PUBLISHED: OCTOBER 14, 2021

Purpose INVESTMENTS

FUND COMMENTARY

Purpose Strategic Yield Fund

FUND DETAILS

	FX HEDGED	USD
ETF TICKER	**SYLD**	--
MGMT FEES	0.80%	
SERIES F	**PFC4601**	**PFC4606**
MGMT FEES	0.80%	0.58%
SERIES A	**PFC4604**	--
MGMT FEES	1.55%	

INCEPTION DATE: **AUG 19, 2011**

We continue to view post-lockdown corporate earnings growth and inventory rebuild as the most important fundamental opportunity today.

FUND MANAGER

Sandy Liang

Sandy Liang has more than 30 years of institutional investment experience. He spent 12 years working on Wall Street, leading fixed income for Cobalt Capital Management, and was a Senior Managing Director at Bear, Stearns & Co. Sandy has won a Canadian Hedge Fund Award for top performance in the Credit Focused category in 2018, 2019 and 2020 and he is also a Morningstar 5-Star Fund Manager.

MARKET OVERVIEW

September 2021 was a reality check for asset managers and investors as both equities and traditional bonds traded down together. The S&P500 declined by 4.7%, while the bond market measured in various ways returned negative 1.5% (XBB ETF) to negative 2.9% (TLT ETF) in the month. It is often difficult to pinpoint a market narrative but in this case it's pretty clear the stock market and bond market accelerated its sell-off (with yields higher) after the September 22 post-Fed meeting press conference. During the press conference it became apparent the Fed will be tapering its support of the bond market, with a likely exit from quantitative easing (QE) over the next 12 months. We view this news as a mixed message for risk assets because the Fed is only tapering its bond buying due to "substantial further progress" on its dual mandates of employment and inflation – in other words, the economy is moving forward so the training wheels are coming off through withdrawing support of the bond market and long-term interest rates. Thus, if earnings growth and credit quality improvement are an important component of your portfolio's returns, the news wasn't all bad – the economy is moving forward. This was reflected in the relative performance of non-investment grade credit during the month where high yield debt, preferred equity, and bank loans were all roughly flat during the month.

In previous commentaries we have observed that the path of the traditional bond market, using TLT as a proxy (the largest long-term bond ETF with 20+ year bonds), moved lockstep with how the S&P500 Index was doing relative to the Equal Weighted S&P500 Index. In other words, how mega-cap technology equity shares, or the largest weights in the S&P500, are doing relative to the rest of the stock market, or growth vs. value in equities, is all the same trade as buying long bonds and enabled by the Fed's QE supporting the bond market. Conversely, as QE gets tapered and interest rates go higher, the market values near-term earnings over long-term earnings and value /re-open /small-cap stocks outperform due to lower duration. Then market leadership broadens. And as QE taper is positive for high-yield bond performance over investment grade corporate debt, because it's all the same dynamic, near-term earnings and credit quality improve over long duration and interest rate risk.

TLT Bond ETF (blue, left axis) vs S&P500/S&P500 Equal Weight (red,right)

ALL PERFORMANCE DATA AS AT OCTOBER 13, 2021.

Source: Bloomberg

We know Fed support of the bond market (QE) will be waning – most likely after the next Fed meeting in November. Remember from our commentary last month that long-term fair value for 10-year bond yields is not 1.53%, or the most recent level, it's higher. Fair value should be higher than the inflation rate, and historically it has resembled nominal GDP growth (inflation plus real growth). We are not saying it's going there overnight, and we don't know where the 10-year trades next month. But we can tell you about historical fair value going back decades: U.S. CPI is 5% today, in Canada it's 4%. Inflation may moderate to 3% next year, but that's still a lot higher than where bond yields are today – real interest rates are still negative.

In summary, the longer-term interest rate picture is currently at a crossroads with the Fed openly discussing tapering its support of the bond market. This makes the current period analogous to the 2013 "Taper Tantrum," with similar implications for real interest rates. However, this news is not all bad because it means the economy is moving forward which is positive for earnings growth and credit quality. We do not expect a real recession any time soon for several reasons, but mostly because economies are only now emerging from lockdown and pent-up demand for goods and services, combined with off the charts money supply growth in the past 18 months, should result in above-trend economic growth at least through 2022. We continue to view post-lockdown corporate earnings growth and inventory rebuild as the most important fundamental opportunity today and view the environment as constructive for investment risk assets, including non-investment grade corporate credit, however less positive for traditional, long duration fixed income where investors get all the interest rate risk with little reward (yield).

FUND PERFORMANCE AND POSITIONING

In the month of September, the Fund returned +0.2% compared with 0.5% loss for passive high-yield debt exposure (XHY ETF). This year to date, through October 13, the Fund has returned 11.7% compared with 3.0% for passive high yield debt exposure. The internal yield of the Fund is currently in the mid-5% area – in line with internal yield at the start of 2020, prior to the pandemic. Historically, Fund returns have included capital gains over and above the Fund's internal yield. Earlier in the year we culled all longer duration holdings so that the duration of the fund is under two years. While calculated duration is under two years, the "effective" duration of the fund is negative because it normally performs well as interest rates rise (at a measured pace) due to credit quality and credit spread improvement as well as some zero duration investments in the Fund (including a small allocation to preferred equity income investments).

The month of September was volatile in risk assets, with the S&P500 returning -4.7% and the long duration bond ETF (TLT) returning -2.9%. For the quarter as a whole, ending September 30, returns in capital markets were roughly flat as risk assets did a round trip. In the quarter, the Strategic Yield Fund returned 0.7% compared with 0.1% for passive high yield debt exposure, 0.6% for the S&P500, and 0.4% for the long duration bond ETF. Top contributors to the quarter's returns were Vine Energy 6.75% of 2029 (natural gas – company to be acquired by Chesapeake Resources), Granite Point Mortgage Trust 5.625% of 2022 (U.S. mortgage REIT), and Stonemor 8.5% of 2029 (U.S. funeral and cemetery operator). There weren't any significant detractors in the quarter, however P&L was negative in 99 Cents Only 7.5% of 2026 where the company's near-term earnings were affected by continued covid-related lockdowns in California through the month of June. We are reminded from this situation that mark to market is favourable for our risk process because changing bond prices force a re-examination of the thesis that got us involved in the first place. In the case of 99 Cents Only, we view the weak 2Q earnings as beyond management's control, but more importantly, the company's real estate asset value continues to underpin our Plan B for principal repayment should operations continue to falter. Having said that, lockdowns in California were lifted in June 2021 and we expect an earnings resurgence in 2H 2021.

The internal yield of the Fund is currently in the mid-5% area – in line with internal yield at the start of 2020, prior to the pandemic.

FUND PERFORMANCE

ALL PERFORMANCE DATA AS OF SEPTEMBER 30, 2021

PURPOSE STRATEGIC YIELD FUND	1 MONTH	3 MONTHS	6 MONTHS	YTD	1 YEAR	3 YEARS	5 YEARS	SINCE INCEPTION
SERIES A	0.10%	0.52%	3.80%	11.06%	20.90%	7.42%	8.21%	6.33%
ETF	0.17%	0.72%	4.23%	11.74%	21.89%	8.31%	-	7.89%
SERIES F	0.16%	0.72%	4.21%	11.72%	21.85%	8.27%	9.08%	7.21%

All data sourced to Bloomberg unless otherwise noted.

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