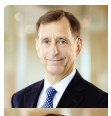
# Ninepoint Fixed Income Strategy

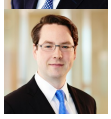
January 2021 Commentary

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


Investment Team



**Mark Wisniewski,**
Partner, Senior Portfolio Manager



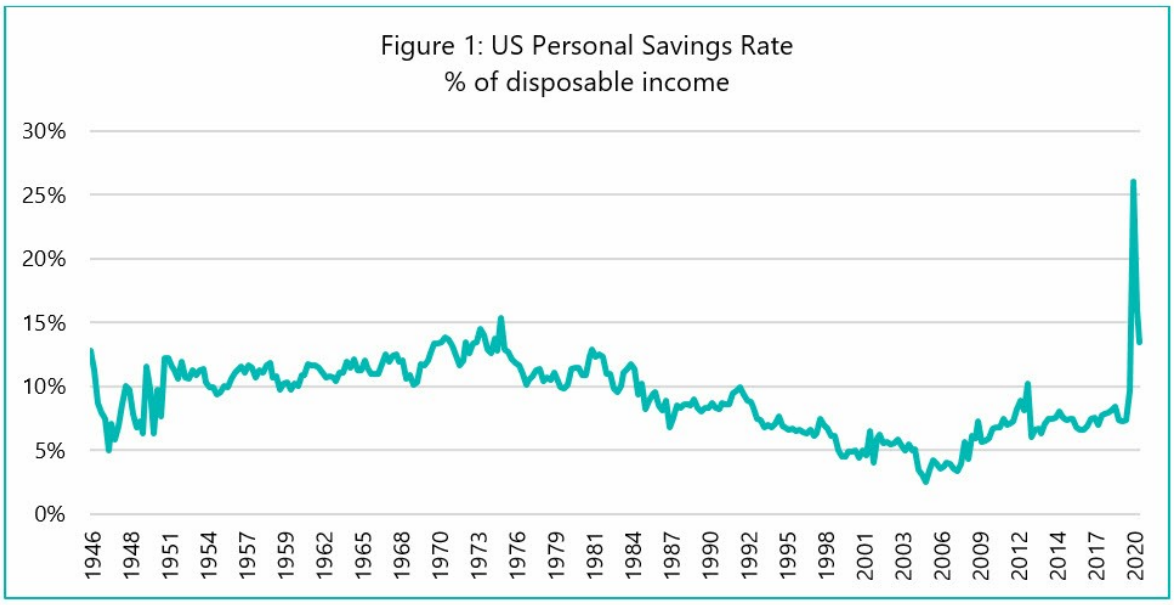
**Etienne Bordeleau-Labrecque, MBA, CFA**
Vice President, Portfolio Manager


## Macro

With the Democrats now firmly in charge of all levels of the US government, everyone's attention has now turned to their ambitious fiscal proposals. In addition to December's already generous $900bn, the current administration wants to "go big" and push forward an additional $1.9tn of stimulus. To put things in perspective, the pre-pandemic US nominal GDP was $21.5tn, so the combined effect of those two massive fiscal bills will be approximately 13% of GDP in a single year.

That is a lot, particularly at a time where the vaccine rollout, in the US, is going relatively well (at the time of writing, over 10% of the US population had been inoculated with the first dose of a COVID-19 vaccine) and the recent lockdowns have finally managed to lower cases, hospitalizations, and deaths. We find it strange, if not misguided, for this administration to use this much fiscal space this early on in their tenor. Moreover, very little of these funds has been earmarked for productive uses (i.e., infrastructure projects); the vast majority is instead targeted at unemployment benefits and "helicopter money" (i.e., cheques for everyone).

This raises the question: what is all this money going to be used for? The U.S. economy had already received material fiscal support in 2020, when the $2.2tn "CARES Act" resulted in significant growth in aggregate disposable income. In other words, the fiscal stimulus received by households in 2020 was greater than the loss of income they suffered as a result of the pandemic. The net impact was the largest increase in savings in the history of the country (Figure 1 below).




Source: Bloomberg

There is only so many deferred haircuts, dinners at your favorite restaurant and sunny vacations one can take,

particularly if everyone in the US (and around the world) tries to do the same all at once. Given this recent experience, an additional $2.8tn of fiscal spending in 2021 seems unnecessary, especially if it is mostly saved. So the question is: once enough people are vaccinated and the economy slowly returns to "normal", how will these newfound savers behave? Will they keep this unexpected windfall as precautionary savings, reduce debt, or try to spend it all on those services they have been denied of for over a year now. The answer to this question is very important as it might provide clues for the future path of monetary policy.

