REFLECTION

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AMETHYST ARBITRAGE FUND

Excellent Start to the Year

In our last year's quarterly newsletters, we often spoke about how our arbitrage strategies were guided by caution. Faced with frequent and excessive volatility, uncertainty surrounding the end of the interest rate cycle, and equity market valuations that we found to be excessive, we often adopted an approach that put capital preservation at the core of our investment decisions. At the same time, we were able to find many high-quality opportunities that offered attractive risk/return profiles. Today we are reaping the rewards of this cautious yet opportunist approach. The Fund is off to a good start this year (+6.5% CL.F), holding its own against the main benchmark indices. And we believe that we can build on this momentum, even though we still consider the conditions challenging.

Fear of Missing Out

Several asset classes, including equities, bonds and Bitcoin, benefited from significant capital inflows during the first three months of the year, despite relatively high valuations and tight spreads. In our view, the craze for risky assets is partly motivated by the fear of missing out – also known as "FOMO syndrome" – which often leads investors to exercise poor judgment, leading ti disastrous outcomes. The sentiment in the markets has completely reversed over the past year. ***Surveys show that approximately 75% of investors no longer appear to be worrying that the economy may turn and face a much more difficult period. The opposite was true just one year ago.*** Most investors appear to have been won over to the idea of a soft landing. But we remain unconvinced.

How Cycles End

Many economists and strategists are putting forward arguments to justify current valuation levels on the equity and debt markets. They offer assurance that the situation today is different from what happened when economic cycles ended in 2000 and 2007. We have our doubts. Our first-quarter results confirm that despite a cautious approach there are still opportunities to generate returns.

Our discussion below will focus on the first quarter of 2024, followed by our outlook on what to expect in the upcoming quarters.

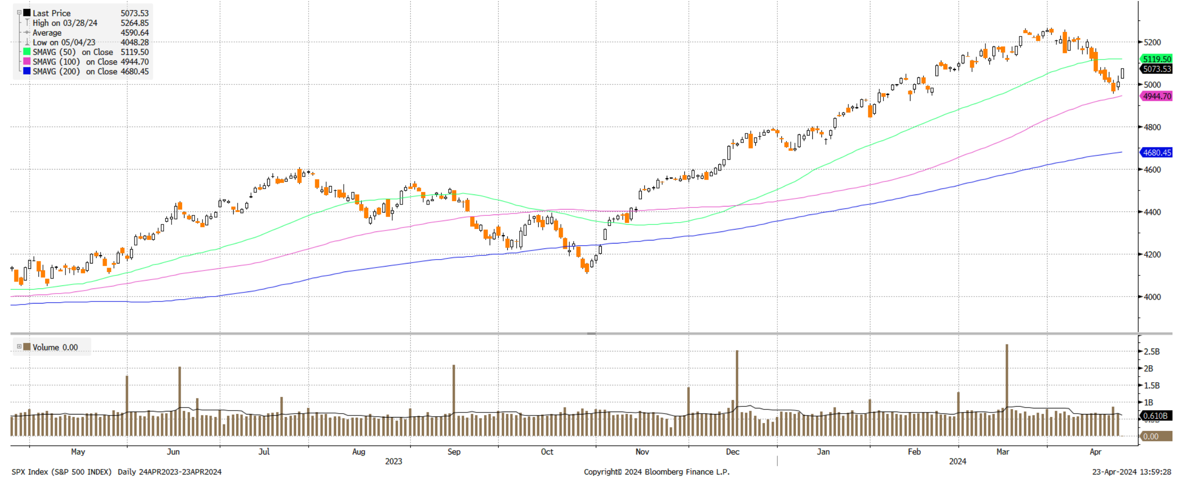
MARKET EVENTS

We thought that the potential arbitrage returns on many M&A opportunities in the first quarter were insufficient when weighed against the risks involved. As a result, we were selective and took part in only 22 new transactions during the period, compared with our historical average of 30 to 40 transactions.

