

ARROW EC INCOME ADVANTAGE ALTERNATIVE FUND

september 2024



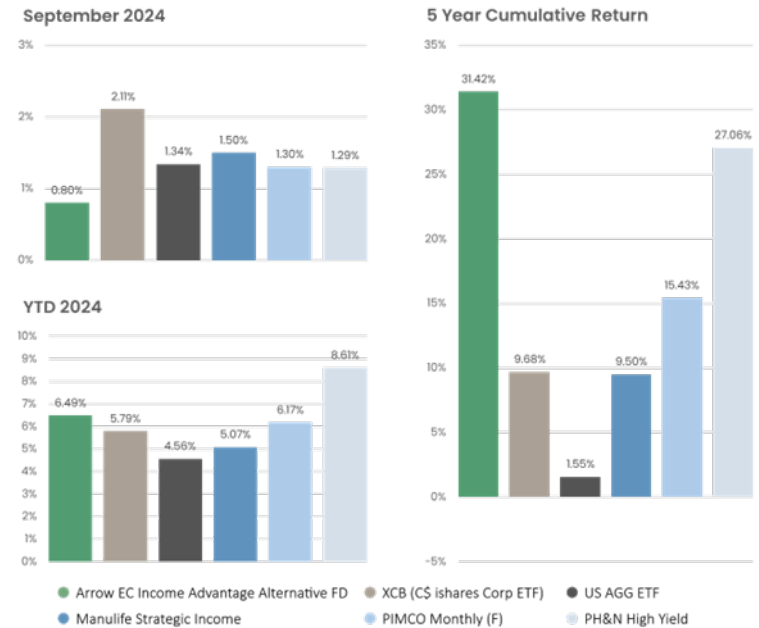
North American equities continued their upward trajectory with the S&P 500 gaining +2.1% for the month (5.9% for the quarter) and the S&P/TSX outperforming at +3.2%. The respective bond markets saw outsized gains following central bank interest rate cuts. In the US, the Federal Reserve cut rates by 50bps, marking its first reduction since 2020. The Bank of Canada, having already decided to start cutting interest rates three meetings ago, continued the cutting cycle with a 25bps reduction in September. Short-dated rates (2yrs) in the US rallied (moved lower) -28bps by month end while Canadian rates rallied a staggering -42 bps.

Investment Grade (IG) credit markets saw spreads tighten 3bps in the US and 7bps in Canada linked to economic resilience and strong issuance demand. In September, there was \$10.6bn of new issuance in the Canadian IG market, all of which was well absorbed.

The significant rally in interest rates drove positive returns for traditional funds, which are highly correlated to interest rate moves. The performance of the AECIAA credit strategy remains unaffected by fluctuations in interest rates and therefore did not derive any advantage from the large rate rally in September. That said, AECIAA still delivered another excellent monthly return for investors, helped by strong carry, active trading, and overall credit spread compression. The graphs at right show the 1-month, YTD, and 5-year return performance of the AECIAA strategy relative to popular fixed-income indices and funds.

Central bank easing, and the subsequent interest rate rally, has been the single largest market focus of 2024. East Coast's YTD returns remain impressive, without exposure to interest rates or the associated volatility; instead, focusing on the strategy's isolation of high-quality Investment Grade (IG) credit.

Performance: Popular Fixed Income Benchmark Returns Morningstar, Bloomberg



Source: Morningstar Direct: Arrow EC Income Advantage Alternative FD, Blackrock: Index iShares ETFs (XCB, AGG), PIMCO Monthly Fund (F), Manulife Strategic Income Fund (F), PH&N High Yield Bond Fund (F)


Canadian Short-Dated Rates vs Credit Volatility (3yrs) Bloomberg, BMO Capital Markets – Daily yield/spread 3yr history and average



The chart at left shows the Government of Canada rates (3yrs) in red, with the average rate (dotted red line) against Senior Bank credit spreads (3yrs) in green, with the average rate (dotted green line). The GoC 3yr rate has traded within an extremely broad 412bps range over last 3 years (0.65%-4.77%); with an average rate of 3.31%.

In comparison, Bank credit spreads have traded within a narrow 91bps range (0.54%-1.45%) over the last 3 years; with an average spread of 105bps (1.05%). This difference in interest rate and credit spread volatility is clearly visible in the chart at left; however, the standard deviation (volatility) is also highlighted in the table below. GoC 3yr interest rate yields have been 5.3x more volatile than 3yr Sr. Bank credit spreads.

3yr Volatility (Std Dev)	
3yr GoC Yields	1.23%
3yr Credit Spreads	0.23%

 5.3x

Combined with active trading & portfolio management, this lower volatility IG asset class is core to the AECIAA strategy delivering consistently positive returns, with September representing the 18th consecutive month.

The investment team's view remains consistent. As noted in our August investor update:

The investment team's view is that the cuts currently priced into the market will not be realized outside of a recession. The cut pricing is clearly skewed based on a market wanting, or expecting, to account for this recession probability. The market doesn't seem to be putting too much weight on the possibility of a 'pause' at some point over the next 6-8mos period.....If the cuts are not realized, rates will move higher.

Ultimately, the investment team believes the market has fully priced an economic slowdown and mild recession. They believe a full-blown recession (unlikely at this time) would need to occur for rates to move substantially lower than current rate levels. A slower path of cuts, or even a pause, should see rates rise from current levels. This means the big rally seen in interest rates, and therefore traditional fixed income (which is over +0.9 correlated to rates), is likely to slow down for the time being.

Whilst the market got what it wanted from the Fed in September with a 50bps cut, the subsequent market reaction has been volatile and there has been a significant sell-off (rise) in both short-term and longer dated rates thus far in October.

The team expects Interest rate volatility will continue for the foreseeable future. The AECIAA credit strategy is agnostic to changes in interest rates, meaning investor returns, which have been extremely consistent, are unaffected by movements in interest rates. The investment team, in a continued effort to maximize risk-adjusted opportunities, remains focused on deriving investor returns from high-quality, short-dated IG credit investments.

Historical Performance	1 yr	3 yr	5 yr	10 yr	ITD
Arrow EC Income Advantage Alternative Ser FD	9.94	6.17	5.62	4.34	4.09

Returns as of September 30, 2024

The inception date of the Arrow EC Income Advantage Alternative Fund (formerly East Coast Investment Grade Income Fund) was April 26, 2012. On June 26, 2020, the East Coast Investment Grade Income Fund (TSX: ECF.UN) was converted from a closed end fund into an open-end alternative mutual fund, renamed Arrow EC Income Advantage Alternative Fund and delisted from the TSX. Details of the conversion are outlined in the information circular which is available at www.sedar.com. Unitholders of Fund had their units redesignated as Series FD Units.

Commissions, trailing commissions, management and performance fees and expenses all may be associated with mutual fund and exchange-traded fund (ETF) investments. Please read the prospectus and Fund Facts for Arrow EC Income Advantage Alternative Fund carefully before investing. Unless otherwise indicated, 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 and ETFs are not guaranteed, their values change frequently and past performance may not be repeated. You will usually pay brokerage fees to your dealer if you purchase or sell securities of an ETF on recognized Canadian exchanges. If the securities are purchased or sold on these Canadian exchanges, investors may pay more than the current net asset value when buying securities of the ETF and may receive less than the current net asset value when selling them.

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 Arrow EC Income Advantage Alternative Fund as compared with the historical performance of a widely quoted market index or a weighted blend of widely quoted market indices or other investment funds. There are various important differences that may exist between the Fund and the stated indices or other investment funds 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. Published October 2024.