REFLECTION

2nd QUARTER 2023 REVIEW

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SUMMARY

AMETHYST ARBITRAGE FUND

Far From a Smooth Ride

In the financial markets, there are certain events that can grab all the attention, but in the process they may hide a somewhat different reality. On equity markets, for example, last quarter's sudden infatuation with artificial intelligence drove up all stocks closely or even remotely related to this industry. As a result, the second quarter produced major gains in some of the stock market indexes. But this masked a tenser situation in many sectors, as the March banking crisis continued to fuel fears among investors. As for the convertible securities market, it hit a rough patch, for no apparent reason.

Similarly, there were one or two decisions by regulatory authorities that could be considered highly questionable, and they cast a shadow over the M&A sector, which had nevertheless been generating good opportunities for arbitrageurs.

Of course, such are the risks. But they are risks that we know how to handle. This is why our expertise and diversification across multiple sub-strategies and sectors is so important: it allows us to seek out and find good opportunities. And that is what we managed to do in our fixed-income arbitrage strategy, maximizing positions with a strong defensive carry, a strategy that proved highly profitable throughout the quarter. So now let's take a closer look at what happened during the quarter.

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MARKET EVENTS

In addition to having to steer a path through multiple pitfalls, participants in the M&A market are sometimes confronted with decisions by the regulatory authorities that can be difficult to explain. This occurred in the second quarter when Amgen, a world leader in the medical biotech industry, announced the acquisition of Horizon Therapeutics for US$28 billion. On the face of it, the transaction looked good. Amgen executives were very optimistic, and the financing was in place. ***But the Federal Trade Commission (FTC) decided to block the deal, claiming it would create barriers to competition.*** We stood to make a very attractive profit on this transaction… until the FTC decided to intervene. Early gains on the position quickly reversed, and we decided to sell a portion to mitigate the risk. Despite this setback, we trust that the transaction will go through. In the meanwhile, we will manage this position tactically. We are confident that mark-to-market losses can be recovered, and we may even generate a profit.

A Transaction That Was Simply Cancelled

Another major transaction that we reported on in the previous quarter – TD Bank's acquisition of the U.S. regional bank First Horizon, for which it was prepared to spend over $13 billion – was simply cancelled in the wake of last March's banking crisis. Although this crisis rendered the transaction somewhat precarious, certain solutions were nonetheless conceivable, including setting a new price.

The fact that these regulatory bodies are assuming a role that is perhaps too big or even unjustified is shaking the very foundations of the market. In addition to the spill-over effect this has had on many other transactions, investors are unsure where to turn next. We hope that, in Amgen's case, the situation can be resolved in a timely manner.

FROM Jul. 1998 to Jun. 2023	ANNUALIZED RETURNS (%) *Net of all fees*							Volatil.	Correl.	% Mths > 0	Sharpe Ratio
	YTD	1 yr	3 yr	5 yr	10 yr	20 yr	Incep.				
Amethyst Arbitrage Fund - Cl. F	**-2.5%**	**1.5%**	**4.2%**	**1.6%**	**4.8%**	**6.5%**	**7.5%**	**7.9%**	**-**	**73%**	**0.68**
HFRI - Global Fund Weighted	3.1%	5.2%	8.8%	5.0%	4.7%	5.4%	6.1%	6.9%	0.47	65%	0.57
S&P 500 (TR)	16.9%	18.1%	14.6%	12.3%	12.9%	10.0%	7.6%	15.9%	0.43	65%	0.31
S&P/TSX Composite (TR)	5.7%	10.4%	12.4%	7.6%	8.4%	8.4%	6.8%	14.8%	0.49	63%	0.31
EAFE World Equity (TR)	9.7%	15.5%	6.2%	1.7%	2.7%	3.7%	1.8%	16.9%	0.43	56%	-0.02
FTSE CAN Long Term Bond	5.4%	5.9%	-7.5%	-0.3%	2.8%	4.9%	5.3%	7.9%	0.14	59%	0.40

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NASDAQ Composite Index

Despite these two notable setbacks, there were many M&A deals announced during the quarter involving small and medium-sized companies, and we participated in 27 of them. This produced good results. We have considerable expertise in such transactions. Overall, our results in this segment were not bad for the quarter. But they could have been excellent, had it not been for the large transactions that stalled, to everyone's surprise.

