



The Lure of the Long Ball | May 2017

“It could be, it might be...it is! A home run!”

Harry Caray

The Home Run. With one single swing of the bat, all the baserunners and the batter come home to score. For a hitter, it doesn't get much better than knocking the ball out of the park.

Between them, Reggie Jackson, Jim Thome, Adam Dunn, Sammy Sosa, and Alex Rodriguez have had 2,942 of these magical moments and rank amongst the most prolific sluggers in the game. They are also the five players with the most career strikeouts. Barry Bonds, the home run leader, with 762, struck out more than twice that much.

These men were willing to strike out to swing for the fences. Perhaps the same can be said of those chasing investment homers.

Both types of home runs are high risk, high reward ventures, and both can be game changers. The difference is the magnitude of those risks and rewards.

In baseball, it's strike three, and you're out. But this is a game where even the best hitters get out 60% of the time. So the worst case is an out, and the winning team will have at least 24 of those. On the other hand, when you're swinging for investment homers, you face the potential of a total loss of capital.

As for upsides, the maximum in baseball is four runs; a 'grand salami.' On the investment side, it is relatively unbounded. Think of early investors in Facebook, Amazon, and Google. Peter Thiel cashed out on over \$1 billion in Facebook stock from an initial investment of \$500k.

That's exciting stuff, and the lure of hunting such opportunities is strong. Psychologists and neuroscientists have even compared this excitement to the effects of cocaine on the brain. And under the haze of a potentially big payoff, there is the tendency to overlook or underemphasize the risks.

The other push to swing for the fences is the fear of missing out (FOMO). Unlike baseball, where you never know what could have been if you had gone for it, in investing, the future will painfully show when you passed on a big winner.

This anticipation of regret and the draw of the big payoff can have us chasing too many bad pitches in search of the moon shot. As grizzled baseball managers would remind us, you can't try to knock it out of the park every trip to the plate. While it would be fun to watch an entire line-up of sluggers swinging for the fences, that approach might not fare well over a 162-game season.

A winning team and a robust portfolio consist of all types of players. And there are an infinite number of player combinations that can result in success. You just have to choose the right mix and balance for you. The lovely thing about investing is that, unlike baseball, everyone can be a winner.

The Fund

After eight months in a row of steady narrowing, domestic credit spreads finally buckled under the weight of a record-breaking \$15.65 billion of new issuance. The abundance of supply coupled with concerns related to Canadian real estate (especially the GTA) pushed spreads generically wider by 10 bps.

Housing worries and Moody's downgrade of the big six domestic banks prompted selling in mortgage-related names and helped drive Bank NVCC roughly 18 bps wider while deposit notes moved out 10 bps. It is no surprise that REITs were hit especially hard, with spreads wider by over 20 bps. Fears of a slowdown in US auto sales and a class action lawsuit launched against GM pushed auto paper out around 10 bps. We also saw significant profit taking in telco paper which had performed well for several months.

Despite holding mostly shorter maturities in our portfolio, the fund lost 0.22% in May as losses from credit spread widening were only partially offset by interest carry and active trading.

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2017	1.73%	1.30%	0.44%	1.03%	(0.22%)	-	-	-	-	-	-	-	4.35%
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

US credit was largely unchanged in May, supporting the view that supply was the primary cause of the lousy performance of Canadian corporate bonds. Question marks surrounding the health of the GTA housing market will likely linger for several months as people wait for more data.

The new issue calendar looks robust for the first half of June. This may result in credit spreads trading 'sideways' through the month. However, a likely slowdown in primary supply over July and August may create the required conditions for a more constructive credit environment.

Our sense is that May was about a healthy correction and that barring an external shock, the corporate bond market will be less volatile in June. Rather than swinging hard, we will look to 'hit for average' this month.

Rates

The surprise coming out of the Bank of Canada meeting was that Governor Poloz sounded slightly more optimistic about the economy than expected. Meanwhile, south of the border the pundits are calling for a 'quarter point' hike by the Federal Reserve.

Oddly enough, despite the seemingly 'bearish' news for bonds, yields moved 5 to 10 bps lower. Perhaps the move is related to concerns that President Trump will be unable to deliver on promised fiscal stimulus or because US economic data has been uninspiring. While the reasons behind the move are murky, it is important to note the change in tone. Interest rates may be an ominous signal that the global economic picture may not be as rosy as it appears.



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