ehp|FUNDS

Q1 2022 Fund Commentary

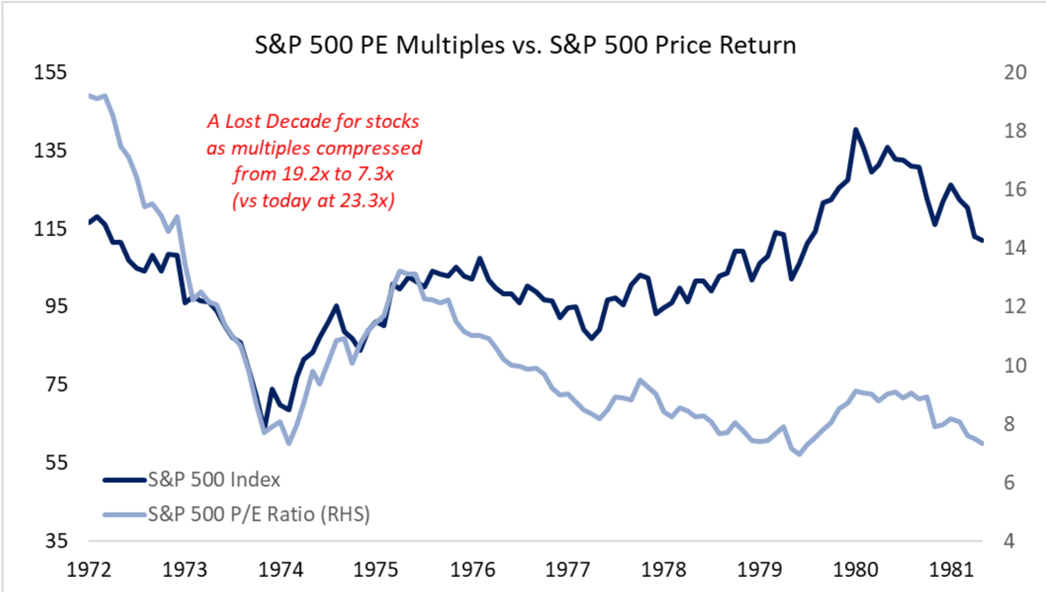
The turn of the calendar marked not only a new year, but a suddenly different market environment than the one we left behind in 2021. Both equity and bond markets suffered major corrections, and some, like the Nasdaq and German DAX, briefly entered “bear” market territory as defined by a 20% pullback from prior highs. The double-whammy of a suddenly hawkish U.S. Fed and the unprovoked invasion of Ukraine by Russia was more than the market could bear, and we saw the worst pullback since Covid before a furious rally into the end of the quarter, led by some of the lowest quality stocks that had been badly beaten up in months prior.

There was real damage done to the bond market, with the Bloomberg Barclays Aggregate Bond Index pulling back -8.1% from its summer high, and ending Q1 down -5.9%, its worse quarterly showing since September of 1980. Back in 1980, inflation was running around 12%, and was actually on the decline after Paul Volcker shocked the market by raising rates to nearly 18% that year. Back then, bond returns up to that terrible quarter had also been pretty terrible, having lost 7% in real terms from the late 70s. We highlight this not to suggest that our debt-driven economy could support anything close to that level of interest rates today, or that we are on a path to something similar, but more as a reminder that we are in relatively uncharted territory for investors. There aren’t many managing money today that have experience navigating an inflationary period with rising rates (us included), and so historical precedents become that much more important.

From Transitory to Troubling

We highlighted back in our Q2 2021 newsletter why we felt that “transitory” inflation was a rather optimistic assessment by the Fed given that not only money supply had increased by the largest amount in history (up 25% YoY as the Fed stepped in to battle Covid), but that unlike other episodes of QE that proved to be deflationary, this time the money supply increase was met with an equally impressive fiscal spend from governments – the largest by a long shot since World War II. While the impact from the monetary and fiscal stimulus is slowing, it has had the knock-on effect of driving inflation to levels not seen since the 1980s. The Fed is now stuck in an uncomfortable spot, having more than achieved their original goal of “average” inflation targeting, and now forced to raise rates aggressively lest it become pervasive. The problem is that an estimated 2/3^{rds} of inflation is supply-driven rather than demand-driven, meaning that rate hikes can only go so far in controlling it. The Fed can’t create new oil supply, or fix global supply chains, or make more fertilizer. Rate hikes will have the effect of demand destruction in an effort to slow growth so that hopefully supply can catch up, all while trying not to tip the economy into recession.

More recently the narrative on equities has shifted to one where they are the best alternative in a world of high inflation, and better than cash or bonds (T.I.N.A. – there is no alternative). We’re not so sure about that. There is no doubt that equities are a real asset with a claim on GDP, which means that in theory cash flows can grow alongside inflation, whereas bond cash flows cannot. And we certainly agree that certain sectors have historically been effective hedges against inflation (energy, gold, materials), but overall, stocks lose money in *real* terms. Worse, the sectors that have worked well for years, and are arguably still overweight in broad indices (mega-cap growth stocks), tend to see meaningful multiple compression. The chart below shows the notional price return on the S&P 500 as well as its PE multiple during the last major bout of inflation, from 1972 to 1982. It was essentially a “lost decade” for stocks, with a total notional return (including dividends) of 4.3% annualized - not terrible at face value - but not great when adjusted for inflation which was running an at average of 8.9% annually, leaving investors with a -4.6% *real* return. Multiples spent the decade contracting from 19.2x to a remarkable 7.3x (vs. a starting point of 23.3x today).



