

Where to Now?

“An investor is more likely to do well by achieving consistently good returns with limited downside risk than by achieving volatile and sometimes even spectacular gains but with considerable risk of principal” - Seth Klarman, Margin of Safety

By anyone’s standards the stock markets in North America have had a remarkable run over the last nine years. But now that the business cycle has likely peaked and there are no further corporate tax cuts or extensions of Quantitative Easing on the horizon to keep the party going, we believe the trend will inevitably be downward.

For Canadians, the future to be expected of equities could be even worse. Canadians traditionally have one of the highest home biases when investing in stocks. With growth slowing globally and China under pressure, our currently real estate-dominated economy will most likely underperform and will be under still further pressure if interest rates continue to rise as expected.

So where are prudent investors turning to?

Professional money managers are increasingly turning to alternative strategies to fulfil their mandates. Alternatives are able to provide a degree of certainty that the stock market cannot because they can be designed to deliver an expected level of risk. Instead of being a passive slave to the market, with no control over the outcome, alternative strategies allow investors to determine, in advance, exactly how much risk they will tolerate to achieve a potential return. That’s something a passive investment in the stock market just can’t do.

Both of our funds, ISOF and ULTRA, comprise a broad basket of international alternative asset strategies diversified by strategy and geography that aim to produce the level of returns our investors desire with the least possible risk. And both have a low correlation to the stock market over longer periods of time. A crucial consideration at times like these.

We believe that the increasing equity market volatility we’ve been seeing this year, and particularly in October, is an indication that equity markets could be entering a topping process and that volatility is likely here to stay for some time. Sustained volatility and changes in trend can produce meaningful opportunities for many of the strategies in our funds. So, despite the initial heartburn of a broad market transition, our managers and investors are extremely excited about where we’re headed now.

Inflection Performance: September 2018

Contribution (Series A USD)

September was a plain vanilla month for our funds. ISOF Series A USD returned +0.13% and Ultra Series A USD returned -0.05%. 15 of our 21 strategies were positive in September, with 2 managers contributing more than 0.10% for the portfolio and 2 detracting more than -0.10%.

Our largest contributor in September was AND, an energy macro specialist, who profited handsomely from the move up in Brent Crude and added 0.67% for our portfolio. Our second largest contributor in September was PIN, an ETF arbitrage specialist focused on index rebalancing, who produced 0.12% for the portfolio.

The rise of passive investing has created new arbitrage opportunities for managers like PIN with the specialized skills and knowledge to capitalize on the inefficiencies inherent in them as an asset class. As the economic cycle turns and passive investing continues to grow in size, we expect these strategies could do even better than they have in the more placid markets of the last several years.

Our largest detractor in September, was TSA, a structured credit specialist, who detracted -0.46% from returns on the month. Our second largest detractor in September was GAR, a merger arbitrage specialist, who detracted -0.31% from returns. Perhaps we should have coded this fund GRRRR, as it is taking all of our fortitude to hold on for the payoff we still expect could be coming.

Portfolio Changes

We exited one manager in September, NAP, a European credit specialist. Although corporate default rates are expected to remain low due to the lower levels of leverage, ultra-low interest rates and the wind down of QE have made this opportunity less attractive than it was when we invested May of 2014.

Sincerely,

The Inflection Team

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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 quoted in 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.