Ninepoint Fixed Income Strategy

August 2022 Commentary

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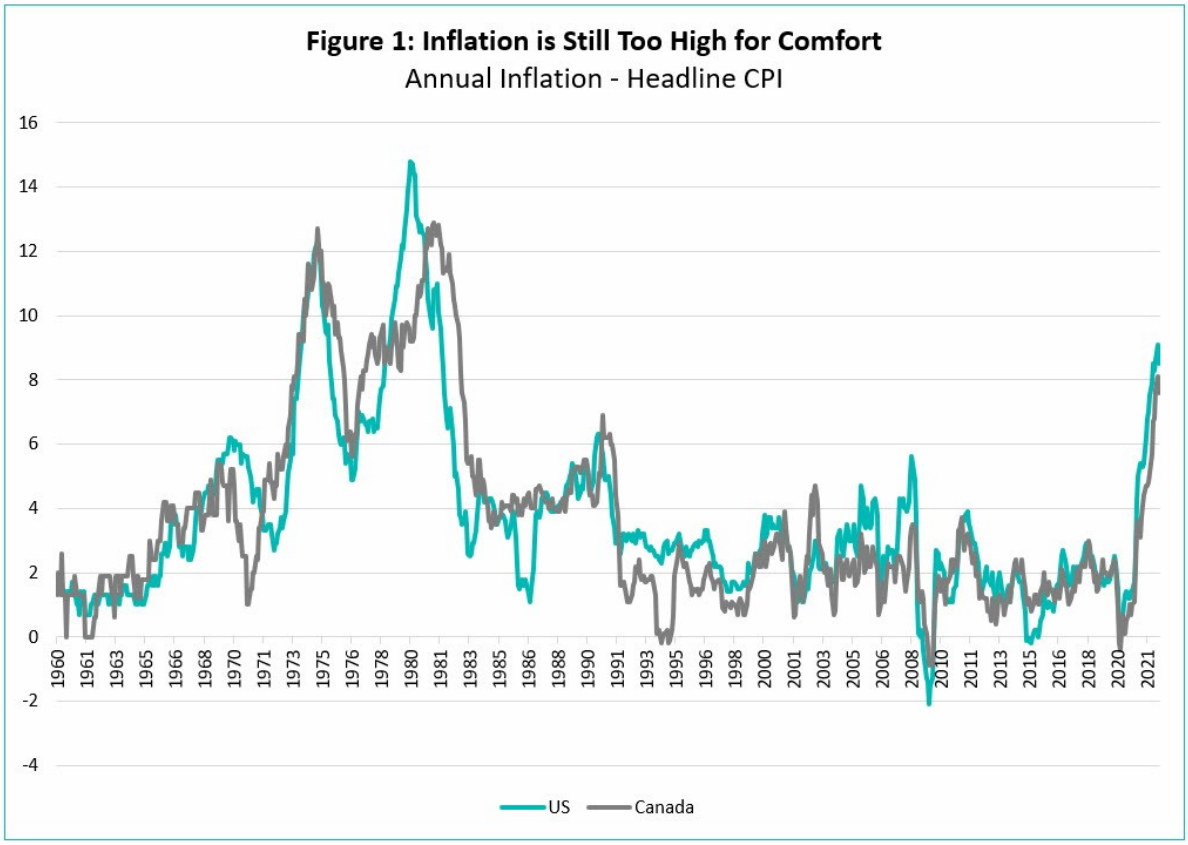
*Monthly commentary discusses recent developments across the **Diversified Bond**, **Alternative Credit Opportunities** and **Credit Income Opportunities Funds**.*

