Ninepoint Fixed Income Strategy

February 2020 Commentary

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

Investment Team

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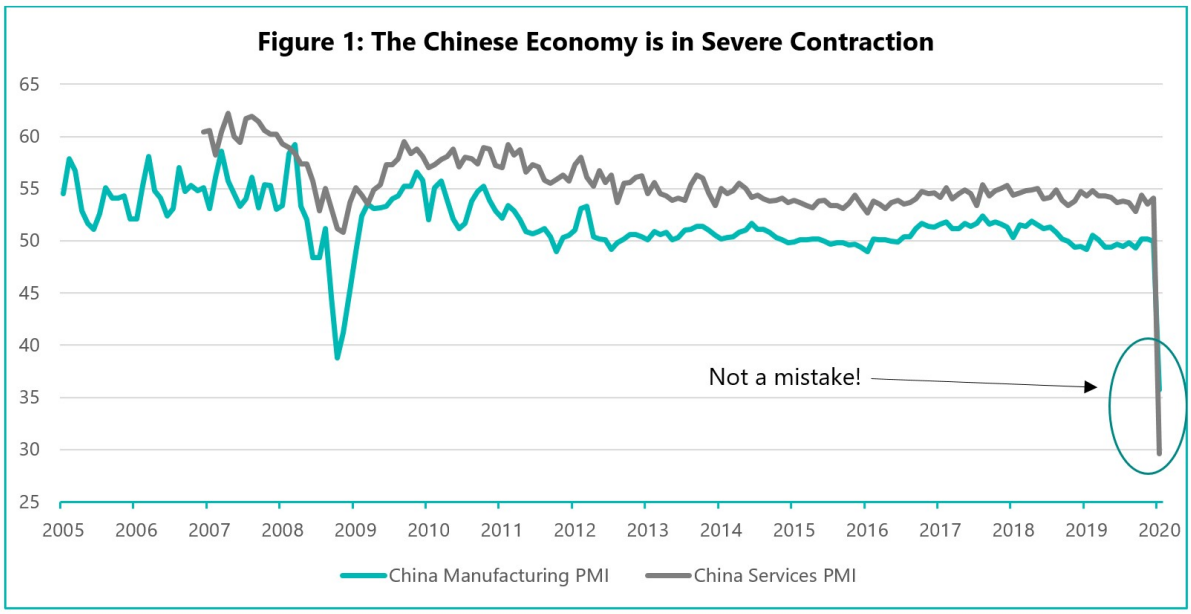
Macro

What a month February was; as feared, the coronavirus has continued to spread, although cases are plateauing, in China, it is now spreading in other countries (Japan, Korea, Italy and Iran). These countries have responded forcefully, isolating entire cities, shutting down schools and quarantining people. According to several experts, it is a matter of when, not if, the rest of the world sees similar outbreaks. Accordingly, global growth expectations have been revised downwards, with several forecasters now expecting flat to negative growth in the first half of 2020. Still, the risks remain to the downside, suggesting that a global recession is a non-trivial possibility. For now, economic data has yet to reflect the impact of the virus, but if the Chinese PMIs are any guide of things to come, this could turn ugly very quickly. Figure 1 below shows the Chinese Manufacturing and Services PMIs, which plunged to all time lows in February. Given the extent of the containment actions taken by the Chinese, it shows how quickly this virus outbreak can change an economy's fortunes.



