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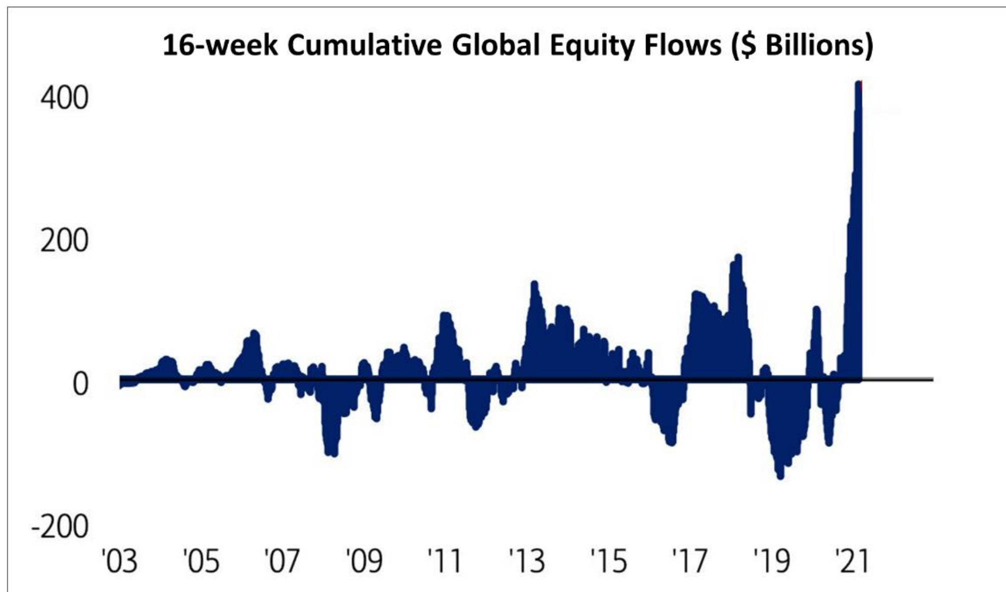
Q1 2021 Fund Commentary

Q1 did not disappoint, with a solid continuation of the global equity rally, and with a host of market moving events. In some ways, it felt as if we had a year of news packed into just three months, from the insurrection at the U.S. capital and the subsequent concession by Trump (as well as, mercifully, his ban from twitter), to the Democratic sweep of the Georgia senate run-offs which ultimately led to the easy passing of another massive stimulus bill, to "meme" stocks like GameStop causing massive losses for short-focused hedge funds, to a mini-crash in the most speculative parts of the market. What themes connect most of these seemingly random events? An excess of easy money, coupled with an historic willingness of investors to speculate, and insufficient liquidity and risk-management to deal with it all.

While broad equity indices advanced, what was more interesting was the view from under the surface, with a rapid rotation from growth to value, along with one of the worst quarters in 50 years for the bond market, driven by a double whammy of a steepening yield curve and rising inflation expectations. The uneven reopening of economies is proceeding as vaccine rollouts pick up speed, with the U.S. and U.K. well ahead, and Europe and Canada lagging. Ultimately, we think markets look through any short-term setbacks, and that there is ample room for this reflation and rotation to continue in the coming quarters.

The Flow Show

One of the primary drivers of the equity rally has been an epic flow of funds into stocks, as illustrated in the chart below, with a colossal $414 Billion moving into mutual funds and ETFs over the last 4 months, reversing years of negative flows for the industry:



