DALIS
DALHOUSIE INVESTMENT SOCIETY

December 2021 | ISSUE NO. 3

The Schooner

December was a great month for The Maritime Fund. A number of great trades were executed across all four sub-portfolios. However, the trade of the month goes to the North American Equities group for a pairs trade on Interactive Brokers and Robinhood.

Position: On 11/22/21, 21K shares of Interactive Brokers were purchased at $75.00, and 55K shares of Robinhood were sold short at $29.00. As of 12/31/21 the Interactive Brokers long position has total return of 6%, while the Robinhood short position has a return of 39%. Both the long and short end of the pairs trade remain open today.

Rationale: Robinhood had one of the worst IPOs of 2021. The stock is down nearly 50% from its IPO price and 75% from its all-time-high. Robinhood is a poorly managed company with a weak business plan, pair this with the growing fear of higher interest rates and you have a very attractive short opportunity. 80% of Robinhood's revenue comes from payment for order flow, and we believe it is only a matter of time before US regulators look to outlaw this controversial practice.

Going long Interactive Brokers was done to achieve some delta neutrality given the uncertainty in the market. Interactive Brokers is a pure-play brokerage firm with a healthy balance sheet, seasoned management team, and offers a product its users love.

Alex Saratsiotis, DALIS VP
BComm'22

A GLIMPSE OF WHAT'S INSIDE:

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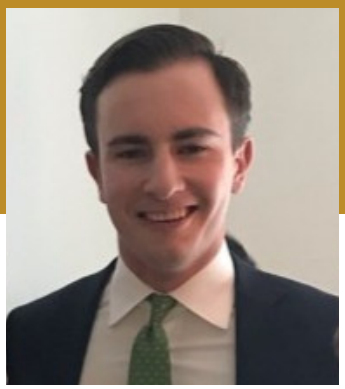

ALUMNI SPOTLIGHT:

Griffin Haines
DALIS Vice-President 18/19

Q: How did your experience in DALIS help you in the professional world?

In my experience, DALIS did an incredible job at preparing me for co-ops and job interviews by not only educating me on the fundamentals of the financial markets but also giving me the platform to work hand-in-hand and develop strong relationships with a wide network of Dal Commerce Alumni.

As a first-year/second-year student looking to try and get my first co-ops on Bay Street, it was invaluable having the ability to walk into a DALIS meeting or the Bloomberg lab and pick the brains of older students who were working those internships at major financial institutions in Investment Banking or Trading Floor positions. It's an excellent venue to get first-hand knowledge on how to prepare for interviews, what to expect from the grueling super days, or how to write a cold-email to a sell-side trader or an Asset Manager PM asking them for a coffee chat. Those were the kind of fundamental skills I was able to learn very early on as a Dalhousie student that really helped me in my pursuit to acquire a full-time position on a trading floor, all thanks to DALIS.

Even to this day I still have very close relationships with those DALIS members who showed me the ropes early on and really gave me excellent advice that without a doubt helped me get to the position I'm currently in. It also was through DALIS where I discovered my passion for the financial markets, and I found that I had an itch to learn as much as possible about trading and to continually develop my knowledge on markets and my involvement in the society throughout my 4 years at Dal.

Q: What is it like on the desk when a rate change is announced

Central bank meetings or economic data releases such as GDP/CPI/Non-farm are always very exciting days to be a market maker in Government bonds because these events will always spark some volatility into our markets, which is good as a liquidity provider because it gives us the opportunity to extract a wider bid/offer on trades with clients as the market moves around. These events are also very important because it gives the market more data to chew on with respect to how the market thinks the Central Bankers are feeling about the economy and will hopefully reveal more information on what steps will need to be taken in order to achieve the natural rate of interest (R*).

The days and hours leading up to these events there's a lot of time spent collaborating and strategizing with fellow traders or salespeople on how we anticipate the market will react to a variety of central bank meeting outcomes. We'll map out how we think the market and yield curve will react to a hawkish/dovish central bank, where we think the BOC/FED/ECB will tweak their language and forward guidance on inflation and interest rates based on the economic data releases and any new systematic risks introduced into the market. Salespeople will collaborate with traders on creating trading ideas for clients that will produce alpha based on the sentiment of the Central Bank or provide hedging ideas for any tail end events.

