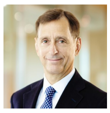
Ninepoint Fixed Income Strategy

June 2023 Commentary

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



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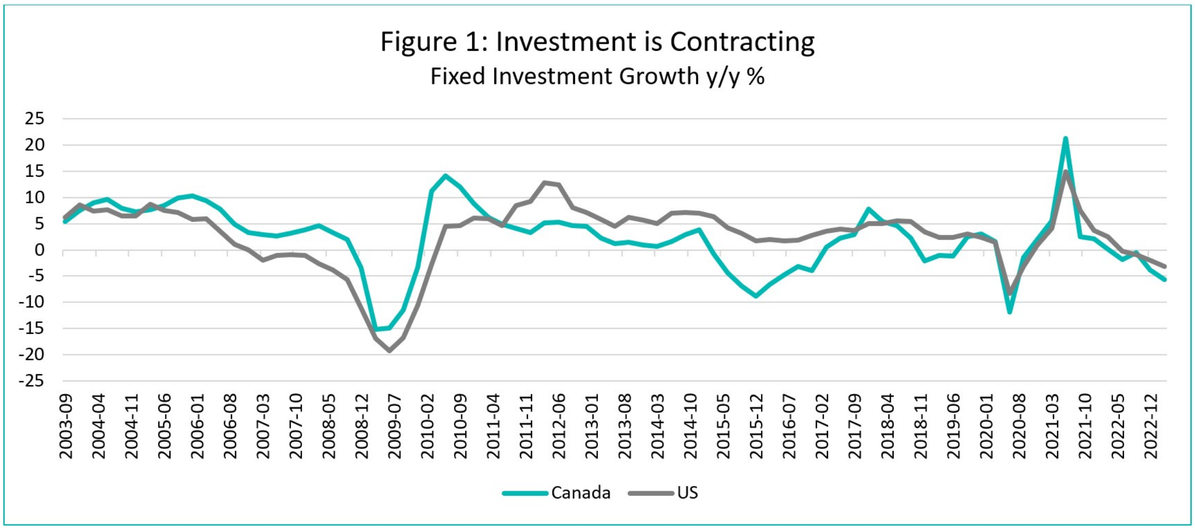
Summary

- The Fed signals two more hikes this year, the market is pricing-in one
- The BoC hiked again in July, and is probably done
- Overall, the labour markets in North America are showing early signs of softening. The unemployment rate is off cycle lows and wages are decelerating
- Manufacturing has been contracting for numerous (8) months now, while services remain more resilient
- In credit, cracks are starting to appear in lower quality securities; we are cautious on high yield and leveraged loans

