

The Hitchhiker's Guide to Trump | January 2017

"DON'T PANIC"

Douglas Adams, 'The Hitchhiker's Guide to the Galaxy'

Through the early days of Trump's presidency, we found ourselves reminded of Arthur Dent; regular Earth-person and protagonist of 'The Hitchhiker's Guide to the Galaxy.' After discovering that both his house and planet are to be destroyed, Dent must negotiate a series of increasingly unpredictable and bizarre events.

Following some of the President's more controversial first moves, many earthlings may even empathize with another of the book's characters, Marvin the depressed robot, who held the view: 'Loathe it or ignore it. You can't like it.'

From an investment perspective, perhaps the relevant line is: 'Like it or loathe it. You can't ignore it.' Or can you?

The investors' predicament is a difficult one, and they don't have the benefit of a handy guide for navigating the new administration. On the one hand, lower corporate taxes, deregulation, and fiscal stimulus bode well for business confidence. But against this backdrop are the President's unpredictability and the potential for trade wars between the US and, well, the rest of the world.

Should the US employ trade tariffs, the reaction of the affected countries is impossible to predict. And while it may be 'America First,' the law of unintended consequences could cause 'the First' some pain. Business leaders don't like uncertainty. So despite the government's efforts to create jobs, companies may decide to 'hunker down,' and wait out the storm.

We expect all of this to lead to a challenging and volatile environment. Perhaps the best course of action is to 'Ignore it or like it.'

Those following passive strategies can ignore the asset price gyrations and simply enjoy the circus show. After all, the markets have managed to deal with far more turbulent periods and have rewarded the long-term, patient investor, very well.

Active managers may face a dizzying array of opportunities and risks to manage. The opportunities should present themselves not only in general market levels, but also within sectors and individual companies. Events ranging from 'twitter-attacks' to changes in the tax code, regulations and trade agreements will change the playing field for many businesses. In this type of environment, with the potential for market overreactions, astute investors will likely be able to pick up a bargain or two.

The risk is that this is much easier said than done. It requires analytical rigour, objectivity, and a strong stomach, as 'mistakes' will be unavoidable. And when in doubt, or just dumbfounded, don't panic, remember the answer is 42.

The Fund

We started the year with our analysis providing a conflicting view on domestic credit markets. While the technicals and sentiment were supportive of credit spreads, the rally into year-end and the outright levels indicated that caution was warranted. Accordingly, we adopted a medium risk posture and remained on high alert for any indications of weakness.

In the end, it was like carrying an umbrella on a cloudy day with no rain. Our caution, while perhaps prudent, was proven unnecessary. With new bond issues well oversubscribed, portfolio managers were forced to do their buying in secondary markets, pushing spreads tighter. We were able to add to the returns from carry and credit spread tightening through tactical trading to end up with a 1.73% gain for the month.

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2017	1.73%	-	-	-	-	-	-	-	-	-	-	-	1.73%
2016	0.19%	1.49%	5.32%	3.51%	0.60%	0.54%	1.73%	1.63%	1.01%	1.86%	1.60%	1.62%	23.15%
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.

Credit

We continue to be cautious around credit spreads, mainly because we can't make the case that they are cheap. However, it is just as difficult to make a case that they are very expensive. Portfolio managers seem to have cash to put to work, the new issue calendar is unusually light, and higher rates are attracting yield starved buyers. The situation is ideal for corporations who are able to raise debt without paying a concession.

In spite of these positive fundamentals, the market may be a 'tweet' away from a sharp 'Trump Dump,' and given our desire to retain flexibility, maintaining a medium risk posture continues to be an appropriate course of action.

Rates

US economic data still points to a strengthening economy, which coupled with fiscal stimulus, keeps the Federal Reserve on track to raising rates at least two more times this year. For the most part, bond yields seem to have settled into a new trading range, although the risk remains that US yields will drift higher. As long as the European Central Bank and the Bank of Japan continue with quantitative easing programs a sharp rise in yields is highly unlikely.

As expected, the Bank of Canada left the overnight rate unchanged in January. Without any clarity on US policy, Governor Poloz has no choice but to patiently wait for the impact on the Canadian economy to unfold. If US policy severely curtails Canadian exports, the Bank of Canada might need to utilize monetary stimulus while the economy adjusts to a new reality. Should this scenario unfold, a significant drop in interest rates would occur.

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