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VERTEX FUND

Fourth Quarter Report, 2014

"Ohh those Russians"
Rasputin – lyric by Boney M

History is never the same, but it can rhyme.
The second half was not like the first half. After a solid start to the year which saw the fund up 7.39% at the midway point, the back nine was starkly different. As the market sold off in the fourth quarter we received a crude awakening. We had wrongly estimated that after a 20% decline, oil was a buying opportunity. Instead, Oil (and gas) declined by 50% and in its wake swept along our refiners (yielding over 10%), ethanol producers, LNG shippers and the debt of oil producers. Like the Russian debt crisis of 1998, when Russia defaulted on its debt as the oil price collapsed, history rhymed to the fund's first year, 17 years ago, when it declined 30% on the back of the Russian crisis. What a start! However, it was a blip in the fund's history which setup a sustained rally. The sell off this past year felt as violent as 1998 and it remains to be seen if there is a similar snapback. Still, one thing is certain, people panic to get out of stocks the same way that they panic to get back in – affectionately known as "PIPO" (panic in, panic out).

So, what is going to happen with oil?
Ironically, the best cure for low oil prices is low oil prices. Over $30 billion in cancelled capital expenditures over the past 90 days will have a stronger impact than anything OPEC could deliver. In the distant future this correction will be just that, a blip, and the cycle will continue again. After all, oil & gas have the best supply/demand characteristics of any commodity, as every user sets fire to it after use - allowing no chance for re-use. To reduce our realized capital gains in the fund, we sold all our oil and gas preferred equity, preferring to own debt, as it gives us a claim on assets should the price of oil decline from current levels.

The opportunity lies in Europe.
In US dollar terms, European equities were down double digits in 2014, compared to the opposite south of the border, which did not help our performance. Investors panicked to buy bonds to the point where yields in 5-year bonds in Germany and Switzerland are now **NEGATIVE** and Japan, Sweden and the Netherlands are near zero. Equities in Europe should experience a multiple expansion, as price values to book value are at extreme discounts. Much like 2009, when equities (S&P 500) yielded more than bonds for the first time in decades, it setup the following 5 years of US equity outperformance. Below is a current comparison between stock and bond yields in the USA versus Europe:

USA	YIELD	EUROPE	YIELD
S&P 500	1.9%	Euro Stoxx 600	3.7%
30-year Treasury	2.6%	UK 30-year Bond	2.3%
		German 30-year Bund	1.2%
		France 30-year Bond	1.7%

This is only the second time we have seen a pick-up in yield by swapping out of Government bonds into equities. As mentioned in our last report, we have increased our weights in Royal Bank of Scotland and Barclays, as highlighted by the below comparison of global bank valuations:

Banks	Region	Price/Book Value
BMO	Canada	1.71
RBC	Canada	2.40
TD	Canada	1.90
JPMorgan	USA	1.00
Lloyds	USA	1.20
Uni Credit	Europe (Italy)	0.65
Barclay's	**Europe (UK)**	**0.61**
RBS	**Europe (UK)**	**0.67**
Commerzbank	Europe (Germany)	0.45

Source: Bloomberg

We were invited to the European party a little early, but 2015 should be its time to shine. In late January, a fresh round of European QE to fight deflation may be the catalyst to start the rally of this deeply discounted financial sector. We have also have a built a large position in Chrysler (now known as Fiat or "Fix It Again Tony") which will soon be spinning out its Ferrari division. This catalyst event should lift the valuation, as Fiat trades at almost half the valuation of Tesla and Ferrari itself should be worth more than Tesla. Not to mention other units that Fiat owns.

Utilizing optionality.

We are continuously looking for optionality with large upside and little downside to the portfolio as highlighted by two investments we currently own. The first is our position in Franco Nevada warrants. This position is currently 2.7% of the portfolio and gives us the option to acquire approximately 3,000,000 shares of Franco Nevada at $75 versus the current price of $60. This conservatively-run gold royalty company makes a profit regardless of gold's price. As evidenced by trading near a 52 week high in an industry that has sold off 25% the past 4 months alone. Our warrant position fully exercised would represent a $225,000,000 position or a fairly large upside with 2.5 years to go before the warrants expire. We also have a similar position in New Gold, while it is substantially more out of the money and it would add another $100,000,000 exposure to the fund.

