Ninepoint Fixed Income Strategy

June 2020 Commentary

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

Investment Team

Mark Wisniewski,
Partner, Senior Portfolio Manager

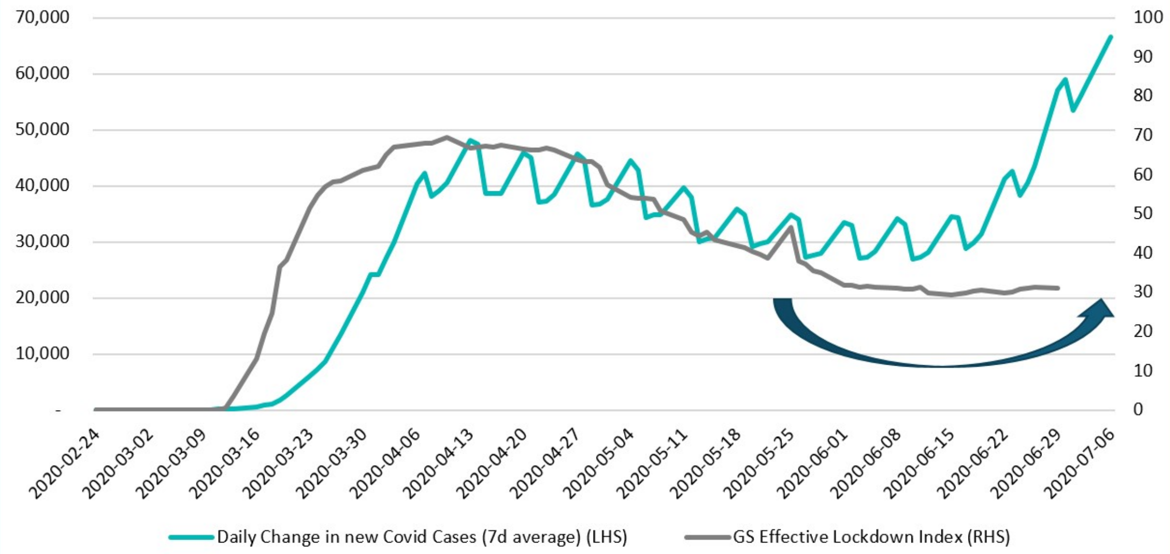
Etienne Bordeleau-Labrecque, MBA, CFA
Vice President, Portfolio Manager

Macro

The first half of 2020 will probably go down as one of the weirdest times in our life. At the time of writing, the Covid infection rate seems to be controlled in Canada and Western Europe, with daily cases fairly low. The gradual reopening of those economies is progressing well. However, our neighbour to the south, having never managed to completely "flatten the curve", is seeing the pandemic migrate from the East Coast (where things are under control) to the south and west states, where the risks associated with Covid-19 were never really taken seriously. Predictably, the virus is now spreading quickly into those populations.

As shown in ***Figure 1*** below, the daily change in new cases for the US has now surpassed its previous peak and is showing no sign of slowing down. For the US as a whole, the reproductive rate of new cases (the so called Rt) is now estimated to be above 1.1, meaning that each 10 Covid cases will go on and infect another 11 people, leading to an exponential rise in cases. In many counties and states, hospitals are reaching full capacity. The most affected states, such as Arizona, Florida, Georgia, Texas and California, have now either completely stopped or even reversed the reopening of their economies. As a result, the Goldman Sachs Effective Lockdown Index (shown in grey in the chart, 0 = no lock down) has stopped declining, increasing marginally.

Figure 1: The acceleration of new infections in the US risks a new round of lockdowns



Source: Bloomberg

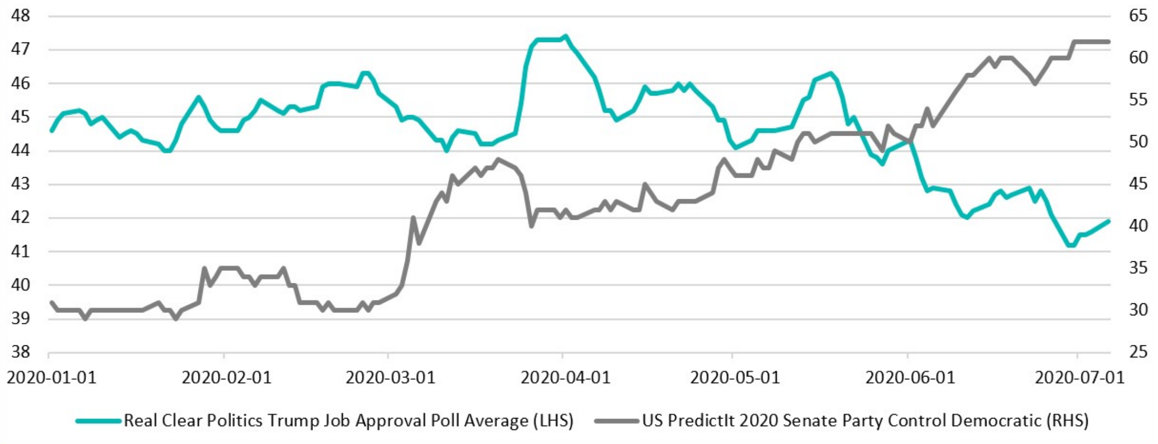
Research (and common sense) has shown a direct inverse relationship between the magnitude of the GS lockdown index and economic activity. With this new escalation of infections in the US and the lockdown measures intensifying, we expect that economic growth will suffer. This "wack-a-mole" dynamic, where states loosen restrictions, only to see further infections, leading to tighten them again, and so on and so forth, could very possibly create a recession that is longer and deeper than most market participants expect.

