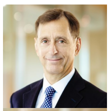
Ninepoint Fixed Income Strategy

March 2021 Commentary

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

Investment Team



Mark Wisniewski,
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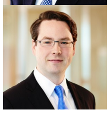

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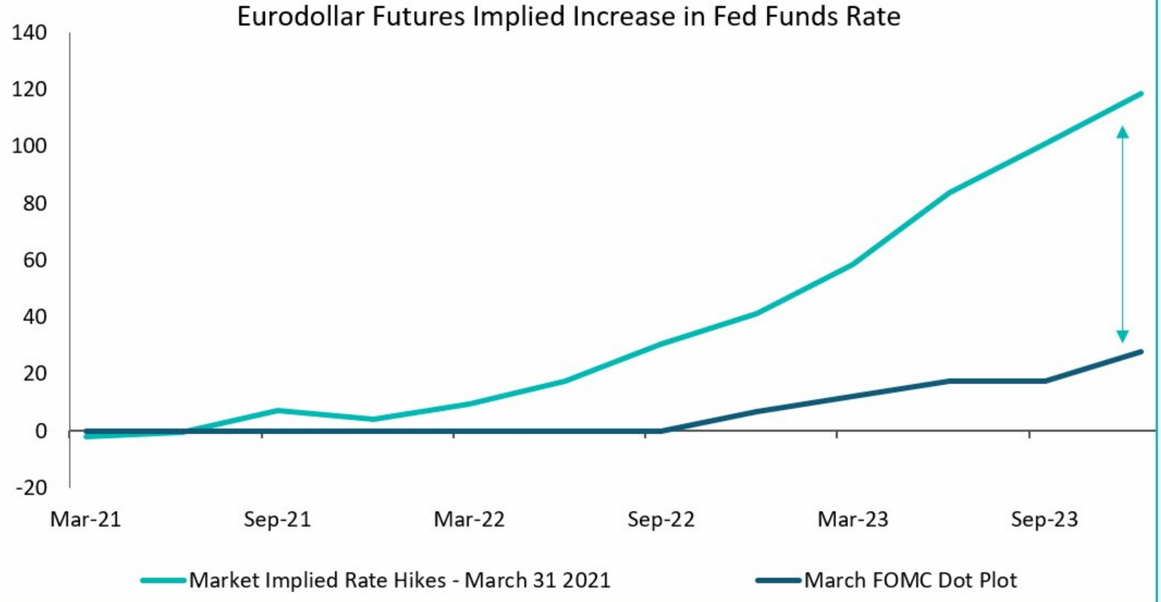
Vice President, Portfolio Manager

Macro

The highlight of the month was certainly the March 17th FOMC meeting, where the Fed was finally given an opportunity to weigh in on the recent interest rate gyrations. The result was predictably disappointing; while they continued to reiterate previous guidance, they failed to address the rapid increase in interest rates, simply acknowledging that it is consistent with an improving economic outlook. However, the bond market continues to price-in a much steeper pace of rate increases than the average FOMC participant (Figure 1).

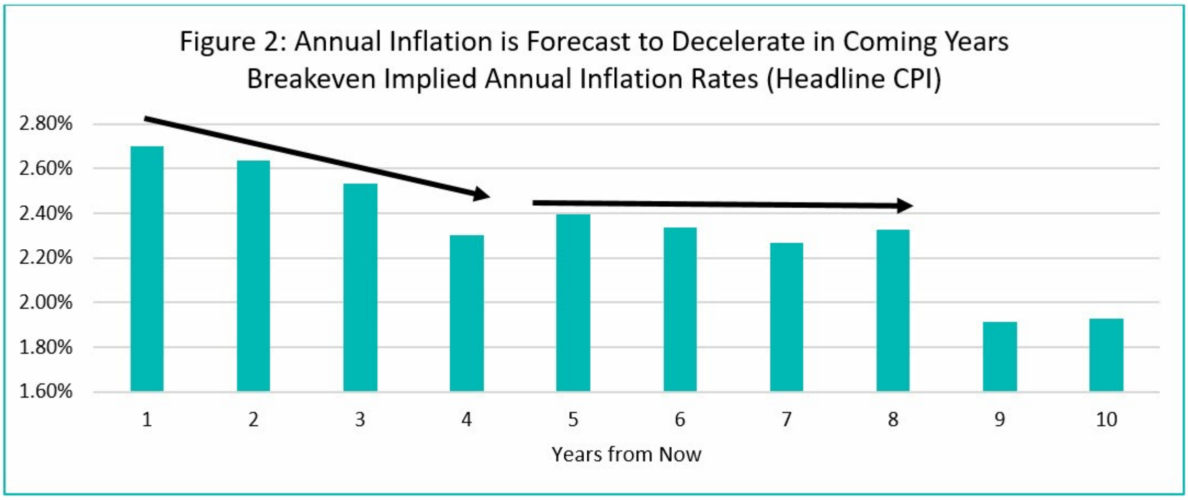
While the Fed has significantly increased its economic growth forecast for this year, most FOMC participants still see no rate hikes for the next few years. In subsequent speeches, the central bank's leadership is intently focused on its employment goals (still 9.5 million fewer employed Americans than pre-pandemic), setting aside any concerns about inflation.

