



Ninepoint Fixed Income Strategy

May 2023 Commentary

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



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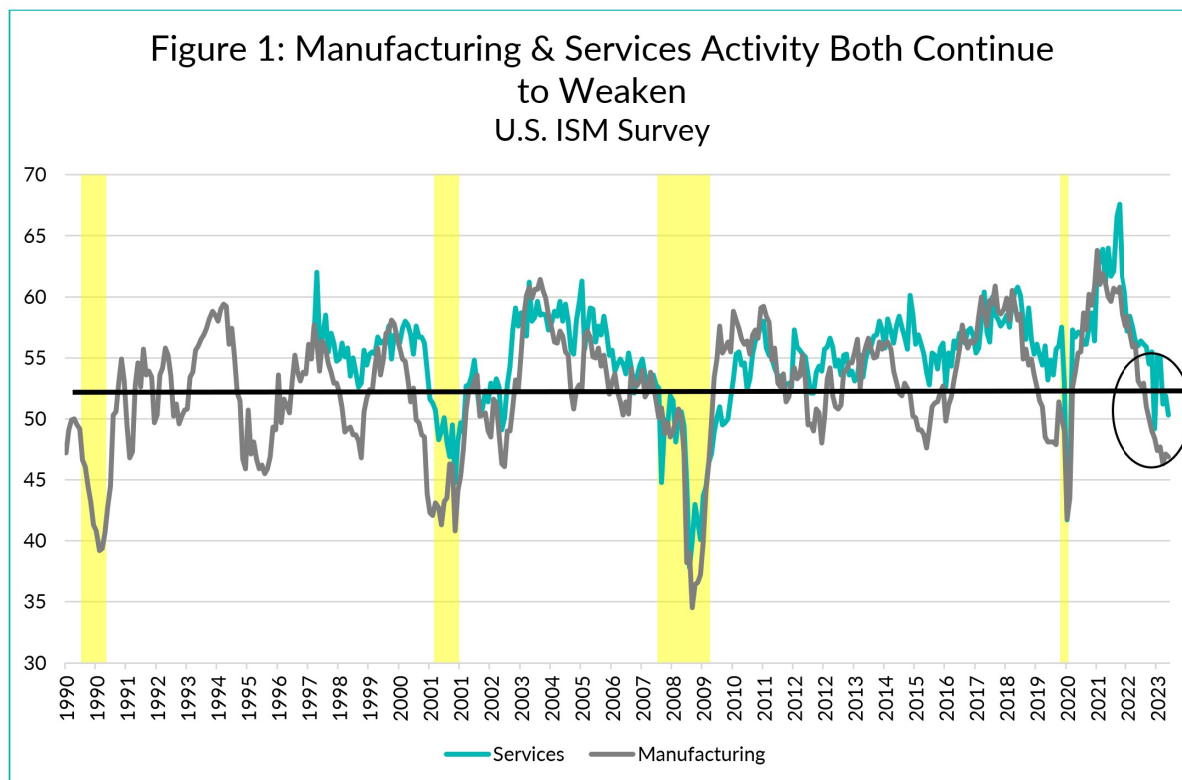
Summary

- While inflation is off the highs, recent progress has been slowing, prompting Central Banks to do more rate hikes
- The BoC surprised markets with a hike, odds are on for July increase as well
- As advertised, the Fed skipped June, positioning for what could maybe be their last hike in July
- Consumption remains elevated, still bolstered by excess savings
- Economic data continues to slow, the lagged impact of 2022s rate increases. We expect this trend to continue through the summer
- Credit continues to behave well, bolstered by low primary supply and strong fund flows

Macro

Kudos to the politicians in Washington on resolving the debt ceiling. What could have been a disaster was averted, and with some time to spare. The U.S. Treasury will now be able to issue T-Bills and replenish their “chequing account” at the Fed. This will suck deposits out of the banking system as buyers of treasury bills will do so using cash in their bank accounts. Along with ongoing quantitative tightening in the U.S., Europe and the maturity of a large slice of the Eurozone’s TLTROs (cheap loans to banks), the next few months will see the largest Central Bank liquidity draw-down so far in this tightening cycle.

