REFLECTION

1st QUARTER 2021 REVIEW

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SUMMARY

AMETHYST ARBITRAGE FUND

Even though the financial markets were a disaster just 12 months ago, euphoria reigned in the first quarter of 2021. The markets had become fertile ground for good returns due to a new President in the White House, who brought an end to the chaos of the last few years, more than enough fiscal and monetary stimulus and, above all, a surprisingly rapid roll-out of a massive vaccination campaign. And yet...

The fundamentals are, for the most part, highly favourable for hedge funds, but special situations can sometimes throw off the valuations of certain positions. Crystalline had two such examples during the last quarter: one in an M&A transaction and the other in bond spread arbitrage. Of course, they had an adverse impact on our results. ***But whenever such situations arise, we move quickly to mitigate the risk within our established framework.*** A negative return in February marked the end of an unbroken run of positive monthly returns since March 2020. But the quarter's losses were held in check by the discipline we applied to contain these two situations, as well as the success of our overall strategies.

MARKET EVENTS

A Dream Turns into a Nightmare

Rarely have we seen all the elements for exceptional performance come together so well for our M&A arbitrage strategy. The market was so active that we took part in 43 transactions, all of which offered attractive margins. Market movements also allowed us to enhance returns by adjusting our positions as the mood shifted in the market. We added to our positions when margins widened and reduced them when margins narrowed. Then, for the first time in almost five years, there was a surge in Canadian transactions. This was particularly true in the resource sector, where we have long maintained solid expertise. Yet despite this confluence of positive factors, a storm lay ahead.

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The Reddit Storm

In February, Tilray, a Canadian pharmaceutical and cannabis company, announced its intention to buy Aphria, a competitor, through an exchange of shares. We decided to participate in this transaction, as it offered a relatively simple arbitrage by buying Aphria's shares and selling short Tilray's shares. Moreover, the deal was very likely to go through, since the regulatory requirements appeared easy to satisfy. Indeed, this proved to be the case.

However, we had not counted on the influence of events surrounding GameStop, a company specialized in the distribution of video games and electronic equipment. Its stock was one of the most shorted stocks on the American stock exchange (propelled by an investor forum on reddit.com, GameStop stock rose 1500%). Shortly after, Tilray's share price started to follow suit, but Aphria's share price was unable to keep up. As a result, our position incurred a heavy loss. Not knowing if the situation could deteriorate into another GameStop, we quickly liquidated a large part of the position and realized the loss, in accordance with the principle of discipline that underpins all our risk management. Things eventually returned to normal, so we were able to recoup at least some of our loss on the position.

FROM July 1998 to March 2021	ANNUALIZED RETURNS (%) *Net of all fees*						Volatility	Correl.	% Mths > 0	Sharpe Ratio
	1 yr	3 yr	5 yr	10 yr	15 yr	Incep.				
Amethyst Arbitrage Fund	**19.1%**	**1.9%**	**4.1%**	**3.9%**	**5.5%**	**7.5%**	**8.1%**	**-**	**74%**	**0.65**
HFRI - Global Fund Weighted	31.6%	7.3%	7.3%	4.5%	4.7%	6.5%	7.0%	0.48	66%	0.62
S&P/TSX Composite (TR)	44.2%	10.2%	10.1%	6.0%	6.0%	6.8%	14.9%	0.49	63%	0.31
EAFE World Equity (TR)	41.6%	3.3%	6.0%	2.6%	1.3%	2.1%	16.8%	0.44	56%	0.00
FTSE CAN Long Term Bond	-0.2%	4.2%	3.8%	6.0%	5.9%	6.5%	7.2%	0.14	61%	0.59

