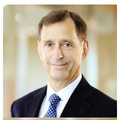
# Ninepoint Fixed Income Strategy

## April 2020 Commentary

*Monthly commentary discusses recent developments across both the **Diversified Bond** and **Credit Income Opportunities Funds**.*


Investment Team



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### Macro

The covid-19 pandemic continued to dominate the narrative throughout the month of April. Thankfully, the growth rate of new cases peaked late March and has continued to decline, sitting at about 2% at the beginning of May (Figure 1). Europe now seems to be past the worst and many countries are starting to relax some of the harshest social distancing measures. In the U.S., the daily number of new cases has stabilized, but remains elevated. Emerging markets, particularly in Africa and Latin America, are starting to see large increases in cases. Brazil has been hit particularly hard, thanks to an inadequate government response.

Overall, it feels like the first wave of Covid-19 infections is past its peak and the focus of policy makers around the G7 is now on how, when and at what pace they should reopen their respective economies. It will likely be a slow process and progress in different phases. As this happens, the main concern by the authorities and individuals is whether or not there will be a second wave of infections once countries start relaxing stay-at-home orders.

**Figure 1: Global Covid-19 Cases - Daily Growth Rate**


Source: Bloomberg

From the information we gathered, listening to various experts and policy makers, three things need to happen before we can go back to the “old normal”:

1. access to broad and rapid testing technology to be able quickly isolate new cases and know who has immunity,
2. an efficient way to treat the disease, so that hospitals discharge patients quicker and reduce the load on the health care system
3. a vaccine, so that vulnerable populations can be immunized and that over time, we can achieve herd immunity (i.e. enough of the overall population has antibodies and does not contract/spread the disease).

There is no stopping human ingenuity, particularly in difficult times. Testing is improving both in quality and quantity. Some drugs, such as Gilead's Remdesivir, have been shown to reduce the duration of the disease in severe cases and other drugs are in development or various stages of testing. As for a vaccine, several reputable companies have announced phase 1 trials and are hopeful that approval and production can be achieved by year end or early 2021.

Unfortunately, until there's a vaccine social distancing measures will continue and the best we can hope for is a partial reopen of the economy. This is why we do not think that this recession and subsequent recovery will be as fast (i.e. V-shaped) as market participants seem to think it will. As we've shown in the chart (Figure 2), the trajectory of this recession is on track to be potentially worse in depth and duration than the Great Financial Crisis. The US unemployment rate for April is at a staggering 14%; over 20 million people have lost their jobs. Yes, over time, some of this will reverse itself as the economy partially reopens, but what about the rest of the businesses and workers that might have to wait for 2021 for things to go back to "normal"? Furthermore, there will likely be permanent or at least very persistent changes in consumer and business behaviour resulting from the very unusual times we are going through. For example, several airline CEOs have been on the record predicting that it could take three to five years before flight volumes come back to normal. And that's just the start.

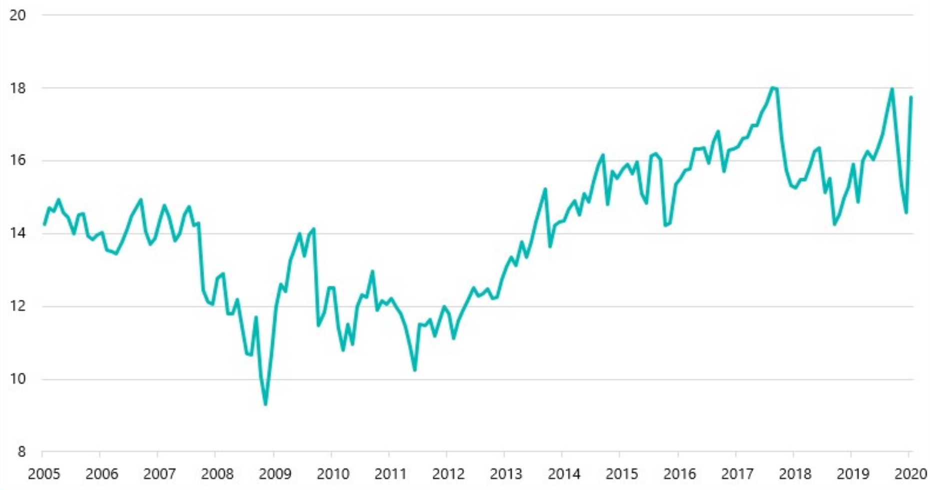
**Figure 2: The COVID-19 Recession will be comparable in scale to the Great Recession**
**Goldman Sachs Global Leading Indicator**


Source: Bloomberg

This implies that the recovery phase of this recession will be long and shallow, which seems inconsistent with the way risk assets have recently performed. Using US equities as a proxy for growth expectations, we see that the market is willing to assign a 2021 price to earnings multiple of about 17.5 times, the same as it was in December 2018 (after the big US tax cuts) and December 2019 (when expectations were for double digit earnings growth) (Figure 3).