Up until now, market participants (us included) have been working under the assumption that the Fed's new framework would leave interest rates at the lower bound for a considerable amount of time. But there is now a clear risk that the proposed outsized amount of fiscal stimulus that could be unleashed, and if all spent once the economy reopens, could lead to significant inflationary pressures. This could put the Fed in an uncomfortable posture; on the one hand, their framework allows (and even welcomes) inflation above target for a little while, but if this happens too quickly, before the labour market has had time to heal (there are still about 10 million fewer Americans working than there were entering 2020), they could be forced to act. Should they react and tighten monetary policy, or should they stay put and try to squeeze more gains out of the labour market, hoping that they can effectively deal with inflation later on?

This setup has caught our attention, as it could prove particularly tricky for policy makers to navigate. A policy mistake is certainly a risk and it could have important consequences for the direction of rates and risk assets - equities and credit. Given how pivotal the environment could be for monetary policy, we believe that it is prudent to keep portfolio duration relatively low and have some tail hedges in credit, just in case.

## Credit

As we start the year credit continues to perform extremely well, and selloffs are continually bought. Even if interest rates drift slightly higher this year, we believe that we could see index spreads make all time lows (adjusted for credit quality and duration). Of course, this benign view is conditional on the environment remaining favourable (i.e., stable monetary and fiscal regimes, no accelerating inflation, vaccination programmes on track, etc.), but in this low interest rate world, US and Canadian high grade corporate credit really stands out as the only corner of the market that still yields more than 1%. This relative attractiveness, given the opportunity set, is what leads us to believe that those markets can keep performing well.

## Diversified Bond Fund (DBF)

As mentioned above, we had significantly reduced portfolio duration at the beginning of January. It now stands at 3.75 years. We have sold most of our government bond positions and replaced them with option positions in the TLT ETF (the equivalent of 30-year government bonds). This replacement affords us a margin of safety and significantly reduces the volatility that we experience owning a position in actual government bonds. It leaves us with some upside participation should long term yields decline, but we only start to bear the downside of higher rates should they go well past 2%.

As discussed last month, we have been building a position in (very) likely to get called bank and lifeco preferred shares. At a 6% weight, we are now done and will only replenish what gets called, if we can find attractive substitutes.

Our expectation is that we will continue to slowly increase the credit duration of the portfolio, but we will do so at a measured pace. Moreover, we intend on protecting the portfolio from interest rate risk, so corporate bonds with longer duration will have more of that risk hedged out. As such, expect to see a small net negative weighting in government bonds in coming months.

Additionally, we have entered low-cost tail hedges in HYG (US High Yield ETF); while our base case is for calmer markets, we see some tail risks (discussed above) that are worth keeping an eye on. We therefore took advantage of cheaper implied volatility and high valuations to give the portfolio a bit of credit ballast.

## 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 | Jan 2021 | Outlook |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Government Bonds** | **100%** | -2% | 0% | -4% | 2% | 1% | 7% | 22% | 28% | 13% | 9% | 9% | 14% | 8% | **1%** | ↓ |
| **Investment Grade** | **80%** | 37% | 56% | 66% | 73% | 76% | 72% | 58% | 61% | 58% | 78% | 80% | 71% | 74% | **77%** | ↔ |
| **High Yield** | **40%** | 32% | 24% | 17% | 16% | 13% | 14% | 9% | 7% | 6% | 13% | 11% | 12% | 11% | **10%** | ↔ |
| **Emerging Market Governments** | **10%** | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 1% | **1%** | ↔ |
| **Preferred Equities** | **10%** | 6% | 6% | 6% | 6% | 2.5% | 0.7% | 0% | 0% | 0% | 0% | 0% | 2% | 4% | **6%** | ↔ |
| **Common Equities & ETFs** | **10%** | 0% | 0% | 0% | 1.5% | 1.5% | 4.3% | 2.4% | -1.3% | 0% | 0% | -6% | -5% | -2% | **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%** | **N/A** |
| **Cash and Equivalents** | | 28% | 14% | 15% | 1.5% | 6% | 2% | 9% | 6% | 22% | 0% | 6% | 6% | 5% | **5%** | ↔ |
| **Total** | | 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 | **3.8** | ↓ |
| **Spread Duration** | | - | - | - | 3.4 | 2.9 | 3.0 | 2.3 | 3.1 | 3.0 | 2.2 | 4.1 | 3.8 | 3.9 | **4.2** | ↑ |
| **Unhedged FX Exposure** | **20%** | 0% | 0% | 0% | 0% | 0% | 0% | 6% | 5% | 3% | 3% | 5% | 6% | 6% | **2%** | ↓ |

Source: Ninepoint Partners

### Credit Income Opportunities Fund

The current environment is one where we expect the Credit Ops to perform well; we have very low duration (3.1 years), more income (6% current yield) and low leverage (~1x).

