Inflection Commentary

INFLECTION
Alternative Assets

Inflection Performance: March 2019

Time for Inflection to Inflect

As our investors have already been informed, we have made the decision to wind-up both ISOF and ULTRA effective June 28th, 2019

Throughout Inflection's history our funds' underlying investment strategies have fulfilled our investors' mandate to find diversified, risk-adjusted returns especially tailored to Canadian sensibilities and risks, and to be responsible stewards of investors' capital. After over 20 years of serving our clients, both at Inflection and at my predecessor firm, KCS, I have decided to return my focus to managing my family office. We will, however, continue to leverage the knowledge and skills we have built in alternative assets over an historically unique period to create and manage separately managed accounts for clients investing over 10 million USD.

Since the 1998 Long Term Management crisis, through the collapse of the Tech Bubble of 2000, and most famously during the Great Financial Crisis of 2008 and the following Great Reflation of 2010, my teams and I accurately foresaw and acted on the biggest macro-economic currents of our time. Contrary to the popular fiction that many of these events were unforeseeable, we saw them coming, wrote about them, and prepared our investors as best we could to profit from them.

In recent years, the benefits of the prudent diversification we adhere to have been overshadowed and all but forgotten, eclipsed by the seemingly unstoppable ascent of U.S. equities and a myopic focus on short term history. While we continue to believe equities are a valuable part of our clients' portfolios, we also continue to caution that many of the elements that led to the Great Recession of 2008, when equities lost an average of 60% of their value at their worst point, remain unresolved. Indeed, some of the risks have gotten far worse.

In the New Yorker magazine September 17, 2018 article 'A World of Woes', John Cassidy details some of the behind-the-scenes events that world leaders and central bankers never wanted the public to know about, including how they worked in concert to hide their actions in order to prevent a 1930s style run on the banks, a complete collapse of the developed world's banking system, and a likely global depression.

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The inflation of risk assets like stocks from 2009 to 2019 was a direct result of their actions. At Inflection we believed that if the US Federal Reserve and its worldwide brethren insisted on pouring gasoline on the speculative fire that had gotten us into the predicament, it only made financial sense for investors to warm their toes at the flames and enjoy a hotdog or two (or, in plain language: invest a portion of their portfolio in the stock market.) However, we consistently advised wearing flame retardant clothing and investing in some dependable fire insurance should the flames spread and burn out of control.

Inflection provided those prudent protections (diversifications) through our ISOF and ULTRA portfolios of low correlation strategies. Of course, as history transpired, those protections were not called upon, and instead the 2009-2019 period broke records to become the longest expansionary period in history. But it could have easily gone a different way[1] and investors would be foolish to think the experience of the last 10 years is predictive of the next 10. Worryingly plausible is the theory that conditions today are disturbingly similar to 1999, when we last saw record equity valuations after a previous record period of expansion. After that bubble collapsed in 2000, the much heralded and over emphasized S&P 500 went sideways until 2013, with two declines in excess of -40% along the way.

And that is perhaps the optimistic view. The more pessimistic view is that things can get much worse. Many of the protections that were put into place after 2008, have since been weakened by the Trump Administration, and governments and corporations have levered up to record levels on the back of a decade of near zero interest rates. Further, the kind of fraternity that allowed countries all over the world to successfully work together despite their rivalries back in 2008, appears to no longer exist. Trump and his nativist and isolationist ilk in Europe, Asia, and Africa, have taken a wrecking ball to the agreements, pacts, and diplomacy that existed back in 2008 making it highly unlikely that they could work in concert were any of the risks in markets today to suddenly kindle into a fully-fueled conflagration

The last time I warned investors to check where their umbrella was stashed because the forecast was looking a lot like rain in the forecast was in 2006 ('Lotusland East', November 2006). Our umbrella back then took the form of John Paulson's short position on sub-prime mortgage backed securities, popularly known as The Big Short and now justly celebrated as the greatest trade of all time.

[1] Adam Tooze, *Crashed: How a Decade of Financial Crises Changed the World* (2018)

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Therefore, we can only look on in dismay as many otherwise very smart investors have begun to forget the lessons of 2008. Some have selectively scrubbed from their memory the depths of despair they were in in 2008, and have allowed subsequent events, like Quantitative Easing which saved their portfolios, to delude them into a belief that nothing was really lost.

That is not correct. The opportunity cost of 2008 was huge. If you were prescient enough then, you would have taken your money out of equities in say, August of 2008, and reinvested in the market in say, February of 2009, and made a great deal of money.

That kind of trade required extreme fortitude and confidence and involved a degree of risk we would not recommend to our clients. Instead we created the lower risk solutions of ISOF and ULTRA to provide similar benefits without the need for perfect timing. While ISOF and ULTRA will not be options for prudent investors for the time being, we still advise them to seek the kinds of protection ISOF and ULTRA provided.

Because history shows that diversification is always prudent and capital preservation never goes out of style.

Contribution (ISOF Series A USD)

ISOF Series A USD returned +0.36% and Ultra Series A USD returned +0.10% in March. 11 of our 19 strategies performed positively for the month.

Our top contributor was AHL, a CTA, who produced 0.58% for the portfolio. Our second largest contributor was GAR, a merger arbitrage specialist, who produced 0.13% for the portfolio, and our third was RID, a quantitative equity market specialist, who produced 0.11% for the portfolio.

Our largest detractor was CBH, a regional bank specialist, who detracted -0.33% from the portfolio. Our second largest detractor was ART, a volatility and tail hedging specialist, who detracted -0.18% from the portfolio, and our third largest detractor was VEC, a technology credit specialist, who detracted -0.15% from the portfolio.

Sincerely,

Ari Shiff and 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 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.