JEMEKK HEDGE FUND

Inception date: August 1999
Q3 2019 Commentary

	Q3 2019	YTD 2019	Since Inception
Jemekk Hedge Fund	-3.61%	3.95%	498.33%
S&P TSX Composite	2.48%	19.11%	289.95%

**Benchmarks quoted in Total Returns*

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The trade war which began in March 2018 continues to plague global markets which has heightened volatility and increased risk. In the face of this however, North American capital markets have had an impressive year to date performance (although coming off very depressed levels due to the selloff in Q4/18). When looking at the one-year performance, markets are up fractionally and understandably so - the same risks that were present last year are present today and are real. Trade negotiations seem to be one step forward two steps back and trying to predict what's going to happen next is like trying to make sense of Trump's tweets. That said, the Jemekk Hedge Fund underperformed its relative benchmarks in the quarter as a result of its conservative approach (zero leverage) and growth orientation of our names. We have been surprised the market has moved strongly higher, in the face of heightened risks, and the underperformance of our growth-oriented portfolio. Clearly given the numbers, 2019 has been a year of "growth of capital" as opposed to "protection of capital" and we were positioned incorrectly. We will discuss Fund specifics and our outlook for the balance of the year below.

The markets continue to show resilience in the face of material risks. During the quarter the TSX was up 2.5% continuing its upward trend in the first half of the year. What was different however was the leadership group. Increased geopolitical risk resulted in a bid to the gold sector and positive housing data and interest rate environment benefited the Canadian mortgage lenders such as Equitable Group and Home Capital Group at the expense of the former leaders Technology, Consumer Discretionary and Cyclicals.

In July a rotation began in North American markets where momentum stocks stalled, and value stocks were sought after. Long defensive/short growth became the consensus trade as recession talks began to surface once again. Estimates call for the Bank of Canada to cut rates in December following a similar path of easing as our US neighbors. The data shows since 1953 when the US slips into a recession Canada falls into one too. Therefore, measures need to be acted upon now in an attempt to avoid a recession. If all goes well, 2020 could be a year of digestion and 2021 returning to a path of rate hikes.

Mentioned above, the rotation in the US markets was much more pronounced given its larger Technology sector. Technology has lead markets for some time now so by virtue generalists have found it as a place to hide. This all came to a screeching halt in July when sentiment changed, and value is now in vogue. The rotation was violent leaving some large cap names 15% off their highs. To be determined is if this rotation is over or just gearing up for a second wave. In mid-August we also witnessed the yield curve inverting a further sign of a potential recession and global growth slowdown. Trade tensions are the key drag in this cycle and we can see it in the numbers - global growth slowdown from 4.1% in Q1/18 to an estimated 2.9% in Q3/19. The Fed has quantified the impact of the trade wars on the global economy estimating the trade uncertainty has accounted for 100 basis points decline in global GDP by the first half of 2019. The follow-on effects hinder corporate confidence and capex. So, you can see how a recession can almost be seen as self-fulfilling. On the bright side, consumer confidence screens high which has always been a material driver of GDP.

In addition, the stock market is not overly expensive or cheap but behaving rationally. We say this with respect to the WeWork IPO failure among other IPOs that have debuted this year. In an irrational market (Dotcom bubble) tech IPOs were being bought regardless of valuation among other things. First off, WeWork is not a tech company so should never have commanded a tech multiple but the corporate governance of the company was what was really in question and went from being a $47b company to a company that might not be able to meet its lease obligations. The company was forced to first delay the IPO eventually shelving it - a sign of a healthy stock market.

That said, there are some stocks in the public market that need to correct further. One company for example we really like is Zoom Video Communications (ZM) a stock we would like to own but not at the current 30x Sales its trading at now. This is a case of a great company but not a good stock and a reason we carry more cash now than usual-to take advantage of market disruptions, and opportunely add new names.

Heading into Q3 the Fund positioning was of a neutral tone (62% net long) and even though lots of risk unfolded in the quarter we allocated accordingly to ideas that presented favorable risk/reward opportunities and ended the quarter 76% net long. In terms of winners and losers for the Fund nothing in particular stands out. We made some good gold bets however some cyclicals and energy related names dragged the Fund. We are constantly discussing how best to position the Fund and which sectors will outperform in the longer term. However, repositioning like this can cost the Fund performance in the short term until our thesis plays out - patience is a virtue. Ultimately, we are fundamental investors looking for the best ideas that are not being valued by the market appropriately. Following we would like to highlight a holding we have already discussed in a past commentary, but material news has unfolded which is playing into our thesis.

IAC/Interactive Group (IAC) – As a refresh, IAC is a holding company with decades of storied success in investing and successfully spinning off companies. The company currently holds majority stakes in Match Group (largest owner of online dating platforms) and Angi Homeservices Inc. (online portal for home improvement services). Both these companies are public. The thesis for IAC was the market capitalization of IAC is below its interest in these two companies alone with negative value being ascribed to its other assets such as Vimeo and Dotdash and the $1.2b of net cash on the books. We acknowledge as a holding company it should trade at a discount, but we always found the spread to be too wide.

During its last earnings call in August management announced steps to unlock value for shareholders via a spin off of all or partial public assets. This is the catalyst we have been anticipating. At the time of writing more news has come out with a more formal plan which involves spinning off MTCH entirely from IAC. Why do we like this as IAC shareholders? Pro forma, IAC successfully harvested a prize asset and will be left with $4b in net cash along with other assets mentioned above (Vimeo and Dotdash are growing at over 20% a year). With all this cash IAC is once again able to add to its winning playbook. This is the modus operandi for the company, and we believe given its multi-decade successful track record management will again deploy the capital effectively.

In August when the yield curve inverted major North American indices went into free-fall down 3% in one trading session. No doubt slower global growth is occurring, and investors are racing into yield, not a big focus of our Fund. The debilitating effect of trade tensions was apparent in economic data points from large nations this quarter. Trade wars continue to be the largest cloud on the markets and experts forecast could be the reason we slip into recession faster than expected unless a truce can be struck. Although we are closer now, and the market is strongly discounting a deal-we are not there yet. The yield curve is under a microscope these days and the inversion seen a couple months ago has investors, and markets, on edge. However, markets tend to move higher in the weeks and months following an inversion.

Since 1978, the S&P 500 has risen 13% on average from inversion to beginning of a recession. We are cautious on stats like these and haven't added exposure based on these historical trends, but the takeaway is that it's very difficult to predict markets in the short term. We are constantly monitoring economic data points we feel are leading indicators and allocate capital accordingly. It's impossible to predict the outcome/timing of the trade war. At the time of writing positive developments are unfolding but later met with negative follow-ups leading to a market retracement. All we can do is continue to filter out the noise and stick to the fundamentals.

Clearly our cautious approach to the market thus far in 2019, and our positioning has been wrong for the market we are experiencing. Although much of what we were concerned about has played out this year, the market has moved higher in the face of these greater risks, and has left the Fund with positive, yet disappointing results. We continue to remain patient, and not chase, and expect 2020 to provide many opportunities for gains-both from the long and short side of the portfolio.

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

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