JEMEKK LONG/SHORT FUND L.P.

Inception date: July 2004
Q2 2019 Commentary

	Q2 2019	YTD 2019	Since Inception
Jemekk Long/Short Fund	-1.03%	6.16%	229.94%
S&P TSX Composite	2.58%	16.22%	191.20%
S&P/TSX Small Cap Index	-0.26%	10.42%	51.89%

* Benchmarks quoted in Total Returns

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Since our last letter, the market's expectations on the US Fed's move has done a full 180. Specifically, we went from expecting 2-3 rate *hikes* to 2-3 rate *cuts* with the first potential cut as early as the end of July. The case for the cut is supported by subdued inflation, global growth concerns, and being more in line with interest rates globally where we have not seen as much tightening as the US. The TSX continued its positive trend from Q1 and posted a 2.6% Q2 whereas the TSX Small Cap Index was much more muted being down 26 basis points for Q2. The Long/Short Fund was down 1% for the quarter bringing year to date performance to 6.16%. Not keeping up with the torrid pace of the markets but respectable performance given the volatility exposure of the Fund versus the markets. We will discuss Fund specifics and our outlook for the second half of the year below.

After an impressive Q1, major North American indices continued to march higher posting a giant first half. May was a sore spot as new rounds of tariffs hit but as we have mentioned several times before the markets continue to overshoot on both ends. In terms of performance, the TSX showed good breadth with strong gains from Technology and Material sectors, while detractors came from Health Care (cannabis related stocks namely) and Energy. In Q1, we highlighted how in the top 10 performers, six were cannabis stocks. In Q2 there were no weed stocks in the top 10 possibly signaling investor fatigue in the space. We think the best days for large Canadian licensed producers are in the past and if exposure is desired investors should look to companies with a US presence. In terms of the bottom 10, eight were energy related. The TSX Small Cap also showed wide breadth in sector performance but similar to the TSX the two weak groups were Health Care and Energy. The Energy sector had a volatile quarter at one-point WTI being down 25% peak to trough. Oil demand estimates for the balance of the year remain bearish. Manufacturing data in North America and overseas suggests slowing economic growth.

Participants are responding to this news. In the first week of July OPEC and its allies agreed to extend production cuts for nine months in an effort to combat weakening global demand. Elsewhere, the market's poor economic backdrop is affecting corporate profit forecasts. For example, over the past six months, analysts have pared their one-year earnings expectations for the TSX by 3.2%. In April we saw the BoC halting interest rate hikes and at the time of writing BoC has again maintained the benchmark overnight rate at 1.75% and we don't see them deviating from this path anytime soon. The report included a slight increase in Canada's economic growth forecast for 2019 (1.3% from 1.2%) while estimating slower growth in 2020.

Not ones to subscribe to old adages but 'sell in May and go away' would've worked this year provided you bought back on June 1st (S&P 500 had its best June since 1955!). May was a dismal month for indices driven by Trump threatening new rounds of tariffs. As an aside, Twitter has now replaced Bloomberg for real time breaking news. All major US indices posted impressive performance in Q2 continuing where they left off in Q1. The S&P 500 had its best first half in 22 years in the face of material risks such as a slowdown in global growth, ongoing trade wars, geopolitical tensions in the Middle East and an inverted yield curve. Q2 was a busy one on the trade war front deeply affecting global markets. However, in June we saw a 'truce' between Trump and Xi at the G20 Summit. To be clear, this isn't removing the existing tariffs in place but more a halt on a new scheduled round of $300b. Trump also said he would allow US companies to continue to sell to Huawei, which we see as a material win for China. We view the outcome of the meeting as moderately constructive and provided the market with some much-needed relief. Agreeing to restart talks and pausing on further escalation doesn't exactly scream positive but with the absence of this deal the markets would continue to trade with a tariff discount.

In return for the Huawei ban lift, China committed to buy US farm products in large quantities. We say moderately constructive because nothing definitive came from the meeting. There is still a possibility the Trump administration will start levying tariffs on the remaining Chinese products in the coming months. Ultimately, no real resolution on tariffs which doesn't provide corporations the comfort to move forward on investing and leaves the US-China conflict unresolved.

