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Q4 2022 Fund Commentary

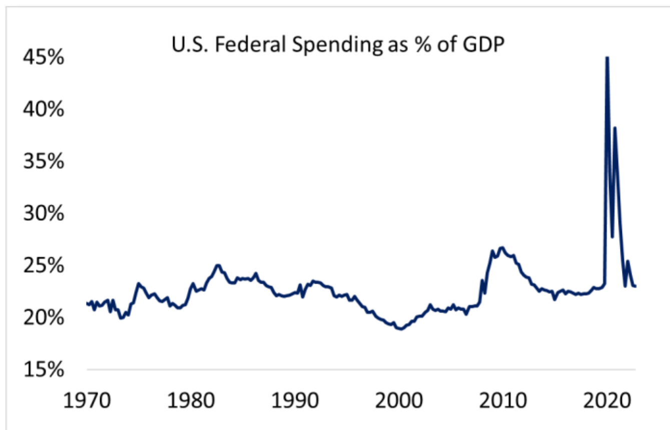
December was a fitting end to a year that many will be eager to forget, with the S&P 500 declining -5.7% on the month, and ending -18.1% on the year, its worst showing since 2008. Other markets finished deep in the red as well, with the tech-heavy Nasdaq ending down -33.0%, and the S&P TSX down a more modest -12.0%, helped by its energy exposure. Bonds compounded the pain, with the Barclays Aggregate Index down -13.0% for the year, posting two consecutive down years for the first time since the index began in 1976. The bond market was driven much more by rates than credit, with the high yield market down "only" -10.7% as compared to the duration-sensitive U.S. long bond down -33.4%, its worst showing in at least 40 years. Treasury bonds were not the only ineffective safe haven this year, with gold spending most of the year underwater before finishing flat (so much for being an inflation hedge), and the VIX printing its high for the year in January and never rising much above 35, leaving volatility-based hedges largely ineffective as well.

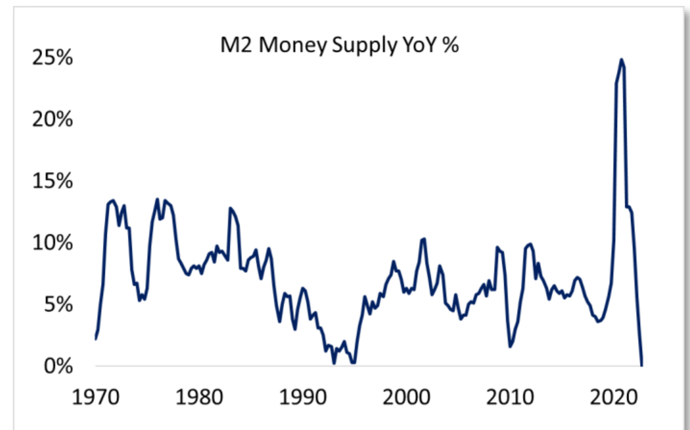
The primary reason for this grief? Central banks and their dogged campaign to raise interest rates at the fastest pace since the 1980s, all in an effort to fight the inflation they themselves helped create. Handicapping how far the Fed is willing to go to reign in prices has become virtually the only game in town, and macro has dominated individual stock selection all year. We've been suggesting that the Fed is essentially "done" and that the market has now fully discounted what will eventually be the terminal rate, and any additional Fed hikes will only get us to the level already implied by the bond market. For this to be true though, inflation must come down to acceptable levels, and investors are largely betting that the only way to accomplish that is to see the economy roll into a full-blown recession. The recession call is now consensus, with exactly zero portfolio managers in BofA's Fund Manager Survey expecting a "goldilocks" scenario in 2023 (rising growth and falling inflation), while 92% expect the opposite. Positioning continues to reflect this view, with institutional managers holding high levels of cash, hedge funds near trough levels in terms of gross exposure, and now retail is showing signs of cracking, exhausted by their losses. Virtually every major top-down strategist has at best flat returns for next year, with the bulk predicting a recessionary sell-off before recovering somewhat in the second half of next year.

So – is a hard landing inevitable? Certainly, there are numerous indicators that would suggest it is. Virtually the entire yield curve is now inverted, and the 10yr-2yr hasn't been this negative since 1981. A number of economic datapoints (ISM and PMI Manufacturing, Housing Starts, LEIs) are at levels that preceded prior recessions, although other indicators like employment and retail sales would disagree. Corporate earnings have proven to be remarkably resilient, but are widely expected to be the next shoe to drop.

What we do find surprising is the willingness of market participants to take the Fed at their word in terms of their willingness to hike rates at all costs, including a recession. The Fed has been a truly terrible forecaster of the future as it relates to both inflation and their own path of rate hikes and cuts. We know from history that they are likely to jawbone the market into keeping financial conditions tight until the very last minute – recall Jay Powell's "we're a long way from neutral" comment in October of 2018 referring to the need for more hikes, only to cut rates as the market panicked only months later. In terms of this hiking cycle, the Fed was resolutely confident that inflation was transitory, despite plenty of data to the contrary, and that any hikes were a long way off, even continuing to expand their balance sheet *this March,* only to then embark on the most aggressive hiking cycles since the 1980s.

