Maxam Diversified Strategies Fund – Q1 2018 Commentary

The Maxam Diversified Strategies Fund[1] declined -2.1% for the first quarter of 2018. The table below outlines how the fund performed relative to Canadian benchmark indices during Q1 and since fund inception.

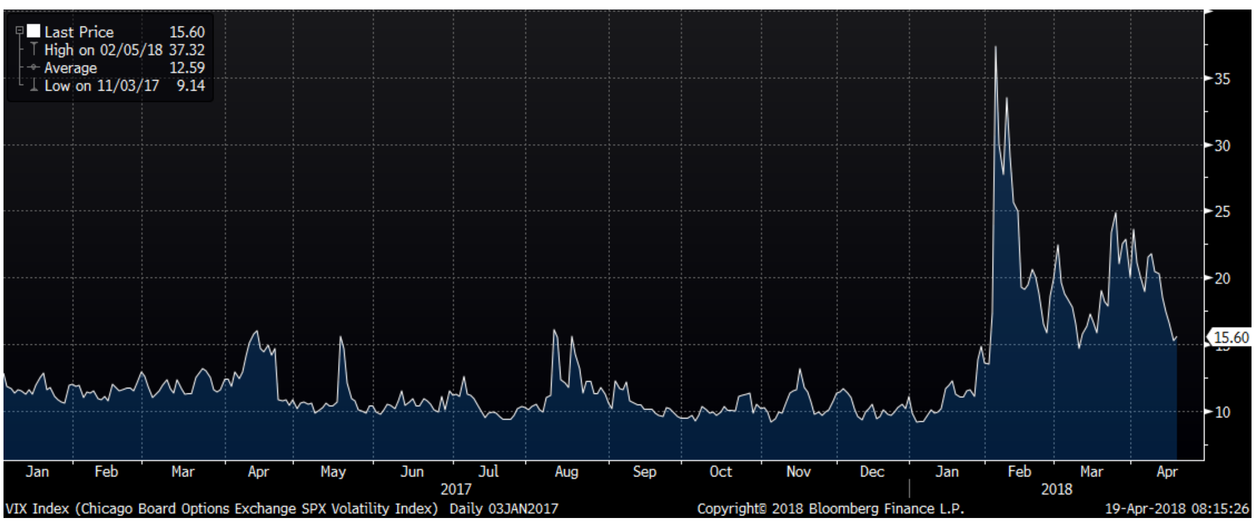
As at March 31, 2018[2]	Q1 2018	1 Year	5 Years	Since Inception
Maxam Diversified Strategies Fund	-2.1%	7.2%	13.6%	12.9%
S&P/TSX Composite TRI	-4.5%	1.7%	6.9%	6.9%
S&P/TSX SmallCap TRI	-7.7%	-6.6%	3.5%	3.0%

"I'm back baby!" - *Volatility*

During 2017 there were only seven days when Canada's S&P/TSX Composite index finished higher or lower by at least 1%; just over three months into 2018[3] we've already had eleven such days.

Below is a chart of the Chicago Board Options Exchange (CBOE) S&P 500 Volatility Index from January 2017 to present[3]. Better known simply as the "VIX", this index is a popular measure of stock market participants' expectations of volatility. Some also call it the *Fear* index.

A rising VIX theoretically indicates that investors are willing to pay more for insurance against a decline in stock prices. Think of it like car insurance. If you became increasingly worried about getting into a fender bender you'd likely be willing to pay more for insurance that would protect you from the negative cost of such an event.



The VIX was largely range bound throughout 2017 as you can see above. This suggests to us that investors, in aggregate, were feeling confident about the prospects for their investments and the state of the capital markets in general. At the very least, investors were complacent.

Clearly things changed in early 2018. We can point to a number of items that, perhaps cumulatively, put investors on edge. Rising interest rates, geopolitical tensions, U.S. politics, trade wars, fake news, Facebook data privacy issues… we could go on.

So, it appears volatility is back. What now?

We've been a broken record for over a year now with our call that we expected the environment of low stock market volatility and investor complacency to come to an end. In tune with that view we had been preparing and positioning for an uptick in volatility by holding a higher percentage of cash than normal, focusing on value and hard (versus soft) catalysts, increasing our short exposure and maintaining our market hedges (insurance).

Thus far in 2018, our core long positions have hung in well, while our short positions, volatility hedges and our healthy cash position have helped us weather the volatility better than the broader Canadian market. Our modus operandi is to balance patience and opportunism in the current environment.

What worked in the quarter.

Notable holdings that had a positive impact on the fund during the first quarter included: Park Lawn Corporation, ZCL Composites, Neulion Inc. and Boyd Group.

Park Lawn is a Canadian-listed funeral, cremation and cemetery provider with assets and operations in the U.S. and Canada. Continuing its strategy of consolidating a fragmented North American market, Park Lawn announced a tuck-in acquisition in March that was well received by the market. Subsequent to quarter end Park Lawn announced two more acquisitions that look to be nicely accretive. We like the stable nature of this business and think there is more growth to come.

