and sentiment, while spillover effects from high US spending should be net positive. In addition to CUSMA uncertainty, growing deficits and interest burdens, as well as the impact of higher rates on interest-sensitive sectors (e.g. housing and mortgage refinancing), could continue to weigh on the economy, and any slowdown in US growth would likely impact Canada via contagion effects.

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