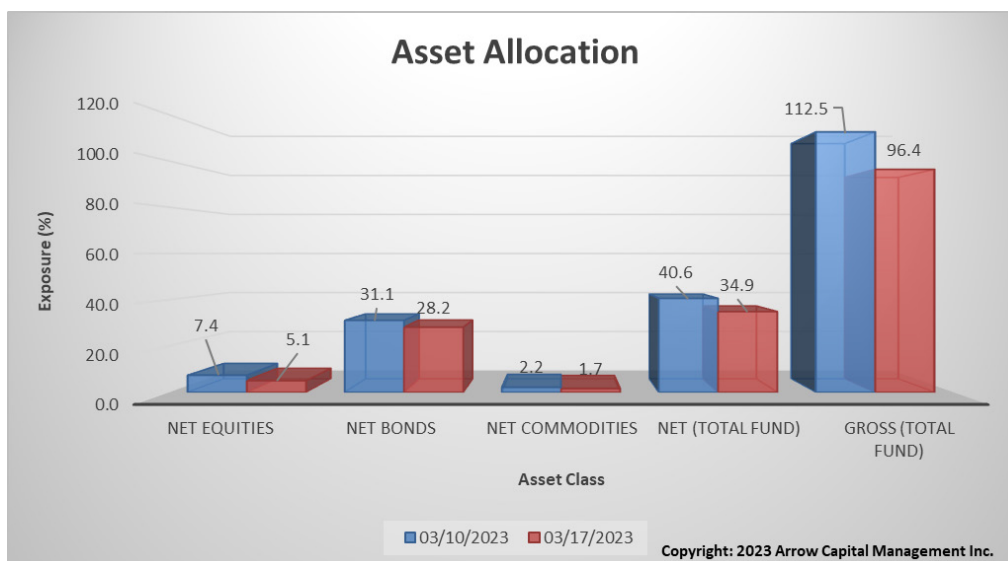


ARROW CANADIAN ADVANTAGE ALTERNATIVE CLASS

Week ending March 17, 2023



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

Performance

March 17, 2023

Arrow Canadian Advantage Alternative Class (F Class):

WTD -0.56%

MTD 0.41%

YTD -1.25%

S&P TSX Composite

WTD -1.96%

MTD -4.12%

YTD 0.69%

S&P 500:

WTD 1.43%

MTD -1.35%

YTD 2.01%

Fund Commentary

The Fund had a small loss on the week but given the extreme volatility of the volatility in bonds / FX and equities we are pleased to start next week in good shape! US Treasuries got an enormous bid across the curve but at the end of the week, the volatility (as measured by the MOVE index) hit cycle highs over 200 – think about that relative to the VIX at 25! The 2yr had its biggest fall in years (over 100bps!) as the market has now moved to price in cuts this year and a terminal rate all the way back to 4.8% - slightly above the policy rate. On the positive side, the FED's balance sheet has expanded dramatically as liquidity has been injected (not really QE though) which often leads to stable or better risk appetite. On the other hand, the reduction in the yield curve inversion is welcome but is often a sign that a recession is now close at hand.

US equities performed well, but that was all about technology and in particular the artificial intelligence names – MSFT, NVDA etc. The Nasdaq is now up over 14% this year on the back of lower rates but the Goldman AI basket is up almost 25%! There is no question that Messrs. Satch Nadella and Jensen Wong can spin the AI tale better than anyone and

with the market starved for a good story it is getting frothy. The Russell 2000 index was clobbered again given its exposure to banks while credit also sold off, but not by as much as we would have thought.

Two big issues last week. Let's start with the complicated one – Banking. Here we have a European problem with Credit Suisse (CS) and in the US we have a regional bank issue with a focus on contagion effects from 2 failures (SVB & Signature). CS is a SIFI bank (one of a small number of systemically important banks in the world) and this week the Swiss National Bank (SNB) provided the necessary support to prevent its insolvency. That being said, the credit default swaps (price of protection for CS debt) continued to soar to over 10% - why? Because a growing number of depositors continued to leave and a growing number of counterparties continued to reduce exposure / dealings with CS. So this weekend we expect CS to either be busted up into pieces for the vultures circling or sold entirely to a firm like UBS. So the problem hopefully will be solved quickly. The regional bank issue is a bit more tricky but rather than getting into the “weeds”, because it is very technical and complicated, let's hit the high points.