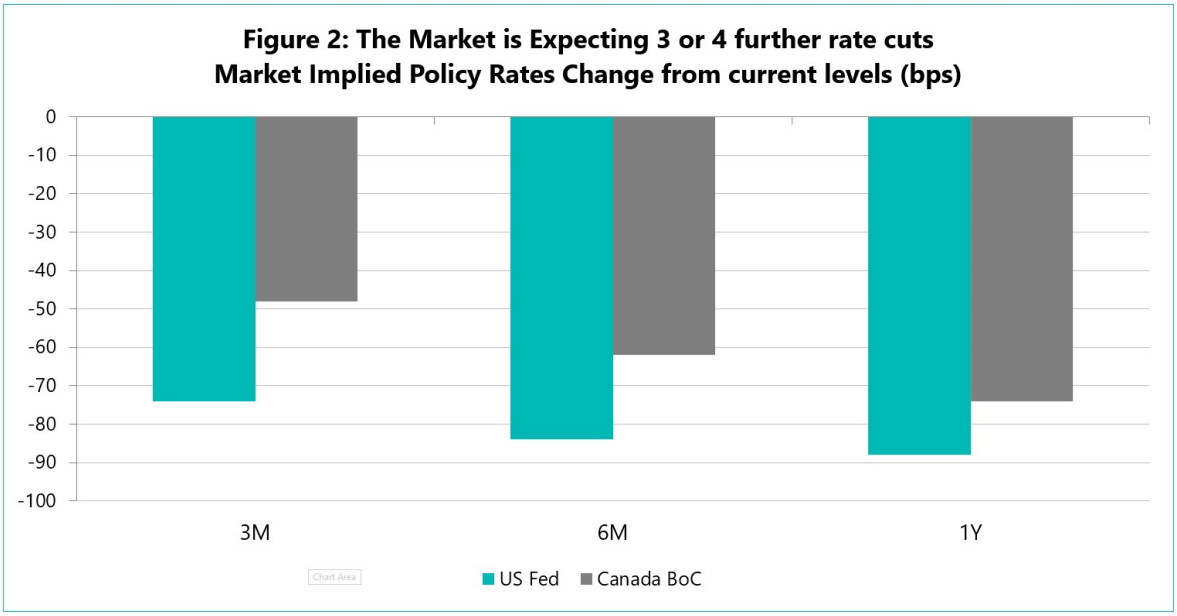
Source: Bloomberg

After virtually ignoring the virus for the past two months, the equity and credit markets have finally taken notice. The last week of February saw the biggest decline (11.5%) in the S&P 500 since the

great recession of 2008. The VIX jumped to 50 and credit spreads widened. Still, the starting point for this selloff was all time high equity markets (and very rich valuation multiples) and credit spreads at nosebleed levels, so even with the recent selloff, we think it's too early to go bargain shopping.

Several market participants are expecting a V-shaped recovery, hoping that the virus spread slows down with the spring weather and that growth comes back to trend in the second half of 2020. We think this is optimistic; China has been battling the outbreak with very extreme containment measures, something that is unlikely in the rest of the world. We are already seeing signs of community transmission (transmission of the virus by people that can't be traced back to China), which suggests that the virus is now well established and spreading outside China.

So far, central banks have responded forcefully; in a very unusual move, the Fed cut rates by 50bps on March 3rd (the last intermeeting cut was in October 2008) and the Bank of Canada followed with another 50bps rate cut on the 4th. Current market expectations are for another three or four cuts in the next 12 months by both central banks (Figure 2). Elsewhere, the ECB and BoJ have less room to maneuver, having already cut rates to zero (or negative) and buying assets. They could cut deeper in negative territory, or, as we think is more likely, increase the size of their QE programs.



