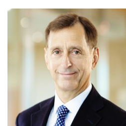
Ninepoint Fixed Income Strategy

June 2021 Commentary

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

Investment Team



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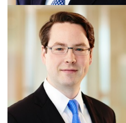

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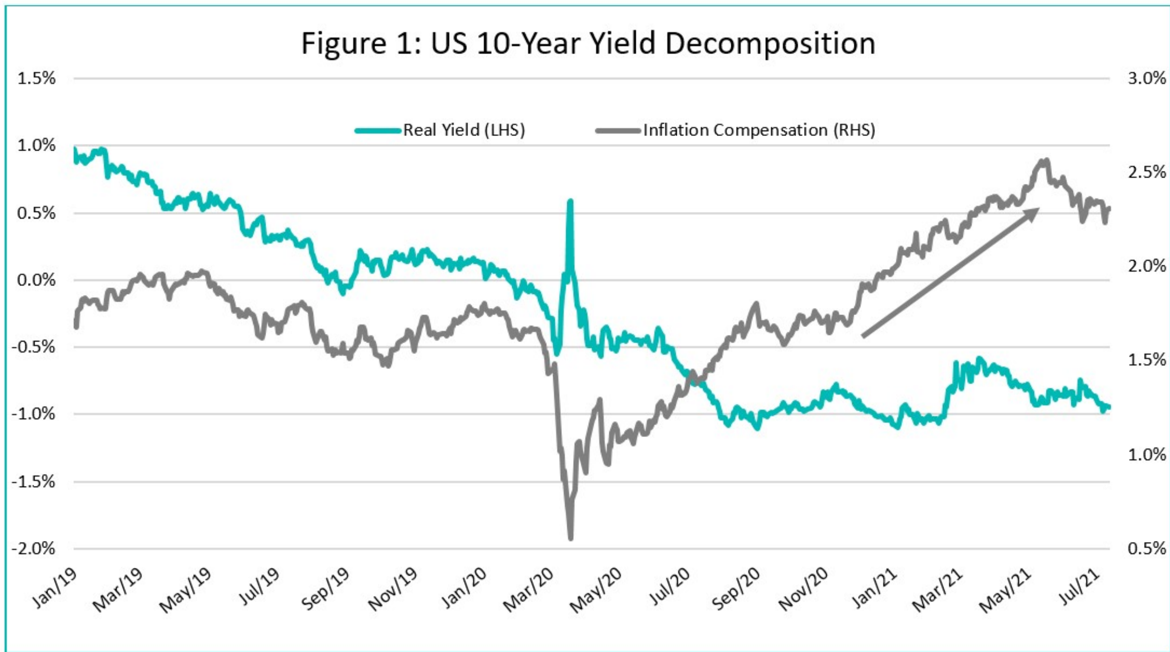
Macro

The real highlight of June was the FOMC meeting, where the Fed surprised markets with a somewhat hawkish statement and set of forecasts (the famous Dot plots), which resulted in a decline in long term interest rates. To understand how we got there and where we might be going, we thought it might be useful to backtrack to the beginning of 2021.

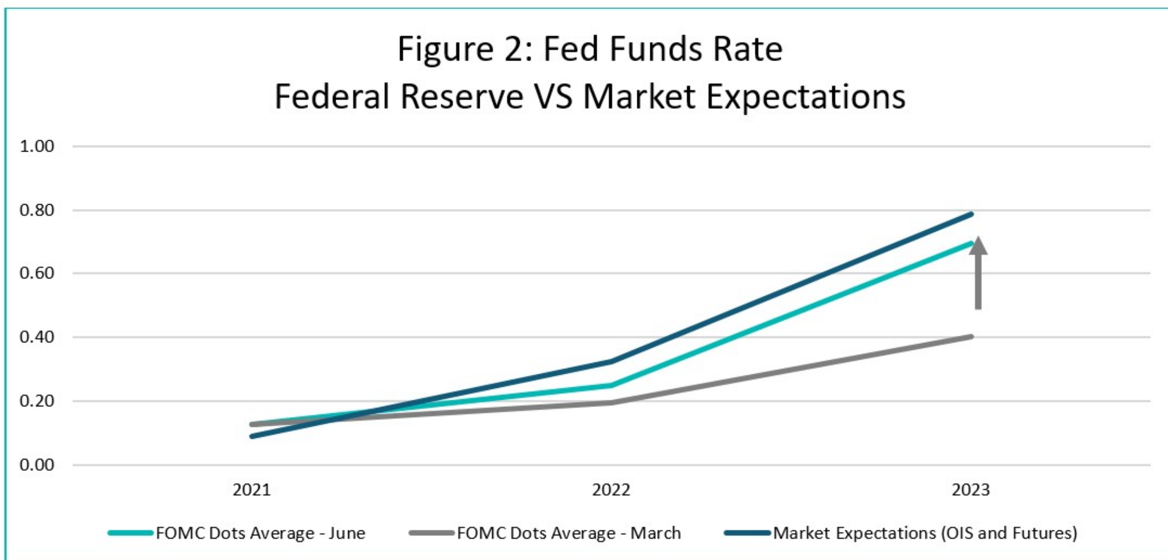
Since the start of the year, the market consensus has been working under the assumption that the Fed was intently focused on the labour market, constantly reminding us of the roughly 10 million fewer Americans participating in the labour market. Given the Fed's new framework and its stated intention of letting inflation run a little hot to compensate for previously low inflation readings, measures of inflation compensation rose meaningfully (Figure 1). In other words, the Fed's framework was gaining credibility.

