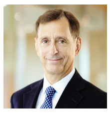
Ninepoint Fixed Income Strategy

December 2022 Commentary

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

Inflation continues to moderate, particularly in the goods sector and services excluding housing (health care, travel and leisure in particular). Housing inflation remains elevated, but higher frequency indicators such as house prices and new rents are pointing to a deceleration over the coming months. Overall, the “inflation has peaked” narrative of the past few months continues to resonate through financial markets. Investors welcome this moderation in inflation, as it takes off the table another round of outsized rate hikes by the Fed and the BoC.

The current rate hike cycle is almost over. The BoC has indicated at its December 2022 meeting that the next monetary policy decision would be either to hike 25bps or not at all. Similarly, the Fed has indicated that it would now be downshifting to a 25bps per meeting cadence, with a terminal rate target of about 5% (so perhaps two or three additional 25bps rate increases).

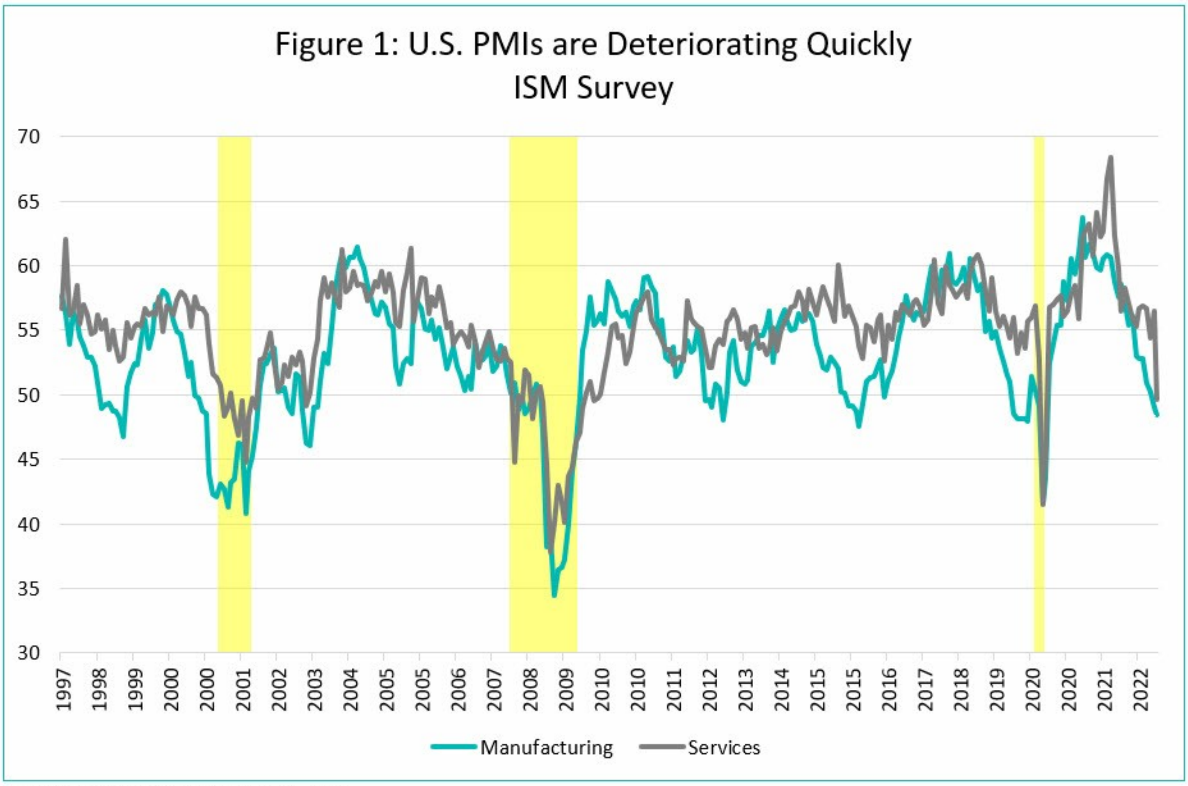
That is certainly good news for fixed income investors. Lower uncertainty on the future path of interest rates should lead to less interest rate volatility and allow us to “earn our carry” without constant fear of mark-to-market losses.

Up to this point, we agree with the current market narrative. However, we do differ in our interpretation of what likely comes next. A bit perversely, better news on the inflation front has been associated with greater odds of a “soft landing” for the economy, leading investors to bet on rate cuts later this year. Both the US and Canadian markets are currently pricing 50bps of rate cuts by the end of 2023.

But central bankers have been very clear: they would rather err on the side of caution with regards to inflation. They are highly credible when they tell us repeatedly that they do not intend on cutting rates in 2023, that they want to see inflation fall back close to target before they consider taking their foot off the brake. The lessons of the 1960s and 1970s are top of mind, and with labour markets still very much at cycle tights, they know full well that relaxing monetary policy prematurely could jeopardize all the hard-earned progress achieved in 2022.

