Maxam Diversified Strategies Fund – Q4 2019 Commentary

The Maxam Diversified Strategies Fund[1] ended the year on a strong note, gaining +4.0% in December, +7.0% during the fourth quarter and finishing the 2019 calendar year up +10.1%.

What a year.

Markets successfully climbed the steep wall of worry that was prevalent at the outset of 2019. Very broadly speaking, equity market gains over the past year were fueled by easier monetary policies globally and the stabilization of macroeconomic conditions, both of which led to multiple expansion and an environment where expensive growth stocks thrived. It was the *growth at any price* market.

While in the context of a long-term track record we shouldn't look too harshly at a one-year return of +10%, we'd be a little dishonest if we didn't admit to casting a jealous eye at the TSX Composite's return in 2019. Yes, we always want to do better, but as value-oriented investors we know that these types of momentum driven markets aren't necessarily environments we will outperform in over short periods of time. As an active manager we strive to balance both reward and risk when constructing a portfolio.

We've stuck to our knitting – that which has enabled us to generate a long-term track record of relative outperformance and strong risk-adjusted performance. As we espouse below, we believe the dynamics of this current market environment set us up for some strong returns.

What worked | What didn't.

Notable strong performers for the fund in Q4 2019 included HLS Therapeutics, Quorum Information Technologies, Boyd Group and Medicure.

The final two months of 2019 were catalyst rich for HLS Therapeutics, culminating with news that this Canadian pharmaceutical company received Health Canada approval for its cardiovascular drug Vascepa. Our belief that Vascepa approval in Canada was low risk given the drug was already FDA approved in the United States proved correct. Health Canada fast-tracked the approval of Vascepa because it meets an unmet need in Canada – and we see it as having the potential to become a blockbuster drug for HLS.

Quorum Information Technologies, a provider of software solutions to the automotive dealership market, moved higher in the fourth quarter on the back of solid Q3 results. Quorum has strengthened its product offering through strategic acquisitions and continues to win new dealership customers. Quorum is investing in growth and we believe that potential approval from additional Original Equipment Manufacturers ("OEM's"), such as VW/Audi, will be key catalysts for the company.

Boyd Group continued to march higher through 2019. When we first bought shares of Boyd almost nine years ago we were quite optimistic about the prospects for this stable, recession resistant business led by a strong management team making accretive acquisitions in a fragmented industry. Happily, Boyd has performed beyond our expectations. For the majority of the time we owned Boyd the business had been structured as an income trust (remember those!) – however in late Q3 2019 Boyd announced that it was going to convert from this legacy structure into a traditional corporation. While this conversion will have no impact on business operations, we think a significant benefit for Boyd will be the lifting of the 49% foreign ownership cap. With about 88% of their revenues generated in the U.S. we think this conversion will open up Boyd to a large pool of new buyers and potentially paves the way for a U.S. listing.

Long-term holding Medicure was also a strong performer for the fund in Q4. In early November Medicure announced plans to commence a substantial issuer bid ("SIB") pursuant to which the company would offer to purchase approximately 26% of its outstanding shares at a considerable premium to the current share price. We viewed this offer as a good use of capital by the company, as it not only signaled to the market that management believes its shares are materially undervalued, but that through utilizing their overcapitalized balance sheet they can find creative ways to unlock value and reward existing shareholders. We tendered the fund's shares to the SIB and consequently disposed of almost 40% of our position at a substantial premium to the company's recent share price.

Broadly speaking, we were pleased to see some strength across a variety of the fund's holdings in Q4. This strength coincided with some renewed interest in so-called *value stocks* in general, and reaffirms our belief that fundamentals do still matter.

In a relative sense, what didn't work for most of 2019 was investing with a value-oriented focus on fundamentals. As we've previously discussed, investor focus on top line growth (and in our view regardless of value in many instances), combined with the momentum inducing feedback loop of passive index products has helped most name brand large caps become even larger and more richly valued.

These dynamics have led to an environment where one can make attractive investments in under the radar businesses such as Hamilton Thorne, Westaim and others. As we've seen throughout history, either investors reward fundamentals and value, or an acquiror eventually does.

Trees don't grow to the sky.

After a strong move higher for major equity indices in 2019, it is fairly common these days to hear pundits talk about the "stock market" being expensive. But should investors worry and avoid equities? Rather than make a broad market call (that's a mug's game and not how we invest), we're keenly focused on where we see value and opportunity today.

Value is of course in the eye of the beholder and, in our view, certain stocks and segments of the market do appear expensive today. The last couple of years has undoubtedly favoured expensive large cap growth stocks, whose multiples have re-rated much higher. If top-line growth for companies trading at high multiples stalls or declines, then those multiples can contract quite quickly. Trees don't grow to the sky.

Is the market expensive? I think it depends how you define the "market". We remind investors that a portfolio of securities is not necessarily analogous to the market. In fact, a truly actively managed portfolio can be quite different.

[Not] left behind.

As we highlighted in our last quarterly commentary:

We enjoy 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 mispricings of securities that arise when investors either won't, or can't, invest in certain segments of the market.

While several of the fund's holdings do have market caps counted in billions, we see compelling value and opportunity today beneath the surface of the largest caps. During the last few months of 2019 in particular, we saw encouraging signs that investors are taking note of strong financial performance and positive company news regardless of a company's market cap.

Positioning.

The fund's net exposure averaged about 85% in 2019 with long positions, characterized by situations where we have identified both attractive value and a catalyst, comprising our largest allocation. At year end, the fund's top 10 positions accounted for 33% of assets.

We were active with our shorts last year, including reducing some of our short exposure towards the end of Q4. We have already added back some incremental short exposure in January and we continue to monitor additional candidates – seeking to add exposure when specific situations meet our risk/reward criteria.

Arbitrage strategies were a source of excellent risk-adjusted returns for the fund in 2019. With a number of deals successfully closing in Q4 we have some fresh capital that we are actively deploying into new transactions that meet our strict investment criteria. We're big fans of this market neutral and tax-efficient strategy that we've utilized in the fund since its inception.

Heading into 2020 we are looking forward to a number of company specific catalysts that we believe will drive material value for the fund's holdings.

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

Sincerely,

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

Please note that the Maxam Diversified Strategies Fund did not incur a taxable distribution for 2019 and therefore we will not be distributing tax slips.

[1] Maxam Diversified Strategies Fund, Series F units, net of fees and expenses.

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