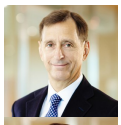
Ninepoint Fixed Income Strategy

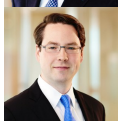
February 2019 Commentary

Monthly commentary discusses recent developments across both the Core and Diversified Bond Funds.

Investment Team



Mark Wisniewski,
Partner, Senior Portfolio Manager



Etienne Bordeleau-Labrecque, MBA, CFA
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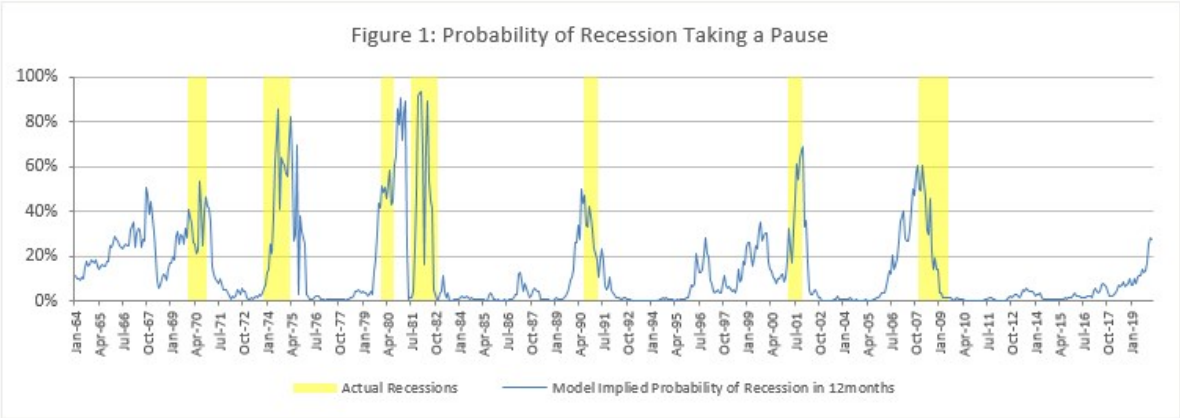
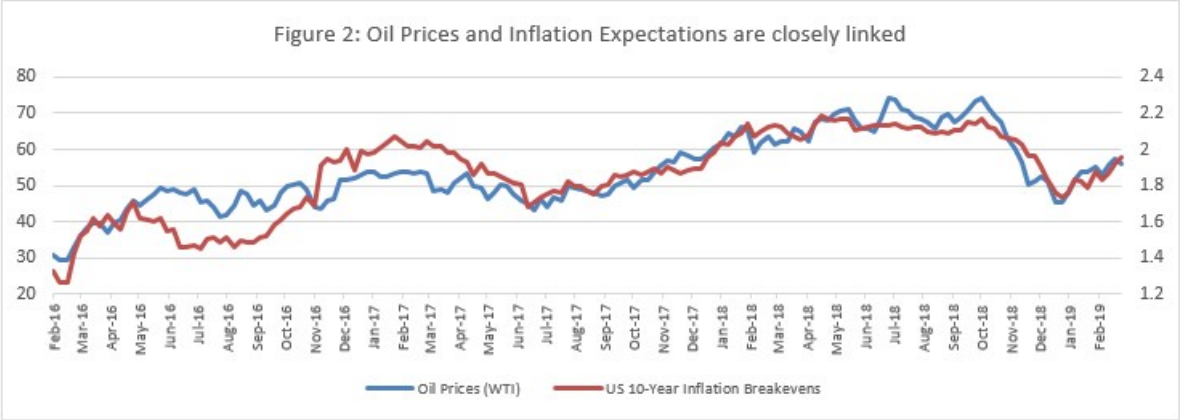
February was another strong month for risk assets, and credit was no exception. Government bond yields have finally stabilized and the yield curve even steepened a bit, consistent with our view that the combination of a Fed pause, trade tension détente and Chinese stimulus should stave off a further deceleration of the global economy. Accordingly, our U.S. recession indicator has stabilized and even pulled back a few points to 28% (Figure 1). While we are still awaiting concrete evidence (i.e. hard data) that growth has bottomed, we are optimistic that 2019 should be a year of moderate but still positive growth.



Source: Ninepoint

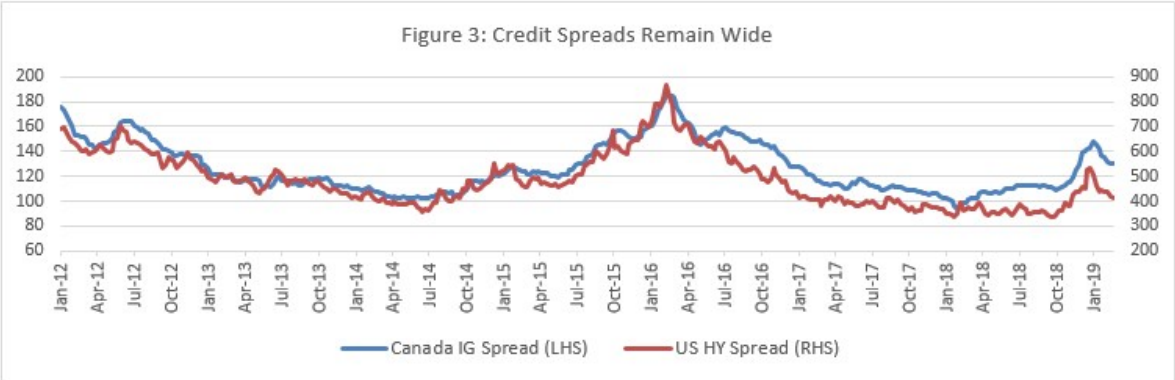
Lending further credence to our curve steepening bias (through higher long-term yields), OPEC+ seems intent on delivering on its production cuts, putting upward pressure on oil prices and by extension inflation expectations (Figure 2). Moreover, the Federal Reserve has initiated a review of its inflation targeting framework. Without delving into details, the Fed is looking at ways to make its 2% inflation target more credible by allowing inflation to overshoot in good times as much as it undershoots in bad times. All else equal, if they move forward with this change, it should result in higher inflation expectations, a higher term premium and a steeper yield curve.



