MONTRÉAL EXCHANGE

Futures Market Forecast 2026

Futures Flash Series
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Unlike many other areas of financial markets, certain aspects of the futures market can be predicted with a very high degree of certainty. For example, aspects of the fixed income physical deliverable contract market can often be anticipated well in advance by examining the formula for delivery basket inclusion and the expected path of short-term interest rates. While alternative scenarios could cause these predictions to fail, the overall certainty remains quite high for most.

Positive Gross Basis All Year

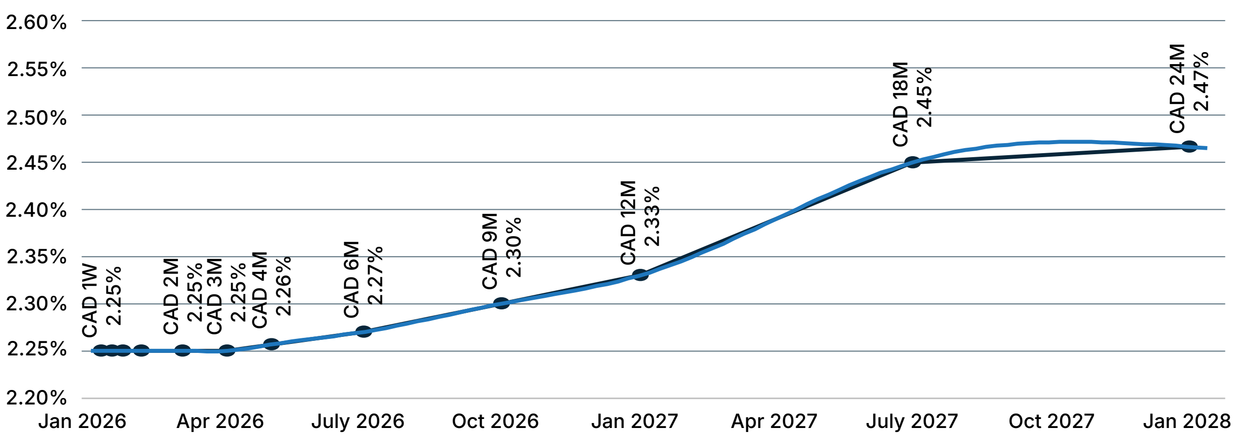
Apart from the two-year Government of Canada Bond Futures (CGZ®) contract, we expect that "the basis" between bonds and futures contracts will trade positively in 2026. The primary factor influencing this is the coupon rate of the bonds in the contract's delivery basket, especially that of the cheapest-to-deliver bond.

The gross basis is the price at which an investor can execute a cash-and-carry arbitrage trade by simultaneously buying a cash bond and selling a futures contract, or vice versa. Under normal yield curve conditions, deliverable bonds have coupons that exceed the overnight target rate, making a cash-and-carry futures arbitrage—where the investor is short futures and owns cash bonds (long the futures basis)—a positive carry trade. Conversely, when overnight rates exceed the coupon rates on the deliverable bonds, a long futures basis position results in a negative carry. This causes the gross basis to fall below zero, offsetting the negative carry for the long basis holder. This event sometimes causes confusion, as most investors expect basis quotes to be positive[1].

With the Bank of Canada expected to raise its target rate only slightly in 2026, as shown in Figure 1, the only bond in any of the deliverable baskets with a coupon lower than the 2.45% or so, which the Bank is projected to reach by summer 2027, is most likely to be the deliverable bond for the June 2026 CGZ (2-year) contract. Although bond auctions will introduce new bonds, those created for 5-, 10-, or 30-year auctions would not bear such low coupons unless interest rates decline significantly. Even then, they are still unlikely to be the cheapest bond to deliver for those contracts.

FIGURE 1

CAD Overnight Index Swap



Source: BMO Capital Markets[i] Fixed Income Sapphire database

In conclusion, given current expectations, the 2-year contract might trade at a negative basis relative to bonds in the latter half of the year, but none of the others are likely to do so in the current environment.