Of course, the silver lining since March has been the incredible speed and breadth of fiscal and monetary measures. Those have helped tremendously and are no doubt behind some of the strength we have seen in the latest macroeconomic releases (jobs, ISM, etc). We do not expect much change on the monetary front until September, the Federal Reserve has already signalled that they will wait until then to unveil more details regarding forward guidance and the extent of the QE program. In any case, it is unimaginable that they could do significantly more than they've already done.

On the US fiscal side, we are approaching the cliff's edge. The generous unemployment benefits (CARES Act) that have been deployed since the beginning of the crisis are set to expire at the end of July. With Congress in recess until July 20th and political considerations becoming increasingly important as we approach the November elections, there is a real risk that relief aid does not get extended. As well the recent strength in the economic data isn't helping to make the case for an extension of those benefits. Of course, the recent acceleration in the spread of Covid and the associated lockdown measures will likely be felt in the coming months, softening the economic recovery. The fate of the CARES Act could have a material impact on the shape of the recovery.

Related to the Covid crisis in the US, another issue that is top of mind is the November Presidential Election. The stakes are high; 4 years of Republican administration saw the tax rate for corporations drop from 35% to 21% and a very large number of regulations that were put in place by the Obama administration were removed. This ultra business friendly environment has fueled incredible profit growth for US corporations over the past few years (S&P 500 EPS grew from $109 to $150 per share, between 2016 and 2018).

Figure 2: With Trump's Approval Ratings Sinking, Odds of a Democratic Sweep in November are Increasing



Source: Bloomberg

While Trump has never been popular outside his base, the Covid crisis and the civil rights actions of the past few months seem to be cementing his demise. Current nationwide polls have his opponent, Joe Biden, with a 9 point lead. ***Figure 2*** above shows Trump's job approval rating, on the left axis (<40%) and the odds (from a betting website) of the Democrats taking control of the Senate on the right axis (>60%). If the elections were to be held today, it is very likely that we would see a Democratic Sweep (i.e. Democrats controlling the Presidency, Senate and House). The more inept Trump is at fighting the Covid crisis and appeasing the civil rights movement, the more likely this scenario becomes.

Under a Democratic sweep, investors should be pricing-in higher corporate and personal tax rates, more regulations and overall a less business friendly environment. On the positive side, we may finally say goodbye to Mr. Trump and see a return to normalcy in US diplomatic relationships with the rest of the world.

Credit

The level of activity in the credit markets has started to slow down in June, new issues are scarcer, and volumes in the secondary market are declining. We are finding it a bit more difficult to recycle maturing positions into opportunities we feel are a bargain. As discussed earlier, given the supply and demand dynamics in credit right now, it is entirely possible that we see credit continue to rally particularly with central banks acting as a backstop to investment grade.

Diversified Bond Fund (DBF)

The DB fund performed very well in June, returning 1.68%. In this extremely low interest rate environment investment grade credit continues to be the go-to product to generate yield. The credit markets have recovered materially from the March lows. Although, we are still constructive on credit, the run in the markets, relative to the prospects for economic growth appear to be somewhat overdone. As we articulated above our expectation is for a slower recovery and a recession that is deeper and longer in duration than what the market expects. We struggle with the “V” trajectory and think an elongated “U” is much more probable. With that bias we are avoiding lower quality credit. High yield spreads make no sense to us, especially if and when defaults escalate through this recession cycle. As a precaution, we increased our short position in HYG (US high yield ETF) to 6% and added a few US 30 year treasuries.

The HYG short is collared $1 up and $4 down (bought a call $1 out of the money, sold a put $4 out of the money). Doing so protects the fund in the case HYG rallies further from here, at the cost of less hedging power after it declines $4. We find that this is an attractive risk/reward for a hedge. Incrementally, by implementing this collar, we collected premium worth two months of distributions (i.e. it pays for the carry cost of being short HYG for 2 months).

Liquidity remains high, with approximately 6% of the fund in cash and 10% maturing within the next 12 months. This will allow us to continue to evaluate market conditions and take advantage of hiccups, when they arise.

