

## Inflection Performance: March 2015

### Do High Returns Always Mean High Risk?

In previous commentaries we have called our readers' attention to the distinction between investments with high returns and investments with high returns relative to the risk taken. The distinction is important for investors who wish to grow their wealth responsibly over the long term, but don't want to expose themselves to risks that could not only disappoint by not delivering the expected return but may also lead to capital loss - obviously not a desirable outcome.

Risk analysis is especially important in a low return environment like we have now in Canada, when GICs have struggled to return 2%. Risk-efficient investors should be on high alert when presented with investment opportunities that forecast greater than average returns.

There are however jewels to be found, investments that differ fundamentally in their approach and that have historically produced very healthy net returns at lower risk. And just as it would be imprudent for an investor to take on too much risk, it would also be imprudent, and an inefficient use of one's money, to settle for a low return when better opportunities are available.

The nature of investing is that some years return better than others. And while it is very difficult to find opportunities that consistently gain value year after year, it is possible to find investments that use sophisticated risk controls to attempt to mitigate the risk of giving back the returns of good years during inevitable less-good years. When graphed over time, these investments stand out because of their unique profile. Rather than the familiar equity profile of peaks and valleys, these investments tend to have a profile of hills and plateaus. Sometimes, the hills are also noticeably steeper, indicating a better over-all return as well.

The Inflection Strategic Opportunity Fund ('ISOF') is constructed to assist with capital preservation and growth over the long term by assembling a portfolio of alternative risk-aware strategies. ISOF's performance graphs have mostly exhibited the preferable hill-plateau profile over several market cycles, a good indication of an historical lack of correlation with the other components typically found in a Canadian investor's portfolio, like stocks and real estate, which makes it potentially an important source of return during periods of stress like the stock markets are experiencing now.

ISOF's March return of 1.49% brings our first quarter ('Q1') 2015 net return to 5.82% (15.53% in Canadian dollar terms). By comparison, the HFN Fund of Funds-Multi-Strategy Index, our closest US dollar benchmark, returned 0.79% for March (2.56% for Q1) and the S&P TSX Index returned -1.62% for the month (2.86% for Q1). The Scotiabank Canadian Hedge Fund (Equal Weighted) Index gained 0.07% for the month and is up 3.85% for the first quarter.

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Since inception in October 2010 ISOF has produced a net US dollar return of 41.35% (73.99% in Canadian dollar terms), outperforming the Scotiabank Canadian Hedge Fund Index by 63.91%, the TSX Index by 36.39% (on a Canadian Dollar returns basis), and the HFN Fund of Funds-Multi-Strategy Index by 23.65% (on a US Dollar returns basis). Over that period ISOF maintained a Sharpe ratio of 1.33 (1.50 in Canadian dollar terms), and a correlation to the S&P TSX Index of -.04 in Canadian dollar terms.

### Q1 2015 In Brief

Seven of our eight strategies contributed positively in the first quarter of 2015. Needless to say, number eight, global macro, will not be darkening our doorstep for the rest of the year.

While none of the major world economies is performing especially well, the fact that each is suffering in a different way has produced an opportunity for ISOF's managers, most noticeably in our European strategies. The Euro declined by a further 4% vs. U.S. Dollar in the first quarter while the European equity (Stoxx 50) index increased by 17.51%. Our managers improved on that already excellent dispersion with thoughtful equity selection on both the long and short side, producing what we think of as a rare quadruple win (with a half twist).

Among our top European contributors on the long side were Altice, Braas Monier, Aalberts, Moncler and Fiat. On the short side single stock contributors included Royal Dutch and Seadrill. Some are forecasting a further drop in the euro by year end, which might be expected to further boost European exporters and further weaken companies dependent on domestic consumption.

More generally, equity long/short contributed 57.64% for the quarter. Other notable contributors were event driven managers, including the ongoing boom in mergers and acquisitions ('M&A'), and technology.

Ironically, the M&A boom has made technology sector investing more challenging for long/short managers as it is rewarding both acquirers and targets despite the mixed record for tech M&A. Nevertheless our managers have had some strong successes particularly in the hot security space with companies like Palo Alto Networks and Proofpoint.

Our second biggest strategy contributor for the quarter was distressed and corporate bonds at 19.86%, followed closely by quantitative behavioural traders at 13.35%. Systematically-focused behavioural trading continues to look more and more interesting to us as a third wave of mathematical strategies continues to evolve. While we had a skeptical opinion of the first two waves, which simply used more and more powerful computers and bigger and bigger databases to do backward looking analysis, it appears that the third wave is making exciting headway in predictive modeling.

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Our various overlay hedges detracted 31 basis points from our first quarter net return of 5.82%. As usual, we accept this modest “tax” as the price for sleeping well at night and knowing where your insurance policies are.

Looking forward we see further strengthening of trends already noted. ISOF continues to find it rewarding to invest in areas others have overlooked and sees no reason why investors should settle for either lower returns or higher risk when assembling their 2015 investment portfolio.

Inflection In the News

Ari Shiff, Inflection Management’s Founder and Head of Fund Research, was a guest panelist at Opal’s Family Office & Endowment Investment Forum in April, and a guest author for Advisor.ca.

Ari’s article, “Benefit from energy without energy price exposure,” discusses how Canadian investors may benefit from the ongoing dislocation and volatility in the energy markets and the Canadian dollar. To read the article, please click on the link below:

<http://www.advisor.ca/investments/alternative-investments/benefit-from-energy-without-energy-price-exposure-181480>

or visit our website to view all of our past articles and commentaries.

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

Tel: 604.730.9147 Fax: 604.730.9149  
[www.inflectionmanagement.com](http://www.inflectionmanagement.com)

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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.