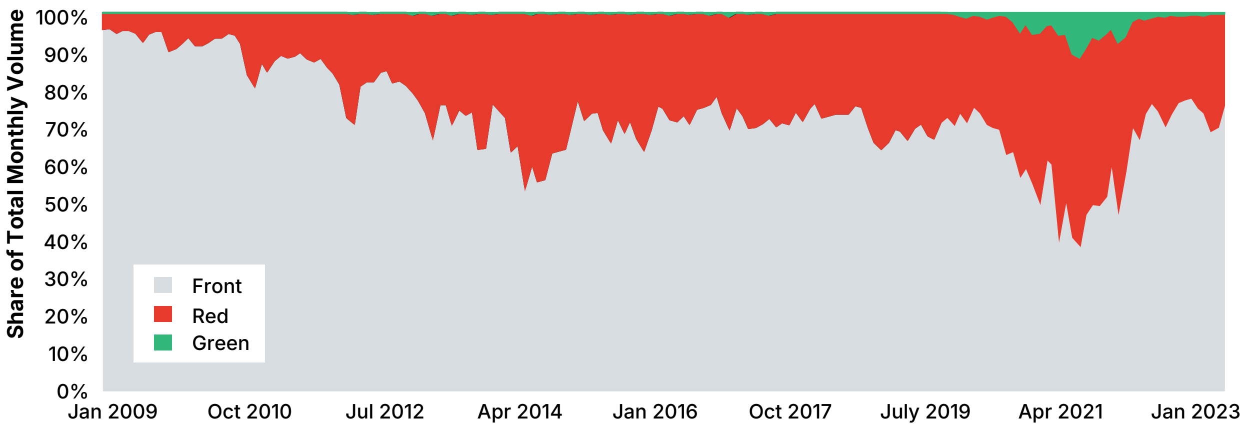
1 Investors interested in a more thorough explanation of negative basis can refer to "Forecasting/Understanding Negative Basis in Futures" published by Montréal Exchange in April 2021.

Heightened Activity in CORRA Reds and Greens

This trend is already established but will likely persist into the new year and possibly longer. An aspect of the old BAX contract that many managers lamented was that the 5th to 8th contracts in the series, referred to as the "Reds" or the "Red Pack", along with the subsequent four contracts referred to as the "Greens" or the "Green Pack", often accounted for only 20-30% of the volume across all BAX contracts. This lack of activity did not create deep liquidity, limiting the types of transactions that could be accomplished. We illustrate this with the (now defunct) BAX (90-day Bankers' Acceptance) contracts in Figure 2 and note that we originally prepared this chart to celebrate the rise of the Greens and Reds, which finally surpassed 50% of the volume in BAX in late 2020 and early 2021.

