Ninepoint Fixed Income Strategy

March 2019 Commentary

Investment Team

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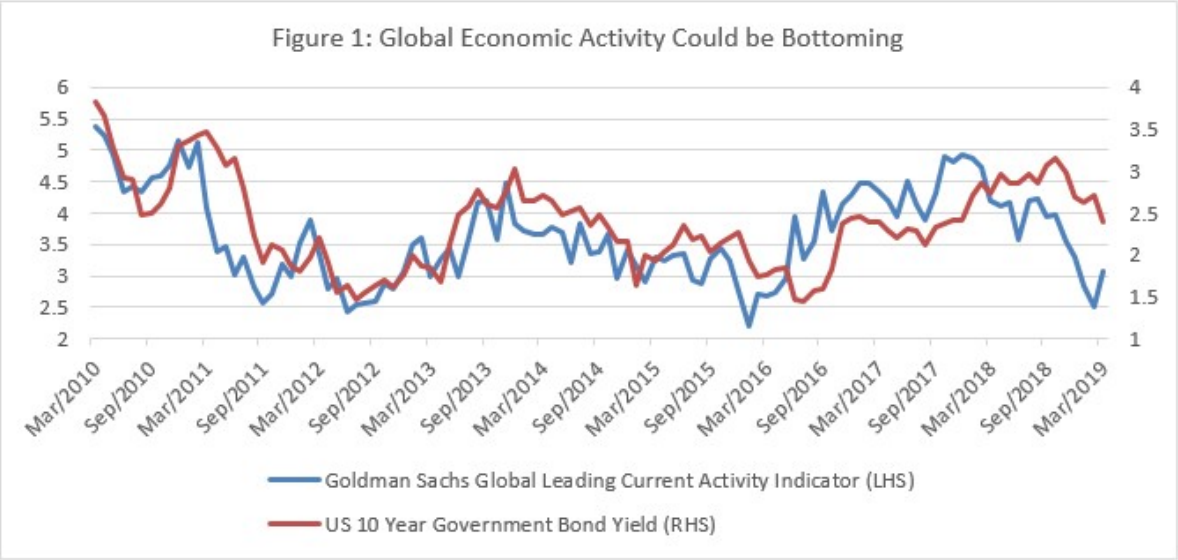
Macro

March was another solid month for investors; equities and credit went up, bond yields down, generating strong returns across asset classes. Since the beginning of the year, risk assets (equities, credit, etc.) and government bond yields have been telling very different stories. On one side, we have seen the best first quarter in equities and high yield bonds since the Great Recession of 2008/09. On the other hand, the yield curve has flattened to negative 9bps, a level corresponding to a 40% chance of recession 12 months forward (according to our models). In other words, equity and credit markets are discounting a rebound in economic activity, while the more pessimistic government bond market is worried about recession. They cannot both be right, so at some point, these two opposing views of the world would need to converge.

After a long wait, the end of March finally saw some green shoots in Chinese data, where PMIs rebounded strongly. Given that much of this global growth slowdown scare originated in China, this data release was of particular importance. Since then, economic data has been somewhat better, leading us to posit that global economic activity could have found a bottom. As seen in Figure 1 below, broad composite indicators of global economic activity (this specific one by Goldman Sachs) has finally ticked up in March. Subsequently, global long-term government yields have also risen, pushing the slope of the curve to "a more comfortable" 10bps. While we are by no means out of the woods yet (e.g. Brexit, Trumpism, etc.), for now things have stabilized.