Macro

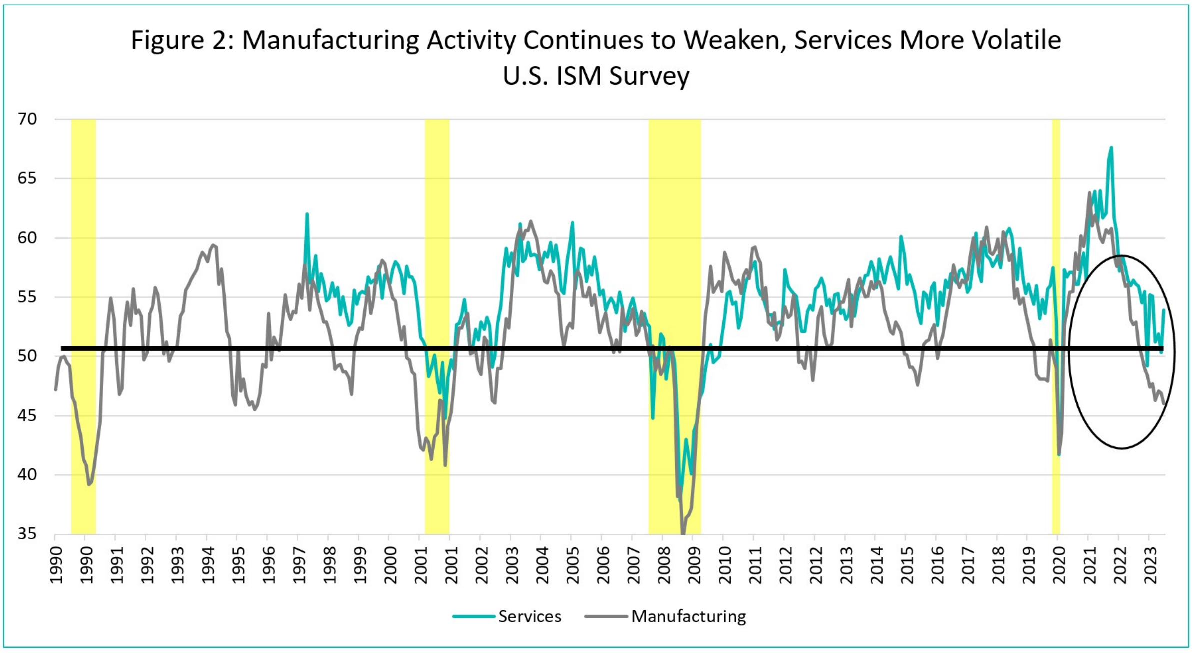
The June FOMC meeting was, as usual, the highlight this past month. As widely expected, the Fed did not raise the Fed Funds Rate at the June meeting but delivered as hawkish a “pause” or “skip” as they could. The famous dot-plot showed that FOMC participants now expect 2 more rate increases this year, taking the Funds Rate to 5.6% by year end. This took market participants by surprise. Most, including us, expected one more hike in July to conclude the hiking cycle. Why would the FOMC signal that they are done with the hiking cycle (i.e., signal a pause), when that could lead to a loosening of financial conditions (i.e. stocks higher, bond yields lower)? Maybe to leave the market guessing for as long as possible. Clever move by the Fed. However, it seems that Powell failed to completely convince market participants that this surprise additional hike to 5.6% was anything other than jawboning. Fed Funds Futures at the time of writing were only showing one additional rate hike fully priced-in for 2023.

Whether it is one or two more hikes this year, doesn’t really matter. Overall, most of the heavy lifting has already been done by the Fed and BoC, and that is why we are confident that their respective hike cycles are nearing an end. Monetary policy operates with a significant lag, and it is slowly working its way through to the real economy, which was overheating. Yes, consumption in the first quarter has surprised to the upside, leading central bankers to revise their growth estimates for this year. But growth has decelerated meaningfully from the post-pandemic highs and the latest monthly indicators (Personal Consumption) show a measured slowdown in spending by households. Investment (machines, structures, houses, etc.), has been contracting for four quarters now (Figure 1), something we typically only see in periods of overall economic contraction.



