

Maxam Diversified Strategies Fund – Q2 2021 Commentary

Dear fellow investors,

The Maxam Diversified Strategies Fund¹ gained +5.3% during the second quarter, +17.9% through the first half of 2021 and +60.5% over the last 12 months.

As at June 30, 2021	1 Month	3 Months	YTD	1 Year	2 Years*	3 Years*	5 Years*	10 Years*	Since Inception ¹	
									Annualized	Cumulative
Maxam Diversified Strategies Fund ¹	2.1%	5.3%	17.9%	60.5%	17.3%	8.0%	8.8%	10.0%	10.6%	234.4%
S&P/TSX Composite	2.2%	7.8%	15.7%	30.0%	10.9%	7.4%	7.5%	4.2%	5.7%	94.4%

*Annualized

Canadian equities, and global risk assets in general, continued to march higher during the second quarter of 2021. The strongest performing sectors were technology, energy and materials whereas the health care and industrials sectors lagged.

Over the past 15 months, in reaction to the coronavirus pandemic, central banks and governments have flooded markets and economies with massive amounts of monetary and fiscal stimulus. The *print-money*, *reduce-rates* and *buy-bonds* playbook was largely accepted as the correct response to the *unknowns* of the pandemic at the time.

Investor attention has shifted towards inflation concerns (and we'd be remiss not to note, some recent growing concern over the rise of the COVID-19 Delta variant). With the uptick in inflation readings, notably during May, policymakers are walking the tightrope of messaging plans for an eventual tapering of bond purchase programs and other stimulative policies.

The market isn't usually a fan of the punchbowl being taken away – however, the Fed, for its part, has messaged that they won't take it away any time soon and that interest rates will remain low. With record amounts of accumulated debt and the post-pandemic recovery still in its early stages, we can certainly see the Fed and other central banks being willing to let the economy run hot.

Inflation? Reflation? Deflation?

It's dizzying to think about. And, truth be told, we don't spend most of our time thinking about it.

We do spend the majority of our time researching businesses.

Top-down factors are certainly an input in our process, but our focus is bottom-up, company-specific research first. We consider ourselves to be business investors at Maxam. That's why you're more likely to find us highlighting an investment thesis on a company that excites us rather than a debating inflation vs deflation at the local CFA club².

Investing in a company run by owner-minded leadership at an attractive valuation, that is approaching or has gone through an inflection point is a great recipe for driving investment returns through a variety of market environments.

We are also opportunistic and flexible investors. We enjoy the flexibility to adapt to different market conditions and to invest where we see opportunities. If we see increased market volatility due to a slower

economic recovery, a wind-down in stimulus measures, inflation, deflation or something else – then we would encourage investors to look at that volatility as the opportunity for future returns. We do.

Fund exposure.

On a gross basis, the fund ended the second quarter with approximately 15.3% in arbitrage and 3.5% in short exposure, respectively. Arbitrage and shorts combined account for 18.8% of the fund's gross exposure and represent an allocation that exhibits low correlation to the equity markets. The balance of our exposure is in long positions comprised of companies where we believe we have identified both value and a catalyst, and special situations where we believe we are exposed to asymmetric reward-to-risk profiles.

While we did have several strong contributors to fund performance in Q2, Photon Control was a standout. We began purchasing shares of this fiber optic measurement solutions provider in late 2018 after its share price had significantly decreased. Our investment thesis was supported by two key factors: first, our view that Photon's solutions were a key component for their customers in the semiconductor industry and poised to deliver solid growth, and second, Photon had a fortress balance sheet with over half of its market cap in cash – representing both an attractive margin of safety and future optionality.

Another key aspect to our thesis on Photon were some changes at the board level and a new CEO that was brought in to lead the business. As mentioned above, we like catalysts and inflection points. Fast forward to the second quarter of 2021, Photon received an all-cash offer from MKS Instruments to be acquired for \$3.60 per share.

Long time investors with us will know that we are big fans of strong balance sheets and companies that are not on the radar for most investors. We believe we have a few more companies that fit this profile in the fund today.

M&A.

Speaking of mergers and acquisitions, we are in a very robust deal-making environment today and it appears poised to continue. Factors fueling the M&A boom include significant amounts of private equity capital seeking targets (their mandate is to acquire), low interest rates, executive confidence in a post-pandemic recovery and some wide disparities in relative valuations for acquirers to take advantage of.

We will continue to take advantage of this healthy M&A environment through merger arbitrage. And we believe we have existing holdings in the fund that will be active on the acquisition front themselves, and others that may be likewise targeted by acquirers.

Don't be a hero.

Shorting stocks has been extremely difficult over the last few years. In truth it is never *easy*, however in a time of easy money and strong risk-appetite it is especially challenging.

Although our short exposure is not significant today, we believe that we will begin to see more opportunity to profit from short positions as certain segments of this market inevitably turn. Our attention in this regard is focused on pockets of speculation and highly valued mania or momentum stocks – companies that have experienced dramatic stock price appreciation and, in our view, where valuations are well beyond even the most bullish of realistic scenarios.

We won't try to pick a top, nor try to be heroes on the short side. Instead, we will observe and wait patiently for opportunities where disappointment has begun to ensue, and it is apparent that nothing more than a (formerly) strong narrative was supporting the stock price. Discipline and timing are a key focus for us here.

Hindsight / Foresight.

In March 2020 a new virus was circling the globe, economies ground to a halt, businesses closed, and consumers hunkered down. People worried about their income and mortgage payments were deferred en masse. Put up your hand if you thought residential real estate would skyrocket in value.

It seems obvious today though, doesn't it? That is because it happened and we can, in hindsight, look back and identify factors that explain why.

I often ask myself, what should I invest in today that when I look back a year or two from now will seem like an absolute no-brainer. Hindsight has the best investment track-record of us all.

We don't have a crystal ball that affords us a look into the future, but we can look backwards to look forwards. We have the benefit of experience that includes hard knocks, lessons learned, and triumphs earned.

With the foundation of our collective experiences, humility, and learnings, both recent and long-standing, we will continue to follow and refine our investment process that has enabled us to generate strong risk-adjusted returns for more than 12 years.

On that note, the Maxam Diversified Strategies Fund is not a static portfolio of holdings, and we continue to discover new and compelling investment opportunities to take advantage of today.

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 an environment that we believe our investment approach and style is particularly well suited for.

My colleagues and I are grateful for the trust you have placed in us to manage a portion of your hard-earned capital.

We look forward to formally reporting to you again after Q3, but in the meantime please don't hesitate to call or email if you have any questions or would like an update.

Enjoy your summer.

Sincerely,

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

¹ Maxam Diversified Strategies Fund, Series A, net of fees and expenses. Inception date June 30, 2009. Please contact us regarding other series of fund units or visit our website www.maxamcm.com

² I am not sure if there is a Chartered Financial Analyst (CFA) club where they debate inflation and deflation. But there is a CFA Society of Vancouver, and we do enjoy attending some of their events.