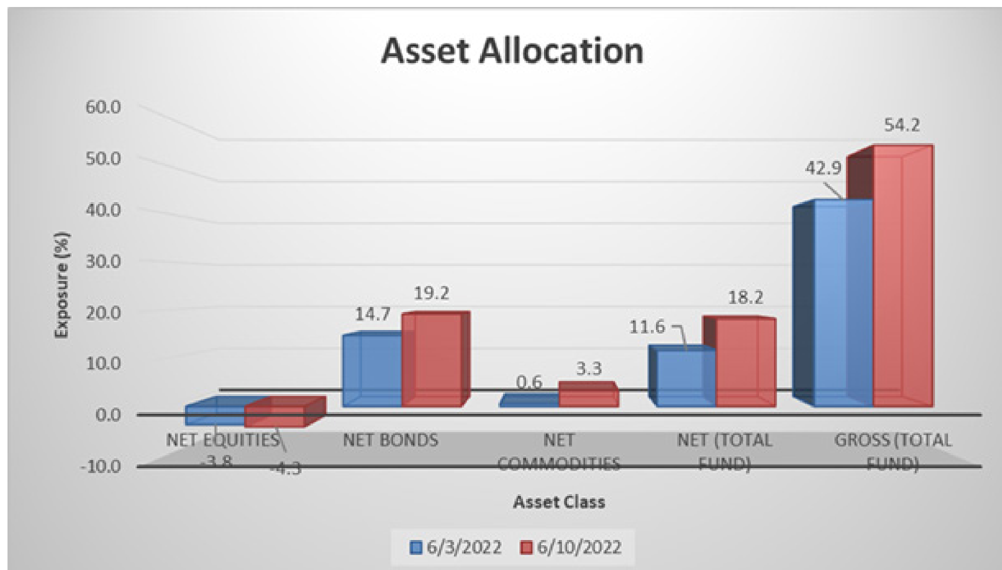


Monthly performance, macro context, current positioning and future expectations.

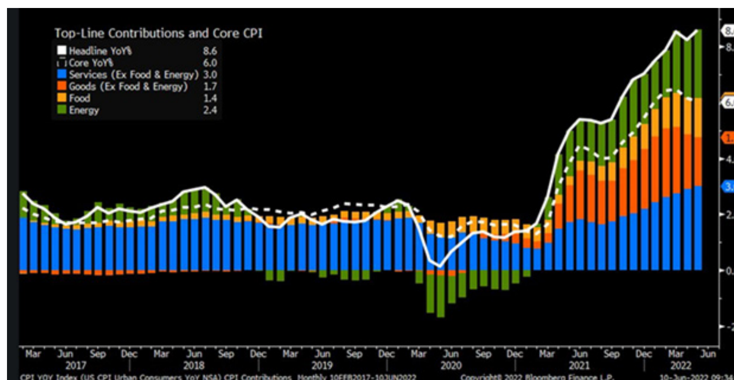
Performance
Week of June 10, 2022

Arrow Global Advantage Alternative Class (F Class):
WTD 0.24%
MTD 0.19%
YTD -2.36%

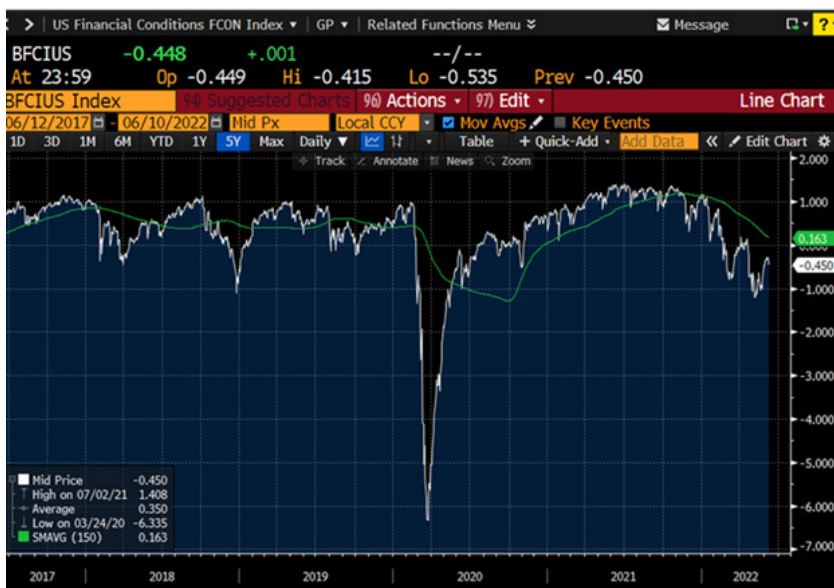
MSCI ACWI:
WTD -4.44%
MTD -4.98%
YTD -17.82%