Source: Bloomberg

Its certainly true that there are sectors and strategies that can help in this environment (in fact it's why we launched the EHP Global Multi-Asset Absolute Return Fund this fall as a direct inflation and tail-risk hedge), and we re-highlight the real returns for various sectors and strategies from our Q3 newsletter for those that missed it. Unsurprisingly, sectors that are direct producers of the commodities that drive a large part of inflation are beneficiaries (energy, materials, golds), as well as price inelastic healthcare. High multiple sectors like technology are at risk, along with consumer businesses that don't have the pricing power to raise prices enough to offset their input costs. With margins squeezed, staples is one of the worst sectors. We would expect to see a lot of commentary on this effect from CEOs in the coming earnings reporting season, and we think its worthwhile reading this quote from Restoration Hardware CEO Gary Friedman, who summed up on their recent earnings call what many CEOs are likely thinking:

Sectors	Inflation Regimes	Normal Regimes
Energy	1%	8%
Health Care	-1%	11%
Materials	-6%	11%
Consumer Discretionary	-6%	11%
Telcos	-7%	9%
Industrial/Manuf.	-8%	11%
Utilities	-9%	10%
Financials	-9%	11%
Technology	-9%	12%
Consumer Staples	-15%	13%

> "I mean, I think, I don't think anybody really understands what's coming from an inflation point of view, because either businesses are going to make a lot less money, or they're going to raise their prices. And I don't think anybody really understands how high prices are going to go everywhere, in restaurants, in cars, and everything. It's – and I think it's going to outrun the consumer. And I think we're going to be in some tricky space."

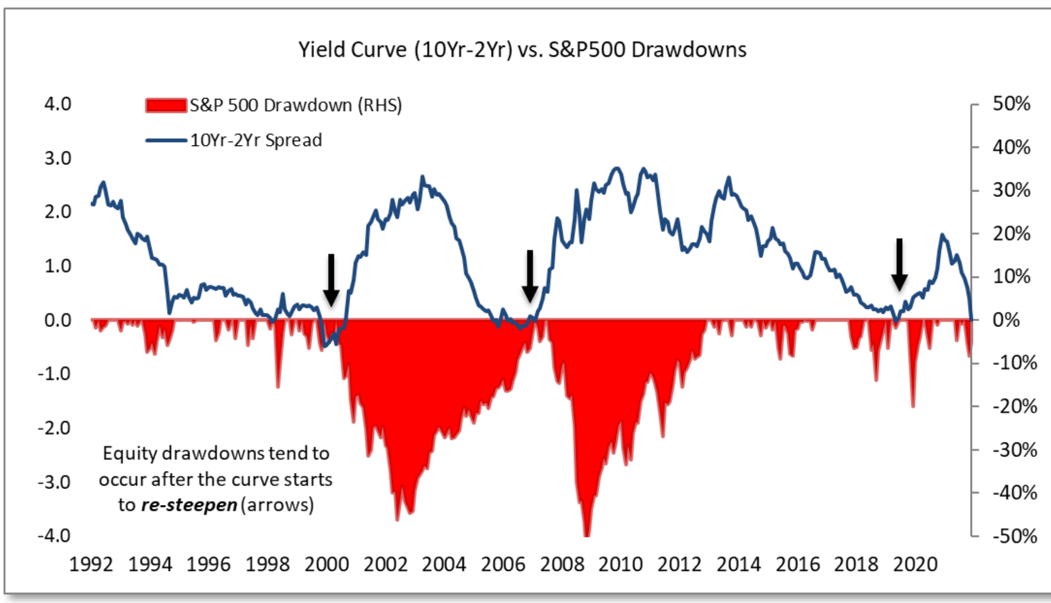
Alternative Strategies	Inflation Regimes	Normal Regimes
Trend - Multi Asset	25%	15%
Trend - Commodity	20%	8%
Momentum Factor	8%	4%
Quality Factor	3%	3%
Value Factor	-1%	2%
Low Volatility Factor	-3%	8%
Small Size Factor	-4%	1%

Alternative Assets	Inflation Regimes	Normal Regimes
Gold	13%	-1%
Wine	7%	2%
Art	5%	6%
Residential Real Estate	-2%	2%

Source for charts: The Best Strategies for Inflationary Times, HENRY NEVILLE, TEUN DRAAISMA, BEN FUNNELL, CAMPBELL R. HARVEY, and OTTO VAN HEMERT, May 25, 2021

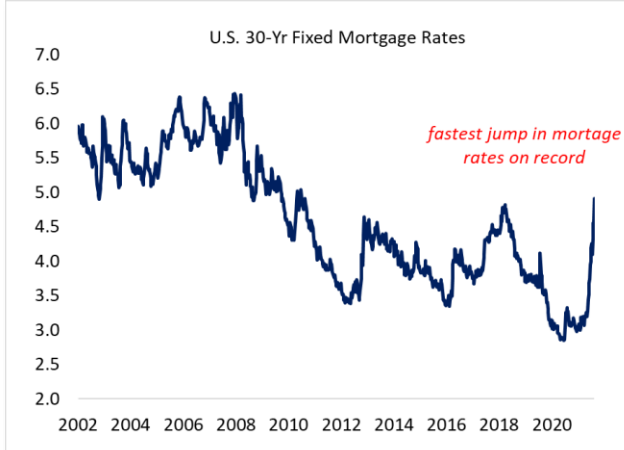
Guess who's back?