Source: BofA Global Investment Strategy, EPFR Global

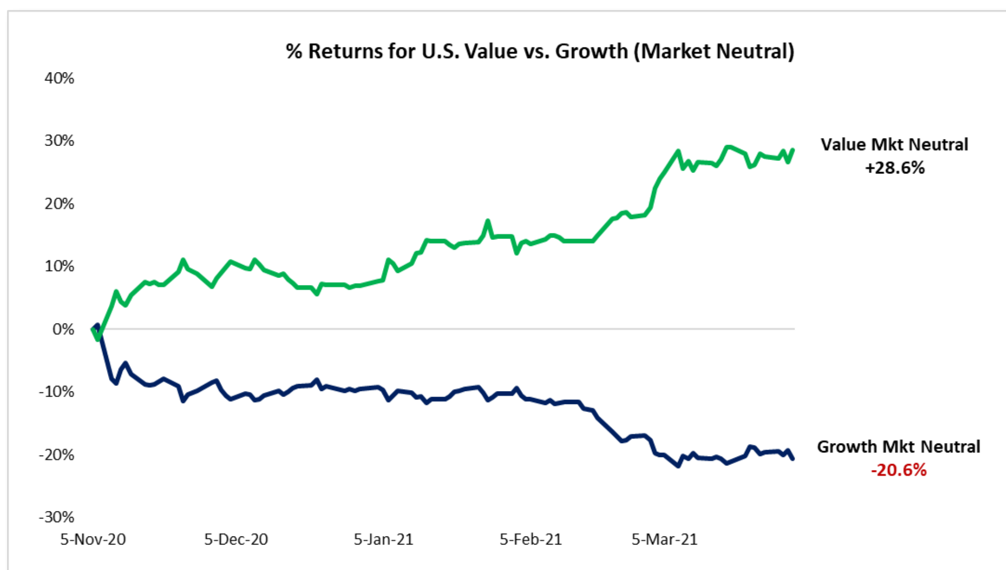
It's clear that investors have now fully embraced the rally, with the most recent AAII Investor survey showing allocations to stocks at 70% of assets, just shy of the 75% peak during the dot-com boom in 2000, and well above the 55% allocations they carried last March. Like the late 1990's, investor dollars have tended to chase the areas of the market with the highest prior returns, leading to a self-fulfilling "momentum machine" for growth stocks in technology and more speculative sectors like electric vehicles, biotech, space exploration, fintech and SAAS software. No single firm has benefited more from these excesses better than the ARK family of ETFs, led by Cathie Wood, who's firm at one point

this year was outraising all other ETF including behemoths like Blackrock with her focused investments in these hottest sectors.

As we know from history, momentum machines can work in both directions, and by mid-February it seemed that the pressure of massive IPO, secondary and SPAC issuance had overwhelmed the demand from investors. Despite continued fund flows into equities, the tide appears to have turned on these most speculative sectors, with the ARKK ETF correcting 31% from its recent highs before stabilizing somewhat into quarter end. Call option volume, one of the hallmarks of the retail rally, is receding quickly, as is overall market implied volatility. We suspect that as people return to work, and stimulus is replaced with employment income, we'll see a further reduction in speculative interest. In our view, February likely marks the top for this cycle in terms of the relative performance of these most expensive and speculative growth stocks. We'll be watching ARKK and other indicators closely as a measure of the overall health of growth stocks.

When Value becomes Momentum

Much press has been written about the death of value investing over the last few years, while at the same time growth investors created new methodologies to justify sky-high valuations for non-profitable businesses. As opposed to the dot-com boom when a "multiple of page views" became a popular metric, this cycle we've seen the "Enterprise Value to Total Addressable Market (EV/TAM)", leading to nearly infinite potential growth projections. As we argued in our last quarterly letter, disregard for profitability or even a logical path towards cash-flow would likely be upended in an environment where growth was suddenly less scarce, and interest rates started moving higher, increasing the discount rate for these "long-duration" speculative stocks. While they don't ring a bell at the top, the last six weeks have seen an acceleration of the rotation that started in earnest after the November vaccine announcements, with value outperforming growth stocks by a wide margin when comparing their respective market neutral indices:



Source: Bloomberg, Goldman Sachs, EHP Funds

As evidenced from the chart above, value and growth are typically two sides of the same coin - when one is working, the other is not. But what about the "momentum" style of investing which adapts itself over time as trends shift? In our view, momentum is a window into fund flows, and represents which stocks dollars are currently flowing into (for positive price momentum), or out of (for negative price momentum). Human behaviour tends to see investors "herd" and stick with the dominant trends, which is why stocks that have recently been strong tend to stay that way and outperform for a period of time into the future. Understanding what type of stocks are currently becoming momentum stocks is important for understanding "where the puck is going". Most momentum strategies look at the last 9-12 months of

