Ninepoint Fixed Income Strategy

November 2021 Commentary

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

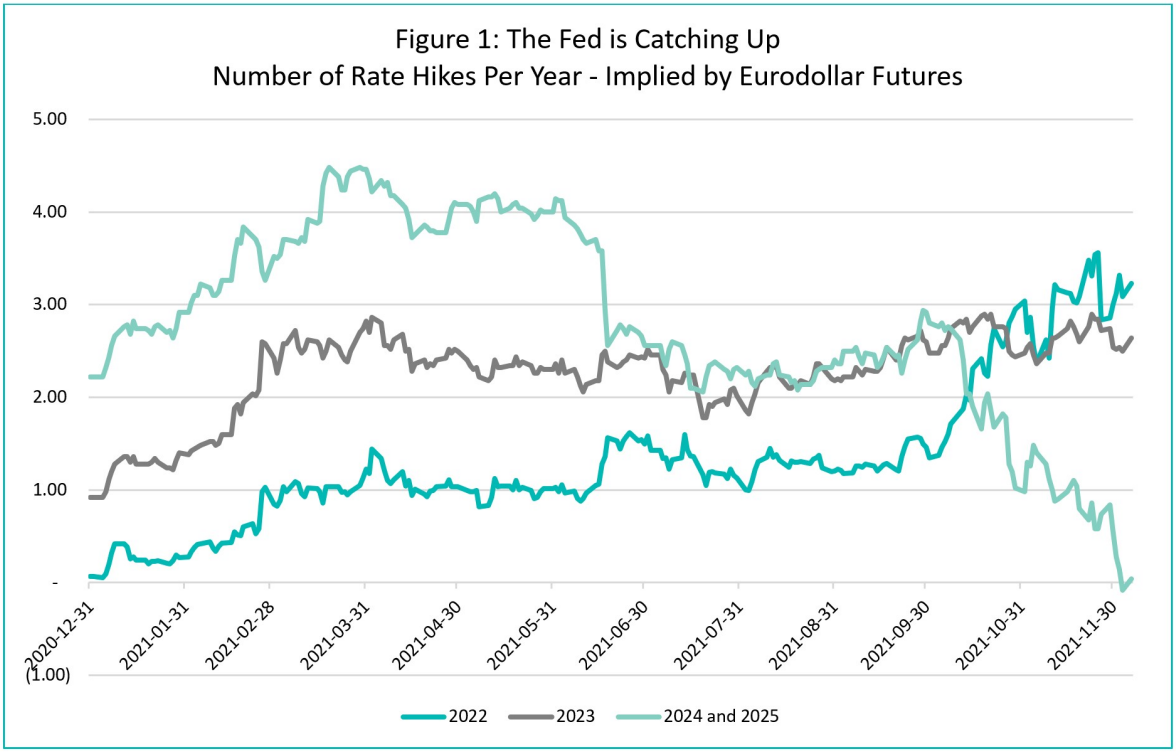
Ninepoint Partners,

Macro

While on net, interest rates went down in November, it certainly didn't feel like it. Two overarching and competing themes were at play: Central Banks' (and increasingly the Fed) hawkish pivot and the newest Covid-19 variant of concern: Omicron.

On the Friday following the US Thanksgiving Holiday, news of a highly transmissible variant surfaced, prompting a major risk off reaction in global markets. With that Friday being a half day in equity and fixed income markets, attendance was very light, exacerbating the response. In typical risk off fashion, equities dropped, credit widened, and Treasuries rallied aggressively.

However, prior to that event, rates were at recent highs following the reappointment of Jerome Powell to the head of the Federal Reserve and his subsequent testimony, where he retired the now over-used inflation adjective "transitory" and set the stage for an acceleration of the Fed's plans to reduce their asset purchases in December. Inflation is clearly top of mind at the Fed and other central banks right now, and they are signaling that their intent is to act sooner rather than later. If they do accelerate the pace of reduction in asset purchases, they could hike as early as March 2022. If that is the case, our expectation of three rate hikes next year (in line with current market pricing, Figure 1) could prove to be too conservative.



Source: Bloomberg

Now, with the advent of Omicron, one might be excused to think that the Fed (and other central banks) would be inclined to wait, assess the economic damage from this variant and keep financial conditions accommodative. And while we are still waiting for more definitive data on the effectiveness of vaccines (and prior infections) to ward off the worst outcomes (i.e. hospital or morgue visits), so far it seems like symptoms resulting from infections in South Africa from this new variant are milder and seem to affect younger people (less vaccinated). But notwithstanding this, we are well on our way towards tighter financial conditions.

