ehp | FUNDS

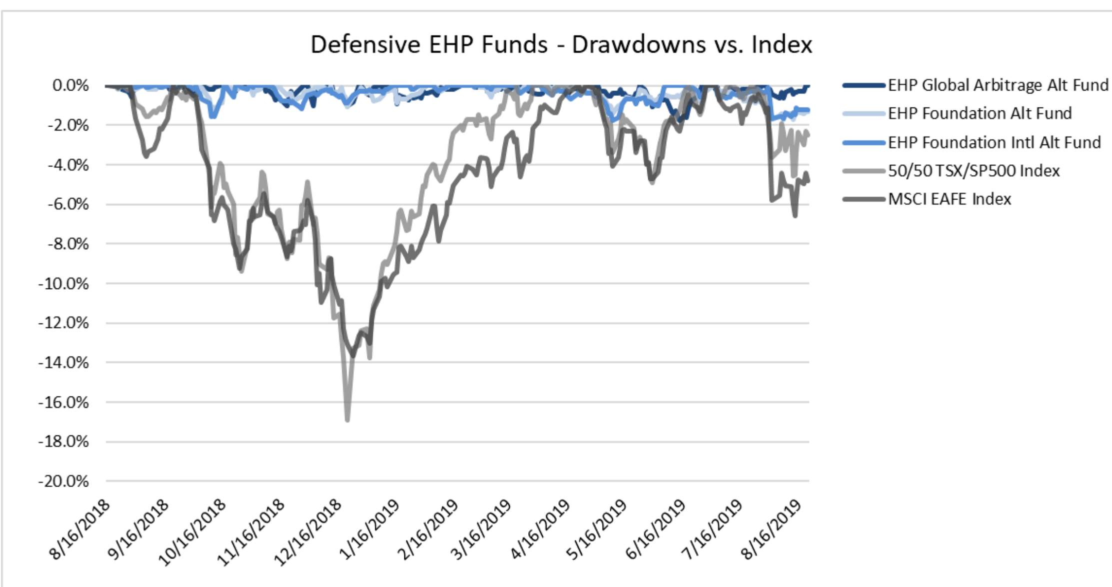
The Case for Liquid Alts
Our One-Year Report Card

It's been just over a year since we launched six "liquid alt" funds that utilized the changes in regulation allowing for the moderate use of leverage and shorting in a traditional regulated mutual fund. What we couldn't have known at the time of launch is that the next twelve months would prove to be a roller-coaster of a market – and a near perfect test case for how funds like ours can help achieve better outcomes for investors. The goal of our liquid alts is simple: protect capital during times of market stress, reduce the risk of major pullbacks, and provide reasonable returns that are less correlated to traditional stocks and bonds.

We are risk managers first and foremost. Everything we do in terms of investing your dollars starts with a risk framework for each fund that targets a specific volatility, and allows for a tolerable amount of "drawdown", or decline from the highest peak to the lowest trough. Another way to define drawdown is "the thing that makes your clients angry". There are very few investors that can bear large, sudden drops in their net worth, and our experience is that true investor tolerance for drawdowns is about *half* the amount that they will tell you it is in advance. Conventional "buy and hold" doctrine would argue that drawdown is not true risk since it is only a temporary loss of wealth. It's a reasonable point, but it makes two key assumptions: 1. That the investor won't panic in a major pullback and turn a temporary loss into a permanent one, and 2. That the investor has enough time to recover from the drawdown before their need for cash withdrawals permanently impairs their retirement goals. Given that we run money for a broad range of clients, we can't assume either of these are true.

