

Inflection Performance: October 2015

If Everyone Jumps Off a Bridge...

In October risk assets such as equities, corporate bonds, and emerging market currencies appreciated notably, recovering some of their losses from earlier in the year. The catalyst for the rally appears to have been weaker U.S. labor market data. Yes, weaker.

That's because over the last six years markets have become increasingly addicted to the US Federal Reserve's extraordinarily accommodative policy of easy money. Low interest rates have made it too easy for investors to reap rewards without too much concern for what, in more normal times, are the real drivers of returns. So, if you follow the currently fashionable topsy turvy reasoning of the markets, weaker U.S. labor and economic data make it more likely that the Fed will take a slower approach to raising rates, and therefore is being seen as good news for risk assets.

But extraordinarily accommodative monetary policies also stoke the likelihood that riskier assets will eventually suffer because, make no mistake, rates will unquestionably rise and, at some point, market sentiment will unquestionably reverse. When it does, watch out. Hitherto ignored anemic growth figures will be seen for what they are, an indication of economic weakness, and bad news will be seen as bad news. Riskier assets will lose their artificial drivers, and safety nets that are currently out of fashion will become desperately attractive (and expensively priced) for those who are now heedlessly jumping off the bridge.

The challenge for investors therefore is to position their portfolio to have it both ways. To get the thrill of jumping (reaping the rewards of risk assets) and the reassurance of knowing that the safety net will catch and the safety line will hold. We can't know in advance exactly when the current 'risk-on' environment will reverse, so we have to be prepared for both eventualities.

For the Inflection Strategic Opportunities Fund ('ISOF') this has meant a delicately balanced portfolio, positioned for positive opportunities such as we've seen in October, but also positioned to benefit from the reverses, such as those we saw in August and September. Moreover, we've additionally allocated to strategies that can benefit from the bouncing itself, volatility-based strategies that profit from oscillation.

Our hedged and nimble approach has kept ISOF in positive territory in a year when most of our peers are negative. The strategies we've employed may be more complex to understand and deploy than traditional stocks and other risk assets, but we believe that's a reasonable price for safety. The investing universe has become much more sophisticated over the last two decades, and that necessarily requires that investors evolve their technologies and thinking if they want to benefit from the new investing environment.

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Our willingness to review the entire portfolio weekly and make the necessary changes is an approach that we believe is best at preserving capital. In a year when jumping off bridges is in vogue (despite being unprofitable: the TSX equity index has actually lost roughly 13% of its value over the past year), the best way we can serve our investors is by providing the bungee cords and safety nets.

In October ISOF had a net return of 0.07% (-1.95% in Canadian dollar terms) bringing our year to date return to 0.19% (12.92% in Canadian dollar terms). By comparison, the HFN Fund of Funds-Multi-Strategy Index, our closest US dollar benchmark, returned 0.76% for October (-0.68% YTD) and the S&P TSX Index returned 2.46% for the month (-5.20% YTD). The Scotiabank Canadian Hedge Fund (Equal Weighted) Index gained 0.58% in October (0.19% YTD).

Since inception in October 2010 ISOF has produced a net US dollar return of 33.84% (70.06% in Canadian dollar terms), outperforming the Scotiabank Canadian Hedge Fund Index by 63.85%, the TSX Index by 43.24% (on a Canadian Dollar returns basis), and the HFN Fund of Funds-Mul-Strategy Index by 19.88% (on a US Dollar returns basis). Over that period ISOF's Sharpe ratio is 0.96 (1.19 in Canadian dollar terms), and its correlation to the S&P TSX Index is -0.03 in Canadian dollar terms.

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.

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Disclaimers

ISOF performance numbers presented are blended net returns after investment management and performance fees which vary by class of unit. 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 we have reported these numbers. These amendments may be due to repricing adjustments or receipt of more accurate data, among other things, and are reflected in the next document. Benchmarks selected are for informational purposes only and may or may not accurately represent the composition or potential performance of Inflection Strategic Opportunities Fund. All comparative returns are provided for informational purposes only and may or may not be useful for performance comparison purposes. USD returns source: The HedgefundNet Fund of Fund Multi-Strategy (HFN FOF Multi Strategy) index, a USD denominated index comprised of funds of hedge funds. CAD returns source: ISOF USD returns converted into CAD returns based on the last monthly closing USD/CAD exchange rate as posted on the Bank of Canada website. The S&P TSX Total Return index measures the total return of a basket of stocks traded on the TSX index in Canada. The ScotiaMcLeod Equal Weighted Hedge Fund Index is comprised of Canadian-based hedge funds whose returns are equally weighted within the index. Inflection Strategic Opportunities Fund is an exempt market fund available to Canadian resident accredited investors in British Columbia, Alberta, Saskatchewan, 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 detailed information.