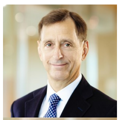
Ninepoint Fixed Income Strategy

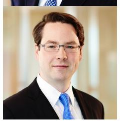
December 2019 Commentary

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

Investment Team



Mark Wisniewski,
Partner, Senior Portfolio Manager

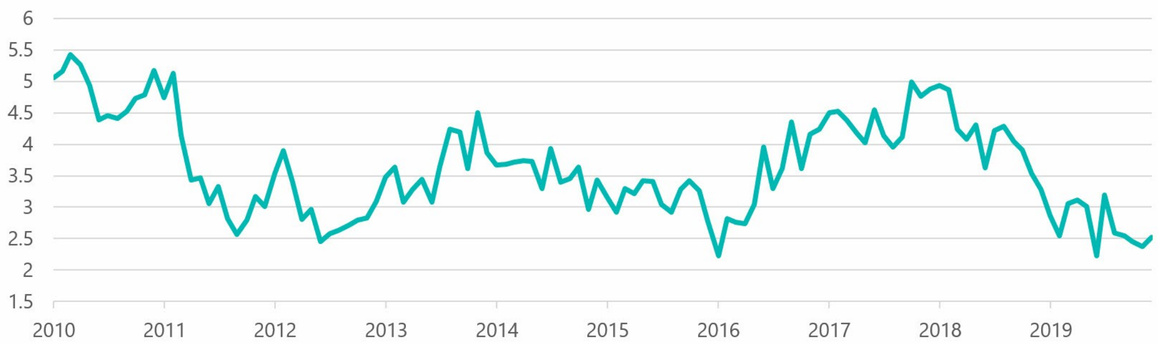


Etienne Bordeleau-Labrecque, MBA, CFA
Vice President, Portfolio Manager

Macro & Credit

With 2019 now behind us, we are left pondering what to expect for 2020 and how that will guide our portfolio decisions. The global economy has slowed, but for now has stopped deteriorating (Figure 1). The prevailing view amongst market participants is that lower US/China trade tensions and the lagged effects of more accommodative monetary policy across the globe should lead to a pick up in economic activity, probably pushing recession out to 2021.

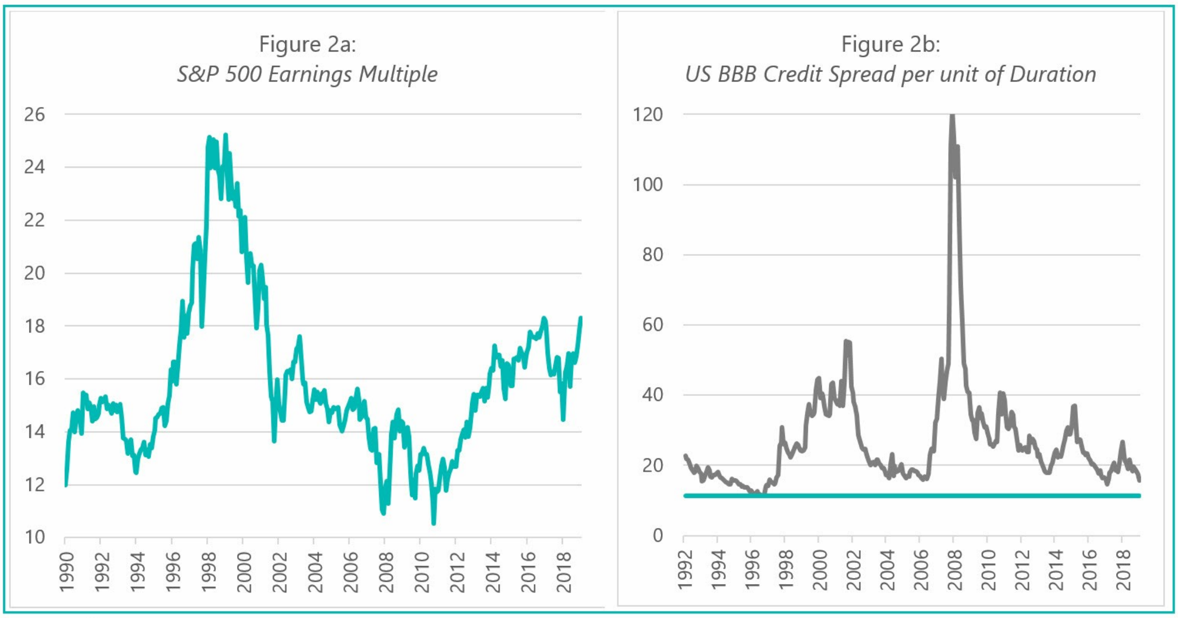
Figure 1: Still Waiting for the Data to Turn
Goldman Sachs Global Leading Activity Indicator