In the minutes leading up to these Central Bank events, it often gets very quiet on the trading floor as trading desks conduct last minute hedging and traders and salespeople await the release of the official statements from the central banks and listen to the press conferences very attentively for any change in language or sentiment on the economy in the statements given by the Central Bank Governors.

In the seconds following the rate announcement and release of these statements, the energy in the trading will come roaring back as salespeople yell out to client inquiries to traders, strategists yell out key pieces of the statements for traders and salespeople. This information will then get relayed to clients and will create conversations on how they believe these excerpts will get priced into the market, and what trades clients can put on to express how the yield will react to the statements.

As a market maker in Canadian Government Bonds, we will have clients come to us instantly after Central Bank meetings or Economic data releases looking to put on larges trades based on their impressions of the meeting. It's up to us to have the expertise and market wisdom to be able to quickly understand how the BOCs language should impact the pricing dynamics of the yield curve to ensure we don't get put into trades that contradict our perspective on the markets, especially in the volatile periods surrounding central bank meetings.

After the market settles down following a Central Bank meeting, all of the desks within Global Fixed Income Trading and the Strategists and Economists at CIBC will gather to collaborate on how we all interpreted the statements from the central banks, and how we feel it will impact market positioning and our expectations on the trajectory of interest rates in the future.

Q: How did COVID-19 Affect the Interest Rate Desk?

To quote Charles Dickens, the beginning of COVID was "the best of times, it was the worst of times". It was obviously a very hard time for everyone in the beginning with so much uncertainty surrounding COVID, and so much change introduced into all our everyday lives in such a short period of time. But COVID presented some incredible opportunities in the financial markets, not necessarily just fixed income but in every asset class with every market experiencing some form of repricing itself in late Feb to May of 2020.

Personally speaking, I joined CIBC in August of 2019 and participated in a 6 month job rotation before starting on the Government Bond desk in February of 2020, meaning I was just starting my career in Fixed Income trading as the world started to blow up in front of our eyes and life itself came to a grinding halt. So while I was learning the ins and outs of my new job and the tasks I was starting with as a junior trader, and on top of that there was so much for me to learn in terms of how the developments in COVID would re-price the yield curve, and learning the ins and outs of Canada's Debt Management program, and how the BOC's Repo operation or Quantitative Easing (QE) programs would impact pricing dynamics between various sectors of the yield curve as more and more cash was printed and pumped into the financial systems.

COVID has been a polarizing event for Government debt markets as governments had to drastically increase bond issuance amounts in order to fund the economic relief and stimulus programs that the governments have been providing to citizens throughout the pandemic. On top of the wave of government bond supply entering our markets, we also had quantitative easing programs being introduced into our market by the BOC in order to cool volatility and restore proper liquidity into the bond market.

So throughout the pandemic, my team has been paying very close attention to net supply dynamics in our market as the BOC has tinkered with QE programs throughout the duration of the pandemic depending on how the job market and inflation has been recovering. For example, at the beginning of COVID (Apr 2020) the BOC would purchase $5bln of GOC securities ranging from Bills to 30y bonds every week, but as the economy has started to claw its way back to full employment and inflation cools off, that number has been reduced to now just $1bln a week and will be ended all together when they decide start hiking rates in the near future. This is obviously quite meaningful for how our yield curve trades because you go from having a buyer (the BOC) of $5bln worth of GOC Securities every week, lending immense amounts of support to our yield curve, to taking that buyer completely out of the market which could lead to our yield curve cheapening as the year goes on and the BOC buys less and less of their own securities on a weekly basis.

Q: What is your 2022 Outlook on Interest Rates?

As it currently stands I believe there's two themes that will dominate how our yield curve trades over the next year, with the first being the speed at which Central Banks, Canada in particular, will hike rates over the years to come, and the second being the ever-changing funding needs from the Canadian government and how they decide to adjust net-supply across the various sectors of the yield curve.