The interesting part about managing money is that despite every market environment being unique in its own way, there is ultimately consistency across major cycles, and we are now at the crossroads of one of those major macro events that tends to get a lot of press coverage and drives investor angst: the inversion of the yield curve. There are a number of curves (the 30yr-5yr, the 18mos-3mos, the 10yr-3mos, etc), but the one that typically draws the most attention is the 10yr-2yr, which has now officially inverted for the first time since 2018. Of course, the flattening of the yield curve just tells you that bond investors believe that short-term rates are going to rise faster than long-term rates, which is in-line with Fed guidance, but is useful as a predictor of where we are in the market cycle, and has an enviable track record of predicting eventual recessions. That said, it is not a particularly useful timing indicator, and it's worth noting that in the four prior 10yr-2yr inversions, stocks *rallied* an average of 28.8%, with a range of 6 months to 22 months before the bull market hit its peak. In the last eight inversions going back to 1978, only two had small negative returns one year later, with the average up 15.2%. In fact, if we look at S&P drawdowns alongside the yield curve (chart below), it is once the curve begins to *steepen* again after inverting that equity markets decline, as at that point the bond market is predicting the end of cycle and an upcoming rate cut at the short end.

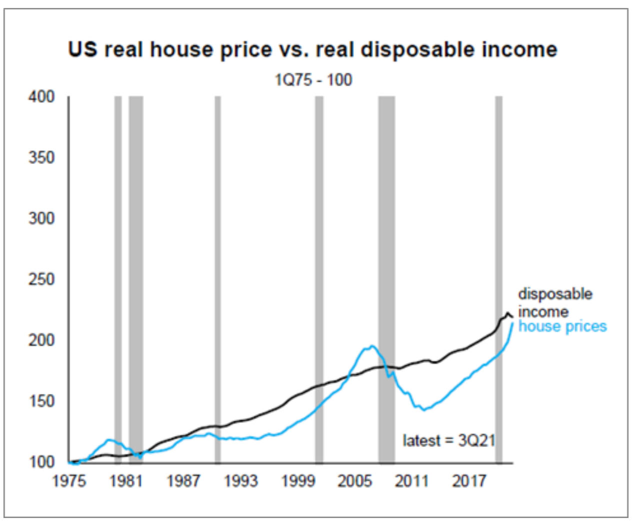


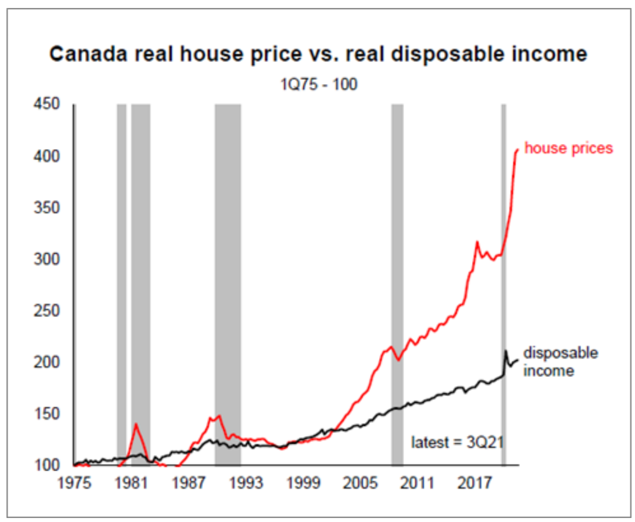
So, while we can't ignore the yield curve as it does imply we are getting late in the cycle, it by itself is not a reason to clear the decks. Also, of note – inflation can change the signal the curve sends somewhat. Back in the '70s and '80s, the yield curve had much deeper inversions (100-200 bps) before signalling recessions, and so if we do enter a "stagflation" environment, we may get conflicting signals from traditional indicators.

A tale of two housing markets



We wanted to share some charts that don't have as much to do with the Funds themselves, but are likely of great interest to all Canadians who own or want to own a house. One of the obvious consequences of the rise in yields is that mortgage rates must rise as well. The chart to the right shows the US 30-yr fixed mortgage, now with one of the fastest and largest jumps on record. What has been remarkable this time is the *pace* at which rates have moved rather than the absolute level. 5-yr fixed mortgages, which could be had for as low as 1.5% last summer in Canada, are now approaching 4%. While the absolute level of 4% seems reasonable in the historical context, quick jumps like this will slow markets, and unlike the U.S. where the market is more in balance after their housing reset in 2008, the Canadian market does not appear to be in any type of balance when viewed against the long-term trend of disposable income (see chart below). U.S. homebuilder stocks have corrected to very cheap valuations on these concerns, and we'd suggest they represent good value at these levels, but we are quite concerned about the impact of a slowing housing market in Canada given the industry now represents a stunning 9.6% of GDP! Far be it from us to call a crash in housing given how resilient it has been in the past, and given that lack of new supply and immigration should keep demand strong, but we would be ill advised to ignore the potential consequences for sectors where housing has been an important driver.

