Fifty Words For Snow | September 2021

"There is no greater impediment to the advancement of knowledge
than the ambiguity of words."
Thomas Reid

Most Canadians are familiar with the trope about how 'the Inuit have more than 50 words for snow.' A claim that was originated by anthropologist Franz Boas during his time on Baffin Island in the late 19th century.

Since then, academics have debated the veracity of this claim, with some accusing Boas of gross exaggeration and others of underestimation. We will leave this argument to the learned scholars and linguists but will note that the Inuktitut vocabulary does have an impressive ability to distinguish different types of snow and ice formations.

Perhaps the financial lexicon could take a page from the snow book when it comes to the word risk. The term is used ubiquitously with the assumption that we all share a common definition. But in reality, risk is very personal and varies from person to person and changes over time.

In the world of finance, it is defined as volatility or the standard deviation of returns. But does this statistical metric capture what investors think of as risk?

Volatility is so widely used because it's easy to understand and compute, and also forms the basis for Modern Portfolio Theory. While a useful metric, it isn't difficult to see its shortcomings as a basis for risk categorization and classification.

Consider an investment that consistently loses 5% every year. If we use volatility to define risk, this would be deemed risk-free. On the other hand, a fund with annual returns of 5%, 25%, and 75% would be deemed high-risk. But we all know which we would rather own.

The problem with using such a narrow definition for risk is that it does not capture the real objectives and concerns that investors have. As per a Scotiabank poll conducted just before the pandemic, over 70% of Canadians are worried about not having enough for retirement. This fear has less to do with volatility and is more about incurring permanent losses, not saving enough, and not earning enough return.

Of these perils, that of not generating enough is becoming more prevalent in today's low-rate, low-return world. Take for example traditional fixed income, where current bond yields imply after-tax returns that are below inflation. These 'safe' investments might preserve your capital and sanity but over time will erode your purchasing power.

After all, in the '60s you could buy a shiny new corvette for $3,000. If you had stuffed that in a mattress sixty years ago, today you could buy yourself a shiny new electric scooter.

Thinking about investing in terms of preserving or increasing spending power reveals the significant risk in low-risk products. The very real potential of falling short of your long-term goals. Which for most of us, is of far greater concern than a smooth 'low-vol' ride.

We, therefore, propose following the Inuit's approach to snow. Inuktitut is an agglutinative language, where many affixes are attached to a base word to change the meaning. This is in part why linguists fight over how many unique words there are for snow and ice.

If we do the same with financial vernacular, we can distinguish various types of risk and compare them to our investment objectives. There could be volatility-risk, loss-risk, inflation-risk, home-downpayment-risk, the risk-of-underperforming-the-neighbours, and of course, the all-important retirement-risk.

After all, an investor might like the idea of a low-volatility-risk portfolio but not the high risk of running out of money in retirement. By expanding our vocabulary and creating clearer distinctions, we reduce the risk of 'risk' getting lost in translation.

The Month of September.

Credit.

In the face of stocks selling off and sharply rising interest rates, credit remained resilient and steady. With all in yields having improved on corporate debt, any bouts of weakness were promptly met with eager buyers.

With a few holidays in the September calendar, domestic supply was on the lighter side. Notable deals were a $400 mm unsecured bond from Case New Holland, a new (non-ABS) issuer, CGI Inc. coming with a $600 mm issue, and the long-awaited Cogeco bond (which remarkably, is now more expensive than Rogers). Enbridge also did a Sustainability Linked Bond (SLB), which obligates them to meet targets relating to greenhouse emissions, diversity, and gender balance. September also saw Honda, Nissan, and Hydro One come to the domestic market, while BNS issued an LRCN south of the border.

Generic Investment-Grade Credit Spreads:

- Canadian spreads tightened 3 bps to finish at 105 bps
- US spreads tightened 3 bps to finish at 84 bps

Interest Rates.

The third quarter was a tale of two halves. After declining through July and most of August, rates began to march higher and rose rather sharply into the end of September. It appears the markets are preparing for the withdrawal of monetary stimulus, with the Federal Reserve poised to start tapering in the coming months.

Sovereign yields:

- Canadian 5y finished at 1.11% (+27 bps) and the 10y at 1.48% (+26 bps)
- US 5y finished at 0.98% (+21 bps) and the 10y at 1.52% (+24 bps)

The Funds.

Algonquin Debt Strategies Fund

On top of the profits generated through credit trading, the Fund benefitted from short interest rate positions. While we took some profits on the move higher in government yields, we continue to maintain a bias towards yields going higher.

Through the month, the Fund reduced overall credit exposures and increased hedges via short position in credit derivatives. From this more conservative posture, we are well-positioned to capitalize on attractive new issues and any market sell-offs.

	1M	3M	6M	YTD	1Y	3Y	5Y	SI
X Class	0.63%	0.69%	1.95%	3.23%	7.24%	4.88%	6.20%	9.51%
F Class	0.55%	0.53%	1.59%	2.66%	6.27%	4.09%	5.32%	NA

As of September 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.

Algonquin Fixed Income 2.0

With the interest rate duration being managed around 2y, the Fund was able to preserve capital despite the sharp move higher in yields. Although the move in rates did eat into the yield earned and profits from credit trading. The net result was a modest gain on the month.

	1M	3M	6M	YTD	1Y	2020
F Class	0.05%	0.69%	2.85%	2.30%	6.62%	10.53%

As of September 30th, 2021

Algonquin Fixed Income 2.0 Fund is an Alternative Mutual Fund and was launched on December 9, 2019. Returns are shown for Class F since inception and are based on NAVs in Canadian dollars as calculated by SGGG Fund Services Inc., net of all fees and expenses. Investors should read the Simplified Prospectus, Annual Information Form, and Fund Facts Documents and consult their registered investment dealer before making an investment decision. Commissions, trailing commissions, management fees, and operating expenses all may be associated with mutual fund investments. An Alternative Mutual Fund is not guaranteed, its value changes frequently and its past performance is not indicative of future performance and may not be repeated. Payment of quarterly distributions is not guaranteed and paid at the discretion of the manager, therefore, it may vary from period to period and does not infer fund performance or rate of return

Looking Ahead.

Barring a new economic shock we expect credit spreads to remain resilient even amidst a rethinking of equity valuations. Given the recent decline in stock prices, spreads would normally be 5 to 10 bps wider. Any hint of weakness immediately drew in buyers, suggesting that there is a significant cash hoard looking for corporate debt.

The rate market ought to remain interesting with the Federal Reserve widely expected to announce 'tapering' in November. Furthermore, it appears that central bankers are becoming a little more nervous about the supply chain problems which are driving prices higher. Instead of improving, these problems are spreading to encompass a wider array of goods, leading to concerns that higher CPI will persist well into next year. We are keeping a close eye on their communications, looking for signs that they will be more aggressive in terms of removing monetary stimulus than originally thought.

Contact

Algonquin Capital
40 King Street West, Suite 3402
Toronto, Ontario, M5H 3Y2
www.algonquincap.com

Raj Tandon
Founding Partner
raj.tandon@algonquincap.com
+1 (416) 306-8401

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