Executive Summary

- During the quarter there was a repricing of financial assets the magnitude of which we have not seen since the Global Financial Crisis.

- Central banks have acted quickly to backstop credit markets in an unlimited fashion - with the US Federal Reserve going so far as to announce last week that they will buy corporate bonds recently downgraded to high yield.

- This has created a unique opportunity for us to invest in quality, defensive businesses that will exist post-COVID-19 at levels not seen in over a decade.

The double “Black Swan” of COVID-19 and the Saudi/Russia-induced oil price collapse rocked markets in March. It’s hard to imagine now, but early this quarter leading economic indicators had turned positive and progress had been made on a US-China trade deal. Two “black swan” events then occurred in quick succession to dramatically change the global investment landscape. First, the spread of COVID-19 led to an unprecedented shutdown of the world economies that is likely to reverberate for several quarters. In addition to this, there was an energy supply shock as Saudi Arabia dramatically increased oil production. These twin developments sent financial markets into a tailspin with stocks and bonds experiencing their biggest drawdowns since the Global Financial Crisis. It also set-off a liquidity crisis, with corporations drawing down on bank lines and individuals selling assets of all types – even risk-free assets such as government bonds – in order to generate cash. With trading desks thinly staffed due to social distancing, the resulting downward pressure on prices was exacerbated.

Credit Spreads Corrected Violently During March

Source: Bloomberg; US Investment Grade = Bloomberg Barclays U.S. Agg. Corporate Bond Index; Canadian Investment Grade = Bloomberg Barclays Canadian Corporate Bond Index; US High Yield = Bloomberg Barclays U.S. High Yield Index
Against this backdrop, corporate bonds of all types dropped significantly in value. There are two reasons why corporate bonds moved so violently during March. The first was an increase in the Credit Risk Premium – in other words, as investors (correctly) started to anticipate a recession, they demanded more compensation to lend to corporations. This put downward pressure on bond prices. The second was an increase in the Liquidity Premium. Against an uncertain backdrop, investors reappraised the value of having cash now rather than at a future time. This sharp change in the Liquidity Premium pushed prices of corporate bonds lower again. Generally speaking, investment grade rated corporate bonds close to maturity tend to behave defensively during “risk off” periods. This was not the case during March as investors liquidated even high-quality securities close to maturity. In fact, the considerable selling of these types of securities became so pronounced that some credit curves inverted during the month.1

Central banks acted quickly to effectively backstop credit markets in an unlimited fashion. The speed at which corporate bonds retraced to levels not seen since 2009 was astonishing, occurring in a matter of three weeks. In response, the US Federal Reserve (“the Fed”) took the 2008 playbook and went even further by cutting interest rates to zero, purchasing huge quantities of government debt, and, for the first-time ever, setting up to buy corporate bonds. While economic activity has been halted in an unprecedented fashion, the Fed has taken a “whatever it takes” approach to ensure the economy’s capacity to produce once the threat of COVID-19 has passed. In a similar vein, the Bank of Canada responded quickly by announcing a raft of measures to provide liquidity, including programs to support the market for Bankers Acceptances and Commercial Paper. As a result the Canadian system seems to be operating well. The Bank of Canada has also made it clear that they have plenty of additional tools available should they be needed.

On Thursday of last week (April 9th), the Federal Reserve surprised the credit market very positively. It achieved this by announcing its intention to purchase securities that have been downgraded to high yield ratings of BB- and above since March 22nd, as well as High Yield ETFs. This was unexpected and markets began to rally on Thursday even though it was only a half day for fixed income. April had already seen an improvement in conditions in the corporate bond market, although liquidity continued to be challenging amid the height of COVID-19 in NYC/US and as investors digested the impact of initial policy responses for credit. While higher-rated securities had started to retrace some of the price declines of the previous month, BBB and lower rated securities did not meaningfully participate in this retracement. However, on Thursday we saw a strong rebound in the BBB and BB segment of the market after the Fed expanded the eligible securities for the Primary and Secondary corporate bond programs. The programs were increased in size as expected, but the inclusion of a large portion of high yield securities is a major positive ahead of the upcoming challenging earnings season and we believe that will enable investors to feel comfortable adding risk once again.

