ALGONQUIN
CAPITAL

Waiting For Godot | September 2023

"If I had known who Godot is, I would have written it in the script."
Samuel Beckett

Samuel Beckett's famous 'tragicomedy in two acts' is often described as a play in which nothing happens, twice. The two protagonists, Vladimir and Estragon (Didi and Gogo), spend the entirety of the play (as the title would suggest) *Waiting for Godot*. But it is unclear as to how long, why, and even what (or who) they are waiting for.

The very cryptic and barren nature of the work leaves it open to all sorts of interpretations. The most common being some form of absurdist existentialism, highlighting the tension between our desire for meaning and our inability to find it.

But Beckett's genius is not in the message itself but in how it is delivered. In that, he forces the audience to endure and suffer the absurdity, toil, and pain of waiting in vain. A predicament many economists and investors can relate to these days.

Act I.

Last summer, economic weakness seemed inevitable, in what was being dubbed the most well-telegraphed recession. Central bankers were on the inflation warpath and raising rates to induce a slowdown.

By the Fall, the S&P was down 25%, yield curves had inverted, and investment-grade credit spreads had doubled over the previous year. The doomsday forecasters were out in full force.

The market was poised for a recession, and just as in the play, nothing materialized in the first act. However, like the 'boy' claiming that Godot would surely come tomorrow, central bankers warned us that growth would slow significantly in early 2023.

Act II.

At the start of the second act (i.e., 2023), people continued to expect something to break from the weight of soaring yields. Godot was en route and bringing summer rate cuts with him.

In March, it appeared that he was entering stage left, as we witnessed failures at US regional banks and Credit Suisse. But central bank and government intervention limited the contagion, and we were left waiting for the next sign of trouble.

By summer, there was a growing consensus that Godot was not coming. The S&P had rebounded over 25% from the lows of last autumn, as the potential economic landings shifted from hard to soft to nirvana. There was hope that the economic script would follow the play and that we might have been waiting for nothing.

But once autumn rolled around both the temperatures and optimism cooled. The higher-for-longer narrative took hold, renewing speculation that Godot was indeed going to make an appearance. After all, the longer rates remain restrictive, the greater the odds that something breaks. Fearing such economic cracks ahead, equity investors decided to cash in some chips and head to the sidelines.

ALGONQUIN CAPITAL

So back to waiting we go. It has now been 15 months since yield curves inverted. The longest such stretch since the early 80s for one of the market's favourite recession indicators. Like Beckett's protagonists, Didi and Gogo, we have been in suspense so long that we are not even sure what we are waiting for.

But unlike Mr. Beckett, the author of the current tragicomedy has not revealed how many acts we must endure. This might seem a far worse fate than *Waiting for Godot*, but at least higher yields mean fixed-income investors are getting paid while they wait.

The Month of September.

Credit.

Despite the sell-off in equities and a heavy amount of new supply, investment-grade credit spreads held up remarkably well. The generic domestic index was wider by 1 bps, but banks did underperform with senior bail-in spreads leaking out 5 bps.

September saw $16bn of new issues in the domestic market, which now puts the 2023 pace closer to 2022. Notably, the year-to-date supply from non-bank issuers is almost 50% ahead of last year.

The big deal to hit the tape was Rogers' $3 bn four-tranche offering, which came on the heels of Telus' $1.75 bn three-tranche deal. The new bonds came with good concessions and were met with robust demand. With the Telco supply out of the way, Capital Power, John Deere, Caterpillar, Dollarama, Canadian Tire, and Couche Tarde all came to market.

Even real estate borrowers were able to refinance maturities as the likes of Morguard, West Edmonton Mall and RioCan issued bonds. These companies faced lofty borrowing costs, indicative of the refinancing difficulties for certain segments of the market. However, it is a positive sign that buyers could be found at higher coupon levels.

Also notable on the month was Enbridge announcing its acquisition of three US-based natural gas utilities, which will be funded through a combination of equity, senior borrowing, and hybrids. We expected most of the debt to be issued in US$ to match the asset profile, but they followed up some well-received transactions down south, with a $1 bn hybrid deal in Canada.

Canadian banks were not to be left on the issuance front. However, with it being cheaper to borrow in the US, they focussed their deals south of the border.

- Canadian spreads widened 1 bps to 150 bps
- US spreads widened 3 bps to 121 bps

Interest Rates.