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	Outlook
Government Bonds	**100%**	-2%	0%	-4%	2%	1%	7%	22%	28%	13%	9%	**9%**	↔
Investment Grade	**80%**	37%	56%	66%	73%	76%	72%	58%	61%	58%	78%	**80%**	↔
High Yield	**40%**	32%	24%	17%	16%	13%	14%	9%	7%	6%	13%	**11%**	↔
Emerging Market Governments	**10%**	0%	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%	**0%**	↔
Common Equities & ETFs	**10%**	0%	0%	0%	1.5%	1.5%	4.3%	2.4%	-1.3%	0%	0%	**-6%**	↔
Derivatives	**+/- 2.5%**	-0.1%	+0.5%	-0.1%	-0.05%	0.0%	0.0%	-0.2%	0.0%	0.2%	0%	**0%**	**N/A**
Cash and Equivalents		28%	14%	15%	1.5%	6%	2%	9%	6%	22%	0%	**6%**	↔
Total		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**	↔
Geographic (% North America)	**>75%**	89%	90%	89%	93%	91%	87%	85%	86%	85%	92%	**92%**	↔
Unhedged FX Exposure	**20%**	0%	0%	0%	0%	0%	0%	6%	5%	3%	3%	**6.7%**	↔

Source: Ninepoint Partners

Credit Income Opportunities Fund (Credit Opps)

As the rally in credit persists, the Credit Opps continues to perform well, returning 4.49% in June (the best month in the history of the fund), taking our YTD performance to 2.69%. We have continued to add to our investment grade positions, primarily in the core and slightly reduced leverage. We aren't fans of lower rated high yield, as we expect defaults to escalate throughout the year, but we believe fallen angels (IG bonds downgraded to HY) will be a fantastic opportunity and focus of the fund throughout this recessionary cycle. With lots of cash and low leverage we have ample capacity to capitalize on this and other opportunities in credit.

We are maintaining our HYG short position, and just like the DBF, we have entered into a collar to improve the risk/reward of the hedge. Expect us to continue to slowly add insurance trades into the portfolio over the next few months.

Credit Income Opportunities Portfolio Characteristics

	Limits	Oct 2018	Dec 2018	Mar 2019	June 2019	Sept 2019	Dec 2019	Mar 2020	June 2020	Outlook
Government Bonds	**100%**	0%	0%	6%	0%	18%	0%	0%	**0%**	↔
Investment Grade	**100%**	58%	55%	58%	53%	68%	64%	72%	**65%**	↑
High Yield	**40%**	29%	24%	19%	16%	10%	6%	22%	**28%**	↔
Private Loans	**10%**	3%	3%	2%	3%	2%	2%	4%	**7%**	↑
Preferred Equities	**10%**	4%	4%	0.5%	0%	0%	0%	0%	**0%**	↔
Common Equities & ETFs	**10%**	0%	0%	0%	0%	-7%	-7%	-10%	**-15%**	↔
Derivatives	**+/- 2.5%**	0%	0%	0%	-0.4%	0%	0%	0%	**1%**	**N/A**
Cash and Equivalents		6%	14%	15%	28%	8%	32%	12%	**8%**	↓
Total		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	**3.27**	↔
Leverage	**0-4x**	0.7x	0.7x	1.0x	1.0x	0.77x	1.04x	0.87x	**1.67x**	↓
Unhedged FX Exposure	**>25%**	0%	0%	0%	2.7%	5.1%	-3.2%	0%	**0.3%**	↔

Source: Ninepoint Partners

Conclusion

What a year it's been so far!

It's never easy to stick to your convictions and be disciplined when things go against your thesis, but ultimately sensibility paid off. We are proud to have delivered our clients consistent and positive risk adjusted performance so far in this difficult year and aim to continue to do so in the second half, and beyond. Thank you for your continued support.

Have a good summer and until next month,

Mark & Etienne
The Bond Team
Ninepoint Partners

NINEPOINT DIVERSIFIED BOND CLASS - COMPOUNDED RETURNS[1]

AS OF JUNE 30, 2020 (SERIES F NPP221)

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	1.7%	4.1%	3.8%	4.1%	4.7%	3.4%	3.7%	4.7%

NINEPOINT DIVERSIFIED BOND FUND - COMPOUNDED RETURNS[1]

AS OF JUNE 30, 2020 (SERIES F NPP118)

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	1.7%	4.2%	3.9%	4.2%	4.9%	3.6%	3.8%	4.6%

NINEPOINT CREDIT INCOME OPPORTUNITIES FUND - COMPOUNDED RETURNS[1]

AS OF JUNE 30, 2020 (SERIES F NPP507)

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	4.3%	2.6%	8.9%	2.6%	3.9%	3.4%	4.1%	4.1%

[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 June 30, 2020 [1] All Ninepoint Credit Income Opportunities Fund returns and fund details are a) based on Class A units (closed to subscriptions); b) net of fees; c) annualized if period is greater than one year; d) as at June 30, 2020.

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.

Ninepoint Credit Income Opportunities Fund is offered on a private placement basis pursuant to an offering memorandum and are only available to investors who meet certain eligibility or minimum purchase amount requirements under applicable securities legislation. The offering memorandum contains important information about the Funds, including their investment objective and strategies, purchase options, applicable management 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 June 30, 2020 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