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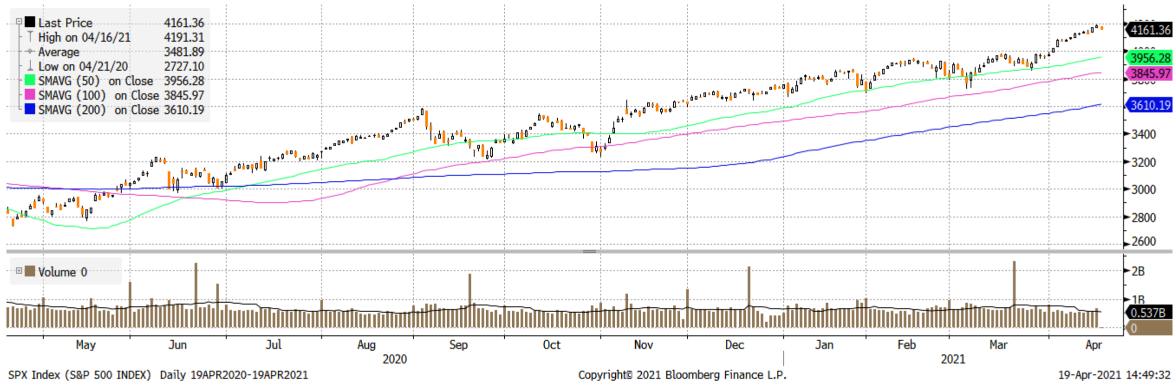
CANADIAN MANAGER OF ALTERNATIVE FUNDS, SINCE 1998

1002 Sherbrooke Street West
Suite 1525
Montreal (Quebec)
Canada H3A 3L6

TEL. +1 514 284 0248
info@cristallin.ca

S&P 500 Index



This setback, while unfortunate, does not prevent us from noting that the current environment is one of the most favourable in years for delivering solid returns. And we intend to take full advantage of it over the next few quarters.

CONVERTIBLE SECURITIES

As has been our habit since the pandemic first threw financial markets into disarray, we continued our arbitrage activities in the convertible bond market, without necessarily putting the pedal to the metal. And once again, this approach paid off.

The convertible bond market was generally strong during the first half of the quarter as credit spreads narrowed. However, the trend then became less pronounced. We took advantage of the market's strength up until mid-February to reduce our holdings, then we cautiously added a few securities as the quarter was drawing to a close.

We took part in only a few new issues, when the situation seemed to offer attractive volatility and the security had a solid credit rating.

Wary in the Face of High Asset Prices

A cautious approach certainly seems appropriate, given the factors that are currently driving asset prices. First, these prices are partly due to a very low interest rate environment, yet the market seems to be paying little attention to the substantial rise in bond rates. Asset prices are also supported by statistics that suggest very good economic growth, partly because they are being compared to the worst period of the pandemic. Lastly, excessive valuations of some assets seem to be the inevitable consequence of enormous monetary stimulus, but this will not last forever.

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FIXED INCOME

Our plans during the quarter were thwarted by a surprising widening of the credit spreads on government backed agency securities. ***This was the only one of our three alpha drivers to suffer a loss during the quarter, but it was enough to provoke a slightly negative return on our overall fixed income segment for the period.*** Agency spreads widened during the quarter by 10 basis points from their narrowest point reached in January. In a normal environment, this would have been accompanied by provincial spreads widening by approximately 15 basis points and corporate spreads widening by 30-40 basis points. Such was not the case. Provincial spreads widened by only 5 to 6 basis points, as did US investment grade corporate spreads. This unusual situation in agency spreads was due to a few technical factors, in addition to the Bank of Canada's announcement that it was ending purchases of agency securities under its quantitative easing policy.

Good Results on Duration and the Yield Curve

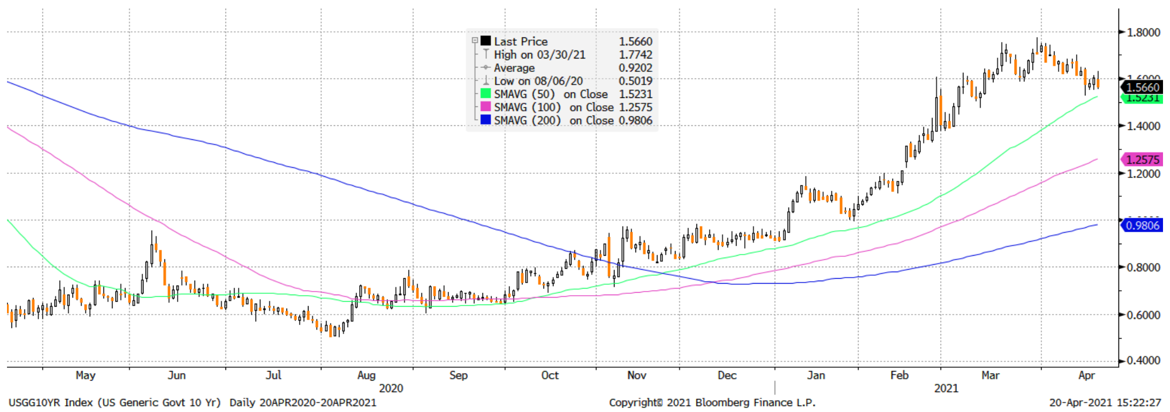
In the rest of our transactions, short positions on longer-term rates and positions taken on the prospect of the yield curve steepening served us well when bond yields rose, mainly in January and March. This allowed us to erase most of the losses caused by widening credit spreads on agency securities.