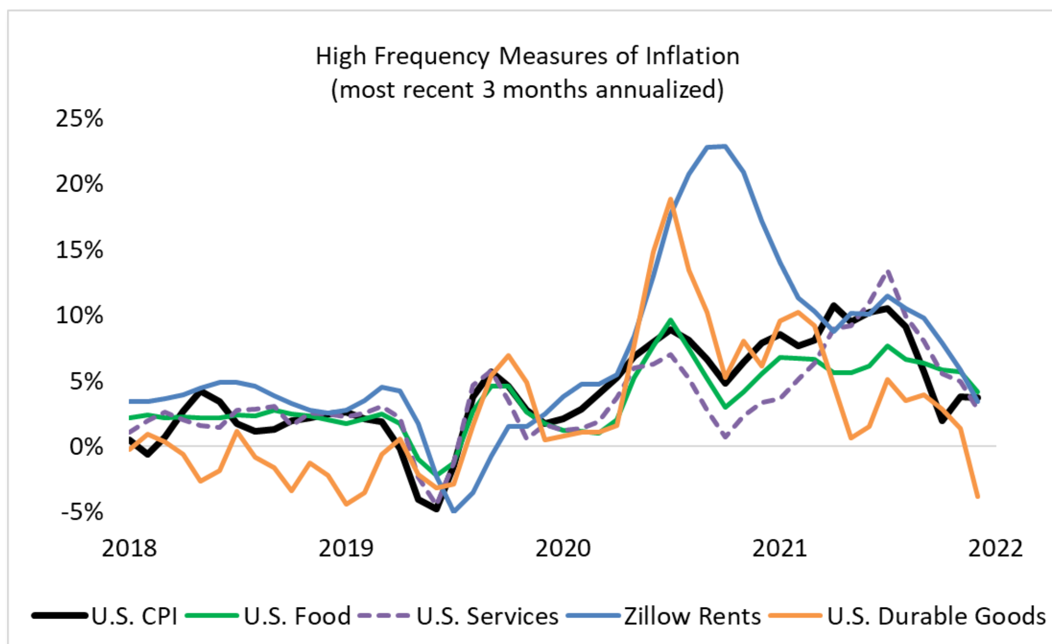
So, since we can't really believe what the Fed says, nor can we use their forecast of the future to reflect reality, what we can do is look at the data itself. We had written back in Q3 of 2021 that we felt it was very unlikely that inflation would be "transitory" based on the double whammy of a massive increase in money supply (courtesy of the Fed) and the largest fiscal spending since World War II to backstop the world during Covid (courtesy of the government). We update the two measures in the charts below.





Sources: Federal Reserve Economic Data, Bloomberg

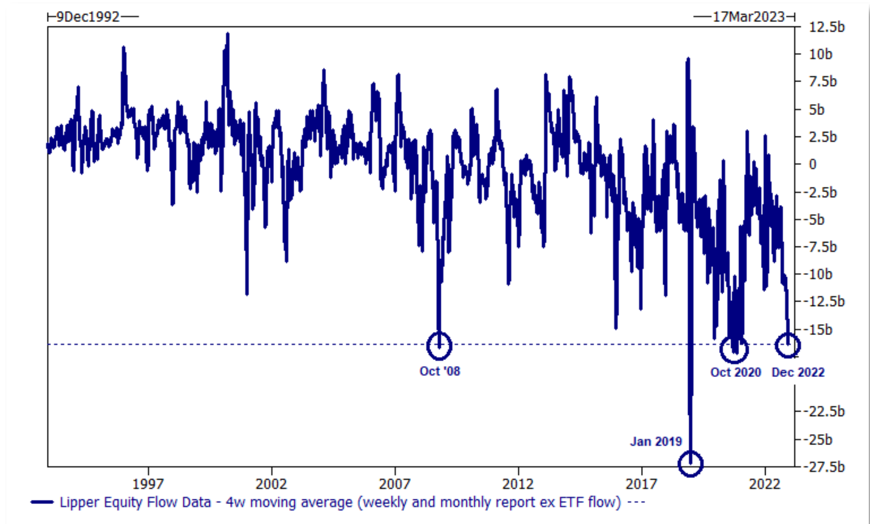
As we can see, fiscal spending has reverted back to normal levels, and money supply, as measured by M2, has completely reversed, having fallen to zero percent YoY growth for the first time in history. If persistent inflation "is and always has been, a monetary phenomenon" as economist Milton Friedman stated, which the data from the last few years appears to confirm, would it not be true that the decline in money supply could have the opposite effect? Inflation is, after all, a year-over-year number. Prices that stay flat for a year are "zero" inflation, and we are coming up on some very large price increase "comps" in coming quarters when measured against the prior year. One of the challenges with the CPI numbers is they can have many "stale" data items – like rental costs that can be as much as 10 months old even in the current monthly data print. One way to get a higher frequency indicator of inflation is to sum the most recent 3 months, and annualize to get a sense of the *recent* pace. The chart below shows this calculation for some of the components of CPI. On this measure, it's evident that CPI has come down a lot in response to the Fed's actions, with rents (as measured by Zillow) declining from a high of 20%+ inflation to just 3.4% today. Food and services show a similar path. Durable goods prices are actually deflating as an inventory glut gets dumped into the market. The overall CPI number is just 3.7% and declining rapidly using this approach, and is likely a better indicator of the future path. We may be surprised at the slowing pace of future inflation prints, easing the pressure for the Fed to continue to raise rates.



Sources: Bloomberg, EHP Funds

Retail finally throwing in the towel?

