



Who's Afraid of the Big, Bad Fed? | November 2015

"The luck of the third adventure is proverbial"

Elizabeth Barrett Browning

After seven years at zero and nine years since the last hike, 'Lady Janet of Brooklyn' is poised to move interest rates higher tomorrow. Recent history suggests that the various asset classes ought to tremble with fear.

In 2013 when 'Helicopter Ben' Bernanke announced he would end his quantitative easing programs, the result was the 'Taper Tantrum.' Investors dumped their bonds, and equities slumped 7%. After a couple of months, people realized that the Federal Reserve was still a long time away from raising rates and promptly took bonds and stocks to higher prices.

Just this summer, Governor Yellen made it painfully clear that she felt the Fed would raise interest rates in 2015. That helped drag the TSX and S&P down by 10%. This time it took only a month or so for US stocks to recover handsomely, while the feculent TSX only managed to claw back a few percentage points.

In November it seemed as if everyone adopted the British WWII slogan, 'Keep Calm and Carry On.' Despite the odds of a hike at 80%, the shocking attack in Paris and rising tension between Russia and Turkey, the TSX, S&P and bond yields barely budged.

Perhaps investors have concluded that this is not their father's tightening cycle with a series of successive rate hikes to come, and are confident that the Fed will be patient in their approach. Or perhaps, it's just that the third time is a charm.

The Fund

With only \$2.9B of new issue supply, and government bonds trading in a narrow range, we looked for active trading opportunities to generate returns beyond the carry component of the Fund. We took advantage of momentum as portfolio managers capitalized on the quiet market to add to their portfolios, and enjoyed solid returns from the telecom and REIT sectors, which had fallen heavily out-of-favour in the summer. Furthermore, our VW and ABS positions performed well enough for us to take our profits.

December is typically a good month for credit as the first two weeks are often busy with issuers trying to get deals out the door before things quiet down around year end. The result is that credit spreads normally narrow quite nicely. We remain cognizant that events could unfold differently this time, as people ponder the weakness in commodities, the removal of stimulus and a slowdown in China.

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%	-	14.87%

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.



Credit

After several months of steady widening, Canadian investment grade credit spreads responded to the dearth of supply and generally performed in November. The BBB sector, which had been a laggard for most of the year, showed signs of life with REITs and telecoms leading the charge. Meanwhile, the bank NVCC sector continued to underperform as investors braced for potential supply after bank earnings season. By our calculations, the borrowing environment in the US market is attractive for Canadian banks, which means little in the way of bank deposit note supply in December.

On a regular basis, a variety of folks ask us about high yield bonds. Other than one position, which matures in nine weeks, we have avoided this market due to concerns over poor liquidity. Our conclusion is that the catastrophic destruction of wealth in commodity related debt poses contagion risk to other high yield sectors. As a result, we will continue to avoid this asset class for a while.

Rates

The Federal Reserve is largely expected to raise rates 25bps tomorrow. We believe the accompanying statement will be chock-full of 'wait and see' language as Ms. Yellen elaborates on what exactly she means by a 'moderate pace'. Under this hawkish/dovish scenario, it shouldn't be surprising to see bond yields dip post meeting. After a couple of days of bouncing around, the bond market ought to settle into a narrow range for the holidays.

The domestic economy continues to grapple with lower commodity prices. Despite a steady decline in the 'loonie', the export sector hasn't given the economy a serious boost yet. Governor Poloz is undoubtedly weighing the need to add further stimulus, however he will likely be patient until the federal government unveils further details on their spending plans. Although the Federal Reserve will likely continue to hike in 2016, we believe the Canadian yield curve will remain anchored near current levels.

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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