JEMEKK TOTAL RETURN FUND L.P.

Inception date: April 2008

Q4 2018 Commentary

	Q4 2018	YTD 2018	Since Inception
Jemekk Total Return Fund	-11.49%	-6.57%	82.18%
S&P TSX Composite	-10.11%	-8.89%	47.72%
S&P 500	-13.52%	-4.38%	138.66%

* Benchmarks quoted in Total Returns

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A common theme from our commentaries in the past couple years was highlighting how complacent markets were. That all ended in 2018 - as we went from new all-time price highs in North American markets to posting the worst Q4 since 2008. Suffice it say, volatility is back. Cash was the only asset class that wasn't down. As a result of this violent sell off, the Total Return Fund was not immune. The Fund was down slightly more than the TSX but managed to outperform the S&P 500 for the quarter. For the year, the relationship was reversed - the Fund performed better than the TSX but underperformed the S&P 500. We do not take any solace in this, on an absolute basis the Fund is still down on the year, but we worked steadfast to contain losses as fast as possible.

With Fed commentary suggesting higher normalized rates, the 10-year yield spiked at the beginning of Q4 and triggered a flight to safety. For the TSX the best performing sector were the Staples and for the S&P 500 it was the Gold sector. For the year, Technology was by far the best sector for the TSX led by Shopify which the Fund still owns and the largest detractor was Energy. The resource sector was already having a challenging year before Q4 hit but suffered another leg down as fears of a global slowdown could curtail crude consumption. The short-term picture for oil is mixed. Global politics are a large factor in the commodities sector. Specifically, timing decisions such as the status of the US-China trade talks come March where the interim truce either ends or turned into a future roadmap for ongoing negotiation. Or determining the level of inventory builds in the oil market and whether OPEC decides to make deeper cuts. By the end of Q1/19 other factors that will also help the direction of commodities include the path of the USD, the Fed tightening cycle and US sanctions on Russia and Iran. We believe it's going to be a bumpy ride in the commodity market for at least the next quarter. On the bright side, the selloff has led to a steep contraction in valuations. The TSX is now trading at 14x PE, a level we haven't seen since 2011.

We do not see signs of a near term recession and with the TSX trading where it is, we believe the market has already priced in significant economic and earnings deceleration. However, we remain cautious as speculation and fear continue to drive markets.

From peak to trough, the S&P 500 was down 19.8% which, for argument's sake, is bear market territory. The S&P 500 was down almost 7% in October and then up 179 basis points in November. Traditionally, December is a positive month for equities and everyone was waiting for that all important 'Christmas Rally' to begin. But that never materialized, and the S&P 500 was down over 9% in December its worst December performance since 1931. Amid all this market volatility and continued downside surprises in global growth, investors are focusing on the Fed and China (with respect to trade talks and slowing growth). Regarding the Fed, the issue is twofold: (1) does the Fed back away from its prior hawkish stance and whether and when it could signal potential changes in balance sheet normalization. As of today, the Fed has definitely walked back its hawkish view and sounds more dovish signaling its flexibility on the policy path. We believe this is prudent. Despite robust consumption growth and a strong labor market the US economy is not operating in a silo and will be affected by slowing global growth of which there are many signs. On China, ongoing trade disputes are a risk and growth has decelerated in the second half of 2018 surprising on the downside in recent months. The question now is what measures will be taken to stabilize growth. Similar to the TSX, US markets have also corrected materially, and the set-up looks positive. Meaning, valuations are much more attractive, earnings growth remains healthy (SPX earnings are estimated to grow by 6.5% in 2019), inflation outlook remains subdued, and the yield curve is positive. As we enter earnings season, we are focused on management commentary for the upcoming year. We believe companies will have a cautious tone to set the bar low for the year with some companies even cutting guidance.

As a whole the backdrop for North American equities screens positive. Economic data suggests no clear sign of a forthcoming recession however we are cognizant that this is a market where sentiment outweighs fundamentals.

We decreased exposures materially in October. The Fund entered Q4 65% net long and when the selloff began in early October, we were quick to raise cash and add to shorts. The Fund exited Q4 40% net long. Even with the low exposure, the Fund was not immune to the violent selloff. Although our index shorts and a short in a cannabis name helped, the detractors (Brookfield Business Partners, Hexo) took down performance materially. On the year, Parkland Fuel and Shopify were top gainers for the Fund while Cobalt 27 and The Stars Group weighed negatively on performance.

We pay close attention to M&A activity across all sectors but let's focus on Technology for now. We believe M&A is a signal from management on confidence and the direction of the company as well as providing price discovery. But not all M&A deals make both financial and strategic sense. In Q4 we saw several 'Hail Mary' deals announced and will watch these carefully to see how well management integrates the new companies. If we believe the target is not meeting expectations and could lead to deteriorating fundamentals and a swollen balance sheet, then we will short these stocks. Examples include, IBM paying all cash for Red Hat in a $34 billion enterprise value deal and SAP buying Qualtrics for $8 billion also in an all cash deal.

A core holding in the Fund is Microsoft and lost in all the FAANG talk is this tier one technology play with so many shots on net which in our opinion will also join the $1 trillion market capitalization club. Rather than go through our entire investment thesis on MSFT, we want to highlight how M&A plays a role into the MSFT story. First let's address the financial strength of the Company, an important factor considering we are in an increasing interest rate environment so companies that depend on debt markets will have to raise money at less attractive levels. It is estimated that MSFT will generate approximately $100 billion in free cash flow over the next three years while accumulating $75 billion in cash. Safe to say MSFT will have an arsenal of liquidity and has shown, is not scared of large-scale M&A acquisitions (paid $26B for LinkedIN).

Which leads us to its latest purchase of GitHub which closed in Q4. What did they pay? $7.5 billion in an all-stock transaction. Already we like this structure better than the all cash deals mentioned above. When you buy software companies you want to retain top engineers and want management to be aligned with the go-forward company. Why did they buy? To put it simply, think of GitHub as a social media type platform for developers. It's an open source system where developers can build, share and collaborate on projects. GitHub has more than 30 million contributing developers and growing. We view the purchase as a strategic fit for MSFT and will help on the backend software development side. In turn GitHub now has full access to MSFT sales reach and global cloud infrastructure. Time will tell but to us this is a win/win M&A deal. We continue to hold MSFT and see it as a core holding for the Fund.

In 12 months, market expectations have done a full 180. At the start of 2018 we saw global synchronized recovery, extremely low volatility and consensus bullishness. Fast forward to today and we now see global slowdown, high volatility and a much more bearish tone. We believe the markets are already discounting material risks and we could see some strength provided major obstacles such as trade disputes being resolved and the Fed being more flexible on policy decisions. But one thing is for certain, volatility will be a common theme for the foreseeable future. For instance, the year has just begun, and it's been wild ride already. With negatives such as China PMI numbers, Apple cutting guidance and a weak US ISM reading. Followed by, China stimulus news, a blow-out jobs report and most importantly a dovish Fed.

The market is definitely bifurcated. We feel however the swings are too far in each direction meaning extreme sell offs are met with over-corrections (and vice-versa). For example, at the time of writing the S&P 500 is up 10% since Christmas Eve - too much too fast in our opinion. To date, stocks have rallied, spreads are tighter and the VIX has fallen 10 points. We believe this bullishness should be met with reality. Meaning last year's material risks are still outstanding and warrant continued caution.

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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