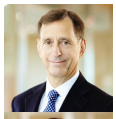
Ninepoint Fixed Income Strategy

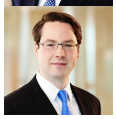
October 2020 Commentary

*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

With the US election now (mostly) behind us, we can start reflecting on what comes next. At the time of writing, Joe Biden will be "Leader of the Free World" for the next four years. However, the blue wave that pundits were predicting has failed to materialize. It is yet unclear if Democrats will be able to win a slim majority in the Senate, owing to two runoff senate elections in Georgia. Because of this, we won't know until January 5th if Democrats will take control of the Senate. Most of those same pundits assume that the status quo will prevail (i.e. Republicans keep the senate). Without it, most of the tax hikes and large spending plans that are on the Democratic platform are unlikely to become reality. It will also complicate the appointments the President wants to make, as those are vetted by the Senate. If Republicans want they can delay and prevent Democrats from governing effectively. The Biden White House will still be able to re-enter the Paris Agreement, or reverse much of the deregulation that has taken place over the past 4 years, but its grand left wing, high spending agenda will have to wait for the 2022 mid-terms. In this acrimonious context, we do not expect a large (e.g. $2tn plus) fiscal package to be enacted any time soon, dashing hopes for a fiscally induced economic boom in early 2021.

In the meantime, the Covid-19 pandemic is now firmly into its second wave. Cases are spiking across Europe and North America. Many countries, mainly across Europe have already re-entered some forms of lockdowns and the expectation is that there will be a double dip recession in the UK and Eurozone in 2020/Q4 or 2021/Q1. Judging by the pace of increase in cases here and in the U.S., we would not be surprised to see some forms of lockdowns being re-instated here this fall, which should weigh on economic activity. The end of the pandemic and the ensuing recovery will only be allowed to start with the widespread availability of a vaccine.

On that front, Pfizer has recently released some very encouraging information on the efficacy of its Covid-19 vaccine. While we are still awaiting the full completion of the phase 3 trial, they showed over 90% efficacy in preventing infections and so far, the safety data has been reasonably good. If all goes well, Pfizer expects the vaccine to be approved by the end of the year, with about 100 million doses available in 2020 and a further 1.3bn doses in 2021 (each patient needs two doses for immunity). The end of the pandemic is thus in sight, at least in developed countries where governments have secured early access to the first vaccines. Based on logistics and supply chain considerations, experts now say that we could reach herd immunity, and thus a return to "normal", by the third quarter of 2021. That's still long way away and the second wave is far from over, but at least there's some light at the end of the tunnel.

Assuming we go back to "normal" towards the end of 2021, with Covid-19 all said and done, what set of economic and monetary policies are we likely to face? To fight the pandemic and assuage their populations, governments across the world have run immense deficits and accumulated a large stock of

debt, taking their debt-to-GDP ratios back to post-WW2 levels. The U.S., following the Trump tax cuts, was already on an unsustainable fiscal path. Long term forces such as population ageing are also negatively impacting public finances. When these are all combined, government finances become increasingly vulnerable to the level of interest rates. A simple look at Japan, which carries debt-to-GDP of more than 200%, shows you what happens when a country falls into the so called "liquidity trap". Many developed countries were already heading in that direction, but the Covid-19 recession and the massive fiscal spending that ensued has accelerated the phenomenon. As debt levels grow to this magnitude, a very small increase in interest rates has a very large impact on government finances. We had a similar situation here in Canada a few years ago; household debt was very high because of the housing boom, and the BoC was trying to raise rates, but quickly realized that the impact it was having on households finances was so large that they had to slow down their pace of increases. Now apply that same logic to governments, households and corporations, which have all been gorging on debt over the past 6 months to cover the unexpected fallout from the pandemic induced lockdowns: we have an economy which is hyper-sensitive to interest rates. It can operate just fine, as long as interest rates do not move up much, otherwise it starts to feel the pinch. That's what central bankers mean when they say that the natural rate of interest is declining. We now have a situation where it will be extremely difficult for any central banker to raise interest rates, as long as debt levels remain so large. Japan has been there for several decades, the Eurozone made the mistake of raising rates too fast in 2011, only to cut them aggressively afterwards. They are now of course in negative territory.

North America is facing the same liquidity trap problem; lower rates begets lower rates. Central bankers know this, and while none of them will ever publicly acknowledge that the economies they are presiding over are stuck in a liquidity trap, they will act according to their mandates, and that means keeping rates as low as possible across the curve to prevent negative shocks to the economy (they call this a tightening of financial conditions).

Over the past few weeks, the BoC explicitly told us that they had no intention of raising rates until 2023 and that they would start buying more long-term government bonds to keep rates low longer out the curve. In the U.S., the Fed has recently suggested that they are having a "full discussion" of the parameters of their QE program. We expect them to start tilting their purchases to the long end of the curve after their December meeting. In Europe, the BoE and the ECB have (or strongly hinted at) increased their QE programs.

Accordingly, we expect that short-term interest rates will remain at current levels, but that longer-term interest rates will be capped (for now implicitly, eventually perhaps explicitly if we hit a speed bump). In such an environment, with interest rates poised to be very low for a long time, the best place for a fixed income manager will be in credit or spread products. This will be the go-to place for a portfolio manager to find a decent yield with for an acceptable amount of risk.

Credit

Credit, like equities was weak into the U.S. Election, only to rally strongly in the aftermath. Cross-asset price action was somewhat unusual, as government bonds moved in tandem with risk assets over the past few weeks, detracting from their usual safe heaven role. There was nowhere to hide during the late month selloff.

