Inflection Commentary

INFLECTION
Alternative Assets

Inflection Performance: May 2016

A Rock, a Hard Place, and Other Navigational Hazards of 2016 and Beyond

Since the inception of the Inflection Strategic Opportunities Fund ('ISOF') we've been warning that some of the fixes that were instituted to bring stability to the markets after the Collapse of 2008 would themselves lead to future instability and that investors might do well to seek protection offered by non-correlated alternatives.

The Brexit decision to leave the EU was not particularly surprising when viewed through the lens of history, which repeatedly teaches that periods of political upheaval and protectionism frequently follow periods of economic upheaval. 2008 was a huge economic upheaval. Brexit and the ensuing political and economic instability that is unfolding in Great Britain is likely just the beginning of a period of prolonged political upheaval in Europe that will ratchet up the risks of holding traditional assets globally.

If stocks are the rock, bonds are the hard place, and both will likely suffer more than in prior periods of political turmoil because of the ultra-low interest rate environment that has dominated since 2008 and which shows no signs of letting up soon. While it is not our place to opine on political issues, it is our place to watch for the effects of politics on markets, and the trading days since the Brexit vote are an object lesson on just how much markets hate uncertainty.

And for good reason. The implications of the Brexit vote are still largely unknown. Aside from the fuel Britain leaving will add to the fires of nationalism burning in every major EU member country, there is the significant economic issue of how Europe's financial centre, London, will continue given the change in Britain's status.

In our view, Canada will not be immune to Europe's problems. Virtually every major economy, including both the US and China, arguably the two biggest drivers of world economic prospects, will be on the receiving end of the turmoil unleashed last week in Britain. The effects will likely come in waves and will be felt for many months if not years.

A recent Wall Street Journal article, titled "Taking on Risk for This?" illustrates the dilemma facing investors today and points towards a possible solution. It explained just how risky traditional investing has become at this intersection of low rates and political uncertainty.

Back in 1995 for an investor to earn a healthy, conservative return of 7.5% per year, the investor had only to park money in bonds with their relatively low risk, measured at 6% in standard deviation.*

*Standard deviation is a measure of risk which indicates the historical return variability from the average annualized return

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For that same investor to earn 7.5% in 2015, however, the investor would have had to invest in a selection of much riskier assets and accept a 17.2% standard deviation, or three times the risk of 1995. Three times the risk means much more vulnerability to navigational hazards like economic health, the political climate, and other exogenous (i.e. non-financial) events, and much less certainty of outcome for the investor.

Clearly, a better option is to build a portfolio with expected returns of 7.5% and minimal correlation to risk assets. This can be done by adding high quality hedge funds which, because of their uncorrelated nature both to traditional risk assets and between themselves, can potentially diversify a portfolio, reduce volatility, and improve returns over time.

In May ISOF's net return was 0.79% bringing our year to date net return to -3.65%. By comparison, the HFRI Fund Weighted Composite Index returned 0.35% for the month (0.74% YTD), the S&P TSX Index returned 1.00%, (9.46% YTD) and the Barclays Global Aggregate Bond Index Index gained 1.34% in May (8.75% YTD). The Scotiabank Canadian Hedge Fund (Equal Weighted) Index gained 1.30% in May (3.04% for the year).

Since inception in October 2010 ISOF has produced a return of 28.89% outperforming the Scotiabank Canadian Hedge Fund Index by 19.00%, the HFRI Fund Weighted Composite Index by 9.99%, and the Barclays Global Aggregate Bond Index by 16.68%. With only 60% of the volatility, ISOF is behind the S&P TSX Index by 5.35% during the period, with a Sharpe ratio of 0.71 and a beta to the S&P TSX Index of 0.35.

ISOF's gains in May were widespread with the majority of strategies contributing between 0.06% and 0.22%. The three exceptions were our Volatility, Short Credit, and CTA managers which detracted slightly with returns of -0.12%, -0.17%, and -0.20%, respectively.

The portfolio is reacting well as the reduction of beta (market) exposure undertaken at the end of 2015 increasingly manifests itself and lower correlation strategies produce higher risk-adjusted returns. We believe that reducing the portfolio's reliance on the health of the economy and expanding the diversification of return drivers will continue to reduce our total portfolio volatility over time, providing peace of mind and increasing our value to our investors' overall portfolio.

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 USD net returns after investment management and performance fees which vary by class of unit and includes units that pay no management or performance fees. Units that pay no management fees or performance fees comprise approximately 14% of the NAV of the Fund. 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. Benchmarks and 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. The HFRI Fund Weighted Composite Index is a global, equal-weighted index of over 2,000 single-manager 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 S&P/TSX Composite Index (Net TR) is the Net Total Return version of the S&P/TSX Composite Index and is presented in Canadian Dollars. The Net Total Return Index Value is based on the aggregate, float quoted market value of the index constituents (Stock Price Index Value) plus their paid net dividends/distributions after applying a withholding tax at the national level. 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, 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 more detailed information.