

Not So Quiet on the Western Front | March 2017

“The machine gun is a much over-rated weapon.”

Field Marshal Douglas Haig, Commander British Expeditionary Force 1915-1918

With the 100th anniversary of Vimy Ridge approaching, we take a look back at this historic battle, and why four Canadian divisions, fighting together for the first time, were able to capture a German position where the British and French had been unsuccessful for two years.

World War I has the sad distinction of being one of the deadliest conflicts in human history, with over 17 million killed and more than 20 million wounded. One of the reasons for the significant number of military casualties was the tremendous strides in weaponry just before and during the war. The machine gun, heavy artillery, aircraft, barbed wire, armoured vehicles, and chemical weapons were put to frighteningly efficient use.

Unfortunately, the generals were utterly unprepared to cope with the new technology. During the early years of the conflict, they still relied on Napoleonic tactics that depended on cavalry and short range cannons. Perhaps the Battle of the Somme, where nearly 60,000 British soldiers fell on the first day of battle, epitomizes the catastrophic results of failing to adapt to change.

So what did the Canadian Expeditionary Force, under the leadership of Lieutenant-General Sir Julian Byng*, do differently?

Historians attribute the success of the Canadian Corps to meticulous planning, extensive training, powerful artillery support, and a mixture of technical and tactical innovation. Canadian's pioneered the science behind the effective use of artillery and perfected small unit fire and movement tactics. Also, recognizing that the men in leadership positions were likely to be wounded or killed, soldiers learned the jobs of those beside and above them.

While we cannot compare the hardships of the Great War with the challenges facing the modern investor, we can learn a lesson about questioning if the methods that worked in the past can deal with the future.

An important component of this is challenging the assumptions that underlie our approach. At a high strategic level, this involves reassessing asset and geographic allocations against changes in capital markets, global economics, the geopolitical landscape, and of course, your objectives. In a low-interest rate world, where people are living longer, does pegging your fixed income allocation to your age still make sense?

At a more tactical level, there is the question of how to fill your investment buckets; which specific strategies and exposures to select. Between a plethora of low-cost ETFs and access to esoteric, niche products, the consumer is spoilt for choice. The question now is whether our existing models can evaluate this larger and ever-changing set of opportunities. As an example, with the movement to green energy and online viewing and shopping, how do we value traditional energy, broadcasting, and retail companies?

The status quo is comfortable, especially when it has worked in the past. But with the current pace of change, investors need to challenge the conventional wisdom and consider whether different approaches might yield better results. Like the generals of the Great War, much will be learned through trial and error, but these mistakes might pale in comparison to remaining stuck in your ways.

* For NHL hockey fans, his wife, Lady Byng, donated the trophy awarded to the "player adjudged to have exhibited the best type of sportsmanship and gentlemanly conduct combined with a high standard of playing ability."

The Fund

Mariners used the expression ‘doldrums’ when referring to calm periods when the winds disappear altogether, trapping sailing vessels for days or even weeks. The term seems appropriate in describing the corporate bond market in March. Due to mounting valuation concerns, credit spreads ‘toed-and-froed,’ with some sectors widening while others narrowed slightly.

An exception was CNQ, which announced a surprise acquisition that immediately widened its credit spreads 15 to 20bps as investors considered rating implications and braced for significant issuance in the near future. The CNQ bonds we owned resulted in a small loss to the fund. We exited a majority of our exposure, expecting an opportunity to participate in a new deal if the pricing is attractive.

With little in the way of interesting opportunities, we elected to maintain a lower risk profile. The hiccup with CNQ and weakness in the energy sector was offset by gains in bank NVCC debt and our small preferred share holdings. With the movements in credit being a wash, active trading and carry resulted in a gain of 0.44% for the month.

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2017	1.73%	1.30%	0.44%	-	-	-	-	-	-	-	-	-	3.51%
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

The issuance calendar for early April appears light, but that could change as various energy and REIT names come to market. Regarding credit spreads, we expect a similar pattern to March with modest widening or tightening depending on the sector. Trial balloons related to US tax reform, and the first round of the French presidential election on April 23rd could provide a few trading opportunities. To maintain flexibility we have exited positions in ‘triple B low’ credits such as Cominar and Shaw while adding to other higher rated names.

Rates

Interest rates continue to trade in a narrow range. Canadian economic data surprised everyone with its strength. However, Governor Poloz repeated his cautious outlook, which isn’t surprising given the lack of clarity on potential NAFTA renegotiation. We expect the Bank of Canada to keep the status quo until there is clarity on trade policy.

Events in Europe are starting to make headlines. Some signs of economic strength are emerging on the continent, leading to speculation about when and how the ECB will exit quantitative easing. As we’ve pointed out in the past, the ECB’s program is important when trying to predict moves in the domestic bond market.



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