Therefore, following 2022, the year where the BoC and the Fed hiked rates by 400 and 425bps respectively, we expect overnight interest rates to remain at the terminal rate in 2023. That is, higher for longer. The labour market is still out of balance, with too much demand, not enough supply, and the only way to balance this market in the short term is for monetary policy to do what it does best: reduce demand across the economy.

And it is working. Why is inflation turning into deflation in cars, airfares, hotels, etc.? Demand for those goods and services is declining sharply, inventories are elevated, and the outlook is deteriorating, leading companies to slash prices. The same is true of homes, where demand and affordability go together, leading to declining prices. Hence, it should be no surprise that PMIs in both manufacturing and services have declined sharply (Figure 1). That is how monetary policy works, higher interest rates slashes demand, trying to bring it back in balance with supply.



Source: Bloomberg. As of January 12, 2023.

And that is why the Fed and the BoC need to keep at it. If they loosen monetary policy too early, demand will roar back for those same goods, services, houses, and the reduction in inflation that they have worked so hard to generate will vanish. That was the mistake of the Fed in the 1960s, and they are not about to repeat it. That is why we believe that the market narrative of a soft landing as the base case is unlikely to transpire. Yes, it is possible, but in our opinion, it should not be the base case.

Credit

With attractive all-in-yields, investors continue to flock to investment grade credit, which has led to a continued rally in credit spreads, albeit far less pronounced than November. The US Investment Grade Corporate Bond Index tightened 2 bps (vs 24 bps of tightening in November) while Canada tightened 4bps (vs 15 bps of tightening in November). This contrasts with the S&P 500 which declined 6%.

Turning to Canada, banks were the outperformer on the month, especially subordinated, callable bonds, partly thanks to National Bank's announcement that they will be calling one of their subordinated bonds in early 2023. This helped alleviate fears of term extension, which some market participants held. Historically, even during the Great Financial Crisis, Canadian banks and Lifecos have always called their subordinated bonds, so we have always thought that was very unlikely to change. Also, the pipeline sector continued its strong performance in December, thanks to its defensive characteristics, superior liquidity and its material spread pick up vs the quasi-comparable utility sector.

Moving to the primary market, it was very quiet in Canada as expected given the holidays. The lack of supply served as a tailwind for credit spreads and helps explain some of the difference between credit spreads and equity performance on the month. Turning to corporate bond issuance for 2023, most syndication desks are forecasting total Canadian supply to slow by ~7% year-over-year which should help spread performance, at least from a technical perspective. Given the relatively attractive all-in yields, we will continue to scour the new issue market for candidates to include within the portfolios.

Ninepoint Diversified Bond Fund (DBF)

We took advantage of the strong tone in December to trim some exposure to high yield. To be clear, not because we are worried about the credit fundamentals of the companies we own, but more because the risk/reward is more compelling within investment grade. We participated in the Canadian Western Bank new issue as the ~6% coupon was compelling for the 5-year call term in addition to good compensation for the BBB- credit rating. We also participated in the Brookfield Finance 10-year bond offering as it allowed us to increase exposure to this high-quality credit (rated A-) that also offered good compensation with a 5.4% coupon. We sold a Fairfax Financial 2031 bond against this new issue and gave up only 7 bps all-in while moving three notches up in credit quality. As of month-end, the fund's yield-to-maturity was 7.5% (flat month-over-month) while duration remained unchanged at 3.4 years.

Diversified Bond 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	Sept 2022	Dec 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%	1%	↑
Investment Grade	80%	37%	56%	66%	73%	76%	72%	58%	61%	58%	78%	80%	71%	74%	84%	76%	73%	70%	73%	65%	70%	75%	↑
High Yield	40%	32%	24%	17%	16%	13%	14%	9%	7%	6%	13%	11%	12%	11%	12%	14%	18%	18%	23%	29%	26%	23%	↓
Emerging Market Governments	10%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	1%	1%	1%	1%	1%	0%	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%	1%	↔
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%	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%	0%	0%	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%	1%	0%	↑
Total		100%	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*	3.4	↑
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	3.7	3.2	↔
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%	0%	↔

Source: Ninepoint Partners. As of December 31, 2022

Alternative Credit Opportunities Fund (NACO)

We participated in the Brookfield Finance 10-year bond offering as it allowed us to increase exposure to the highly rated credit (rated A-) while offering good compensation. Against this deal we sold some telco, pipeline and utility bonds as they screen expensive from a relative value lens. As of month-end, the fund's yield-to-maturity was 10.3% (down slightly from 10.4% in November) while both duration and leverage remained unchanged at 2.4 years and 1.1x respectively.