Global Market Summary

This week all eyes were firmly focused on the May US CPI figures. Usually when everyone is focused on one number it becomes over-hyped but not this time! The headline CPI came in "hot" at 8.6% YoY – ahead of expectations for 8.2%, while core CPI was lower but by less than expected and higher than last month. The real issue was the "diffusion" i.e. the trending higher of inflation across many more sub-sectors – the principle culprit is energy of course as it spills into any and all facets of the economy (think higher refined product prices like gasoline, jet fuel and diesel creeping into prices of goods and services now). The chart below provides a breakdown.



Many components of inflation YoY figures were really crazy – chicken +17.4% (largest ever); Restaurants +9% (largest ever); Rent +5.2% (largest since 1987); Airfare +37.8% (largest since 1980) – I think you get the picture. The major takeaway was the rising probability of "sticky" inflation staying sticky for a longer time. The market took all this data and simply crushed any thinking of a "pause" this September in the hiking cycle. The short end of the curve was quick to react with the 2yr jumping 25bps on Friday to 3.26% while the 10yr rose a more modest 11bps to 3.15%. The terminal rate rose to 2.86% on the week. The big question is at what level of inflation / rates will make financial conditions tight enough to cause a slowdown in aggregate demand – as the BBG Financial Conditions Index below shows we likely have much more work to do on the downside. While real rates have risen they likely have much more to go now.



The idea of whether we will have a hard or soft landing as the FED raises rates has been debated – the historical evidence as noted by Stan Druckenmiller at this week's Sohn Conference – is simply not good when CPI is north of 5% so a soft landing is a bad bet.

Our views on inflation have not materially changed but certainly the fact that goods inflation is not falling as fast as we would have expected is cause for some concern. That being said, retailer after retailer is saying the same thing about inventories and getting them lower – so we have to believe this happens in the next 3 months via deep discounting. This might be even more dramatic given the University of Michigan's Consumer Sentiment index reading – a total disaster – lowest ever! The FED however may now hike even more aggressively next week if they believe inflation is becoming more embedded in the system – history suggests that a more aggressive approach fits with historical evidence in terms of pre-emptively fighting inflation – they should not follow inflation with small hikes but rather get out ahead of it substantially. Contrast this situation with the ECB decision last week – a complete farce to be honest. Headline CPI is running over 8% in the Eurozone and the ECB is "fighting" this with a 25 bps hike in July (to go to -25bps) and they will stop QE – you show 'em Madame Lagarde! The Euro which had a small pulse earlier was hit post the decision. To be fair though, the EZ is likely already in a recession so how can you raise rates? And how do you raise rates when periphery debt levels (Italy / Spain/Greece) have only continued to rise. The ECB is watching as German/Italian spreads continue to widen – now at 2.25% for 10yr spread. The ECB pledged to prevent "fragmentation" from occurring but did not provide any specifics. The ECB is truly between a rock and a hard place. Will stay short small euro/$.