Why aren't central banks considering a less hawkish playbook in the face of Omicron?

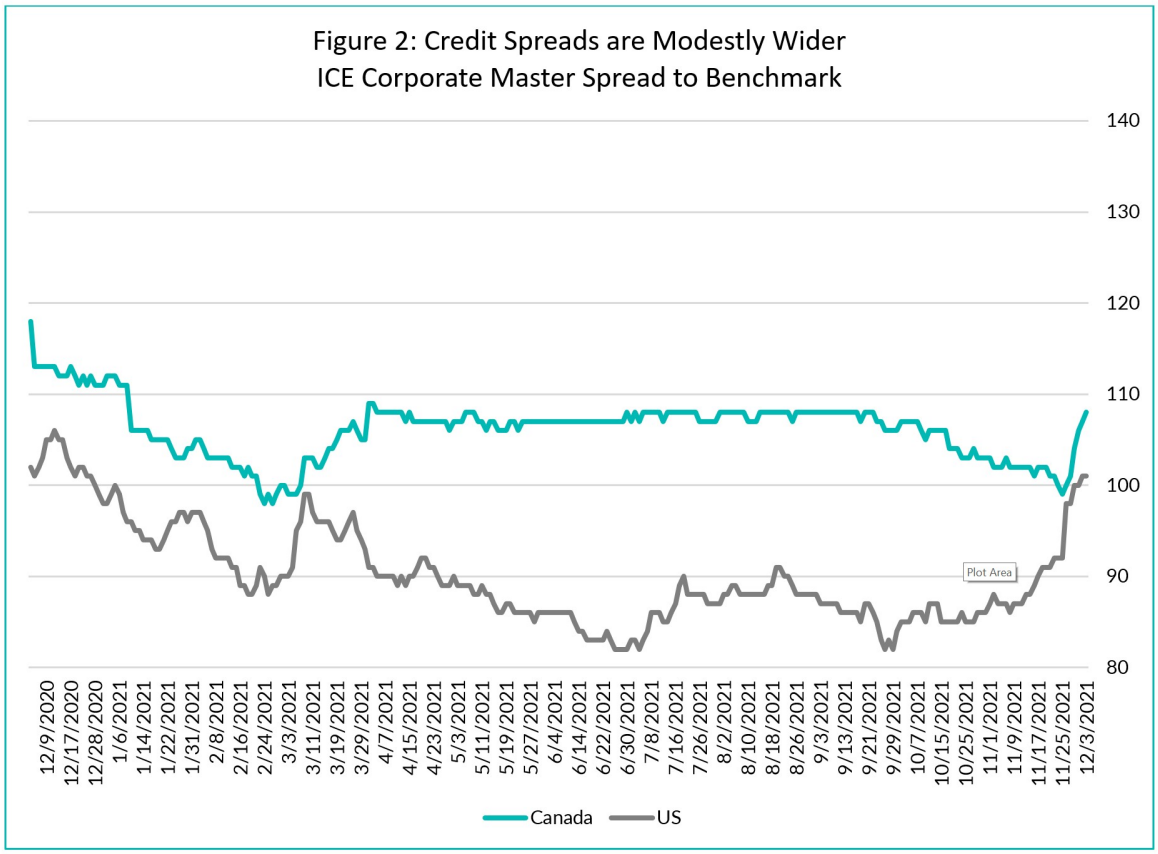
With each new wave of the virus, we have seen less of an economic impact. Also, the labour market is very tight (unemployment rates are 4.2% in the US and 6% in Canada, a few tenths from their pre-pandemic lows) and if anything, a new wave of Covid-19 is more inflationary (supply chain issues, more workers staying on the sidelines) than deflationary (negative demand shock is minimal at this point).

Thus, while the new variant is a concern and the impeding winter Covid wave is certainly going to be a drag on growth in late Q4 early Q1, it is not enough for policy makers to reverse their hawkish stance. They will continue to pivot towards a more aggressive, inflation fighting, stance. Therefore, we expect rates to continue to increase in a flattening fashion (short term rates increase more than long term rates) as we reverse the "Omicron induced rally" in government bonds.