Currently speaking, the market is very bullish on the CAD Front end, with North American interest rate swap markets currently pricing in that the BOC will hike much quicker than the FED. OIS Markets have the BOC hiking rate rates 5 times by Dec 2022 vs. the 3 hikes priced into the US's front end in that same period with the first hike in Canada happening this April. I have some difficulties agreeing with where the market has the hikes priced, primarily with Omicron cases surging globally. I think there's enough information out on Omicron to declare that it won't have the detrimental impact to economy that prior variants did initially, but it's still something the BOC can't totally discount its impact on the Canadian consumer. Additionally, the rate at which the market has our hikes priced in leaves the BOC with a very tiny margin for error on how consumer prices will react to rising rates. I think with 5 hikes by next January, it doesn't give them ample room to monitor prices to ensure that their thesis of transitory demand inflation is correct and the global supply chain bottlenecks aren't the cause of rising prices. This leads me to believe that ~3 hikes will be achieved by Dec 2022, taking our Target O/N rate to 1.0%, with the 4th hike coming in Jan 2023.

The next theme I've got an eye on for this year is how to yield curve reacts to the net-supply adjustments this year as the BOC brings its QE programs to a halt. In the past Monetary

Policy Reports (MPRs), Governor Macklem and his colleagues have suggested that they would exit reinvestment 'around' the timing of the first rate hike, which would create yet another upward shock for net-supply driving a cheapening of our yield curve. By tenor, the 2yr & 3yrsectors will see a net-supply increase of 88.0% year-on-year on a duration basis, 5yrs will rise by 123.0%, 10yrs will rise by43.0% while 30yrs rise by 66.0%. In aggregate, the rise in supply across the belly to back end of the yield curve is consistent with my first view of the front-end of the yield curve being to ambitiously priced with 2-3y rates currently too high. However with the increase in 30y issuance for 2022, my perspective is the long-end of the yield curve will struggle to perform this year and will experience cheapening against US and other major G7 debt.

2021 Wrapped

Tacc Chatterson

2021 was one hell of a year. I can't recall, were there two, three, or four variants? Another lockdown? What's the definition of fully vaccinated again?

This year has been a rollercoaster of nonsense and speculation. I think some of the most noteworthy events that have taken place in 2021 were: meme stock rallies, crypto, the Federal Reserve's transitory inflation, and well, China.

At the start of January, GameStop hit $350 in less time than it takes to walk home from Split Crow on a Friday night. Bitcoin just missed $70K after China dealt damage, prohibiting all domestic crypto transactions. NFTs are gaining popularity with retail investors, some of whom are upset about the fact that one can just screenshot and share.

Only a couple of months ago, the Fed called inflation transitory, leaving top economists with their heads shaking. If I received a nickel for every time, I heard the words "supply chain disruption" and reinvested it in the S&P, I think I'd be a millionaire. Looking forward, I hope analysts have reassessed their models because, the word transitory isn't what I would've used based on my first-year macroeconomics class.

Moving on, big news surfaced on Evergrande's looming debt and failure to meet interest payments to international investors. Fitch Ratings recently declared Evergrande in default, but who didn't see that coming.

Investors are already losing confidence in Chinese markets with more lies, people disappearing, and questionable human rights. During an interview with Global News, even Trudeau came to his senses. He finally realized that "the Chinese government is using its economic weight to cleverly play democratic countries off one another." Well analyzed Trudeau...

Heading into 2022, I'm expecting a few things to happen. Firstly, significant talks of interest rate hikes should be expected at least a couple times through the year as central banks try to combat high inflation. Secondly, demand for commodities is thought to increase as cold weather doesn't really care whether you have double or triple-pane windows. Thirdly, the disappearance of Omicron and the surfacing of a new variant.

The hawks are flying, and economists predict rate increases as early as the first quarter into 2022. Let's hope self-directed retail investors understand the effects of rate hikes on the equity market...

