NorthStream Credit Strategies Fund LP

Monthly Commentary: July 2024

The NorthStream Credit Strategies Fund returned +0.07% for the month of July, and +3.47% for the last twelve months.

Interest rates fell significantly in July as weaker growth and softer than expected inflation data caused the yields on US 2-year and 10-year bonds to sprint towards 4%. The unwinding of the Yen carry trade pushed the yield curve below 4% in August and flattened the yield curve to the point where the yield curve inversion is almost in the rear-view mirror. The US labour market cooled in July with non-farm payrolls rising only 114k compared to estimates of 175k, bringing the 3-month average of job gains to 170k, which is notably below the 200k breakeven rate. The unemployment rate rose two ticks to 4.3%, triggering the Sahm rule. The markets now see a 40% probability of a 50-bps rate cut in September and a 108-bps reduction in rates between now and the end of the year. A few months ago, the expectation was for 1-3 rate cuts in 2024 rather than five.

So why the quick flip from soft landing to recession?

Capital spending on generative AI has prolonged the US expansion. The magnificent 7 have been the primary ways to gain exposure to the growth in generative AI. Not since the age of the early internet has there been so much hype about a new technology. The McKinsey Global Institute forecasts that generative AI has the potential to generate value equivalent to $2.6 to $4.4 trillion in global corporate profits. Although AI applications have yet to turn a profit, nobody wants to miss out on the expected growth and the immediate share appreciation granted to AI first movers & leaders. Chat GPT was introduced in November of 2022 and has coincided with the appreciation of the S&P 500 by $10 trillion dollars even after the recent correction. The decline in AI related stocks is only a quarter after Daron Acemoglu, an economist at MIT published a white paper in which he calculated that the effect of generative AI on total factor productivity and GDP growth will range from only 0.66% and 0.93% over the next 10 years. Until the magnificent 7 can demonstrate how they can monetize their aggressive investment in expensive AI chips, their profit margins will suffer.

The Sahm rule is a necessary but not sufficient condition for a recession but also requires a decline in US corporate profit margins. Unless improved margins are derived from AI spending, recession risks are growing. The magnificent 7 have become the US stock market. The stock market has become a bet on the potential return generated from AI capital spending. The stock market appreciation has caused financial conditions to ease over the past year. We expect that it will not provide the same tailwind in the next 12 months.

Any hopes that falling borrowing costs would stem the pain from the US office downturn were confronted with the news the Blackstone mortgage Trust slashed its dividend by 24%. New York Community Bancorp shares plunged the most since the last bout of CRE-related turmoil in March after provisions for losses came in at more than double the average expected by analysts. The announcement signals that lenders may not be able to just amend and extend loans in the hope that lower interest rates will ease borrower’s pain and give property owners more time to refinance debt. More than $94 billion of US commercial real estate is currently distressed, according to MSCI Real Assets, with a further $271 billion at risk of slipping into that category.

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Commercial real estate has a $1.5 trillion wall of loan maturities over the next two years. As appraised valuations and REIT indices remain weak it will make loan extensions more costly. The real estate sector has the largest amount of distressed bonds and loans outstanding at $195 billion, with thee next largest at a mere $37 billion and $31 billion for the telecom and software sectors respectively. We continue to maintain short bond positions in the commercial real estate and home building sector as fundamentals continue to weaken. Our short positions represent 19% of the portfolio.

The fund held two Canadian listed bank preferred shares that were called in the last month. We added another three series of bank reset preferred shares to fill out our ladder of bank preferred shares with rate reset dates over the next five months. The return profile on the bank reset preferred shares including dividends is 10% or more on an annualized basis. The portfolio has a 26% weighting in short maturity or bonds where a call date has been announced. We are carefully adding market risk in shorter duration bonds as the impact of higher rates has not been reflected in credit spreads yet.

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%	-0.36%	0.07%	-	-	-	-	-	1.50%
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 July 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: 167.08%

Performance & Risk Metrics

Return Since Inception	167.08%
YTD	1.50%
1-YR Return	3.47%
Annualized Since Inception	12.65%
% of Positive Months	79.80%
Maximum Drawdown	-14.81%
Annualized Standard Deviation	8.65%
Sharpe Ratio [1]	1.21

Correlation

Index	XGB [2]	TSX	S&P 500
Correlation	-19.36%	35.71%	21.55%
Upside Capture	60.35%	43.96%	29.41%
Downside Capture [3]	-106.80%	-16.60%	-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.