The Fund started Q2 70% net long and throughout the quarter there were pockets of positive economic data but with the looming trade war still outstanding didn't give us the confidence to add to positions materially. We ended the quarter 78% net long and look to take these exposures down in the near term. In terms of market performance, Q2 continued where Q1 left off and never happy with reporting a negative quarter the Fund unfortunately didn't participate with the market move. The Fund had strong gains from Shopify and Polaris Infrastructure but was significantly impacted by the energy book. Year to date we are still pleased with how the Fund fared given the material macro risks in the economy and its hedged bias. Following, we would like to introduce you to a new name in the Fund as of this year and has already contributed meaningfully to performance.

Everi Holdings (EVRI) – with two complementary business units, Everi Holdings not only designs, develops, and manufacture casino games, the company also has a lucrative cash management business. We first heard of the company when attending a conference earlier this year and intrigued by how the two business segments were trading at a discount and impressed with the FCF generation although acknowledging the high debt outstanding but could see a clear path to de-levering. What does EVRI do? Everi is a 'jack of all trades' when it comes to Casino operations with two primary business segments:

1. Casino Games – licenses and sells game related equipment to its customers namely casinos along with providing system software, ancillary equipment and maintenance. The largest part of the Games business is gaming operations consisting of placing slot machines in casinos and receives a percentage of revenue win per day.
2. FinTech (formerly Payments) – there are three parts to this business: cash access services, information services, and equipment. Cash Access is the largest and most profitable of the three and is made up of cash advances, ATM services, and check warranty. The FinTech segment processed 100+ million transactions and $25+ billion in the last year.

With a diverse product offering that services casino operators' primary needs, EVRI has the potential to penetrate a larger portion of the casino market and gain meaningful market share. EVRI's install base/unit is growing at a healthy clip and unit sales is growing at over 20%. The majority of revenue is recurring in nature. Approximately 80% of total consolidated revenue is recurring including 90%+ from FinTech and 65% from Games revenue. There are two tenets central to our long thesis: investor underappreciation of FCF generation (2020 FCF which should double for the second year in a row) and the FinTech business being valued at a deep discount. When we first began working on EVRI we were of the view that if the FinTech business was spun out/sold it would unlock material value for shareholders. In late May an article surfaced that the company has hired financial advisors seeking to sell one or perhaps the entire business. Not ones to speculate on potential M&A but we are happy to see our thesis unfold and will continue to hold the stock even if a deal doesn't materialize as the company has been performing very well.

In June we celebrated the 10-year anniversary of the US economic expansion that began June 2009 and if the streak continues into July, it will make history surpassing the 1991-2001 growth cycle to become the longest since 1854. Even in the face of material macro and geopolitical risks, the US economy by and large continues to charge ahead. What doesn't sit well with us is how the market is reacting to bad news forcing the Fed to cut rates for a more accommodative market. This may help stocks in near term but has serious longer-term risks. All eyes are on the next Fed meeting at the end of July where the market is as of now 100% pricing in a rate cut. This would be the first cut since 2008 when the Fed began embracing easy money post the financial crisis. The Fed has hiked nine times since December 2015, but the rate still remains well below pre-crisis levels. What we are watching is if/when the Fed cuts rates and the economy still slows this is a harbinger for a recession. As of now, we do not believe the economy is facing a recession in the near term.

Another anniversary we are celebrating which makes us very happy is the 15-year anniversary of the Jemekk Long/Short Fund. We are very proud of this accomplishment and long tenure. There are not many other Funds with this lasting track record and performance we have delivered for our valued clients. We look forward to continuing to find great investments for you.

One last operational note is on our growing team. Michael Lam has joined Jemekk in the second quarter of 2019. Michael joins us from another hedge fund manager who also has a long track record in the North American investing space. A generalist, Michael brings a deep knowledge base from both the buy and sell-side of the street across many sectors and types of securities. We look forward to sharing his ideas and contributions with you in future commentaries.

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

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