Volume 28

1st Quarter 2015

REFLECTION

Canadian Event-driven Convertible Securities and Fixed Income Arbitrage Fund

Managed by

Crystalline Management Inc.

1002 SHERBROOKE ST. WEST
SUITE 2110
MONTRÉAL (QUÉBEC)
CANADA H3A 3L6

TEL. +1.514.284.0248
FAX +1.514.284.0249

Info@cristallin.ca

Quarterly Review

AMETHYST ARBITRAGE FUND

ECONOMY

The first quarter of 2015 saw weaker than anticipated economic data south of the border. However, accompanying this slowdown in consumption, which was deemed temporary, was a new injection of stimulus to the global financial system. In theory then, we have a recipe for US stock prices to rise in the coming months, that is, unless geopolitical risks spoil the mix.

Obviously many other important variables are influencing financial markets, and in 2015 these may manifest into increased volatility. The extremely expansionary monetary policies of the major global central banks is in contrast with the Fed's desire to start a mini-round of monetary tightening as part of with its objective to "regularize" short-term US rates. For now, inflation remains very low as the liquidity glut drives up the price of financial assets, without affecting the price of tangible goods and services. It is the supply of goods and services, rather than their demand that seems to be influenced by low interest rates. The long term deflationary forces (technological innovation, digitization, globalization, etc.) also influence price trends. Without real growth in wages, the Fed will likely remain patient before initiating rate hikes. Overall we remain optimistic, knowing that initial rate hikes are preventative and the normal price to be paid for a moderate continuation of the expansionary phase of the economic cycle.

This year we expect to again see positive results for global equity markets. Oil prices will likely remain low, between $40 and $60, while the Canadian dollar will likely fluctuate in a range between $0.75 to $0.85 USD. Regardless, we remain cautious in light of European geopolitical turmoil, but also the ultra-expansionary monetary policies which continue to raise many questions for our team. Can quantitative measures implemented to date in the US, Europe and Japan, truly drive sustained economic recoveries? For the moment at least, the story seems to single out financial assets as the big winner of these unprecedented measures, while the real economy drags its feet.

In the short-term, and aside from the unsettled Greek question, equity markets should continue to perform well, with relatively low bond yields on a historical basis. But we must keep in mind the vagaries of these quantitative measures: rising long-term national debts, investors sometimes taking on inappropriate levels of risk, and certain asset classes (e.g. bonds vs. shares) being assigned irrational valuations / risk premiums.

RETURN, NET OF ALL FEES (as of April 30, 2015)

	AMETHYST Onshore	AMETHYST Offshore	HFRI Conv. Arb.	HFRI Merger Arb.	HFRI Event Driven
Last quarter	2.8%	2.4%	3.6%	2.9%	4.8%
Last 12 months	6.9%	4.5%	3.8%	3.9%	5.2%
Annualized since inception	8.5%	7.5%	6.7%	5.8%	7.9%

PORTFOLIO

Convertible Securities

Despite reporting a positive quarter, we have been fighting an ebbing tide in convertibles. Low volatility, lower levels of new issues and in some cases their poor pricing, commodities weakness, and lite overall trading volumes have been challenges we continue to overcome. But we view these conditions as transitory, as a general interest rate trend reversal will undoubtedly again make convertible issuance an attractive option for companies seeking financing.

The beauty of our strategy is that so long as a company does not go bankrupt, with nothing paid to its bondholders, it is very difficult to lose money over the life of a bond. Regardless, we are not immune to mark-to market volatility when valuations become periodically disjointed, often driven by unfounded fears. The phenomenon is obviously amplified when markets are spooked by large and publicized bankrupt-

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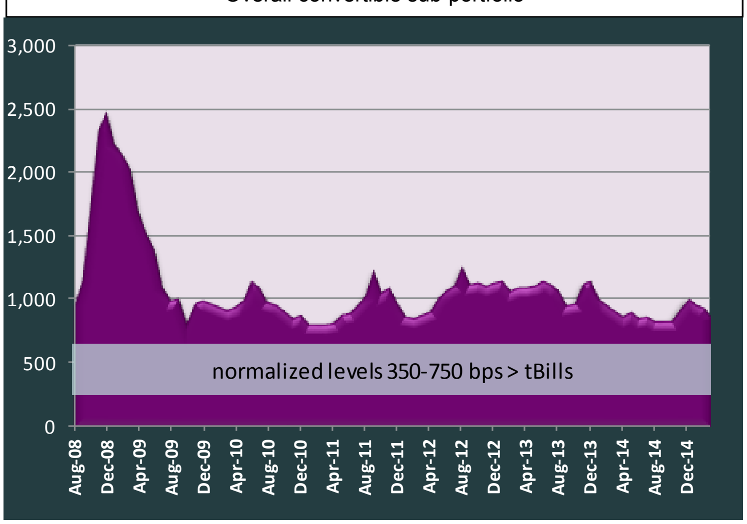
cies. Some of our portfolio holdings have been subject to such fears over the last quarters, despite sufficient cash runway before running into potential liquidity issues. Lately however, a reality check allowed some stabilization and price improvements.