CONVERTIBLE SECURITIES

During the last quarter, the convertible bond market seemed to be marking time, with no clear overriding theme. But one thing was certain: there were very few sellers. This clearly limited the number of attractive opportunities. We focused on quality new issues where we could take advantage of an attractive carry.

Toward the end of May, a more fearful mood in the market caused convertible bonds to lose ground. Our portfolio was no exception, but because many of our positions have a relatively close maturity date, there was no reason to panic and sell quality positions at discount prices as this sell-off simply meant that investors will reap larger gains in the future when positions climb back to their par value as bonds approach maturity.

In fact, June brought a certain return to liquidity, and we took advantage of opportunities to buy a few bargains.

Few Opportunities to Carry Forward Our Portfolio Positions

We also continued our efforts to "roll" the portfolio, i.e., to shift it toward convertible bonds in companies that are showing good prospects and that are closer to par value. However, we are proceeding with patience and caution to avoid overpaying for our next purchases.

FIXED INCOME

There was certainly no lack of volatility in bond yields in the last quarter! Yields on the benchmark 10-year U.S. Treasury notes varied by over 40 basis points during the period, but this did not prevent us from having a good quarter in our fixed-income strategy. Gains on our credit spread portfolio and certain exchange-traded fund (ETF) hedges more than offset any losses incurred on yield curve and duration portfolios.

We are taking the same approach as the new quarter begins. Use of the risk envelope is currently at 100%, compared with 80% at the end of the previous quarter. In the second quarter, it varied in a range of 80% to 100%. The portfolio's average credit spread duration now stands at 2.65 years. And our strategic positioning favours government agency bonds: mainly three- and five-year maturities. In our curve and duration strategies, because of the current volatility, we are remaining neutral, at least for now.

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Defensive Carry

The current cycle of interest rate hikes will come to an end, and this is often accompanied by volatility, so we have established defensive positions that should still deliver an attractive carry wherever possible. This includes holding positions in federal government agency bonds maturing in 3 to 6 years, government guaranteed collateralized mortgage obligations maturing in 1.5 years, and certain municipal bonds where the credit curve is steepest. We are pleased with the results from these defensive positions and their positive contribution to the portfolio, especially as the trading in Canadian credit lacked overall conviction in June. As the third quarter begins, this strategy remains an important part of our positioning.

THE ECONOMY AND FINANCIAL MARKETS

The progression in equity markets came to an abrupt halt in March with the banking crisis that erupted following the collapse of Silicon Valley Bank. But a speedy intervention by the authorities eliminated any significant contagion, at least for the time being. Stock markets rallied, this time driven by investor enthusiasm around the prospects for artificial intelligence. The S&P 500 was up 8% for the quarter, and the Nasdaq surged 13%. The Canadian equity market, with less weight in technology stocks, rose just 1%. The easing of inflationary pressures and anticipation around the

US Government Bonds - 10 Year Yield

current cycle of interest rate hikes coming to an end favoured bonds, with the DEX Universe Canadian Bond Index posting a positive return of 2.51% for the quarter.

End of the Rate Hike Cycle

The macroeconomic environment is still characterized by uncertainty. It appears likely that both the U.S. Federal Reserve (the Fed) and the Bank of Canada will end the current cycle of interest rate hikes, and this will undoubtedly attract a great deal of attention. When the Fed stops raising rates, we generally see rising equity markets, improved credit spreads, lower interest rates across the board, and a steeper yield curve. History teaches us that the first rate cut occurs, on average, six months after the last rate hike, and at most 14 months after that.

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The Bank of Canada has just raised its key rate to 5%, but according to its Governor there are no guarantees that this will be the last increase in this cycle. Canadian inflation has fallen below 3%, which is within the Bank's target range of 1% to 3%. But it would appear that the Bank wants to ensure that this trend continues before bringing the current cycle to an end.

OUTLOOK

As the cycle of interest rate hikes draws to a close, one would expect such a dramatic increase in rates over such a short period of time to have a significant negative impact on the economy. As we enter the quarterly earnings season for major North American companies, it is worth recalling that profits have already been falling over the last three quarters. But that did not prevent the S&P 500 index from posting a 25% gain over those nine months. It is not difficult to imagine that a slowdown will appear somewhere on the horizon.

In such an environment, it will be essential to keep portfolios diversified over the coming quarters. To this end, the Amethyst Arbitrage Fund is ideally suited to play a vital role, given the diversity of its positions and its use of non-directional arbitrage strategies, which do not depend on market trends.

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