JEMEKK LONG/SHORT FUND L.P.

Inception date: July 2004
Q4 2022 Commentary

	Q4 2022	YTD 2022	Since Inception
Jemekk Long/Short Fund	5.88%	-14.45%	205.93%
S&P TSX Composite	5.96%	-5.84%	282.93%
S&P/TSX Small Cap Index	8.37%	-9.29%	96.23%

* Benchmarks quoted in Total Returns

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After two tough quarters, major indices witnessed some relief in Q4, posting positive returns across the board - inclusive of a very challenging December. In Q4 the TSX was up almost 6% led by Technology (+13%) and Energy (+9%) offset by weakness in Health Care (-11%). The TSX Small Cap had a solid quarter led by Commodities (Materials +16% & Energy +14%). South of the border the S&P 500 was up 7.6% though the tech heavy NASDAQ was unable to post a positive quarter finishing down 80bps for the quarter. For the year, the TSX performed better than the U.S. market indices because of its high commodity exposure. TSX was down 5.8% with Energy up 31% but offset by Health Care and Tech down 62% and 52% respectively. Similarly, the TSX Small Cap was down 9.3% for the year with Energy (+31%) the only positive sector. In the US, the S&P 500 and Nasdaq faced much more volatility finishing the year down 18% and 33% respectively. The Fund performed in line with its benchmarks in the quarter but suffered more on a year-to-date basis. The combination of a few stocks being major detractors plus not being long enough energy accounted for this performance, mostly realized in Q1. More detail on this later.

The main factor impacting 2022 (and Q4) was rapidly rising inflation and the efforts to raise rates to combat it. Central bankers were humbled in the past year providing mea culpas on not acting fast enough to tame inflation. For example, a year ago the Fed estimated rates would be at 1% versus the 4.25% they are now - a healthy forecasting error from an outfit that employs 400 PhD's. Our view, despite being admittedly late to react to tightening financial conditions, is that it's not a stretch to conclude they will overstay their welcome on the tightening front and cause a recession. In every business cycle, every economic expansion ends with a recession. The questions that emerge are when will the downturn begin, how long and severe will it be?

Central bankers have a fine needle to thread. On one hand, inflation must be controlled and there are signs of inflation coming down but accurate readings on the level are not easy for idiosyncratic reasons. But raising rates too much results in the risk of a recession - the Fed is attempting to engineer a soft landing but time will tell. On the other hand, the fixed income market (like it did in Q4 2021), is leading the Fed towards the resumption of easing conditions as witnessed by the fall in rates in reaction to softening economic data.

In Q4, the Fed raised rates by 75bps in November and 50bps in December bringing the Fed Funds Rate to 4.25-4.50%. The Bank of Canada raised by 50bps in both its Q4 meetings bringing the Target Overnight Rate to 4.25%. The only thing we can say with certainty is we are largely done with aggressive rate moves but still see more gradual hikes coming (less so for BoC). One thing we want to highlight is it takes on average one year for policy decisions to show up in leading economic data. Both the Fed and BoC began tightening in March 2022 so the real pain from the hikes has yet to enter the market. Said differently, in 10 months the Fed increased rates by 17 average times and BoC 16 (avg move is 25bps). We have not seen this magnitude of aggressive tightening since the 1970s. We acknowledge the cure for sustained inflation is taking an axe to economic activity but at what cost? The real impact of the hikes will begin to reveal itself during this year. Housing is a good barometer and we have already seen overdue cooling in frothy pockets of real estate. Central Banks need to pause and allow the tightening to hit the economy in an effort to avoid overdoing it. Once a sharp downturn is apparent in the data the damage has been done and it's too late for a course correction. We believe we are approaching this point.

The Fund entered Q4 78% net long and exited 71%. But there was notable movement from a sector perspective. Materials went up from 23% to 30% supportive of our bullish view on gold. Energy went from 19% net long to 13% and Technology was flat at 5% but we added more names on the short side. No surprise, the main contributors of performance for the year were from our Energy names (Advantage, Tourmaline, and MEG Energy to name a few) and the detractors were from a mix of sectors, predominately Technology (1H 2022 weighted), Industrials, and Healthcare. Currently, we are positioned for strength in commodities (bullish stance on gold, energy, and coal) and selective on tech but with the capability of quickly adding exposure when we see fit. The Fund is currently skewed towards more liquid names, employing no leverage and closely watching the economic data for changes in the macro narrative.

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

SupremeX Inc. (SXP) – A leading North American producer and marketer of envelopes and other paper-based solutions, SupremeX is the leading national envelope manufacturer in Canada (12 facilities) and now has its sights on expanding meaningfully in the U.S. (4 facilities and counting).

The revenue split is 70/30 envelopes/packaging and within envelopes SXP has 85% share in Canada with a broad product offering and a sticky customer base. The longer-term goal is to leverage their expertise to expand in the US which is a much greater market. The packaging business offers a range of products and has exposure to the secular growth of e-commerce. SXP is a supplier to this discretionary end market, but the majority of exposure is consumer staples, pharma, and food, which are much more defensive sectors.

No question the envelope market is in decline, but the market is still very much alive and the last ones standing will control the industry. The market size of NA is ~$2.80b and the US remains highly fragmented and ripe for market share gains (SXP <5% of addressable market). One thing to note is the US market is declining much slower than in Canada → Volume declining by 6.2% annually since 2017 vs 4% Stateside.

The Packaging side tells a different story with growth expectations of over 5% CAGR over the next four years. We believe this estimate is too low and will come closer to mid-single digit growth as experienced in the past five years.

SXP is successfully executing on its three-pronged growth strategy of (1) Maintain Canadian leadership; (2) Grow envelope business in the US; (3) Meaningfully build out Packaging vertical in NA. The stock trades at 3.5x EBITDA, has a $160mm market capitalization with a net debt to adjusted EBITDA ratio of 0.6x. With a 15% FCF yield and paying 2% dividend yield we like SXP for its recession resistant defensive business (saw no real deceleration during covid) and it's under the radar status (not widely followed).

Managing money in the face of a potential recession has its issues. For one, once the NBER announces a recession we are generally more than halfway through it. We believe we are in the phase where multiples and EPS metrics are still contracting. That said, the market is a discounting mechanism and will rally when it suspects the bad news is behind it. We believe the markets have largely taken its medicine and will not suffer another down year like 2022. Further, you could see bifurcation between the markets and the economy where the markets begin to discount a recovery phase and the economy reacts to the very aggressive tightening and weakens materially. As of now, we still do not think the market has de-risked enough. Last quarter we highlighted the EPS for the S&P 500 was $242 and we believed this was too high. Since then, the estimates are down to $227 - still too high in our opinion. In other words, the market is still expecting too much growth and we believe estimates will continue to ratchet down. We presume peak inflation is behind us but now the question is how sticky is inflation on the way down.

We thank you for your continued support and look forward to communicating with you at the end of Q1. As always, please feel free to reach out to any of us below.

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