

# MAXAM

CAPITAL MANAGEMENT

## Maxam Diversified Strategies Fund – October 2016 Commentary

If we've learned anything of late, it's that we should attach a larger margin of error to the *intelligence* we receive from traditional polling methods.

The consensus call for the reaction to a Trump victory was for gold to rally and stock markets to fall. As U.S. election night unfolded and a Trump victory appeared more and more certain, that consensus view appeared to be playing out as expected – with stock index futures dropping dramatically and the price of gold rising. However, by the end of the first trading day in a President-Elect Trump world, gold was sharply lower and the Dow Jones Industrial Average was hitting new all-time highs.

*Hmmm...*

We were initially more surprised with the market reactions to Trump's victory than we were by the fact that he won.

Investors have, and continue to, reset their playbooks. With a policy list full of tax cuts, fiscal stimulus and de-regulation, the inflation trade seems to be on. Defense stocks, banks, pipelines, industrial and construction companies have been anointed as the immediate winners under a Trump regime.

Perhaps the biggest election winners are the writers at Saturday Night Live who will have a four-year bull market in political material to work with.

Early losers have included government bonds, and not just in the United States. The yield on Canada's 10-year bond has risen roughly 30bps since election night, making it more expensive for our government to finance deficits and for consumers to take on additional personal debt. Trump's proposed tax policies should benefit U.S. corporations, which means we could see further U.S. dollar strength, especially considering that Europe poses an even more uncertain political environment for investors. Trump's anti-free trade rhetoric is obviously a concern for countries like Canada – however his 'tariff-talk' has been largely focused on Mexico and China.

Time will obviously tell what this all means; however, our expectation is that President-Elect Trump will find that the well-entrenched U.S. political system will make it difficult to push through the full agenda he promoted during the election.

Our fund exposure is biased towards less economically sensitive companies – businesses that will do quite well if economic growth strengthens, but that have also enjoyed stable demand for their products and services throughout economic cycles. Several of our largest holdings also derive a material percentage of their revenue from the U.S., meaning they should have a positive tailwind at their backs if the U.S. dollar continues to rise relative to the loonie.

The Maxam Diversified Strategies Fund<sup>1</sup> declined -1.3% for the month of October and is up +9.1% through the first 10 months of 2016.

Long-time investors of ours will know we like to look at special situations. One type of special situation is known as a *spin-off*. A spin-off is a type of divestiture whereby a company that wishes to streamline its operations 'spins-off' an unrelated or non-core subsidiary business into its own entity. The basic idea is that the now separate entities can be valued on their own unique attributes and prospects – ideally resulting in the combined value of the two companies being worth more alone than they were together. The proverbial *win-win*.

ECN Capital is a spin-off situation that we recently invested in. Unfortunately, ECN was a weak performer for the fund in October, declining about -15%. ECN, together with Element Fleet Management, was previously known as Element Financial Corporation. Long story short: management believed that separating these two businesses would unlock value for both, but thus far the market has treated them both with a poor reception. For ECN, we believe investors have treated the company like a child treats an unwanted toy, and that the shares are essentially being tossed away irrespective of their value. At an attractive discount to book value we

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think there is opportunity for these shares to re-rate higher as management executes and investors afford the company a fresh look.

Polaris Infrastructure, a holding we've mentioned a few times in our recent commentaries, pulled back during the month of October. The pullback appears to be some profit taking on the heels of very strong year-to-date performance. This growing producer of geothermal power still trades at an attractive valuation, pays a healthy dividend, and announced strong quarterly results in early November.

Sandvine, a provider of hardware and software solutions to cable and telecommunications companies, is a holding of ours that we think has a great risk-reward profile at current levels. Cash represents over 40% of Sandvine's current market capitalization (and they have no debt). On a valuation basis Sandvine trades a little over 5x EV/EBITDA on 2017 estimates. With a rock-solid balance sheet, good growth prospects and a valuation that is attractive on both an absolute and relative basis, we think we could see meaningful upside for the stock.

***It is volatility that provides us with opportunity.***

The uncertainty associated with a Trump presidency, rising yields and continued global geopolitical issues, means we will likely see increased market volatility. We are positioned for a more volatile market and – *dare I say* – we're looking forward to it. As a smaller pool of capital relative to our larger peers, we have a significant 'opportunity set' and 'liquidity' advantage across the capitalization spectrum. This should allow us to take advantage of opportunities to generate returns, and better enable us to manage risk in a dynamic market.

With the final stretch of the year poised to be full of potentially market moving news, we believe our active approach of looking for *value with a catalyst* will enable us to take advantage of opportunities as they arise.

Thank you for your investment and your continued trust.

Sincerely,

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

<sup>1</sup>Returns are for Series A Master Units, and are net of fees and expenses.