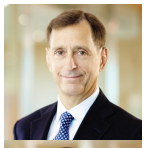
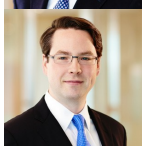
Ninepoint Fixed Income Strategy

July 2021 Commentary

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



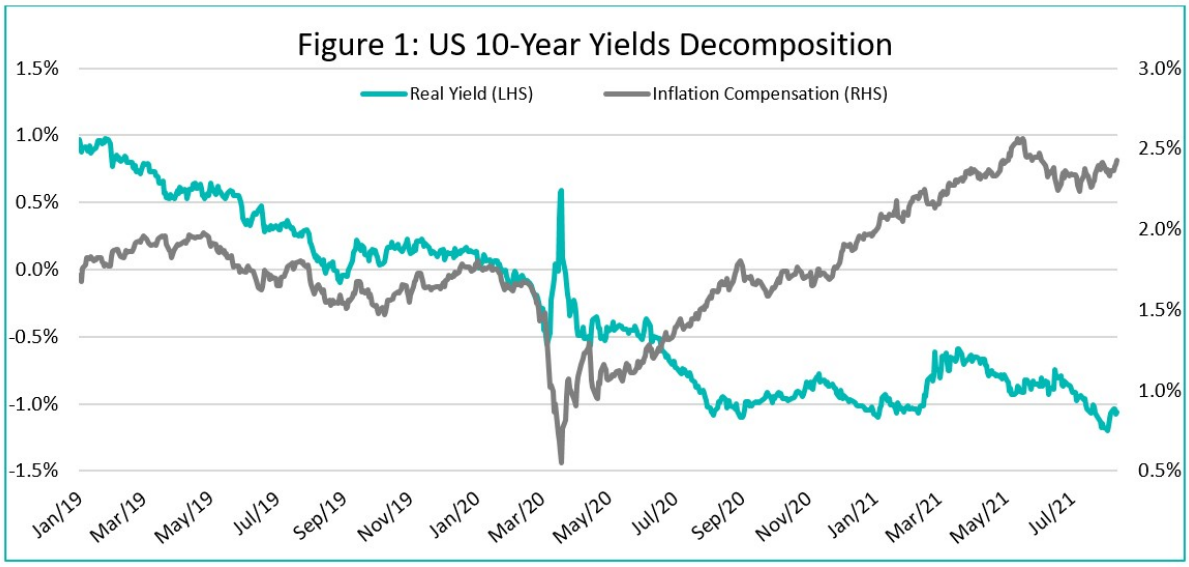
Mark Wisniewski,
Partner, Senior Portfolio Manager



Etienne Bordeleau-Labrecque, MBA, CFA
Vice President, Portfolio Manager

Macro

Consistent with the price action in June,
long term yields continued to decline in July, reaching as little as 1.12% on the US 10-year benchmark, a level not seen since the beginning of the year. Most of this recent decline can be attributed to a decline in real yields (Figure 1 below), which reached all-time lows of -1.2%. There are many reasons being attributed to this sharp decline in real yields; peak US growth (PMIs have recently decelerated), slowing growth in China, the Delta variant, more short covering (see last months discussion). Some, such as Fed Chair Powell and Vice-Chair Clarida, remain puzzled as to why yields have declined so much.