There is an opportunity in high-quality credits that will continue to be integral to the functioning of society and the economy. During the last month, we would argue that the baby was thrown out with the bathwater. We saw bonds issued by companies in the cable and wireless, technology, healthcare and utilities sectors come under severe pressure – even though many of these companies provide essential services. During the last financial crisis, commentators assumed that people would prioritize their mortgage payments first, and then car lease payments second. This turned out not necessarily to be the case as cars were essential for people to get to their jobs. This flew in the face of everything we knew up to that point. This time around, there are certain industries like communications which were once thought of as luxuries but are now known to be essential – and will therefore be less sensitive to a recession.

1In other words, the credit spread on 2-year corporate bonds was greater than the credit spread available on the same issuer’s 10 year or 30-year bonds. This is an extremely unusual state of affairs.
There is an opportunity today to acquire securities issued by companies that meet this criteria and stand to benefit from central bank programs – at exceptional levels. It is also worthy of note that the current crisis is different to the Global Financial Crisis. Banks are well-capitalized today after a decade of stricter regulation, and as such the global economy is underpinned by a healthy banking sector.

We believe a lack of clarity about future earnings at many companies will mean continued volatility in equity prices. Many corporations have reduced or cancelled their equity dividends, and around $190 billion of share buybacks have also been suspended. These are exactly the types of shareholder value actions that have driven much of the equity market rally in recent years. These actions will support balance sheets and we know that the Fed is set to start buying up to $4 trillion in corporate credit. As a result, we think the value in credit markets is much easier to analyze than in equity markets going forward. With much uncertainty about the long-term impact of COVID-19, we would expect continued volatility in the equity market.

However, we believe the outlook for corporate bonds is very compelling at this point. Against a highly uncertain background, credit has some noteworthy characteristics. As a bondholder you are higher up in the capital structure than equity investors, and coupons are fixed and can’t be cut like dividends. Bonds are contractual obligations so returns are known as one has done one’s credit analysis. We believe the forward-looking return from credit is very attractive at this point given credit spreads which are extremely large by historical standards. Simply put, high quality securities are available at prices not seen for a decade. Although there is uncertainty with respect to COVID-19, central banks have demonstrated a “whatever it takes” approach to ensuring that companies that were viable before COVID-19 will be viable again afterwards. In addition to credit spreads not seen for over a decade, there is the potential for short term gains from credit spread compression. Finally, after previous crises, credit markets have typically recovered from drawdowns significantly faster than the equity market. We would expect that to be the case this time around also.

Relative Value and Active Trading Opportunities tend to be best after a period of disarray. In addition to a passive return, the opportunities to actively add returns from active management / trading tend to be best after periods of violent market correction. We expect that to be the case this time around also. This environment is a fertile one for the relative value opportunities that have been the mainstay of our investment approach for many years. We feel that this is an ideal time to put capital to work at valuations we have not seen for many years. In addition, with the reopening of the new issue market we have seen some exceptional opportunities to buy high quality bonds at steep discounts. Indeed, the last week of March was the biggest week ever for new issuance in the US market with $110bn of deals. Actively participating in the new issue market has historically been a very profitable activity for us, particularly so when concessions are elevated. As a result, we are encouraged by the opportunity to add significant additional value for our investors in our mandates.

Materially higher yields have started to attract new buyers of corporate bonds. Prior to the recent market repricing fixed income investors have been pushed into taking more risk and exploring private asset classes in order to find incremental yield. Now the yield on public investment grade credit has moved dramatically higher from 2.6% to 4.6% for the universe overall (US market). For BBB rated credit, yields have gone from 2.9% to 5.3%. There is even more yield available lower down in the rating spectrum with BB yields moving from 3.9% to 8.7%.

2 In some cases, companies paid concessions of 50-75 bps to get deals done. In normal times, a new issue concession would typically range from 0-5 bps
3 Source: Bloomberg
Last week we saw deployment of capital from investors that don’t typically focus on investment grade credit – equity managers, distressed investors, high yield managers - investing at levels that until recently were only obtainable in the high yield market. This “new buying” is another encouraging fact that gives us reason to be very optimistic on forward-looking returns from here.

**Our business continues to function well despite the challenges of COVID-19.** We are pleased to say that our disaster recovery procedures and infrastructure have allowed the firm – and the Portfolio Management team – to function well, despite the logistical and operational challenges posed by COVID-19. Our preparations have paid-off, supported by our significant investments in technology. A core team of five of the Portfolio Management team are physically present in the office every day, fully respecting social distancing rules. Others are working at the disaster recovery site and the remainder of the firm working from home. This has allowed us to keep moving and keep doing our jobs.

