HPR: 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 bp 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.

The Canadian preferred share market was broadly unchanged in Q3. The S&P/TSX Preferred Share Index returned 0.03% while the Solactive Laddered Canadian Preferred Share Index (100% rate reset) returned 1.84%. Fixed rate perpetual issues underperformed due to the increase in rates, while floating rate and fixed reset issues outperformed. Hybrids were also impacted by higher rates across the curve and underperformed during the quarter while LRCNs outperformed, especially the lower reset issues. Within the rate reset preferred share market, issues with lower reset levels that trade at a discount and will reset over the next 2 years, as well as those that just reset, outperformed. The real estate and insurance sectors outperformed in Q3 while financial services and utility sectors underperformed.

Portfolio Performance and Positioning

The fund returned 0.26% net of fees for the quarter vs 0.03% for the benchmark.

Our underweight positions in fixed rate perpetuals and insurance & financial services names, as well as our selection of securities that will reset in 2030 and 2031 were the primary drivers of outperformance over the quarter. Our underweight position in utilities and the energy sector detracted from performance.

Over the last quarter, we continued to focus our investment on quality issuers. We increased our allocation to LRCNs and institutional preferred share issues while slightly reducing our overweight position in fixed rate perpetuals. We increased our allocation to fixed reset issues with mid reset levels that should reset in 2027 and 2028. We bought the new National Bank institutional preferred share security which was issued with an attractive coupon and reset level.

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. 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 expect market volatility to remain elevated which will present us with trade opportunities.

The average preferred share yield remains attractive and should continue to increase over the next few years as fixed reset issues reset at higher 5yr Canada rates. A higher 5yr Canada rate is a net positive for the asset class, especially when the credit tone is stable. The market could experience volatility, particularly due to central bank policy amid above-target, sticky inflation, high energy prices, and geopolitical risks. The pace of preferred share redemptions may be limited for the remainder of 2026 and into 2027 and flows of funds could exacerbate any volatility after strong performance over the last 3 years. We are well positioned to add risk if opportunities arise or to take profits if needed. In this environment, our focus remains defensive, concentrated toward high-quality issuers. We see the best risk/reward opportunities in fixed reset issues with mid reset levels that are providing high current yields and that will reset in 2027 and 2028.