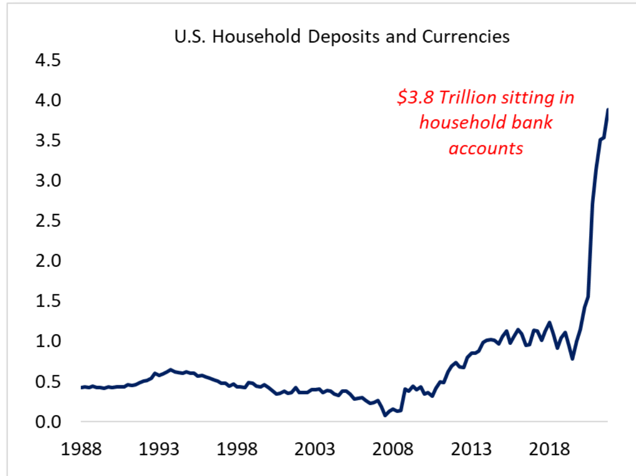




Source: Macquarie

So what's the good news?

While much of the commentary above seems quite pessimistic, the fact is that all of it is already known, and most likely discounted by the market. The war, inflation, eight rate hikes with a few 50bps thrown in, the largest drawdown for bonds ever, and a good amount of repositioning by investors, and despite all of that, the market found a way to rally sharply off its lows. If anything, from here, news that is less bad than what has been priced in should act as positive catalysts. As mentioned, markets tend to rise during rate hike cycles, at least for a while. Democrats are likely to lose their double majority in the mid-terms, which at the margin is pro-business, and maybe pro-energy supply. The consumer is still in remarkably good shape financially (see chart to the right) and has the ability to spend through at least some of the current inflation while they wait for wages to catch up. GDP is coming off the boil, but is by no means close to recessionary levels, and employment remains strong and growing. Supply chains are improving as indicated by some of the commentary in recent ISM surveys, and China abandoning or softening its zero-Covid stance could have a major impact if it comes to pass. Russia is losing the war versus what their initial expectations were, and barring the tail risk of a dramatic escalation by a suddenly weakened Putin, the odds favour a face-saving armistice, further relaxing pricing and supply pressures. In other words, markets tend to muddle through when the risks are known, and climb the proverbial wall of worry.



Source: St. Louis Federal Reserve

The quarter was a challenging start to the year not just for equity and bond markets, but also our strategies, as the aggressive de-risking by hedge funds had the effect of seeing higher quality, formerly trending stocks get sold, while lower quality, high beta stocks were covered, making our shorts much less effective in hedging against losses from longs. Just as this de-grossing was winding up, and long/short strategies stabilized with meaningful outperformance against benchmarks, the market staged a remarkable rally with another wave of aggressive buying of the lowest quality stocks. It's unusual for our shorts to have lost money in a quarter where indices finished lower, but that was the hand we were dealt this time around, and importantly those same shorts are what offered real protection to the Funds during bear markets like 2020.

The question now is whether what we just witnessed was just a bear market rally, or the resumption of the uptrend that started post-Covid, and one in which investors had overly discounted the pessimistic scenarios. If this is indeed a bear market rally, it's a big one by historical contexts, although not unprecedented, with BofA noting that there have been four larger 10-day rallies than the current one in previous bear markets going back to 1927. But, unless we are on the cusp of recession, which is not yet in the data, then respecting the "green shoots" that we are seeing across markets globally is the path with the better odds.

There is ample fuel for a rally to continue. Hedge fund positioning is near the lowest of its historical net and gross exposure, with a net of only 45% on average, or in the 14th percentile, according to MS Prime Brokerage. In fact, it was in part this de-risking that caused higher quality stocks to sell off in January and February while low quality stocks were bought to cover shorts, worsening their (and our) returns. Institutional money managers have raised cash to the highest level since April of 2020 according to the latest BofA survey, the lowest equity exposure in two years, and the share of managers expecting a bear market this year has risen to 60% (from 40% in February). All this to say that there is a lot of money that will need to chase the market higher if consensus of a recession turns out to be nothing more than a growth scare. So, who's been buying all the stock that hedge funds and institutions have been selling? Retail and corporate buybacks, that's who. Typically, during an equity market sell-off of 10%, there would be an average of $10 Billion of equity outflows from US equity funds during the 3 months following a market peak. This time, $93 Billion flowed *into* US equity funds YTD, following on from the record $243 Billion of inflows in 2021. Remarkably, retail has "bought the dip" yet again.

Its quite likely that given high cash balances and current dislike of bonds, retail investors may continue to be net buyers of stocks, and corporate buybacks have been very active, with a record $319 Billion authorized this year according to Goldman (up from $267 Billion this time last year).

As of the end of the month, our risk process has added back moderate risk, first in cyclical markets like Canada and Australia, and more recently in the U.S., the U.K. and Europe. Some stocks, like those tied to homebuilders, and financials, look oversold, and where trends have held in, we remain allocated to higher quality, now more reasonably priced equities in these sectors. Select technology names have become cheap enough as well, and also have a high quality of earnings. And while energy stocks and materials (like fertilizers) have obviously been the star sectors this year, we see plenty of remaining value and earnings growth in these and other resource companies like copper, coal, steel, and lumber. High yield bonds remain the holdout for our risk models, held down not by credit concerns as much as overall yield pressure. While they have not yet resumed an uptrend, we have the benefit of buying them back at much cheaper prices than where we sold them in January if and when they do. While we're cautiously optimistic, we're also pragmatic, and a resumption of the market declines would have us protect capital again, unemotionally following our process without judgement.