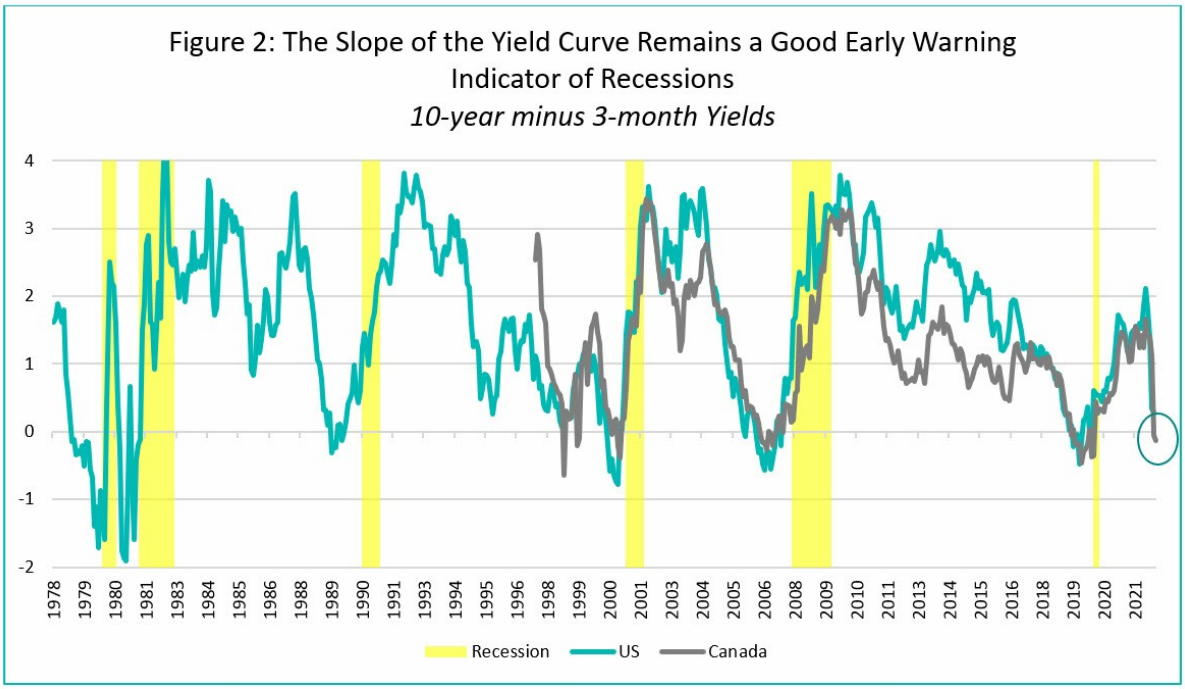
The highlight of the month was unequivocally the Jackson Hole Symposium, organized by the Federal Reserve Bank of Kansas City. This annual gathering is a forum for the top brass of global central banking to gather and, usually, discuss broader themes. But, given the problematic inflation faced by most nations, the focus this year was squarely on the near-term policy outlook. Several high-level officials from the European Central Bank took the opportunity to push for a 75bps rate hike at their upcoming September meeting, while the Fed's Chairman made sure in his remarks to dispel this idea of a "Fed Pivot". Fed Chairman Powell's speech was one of few words, lasting only 9 minutes, but it brought the message home: the Fed cares solely about inflation right now, and is ready to inflict some pain on households and businesses to achieve its objective. In other words, rates could not only go higher than expected, but they could also remain there for longer. This message was in line with our own interpretation of the situation but was grossly misaligned with market participants', which seemed to believe that the Fed would flinch at the first sign of an economic slowdown.

As discussed last month, yes, inflation has ticked down slightly from its peak (Figure 1), but it is too early to declare victory, as doing so would nullify much of the hard work that has been achieved over the past 6 months. Therefore, we expect central bankers to remain resolutely hawkish until either inflation is on a clear downward trajectory both at the headline and core levels, or the economy is clearly entering a recession, in which case lower aggregate demand and unemployment could be sufficient to break inflation.



Source: Bloomberg, as of July 31, 2022.

Given the very rapid pace of this hiking cycle and the important lag between monetary policy actions and its impact on the economy (6-12 months), we believe that it is increasingly likely that by the time the Fed and BoC reach this cycle's terminal rate (i.e. stop hiking), they will have gone too far already. One way to assess whether they have indeed gone too far is by looking at the slope of the yield curve (Figure 2).



Source: Bloomberg, Ninepoint Partners, as of August 31, 2022.

In particular, we like using the 10-year minus 3-month spread, because 3-month yields reflect the most up to date monetary actions (i.e. Fed funds rate plus whatever is expected in rate increases in the very short term) and 10-year yields reflect market's expectations for longer run interest rates (this is also what decades of academic research has shown to work best). If this spread inverts, as was the case prior to every recession since the 1960s, the bond market is telling us that the current stance of monetary policy is too restrictive, meaning that it will put downward pressure on the economy, usually to the point of triggering a recession. In the U.S. the upcoming rate hikes will likely invert the curve over the coming weeks. In Canada, the curve has been inverted since the start of August. Recessions usually follow an inversion of the curve by about 12-months.