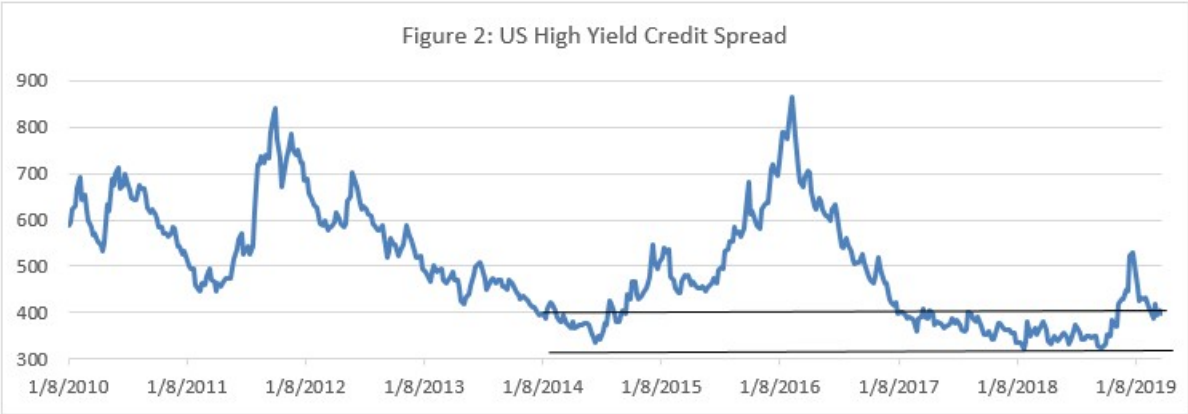


Source: Ninepoint Partners

As discussed in previous commentaries, the current environment is oddly reminiscent of 2016, where the global economy stabilized in the spring, rebounded in the summer and reaccelerated in the fall. If we were to follow a similar 2016 play book, we would expect that, at some point, long-term bond yields should increase , following economic growth to the upside (Figure 1). For now, the government bond market still believes in an imminent recession, pricing greater than 50% odds of interest rate cut in Canada and the U.S. by year end. Clearly, we are still a long way from thinking about interest rate hikes, but as growth continues to improve, we would not be surprised to see hikes come back in the market's narrative towards the end of the year, putting additional upward pressure on bond yields.

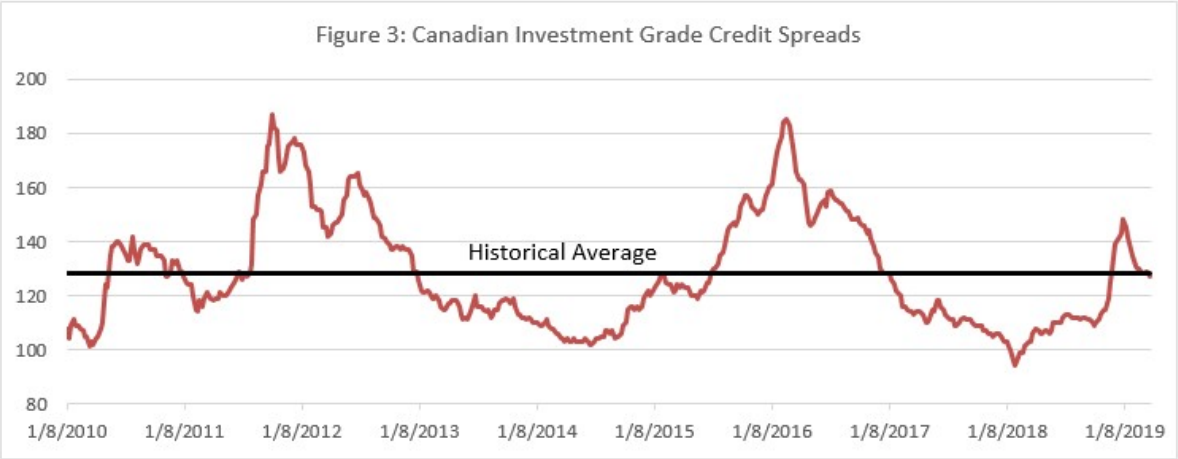
Credit

In credit (as in equities), spreads are already reflecting a decent economic outlook. High yield (HY) is up 8% year to date, its best Q1 performance since the lows of the financial crisis. Generically, HY spreads are now back to the high end of their cycle low trading range of 330bps to 380bps (Figure 2), leaving little room for error. As such, we currently see little value in HY and prefer to seek opportunities in lower rated investment grade.



Source: Ninepoint Partners

In investment grade credit (Figure 3), while spreads are off the highs reached in January, we still see room for some compression. As opposed to HY, which rallied like equities purely based on expectations, IG spreads tend to track realized economic data more closely. Therefore, if data has indeed stabilized and growth rebounds in the second half of 2019, we would expect IG spreads to compress further towards the 110-120bps range.



Source: Ninepoint Partners

Diversified Bond Fund

With the expectation that global growth will stabilize yet be slower in the first half of 2019, we feel it's prudent to start adding government bonds to our portfolio. As our view is that the European economy is the most vulnerable and will likely require additional monetary easing, we have added a 5% weight in core European sovereign bonds (primarily France, Germany). To most people's surprise, French 10-year bonds actually yield 2.7% (35bps + 2.35% currency hedging benefit). We have also purchased long term (30-year) US government bonds, which offers ballast to the portfolio in the event things do not pan out the way we expect. Additionally, using options on the TLT ETF, we have collared our US 30-year government bond position, leaving us protected if yields increase past 2.95%. Given the very high cost of hedging USD exposure (>1%), we have elected to keep our TLT position unhedged.

In credit, we continue to recycle maturing positions into short and medium term bonds (typically 5-years and less); we like keeping duration and volatility low. With risk assets performing the way they have year to date, we have added a small (<2% notional) HYG option hedge to the portfolio.

