NorthStream Credit Strategies Fund LP
Monthly Commentary: September 2022

Higher Yields on Credit Still Expected – Yield Curve Inversion and Inflation Persist

The same two questions continue to be asked by everyone - has inflation peaked? When does the Fed stop raising rates? Inflation may have peaked but US CPI and other inflation metrics need to significantly weaken for the Fed to stop raising rates.

September US core inflation increased to 6.6% up from 6.3% in the prior month, with prices excluding food and energy rising 0.6% month-over-month against expectations for growth to moderate to 0.4%. The 6.6% core inflation print is the highest since 1982 and is in contrast to the 0.1% decline in the annual US CPI rate of 8.2%. Inflation risk is still high and running well above the current policy rate.

How much does the inflation rate need to decrease to allow the Fed to stop increasing rates? Looking at the Fed Funds Futures on October 13th, the Fed will increase interest rates by 75 basis points in November and 50-75 basis points in December as shown in the table below. The first meeting in 2023 is early February where the Fed will incorporate three more months of CPI & other inflation data into its policy decision. Currently the expectation is for one more interest rate increase of 25 basis points in February 2023 to end the tightening phase with a policy rate of 4.8%. The March 2023 FOMC decision will be based on the CPI and other economic data for the coming five months.

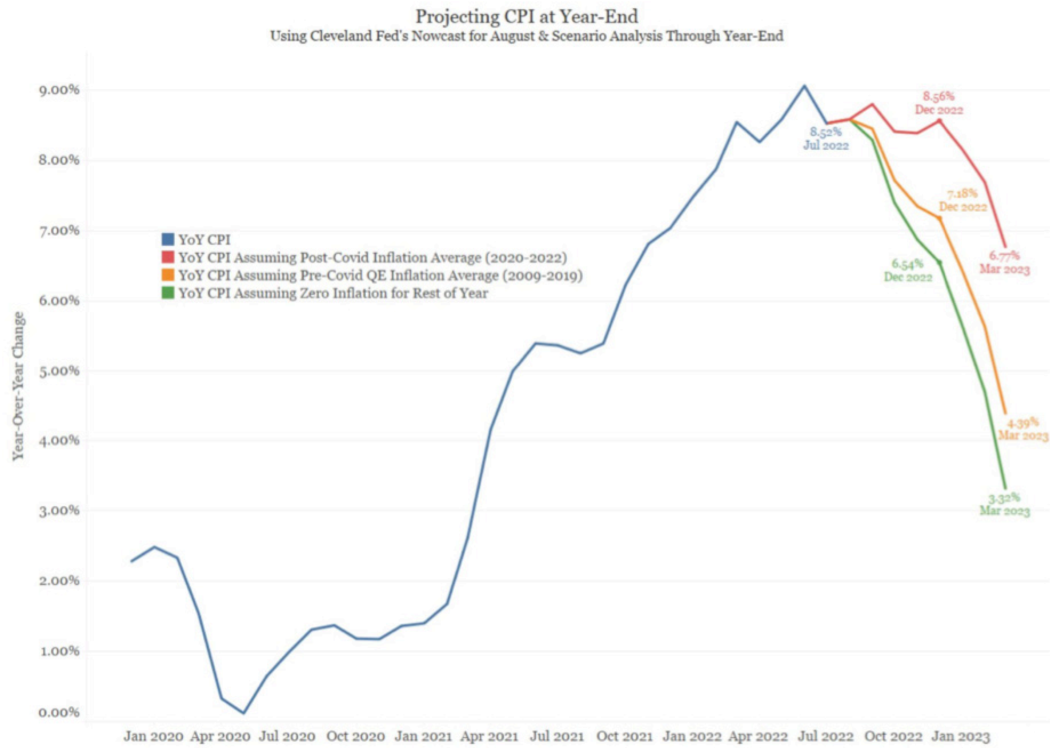
US Fed Fund Futures – October 13th, 2022

Region: United States » | Instrument: Fed Funds Futures »
Target Rate 3.25 | Pricing Date 10/13/2022
Effective Rate 3.08 | Cur. Imp. O/N Rate 3.081

Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate	A.R.M.
11/02/2022	+3.179	+317.9%	+0.795	3.876	0.250
12/14/2022	+5.705	+252.6%	+1.426	4.508	0.250
02/01/2023	+7.023	+131.8%	+1.756	4.837	0.250
03/22/2023	+7.345	+32.2%	+1.836	4.918	0.250
05/03/2023	+7.301	-4.4%	+1.825	4.906	0.250
06/14/2023	+7.178	-12.2%	+1.795	4.876	0.250
07/26/2023	+6.995	-18.3%	+1.749	4.830	0.250
09/20/2023	+6.775	-22.0%	+1.694	4.775	0.250
11/01/2023	+6.341	-43.4%	+1.585	4.666	0.250
12/13/2023	+5.962	-37.9%	+1.491	4.572	0.250
01/31/2024	+5.675	-28.7%	+1.419	4.500	0.250

Source: Bloomberg

For the Fed to pause, inflation must shrink to a monthly CPI increase rate of 0.1% or lower in each of the next five months to reach annual rate of inflation in the range of mid 4% as shown in the following table. The table was prepared using the Fed's August nowcast & scenario analysis prepared by Bianco Research through year end. The orange line in the table incorporates an annual inflation rate from 2009 to 2019 of 1.6% or just over a 0.1% increase month over month.