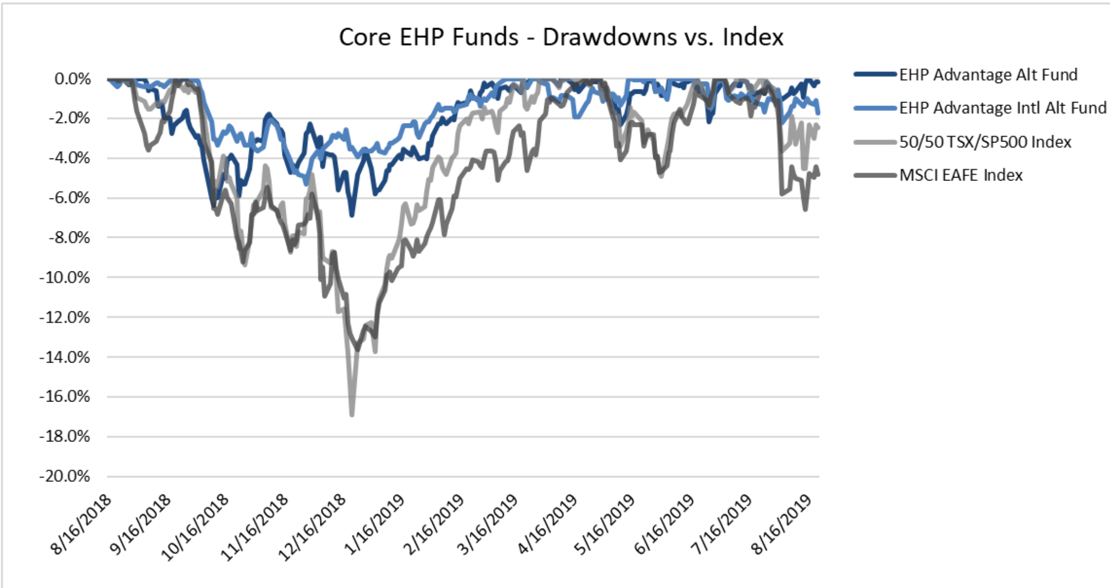
All things equal, our view is that mitigating drawdowns is a key attribute of a well-managed alternative fund. Under this measure, we present two charts that show how we did over the last year:

First, we show the drawdowns of our three most defensive funds versus that of the major benchmarks. The chart presents daily data since monthly data hides much of the volatility that can occur intra-month:

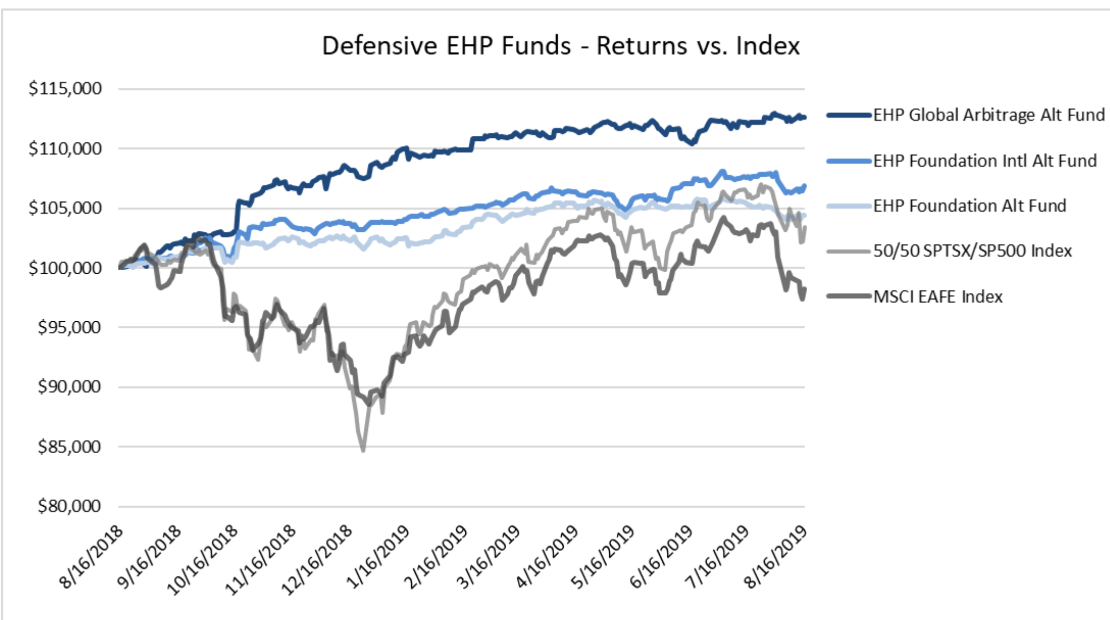


Broad markets have experienced three periods of drawdown over the last year, with the Q4 2018 period declining -16.9% for a North American index and -13.6% for the MSCI EAFE at its worst. In all periods, our three defensive funds had drawdowns no worse that -1.8% before recovering to their respective highs.