Figure 1: Market Rate Hike Expectations Are Well Ahead of the Fed
Eurodollar Futures Implied Increase in Fed Funds Rate



Source: Citi Rates Trading, Bloomberg

To be clear, they do expect inflation to increase in the short term, mostly due to base effects (very low prices in March and April of 2020), but expect prices to normalize as the pre-pandemic inflation dynamics re-establish themselves. At the very least, the market and the Fed seem to be on the same page with regards to their inflation expectations. In Figure 2 below, we show the inflation (headline CPI) expectations by the bond market for each of the next 10 years. Consistent with the FOMC's views, we should observe higher but declining inflation over the next few years, settling down to levels consistent with their inflation mandate in about 4 years[i].



Source: Bloomberg / Ninepoint Partners

From the chart above, the bond market and the Fed are on the same page with respect to inflation dynamics over the next few years. Higher inflation is seen by both as a temporary phenomenon. In fact, judging by the breakeven for years 9 and 10 in the chart above, the bond market does not even believe the Fed will achieve its long run goal of 2% inflation.

The biggest point of contention between the Fed and the market is the pace of liftoff. If the FOMC's forecasts are internally consistent, they must assume that we will get the economic outcomes they are predicting consistent with their path for the funds rate (i.e., very shallow, no chance of a hike until late 2023). By contrast, the market is expecting the Fed to start raising rates in early 2022, when the unemployment rate is expected by both the Fed and consensus macroeconomic forecasters to be around 4-5%. Even if we were to have a furiously quick recovery in the second half of 2021, we are far from where the FOMC sees full employment; they will not even "think about thinking about raising rates" (to use the Chairman's own words). Therefore, our expectation is that the 100bps (and 1-year) wedge we are currently observing on Figure 1 will slowly close, probably because over time the Fed will nudge forward their rate hike expectations, and in turn the bond market will tamper its enthusiasm. In other words, the bond market has moved too far too fast, and the Fed is (probably purposefully) behind the curve on rate hikes, trying to keep financial conditions as accommodative as possible.

A meaningful risk to this base case, and one that shouldn't be dismissed too easily, is that higher realized inflation in the short-term increases inflation expectations of firms and households. As we have discussed in previous commentaries, the scope and scale of the fiscal stimulus that is being deployed in the US, coupled with the meaningful savings accumulated in 2020 could unleash tremendous demand once things gradually return to "normal". Economic experiments of this scale are few and far between in the history books, and we would not be surprised if things did not play out exactly as intended. If, as expected, inflation does accelerate over the next few months but does not show signs of stabilization later this summer, we expect that the inflation overshoot narrative will pick up steam, and with it interest rates will march higher, potentially making new 2021 highs.

Credit

After a period of new issue indigestion, the market is once again performing well. Spreads have been tightening gradually as investors regain confidence and put money to work. As discussed last month, we have been active in the primary and secondary market, using up some of our cash to take advantage of more attractive spreads and all in yields.

