JEMEKK
TOTAL RETURN FUND L.P.

Q3 2017 COMMENTARY

Gerard Ferguson CFA
CEO, Portfolio Manager

Rick Ummat, CFA
Portfolio Manager

The TSX reversed its weak trend from Q2 and printed an impressive 3.7% for the quarter. As for US markets, the S&P 500 continued its torrid pace posting a 4.5% quarter now up over 14% on the year. The Jemekk Total Return Fund although still having a positive quarter was unable to keep pace with the momentum of its benchmarks and as such was up only 1.7% on the quarter. While we are not pleased with underperforming our relative benchmarks for the quarter, we point to our year to date returns being a more accurate picture of our performance. The strong gains for the TSX were led by Energy and for the S&P 500 it was both Technology and Energy.

Below is a statistical representation of the Fund to comparative benchmarks in Q3:

	Q3 2017	YTD 2017	SINCE INCEPTION
Total Return Fund	1.67%	9.75%	93.99%
S&P/TSX Composite	3.68%	4.45%	55.22%
S&P 500 (USD Return)	4.48%	14.24%	134.05%

Benchmarks are quoted in Total Returns

The Energy sector fueled the rebound in the markets in the third quarter. The move in the USD along with positive oil data in September helped crude return to bull market territory and lifted stocks in the sector, from oversold territory. We should mention Consumer Discretionary also added to the strong gains from the TSX where major detractors were the more defensive Health Care and Consumer Staples sectors. Down south, in addition to Energy, Technology stocks continued to be bid up even after brief hiccups in September as shares of semiconductor companies fared best. The US markets also showed more breadth in returns as only one sector, Consumer Staples, posted a negative quarter. A common theme all year is how resilient the US markets have been despite all the political rhetoric. The third quarter continued the strong growth exhibited in the second quarter. We are surprised at how the major US indices continue to push all-time highs. The geopolitical risks we have mentioned in past letters do not seem to be abating, but are in fact increasing in frequency. This quarter we are seeing more talk of a potential war where NK leaders and the Trump Administration are using Twitter as a battle ground. This is highly concerning as threats of a possible nuclear war are being discussed alongside the latest Kardashian tweet. Another material event exposed in the quarter was the alleged involvement of Russia influencing/spreading 'fake news' on Facebook for its own political agenda. With two billion people on Facebook worldwide, the venue is not only massive but also the dissemination of said 'fake news' is instant. Facebook is now in front of this and working to control the matter. Continuing with tech stocks we wanted to mention the growing risk of Amazon taking over the world. In Q3 we saw AMZN buy Whole Foods, which was a surprise announcement at first but as the market digested the news the street switched from 'why would they do this?' to 'why wouldn't they do this?'. Our take, we are very bullish on e-commerce and have owned AMZN before and will most likely own it again. The disruption witnessed from AMZN is like no other. What's interesting is how post the Whole Foods deal every industry is now on defence looking to not becoming 'Amazoned.' We too had to audit our list of holdings to see which industries could be displaced by this juggernaut.

Switching to the political front – all eyes are on the Trump Administration to put forward its new Tax Reform Policy. Although the market is leaning towards a favorable outcome we are less optimistic judging by his track record of execution. So, the next time we report to you in early January we will be discussing Q4 and will have an answer to whether the Trump Administration has made a meaningful push to papering up his new policy.

Specific to the Fund, we entered the quarter 60% net long and finished at 75%. However, as we entered September exposures got as low as 45% mostly by adding to our short book. We felt this was prudent to do as September

has been a highly volatile month and felt the geopolitical events occurring coupled with the US markets at all time highs suggested caution. This ultimately proved to be overly conservative and led to the Fund missing most of the September move. As mentioned, both the US and Canada posted strong quarters but almost all the performance for the TSX was in September led by the aformentioned move in Energy. Gains from our Technology and Consumer Cyclical book helped but the Fund was not positioned to capture the strong move in the market.

Last quarter we introduced Activision Blizzard (ATVI) to you highlighting our positive stance on the gaming industry and how ATVI, from our analysis, was positioned best to benefit. When we first worked on this sector we looked at it as a competitive environment where other gaming publishers sought to steal market share from others – we were somewhat wrong. This isn't an entirely zero sum 'game' if you will. Since adding ATVI to the Fund, we have continued to do work on the industry and found gamers are loyal to their favorite games and all major players in this industry are experiencing a secular growth theme. In other words, each gaming company does have some overlap on its offerings but for the most part offer a unique product exclusive to that brand.

Why do we want more exposure to the gaming industry? From our analysis, the gaming industry has changed dramatically over the past decade. What was once lumpy business models with low predictability of cash flows entirely tethered to the success of one launch has transitioned to foreseeable, high margin, cash generative growth stories with more diversified business models less dependent on hardware sales. We believe the key drivers of this change are but not limited to the following: (1) sustained player engagement; (2) shift from hardware to digital consumption; (3) subscription based model lending to more predictable cash flows; and (4) model diversification as seen by the gaming co's entering the movie space.

What about growth and valuation? We believe we are at the middle stages of growth and earnings should drive the next move in the group. As for valuation, on a year to date basis the gaming complex is up 2.5x that of the Internet names. Despite this outperformance the sector is trading at 23x 2018 EPS and forecasted EPS growth for the next three years is 26% annually. So, on a growth adjusted basis, valuation for the group still appears compelling. Furthermore, we feel gaming stocks are still relatively underowned and as investors become more aware of these companies the stocks could have another leg up.

Given our positive macro view for gaming stocks we decided to add **Electronic Arts (EA)** to the portfolio as well. Why do we like EA? When we first looked at the company we knew it was largely known for its strong sports franchises and gave little credit to its other games. We have now learned the sports franchises are gaining meaningful momentum in the e-sports arena and the company's non-sports games are highly coveted. One hotly anticipated game is Star Wars Battlefront 2, which is expected to do very well. Along with favorable industry dynamics highlighted above that should benefit both ATVI and EA, specific reasons why we chose EA are as follows: (1) strong margin expansion for EA from 32% to over 40% as the shift to digital continues; (2) valuation discount abating for EA as historically the company was valued lower because it licensed its IP but now EA is establishing Battlefield as a tier one franchise focused on live service engagement and EA has two other potential franchises on the way which we feel are being overlooked; (3) strong balance sheet with cash on hand of $4.5b and cash flowing $1b a year provides ample dry powder for buybacks or acquisitions.

We are bullish on the gaming industry and see material upside to the group going forward. This is not a sector where one company can take all. We like the cash flow predictability and margin upside along with both ATVI and EA aiming to be the major players in e-sports, a topic we discussed with you last quarter. As mentioned previously about all industries put on watch by Amazon going after Whole Foods, we are confident the gaming group is safe from becoming *Amazoned* rather AMZN has made investments to partner with these incumbents.

The fourth quarter has begun where the third left off, moving higher. Against the backdrop of rising valuations, economic data has continued to surprise to the upside as evidenced by the strong PMI numbers. With the S&P 500 trading at reasonable levels, things look relatively stable. Earnings are expected to increase double digits and should provide the next catalyst for higher equity prices, a healthy move in bull markets. For the balance of the year we see the TSX outperforming its US comps as the valuation spread seems too high to us and some of the later cycle sectors that dominate Canada begin to contribute. However, we remain cautious, as always, as macro crises and volatility remain visible in the horizon. Thank you for your continued support. *As always, if you have any questions or concerns please feel free to contact us directly. We look forward to reporting to you at the end of Q4 2017.*

Gerard Ferguson: +1.416.777.4491
Rick Ummat: +1.416.777.4496