Even if the current inflation and rate hike cycle doesn't slow growth to the point of recession, the path forward for real returns for all asset classes in now challenged. The case for alternative funds remains strong with bonds offering little to no nominal yield, and negative real yields if we account for expected inflation. While the M&A market will be hard pressed to repeat the activity level of 2021, an apparently endless supply of SPACs currently offer good rate-of-return opportunities and asymmetrical risk-reward. Merger arbitrage strategies continue to stand out as good bond replacements. The environment described above should continue to suit active long/short managers who can take advantage of wide dispersion of valuations among stocks and sectors, as well as those that are nimble enough to adjust in what may continue to be a market of extremes. As always, we will remain patient and disciplined in terms of applying our process, following an approach that relies on actual market changes and not forecasts of such.

Thank you for continuing to trust us with your investment dollars.

Fund Specific Commentary

Summary of Returns (F-Class unless otherwise denoted):

Fund	1M	3M	YTD	1YR	3YR	Inception
Defensive/Conservative Funds:						
EHP Foundation Alternative Fund	-0.9%	-4.0%	-4.0%	1.1%	3.2%	4.0%
EHP Foundation International Alternative Fund	-0.3%	-4.1%	-4.1%	0.0%	0.5%	2.1%
EHP Global Arbitrage Alternative Fund	-0.8%	-3.6%	-3.6%	2.7%	5.5%	7.7%
EHP Strategic Income Alternative Fund*						
Core/Moderate Funds:						
EHP Advantage Alternative Fund	0.3%	-3.5%	-3.5%	7.9%	6.6%	6.2%
EHP Advantage International Alternative Fund	0.7%	-5.3%	-5.3%	2.9%	2.1%	2.9%
EHP Select Alternative Fund	1.7%	-4.2%	-4.2%	1.3%	14.5%	12.8%
EHP Global Multi-Strategy Alternative Fund[1]	-0.2%	-5.3%	-5.3%	3.4%		6.5%
Specialty Funds:						
EHP Multi-Asset Absolute Return Fund[2]	5.7%	6.2%	6.2%			7.4%[2]
EHP Global ESG Leaders Alternative Fund*						

*Returns are available after 1 year of track record as per National Instrument 81-102

[1]The EHP Global Multi-Strategy Alternative Fund (formerly the EHP Global Multi-Strategy Fund) (the "Fund") was not a reporting issuer during the period of December 28, 2020 to December 31, 2021 (the "Relief Period"). EHP Funds Inc., the manager of the Fund, obtained exemptive relief on behalf of the Fund to permit the disclosure of performance data of the units of the Fund relating to this Relief Period prior to which the Fund was not a reporting issuer. On January 1, 2022 the Fund became a reporting issuer. While the manager reduced, as of January 1st 2022, both the management fee rate (from 1.0% to 0.9% per annum) and performance fee rate (from 20% to 15%) for Class F unitholders of the Fund, the other operating expenses of the Fund would have been higher during the Relief Period the Fund was not a reporting issuer due to the additional regulatory requirements applicable to a reporting issuer.

[2]EHP Multi-Asset Absolute Return Fund was launched November 1, 2021. Returns shown are for Founders Class which is currently available to new investors. "Inception" for this Fund refers to the cumulative return from the inception date (i.e., such rate has not been annualized, while the "Inception" for both the Defensive/Conservative Funds and Core/Moderate Funds do reflect an annualized return).

Defensive / Conservative Funds

EHP Foundation Alternative Fund

The Fund was down -4.0% over the quarter, in what was a particularly challenging environment for the strategy. The Fund entered the year at the higher end of its risk ranges, following performance that was in excess of targeted returns for 2021. As the markets declined in January our systematic risk-gearing approach cut risk by exiting high yield positions, decreasing long equity exposure, and increasing weight to equity shorts. What was evident in both January and February was that other players, notably long/short hedge funds, were also aggressively "de-grossing" their books, which had the effect of higher quality stocks being sold, while lower quality shorts were covered, causing the Fund moderate losses as shorts offered little protection. There were few places to hide as U.S. long bonds fell alongside stocks, removing one source of tactical protection for our approach. As broad markets dropped further into March (with the S&P declining nearly -15% from prior highs at its worst point), the Fund held stable and protected capital, but, as has been the case in more recent corrections, the market rallied furiously from the lows, up 10%+ in short order and with some of the lowest quality, highest beta stocks reversing course to jump higher. Given our defensive positioning, the Fund had further losses as our shorts outran our longs into quarter end.

While frustrating, losses were contained within our tolerance for the strategy, and can be an unfortunate by-product of having more volatile, lower quality shorts that can be so valuable during major corrections like March of 2020. In terms of attribution, losses came from both longs and shorts, with only Canada providing positive absolute returns as our commodity-heavy home market meaningfully outperformed the U.S. for the first time in years. Our Credit Momentum strategy had moderate losses from both High Yield as well as U.S. Long Bonds, which whipsawed higher in early March, only to roll over again in one of their toughest quarters on record. Merger Arb had small losses as arbitrage spreads widened in sympathy with credit spreads, and SPACs remained decidedly for sale and at their widest spreads ever.

