Inflection Commentary

INFLECTION
Alternative Assets

Inflection Performance: April 2018

The Recipe for Happiness, Stability, and Long-Term Appreciation

- We are in a late cycle economy
- Investor portfolios will require different drivers to maintain returns of previous cycle
- Timely diversification protects capital and produces steady returns over the long run

Argentina, Indonesia, Hong Kong, Turkey, Brazil, the U.S., Canada… Pick your country and there was likely some notable activity in its currency over the last few weeks. With the US dollar and interest rates both rising, macroeconomic and political risks that were swept under the rug when investors were heedlessly reaching for yield over the last nine years can no longer be ignored. The long-awaited chickens are finally coming home to roost.

In addition, while global growth remains healthy after many consecutive quarters of acceleration, high frequency indicators point to a slowdown in both Europe and China and potentially slower growth in the US later this year. Labour market tightness will make it difficult to add jobs at the pace required to maintain the current level of growth, and inflation has been surprising to the upside in the US, creating further difficulties for risk assets.

While there are no signs yet that a recession is imminent, all of the precursors are now in place (high asset valuations, a tight labour market, fed hiking rates, and rising volatility). The risk is that a poorly foreseen shock like higher than expected inflation, a country leaving the Eurozone, or any number of political surprises both in the US and abroad, could trigger a rapid re-pricing of assets and a recession, and materially reduce the value of an investor's portfolio.

For ISOF and ULTRA, this kind of transition does not contain the negative risks they do for a long-only portfolio of stock and bonds. Indeed, the transition may, in fact, be positive for our funds. Unlike more exposed higher risk strategies like long-only investing, our managers utilize strategies where they don't have to rely on a positive future for markets to generate returns. Their returns are primarily derived from arbitrage and relative value situations where they can make money from the movement of one security relative to another. This tends to remove, or at least greatly reduce, the negative effects of the whole market moving lower, which happens to most long-only asset classes with gut-wrenching regularity.

As an added bonus, market dislocations also tend to produce wider spreads between mispriced assets, and therefore the potential for better returns. These profit drivers that are very different from traditional stocks and bonds make alternative assets very useful to an investor's portfolio if the goal is stability and long-term appreciation:

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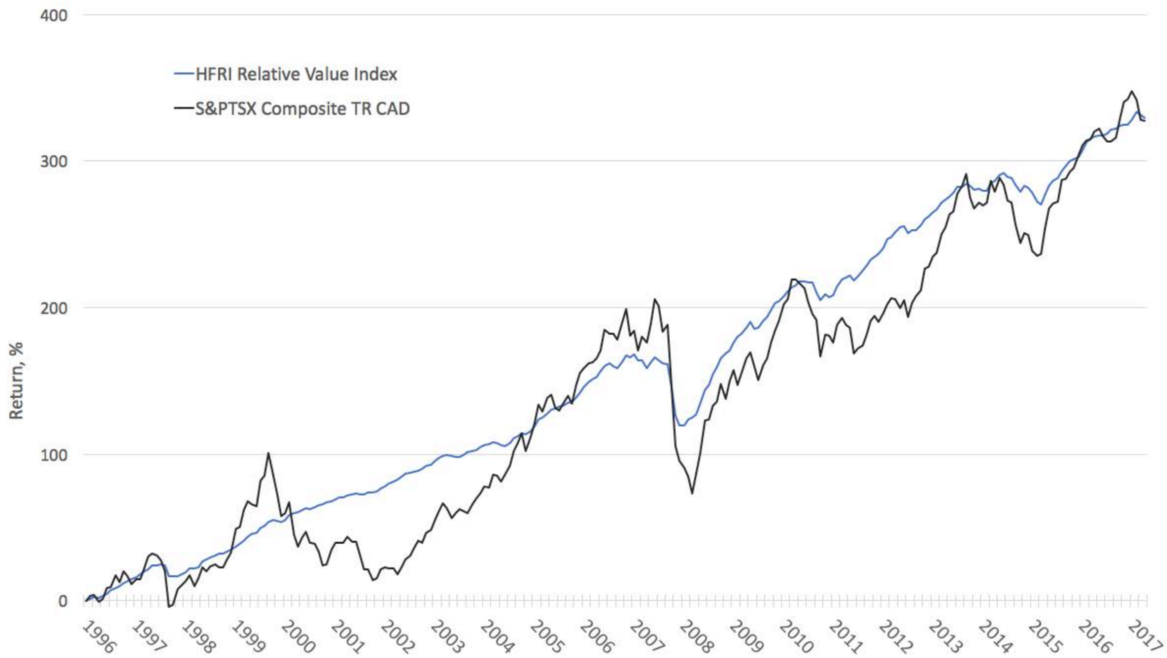