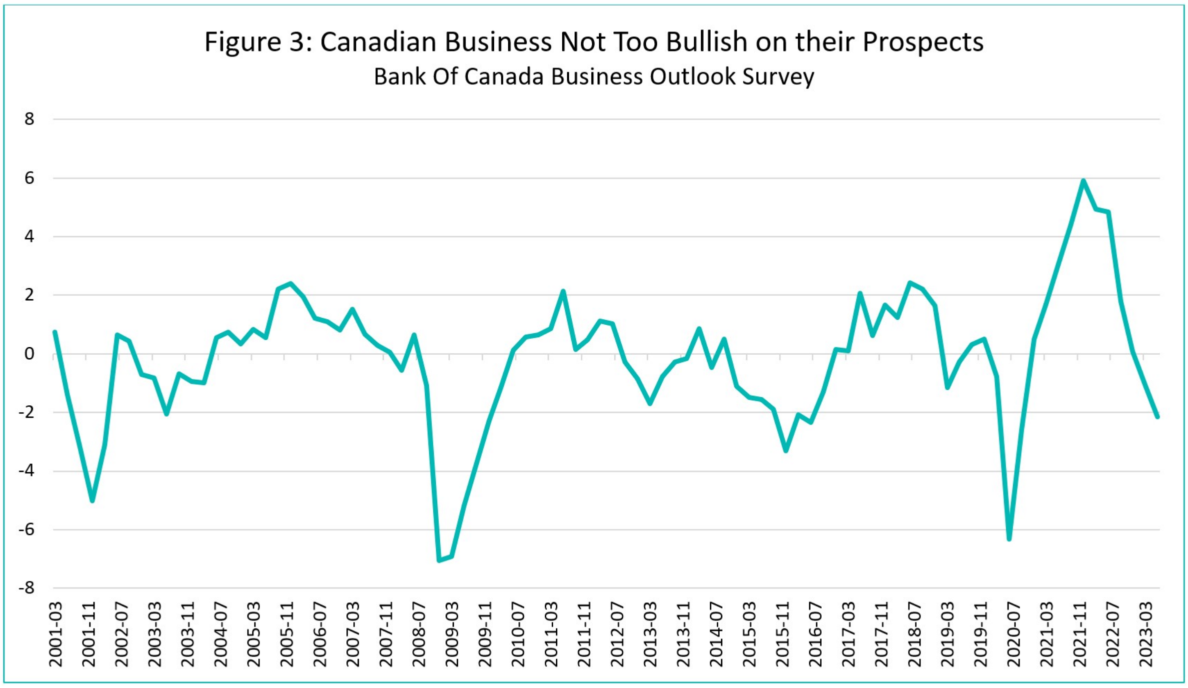
Source: Bloomberg. Data as of 2023Q1

By sector, manufacturing is already facing challenging conditions, contracting for the 8th straight month, according to the U.S. Institute for Supply Management (Figure 2). Thus far, demand for services remains strong enough to narrowly avoid a contraction.



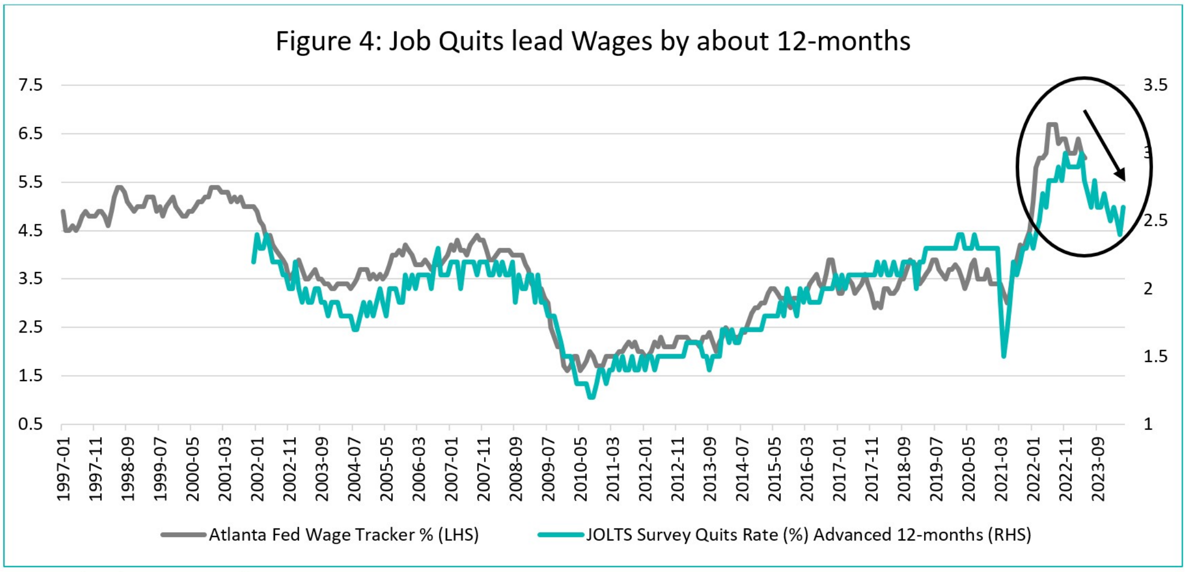
Source: Bloomberg. Data as of June 2023

In Canada, the BoC's recently released the Business Outlook Survey (2023Q2) which is also pointing to a contraction, posting a level last seen during the 2015-2016 oil-fuelled recession (Figure 3).