In last month's commentary, we questioned the value of long-end rates and whether the 'new normal' era of low rates post-GFC was over. We also considered what term premium investors would demand for owning government bonds for 10 years or longer.

It seems more people are asking similar questions, resulting in global bond yields soaring higher. Longer maturity bonds bore the brunt of the damage, as yield curves bear-steepened (i.e., higher and less inverted). We think the debate has just started and expect more volatility as people recalibrate perceptions of fair value.

Sovereign yields:

- Canadian 2y finished at 4.87% (+23 bps) and the 10y at 4.02% (+46 bps)
- US 2y finished at 5.05% (+18 bps) and the 10y at 4.57% (+46 bps)

The Funds.

Algonquin Debt Strategies Fund.

The return from the month was mainly derived from the portfolio yield, as profits from active trading were dented by the move wider in bank spreads.

Portfolio Metrics:

- 10-11% yield
- IR Duration: 1.7y
- Average maturity: 1.7y
- Average credit rating: A-

	1M	3M	6M	YTD	1Y	3Y	5Y	SI
X Class	0.58%	2.21%	4.91%	6.42%	9.27%	3.77%	3.75%	7.75%
F Class	0.51%	1.95%	4.50%	5.86%	8.55%	3.05%	3.03%	NA

*As of September 30th, 2023

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

While the sell-off in rates was painful, having most of our exposure at the short end of the curve limited the damage. The portfolio yield and active trading also helped to offset some of the losses from rates moving sharply higher.

Portfolio Metrics:

- 8-8.5% yield
- IR Duration: 5.3y

- Average maturity: 3y
- Average credit rating: A-

	1M	3M	6M	YTD	1Y	2022	2021	2020
F Class	-1.43%	-1.21%	-0.49%	2.27%	4.72%	-6.15%	2.42%	10.53%

*As of September 30th, 2023

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.

The possibility that rates will remain elevated for longer should continue to be a dominant issue within the investment community. If we are in a 5% sovereign bond yield world, then people will likely need to reassess what the appropriate risk premium looks like for equities, real estate, private investments, etc. Determining the appropriate premiums for risk assets will involve a lot of price volatility, as investors tend to express their point of view through buying and selling.

Based on valuation, liquidity, and security, we continue to favour Canadian high-quality, investment-grade credit. Spreads continue to trade at the wider end of their typical range and above their historic averages. For example, over the past two years bank spreads have doubled, and appear cheap relative to high yield and US investment-grade credit. Thus, even if we hit some speed bumps ahead, these 'blue-chip' domestic issuers offer some cushion.

In terms of potential trouble ahead, it seems we have been waiting for so long, that we can no longer be sure of what we are waiting for. Of course, the easy answer is that something will eventually 'break' and plunge the economy into a recession. But for now, the anticipation continues. Fortunately, in the meantime, we can get paid handsomely in short-maturity bonds as we watch the drama unfold.

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

Disclaimer

Algonquin Capital Corporation ("Algonquin") is registered with the Ontario Securities Commission as an exempt market dealer, investment fund manager, and portfolio manager. This commentary is confidential and for authorized use only. Under no circumstances are its contents to be reproduced or distributed to the public, media, or potential investors without written authorization. The information contained herein, while obtained from sources believed to be reliable, is not guaranteed as to its accuracy or completeness.

The information contained in this commentary is not investment or financial product advice and is not intended to be used as the basis for making an investment decision. This commentary by Algonquin is not, and does not constitute, an offer to sell or the solicitation, invitation, or recommendation to purchase any securities.

This commentary contains statements that constitute "forward-looking statements". Examples of these forward-looking statements include, but are not limited to, (i) statements regarding future results of operations and financial condition, (ii) statements of plans, objectives or goals and (iii) statements of assumptions underlying those statements. Words such as "may", "will", "expect", "intend", "plan", "estimate", "anticipate", "believe", "continue", "probability", "risk" and other similar words are intended to identify forward-looking statements but are not the exclusive means of identifying those statements. Forward-looking statements included herein are based on current expectations and beliefs, and Algonquin disclaims, other than as required by law, any obligation to update any forward-looking statements whether as a result of new information, results, future events, circumstances, or if Algonquin's expectations or opinions should change, or otherwise. By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks exist that such predictions, forecasts, projections, and other forward-looking statements will not be achieved. A number of important factors could cause Algonquin's actual results to differ materially from the plans, objectives, expectations, estimates, and intentions expressed in such forward-looking statements. As such, undue reliance should not be placed on any forward-looking statement.