Source: Bloomberg

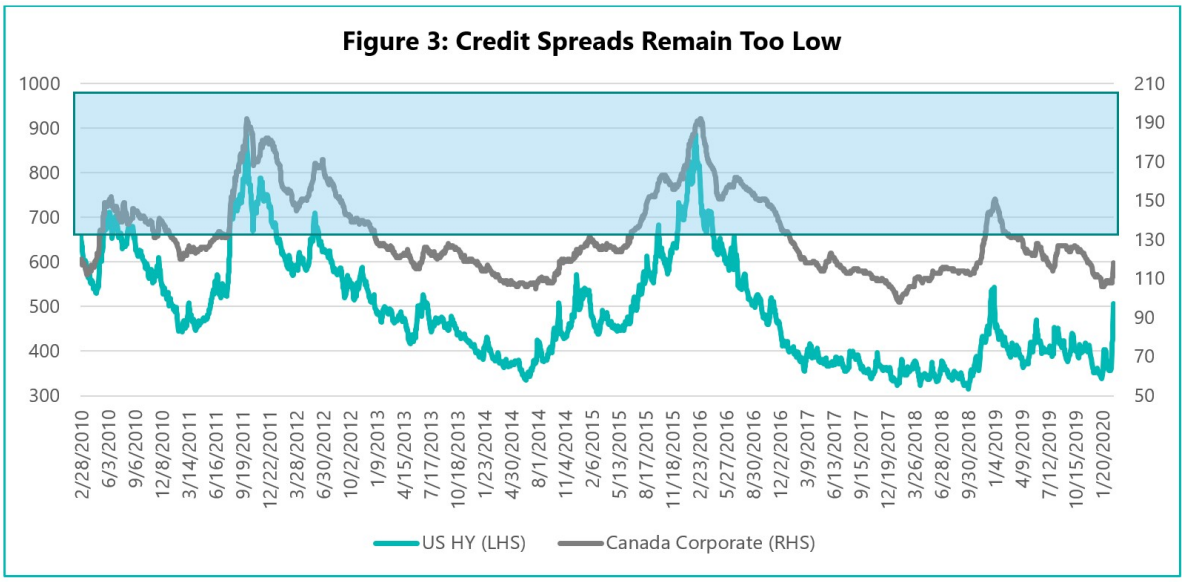
Unfortunately, there is only so much that a central bank can do to help in this situation. This is mostly a public health issue, a supply shock and finally a negative confidence shock. People not going to work because of quarantines means less supply of labour. Factories not producing in certain parts of the world means supply chains are disrupted, with ripple effects everywhere, even where there's no virus contagion per se. Finally, public fear of the virus means people stay home, defer non-essential purchases and keep spending at a minimum. There's no telling how long the psychological impact of these changes will weight on people's behaviour. There's very little a 50, 75 or even 100bps rate cut can do to offset these challenges.

All this to say that the V-shaped recovery market participants are hoping for seems elusive. It will take time for all this to get behind us. At the moment, North America has been relatively spared from a large virus outbreak, but it is probably only a matter of time before it spreads here, at which point investors will need to grasp the extent of the disruption and reflect it more fully into asset

prices. On a positive note, the tail risks surrounding the US election has somewhat subsided, as it seems increasingly likely that Joe Biden could win the Democratic Nomination, removing the risk that Bernie Sanders and his socialist agenda might make it to the White House. The situation remains fluid and we will continue to assess the risks emanating from the 2020 US Presidential Election as the year progresses.

Credit

While the correction in equities has so far been quite rapid, credit has been slower to react. Over the past month, spreads on IG and HY did move wider, however, compared with previous recessionary episodes, they should have more to go. Figure 3 below shows US High Yield and Canadian Corporate credit spreads over the past 10 years. During times of credit stress, High Yield spreads climbed to around 700bps or greater, and investment grade corporate spreads moved above 130bps. Although they are moving in the right direction, spreads at 500bps and 110bps for HY and IG, respectively, appear to be too low, relative to the environment.



Source: Bloomberg

Diversified Bond Fund (DBF)

Following the massive decline in US government bond yields during the month, we closed our TLT ETF position as it's P&L was maxed out. Given the magnitude of the rally year to date, we will wait for a pull back to add more duration with government bonds.

In credit, there's been no change to our stance, we have been cautious in our positioning and maintain our defensive position. We are starting to see some interesting opportunities in credit; and if the deterioration persists, we will start to add selective positions in IG and HY.

Subsequent to month end, we monetized our investment in French 30-year government bond and replaced them with equivalent maturity Canadian government bonds. Similar to our thesis in Europe last year, as the BoC cuts rates towards zero and the market internalizes this, we believe that the Canadian yield curve will bull flatten, thus benefiting a position in the long end of the curve.