The chart above illustrates how the best time to allocate to alternatives has been near the top of the economic cycle, as in 2000 and 2007. ISOF and ULTRA aim to outperform the HFRI index above by maintaining an allocation to tail hedge managers that produce large payouts and portfolio-changing returns in environments like 2008.

It is commonly agreed that we are now in the late stages of the economic cycle. Timely shifts in allocations aren't just the stuff of interesting anecdotes over dinner. Asset allocation is the number one determinant of portfolio returns.

Contribution

ISOF was up +0.23% and Ultra +0.01% in April for Series A USD investors, bringing ISOF to -1.07% and Ultra to -2.16% YTD. While we would prefer to be in positive territory year to date, it's notable that ISOF is continuing to fulfill its mandate by protecting capital and maintaining a low correlation to broad equity and credit markets, outperforming the TSX with a fraction of the volatility.

Our biggest contributor in April was AND, our energy specialist, who was up +11.59% on the month and provided +0.47% to the portfolio. Our second largest contributor was MAL, a relative value volatility specialist. They were up +3.74% on the month and provided +0.41% of return to the portfolio. By mandate, we tend to avoid strategies that may correlate with the assets already found in Canadian investor portfolios, but AND, unlike the price of oil that drives much of the TSX, is directionally agnostic. They have produced some of their best returns when oil is falling, as in late 2008 and 2014.

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In the last few months idiosyncratic events in two positions have produced mark-to-market losses that we believe will be temporary in nature that have been obscuring what has otherwise been excellent performance in the remainder of the portfolio. Widening merger spreads negatively affected portfolio returns but the two affected managers continue to have a high degree of conviction in the deals. The imminent closing of the mergers could resolve this situation in the near term producing meaningful returns.

Our biggest detractor in April was GAR, one of our merger specialists, who was down -4.79% on the month and detracted -0.52% from performance. Our second biggest detractor in April was HUN, who is also suffering from spread widening on a merger deal. They were down -4.32% on the month and detracted -0.42% from performance. As mentioned above, both positions could be very profitable in the month ahead.

Sincerely,

The Inflection Team

The Inflection Strategic Opportunities Fund (ISOF) and the Inflection Strategic Opportunities Fund Ultra (Ultra) invest in a broad array of carefully selected hedge fund strategies in order to capitalize on dislocations and market opportunities. The funds have global mandates and focus 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 funds' option structure has significant tax benefits. Please refer to the attached Factsheet for additional information.

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Disclosure

ISOF/Ultra performance presented are USD net returns after investment management and performance fees and is not an estimate of any specific investor's actual performance, which may be materially different from such performance depending on numerous factors. ISOF returns represent historical returns adjusted for the June 2015 performance fee structure change to the current fee structure. 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. Comparative returns selected are for informational purposes only and may or may not accurately represent the composition or potential performance of ISOF/Ultra and may not be useful for comparison purposes. The Scotiabank Canadian Hedge Fund Equal Weighted Index (SCHF | Equal Weighted) is an equal weighted index intended to represent a comprehensive overview of the Canadian Hedge Fund universe. The index includes both open and closed funds with a minimum AUM of C$15 million and at least a 12-month track record of returns, managed by Canadian-domiciled hedge fund managers. Index returns are quotedin CAD. 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/Ultra are exempt market funds available to Canadian resident accredited investors in British Columbia, Alberta, 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.