

Maxam Diversified Strategies Fund – Q1 2022 Commentary

The Maxam Diversified Strategies Fund¹ gained +2.0% in the first quarter of 2022.

Geopolitical tensions, rising interest rates and high inflation made for a challenging investment climate during the quarter. We expect these factors will continue to shape markets in the near-term.

Equities were volatile and broadly lower – the MSCI World, S&P 500, and NASDAQ declined -5.0%, -4.9% and -9.1% respectively. Canada’s heavy weighting in energy and materials companies, and its relatively low weight in technology, enabled the TSX to buck the trend with a +3.8% gain.

Faced with increasingly hawkish central banks, bonds did not fare any better than equities. The U.S. focused Vanguard Total Bond Market ETF and the iShares Core Canadian Universe Bond Index ETF declined -5.8% and -7.3% respectively.

There were not many places to hide during the quarter and the volatility has continued into April.

Houston, we have a duration problem².

Record low interest rates, money printing, supply chain problems, pent-up demand from the pandemic, Russia’s invasion of Ukraine... put that all in a blender and you have an inflation smoothie.

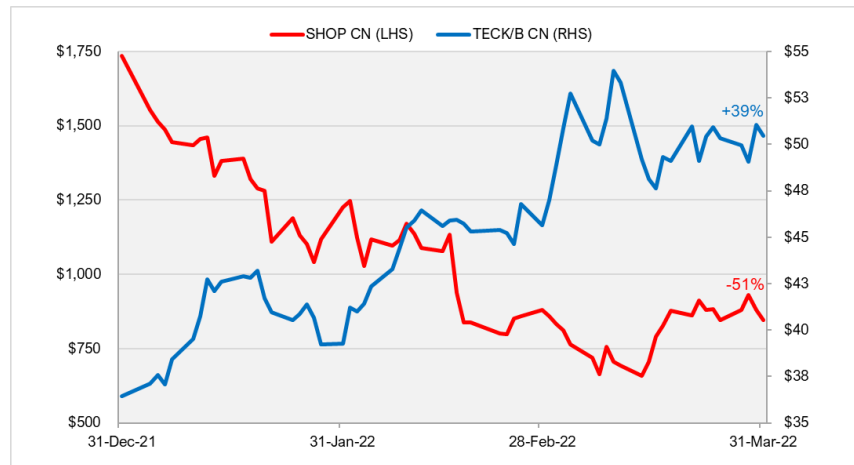
Statistics Canada reported that annual inflation rose to 6.7% in March – the highest reading since 1991. That doesn’t feel too *smooth-y*.

In our Q3 2021 commentary we wrote:

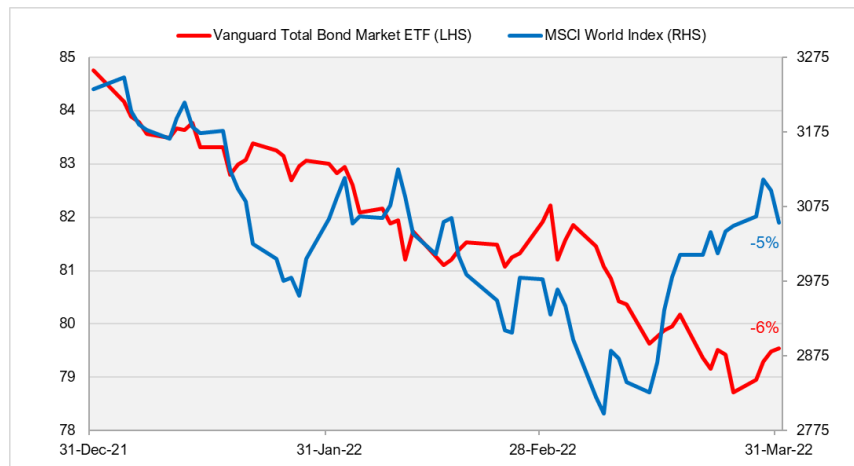
Duration is a term that has been co-opted from the world of fixed income into the equity market of late. Long-duration equities, companies whose earnings are expected to be generated in the more distant future (as opposed to short-duration equities who are expected to deliver in the short-term), are more sensitive to changes in interest rates.

As central banks reduced interest rates to near-zero levels and flooded the markets with liquidity in response to the Covid-19 pandemic, long-duration growth stocks outperformed by a wide margin. And more recently, as interest rate expectations have changed in response to higher inflation and bond yields have risen, short-duration and value stocks have outperformed.