FIGURE 2

BAX Volume by Series, Jan 2009 to present

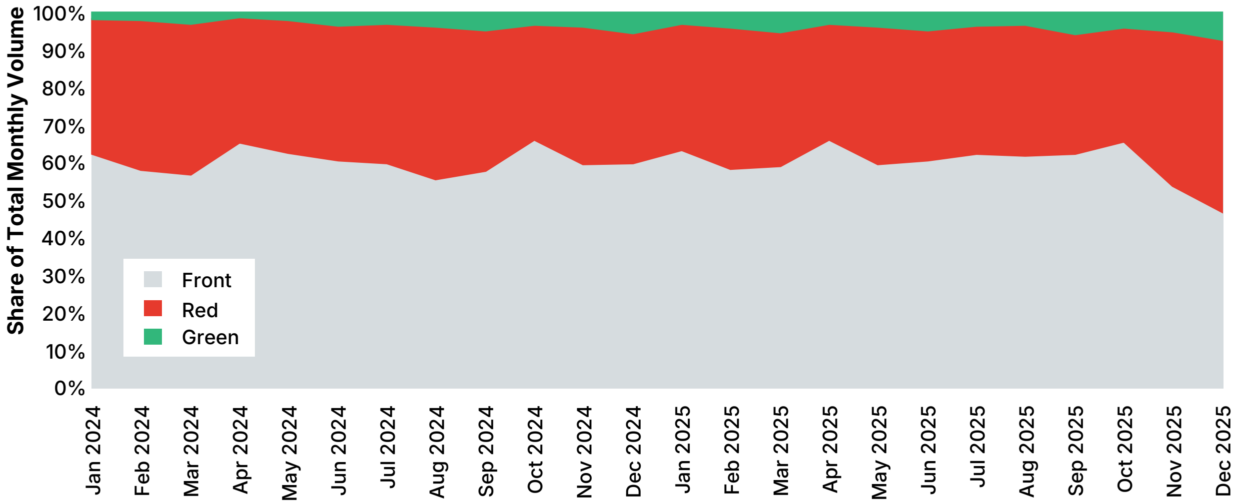


Source: Montréal Exchange, Author calculations

Following the benchmark transition from CDOR to CORRA in 2024, BAX contracts were replaced by three-month CORRA Futures (CRA™) contracts. We can produce a similar chart for the new front-end play, as shown in Figure 3. At the end of December 2025, the Greens and Reds of CORRA contracts have once again surpassed the volume in the "Front" contracts, which cover the first four expiration dates. More importantly, CORRA has demonstrated a healthier dynamic most of the time with the recent share of front contracts rarely exceeding 60%, unlike the previous Bankers' Acceptance contracts, which often did. We cannot think of any market participant that will not welcome greater liquidity and activity in the 5th to 12th CRA contracts.

FIGURE 3

CRA Volume by Series, Jan 2024 to Dec 2025



Source: Montréal Exchange, Author calculations

Low Wildcard Option Activity Expected

Investors using Canadian fixed income futures contracts (such as CGZ (2-year), CGF® (5-year), and CGB® (10-year)) with a delivery period as alternatives to cash bonds will be pleased to discover that Wildcard options are unlikely to pose an issue this year, unlike in many post-pandemic years.

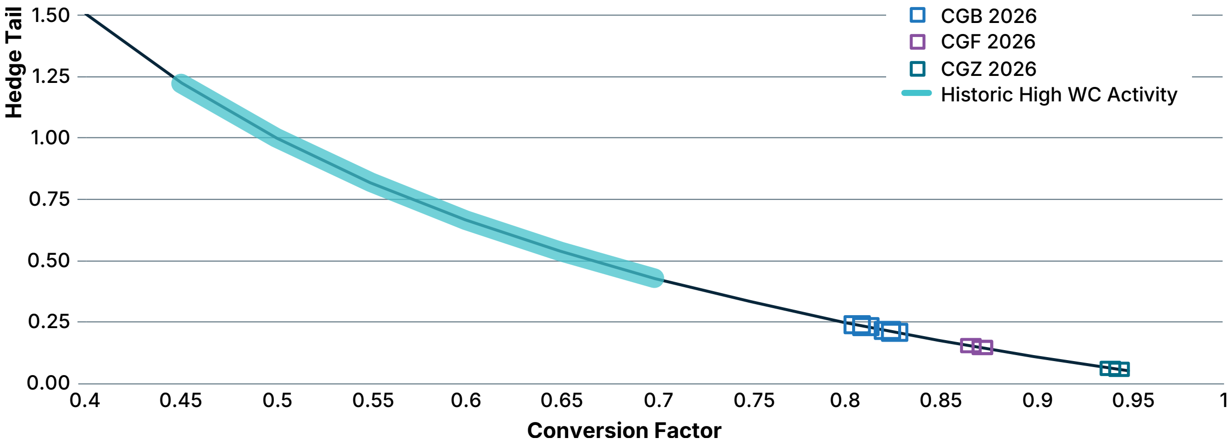
The primary reason for the reduced expectations for Wildcard activity is that very low coupon bonds are unlikely to be in the delivery basket for the 5-year and 10-year contracts this year. When low coupon bonds are the cheapest-to-deliver, they create low conversion factors for that bond, which in turn lead to larger hedge tails. Hedge tails are the "leftover amount" of bonds that short futures basis positions can sell to generate a profit if an opportunity arises to deliver bonds late in the afternoon during the delivery period. Smaller hedge tails result in lower profits when managers monetize the embedded option in the physical delivery futures contract.

