

Will Tsipras Fold? | March 2015

“The beautiful thing about poker is that everybody thinks they can play.”

Chris Moneymaker

The big story these days is whether or not Greece will default, and if so, what implications that will have on financial markets. For the life of me, I can't figure out if Alexis Tsipras is a genius or a neophyte. He most certainly is testing the patience of the seasoned Eurozone administrators, who appear to be baffled by his game. Perhaps he is like the poker amateurs, who from time-to-time win big tournaments because they don't bet like the pros. They stay in hands that should have been folded a long time ago, and then get lucky on the “river”. On the other hand, perhaps he knows how the pro would bet and strategically bets against common wisdom in an effort to get the pro to fold winning hands. Only time, and perhaps a favourable biographer, will tell the story, however, I'm certain about one thing: a default by Greece will cause a high degree of pain in the markets.

We will continue to keep a vigilant eye on Greece and maintain a liquid portfolio that can be swiftly reduced if required. Over our long trading careers, we have learned the value of keeping some dry powder on hand in order to take advantage of the “babies” that will surely be thrown out “with the bath water” should Greece default.

Credit

I thought the supply in February was crazy, but the frenzy continued into March. By the time the dust settled, the quarter saw \$35.7 billion of new corporate issuance, eclipsing the old record of \$31.9 billion.

Despite the deluge of supply and a minor widening of credit spreads south of the border, Canadian credit remained surprisingly resilient. With yields so low, bond funds were eager to foray into riskier securities in an effort to at least cover their MER. I was amazed at how long it took to satiate their voracious appetite. Only towards the end of March did it appear that the buyers were becoming more selective.

I expect the supply machine to be rather quiet at the start of the next quarter which should allow the market to digest the recent supply and lead to a modest narrowing of credit spreads. Given the seemingly endless poker game in Europe, we have concentrated on highly liquid, shorter maturity bonds in order to remain nimble.

Rates

Governor Poloz continues to make central bank watching an entertaining pastime. I find his communication style interesting, albeit confusing, in a world where central bankers have become increasingly bland. Admittedly it is a close call, but my view is the BoC will not deliver further rate cuts this year. I think the front end of the yield curve (out to 5 years) is absurdly expensive, however, maintaining an outright short position will be tiresome, as international buyers continue to buy any dips. Recent changes to the Government of Canada bond auction schedule, which increase the size of benchmark issues, might allow a modest rise in front end yields.



In the US, the removal of the word 'patient' from the FOMC's March statement was not taken as a pre-commitment to a summer rate increase, but rather as a restoration of policy flexibility. It is clear that the Fed will remain data dependent, as they have reiterated time and again, and in that context we see room for the economy to improve before any action on the part of the Fed is justified, particularly while the dollar strengthens, wage growth remains tepid, and geopolitical risks linger in the headlines. We expect the Fed will remain on hold through the summer with the first potential rate hike coming in September at the earliest.

While any hawkish action on the part of the Fed will exert upward pressure on short rates, we don't expect much of an impact further out in the curve, particularly while the ECB and BoJ continue with substantial QE programs. Faced with either negative or zero yields, Canadian and U.S. bonds will continue to look attractive to investors in those regions.

Regards,

Brian

The Fund

March was another strong month for the Fund generating 2.51% for our investors, bringing the compounded two month return to 4.86%. While our core strategies continued to perform well, we were able to generate excess returns from trading Telus bonds. Telus had been on our radar for a while, as our analytic model indicated that the telecom sector was attractive and that Telus was particularly cheap. However, we elected to be patient, as we felt that the market would widen telecom spreads in the face of significant supply following the wireless spectrum auction. With the Telus \$1.75bn multi-tranche offering, we saw our opportunity to enter the market and then enjoyed some solid spread performance for the balance of the month. Once spreads reached fair value according to our model, we exited the position capturing over 50 bps of performance for the fund.

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
N/A	2.29%	2.51%	-	-	-	-	-	-	-	-	-	4.86%

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.

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