



Are You a Bad Loser? | January 2016

"I hate to lose more than I like to win."

Larry Bird

If you were watching your stock portfolio closely last month, you were reminded of just how much losing hurts. Behavioural economists postulate that the pain from loss is twice the joy of gain. While the magnitude can vary between individuals and situations, it seems fair to conclude that losing sucks.

The danger of this pain is that our emotions can take over. So rather than join the 'chicken little' parade and rehash all the negative news, we thought it more useful to remind our readers of a couple of the psychological pitfalls associated with losses.

By our very nature humans are averse to losing. For our survival this makes sense. It is more prudent to be aware of threats than opportunities, to protect what one has than take risks to gain more. This feeling is accentuated by the recent sting of falling markets. This can lead us to passing up on opportunities with attractive risk/return profiles, as we overemphasize the prospects of further loss.

On the flip side, losses can make some of us more aggressive in taking risk. Consider the following two scenarios:

- I. Receive \$900 for sure OR take a 90% chance to get \$1000 and 10% chance of getting nothing
- II. Lose \$900 for sure OR take a 90% chance to lose \$1000 and 10% chance of losing nothing

Despite being mathematically equivalent, most people would take the \$900 in the first scenario but gamble in the second. This is because when presented with the opportunity to recoup our losses, we become inclined to take risks that would otherwise be unacceptable to us.

The simple point is that our emotions can sway us to the extremes of becoming overly loss averse or aggressive, to miss opportunities or go chasing them. The important thing is to recognize these influences within ourselves. As whether markets go up or down, it is better to proceed rationally rather than emotionally.

The Fund

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2016	0.19%	-	-	-	-	-	-	-	-	-	-	-	0.19%
2015	-	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.



When we launched our fund last February, we could not have guessed how strange the journey would be. After three or four months of robust credit markets, things got ugly. For the last half of 2015, credit spreads steadily widened, especially punishing anyone who dared to own 30 year corporate debt.

With equities dropping 10% in the first two weeks of 2016, the trend to wider credit spreads continued unabated. The Fund's gain in January can be attributed to continuing our December strategy of holding very short dated securities and capitalizing on a few active trades.

After avoiding the oil sector for most of last year, the recent dip in crude and the ensuing carnage in the bonds of many Canadian investment grade issuers means we will re-evaluate the risk/reward trade-off in these securities.

Credit

The negative sentiment of global markets and the drop in oil pervaded domestic credit markets, taking spreads wider through the month. Bank NVCC debt struggled in the difficult environment, widening +25bp through January, while the oil and gas sector continued to get pounded as crude dipped below \$30bbl. JP Morgan's decision not to call their C\$ sub-debt caught investors off-guard with an instant \$3 dollar drop in the bonds leaving a mark. We have avoided holding callable fixed/floater subordinated bonds from foreign issuers for precisely this reason.

2016 is off to an exceptionally slow start as far as Canadian bond supply is concerned. With just C\$5bn issued so far out of an expected C\$100bn this year, the market is well behind schedule. Hopefully deal flow picks-up in February, particularly as redemptions and delayed transactions force corporate issuers to market. In the US, the AB InBev (US\$46bn) transaction was one of the largest of all-time, which by amusing comparison amounts to more than half of the total expected C\$ corporate supply for the year.

Rates

Amidst the equity volatility and deteriorating economic prospects, Canadians were bracing themselves for another rate cut. The Bank of Canada decided not to lower rates, choosing instead to allow the weak loonie and promised fiscal stimulus some time to work. Given that the low dollar has yet to benefit the struggling manufacturing sector, we believe that additional monetary accommodation may be required, although one shouldn't expect to see any action until after the federal budget.

South of the border, the next hike has been pushed out like a carrot on a stick. US 10yr yields are significantly lower than where they were around the December rate hike, so bond investors clearly disagree with the Fed's improbable outlook of 4 hikes in 2016. That said, we believe that yields have overshot to the downside, and the risk now is that they snap sharply higher on the slightest bit of good news.

Regards,

The Algonquin Team



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