Inflection Commentary

# INFLECTION
Alternative Assets

## Inflection Performance: November 2015

**You Don't Need a Crystal Ball**

Early indications are that 2016 is going to be a very exciting year for the Inflection Strategic Opportunities Fund ('ISOF'). Many of the themes that we've discussed in previous commentaries in theoretical terms and for which our managers have patiently deployed are finally becoming reality as the world slowly comes to understand and accept how markets will be affected by the end of Quantitative Easing in the US. Over-reactions and dislocations in asset prices tend to be good for our managers, and even this early in the year we've already seen plenty of both and expect plenty more to come.

January is typically the time of year when managers discuss their performance over the past year and hazard a few predictions for the coming year. As a fund that expresses its themes through multiple strategies, it takes ISOF extra time to collect, verify, and collate the performance of all of our managers, and we are about a month away from our 2015 summary of what worked and what didn't.

Predictions, however, are a different matter, and for those we don't even need a crystal ball. That is because, regardless of asset class, we prefer managers who express their ideas through long-short investing and hedging. That important combination of risk mitigation techniques creates a safer space for us to do our work. All we have to do is foresee the range of possible outcomes, prepare for the most likely ones, and hedge in case we're wrong. As with horseshoes, we don't have to be exactly right because being close counts.

That subtlety and carefulness should be valuable in a year that is already flashing red with geopolitical and financial risks. With the potential for any one of the current flashpoints to become a full blown crisis at any time, we believe these are not the kinds of conditions for investors to take bold risks. Far better to assemble a well-diversified portfolio of targeted opportunities that should benefit from the expected dislocations and that are highly asymmetric in offering an outsized potential return vs. potential loss. Accordingly, we've added what we believe will be valuable themes to our 2016 arsenal.

Volatility was the bane of many managers in 2015. ISOF correctly anticipated increased 'vol' last year and we believe it will continue and likely intensify in 2016 as the Federal Reserve experiments with raising rates in the face of weakening data and the regulations of the Volcker Rule continue to remove key players from financial markets. As with Quantitative Easing, tightening will involve trying out many new techniques and methods that have no historical precedent and no certain outcome. Add to that the fact that the implementation of new regulatory rules will be difficult, unintended consequences will manifest and, because the new regulations have either kicked some of the biggest traditional players like banks out of markets or made it much harder for them to operate, many markets are missing the experienced traders and market makers who served as shock absorbers during times of stress by moderating abrupt swings in asset prices. Put it all together and you get the likelihood that volatility will be with us for some time.

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Rather than hide from volatility, ISOF has embraced it in several ways. As always, our first line of offence is the nimbleness that allows us to spot inflection points and act on them quickly, and the manager and strategy specific risk management protocols that help to limit our downside. To go a step further, and turn 'vol' into a potential source of return, we have added a stable of managers who use quickly evolving technology, the increased availability of detailed market data, and ever-growing computer capacity to find more nuanced ways of capitalizing on the volatility of particular markets. These strategies are necessarily complex. One of our managers benefits from prolonged periods of volatility while another uses forward-looking market dislocation indicators to time the buying of protective options to benefit from spikes in volatility.

One of the lessons we have learned over the years is that successful investors must continually evolve. While certain basic principles of business and common sense never go out of style, technological changes have had a profound effect on the financial world and are disrupting older less-flexible models. The world saw a stunning example of this last August when automated trading platforms took a piece of bad news on a sleepy summer day when many traders were on holiday and quickly turned it into a market rout. We believe that what we saw in August was a harbinger of the increasing effects of robo-trading.

Many of the newer technologies will dislocate traditional forms of investing. But they will also seed new investment strategies that are better at uncovering value and managing risk. As an example, the 'big data' we've heard so much about over the past few years is bearing fruit in the form of new trading markets that never existed previously and predictive algorithms that are becoming progressively more accurate. By digitizing more and more kinds of data that used to be anecdotal, analysts have been able to bring the power of math as well as Moore's Law to bear to greater effect, even when trading very traditional markets like cash equities and fixed income.

Similarly, machine learning, the ability of programs to adapt to changing conditions and pick up signals and patterns that may be difficult for humans to perceive, is ushering in a new era of systematic funds that are able to overcome the previous generation's Achilles heel: their tendency to become increasingly unstable over time because of the accumulation of new data points that are unaccounted for.

Instead, machine learning techniques enable mathematical models to pick up new patterns and re-weight signals, adapting over time as more data becomes available. Far from being a new paradigm (which more often than not, proves illusory) it is a computer-age adaptation of what the greatest traders in history have always done: make an educated investment based on superior data. And far from being black boxes that are set and left to run without human intervention, these third-wave algorithms are obsessively tinkered with in the realization that there is no shortcut to the hard work of adapting investment decisions to a world that changes daily.

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We believe that continuous learning and innovation are the key to long-term alpha generation and profits for our investors. Staying fully deployed in strategic opportunities while preserving wealth was difficult for ISOF in 2015 and required a very dynamic approach to hedging. We look forward to our patience being rewarded in 2016.

In November ISOF had a net return of 0.39% (2.52% in Canadian dollar terms) bringing our year to date return to 0.58% (15.77% in Canadian dollar terms). By comparison, the HFN Fund of Funds-Multi-Strategy Index, our closest US dollar benchmark, returned 0.02% for November (-0.59% YTD) and the S&P TSX Index returned 1.01% for the month (-4.25% YTD). The Scotiabank Canadian Hedge Fund (Equal Weighted) Index gained 0.65% in November (0.84% YTD).

Since inception in October 2010 ISOF has produced a net US dollar return of 34.36% (74.35% in Canadian dollar terms), outperforming the Scotiabank Canadian Hedge Fund Index by 67.45%, the TSX Index by 46.25% (on a Canadian Dollar returns basis), and the HFN Fund of Funds-Multi -Strategy Index by 27.46% (on a US Dollar returns basis). Over that period ISOF's Sharpe ratio is 0.94 (1.23 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.