Next, whoever said oil & gas will likely be squeezed out by 2050, try taking a walk in Calgary in negative thirty degrees. Other than cryogenically frozen nostrils, you'll wonder why you chose R-40 insulation rather than Rona's recommended R-60. It's hard to believe solar will heat your house when it's cloudy with a hundred percent chance of snow.

On another note, does the media just forget about old variants once a new one emerges? They must just disappear because Delta hasn't been mentioned once since Omicron surfaced.

More positively, heading into 2022, there might be an end in sight for the pandemic, hopefully leading to a healthy economic recovery. Unemployment rates are recovering as government subsidies fade, and equity markets are rallying ahead rate hikes, primed for the bears.

Good luck in the New Year. I hope all goes as planned.

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Book Review: One Up On Wall Street by Peter Lynch and John Rothchild

Quinton Luck

Peter Lynch, the co-author of One Up On Wall Street, managed Fidelity's Magellan Fund between the years of 1977 and 1990. Under his management, the fund averaged 29.2% annual return and the assets under management of this fund increased from US$18 million to $14 billion. This impressive performance makes it easy for the reader to treat Lynch's words like more than just advice, but rules. An interesting part of this book is that it was published in 1989, which means that some of the companies he talks about no longer exist or have fallen from grace. Notably, his praise of GE was interesting to see given their turbulent recent history and ultimate drop from the DJIA in 2018, ending their 100-year run on the index. On the flip side, we see Lynch praise some companies that today are household names, but to him they were little companies that had a bright future ahead of them. His coverage of both small and large cap, as well as growth and value stocks, allows the book to bring with it a breadth that most readers will get something from.

I think this book, more than the previous ones I have reviewed in past issues of the Schooner, is directly applicable to most, if not all, areas of DALIS. Lynch goes out of his way to emphasize the importance of finding niches to invest in, not just sticking with S&P500 companies. This is a concept that we have been pushing in DALIS, as we strive to fully utilize the 'paper fund' aspect of our portfolio. Additionally, Lynch speaks of the importance of setting price targets, another aspect of DALIS that was emphasized this last term through our new investment thesis process.

Overall, One Up On Wall Street is a book that I think everyone interested in finance can get something from, despite its age. Perhaps with Lynch's advice we can all find the elusive tenbagger (or twentybagger, or one-hundredbagger) and bring the DALIS Maritime Fund to new heights.

I would give One Up On Wall Street by Peter Lynch 4.5/5 DALIS Boats

Is Private Debt Really as Attractive as it Seems?

Noah Latimer

If you've stuck with Professor McLarney's advice and have been reading the Globe recently, you've likely read something about Bridging Finance. For those of you who prefer to skim the headlines, here's the gist: Bridging Finance was started in 2012 with the goal of developing a private debt fund that would allow investors to extend credit to businesses that could not traditionally borrow from banks. Bridging had assets under management of more than 2 billion dollars with partnerships and investments from many big investment names include all five major Canadian banks. More recently, however, the company has been under investigation by the OSC and been put under the control of PwC as a receiver. This fund's story got me wondering what role private debt does and should play in the portfolios of Canadian investors.

The Value Proposition

Obviously not every private debt fund will have the same fate as Bridging Finance so let's use one of their competitors; Westridge Capital to discuss some of their advantages. Westridge's income fund seeks to achieve a yield of about 11% in today's environment by investing in a diversified portfolio of mature private companies, with long operating histories. The first advantage the fund advertises is that they've always received payment in full on every loan since the inception of the income fund. Likely the biggest advantage that private debt appears to have (aside from their higher-than-average yields) is the fund's lack of correlation to both the equity and debt markets. A graph presented in Westridge's promotional materials shows that their private debt income fund has returned a higher yield than a high yield bond index without increasing the position's volatility.

Takeaways from Bridging Finance

While there are certainly many advantages to private debt, the Bridging Finance story makes clear some of the risks and weaknesses of the asset class. The first weakness that Bridging Finance made obvious, was the degree to which private debt funds rely on the discretion of a concentrated group of fund managers. Bridging's manager, for example, allocated huge amounts of credit to companies that he had personal connections to. Another example of Bridging's poor investment decisions was their extension

of nearly $320 million in credit to the Alaska Alberta railway company. This company was trying to build a railway from Alberta to Alaska to bring more oil to the international markets. The problem however was the fact that this company was found to have nearly no assets with the exception of their intangible IP.