Diversified Bond Fund Portfolio Characteristics:

	Limits	Dec 2017	Mar 2018	Jun 2018	Sept 2018	Dec 2018	Mar 2019	Outlook
Government Bonds	**100%**	-2%	0%	-4%	2%	1%	**7%**	↑
Investment Grade	**80%**	37%	56%	66%	73%	76%	**77%**	↓
High Yield	**40%**	32%	24%	17%	16%	13%	**12%**	↔
Emerging Market Governments	**10%**	0%	0%	0%	0%	0%	**0%**	↔
Preferred Equities	**10%**	6%	6%	6%	6%	2.5%	**0.5%**	↓
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%	**2%**	↔
Total		100%	100%	100%	100%	100%	**100%**	
Duration	**1 to 8 years**	2.4	2.1	2.3	1.0	2.4	**3.2**	↑
Geographic (% North America)	**>75%**	89%	90%	89%	93%	91%	**87%**	↔
Unhedged FX Exposure	**20%**	0%	0%	0%	0%	0%	**4.5%**	↔

Source: Ninepoint Partners

Credit Income Opportunities

After a strong start to the year, we have been busy tuning risk down. Investment grade credit and high yield have rallied back to levels that are very close to last years averages and the fund has performed relatively well. As such, we feel it is prudent to adjust the portfolio risk characteristics, raise liquidity and add some hedges.

In the core portfolio, we have increased overall duration by 1 year (now 3 years duration) by adding long-term US government bonds through a TLT ETF option position that offers, limited downside, but upside should government bonds appreciate in a risk-off environment. To be clear, we view this position as more of a portfolio hedge, than a holding in government bonds. It will provide ballast against our credit positions, should a greater slow-down or recession surprising occur earlier than 2020.

To manage our lower rated credit risk, in the event of an unanticipated economic slow down this year, we have hedged half of the fund's high yield exposure (about 20%) with HYG puts. We like the incremental yield we receive from HY bonds and this rally could continue, but we feel adding some insurance against these potions is prudent. And if HY eventually sells off, with the equity markets, we want to be ready to act from a position of strength.

Finally, in the overlay (the leverage component of the fund), we have reduced risk by altering the duration composition of securities. We decreased exposure to longer dated credits, which will be more volatile in a sell-off, and increased overall leverage by adding very short dated investment grade positions. The average spread duration of positions therefore decreased from 5.25 years to 3.75 years, but the fund's leverage increased from 0.7x to 0.94x. To the untrained eye, the net impact of these changes to the overall fund characteristics is small, but in the event of increased volatility in the credit markets, our current positioning should perform meaningfully better.

The fund currently yields about 5.5% with a duration of approximately 3 years. Average credit

quality is a BBB average, leverage is 0.94 times on 5.5 years of spread duration and we have no FX exposure.

It has been a good start to the year and we believe that our current positioning will generate solid returns in 2019 with minimal volatility.

Until next month,

The Bond Team: Mark, Etienne and Chris

NINEPOINT DIVERSIFIED BOND FUND - COMPOUNDED RETURNS[1] 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 RETURNS[1] 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%

[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 March 31, 2019 [1] All Ninepoint Credit Income Opportunities Fund returns and fund details are a) based on Class A units (closed to subscriptions); b) net of fees; c) annualized if period is greater than one year; d) as at March 31, 2019.

The Ninepoint Diversified Bond Fund is generally exposed to the following risks. See the prospectus of the Fund for a description of these risks: Capital depletion risk (Series T, Series FT, Series PT, Series PFT, Series QT, and Series QFT shares only); Capital gains risk; Class risk; Concentration risk; Credit risk; Currency risk; Cybersecurity risk; Derivatives risk; Exchange traded funds risk; Foreign investment risk; Inflation risk; Interest rate risk; Liquidity risk; Regulatory risk; Securities lending, repurchase and reverse repurchase transactions risk; Series risk; Short selling risk; Specific issuer risk; Tax risk; Tracking risk.

The Ninepoint Credit Income Opportunities Fund is generally exposed to the following risks. See the offering memorandum of the Fund for a description of these risks: General Economic and Market Conditions; Assessment of the Market; Not a Public Mutual Fund; Limited Operating History for the Fund; Class Risk; Charges to the Fund; Changes in Investment Objective, Strategies and Restrictions; Unitholders not Entitled to Participate in Management; Dependence of the Manager on Key Personnel; Reliance on the Manager; Resale Restrictions; Illiquidity; Possible Effect of Redemptions; Liability of Unitholders; Potential Indemnification Obligations; Lack of Independent Experts Representing Unitholders; No Involvement of Unaffiliated Selling Agent; Valuation of the Fund's Investments; Concentration; Foreign Investment Risk;

Illiquidity of Underlying Investments; Tax; Litigation; Fixed Income Securities; Equity Securities; Idle Cash; Currency Risk; Suspension of Trading.

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