Once again this quarter, the attitude of the regulatory authorities did nothing to bolster investor confidence. Three new transactions in the U.S. oil and gas sector appeared to be fairly well conceived, but they were delayed when the Federal Trade Commission (FTC) requested additional information before issuing its rulings. These delays and uncertainty only added to

FROM July 1998 to March 2024	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	**6.5%**	**7.8%**	**3.7%**	**3.1%**	**5.1%**	**6.3%**	**7.7%**	**7.9%**	**-**	**73%**	**0.69**
HFRI - Global Fund Weighted	2.4%	9.4%	3.7%	6.5%	4.7%	5.1%	6.2%	6.8%	0.48	65%	0.57
S&P 500 (TR)	10.6%	29.9%	11.5%	15.0%	13.0%	10.2%	8.1%	15.9%	0.44	65%	0.33
S&P/TSX Composite (TR)	6.6%	14.0%	9.1%	10.0%	7.7%	7.9%	7.1%	14.7%	0.50	63%	0.33
EAFE World Equity (TR)	5.1%	12.3%	2.1%	4.6%	2.1%	2.9%	2.1%	16.8%	0.44	56%	-0.01
FTSE CAN Long Term Bond	-3.6%	0.8%	-4.1%	-1.4%	2.4%	4.6%	5.2%	8.2%	0.15	58%	0.36

S&P 500 Index



the risk and complexity of these and similar deals, which on the one hand can create opportunities, but on the other means that event driven investors must be very selective ans carefully chose their entry points.

Too Much Risk in the Medical Sector

Transactions in the medical sector offer good opportunities in terms of price. However, they also carry more risk factors than deals in other sectors, including the risk that new drugs or products won't make it past their clinical trials, or that the regulators will simply refuse to grant approvals.

It Paid to be Cautious

Despite our defensive approach, we nevertheless found interesting opportunities to deploy capital and deliver solid results for the quarter. Our expectation is that deal activity will remain strong throughout the rest of the year and that we can build on the positive momentum, but we will always follow a cautious approach.

CONVERTIBLE SECURITIES

The first quarter proved positive, as we were able to generate gains as credit spreads tightened. Particularly at the start of the quarter, we invested in new issues, mainly high-yield bonds, and to a lesser extent in convertible securities. But as the quarter progressed, we increasingly sold some of these positions at a decent profit as yields fell and credit spreads narrowed and the risk/reward tradeoff became less compeling. In particular, we unwound at a nice gain some of the positions we had been accumulating since July. It's important to note that we're not necessarily focused on making a quick profit, but we'll take advantage of any opportunity that presents itself. Instead, our approach is to manage positions for the medium to long term.

Hedging Risk

During the last quarter, we also focused on hedging positions that provide a good positive carry, or income, while taking advantage of market volatility to be tactical when the time was right. The goal is to hold a quality highly liquid portfolio while ensuring that the risk is well hedged. This discipline should enable us to sidestep the market turbulence that we foresee, while maintaining enough liquidity to seize the opportunities that inevitably arise. Without going so far as to predict a complete collapse in equity markets, we are expecting a correction, and it could be a material one. We think that we comfortably positioned should we be correct, and, with enough ammunition to take full advantage of the attractive opportunities that such a correction should create.

FIXED INCOME

Our Sovereign Bond Absolute Return (SBAR) Fund also performed very well in the first quarter, even if Canadian bond indices posted negative returns. Our gains were mainly due to a gradual normalization of the anomalies we had identified in certain segments of the credit curve, as well as our décision to maximize the portfolio's a positive carry and defensive positioning.

The bond markets remain highly volatile, and the likelihood of central banks making interest rate cuts sooner rather than later has diminished in recent months. Inflation remains a source of concern, particularly in the United States, where market observers continue to be caught off guard by the strength of employment figures. Conditions in the job market are preventing policymakers at the Federal Reserve (the Fed) from initiating a round of interest rate cuts, at least for the time being.

Still No Directional Positions

There has been excessive and unrelenting volatility in the bond markets over the last few quarters, and the first quarter of 2024 was no different. Yields on 10-year U.S. government bonds rose 33 basis points during the period. We therefore continued to steer clear of directional positions on either duration or the yield curve.

We will maintain our defensive stance over the next quarter. We believe that the current economic cycle is approaching its inevitable end, and this will be marked by an economic slowdown, or even a recession. The markets will then quickly move from a state of risk appetite (risk-on) to risk

