Maxam Diversified Strategies Fund – Q4 2017 Commentary

The Maxam Diversified Strategies Fund[1] had a strong finish to the year, gaining +4.0% in the month of December. For the 2017 calendar year the fund gained +14.7%. The table below outlines how the Maxam Diversified Strategies Fund performed relative to some Canadian benchmarks in 2017 and since fund inception.

As at December 31, 2017[2]	Q4 2017	1 Year	5 Years	Since Inception
Maxam Diversified Strategies Fund	7.3%	14.7%	16.0%	12.8%
S&P/TSX Composite TRI	4.5%	9.1%	8.6%	8.5%
S&P/TSX SmallCap TRI	4.7%	2.8%	5.3%	8.3%
Scotiabank Canadian Hedge Fund Index[3]	3.5%	4.4%	4.6%	5.5%

Canadian equities delivered a solid return in 2017 with 10 of 11 industry sectors finishing in positive territory. The lone sector to finish negative for the year was Energy with a -10% decline. The average Canadian alternative fund manager underperformed Canadian equities in 2017, which is not a surprise given the broad-based strength for the markets, a lack of volatility to take advantage of and muted returns from short selling activities.

Q4 Performers.

Notable strong performers for the fund during the fourth quarter of 2017 included Greenspace Brands, Park Lawn Corporation, Boyd Group and Baylin Technologies.

Greenspace Brands was a new purchase for the fund in the fourth quarter, but a company we have followed for some time. Greenspace Brands develops, markets and sells premium convenience natural food products to consumers. They have more than eight distinct brands that they distribute primarily through grocery stores in Canada such as Loblaws, Metro, Safeway and others. Their organic and natural products are on trend and in the fastest growing grocery segment. Greenspace has demonstrated an ability to both launch and acquire brands, taking advantage of their scale to extend their distribution and expand their listings.

As our investors and regular readers of our commentary know: we like *value with a catalyst*. While we've known Greenspace Brands for some time, we dug deeper when we took note of some share price weakness during the second half of 2017. Greenspace's valuation declined to an attractive level, in our opinion, and we began building a position. The ongoing catalysts we expect from Greenspace include new product launches, accretive acquisitions and sales growth. There has also been quite a bit of M&A activity in the organic and natural foods space and we wouldn't be surprised to see Greenspace become an acquisition target itself.

In mid-December Greenspace announced the acquisition of Galaxy Nutritional Foods, a U.S. company that sells its products in over 12,000 locations. Another tick in the *catalyst* box. Greenspace Brand's stock ticker is JTR which stands for *Join The Revolution*. We're in.

Baylin Technologies was another solid performer for the fund in Q4. Baylin designs, produces and supplies antennas for mobile phones, small devices and base stations. The theme we are attracted to here should be apparent (*MOAR* data please!). We first took note of Baylin a few years ago when they completed an initial public offering that didn't end up going very well. Baylin completed their IPO at $8 per share back in late 2013, and unfortunately for investors who participated in the offering the shares were

below $1.50 less than two years later. Samsung was the company's largest customer by a wide margin when they went public, and I'm sure many of you will recall the unfortunate incidents of some Samsung devices catching fire a few years ago (a battery issue, <u>not</u> an antenna issue!). I think we can chalk Baylin's 2013 IPO up to "busted" status.

Suffice it to say, investors were not paying attention to this small cap Canadian technology company and the substantial decline in share price created a value opportunity for us to examine. We liked where the company was heading – they had been developing new antenna products and significantly diversifying their customer base. We bought our initial position in late 2016 at a very attractive valuation. As investors began re-discovering Baylin and the positive developments at the company, the share price has trended higher.

Subsequent to year-end Baylin announced the acquisition of the radio frequency, terrestrial microwave and antenna equipment divisions of Advantech Wireless Inc. This acquisition will be accretive to earnings, improve margins and it should open the door to new market verticals and geographies. *We like*.

Boyd Group Income Fund, delivered another solid quarter of performance. Boyd generates over 90%of their revenue in the U.S. and should benefit from the new lower corporate tax regime south of the border. In fact, a number of our Canadian holdings generate meaningful revenue in the U.S. and we expect that they will likewise benefit.

