The Paradox of Experience | April 2021

"Experience is simply the name we give our mistakes."
Oscar Wilde

Experience is a great teacher and an invaluable commodity. There is no substitute for it. Or at least that is what we tell anyone younger than us.

The theory being that the more you see and do, the more knowledge you accumulate. Collect enough knowledge, and you might even arrive at some form of wisdom.

But this of course presupposes that we learn from experience and draw lessons from our successes and failures. But what if some experiences make you dumber?

Consider the following two questions. What was the best decision you made in the last 10 years? Now, what was your worst decision over the same period?

If you're like most people, your answer to each was based on the eventual outcome rather than the decision process itself. It is a mental shortcut we all use; judging the quality of a decision based on the result. Psychologists refer to it as 'outcome bias' or 'resulting', and it has significant implications for investors.

One of the unique features of investing is the results are black-and-white and quantifiable in dollars and cents. This creates a very powerful and direct feedback loop to assess one's investment process. But occasionally, this learning loop gets distorted by improbable events with extreme outcomes.

For a big lottery winner, the smartest decision ever made was buying that fateful ticket. For the restauranteur, opening that new location in January 2020 feels like the worst decision ever. If your first experience purchasing stocks was in 2008 or February of 2020, you might be relegated to a lifetime of investing in GICs.

Once the past has been determined, it becomes extremely difficult to look through the outcomes and beyond our hindsight. The countless other possibilities that once existed, melt away. What happened, no matter how improbable, feels as if it was always inevitable.

Looking through this fatalistic rear-view mirror blinds us to the role that luck, chance, or an Elon Musk tweet can have on our profits and losses. It has the potential to reinforce bad habits or make us fearful of good ones. This is when experience can be a bad thing.

But before the millennials do away with all the boomers, this is not to say that experience is useless. It is essential and necessary for learning. But individual, improbable events can interfere and distort the teacher's lessons.

Thankfully, the more experience you have, the better you become at identifying and discounting such instances from the greater realm of probabilities. Phew. Us old folks still have some value left.

As for our responses to the two initial questions. Both our best and worst decision was starting our firm. The best because we love running our business and would not trade it in for the world. The worst because we sacrificed successful careers as bank traders to start a venture where the odds of success were 'slim to none.' Sometimes, it truly is better to be lucky than good.

The Fund.

April is traditionally a strong month for credit. And while demand for investment-grade bonds was strong, this demand was met with a robust amount of new supply on both sides of the border. The result was a modest grind tighter in credit spreads.

Sector performance was mixed as CN Railway launching a bidding war for Kansas City Southern lead to weakness in transportation, while auto finance led the pack tighter as new car purchases remain robust.

Generic Investment-Grade Credit Spreads:

- Canadian spreads tightened 2 bps to finish at 108 bps
- US spreads tightened 3 bps to finish at 88 bps

While the overall index move was small, it occurred amidst a heavy new issuance calendar. Domestically, $13bn of deals priced, including Algonquin Power, Summit Industrial REIT, WSP Global, an inaugural LRCN offering from Laurentian Bank, and deals by both domestic and international airports.

The HY market was also active with Corus Entertainment, Superior Plus, and Auto Canada bringing very well-received new issues to market.

The Fund was well-positioned heading into the month and benefitted from trading activity and outperformance in selected issuers. The net result was a return of 0.52% for April.

Heading into May, we trimmed around the edges of our portfolio and reduced exposure to make way for anticipated issuance by some of our favoured credits.

	1M	3M	6M	YTD	1Y	3Y	5Y	SI
X Class	0.52%	0.77%	5.31%	1.77%	19.72%	4.90%	7.07%	9.93%
F Class	0.45%	0.60%	4.72%	1.50%	18.74%	4.10%	6.12%	N/A

As of April 30th, 2021

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.

Interest rates ought to move sideways as people await further employment and inflation data. Nearly everyone is braced for higher CPI numbers over the next few months, with production bottlenecks continuing to emerge as demand surges.

As witnessed south of the border, one of the limiting factors to increasing production capacity is the availability of labour. Generous government income programs coupled with anxiety around the safety of workplaces are inhibiting people from looking for work. With Canada several months behind the US in terms of vaccinations, it will be interesting to see how quickly businesses will be able to scale up their workforce.

Production bottlenecks and higher costs of labour add to the inflationary pressures at play. But as long as CPI remains on a simmer and doesn't boil over, it appears the central bank is more concerned with employment.

Despite the disappointing April job numbers, we continue to believe that employment growth will be robust over the balance of the year. Furthermore, unless inflation shows signs of abating in the fall, strong economic growth will pressure long yields higher and accelerate the timetable for rate hikes.

In terms of credit, May is usually a heavy month for new issue supply as CFOs look to get their financing done before the summer doldrums. Banks tend to be the feature attraction once quarterly earnings are out of the way. In addition, flush corporate balance sheets underpin the potential for M&A activity to deliver some interesting debt transactions.

With the vaccine roll out well underway, and continued monetary and fiscal stimulus in place, we believe that credit spreads remain well supported and that any widening due to surges in issuance are good buying opportunities.

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