MAXAM
CAPITAL MANAGEMENT

Maxam Diversified Strategies Fund – Q4 2020 Commentary

Dear fellow investors,

The Maxam Diversified Strategies Fund[1] gained +12.8% during 2020. This compares favourably to Canada's S&P/TSX Composite which gained +2.2% for the year (+5.6% on a total return basis).

What a year.

With the COVID-19 pandemic causing disruption to both society and the economy, it is more than a mild understatement to say that 2020 was a year like we've never seen before.

We endeavoured to both manage risk and take advantage of numerous opportunities in what was a very volatile market environment. We stayed true to our fundamental and value-oriented approach, and this held us in good stead.

We continue to see compelling opportunities and unique special situations to take advantage of in the current market environment – and to be forthright, we also see some risks. We believe this is an environment that our active, opportunistic, and flexible style is particularly well suited for.

The Good Ol' Hockey Game[2].

The *First Period* of 2020, January to March, was rough: COVID-19 had a materially negative impact on capital markets and security prices across almost all asset classes. Not much was left unscathed and we finished the first period *behind on the scoreboard*.

There is no intermission in the markets and you can't call a time out, thus we were assessing the situation in real-time.

While we are constantly monitoring our existing investments, we initially focused on reviewing the balance sheets and the immediate implications of the emerging COVID-19 pandemic on the companies we were invested in: assessing our line-up so to speak. Do we have the players to win? Should we adjust our strategy?

In a late *first period* commentary, we wrote:

> We of course already like the companies that we own in the fund, and while their stock prices have moved lower, our view on the medium and long-term value of these businesses has not changed.
>
> In addition to our existing holdings becoming more attractive from a valuation perspective, we are always looking to improve the reward-to-risk composition of the portfolio. A significant market dislocation like this increases our opportunity to do so. In some instances, we have been able to begin acquiring companies on our watch lists at prices that we didn't believe would be possible even a few short weeks ago.
>
> There is a saying that *one shouldn't let a good bear market go to waste*. In addition to the brief comments above on our actions, I believe we are going to see some **tremendous opportunities**. While the current environment is obviously quite fluid, we are already starting to uncover some unique and compelling situations that we are excited about.

Maxam Capital Management Ltd.
902 – 510 Burrard Street Vancouver, BC, Canada V6C 3A8 T 604 685 0201 F 604 685 9970

We were certainly active, but we kept many of our core players (our core *holdings*) in the game, and we began to selectively take advantage of some new opportunities.

Second Period. Let's call this the April to September timeframe.

The fiscal and monetary stimulus response from governments and central banks was, and continues to be, huge. Analysis by CBC News[3] suggests the Canadian government has spent almost $1 billion per day.

This support and liquidity began to fuel investor confidence and the bellwether equity indices in North America rallied off their March crash lows. The largest capitalization companies, especially those with a theme or narrative associated with *work from home*, ecommerce, and the acceleration of all things digital, were the biggest movers and index influencers.

Characterizing the market environment and relative performance was: mega caps > large caps > small caps, growth > value, and narratives > fundamentals. Shopify, which had become the largest company in Canada by the midpoint of 2020, is a great example of the aforementioned characteristics and themes outperforming. Shopify alone had a material impact on TSX performance through the first half of 2020, and the entire year.

	First 6 Months of 2020	Full Year 2020
S&P/TSX Composite	-9.1%	+2.2%
S&P/TSX Ex-Shopify	-12.5%	-1.9%
S&P/TSX Ex-Top 5 Contributors	-14.5%	-4.0%

We were in the game but still a little behind on the scoreboard. Encouragingly, beneath the surface of the companies that were garnering most of the headlines, we were seeing signs that staying true to our process and core principles – a value-oriented, opportunistic, and company-specific approach – was working.

Third Period. aka "the shift": (October to December):

Growth as an investing style has outperformed value for more than a few years now – and it has been a much debated topic. As a firm with a fundamental and value-oriented approach to investing, we've felt some of that relative headwind.

In November the TSX had a strong month of performance and the culprit was value stocks! Headlines abounded that a shift in leadership from growth to value was underway. The Maxam Diversified Strategies Fund also had strong month in November, however I would not broadly characterize our names as 'traditional' value.

From our perspective we were seeing the continuance of a shift. The recovery in equity markets over the past several months had been somewhat uneven, characterized by low breadth and a large divergence between the *winners* and the so-called *losers*. We believe what we were seeing was a rotation from momentum and growth-at-any-price towards investors seeking out and rewarding attractive fundamentals.

The fund finished 2020 on a strong note, completing a volatile and uncertain year with a respectable return. Sticking with the hockey analogy (and I promise that's it!) we stuck to our game plan and finished ahead on the scoreboard.

This isn't a game of course. We are always looking to adapt and learn in a continuous effort to improve our ability to deliver strong risk-adjusted returns in future. We have added to our collective experience and will bring that to bear.

Fund exposure.

The fund ended the fourth quarter with approximately 23% gross exposure across arbitrage, shorts and cash equivalents. We consider this to be the fund's 'market neutral' allocation. Arbitrage and cash typically exhibit low correlation with equities, while short exposure typically exhibits negative correlation with long equity exposure. The balance of fund exposure is long and invested in companies that, in our view, remain mis-priced relative to their assets, prospects and/or a future catalyst.

While our holdings broadly performed well in Q4, areas of notable strength for the fund included holdings in the Technology, Health Care and Materials sectors, and arbitrage strategies. Polaris Infrastructure (+30%), HLS Therapeutics (+28%) and Liquidity Services (+113%) were particularly strong performers for the fund in the third quarter.

In our Q3 commentary we wrote the following about Liquidity Services Inc. *(emphasis added)*:

> 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.

Multiple insider purchases by several officers in a short period of time is a great signal with respect to the current value and the future prospects of a business. We refer to this as cluster buying. We highlight it again here because insider transactions are something we consistently monitor. It was a particularly helpful signal during a very tumultuous and uncertain year for the markets.

Looking forward.

We are mindful that equity markets have had a heck of a run over the last several months. In our view there are certain segments of the market that are overheated and even in bubble territory – segments and companies that we are seeking to avoid.

And we continue to see compelling opportunities and unique special situations in the current market environment as well. 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.

This is increasingly an environment that I believe our style is particularly well suited for. Our focus remains on companies that, in our view, remain mis-priced relative to their assets, prospects and/or a future catalyst.

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.

[1] Maxam Diversified Strategies Fund, Series F, net of fees and expenses.
[2] The Hockey Song. A classic. Pure *Canadiana* by Stompin' Tom Connors. RIP.
[3] https://www.cbc.ca/news/canada/tracking-unprecedented-federal-coronavirus-spending-1.5827045