The removal of Central Bank liquidity makes funding more expensive for banks. With borrowers less credit worthy, commercial banks in Canada, the U.S. and Europe are tightening lending standards at a rapid pace, restricting the availability of credit for most types of borrowers (discussed at length in [last month’s commentary](#)). In our view, this late cycle dynamic of tighter credit conditions is what is needed to finally see a broad and sustained decline in economic activity. Manufacturing activity has been in contraction for seven months now, but services had managed to hold steady (Figure 1), driven by elevated demand. Last month, the closely followed U.S. ISM Services Index plunged several points to 50.3. Details of the survey were weak, with employment and new orders contracting.



Source: Bloomberg. Data as of May 2023

Meanwhile, headline employment continues to perform extremely well, but the May releases have showed some signs of slowing. In the U.S., while the non-farm payroll numbers came in very strong, the household survey (where the unemployment rate comes from) showed net job losses for the month, resulting in an increase in the unemployment rate to 3.7% from 3.4%. Similarly in Canada, the employment numbers were weak, with a net loss (all full-time) of 17 thousand jobs, driving the unemployment rate up 0.2% to 5.2%. Wage growth also decelerated and so did hours worked.

Monetary policy is working but with its usual lag. Investment is declining, credit is harder to get for the purchase of big-ticket items and firms are starting to see their margins compress, leading to layoffs. Anecdotally, the Big 6 Banks' Q2 earnings were a microcosm of what is happening in the economy. Their revenues are slowing because the cost of their liabilities is growing faster than what they earn on their assets. Provisions for credit losses are creeping up, expenses are also growing too fast. As they always do, we expect the banks to restructure, laying off excess workers and right sizing their units. Typically, weakness in the economy always shows up last in employment.

A lot of heavy lifting has already been done by central banks, and both the Fed and BoC are very close to being done. One more hike here or there to fine tune the terminal rate and make sure people do not take a "pause" as a signal that cuts are coming (cuts will eventually come, but we need to see real pain first). If we see a further deterioration in the employment picture, it will likely be enough to signal a lasting pause for central bankers, as they consider the lagged impacts of this entire rate hike cycle, the fastest and largest since the early 1980s.

Credit

The rally in credit spreads that began in late March and throughout all of April took a breather in May. The Bloomberg Canada Corporate Bond Index was one basis point wider on the month, although June has experienced tightening thus far. While March and April had very clear winners and losers in terms of sectors, May was much more balanced. All non-financial sectors tightened, but banks widened a bit, and given they make up a big portion of the index, spreads ended wider at the benchmark level.

The Canadian primary market heated up in May after a very slow April. Many different types of issuers printed deals ranging from financials to real estate and industrials, to name a few. Order books were generally healthy which resulted in solid performance once the bonds started trading in the secondary market. As we always do, we took advantage of the new issue market to proactively add to credits we like, especially when the deal comes with a reasonable new issue concession. Some examples of new issues we participated in were CN Rail, AltaGas and TD Bank. We expect the new issue market to slow as Q3 is generally light given the quieter summer months. At the time of writing, total YTD Canadian issuance stands at \$42.6bln, down 37% from the same time last year. Interestingly, bank issuance is 62% below 2022 YTD levels while corporate issuance is up 48%.

Ninepoint Diversified Bond Fund (DBF)

Given our macroeconomic outlook, the portfolio remains defensively positioned, while still offering a very attractive yield-to-maturity of 7.9%. As we have been discussing for months, duration continues to move higher and now sits at 4.5 years (vs 3.9 years last month). Do not expect us to move much beyond 5 years of duration. Additionally, spread duration continues to move down and ended the month at 2.1 years, which showcases the portfolio's resiliency from potentially wider credit spreads. In terms of liquidity, 30% of the portfolio matures within the next 12 months. We sold some high yield securities this month and expect that weight to gradually drift lower as our very short dated HY bonds mature. We increased our hedging short position in HYG, which now stands at -4% (target -5%).

