Inflection Commentary

INFLECTION
Alternative Assets

Inflection Performance: February 2017

"Don't Buy the Past; Buy the Future"[1]

A recent article in Forbes magazine, titled "Too Big on Trump?", nicely captures our philosophy on diversification while stating the risks to investors of having a portfolio lopsided with domes-tic stocks after the kind of run up we've experienced over the last eight years. The article quotes a US money manager who points out that diversification of assets has the advantage of producing a better return with markedly less risk, but that it requires hard work to find assets that are truly uncorrelated and likely to remain so during periods of stress like 2008.

Investors have a natural tendency to favour what has worked in the past, but sometimes do so without realizing how the macro-economic climate has shifted and therefore 'past performance is not indicative of future performance', as the standard investment disclaimer puts it. We believe that is exactly the case now, with macro-conditions completely different from those of the past eight years and US equity valuations in the 96th percentile. It should indeed give investors pause to consider that, historically, stocks have only been more expensive relative to earnings in 1929 and 1999, both years infamous for the crashes that followed. Now might be a very good time for investors to rebalance their portfolios!

At the Inflection Strategic Opportunities Fund ('ISOF') we take a very similar approach to the one discussed in the Forbes' article but refine it further by focusing on a narrower range of strategies with very favourable asymmetry of returns. In simple terms, whereas the likely range of annual return for an asset class may lie between a positive or negative of a single number, like ±25%, we consider only managers with a much more asymmetric historical range of eg. -5% to +25%. By shifting the goal posts we markedly improve the likelihood of meeting or exceeding our goal of an 8-10% net return averaged over 10 years with one third the volatility (risk) of the TSX.

Of course it's not as simple as it sounds. A great deal of work goes into studying the historical fundamental and quantitative factors that lead to outperformance, and determining the likeli-hood that that edge will persist in the future. But over the years we've refined our process to be able to reliably find these needles in a haystack of over 10,000 managers worldwide, and have found that the extra work is worth it.

By keeping our eyes firmly fixed on the road ahead (while iteratively analyzing what we see in the rearview mirror) we have been able to avoid some serious potholes over the years. Though we can't predict the future, we can, to paraphrase a famous (if not necessarily loved) former US Secretary of Defense, say that we act on the 'known knowns,' and are prepared for the 'known unknowns'.

Real diversification can improve the safety and likelihood of success for our clients' portfolios.

[1] Paraphrased from "*Too Big on Trump?*", Forbes Magazine, February 28, 2017.

Inflection Commentary

INFLECTION
Alternative Assets

Inflection Performance: February 2017

Market Review

Equity markets broke out of their holding pattern in February and resumed the rally that started with the election of President Trump. Catalysts appear to include a broad-based improvement in economic activity and the expectation of more deregulation by the Trump administration. Financials were the strongest performing sector.

The economic picture remains largely the same as in January with the global economy growing above trend in a self-reinforcing, synchronous, upswing. Inflation has increased considerably in recent months, albeit from a very low base, and accordingly the US Federal Reserve increased their benchmark interest rate target by a quarter percent to 0.75-1.0% in March and, importantly, reaffirmed its intention to continue raising rates by as many as four times over the course of the year.

Meanwhile, the European Central Bank is talking about raising rates even though it is still in the midst of Quantitative Easing with sovereign and corporate bond purchases. And the Bank of Japan is considering tapering their own bond purchase programs. As noted in previous commentaries, global divergence in rates should create nice opportunities for our macro strategies.

Contribution

ISOF was up 0.43% in February. Nine of our fourteen managers were positive; one manager in Macro and two of our Volatility strategies were negative. Community Banking, which falls under our Macro bucket, was again our best performer contributing 0.37% on the month.

The portfolio is designed with varying levels of volatility and return for different strategies. The volatility of the managers in our Macro and Volatility strategies can be up to ten times the volatility of our Relative Value and Arbitrage managers but with the potential to generate much higher returns in addition to providing additional diversification. It is not uncommon to have periods of negative returns for these managers. But to quote another old saw, ‘With risk comes return‘.

Strategy	# of Managers	Contribution
Arbitrage	3	0.28%
Relative Value	6	0.21%
Macro	3	0.35%
Volatility	2	-0.40%

INFLECTION
Alternative Assets

Inflection Performance: February 2017

Portfolio Activity

In February we added another Merger Arbitrage manager to our portfolio. This manager has been perfecting their approach since 2000 and invests exclusively in announced deals, thus avoiding most of the greatest risks to this strategy, including anti-trust concerns, cross-border complications, and hostile bids. With a greater than 99% deal-completion rate this manager provides the kind of steady stream of high risk-adjusted returns, uncorrelated to the markets, that we believe are most beneficial to our clients.

We find this strategy particularly attractive now, as it tends to benefit from higher interest rates and volatility, both of which appear to be opportunities very much in the road ahead.

Sincerely,

The Inflection Team

The Inflection Strategic Opportunities Fund (ISOF) invests in a broad array of carefully selected hedge fund strategies in order to capitalize on dislocations and market opportunities. The Fund has a global mandate and focuses primarily on the Americas, Europe and Asia, providing access to the expertise of hedge fund managers in identifying what we believe are exceptional investment opportunities throughout the world. Some taxable investors may find that the Fund's option structure has significant tax benefits. Please refer to the attached Factsheet for additional information.

Inflection Management Inc.
Suite 2300 - 1066 West Hastings Street
Vancouver, British Columbia
Canada V6E 3X2

Tel: 604.730.9147
www.inflectionmanagement.com

Inflection Commentary

INFLECTION
Alternative Assets

Inflection Performance: February 2017

Disclosure

ISOF performance presented are USD net returns after investment management and performance fees and are not an estimate of any specific investor's actual performance, which may be materially different from such performance depending on numerous factors. ISOF returns represent historical returns adjusted for the June 2015 performance fee structure change to the current fee structure. Information presented is believed to be correct and accurate at the time of production but may change due to circumstances beyond our control. Returns may be amended after these numbers have been reported due to repricing adjustments or receipt of more recent data, among other things, and will be reflected in the most recent document. Comparative returns selected are for informational purposes only and may or may not accurately represent the composition or potential performance of Inflection Strategic Opportunities Fund and may not be useful for comparison purposes. Past performance should not be taken as an indicator of future performance. The HFRI Fund Weighted Composite Index is a global, equal-weighted index of over 2,000 single-manager hedge funds that report to HFR Database. Constituent funds report monthly net of all fees performance in US Dollars and have a minimum of $50 Million under management or a twelve (12) month track record of active performance. The HFRI Fund Weighted Composite Index does not include Funds of Hedge Funds. The Barclays Global Aggregate Bond Index is a market capitalization-weighted index denominated in US Dollars representing the universe of investment grade bonds available for purchase in the United States, securities underlying the index include Treasuries, Agencies, Mortgages, and Corporate Bonds. ISOF is an exempt market fund available to Canadian resident accredited investors in British Columbia, Alberta, Ontario, and Quebec and to a limited investor base in certain provinces under the Minimum Amount exemption. Investing involves risk. Please seek professional advice before making any investment. This is not an offer to purchase or sell securities. It is for information only. Please refer to the Confidential Information Memorandum for more detailed information.