

Maxam Diversified Strategies Fund – Q3 2020 Commentary

Dear fellow investors,

The Maxam Diversified Strategies Fund¹ gained +0.7% in the month of September and +10.3% in the third quarter of 2020. This compares well relative to Canada's S&P/TSX Composite which was down -2.1% in September and up +4.7% in Q3.

The market environment.

The market environment during Q3 continued to reward the largest capitalization equities, most notably those in the technology sector and with a theme related to *work from home* and/or *shop from home*. This is broadly a continuation of what we have seen since the coronavirus-induced market crash in March – however, encouragingly, we have seen breadth begin to improve of late.

On a short-term basis, day-to-day and sometimes hour-to-hour, markets are reacting to the latest news and speculation regarding COVID-19 cases, vaccine developments, stimulus packages and the U.S. presidential election. This was increasingly the dynamic in September and has been thus far in October as well.

From the coronavirus to politics, this is a very uncertain environment in which to have a confident view of where markets and the economy are headed. A common observation these days is that equity markets seem to be disconnected from the economy. While this is not without precedent, it may seem somewhat perplexing given the historic decline in economic activity over the last several months and the uncertainty regarding the path to, and pace of, the recovery.

Uncertain times can make for incredibly attractive investment environments, especially for strategies focused on individual stock-selection. This is the environment we believe we find ourselves in today.

Fund exposure.

The fund ended the third quarter with approximately 20% gross exposure across arbitrage, shorts and cash equivalents. We consider this to be the fund's 'market neutral' allocation. Arbitrage and cash typically exhibit no-directional correlation with equities, while short exposure typically exhibits negative correlation with long equity exposure.

Similar to the second quarter, the fund generally exhibited low downside capture on the days when the major indices moved lower. In our view, the fund's low downside capture on the market's negative days was not only due to our aforementioned arbitrage, short and cash exposure, but also because our holdings are not the typical 'household' names that comprise a large weight in, and significant influence on, Canada's S&P/TSX Composite.

Areas of strength for the fund in Q3 included holdings in the Financials, Technology, Health Care and Consumer Staples sectors and in arbitrage strategies. Trisura Group, Westaim Corp and Liquidity Services Inc. were particularly strong performers for the fund in the third quarter.

Trisura Group is a Canadian-based specialty insurance provider that was spun out from Brookfield Asset Management in mid-2017. Trisura has demonstrated strong growth in both Canada and the U.S., highlighted by return on equity levels near 20%.

The Westaim Corporation was a solid performer for the fund in Q3. Westaim is a Canadian company with two significant holdings in the financial services industry: the Houston International Insurance Group, a U.S. domiciled specialty property and casualty insurance company, and Arena Group, a credit focused investment manager. We remain attracted to the value of Westaim which trades at a material discount to its book value, and to potential future catalysts that we think will drive its share price higher.

Another strong performer for the fund in third quarter was Liquidity Services Inc. We discovered this company while searching for investment opportunities that we thought could not only survive the coronavirus pandemic, but also benefit from it. Liquidity Services operates an online auction marketplace for wholesale, surplus, and salvage assets – offering products by industry such as consumer electronics, general merchandise, apparel, scientific equipment, and aerospace parts and equipment. Firming up our conviction in Liquidity Services was significant insider buying by the CEO and senior management team during the coronavirus crash in March and continuing throughout the second quarter.

In fact, insider buying, something we consistently search for (an attractive signal at any time but perhaps moreso during a significant market dislocation) was also present for Trisura and Westaim over the last several months.

In aggregate, the Maxam Diversified Strategies Fund's exposure reflects our positive view of the companies that we have long positions in, and our somewhat cautious view on the macroeconomic and political environment in the short-term. As always, we will endeavour to utilize any forthcoming market volatility to opportunistically take advantage of the situations we are close to and knowledgeable of.

Tuning out the noise.

While we have experienced our share of market corrections and dislocations throughout our careers, the 2020 calendar year thus far has been one of the oddest we have experienced as investors.

It remains an ongoing pursuit to tune out the noise – especially since there is a lot of it these days, dominating headlines and influencing risk appetite. Beneath the surface of the noise, we remain focused on investing in companies with strong fundamentals where we have identified attractive value and the presence of a catalyst. Conversely, we are not invested in the mega caps and the “story stocks” where we believe one is taking high beta risk in the current market environment.

Our fundamental-oriented, value-conscious and market cap-agnostic style has been arguably out of favour since early 2018, but we do sense a shift of late. Breadth is beginning to improve as investors search for opportunities that have been ignored or undeservedly left behind. If value does begin to takeover leadership from ‘*growth at any price*’, we are well positioned for it.

As we discussed in our Q2 commentary, value rises to the surface.

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.

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