Ninepoint Diversified Bond Fund Changes to Portfolio

	Limits	Dec 2017	Jun 2018	Dec 2018	Jun 2019	Dec 2019	June 2020	Dec 2020	June 2021	Dec 2021	June 2022	Dec 2022	March 2023	April 2023	May 2023	Outlook
Government Bonds	100%	-2%	-4%	1%	22%	13%	9%	8%	2%	-7.0%	2%	1%	3%	3%	4%	↑
Investment Grade	80%	37%	66%	76%	58%	58%	80%	74%	76%	70%	65%	75%	67%	68%	74%	↔
High Yield	40%	32%	17%	13%	9%	6%	11%	11%	14%	18%	29%	23%	24%	24%	24%	↓
Emerging Market Governments	10%	0%	0%	0%	0%	0%	0%	1%	1%	1%	0%	0%	0%	0%	0%	↔
Preferred Equities	10%	6%	6%	2.5%	0%	0%	0%	4%	5%	1%	2%	1%	0%	0%	0%	↔
Common Equities & ETFs	10%	0%	0%	1.5%	2.4%	0%	-6%	-2%	0%	0%	0%	0%	0%	-2%	-4%	↓
Derivatives	+/- 2.5%	-0.1%	-0.1%	0.0%	-0.2%	0.2%	0%	0%	0%	0%	3%	0%	0%	0%	0%	N/A
Cash and Equivalents		28%	15%	6%	9%	22%	6%	5%	1%	14%	0%	0%	6%	7%	1%	↑
Total		100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	
Duration	1 to 8 years	2.4	2.3	2.4	5.4	4.3	5.9	5.3	4.5	2.9	2.4	3.4	3.8	3.8	4.5	↑
Spread Duration		-	-	2.9	2.3	3.0	4.1	3.9	5.4	5.1	4.3	3.2	2.5	2.3	2.1	↔
Unhedged FX Exposure	20%	0%	0%	0%	6%	3%	5%	6%	4%	0%	0%	0%	1%	1%	1%	↔

Source: Ninepoint Partners

Ninepoint Alternative Credit Opportunities Fund (NACO)

Given our macroeconomic outlook, the portfolio remains defensively positioned but still offers a very attractive yield-to-maturity of 10.0%. As we have been alluding to for months now, duration moved up 0.6 years and now sits at 3.2 years while spread duration moved down 0.8 years and sits at 4.8 years. Expect duration to keep drifting higher as we add to our TLT options position. We brought down leverage during the month and as of month-end was 0.8x (vs 0.9x last month). Given the yield curve is the most inverted it has been all year, we are finding many attractive opportunities in the front end, both outright and in switch. For example, we sold a Nissan bond maturing in 2025 to buy a Nissan bond maturing in 2024 and picked up almost 50bps in all-in yield. We also trimmed select high yield securities while moving into high quality short dated corporate bonds.

In terms of liquidity, 30% of the portfolio matures within the next 12 months. Our HYG hedge now stands at -7%, with a target of -10%.

Ninepoint Alternative Credit Opportunities Fund Changes to Portfolio

	Limits	June 2021	Sept. 2021	Dec. 2021	March 2022	June 2022	Sept. 2022	Dec. 2022	March 2023	April 2023	May 2023	Outlook
Government Bonds	100%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	↑
Investment Grade	100%	66%	44%	44%	51%	51%	53%	52%	52%	56%	63%	↑
High Yield	40%	32%	22%	29%	27%	28%	24%	19%	19%	17%	14%	↔
ABS	20%	4%	6%	7%	11%	15%	18%	23%	23%	23%	23%	↓
Loans	10%	0%	3%	5%	5%	4%	3%	4%	3%	3%	3%	↓
Preferred Equities	10%	8%	3%	2%	1%	1%	1%	0%	0%	0%	0%	↔
Common Equities & ETFs	10%	0%	0%	0%	0%	0%	0%	0%	0%	-3%	-7%	↓
Derivatives	+/- 2.5%	0%	0%	0%	1%	1%	0%	0%	0%	0%	0%	N/A
Cash and Equivalents		-18%	19%	13%	5%	0%	3%	3%	7%	7%	2%	↑
Total		100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	
Duration	0 to 5 years	2.7	2.9	2.7	2.1	2.0	2.9*	2.4*	2.6*	2.6*	3.2*	↑
Leverage	0-3x	1.37x	1.09x	1.00x	1.10x	1.10x	1.30x	1.10x	0.90x	0.90x	0.80x	↓
Unhedged FX Exposure	<20%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	↔

Source: Ninepoint Partners

Ninepoint Credit Income Opportunities Fund (Credit Ops)

Given our macroeconomic outlook, the portfolio remains defensively positioned but still offers a very attractive yield-to-maturity of 10.8%. As we have been alluding to for months now, duration moved up 0.2 years and now sits at 2.9 years while spread duration moved down 0.7 years and sits at 4.7 years. Expect duration to keep drifting higher as we add to our TLT options position. We trimmed some securities that have had a good run which resulted in leverage ticking down to 0.8x (vs 0.9x last month). At the margin we also sold some high yield securities to further de-risk the portfolio. In terms of liquidity, 30% of the portfolio matures within the next 12 months. Our HYG hedge now stands at -8%, with a target of -10%.