We have managed to minimize negative events, and when they do occur, mitigate them employing innovative solutions, leveraging synergies between internal skill-sets, and carefully controlling risk. We continue to use bonds, both convertible and high yield to enhance merger and acquisition activity. These positions still derive interesting returns while limiting downside, and in some cases we have successfully morphed them into our longer term convertible strategy due to post merger pricing and the nature of individual issues.

We have also increased the use of options to more efficiently profit from volatility in convertibles. For certain positions it is better to not engage in dynamic hedging, instead capitalizing on volatility by writing calls which are hedged through the implicit call imbedded in the convertible. We have been actively seeking and implementing such enhancements to our dynamic trading in order to maximize trading profits from our convertible hedging program.

AMETHYST IMPLIED CREDIT SPREADS ABOVE T BILLS
Overall convertible sub-portfolio



Market Events

In thinking about our comments on this first quarter of 2015, an old Led Zeppelin song came to mind ("The song remains the same") as Q1 closely resembles the last quarter of 2014; even the low levels of Canadian transactions (24) is identical for both periods according Bank of America Merrill Lynch! Our response also remains the same: we prefer to allocate the capital devoted to this sub-strategy to the US where the merger and acquisitions activity remains vibrant, especially for companies in the pharmaceutical and biotechnology industries.

We added 32 transactions to the portfolio during the quarter with no deal failures, although two Canadian cases have been slow to get regulatory approval. In these cases we reduced their weightings to account for the perceived increased risk, despite the fact that the outcomes did not appear to be seriously compromised.

Deal spreads remained volatile in the US, closely following the vagaries of the stock market, which has enabled us to initiate or add to our positions at favorable prices. Our smaller size gives us the ability to move quickly to seize these opportunities without market impact. During the quarter we did not however have any opportunities to play M&A deals via convertible corporate bonds as we have done successfully many times in the past.

Fixed Income

The FI arbitrage sub-strategy began the year with slightly negative performance in the first quarter. On the one hand, the surprise lowering in January of the Bank of Canada's (BOC) key rate made it difficult to borrow some 5 year and under federal government securities ("repo squeeze"). As a result, credit spreads for short-term securities such provinces, municipalities and agencies have all increased. On the other hand, our position-

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ing on the yield curve (the opportunistic component of the sub-strategy with low relative weighting in the portfolio) had a slightly positive contribution as the marked flattening of the curve in Canada and the US in January at the 5 year and under segment paid off.

The second quarter of 2015 started out with a utilization of about 85% of the available capital to this sub-strategy, an increase of 15% from three months ago. With credit spreads backing up some, we took the opportunity to liquidate some positions with maturities in 2016 - 2017 and "climbed" up the curve to 2020 and 2022. The return on capital (ROC) for agencies and provinces remains very attractive relative to corporate credit, and therefore the weight of corporate credit in the portfolio is still low. Our more directional exposure to the yield curve is also low. In Canada, we view curve as too steep at the long end, and conversely, too flat at the short end. In the US, we have a single exposure for the moment, a position for widening at the very short end of the curve (2 year vs. 3 year).

Given the fragile nature of the economic recovery currently underway, an increase in Canadian or US key rates would appear premature. However, and this is a crucial consideration, we believe that it would be positive from the viewpoint of valuations, and more generally, equilibrium of risk premiums, if the Fed were to raise rates 1 or 2 times by the end of the year, in a clear signal that the quantitative measures (QE) in effect since 2008 are not everlasting.

CONCLUSION

Although the volume of convertible new issues and the level of M&A transactions continue to be low in Canada, on balance these two market segments appear healthy. Combined with the fixed income arbitrage sub-portfolio which continues to do its job well, the solid framework invites confidence that the fund will attain its performance target in 2015.

Marc Amirault

Principal Manager
mamirault@cristallin.ca