



“Every Day is Game Seven” | September 2015

“You can observe a lot by just watching.”

Yogi Berra

What you observe depends on what you are watching. Those watching the Blue Jays were treated to a thrilling ride en route to their first American League Championship Series appearance in 22 years. Those watching their investment account balances and the markets in September experienced a different sort of thrill ride. After a terrible August, the end of the quarter brought its own set of challenges. While the turbulent markets and the Volkswagen scandal led to indigestion on the part of investors, they provided sensational headlines and plenty of fodder to lather up a bearish sentiment. Rather than add to the fear mongering, we thought it best to step back from the noise and look at the markets from a distance. With that in mind, we would like to share some observations that might suggest that the sky isn't falling just yet.

Although oil traded violently, at times moving 8% in a day, it ultimately didn't go anywhere and closed where it opened at around \$45 per barrel, which may indicate that it has finally found a support level. Secondly, even though the TSX was down 4% on the month, it finished almost 2% higher than the lows of late August. Lastly, despite weaker economic data and a reluctant Fed, Canadian bond yields were virtually unchanged.

While these observations provide some perspective and perhaps comfort, they by no means suggest the worst is behind us. Rather, our read of the tea leaves is that the markets have justifiably priced in a substantial amount of negative information, and are likely to continue to move sideways until a clearer picture of the health of the global economy is formed. We'd like to see daily stock market moves of less than 0.5% before we can be comfortable that the worst of 2015 is behind us. In the meantime, perhaps the best course of action for long-term investors is not to watch the market. As history has shown, overreacting to noise and deviating from one's plan rarely serves one's investment objectives. And with the Blue Jays providing the thrills, it is easy to stay distracted.

The Fund

Even though spreads generally widened, there were decent opportunities to actively trade credit in September. We played an aggressive game, but instead of swinging for the fences, we choked up on the bat and looked to hit singles and doubles. In particular, Volkswagen's debacle provided us with a unique occasion to trade their credit from both the short and long side. We also pounced on the solid tone in long dated utility and pipeline bonds, actively trading a couple of positions that contributed handsomely to September's performance. These timely hits coupled with an effective defence lead to a +1.68% return for the month.

The old adage 'you can't win ball games without good defence' is our mantra for October. The tone in credit markets remains weak, so caution is the order of the day.

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%	-	-	-	11.42%

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 the dismal performance of credit spreads in August, we looked forward to a strong recovery in September. It turns out credit battled ‘five hundred’. Spreads did narrow early in the month in spite of a wall of supply, but reversed course as time wore on, closing modestly wider over the period. Contributing to the reversal were unanticipated events surrounding Molson’s and Volkswagen. To be fair to Molson’s, their bonds got sideswiped over the potential merger between AB InBev and SAB Miller, while Volkswagen got caught trying to steal a base.

While the month did see an increase in bond supply, new issues were priced with extreme concessions, which adversely affected secondary market spreads. As an example, we sold 8 year Bell Canada bonds at a credit spread of +188. Two days later, Bell announced a new 7 year bond at a spread of +195. By the end of the deal, the 8 year bonds we sold were trading around +205.

With a great deal of the year’s new issue supply out of the way, we expect that spreads will stabilize near current levels. Having said that, we do remain wary of the fragile tone in credit markets.

Rates

The fact that the Federal Reserve chose to keep rates unchanged was not a total surprise, however, the ‘dot plot’ revealed that one voting member felt that an ease into negative territory was warranted. This bombshell helped spark another kerfuffle in equity markets, resulting in Janet Yellen clarifying her stance on the matter. While she still foresees a rate hike in 2015, the market currently disagrees with that view and is pricing the odds of it happening at less than fifty percent. As far as the Bank of Canada is concerned, we don’t believe 3rd quarter GDP results will sway them one way or the other. It makes far more sense for the BOC to wait and see which party forms the next government and understand the impact of the fiscal policies they will pursue before making their next move. Our view is that the Bank of Canada will remain on hold, and that short end rates will drift slightly higher over the next six months.

Go Jays Go!

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