The situation at SVB and a few other banks is one where the percentage of “non-insured” depositors was very high especially relative to the industry (70%+). They all shared this common feature and it was a deliberate business strategy – they typically deal with wealthier individuals and growthier companies – all of whom were presumably comfortable knowing full well that the FDIC only insures deposits up to \$250k (CDIC here is \$100k). So the risk here is chunky and undiversified deposit bases makes these bank more susceptible to runs. This week saw a continuation of a flight of deposits out of other high proportioned non-insured deposit institutions like First Republic (FRC) and into SIFI banks like Bank of America and JP Morgan. The normal backstops for these regionals is often the Federal Home Loan banks but details this week revealed that both SVB and FRC were “tapped out” there, so likely one or both had to go the last line of liquidity – the Fed Discount window (Primary Credit on the H8) – which typically takes less secure loans etc. but also overcollateralizes to ensure they are paid back – and charges a higher rate. The rise here will likely be offset by greater take up next week of the FED's BTFP (not BTFD) program as regionals can now get 100% collateral on any TST/agency MBS even if they are only worth 80c on the dollar today. A problem for FRC is they do not have that much in TSTs/MBS on their balance sheet. So the FED orchestrated a consortium of banks to put deposits into FRC (\$30 billion) – ironically the deposits that fled FRC have now come full circle back to FRC! So is the problem / contagion contained? Short answer is real progress is being made...in the short run...but when confidence is fragile anything can happen.

In the long run we have two big issues. Firstly the BTFP is a one year deal i.e. it buys time for the regional bank to sell its assets (loans) in a less stressed environment. The deposits that left these banks and other regionals are likely not coming back IMHO – it is a real hassle to switch banks as we all know. So we are going to have a slow bleed for a considerable period of time. It is hard to manage a business when it is declining to say the least and when it is a matter of confidence to attract any new deposits (and when that confidence is shaken by the Fed, government regulators failures in the recent past etc.). The second, and bigger, issue is the declining state of the US economy and growing credit quality concerns especially around commercial real estate (CRE). In other words QUAD 4 in our vernacular is now in full force. What many have come to realize is that collectively the regional / small banks are major lenders to not only CRE (80%) but also commercial & industrial (C&I) (50%), residential lending (60%) and consumer loans (50%). Goldman estimates that the coming drop off in regional bank lending (roughly 15%) is equivalent to a 25-50bps hikes in rates. The FED no longer has the blanket ability to guarantee all deposits thus curtailing its ability to quickly quell deposit worries.

So if the FED, Congress and the FDIC are not careful in managing the regional bank issue, the slowing rate of credit growth associated with bank deleveraging combined with higher for longer rates associated with sticky inflation and strong employment, will be a toxic mix. Our GDP forecast is for Q1 GDP to be -2.11% versus the Atlanta FED GDP Now at +3.25% - quite the spread. BBG consensus is at 0.6%. Into our negative view on growth comes the FED this week. It appears that 25bps or a pause are the options. This week the ECB raised 50bps and remained hawkish and like episodes before, they are making the situation for themselves even worse yet again.

We are now 1 year on from the start of the hiking cycle – it has felt like an eternity! Is it a coincidence that monetary policy, which acts with “long and variable” lags, is now beginning to be felt in earnest in our “refi” economy (rhetorical

question)? Growth is now front and centre but with inflation still “sticky” and well above target the FED is truly boxed now between growth/inflation and now financial stability.

We have not changed portfolio positioning much over the week.

Data this week is pretty light so all eyes will be on the FED meeting and the new SEP.

Geographic Equity Exposures (% Total Portfolio including Futures)

ASSET ALLOCATION	NET	GROSS	LONG	SHORT
Canada	10.3	32.1	21.2	-10.9
US	-5.7	29.8	12.1	-17.7
Rest of World	0.4	1.9	1.2	-0.8
Equities Total	5.1	63.8	34.4	-29.4
Bonds	28.2	30.9	29.5	-1.4
Commodities	1.7	1.7	1.7	0.0
Total	34.9	96.4	65.6	-30.7

Net equity exposure was reduced from 7.4% to 5.1%.

Canada net exposure was reduced by 3.6%.

US net exposure was increased from -7.2% to -5.7%.