Diversified Bond Fund (DBF)

As discussed last month, we have been busy reinvesting maturing bonds into more attractive opportunities in the 7-10 year part of the yield curve. Due to higher rates, we are now finding good quality corporate bonds with yields in the 2.5-3.5% range and in some cases as much as 4%, much better than what we could find just a few months ago. The portfolio now has a current yield of about 3.3%, and with 15% of our portfolio maturing within the next 12 months, reinvested at these higher rates, we should be able to increase the fund's yield by another 40-50bps.

We retain a short position in government bonds (-8%) as a hedge against our longer duration corporates (anything 10 to 30 years is interest rate hedged). Since these shorts generate cash, we have bought some short duration (<1y) corporate bonds, which explains our Investment Grade weight slightly above our limit (84%). Buying these bonds as opposed to holding cash helps limit the carry cost of the short positions. We expect to keep this interest rate hedge until we have a better sense of how the inflation dynamics we discussed above pan out.

In the coming months, investors should expect the portfolio duration to remain stable, and for spread duration to increase mildly as we invest maturing positions further out on the curve. Over time, as we close our government bond short positions, duration should equal spread duration.

Diversified Bond Fund Portfolio Characteristic

	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	March 2021	Outlook
Government Bonds	100%	-2%	0%	-4%	2%	1%	7%	22%	28%	13%	9%	9%	14%	8%	-8%	↔
Investment Grade	80%	37%	56%	66%	73%	76%	72%	58%	61%	58%	78%	80%	71%	74%	84%	↓
High Yield	40%	32%	24%	17%	16%	13%	14%	9%	7%	6%	13%	11%	12%	11%	12%	↑
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	3.6	↔
Spread Duration		-	-	-	3.4	2.9	3.0	2.3	3.1	3.0	2.2	4.1	3.8	3.9	4.5	↑
Unhedged FX Exposure	20%	0%	0%	0%	0%	0%	0%	6%	5%	3%	3%	5%	6%	6%	0.5%	↔

Source: Ninepoint Partners

Credit Income Opportunities Fund (Credit Opps)

It was another good month for the Credit Opps, returning 37bps. Like last month, slightly wider credit spreads were more than offset by the income the fund generates, and with its very low duration, performance was not materially impacted by higher rates.

We have had a few loans mature since the beginning of 2021 and we are actively looking to replace them, so we expect their proportion of the portfolio to nudge higher over time. Another subsector we are slowly and selectively adding to is HY, mostly fallen angels, higher quality companies (BB+) or hybrid bonds of IG companies that are rated HY.

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	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%	53%	↓
High Yield	40%	29%	24%	19%	16%	10%	6%	22%	28%	26%	26%	30%	↑
Private Loans	10%	3%	3%	2%	3%	2%	2%	4%	7%	6%	6%	3%	↑
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%	0.3%	↔
Derivatives	+/- 2.5%	0%	0%	0%	-0.4%	0%	0%	0%	1%	0%	1%	1%	N/A
Cash and Equivalents		6%	14%	15%	28%	8%	32%	12%	8%	2%	3%	-0.5%	↔
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	2.6	↔
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	↑
Unhedged FX Exposure	<25%	0%	0%	0%	2.7%	5.1%	-3.2%	0%	0.3%	0%	2%	1%	↔

Source: Ninepoint Partners

Conclusion

The interest rate volatility surrounding the March FOMC meeting has now subsided, and the path forward for the economy has markedly improved. While there are inflationary tail risks, we won't get clarity on those until later in the year, so for now we think that prudently deploying our dry powder to take advantage of much better all-in yields is a sensible thing to do.

Until next month,

Mark & Etienne
Ninepoint Partners

[i] It is important to note that the bond market prices inflation based on headline CPI, whereas the Fed targets the PCE measure of inflation. Historically, CPI is on average 30bps higher than PCE, so 2% inflation on the Fed preferred measure translates to approximately 2.3% headline CPI inflation.

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

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	-0.3%	-1.4%	-1.4%	-0.7%	4.6%	2.9%	3.9%	4.4%

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

	1M	YTD	3M	6M	1YR	3YR	5YR	10YR	INCEPTION
Fund	-0.3%	-1.4%	-1.4%	-0.7%	4.7%	3.1%	4.0%	3.9%	4.4%

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

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	0.4%	1.6%	1.6%	7.3%	23.6%	6.8%	7.2%	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 March 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 March 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.

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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