Ninepoint Credit Income Opportunities Fund

Changes to Portfolio

	Limits	Dec 2018	June 2019	Dec 2019	June 2020	Dec 2020	June 2021	Dec 2021	June 2022	Dec 2022	March 2023	April 2023	May 2023	Outlook
Government Bonds	100%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	↑
Investment Grade	100%	52%	48%	59%	57%	49%	34%	31%	32%	37%	36%	47%	49%	↑
High Yield	40%	24%	16%	6%	28%	26%	32%	33%	38%	31%	29%	27%	27%	↓
ABS	20%	3%	5%	5%	8%	15%	10%	14%	8%	10%	12%	11%	9%	↔
Loans	10%	3%	3%	2%	7%	6%	4%	8%	7%	9%	6%	9%	7%	↓
Preferred Equities	10%	4%	0%	0%	0%	5%	8%	2%	3%	2%	0%	0%	0%	↔
Common Equities & ETFs	10%	0%	0%	-7%	-15%	-8%	0%	1%	2%	1%	1%	-2%	-7%	↓
Derivatives	+/- 2.5%	0%	-0.4%	0%	1%	1%	1%	1%	3%	1%	0%	0%	0%	N/A
Cash and Equivalents		14%	28%	32%	8%	3%	1.2%	5%	1%	5%	12%	6%	9%	↔
Total		100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	
Duration	0 to 5 years	2.1	2.2	1.7	3.3	3.8	2.5	2.5	1.4	2.4*	2.6*	2.7*	2.9*	↑
Leverage	0-4x	0.7x	1.0x	1.04x	1.67x	1.04x	1.36x	1.30x	1.40x	1.20x	0.90x	0.90x	0.80x	↓
Unhedged FX Exposure	<25%	0%	2.7%	-3.2%	0.3%	2%	0%	0.5%	-0.2%	0.3%	0.2%	0.1%	-0.2%	↔

Source: Ninepoint Partners

Conclusion

Given the magnitude of the rate increases over the past 18 months, our base case remains a recession sometime later in 2023 or earlier 2024. While they will never admit it, Messrs. Macklem and Powell know full well that a recession is the only way flush out excess demand and bring the economy and inflation back into balance. The Fed or BoC will never cut rates until the labour market has rebalanced, and for that to happen, we need to see a higher unemployment rate.

Therefore, we continue to add to our defensive positioning across all the funds. Investing in short term corporate bonds (and being paid handsomely to do so right now), layered with some credit hedges, and an allocation to long term government bonds. This is the same playbook we employed in 2019 and early 2020, and it served our clients well, allowing us to act from a position of strength once the recession finally started.

Enjoy the summer, it's always too short!

Until next month,

Mark, Etienne & Nick

Ninepoint Partners

NINEPOINT DIVERSIFIED BOND FUND - COMPOUNDED RETURNS¹ AS OF MAY 31, 2023
(SERIES F NPP118) | INCEPTION DATE: AUGUST 5, 2010

	1M	YTD	3M	6M	1YR	3YR	5YR	10YR	INCEPTION
Fund	-0.6%	1.7%	-0.1%	1.5%	-1.1%	-1.6%	0.4%	2.1%	3.0%

NINEPOINT CREDIT INCOME OPPORTUNITIES FUND - COMPOUNDED RETURNS¹ AS OF MAY 31, 2023 (SERIES F NPP507) | INCEPTION DATE: JULY 1, 2015

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	0.0%	2.8%	-0.9%	2.6%	1.5%	5.6%	3.8%	4.1%

NINEPOINT ALTERNATIVE CREDIT OPPORTUNITIES FUND - COMPOUNDED RETURNS¹ AS OF MAY 31, 2023 (SERIES F NPP931) | INCEPTION DATE: APRIL 30, 2021

	1M	YTD	3M	6M	1YR	INCEPTION
Fund	0.0%	2.6%	-0.6%	2.9%	0.4%	-2.8%

¹ All Ninepoint Diversified Bond Fund 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 May 31, 2023. ¹ All Ninepoint Credit Income Opportunities Fund returns and fund details are a) based on Class F units; b) net of fees; c) annualized if period is greater than one year; d) as at May 31, 2023. ¹ All Ninepoint Alternative Credit Opportunities Fund returns and fund details are a) based on Class F units; b) net of fees; c) annualized if period is greater than one year; d) as at May 31, 2023.

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