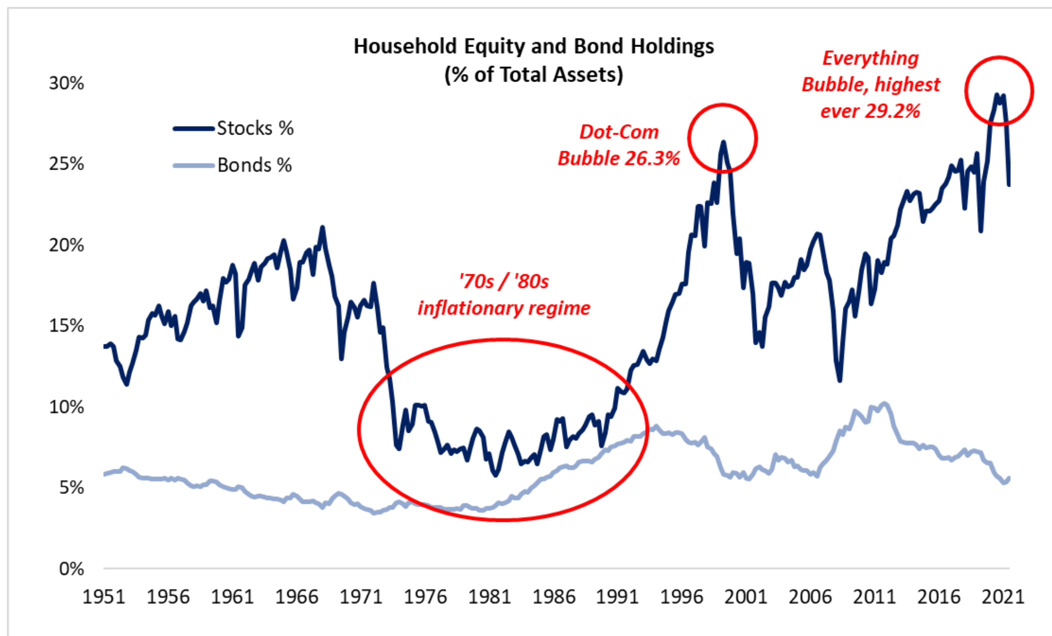
We noted in prior commentaries how resilient the retail investor has been in the face of rising losses of the growth stocks they have crowded into. We've marvelled at how the ARKK ETF, which finished the year down -70% and more than erased all of its gains from the massive "growth at any price" rally, still managed to have net *inflows* on the year. September's sell-off seemed to be the turning point for the "buy the dip" crowd, and December had a whiff of panic with some of the last remaining generals falling hard as retail appeared to finally capitulate. Tesla, the poster child for the growth at any price bubble in our opinion, fell -37% in December alone, and is now down -74% from its highs. As the saying goes, it's a long way down from "growth" to "value" and it seems as if the bubble in growth stocks has well and truly popped. As the chart to the right from Goldman shows, equity outflows have been negative for 26 consecutive weeks, with the 4-week average hitting $65 Billion – rivaling past short term extremes reached in 2008, just after the 2018 mini-crash, and the 2020 election. In our funds, where we'd been lamenting the fact that low quality shorts had outperformed high-quality longs (in contrast to all other bear markets on record), the retail capitulation has benefitted the style, with a market-neutral quality basket up 18% since the mid-September lows.



Source: Goldman, Refinitiv Lipper

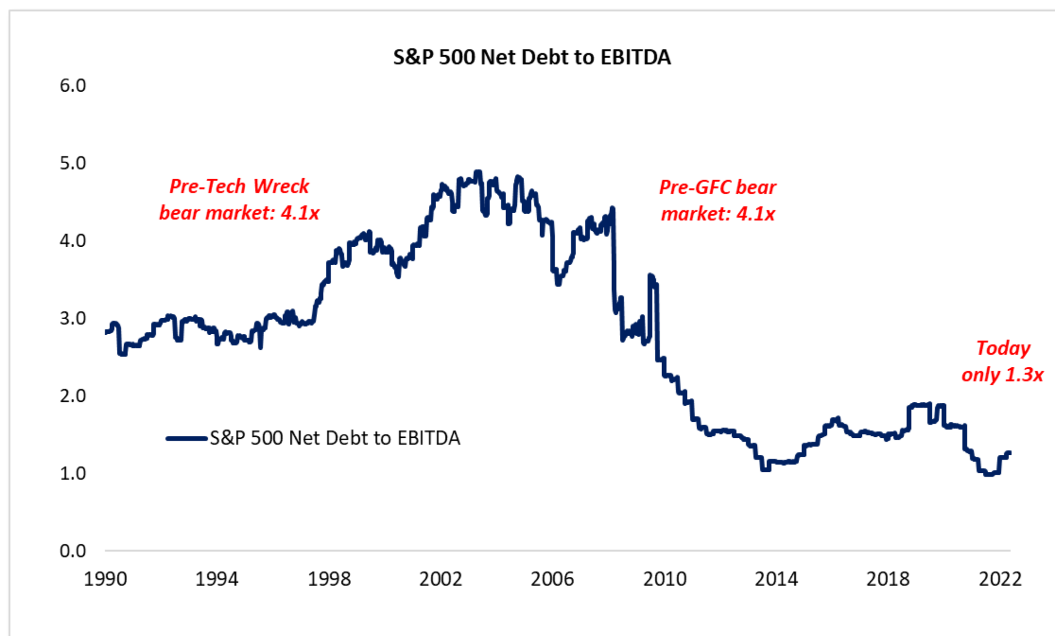
Credit the best bet on the board?

As we survey the landscape of asset classes in search of the best opportunities, the one that consistently stands out to us is credit. For now, retail sellers of stocks appear to be hiding out in the safety of cash. And why not? A 1-yr GIC averages around 5% yield today, and that seems a lot more appealing than potentially losing more money in the stock market. Looking at the bigger picture, the excessive retail flows into equities fueled by fiscal handouts during Covid have left the typical portfolio in a very unbalanced position. In the world of "TINA" (There Is No Alternative), it made sense to avoid bonds yielding next to nothing for the privilege of credit or duration downside risk. Households reduced their bond allocations back to levels last seen in the 1970s, but they also overallocated to stocks, with the later hitting the highest ever proportion of investment portfolios, and surpassing the levels seen in the last great bubble, the dot-com boom that ended in 2000. The chart below illustrates the point, and despite recent outflows from stocks, it implies that the typical retail portfolio sits at about 85% equities and 15% bonds.