The fee structure that private debt funds maintain is also a major weakness of the asset class. As is expected, private debt funds often charge high management fees. Bridging charged a fee of 2% annually on funds under management along with multiple more complex incentive fees if their target returns were met. Westbridge, Bridging's competitor charges very similar fees although it offers a graduated AUM rate to encourage greater investments. While these fees may not sound incredibly high compared to some of the fees charged by other complex actively managed funds. This 2% fee is an incredibly high percentage of a fund's expected annual yield of about 11%. The other weakness of the fee structure that most private debt funds observe, is that this fee is often based on the fund's net asset value (NAV), a value that's produced by the fund manager. The risk here is that the stated NAV may not always reflect the true value of the fund. PwC showed us that this was the case with Bridging Finance.

The final major weakness that Bridging's fall has made clear is the lack of liquidity that many private debt funds struggle with. Bridging offered five different income funds at the time of their demise. When the managers of these funds started to realize that they might struggle with their investor's redemption requests, they sought permission to accept or reject redemptions at their sole discretion. This permission was granted by the investors of all five of Bridging's funds. This lack of liquidity absolutely puts private debt funds at a disadvantage compared to the public debt available to investors that maintain a highly liquid secondary market. Even if redemption permissions are not granted to the fund's manager, investors must understand that the makeup of a private debt fund's portfolio often create the perfect storm for a liquidity crunch if many investors try to withdraw their investments at the same time.

Final Thoughts

While I think there could be a place for private debt in some investors' portfolios, I think advisors should discuss the risks that come along with these sorts of funds more thoroughly with their clients than many currently do. As most in-depth financial analysis usually reveals, private debt funds are not the magic investment vehicle that they often present themselves to be. Perhaps an investment in structured notes would be a more suitable investment.

Young Women Need Opportunities to Get into Finance Earlier

Sarah Houston

When I was sixteen, I did not know what the stock market was and how exactly it worked. At that moment in my life, I was more concerned with how many tricks I could teach my horse. I can remember the boys in my classes talking about investing and Bay Street, but for fear of looking stupid I never engaged in their conversations. Now, as a third-year finance major, I wonder how further advanced I could have been if I had been given the opportunity to get exposed to finance earlier or at the same time as many of my male classmates. If there had been programming available in high school for young women to learn about the many career opportunities in finance, maybe I would not have felt as behind as I did last year when I decided to major in it. What felt like an eternal game of catch up led me to the realization of the significant need to provide young women an opportunity to get an equal start at a career in finance.

To achieve an equal opportunity at a career in finance we must first help young women discover a passion for finance before they start their post-secondary endeavors. There have been efforts made towards achieving this goal by groups like Women in Capital Markets which hosts In2fin, a half-day event that teaches female high school students about the opportunities that exist within business and STEM. However more initiatives by financial institutions in Canada need to be taken in order to inspire more young women to get involved. Financial institutions should look to provide programming for female high school students such as investment clubs and mentorship programs. They should also look to host events similar to In2fin, where they can provide an inspirational platform for young women to discover an interest in finance. There is nothing more inspirational to a young woman than to hear the journey of a successful woman that they can identify with.

Feeling behind in your desired career path is a major deterrent to continuing on within that field. If financial institutions in Canada provided young women with the tools to learn about finance in high school, it would mitigate the risk of them feeling behind once they are in university.

Furthermore, it would enhance their knowledge of finance, give them confidence, and make them feel qualified to pursue a post-secondary education and career in finance. As financial institutions look to hire more women to bring gender diversity to their workforce, it is not in their best interest to invest in finance related programming for young women?

What is the right asset allocation for you?

Matthew McKee

Risk and return come hand in hand when investing and creating your portfolio. Over the long term , investors who want to grow their portfolio will have to endure some volatility but taking on too much risk can be catastrophic. For this reason, all investors need to find the asset allocation that matches their situation and financial needs.