Source: Bank of Canada. Data as of 2023Q2

And the last piece of the inflation puzzle, labour markets, are finally normalizing. The unemployment rates in both Canada and the U.S. are up from their cycle lows and, judging by the pace at which Americans are quitting their jobs (the quits rate), U.S. wage growth is about to slow meaningfully (Figure 4).



Source: Bloomberg. Data as of June 2023

So overall, the economy is broadly moving in the right direction, which should reassure policy makers. It simply takes time. With the Fed and BoC now fine tuning their respective benchmark rates to reflect the evolution of the economy and slowing inflation, this leaves market participants in a hyper data-dependent mode. Economic releases are often volatile, and rarely all go in a straight line. What matters most is the trend. With central bank policy at the cusp of a change of direction (i.e., permanent pause), every single release has an added measure of importance, leading to increased market volatility. As we like to say, we do not have a crystal ball, but strive to be directionally accurate in our views and positioning. At this point in the cycle most of the leading indicators that we follow, are heading in the direction of a slowdown in economic activity and a looming recession.

Credit

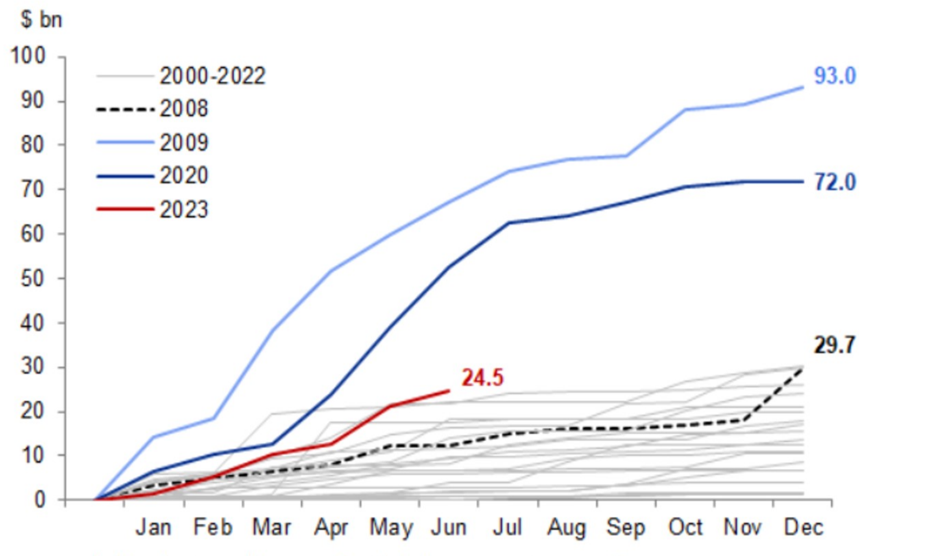
Investment Grade Credit aggregates performed well in June, driven by strong investor demand. Supply picked up this month and was generally well absorbed. Our overweight to large-cap banks (Canadian and U.S.) is finally paying off, with that sector outperforming. Given our view of a deteriorating economic outlook, we find overall credit spreads marginally unattractive at current levels. At this juncture, our credit exposure is concentrated in corporate bonds (average quality BBB) with term to maturity generally under 3 years. As such, we expect our funds to be less sensitive to a general widening in credit spreads.

We expect the new issue market to slow in the summer months, Q3 is generally very light. At the time of writing, total YTD Canadian issuance stands at $57.5bn, down 18% from the same time last year.

While broad credit markets (and equities) are still behaving quite well, some corners of the credit markets are starting to reflect the more challenging macroeconomic environment. Leveraged Loans, which are floating rate senior-secured loans to highly levered companies (often Private Equity sponsored), have been a fast-growing corner of the leveraged credit markets. Over the past several years, the U.S. Leveraged Loan market has caught up to the High Yield market and is now of about the same size. Because they pay a floating coupon, companies borrowing in that market have felt the full effect of the past 500bps of rate increases in the US. We borrowed Figure 5 below from Goldman Sachs Investment Research. It shows the cumulative value of loans having defaulted per year. At the current pace, 2023 will be the third worst year for leveraged loan defaults since 2000.