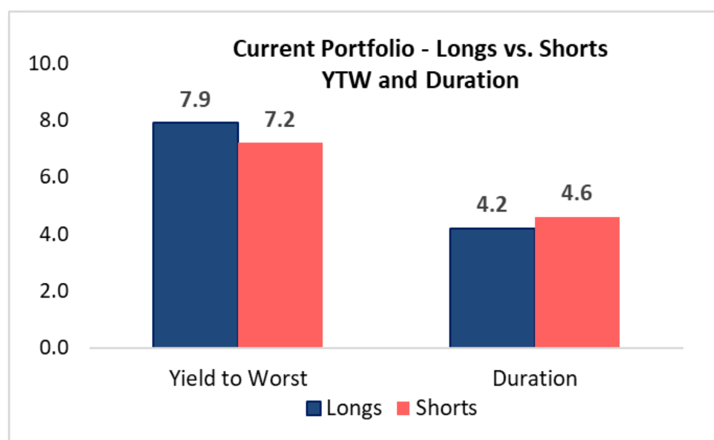
Source: Federal Reserve Economic Data, EHP Funds

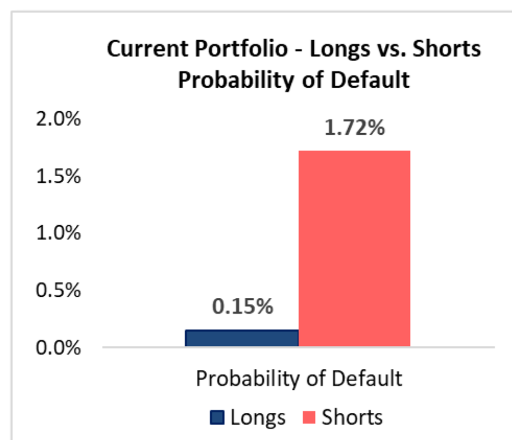
If we are to enter a protracted period of high inflation, there could be a *lot* more selling of passive equity holdings still to come, with household stock ownership needing to decline by about 70% from current levels to get back to where it was in the 1970s. Either way, as the near-term fear subsides, and those hiding in cash want to allocate to something with higher returns, we suspect that the first place they'll go is bonds. Corporate balance sheets have also been bolstered by central bank and fiscal stimulus, as record profits and margins afforded them the opportunity to cut debt, especially in sectors that would typically be considered cyclical. Part of what historically makes energy and materials stocks more cyclically sensitive is their penchant for levered balance sheets, but this time truly is different. If we look at the market as a whole, this cycle looks entirely different from past recessions, with the net debt to EBITDA for the S&P 500 sitting at only 1.3x vs. 4.1x in both 1999 and 2007 (chart below).



Source: Bloomberg

Given this backdrop, it's not surprising that credit spreads have not blown out the same way they have in prior downturns, and most of the pain in high yield bonds this year was the result of rising rates and not a new default cycle. In our EHP Strategic Income Alternative Fund, which was down only -1.5% in one of the worst years for bonds ever, we are seeing yields in the 7-8% range for bonds which we evaluate as having a low probability of default. In fact, this is the crux of our true quantitative long/short approach to the bond market. We believe there is a persistent mispricing among bonds, and it is possible to construct a portfolio that is long bonds with very similar yields and duration, but with radically different default risk. The charts below illustrate the point. In our current portfolio of 100 longs and 100 shorts, selected from the 800 or so most liquid high yield bonds, our longs actually have slightly higher yield-to-worst and slightly lower duration than our shorts. At the same time, our shorts have more than 10x the default risk. While the risk of default is small even in the basket of shorts, this risk can balloon higher in a real credit downturn and economic recession, providing a valuable "put" option for the fund, and an opportunity to earn attractive yields with limited downside.





Source: EHP Funds

Is anything cheap enough yet?

While credit looks compelling, there is certainly a strong argument to look at long/short strategies in the equity space as well. If dollars are expected to be scarce in terms of future preference for stocks vs. bonds, then it stands to argue that investors should be pickier about which stocks they choose to buy. We think it's quite unlikely that investors who have just been badly burned buying all forms of expensive "nonsense" stocks will be buyers of low quality, unprofitable businesses anytime soon. Value has been outperforming growth for more than a year now, but there is still room for divergence in returns looking forward. In the chart below, it's clear that the bubble has popped for the most expensive quintile of S&P 500 stocks, as measured by their median EV/EBITDA levels. In fact, their peak of more than 40x easily surpassed prior dot-com levels. The lowest valuation cohort was also expensive relative to their historical long-run average, but today we sit with expensive stocks still 5 multiple points more expensive than their long-term average, while the cheapest stocks are slightly below their long-term average.

