NorthStream Credit Strategies Fund LP

Monthly Commentary: May 2024

The NorthStream Credit Strategies Fund returned +0.38% for the month of May, and +5.39% for the last twelve months.

The Bank of Canada cut interest rates by 25 bps on June 5th as core inflation declined below 3%. The three-month annualized rates of the Bank of Canada's measures of inflation have been running at just above 1% for a couple of months now (core median and trimmed mean). The futures market is pricing in two more 25 bps cuts in the four remaining BOC meeting dates in 2024, bringing the expected overnight rate to ~4.25% by year end. The expected rate cuts will ease the impact of the mortgage renewal wall in 2025. The Bank of Canada's mortgage renewal simulations show both fixed-rate and variable-rate borrowers are expected to see significantly higher payments at renewal in 2025 and 2026, which means that Canadians will need to scale back on other consumption items as mortgage payments rise.

The Fed kept the fed funds rate steady at 5.375% at the June FOMC meeting and signaled one 25 bps cut for this year, down from three back in March. Fed Funds have been north of 5% for over a year now and the latest Non-Farm Payroll report showed the US keeps adding jobs at a sustained pace. Non-farm payrolls added 272K positions in May, well above the consensus forecast of 180K and a big step up from the 165K added in April. When thinking about the unemployment rate which has drifted slightly higher in both Canada and the US, keep in mind the supply of labour in both countries has been growing due to strong immigration. One way of looking at the health of the labour market is to look at the change in wages. The 4.1% increase in average hourly earnings over the past year is an acceleration over the prior month and hotter than what economists predicted. Canadian wage growth accelerated 5.1% in May.

As long as employment is strong and wage growth is above the inflation rate, we could be in a higher-for-longer environment for several quarters, as expectations for rate cuts get pushed into 2025. The consumer seems to be doing fine but there are some signs that higher rates are having an impact on some sectors.

The cracks in the commercial mortgage market have been visible for some time. Moody's Analytics predicts that roughly 80 per cent of the US$15.2 billion of commercial mortgage-backed securities (CMBS) office loans expected to mature this year are at risk of failing to refinance. The Mortgage Bankers Association is tracking US$929 billion in commercial real estate maturities in 2024, a rise of US$270 billion from the beginning of 2023.

For the first time since the financial crisis, investors in top-rated bonds backed by commercial real estate debt are getting hit with losses. Buyers of the AAA portion of a $308 million note backed by the mortgage on the 1740 Broadway building in midtown Manhattan got less than three-quarters of their original investment back earlier this month after the loan was sold at a steep discount of $117 million.

The overall US CMBS delinquency rate is 4.7% compared to a 6.6% delinquency rate for office CMBS. With about $700 billion of non-agency CMBS outstanding and another $3 trillion of commercial mortgages on bank balance sheets, even a modest uptick in losses could weigh on the financial system.

To date, concerns about CRE exposure have focused on US community banks, which hold a higher proportion of direct loans than the large banks. A study published in Risk.Net on May 30th shows that large banks also have significant indirect exposure via credit lines to non-financial institutions –

specifically real estate investment trusts (REITs). These credit lines only appear on banks' balance sheets in full once they are drawn, and the associated credit risk is therefore easier to underestimate. Specifically, the study finds that CRE exposures at the nine largest US banks more than double when factoring in credit lines to REITs.

We are closely monitoring CMBS investment grade credit spreads as it represents a significant portion of a bank's total loan exposure that could force substantial provisions for credit losses and an erosion of bank's tier one equity capital. We view the commercial real estate sector as an important canary in the coal mine for the direction of corporate credit spreads.

NorthStream Credit Strategies Fund LP - Performance

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2024	0.55%	0.14%	0.21%	0.51%	0.38%	-	-	-	-	-	-	-	1.79%
2023	0.69%	2.65%	0.50%	0.49%	0.75%	1.10%	0.46%	0.81%	0.68%	0.43%	0.03%	-0.02%	8.89%
2022	1.35%	0.24%	5.67%	3.81%	3.74%	2.09%	-0.95%	-1.33%	-0.62%	1.39%	3.25%	3.09%	23.70%
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 May 31, 2024. 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: 167.86%

Performance & Risk Metrics

Return Since Inception	167.86%
YTD	1.79%
1-YR Return	5.39%
Annualized Since Inception	12.96%
% of Positive Months	80.41%
Maximum Drawdown	-14.81%
Annualized Standard Deviation	8.72%
Sharpe Ratio [1]	1.24

Correlation

Index	XGB [2]	TSX	S&P 500
Correlation	-18.69%	36.36%	21.93%
Upside Capture	64.35%	45.58%	30.12%
Downside Capture [3]	-106.80%	-17.35%	-18.23%

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.