Source: Ninepoint

While duration has performed well year-to-date, we believe it is overdone and, consistent with our base case we are better off keeping duration low until the curve steepens.

In credit, concurrent with the appreciation in equities, the first two months of the year have seen a rapid retracement of the spread widening seen last year. Due to solid fund flows and low supply, the tightening has been particularly rapid in high yield (HY), where spreads have rallied over 120bps in a very short time frame (Figure 3). Meanwhile, investment grade (IG) spreads have only rallied 20bps, underperforming their historical relationship to HY spreads. We therefore continue to see better value in IG. The new issue market has returned, albeit at a slower pace than last year. For now, demand is solid, and deals perform well, suggesting that credit should remain well bid.



Source: Ninepoint

In the Core Bond Fund, we have increased our government bond allocation to 7% by buying some German 10-year bonds. While the headline yield may seem small (10-15bps depending on the day), the all-in-yield once we hedge the currency exposure is closer to 2.5-2.6%, much more attractive than what we can earn in Canada (1.9%) or in the U.S. (2.7% headline, 1.9% after currency hedging). We also believe that they offer better “hedge” value in a negative economic environment; the Eurozone has been the weaker economy and depends in large part on exports for growth, hence it is more affected by the global trade. Furthermore, Italy is in technical recession, Brexit looms, German economic growth is weak and the ECB has turned dovish. If China ends up buying more U.S. goods as part of a trade deal with Trump, it will partly be at the expense of export powerhouses such as Germany. All things considered, we like German Bunds and we will look to add high grade core Eurozone government bonds to the portfolio.

In the Diversified Bond Fund, we continue to sell down our preferred share portfolio. At month end, our weight was now 1.8%, of which 1.1% is a position in an issue that has been called and will be retired as of March 20th. By the end of the first quarter, we expect to be essentially out of the asset class. In IG, we are still adding to maturities where we see good opportunities and attractive yield. In terms of positioning, there has been no change to our stance: we like low duration, higher yielding IG and believe yield curve steepening will provide us with a better entry point to add some government exposure, when we see recession risk increasing.

Until next month,

The Bond Team: Mark, Etienne and Chris

Core Bond Fund Portfolio Characteristics:

	Limits	Dec. 2018	Jan 2019	Feb 2019	Outlook
Government Bonds	**30%**	13%	0%	**7%**	↑
Investment Grade	**100%**	61%	68%	**87%**	↔
High Yield	**25%**	2%	2%	**5%**	↔
Preferred Equities	**10%**	0%	0%	**0%**	↔
Derivatives	**+/- 2.5%**	0%	0%	**0%**	**N/A**
Cash and Equivalents		24%	30%	**1%**	↔
Total		100%	100%	**100%**	
Duration	**1 to 8 years**	**3.2 years**	**1.9 years**	**2.7 years**	↑
Geographic (% North America)	**>70%**	97%	97%	**90%**	↓
Unhedged FX Exposure	**5%**	0%	0%	**0%**	↔

Diversified Bond Fund Portfolio Characteristics:[i]

	Limits	Dec 2017	Mar 2018	Jun 2018	Sept 2018	Dec 2018	Feb 2019	Outlook
Government Bonds	**100%**	-2%	0%	-4%	2%	1%	**-2%**	↑
Investment Grade	**80%**	37%	56%	66%	73%	76%	**83%**	↓
High Yield	**40%**	32%	24%	17%	16%	13%	**12%**	↔
Emerging Market Governments	**10%**	0%	0%	0%	0%	0%	**0%**	↔
Preferred Equities	**10%**	6%	6%	6%	6%	2.5%	**1.8%**	↓
Common Equities & ETFs	**10%**	0%	0%	0%	1.5%	1.5%	**1.5%**	↔
Derivatives	**+/- 2.5%**	-0.1%	+0.5%	-0.1%	-0.05%	0.0%	**0.0%**	**N/A**
Cash and Equivalents		28%	14%	15%	1.5%	6%	**3.7%**	↔
Total		100%	100%	100%	100%	100%	**100%**	
Duration	**1 to 8 years**	2.4	2.1	2.3	1.0	2.4	**2.1**	↑
Geographic (% North America)	**>75%**	89%	90%	89%	93%	91%	**91%**	↔
Unhedged FX Exposure	**20%**	0%	0%	0%	0%	0%	**0%**	↔

[i] In IG, we are slightly above our 80% limit, but expect be within it in short order as we have several maturities in the first few weeks of March.

COMPOUNDED RETURNS[1]

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	0.5%	1.3%	1.5%	0.6%	1.2%	4.5%	3.4%	4.5%

[1] All 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 February 28, 2019; e) 2010 annual returns are from 08/05/10 to 12/31/10.

The Fund is generally exposed to the following risks. See the prospectus of the Fund for a description of these risks: capital depletion risk (Series T, Series FT, Series PT, Series PFT, Series QT, and Series QFT units only); concentration risk; credit risk; currency risk; cybersecurity risk; derivatives risk; exchange traded funds risk; foreign investment risk; inflation risk; interest rate risk; regulatory risk; securities lending, repurchase and reverse repurchase transactions risk; series risk; short selling risk; substantial unitholder risk; tax risk.

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 February 28, 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

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