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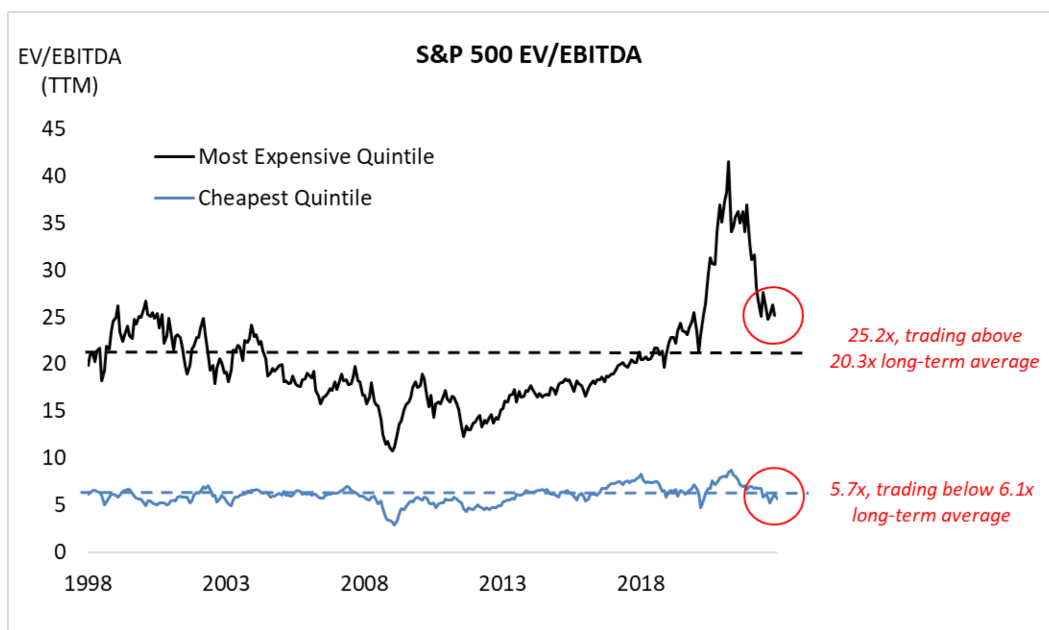

Source: Compustat, EHP Funds

The other important take-away is that neither group is trading at prior "crisis" levels of valuation seen during the Great Financial Crisis, when the expensive cohort traded to 10.7x, or less than half of today's levels. Given this is a man-made growth slow down at this point, driven almost entirely by central banks, we don't think that valuations need to revert to such crisis levels for the Fed to see progress on inflation. The other important factor, especially for the cheap cohort, is that balance sheets are materially different this time around, and what used to be cyclical because of excessive leverage may be much less so this time. What the data does suggest, however, is that investors today who could take advantage of being long the cheaper group and short the more expensive should be rewarded as valuations normalize to their respective averages, while also being protected by those same shorts if we do enter a more pronounced recession and a further market pullback.

Where to from here?

It's been an endlessly frustrating year, and certainly our most challenging since we began running money at EHP. We take some solace that in the context of the worst returns ever for a classic 60/40 balanced portfolio (down 16.9% for the year), our funds held in reasonably well, and in most cases did materially better. The endless chop of markets dominated by the latest macro datapoint seems to be a feature of this new regime, and we've adapted our approach to implementing our risk gearing process somewhat to lessen the risk of repetitive whipsaws, an approach that has proven effective in more recent quarters. We look forward to the day that markets settle back into a more typical cycle, as they are likely to do, after the wild fluctuations caused by the most aggressive stimulus in 50 years, followed by the most rapid tightening of financial conditions in history. The post-Covid times have indeed been unprecedented, but they will not last indefinitely.

While our Funds don't rely on us making predictions, but rather follow a consistent process, we recognize that our positioning often reflects macro conditions, and we think it's important to understand how the future might unfold. With that in mind, here is a review of what we got right and wrong in last year's predictions, and a handful of views of what might come next.

1. We believe we were correct in predicting that the pandemic would finally end, at least as we had known it. For the majority of the world, Covid is no longer a primary source of fear, but just another circulating virus among many others. That said, for China, this change to the new reality is playing out as we speak, and we'll suggest that their stimulus-led growth on the other side of an explosion in cases will surprise to the upside in terms of its strength. We favour Canada and other commodity driven markets over the U.S.
2. While we were right that inflation would prove to be anything but transitory, we were wrong about the Fed taking a slow and steady approach to dealing with it, and didn't expect their level of hawkishness. Looking forward, we think the Fed is on the cusp of making yet another policy mistake, seeing perpetual inflation where in reality prices are already slowing rapidly. We expect that most central banks are already done hiking, and the Fed isn't far behind, finishing in Q1 2023 as it becomes clear that their tightening is having the desired effect. We don't expect cuts anytime soon, barring an outright recession, but believe the economy may be strong enough to handle a longer than normal period of "pausing" for rates.
3. Our most accurate prediction was that value stocks would continue to outpace growth stocks, and the charts of most of the "nonsense" stocks with huge multiples of sales, and no hope of realized earnings to match, would resemble those of the cannabis stocks – now left for dead following their peak a few years ago. We believe this is set to continue, with value stocks still trading at attractive relative levels, especially in the context of much improved balance sheets versus prior recession periods. Typically, after a bubble for growth stocks, it takes many years for speculative spirits to return to the sectors that were the former leaders, and we don't expect this time will be different.
4. We think that the global economy will avoid an outright recession despite the rapid increase in rates, as strong balance sheets for both consumers and businesses give them room to deal with the pressure of higher yields. As it becomes clear that inflation is receding nearly as fast as it rose, the Fed will guide to financial conditions being balanced, and the most cyclical parts of the market will reset higher in anticipation of renewed economic growth.
5. We were finally right about Canada outperforming the U.S., and we expect the same for 2023 as the drivers of that prediction – continued underinvestment in resource sectors and an attractive relative valuations. The world remains short traditional energy and materials, especially as it moves to electrify the economy, and ESG policies will continue to contribute to localized energy shortages as the speed of implementing renewables won't keep up with demand for traditional sources.
6. Lastly, we think 2023 will see the return of the 60/40 model, with bonds poised to offer some of their best returns in years. We think duration in the form of flight-to-safety U.S. long bonds will once again prove to be an effective tool to hedge equity and credit risk, especially if we are wrong about our recession prediction and the Fed ultimately is forced to cut rates.

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.