Either we are wrong on the recession and the growth path forward for the economy (i.e. it will rebound really quickly), or risk assets are grossly mispriced here.

**Figure 3: Equity multiples trading at recent highs despite the Covid Recession**
**S&P 500 2-year Forward PE Ratio**




Source: Bloomberg

## Credit

Since the Fed and the BoC announced their corporate bond buying facilities, liquidity conditions in credit markets have normalized quite rapidly. Spreads are tighter than they were in March, reflecting that the uncertainty about the economic environment has eased somewhat, panic selling has subsided, dealers are once again making (reasonable) markets and new issue activity has rebounded. Interesting to note: neither the Fed nor the BoC have actually bought any corporate bonds to date, and so far, the knowledge of a potential backstop has been enough to calm markets.

The new issue market has been extremely active in April, particularly in the US, where massive multi-tranche deals were almost a daily occurrence. Corporations have been keen to raise liquidity for what they see as very challenging times ahead. Investors have looked past the economic hardship and met this issuance with gusto; deals have been several times oversubscribed, even with thin new issue concessions.

We have been very active, but selective, in the new issue market, buying what we think makes sense from a portfolio diversification perspective and where we thought things were particularly cheap. Given the large amount of maturities both funds have over the next 12 months and client inflows, we have had a lot of cash to put to work.

Still, after the rally in credit and equities since the March lows, it feels like we have come too far too fast. As discussed earlier, at this current juncture, there seems to be more downside than upside to equities, and another leg down could put pressure on credit. Therefore, we are in no rush to deploy all our excess liquidity, preferring a more progressive and measured approach.

## Diversified Bond Fund (DBF)

The DB fund continues to perform according to expectations, returning 1.4% in April, mostly driven by the normalization in credit mentioned above. We did not make any significant changes to the overall portfolio characteristics in April. On the margin, new positions in IG had longer duration than the maturities they were replacing, taking the fund's duration up to 4 years. Naturally, as we recycle maturing bonds into new issues, the portfolio's duration drifts upwards. Later in the cycle we'll start disposing of our government bonds, which should stabilize duration in the 3 to 4 years range. The increase in our cash position reflects client inflows, which will be deployed as opportunities present themselves.

**Diversified Bond Fund Portfolio Characteristics**

| | Limits | Dec 2017 | Mar 2018 | Jun 2018 | Sept 2018 | Dec 2018 | Mar 2019 | June 2019 | Sept 2019 | Dec 2019 | Mar 2020 | Apr 2020 | Outlook |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Government Bonds** | **100%** | -2% | 0% | -4% | 2% | 1% | 7% | 22% | 28% | 13% | 9% | **9%** | ↓ |
| **Investment Grade** | **80%** | 37% | 56% | 66% | 73% | 76% | 72% | 58% | 61% | 58% | 78% | **74%** | ↑ |
| **High Yield** | **40%** | 32% | 24% | 17% | 16% | 13% | 14% | 9% | 7% | 6% | 13% | **12%** | ↑ |
| **Emerging Market Governments** | **10%** | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | **0%** | ↔ |
| **Preferred Equities** | **10%** | 6% | 6% | 6% | 6% | 2.5% | 0.7% | 0% | 0% | 0% | 0% | **0%** | ↔ |
| **Common Equities & ETFs** | **10%** | 0% | 0% | 0% | 1.5% | 1.5% | 4.3% | 2.4% | -1.3% | 0% | 0% | **0.8%** | ↔ |
| **Derivatives** | **+/- 2.5%** | -0.1% | +0.5% | -0.1% | -0.05% | 0.0% | 0.0% | -0.2% | 0.0% | 0.2% | 0% | **0%** | **N/A** |
| **Cash and Equivalents** | | 28% | 14% | 15% | 1.5% | 6% | 2% | 9% | 6% | 22% | 0% | **4%** | ↓ |
| **Total** | | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | **100%** | |
| **Duration** | **1 to 8 years** | 2.4 | 2.1 | 2.3 | 1.0 | 2.4 | 3.4 | 5.4 | 6.5 | 4.3 | 3.8 | **4.0** | ↔ |
| **Geographic (% North America)** | **>75%** | 89% | 90% | 89% | 93% | 91% | 87% | 85% | 86% | 85% | 92% | **92%** | ↔ |
| **Unhedged FX Exposure** | **20%** | 0% | 0% | 0% | 0% | 0% | 0% | 6% | 5% | 3% | 3% | **3%** | ↔ |