For the foreseeable future, hedge tails will be less than 25% for all Montréal Exchange physical delivery fixed income contracts[2]. This is a direct result of bond coupons now being in the 2.5% to 3.5% range, unlike the very low coupon bonds auctioned during the COVID-19 pandemic. Notably, Wildcard activity has been observed much more often when hedge tails are between 40% and 125%, as shown in the highlighted area in Figure 4.

2 The LGB® (30-year) contract has a fixed delivery date and thus no embedded Wildcard option. Cash settled contracts like CRA (3-month CORRA) contain no embedded options.

FIGURE 4

Hedge Tail vs. Conversion Factor



Source: Montréal Exchange, Author calculations

While Wildcard option activity will likely continue as dealing desks often accumulate short futures basis positions and take them into delivery, the positive carry for those positions discourages early exercise. Additionally, the potential to profit from late-day delivery has all but disappeared for 2026[3], barring some unforeseen event that makes a very low coupon bond the cheapest-to-deliver bond for a CGF or CGB contract.

Delivery Switches Not a Problem

Although we mentioned the possibility of an unanticipated change in the cheapest-to-deliver bond for a contract in the previous section's final paragraph, the likelihood of a delivery switch for all of 2026 in any Montréal Exchange contract is very low.

Delivery switches are possible for Canadian fixed income contracts. However, the extremely consistent and predictable auction schedule, combined with the Bank of Canada's aversion to reopening old issues, creates a predictable delivery basket of potential bonds. The "stack" of potential deliverables is virtually always a list of bonds with maturities 6 months apart for the 10-year and 5-year contracts and 3 months apart for the 2-year contract. In such an environment, interest rates usually need to rise by hundreds of basis points, or the curves need to steepen dramatically (or both) during the life of a contract to trigger a delivery switch.

We would need to revisit our "no switches" assumption for 2026 if interest rates rose dramatically or if the yield curve steepened significantly. But, neither of these events, especially in combination, should be the baseline prediction for most economists or portfolio managers in 2026.

CGF (5-year) Could Take on Added Importance

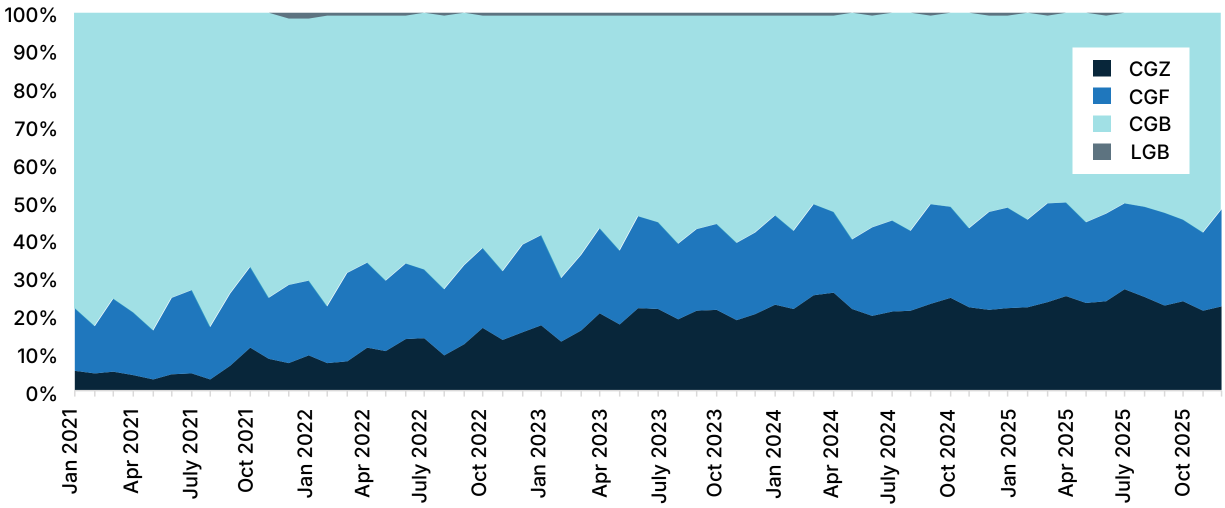
Both the CGZ (2-year) and CGF (5-year) contracts have seen consistent growth in trading volume and open interest[4] since their reintroduction after 2020. These two contracts now account for nearly half of the physical delivery fixed income contracts traded on Montréal Exchange, especially in or near the expiry months, as shown in Figure 5.

