

### **Trump, Brexit, and a World Going to Hell in a Hand Basket Or The Beauty of Uncorrelated Returns**

Stock markets have lately grown highly sensitive to political issues like whether or not Britain will leave the EU, whether ultra-nationalism is on the rise in Europe, and whether or not the Donald is the Anti-Christ. We believe the unusual sensitivity of markets to non-financial issues can be largely explained as the inevitable consequences of eight years of global central bank intervention and that it will likely get worse, and subject to greater extremes, until the economic situation improves substantially. We don't see that happening any time in the near future, but rather than question the whys and wherefores of geopolitical trends, we believe it is more profitable for investors to craft a portfolio that responds to the markets such as they are now and as they are likely to be for the foreseeable future.

Importantly, all of these issues and a half-dozen more that have been crowding the front pages of your morning newspaper over the last year or so, are creating periods of heightened volatility in asset markets. That volatility has been poisonous for stocks and bonds, but in the world of alternatives, the 'third leg' of a balanced portfolio, that same volatility has created and will continue to create tremendous opportunity.

At the Inflection Strategic Opportunities Fund ('ISOF') our job is to provide a sturdy third leg, a stream of uncorrelated returns to complement our investors' traditional portfolio of stocks and bonds. Our goal is to lower our investors' total portfolio volatility and thereby reduce overall portfolio risk while improving returns. As we've said many times before, this is the closest thing the investing world offers to a free lunch, and it is one well worth eating.

We accomplish this goal by assembling a portfolio of best in class investment managers with a definable, defensible edge that results in a replicable process, and with minimal overlap of strategies likely to be found in a Canadian investor's portfolio. And while we have been finding great opportunity in volatility for the last year, it is only our third best strategy year to date, and only one of the high conviction themes around which we've built our portfolio.

#### **Our Top Themes**

##### Volatility

Volatility is often an outcome of inherently inefficient markets due to natural human biases in underestimating (or mispricing) the range of possible outcomes. Inefficiency is good for those traders able to wield the technological tools for capturing pricing discrepancies. ISOF has three managers who capitalize on these swings and mispricings to generate returns, each in different markets and in very different ways.

The nuts and bolts of what each manager does is necessarily complex, but the beauty of their

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processes is their repeatability and their independence from the traditional drivers of investment returns. At a time when there is tremendous uncertainty about the direction of economies worldwide, the ability of these managers to make money whether markets go up or down is extremely beneficial.

### Merger Arbitrage

Merger and acquisition activity is a staple of the business world. Whether times are good or times are bad, mergers must take place because of the internal logic of the companies involved. The 'dance' between the acquirer and acquired is a classic example of a repeatable process.

Merger spreads are dictated by the amount of capital deployed in the space and the number of deals available to arbitrage, the level of interest rates, and the perceived risk of a deal breaking or successfully closing, among other factors. While there are many ways to invest in merger activity, one of our preferred managers' lower-risk approach is to only invest in deals that have definitive merger agreements and are not subject to any breakage inducing risks such as regulatory review, cross-border legalities, or dependent financing. The result is a steady, unexciting stream of returns that is independent of overall stock market movement.

### Energy Trading

At Inflection Management we try to avoid exposures that duplicate our investors' portfolios, and therefore, when it comes to natural resources, are very careful to find opportunities that are not dependent on exclusively positive or negative forecasts of energy prices. While we don't know whether energy prices will move up or down, we do know they will move, and therefore have sourced a manager who can make money from the actual change in prices, whether up or down.

Our manager has displayed incredible skill in navigating the complexity of oil fundamentals for over ten years while adhering to a strict risk-management protocol. The inefficiency created by mismatches in supply and demand from natural buyers and sellers and from 'tourist' speculators has created an ideal environment for our manager to consistently produce outsized returns with little correlation to other markets or other managers in our portfolio.

### Municipal Bond Trading

The municipal bond market in the United States is one of the most fragmented and inefficient major markets around. Most of the significant markets, such as stocks and currencies, have become increasingly 'efficient' due to the rise of computerized trading, exchange-listed pricing, and rules requiring equitable dissemination of formerly privileged information. Not so for the municipal bond market. 72% of the municipal bonds outstanding are held by retail (i.e. non-professional) investors and traded in blocks by brokerage firms via direct message, which resulted in limited availability of price history until our manager started to collect the data.

Pre-Volcker, banks dominated this space, making money for their own account using their proprietary trading desks. Post-Volcker banks have been forced to dramatically curtail this business

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creating a liquidity vacuum in the market that further increases pricing inefficiency and encouraging true trading talents to leave the banks and open private hedge funds.

### Big Data

The increasing ubiquity of cheap computing and storage power has had many far-reaching implications for the way we live. One of the more interesting investing opportunities it has created is the ability for sophisticated managers with access to a torrent of trading data to apply the signals created to trade esoteric markets that are lightly traded and therefore inherently inefficient.

By leveraging the resources that only a very large firm can muster, our manager has been able to apply the same trend following signals that have been successful in more crowded traditional markets to much more uncrowded markets where profits are easier to maintain. The access points systematic strategies require to apply their processes did not exist in these markets until our manager built the private informational bridges to facilitate trading, an enviable edge that will inevitably erode over time and therefore requires a sustained commitment to the innovation required to continually add new markets.

### **April**

In April ISOF's blended asset net return was 0.70% bringing our year to date net return to -3.83%. By comparison, the HFRI Fund Weighted Composite Index returned 1.02% for the month (0.39% year to date), the S&P TSX Index returned 4.04%, (8.38% YTD) and the Barclays Global Aggregate Bond Index gained 1.33% in March (7.31% YTD).

Since inception in October 2010 ISOF has produced a return of 28.54% outperforming the HFRI Hedge Fund Index by 10.05%, and the Barclays Global Aggregate Bond Index by 17.82%. With only 60% of the volatility, ISOF has underperformed the S&P TSX Index by 4.38% during the period, with a Sharpe ratio of 0.73 and a correlation to the S&P TSX Index of 0.59.

### Inflection In the News

Ari Shiff, President and Chief Strategist at Inflection Management Inc., appeared on Bloomberg TV's Daily Brief on Wednesday, June 1st to talk about investing in alternative funds. To view the segment click on the following link:

[Bloomberg TV - Inflection's Ari Shiff on Investing in Alternative Funds](#)

Sincerely,

The Inflection Team

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*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.