Figure 5: 2023 is on track to be the 3rd most severe default year in history for leveraged loans

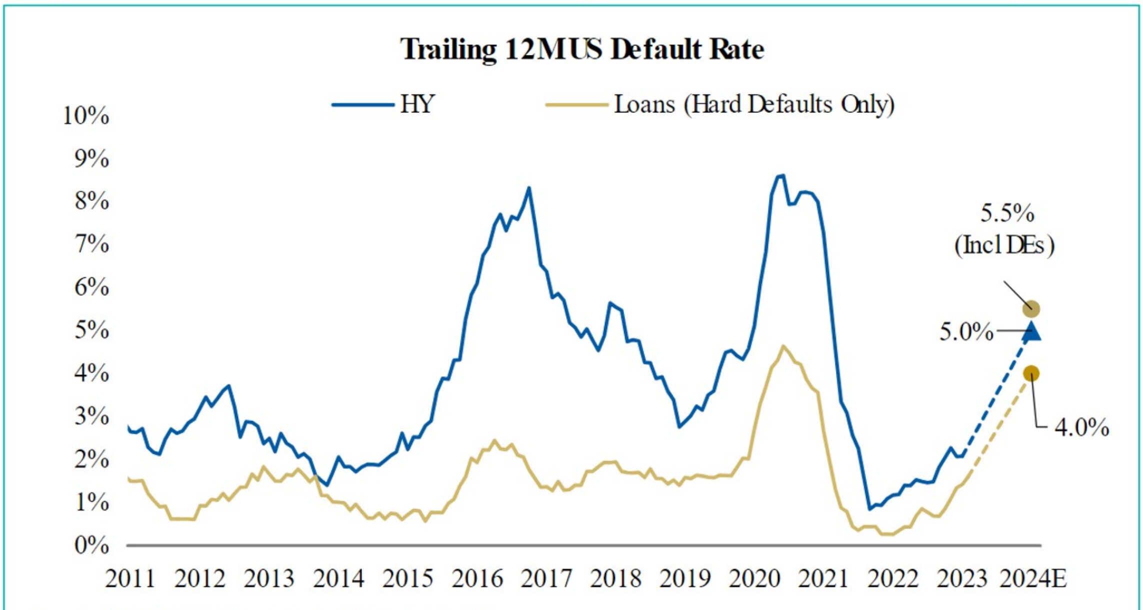
Cumulative notional value of defaulted loans by year



Source: Pitchbook LCD, Goldman Sachs Global Investment Research

Similarly, in Figure 6 below, Morgan Stanley Research shows that HY and Loan default rates have picked up substantially this year, and forecast defaults in both asset classes to continue to increase.

Figure 6: Default rates are increasing for the most levered companies

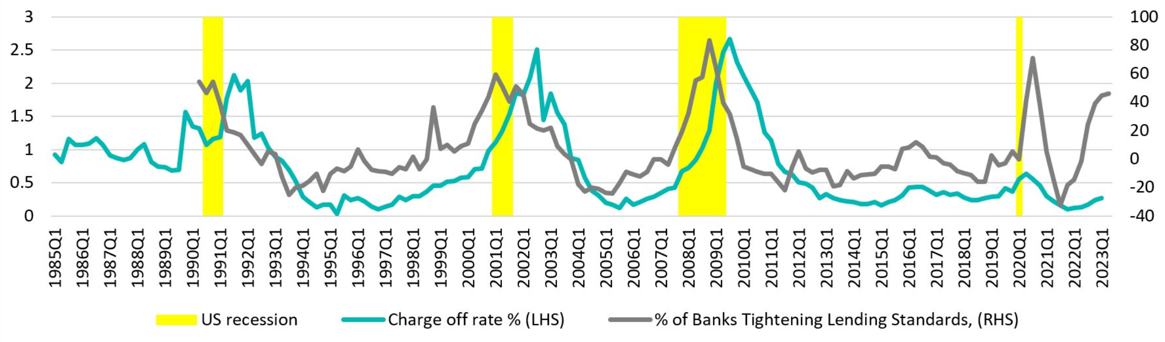


Source: Moody's, LCD, Morgan Stanley Research estimates

Along with tightening credit conditions at banks, which typically lead to loan losses (Figure 7 below) (see our April commentary for a longer discussion of these dynamics), the developments year-to-date in the higher risk corners of the credit markets point to the start of a new credit cycle. There is already financial stress for the most highly leveraged companies, and the longer interest rates hold, the tougher it will be for those that took on too much leverage when the times were good. And that is why, at this point in the cycle, we are avoiding lower quality corporates, and focus on high quality companies with solid balance sheets. The current risk-reward simply isn't there for us.