Source: Bloomberg

Equity and credit markets are already discounting better growth and earnings; the S&P 500 price-to-earnings ratio is back to its pre-tax reform high (Figure 2a) and corporate credit spreads (adjusted for duration) offer investors very slim risk premiums (Figure 2b). Closer to home, Canadian credit also feels stretched, new issues come with very little concessions and still attract large amounts of buyers. Secondary trading is mostly one-sided as buyers can't seem to find enough bonds to satisfy their appetite. Overall, the market seems a little stretched, assuming that the data will inevitably turn for the better. Given that the potential improvement in global growth has already been reflected in asset prices, we continue to prefer a defensive stance, keeping risk low, portfolios liquidity high and our powder dry.

Figure 2: Risky Assets Valuations Remain Very Elevated



Source: Bloomberg

Given the positive tone around growth, yields on long term government bonds have been drifting higher. Interestingly, most of the increase in bond yields has been driven by inflation compensation. Real yields have remained very low (Figure 3), suggesting that the government bond market does not yet share the enthusiasm reflected by equity and credit markets.

Accordingly, we have significantly reduced our duration by selling most of our government bonds. We remain on the sidelines as we await more direction one way or another, avoiding the volatility higher duration brings. We feel interest rates probably continue to drift higher to start the year as the market responds to excess monetary stimulus, a de-escalation in US/China trade tensions and remote recession fears.

Figure 3: Real Yields Remain Low

US 10-year inflation protected bonds

Source: Bloomberg

In terms of what we are keeping an eye on in 2020, the US presidential election is top of mind. Trump's approval ratings are relatively low (mid-40%) and the Democratic Party's presidential nomination process will kick into higher gear this spring. Several candidates support less market friendly policies and all of them have indicated their intention of rolling back the Trump tax cuts to pay for their political promises. Accordingly, it is not out of the question that 2019's trade uncertainty be replaced with domestic political uncertainty in 2020, paving the way for a more sluggish growth outlook than what is currently discounted.

Of course, US trade policy will also be on our radar. Assuming the Phase 1 deal with China goes through as planned in January, we expect that Trump's focus will then turn to the more challenging and contentious Phase 2 deal. Also, of significance, some US officials have signaled that the trade relationship with Europe might be tackled next.

After a busy year cutting rates, we expect that most central bankers will wish to remain on hold this year. At the Fed, officials will want to assess the impacts of their three "insurance cuts". The bar is high for them to cut again and they would need to see a "material deterioration" to act. However, the bar is even higher for them to hike, with inflation below target and inflation expectations having drifted lower, they are in no hurry to raise rates.

In Europe, the ECB has already deployed as much stimulus as it can, reactivating QE and lowering rates close to the effective lower bound. There again, policy makers are in wait-and-see mode and will instead focus on their recently announced mandate review.

In Canada, Governor Poloz has so far resisted the urge to lower rates, even though the Canadian economy has been steadily losing steam throughout 2019. His reticence to act can be primarily attributed to financial stability concerns; the Canadian consumer is still heavily indebted, and they want to avoid spurring another borrowing spree. But, with Poloz stepping down in early June, we could see the BoC under a new Governor take a different approach. Given the apparent reticence to ease policy for financial stability considerations, we remain of the view that the BoC is likely to be behind the curve, and that when they do finally decide to cut rates, they will have to cut quick and hard.

Diversified Bond Fund (DBF)

The Diversified Bond Fund returned 4.3% in 2019, net of fees. The bulk of the return this year can be attributed to our investment grade holdings. As discussed earlier, credit spreads across North America had performed exceptionally well in 2019, finishing the year close to cycle tights.
As opposed to 2018, we did have an allocation to government bonds throughout the year, which contributed about 85bps to the fund. As regular readers would recall, we started allocating to European sovereign bonds (France and Germany) in March. At the time, we felt that Europe would be the hardest hit from a continuing slowdown in China and a potential intensification of the trade war, making those bonds a good insurance policy. Later in the summer, as things deteriorated further between the US and China, we added 10 and 30 year US treasuries as well as 30 year Canadian government bonds, taking our government bond allocation to 28% at the end of September. Since then, trade tensions have improved and the world economy has stabilized, prompting us to reduce the fund's duration. As of the time of writing, the only government bonds left in the diversified bond fund are German and French bonds, and duration has been reduced to 4.3 years.