Given the outlook for rate hikes this Fall, the war in Ukraine and its implications for energy prices leading to a decelerating economy globally, we think that Chairman Powell is right to expect some pain for households and businesses, as it seems more and more unavoidable.

Credit

Most risk assets began the month of August on a firm footing following a strong early summer rally. However, following Jackson Hole, sentiment changed quickly, and the bear market resumed. As we mentioned last month, Canadian credit had failed to keep up with the summer rally and as such didn't weaken as much in the back half of August. We saw an uptick in Canadian corporate bond supply, with most deals having very strong books and trading well in the secondary markets. We also received Canadian bank earnings this month with the predominant themes being strong loan growth, weak capital markets activity, rising provisions for credit losses and cautious outlooks. These themes are consistent with our own outlook and as such, we continue to defensively tilt the portfolios. In August we continued to capitalize on valuation dislocations across sectors to high-grade the portfolio, improving both credit ratings and liquidity.

Ninepoint Diversified Bond Fund (DBF)

August was a continuation of past months in that we moved into more defensive credits while maintaining strong all-in yields. In July, the 2s/10s Canada yield curve went deeply inverted which allowed for various retractions trades this month while often not giving up any yield. For example, we sold an Allied REIT bond with a 2029 maturity date to buy a Barclays bond callable in 2026 at a flat all-in yield while picking up one notch of credit quality and material liquidity. With yields a bit higher, we continue to monetize our interest rate swaps (IRS), slightly adding to the fund's duration. As of month-end, the fund's yield-to-maturity is 6.6% with a duration of 4 years (of which 0.3 years is the TLT call option position contribution).

Ninepoint Diversified Bond Fund
Portfolio Characteristics

	Limits	Dec 2017	Mar 2018	Jun 2018	Sept 2018	Dec 2018	Mar 2019	Jun 2019	Sept 2019	Dec 2019	Mar 2020	June 2020	Sept 2020	Dec 2020	Mar 2021	June 2021	Sept 2021	Dec 2021	March 2022	June 2022	Aug 2022	Outlook
Government Bonds	100%	-2%	0%	-4%	2%	1%	7%	22%	28%	13%	9%	9%	14%	8%	-8%	2%	0%	-7.0%	1%	2%	1%	↑
Investment Grade	80%	37%	56%	66%	73%	76%	72%	58%	61%	58%	78%	80%	71%	74%	84%	76%	73%	70%	73%	65%	67%	↑
High Yield	40%	32%	24%	17%	16%	13%	14%	9%	7%	6%	13%	11%	12%	11%	12%	14%	18%	18%	23%	29%	30%	↓
Emerging Market Governments	10%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	1%	1%	1%	1%	1%	0%	0%	0%	↔
Preferred Equities	10%	6%	6%	6%	6%	2.5%	0.7%	0%	0%	0%	0%	0%	2%	4%	6%	5%	3%	1%	2%	2%	2%	↓
Common Equities & ETFs	10%	0%	0%	0%	1.5%	1.5%	4.3%	2.4%	-1.3%	0%	0%	-6%	-5%	-2%	0%	0%	2%	0%	0%	0%	0%	↔
Derivatives	+/- 2.5%	-0.1%	+0.5%	-0.1%	-0.05%	0.0%	0.0%	-0.2%	0.0%	0.2%	0%	0%	0.1%	0%	0%	0%	0%	0%	1%	3%	1%	N/A
Cash and Equivalents		28%	14%	15%	1.5%	6%	2%	9%	6%	22%	0%	6%	6%	5%	5%	1%	3%	14%	0%	0%	0%	↔
Total		100%	100%	100%	100%	100%	100%	100%	100%	100%	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	5.9	6.2	5.3	3.6	4.5	4.2	2.9	2.2	2.4	4.0*	↑
Spread Duration		-	-	-	3.4	2.9	3.0	2.3	3.1	3.0	2.2	4.1	3.8	3.9	4.5	5.4	5.1	5.1	4.6	4.3	3.8	↔
Unhedged FX Exposure	20%	0%	0%	0%	0%	0%	0%	6%	5%	3%	3%	5%	6%	6%	0.5%	4%	0%	0%	0%	0%	0%	↔

Source: Ninepoint Partners

Ninepoint Alternative Credit Opportunities Fund (NACO)

We continued to reduce exposure to consumer facing credits while we took advantage of the Desjardins new issue to increase exposure to the credit. A >5% coupon for an 'A-' rated bond callable in 5 years was attractive to us. We also took some profits on a Rogers Communications bond after getting confirmation on the timing and amount of the consent solicitation. With yields a bit higher, we continue to monetize our interest rate swaps (IRS), slightly adding to the fund's duration. As of month-end, the fund's yield-to-maturity was 9.6% while duration moved up 0.2 years to 2.7 years (of which 0.5 years is the TLT call option position contribution).

