JEMEKK LONG/SHORT FUND L.P.

Inception date: July 2004

Q4 2018 Commentary

	Q4 2018	YTD 2018	Since Inception
Jemekk Long/Short Fund	-10.09%	-3.59%	204.20%
S&P TSX Composite	-10.11%	-8.89%	150.55%
S&P/TSX Small Cap Index	-14.38%	-18.17%	37.56%

* Benchmarks quoted in Total Returns

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No other way to say it, Q4 was tough. Fear became the dominant sentiment in the quarter. Who knew five words from Fed Chair Jerome Powell could cause such a violent reaction in the markets when he said rates are 'a long way from neutral.' The Long/Short Fund suffered alongside with its benchmarks. Specifically, in tandem with the TSX but beat out the Small Cap Index by over 400 basis points. However, on the year, the Fund beat its benchmarks by a wide margin, but we are still disappointed, so not taking any victory laps. We will discuss Fund specifics and our outlook for the new year below.

A common theme in our commentaries for the past couple years was the amount of complacency in the markets in the face of material adverse risks. Well, that all came to a screeching halt in early October when the 10-year spiked and caused a precipitous drop in global markets. In other words, volatility is back. The TSX fell almost 17% from its July peak. For the quarter, the Staples sub-sector was the only bright spot within the TSX and six of the eleven sectors were down double digits. Health Care was the biggest laggard due to its marijuana related names. On the year, Technology was the best performing sector by a wide margin (+13%), primarily from Shopify which printed a 50% return (the Fund is still long SHOP). On the other end, Energy was the clear detractor being down almost 20% for the year. The TSX Small Cap Index had a terrible quarter and year with no single sub-sector up in either the quarter or year. Again, Energy was one of the main culprits being down 34% on the year. Crude posted its worst quarter since 2014 as the oil market was engulfed by fears of a slowdown in global growth as concerns build that the combination of falling demand and increased output will lead to a glut of oil in the market. In December Alberta announced a temporary oil production cut in an effort to control the widening differentials, which has materially impacted Canada. The Premier says if they don't see the results they want deeper cuts could be made this year.

To us, this seems like temporary reprieve only and the involvement of the government usually is not a good sign. Sentiment remains negative as both global and domestic concerns continue to weigh on Canadian markets. Unless we see a global recession, we believe Canadian stocks have already priced in significant earnings deceleration. The TSX, trading at 14x PE, hasn't been at these levels since 2011. In other words, valuations in Canada are not only looking attractive compared to past multiples but also compared to its US counterpart indices. However, we acknowledge the valuations are more depressed in Canada than the US due to the resource sectors, and structural issues like tax reform, and without material catalysts this relationship could continue.

US markets experienced a significant correction in Q4. Specifically, the S&P 500 was down 19.8% from peak to trough and posted its worst December (-9.2%) since 1931, even after a strong move in the last few days, post tax loss selling. Volatility is unlikely to diminish given the shape of the yield curve and ongoing trade disputes (specifically China). The market is clearly bifurcated. From our analysis there is a widening divergence in views on the prospect for 2019. A flattening yield curve is indicative of increased volatility, and potential recession, which partially explains recent market swings and suggests the pattern will continue in the near term. Layer on the escalation of trade wars, elevated multiples for the market and global growth slowing are all ingredients for a market selloff. But fundamentals do not suggest such a dire market. For instance, the inflation outlook looks subdued, yield curve remains positive, and earnings (albeit down year over year) are still strong - earnings for the S&P is estimated to be up 6.5% this year, still a solid number on a long-term basis. Overall, we believe its healthy for the market to react to a potentially negative outlook but what is unsettling is the speed in which it occurs. The pendulum for the market seems to be swinging too far each way meaning the sell offs are extreme followed by overcorrecting, hence a heightened volatility environment.

The market is keenly focused on Fed announcements and the Fed is acknowledging they cannot ignore financial markets as shown by their much more dovish tone as of late. The positive take-away from this is the Fed's focus on market moves/volatility in the market has created a "Powell Put" providing downside support.

The Fund started Q4 75% net long but once we recognized the selloff, which began the first week of October, had teeth we began raising cash and adding to our short book. We exited Q4 with a 45% net long position. At the time we thought we acted quickly but clearly not quickly enough. The Fund was down in line with the TSX and some of our larger positions weighed materially on the overall performance. It was a very challenging quarter to say the least and although never pleased with printing negative performance we worked hard to preserve capital on a relative basis and continue to work diligently to find the best risk/reward opportunities. In the fourth quarter main contributors to performance came from our Index shorts and our single name shorts while the detractors were Brookfield Business Partners and Hexo. For the year, top performers were Cannabis Strategies Acquisition Corp., Parkland Fuel and Shopify; while Stelco and Cobalt 27 accounted for the losses. In our Q2 letter we mentioned we have been finding new small cap stocks in Canada and have built positions in a handful of names that meet our criteria for compelling ideas. In our Q3 letter we highlighted Quantum International Income Corp. (QIC), which we still hold and remain committed to. We would like to introduce to you the second installment of 'Small Cap Corner':

Sangoma Technologies Corp. (STC) - a global provider of on premise and cloud-based solutions, Sangoma's unified communication (UC) system is sold to carriers, small-medium businesses as well as original equipment manufacturers. UC describes a broad range of technologies and applications that act as a communication platform to optimize business productivity. Examples include automated answering services, VOIP, video conferencing and document collaboration to name a few. Over the past few years STC has transformed both organically and inorganically to a company that will generate $100mm in sales in FY19. Big number for a Venture listed company (for now) with a $65mm market capitalization. Sangoma has completed seven acquisitions in the past seven years which we believe provides STC with the scope and scale to compete in the rapidly evolving UC industry.

Sangoma has a strong management team demonstrated by successfully diversifying from a one product offering to a multi-solution global company. To us, STC made a game changing acquisition in August of last year and we were confused of how the market reacted. The stock was down after STC agreed to acquire Digium, a top player in open sourced communications, for $28mm USD (1x Sales). The pushback was Digium is EBITDA flat but to us we see a tremendous opportunity for the tier one management team at STC to drive significant revenue and cost synergies all the while removing a competitor from the market. We are confident this deal will unlock shareholder value and when speaking to management it sounds as if everything is on track with the integration. We acknowledge the risks of STC such as its small cap status/liquidity, competition but these things are overshadowed by a stock trading at 5.5x FY2020 EBITDA, 10% FCF yield with a laser focused CEO who has a stellar track record of executing on M&A and realizing synergies.

The fourth quarter was a challenging one but has brought the market down to more attractive levels. At the time of writing the market has bounced off its lows as the Fed has signaled it will take a more cautious path on future interest rate hikes. We are not materially increasing exposures at this time (as we feel the market could take another leg lower and retest its prior lows) but being selective and adding to both our long and short book. Overall, we are constructive on markets given current multiples and earnings outlook. As we approach earnings season in the coming weeks, we will be focused on management commentary for their outlook for the year. We expect volatility as we believe management will have cautious language even going as far as cutting guidance to set the bar low, as is typical in Q1. Fundamentals remain strong and the market is pricing in a lot of the known risks. Meaning, if we see US-China trade disputes being resolved this could be a major positive catalyst for the markets. However, the timing of this is unclear and could take several more months. The tactics of the Trump Administration are beginning to have a toll on stocks and as portfolio managers we have to account for political risk to enter financial markets which adds another layer of volatility to manage, and warrants caution short-term.

Thank you for your continued support and we look forward to reporting to you at the end of the first quarter 2019.

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