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# VERTEX FUND

Third Quarter Report, 2016

Over the quarter the Vertex Fund was up 5.26% (Class A). The Vertex Fund has lagged the performance of the Vertex Growth Fund, which focused on the best long ideas of the Vertex Fund. We have reduced our exposure to 25% in M&A, as we look to mimic the Vertex Growth Fund going forward. We hope to align performance between the two funds as the trailing performance of the Vertex Fund is unacceptable.

Lower interest rates year-after-year have compressed yields in Merger Arbitrage and reduced returns in this space. The TSX yields almost 3%, versus 1.2% for a Canadian Government ten year bond – almost 3 times the return to own stocks over bonds. Given the number of securities that we've seen yield over 7%, and trade below their net asset value, we've added Real Estate Investment Trusts (REITs). Along with utilities and pipelines, high-yielding equities now represent approximately 30% of our portfolio. On a risk-reward basis, this area looks as interesting today as our corporate bond exposure did when we added it in 2009.

Italy's upcoming referendum, scheduled for the first week of December, will be their own Brexit vote. This will make for some volatile times in Europe; we have all but eliminated our exposure to Europe, where equities are down 10% year to date. Our entire European exposure is now 2% of the portfolio – comprised solely of Fiat Chrysler, which trades at 4X earnings.

We've sold all of our bonds in Silver Standard, Hecla Mining, and IAM Gold, which now all yield in the low single digits, having rallied this year on bullion. Our metals exposure is now in Franco-Nevada warrants which are up over 100% this year. We view this as the safest way to own gold, with Franco-Nevada's diversified portfolio of hundreds of properties that collect royalties.

We covered our short position in Medallion Financial, as there has been a decreased value in taxi medallions based on the strength of Uber. The result: our short portfolio has performed well. In Canadian cities where Uber doesn't even operate, the value of medallions has been cut in half due to incoming competition. Medallion Financial shares were cut in half this quarter, but the borrow rates made it worthwhile to cover this short before its eventual downfall to zero. This is a much needed boost for consumers of expensive taxis. The dairy boards and liquor boards could stand to learn a thing or two from this.

Although a small position, Pacific Exploration & Production was a quick short that got delisted in Canada and is currently going through bankruptcy – the best outcome of a short sale leading to 100% return. We've covered our long outstanding short in Bon-Ton Department stores, as shares are near all-time lows, but the borrow rate does not make it worth our time. The funeral march continues for the retail sector – the only respite has been AAA malls (lower ranked malls will still end up closing). Due to the inclusion of a 'store within a store' concept with Sephora, JCPenney is one of a few department stores that has been able to post same store sales growth off of a lower base. Every retailer is in the midst of trying to reinvent themselves as the power of the internet has become equivalent to the Borg (think Star Trek). When millennials start to prefer "apps" over clothing for Christmas, it's going to be a rough road. Although JC Penney's customer is the last to adopt online shopping, we're losing hope for all department stores – other than those in AAA locations – so, we've decided to exit this position at a small loss.

One notable transaction in the quarter was the acquisition of Whistler Blackcomb by Vail Resorts. While a relatively straightforward transaction from a regulatory perspective, the deal structure had a small wrinkle: the number of shares of Vail to be received was dependent on the CAD/USD currency exchange rate just prior to close. This quirk was enough to disproportionately widen the spread and we were able to earn an annualized return over 10% for a low-risk merger situation. This serves to highlight attractive inefficiencies we often see in Canadian merger arbitrage; while our portfolio is predominantly invested in America presently, we are always poised to capture Canadian opportunities as they arise – Whistler was one of our largest winners this quarter.

Our SPAC portfolio continues to generate attractive risk-adjusted returns. As a reminder, SPACs (Special Purpose Acquisition Companies) are publicly traded vehicles that raise funds to pursue an acquisition. As SPAC IPO investors, we always have the right to get our initial investment back (with interest) when a deal is announced or at the end of a SPAC's life (typically 2 years). Additionally, we receive warrants allowing us to further participate in the upside of attractive deals. One SPAC win for us this quarter was the acquisition of Hostess Brands, by Gores Holdings. Gores is a prominent US private equity player that raised a $400 million SPAC in 2015. This July they announced the acquisition of Hostess Brands, makers of the famous Twinkie dessert. The market reaction to this announcement was very positive as a result of the attractive price paid for a marquee brand with lots of upside. We were able to sell our position for a 10%+ annualized return – a solid result, considering we never had any downside exposure.

A nice feature of the warrants is that they allow us to capture a more arbitrage-like 5% annualized return even if a SPAC doesn't successfully complete an acquisition. This was the case in the Infor/ECN Capital proposal. Despite having enormous regard for Steve Hudson's business building abilities, we felt it was unlikely that this combination would be approved by SPAC holders on the proposed terms and we sold our warrants to more optimistic buyers who had an opposing viewpoint. Although the deal was eventually cancelled, we earned a very attractive return on our capital for minimal risk taken. As a result of a number of successful US SPAC acquisitions, we continue to see healthy SPAC issuance activity in the US and we are selectively participating in IPOs of the highest quality sponsors. Today, SPACs represent 5% of our portfolio.

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

**PERFORMANCE** (Class A returns as at September 30, 2016)
Returns are net of all fees and include reinvested distributions.

| Net Asset Value | 1 Month | 3 Month | Year to Date | 1 Year | 5 Year+ | 10 Year+ | 15 Year+ | Since Inception+ |
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| $65.5349 | 1.75% | 5.26% | -2.79% | 3.82% | 4.70% | 6.72% | 10.42% | 14.10% |

+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.