In Canada, the jobs data reported on Friday was solid with the unemployment rate hitting an all-time low. Of course this is a lagging indicator and there were a few knits including falling private sector employment (the Canadians love their public sector!) and hours worked also fell again (vs April). The annual Financial System Review made a few headlines – will not bother to comment as the housing market issues are really all you need to know – home prices up 50% since onset of pandemic and household indebtedness at the top of the global league tables (OK maybe the Aussies and Danes are tough competition). We doubt that the next 150bps+ of tightening for all those variable rate mortgages, along with maturing 5 year fixed's and HELOC's outstanding, will go well for our economy that is too reliant on residential investment. The Canadian dollar will be the release valve here – 1.35 $/CAD is our target.

As you can tell by the above note, when rates start to rise, the weak links get exposed and debt serving issues start to become very important. Looking at credit default swaps and high yield spreads the bad news is beginning to get priced in and the trend is not looking very good.

This coming week will feature the FED meeting on the 15th along with PPI, Retail Sales, Housing Starts, Industrial Production in the US. That is one heck of a busy data week!

Summary Table
Economic Forecasts (Q2/2022 and Q3/2022)

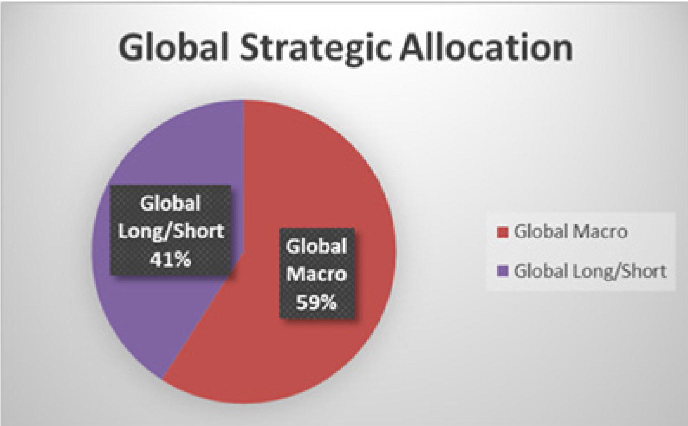
Country	Q2 Outlook	Q3 Outlook
US	D	G
Canada	G	D
Eurozone	D	D
China	R	R
Japan	R	G

D= Deflation / G= Real Growth / R= Inflationary Growth / I = Inflation

Q2 in the US remains more in the Inflationary “I” zone in the first part (April / May) and then Deflationary “D” as base effects kick in for real.

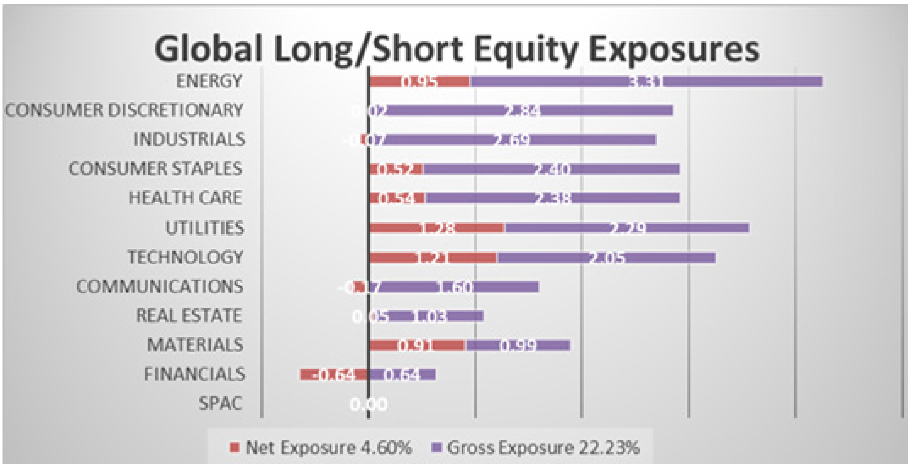
Economic Weekly Update

Below is a summary of the week and significant changes.



The portfolio is divided into 2 parts – a Global Long/Short part (individual securities) and a Global Macro part that focuses on liquid futures, ETF’s etc. across FX, Commodities, Fixed Income and Equities.

