Inflection Commentary

INFLECTION
Alternative Assets

Inflection Performance: June 2015

The *Deus* Gets Back Into the *Machina*

In ancient Greek tragedies impossibly tangled plot complications were sometimes resolved at the last minute by the simple expedient of a god (*deus*) arriving in a machine (*machina*) to use super-human powers to neatly resolve the conflict and bring the play to an end. Since then the term deus ex machina has come to be used to describe any seemingly unsolvable problem that is magically resolved by the contrived intervention of some fantastic power.

Over the last decade the world has not lacked for expectations that various gods would miraculously save the financial system. Unfortunately, one by one, many of them have proven false and slyly exited the stage until today only one, the US Federal Reserve, continues to attract an audience that believes it will survive the final act: successfully soaking up the massive liquidity that has sustained us for the last seven years without tipping the US, and perhaps the world, back into recession. We shall see. (And we shall hedge!)

Meanwhile, in June two more gods ignominiously climbed back into the machine and vamoosed: The European Economic Community (EEC) and China.

Fittingly, the stage for the EEC's tragedy was Greece. Although the latest drama between the European 'haves' (represented by Germany) and the 'have nots' (represented by Greece) resolved itself with an eleventh hour agreement, we believe it is nothing more than a further forestalling of the inevitable realization that the economic union is not sustainable in its present form. There are 28 countries in the EEC; there is only one Germany. The European Central Bank may indeed require the mythological powers of the Greek Gods to successfully resolve all the loose threads of this tangled mess without killing all the actors.

Perhaps far more important to our immediate financial wellbeing is the shadow play being staged in China. Way back in 2010 we wrote about the dangers of believing that China, a notoriously non-transparent economy, should be counted on to consistently produce the demand that would allow the rest of the world to rebuild its economic base. In June the Chinese stock market bubble popped dramatically and, more importantly, exposed the chasm between western-style free markets and the Chinese version. The Chinese government is more than willing to intervene in every possible way to achieve the politically desirable outcome, liquidity and rule of law be damned.

Far from an opportunity for schadenfreude for all of those clever enough to have avoided Chinese stocks, we believe investors should be seriously concerned that both China's attempt to control their stock market and its failure to succeed are perhaps a foreshadowing of the country's future inability to engineer a soft landing as its economy slows. Moreover, unlike the locally-contained damage of the Shanghai and Shenzen stock market routs, the spillover of the Chinese economy's weakness will likely affect resource and manufacturing economies worldwide, and particularly here in Canada.

Inflection Performance: June 2015

While these events certainly contributed to both June and the second quarter of 2015 ('Q2') being difficult periods for investors, they will also likely follow the pattern of previous inflection points and prove to be opportunities for future profits for veteran managers. Markets tend to react negatively to uncertainty, and with uncertainty often comes big over-reactions and the ideal conditions for our managers to act on the misunderstandings and imperfect distribution of information that can lead to the mispricing of hard assets.

In June the Inflection Strategic Opportunity Fund ('ISOF') had a net return of -1.29% (-0.87% in Canadian dollar terms) bringing our year to date return to 5.48% (13.56% in Canadian dollar terms). By comparison, the HFN Fund of Funds-Multi-Strategy Index, our closest US dollar benchmark, returned -1.12% for June (2.62% YTD) and the S&P TSX Index returned -3.17% for the month (0.90% YTD). The Scotiabank Canadian Hedge Fund (Equal Weighted) Index lost -0.41% for the month and is at 3.91% year to date.

Since inception in October 2010 ISOF has produced a net US dollar return of 40.90% (71.02% in Canadian dollar terms), outperforming the Scotiabank Canadian Hedge Fund Index by 60.87%, the TSX Index by 36.03% (on a Canadian Dollar returns basis), and the HFN Fund of Funds-Multi-Strategy Index by 23.13% (on a US Dollar returns basis). Over that period ISOF maintained a Sharpe ratio of 1.27 (1.30 in Canadian dollar terms), and a correlation to the S&P TSX Index of -0.07 in Canadian dollar terms.

Q2 2015 In Brief

Five of our eight strategies contributed positively in the second quarter of 2015, but that was not enough to overcome the two negative contributors, Quantitative Behavioral Traders and Currency & Commodity Traders, both of which suffered from the macroeconomic events mentioned above, but both of which are likely to do well as we emerge from the inflection point in Q3.

Among our positive contributors for Q2, Merger Arbitrage (M&A) and Equity Long and Short Managers were the standout performers once again, contributing 25.80% and 59.48% of returns for the quarter, respectively. Much ink has already been spilled on superlatives describing the pace of M&A activity this year. Rather than repeat what has been better said elsewhere, we note that the cycle is nowhere near over. In fact it is continuing to accelerate both in the number of deals and in their size.

As the frenzy has accelerated, acquisition hungry companies have increasingly 'gone hostile' to overcome reluctant targets, and the total value of unsolicited takeovers has soared to $383 billion so far this year. On unsolicited bids our managers tend to fall into two camps: our activist managers, who precipitated much of this activity, have benefitted from their size, longevity, and controlling the playing field; our more risk-averse M&A managers have tended to avoid non-consensual deals, but have benefitted nonetheless when topping bids have pushed purchase prices still higher.

INFLECTION
Alternative Assets

Inflection Performance: June 2015

Also of note during the quarter has been the performance of our European equity managers. While our managers already distinguished themselves by outperforming virtually all of their peers while the European markets were rising in Q1, they truly endeared themselves to our long/short hearts in Q2 by outperforming their peers with their short performance. We believe it takes real talent and discipline to make money in both directions when markets are this volatile for a prolonged period.

As we move into the fall and the Fed is signalling strongly that it really is going to raise interest rates this time, our opportunities are multiplying nicely. We also take comfort in the fact that, though new gods may come and go, time-tested strategies tend to profitably endure year after year after year.

Inflection News

Last month we announced that we are now accepting commitments for RRSPs, RESPs and TFSAs for a minimum of $25,000. In response to requests, we are pleased to announce that we are now accepting commitments for RIFFs as well. All are available in either a US dollar class or a Canadian dollar class that is hedged to the Canadian dollar (that aims to produce the same return as the US dollar class). Interested investors should contact our Director of Business Development, Paul Mayer, at pmayer@inflectionmanagement.com (647.923.4161) or any member of the Inflection Team.

Ari Shiff, Inflection Management's Founder and Director of Research, will be a guest panelist at Opal Financial Group's Family Office and Endowment Investment Forum in Vancouver on September 10th and 11th. Clients interested in attending should contact Jamison McAuley at jmcauley@inflectionmanagement.com (604.742.2334) or any member of the Inflection Team.

Sincerely,

The Inflection Team

The Inflection Strategic Opportunities Fund (ISOF) invests in a broad array of carefully selected and analyzed hedge funds 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 Commentary

INFLECTION
Alternative Assets

Inflection Performance: June 2015

Inflection Management Inc.
1981 West 19th Avenue
Vancouver, British Columbia
Canada V6J 2P2

Tel: 604.730.9147 Fax: 604.730.9149
www.inflectionmanagement.com

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.