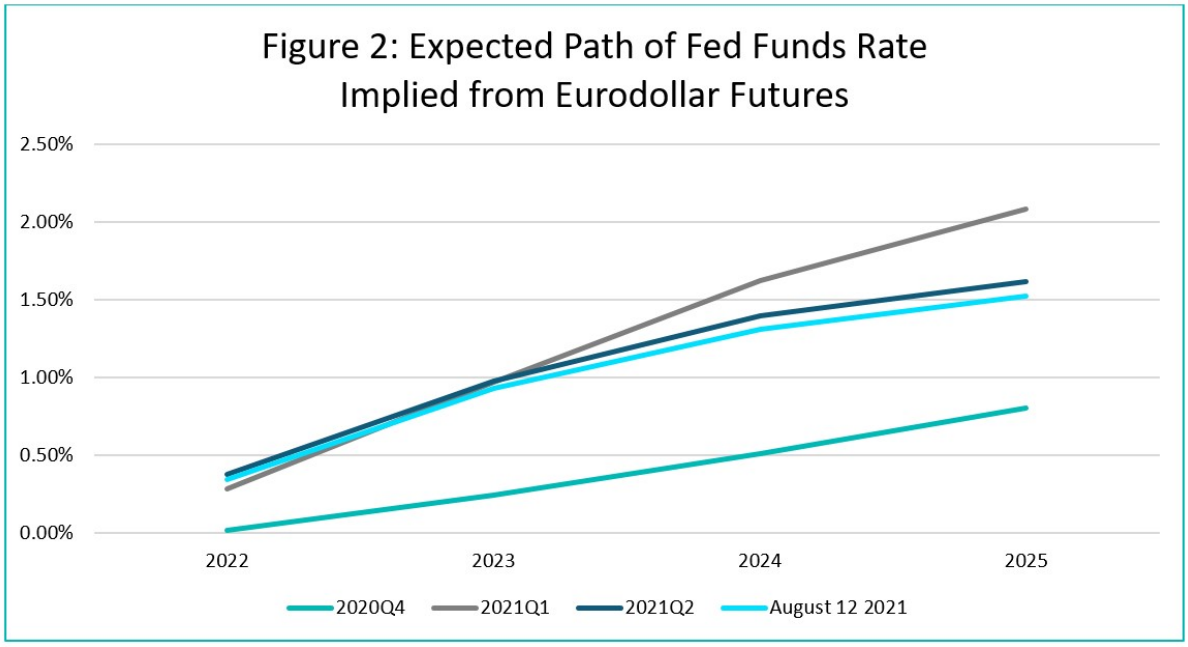
Source: Ninepoint Partners

From our perspective, and as discussed last month, real yields have declined too much due to massive short covering in a low liquidity environment. As regular

readers know, we also thought that yields had risen too far too fast at the beginning of the year. Oftentimes, the pendulum swings too far in one direction or the other.

We have always been sympathetic to the view that inflation will prove transitory, but several of the FOMC members now seem worried about upside risks to inflation. Thus, with a decidedly more hawkish Fed, we expect that QE tapering will be announced either at the Jackson Hole Symposium in late August or at the September FOMC meeting, with a reduction in net purchases effective either in December or January 2022. Moreover, due to the recent high inflation readings, they now consider their "average inflation target" mandate fulfilled, opening the door to rate hikes as soon as the tapering process is completed. It is therefore entirely conceivable that the first rate hikes could come as early as H2/2022.

The market is now expecting at least 1 rate hike in 2022, followed by 3 hikes in 2023 (Figure 2 below). Interestingly, since the June FOMC meeting, the expected pace of rate hikes, further out (2024 and 2025) has declined sharply, suggesting that, if the Fed is indeed more hawkish now and accelerates the pace of rate hikes, they might have to stop fairly quickly, achieving a "terminal rate" of only 1.5% for this cycle. For reference, the median FOMC participant thinks that the long-term Funds rate is about 2.5%. In other words, a faster than expected hike cycle would slow inflation, but at the cost of reducing economic growth to a point where the Fed would, at the very least, take a pause.



Source: Bloomberg

Given the information currently at our disposal, this is our base case scenario. This is a very unusual cycle, progressing very quickly due to the nature of the shock

(Covid-19 is more like a natural disaster) and the strength of the response (fiscal and monetary). We therefore need to adapt our stance more rapidly than last cycle. Assuming the above path of the Funds rate is correct (terminal rate ~1.5%), then it is hard to envision the US 10-year yield going well above 2%. This means that the slope of the yield curve should start to flatten sometime in late 2022, at which point our asset allocation framework would dictate that we start reducing duration in the portfolios.

The QE taper has been very well telegraphed this time around, and we don't expect the market to react as negatively as in 2013. Obviously, risk assets are expensive (equities haven't been this expensive since the dot-com bubble and credit spreads are close to lows), but as long as yields remain so low, there will be a bid for credit. We expect selloffs to be modest and to be met with dip buying.

Diversified Bond Fund (DBF)

July was a great month for the DBF, returning 82bps. We continued to benefit from declining interest rates and stable credit spreads. We have modestly increased our allocation to High Yield, with purchases of hybrid bonds and Bank LRCN. Preferred shares continue to be called, and we are having a hard time finding attractive replacements with decent yield-to-call, so we expect to see our allocation to this asset class to decline further in the coming months, probably replaced by HY. Otherwise, we continue to believe that the portfolio is appropriately positioned for the current environment. After month end, we have layered a few hedges (LQD options) for the fall, just in case the QE taper doesn't go as well as planned.

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	July 2021	Outlook
Government Bonds	**100%**	-2%	0%	-4%	2%	1%	7%	22%	28%	13%	9%	9%	14%	8%	-8%	2%	**2%**	↔
Investment Grade	**80%**	37%	56%	66%	73%	76%	72%	58%	61%	58%	78%	80%	71%	74%	84%	76%	**73%**	↓
High Yield	**40%**	32%	24%	17%	16%	13%	14%	9%	7%	6%	13%	11%	12%	11%	12%	14%	**16%**	↑
Emerging Market Governments	**10%**	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	1%	1%	1%	**0%**	↔
Preferred Equities	**10%**	6%	6%	6%	6%	2.5%	0.7%	0%	0%	0%	0%	0%	2%	4%	6%	5%	**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%	**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%	**0%**	**N/A**
Cash and Equivalents		28%	14%	15%	1.5%	6%	2%	9%	6%	22%	0%	6%	6%	5%	5%	1%	**1%**	↓
Total		100%	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	**4.4**	↔
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	**5.1**	↔
Unhedged FX Exposure	**20%**	0%	0%	0%	0%	0%	0%	6%	5%	3%	3%	5%	6%	6%	0.5%	4%	**4%**	↔

