



## NorthStream Credit Strategies Fund LP

*Monthly Commentary: September 2018*

The NorthStream Credit Strategies Fund generated a return of -0.11% for the month of September, 3.66% YTD, and 33.73% in the 29 months since inception. The yield on five-year government bonds in Canada and the US increased 17 bps and 21 bps respectively in September. Interest rates have continued to increase in the first ten days of October, finally creating some volatility in the credit markets.

The absence of volatility in the credit markets has been surprising given the 79 basis point increase in US 5-year government bonds in 2018. Recently, the US 10-year bond has risen above 3.2% to a new seven-year high, causing concern among investors. The Fed has increased interest rates three times this year and the market expects three more rate hikes from the Fed in the coming year.

We have positioned the portfolio to take advantage of market volatility and preserve capital while interest rates drift higher. The steps we have taken are as follows:

- reduced the portfolio duration to 2.56 years;
- underweight BB rated bonds, which tend to be more sensitive to interest rates;
- raised our yield-to-call (short maturity) weighting in the portfolio to 38% to have the liquidity to take advantage of market opportunities as they arise;
- maintained a high weighting in Canadian dollar bonds due to a lower risk of rising rates;
- emphasized near-term event-driven opportunities that have low correlation to the market;
- selectively identified short positions with deteriorating fundamentals and events that will result in a capital loss.

Overall we view an increase in interest rates and periodic swings in credit spreads as an opportunity to purchase positions with better value and return profiles.

Recent additions to the portfolio include merger arbitrage opportunities such as the combination of Baytex and Raging River. The companies announced an all-stock deal in June 2018 that would create a larger entity with greatly reduced leverage and increased production. Shares of both companies sold off after the announcement reflecting concerns that the deal would dilute per-share cash flow and that Raging River would be better off as a standalone entity. The merger was subject to approval by shareholders of both companies.

Our view was that Baytex's 5.125% Notes due 2021 would appreciate if the merger was approved due to the significant leverage reduction and high probability of a ratings upgrade. We purchased the 2021 Notes at \$96.50 on August 20<sup>th</sup> and at \$97.00 on August 21<sup>st</sup>, the day of the shareholder votes. We made our investment at a point where deal risk was minimized but not completely eliminated.

Shareholders ultimately voted in favour of the deal and on August 23<sup>rd</sup>, Moody's upgraded Baytex's unsecured debt to B2 from Caa1 causing the 2021 Notes to appreciate to \$99.50. The 2021 Notes are callable now at \$101.281 and step down to par on June 1<sup>st</sup>, 2019. We expect Baytex to refinance the 2021 Notes in the first half of 2019 once the synergies of the merger are reflected in the financial results. The 2021 Notes provided an attractive return profile, with the 5.125% coupon plus the capital gain equating to a roughly mid-teens return on an annualized basis.

Our bond holdings by rating were 21% BB, 60% B, 5% CCC, and 14% unrated. Canadian dollar positions comprised 71% of the portfolio. The performance, risk, and correlation metrics are detailed in the tables on the following page.



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### NorthStream Credit Strategies Fund LP - Performance

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2018	1.32%	0.01%	0.72%	0.72%	0.52%	-0.17%	0.30%	0.30%	-0.11%	-	-	-	3.66%
2017	2.69%	0.66%	-0.89%	0.64%	0.63%	0.02%	0.31%	1.30%	1.03%	1.40%	0.66%	1.58%	10.46%
2016	-	-	-	-	0.49%	0.81%	3.40%	2.98%	2.29%	2.12%	0.75%	2.88%	16.80%

### Return Since Inception: 33.73%

The NorthStream Credit Strategies Fund LP ("the Fund") launched on May 2, 2016. The monthly returns above are shown net of all fees and expenses and are based on the Fund's Class X Lead Series NAV. Monthly NAV and returns are calculated by SGGG Fund Services Inc. Past performance is not indicative of future results. Performance, risk metrics, and correlations are as of September 30, 2018.

#### Performance & Risk Metrics

Return Since Inception	33.73%
YTD	3.66%
1-YR Return	7.48%
Annualized Since Inception	12.78%
% of Positive Months	89.66%
Maximum Drawdown	-0.89%
Annualized Standard Deviation	3.61%
Sharpe Ratio <sup>1</sup>	2.98

#### Correlation

Index	XGB <sup>2</sup>	TSX	S&P500
Correlation	-0.75%	34.32%	11.15%
Upside Capture	85.37%	86.33%	59.19%
Downside Capture <sup>3</sup>	-133.44%	-40.93%	-42.93%

<sup>1</sup> Using 1-year T-bills.

<sup>2</sup> iShares Canadian Government Bond Index ETF (XGB).

<sup>3</sup> Negative downside capture vs. XGB, TSX, and S&P 500 is a result of NorthStream generating positive returns in months when these indices generated negative returns.

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