Arrow Capital Management Inc.

Experience. Active Management.

EAST COAST MARKET COMMENTARY

NOVEMBER 2021

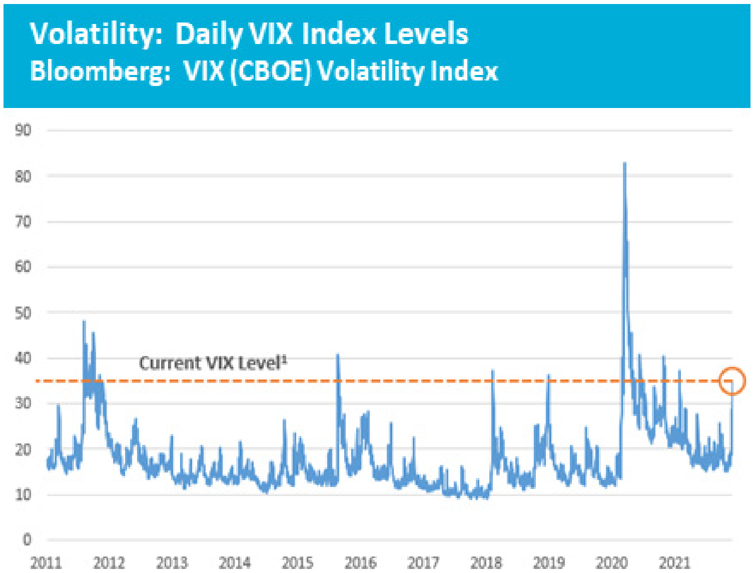
In late November, virtually all asset classes sold off due to two major macro events: 1) The new COVID-19 variant, Omicron, which has caused extremely swift changes to border restrictions around the globe, given its unusually high number of mutations that have the potential to make the virus more transmissible and less susceptible to current vaccines. 2) The FED finally threw in the towel on the term “transitory” with regard to inflation and hinted to a more rapid tapering of its bond purchase programs. This more hawkish rhetoric from Powell took some steam out of risk assets in the month of November. The Energy and Financials sectors were the worst performers and US equities (S&P 500) closed down -0.7% and Canadian equities (TSX Comp) down -1.6% by end of November.

In a risk-off move, lower-quality assets, like high yield, tend to weaken more substantially than higher quality assets, like investment grade credit. This was certainly true in November, with high yield weaker (wider) by +50bps while higher-quality, investment grade credit weakened (widened) by +12bps in the US and by +9bps in Canada. Commodities also weakened as oil prices fell amid worries Omicron could lead to reduced demand.

Risk-off moves often lead to a flight-to-safety driven rally in bonds issued by the highest rated and most secure governments around the world. This resulted in additional interest rate volatility as 10yr government bonds (interest rates) in Canada rallied -15bps in November, on the heels of selling off (weakening) +21bps in October, and 10yr US Treasury bonds rallied -11bps this month.

VOLATILITY GAUGE SPIKES

The week of Nov 29th showed the first signs of a nervous market and the swift moves that are possible when investor sentiment shifts. The volatility index (VIX) spiked, signaling an increased level of risk, fear, and stress in the market. As you can see in the chart at right, prior to the COVID Crisis (Mar-2020), there were less than a handful of instances over the last decade when volatility was as high as it was in late November. That said, within a few days markets appeared to settle, and risk assets began rallying again. We expect more risk volatility and believe the probability of further equity (risk) weakness is higher than markets are currently pricing.

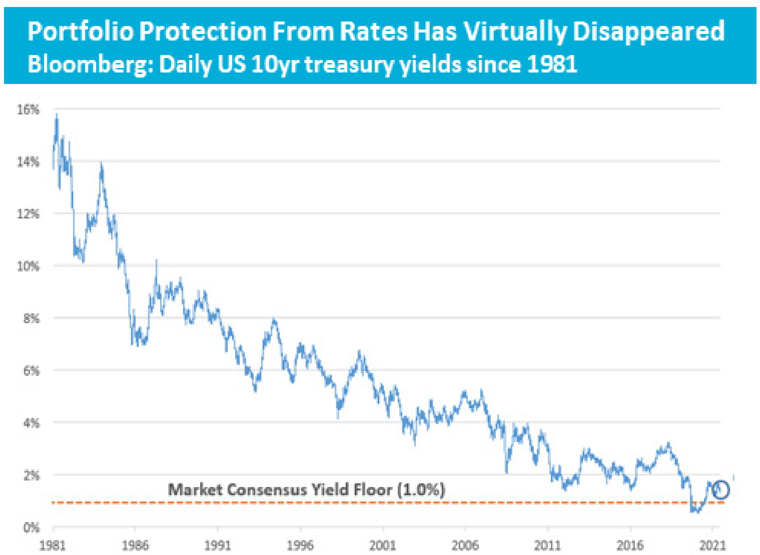


Source: East Coast Fund Management

INTEREST RATE CAN'T PROTECT INVESTORS LIKE THEY HAVE IN THE PAST

As mentioned above, government bonds (interest rates) typically rally in risk off market environments. This is due to cash flooding to a safe haven (hiding spot) after selling riskier assets) often in a panic response). This has led to a historically well-defined negative correlation between risk assets and interest rates. Mike MacBain, our CIO, takes investors through the negative correlation analysis between IG credit spreads and interest rates in the podcast.

The negative correlation of interest rates and risk assets has historically proved valuable to investors as government bonds tend to rally, providing a positive return buffer for the portfolio, during months when equities (and other risk assets) sell off and provide a negative return. The conundrum for investors today is that interest rates still sit near all-time lows. For example, US 10yr rates are currently 1.34% and the consensus opinion is that the floor on 10yr yields is about 1.00%. This significantly reduces the ability for interest rates to act as a buffer going forward. There is virtually no room for a rally in rates to offset losses in risk assets if we go into an economic downturn. The chart at left visually reflects the inherent challenges of the 60/40 portfolio.



Source: East Coast Fund Management

Our actively managed, flexible mandate IG credit strategy has been able to outperform traditional Canadian bond index funds by over 5% YTD; yet the Investment team has been primarily focused on capital preservation for investors in 2021. We will actively rotate into higher return opportunities for investors (greater yield) once we believe the risk-adjusted yields are more compelling. Current metrics do not warrant our PMs reaching for yield as there is extremely limited upside presently available in riskier assets and it is our team's expectation that there will be another credit spread widening event in 2022.

MARKET SNAPSHOT

Canada		US	
Credit (Bloomberg Barclays Cdn Corporate Index)	+9bp (weak)	**Credit** (Barclays US Aggregate Credit Index)	+12bp (weak)
Equities (TSX Composite)	-1.6%	**Equities** (S&P 500)	-0.7%
Interest Rates (GoC 10yr)	-15bps (rally)	**Interest Rates** (TSY 10yr)	-11bps (rally)

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.

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