REFLECTION

2nd QUARTER 2020 REVIEW

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SUMMARY

AMETHYST ARBITRAGE FUND

Ending the Year in Positive Territory

In comments made on March 23, Jerome Powell, Chair of the U.S. Federal Reserve (the Fed) suggested that the financial markets would recover in the second quarter. He confirmed that a liquidity shortage was rapidly developing in all sectors of the economy, and he offered his assurance that the Fed would do whatever was necessary, and use every resource imaginable, to fill these gaps as required. That was all it took: a substantial rebound in the second quarter erased much of the historic rout in equity markets during the first quarter.

In this unprecedented environment, two of our three main strategies made up most of the losses incurred during the first three months of the year. But we were disappointed by the performance of the mergers and acquisitions sector overall, which did not provide as many opportunities as we would have liked. However, we are confident that the market will present more opportunities going forward, and that the outlook and our portfolios' positioning should allow us to end in positive territory.

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MARKET EVENTS

Difficult Environment

At the start of the quarter we had 27 M&A positions in our portfolio. Based on the "mortality" rate of this type of position seen during the 2008 crisis, we believed that three or four of our positions would not survive the economic conditions caused by COVID-19. But the actual count was worse: five transactions failed, while a sixth (Cineplex) was cancelled by the buyer and is now before the courts. In addition, some other transactions remain unconsummated due to delays in regulatory decision-making related to the health crisis. Our results have suffered as a consequence. Our profits for the quarter did not rebound as strongly as we might have hoped following the sharp decline in the first quarter.

Lack of Good Offers

Expectations were high that most of the transactions announced after mid-March in sectors largely unaffected by COVID-19, such as gold and technology, would be our safest bets and provide good returns. And this proved to be the case. For two of the transactions on which we had taken an initial position, the price was even bid up. ***But we were left wanting more, since only about 10 transactions were offered, probably the poorest showing in 20 years.*** This was clearly due to uncertainties surrounding the state of the post-pandemic economy, in which working conditions and consumption habits are bound to change substantially. Given this context, we will continue to optimize our arbitrage portfolio in the third quarter and deploy capital as opportunities arise, which they inevitably do.

FROM July 1998 TO June 2020	ANNUALIZED RETURNS (%) *Net of all fees*						Volatil.	Correl.	% Mths > 0	Sharpe Ratio
	1 yr	3 yr	5 yr	10 yr	15 yr	Incep.				
Amethyst Arbitrage Fund	**-7.7%**	**-1.9%**	**3.2%**	**4.2%**	**5.7%**	**6.5%**	**8.2%**	**-**	**73%**	**0.61**
HFRI - Global Fund Weighted	-2.3%	1.5%	2.0%	3.5%	4.1%	5.7%	6.9%	0.49	66%	0.50
S&P/TSX Composite (TR)	-2.2%	3.9%	4.5%	6.3%	6.0%	6.0%	14.9%	0.50	63%	0.25
EAFE World Equity (TR)	-7.4%	-1.9%	-0.7%	2.8%	1.3%	1.2%	16.7%	0.45	56%	-0.06
FTSE CAN Long Term Bond	12.0%	8.3%	24.4%	12.1%	6.8%	7.2%	7.1%	0.13	61%	0.70

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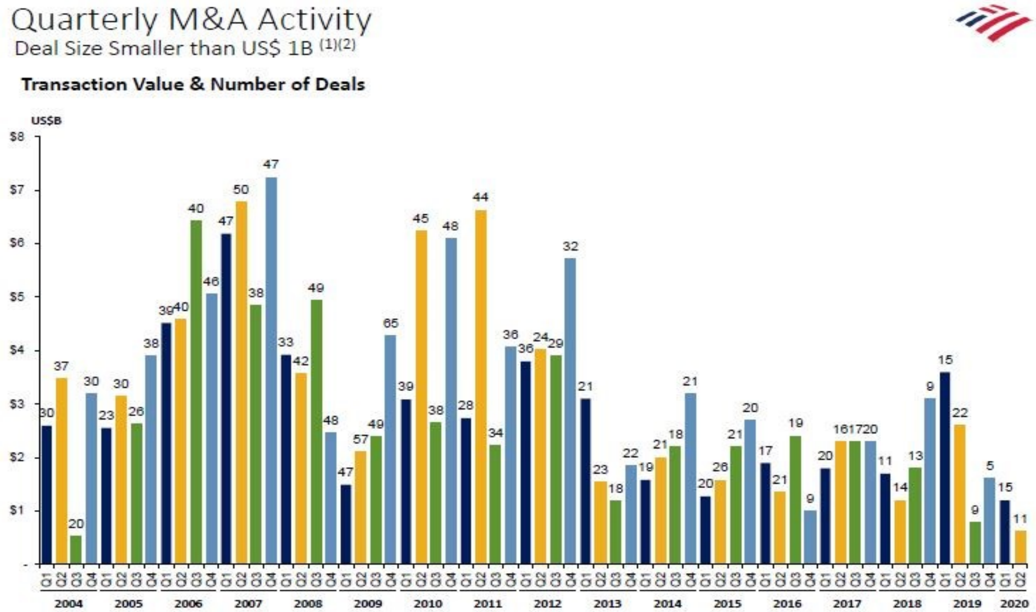