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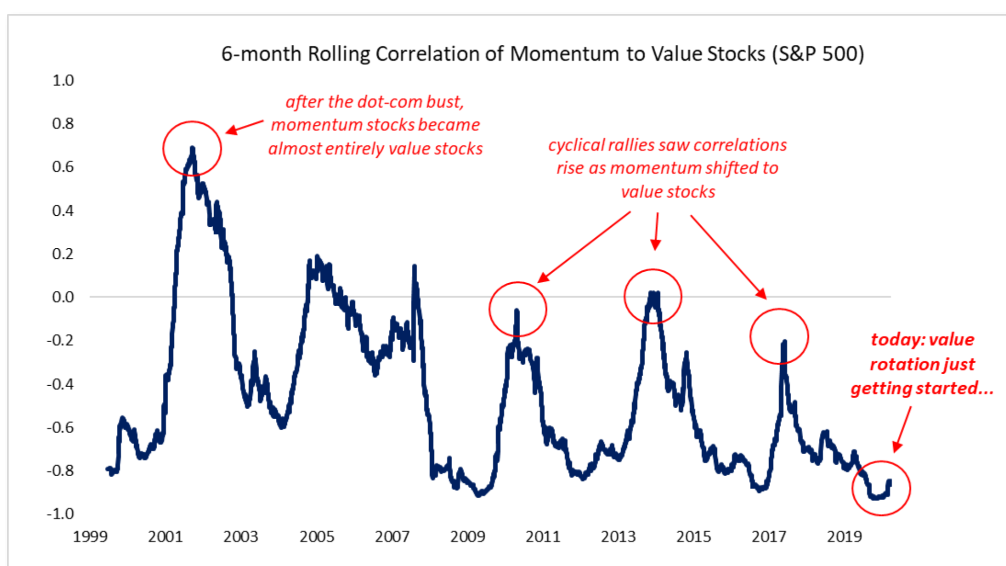
price performance, and on these measures, the sectors with the best performance include consumer discretionary, financials, industrials and energy – sectors that are traditionally associated with cyclical value. The worst performers include golds, staples, telecommunication services, technology, and utilities – all sectors traditionally considered to be defensive or growth.

What does all of this mean? For the first time in years, value stocks have a material flow of funds *tailwind*, rather than a headwind, as the momentum firehose of money points in the direction of cyclicals. Lest we think that this rotation has run too far, the data suggests quite the opposite. The historic outperformance of growth over value in the last few years would require many quarters or even years of mean reversion just to get back to a normal "baseline", similar to what occurred following the dotcom bust. We can see this when looking at the rolling correlations of momentum stocks to value stocks in the chart below. As correlations rise too much, it can indicate the value rally is becoming overextended. Today, with just 6 months or so of value outperformance, we appear to be a long way off from overbought conditions.



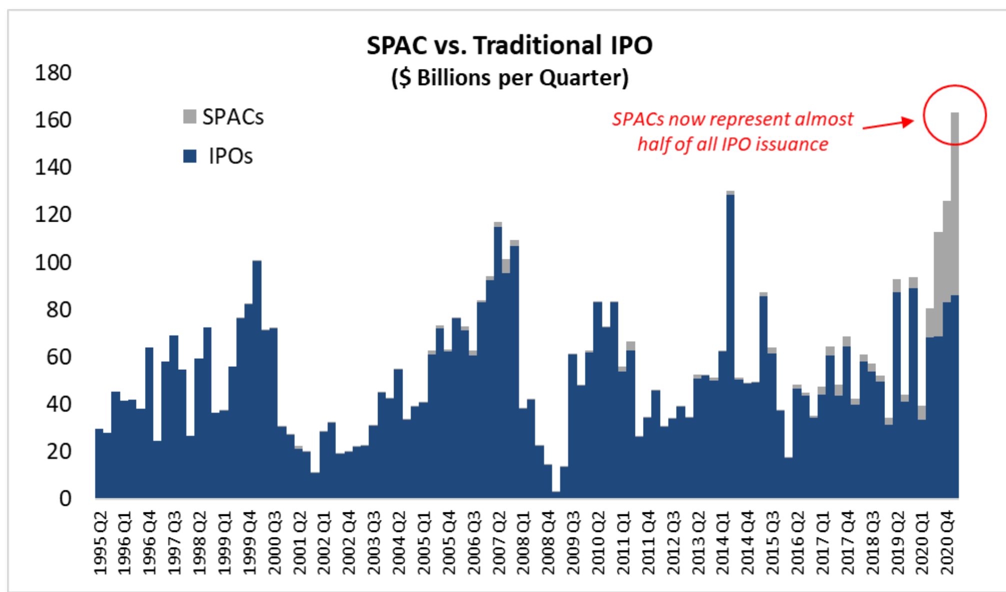
Source: Goldman Sachs, Bloomberg, EHP Funds