Given the widening spreads, we have significantly reduced our risk envelope. We consider agency spreads inexpensive in comparison to other credit spreads, but they have continued to narrow. Furthermore, we believe that the probability of credit spread compression across the board is relatively low at this time. We will be attentive to any opportunities that may arise, but we do not see any urgency around increasing our risk envelope. As the second quarter begins, we are nevertheless maintaining short positions on longer-term rates, and we continue to expect the yield curve to steepen going forward.

THE ECONOMY AND FINANCIAL MARKETS

Economic growth is now keeping pace with the vaccination efforts. The United States has clearly taken the lead, as can be seen in the North American giant's employment figures for the past two months. Europe seems to be lagging far behind, at least for now. As for Canada, wide-scale vaccinations have begun, and the economy is also benefiting from the boom south of the border. But doubts remain everywhere due to the appearance of a third wave, marked by the arrival of variants

U.S. Treasuries - 10 Year Yield



whose effects are unpredictable. This has led health specialists to wonder whether our current vaccines will continue to work as the virus mutates.

Economists' forecasts are now clearly showing more enthusiasm. Compared to a stagnant US growth rate of close to 2% over the past decade, many economists are now predicting that we are entering a new long-term cycle of 3% annual growth.

The effects of these forecasts were felt in the financial markets throughout the first quarter. The S&P 500 Index rose 5.8% during the quarter and, in a sign of growing speculation, the Russell 2000 Index rose by 12.4% over the same period. In Canada, the S&P/TSX Composite Index posted a total return of 8.1%.

This appetite for risk, combined with economic data showing a solid recovery, has ultimately had a devastating effect on the bond markets. In the United States, the yield on 10-year Treasury notes rose from 0.93% to 1.74%, while the Canadian Bond Universe Index was down 5% for the quarter. Commodity prices surged 10.2% during the quarter, according to the CRB Commodity Index.

The US Federal Reserve says that it does not expect to raise interest rates until 2024.

OUTLOOK

We mentioned this in our last newsletter, and it is worth mentioning again: what has us particularly concerned is the fact that the majority of market participants share extremely similar views. At this juncture, nothing seems to be able to satiate investors' appetite for risky assets. Clearly this could lead to a positioning problem at some point during the current quarter, as we saw one year ago when the pandemic hit. An unexpected event or bad news could then quickly put an end to this one-way stampede.

For now, everyone continues to rely on the generosity of governments and the eminently expansionary policies of the central banks. The US Federal Reserve says that it does not expect to raise interest rates until 2024. However, data in the futures markets indicate that this could happen as early as the fall of 2022. In Canada, economists are expecting increases as early as June 2022.

The Biden Presidency's First 100 Days

The stock markets are probably making former President Trump green with envy, if not red with rage, since he predicted that the bull market would end if he lost the election in November. ***However, since Joe Biden's victory barely five months ago the S&P 500, the flagship index of the US stock market, is up 25%.*** We can take this as proof (if any were needed) that no one is irreplaceable.

But the end of the new administration's first 100 days is fast approaching, and this often signals the end of a new leader's honeymoon. The promises of economic stimulus, including the infrastructure plan, are well on their way to being realized. For now they can only add to investors' enthusiasm. But there may be disappointment on the horizon. The Democratic majority in Congress is very slim and barely exists at all. Even though we are only a year and a half away from the next round of midterm elections, we should expect that the Republicans will systematically try to block any bill that could be good for the Democrats' image. Financial markets could suffer in the stagnation that would follow.

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