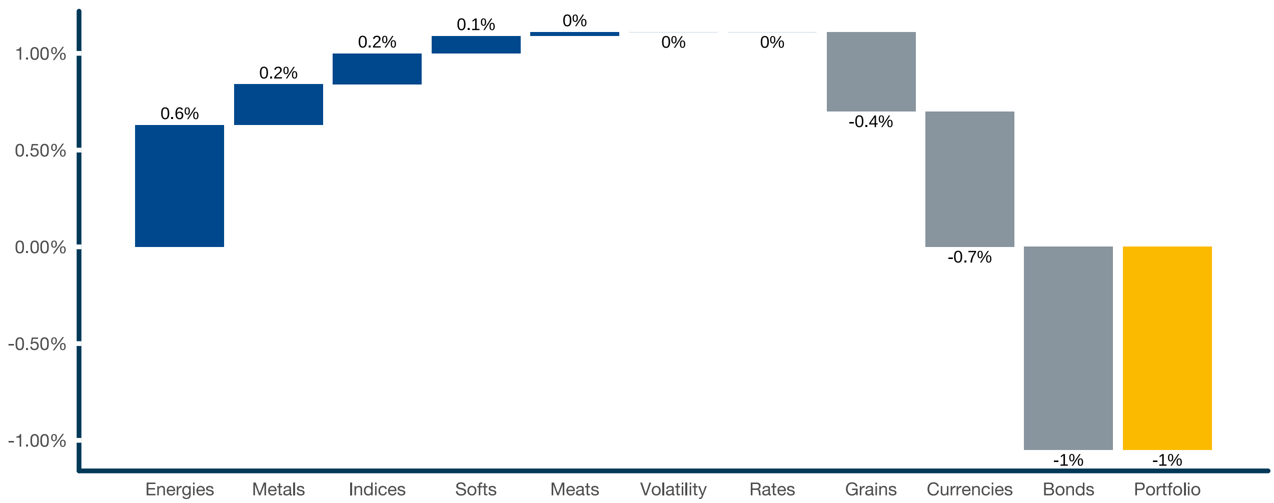
PERFORMANCE REVIEW

Marginal gains in July were offset by small losses in August and September, leading to a one percent decline in the Osprey Program for the third quarter. The strategy is still up by almost 9 percent year-to-date.

Figure 1. Q3 Return Attribution



Source: ReSolve Asset Management. Results may differ due to rounding. Performance is expressed in CAD. Strategy attribution is a best efforts approximation, net of all applicable borrowing costs, fees and fund accruals for the period. Indicated returns of one year or more are annualized. Past performance is not indicative of future performance.

Energies were once again the main positive performing sector, led by long positions in crude oil and gasoil.

Metals also contributed positively, with the lion's share stemming from a short position in silver.

Equity Indices were the other major source of positive returns, with gains from long the British FTSE and Japanese Nikkei, and a short position in the Hang Seng. The only meaningful detraction stemmed from long exposure to the German DAX.

Softs benefitted from long exposure to cotton, while the marginal positive contribution from meats came from a short feeder cattle position.

Bonds were the largest drag on the portfolio, especially from longs on the German 30-year Buxl and US 30-year Treasuries, and short exposure to the Aussie 3-year.

Currencies also detracted, deriving mostly from our short on the Japanese Yen, and longs on Canadian Dollar and Euro.

While **Grains** profited from shorts on soybeans and soymeal, they were offset by shorts on palm oil, canola and wheat.

GENERAL MARKET REVIEW

Investors have begun to price in the possibility that growth may have peaked in the US and globally. The US economy grew by 6.5 percent in the second quarter, well below expectations of 8.4 percent, as strong consumption was offset by weak private investment. Chinese growth of 7.9 percent for the same period was also shy of estimates, burdened by higher commodity prices and new coronavirus outbreaks. The rapid spread of the so-called Delta Variant, one of several COVID-19 mutations, is the other major variable in this equation, fueling fears that new lockdown measures could be enacted, though the spike in cases has not yet translated into meaningfully higher hospitalization rates in North America or Europe. As the quarter progressed, data continued to show signs of US activity losing steam, as the effects of fiscal stimuli began to fade. Online sales fell sharply in July, while consumer sentiment (measured by the University of Michigan) dropped 11 points to its lowest reading since the start of the pandemic amidst one of the largest declines in more than 50 years.