We will suggest however, that as the new bull market rolls on, we should expect to see a rotation towards "quality" value, and less of a focus on "deep" cyclicals which have enjoyed sharp gains over the last year. Quality value, which has lagged meaningfully since the rally started, looks to own stocks that are cheap on metrics like price-to-cash-flow, with high returns on equity, and with reasonable balance sheets. "Deep" value stocks, which have had spectacular returns off the bottom, tend to be over-levered and have a low "price to book". Our Funds, which tend to favour high-quality value stocks with strong price momentum, should be well positioned for the next leg of the bull rally.

A word about SPACs

It has been impossible to read the financial papers or watch business news without hearing about how many SPACs have been issued and the spectacular returns of some of the winners. For the uninitiated, a SPAC is a "special purpose acquisition company" which is essentially a blind pool of cash, sitting in trust, with a sponsor that has 18-24 months to find a company to buy with that cash before he or she has to return it with interest. It's a no-risk proposition for the SPAC buyer, as long as you don't pay more than the $10/share value of the cash, as you always have the ability to either get your $10 back with interest, or sell your shares in the market at a higher price if a proposed deal is well received. It's a bit like getting to participate in a future IPO with a guarantee of getting your money back if the IPO flops.

SPAC issuance has been off-the-charts recently, and in Q1 of this year nearly surpassed the total of all other traditional IPOs (see chart below). There were 298 SPAC IPOs just this year so far, raising $78 billion ($96 billion when including greenshoes).



Source: Bloomberg, EHP Funds

And no wonder. The economics for the sponsor are terrific, as they end up owning about 20% of the eventual merger at an all-in cost of ~$2-3/share. In other words, even a terrible deal that declines 70% is at worst break-even for the sponsor. SPACs have become synonymous with the speculative growth bubble, with a virtuous cycle of new SPACs immediately trading above $10 issuance, and SPACs announcing deals routinely popping 20-50% or more, leading to more speculation and more issuance. In mid February, the average SPAC searching for a deal was trading 12% above trust value, meaning you paid $1.12 to buy a dollar with the hope of a blow-out deal announcement to come. As with all good ideas, Wall Street has beaten it to death in search of fees, and the tidal wave of issuance has overwhelmed the market. As of the end of March SPACs now trade at a 1.2% *discount* to trust value, making them appealing once again.

SPACs have also been relying on the willingness of retail investors to be the ultimate "bag holder" in the transaction. Typically, once a sponsor finds a target, they backfill the transaction with extra cash from investors in a "PIPE" (private equity in a public company) at the original $10 price. These PIPE buyers have recently been the who's who of public and private investors, but they are buying the deal often to be able to sell it back to the public only months later at more than $10. Successful SPACs have thus gravitated to the most speculative sectors like EV, batteries, space exploration, gaming and gambling, etc, where the odds of a higher share price are better. But what happens when suddenly retail is realizing losses on these SPACs as they are now, and refuse to be the sucker at the table? We're about to find out, and we suspect it will lead to further weakness in the SPAC market, creating opportunities for a pure arbitrage player like ourselves, happy to generate a riskless rate of return with upside optionality. While we've recently added to our SPAC exposure, we are waiting patiently for the highest quality SPACs, with sponsors with the best access to deal flow, to trade at a discount to NAV before adding more.

