

Maxam Diversified Strategies Fund – Q4 2022 Commentary

Dear fellow investors,

The Maxam Diversified Strategies Fund¹ gained +2.8% in the fourth quarter and declined -7.4% in 2022.

The market environment faced downward pressure in 2022 from a multitude of factors – including high inflation, rising interest rates, recession fears and geopolitical tensions. The most dominant factor was the relentless efforts by central banks to crush surging inflation via tightening monetary policy. Most notably, the U.S. Federal Reserve raised interest rates seven times during 2022, taking the federal funds target rate to its highest level since 2007.

The consistent march towards higher interest rates took no prisoners. Rising rates are a negative for short duration bonds, and even worse for bonds with longer duration – which were hit the hardest as inflation reached levels not seen since the early 1980s. In addition, many growth stocks and speculative companies fell precipitously after reaching nonsensical heights following the deluge of Covid-19 pandemic stimulus, which included central banks flooding the markets with liquidity and reducing interest rates to near-zero levels.

	2022
Maxam Diversified Strategies Fund ¹	-7.4%
S&P/TSX Composite Index	-8.7%
S&P/TSX Small Cap	-11.2%
S&P 500	-19.4%
NASDAQ	-33.1%
MSCI World	-17.4%
iShares Core CAD Universe Bond Index ETF	-11.7%
Vanguard Total Bond Market ETF	-13.1%

Source: Maxam, Bloomberg

Déjà vu? Yes.

Despite there being almost nowhere to hide in 2022, we’re not pleased anytime we have a negative annual return. However, *we have been here before*.

In almost every bear market we hear the argument that *it’s different this time*. While there is no denying the challenges facing economies and markets today, we believe it is important to remind investors – and ourselves – that we have faced similar challenges many times throughout history: world wars, high interest rates, high inflation, technology bubbles, real estate bubbles, debt defaults, double digit unemployment, corporate scandals, and multiple bear markets.

One thing all crises have in common is that they end. Another is that they always unveil compelling opportunities. And we’ve historically done some of our best work during periods of elevated market volatility and after market declines.

Since the inception of the Maxam Diversified Strategies Fund in 2009, the S&P/TSX Composite Index (the “TSX”) has had three negative calendar year returns besides 2022. Per the table below, our fund was down in two of those years, and positive in one.

	2011	Next 2 Years	2015	Next 2 Years	2018	Next 2 Years	Average in Down Years	Average Next 2 Years
MDSF ²	-14.5%	+40.5%	+5.5%	+31.2%	-16.8%	+22.9%	-8.6%	+31.6%
TSX	-11.1%	+13.9%	-11.1%	+24.6%	-11.6%	+21.7%	-11.3%	+20.1%

Source: Maxam, Bloomberg.

During each of these previous market declines we took advantage of attractive investment opportunities. And each decline also represented an opportunity for our investors. The fund's returns over the next couple of years were very strong. History doesn't always repeat exactly, but it often rhymes.

Today, like 2011, 2015 and 2018, we believe we have attractive value in our current holdings, and we are excited about the opportunities we are taking advantage of.

Exposures.

As at the end of the quarter, the fund was invested across all 11 industry sectors with no sector weight larger than 20% of net exposure (excluding arbitrage). From a strategy perspective, the fund is invested in long positions where we believe we have identified value and catalyst, as well as special situations, arbitrage, and short investments.

Notable positive contributors to fund performance during the fourth quarter included H2O Innovation Inc, Vecima Networks, Chemtrade Logistics, Guardian Capital Group and TransAlta Corp. Individual holdings detracting from results in the quarter included Nutrien Ltd, Polaris Renewable Energy and Winpak Ltd.

The fund's arbitrage strategy, 31% at year end, was a positive contributor to fund performance in 2022. This market neutral strategy demonstrated its value as a low-risk source of returns with low-correlation to traditional equities and bonds³.

During the fourth quarter we reduced short exposure from 13% to just under 3% – taking some profits and acting to increase the fund's net exposure, excluding arbitrage, to 81% at year end.

We expect to continue to increase the fund's net exposure as we selectively take advantage of compelling value and special situations-oriented investments in the current market environment.

The shift is just getting started.

In recent communications we have been highlighting our view 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.

The current market structure and set-up reminds us of the post-technology stock bubble period between 2001-2005. During this period, value outperformed growth, and small/mid-caps outperformed large caps – there was a stealth bull market beneath the surface of the bellwether indices which didn't really go anywhere. We are beginning to see the onset of similar dynamics over the last few months.

Part of this shift is being driven by many of the previous market leaders becoming overvalued or overbought and no longer representing attractive investments. And perhaps equally as important and consequential, is that capital has a cost again – which should bring some rationality back to valuations. This is not good news for the former high-flying growth darlings that relied on easy money to fund their losses and prop up their stock prices

(many still remain unattractively valued today in our opinion). Conversely, it is good news for companies with solid balance sheets and positive bottom lines, that are trading at attractive valuations.

While a single month should not be extrapolated into the future, the fund finished 2022 on a positive note, gaining +0.7% in December whereas the S&P/TSX Composite, S&P500 and NASDAQ Composite declined -5.2%, -5.9% and -8.7% respectively. Perhaps some of the above dynamics at play.

Said it once before but it bears repeating now⁴.

In our Q3 commentary we wrote that: a challenging and shifting market environment always delivers and unveils compelling opportunities. With security prices down significantly, it has most certainly become a more fertile investment environment.

We don't want to diminish today's challenges, but we're mindful that throughout history successful investors have prospered through selective and opportunistic buying during bear markets. We believe that market volatility will remain elevated in the near term and that investors will remain broadly cautious and prone to emotional decisions – this is a recipe for opportunity.

And, as we showed in the table above, we have historically done some of our best work during periods of elevated market volatility and after market declines. This is an attractive environment for our investment style and strategy in our opinion – one that we believe increasingly favours our value-oriented and active approach.

We are excited about the prospects for 2023 and beyond – as much as we have been in several years.

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 F, net of fees and expenses. Please contact us regarding other classes of fund units or visit our website www.maxamcm.com

² Maxam Diversified Strategies Fund, Series X, net of fees and expenses. Series X is displayed in this table because it represents the funds oldest class of units. Please contact us regarding other classes of fund units or visit our website www.maxamcm.com

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

⁴ Said it once before but it bears repeating now' are lyrics from the 2001 hit song "Fell in Love with a Girl" by the American garage rock band the White Stripes. https://en.wikipedia.org/wiki/Fell_in_Love_with_a_Girl

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