



Curiouser and Curiouser | March 2016

"It would be so nice if something made sense for a change."

Lewis Carroll – Alice's Adventures in Wonderland

'Twas a warm summer's day in August when equities ventured down a mysterious rabbit hole and into a nonsensical world of uncertainty. Like *Alice's Adventures in Wonderland*, the journey has been confusing, chaotic and at times rather harsh. But unlike dear Alice, these markets don't need magic cookies, mushrooms or strong catalysts to shrink and grow at random. The shifts in investor sentiment take care of that.

In the past eight months, the S&P has experienced four swings of over 10%, including starting the New Year with a dramatic fall only to climb back and finish the quarter pretty much unchanged. With no significant changes in the underlying global risks or economic fundamentals, making sense of these moves is like trying to understand the gibberish at the Mad Hatter's tea party. As Alice put it, 'you might do something better with the time than wasting it in asking riddles that have no answers.'

The only conclusion we can draw is that uncertainty around the central banks and the health of the global economy has driven investors between the extremes of panic and euphoria. It seems that at every turn we can see the eerie grin of the Cheshire cat reminding us that 'common sense doesn't really work here.'

While it is easy to get lost in the madness and chaos, one must remember that cooler heads typically prevail. With the exception of arguments with small children, reason can oppose nonsense, and in the long run reason will win.

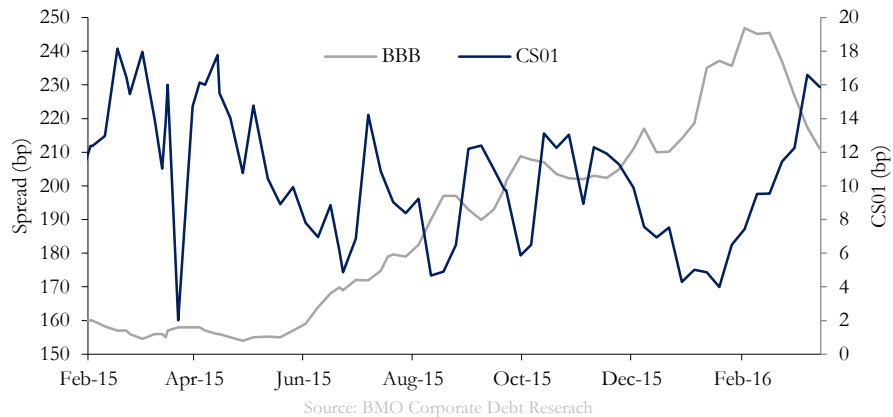
The Fund

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2016	0.19%	1.49%	5.32%	-	-	-	-	-	-	-	-	-	7.09%
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.

Given the strategies we run and the risk parameters within which we operate, March certainly qualifies as an exceptional month. To explain how the returns were generated, we are enlisting the help of a pretty picture.

The graph below shows a composite of 'BBB' rated Canadian credit spreads and our credit exposure (CS01) since the Fund's inception. Over the period, spreads have steadily drifted higher and increased sharply in the first six weeks of 2016. As per our mandate, we have actively managed our exposure depending on the market conditions and opportunities.



In the middle of February, we decided the opportunities in credit were overwhelmingly compelling. The yields on corporate bonds offered tremendous value and provided a healthy cushion to withstand further spread widening. Accordingly, we targeted higher beta sectors such as energy, subordinated bank debt and REITs. As spreads started narrowing, we steadily increased our overall exposure.

The rally in credit combined with our positioning and active trading were responsible for the majority of the Fund's gains, while carry contributed the rest. At the end of the month, the portfolio was distributed across a larger number of smaller investment grade positions to facilitate rapid liquidation should conditions change and a reduced exposure be warranted.

Credit

Canadian credit spreads have narrowed steadily since late February thanks to the rebound in equity markets and lighter than expected new issue supply. As has been the case in the surreal markets of late, investor sentiment shifted quickly in favour of non-government bonds. Dealers, who had been defensive for months, simply weren't warehousing enough inventory to satiate this suddenly materializing demand for corporate debt. The result forced credit spreads to recoup most of the losses on the year. We are cognisant that despite the recovery, investment grade bonds still offer good value.

Looking ahead, the corporate bond market still has a positive bias to it. New issue supply ought to continue trending well below forecast in April, supporting valuations. Having said that, we have taken some chips off the table and upgraded the credit quality of our portfolio. This provides us with the flexibility to take advantage of the opportunities that will inevitably surface.

Rates

The ECB managed to surprise everyone by firing what looks to be every bullet left in the chamber. They cut the deposit rate to -40 bps, re-instated low cost loans to banks to allow them to lend at higher rates and increased quantitative easing to €80bn/month. Most surprisingly of all, the ECB announced that they will be



buying non-financial corporate bonds. The details for the moment are sketchy, but there is little doubt that the ECB's efforts will lend support to global bond markets.

On this side of the pond, the Liberal budget delivered the promised fiscal stimulus that should keep the BoC on the sidelines for months to come. Meanwhile, Janet Yellen reiterated that the Fed would be very cautious in its approach to lifting rates. As such, 'low for longer' continues to be the theme in fixed income.

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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