This massive SPAC issuance and subsequent sell-off has had an interesting knock-on effect on the traditional merger arb market, which profits from the small "spread" between the price of a stock the day a takeover is announced and the day the deal closes. Historically, this spread has annualized ~400bps over T-Bills, but the current environment of record

merger volumes as well as SPAC oversupply competing for available dollars has led to some very attractive spreads on what we would consider high-quality deals. Currently, our EHP Global Arbitrage Alternative Fund owns 47 traditional deals, with a gross spread averaging 5.7%, implying that assuming no deal breaks, extended timelines or higher competing bids, the portfolio should annualize at ~1800 bps over T-bills, the widest spread we have seen since just after the COVID crash in April when there was still the fear that many deals would fail outright because of the pandemic. It's rare to see opportunities this good for relatively low volatility strategies, and we are taking advantage of it across the Funds.

A canary in the coal mine?

We'd be remiss not to comment on the Archegos fund blow up and its implications for the market looking forward. While the Archegos margin call has thankfully not become a source of systemic risk, it did end up costing the banks that funded them some $10 billion, and calls into question how a prime brokerage desk can truly assess the risk of clients who might hold the identical positions multiple times over with other counterparties. The event also exposes just how levered market participants may have become in an environment of low rates and easy money. Back in the summer of 2007, a year before the great financial crisis got into full gear, Bear Sterns closed two mortgage hedge funds that had gotten into trouble by overleveraging themselves in less liquid sub-prime MBS securities. It was a canary in the coalmine event, that in hindsight was an obvious warning sign of what was to come. We view Archegos in a similar light, as well as some of the other notable recent failures like Greensill and Woodford. In each case, the proximate cause is the same as the Bear Stearns event: too much leverage, not enough liquidity, and usually a combination of both.

One of the unintended consequences of an easy money policy and low interest rates has been excessive speculation by retail investors. Another has been the massive re-leveraging of "carry" trades, where small returns can be amplified with high amounts of leverage, made possible by the implied backstop of central banks. In the Archegos case, it may well be that the unregulated family office essentially lied to its prime brokers, hiding the true extent of their single-stock concentration, and using derivatives to massively juice already high leverage. But the event highlights just how much leverage is available to funds that *are* regulated and are properly reporting it. It is not unusual for large multi-strategy funds or credit funds to utilize 6-8x leverage on their capital. We can envision the fire drills being run at prime brokers everywhere, seeking to ferret out excessive risk-taking clients and lower the overall leverage available to the system.

We have always believed that using moderate leverage with more than ample liquidity (even in a crisis) is critical to long-term success, and recent events have only reinforced that view. We also believe that the seeds of the next crisis are already being sown with the rising popularity of volatility-based products that cause asymmetric risk for the dealers that issue them (see our Q1 2020 commentary for more details), and as it becomes clear how much leverage is being used once again in the system. While we're not particularly concerned today given the massive central bank support and easy financial conditions, these issues will likely move to front and center when the Fed eventually starts to tighten, and are worthy of being monitored now. As always, we do our best to understand and adapt to emerging risks as a part of our investment process.

Where to from here?

With the bond market having experienced once of its worst quarters in 50 years, and with the prospect for continued inflationary pressure and rising rates, the outlook for the traditional 60/40 model continues to be concerning. With clients everywhere searching for an alternative to bonds, we continue to believe (with a heavy dose of bias) that alternative strategies like merger arbitrage, market neutral and long/short can help solve for this problem. We expect the rotation from growth the value to continue for some time to come, and for overall market multiples to contract as earnings improve and as higher rates raise the discount rate for investments. These factors may lead to a period where passive, tech heavy indices struggle to make much headway, while relative sector and stock calls provide opportunities for outperformance. The environment may well suit active long/short managers who can take advantage of fairly wide dispersion of valuations among stocks and sectors, as well as those that are nimble enough to adjust in what may

continue to be a market of extremes. As always, we will remain patient and disciplined in terms of applying our process, following an approach that relies on actual market changes and not forecasts of such.