Ninepoint Alternative Credit Opportunities Fund
Portfolio Characteristics

	Limits	May 2021	June 2021	July 2021	Aug. 2021	Sept. 2021	Oct. 2021	Nov. 2021	Dec. 2021	Jan. 2022	Feb. 2022	March 2022	April 2022	May 2022	June 2022	July 2022	Aug. 2022	Outlook
Government Bonds	100%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	↑
Investment Grade	100%	58%	66%	53%	49%	44%	48%	52%	44%	46%	48%	51%	50%	51%	51%	49%	50%	↑
High Yield	40%	36%	32%	29%	24%	22%	28%	29%	29%	33%	29%	27%	29%	28%	28%	29%	29%	↓
ABS	20%	0%	4%	1%	8%	6%	7%	7%	7%	9%	10%	11%	13%	13%	15%	16%	15%	↔
Loans	10%	0%	0%	0%	3%	3%	3%	6%	5%	5%	5%	5%	4%	4%	4%	4%	4%	↔
Preferred Equities	10%	8%	8%	4%	4%	3%	3%	2%	2%	2%	2%	1%	1%	1%	1%	1%	1%	↔
Common Equities & ETFs	10%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	↔
Derivatives	+/- 2.5%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	1%	1%	1%	1%	1%	1%	N/A
Cash and Equivalents		-2%	-18%	11%	10%	19%	3%	6%	13%	7%	8%	5%	0%	2%	0%	0%	0%	↑
Total		100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	
Duration	0 to 5 years	3.0	2.7	3.1	3.0	2.9	3.2	3.0	2.7	1.7	1.9	2.1	2.2	2.0	2.0	2.6*	2.7*	↑
Leverage	0-3x	1.4x	1.37x	1.13x	1.06x	1.09x	1.10x	1.10x	1.00x	1.20x	1.20x	1.10x	1.18x	1.17x	1.10x	1.20x	1.20x	↔
Unhedged FX Exposure	<20%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	↔

Source: Ninepoint Partners

Ninepoint Credit Income Opportunities Fund (Credit Ops)

In terms of credit exposure, we did not make any material changes to the portfolio this month as we feel that our average credit rating of BBB is appropriate given the backdrop. Of note, we did take profit on a Rogers Communications bond for the same reasons outlined above in addition to increasing duration 0.3 years to 2.2 years (of which 0.5 years is the TLT call option position contribution). With yields a bit higher, we continue to monetize our interest rate swaps (IRS), slightly adding to the fund's duration. Overall, we remain comfortable with the positioning of the portfolio, especially given the elevated yield-to-maturity of 10.6%.