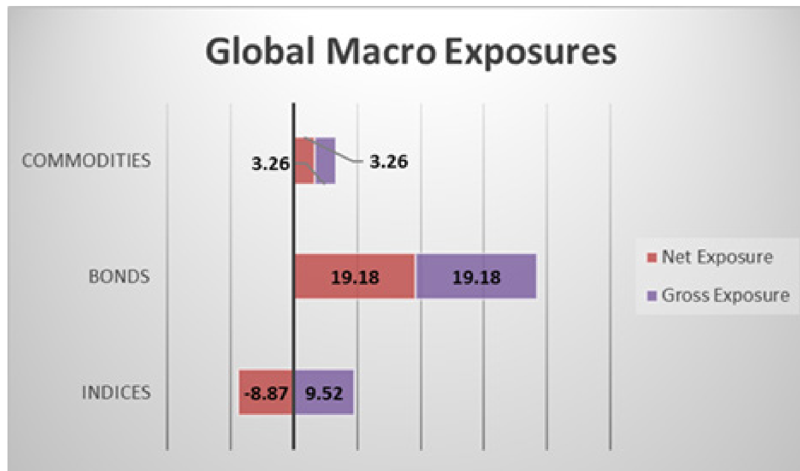
1) Global Sector Exposures (Long / Short Portfolio of individual companies:



We continue to have a tight net exposure which helped us during the week. Given the magnitude of the moves lower on Thursday and Friday, we are more inclined to think about booking gains on some shorts than we are about increasing shorts at this time. The S&P, 10yr UST yield, and the US dollar are all at critical levels, and we will take our cue from the market as to what the next play is.

Some argue that this time looks somewhat similar to the dot-com bubble in the late 90's with regard to the rich valuation in tech stocks and across crypto. We've seen the software index (IGV) fall 40% from its peak in late 2021 on multiple contraction, while earnings estimates have only come down 5% for the year. We think it is likely that once that economy reveals more pain and companies begin to cut CapEx, we will see more downside in earnings. Last week we had the earnings from DocuSign, a large pandemic winner. Guidance was lowered again following the previous two guide-downs. Unsurprisingly, losses increased after growth started to slow. Downside in earnings estimates, in combination with shrinking liquidity, will mean more downside for risky assets, particularly those with unhealthy balance sheets.

2) Global Macro Exposures



Total Gross: 31.9%, Total Net: 13.6%

Commodities – Bullish Gold
We re-established a long gold futures position last week

Bonds – Bullish Duration / Short Credit
We added a small 10 yr. US Treasury position. The key level here is 3.2% technically.

Equity Futures – Negative
We have maintained similar net short equity position via put spreads on US equity indices.

Foreign Exchange Positions:

FX EXPOSURE	%
CAD	94.2
USD	13.5
Other	0.7
GBP	0.2
JPY	-5.9
AUD	-0.6
EUR	-2.2
DXY	0.00
Total Fund	100%

FX – Bullish USD
We remain short CAD and JPY vs USD and a smaller bet short EUR/USD.

Historical Performance – As of May 31, 2022

	1-Year	3-Year	ITD
AGAA - Series F	-0.39%	5.01%	3.82%

Published June 13, 2022.

Commissions, trailing commissions, management and performance fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. The indicated rates of return are the historical annual compound total returns net of fees and expenses payable by the fund (except for figures of one year or less, which are simple total returns) including changes in security value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

The rates of return are used only to illustrate the effects of the compound growth rate and are not intended to reflect future values or returns on investment in an investment fund.

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The comparison presented is intended to illustrate the historical performance of the Fund as compared with the historical performance of a widely quoted market index or a weighted blend of widely quoted market indices or other investments. There are various important differences that may exist between the Fund and the stated indices or other investments that may affect the performance of each. The objectives and strategies of the Fund result in holdings that do not necessarily reflect the constituents of and their weights within the comparable indices. Indexes are unmanaged and their returns do not include any sales charges or fees. It is not possible to invest directly in market indices. Certain statements contained in this communication are based in whole or in part on information provided by third parties and Arrow Capital Management has taken reasonable steps to ensure their accuracy. Market conditions may change which may impact the information contained in this document.