Fund Specific Commentary

Summary of Returns (F-Class):

Fund	1M	3M	YTD	1YR	Inception
EHP Foundation Alternative Fund	2.9%	4.5%	4.5%	10.9%	5.1%
EHP Foundation International Alternative Fund	3.1%	2.4%	2.4%	2.8%	3.0%
EHP Global Arbitrage Alternative Fund	0.4%	1.9%	1.9%	20.8%	9.7%
EHP Advantage Alternative Fund	4.0%	4.9%	4.9%	14.2%	5.6%
EHP Advantage International Alternative Fund	5.4%	3.4%	3.4%	10.3%	2.9%
EHP Select Alternative Fund	4.5%	12.5%	12.5%	63.0%	17.6%
EHP Global Multi-Strategy Fund	2.9%	4.6%	4.6%	N/A	N/A

Defensive / Conservative Funds

EHP Foundation Alternative Fund

The Fund was up 4.5% over the quarter, with gains led by Canadian long/short equity, and positive contributions from U.S. long/short equity and Merger Arbitrage. Equity shorts, which had been a challenge in 2020 and the earlier parts of this year, performed better in March as the speculative mania in expensive sectors retreated. Credit Momentum was flat over the period, as U.S. Treasuries had one of their worst quarters in 50 years, and the high yield market weakened enough to move us out of the asset class and into cash. It's fairly rare for both high yield credit and flight-to-safety treasuries to be in a downtrend, but we should expect to see this condition more frequently in the future as rates rise from historically low levels, and inflation expectations increase. Our "safety valve" in the event of a persistent bond bear market is to simply have no allocation to our Credit Momentum strategy. As of the start of April, high yield bonds are resuming their uptrend, with the Fund moving out of cash and back into the credit market.

From an equity factor perspective, value was by far the best performing style, followed by low volatility, while momentum and growth styles meaningfully underperformed. The Fund was well positioned for this environment, with its focus on sustainable dividend yield, which in recent quarters became synonymous with cyclical value. The rotation from expensive growth and defensive stocks towards deeper value cyclicals has become much more pronounced, and while we expect to see pauses along the way, it is still early days with room to run on a relative return basis. We also expect that as this cyclical reflation matures, we should see higher quality value stocks, as measured by metrics like free-cash flow and return-on-equity, start to outperform their deeper value counterparts. The momentum style is adapting to the new environment, dropping technology and staples from its ranks while adding financials, industrials, materials and energy, which should turn what has been a headwind for these economically sensitive sectors for years into a tailwind looking forward.

From a sector perspective, the Fund is skewed toward higher quality dividend-paying stocks in industrial, discretionary, healthcare, and energy sectors, with underweights in utilities and communication services. We enter Q2 with the Fund just below the higher end of its risk range, carrying an estimated market beta of ~0.3.

EHP Foundation International Alternative Fund

The Fund was up 2.4% over the quarter, with gains led by Europe long/short equity, with positive returns from U.K. and Japan long/short as well as Merger Arbitrage. Equity shorts, which had been a challenge in 2020 and the earlier parts of

this year, performed better in March as the speculative mania in expensive sectors retreated. Credit Momentum was a detractor from returns over the quarter, as U.S. Treasuries had one of their worst quarters in 50 years, and as both the high yield market and emerging sovereign debt weakened enough to move us out of the asset class and into cash. It's fairly rare for both high yield credit and flight-to-safety treasuries to be in a downtrend, but we should expect to see this condition more frequently in the future as rates rise from historically low levels, and inflation expectations increase. Our "safety valve" in the event of a persistent bond bear market is to simply have no allocation to our Credit Momentum strategy. As of the start of April, high yield bonds are resuming their uptrend, with the Fund moving partially out of cash and back into the credit market.

From an equity factor perspective, the value style dominated returns, while momentum, growth and defensive low volatility styles meaningfully underperformed. The Fund was fairly well positioned for this environment, with its focus on sustainable dividend yield, which in recent quarters became synonymous with cyclical value. The Fund's balanced approach to also favouring lower volatility, trending stocks was a drag on returns as higher beta stocks continued to outperform internationally. The rotation from expensive growth and defensive stocks towards deeper value cyclicals has become much more pronounced, and while we expect to see pauses along the way, it is still early days with room to run on a relative return basis. We also expect that as this cyclical reflation matures, we should see higher quality value stocks, as measured by metrics like free-cash flow and return-on-equity, start to outperform their deeper value counterparts. The momentum style is adapting to the new environment, dropping technology and staples from its ranks while adding financials, industrials, materials and energy, which should turn what has been a headwind for these economically sensitive sectors for years into a tailwind looking forward.

