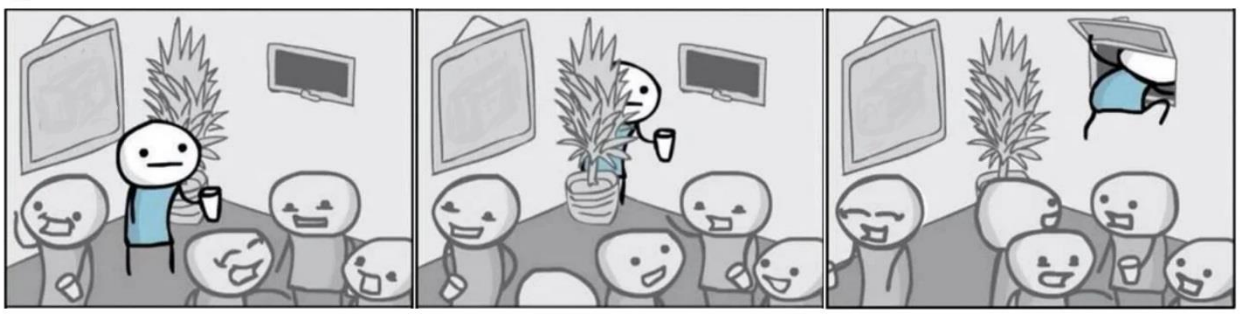
Maxam Diversified Strategies Fund – Q3 2019 Commentary

The Maxam Diversified Strategies Fund[1] declined -2.97% during the third quarter and is up +2.82% through the first nine months of 2019.

Despite both humans and machines[2] showing plenty of love for large cap growth equities so far in 2019, some market commentators are referring to the current market rally as one of the most hated in history.

Where is the love?

Over the last few years, and more intensely of late, investors have increasing focused their attention and capital on large cap and high-growth momentum stocks, regardless of valuation – in many cases, *in spite of valuation*. If you are the CEO of a company with a market capitalization of less than $1 billion, you likely find yourself alone at the party. With a market cap of less than $500 million, you're probably not even invited these days.

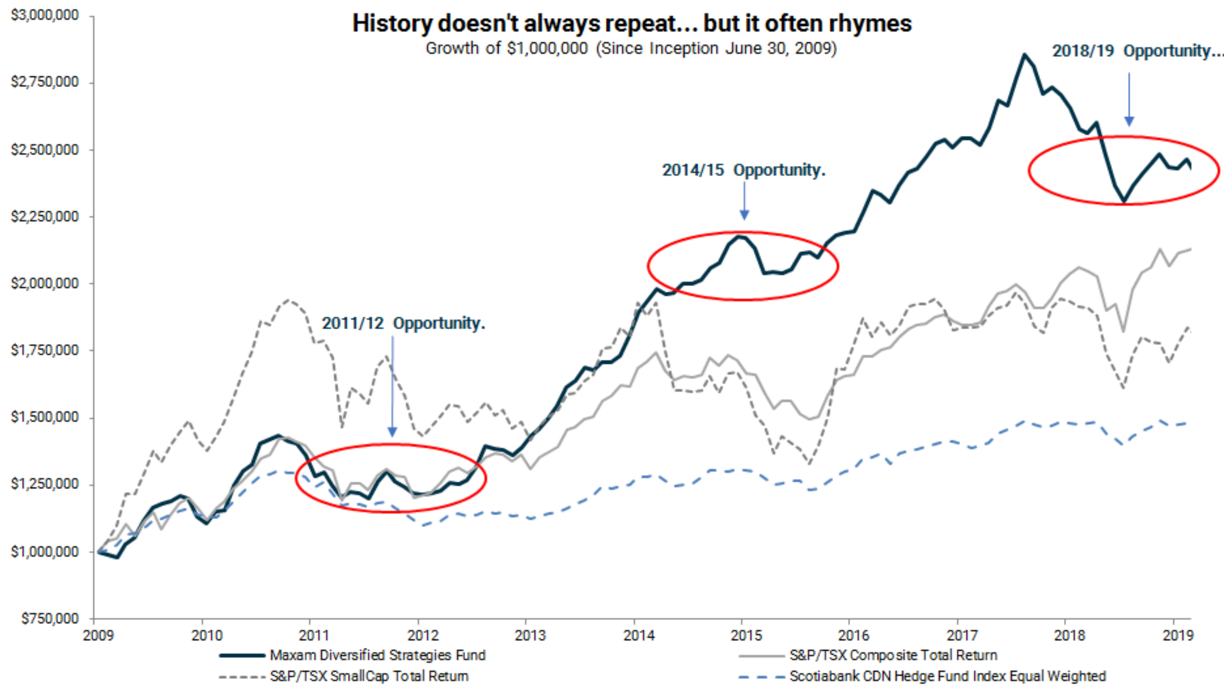


Granted not all companies deserve love, and smaller companies are no different. However, with the growth of index products and passively managed funds, just being included in an index does actually give a company some love. Every time an investor purchases an index fund or an ETF, every company included in that product automatically gets some love whether you, I, or another discerning investor thinks it is deserving of some investment dollars or not. And the bigger the company is, the greater its weight in an index, and typically the more love it gets.