Source: Ninepoint Partners

## Credit Income Opportunities Fund (Credit Opps)

After a challenging March, the Credit Opps bounced back in April, returning 2.78%. The normalization in credit conditions mentioned above was the primary driver of last month's returns. Above the surface, the overall characteristics of the fund have not changed materially. However, we have been quite active in the past few weeks, recycling capital into new investment grade credit opportunities, particularly in the US market. We also modified our HYG hedge quite a bit during the month; after the Fed announced that fallen angels would be eligible for their corporate bond buying program, HYG rallied by more than 8% in a single day. This was clearly an overreaction. We took advantage of this to monetize the call options we had bought as part of our short position. Subsequent to that, HY has continued to sell off and retraced more than half of the Fed induced pop. Consistent with our view that HY will remain challenged, we are maintaining our hedge, preferring to invest in higher rated securities.

## Credit Income Opportunities Portfolio Characteristics

| | Limits | Oct 2018 | Dec 2018 | Mar 2019 | June 2019 | Sept 2019 | Dec 2019 | Mar 2020 | Apr 2020 | Outlook |
|---|---|---|---|---|---|---|---|---|---|---|
| Government Bonds | 100% | 0% | 0% | 6% | 0% | 18% | 0% | 0% | 0% | ↔ |
| Investment Grade | 100% | 58% | 55% | 58% | 53% | 68% | 64% | 72% | 68% | ↑ |
| High Yield | 40% | 29% | 24% | 19% | 16% | 10% | 6% | 22% | 23% | ↑ |
| Private Loans | 10% | 3% | 3% | 2% | 3% | 2% | 2% | 4% | 4% | ↔ |
| Preferred Equities | 10% | 4% | 4% | 0.5% | 0% | 0% | 0% | 0% | 0% | ↔ |
| Common Equities & ETFs | 10% | 0% | 0% | 0% | 0% | -7% | -7% | -10% | -10% | ↓ |
| Derivatives | +/- 2.5% | 0% | 0% | 0% | -0.4% | 0% | 0% | 0% | 1% | N/A |
| Cash and Equivalents | | 6% | 14% | 15% | 28% | 8% | 32% | 12% | 16% | ↓ |
| Total | | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | |
| Duration | 0 to 5 years | 2.5 | 2.1 | 2.9 | 2.2 | 2.9 | 1.7 | 2.6 | 2.2 | ↔ |
| Leverage | 0-4x | 0.7x | 0.7x | 1.0x | 1.0x | 0.77x | 1.04x | 0.87x | 0.93x | ↑ |
| Unhedged FX Exposure | >25% | 0% | 0% | 0% | 2.7% | 5.1% | -3.2% | 0% | 1% | ↔ |

Source: Ninepoint Partners

## Conclusion

This year will continue to be volatile, presenting us with both challenges and opportunities. We believe that our performance over the past few years has demonstrated our ability to anticipate challenges and capitalize on opportunities. We remain confident in our ability to do so in the future. We wish our clients and their families good health and the best of luck navigating these unique conditions.

Until next month,

The Bond Team: Mark, Etienne and Chris

**Ninepoint Partners**

## NINEPOINT DIVERSIFIED BOND CLASS - COMPOUNDED RETURNS[1]
AS OF APRIL 30, 2020 (SERIES F NPP221)

| | 1M | YTD | 3M | 6M | 1YR | 3YR | 5YR | INCEPTION |
|---|---|---|---|---|---|---|---|---|
| Fund | 1.4% | 1.6% | 0.3% | 1.0% | 3.5% | 2.5% | 3.2% | 4.5% |

## NINEPOINT DIVERSIFIED BOND FUND - COMPOUNDED RETURNS[1]
AS OF APRIL 30, 2020 (SERIES F NPP118)

| | 1M | YTD | 3M | 6M | 1YR | 3YR | 5YR | INCEPTION |
|---|---|---|---|---|---|---|---|---|
| Fund | 1.4% | 1.7% | 0.4% | 1.1% | 3.6% | 2.7% | 3.4% | 4.4% |

## NINEPOINT CREDIT INCOME OPPORTUNITIES FUND - COMPOUNDED RETURNS[1]
AS OF APRIL 30, 2020 (SERIES F NPP507)

| | 1M | YTD | 3M | 6M | 1YR | 3YR | INCEPTION |
|---|---|---|---|---|---|---|---|
| Fund | 2.8% | -3.2% | -3.7% | -2.6% | -1.0% | 1.4% | 3.0% |

[1] All Ninepoint Diversified Bond Fund/Class returns and fund details are a) based on Series F units; b) net of fees; c) annualized if period is greater than one year; d) as at April 30, 2020 [1] All Ninepoint Credit Income Opportunities Fund returns and fund details are a) based on Class A units (closed to subscriptions); b) net of fees; c) annualized if period is greater than one year; d) as at April 30, 2020.

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