3 The Wildcard option therefore has a value very close to zero.

4 With ~347,000 contracts at the time of writing, CGZ open interest is near all-time high.

FIGURE 5

Volume Share by Contract



Source: Montréal Exchange, Author calculations

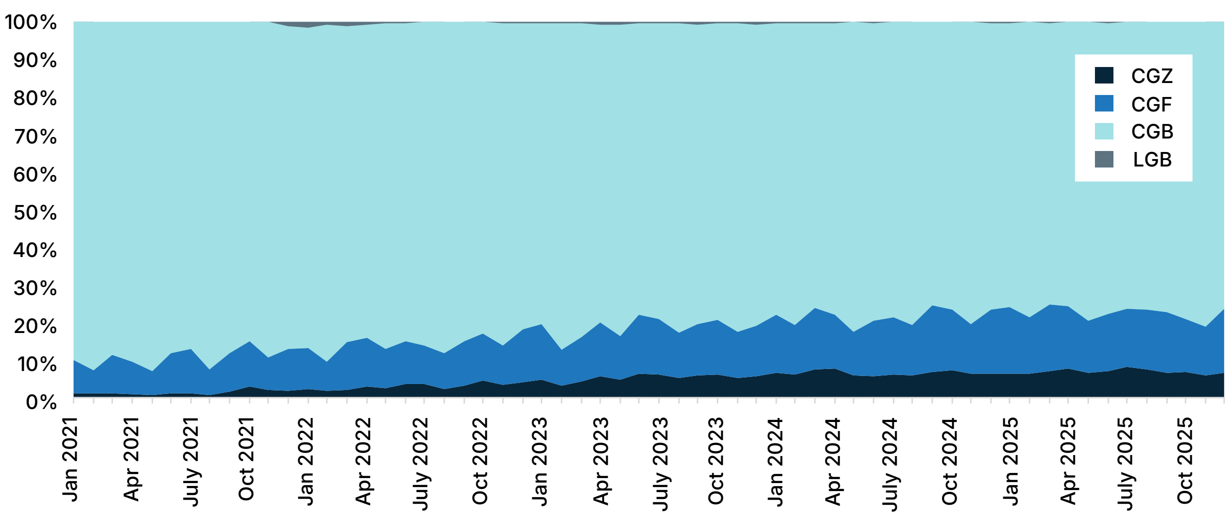
At first glance, the growth of the 2-year contract has eclipsed that of the 5-year contract with rapid growth from 2021 through to the end of 2025. This is true to some extent. This growth has been greatly facilitated by an economic environment with an active central bank that has given many managers an added incentive to trade shorter maturity bonds in anticipation of central bank policy changes.

Given that Canada's monetary policy has (almost) come full circle from the post-2020 low-interest-rate environment, through the inflation years, and now back to easy policy amid trade uncertainty, could 2026 bring a period of profitable trading in the belly of the curve that favours the CGF (5-year) contract growth?

We recalculated the volume share per contract in Figure 5 to adjust for each contract's DV01 and found, in Figure 6, that the CGF DV01 volume per month remained stagnant since the inflation scare, or since about mid-2023. There is plenty of room for this contract to grow in importance as managers shift from policy anticipation trades at the 2-year point to anticipating changes in the curve shape via 2-5 slope, 5-10 slope, or 2-5-10 butterfly trades, in an environment of low long-term overnight rates and a less aggressive central bank.

FIGURE 6

DV01-Adjusted Volume Share by Contract



Source: Montréal Exchange, Author calculations

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