Virtually all market rallies after larger corrections start with a “dash for trash”, as the most beaten down stocks are bought by those who are short, or those who seek “bargains”. It is impossible to tell until after the fact if a rally is a “bear market rally” that ultimately reverses, or whether it’s the start of a new bull run, but as always, we respect our gearing process, and add back risk as the signals dictate. Most often after periods of junk rallies, comes a “normalization” where higher quality stocks outperform and overbought low-quality stocks stall out, leading to gains for our approach. We enter Q2 with the Fund partially risk on, with our Credit allocation still sitting in cash rather than either high yield or treasuries. We are overweight sectors that benefit from inflation like materials and energy, and long select technology names where multiples have meaningfully declined. We remain underweight expensive technology as well as bond-proxy utilities and REITs, plus staples that face the most headwind in a stagflationary environment.

<u>EHP Foundation International Alternative Fund</u>

The Fund was down -4.1% over the quarter, in what was a particularly challenging environment for the strategy. The Fund entered the year at the higher end of its risk ranges. As the markets declined in January our systematic risk-gearing approach cut risk by exiting high yield positions, decreasing long equity exposure, and increasing weight to equity shorts. What was evident in both January and February was that other players, notably long/short hedge funds, were also aggressively “de-grossing” their books, which had the effect of higher quality stocks being sold, while lower quality shorts were covered, causing the Fund moderate losses as shorts offered little protection. There were few places to hide as U.S. long bonds fell alongside stocks, removing one source of tactical protection for our approach. As broad markets dropped further into March (with the MSCI EAFE Index declining nearly -17% from prior highs at its worst point), the Fund held stable and protected capital, but, as has been the case in more recent corrections, the market rallied furiously from the lows, up 10%+ in short order and with some of the lowest quality, highest beta stocks reversing course to jump higher. Given our defensive positioning, the Fund had further losses as our shorts outran our longs into month end.

While frustrating, losses were contained within our defined tolerance for the strategy, and can be an unfortunate by-product of having more volatile, lower quality shorts that can be so valuable during major corrections like March of 2020. In terms of attribution, losses came from all regions, led by Europe which was hardest hit by the Russian invasion of Ukraine on its doorstep. Shorts offered almost no protection over the period, with only small gains in Europe and losses in other regions. Our Credit Momentum strategy had moderate losses from both High Yield as well as U.S. Long Bonds, which whipsawed higher in early March, only to roll over again in one of their toughest quarters on record. Merger Arb had small losses as arbitrage spreads widened in sympathy with credit spreads, and SPACs remained decidedly for sale and at their widest spreads ever.

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EHP Global Arbitrage Alternative Fund

The Fund was down -3.6% over the quarter in what was a challenging environment for the strategy. Losses came from merger arb spreads widening in sympathy with credit spreads, ending the quarter close to 10% annualized, levels not seen since May of 2020, as well as from SPACs and SPAC warrants that were sold relentlessly to fresh all-time lows. It is remarkable that only a year ago investors were paying a premium to cash for virtually all SPACs, and today the exact opposite conditions exist. The average SPAC seeking a deal now yields an attractive 3.3% (unlevered), with no risk of capital loss if held to redemption, as well as the upside optionality that the SPAC finds an attractive deal and shares can be sold above trust value. SPAC warrants, which we had added in late Q4 and early this year, were down materially as holders sold at what can only be described as heavily discounted levels. The average completed SPAC warrant trades ~$1, (given they are 5-yr warrants, the time value hold value even if the underlying equity declines) while the average pre-deal warrant now trades at $0.33. The market is effectively implying that 2/3rds of existing SPACs will fail to find a deal, despite the fact that there have historically been very few liquidations, even in the current environment (approx. 2% of SPACs have liquidated historically). SPAC sponsors have real capital at risk in these structures, and are already adapting to both SEC scrutiny on overly promotional forecasts, as well as investor desire to support "real" companies with both current profits and growth potential. While the weight to SPACs overall sits at our max 20% given liquidity considerations, (approx. 16% common shares and 4% warrants), we see the asset class as the most attractive among the current opportunities.

The Fund participated in over 98 traditional arbitrage opportunities, and holds 43 positions as of the end of the quarter. There were no deal breaks in the portfolio during the period. SPACs now account for approximately 20% of the Fund, represented by 244 positions. The traditional merger market has slowed vs. its pace last year – boards tend to be most confident when markets are rising, and their ability to raise debt or use inflated equity as currency are high. Deal timelines remain stretched as competitive reviews are more common under the Biden administration and taking longer to complete, and in general we've been avoiding deals with such risk, particularly given that downside risk increases in the event of a break during volatile markets. The outlook for deal flow is hard to handicap. On one hand, private equity still has a large war chest of cash it needs to put to work, and multiples in many sectors have come down from prior highs. One the other hand, high yield debt markets, which are often a source of funds for deals, are less supportive and the cost of that debt is higher, making transactions more difficult to finance. The market is concerned about a growth slowdown, which would further pressure deal flow if it comes to pass, although typically even during recessionary periods there can be adequate deal flow priced with wide spreads to maintain an attractive overall return. Rising interest rates tend to be a benefit for merger arb in that new deal spreads reflect the higher yields immediately, increasing notional returns on these mergers. Given that mergers tend to be completed in 3-6 months, the strategy is akin to a "floating rate" note that adjusts quickly to the current yield environment.

