JEMEKK LONG/SHORT FUND L.P.

Inception date: July 2004
Q3 2022 Commentary

	Q3 2022	YTD 2022	Since Inception
Jemekk Long/Short Fund	-2.01%	-19.20%	188.93%
S&P TSX Composite	-1.41%	-11.14%	261.38%
S&P/TSX Small Cap Index	-2.48%	-16.30%	81.07%

* Benchmarks quoted in Total Returns

Gerard Ferguson, CFA
CEO, Portfolio Manager

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Portfolio Manager

After a dreadful June, North American markets corrected materially with strong gains in July. But this all came to a screeching halt in September with major indices posting their worst September since 2008. The S&P was down 9.3% and the NASDAQ in double digit territory, -10.5%. The TSX was down 4.6% and the TSX Small Cap Index printed a -7.3% in September. In our opinion, Q3 marked the end of **TINA** - There Is No Alternative (something we have highlighted in past commentaries regarding the favorable backdrop for equities) and ushered in **TARA** - There Are Reasonable Alternatives. The 2 year is yielding 4.3% and the 10 year is yielding 3.9%. This is a much different yield environment then a year ago. Another reason for investors to lower their equity allocation. For the quarter, the Fund performed in line with its respective benchmarks but still has work to do on the year-to-date basis.

This market continues to be 100% macro driven. Macklem at the helm in Canada and Powell puppeteering the US. The BoC has been amongst the most aggressive central banks globally in our opinion (note, there were 90 bank rate hikes in Q3 globally, more than 2x as many hikes in Q2) and the language from the Governor doesn't seem to signal they are slowing down. Macklem's latest speech was hawkish with such comments as 'there is more work to be done.' That statement should not be taken lightly given the 300-basis point move the BoC has already made this year. Too early to guess what is to come in the December announcement but a 50bps hike in October is almost a lock. Powell channeled his inner-Volcker at Jackson Hole in August parting with his original vanilla speech and instead opted for an eight-minute verbal economic assault saying the Fed is ready to 'bring some pain' to households and businesses - 'These are the unfortunate costs of reducing inflation.' This speech coupled with the new dot plot from the September meeting indicates a more restrictive monetary policy than expected.

Bond yields have surged as of late as markets digest the reality that financial conditions will most likely remain tighter than expected in the ongoing battle against inflation. In fact, during the quarter global bonds entered their first bear market in a generation (September 2002). The market is now expecting rates to peak in March 2023 in the US. The market does not like uncertainty and the current path and level of interest rates over the next year is one of the largest risks to equity multiples. Stocks have already de-rated this year (24x to 15x) as bond yields have increased. The latest inflation numbers show a slower than expected deceleration which brings into question when inflation will move toward the 2% goal. There are two more FOMC meetings this year and we believe 75bps in November is almost certain and December could see a 25-50bps hike. We feel estimates for earnings remain high and will continue to see EPS cuts. Currently, the 2023 consensus EPS is at $242 suggesting +7% year over year growth. Note, the average recession has seen a -10% YoY EPS growth. Therefore, we see 2023 SPX EPS closer to $200.

The Fund entered Q3 80% net long and exited 78%. But there was notable movement from a sector perspective. Energy went from 40% net long to 19% and Technology went from 8.5% net long to 5%, as we have increased our short book. Energy remains an area of concentration for us as we simply cannot ignore the value proposition for these stocks. Even at $70 a barrel the names we own are minting cash and continue to return capital to shareholders and/or buybacks. As for tech, valuations are now much more palatable, and we have a list of names we like and ready to buy once the backdrop becomes more favorable.

Following, we would like to highlight a new position in the Fund:

Delek U.S. (DK) – Delek, a fairly new name to the portfolio (2022), is a US based refiner. The company, we believe, trades at a material discount to the sum of its parts. While we believe all North American refiners are poised for exciting returns going forward, we highlight DK as it has a unique dynamic vs. its peers. DK owns 78% of Delek Logistics Partners (DKL), a publicly traded pipeline/logistics MLP. The value of shares in DKL alone represents about 80% of the $2.0 billion market cap of DK. When considering the value of DK's retail gas station business (even at a material discount) shareholders of DK are getting its 300,000 bbls/d of refining assets at notionally "zero cost". Furthermore, DK's refining assets provided contribution margin of $557 mm in Q2/2022.

We believe the refining sector is structurally poised to generate profit margins well above historical levels for the foreseeable future. This is due to the convergence of a couple of unrelated factors. First, after the dramatic fall in oil prices in 2015 OPEC substantially curtailed sanctioning new refineries and were focused on only completing already sanctioned projects. As a result, we have seen a reduced amount of new refinery capacity adds in the past few years and there is expected to be a dearth of new capacity outside of China after 2023. For the better part of two decades most new refineries built in the world outside of China were backed by OPEC nations whose motivations were to design refineries to process their specific blends of crude with little regard to the economics of the refinery business itself.

Secondly, the collapse of oil demand at the onset of Covid-19 resulted in massive cash burns for the refinery sector, which prompted over 3 mm barrels a day of higher-cost capacity being permanently closed. The loss of this capacity, especially the 1 mm bbls/d lost in the U.S., has been a major factor for high crack spreads in North America in 2022. It is important to note that the Russia-Ukraine war has so far had only a moderate impact on global refining crack spreads given Europe has continued to import fuels from Russia at a pace similar as in 2021.

We view DK as a direct beneficiary of the above two factors. Coupling this with the sum of the parts valuation highlights the substantial unlocked potential of the name and as such the name represents a core holding of the Fund, and we expect will perform well as it reports quarterly earnings going forward.

Last quarter we laid out the anatomy of a bear market (Selloff in unprofitable technology; Market de-rates; Generals get shot; Downward EPS revisions; All sectors capitulate). Exiting Q3, we feel we are in the Downward EPS revision phase as Q3 witnessed sizable pullbacks in widely held names such as Google and Microsoft. It took three months from the low in June to be re-tested and eventually taken out. Unfortunately, we don't think the low in September was the absolute low and will again be breached - as for timing, who knows but we can say we are nearing the end, and stocks are reflecting that. We have said before and we will say again - the old adage of 'Don't Fight The Fed' reigns true. In this year, the Fed has gone from a near zero interest rate to above 3% in record time. And they have made known they are not done. The Fed is laser focused on quelling inflation and will increase rates as long as that remains their singular focus. However, in our opinion, the Fed won't achieve this goal as surgically as they've laid out. We now run the risk of overshooting to the downside, which some are signaling now, but the Fed seems to ignore these calls and are willing to risk a deeper recession to hit their targets.

We thank you for your continued support and look forward to communicating with you at the end of Q4. As always, please feel free to reach out to any of us below.

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