Long-duration stocks were hit hard in Q1 while short-duration securities moved higher. The chart below of high growth ecommerce technology company Shopify, and diversified materials miner Teck Resources, typifies what has transpired.



And rising rates are a clear negative for bonds as well. The following chart of the Vanguard Total Bond Market ETF and the MSCI World Index in Q1 shows that balanced investors haven't experienced much balance of late.



If your portfolio was all long-duration growth and speculative *momo* stocks, or heavy on traditional bond exposure, it has likely been a disappointing start to 2022.

Central banks are signalling that they will aggressively fight inflation, and current expectations are for several more interest rates hikes in Canada and the U.S. by the end of this year. With financial conditions already tightening significantly, and mounting calls that a recession is coming, it would seem to us that central banks will have the opportunity to soften their approach and even reverse course if circumstances warrant.

Exposures.

The Maxam Diversified Strategies Fund has weathered the market volatility well thus far, with a small decline in January followed by gains in both February and March. The fund's *shorter-duration* holdings were, unsurprisingly, the fund's best performing positions during the quarter. These companies were largely in the energy and materials sectors – significant beneficiaries of inflation. Modest short exposure was also a positive contributor to fund performance.

Technology has been the hardest hit sector year-to-date. The fund's weight in technology was approximately 12% on March 31, excluding arbitrage positions. Our technology holdings, focused on where

we see attractive value and catalysts – and avoiding companies we consider speculative and unjustifiably valued – have held in quite well relative to the overall downward move in the sector.

The fund's short-duration exposure also includes its arbitrage strategy allocation, which was approximately 19% at the end of the quarter. Arbitrage was a modest positive contributor to performance in Q1, with the added benefit that this largely market neutral strategy preserved capital and reduced overall portfolio volatility. We continue to see low-risk and attractive arbitrage situations in the current environment that can reduce market risk and help diversify a portfolio, especially during a period of rising interest rates³.

Fund exposure remains well-diversified across sectors, strategies, and individual positions. As at the end of the quarter, the fund was invested across 10 industry sectors with no sector weight larger than 16% of net exposure (excluding arbitrage). The fund's long exposure is in positions that we classify as compounders, event-driven and special situations.

The shift is on.

In recent fund commentaries, we have highlighted our belief that the market is in the early stages of transitioning away from an environment that has favoured high-multiple, growth-at-any-price, speculative stocks – towards an environment where companies with current and tangible revenues and growing bottom lines will be increasingly rewarded.

We held these views prior to Russia's invasion of Ukraine, the ramp in inflation and the now in-motion interest rate increases. We already owned companies where we saw value (and catalysts) – and perhaps more importantly over the last few months, we were not invested in the companies that have been, and are now, under the most significant pressure.

In our opinion, *the shift*, and its ramifications, is still in the early stages of playing out.

The brightside.

Macro-driven investing is not core to our approach at Maxam. We consume news and information and observe trends, but we won't offer any unique commentary here on geopolitical events, inflation, or interest rate policies.

What is core to our investment approach is taking advantage of opportunities and a keen focus on risk and reward. An environment characterized by volatility and change has historically and repeatedly been where we have found compelling investment opportunities.

And the reasons for the volatility can lead to specific investments. For example, certain trends and themes appear likely to solidify and even accelerate, such as: food security, agriculture, energy security and infrastructure. Befitting those themes, we purchased shares in Nutrien a few months ago, one of the largest fertilizer producers and agriculture retailers in the world. We also made a similar investment in a smaller fertilizer company that we expect will generate significant free cash flow from higher product prices.

We've experienced more than a few market declines and events over the years. From the bursting of the tech bubble in 2000, the financial crisis in 2008-09, the sovereign debt and Eurozone crisis in 2010-11, the growth scare and trade wars in 2018, the Covid crash in early 2020, and more. Each of these market declines have presented substantial and unique investment opportunities.

Today's concerns will eventually become yesterday's opportunities. Supply chain backlogs will alleviate, inflation will slow, consumer and investor demand will return. The market loves a wall of worry on which to climb higher.

This is an attractive environment for our investment style and strategy in our opinion – one that will increasingly favour our value-oriented and active approach. We continue to look forward to some specific events and catalysts for several of our holdings throughout the balance of 2022.

Thank you for your trust and confidence. Please don't hesitate to reach out with any questions.

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 classes of fund units or visit our website www.maxamcm.com

² https://en.wikipedia.org/wiki/Houston,_we_have_a_problem

³ Arbitrage is a low-risk, consistent and absolute return-oriented strategy. We manage the [Maxam Arbitrage Fund](#) which focuses exclusively on arbitrage strategies.