Diversified Bond Fund Portfolio Characteristics

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

Source: Ninepoint Partners

Credit Income Opportunities Fund (Credit Opps)

For the full year 2019, the Credit Opps returned 6.3%, net of fees. Like the DBF, the Credit Opps benefited from strong performance in credit. Throughout the first half of the year, we harvested profits on high yield positions, taking the sector's weight from 24% in December 2018 to 16% in June 2019. In the summer, we also entered credit hedges through the HYG ETF, further reducing the risk of the portfolio.

Leverage was relatively constant, oscillating around 1x for most of the year. One change we made to the overlay was reducing the term of the bonds we own, thereby reducing risk and volatility (i.e. instead of buying 5-10 year corporate bonds, the overlay was mostly composed of 3-5 year bonds). Due to the exceptional circumstances brought about by the US/China trade war, we felt it was prudent to add US treasuries to the Credit Opps in July. We eventually exited the position in December, with a net gain to the fund of about 30bps.

Credit Income Opportunities Portfolio Characteristics

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

Source: Ninepoint Partners

Conclusion

Credit spreads on investment grade and high yield have moved tighter, as money continues to pour into bond funds. As we screen for securities across sectors and within ratings buckets the opportunities are few and far between. If we don't see an economic slowdown, duration won't be much help as interest rates, for now, don't appear to be heading much lower. Although its early in the year, our expectation is that this will be a tricky year for bonds. With risk-reward as marginal as it is, being sensible about positioning, credit exposure and liquidity will be key. We remain confident that our conservative posture will payoff when markets become more rational.

Until next month,
The Bond Team: Mark, Etienne and Chris

Ninepoint Partners

[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 December 31, 2019 [1] All Ninepoint Credit Income Opportunities Fund returns and fund details are a) based on Class F units (closed to subscriptions); b) net of fees; c) annualized if period is greater than one year; d) as at December 31, 2019.

fees, performance fees, other charges and expenses, and should be read carefully before investing in the Funds. Performance data represents past performance of the Fund and is not indicative of future performance. Data based on performance history of less than five years may not give prospective investors enough information to base investment decisions on. Please contact your own personal advisor on your particular circumstance. This communication does not constitute an offer to sell or solicitation to purchase securities of the Fund.

Ninepoint Partners LP is the investment manager to the Ninepoint Funds (collectively, the “Funds”). Commissions, trailing commissions, management fees, performance fees (if any), other charges and expenses all may be associated with mutual fund investments. Please read the prospectus carefully before investing. The indicated rate of return for series F units of the Fund for the period ended December 31, 2019 is based on the historical annual compounded total return including changes in unit value and reinvestment of all distributions and does not take into account sales, redemption, distribution or optional charges or income taxes payable by any unitholder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. The information contained herein does not constitute an offer or solicitation by anyone in the United States or in any other jurisdiction in which such an offer or solicitation is not authorized or to any person to whom it is unlawful to make such an offer or solicitation. Prospective investors who are not resident in Canada should contact their financial advisor to determine whether securities of the Fund may be lawfully sold in their jurisdiction.

The opinions, estimates and projections (“information”) contained within this report are solely those of Ninepoint Partners LP and are subject to change without notice. Ninepoint Partners makes every effort to ensure that the information has been derived from sources believed to be reliable and accurate. However, Ninepoint Partners assumes no responsibility for any losses or damages, whether direct or indirect, which arise out of the use of this information. Ninepoint Partners is not under any obligation to update or keep current the information contained herein. The information should not be regarded by recipients as a substitute for the exercise of their own judgment. Please contact your own personal advisor on your particular circumstances. Views expressed regarding a particular company, security, industry or market sector should not be considered an indication of trading intent of any investment funds managed by Ninepoint Partners LP. Any reference to a particular company is for illustrative purposes only and should not to be considered as investment advice or a recommendation to buy or sell nor should it be considered as an indication of how the portfolio of any investment fund managed by Ninepoint Partners LP is or will be invested. Ninepoint Partners LP and/or its affiliates may collectively beneficially own/control 1% or more of any class of the equity securities of the issuers mentioned in this report. Ninepoint Partners LP and/or its affiliates may hold short position in any class of the equity securities of the issuers mentioned in this report. During the preceding 12 months, Ninepoint Partners LP and/or its affiliates may have received remuneration other than normal course investment advisory or trade execution services from the issuers mentioned in this report.

Ninepoint Partners LP: Toll Free: 1.866.299.9906. DEALER SERVICES: CIBC Mellon GSSC Record Keeping Services: Toll Free: 1.877.358.0540