Once the Fed and the BoC start raising rates in early 2022, the pivotal question for next year will then become: how far can rates really go before they risk a push back into recession (or at the very least an economic slowdown). Or, put another way: how many rate hikes do we need, and over what time frame, to tame inflation? Historically, it takes about 6-18 months for monetary policy actions to make their way through the economy. So it won't be until the fall of 2022 that we will see if they are successful in slowing down inflation. If not, they will probably accelerate the pace of hikes, with potentially damaging consequences for the economy. Generally, Central Banks have a very poor track record of engineering a soft landing for the economy, so the path of least resistance has to be for more, not less rate hikes.

Credit

In credit, consistent with the move in equities, we saw rapid widening of spreads off what was essentially yearly tights (Figure 2 below). Credit fundamentals continue to be solid, but supply has been very heavy this year (particularly in Canada, where we will finish the year >20% above last year). Going into November, the street's balance sheet was full and liquidity was thin, particularly around the Thanksgiving Holiday, so it is not surprising to see spreads generically 10bps wider. Already since the start of December, we have seen market conditions marginally improve. To us, the fundamental economic picture, particularly the strength of corporate balance sheets, has not changed, but we are mindful of where we are in the cycle. Central banks are removing accommodation, and are bound to accelerate their reduction in stimulus, which will reduce liquidity in the system.



Source: Bloomberg

Additionally, equities are trading at very expensive multiples, with many unprofitable or marginally profitable companies contributing a large weight in indices, making them more vulnerable. Since credit usually gets dragged along for the ride during equity corrections, we are being mindful of those cross-asset risks in 2022.

Diversified Bond Fund (DBF)

Between rising credit spreads and lower (on net) rates, the DBF managed to eke out a small positive return in November (+18bps), bringing our YTD total return to -56bps. 2021 has been a challenging year for fixed income investors, with rising rates a consistent headwind to performance. Looking into next year, the silver lining of higher rates is, well, higher rates. Portfolio yield-to-maturity is meaningfully higher now (2.9%) than where it was when we started 2021 (2.1%), providing us with more income potential. But, given our view on rate increases next year, we have also reduced portfolio duration, from 5.3 years in January 2021 to 3.9 years now.

To reduce our portfolio duration, we have entered interest rate swaps (IRS). Essentially, an IRS allows us to temporarily convert a fixed coupon corporate bond into a floating rate bond. At the time of writing, approximately 30% of the portfolio has been immunized from interest rate gyrations with IRS. As the Bank of Canada raises rates next year, the payments from the swaps will increase commensurably, increasing overall portfolio yield while reducing interest rate risk.

In the coming months, expect us to continue to reduce portfolio duration as we prepare for rate hikes next year.

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	Nov 2021	Outlook
Government Bonds	100%	-2%	0%	-4%	2%	1%	7%	22%	28%	13%	9%	9%	14%	8%	-8%	2%	0%	1%	↔
Investment Grade	80%	37%	56%	66%	73%	76%	72%	58%	61%	58%	78%	80%	71%	74%	84%	76%	73%	75%	↔
High Yield	40%	32%	24%	17%	16%	13%	14%	9%	7%	6%	13%	11%	12%	11%	12%	14%	18%	18%	↔
Emerging Market Governments	10%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	1%	1%	1%	1%	1%	↓
Preferred Equities	10%	6%	6%	6%	6%	2.5%	0.7%	0%	0%	0%	0%	0%	2%	4%	6%	5%	3%	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%	2%	↔
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%	N/A
Cash and Equivalents		28%	14%	15%	1.5%	6%	2%	9%	6%	22%	0%	6%	6%	5%	5%	1%	3%	2%	↑
Total		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	3.9	↓
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	5.2	↔
Unhedged FX Exposure	20%	0%	0%	0%	0%	0%	0%	6%	5%	3%	3%	5%	6%	6%	0.5%	4%	0%	0%	↔

Source: Ninepoint Partners

Alternative Credit Opportunities Fund (NACO)

With credit spreads increasing rapidly and little exposure to falling interest rates, the end of November was challenging for our credit focused strategies, including NACO. With the Omicron induced selloff so far proving short lived and new issue activity winding down for the year, we should see some recompression in spreads over the coming weeks. As of month end, the portfolio's yield-to-maturity was 5.1%, with 3 years of duration, and an average credit rating of BBB.