All in all, we stay the course, and remain as focused as ever on following our risk process and avoiding emotional decisions that can be so detrimental to long-term returns. We thank you as always for continuing to trust us with your investment dollars.

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Fund Specific Commentary

Summary of Returns (F-Class unless otherwise denoted):

Fund	1M	3M	YTD	1YR	3YR	Inception
Defensive/Conservative Funds:						
EHP Foundation Alternative Fund	-0.4%	3.9%	-6.1%	-6.1%	2.2%	2.8%
EHP Foundation International Alternative Fund	0.3%	1.1%	-7.3%	-7.3%	-1.3%	1.0%
EHP Global Arbitrage Alternative Fund	0.7%	2.8%	-7.3%	-7.3%	2.4%	5.4%
EHP Strategic Income Alternative Fund	0.2%	3.2%	-1.5%	-1.5%		0.9%
Core/Moderate Funds:						
EHP Advantage Alternative Fund	-2.0%	4.2%	-8.1%	-8.1%	4.3%	4.0%
EHP Advantage International Alternative Fund	-1.0%	2.2%	-12.8%	-12.8%	-1.1%	0.5%
EHP Select Alternative Fund	-2.6%	6.2%	-19.2%	-19.2	8.4%	6.3%
EHP Global Multi-Strategy Alternative Fund[1]	-1.2%	4.0%	-11.5%	-11.5%		0.5%
Specialty Funds:						
EHP Multi-Asset Absolute Return Alt. Fund[1]	-2.3%	-3.1%	7.3%	7.3%		8.3%
EHP Global ESG Leaders Alternative Fund*	NAV as of December 30th: $9.9953 (net of $0.29 distribution)					

*Returns are available after 1 year of track record as per National Instrument 81-102

Defensive / Conservative Funds

<u>EHP Foundation Alternative Fund</u>

The Fund was up 3.9% over the quarter, with gains in both Canada and the U.S., as markets rebounded from their September lows. Shorts were much better behaved despite the overall market strength as it appears that the desired for investors to buy the dip in low quality stocks has waned. The Fund entered Q4 “risk off”, but added some exposure in November as the market rally was strong enough to have our process rise above risk levels in both the U.S. and Canada. Currently, markets are once again at risk of resuming their downtrends for both equities and bonds, and prices are close to breaching key risk levels. Persistent whipsaw has been one of our key challenges this year, although we have been better able to deal with it in recent quarters, improving our performance.

Our Credit Momentum strategy had small gains over the quarter as the high yield market recovered from its September lows. While the strength could prove fleeting, it’s an encouraging sign that a credit crisis appears for now to be mitigated by strong corporate balance sheets. As of the end of Q4, the credit allocation sits in high yield bonds. Importantly, we anticipate that in the event markets do start to discount a full-blown recession, the long end of the treasury curve will once again offer a source of tactical protection.

Merger arb strategies had modest gains during the quarter as well as a number of the SPACs we hold were redeemed for cash, and a number of vanilla arbitrage deals closed. Arb spreads ended the quarter at an average of ~10% annualized.

From a sector perspective, the Fund has moderate net exposure to high dividend paying stocks in communication services, materials and industrials, while underweight staples, utilities and consumer discretionary where yields are lower or less sustainable. The Fund enters the new year with markets mixed in terms of risk, and with an estimated beta to equity markets of approximately 0.2.

EHP Foundation International Alternative Fund

The Fund was up 1.1% over the quarter, with small gains across sub-strategies earlier in the period before moving the portfolio to cash. Given the small size of the Fund and the ability of our other funds to offer similar return profiles, we opted to close the Fund at the end of the year. We are always sensitive to the expense burden to unitholders for any of our funds, and will continually review our fund line-up in that context.

EHP Global Arbitrage Alternative Fund

The Fund was up 2.8% over the quarter in what was a partial recovery after a difficult year. Gains came from merger arb spreads tightening from ~13% to ~10% annualized at the end of the quarter, as well from SPACs that opted to liquidate early and return cash to shareholders. Our portfolio of SPAC warrants, which have driven an outsized portion of our losses this year, has finally appeared to find its low as tax-loss selling drove them to pennies, suggesting investors are now giving virtually no value to their optionality value. It was a difficult year for Arbitrage overall, with the S&P Merger Arbitrage Total Return Index falling -4.2% in 2022. Among the challenges this year has been deal delays caused by a marked increase in regulatory reviews and challenges by a very aggressive FTC. The challenge for our process is that given we “time out” our deals after 6 months to avoid the higher probability of deal breaks that comes with delays, it means we are often selling a deal at a similar spread as to where we bought it, never crystalizing the potential gain. The process does protect downside though, as the failed Rogers Corp (ROG) deal showed. We timed out of that deal in April for a small loss, avoiding the massive 55% decline when Dupont abandoned the deal.

The Fund participated in 62 traditional arbitrage opportunities, and holds 29 positions as of the end of the year. SPACs now account for approximately 19% of the Fund, represented by 168 positions. The traditional merger market has slowed vs. its pace last year, but remains relatively healthy with more than enough attractive opportunities to invest in. Deal timelines remain stretched as competitive reviews are more common under the Biden administration and taking longer to complete, and in general we’ve been avoiding deals with such risk, particularly given that downside risk increases in the event of a break during volatile markets. The outlook for deal flow is hard to handicap, in particular because the risk of the high yield bond market becoming stressed in a recession scenario would likely slow the pace of private equity deals which typically rely on levered financing. The market is concerned about a growth slowdown, which would further pressure deal flow if it comes to pass, although typically even during recessionary periods there can be adequate deal flow priced with wide spreads to maintain an attractive overall return. Rising interest rates tend to be a benefit for merger arb in that new deal spreads reflect the higher yields immediately, increasing notional returns on these mergers. Given that mergers tend to be completed in 3-6 months, the strategy is akin to a “floating rate” note that adjusts quickly to the current yield environment.