CONVERTIBLE SECURITIES

The second quarter saw a semblance of normalcy return to the pricing of convertible securities, allowing us to recoup over two-thirds of our first-quarter losses. But it soon became clear that some of our positions would never return to their pre-pandemic values, so we sold them. We also liquidated positions that may suffer again if there is a new wave of panic in the markets. Instead, we retained positions that were resilient in the face of the pandemic, either because of their industry or due to their high hedge ratio. Other positions had to be sold, because it became impossible to borrow the underlying security to make the short sale required to hedge the risk.

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Dichotomy Between the Economy and Equity Markets

We have a diversified portfolio of securities issued by numerous companies in several sectors. We were nevertheless cautious in the second quarter, as the strength in the financial markets appears to have outpaced what can be reasonably expected given the global economic outlook for the next few years. Despite a record level of activity in the new issue market in the second quarter, we added only two new positions to our portfolio. While some issues appeared to be attractively priced, they generally involved companies that had been hit hard by the health crisis and whose long-term future appeared highly uncertain.

Expect Roller-Coaster Markets this Summer

We have ample capital to take advantage of opportunities and corrections as they arise. We expect fewer new issues, and prices should continue to adjust to the new reality. We may face a bumpy ride in the markets this summer before longer-term economic and health outlooks become clearer. But everything is now cheaper, return expectations have improved, and the most hard-hit investors will be less present in the market.

FIXED INCOME

The highlight of the quarter was undoubtedly the Fed's implementation of a corporate bond-buying program, initially through exchange-traded funds and then through individual securities. The Bank of Canada responded in kind when it launched its corporate bond purchase program. In early March, the Bank was already buying agency securities and bankers' acceptances in the short-term market. Then, beginning in late April it began purchasing provincial and corporate bonds as well. Although few purchases were actually made under these new programs, the markets found these interventions persuasive, and spreads narrowed. Massive capital inflows into mutual funds and bond exchange-traded funds fully reversed the trend of massive outflows in March.