Park Lawn, the largest publicly traded Canadian-owned funeral, cremation and cemetery provider in Canada, also delivered a nice gain for us in 2017. Park Lawn exhibits some characteristics similar to our long-time holding Boyd Group. While Boyd enjoys a stable and economically *insensitive* revenue profile due to people regularly getting in fender benders; Park Lawn similarly benefits from activity that… *how do we say this sensitively*… also occurs somewhat regularly. Also like Boyd, Park Lawn's strategy is to consolidate a fragmented North American market. We're optimistic about Park Lawn's opportunity to grow and perform.

The final few months of the year were also active for our merger arbitrage strategy. Polaris Materials, Pure Technologies, Alarmforce, Aecon and NYX Gaming have all either successfully closed already or we anticipate successful closings in early 2018.

We'll be looking to increase exposure to our merger arbitrage strategy in 2018 on an opportunistic basis. As a quick refresher, merger arbitrage is a market neutral strategy – meaning the strategy can and should perform regardless of the direction of the overall stock market. Merger arbitrage can be a solid source of decent returns, and sometimes even provides optionality for better returns if a higher bid for the target company materializes due to shareholder pressure or another acquirer entering the process.

We ended 2017 with 10 individual short positions: four in the Consumer Discretionary sector, three in the Financials sector and one each in the Real Estate, Technology and Health Care sectors. We've got a 70% win rate on these shorts right now, however none individually are significant in size. We continue to search for incremental short exposure but we won't add exposure just because we want to be the cool guys at the hedge fund parties[4].

Buy the dip!

The complacency of investors in the face of some significant geopolitical and economic news was consistent theme throughout 2017. Canada's S&P/TSX Total Return Composite delivered only three negative monthly returns in 2017 while the U.S. bellwether S&P 500 index didn't have a single down month on a total return basis. That's not the norm folks.

The promise of big corporate tax cuts in the U.S., strong corporate results – both north and south of the border – and generally strong economic statistics kept the party going. Rising interest rates, global trade uncertainty, tensions with North Korea all be damned! The *dips* were bought so quickly that we we're not even sure we can call them dips in hindsight…

We love a market that moves higher as much as the next investor, however, we are wary that investors may not be appropriately pricing risk in some cases. It's certainly been a bear market in volatility.

Marijuana and Bitcoins and Tweets! Oh my!

Certain themes and sectors of the market appear to us like they may be in a mania phase. It seems all a company needed to in 2017 was announce they were exploring opportunities related to marijuana, cryptocurrencies or blockchain and their share price would immediately spike higher.

And before anyone sends us hate mail, we are not dismissing the real opportunities and companies that will emerge related to each of these themes. However, we are wary of the magnitude of the share price gains and some company market capitalizations that may be years away from being supported by even the most bullish estimates of industry and company revenues.

There have certainly been opportunities to make money associated with these themes, and we have dabbled in a small way, utilizing risk-adjusted and hedged strategies. We've focused on companies that have real products and revenues today, steering clear of pre-revenue companies that only have an idea and a press release. We are not willing to commit any significant capital to these themes at this stage.

In the end, hindsight will maintain its perfect track record and we will eventually find out what's behind the Wizard's curtain.

2018.

We don't like guessing what's behind the curtain. Our focus remains on finding and investing in companies where we believe we have identified both value and a catalyst. We believe that our active, opportunistic and flexible investment philosophy is particularly well-suited to this market environment.

While value and risk are always in the eye of the beholder, we continue to have a preference for stable business models, revenue that is less economically sensitive, clean balance sheets, identifiable catalysts and strong management teams.

We are quite excited about some of the catalysts that we expect will occur for several of our holdings over the course of 2018.

As always, 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 A Units, and are net of fees and expenses.
[2]Rates of return longer than 1 year are annualized; Inception date is July 1, 2009.
[3]Scotiabank Canadian Hedge Fund Index Asset Weighted, source Scotia Capital Inc.
[4]Do these even happen? Travis Dowle has yet to be invited to any hedge fund parties.