Throughout the month, we have covered our short HYG position and replaced it with the same position we discussed above for the DBF. During last year, this short position (along with options overlays on the same ETF) helped us navigate the environment, reducing drawdowns and managing volatility. At this juncture, given our base case and market conditions (low implied volatility, high valuations), we prefer to transition to a lower cost option hedge that should protect the portfolio in cases of severe stress, but save us the carry cost of the short.

Finally, like the DBF, we have now accumulated our final weight in preferred shares (10%) and expect it to remain at around this level throughout the year. All in, these preferred shares generate a yield comparable to HY, but with much lower volatility (as they trade to call). We therefore see this as a better risk reward.

## Ninepoint 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 | Jan 2021 | Outlook |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Government Bonds** | **100%** | 0% | 0% | 6% | 0% | 18% | 0% | 0% | 0% | 0% | 0% | **0%** | ↔ |
| **Investment Grade** | **100%** | 58% | 55% | 58% | 53% | 68% | 64% | 72% | 65% | 77% | 64% | **52%** | ↑ |
| **High Yield** | **40%** | 29% | 24% | 19% | 16% | 10% | 6% | 22% | 28% | 26% | 26% | **24%** | ↔ |
| **Private Loans** | **10%** | 3% | 3% | 2% | 3% | 2% | 2% | 4% | 7% | 6% | 6% | **6%** | ↔ |
| **Preferred Equities** | **10%** | 4% | 4% | 0.5% | 0% | 0% | 0% | 0% | 0% | 0% | 5% | **10%** | ↔ |
| **Common Equities & ETFs** | **10%** | 0% | 0% | 0% | 0% | -7% | -7% | -10% | -15% | -13% | -8% | **0.1%** | ↔ |
| **Derivatives** | **+/- 2.5%** | 0% | 0% | 0% | -0.4% | 0% | 0% | 0% | 1% | 0% | 1% | **2%** | **N/A** |
| **Cash and Equivalents** | | 6% | 14% | 15% | 28% | 8% | 32% | 12% | 8% | 2% | 3% | **2%** | ↔ |
| **Total** | | 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 | **3.1** | ↓ |
| **Leverage** | **0-4x** | 0.7x | 0.7x | 1.0x | 1.0x | 0.77x | 1.04x | 0.87x | 1.67x | 1.15x | 1.04x | **1.10x** | ↔ |
| **Unhedged FX Exposure** | **<25%** | 0% | 0% | 0% | 2.7% | 5.1% | -3.2% | 0% | 0.3% | 0% | 2% | **3%** | ↔ |

Source: Ninepoint Partners

## Conclusion

With a new year comes a new set of challenges. We believe that we are appropriately positioned for the current environment; low duration, relatively high portfolios yield, a decent amount of liquidity and should we get a bit of volatility, tail hedges, just in case.

Until next month,

**Mark & Etienne**
Ninepoint Partners

## NINEPOINT DIVERSIFIED BOND CLASS - COMPOUNDED RETURNS[1]
AS OF JANUARY 31, 2021 (SERIES F NPP221)

| | 1M | YTD | 3M | 6M | 1YR | 3YR | 5YR | INCEPTION |
|---|---|---|---|---|---|---|---|---|
| Fund | -0.2% | -0.2% | 0.8% | 0.6% | 4.8% | 3.3% | 4.3% | 4.6% |

## NINEPOINT DIVERSIFIED BOND FUND - COMPOUNDED RETURNS[1]
AS OF JANUARY 31, 2021 (SERIES F NPP118)

| | 1M | YTD | 3M | 6M | 1YR | 3YR | 5YR | 10YR | INCEPTION |
|---|---|---|---|---|---|---|---|---|---|
| Fund | -0.2% | -0.2% | 0.9% | 0.7% | 5.0% | 3.5% | 4.5% | 4.3% | 4.5% |

## NINEPOINT CREDIT INCOME OPPORTUNITIES FUND - COMPOUNDED RETURNS[1]
AS OF JANUARY 31, 2021 (SERIES F NPP507)

| | 1M | YTD | 3M | 6M | 1YR | 3YR | INCEPTION |
|---|---|---|---|---|---|---|---|
| Fund | 0.7% | 0.7% | 6.0% | 8.8% | 14.7% | 6.1% | 5.8% |

[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 January 31, 2021 [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 January 31, 2021.

**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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