JEMEKK TOTAL RETURN FUND L.P.

Inception date: April 2008

Q3 2018 Commentary

	Q3 2018	YTD 2018	Since Inception
Jemekk Total Return Fund	0.63%	5.55%	105.83%
S&P TSX Composite	-0.57%	1.36%	64.34%
S&P 500	7.71%	10.56%	175.97%

* Benchmarks quoted in Total Returns

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North American markets delivered a mixed bag with respect to performance. Specifically, the TSX was down 57 basis points while all major US indexes were positive and the S&P 500 posting an impressive 7.7% quarter. We are pleased the Total Return Fund posted another positive quarter continuing its trend all year. Although the Fund is not keeping pace with US markets we are happy with its outperformance versus the TSX. We will discuss the disconnect between how the US markets are behaving in the face of material macro and geopolitical risk and how the Total Return Fund continues to outperform the TSX.

What seemed like an uneventful quarter from the TSX only being down 57 basis points yet there was a lot going on within the index. Meaning, the cannabis related names which are classified as Health Care increased that sub-index by 31% for the quarter and the Materials sub-index posted a terrible quarter down 13% as gold stocks underperformed materially. Three of the ten largest contributors to the TSX in Q3 were cannabis stocks. The cause for the spike in weed stocks was largely due to a $5b investment from Constellation Brands into Canopy Growth in Q3 further signaling to the market the global opportunity from the legalization of cannabis. This was the second cash injection from Constellation and as holders of the stock it took us time to get our arms around the initial investment last year however after the second tranche we decided to sell our position in Constellation as we believe the risk profile is no longer congruent with the Fund's parameters. We applaud management for taking risks and investing into a new growth vertical but after a 50% increase in the stock we are happy to exit the position and watch how this new industry emerges.

Despite material risks that could shake the markets, all three major US indices began Q4 near record highs. The market continues to be split into two camps but the bulls continue to prevail.

That said, at the time of writing the spike in the 10 year has taken center stage as higher multiple growth stocks sold off – a similar picture as in January of this year. We have seen quick rotations before and need to determine - is the flight from stocks to bonds and from growth to value going to be the new norm, or are we in the midst of another opportunity to buy growth stocks? The US has yet to settle its trade disputes with China and in September we saw Trump announce a third round of Chinese tariffs. We don't see the market pricing in this risk accurately. Specifically, we have seen individual stocks particularly in auto and semiconductor makers sell off but only a marginal impact to the broader markets. For example, the Dow Jones home to the largest multinationals thereby being the most sensitive to trade wars was up a staggering 9% in the quarter beating the other major US indexes. This is concerning. Along with escalating trade wars, in the coming months the US will have its midterm elections and the market is expecting another rate hike in December. But more importantly in the near term the interest rate risk to equities should not be ignored. However, there are several reasons to remain positive on US markets - we are still witnessing robust corporate earnings, economy is at full employment, and consumer confidence remains high. The general economic backdrop looks healthy and there are no near term warning signals a recession is on the near horizon.

The Fund entered the quarter 78% net long and became more defensive as the quarter unfolded exiting Q3 65% net long. Even with these exposures the Fund was able to outperform the TSX albeit by a modest margin. However, the Fund was unable to keep pace with the red hot US indices. Notable contributors to Q3 performance for the Fund were Parkland Fuel and Hydropothecary whereas detractors were The Stars Group and Aurora Cannabis (short). Overall, we are pleased with how the Fund is performing year to date given its risk profile.

Last quarter we introduced two stocks in the beauty space playing off our bullish theme on Millennials - Ulta Beauty and Estee Lauder Companies. We have since exited both positions resulting in gains from both stocks and will look to re-establish when valuations are more compelling. That said, we would like to introduce you to another holding we believe is capturing the Millennial theme:

VF Corp (VFC) – owners of globally popular brands such as Vans and The North Face, VF Corp, in our view, remains an underappreciated platform model with expertise in growing active and lifestyle brands. Along with the brands mentioned, VFC also owns Timberland, JanSport and a sizeable jean portfolio including brands such as Wrangler and Lee. In total, VFC owns 24 brands sold globally and we feel the company has several "shots on net" and Vans in particular still has room to grow especially with the Millennial cohort. The management team at VFC is top notch and known for their brilliant M&A ability on both acquiring and divesting of brands at opportune times. Further M&A is part of the investment thesis and presents optionality in the stock that is not currently priced in. The company generates approx. $1.5b in operating cash flow with capex needs of approx. $250mm resulting in ~$1.25b in free cash flow which we expect will be used for further dividend increases (current yield 2%), share buybacks, and further M&A.

There are several brands in the VFC portfolio to be bullish about but we wanted to highlight Vans, which is its largest brand by revenues and growing at 30%. There is no question the current stock price has appreciated on the back of the success of Vans but we see the momentum continuing and still not fully valued at these levels. Vans is a $3b brand with powerful and sustainable growth built on brilliant brand positioning and marketing. Vans is by no means a new brand. It has been around for decades but is experiencing a resurgence ever since VFC acquired it in 2004, which is a testament to the management team. Vans is experiencing growth globally fueled by marketing collaborations with everyone from Spongebob Squarepants to Marvel to even the ultra-exclusive hot streetwear brand Supreme. Vans has deep roots in surfing and skating and continues to invest heavily being a de facto brand engrained in this culture. VFC hosted an investor day in September and we come away even more bullish on Vans. VFC guides to Vans reaching $5b by FY23, which we think is beatable, but what excites us most is the profitability generated. Vans has an EBIT margin in the low 20s% and gross margin of over 60%.

If the $5b is achieved, Vans alone will contribute double digit EPS growth over the next five years. There is a lot riding on the success of Vans which makes execution of this brand a material risk. Vans contributed to almost half the EPS in FY18 so if momentum slows this will have an adverse impact to our thesis – we are monitoring this carefully.

As we look to the last three months of the year there is a lot that can derail the market. We are constantly looking for the 'event' that will cause a correction and yes you can name a few macro or geopolitical risks but what if the risk to the market is the market itself? What does this mean? Well, this past quarter marked the longest recovery in history for the market and as focus shifts back to fundamentals and Q3 earnings begin in a couple weeks investors will be focused more than ever on the quality of earnings released along with guidance. This market has continued to ignore market headwinds such as: Fed continuing its tightening cycle, flattening yield curve, trade wars, upcoming midterm elections, peak margins, and bloated corporate balance sheets. Despite this laundry list of concerns the US markets entered Q4 at near record highs primarily on the back of strong corporate earnings. So, what we are saying is, as long as companies continue to deliver strong quality beats the market should grind higher, albeit at a slower pace, however when these earnings begin to slow, and revisions abate, this could be problematic for equities as a whole. We are already seeing some rotation occurring but we are keeping a close eye on corporate projections and consumer confidence.

Thank you for your continued support and we look forward to reporting to you at the end of the fourth quarter 2018.

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