Diversified Bond Fund Portfolio Characteristics

	Limits	Dec 2017	Mar 2018	Jun 2018	Sept 2018	Dec 2018	Mar 2019	June 2019	Sept 2019	Dec 2019	Feb 2020	Outlook
Government Bonds	100%	-2%	0%	-4%	2%	1%	7%	22%	28%	13%	9%	↔
Investment Grade	80%	37%	56%	66%	73%	76%	72%	58%	61%	58%	78%	↔
High Yield	40%	32%	24%	17%	16%	13%	14%	9%	7%	6%	9%	↔
Emerging Market Governments	10%	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%	↔
Common Equities & ETFs	10%	0%	0%	0%	1.5%	1.5%	4.3%	2.4%	-1.3%	0%	0%	↔
Derivatives	+/- 2.5%	-0.1%	+0.5%	-0.1%	-0.05%	0.0%	0.0%	-0.2%	0.0%	0.2%	0%	N/A
Cash and Equivalents		28%	14%	15%	1.5%	6%	2%	9%	6%	22%	4%	↔
Total		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	4.5	↔
Geographic (% North America)	>75%	89%	90%	89%	93%	91%	87%	85%	86%	85%	86%	↔
Unhedged FX Exposure	20%	0%	0%	0%	0%	0%	0%	6%	5%	3%	4%	↔

Source: Ninepoint Partners

Credit Income Opportunities Fund (Credit Opps)

There were no material changes in the Credit Opps this past month. Leverage remains low and credit quality high. The small increase in the High Yield weight is attributable to the purchase of 5-month Kraft Heinz bonds, which got downgraded to junk during the month. We took advantage of this fallen angel situation to buy those very short dated bonds on the cheap.

Credit Income Opportunities Portfolio Characteristics

	Limits	Oct 2018	Dec 2018	Mar 2019	June 2019	Sept 2019	Dec 2019	Feb 2020	Outlook
Government Bonds	100%	0%	0%	6%	0%	18%	0%	0%	↔
Investment Grade	100%	58%	55%	58%	53%	68%	64%	82%	↔
High Yield	40%	29%	24%	19%	16%	10%	6%	13%	↔
Private Loans	10%	3%	3%	2%	3%	2%	2%	4%	↔
Preferred Equities	10%	4%	4%	0.5%	0%	0%	0%	0%	↔
Common Equities & ETFs	10%	0%	0%	0%	0%	-7%	-7%	-6%	↔
Derivatives	+/- 2.5%	0%	0%	0%	-0.4%	0%	0%	0%	N/A
Cash and Equivalents		6%	14%	15%	28%	8%	32%	8%	↔
Total		100%	100%	100%	100%	100%	100%	100%	
Duration	0 to 5 years	2.5	2.1	2.9	2.2	2.9	1.7	1.8	↔
Leverage	0-4x	0.7x	0.7x	1.0x	1.0x	0.77x	1.04x	0.88x	↔
Unhedged FX Exposure	>25%	0%	0%	0%	2.7%	5.1%	-3.2%	0%	↔

Source: Ninepoint Partners

Conclusion

We wish our clients and their families good health and the best of luck navigating these challenging

conditions.

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

Ninepoint Partners

NINEPOINT DIVERSIFIED BOND FUND - COMPOUNDED RETURNS[1] AS OF JUNE 30, 2023 (SERIES F NPP118) | INCEPTION DATE: AUGUST 5, 2010

	1M	YTD	3M	6M	1YR	3YR	5YR	10YR	INCEPTION
Fund	0.1%	1.8%	0.0%	1.8%	0.6%	-2.1%	0.4%	2.4%	3.0%

NINEPOINT CREDIT INCOME OPPORTUNITIES FUND - COMPOUNDED RETURNS[1] AS OF JUNE 30, 2023 (SERIES F NPP507) | INCEPTION DATE: JULY 1, 2015

	1M	YTD	3M	6M	3YR	5YR	INCEPTION
Fund	0.5%	3.3%	1.4%	3.3%	4.3%	3.8%	4.2%

[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 February 28, 2020 [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 February 28, 2020.

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