Alternative Credit Opportunities Portfolio Characteristics

	Limits	May 2021	June 2021	July 2021	August 2021	September 2021	October 2021	November 2021	Outlook
Government Bonds	100%	0%	0%	0%	0%	0%	0%	0%	↔
Investment Grade	100%	58%	66%	53%	49%	44%	48%	52%	↔
High Yield	40%	36%	32%	29%	24%	22%	28%	29%	↔
ABS	20%	0%	4%	1%	8%	6%	7%	7%	↔
Loans	10%	0%	0%	0%	3%	3%	3%	6%	↑
Preferred Equities	10%	8%	8%	4%	4%	3%	3%	2%	↓
Common Equities & ETFs	10%	0%	0%	0%	0%	0%	0%	0%	↔
Derivatives	+/- 2.5%	0%	0%	0%	0%	0%	0%	0%	N/A
Cash and Equivalents		-2%	-18%	11%	10%	19%	3%	6%	↔
Total		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	↔
Leverage	0-3x	1.4x	1.37x	1.13x	1.06x	1.09x	1.10x	1.10x	↔
Unhedged FX Exposure	<20%	0%	0%	0%	0%	0%	0%	0%	↔

Source: Ninepoint Partners

Credit Income Opportunities Fund (Credit Opps)

Just like for NACO, it was a slower month for performance due to increases in credit spreads. Still, the fund is up 5.58% YTD, which we think is a decent result, given the overall low levels of credit spreads this year. Just like last month, we continue to experience mark-to-market gains from legacy loan investments, which are performing above expectations. As of month end, the portfolio's yield-to-maturity was 6.5%, with 2.9 years of duration, and an average credit rating of BBB. Expect us to continue to reduce leverage, from 1.4x currently, to about 1x 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	Sept 2020	Dec 2020	Mar 2021	June 2021	Sept 2021	Nov 2021	Outlook
Government Bonds	100%	0%	0%	6%	0%	18%	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%	↔
High Yield	40%	29%	24%	19%	16%	10%	6%	22%	28%	26%	26%	30%	32%	37%	30%	↔
ABS	20%	3%	3%	4%	5%	5%	5%	5%	8%	9%	15%	11%	10%	14%	14%	↔
Loans	10%	3%	3%	2%	3%	2%	2%	4%	7%	6%	6%	3%	4%	4%	11%	↔
Preferred Equities	10%	4%	4%	0.5%	0%	0%	0%	0%	0%	0%	5%	10%	8%	4%	2%	↓
Common Equities & ETFs	10%	0%	0%	0%	0%	-7%	-7%	-10%	-15%	-13%	-8%	0.3%	0%	1%	1%	↔
Derivatives	+/- 2.5%	0%	0%	0%	-0.4%	0%	0%	0%	1%	0%	1%	1%	1%	1%	2%	N/A
Cash and Equivalents		6%	14%	15%	28%	8%	32%	12%	8%	2%	3%	-0.5%	1.2%	6%	9%	↓
Total		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	2.9	↔
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	1.40x	↓
Unhedged FX Exposure	<25%	0%	0%	0%	2.7%	5.1%	-3.2%	0%	0.3%	0%	2%	1%	0%	0%	0%	↔

Source: Ninepoint Partners

Conclusion

As this is our last official communication with clients before the end of 2021; we would like to wish everyone and their families a Happy Holiday and a prosperous New Year.

Thank you for your continued support.

Until next month,

Mark & Etienne
Ninepoint Partners

NINEPOINT DIVERSIFIED BOND FUND - COMPOUNDED RETURNS[1] AS OF NOVEMBER 30, 2021 (SERIES F NPP118) | INCEPTION DATE: AUGUST 5, 2010

	1M	YTD	3M	6M	1YR	3YR	5YR	10YR	INCEPTION
Fund	0.2%	-0.6%	-1.2%	0.0%	-0.3%	3.5%	3.4%	4.4%	4.2%

NINEPOINT DIVERSIFIED BOND CLASS - COMPOUNDED RETURNS[1] AS OF NOVEMBER 30, 2021 (SERIES F NPP221) | INCEPTION DATE: NOVEMBER 2, 2011

	1M	YTD	3M	6M	1YR	3YR	5YR	10YR	INCEPTION
Fund	0.2%	-0.6%	-1.2%	0.0%	-0.4%	3.3%	3.2%	4.3%	4.2%

NINEPOINT CREDIT INCOME OPPORTUNITIES FUND - COMPOUNDED RETURNS[1] AS OF NOVEMBER 30, 2021 (SERIES F NPP507) | INCEPTION DATE: JULY 1, 2015

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	-0.1%	5.6%	1.0%	2.2%	8.0%	8.4%	6.2%	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 November 30, 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 November 30, 2021.

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