But a (more than) healthy dose of fiscal stimulus coupled with high inflation readings created an environment where many thought the Fed might be getting behind the curve. What if inflation is high and stays so persistently, would the Fed continue to focus on the labour market, or would it react to all this inflation? Until the June FOMC meeting, the overwhelming market consensus was that the Fed would let inflation run, at least until employment was back to levels consistent with full employment. Given the slow pace of gains in employment seen recently, this could take a while. As a result of this narrative, a very popular (and crowded) trade was to bet on long dated US government bonds declining in price, since higher inflation and a Fed that is behind the curve should mean much higher interest rates in the future.



Source: Bloomberg

But, at the June FOMC meeting, there was not a single mention of those 10 million or so missing individuals from the labour force. Instead, the discussion was almost exclusively focused on inflation. To the surprise of many, they even started "talking about tapering" their QE program. Moreover, the now famous "Dot plots", showing each FOMC participant's expectation of the most likely path for the Federal Funds Rate, showed a meaningfully hawkish change versus what was presented at the March meeting. Figure 2 below shows the average Fed Funds rate from the Dot plots of both the June and March meetings, along with the most recent market expectations, based on the OIS and Futures market. The Fed's consensus view went from essentially no rate hikes in 2022 to pricing about 3 rate hikes by the end of 2023.



Source: Bloomberg

This is a significant shift, and it matters a lot to the "inflationary" narrative discussed above: if the Fed is now turning its focus on inflation risks as opposed to the labour market slack, they

are a lot less likely to fall behind the curve and this explains the reaction of the bond market since then. With fiscal stimulus now behind us and a more aggressive Fed, risks of runaway inflation are now much diminished and as such longer term interest rate expectations have declined. Accordingly, as inflation expectations have come down so has the probability of the "Great Reflation" trade sending everyone rushing for the exit at the same time, creating a great deal of demand for US treasuries, driving prices up (and yields down).

To add fuel to the fire, this also coincided with renewed restrictions linked to the Delta variant in several countries and a slowing of economic activity in Asia. This was essentially a purge on a very crowded trade that had to be unwound, and the price action over the following weeks was consistent with this capitulation.

Since then, the Fed leadership has reasserted the importance it places on progress in the labour market, acknowledging the risk posed by inflation but tampering the message a little bit. But, for those in the "Great Reflation" camp, it was already too late.

From our perspective, it is refreshing to see that the Fed hasn't lost its willingness to combat inflation. We are in the camp that believes that the current bout of inflation is indeed transitory and the increase in long term yields was overdone (see March 2021 Commentary). The optimism that prevailed earlier in the year (remember the talk of 1 million new jobs a month?) regarding breakneck economic activity has subsided, and that is probably a good thing, as it was always very unlikely to play out that way. PMIs have peaked and other "hot" segments of the market such as housing are cooling down, with high prices deterring new buyers. Supply chains are starting to rebalance themselves, taking down inflation. Workers that lost their jobs over a year ago will take some time to find new jobs but will ultimately re-enter the labour market, but at a slower pace. As well stimulus checks are starting to run out, the sugar rush, the US economy has been operating under is coming to an end.

For what it's worth, long term yields, after moving too high, too fast earlier this year, have probably swung back too far too low after this enormous short squeeze. Liquidity, even in the most liquid asset in the world (UST), is much lower during the summer, which tends to exacerbate moves, one way or another. We believe the pendulum has swung too far in the other direction, consequently we have continued to maintain lower portfolio duration and added some hedges in the DBF to help shield investors from more volatility.

Credit

Credit continues to be exceptionally stable. Spreads are tight, which could be cause for concern, but the economic environment continues to improve, companies (for the most part) are still careful with how they use their balance sheets and demand for their bonds remains very high. With new issue activity expected to slow down during the next few months, we believe the technical bid for corporate credit will continue to be strong.

Diversified Bond Fund (DBF)

The DBF continues to perform well; the duration extension in credit that was done in March and April is benefiting from the recent decline in government yields. Credit spreads, while tight, are very stable, allowing us to earn our good interest carry without much more volatility. There were few changes to the portfolio in June, and we do not expect to make material modifications in July either. We feel we are appropriately positioned for the current environment.