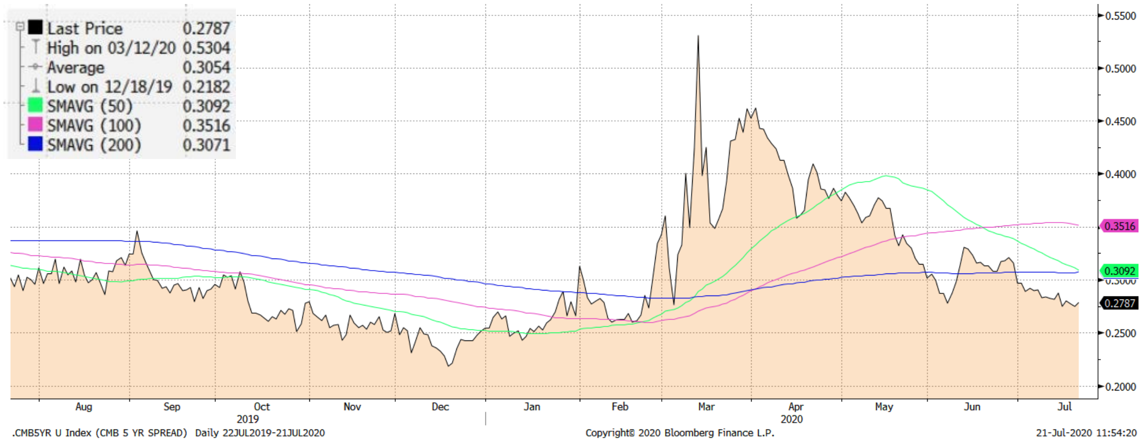
Favourable Narrowing of Spreads

U.S. credit spreads were the first to contract sharply, with Canadian spreads following later in the quarter, albeit to a lesser extent. We took advantage of these conditions to recover over 85% of the losses incurred in the first quarter. It should be remembered that in March we decided to significantly reduce our exposure by selling all the agency credit spreads we had held since January. We also neutralized the risk in what remained of the portfolio by selling short credit spreads on provincial securities, among other things. Seeing the recovery in the risky asset market and given the scope of the interventions by the central banks, we eliminated these hedging positions beginning in early April, accumulating agency securities with three-year maturities. Then, toward the end of May we shifted to five-year agency securities, given their underperformance compared to U.S. securities. Finally, in order to lock in our profits following some very good performance, at the end of the quarter we reduced by half our positions in three-year securities.

Positive Contribution Made by All Our Fixed Income Arbitrage Strategies

Our transactions on duration arbitrage were also

Credit Spread: Canadian Government Agency Bonds – 5 Year



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profitable. Although the market fluctuated much less dramatically than in the previous quarter, we were able to take advantage of better prices by favouring longer-term securities. Our positioning on the yield curve also contributed to earnings.

We are confident as the third quarter begins, using approximately 52% of our risk envelope. This compares to just over 30% at the end of May and a high of 55% at the end of the second quarter. However, we continue to exercise caution in the face of uncertainties in the economic environment, despite the increase in the risk envelope over the last quarter. We do not see an urgent need to take on more risk at this time, preferring to wait for the right opportunities.

THE ECONOMY AND FINANCIAL MARKETS

While stock market activity was driven by the enormous amount of liquidity injected by the central banks in the U.S., Europe and Canada, economies nevertheless fell into recession in February. It is difficult to foresee when this will end. Following unprecedented weakness in April and May, some leading indicators, such as the PMI, rebounded sharply, probably propelled by the gradual reopening of economies. The International Monetary Fund (IMF) nevertheless expects the global economy to shrink by 4.9% in 2020.

The recovery in the U.S. appears to be well underway. However, this may be mainly the result of the government's various aid programs, which will be wound down at the end of July unless the decision is made to extend them. Many economists believe that U.S. GDP will decline 6% in 2020. The extent to which our neighbours to the south will manage to curb the pandemic remains to be seen. At the time of this writing, the outlook is deteriorating dangerously. Major states such as Florida, Texas and Arizona are already facing an alarming resurgence in the number of new cases. At press conferences, the governors of these states have been talking about reintroducing lockdown measures. This stands in sharp contrast to the optimism expressed by these same officials just a few weeks ago.

Canada's response to the pandemic has succeeded: the number of new cases is in steady decline, and economic recovery is underway. Preliminary data from Statistics Canada indicates a 3% rebound in GDP in May. But this is no time to become over-enthusiastic, as the IMF is still forecasting an over 8% decline in Canadian GDP in 2020. Canadian economists are less pessimistic, forecasting a contraction of around 7%.

Beware of Excessively High Valuations

Stock markets responded vigorously to all the signs of economic recovery and ignored any fears over a failure to control the pandemic. As a result, they reached very high valuations relative to actual prospects for corporate profitability: the S&P 500 price-to-earnings ratio, among other indicators, shows that prices are 22 times forward twelve-month earnings. The markets could therefore become highly vulnerable in the event of a resurgence of COVID-19 outbreaks, as suggested by the latest figures from John Hopkins University.

OUTLOOK

The third quarter had barely begun when Dr. Anthony Fauci, generally considered to be the United States' pre-eminent expert in immunology, warned that the country was still caught up in the pandemic's first wave. But many political leaders, particularly in the White House and in some of the most populous states, have been sounding much more optimistic. Given the depth of their denial, it is difficult to conclude that the health crisis can end any time soon and that economic activity will resume as before, despite what the stock markets seem to be indicating.

There can be no doubt that the equity markets have been strongly influenced by the central banks' massive injections of liquidity and the Fed Chair's assurance that it will take all the measures needed to rescue the economy.

It would appear that the major investors are now betting that a vaccine against COVID-19 will be available by the end of the year.

The resilience of the equity markets seems to suggest that, by early next year, this episode with the new coronavirus will be nothing more than a bad dream.