JEMEKK LONG/SHORT FUND L.P.

Inception date: July 2004
Q3 2023 Commentary

	Q3/23	YTD	Since Inception
Jemekk Long/Short Fund	-3.79%	-6.87%	184.90%
S&P TSX Composite	-2.20%	3.38%	295.85%
S&P/TSX Small Cap Index	-0.79%	-1.11%	295.85%

* Benchmarks quoted in Total Returns

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The 'Higher for Longer' narrative took center stage for global capital markets in the quarter of 2023. This is a material difference from this time last year when expectations were for the first rate cuts to occur in the second quarter of this year. Clearly this did not occur, and current expectations now call for a rate cut towards the end of Q1/24. Following two strong quarters of performance, the markets took the pedal off the gas over the past 3 months. In fact, every major North American index clocked in a negative Q3. For Q3 the S&P 500, NASDAQ, and the Dow Jones produced -3.65%, -4.12%, and -2.62% returns respectively. An overdue pullback in our opinion as the bulk of the move in the markets was almost entirely due to multiple expansion – odd given it was against a backdrop of rising rates. There was no one culprit for the weakness but the combination of the Fed moving from holding rates steady during the June meeting to reverting back to increasing rates during the July meeting; 30% increase in oil (inflationary event); and concerns about the health of the consumer (savings are down, student payments are back, car payments are up, and credit card delinquencies are rising) all contributed to the weakness. This quarter also saw one of the greatest bond bear markets of all time - peak to trough the US 30-year loss hit 50%, mirroring the pullback witnessed by the equity markets during the GFC crisis of 2008 – yet in *half* the time. Treasuries continue to be sold at quarter end with yields on the 10 year and 30 year hitting 2007 levels. The sudden sell off could be attributed to a hotter than expected economy (as witnessed by the jobs numbers), increased issuance of US debt coupled with the Fed buying less Treasuries driving yields higher. We continue to monitor market events for possible "things that can break" akin to what was witnessed by the regional bank crisis earlier this year.

From a macro perspective in the quarter (which is still driving everything market related) the Fed raised rates again in July, held in September, and will meet two more times (November 1st and December 13th) this year.

Their actions have been in response to the inflationary spike that began in late 2021. Currently, the market is pricing in a 10% chance of a further November hike – and then a pause. We believe the Fed (similar to Canada) will continue to maintain a hawkish stance – as evidenced by their repeated call for "higher for longer" and that has roiled markets more recently. The Fed is singularly focused on fighting inflation (as witnessed by the job market) and although we are beginning to see signs of this cooling, it seldom occurs in a straight line. Against this backdrop of higher rates, there are clear signs of risks emerging. For example, in August we saw two notable events. First, Fitch stripped the US of its AAA rating as budget deficits swelled (not to be taken lightly). And secondly, Moody's downgraded 10 US regional banks and placed six other lenders (including some large banks) on notice for a potential downgrade. These are significant events that have resulted in tighter credit conditions, restricting the overall economy, in addition to shedding light on what "may be breaking" in this new environment of elevated rates.

Moving to Fund specifics, net long exposure decreased in the quarter from 88% to 63% as we witnessed the Fed's resiliency in the face of repeated calls for looser conditions. From a sector perspective there were no material changes but rather a reduction in exposure across the board. The main positive contributors in the quarter came from a breadth of sectors such as Industrials (North American Construction Group), Financials (EQB Inc.), and Energy (Tourmaline). The detractors were primarily from our precious metal holdings, option and stock specific hedges, and a few small caps we continue to hold but had messy quarters. Specifically, SupremeX, Trisura, and H20 Innovation all had rough quarters - but show signs of bottoming. This was evidenced by H2O receiving an all cash, friendly takeover bid at a 70% premium, after quarter end.

As per usual, we would like to highlight a fairly recent position in the Fund:

North American Construction Group (NOA) – North American Construction Group is one of the largest providers of heavy construction and mining services, namely for oil, natural gas, and resource companies. Historically, the investing public has largely avoided NOA and it was ascribed an extremely low multiple due to its 100% Canadian oil sands focused. Now that number has dropped to 35% through diversification and has expanded its operations to three countries. This new profile coupled with the recent MacKeller acquisition (announced in Q3) has warranted a re-rating in our opinion, as well as others, who rewarded it with a strong move, post announcing this acquisition.

Why we like it:

- During the quarter, NOA announced a $395mm acquisition of MacKeller Group. This was a transformational deal that was highly accretive. MG is an Australian based provider of heavy equipment to the mining sector (similar to NOA). NOA paid 2.75x '24 EV/EBITDA and 1x BV. Management expects this deal to be 50% accretive to EPS (most likely higher on added synergies) and brings in $2b in additional backlog. Hence the immediate reaction.
- NOA has a tier one management team who have made strategic acquisitions while improving the return efficiencies of the company → ROIC has gone from 4% to 14%, ROE > 20%, and FCF yield is >20%.
- The company has built a strong moat around their business. The replacement value of assets is $2.5b with long lead times meaning only a handful of players in the space can service their customers and new competition entering is unlikely.
- NOA is about 10% off its highs and trading at a multiple (3.2x EV/EBITDA) below the MG announcement. That means you can buy the stock today and get the massively accretive acquisition for free. We like this set up and will continue to add on weakness.

Another exposure of note, the Fund continues to maintain a meaningful exposure to precious metals (17%), which is at least twice what most indexes would hold. Although we have regularly updated clients on the rationale for the investment stance, it is probably worthwhile to note that this thesis has struggled against the current backdrop of rising rates and Fed concerns regarding inflation. Given our expectations for a "pause" on interest rates soon, we believe this overhang will soon be removed. Granted, rates have moved farther, and quicker than we expected – but we believe the fundamentals supporting a strong move have only improved. Central banks remain committed to increasing their holdings (even though retail investors continue to liquidate at a heightened pace), the fiscal situation in the US continues to worsen and political risks continue to ratchet up (unfortunately). These and many other reasons continue to support our belief, and as such we remain overweight gold.

We believe we are in the 8th or 9th inning of this tightening cycle. The real debate is whether a soft landing can be engineered or will we enter a much deeper recession than forecasted. Central banks are at an inflection point where upcoming decisions will determine the severity of this economic drawdown. Bullish sentiment peaked in early Q3 and then faded sharply in September as investors came to grips with the higher for longer narrative paring index 2023 gains sharply. Positively, the selloff in September was not panicky but more a textbook seasonal pullback, which has historically been followed by a bottoming in the middle of October. After three consecutive quarters of multiple expansion, Q3 was the first quarter of P/E compression for the S&P 500. We still believe estimates for 2024 EPS skew high and therefore continue to position defensively as earnings growth, not higher multiples, will have to dictate the direction of markets, given the elevated starting point. Even in this defensive posture, many opportunities exist – both long and short – as evidenced by recent M&A activity (see H2O above) and we remain liquid to capitalize when they arise. In addition, short-term, we believe pessimism remains heightened which has historically led to bottoming conditions, which we hope to use our nimble size to take advantage of. In fact, as we write this, the market shows signs of bottoming, shaking off very strong jobs numbers this past Friday and the horrific events occurring in the Middle East.

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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