Our second position is a recent investment in Vancouver-based Cooledge Lighting for $5,000,000. This unique LED Company produces a transformative paper light solution that could see sales triple this year. If this company can IPO in the next 24 months, we think the returns could be exponential if sales forecasts are realized.

Merger Arbitrage: in the driver's seat.
Of the current three main strategies of Merger Arbitrage, High Yield and Long Stocks, Merger Arb was the only strategy to generate positive returns in 2014, with only one negative month (October). The selloff in the capital markets compounded in October with the break of the $100+ billion merger between Shire and AbbVie. This event dominated the quarter for our merger strategies. The Shire deal was the largest merger failure in history and had broader repercussions. Across the merger arbitrage universe investors de-risked their arbitrage portfolios causing spreads to widen. Coincidentally, the deal collapsed in the midst of the mid-October market swoon, which saw the highest implied market volatility since 2011. This was exacerbated by a strong consensus that interest rates could not go lower and we saw a seven standard deviation move in US treasuries the day of the Shire deal collapse. It was estimated that there was over One Trillion Dollars short in US long bonds that forced bonds to move 4% intraday. This caused spreads in Merger Arb to widen as people de-risked, covered their bond shorts and ran to the hills. It is important to remember that this event created a temporary dislocation in the market and the dysphoria subsided quickly.

Participating in merger arbitrage not only has been a consistent fail-safe strategy, regardless of capital market volatility, but it drives our long positions as well. One of the bigger Canadian deals to close this past month was the takeover of Tim Horton's by Burger King. This Warren Buffet-backed Brazilian private equity group 3G (yes that is a mouthful) has been ruthless in tackling costs and introducing new revenue streams for companies they have acquired. Their success at Heinz and the faltering chain of Burger King should bode well for the portly Tim Horton's. We expect much higher earnings-per-share numbers than the street suspects, after the Brazilians work their magic. Consequently, we rolled our merger arb position into one of our largest long positions in the portfolio, a 5% weight in the new stock Restaurant Brands International. Along the same lines, we have a 5% unhedged position in Allergan which is currently being acquired by Actavis.

Merger Arbitrage in 2015 is shaping up to be very exciting! Deal flow has become more conducive to capital deployment with spreads and deal sizes improving. For example: two deals that we currently like are Talisman Energy and TRW Automotive Holdings, which both have 10% plus returns.

Private investments are paying their dues.
In the first quarter of 2015, we will receive our first dividend cheque from Sea-to-Sky gondola. It has been a sensational success, paying 16% in its first partial year of operation. Also, another private investment we have in Sutherland Asset Management, a leading mortgage service provider, recently filed its IPO documents with JP Morgan who are taking them public this month. This 10% yielding equity has a high probability of a warm reception on the NYSE.

2015 Outlook.
Although 2014 was a rough year for the fund, we think the aforementioned highlights our enthusiasm for 2015. Premature deviation from an investment plan rarely yields the intended result. We begin everyday trying to reduce risk in our portfolio but not necessarily volatility. Volatility in the short term is hard on stomachs and nerves, but in the long term will deliver better investment returns.

As always please feel free to contact us with any thoughts or comments you may have.

As a housekeeping note, the fund distributed a 6.5% capital gain to unit holders for the 2014 tax year.

Happy New Year!

PERFORMANCE (Class A returns as at December 31, 2014)

Net Asset Value	1 Month	3 Month	Year to Date	1 Year	5 Year+	10 Year+	15 Year+	Since Inception+
$62.0357*	-3.20%	-8.39%	-4.88%	-4.88%	6.02%	8.99%	12.94%	15.30%

Net of all fees and includes reinvested distributions.

*post distribution

+annualized returns