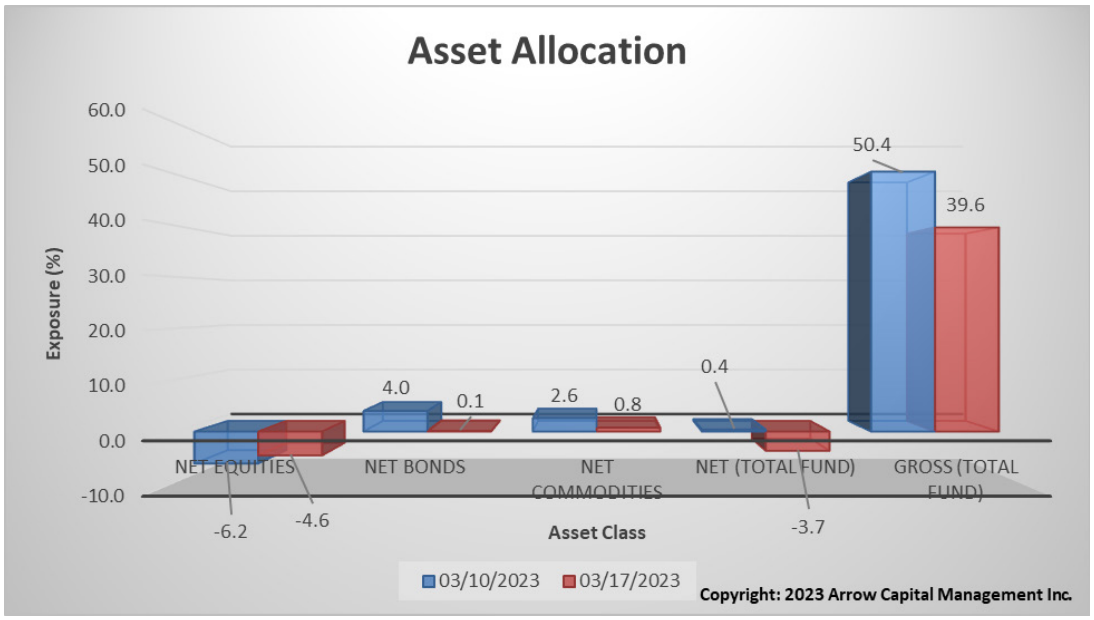


Weekly performance, macro context, current positioning, and future expectations.

Performance

March 17, 2023

Arrow Global Advantage Alternative Class (Series F):

WTD -0.11%
MTD 1.09%
YTD -0.03%

MSCI ACWI:

WTD -0.08%
MTD -2.06%
YTD 1.77%

Global Market Summary

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, lets 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 in 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. We have added some OTM calls on bonds to hedge additional financial stability risks and growing probability of a recession along with some short dated call on regional banks assuming FRC is solved via a takeover. We added to our CAD/JPY short and traded around USD/CAD. In equities, we remain largely short both Russell and S&P500 futures and long put options.

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

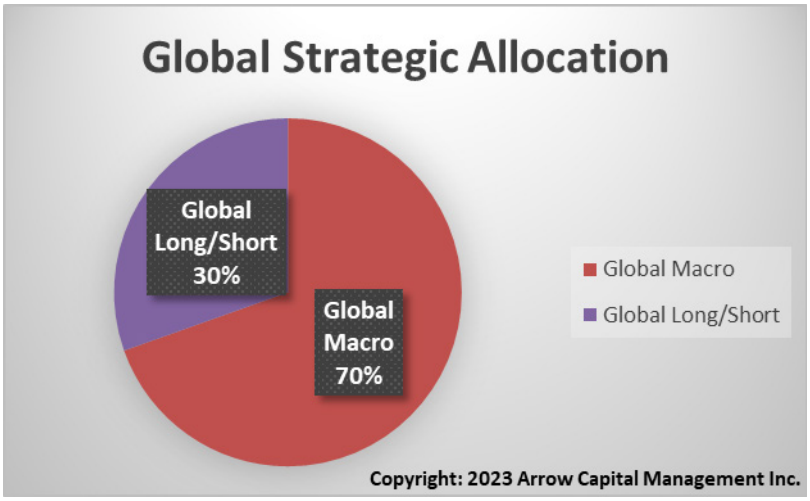
Summary Table
Economic Forecasts (Q4/2022 and Q1/2023)

Country	Q1 Outlook	Q2 Outlook
US	D	D
Canada	D	D
Eurozone	D	D
China	I	G
Japan	G	D

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

Economic Weekly Update

Below is a summary of the week and significant changes.