EHP Strategic Income Alternative Fund

The Fund was up 3.2% for the quarter, posting positive returns in each of the three months. U.S. 10-year traded in a range between 3.4% and 4.2%, but ended the quarter close to where it started, and the quarter’s returns came primarily from credit spreads tightening. All three main sub-strategies (core long-short credit, credit momentum and arbitrage) had positive contributions to the performance in the quarter.

During Q4, the Bloomberg Barclays US Aggregate Bond Index was up 1.9%, while the Bloomberg Barclays US Corporate High Yield Bond Index was up 4.3%. Within high yield, the lowest quality credits lagged, with CCC up 1.2%, while B and BB credits were up 4.3%. Fourth-quarter US high yield issuance continued to be subdued, with bond sales just over $14bn, bringing the year-to-date issuance to $101b, the lowest since 2008. Spreads of investment grade corporate

bonds ended the quarter at 130 basis points over Treasuries, 28 basis points tighter than the end of Q3. The risk premium on high-yield debt ended the quarter at 469 basis points, which was 83 basis points tighter than at the end of Q3.

High yield spreads remain in the wider half of their historic range (most of the time high yield spreads trade in the 300-400 basis points range) and with the all-in yields at 9%, high yield should provide attractive returns from here.

We continued to run our disciplined portfolio management process in Q4 albeit at a lower turnover rate given the wider spreads and implied trading costs. The Fund was appropriately positioned coming into this environment, as our process is designed to allow us the luxury of not being forced to trade in erratic markets and position the portfolio when the trading costs are low.

We enter Q1 of 2023 with credit risk in the middle of its range, with duration at 2.5, and net yield of 5.8% (including the estimated yield from SPACs). The Fund's largest sector exposure Is financials, followed closely by energy. We are neutral on telcos, health care and technology sectors, while consumer discretionary remain a net short for the Fund.

Core / Moderate Funds

EHP Advantage Alternative Fund

The Fund was up 4.2% over the quarter with gains in both Canada and the U.S., as markets rebounded from their September lows. Shorts were much better behaved despite the overall market strength as it appears that the desired for investors to buy the dip in low quality stocks has waned. The Fund entered Q4 "risk off", but added some exposure in November as the market rally was strong enough to have our process rise above risk levels in both the U.S. and Canada. Currently, markets are once again at risk of resuming their downtrends for both equities and bonds, and prices are close to breaching key risk levels. Persistent whipsaw has been one of our key challenges this year, although we have been better able to deal with it in recent quarters, improving our performance.

Our Credit Momentum strategy had small gains over the quarter as the high yield market recovered from its September lows. While the strength could prove fleeting, it's an encouraging sign that a credit crisis appears for now to be mitigated by strong corporate balance sheets. As of the end of Q4, the credit allocation sits in high yield bonds. Importantly, we anticipate that in the event markets do start to discount a full-blown recession, the long end of the treasury curve will once again offer a source of tactical protection.

Merger arb strategies had modest gains during the quarter as well as a number of the SPACs we hold were redeemed for cash, and a number of vanilla arbitrage deals closed. Arb spreads ended the quarter at an average of ~10% annualized.

From a sector perspective, the Fund remains exposed to cheap cyclicals that benefit from inflation in energy, materials and financial sectors, balanced by exposure in less cheap but defensive consumer staples. We remain outright short more expensive bond proxy utility and REIT sectors. The Fund enters the new year with markets mixed in terms of risk, and with an estimated beta to equity markets of approximately 0.5.

EHP Advantage International Alternative Fund

The Fund was up 2.2% over the quarter with gains in Europe and the U.K., and small losses in Japan and Australia. In contrast to our North American funds, international shorts were a source of pain during the quarter, holding back returns as markets rallied from their September lows. The Fund entered Q4 "risk off", but added exposure in November as the market rally was strong enough to have our process rise above risk levels in most markets. Currently, markets are once again at risk of resuming their downtrends for both equities and bonds, and prices are close to breaching key risk

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From a sector perspective, the Fund remains exposed to cheap cyclicals that benefit from inflation in financial, materials and industrials, balanced by exposure in less cheap but more defensive consumer staples. We remain underweight still expensive technology stocks, and outright short REITs. The Fund enters the new year with most international markets "risk on" with the exception of Japan, and with an estimated beta to equity markets of approximately 0.6.

EHP Select Alternative Fund

The Fund was up 6.2% over the quarter as markets recovered from their September lows. Long positions in more cyclical value stocks were the driver of gains, while shorts were much better behaved during the quarter despite the market rally, as it appears the willingness of investors to continually "buy the dip" in lower quality, unprofitable businesses have waned. The Fund entered the quarter "risk off", but added some exposure in November as the market rally was strong enough to have our process rise above risk levels in Canada. Ultimately, markets are once again at risk of resuming their downtrends with indices hovering at levels that will define whether we reduce or add exposure from here. Persistent whipsaw has been one of our key challenges this year, although we have been better able to deal with it in recent quarters, improving our performance.

The Fund is biased to buying higher quality, cheaper stocks, and on that measure the portfolio is holding very cheap companies overall, with our average long position at 8x earnings, 5x cash flow and with an ROE of 32%. Importantly, those same longs carry average net debt to EBITDA of only 1.3x, dramatically reducing their cyclical risk vs prior slowdowns. Our shorts on the other hand carry net debt to EBITDA of 7.1x on average. The Fund is well positioned for a cyclical recovery, with exposure in materials, energy and industrials, while avoiding still expensive technology stocks. We remain short utilities where increased funding costs are likely to compress future earnings.