From a sector perspective, the Fund is skewed toward higher quality dividend-paying stocks in industrial, financial and discretionary sectors, with underweights in utilities and lower quality energy. We enter Q2 with the Fund just below the higher end of its risk range, carrying an estimated market beta of ~0.3.

EHP Global Arbitrage Alternative Fund

The Fund was up 1.9% over the quarter, with positive contributions from both traditional merger arbitrage as well as SPACs. The Fund participated in approximately 110 traditional merger arb deals, and holds 47 positions as of the end of March. We had generally been a net seller of SPACs in Q4 of last year and the start of this year as conditions had become truly euphoric, but with the steep correction in the SPAC market in March, we took advantage to add a number of positions trading at discounts to trust value, with a guaranteed rate of return, even on a "yield to worst redemption" basis. SPACs now account for just over 20% of the Fund (after accounting for SPACs with redemption events in the next few weeks), represented by 103 positions. We're not convinced that the pain for the SPAC market is done yet, with another 200 or so SPACs waiting to be issued, and we are waiting patiently before deploying more capital for the highest quality SPACs (those with a well-known sponsor with access to deal-flow, and with the highest quality underwriters) to trade at a discount to trust.

The traditional merger market was robust in Q1, with $1.3 Trillion of deals globally, the best start to a year on record. Mergers tend to occur when company boards are confident, and that is certainly true today with easy access to cash, low borrowing rates, and improving economic growth. In the SPAC market, the massive issuance of the past few months has weighed heavily on the sector, with more than 500 SPACs trading, and the average SPAC searching for a deal dropping from an 12% premium to trust value in January to a 1.2% *discount* by the end of March. This oversupply of SPACs has diverted dollars away from traditional merger arb, leading to wider spreads across the board. The Fund is now positioned with the highest implied forward returns since April of last year, when concerns about deal breaks from pandemic was front and center. The Fund enters Q2 with an approximate 5.7% gross spread over the average deal life of 143 days, implying an 18% annualized return for traditional merger deals over the next quarter. These calculations assume no deal breaks, but also no higher competing bids, and assume deals close on the timelines we anticipate.

Core / Moderate Funds

EHP Advantage Alternative Fund

The Fund was up 4.9% over the quarter, with gains led by Canadian long/short equity, and positive contributions from U.S. long/short equity and Merger Arbitrage. Equity shorts, which had been a challenge in 2020 and the earlier parts of this year, performed better in March as the speculative mania in expensive sectors retreated. Credit Momentum had small losses over the period, as U.S. Treasuries had one of their worst quarters in 50 years, and the high yield market weakened enough to move us out of the asset class and into cash. It's fairly rare for both high yield credit and flight-to-safety treasuries to be in a downtrend, but we should expect to see this condition more frequently in the future as rates rise from historically low levels, and inflation expectations increase. Our "safety valve" in the event of a persistent bond bear market is to simply have no allocation to our Credit Momentum strategy. As of the start of April, high yield bonds are resuming their uptrend, with the Fund moving out of cash and back into the credit market.

From an equity factor perspective, value was by far the best performing style, followed by low volatility, while momentum and growth styles meaningfully underperformed. Quality factors were also a detractor from returns as the rally remained concentrated in the more leveraged, deeper cyclical stocks. The Fund was better positioned for this environment, having adjusted exposures over previous months, rotating towards value stocks while avoiding the most overpriced growth stocks. The rotation from expensive growth and defensive stocks towards deeper value cyclicals has become much more pronounced, and while we expect to see pauses along the way, it is still early days with room to run on a relative return basis. We also expect that as this cyclical reflation matures, we should see higher quality value stocks, as measured by metrics like free-cash flow and return-on-equity, start to outperform their deeper value counterparts. The momentum style is adapting to the new environment, dropping technology and staples from its ranks while adding financials, industrials, materials and energy, which should turn what has been a headwind for these economically sensitive sectors for years into a tailwind looking forward.