The case for more persistent inflation gathered steam. Recent data from the United Nations points to a whopping 31 percent rise in global food prices for the 12-month period ending last July. Food prices in the US jumped by 8 percent over a similar period, driven largely by imports, while gas lines in Britain and other shortages in developed economies have been capturing headlines. At first glance, CPI and PPI were once again at odds in the US, with the former showing a marginal deceleration (though still printing 5.3 percent annualized) while the latter climbed 8.3 percent, exceeding expectations. But this apparent mismatch is likely symptomatic of a broader phenomenon, linked to what has become one of the most overused catchphrases in recent memory – *supply-chain disruptions*. These disruptions show no sign of abating, and at the margin may be worsening. From the Fed's latest Beige Book we learned that "(…) businesses are finding it easier to pass along more cost increases through higher prices (…) anticipate significant hikes in their selling prices in the months ahead".

The same Beige Book highlighted a resurgence of Delta-led infections as the primary culprit for the recent slowdown in activity, unsurprisingly taking its largest toll on the travel and hospitality sectors. Nonfarm payrolls showed that fewer than one-third of expected positions were filled in August, while JOLTS data revealed almost 11 million unfilled jobs in the country – a record for the series. Time will tell if the answer to this labor puzzle leads to sustained higher wages. Caught between a rock and a hard place – arguably of their own making – central banks delivered a slightly hawkish tilt that, despite being widely anticipated, added to an already souring mood. Though central banks insist they are on track to cross the Rubicon from liquidity providers to liquidity takers, for now they will continue to expand their balance sheets, albeit more slowly once tapering begins.

Global equity markets sustained a roller-coaster quarter, with intense rallies followed by a September selloff for Europe and North America, while Japanese shares lost first and recovered later. Stocks in China and Hong Kong fell by double-digits in the wake of regulatory clampdowns on major industries and troubles in its property sector. Much of the sovereign bond complex was flat to slightly down, except for the small bounce on the 30-year German Buxl (though still down almost 8 percent for the year), while 10-year UK Gilts fell more than one percent and dipped further into negative territory year-to-date. Energies were by far the best performers, led by the spectacular rise in natural gas (rising between 60 and 156 percent, depending on the contract), though the entire sector saw meaningful gains. Metals were deep in the red, with palladium losing 32 percent and platinum and silver also experiencing double-digit losses, accompanied by minor weakness in copper and gold. Agricultural commodities were mixed, with huge gains in palm oil, wheat, cotton, coffee and canola, and steep declines in lumber, soy (beans and meal) and corn. The US Dollar Index increased by 2 percent, with most of the rise taking place in September.

Stagflationary Feelings

Usually driven by its service industry, the US economy benefitted from a reallocation of spending towards durable goods over the last few quarters, fueling its recovery. Now, limited by severe supply constraints – a major driver of recent inflationary overshoots – and the one-off nature of these purchases, America could be facing a 'stagflationary' shock, especially if renewed restrictions are imposed in the wake of a worsening pandemic or geopolitical instability.

Given the flurry of recent developments it can be hard to keep track of all the major risks on investors' radars, much less weight their potential severity and magnitude. Chinese and US GDP have returned to their pre-pandemic levels on the back of unprecedented deficit spending, but enduring inflationary pressures and commensurate downstream effects may limit policymakers' options in the months ahead. Meanwhile, the US is once again faced with the threat of a government funding shortfall as its sovereign debt nudges up against a congressionally-imposed ceiling, a debate that is threatening to derail much-awaited infrastructure legislation. The economy and markets have rarely been more reliant on, and therefore vulnerable to, policy surprises and political uncertainty. This might be the right moment for investors to consider their portfolios' sensitivities to inflation and growth shocks, and reallocate risk accordingly.

Sincerely,

Your ReSolve Team

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