Between 1900 and 2019, US stocks yielded an annual average return of 9.6% outperforming the 4.9% annual return in the bond market. A dollar invested in bonds in 1900 would have grown to $327 by 2019 whereas a dollar invested in stocks would have grown to more than $58,000. However, taking this at face value, we fail to see that the stock market has punished investors over shorter periods. Following the bursting of the dot-com bubble in 2000 and the great recession of 2008, investors lost between a quarter and half of their money. And does anyone need to be reminded of the pandemic-induced crash in early 2020, where some globally diversified portfolios lost nearly 30 percent in a matter of weeks?

History has shown that there is no such thing as a risk-free investment. Building a portfolio is about finding the balance between risk and reward. That personal balance depends on your age, financial situation, and willingness to take risks, but what matters most is your time horizon. The more time you have to invest, the risker the assets you can hold in your portfolio. However, if you can accomplish your financial goals through low and medium-risk investments, it makes no sense to allocate your portfolio to riskier and more volatile assets.

The final part of building your investment portfolio is determining how much risk you can tolerate with your own finances. You may have plenty of time to ride the ups and downs of the economy, but it all depends on whether you have the stomach to endure such a ride. Although there has never been a 15-year period where a broadly diversified portfolio of Canadian or American stocks would have lost money, most people are emotionally unable to handle the ups and downs of an all-equity portfolio. There are many uncertainties about investing but one thing that is certain is that when you let your portfolio be controlled by your emotions it will lead to devastating results in the long term.

Rick's Rant

Rick Nason, PhD, CFA

Well, it is good-bye to 2021, and hello to 2022. Usually, I get very excited about a new year; it is an opportunity for new beginnings, new friends, new opportunities, new chances to make mistakes and new chances to learn. The start of a new year is also a chance to forget about the previous year, all of the mistakes that you made, the opportunities that you did not seize, and the risks that you were too conservative to take. This year however I will be sorry to see 2021 go. It was an absolutely fantastic year to be a finance professor.

The previous year was one in which investors were completely rational. That means that some of our traditional finance theories occasionally were applicable, and common-sense financial investment discipline paid off. That makes teaching finance and investments so much easier as a prof. Fortunately, 2021 did not give us any crazy investment behavior such as car companies with a negligible market share commanding a market capitalization greater than the giants of the car industry combined. Likewise, companies that were rumored to be going broke did not wake up the internet twits and become meme stocks.

The past year was also one in which investors did not invest blindly in the goody bags known as SPACs and RTOs, which, as we all know are simply three-piece-suit-lawyer inventions for skirting security regulations and getting dog-meat companies a public listing through a back-door. Investors avoided the irrational temptation to trust that a name lend by a washed-up sports star would make for a good investment product bought on suspect future promises. (For those of you too young to remember unpretentious candy stores where you did not need a second mortgage to buy something, a goody bag was a device employed by candy-shops to sell all of their expired candy in a mystery bag at the check-out.)

It was a year in which inflation was firmly controlled, as was volatility. Heck, even those crazy crypto-currencies behaved completely rationally with little to no volatility. It all made perfect sense and non-fungible became lost as a financial term. Central banks inspired confidence that they had a total

handle on things with transparent strategic plans keeping employment, inflation, and rates all at such perfect levels that even Goldilocks was completely satisfied. Of course, things were so good, that older workers economists expected to retire have decided in droves to stay on the job for several extra years, ensuring that pension plans will not have to pay down funds quicker than expected. Every potential employee who wanted a job, got a fine livable wage job with desirable and flexible working conditions, while every employer was easily able to hire the exact employees with the skills that they needed.

The year was so fine that the Suez Canal was a smooth functioning supply chain conduit, which allowed us all to become toilet paper dress designers given the surplus of toilet paper from 2020. It was also a surplus year for computer chips which become an almost worthless commodity as all types of computer chips became as plentiful as sand.

Bzzzzzz. Bzzzzzz. Bzzzzzz. Don't you just hate it when your alarm clock wakes you up from a fantastic dream?

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