Our "core" funds are designed to deliver low double-digit returns over time while still mitigating drawdowns. Here's the same chart showing our worst drawdowns for these two funds at less than half that of the respective benchmarks in Q4 of 2018, and drawdowns of only -2% during the May and August market pullbacks.

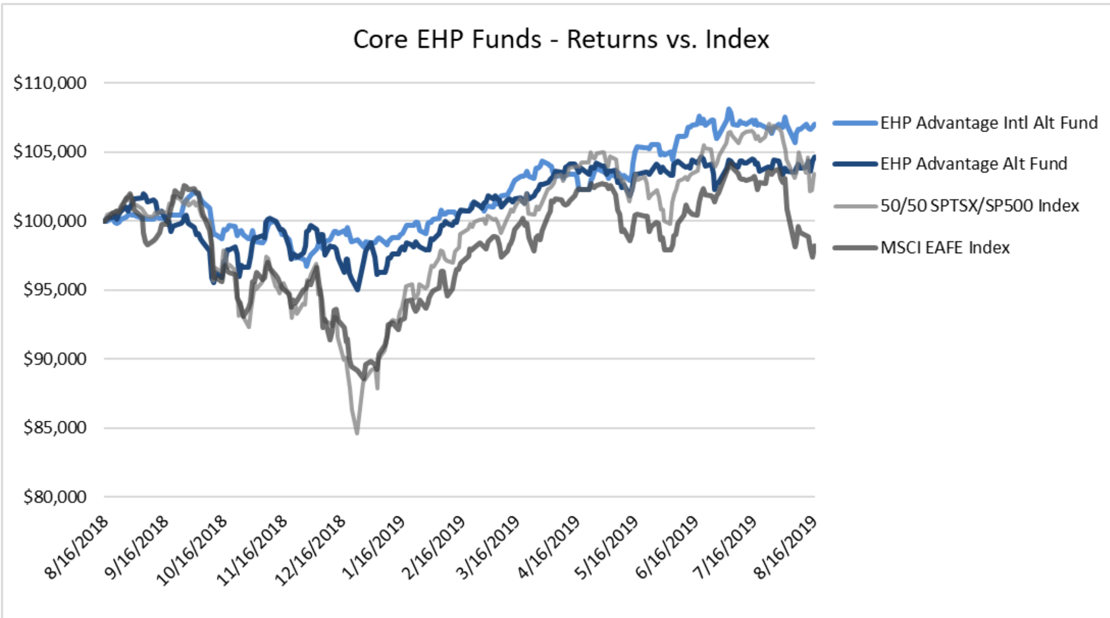


While protecting against losses is important, it's an empty victory if the fund can't generate reasonable returns at the same time. Here we show how our two groups of funds did on this measure over the same period, starting with our three defensive mandates:



In each case, the funds delivered total returns that were higher than the benchmarks over the period, with our EHP Global Arbitrage Alternative Fund the strongest at +12.0%.

The same chart for our core equity replacement mandates:



Again, both funds achieved a higher return than those of the benchmark, with our EHP Advantage International Fund outpacing the MSCI EAFE Index by 4.2%. The funds achieved this not by keeping pace with the sharp v-shaped bounce that characterized the start of the year, but rather by minimizing the drawdown of Q4 2018. Offense sells tickets, but defense wins games.