Figure 7: US Banking System: Lending Standards Lead Loan Losses by 3-5 Quarters

Commercial and Industrial Loans (i.e. Business loans)



Source: Federal Reserve Board. Data as of 2023Q2.

Ninepoint Diversified Bond Fund (DBF)

Given our macroeconomic outlook, the portfolio remains defensively positioned, while still offering a very attractive yield-to-maturity of 8.0%. Duration is holding steady at 4.3 years (vs 4.5 years last month and 3.9 the month prior). We don't expect to move much beyond 5 years of duration. Additionally, spread duration continued to move down and ended the month at 1.8 years. A function of the inverse yield curve and our desire to insulate the portfolio from potentially wider credit spreads. In terms of liquidity, 30% of the portfolio matures within the next 12 months. We expect our High Yield exposure to continue to gradually drift lower as our very short dated HY bonds mature. We increased our short position in HYG (used for credit hedging purposes), which now stands at our target of -5% (subtracting from duration and spread duration).

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	June 2023	Outlook
Government Bonds	100%	-2%	-4%	1%	22%	13%	9%	8%	2%	-7.0%	2%	1%	3%	3%	4%	**5%**	↔
Investment Grade	80%	37%	66%	76%	58%	58%	80%	74%	76%	70%	65%	75%	67%	68%	74%	**74%**	↔
High Yield	40%	32%	17%	13%	9%	6%	11%	11%	14%	18%	29%	23%	24%	24%	24%	**22%**	↓
Emerging Market Governments	10%	0%	0%	0%	0%	0%	0%	1%	1%	1%	0%	0%	0%	0%	0%	**0%**	↔
Preferred Equities	10%	6%	6%	2.5%	0%	0%	0%	4%	5%	1%	2%	1%	0%	0%	0%	**0%**	↔
Common Equities & ETFs	10%	0%	0%	1.5%	2.4%	0%	-6%	-2%	0%	0%	0%	0%	0%	-2%	-4%	**-4%**	↔
Derivatives	+/- 2.5%	-0.1%	-0.1%	0.0%	-0.2%	0.2%	0%	0%	0%	0%	3%	0%	0%	0%	0%	**0%**	N/A
Cash and Equivalents		28%	15%	6%	9%	22%	6%	5%	1%	14%	0%	0%	6%	7%	1%	**3%**	↑
Total		100%	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	**4.3**	↔
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	**1.8**	↔
Unhedged FX Exposure	20%	0%	0%	0%	6%	3%	5%	6%	4%	0%	0%	0%	1%	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 9.9%. Duration drifted a little lower from last month (2.8 vs 3.2 years), primarily due to several retractions in credit (as opposed to a reduction in government bonds positions). Expect duration to drift a little higher as we add to our TLT options position. We brought down leverage during the month and as of month-end was 0.7x (vs 0.8 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. 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 our target of 10% (subtracting from duration and spread duration).