Source: Ninepoint Partners

Alternative Credit Opportunities Fund (NACO)

July was another good month for NACO. Due to a large inflow at month end, leverage has drifted lower to 1.1x, we expect it to increase back up to 1.3-1.4x over the next few months. Otherwise, the composition of the portfolio is quite static. We expect to close on a private label residential mortgage backed security transaction in August, which should be reflected in the Illiquid Securities bucket. After month end, we have layered a few credit hedges (HYG options) for the fall, just in case the QE taper doesn't go as well as planned.

Alternative Credit Opportunities Portfolio Characteristics

	Limits	May 2021	June 2021	July 2021	Outlook
Government Bonds	100%	0%	0%	0%	↔
Investment Grade	100%	58%	70%	54%	↔
High Yield	40%	36%	32%	29%	↑
Illiquid Securities	10%	0%	0%	0%	↑
Preferred Equities	10%	8%	8%	4%	↔
Common Equities & ETFs	10%	0%	0%	0%	↔
Derivatives	+/- 2.5%	0%	0%	0%	N/A
Cash and Equivalents		-2%	-18%	11%	↔
Total		100%	100%	100%	
Duration	0 to 5 years	3.0	2.7	3.1	↔
Leverage	0-3x	1.4x	1.37x	1.13x	↑
Unhedged FX Exposure	<20%	0%	0%	0%	↔

Source: Ninepoint Partners

Credit Income Opportunities Fund (Credit Opps)

The Credit Opps continues to perform well, returning 44bps in July. Similar to the other funds, preferred shares continue to get called and we expect to replace them with HY bonds. Portfolio characteristics have been mostly stable, and we expect it will remain this way for the foreseeable future. After month end, we have layered a few credit hedges (HYG options) for the fall, just in case the QE taper doesn't go as well as planned.

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	July 2021	Outlook
Government Bonds	100%	0%	0%	6%	0%	18%	0%	0%	0%	0%	0%	0%	0%	0%	↔
Investment Grade	100%	58%	55%	58%	53%	68%	64%	72%	65%	77%	64%	53%	44%	42%	↔
High Yield	40%	29%	24%	19%	16%	10%	6%	22%	28%	26%	26%	30%	32%	37%	↑
Private Loans	10%	3%	3%	2%	3%	2%	2%	4%	7%	6%	6%	3%	4%	4%	↑
Preferred Equities	10%	4%	4%	0.5%	0%	0%	0%	0%	0%	0%	5%	10%	8%	8%	↔
Common Equities & ETFs	10%	0%	0%	0%	0%	-7%	-7%	-10%	-15%	-13%	-8%	0.3%	0%	0%	↔
Derivatives	+/- 2.5%	0%	0%	0%	-0.4%	0%	0%	0%	1%	0%	1%	1%	1%	1%	N/A
Cash and Equivalents		6%	14%	15%	28%	8%	32%	12%	8%	2%	3%	-0.5%	1.2%	3%	↓
Total		100%	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	3.0	↔
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	1.40x	↔
Unhedged FX Exposure	<25%	0%	0%	0%	2.7%	5.1%	-3.2%	0%	0.3%	0%	2%	1%	0%	0%	↔

Source: Ninepoint Partners

Conclusion

Enjoy the summer, it always seems too short.

Mark & Etienne
Ninepoint Partners

NINEPOINT DIVERSIFIED BOND FUND - COMPOUNDED RETURNS[1] AS OF JULY 31, 2021 (SERIES F NPP118) | INCEPTION DATE: AUGUST 5, 2010

	1M	YTD	3M	6M	1YR	3YR	5YR	10YR	INCEPTION
Fund	0.8%	0.5%	1.6%	0.7%	1.4%	3.7%	3.9%	4.0%	4.4%

NINEPOINT DIVERSIFIED BOND CLASS - COMPOUNDED RETURNS[1] AS OF JULY 31, 2021 (SERIES F NPP221) | INCEPTION DATE: NOVEMBER 2, 2011

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	0.8%	0.5%	1.6%	0.7%	1.3%	3.5%	3.7%	4.5%

NINEPOINT CREDIT INCOME OPPORTUNITIES FUND - COMPOUNDED RETURNS[1] AS OF JULY 31, 2021 (SERIES F NPP507) | INCEPTION DATE: JULY 1, 2015

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	0.4%	4.2%	1.8%	3.5%	12.5%	7.3%	6.6%	5.9%

[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 July 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 July 31, 2021.

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