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VERTEX ENHANCED INCOME FUND

Third Quarter Report 2016

The Vertex Enhanced Income Fund returned 4.32% for the 3rd quarter, 2016.

If you've noticed a lot more IPOs in the market these days, you're not alone. As the market gains an increased sense of security, new issue volume has grown steadily. It's not only the new issues that are gaining steam – secondary issues are up considerably now that the window to raise capital has opened. All of this can't come soon enough for many of the smaller cap stocks – they've been starved of capital due to a market environment that has been closed to new capital raises for the better part of a year. You can almost hear the collective sigh of relief from Howe Street as companies reach out to fill their empty coffers!

The above provides a strong backdrop for the high-yield bonds in our portfolio. High-yield bonds are "risk-on" assets. An environment in which companies are raising money is indicative of a market that loves high-yield. As an asset class, high-yield performed well over the last quarter and we expect it to continue moving up as companies use free cash flow to pay down debt.

We remain invested in a few former leveraged buyouts (circa 2007 but now fallen stars) as they navigate through these interesting markets. For most of this year, the market had been pricing these securities as if they wouldn't be able to refinance their debt, causing the need to restructure. Managements have been busy pulling levers and thereby confounding critics. They've not only bought themselves more time, they've also made the capital structures more sustainable. This type of bond was left for dead a few months ago; now, with the market opening for fundraising (i.e. re-financing in this case), these bonds still have a lot of room to the upside if managements can get it right.

On a conference call covering one of our bond holdings late last year, we recall management discussing how they had already been through a tough market in 2008 and therefore knew what needed to be done in order to get through this time around. It seemed an odd mispricing that a company, with such experience and such confident management, had bonds trading at 20 cents on the dollar! The bonds have steadily and slowly moved up (20% this past quarter) and now trade at $49. Even though they've already had a good move, there is still plenty of upside. Like many high-yield bonds, once a company successfully renegotiates their short maturity debt, the bond should gain more stability and move up further. In this case, the revolver is more than 2 times covered by EBITDA, a figure that should allow the renegotiation to happen without issue.

On the direct note side, we had an interesting summer with two difficult issues: ARP Factoring and Dynasty Mining. After spending many hours on the phone and in meetings, we were able to replace our Dynasty note on terms that resulted in our interest being paid in full, along with a significant warrant position in Dynasty Mining's underlying stock. We are encouraged by the fact that the new management/investor team placed $4 million equity behind our note, and also by the fact that they're determined to unlock value. ARP was a bit of a different story. A number of borrowers in Alberta ran into difficulty, leaving ARP no choice but to move in and restructure the borrower companies. We now view this as a recovery/workout situation and currently value it at 29 cents on the dollar. We expect recovery to end up somewhere between $0.29 and $0.70. Thus, we remain conservative on our write down.

After performing poorly in 2015, the equity portion of the portfolio has performed very well in 2016. We retained most of our positions from last year as our assessment was that nothing had changed in the businesses, even though stock prices had declined significantly. We did, however, add positions in both Canadian Western Bank (yielding 3.6%) and CI Financial (yielding 5.5%) subsequent to a fall in their stock prices. We purchased both of these investments for current yield and for future capital appreciation.

Lastly, it's important to mention that your portfolio is a diversified portfolio of loans. I say loans because that's largely how we view the bond market. We're concerned less with what Bay St. and Wall St. are doing, and more about the financial well-being of our investee companies. Whether buying a bond in the market (mostly what we do) or negotiating a note with a company, our main thought is… can they pay us back? Not, when will we trade this bond? To this extent, we view ourselves as loan officers – the number 1 risk we need to manage is credit risk. With that, your portfolio is in really great shape. Many of our bonds trade at discounts to par leaving large potential for both high interest and capital gains.

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

PERFORMANCE (Class F returns as at September 30, 2016)

Net Asset Value	**1 Month**	**3 Month**	**Year-to-Date**	**1 Year**	**3 Year***	**5 Year***	**Since Inception***
$9.3398+	1.88%	4.32%	8.32%	4.62%	0.18%	4.61%	5.36%

Net of all fees and includes reinvested distributions.
+Post Distribution *Annualized