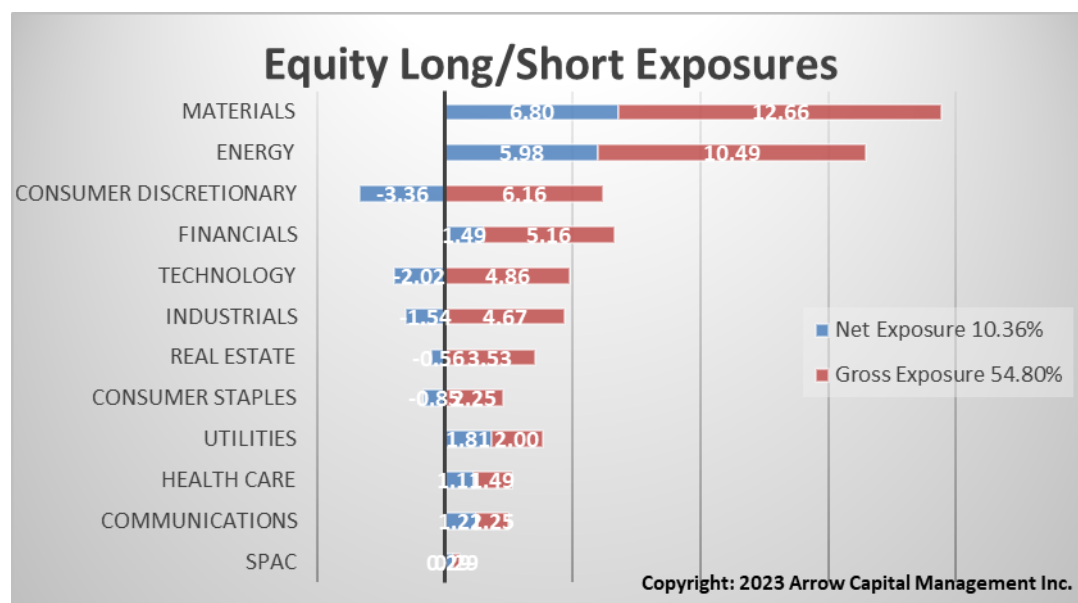
Rest of World net exposure was reduced by 0.3%.

Net bond exposure was reduced by 2.8%.

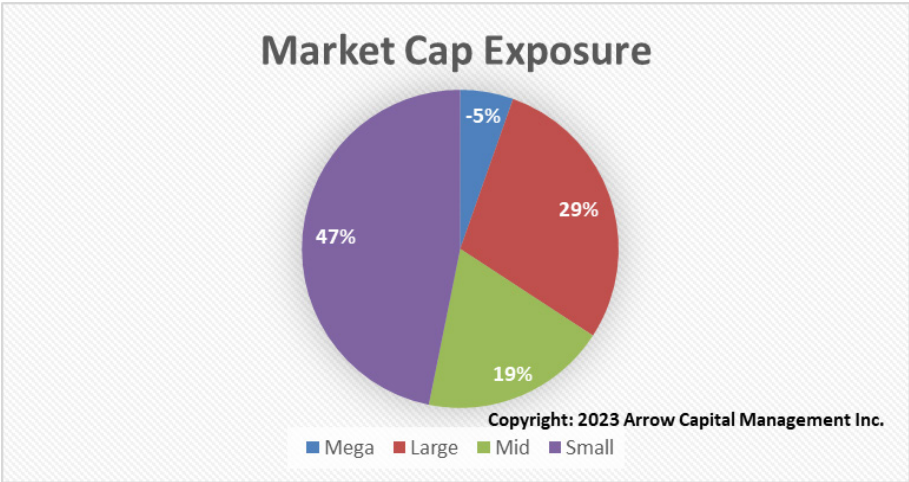
Net commodity exposure was reduced by 0.5%.

Total fund gross exposure was reduced by 16.1%. Total fund net exposure was reduced by 15.7%.

Sector Exposures (% Long / Short Portfolio of individual companies)



Market Cap Breakdown



FX Exposures:

FX EXPOSURE	%
CAD	69.6
USD	28.6
Other	1.9
DXY	0.0
Total Fund	100.0%

As a reminder, we view foreign exchange as active “bets” that are used to either generate alpha or act as a hedge to the overall portfolio. The Fund’s reference currency (except for the USD class) is the Canadian dollar so any exposures other 100% Canadian dollars are considered “active” positions.

FX was unchanged.

We look forward to reporting back next week.

Thanks,
Arrow Investment Team

Historical Performance – As of February 28, 2023

	1-Year	3-Year	5-Year	10-Year
ACAA - Series F	-0.35%	14.05%	10.45%	9.50%

Published March 20, 2023

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