

## **VERTEX FUND**

First Quarter Report, 2016

The New Year started off not with a bang, but a whimper, as credit markets sold-off much like they did last September. Equities took their cue from credit and followed the decline, posting the worst start to a year in the history of the US stock market. The silver lining has been that as credit sold off we saw larger spreads in M&A. Accordingly, we increased our exposure to this strategy to nearly 50% of the fund, the highest level in years. With higher spreads available, the Vertex Fund reduced its weighting in deals yielding less than 5% (annualized) and increased to those with yields of more than 5%. To attain this allocation shift we reduced equities across the board.

We have always favoured merger arbitrage as a diversified source of return in the Vertex Fund, along with its benefit of dampening volatility. That's especially true during times where we have less conviction in valuations and economic direction. Over the last few years, global stock markets have remained bound to a highly volatile range. For example, the MSCI World Index ended March at a level already visited in 2013, 2014, and 2015. The recent low in February marked a peak-to-trough range of about 20%. Closer to home it's even worse, where the Canadian market fell 25% since the fall of 2014. Understandably, this has been hard on investors' and portfolio managers' stomachs alike. That's why, for now, we favour M&A's predictable returns and low volatility profile.

Although the selloff affected stocks the most over the quarter, as illustrated by the performance of some of our largest holdings, the disparity in news was also remarkable:

### **JP Morgan Warrants**

**Bad News:** down 25%.

**Good News:** C.E.O. Jamie Dimon bought \$26 million worth of stock in the best globally run bank with a price-to-earnings ratio of 10.

### **AIG Warrants**

**Bad News:** down 21%.

**Good News:** Carl Icahn won a board seat armed with the goal of breaking up the company to help it trade towards book value - which is 40% higher than current levels.

### **Fiat Chrysler**

**Bad News:** down 12%.

**Good News:** Sales up 9% in the first quarter and has a price-to-earnings ratio of 5.

### **Finmeccanica**

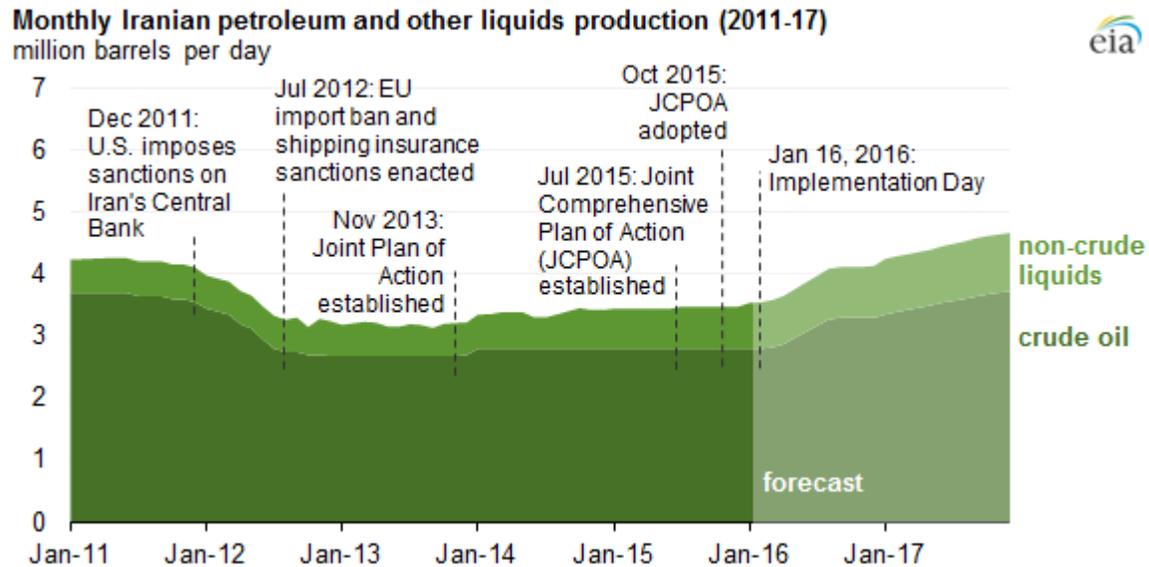
**Bad News:** down 9%.