It really feels like the year is winding down; primary market activity has been slowing down and, with the election now behind us, investors are chasing for the last bit of performance into year-end. Moreover, since the beginning of November, the positive vaccine news out of the Pfizer program is putting additional oil on the fire, quickly driving spreads back to recent lows. This combination of low primary activity, high investor cash balances and year-end performance chasing should keep credit well bid into

year-end. One important caveat is still the Covid-19 virus that the markets seem to have forgotten; the second wave is now upon us and we expect restrictions to start weighting on economic activity once again. For now, investors seem willing to look past this risk. We are not and although we think we are closer to the 7th inning, there will still be some volatility to come.

Diversified Bond Fund (DBF)

October was a difficult month for the DBF, losing 32bps. Increases in interest rates ahead of the "Blue wave" primarily impacted performance, while credit spreads also widened marginally. Our hedges (HYG, S&P500 puts) helped a bit, but could not offset the increase in rates. Otherwise, there haven't been any material changes to the portfolio.

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	Oct 2020	Outlook
Government Bonds	**100%**	-2%	0%	-4%	2%	1%	7%	22%	28%	13%	9%	9%	14%	**13%**	↔
Investment Grade	**80%**	37%	56%	66%	73%	76%	72%	58%	61%	58%	78%	80%	71%	**72%**	↔
High Yield	**40%**	32%	24%	17%	16%	13%	14%	9%	7%	6%	13%	11%	12%	**11%**	↓
Emerging Market Governments	**10%**	0%	0%	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%	2%	**0%**	↔
Common Equities & ETFs	**10%**	0%	0%	0%	1.5%	1.5%	4.3%	2.4%	-1.3%	0%	0%	-6%	-5%	**-5%**	↔
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%**	**N/A**
Cash and Equivalents		28%	14%	15%	1.5%	6%	2%	9%	6%	22%	0%	6%	6%	**9%**	↑
Total		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	**5.0**	↔
Spread Duration		-	-	-	3.4	2.9	3.0	2.3	3.1	3.0	2.2	4.1	3.8	**3.7**	↓
Unhedged FX Exposure	**20%**	0%	0%	0%	0%	0%	0%	6%	5%	3%	3%	5%	6%	**3%**	↔

Source: Ninepoint Partners

Credit Income Opportunities Fund (Credit Opps)

The Credit Opps returned 28bps in October. Most of the return was driven by current income, which more than offset the negative impact of higher credit spreads. Changes to the fund were very minimal.

Credit Income Opportunities Portfolio Characteristics

	Limits	Oct 2018	Dec 2018	Mar 2019	June 2019	Sept 2019	Dec 2019	Mar 2020	June 2020	Sept 2020	Oct 2020	Outlook
Government Bonds	**100%**	0%	0%	6%	0%	18%	0%	0%	0%	0%	**0%**	↔
Investment Grade	**100%**	58%	55%	58%	53%	68%	64%	72%	65%	77%	**75%**	↑
High Yield	**40%**	29%	24%	19%	16%	10%	6%	22%	28%	26%	**20%**	↔
Private Loans	**10%**	3%	3%	2%	3%	2%	2%	4%	7%	6%	**4%**	↔
Preferred Equities	**10%**	4%	4%	0.5%	0%	0%	0%	0%	0%	0%	**0%**	↔
Common Equities & ETFs	**10%**	0%	0%	0%	0%	-7%	-7%	-10%	-15%	-13%	**-14%**	↔
Derivatives	**+/- 2.5%**	0%	0%	0%	-0.4%	0%	0%	0%	1%	0%	**0%**	**N/A**
Cash and Equivalents		6%	14%	15%	28%	8%	32%	12%	8%	2%	**2%**	↔
Total		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	**4.5**	↓
Leverage	**0-4x**	0.7x	0.7x	1.0x	1.0x	0.77x	1.04x	0.87x	1.67x	1.15x	**1.18x**	↓
Unhedged FX Exposure	**>25%**	0%	0%	0%	2.7%	5.1%	-3.2%	0%	0.3%	0%	**0%**	↔

Source: Ninepoint Partners

Conclusion

The US election came and went, and the split government in Washington probably means less fiscal action to help offset the second wave of Covid-19. We expect the new president to be more active in fighting the virus' spread, which could mean more severe restrictions in the U.S, with some impact on corporate earnings and the markets.

We continue to patiently wait for a better entry point in credit and still value the ballast that our government bonds can offer, particularly at these new higher yields.

Until next month,

Mark & Etienne
Ninepoint Partners

NINEPOINT DIVERSIFIED BOND CLASS - COMPOUNDED RETURNS[1]
AS OF OCTOBER 31, 2020 (SERIES F NPP221)

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	-0.3%	5.3%	-0.2%	3.6%	4.7%	3.2%	3.7%	4.7%

NINEPOINT DIVERSIFIED BOND FUND - COMPOUNDED RETURNS[1]
AS OF OCTOBER 31, 2020 (SERIES F NPP118)

	1M	YTD	3M	6M	1YR	3YR	5YR	10YR	INCEPTION
Fund	-0.3%	5.5%	-0.2%	3.7%	4.8%	3.4%	3.9%	4.3%	4.6%

NINEPOINT CREDIT INCOME OPPORTUNITIES FUND - COMPOUNDED RETURNS[1]
AS OF OCTOBER 31, 2020 (SERIES F NPP507)

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	0.3%	8.8%	2.6%	12.4%	9.5%	4.7%	5.6%	5.0%

[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 October 31, 2020 [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 October 31, 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.

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