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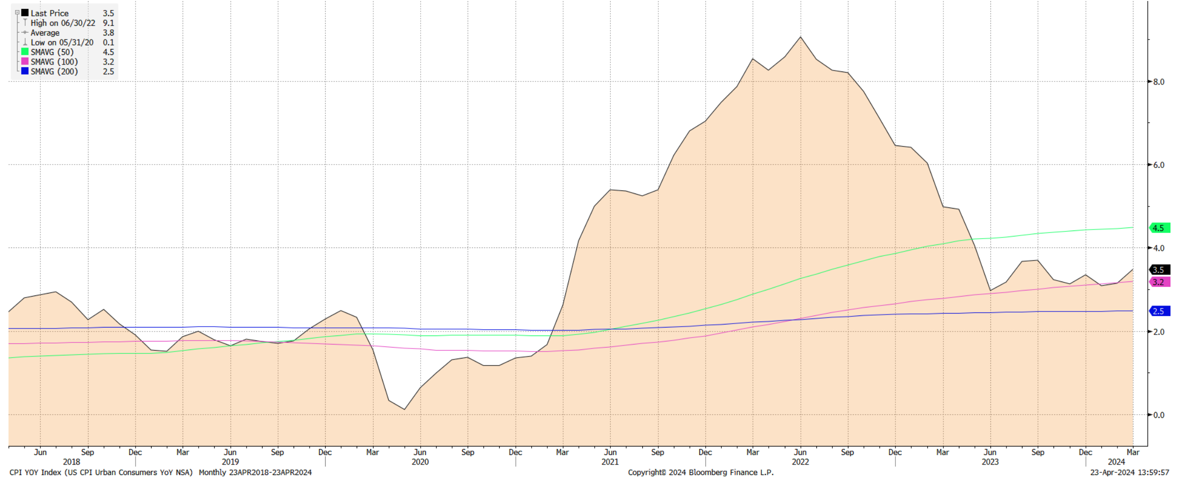
US Inflation



aversion (risk-off). The result will be a decline in the equity market and a widening of credit spreads, as all investors place a premium on safety. Given the uncertain timing of this turning of events, we prefer to position the Fund defensively.

Good Performance Ahead

For the next quarter, we intend to build on an attractive defensive carry and our core positions in government agency credit spreads in five- and six-year maturities. The positive slope of the credit curve and the inverted slope of the federal government yield curve are offering attractive returns on capital. In addition, we will continue to benefit as our efficient use of cash allows us to capture the current Treasury bill yield of close to 5%. We will, of course, be on the lookout for attractive opportunities created by the high volatility in bond markets, which is likely to persist for some time.

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THE ECONOMY AND FINANCIAL MARKETS

Inflation Picks Up in the U.S.

Although some economic data could have been interpreted as showing signs of a slowdown in the first quarter, the U.S. economy remains fairly robust. The job market is showing sustained resilience and, unsurprisingly, there has been an uptick in inflation, at least for now.

The fact remains that, according to the vast majority of economists, this cycle of Fed rate hikes by the Fed is complete. Historically, the first rate cut usually follows six months later, on average. The last rate hike was in July last year, yet most of the Fed officials who have spoken publicly in recent weeks agree that the first rate cut should be postponed. Some have even said that it might not occur this year. ***Unless the inflation data quickly return to a downward trend, it must be concluded that the Fed will remain on the sidelines for the next few months.*** This would take us right into the election period, a time when the Fed generally prefers to keep as low a profile as possible in the economic news cycle.

First Rate Cuts Will Be in Canada

The Bank of Canada has not made a move on rates since last July. ***However, recent comments by Governor Tiff Macklem clearly indicate that he wants to begin cutting rates sooner rather than later.*** He says that he is satisfied with the trends in the economic indicators, but would like confirmation that the progress made in taming inflation will prove sustainable.

OUTLOOK

Worrisome Geopolitical Context

In just three months' time, the world will converge on Paris for the great global event that is the Olympic Games. But will it be necessary for those countries currently embroiled in the wars to declare truces, for the duration of the Olympics, as they often did in Ancient Greece? This might not be that far-fetched an idea, given the quickening pace at which geopolitics are deteriorating. For the time being, the financial markets have not been affected by the downward spirals of the conflicts in Ukraine and the Middle East, nor by the spectre of another latent smoldering conflict in Taiwan. But how much longer can this last?

High Interest Rates and Huge Budget Deficits

Added to this tense situation are the major economic imbalances caused by persistent inflation, an interest rate cycle whose first cuts have been repeatedly postponed, and the budget deficits of the industrialized countries, which for now seem to be quietly spinning out of control. In Canada, a balanced budget is becoming a mirage on an increasingly distant horizon.

American Elections as a Backdrop

And all of this is without considering the fact that our neighbours to the south are about to embark on the final stretch leading to the presidential election on November 5. Given the ideological divide and the polarization among today's crop of elected representatives and their voter bases, the American legislative apparatus is likely to be hamstrung for the rest of the year.