EHP Strategic Income Alternative Fund

The Fund launched June 1, 2021, and finished the month with a NAV per Class F unit of $10.202. As per National Instrument 81-102 regulations, return calculations can only be shown after one year of track record.

The Fund is currently in a risk-off mode. Our core long/short bond portfolio represents 44.5% of NAV on a net basis (77.5% long and 30% short), and our Credit Momentum strategy, representing 30% of the fund, is currently in cash. This sub-strategy normally rotates between U.S. High Yield debt and U.S. 30-Yr Treasuries ETFs, but since neither high yield nor treasuries are in an uptrend, cash is preferred. To recall, these ETFs serve both as a "liquidity buffer", as well as an effective way to quickly reduce credit risk in the event our risk indicators roll over. Given the state of the bond market, with rates rising rapidly, we opted to add additional tactical hedges to protect against remaining credit risk, which we have since removed as markets stabilize. The quarter was a challenge to navigate, no surprise given it featured the largest drawdown in aggregate bonds in 50 years. While our Credit Momentum strategy sustained losses during the quarter, the damage was limited, and we now have the advantage of being able to buy back high yield bond ETF exposure at a meaningfully lower price than where we exited them in January, if and when our risk signal turns positive.

Risk Arbitrage opportunities, which are primarily in SPACs with the highest yields-to-maturities, round out the portfolio at 20% of NAV. We continue to see a wealth of opportunities for safe yields north of 3% unlevered in this space.

In the first quarter, the fixed income market was under pressure from the combination of inflation, rate hikes and war news flows, leading to down months in January, February and first half of March but stabilizing, at least temporarily, in the second half of March. The Bloomberg Barclays US Aggregate Bond Index was down 5.9% during the quarter, while the Bloomberg Barclays US Corporate High Yield Bond Index was down 4.8% in the quarter. The weakness in high yield was primarily driven by treasuries rather than corporate fundamental concerns as the riskiest CCC segment of high yield was down only 3.8%.

The primary market priced a mere $43b of debt, the slowest first quarter since 2016, as borrowers stayed away amid rising inflation and the more aggressive stance taken by the Federal Reserve.

Spreads of investment-grade corporate bonds ended the quarter at 116 basis points over Treasuries, 24 basis points wider than the end of Q4. Similarly, the risk premium on high-yield debt ended the quarter at 324 basis points, (only) 42 basis points wider than at the end of Q4. In contrast to March of 2020 and December of 2018 where high yields bonds had meaningful pullbacks, the moves this time are being driven by the rates market rather than the credit market, suggesting that corporate bonds are not yet overly concerned about a slowdown that would result in a recession. The US 10 years treasuries ended the quarter with a yield of 2.34%, 83 bps wider than at the end of Q4. Our ability to short higher risk bonds and to gear the risk down when the market regime changes has been instrumental in protecting our fund in this kind of increasing rates and general uncertain environment.

We continued to run our disciplined portfolio management process in Q1 albeit we reduced portfolio's churn given the increased trading costs (wider bid-ask spreads from dealers). The fund was appropriately positioned coming into this environment, our process is designed to allow us the luxury of not being forced to trade in erratic markets and position the portfolio when the trading costs are low. The Fund's largest sector exposure remains energy at 14.4%, somewhat higher than at the end of Q4 (12.5%). We enter Q2 of 2022 with credit risk at the lower end of our range, with duration at 1.6, and net yield of 3.0% (including the estimated yield from SPACs).

Core / Moderate Funds

<u>EHP Advantage Alternative Fund</u>

The Fund was down -3.5% over the quarter, in what was a particularly challenging environment for the strategy. The Fund entered the year at the higher end of its risk ranges, following performance that was in excess of targeted returns for 2021. As the markets declined in January our systematic risk-gearing approach cut risk by exiting high yield positions, decreasing long equity exposure, and increasing weight to equity shorts. What was evident in both January and February was that other players, notably long/short hedge funds, were also aggressively “de-grossing” their books, which had the effect of higher quality stocks being sold, while lower quality shorts were covered, causing the Fund moderate losses as shorts offered little protection. There were few places to hide as U.S. long bonds fell alongside stocks, and the commodity-centric CAD outperformed typically flight-to-safety USD, removing two sources of tactical protection for our approach. As broad markets dropped further into March (with the S&P declining nearly -15% from prior highs at its worst point), the Fund held stable and protected capital, but, as has been the case in more recent corrections, the market rallied furiously from the lows, up 10%+ in short order and with some of the lowest quality, highest beta stocks reversing course to jump higher. Given our defensive positioning, the Fund had further losses as our shorts outran our longs into month end.

While frustrating, losses were contained well within our defined tolerance for the strategy, and can be an unfortunate by-product of having more volatile, lower quality shorts that can be so valuable during major corrections like March of 2020. In terms of attribution, losses came from both longs and shorts, with only Canada providing positive absolute returns as our commodity-heavy home market meaningfully outperformed the U.S. for the first time in years. Our Credit Momentum strategy had losses from both High Yield as well as U.S. Long Bonds, which whipsawed higher in early March, only to roll over again in one of their toughest quarters on record. Merger Arb had losses as arbitrage spreads widened in sympathy with credit spreads, and SPAC common shares and warrants remained decidedly for sale and at their widest spreads ever.

