



Strange Times Are These | October 2020

“Your path you must decide.”
Yoda

According to legendary investor Sir John Templeton, the four most costly words in the annals of investing are “this time is different” (1933). The lesson being that economic cycles and history often repeat, or at least rhyme.

But given our current pandemic predicament, investors can be forgiven for thinking those four dangerous words. After all, this recession isn't the product of normal business cycles but the result of a public health crisis and our response to it.

This doesn't mean we ignore the past under the veil of 'unprecedented times', but instead try to understand the unusual aspects of these unusual times.

Unlike previous post-war recessions, the root cause of this incarnation isn't economic. That dubious honour falls on the novel coronavirus. It seems to follow that recovery from this mess depends on 'solving' the pandemic through containment, treatment, or vaccination.

In the meantime, the task of blunting the damage has fallen upon governments and central bankers. Their initial response was 'unprecedentedly' quick and large. The Fed and BoC took rates to zero and flooded the markets with cash. Meanwhile, governments enacted fiscal programs to replace lost income and stave off bankruptcies.

The result was one of the shortest bear markets in history. The aggressive actions of the central banks meant there were only a few precious weeks of widespread fear to pick up bargains before asset prices rebounded.

Which brings us to the current dilemma we face. Despite an environment of extreme uncertainty, low interest rates and stimulus have depressed returns. Cash yields 0%, investment-grade bonds 1-2%, high-yield around 4-5%, and prospective returns for equities are in the 4-6% range.

For retirees depending on their investments, this means either accepting less income or taking more risk. For younger people, the options are saving more, working longer, or taking more risks.

The difficulty in taking more risk is that the premiums available reflect a normal and benign economic environment, not a stressed one. But the risk of not taking more risk is failing to meet your financial goals.

Stuck between a rock and hard place, what are we to do? On one side there is a real and present crisis and on the other, some of the lowest prospective returns ever. Furthermore, abstaining from the party means inflation continuously erodes your purchasing power.

In looking for a solution to this conundrum, we found inspiration in the strangest of places, the regulators. A big theme in recent years has been 'Know Your Client' (KYC) and 'Know Your Product' (KYP). Our variation of KYC is 'Know Thyself'.

Are you a light sleeper who needs a smooth 1-2% GIC ride, someone who can handle the bit of indigestion that accompanies a 2-5% journey, a long term investor who is comfortable with the bumpy ride that goes hand-in-hand with the 6-9% adventure, or a daredevil who relishes the thrill of pursuing double-digit gains?



Let's face it, political circuses aside we are in a pandemic with complete sectors of the economy shut down. The path ahead, while uncertain, will certainly be challenging and noisy. Aligning your strategy with your nature will help you stay the course, which could be more important than which course you choose.

Once you select your strategy then you need to pick and know thy products. Understanding your investments is particularly important if you are seeking higher returns.

After all, you don't get something for nothing. And in good times, the rising tide lifts all boats, and the underlying risks often get masked. But crises and recessions have a tendency to expose them. Perhaps this is why our inspiring friends at the securities commission love to remind us, that past performance is not indicative of future results.

The Fund Performance.

October 2020.

Although the US election drew most of people's attention, surging COVID-19 cases around the world and the reintroduction of 'shutdowns' in Europe also unnerved investors. North American equities were hit hard with the TSX down -3.35% and the S&P -2.77%

Sovereign bond markets also suffered under the fear of a 'Blue Wave' unleashing trillions of dollars of stimulus spending which would be funded with debt. US 10-year treasury and CAD 10-year government yields moved higher by 19 bps and 10 bps respectively.

Surprisingly US investment-grade credit tightened an impressive 11 bps on the month. The rationale is that future issuance is expected to be light, so portfolio managers were reluctant to sell their bonds. Instead, they chose to hedge exposure using the liquid investment-grade derivative index (CDX IG), which widened 6 bps in the month.

In contrast, generic domestic credit spreads narrowed a single basis point. The notable laggard was the energy sector, which was adversely affected by lower oil prices and M&A activity. Cenovus's acquisition of Husky Energy resulted in a downgrade of Husky's debt leading to significant spread widening.

Issuance for the month was light by historical standards, with highlights including limited recourse capital notes (LRCN) from RBC and Canadian Western Bank, a rare deal by Cameco, and Stantec's inaugural transaction.

The Fund's 41 bps gain in October is mostly attributed to interest carry.

	1M	3M	6M	YTD	1Y	3Y	5Y	SI
X Class	0.41%	2.81%	13.69%	0.94%	2.92%	3.83%	8.65%	9.85%
F Class	0.34%	2.68%	13.39%	0.49%	2.26%	3.11%	N/A	N/A

As of October 30th, 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.



Looking Ahead.

Reflecting on Recovery.

While the financial markets might be looking forward to brighter times ahead, the path to recovery in the real economy is dependent on curing the pandemic. Stimulus and time will not be enough, as the only cure is an effective vaccine that can be mass-produced and widely distributed. Until then, fiscal stimulus is merely plugging a hole rather than stimulating the economy.

With COVID-19 cases surging higher in North America and Europe, a broad-based economic recovery is still some time away. As such, businesses based on cramming people into crowded spaces should remain under pressure and some will become insolvent. Unfortunately, all the stimulus in the world will not get people back into restaurants, inside stores, and onto flights.

That said, thanks to monetary stimulus there is no shortage of cash to be put to work. And with inflationary concerns surfacing, investors can't afford to sit on the sidelines and earn nothing. Also, the record-breaking government stimulus has improved consumer credit scores (FICO) and reduced consumer debt. This is remarkable, and at the possibility of rising the ire of the late Mr. Templeton, completely different from previous recessions.

The Path Forward.

With the US election behind us, the Fund is going to increase exposure to Canadian credit. Especially since the gap between domestic and US spreads is wide at the moment. Experience has taught us that this situation does not persist for long.

Like the US, Canadian issuance is also expected to be lighter than usual. This fact coupled with the cheaper valuations in domestic credit increases the odds of spread performance. Or should market sentiment turn sour, would at least provide a cushion against significant widening.

While we await definitive progress on the vaccine front, we continue to focus on resilient sectors and avoid businesses that are currently under stress.

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