Deep Breath | July 2024

"Take a deep breath in, and let it go."
Every Meditation Teacher Ever

For the past couple of years, we have warned investors to be prepared for wild bouts of volatility. With the economy at an inflection point and central bankers engaged in a delicate balancing act, we expected each data point to be over-scrutinized and prone to overreaction.

So far, the economic data has been mixed, showing signs of strength and weakness, causing the pendulum to swing from one extreme to another. It has been sufficient to give investors a healthy dose of indigestion.

And anyone hoping for a summer hol' from all the vol has been sorely disappointed. After euphoric stock markets hit record highs in mid-July, August began with headlines of panic and routs before finding some semblance of calm.

These wild swings and shifts in sentiment are both confusing and unnerving—feelings further exacerbated by the financial media's penchant for hyperbole. With this in mind, we thought it appropriate to take a deep breath and offer some context for the most recent gyrations.

The sky was falling.

In 2022, central banks launched aggressive rate-hiking campaigns to tame the inflationary beasts. The foregone conclusion was that such restrictive policies would plunge the economy into a recession. Yield curves inverted, and the S&P and Nasdaq dropped 25% and 35% respectively.

Towards the end of the year, the inevitability of a hard landing was being questioned, and the prospect of a soft landing gained credence. This sparked the beginning of a market rally.

Never mind, it's Nirvana.

The optimism and exuberance reached the point where a soft landing or no landing (Nirvana) was accepted as fact. For months and months, markets ignored signs that higher rates were restraining and even slowing the economy. The euphoria drove equities to new highs, with the S&P and Nasdaq rebounding 60% and 80% from their 2022 troughs, peaking on July 16th of this year.

The recalibration.

Since then, equities have taken a downturn, dropping 6-10%. A weaker-than-expected July jobs report reminded investors that the economy is slowing, and the probability of a recession was adjusted higher.

While the financial press wrote about routs and panic, we saw this is a more rational recalibration of the risk premium. With the downward trend in employment continuing, it seems reasonable for markets to factor in the possibility of a hard landing of unknown depth and duration. This recession repricing was further exacerbated by the unwinding of the yen carry trade.

Now what?

So, where do we go from here? Back to our original warning: be prepared for more volatility ahead. Each economic data point will continue to be over-scrutinized, leading to market gyrations as investors rejig the odds

of a recession. The risk is that the longer markets remain overly sensitive to each data release, the greater the odds that rational recalibrations become irrational emotional responses.

The Month of July

Credit.

Overall, July was a relatively quiet month in credit markets. Spreads ground tighter to start the month before giving a little back in the second half. After all was said and done, the broad investment-grade indices finished modestly tighter.

The new issue market was active on both sides of the border, particularly in the US, which saw a July record of $132 bn of new deals. Domestically, a healthy (but more seasonally in line) $8 bn of new issues were printed. The banks continue to be active in NVCC issuance, with many legacy deals maturing this year. RBC came to market with $1.25 bn of NVCC bonds and $600mm of institutional preferred shares.

Investment grade credit spreads:

- Canadian spreads tightened 2 bps to 120 bps
- US spreads tightened 1 bps to 93 bps

Interest Rates.

The July central bank meetings produced another rate cut from the Bank of Canada (BoC) and the promise of the Fed beginning its cutting cycle in September. This led to a strong rally in rates, with yield curves becoming less inverted.

Sovereign yields:

- Canadian 2y finished at 3.45% (-54 bps) and the 10y at 3.16% (-34 bps)
- US 2y finished at 4.26% (-50 bps) and the 10y at 4.03% (-37 bps)

The Funds.

The Fund significantly outperformed the broader credit market due to tactical rate trading and outperformance from our credit positions. The result was a solid gain of 1.28% on the month.

Algonquin Debt Strategies Fund.

Portfolio Metrics:

- 6-8% yield
- Average credit rating: A-
- Average maturity: 3y
- IR Duration: 1y

	1M	3M	6M	YTD	1Y	3Y	5Y	SI
X Class	1.43%	2.89%	5.92%	7.71%	13.22%	5.65%	5.29%	8.36%
F Class	1.28%	2.56%	5.27%	6.89%	11.81%	4.79%	4.45%	NA

* As of July 31st , 2024

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

The Fund benefitted from the rally in rates, mainly because our exposures are concentrated in the short end of the yield curve (i.e., 2-5y). The return was further bolstered by outperformance from our credit positions and the yield earned.

Portfolio Metrics:

- 6-7% yield
- Average credit rating: A-
- Average maturity: 3.5y
- IR Duration: 3y

	1M	3M	6M	YTD	1Y	2023	2022	2021	2020
F Class	2.07%	4.48%	4.58%	5.16%	10.93%	9.75%	-6.15%	2.42%	10.53%

* As of July 31st , 2024

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.

At the end of last year, forecasters predicted domestic corporate issuance to be around $115 bn With $87 bn already 'in the can,' it is a foregone conclusion that the forecasted level will be eclipsed. But with a significant portion of issuance brought forward to avoid the US election, we believe activity through to year-end should be much lighter. Given our expectation for bouts of volatility, a muted issuance level makes it easier to 'buy dips.'

With central banks moving to lower rates, the game for bond traders will be guessing the magnitude and timing of each cut. As a result, yields will be very sensitive to incoming economic data. Much of the pundits' time and energy will be spent discussing the implications of each data release; however, we think it makes far more sense to concentrate on the fact that rates will be lower a year from now. With the biggest questions being the pace of the cutting cycle and where it stops.

Although we have enjoyed the benefits of a remarkably sanguine market, we relish the opportunities heightened volatility can bring. Both funds are well positioned in terms of having the flexibility to take advantage of dislocations that arise in the months ahead.

Contact

Algonquin Capital	Raj Tandon
40 King Street West, Suite 3402	Founding Partner
Toronto, Ontario, M5H 3Y2	raj.tandon@algonquincap.com
www.algonquincap.com	+1 (416) 306-8401

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