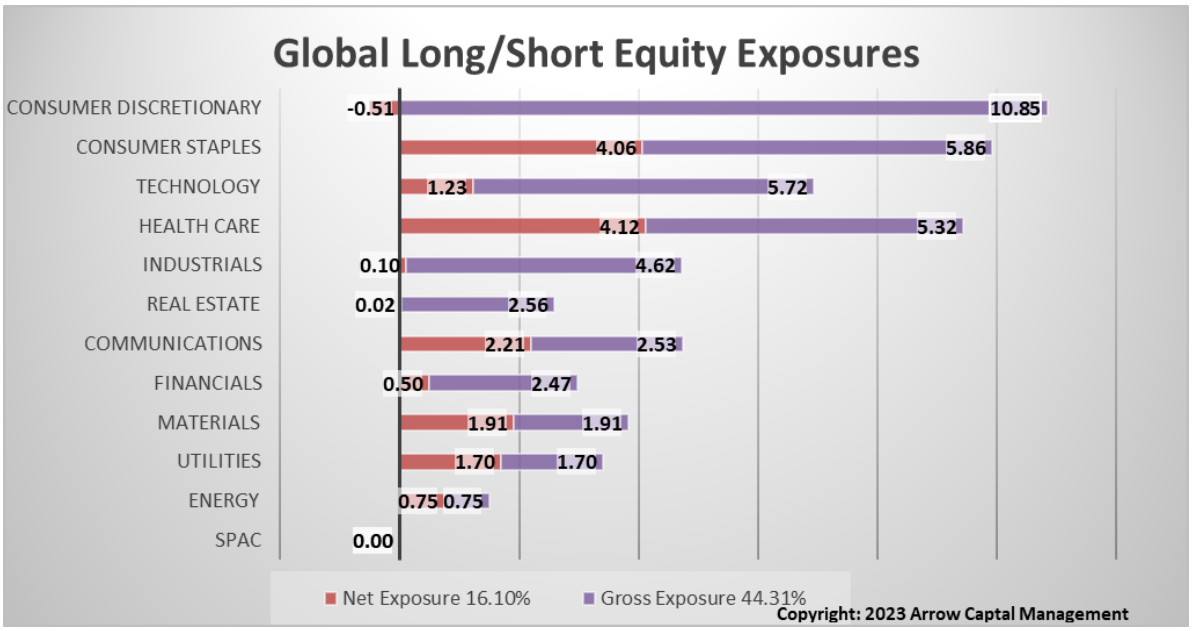
The portfolio is divided into 2 parts – a Global Long/Short part (individual securities) and a Global Macro part that focuses on liquid futures, ETF's etc. across FX, Commodities, Fixed Income and Equities.

Geographic Equity Exposures (% Total Portfolio including Futures)

ASSET ALLOCATION	NET	GROSS	LONG	SHORT
Europe	-0.1	3.3	1.6	-1.7
US	-4.8	26.4	10.8	-15.6
Canada	-0.3	1.5	10.8	-0.9
Japan	0.3	0.3	10.8	0.0
Asia ex Japan	0.3	0.3	10.8	0.0
Australia	0.0	0.0	10.8	0.0
Others	0.0	0.0	10.8	0.0
Equities Total	**-4.6**	**31.7**	**10.8**	**-18.2**
Bonds	0.1	7.1	10.8	-3.5
Commodities	0.8	0.8	10.8	0.0
Total	**-3.7**	**39.6**	**10.8**	**-21.7**

Summary of our current positioning:

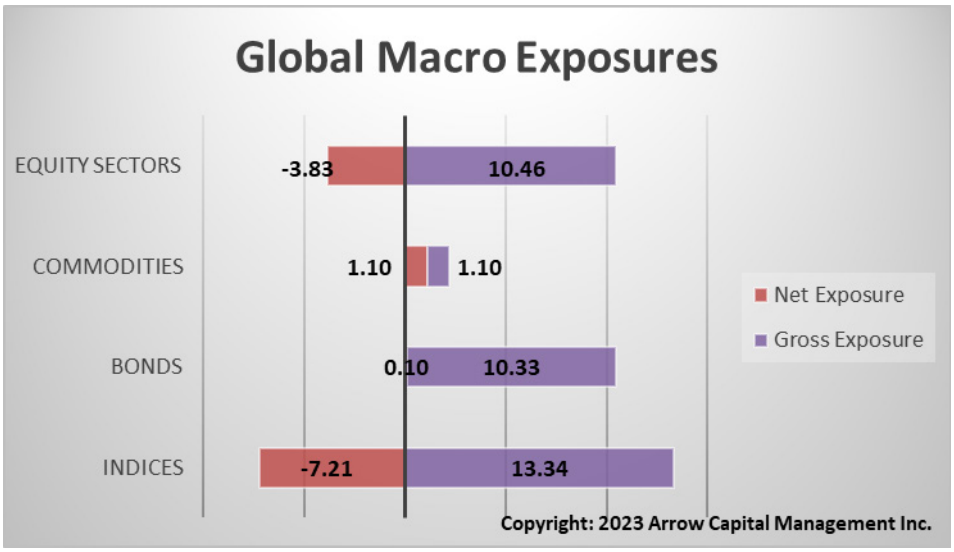
1) Global Sector Exposures (Long / Short Portfolio of individual companies)



Last week we reduced our cyclicals in favour of more defensive exposures. We further reduced our Industrials net exposure by putting on some more cyclical shorts, and added to Healthcare and Staples via some call options. Both of these sectors have been emerging from oversold conditions and outperforming on a relative basis as there is more worry about the economy's growth trajectory after the banking crisis. We also reduced our tech exposure during the week as duration rallied. Tech was one of the worst performing sectors last year, but has made a comeback YTD, led by semiconductors. Semiconductors are a more cyclical sector which does not do well in recessions, but does perform well in early cycle periods. Given our views on growth, we don't believe that these areas of the market should continue to outperform. The Fed this week will be important in setting the path for investor sentiment, and it remains to be seen if growth concerns will be eased and we will return to the environment we experienced to start the year- where the economy surprised on the upside and cyclicals were piled into. Though, that doesn't seem like a high probability scenario right now.

We also wanted to unpack Fedex earnings, which we got on Thursday after-market. Fedex operates as an integrated transportation company, meaning they provide air cargo services in addition to on the ground delivery services- they are a pretty good read into the economy given their business is global and wide reaching. While the company posted an EPS number that beat expectations, under the surface, the read into the economy was dire. Each division saw double digit declining package volumes as global demand continues to weaken. In response to weak demand, Fedex is planning to cut a total of 25k workers from the company which represents 8% of their workforce. They are also grounding and selling planes that are not necessary, given there are not enough packages to ship. They also pulled back $900M of growth investments they were initially planning to make this year. All of these do not send positive signals about future economic growth, especially from a large transportation company like Fedex. If the US economy is expected to grow +0.9% this year, per consensus estimates on Bloomberg, you wouldn't expect Fedex to be taking such drastic actions. We are still in the camp that economic growth will surprise to the downside this year.

2) Global Macro Exposures



Total Gross: 35.23%, Total Net: -9.84%

Commodities – Bullish Gold

Commodities were increased by 1.84%.

Bonds – Bullish Duration / Short Credit

Bonds were reduced by 3.91%.

Equity Futures – Negative

Equity Index shorts were increased by 0.08%.

Foreign Exchange Positions:

FX EXPOSURE	%
CAD	86.3
USD	9.2
JPY	4.6
Other	0.2
AUD	0.1
GBP	0.0
EUR	-0.2
DXY	0.0
Total Fund	**100.0%**

* We have included the delta adjusted totals to the FX summary above.

FX – Bullish USD & Yen

CAD was reduced by 5%. JPY was added to 4.6%. GBP short of -3.5% was reduced to 0%. EUR long of +2.6% was reduced to 0%.

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	ITD
AGAA - Series F	-1.15%	3.99%		3.06%

Published March 20, 2023

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.

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