Ninepoint Credit Income Opportunities Fund
Portfolio Characteristics

	Limits	Oct 2018	Dec 2018	Mar 2019	June 2019	Sept 2019	Dec 2019	Mar 2020	June 2020	Sept 2020	Dec 2020	Mar 2021	June 2021	Sept 2021	Dec 2021	March 2022	June 2022	Aug 2022	Outlook
Government Bonds	100%	0%	0%	6%	0%	18%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	↑
Investment Grade	100%	55%	52%	54%	48%	63%	59%	67%	57%	68%	49%	42%	34%	29%	31%	31%	32%	31%	↑
High Yield	40%	29%	24%	19%	16%	10%	6%	22%	28%	26%	26%	30%	32%	37%	33%	34%	38%	38%	↓
ABS	20%	3%	3%	4%	5%	5%	5%	5%	8%	9%	15%	11%	10%	14%	14%	11%	8%	7%	↔
Loans	10%	3%	3%	2%	3%	2%	2%	4%	7%	6%	6%	3%	4%	4%	8%	9%	7%	7%	↔
Preferred Equities	10%	4%	4%	0.5%	0%	0%	0%	0%	0%	0%	5%	10%	8%	4%	2%	3%	3%	3%	↓
Common Equities & ETFs	10%	0%	0%	0%	0%	-7%	-7%	-10%	-15%	-13%	-8%	0.3%	0%	1%	1%	1%	2%	2%	↔
Derivatives	+/- 2.5%	0%	0%	0%	-0.4%	0%	0%	0%	1%	0%	1%	1%	1%	1%	1%	2%	3%	2%	N/A
Cash and Equivalents		6%	14%	15%	28%	8%	32%	12%	8%	2%	3%	-0.5%	1.2%	6%	5%	2%	1%	3%	↑
Total		100%	100%	100%	100%	100%	100%	100%	100%	100%	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	3.3	5.1	3.8	2.6	2.5	3.4	2.5	1.6	1.4	2.2*	↑
Leverage	0-4x	0.7x	0.7x	1.0x	1.0x	0.77x	1.04x	0.87x	1.67x	1.15x	1.04x	1.26x	1.36x	1.43x	1.30x	1.30x	1.40x	1.40x	↓
Unhedged FX Exposure	<25%	0%	0%	0%	2.7%	5.1%	-3.2%	0%	0.3%	0%	2%	1%	0%	0%	0.5%	0.2%	-0.2%	0.2%	↔

Source: Ninepoint Partners

Conclusion

For several months now, we have been preparing portfolios for the increasing likelihood of a recession in 2023. Our credit quality and liquidity are improving, and we are taking advantage of the slope of the yield to reduce the duration of our credit (i.e. spread duration) while giving up very little yield. We are also increasing our allocation to government bonds, through ownership of TLT call options. Our TLT position is far out of the money for maximum upside should long term interest rates start pricing in a recession, while spending very little upfront premium. It is set to expire in December 2022, a time when we expect to have a lot more information on the most likely path for the economy. Credit hedges will also be appropriate for the two Opportunities funds.

This is the same playbook that we followed in 2019, when we faced an inverted yield curve, as the Trump trade war was wreaking havoc on the global economy. While each cycle is different, they follow similar patterns.

Please reach out to discuss further.

Until next month,

Mark, Etienne & Nick
Ninepoint Partners

NINEPOINT DIVERSIFIED BOND FUND - COMPOUNDED RETURNS[1] AS OF DECEMBER 31, 2023 (SERIES F NPP118) | INCEPTION DATE: AUGUST 5, 2010

	1M	YTD	3M	6M	1YR	3YR	5YR	10YR	INCEPTION
Fund	3.6%	5.9%	6.0%	4.1%	5.9%	-1.5%	1.2%	2.4%	3.2%

NINEPOINT CREDIT INCOME OPPORTUNITIES FUND - COMPOUNDED RETURNS[1] AS OF DECEMBER 31, 2023 (SERIES F NPP507) | INCEPTION DATE: JULY 1, 2015

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	2.9%	7.7%	4.1%	4.3%	7.7%	2.0%	5.2%	4.4%

NINEPOINT ALTERNATIVE CREDIT OPPORTUNITIES FUND - COMPOUNDED RETURNS[1] AS OF DECEMBER 31, 2023 (SERIES F NPP931) | INCEPTION DATE: APRIL 30, 2021

	1M	YTD	3M	6M	1YR	INCEPTION
Fund	2.9%	7.9%	4.8%	4.6%	7.9%	-0.3%

[1] All Ninepoint Diversified Bond Fund 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 August 31, 2022 [1] All Ninepoint Credit Income Opportunities Fund returns and fund details are a) based on Class F units; b) net of fees; c) annualized if period is greater than one year; d) as at August 31, 2022. [1] All Ninepoint Alternative Credit Opportunities Fund returns and fund details are a) based on Class F units; b) net of fees; c) annualized if period is greater than one year; d) as at August 31, 2022.

The Risks associated worth investing in a Fund depend on the securities and assets in which the Funds invests, based upon the Fund's particular objectives. There is no assurance that any Fund will achieve its investment objective, and its net asset value, yield and investment return will fluctuate from time to time with market conditions. There is no guarantee that the full amount of your original investment in a Fund will be returned to you. The Funds are not insured by the Canada Deposit Insurance Corporation or any other government deposit insurer. Please read a Fund's prospectus or offering memorandum before investing.

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