So, no love for smaller companies and non-index constituents. Got it. So, what does this mean?

We've been here before.

Well, very simply put, for us it means we are seeing very compelling investment opportunities that we think will drive strong investment returns. And we've seen this before. Here's a chart of our fund's growth and path of returns since inception[3].



The 2011/12 and 2014/15 periods circled in red both remind us of the opportunity we believe we are presented with today[4].

Beneath the surface.

We have the flexibility to hunt for investment opportunities both across the market capitalization spectrum and in different industry sectors. This means we can take advantage of the inefficiencies and mispricing of securities that arise when investors either won't, or can't, invest in certain segments of the market. We strongly believe this dynamic is present today with mid and small capitalization companies where we see compelling value and opportunity.

In an environment where investors are not only avoiding smaller companies, but where there is palpable disdain for them, shouldn't there be compelling returns to be generated? We certainly think so. Per the chart above, small caps in Canada haven't done much since 2011. In fact, the Canadian small cap index is down approximately -9% since it peaked over eight years ago, in April 2011. However, over that same time frame the Maxam Diversified Strategies Fund has gained 67%.

Rather than making a case for broadly investing in small caps, our point is there are significant investment opportunities that can be exploited beneath the surface of the largest companies.

Positions.

Westaim Inc. was a poor performer for the fund in the third quarter, declining -5%. Despite *growing* its book value nicely over the last several quarters, Westaim now trades at a material discount to book at approximately 0.7x. Trading at 1x book value is about a 40% gain from here. Our value plus catalyst thesis is supported by recent insider buying.

Hamilton Thorne gave back some of its gains from earlier in the year, moving about -3.5% lower in Q3. In mid-August they announced the acquisition of UK-based Planer Ltd., a manufacturer of medical equipment for the Assisted Reproductive Technology and laboratory markets. This strategic acquisition provides Hamilton Thorne with access to new products and markets, and is accretive to both revenue and earnings.

The company also announced Q2 financial results on August 27, reporting solid growth in sales and EBITDA. Hamilton Thorne is positioned to continue capitalizing on an attractive secular growth trend in a fragmented market.

HLS Therapeutics declined -6.2% in the third quarter. We remain bullish on this Canadian pharmaceutical company that focuses on the commercialization of late stage development products. In addition to three existing products generating over US$33 million in EBITDA, HLS owns the Canadian rights to an already FDA-approved and commercialized cardiovascular drug called Vascepa. Amarin Corp. owns the U.S. rights for Vascepa and has applied for label expansion which, if approved, will materially expand the drug's addressable market. HLS has applied to Health Canada for similar approval and has received Priority Review Status, reserved for "new treatments that potentially address serious, life-threatening conditions for which no drug is currently marketed in Canada, and for which there is substantial evidence of clinical effectiveness of that new treatment." We're excited about the prospects for HLS addressing this large market in Canada.

While these names were sources of negative attribution for the fund in Q3, our investment thesis on each remains intact. All else being equal, lower share prices mean the reward-to-risk opportunity has improved.

Beyond the value that we see in our fund's holdings today, we continue to actively discuss with management teams the potential ways in which they can drive shareholder value.

Perfect Storm.

It's difficult to imagine a more contrarian investment than Canadian small caps right now. Investors fear a recession is coming, trade wars are slowing growth and business investment decisions, we have a minority Canadian government and investment in Canada has been declining… is it different this time or is this an opportunity…again?

The divergence between large caps and small/mid caps in 2019 has been frustrating to say the least. The relative underperformance of smaller companies is not warranted by their underlying business performance in many cases. Throughout history, consensus of pessimism has led to significant opportunity.

There won't be a calm after the storm, equities will always be volatile, we'll just see higher prices.

Thank you for your investment and your continued trust. Please take the opportunity to call me if you have any questions.

Sincerely,

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

[1] Maxam Diversified Strategies Fund, Series F units, net of fees and expenses.
[2] Machines, robots – generally referred to as algorithmic trading done by computers. Rise of the machines!
[3] Maxam Diversified Strategies Fund, Series A units, net of fees and expenses; inception date was June 30, 2009.
[4] While we refer to these respective periods as "opportunities", some of our investors may refer to these periods as *"Maxam has lost it"*, *"they don't have a clue"*, and sometimes *"what the F#*&*@#!!!"*.