REFLECTION

2nd QUARTER 2024

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SUMMARY

Investors' fear of missing out (« FOMO ») on good investment opportunities has created a frenzy that is pushing prudent risk management out of the window.

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CANADIAN MANAGER OF ALTERNATIVE FUNDS, SINCE 1998

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AMETHYST ARBITRAGE FUND

No FOMO Syndrome Here

More than ever, investor sentiment could play a decisive role in the financial markets over the coming months. Our previous newsletter discussed the economic outlook among U.S. investors regarding a possible economic landing, whose views completely reversed over the past 12 months. Last year, 75% of them feared a hard landing, but now over 75% expect a soft landing. Some even believe that there will be no landing at all. **As a result, investors' fear of missing out (« FOMO ») on good investment opportunities has created a frenzy that is pushing prudent risk management out of the window.** We did not buy into this excessive optimism three months ago, and we stand by this position. Seeing stock markets at all-time highs only reinforces our cautious approach. We are skeptical and prefer to remain positioned with our « all-weather » portfolio while waiting for the inevitable reversal in confidence that could occur at any time.

Our non-directional strategies and all-weather portfolio are well suited to this environment, we believe. And, our results speak for themselves with our arbitrage strategies on track to meet or exceed their return targets year-to-date. We are well positioned to take advantage of the opportunities that we think will inevitably arise over the coming months and quarters and meet the expectations of our investors. for the Amethyst Arbitrage Fund.

MARKET EVENTS

Conditions in the M&A market in the second quarter were relatively unchanged from the previous quarter. The heightened scrutiny of regulators continues to add an element of risk that must be taken into account when deploying capital. The transactions that are deemed less risky are luring investors which has the effect of tightening spreads leaving little room for maneuvering.

Nevertheless, there remain interesting opportunities and we continue to pursue our strategy of being highly selective, while focusing on smaller deals that receive less regulatory scrutiny and less attention from the bigger investors.

A Multi-Dimensional Opportunity

One interesting transaction announced on June 11 has provided us with an opportunity to implement one of our preferred arbitrage strategies, deployed in several different ways. The transaction is National Bank of Canada's agreement to acquire Canadian Western Bank (CWB) in a share swap. At the same time, National Bank is issuing subscription receipts, which will become National Bank shares when the transaction is complete. If the transaction does not close, the bank is obligated to

FROM July 1998 to June 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	**8.1%**	**11.0%**	**3.3%**	**3.2%**	**5.1%**	**6.3%**	**7.6%**	**7.8%**	**-**	**74%**	**0.69**
HFRI - Global Fund Weighted	4.9%	9.7%	3.0%	6.6%	4.8%	5.3%	6.2%	6.8%	0.49	65%	0.58
S&P 500 (TR)	15.3%	24.6%	10.0%	15.0%	12.9%	10.3%	8.2%	15.9%	0.43	65%	0.32
S&P/TSX Composite (TR)	6.1%	12.1%	6.0%	9.3%	6.9%	7.9%	7.0%	14.7%	0.50	63%	0.32
FTSE CAN Long Term Bond	-3.4%	0.4%	-5.2%	-2.3%	2.1%	4.8%	5.1%	8.2%	0.15	58%	0.35

reimburse in full the amounts paid for these receipts. As the prices at which the three securities trade on the market fluctuate, the spreads evolve, offering various arbitrage opportunities. A manager who is nimble and alert to these spreads can buy the receipts and sell short the National Bank shares, buy shares in the target (CWB) and sell short National Bank shares, or buy the receipts and sell short CWB shares. These same three positions, but in reverse, could also be taken, depending on shifting spreads and expectations around the closing of the transaction. As it will take approximately one year to complete, we will have plenty of time to take advantage of any arbitrage opportunities that the markets may present.

CONVERTIBLE SECURITIES

Our results this quarter were on target, generating a positive return every month. The market outlook in March suggested that we would see a significant decline from April to June, so our overall portfolio was hedged against this risk. The idea was to reduce these hedges when the downturn occurred. Since it did not materialize, this cautious strategy limited our profits somewhat. However, we benefited from the appreciation of some of the event-driven positions while remaining hedged.

Our basic strategy is to hold long positions in convertible bonds and short positions in the underlying equities.

