HAD: Global X Active Canadian Bond ETF

Market Review

The third quarter of 2026 was challenging for fixed income as a renewed surge in energy prices, the collapse of Canada-US trade negotiations, and a hawkish turn from central banks drove a broad selloff in bonds. After falling as low as $72 in June, Brent crude climbed back above $100 per barrel as the Middle East conflict persisted. Trade tensions escalated after talks broke down in August as the US imposed 50% tariffs on a wide range of Canadian goods. Canada retaliated with counter-tariffs in September, before the US responded with bans on certain Canadian imports at quarter end.

The BoC held its policy rate at 2.25% at both its July and September meetings; however, markets read the September statement as hawkish after the Bank flagged increased upside risks to its inflation forecast from elevated energy prices and the new tariff measures. The Fed raised the fed funds target range by 25 basis points to 3.75% - 4.00% in September, its first hike since 2023. The tightening bias extended globally with the ECB and BoJ also raising rates during the quarter while the BoE held steady. At quarter end, markets were pricing roughly 33 basis points of increases from the BoC and a further 30 basis points from the Fed by year end.

Canadian data surprised to the upside early in the quarter, as Q2 GDP grew 3.3% annualized on a rebound in exports, but momentum faded with July GDP essentially flat. Headline CPI remained at 3.0% in August, at the top of the BoC's target range, while the Bank's preferred core measures were contained, with CPI-trim at 1.9% and CPI-median at 2.0%. Employment declined by 42,000 in August, though the unemployment rate held at 6.4%. In the US, Q2 GDP was revised up to 2.2% annualized, headline CPI was steady at 3.4% in August with core easing to 2.4%, and the unemployment rate stayed at 4.1% as payrolls rose 162,000.

Against this backdrop, yields rose sharply across the curve in both countries, led by the front end. Canada yields were up as much as 70 basis points at the front end and 52 basis points at the long end, while US Treasuries underperformed, with rates up over 80 basis points and 60 basis points, respectively. Credit remained resilient amid the volatility in rates; mid-term provincial spreads widened by 1 basis point over the quarter and were 2 basis points tighter year-to-date, while mid-term corporate spreads narrowed by 2 basis points and were 5 basis points tighter year-to-date.

Portfolio Performance and Positioning

The Fund returned -3.16% net of fees for the quarter vs -2.96% for the benchmark.

On a gross basis, the Fund's absolute return was negative for the quarter and underperformed the benchmark. Duration and curve positioning was negative, and while the Fund benefitted from its credit overweight, driven by sector allocation and carry, this was not sufficient to offset the drag from duration, with security selection also negative.

Sector allocation in corporates, particularly Financials and Real Estate, and municipals was positive, offset slightly by provincials. Security selection in federal and provincial securities detracted, partially offset by positive selection in corporates and municipals.

During the quarter we took profits on several strong performers and were very active in the primary market, purchasing issues from BMO, Bank of Nova Scotia, Brookfield Renewable, Choice Properties, CP Rail, Dream Summit, IBM, RBC, and TD, among others.

Over the quarter, our weighted duration deviation on corporate bonds increased from 0.28 to 0.31. Despite the increase, our corporate exposure remains below normal levels, reflecting our view that spreads are tight and compensation is not overly attractive; however, strong fundamentals and technicals gave us comfort to actively participate in the primary and secondary markets.

Our active duration increased from 0.20 to 0.31 as we added exposure during the backup in rates, with the bulk of our exposure concentrated in the front-end of the curve. Portfolio carry was 16 basis points, down from 18 basis points at the beginning of the quarter.

Outlook

We expect the Canadian economy to grow at a modest ~1.5% pace over the next 12 to 18 months following a firm rebound in the second quarter; however, the outlook continues to hinge on the conflict in Iran, which re-escalated through the quarter. Central banks have little tolerance for the risk that higher energy prices feed through into broad-based inflation, and with the Fed, ECB, and BoJ having already moved, we expect the BoC to follow suit if energy prices remain elevated to combat the risk of pass-through inflation. Under our base case scenario, we expect the BoC to increase rates towards 2.75%, the middle of the neutral range.

Further escalation in Iran remains the most significant near-term risk to the outlook for rates and spreads, as a more severe energy shock would heighten the risk of pass-through inflation and further tighten financial conditions globally. Increasing concerns over global sovereign debt levels and bond issuance continue to put upward pressure on term premiums in countries like France and Japan. The breakdown in trade negotiations and the escalation of tariffs on Canadian goods pose a significant risk to growth, and along with weakness in interest-sensitive sectors could temper the need for tighter policy, while deficit spending and AI-related investment should continue to support growth across North America.

We are currently long duration, particularly at the front end, where we expect rates to outperform as the Bank tightens less than the market expects. The market is pricing more than 100 basis points of hikes over the next 12 months, which we view as excessive given that the economy likely requires only modest tightening within the neutral range.

We maintain a modest overweight in corporate bonds with a focus on short-dated issues where carry is attractive, and on quality trades where relative spreads are more appealing. Spreads have remained rangebound, supported by strong technicals, and we will look to add should opportunities arise but remain cautious given tight spreads and the numerous risks to credit noted above.