EHP Global Multi-Strategy Alternative Fund

The Fund was up 4.0% for the quarter. As a "fund of funds", the Fund holds interests in a number of our EHP alternative mutual funds, with a tactical approach to rotating assets to more defensive strategies as markets become more volatile, and our risk triggers are hit. The Fund entered Q4 near the lower end of our risk ranges, with a blend of strategies reflecting a mix of "risk-on" and "risk-off" markets globally, but subsequently added back some exposure as markets recovered from their September lows. We enter 2023 with the underlying funds mixed in terms of risk exposure, waiting for a clearly signal of market direction from the noise of repetitive whipsaw. Credit allocations are showing signs of strength with the underlying funds allocated to high yield bonds where yields are very attractive in the context of historically strong balance sheets.

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Specialty Funds

EHP Multi-Asset Absolute Return Alternative Fund

The Fund was down 3.1% over the quarter, with losses coming primarily from relative value and volatility strategies, while trend was flat. The Fund finished the year up 7.3%, adding value as a source of "crisis alpha" and a hedge against traditional 60/40 portfolios.

In commodities, performance was negative for relative value and volatility while trend was flat. In equities, trend was a positive contributor for the quarter, while repetitive whipsaws in volatility strategies lead to negative performance. In currencies, relative value was a positive contributor to performance while trend was negative. In fixed income, we continued to benefit from relative value while trend was flat.

Heading into 2023, we are well positioned to continue to provide an active hedge against volatile environments caused by inflation or recession and diversifying absolute returns to replace equity and bonds in a portfolio. Equity positioning is currently low, and we are ready to take advantage of either a continued high volatility environment or a shift towards stability. Current positioning in bonds, based on trend and relative value, is biased short with a relative preference for higher yielding Australian bonds versus Canadian and US bonds. In currencies we favour the value and trend of GBP and JPY versus AUD and CAD. Commodity trend and relative value currently favour the long end of curves over short, with relative value positioning providing continued active inflation protection, with long positions in energies and agricultural commodities and some shorts in industrial metals. As always, the Fund will actively adapt positioning to changes in markets and volatility that will inevitably come with developments regarding supply, demand, inflation, central banks, COVID, geopolitical tensions and otherwise.

EHP Global ESG Leaders Alternative Fund

The Fund launched February 1, 2022 with a NAV per Class F unit of $10.00 and finished the quarter with a NAV per Class F unit of $10.00 (net of a 29c distribution). As per National Instrument 81-102 regulations, return calculations can only be shown after one year of track record.

The Fund's objective is to select longs from a universe of global stocks that are considered "ESG leaders" in their sectors as defined by MSCI. From this universe of ~700 global companies, we apply our time-tested approach of buying those that score well on value/quality, momentum, and low volatility measures. Our shorts comprise global stocks that are expensive, declining and volatile, and excludes any company considered an ESG leader as defined by MSCI. More details on MSCI's methodology can be found here:

https://www.msci.com/eqb/methodology/meth_docs/MSCI_ESG_Leaders_Methodology_Nov2020.pdf

The Fund has benefitted from a simplified risk model that uses the MSCI World Index as its primary risk indicator. We've had the good fortune of avoiding the whipsaw that has plagued our other equity funds this year, as well as from owning high-scoring ESG companies carrying a defensive tilt, meaning a lower overall fund beta than our non-ESG funds that have had exposure to more volatile energy and materials sectors.

The Fund enters Q1 in a risk-on position, and with its highest exposures to defensive staples, and reasonably priced, high quality, high ESG scoring companies in healthcare, financials, and staples. We are avoiding expensive technology sectors, and are sightly net short utilities and real estate.

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Disclaimers

Returns are for "F" class units 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 and return data and statistics if not otherwise referenced: data: Bloomberg.

[1]The EHP Global Multi-Strategy Alternative Fund (formerly the EHP Global Multi-Strategy Fund) (the "GMS Fund") was not a reporting issuer during the period of December 28, 2020, to December 31, 2021 (the "GMS Relief Period").The EHP Multi-Asset Absolute Return Alternative Fund (formerly the EHP Multi-Asset Absolute Return Fund)(the "MAAR Fund") was not a reporting issuer during the period of November 1, 2021, to August 1, 2022 (the "MAAR Relief Period"). EHP Funds, the manager of both the GMS Fund and MAAR Fund, obtained exemptive relief on behalf of each such Fund to permit the disclosure of performance data of the units of the applicable Fund relating to the respective GMS Relief Period and MAAR Relief Period, prior to which each such Fund was not a reporting issuer. On January 1, 2022, the GMS Fund and on August 2, 2022, the MAAR Fund each became a reporting issuer. While the manager reduced, as of January 1, 2022, and August 2, 2022, where applicable, both the management fee rate (from 2% to 1.9% for Class A and Class UA units and from 1% to 0.9% for Class F and Class UF units) and the performance fee rate (from 20% to 15% for Class A, UA, F and UF units) for the applicable class of units of the applicable Fund, the other operating expenses of each Fund would have been higher during the respective GMS Relief Period and MAAR Relief Period that each Fund was not a reporting issuer due to the additional regulatory requirements applicable to a reporting issuer This material has been published by EHP Funds. It is provided as a general source of information, is subject to change without notification and should not be construed as investment advice. This material should not be relied upon for any investment decision and is not a recommendation, solicitation or offering of any security in any jurisdiction. The information contained in this material has been obtained from sources believed reliable.

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Commissions, trailing commissions, management fees, performance fees and expenses all may be associated with mutual fund investments. Please read the prospectus or offering memorandum, where applicable, 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 Inc. 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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