



A Happy New Year? | December 2015

"It is always wise to look ahead, but difficult to look further than you can see"

Winston Churchill

After a difficult 2015, which saw the TSX down over 11% and jokes of the northern peso surfacing, Canadians are undoubtedly hoping for a sweeter 16. While we are not in possession of a crystal ball, we believe that the year ahead will be a challenging one for investors.

The ulcer inducing volatility that characterized the second half of 2015 is likely to persist for several more months. The uncertainty surrounding the Chinese economy, the pace of rate hikes by the Federal Reserve, the path of commodity prices and the gnawing suspicion that global growth has somehow been permanently impaired will conspire to send equities see-sawing in all directions.

By comparison, the bond markets ought to remain awfully dull. The Federal Reserve will likely sneak in one or two more rate hikes if they can, while the Bank of Canada will fret over the price of oil as they deliberate on whether another rate cut or other unconventional stimulus is required.

Corporates will need to raise about the same amount of money in the bond market this year as they did in 2015. A wild card will be how much issuance banks do outside of Canada. If the banks choose to raise a significant amount abroad, it should be constructive for domestic credit spreads. The slide in equities and commodities will keep a lid on interest rates so fixed income funds ought to continue to see inflows, which could also be supportive for corporate bonds. That said, there doesn't seem to be a catalyst for a significant narrowing of credit spreads in the near term.

As always, the future is unpredictable and successfully making decisions amidst uncertainty requires hard work, skill and bit of luck. We therefore wish all of you the best of luck for the New Year.

The Fund

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
N/A	2.29%	2.51%	1.27%	2.46%	0.25%	0.73%	(0.25%)	1.68%	1.71%	1.37%	0.87%	15.86%

The Algonquin Debt Strategies Fund LP was launched on February 2, 2015. Monthly returns are based on 'Series 1 X Founder's Class' NAV as calculated by SGGG Fund Services Inc. and are shown in Canadian dollars, net of all fees and expenses.

Last January, we were preparing to give birth to our first fund. As with all new parents, the first year was full of new challenges, sleepless nights, plenty of learning and the occasional tears. That said, the transition from bachelor bank traders to parents of a fund was much smoother than anticipated. With many of the sell-side distractions removed, there was more time to watch trade flows unfold from a favourable vantage point. This enabled us to better identify and take advantage of superior risk/reward opportunities, leading to a return of 15.86% for the year. Furthermore, our relationships with the street and our knowledge of how the bond market operates proved particularly useful when navigating the treacherous waters of August and December.



All in all we are happy with our baby's development and growth over the first year. As a team, we have put in a lot of hard work and had a lot of fun working together. We look forward to a lot more of the same, both the ups and the downs, but are obviously hoping for many more ups.

Market Notes

Like many other investors we noted that asset markets are now highly correlated. Global equity indices seem to move in lock-step (except for the damned TSX which only seemed to go down). Meanwhile bonds, which are supposed to offer diversification, also generally moved in the same direction as equities. We were pleased to see that on days that equities moved 1% to 2%, credit spreads would move in much smaller increments if they moved at all. This type of behaviour certainly supports our view that the fund offers investors excellent portfolio diversification advantages.

The other thing we noted was how frequently portfolio managers complained about the drop in bond market liquidity. Although there was much hand-wringing and moaning, there was precious little in terms of ideas on how to deal with it. Most of the comments seemed to be a form of nostalgia along the lines of, 'in my day prices were reasonable and children respected their elders.' Our view is that liquidity has changed and will continue to change. Asset managers must therefore alter their execution strategies. Those that find a new way to operate will be rewarded during difficult conditions, while those who cling to the past will likely generate sub-standard returns.

Looking Ahead

As wise investors have discovered, it is important to know what you don't know. With that in mind, we are going to disappoint those looking for forecasts for the year ahead. What we do know, is that when the pendulum swings from despair to euphoria and back as fast as it is, that a myriad of opportunities are often unearthed. Accordingly, we go into 2016 optimistic, cautious and above all, ready.

Regards,

The Algonquin Team

Contact

Algonquin Capital Corporation
1 Yonge Street, Suite 1801
Toronto, Ontario, M5E 1W7
www.algonquincap.com

Raj Tandon
Founding Partner
raj.tandon@algonquincap.com
+1 (416) 214-3493



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