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	June 2023	Outlook
Government Bonds	100%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	**0%**	↔
Investment Grade	100%	66%	44%	44%	51%	51%	53%	52%	52%	56%	63%	**61%**	↑
High Yield	40%	32%	22%	29%	27%	28%	24%	19%	19%	17%	14%	**14%**	↓
ABS	20%	4%	6%	7%	11%	15%	18%	23%	23%	23%	23%	**23%**	↓
Loans	10%	0%	3%	5%	5%	4%	3%	4%	3%	3%	3%	**3%**	↓
Preferred Equities	10%	8%	3%	2%	1%	1%	1%	0%	0%	0%	0%	**0%**	↔
Common Equities & ETFs	10%	0%	0%	0%	0%	0%	0%	0%	0%	-3%	-7%	**-10%**	↔
Derivatives	+/- 2.5%	0%	0%	0%	1%	1%	0%	0%	0%	0%	0%	**0%**	N/A
Cash and Equivalents		-18%	19%	13%	5%	0%	3%	3%	7%	7%	2%	**8%**	↑
Total		100%	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*	**2.8***	↑
Leverage	0-3x	1.37x	1.09x	1.00x	1.10x	1.10x	1.30x	1.10x	0.90x	0.90x	0.80x	**0.70x**	↔
Unhedged FX Exposure	<20%	0%	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%. Duration is down slightly from last month (2.6 vs 2.9 years), reflecting a move to shorted dated credit (as opposed to a reduction in long term government bonds exposure). Spread duration moved down again by 0.7 years and sits at 4.0 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 0.7x (vs 0.8x last month). In terms of liquidity, 30% of the portfolio matures within the next 12 months. Our HYG hedge is now at target (-10%), subtracting from both duration and spread duration.

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	June 2023	Outlook
Government Bonds	**100%**	0%	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%	**49%**	↑
High Yield	**40%**	24%	16%	6%	28%	26%	32%	33%	38%	31%	29%	27%	27%	**26%**	↓
ABS	**20%**	3%	5%	5%	8%	15%	10%	14%	8%	10%	12%	11%	9%	**9%**	↔
Loans	**10%**	3%	3%	2%	7%	6%	4%	8%	7%	9%	6%	9%	7%	**8%**	↓
Preferred Equities	**10%**	4%	0%	0%	0%	5%	8%	2%	3%	2%	0%	0%	0%	**0%**	↔
Common Equities & ETFs	**10%**	0%	0%	-7%	-15%	-8%	0%	1%	2%	1%	1%	-2%	-7%	**-8%**	↔
Derivatives	**+/- 2.5%**	0%	-0.4%	0%	1%	1%	1%	1%	3%	1%	0%	0%	0%	**0%**	N/A
Cash and Equivalents		14%	28%	32%	8%	3%	1.2%	5%	1%	5%	12%	6%	9%	**15%**	↔
Total		100%	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*	**2.6***	↑
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	**0.70x**	↔
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%	**0%**	↔

Source: Ninepoint Partners

Conclusion

The summer of 2023 will be crucial for our recession thesis. We expect economic data to broadly decelerate. Some indicators are already flashing red (manufacturing, investment, goods inflation), while others have been slower to react to monetary policy (consumption, services sector, services inflation). Over the coming months, we will continue to carefully evaluate the progression of economic releases and update our views accordingly.

The funds are well positioned to weather market volatility. We are generating lots of yield from lower-risk short-dated corporate bonds, have ample liquidity, some credit hedges and long-term government bond duration for ballast. 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.

Until next month,

Mark, Etienne & Nick
Ninepoint Partners

NINEPOINT DIVERSIFIED BOND FUND - COMPOUNDED RETURNS[1] AS OF MARCH 28, 2024 (SERIES F NPP118) | INCEPTION DATE: AUGUST 5, 2010

	1M	YTD	3M	6M	1YR	3YR	5YR	10YR	INCEPTION
Fund	0.9%	1.1%	1.1%	7.1%	5.2%	-0.7%	1.0%	2.3%	3.2%

NINEPOINT CREDIT INCOME OPPORTUNITIES FUND - COMPOUNDED RETURNS[1] AS OF MARCH 28, 2024 (SERIES F NPP507) | INCEPTION DATE: JULY 1, 2015

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Fund	0.9%	2.7%	2.7%	6.9%	8.6%	2.3%	5.1%	4.6%

NINEPOINT ALTERNATIVE CREDIT OPPORTUNITIES FUND - COMPOUNDED RETURNS[1] AS OF MARCH 28, 2024 (SERIES F NPP931) | INCEPTION DATE: APRIL 30, 2021

	1M	YTD	3M	6M	1YR	INCEPTION
Fund	0.9%	2.4%	2.4%	7.3%	8.7%	0.6%

[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 June 30, 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 June 30, 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 June 30, 2023.

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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