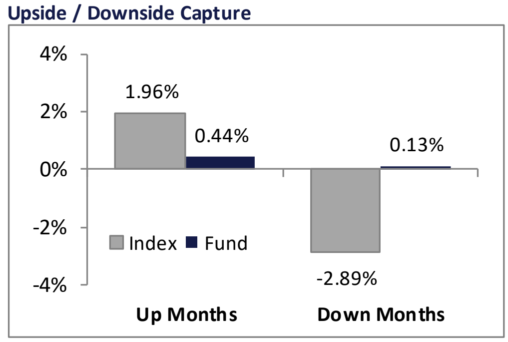
Of course, one year is not nearly enough to measure the success of a strategy. Our ultimate objective with these funds is provide a return uncorrelated to that of traditional stocks and bonds, and provide better risk-adjusted results. We have the benefit of having run these same strategies for up to six years as offering memorandum funds, and we can see if the same results hold up over longer periods of time.

Here we present the data, first for our conservative EHP Foundation Fund since its April 2015 inception:

Risk/Reward Analysis

	Fund	AGG Bond	S&P TSX	S&P 500
Annualized Return	4.4%	3.2%	5.4%	10.4%
Annualized Std Dev.	3.0%	3.1%	9.0%	11.5%
Winning Months	72%	58%	64%	62%
Average Monthly Gain	0.7%	0.8%	1.9%	3.1%
Average Monthly Loss	-0.3%	-0.5%	-2.1%	-2.5%
Largest Drawdown	-2.8%	-3.3%	-14.3%	-9.3%
Sharpe Ratio	1.4	1.0	0.6	0.9
Fund Correlation		7.0%	12.3%	25.9%
Fund Beta		0.07	0.04	0.07

Upside / Downside Capture



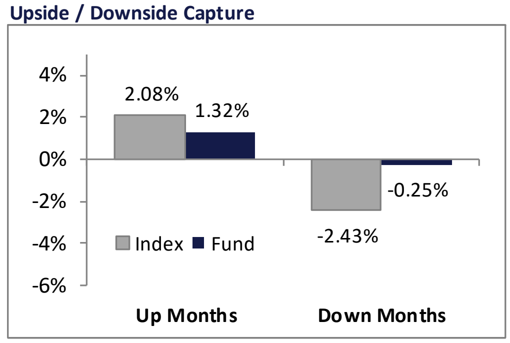
We can see that for this defensive mandate, we outperform bonds over the period by 1.2% annually, but with very similar volatility and drawdowns. We achieve this with low correlation to all benchmarks, and importantly have *positive* downside capture; in months when the equity market is down, the fund tends to be up slightly.

Next, the same data for our core EHP Advantage Fund from its inception in May of 2013:

Risk/Reward Analysis

	Fund	S&P TSX	S&P 500
Annualized Return	10.9%	7.7%	12.3%
Annualized Std Dev.	7.3%	8.8%	11.4%
Winning Months	67%	67%	72%
Average Monthly Gain	2.0%	2.0%	2.6%
Average Monthly Loss	-1.4%	-2.1%	-3.1%
Largest Drawdown	-9.0%	-14.3%	-13.5%
Sharpe Ratio	1.5	0.9	1.1
Fund Correlation		38.7%	47.8%
Fund Beta		0.32	0.30