**Good News:** Signed a \$9 billion deal with Kuwait for Typhoon fighter jets.

Mr. Market may not agree with us in the short term, however, we don't think we could have asked for better fundamental news from our core holdings.

The Vertex Fund has 10% of its holdings in the warrants of AIG, JPMorgan Chase and Franco-Nevada. If we fully exercised these positions they would represent 47% of our portfolio. Most of this growth in our warrants came from Franco-Nevada, which has increased from a 1% position to 7%, on capital appreciation. Due to the volatile nature of the warrants we added hedges for these positions to minimize volatility and lock-in some gains. This did, unfortunately, help hamper our gains in March as markets rebounded.

Another significant headwind (so far) was increasing our exposure to the US dollar (again), which greatly helped our positive performance in 2015 (+8.67%). The Canadian dollar has its strongest correlation to the quote of WTI (West Texas Intermediate), otherwise known as oil. The new oversupply paradigm for oil has been well documented as the culprit for its dramatic fall since the summer of 2014. The problem is, any reaction by North American producers has been more than offset internationally by increased supply. The US is predicted to decrease output by 600,000 barrels a day in 2016. Unfortunately, the lifting of Iranian sanctions in January led to their largest monthly increase in output, in February, since 1997. Further, Iran intimated no intention to cap production output until it reached a level of 4 million barrels per day. The following chart illustrates US EIA's forecast for Iranian production.



Source: U.S. Energy Information Administration, [Short-Term Energy Outlook](#), January 2016

With OPEC essentially flat, the supply equation doesn't appear to be improving any time soon. It is our position, that so long as oil remains below \$50 USD, the Canadian dollar will perform poorly against the US Dollar in the long-run. Until that time, we will maintain our large US dollar exposure.

That said, the portfolio has plenty of flexibility to alter our positions if the facts change. As an example, the story of Vertex vs. JC Penny highlights our flexible attitude. JCP was one of our favourite short positions over the years, as demographic trends and Internet shopping mixed with poor management decisions leading to disastrous results. It was a profitable short investment for the fund. But that was then. Enter a new management team who orchestrated a remarkable turnaround by focusing on their core customer-base who doesn't engage in Internet shopping. The result was being one of the few retailers able to post positive same store sales this quarter. Management has pulled a lot of levers to create positive cash flow and grow EBITDA by 33%. Having kept an eye on the company since divesting, we took all of this into account and reversed

our bearish mindset by entering into a long position in JC Penney during the first quarter. We are investing in continued results from this new management team.

As a friendly reminder, there was no distribution in 2015 for the Vertex Fund so you did not receive a T3 tax slip for your Vertex Fund holdings.

As always, please call or email us if you have any questions or concerns.

**PERFORMANCE** (Class A returns as at March 31, 2016)

Returns are net of all fees and include reinvested distributions.

<b>Net Asset Value</b>	<b>1 Month</b>	<b>3 Month</b>	<b>Year to Date</b>	<b>1 Year</b>	<b>5 Year<sup>+</sup></b>	<b>10 Year<sup>+</sup></b>	<b>15 Year<sup>+</sup></b>	<b>Since Inception<sup>+</sup></b>
\$63.6013	0.34%	-5.66%	-5.66%	-5.00%	1.66%	5.66%	10.78%	14.33%

<sup>+</sup>Annualized returns. This statistical information is intended to provide you with information about the Vertex Fund. Advertised performance is based on Class A shares. Important information about the Fund is contained in the Offering Memorandum which should be read carefully before investing. You can obtain an offering memorandum from Vertex One Asset Management Inc. The Offering Memorandum for Vertex One Asset Management Inc.'s Investment Funds does not constitute an offer or solicitation to anyone in any jurisdiction in which such an offer or solicitation is not authorized or to any person to whom it is unlawful to make such an offer or solicitation. The indicated rates of return are the historical annual compounded total returns for the period indicated, including changes in security value and the reinvestment of all distributions and do not take into account income taxes payable that would have reduced returns. The funds are not guaranteed; their values change frequently and past performance may not be repeated.