Experience. Active Management.

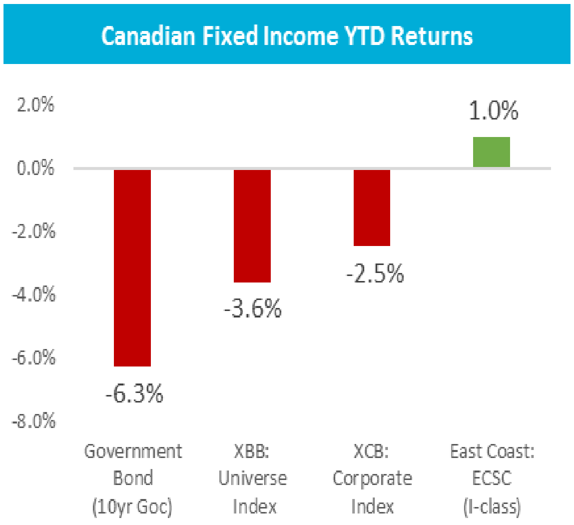
EAST COAST MARKET COMMENTARY

FEBRUARY 2021

Impressive US vaccination rates, stronger than expected US corporate earnings and improving economic data were among the highlights for equities in February. However, interest rates appeared to have the market's focus again this month, as US 10yrs sold off (rose) 34bps and Canadian 10yrs sold off (rose) a massive 47bps in February. Equities finished February +5.3% in Canada (S&P TSX Comp) and +3.2% in the US (S&P 500). As you may recall, Canadian credit spreads rallied 7bps in January, outperforming the US whose spreads were unchanged on the month. The US played catch up in February, with US credit spreads tightening (rallying) 7bps and Canadian credit spreads rallying only 2bps.

RISING INTEREST RATES: FIXED INCOME PLAN

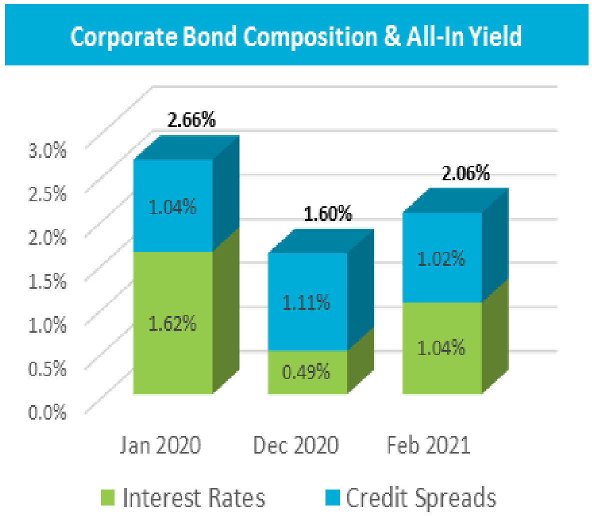
February saw sizeable losses again in traditional fixed income. As investors know, every single bond – including corporate bonds – have interest rate exposure embedded within them. As a result, when interest rates rise (sell off), traditional fixed income funds lose money. The 10yr Gov't of Canada (GoC) bond rose 47bps – if you owned this 'risk free' 10yr bond, you would have lost -4.4% in February alone. YTD 2021 the loss on a 10yr GoC bond is approximately -6.3%. The indices own every bond – not just 10yr governments – so their losses are more tempered, in the -2.5% to -3.5% range. The very strong correlation of the indices to rates can be seen in the YTD return chart below. The diversification benefit of East Coast is clear. The strategy is negatively correlated to interest rates (-0.22 since inception) as our mandate aims to hedge (remove) interest rate exposure from corporate bonds.



Source: Bloomberg, BMO Capital Markets, East Coast

RISING INTEREST RATES: FIXED INCOME PLAN

The bar chart on the next page shows the all-in yield composition (interest rate yield + corporate spread) of the corporate bond index. By end of 2020, credit spreads had almost returned to pre-COVID-19 levels, while interest rates were still more than 100bps lower (prices higher). By Dec 2020 the corporate bond index was yielding roughly 1.6% which we argued was far too little a return for taking interest rate exposure. If an investor had purchased said corporate index on Dec 31, 2020 they could expect to receive 1.6% a year if spreads and rates were unchanged. In the two months since that purchase, 7yr rates have risen (sold off) 55bps and credit spreads have tightened (rallied) 9bps; resulting in a -2.5% return YTD. Any return benefit from credit spreads has clearly been dwarfed by the interest rate move.



Source: Bloomberg, BMO Capital Markets, East Coast

While one can expect to see government bonds (interest rates) experience some monthly rallies in 2021, our team believes the ultra-low rates witnessed after March 2020's Liquidity Crisis will not be revisited. Therefore, their YTD losses are unlikely to turn positive by year end 2021. Indices may be able to claw back the losses witnessed YTD, but it will require credit spreads to move back toward pre-GFC levels (i.e. 2006 spreads) and/or interest rates to rally back significantly.

We are happy with our current positioning. While our strategy is always long credit spreads, our portfolio is more conservatively positioned. Every day our team actively searches for relative value opportunities that allow the portfolio to earn investors a few extra basis points without adding overall portfolio risk. The investment team has had the same goal for the last 3-4 months: earn investors a monthly yield that is better than any other traditional fixed income investment, while simultaneously leaving dry powder, or room, to add risk when there are better risk-adjusted opportunities. We believe patience will continue to be key.

MARKET SNAPSHOT

Canada		US	
Credit (Bloomberg Barclays Cdn Corporate Index)	Rallied 2bps	**Credit** (Barclays US Aggregate Credit Index)	Rallied 6bps
Equities (TSX Composite)	+5.28%	**Equities** (S&P 500)	+3.24%
Interest Rates (GoC 10yr)	Weakened 47bps	**Interest Rates** (TSY 10yr)	Weakened 34bps

Thank you for your continued interest in the Fund. For further information, please contact your regional Arrow Capital Management representative.

Sincerely,

East Coast Fund Management Inc.