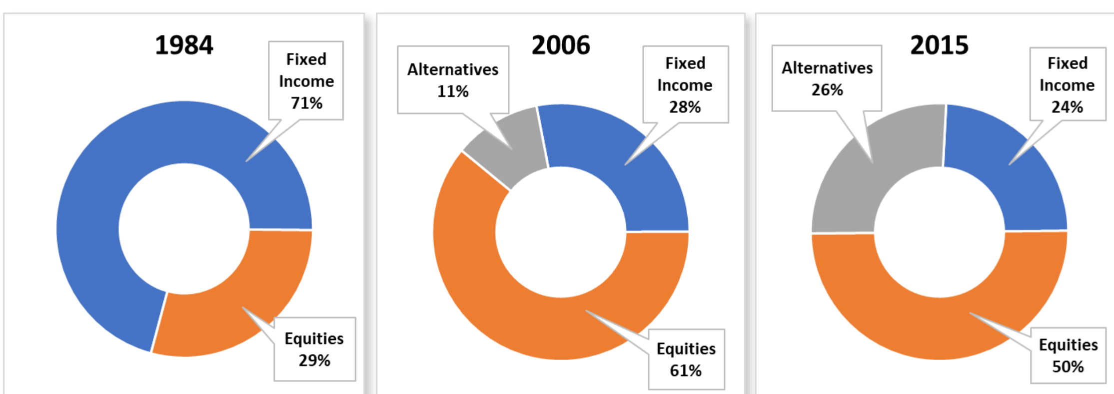
Upside / Downside Capture



In this case, we've achieved returns that are slightly higher than a blended North American index, but with lower volatility and drawdowns, and with mid-range correlation. While we only capture about 2/3rds of the average index up-month, we capture very little of a typical down-month, resulting in better risk-adjusted returns than the benchmarks.

With one year into liquid alts for us (and just over 8 months since the rules became available to all providers), we are encouraged to see some real adoption not just by individual advisors who are ahead of the curve, but also by the dealers themselves who in many cases have recognized the merit of including these types of funds in their model portfolios and recommended lists. In an upside-down world where bonds with negative yields are bought for capital gains, and stocks are bought for yield, it's perhaps no wonder that pension funds in particular have migrated to alternative sources of return over the years:

Typical Pension Fund Portfolio Over Time



Sources: Analysis by the Pew Charitable Trusts of State Comprehensive Annual Financial Reports, Public 100, the Federal Financial Accounts of the United States, and U.S. Board of Governors of the Federal Reserve System

The new regulations that expand the toolkit for fund managers ultimately democratize alternative products and allow the average investor the same access to risk-managed products that the largest and wealthiest investors in the world have had for years. We're proud to have been one of the first in Canada to offer these innovative solutions and look forward to working with our partners to continue to educate and foster their adoption.

Disclaimers

Returns are annualized and since inception unless otherwise noted, and are net of fees and expenses. Statistics are calculated using monthly returns. Partial year returns are unaudited. Index statistics use total return indices. The composition of the Funds' portfolio could differ significantly from the index due to the investment strategy employed, and includes differences such as use of credit strategies, use of equal weight positions, use of short positions, varying fund net exposure, varying currency exposure, and investing in small capitalization stocks. Source for all index data: Bloomberg.

Risk/Reward statistics are calculated using monthly returns. "Index" is a 50/50 blend of the S&P TSX Total Return Index and the S&P 500 Total Return Index in local currencies. "Agg Bond" is the Bloomberg Barclays US Aggregate Bond Index total return index. "MSCI EAFE" is the MSCI EAFE Net Total Return in local currencies. "Max. Drawdown" measures the largest single drop in a class's Net Asset Value Per Unit from peak to trough before establishing a higher peak (the smaller, the better). "Sharpe Ratio" is calculated as the annualized return divided by the annualized standard deviation, and uses a 0% risk-free rate (a higher Sharpe Ratio implies less risk per unit of return). "Fund Correlation" measures the Fund's correlation to the comparative indices, where a value of 100% implies the Fund's movements are identical to the index. "Fund Beta" measures the Fund's volatility relative to the comparative indices, where a value of 1 implies the fund's movements are identical to the index.

"Upside/Downside Capture" is a measure of an investment manager's performance during only the up or down movements of an index (ideally you want to capture as much of index up months and as little of index down months as possible). The numbers shown here are the average returns of the Fund during average up and down months of the index. The index used is a 50/50 blend of the S&P TSX Total Return Index and the S&P 500 Total Return Index in local currencies, rebalanced monthly.

The compounded rate of return showing the growth of $100,000 in "Returns vs Index" chart is used only to illustrate the effects of the compound growth rate and is not intended to reflect future values of the investment fund or returns on investment in the investment fund. Commissions, trailing commissions, management fees, performance fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any unitholder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently, and past performance may not be repeated. EHP Funds is the investment manager to the EHP Funds offered under prospectus. EdgeHill Partners is the investment manager to the EHP Funds offered under offering memorandum, and is an affiliate of EHP Funds Inc. The Funds are available only in those jurisdictions where it may be lawfully offered for sale. This document is not intended to provide legal, accounting, tax or investment advice.

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