ZCL Composites moved higher during the quarter after it reported stronger than expected Q4 2017 financial results. This manufacturer of corrosion free, environmentally safe liquid storage solutions for above and below-ground applications has a strong balance sheet, healthy EBITDA margin profile and a dividend yield over 4%. We're optimistic about ZCL's prospects.

Neulion, a technology company that provides digital video broadcasting and distribution solutions for live and on-demand content, announced that it has agreed to be acquired by Endeavour. Endeavour is a U.S.-based private company operating in the sports, entertainment and fashion industries with interests in entities including WME, IMG and UFC. While our position in Neulion wasn't huge, the acquisition is being done at a very healthy premium to where the stock was trading, providing the fund with a nice gain.

What didn't work in the quarter.

With Canadian and almost all global stock markets of note moving lower in the first quarter, one would expect that most positions *didn't work*. A number of our holdings were not immune to the volatility and the negative price action during the quarter. Overall we are not stressed with what transpired. Notable weaker performers for the fund in the first quarter included Greenspace Brands and Bird Construction.

After Greenspace Brands' very strong move at the end of 2017 on the back of a meaningful U.S. acquisition, the premium convenience natural food products company's share price declined -6% in Q1. Greenspace reported quarterly results in mid-February that were in line with our expectations. Organic revenue growth continued to be very strong, driven by Love Child and Central Roast product sales. On-trend, healthy, convenient, fast growth – our outlook is still positive for Greenspace Brands.

Bird Construction was down -15% in the quarter, putting it back to about the price at which we started building our position. Not a great three months, however we see several reasons to be constructive on the name (pun intended). First, Bird's balance sheet is in great shape and the stock yields >4%. Second, its pipeline is strong and growing. Third, Bird's margins look to be bottoming and at cyclical lows. Fourth, we're heading into an election year in 2019 and the federal Liberals have yet to meaningfully deliver on their infrastructure spending promises – they're going to want to fix that. And, finally, there is a potential catalyst ahead with the LNG Canada project (led by Shell) moving closer to final investment decision – I think it's safe to say the market is factoring in a *zero* for LNG.

"The first rule of Fight Club is: You do not talk about Fight Club.
The second rule of Fight Club is: You DO NOT TALK ABOUT FIGHT CLUB!" – *Tyler Durden, Fight Club*[4]

Shorts are kind of like Fight Club.

As discussed in previous commentaries, we are adding incremental short exposure in a measured fashion as we find opportunities to capitalize on that fit our view of risk and reward. We increased our short exposure during the first quarter to just under 10% of the fund's gross exposure[5]. Not huge, but we had a very strong batting average of 0.867[6] on our existing short positions at the end of Q1.

Rather than discuss individual names that we are short we will instead share that a couple of themes that are relevant to our short positions. The first is interest rate sensitive consumption. Think of the things people buy, sometimes at a frenzied pace, when financing is easy and cheap. The second is highly valued mania or momentum stocks – companies that have experienced dramatic stock price appreciation where, in our view, the fundamentals are not supportive.

Our short positions are diversified across the Telecommunications, Consumer Discretionary, Health Care, Financials, Real Estate and Information Technology sectors. Some of these positions are one side of a pair trade in which our intention is to hedge away the market or sector risk of an associated long position, and some are outright shorts where we have a negative view of the company's prospects and stock price performance.

We are positioned to take advantage of volatility.

When investors are fearful that security prices will move lower, they tend to sell with little regard for company-specific value and fundamentals. This creates opportunity because intrinsic company value, which is based on fundamentals and prospects, is generally not as volatile as company stock prices are. Security prices in the short-run can be heavily impacted by sentiment and emotion. Hence the "buy fear / sell greed" advice we typically hear during swift market declines. While it is always hard to do that in the midst of the storm… we agree with this advice.

On using volatility to our advantage, we've been opportunistically adding to some of our existing holdings when the market has offered us an attractive chance to do so. We've also been able to add some new holdings to the fund that we'd been waiting for better entry prices on, at what we view as attractive valuations. We are being opportunistic, but patient.

Our strategy remains the same as it always has: we're looking to invest in companies where we believe we've identified both value and a catalyst. We remain intensely focused on the reward-to-risk balance for each of our investments.

Thank you for your investment and your continued trust.

Sincerely,

Travis Dowle, CFA
President & Fund Manager
Maxam Capital Management Ltd.

[1]Returns are for Series F Units and are net of fees and expenses.
[2]Rates of return longer than 1 year are annualized; Inception date is January 31, 2013.
[3]As of April 18, 2018.

[4]Fight Club is a movie made in 1999 starring Edward Norton and Brad Pitt; it was a Best Picture nominee at the Oscars.
[5]Gross exposure equals the value of both a fund's long positions and short positions and can be expressed either in dollar terms or percentage terms.
[6]Number of short positions we're making money on divided by total number of short positions.

Maxam Capital Management Ltd.
902 – 510 Burrard Street Vancouver, BC, Canada V6C 3A8 T 604 685 0201 F 604 685 9970