That would be the ceiling of monthly CPI increases to reach an annual CPI increase of mid 4% in March 2023. Even under a scenario where we had zero additional inflation for the rest of the year, CPI would not reach the Fed's 2% inflation target. We will monitor the futures market for changes in probabilities of further rate increases in the first half of 2023, however we believe that the Fed could remain hawkish past Q1 2023. We do not have a high confidence level that interest rates have peaked but recognize they have made a substantial move. Currently we are focused on US 2-year notes which are the most policy sensitive and the 2-year vs 10-year spread which is -52 basis points. The last time the US yield curve had inversion of -50 basis points was in 2000 and prior to that in 1989. *We believe this is a signal that cannot be ignored.*

Our July and August commentary focused on the reliability of an inverted yield curve in predicting a recession. Additionally, we highlighted that high yield credit spreads typically widen out to over 800 basis points during a recessionary period presenting the possibility of a double-digit capital loss on the index based on credit spreads being at 550 basis points at the end of September. Our conclusion was that risk vs reward was not favourable and that a defensive portfolio positioning was warranted.

Recall the yields on corporate bonds are influenced by the level of interest rates and credit spreads. Currently we do not have a signal that either driver of corporate bond yields has reached a level that provides a high margin of safety. We continue to believe that higher yields on corporate bonds are to be expected.

The caveat to this logical and quantitative approach to estimating where rates and credit spreads are headed is that it does not consider the negative impacts on currencies and illiquidity in the government bond markets that are causing hardship. Over the past few weeks, we have seen a crisis with British pension funds exposure to liability driven investments that triggered margin calls. A Bloomberg index shows liquidity in the Treasury market is worse now than during the early days of the pandemic and the lockdowns, when no one knew what to expect. Similarly, implied volatility as measured by the ICE BofA MOVE Index is near its highest since 2009. Daily swings in interest rate swaps have become extreme, proving further evidence of disappearing liquidity. Central banks may be faced with a dilemma of fighting inflation or choosing to intervene in asset markets that are critical to the functioning of the global economy. The tremors have appeared, and we are ready to modify our view if the tremors escalate into a breaking point that greatly increases the probability of a policy change.

The NorthStream Credit Strategies Fund returned -0.62% for the month of September compared to a -3.80% decline for the high yield index and a -6.10% decline in the investment grade bond index. We are maintaining a very defensive positioning with a portfolio duration of 1.3 years compared to a duration of 4.4 years for the high yield index and 8.7 years for the investment grade bond index. *Presently we are focused on having ample liquidity and being prepared for the period where credit spreads widen rapidly as tightening financial conditions impact bond prices.*

NorthStream Credit Strategies Fund LP - Performance

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2022	1.35%	0.24%	5.67%	3.81%	3.74%	2.09%	-0.95%	-1.33%	-0.62%	-	-	-	**14.63%**
2021	10.84%	4.70%	4.87%	-0.06%	1.23%	4.20%	-0.20%	-0.55%	3.78%	1.09%	-0.56%	0.08%	**32.94%**
2020	0.32%	-0.43%	-14.44%	0.43%	1.03%	3.67%	1.01%	2.99%	1.88%	2.36%	2.18%	9.47%	**9.09%**
2019	1.08%	1.34%	0.41%	0.79%	-1.41%	1.00%	0.99%	-0.31%	0.86%	-1.99%	0.01%	0.75%	**3.53%**
2018	1.32%	0.01%	0.72%	0.72%	0.52%	-0.17%	0.30%	0.30%	-0.11%	-0.61%	-1.44%	-0.67%	**0.85%**
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%**

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, 2022. Note that the use of the XGB, TSX, and S&P 500 in the performance tables below is for informational purposes only. The XGB (iShares Canadian Government Bond index ETF), TSX, and S&P 500 have a different composition than the Fund and are not comparable benchmarks. The XGB, TSX, and S&P 500 were chosen to compare the Fund's performance returns against other asset classes.

Return Since Inception: 123.94%

Performance & Risk Metrics

Return Since Inception	123.94%
YTD	14.63%
1-YR Return	15.33%
Annualized Since Inception	13.39%
% of Positive Months	76.62%
Maximum Drawdown	-14.81%
Annualized Standard Deviation	9.65%
Sharpe Ratio[1]	0.98

Correlation

Index	XGB[2]	TSX	S&P500
Correlation	-20.48%	43.47%	27.30%
Upside Capture	80.92%	57.63%	36.87%
Downside Capture[3]	-113.78%	-7.99%	-11.81%

1 Using 1-year T-bills.
2 iShares Canadian Government Bond Index ETF (XGB).
3 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.