Continued Prudent Management

We carefully managed both interest rate risk and credit spread risk. To achieve the latter, we sold short some high-yield bonds, mainly in the consumer discretionary sector, which partly neutralized the credit risk. **Our basic strategy is to hold long positions in convertible bonds and short positions in the underlying equities.** As for interest rates, we were expecting rates to fall, and were positioned accordingly to reap modest gains.

New Issues Just Too Expensive

We have avoided most new issues which have become expensive on strong demand from investment funds that are not permitted to hold too much cash.

Our outlook on the market has not changed, as we still see the risk of a major pullback in risky assets. The cautious all-weather approach that we adopted in recent months has served us well, however, and we are holding firm.

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FIXED INCOME

Our Canadian Sovereign Bond Absolute Return Fund (SBAR) strategy delivered an attractive positive return in the second quarter, although somewhat lower than the returns from Q1, but in line with our objectives. The gains came mainly from our credit spread strategy. Although credit spreads, mainly on sovereign credit, have tended to stagnate over the past three months, positions established based on their positive carry have once again been key to our strategy: they have made a significant contribution to performance. We took the liberty of increasing somewhat the capital allocated to this strategy.

Good Returns on Capital

Although U.S. bond volatility has fallen, it remains high The highlight of the second quarter was that the credit curve remained very steep, while the yield curve for federal bonds was still inverted for 3, 5 and 9-year maturities. Returns on capital reached very attractive levels. We also maintained our core positions in 5-year credit spreads, while adding some positions in 3 and 9-year maturities at the end of May.

in historical terms. We have therefore steered clear of yield curve and duration arbitrage strategies, preferring to take advantage of some of the much lower-risk opportunities in credit spreads. Among other things, our defensive carry positions are designed to be cash neutral, allowing us to generate alpha while also capturing the yield on Treasury bills, which at 4.65% is currently very attractive.

The game plan for the rest of the summer will also be to take advantage of the seasonal effect created by the new issues planned between now and mid-August. With new issues availability becoming scarce, credit spreads tend to narrow during this period. Our focus will be on 3, 5 and 9-year government agency bonds, as well as 5 and 9-year provincial bonds.

THE ECONOMY AND MARKETS

The expression “risk-on” aptly describes the trend in financial markets over the last quarter. Massive capital inflows continued, pushing equities to new highs and squeezing credit spreads even further. **The craze for artificial intelligence and its expected impact on economic development continued, without showing the slightest sign of abating.** The S&P 500 index – which today includes the stocks of the ten largest companies, almost all of which are linked to the technology sector (whether closely or not) – has climbed almost 15% since the start of the year. In Canada, the S&P/TSX Composite Index is up more than 5% over the same period.

The situation on the bond markets remained highly volatile. In the U.S., the yield on 10-year government bonds rose more than 20 basis points during the quarter. In Canada, the FTSX Canada Universe Bond index has posted a negative return of 38 basis points since the start of the year, while the FTSE Canada Long-Term Bond index posted a negative return of 3.39%.

The Fed May Act in the Fall

Furthermore, economic indicators at the end of the period showed that inflation was down and the job market kind of uncertain. This could prompt the Federal Reserve to lower its key interest rates. **The last rate hike by the Fed was in July last year. The first cut will likely come in the fall.**

After rising sharply by approximately 10% in the first quarter, the cost of a basket of commodities was relatively unchanged in the second quarter. This may indicate a slowdown in economic activity.

OUTLOOK

Political events in the United States will now shift into high gear. Following the Republican convention in July – with Donald Trump narrowly and "miraculously" escaping a potentially fatal gunshot – the Democratic convention will be held in August with Vice-President Kamala Harris now having more than enough delegate support to win the nomination. The Harris-Trump electoral battle has now begun, and the outcome is far from certain. It would be naive to think that this will not create volatility in the financial markets.

It is against this backdrop of great political uncertainty that the equity markets are hitting new all-time highs. **Economists and strategists are doing their utmost to rationalize these valuations for risky assets, arguing that the situation is different from what we saw during the previous excesses of 2000 and 2007. We beg to differ.** Rather, we fear that the stage has been set for a major economic slowdown, if not a recession. Given the gigantic deficits run by governments at a time when the unemployment rate is very low, there is a very real risk that fiscal policy will not be able to respond in any meaningful way to an economic downturn.

In geopolitics, the last few months have brought no sign of solutions to the conflicts ravaging Ukraine and the Middle East. Should the unpredictable Donald Trump take the White House, this could muddy the waters, for better or for worse.

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