Ninepoint Diversified Bond Fund

January 2019 Commentary

Following a rather challenging end of 2018, equity and credit markets rebounded strongly to start 2019. As discussed last month, fears of a looming global recession in 2019 were overblown and recent policy actions by central banks (particularly the Fed) and fiscal authorities (additional Chinese stimulus, end of US government shutdown) have finally calmed markets. Additionally, 2018Q4 earnings and the associated 2019 guidance by large corporations were generally good, lending additional support to the idea that global growth is not about to take another leg down.

Investment Team

Mark Wisniewski,
Partner, Senior Portfolio Manager

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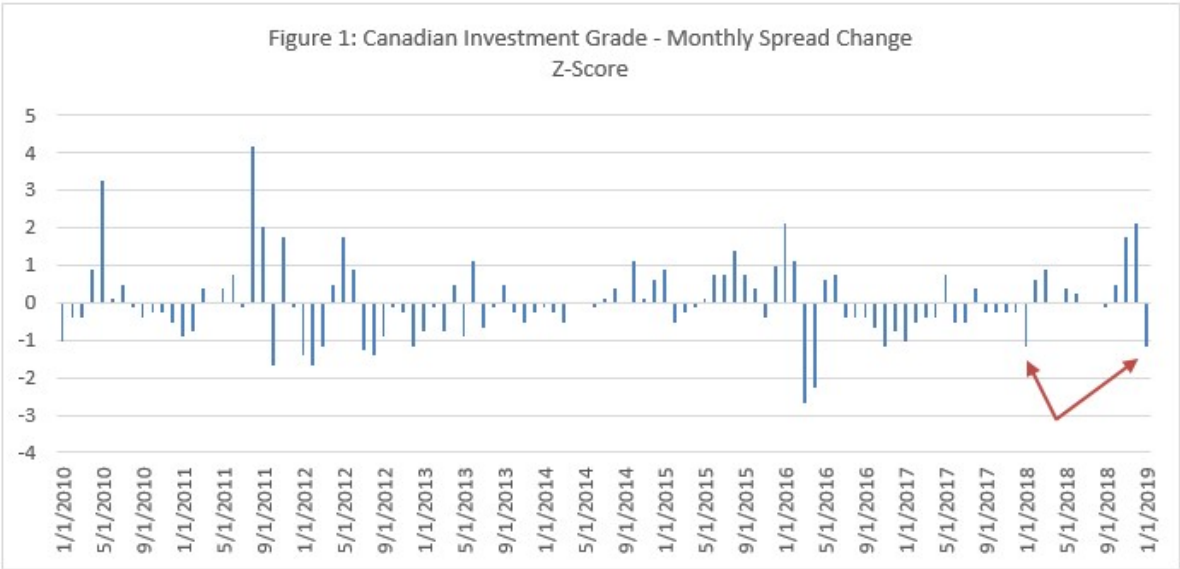
Vice President, Portfolio Manager

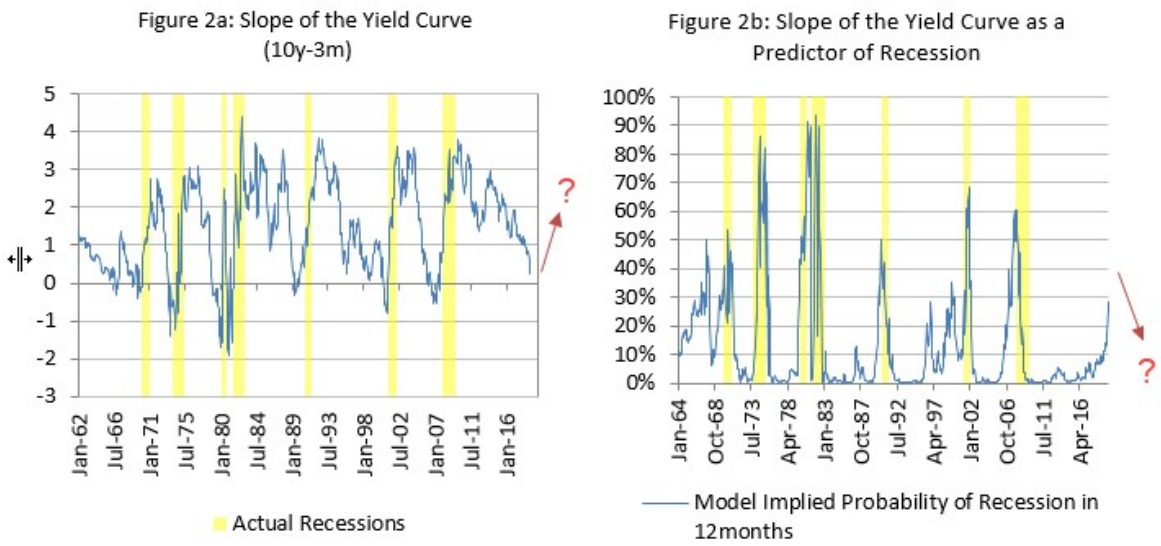
Front and center this month was the January FOMC meeting, which strongly cemented the view that the Fed is on pause for the foreseeable future, with large upside surprises in inflation the only thing that could drive additional rate increases. In a dovish turn of events, Fed Chair Jerome Powell also surprised markets by announcing that the Fed balance sheet shrinkage (or the reversal of QE) would stop sooner than expected and that its ultimate size would be “much bigger” than they had originally anticipated. While details of this transition should emerge in the next few months, this development is definitely a positive for sentiment and risk assets.