From a sector perspective, the Fund is skewed toward higher quality stocks in financials, industrials, materials and discretionary sectors, while net short rate-sensitive utilities and REITs. Energy stocks remain the lone cyclical sector with an underweight as we await a return of more meaningful earnings to the group. We enter Q2 with the Fund at the higher end of its risk range, carrying an estimated market beta of ~0.7.

EHP Advantage International Alternative Fund

The Fund was up 3.4% over the quarter, with gains led by Europe long/short equity, and with positive returns from U.K. and Australia long/short as well as Merger Arbitrage. Japan long/short equity had losses as lower quality, volatile short positions continued to outperform their higher quality long counterparts. Equity shorts, which had been a challenge in 2020 and the earlier parts of this year, performed better in March as the speculative mania in expensive sectors retreated. Credit Momentum was a detractor from returns over the quarter, as U.S. Treasuries had one of their worst quarters in 50 years, and as both the high yield market and emerging sovereign debt weakened enough to move us out of the asset class and into cash. It's fairly rare for both high yield credit and flight-to-safety treasuries to be in a downtrend, but we should expect to see this condition more frequently in the future as rates rise from historically low levels, and inflation expectations increase. Our "safety valve" in the event of a persistent bond bear market is to simply have no allocation to our Credit Momentum strategy. As of the start of April, high yield bonds are resuming their uptrend, with the Fund moving partially out of cash and back into the credit market.

From an equity factor perspective, the value style dominated returns, while momentum, growth and defensive low volatility styles meaningfully underperformed. The Fund exposure to value stocks helped in this environment, although

its balanced approach to also favouring high quality, trending stocks was a drag on returns as higher beta stocks with more stressed balance sheets continued to outperform internationally. The rotation from expensive growth and defensive stocks towards deeper value cyclicals has become much more pronounced, and while we expect to see pauses along the way, it is still early days with room to run on a relative return basis. We also expect that as this cyclical reflation matures, we should see higher quality value stocks, as measured by metrics like free-cash flow and return-on-equity, start to outperform their deeper value counterparts. The momentum style is adapting to the new environment, dropping technology and staples from its ranks while adding financials, industrials, materials and energy, which should turn what has been a headwind for these economically sensitive sectors for years into a tailwind looking forward.

From a sector perspective, the Fund is skewed toward higher quality stocks in materials, discretionary and industrials sectors, with underweights in REITs and utilities. We enter Q2 with the Fund just below the higher end of its risk range, carrying an estimated market beta of ~0.7.

EHP Select Alternative Fund

The Fund was up 12.5% over the quarter and has delivered trailing one-year returns of 63%, a direct reflection of the Fund's bias toward cyclical value stocks, which tend to lead in a bull-market reflation environment. Gains in the quarter were again led by a cross-section of stocks in industrial, materials and consumer discretionary sectors. The rotation towards more cyclical "recovery" stocks continued to benefit the Fund, with its natural bias towards owning cash-flowing, more reasonably priced companies. Larger winners in the quarter included TFI International, AirBoss of America, Interfor, and IA Financial. While not necessarily the "household" stocks typically present in Canadian portfolio, these mid and smaller cap stocks tend to outperform meaningfully at this part of the cycle. As the bull market enters its second year, we expect some rotation to higher quality stocks (as measured by free-cash-flow and return-on-equity), and more scrutiny on deep value stocks with stressed balance sheets. The Fund is well positioned to capitalize on what we expect to be a period of outperformance of Canadian stocks over their U.S. counterparts due to our more cyclically geared economy. We continue to find quite reasonably priced securities in what is an otherwise expensive market.

From a sector and style perspective, the Fund is weighted toward "return to work" sectors in materials, industrial, and discretionary sectors. Utilities, health care (Canadian cannabis), and REITs remain net shorts given their relative underperformance and expensive valuations.

Disclaimers

Returns are for "F" class series of the Funds, 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. Unless otherwise noted, all values are in U.S. dollars. Source for all index data: Bloomberg.

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