Alternative Credit Opportunities 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	Sept. 2022	Oct. 2022	Nov. 2022	Dec. 2022	Outlook
Government Bonds	100%	0%	0%	0%	0%	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%	53%	54%	54%	52%	↑
High Yield	40%	36%	32%	29%	24%	22%	28%	29%	29%	33%	29%	27%	29%	28%	28%	29%	29%	24%	22%	19%	19%	↓
ABS	20%	0%	4%	1%	8%	6%	7%	7%	7%	9%	10%	11%	13%	13%	15%	16%	15%	18%	19%	23%	23%	↓
Loans	10%	0%	0%	0%	3%	3%	3%	6%	5%	5%	5%	5%	4%	4%	4%	4%	4%	3%	3%	4%	4%	↓
Preferred Equities	10%	8%	8%	4%	4%	3%	3%	2%	2%	2%	2%	1%	1%	1%	1%	1%	1%	1%	1%	1%	0%	↔
Common Equities & ETFs	10%	0%	0%	0%	0%	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%	0%	0%	0%	0%	N/A
Cash and Equivalents		-2%	-18%	11%	10%	19%	3%	6%	13%	7%	8%	5%	0%	2%	0%	0%	0%	3%	3%	3%	3%	↑
Total		100%	100%	100%	100%	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*	2.9*	2.6*	2.4*	2.4*	↑
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	1.30x	1.10x	1.10x	1.10x	↓
Unhedged FX Exposure	<20%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	↔

Source: Ninepoint Partners. As of December 31, 2022

Credit Income Opportunities Fund (Credit Ops)

We participated in the Canadian Western Bank new issue as the ~6% coupon was compelling for the 5-year call term in addition to good compensation for the rating of BBB-. We also participated in the Brookfield Finance 10-year bond offering as it allowed us to increase exposure to the highly rated credit (rated A-) that offered good compensation. Against these deals we sold some telco and pipeline bonds as they have had a very good run since November and look expensive versus some other sectors. As of month-end, the fund's yield-to-maturity, duration and leverage remained unchanged from November month-end at 11.3%, 2.4 years and 1.2x respectively.

Credit Income Opportunities 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	Sept 2022	Dec 2022	Outlook
Government Bonds	100%	0%	0%	6%	0%	18%	0%	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%	35%	37%	↑
High Yield	40%	29%	24%	19%	16%	10%	6%	22%	28%	26%	26%	30%	32%	37%	33%	34%	38%	32%	31%	↓
ABS	20%	3%	3%	4%	5%	5%	5%	5%	8%	9%	15%	11%	10%	14%	14%	11%	8%	7%	10%	↔
Loans	10%	3%	3%	2%	3%	2%	2%	4%	7%	6%	6%	3%	4%	4%	8%	9%	7%	7%	9%	↓
Preferred Equities	10%	4%	4%	0.5%	0%	0%	0%	0%	0%	0%	5%	10%	8%	4%	2%	3%	3%	2%	2%	↓
Common Equities & ETFs	10%	0%	0%	0%	0%	-7%	-7%	-10%	-15%	-13%	-8%	0.3%	0%	1%	1%	1%	2%	2%	1%	↔
Derivatives	+/- 2.5%	0%	0%	0%	-0.4%	0%	0%	0%	1%	0%	1%	1%	1%	1%	1%	2%	3%	1%	1%	N/A
Cash and Equivalents		6%	14%	15%	28%	8%	32%	12%	8%	2%	3%	-0.5%	1.2%	6%	5%	2%	1%	8%	5%	↑
Total		100%	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	2.7*	2.4*	↑
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	1.20x	↓
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%	0.1%	0.3%	↔

Source: Ninepoint Partners. As of December 31, 2022

Overall, our funds are very well positioned to weather the risk of a downturn over the coming quarters. The portfolios' first line of defense is yield, and we have lots of it. We have reduced our high yield exposure to lower rated companies and reduced exposure to those sectors that are most likely to be affected by a consumer led recession, namely real estate and consumer finance. In a challenging macroeconomic environment, long term interest rates can offer ballast to the portfolios, so we are in the process of adding a bit more duration to the funds, in the form of long-term government bond exposure. We are also considering credit hedges to dampen volatility. More on all of this next month.

Mark, Etienne & Nick
Ninepoint Partners

NINEPOINT DIVERSIFIED BOND FUND - COMPOUNDED RETURNS[1] AS OF DECEMBER 31, 2022 (SERIES F NPP118) | INCEPTION DATE: AUGUST 5, 2010

	1M	YTD	3M	6M	1YR	3YR	5YR	10YR	INCEPTION
Fund	-0.3%	-10.1%	-0.3%	-1.2%	-10.1%	-1.3%	0.1%	2.2%	3.0%

NINEPOINT CREDIT INCOME OPPORTUNITIES FUND - COMPOUNDED RETURNS[1] AS OF DECEMBER 31, 2022 (SERIES F NPP507) | INCEPTION DATE: JULY 1, 2015

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	-0.2%	-7.3%	0.2%	0.0%	-7.3%	4.1%	3.4%	4.0%

NINEPOINT ALTERNATIVE CREDIT OPPORTUNITIES FUND - COMPOUNDED RETURNS[1] AS OF DECEMBER 31, 2022 (SERIES F NPP931) | INCEPTION DATE: APRIL 30, 2021

	1M	YTD	3M	6M	1YR	INCEPTION
Fund	0.3%	-9.2%	0.1%	-1.2%	-9.2%	-5.0%

[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 December 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 December 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 December 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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