“End of the Road” – Boyz II Men

The weak performance of traditional bonds and stocks in the first quarter of 2018 made 2017 seem like such a distant memory. Looking back at 2017 one could discover that the yield on the 10year US Treasury bond began and finished the year less than 5 basis points apart. Interestingly (or maybe not), this has only happened 3 times in the last 50 years.

Fact, in 1992 when 10year Treasuries only deviated 1.3 basis points over the year, the lowest variation since 1966, was when the No. 1 song on the Billboard Chart was “End of the Road” by Boyz II Men.
This hit at the time had no influence over risk markets as the following year the S&P500 was up 9.97%. Despite the obvious differences in song titles, Ed Sheeran’s top hit for 2017, “Shape of You”, does not possess any negative or positive stock market predictive powers for 2018 … we trust this won’t surprise you.

The point in all this is that it is very difficult to predict the outcome of markets…even assuming you don’t look to song titles for clarity 😉

As market practitioners our job is to listen to signals that are presented by the economy, companies, influencers and other participants and assess whether these risks are appropriately priced into the corporate securities we scrutinize.

As a definition for the risk-free rate and valuation aid in discounting cash flows for the assessment of equity valuations, the yield on the US 10year Treasury bond is the choice for many investors. The graph below highlights the yield on the 10year over the last 15months versus the S&P500.

Source: Bloomberg

The increase in inflation expectations in the first quarter of 2018 fueled a 33bps increase in 10year Treasuries and reversed this seemingly skyward march of risk assets.

Below is the performance of the Fulcra Credit Opportunities Fund versus some popular investment benchmarks over this period.

	FCOF	TSX Composite	S&P 500	US High Yield	US Investment Grade
1Q2018 Return (in Local FX)	0.60%	-4.52%	-0.76%	-0.91%	-2.20%
1Q2018 Return (in C$)		2.21%	2.21%	-1.11%	-2.38%

Source: Bloomberg

We wouldn't normally highlight the Funds' performance over such a short period of time. However, we frequently comment on positioning the portfolio to avoid interest rate driven volatility. This recent spike in interest rates contributed to adjusting risk premiums higher in other areas of the market, evidenced by the negative returns of most asset classes.

Fulcra manages a single mandate. However, we don't think of ourselves as a one trick pony! The FCOF employs various strategies/tactics to generate returns and mitigate risks. Many investors think low risk fixed income strategies are either long duration investment grade funds or short duration / low return money market funds.

These "index" like methods to investing in fixed income are limited in their ability to protect against interest rate volatility and generate inflation beating total returns

The FCOF was created to be focused on a limited number of total investments and embrace flexibility to differentiate ourselves from benchmarks and our relative value contemporaries. As a result, we will define opportunities within five unique buckets of strategies excluding cash and equivalents. They can be defined as Quality Yield, Core, Event Driven, Opportunistic Value, and Deep Value.

- *Quality Yield* are short duration investment grade and "hard" yield to call high yield bonds.

- *Core* investments can be defined as bonds that possess little interest rate risk, and where there is a definable asset that protects us in the unlikely situation that the cash flow generation capability of the business is compromised.

- *Event Driven* bonds are associated with a company that is currently or prospectively pursuing an asset divestiture or merger/acquisition path.

- *Opportunistic Value* are bonds that were, in most cases, purchased well below par and issued by a company that, in our opinion, can successfully bounce back from the situation that created the opportunity.

- *Deep Value* bonds are those where the probability of bankruptcy or a consensual capital structure restructuring, and owning the pro forma equity, is reasonably high. We do not actively pursue these situations but may possess unique insight into an industry/company that enables us to effectively assess the situation.