**We are aiming for genuine transparency – and welcome the opportunity to dialogue with you.** In the following performance commentary sections we have aimed to be even more transparent than normal about how the portfolios were positioned coming into the quarter and how they are currently positioned to make the best of the opportunity ahead. The first quarter of this year witnessed an exceptional combination of events that has dramatically repriced financial markets. We have adjusted the positioning of our portfolios to strike what we believe to be the right balance between defense and offence going forward. We believe the outlook to be very well-suited to our strategies. While there is uncertainty given the unprecedented nature of COVID-19 we feel confident that corporate bond valuations today are very attractive, particularly given the unambiguous policy backdrop.

Should you have any questions or concerns, please feel free to reach out to a member of the team and we would be glad to address them. Many thanks for your support – and we hope you and your families stay well.
Important Information

Unless indicated otherwise, commentary, returns and portfolio data is presented as at March 31, 2020. Index source: Bloomberg.

The information presented herein is for informational purposes only. It does not provide financial, legal, accounting, tax, investment or other advice, and should not be acted or relied upon in that regard without seeking the appropriate professional advice. The information is drawn from sources believed to be reliable, but the accuracy or completeness of the information is not guaranteed, nor in providing it does RP Investment Advisors LP ("RPIA") assume any responsibility or liability whatsoever. The information provided may be subject to change and RPIA does not undertake any obligation to communicate revisions or updates to the information presented. Unless otherwise stated, the source for all information is RPIA. "Forward-Looking" statements are based on assumptions made by RPIA regarding its opinion and investment strategies in certain market conditions and are subject to a number of mitigating factors. Economic and market conditions may change, which may materially impact actual future events and as a result RPIA’s views, the success of RPIA’s intended strategies as well as its actual course of conduct. This document does not form the basis of any offer or solicitation for the purchase or sale of securities. Products and services of RPIA are only available in jurisdictions where they may be lawfully offered and to investors who qualify under applicable regulation. The RP Debt Opportunities, RP Select Opportunities and RP Fixed Income Plus investment strategies discussed are offered pursuant to certain prospectus exemptions to eligible Canadian investors through units of RP Debt Opportunities Fund Trust, RP Select Opportunities Fund and RP Fixed Income Plus Fund, respectively. RP Strategic Income Plus Fund is a mutual fund that is publicly offered in Canada pursuant to a simplified prospectus.

RPIA managed funds and strategies carry the risk of financial loss. Performance is not guaranteed and past performance may not be repeated. Returns are presented in Canadian dollars and is net of fees and expenses. The performance presented herein reflects the applicable strategy level returns for RP Debt Opportunities, RP Select Opportunities and RP Fixed Income Plus. Strategy level returns are presented for illustrative purposes only and actual returns may vary from one investor to the next in accordance with the terms of the governing documents of the relevant entities. The RP Debt Opportunities and RP Select Opportunities strategies derive their respective economic exposures and related returns for their entities via their master-feeder structures. RP Debt Opportunities strategy performance is based on the returns of RP Debt Opportunities Fund Ltd. Class A and RP Select Opportunities strategy performance is based on the returns of RP Select Opportunities Cayman Fund Ltd. Class C Lead. These strategy level returns may differ from the returns of the Canadian fund vehicles described above. RP Fixed Income Plus performance presented reflects the returns of the RP Fixed Income Plus Fund, Class A.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Indicated rates of return include changes in share or unit value and reinvestment of all dividends or distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Returns for time periods of more than one year are historical annual compounded total returns while returns for time periods of one year or less are cumulative figures and are not annualized. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. The compound growth chart is used only to illustrate the effects of a compound growth rate and is not intended to reflect future values or returns of the Fund.

Performance presented for RP Strategic Income Plus Fund is for Class F of the respective fund. Class F units does not include embedded sales commissions, which results in higher performance relative to Class A units of the fund. Performance data for RP Strategic Income Plus Fund is calculated in accordance with NI 81-102.

Trade examples are presented for illustrative purposes and does not necessarily reflect a trade or current holding in any particular RPIA fund or strategy. Portfolio yield is a forward-looking measure of the expected annualized interest the portfolio would receive with respect to the current holdings and should not be viewed as a representation of actual returns.