



The Anniversary Edition | January 2020

“Success is not final; failure is not fatal: It is the courage to continue that counts.”

Winston S. Churchill

While our newborn, Fixed Income 2.0, has been getting a lot of attention lately, it was our firstborn that recently celebrated its fifth birthday. On February 2nd, the Algonquin Debt Strategies Fund completed five years of active trading.

As proud parents, we marvel at how our baby has grown and wonder where the time has gone. And like most child-rearing experiences, it has been a rollercoaster of ups and downs, sleepless nights, and soiled diapers (no names divulged).

To celebrate, we thought to share some of the lessons learnt from our first five years of parenting.

It's a Small Business.

One of the first great challenges our partnership faced was changing the toner in the printer. Thankfully, Mr. Greg Jeffs rose to the occasion, earning him the first-ever Employee of the Month Award. This incident was a simple example of the resources we took for granted working at large institutions and of all the little things that go into running a small business.

Progress is a Process.

Moving our office from a kitchen cupboard to a walk-in closet, to a hotel suite. Growing from three bank refugees to a team of nine misfits. Embracing and accepting that everything is a continuous work in progress and subject to constant improvement.

Ignorance is Bliss.

Not knowing the entirety of what we were getting ourselves into turned out to be a blessing. Building an asset management firm is a daunting, overwhelming, and intimidating adventure. Being ignorant meant we worried less and simply handled problems as they arose. Had we known then what we know now, we might have never taken the plunge.

Laugh Hard and Often.

Humility and a good (or very bad) sense of humour are necessary to survive. Building a business is a continuous stream of steep learning curves, mistakes, and rejection. The best cure has been to have fun along the way and to laugh at ourselves and each other (often).



The Most Important Thing.

The hardest and most important thing is assembling the right mix of people to work together and complement each other. We founders are very fortunate to have surrounded ourselves with incredibly talented individuals that compensate for our gross incompetence.

But the team goes beyond ourselves and employees of Algonquin to include our extended family of investors, service providers, peers, and supporters. As we have often said, it takes a village to raise a fund. And we would like to take this opportunity to remind our village of the gratitude we feel for all the help and support we have received along the way. Thank you.

The Fund

The new year picked up where 2019 left off, with issuance well received by bond investors flush with cash, and credit spreads continuing to grind tighter. That was until January 22nd when the coronavirus infected financial markets. The risk-off tone saw Canadian credit spreads give back their initial gains to finish flat on the month, with higher-quality names outperforming. Energy names were in particular focus as oil prices (WTI) plummeted -15%. South of the border, fears over the coronavirus coupled with a large supply of issuance saw spreads generically higher by 9 bps at month's end.

New issue supply on both sides of the border was much higher than normal, with the general trend towards longer-dated deals as corporate treasurers took advantage of the rally in interest rates and low all-in yields. In Canada, \$9.5 bn of primary deals were completed with the financials leading the charge. BNS, RBS, CWB, Coast Capital, BMO, and John Deere all issued in the domestic market and even Morgan Stanley did a \$1bn Canadian maple deal. Other notable transactions were Pembina's \$1bn and Brookfield Properties' \$500mm deals. The US market was inundated with a 'wall' of supply with \$45bn of US HY and \$150bn of investment-grade debt hitting the books. Of note was Canadian convenience store and gas station champion Alimentation Couche Tard placing its deal south of the border.

The Fund was well-positioned for the rally through the first two-thirds of the month, and we were quick to reduce exposures and increase hedges in the face of epidemiological uncertainty.

	1M	3M	6M	YTD	2019	1Y	3Y	5Y	SI
X Class	0.71%	2.68%	3.26%	0.71%	9.99%	8.57%	5.65%	11.35%	11.35%
F Class	0.63%	2.40%	2.81%	0.63%	8.95%	7.51%	4.82%	N/A	N/A

As of January 31st, 2020

The Algonquin Debt Strategies Fund LP was launched on February 2, 2015. Returns are shown on 'Series 1 X Founder's Class' since inception and for 'Series 1 F Class' since May 1st, 2016 and are based on NAVs in Canadian dollars as calculated by SGGG Fund Services Inc. net of all fees and expenses. For periods greater than one year, returns are annualized.

Credit

Being the worrywarts that they are, fixed income managers started the year with a long list of things to be concerned about. Coronavirus was not one of them. A humbling reminder that the future is indeed unpredictable.



Prior to the looming pandemic, credit markets were in good shape. New issue supply was easily digested as portfolio managers still had cash to put to work. The technical backdrop of low inventory and supply coupled with ample cash holdings remains intact.

But there is a fly in the ointment. Fears that the coronavirus will put the world in recession have resulted in a deeper yield curve inversion which exerts upward pressure on credit spreads. The uncertainty of the virus has put nearly everyone into a holding pattern. Given the unpredictable nature of the epidemic, we have elected to maintain financial flexibility and adapt as the situation develops and unfolds. If the pace of transmission and fatalities increase, markets will react negatively, but with the significant stimulus being added globally, signs of progress on the virus front could be met with a strong relief rally.

Rates

Domestic bond funds had a great month. After rising in December, rates fell between 20 to 30 bps (depending on tenor). Most of the move was fueled by the Bank of Canada's perceived pivot towards easier monetary policy. Fears that the pandemic would further chill the economy pushed feverish traders to at one point price in at least two cuts by the central bank.

Without a doubt, the coronavirus has the potential to severely crimp global growth. The Chinese government has introduced stimulative measures to ameliorate the problem, however, the efficacy of these actions remains unknown. Yields have priced in central bank cuts, however, whether they take action really depends on the magnitude and persistence of the virus.

We don't believe the Bank of Canada or Federal Reserve will move aggressively until there is a clearer picture of the economic damage. If the virus proves to be short-lived, the amount of stimulus being added by the Chinese government to bolster its economy could end up redeflating other economies as well. As a result, expect sovereign yields to be volatile as traders adjust rate cut expectations in response to emerging information.

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