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	Outlook
Government Bonds	**100%**	-2%	0%	-4%	2%	1%	7%	22%	28%	13%	9%	9%	14%	8%	-8%	**2%**	↓
Investment Grade	**80%**	37%	56%	66%	73%	76%	72%	58%	61%	58%	78%	80%	71%	74%	84%	**76%**	↓
High Yield	**40%**	32%	24%	17%	16%	13%	14%	9%	7%	6%	13%	11%	12%	11%	12%	**14%**	↑
Emerging Market Governments	**10%**	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	1%	1%	**1%**	↔
Preferred Equities	**10%**	6%	6%	6%	6%	2.5%	0.7%	0%	0%	0%	0%	0%	2%	4%	6%	**5%**	↔
Common Equities & ETFs	**10%**	0%	0%	0%	1.5%	1.5%	4.3%	2.4%	-1.3%	0%	0%	-6%	-5%	-2%	0%	**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%	**0%**	**N/A**
Cash and Equivalents		28%	14%	15%	1.5%	6%	2%	9%	6%	22%	0%	6%	6%	5%	5%	**1%**	↓
Total		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**	↔
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**	↑
Unhedged FX Exposure	**20%**	0%	0%	0%	0%	0%	0%	6%	5%	3%	3%	5%	6%	6%	0.5%	**4%**	↔

Source: Ninepoint Partners

Alternative Credit Income Opportunities Fund (NACO)

June was NACO's first full month since inception, and it is performing in line with expectations. Since inception, we have been fully invested and the portfolio is essentially positioned where we wanted it to be: low duration (~3 years) and leverage around 1.4x. Our current high yield position reflects allocations to hybrid securities (i.e. high quality companies lower in the capital structure) of investment grade issuers. We are currently reviewing some interesting loans and new hybrid structures which should further enhance the portfolio yield.

Alternative Credit Opportunities Portfolio Characteristics

	Limits	May 2021	June 2021	Outlook
Government Bonds	100%	0%	0%	↔
Investment Grade	100%	58%	70%	↔
High Yield	40%	36%	32%	↑
Illiquid Securities	10%	0%	0%	↑
Preferred Equities	10%	8%	8%	↔
Common Equities & ETFs	10%	0%	0%	↔
Derivatives	+/- 2.5%	0%	0%	N/A
Cash and Equivalents		-2%	-18%	↔
Total		100%	100%	
Duration	0 to 5 years	3.0	2.7	↔
Leverage	0-3x	1.4x	1.37x	↑
Unhedged FX Exposure	<20%	0%	0%	↔

Source: Ninepoint Partners

Credit Income Opportunities Fund (Credit Opps)

The Credit Opps continues to perform very well; credit spreads, although tight, are for the most part stable and fund performance simply reflects the income earned during the month. Several of our preferred shares have been called in the month, so we will look to recycle the cash from these positions into other securities. We are working on a few secured loan opportunities for the fall, that should we pull the trigger, would earn coupons in the low double digits, much better than what we can find in any high yield bonds right now.

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	Outlook
Government Bonds	**100%**	0%	0%	6%	0%	18%	0%	0%	0%	0%	0%	0%	**0%**	↔
Investment Grade	**100%**	58%	55%	58%	53%	68%	64%	72%	65%	77%	64%	53%	**44%**	↔
High Yield	**40%**	29%	24%	19%	16%	10%	6%	22%	28%	26%	26%	30%	**32%**	↑
Private Loans	**10%**	3%	3%	2%	3%	2%	2%	4%	7%	6%	6%	3%	**4%**	↑
Preferred Equities	**10%**	4%	4%	0.5%	0%	0%	0%	0%	0%	0%	5%	10%	**8%**	↔
Common Equities & ETFs	**10%**	0%	0%	0%	0%	-7%	-7%	-10%	-15%	-13%	-8%	0.3%	**1%**	↔
Derivatives	**+/- 2.5%**	0%	0%	0%	-0.4%	0%	0%	0%	1%	0%	1%	1%	**1%**	**N/A**
Cash and Equivalents		6%	14%	15%	28%	8%	32%	12%	8%	2%	3%	-0.5%	**1.2%**	↓
Total		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**	↔
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**	↑
Unhedged FX Exposure	**<25%**	0%	0%	0%	2.7%	5.1%	-3.2%	0%	0.3%	0%	2%	1%	**0%**	↔

Source: Ninepoint Partners

Conclusion

Enjoy the summer, it always seems too short.

Mark & Etienne
Ninepoint Partners

NINEPOINT DIVERSIFIED BOND CLASS - COMPOUNDED RETURNS[1] AS OF JUNE 30, 2021 (SERIES F NPP 221) | INCEPTION DATE - NOVEMBER 2, 2011

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	0.30	-0.32	1.14	-0.32	1.89	3.31	3.83	4.42

NINEPOINT DIVERSIFIED BOND FUND - COMPOUNDED RETURNS[1] AS OF JUNE 30, 2021 (SERIES F NPP 118) | INCEPTION DATE - AUGUST 5, 2010

	1M	YTD	3M	6M	1YR	3YR	5YR	10YR	INCEPTION
Fund	0.31	-0.29	1.16	-0.29	2.00	3.46	3.97	3.96	4.36

NINEPOINT CREDIT INCOME OPPORTUNITIES FUND - COMPOUNDED RETURNS[1] AS OF JUNE 30, 2021 (SERIES F NPP 507) | INCEPTION DATE - JUNE, 2015

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	0.37	3.70	2.04	3.70	15.80	7.19	6.81	5.94

[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, 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 June 30, 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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