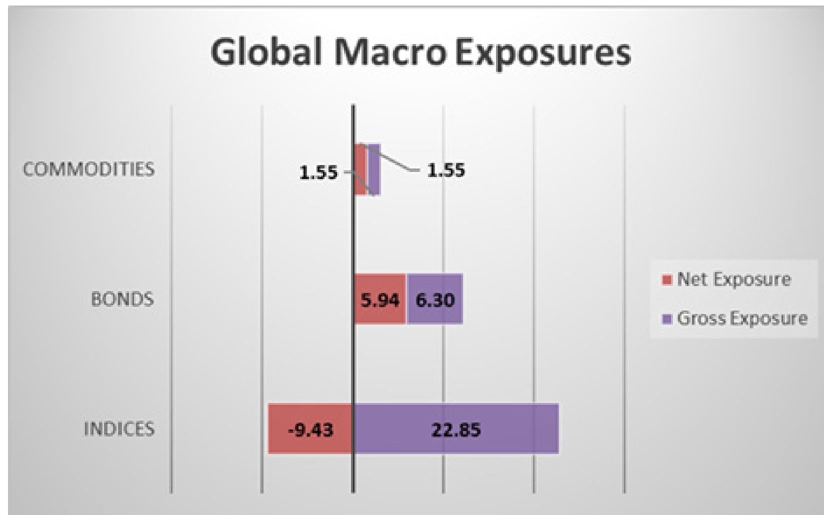
More information about the Fund can be found on our website www.arrow-capital.com.

Last week a rollercoaster for equities, the SPX was up 2.4% from Monday to Wednesday, yet closed the week down 2.6%. Thursday and Friday were painful for pretty much every sector in the market- there were almost no places to hide. We continue to like our defensive positioning at this juncture.

Earnings continues to be the focus, and last week, Netflix was the standout. After a brutal release last quarter which led to the stock gapping down 20% on the open- some investors dared to call the bottom. Bill Ackman, a successful HF investor many hold in high esteem, took a shot and initiated a $1.1B position. Netflix's quarterly release last week brought back memories from the previous, with subscriber growth slowing even further- the stock gapped down 30% on the open. Ackman, like many others, cut their bets and sold their shares. We believe the earnings release shows the flipside of the pull-forward in demand companies like Netflix benefitted from during the pandemic when discretionary spending was exploding. When you have cash, you can afford 6 streaming services. We know real wages are declining, and these discretionary purchases are the first consumers cut. We would expect 'stay-at-home stocks', or 'covid winners', to continue their unwind, as Netflix is currently the poster-child.

In addition to Netflix, we saw very negative price actions from housing related companies (TPH, POOL) even after their strong guidance, same as the negative reactions from semiconductor companies (LRCX, ASML) and certain commodity categories (FCX/AA) after their earnings. Meanwhile, the price actions from consumer packaged goods (CPGs), e.g. PG, KMB, were very positive. It's evident that the market has been looking forward to the normalized earnings and those over-earners have been "punished".
The shift away from goods is still in its early stages. Early signs include both streaming services and used car companies reporting declining unit sales, and declining prices. We are likely to see more from household appliances, home improvement wares, furniture, electronics, cleaning supplies, and sports equipment/clothing as their earnings outlook is still very elevated compared to their pre-pandemic levels. Unit sales will weaken first, then prices.
We will have 61% of Nasdaq report this week. We already heard some tech companies slowed/ froze their hiring, e.g. GOOGL, FB. Falling business confidence generally indicates a deteriorating corporate profit outlook. We should be able to have more clarity on tech sector in the coming week.

2) Global Macro Exposures



Commodities – Bullish Gold

We have reduced our commodities position this week by cutting our gold futures in half in anticipation of a growing risk off market positioning in the FED meeting.

Bonds – Bullish Duration / Short Credit

We added slightly to our UST position this week. We do believe headline CPI is in the process of topping out as the global economy is expected to experience a material slowdown/deceleration in 2H 2022.