All these factors combined drove the first month of significant credit spread tightening in 12 months (Figure 1), which helped drive good performance in the fund (78bps). New bond issue activity was sparse, and very well subscribed for, indicating to us that the market is very starved for credit right now. Some of the higher beta credit that we bought in the middle of last year’s turmoil has outperformed significantly (e.g. GE), adding credence to the notion that being nimble and active in those markets can make a big difference.



Source: Bloomberg, Ninepoint Partners

While government bond yields continued to decline in January (between 5 and 10bps on the Canadian and US 10-Year Notes), we continue to be of the view that the decline is overdone. Looking across asset classes, the outperformance of cyclical equities (industrials, energy, financials), commodities and emerging markets all suggest to us that the recent behaviour of yields is inconsistent with this "reflation" narrative. In the absence of global recession, an increase in energy prices and with that higher inflation expectations, we believe long term interest rates will drift higher. As such, we expect the yield curve will steepen from its currently depressed level (Figure 2a). Consequently, we see less likelihood of a recession in 2019 (Figure 2b).



Source: Bloomberg, Ninepoint Partners

For the portfolio, that means (paradoxically) being "defensively opportunistic":

• Defensive on interest rate risk, keeping duration short, so that if we are right and the curve steepens from here, we do not get hurt holding longer dated securities.

• Opportunistic on credit, taking advantage of the dislocations and illiquidity in the secondary market, buying investment grade bonds at high yield like prices, while keeping them very short in duration.

Good risk management, for us, is about managing the risks for and against one's base case. If the curve keeps flattening from here, fears of a global slowdown return, interest rates decline, and credit widens. But, our short-dated investment grade securities will still mature in a few years, having captured a higher yield for our investors with less volatility. If we are right and the curve steepens, our credit positions continue to perform well, and we won't get hurt by rising long term yields.

Until next month,

The Bond Team: Mark, Etienne and Chris

Diversified Bond Fund Portfolio Characteristics:

	Limits	Dec 2017	Mar 2018	Jun 2018	Sept 2018	Dec 2018	Jan 2019	Outlook
Government Bonds	**100%**	-2%	0%	-4%	2%	1%	**-3%**	↔
Investment Grade	**80%**	37%	56%	66%	73%	76%	**79%**	↔
High Yield	**40%**	32%	24%	17%	16%	13%	**11%**	↔
Emerging Market Governments	**10%**	0%	0%	0%	0%	0%	**0%**	↔
Preferred Equities	**10%**	6%	6%	6%	6%	2.5%	**2.5%**	↓
Common Equities & ETFs	**10%**	0%	0%	0%	1.5%	1.5%	**1.5%**	↔
Derivatives	**+/- 2.5%**	-0.1%	+0.5%	-0.1%	-0.05%	0.0%	**0.0%**	**N/A**
Cash and Equivalents		28%	14%	15%	1.5%	6%	**9%**	↔
Total		100%	100%	100%	100%	100%	**100%**	
Duration	**1 to 8 years**	2.4	2.1	2.3	1.0	2.4	**2.2**	↔
Geographic (% North America)	**>75%**	89%	90%	89%	93%	91%	**91%**	↔

Current Net Foreign Currency Exposure: 0%

Source: Ninepoint Partners

NINEPOINT DIVERSIFIED BOND FUND - COMPOUNDED RETURNS[1] AS OF JUNE 30, 2022 (SERIES F NPP118) | INCEPTION DATE: AUGUST 5, 2010

	1M	YTD	3M	6M	1YR	3YR	5YR	10YR	INCEPTION
Fund	-1.6%	-9.0%	-4.6%	-9.0%	-8.5%	-0.7%	0.7%	2.9%	3.2%