Virtually all market rallies after larger corrections start with a "dash for trash", as the most beaten down stocks are bought by those who are short, or those who seek "bargains". It is impossible to tell until after the fact if a rally is a "bear market rally" that ultimately reverses, or whether it's the start of a new bull run, but as always, we respect our gearing process, and add back risk as the signals dictate. Most often after periods of junk rallies, comes a "normalization" where higher quality stocks outperform and overbought low-quality stocks stall out, leading to gains for our approach. We enter Q2 with the Fund partially risk on, with our Credit allocation still sitting in cash rather than either high yield or treasuries. We are overweight sectors that benefit from inflation like energy and materials, and financials where multiples have meaningfully declined as the market responds to flattening yield curves and rising concern of inflation. We remain underweight expensive technology as well as bond-proxy utilities and REITs.

EHP Advantage International Alternative Fund

The Fund was down -5.3% over the quarter, in what was a particularly challenging environment for the strategy. The Fund entered the year at the higher end of its risk ranges. As the markets declined in January our systematic risk-gearing approach cut risk by exiting high yield positions, decreasing long equity exposure, and increasing weight to equity shorts. What was evident in both January and February was that other players, notably long/short hedge funds, were also aggressively "de-grossing" their books, which had the effect of higher quality stocks being sold, while lower quality shorts were covered, causing the Fund moderate losses as shorts offered little protection. There were few places to hide as U.S. long bonds fell alongside stocks, removing one source of tactical protection for our approach. As broad markets dropped further into March (with the MSCI EAFE Index declining nearly -17% from prior highs at its worst point), the Fund held stable and protected capital, but, as has been the case in more recent corrections, the market rallied furiously from the lows, up 10%+ in short order and with some of the lowest quality, highest beta stocks reversing course to jump higher. Given our defensive positioning, the Fund had further losses as our shorts outran our longs into month end.

While frustrating, losses were contained within our defined tolerance for the strategy, and can be an unfortunate by-product of being uncorrelated to equity and bond markets during times of market stress. In terms of attribution, losses came from all regions, led by Europe which was hardest hit by the Russian invasion of Ukraine on its doorstep. Shorts offered limited protection over the period, with only small gains in most regions that couldn't offset losses on long positions. Our Credit Momentum strategy had moderate losses from both High Yield as well as U.S. Long Bonds, which whipsawed higher in early March, only to roll over again in one of their toughest quarters on record. Merger Arb had small losses as arbitrage spreads widened in sympathy with credit spreads, and SPACs remained decidedly for sale and at their widest spreads ever.

Virtually all market rallies after larger corrections start with a "dash for trash", as the most beaten down stocks are bought by those who are short, or those who seek "bargains". It is impossible to tell until after the fact if a rally is a "bear market rally" that ultimately reverses, or whether it's the start of a new bull run, but as always, we respect our gearing process, and add back risk as the signals dictate. Most often after periods of junk rallies, comes a "normalization" where higher quality stocks outperform and overbought low-quality stocks stall out, leading to gains for our approach. We enter Q2 with the Fund partially risk on, with our Credit allocation still sitting in cash rather than either high yield or treasuries. We are overweight more cyclical sectors, and overweight sectors that benefit from inflation like materials, and financials where multiples have meaningfully declined as the market responds to flattening yield curves and rising concern of inflation. We remain underweight expensive technology as well as bond-proxy utilities and REITs.

EHP Select Alternative Fund

The Fund was down -4.2% over the quarter, with losses occurring in January and February, offset partially by gains in March. The Fund entered the year at the higher end of its risk ranges, following performance that was in excess of targeted returns for the prior two years. As the markets declined in January our systematic risk-gearing approach cut risk, decreasing long equity exposure, and increasing weight to equity shorts, and was whipsawed to a degree by a choppy TSX that oscillated around key risk levels before resolving higher. What was evident in both January and February was that other players, notably long/short hedge funds, were also aggressively "de-grossing" their books, which had the effect of higher quality stocks being sold, while lower quality shorts were covered, causing the Fund moderate losses as shorts offered little protection. While Canadian markets held in well relative to global counterparts, it was led by more levered energy stocks, gold stocks, and materials as opposed to the more profitable, higher-quality stocks in those same sectors which we tend to favour. As global markets rallied furiously from the mid-March lows, these higher beta, lower quality stocks led gains, causing our shorts to outrun our longs into quarter end.

While frustrating, losses were contained well within our defined tolerance for the strategy, and can be an unfortunate by-product of having more volatile, lower quality shorts that can be so valuable during major corrections like March of 2020. In terms of attribution, losses came from both longs and shorts, as low quality, high beta stocks outperformed higher quality, more stable ones. Merger Arb had losses as arbitrage spreads widened in sympathy with credit spreads.

Virtually all market rallies after larger corrections start with a "dash for trash", as the most beaten down stocks or those with highest beta are bought by those who are short, or those who seek "bargains". It is impossible to tell until after the fact if a rally is a "bear market rally" that ultimately reverses, or whether it's the start of a new bull run, but as always, we respect our gearing process, and add back risk as the signals dictate. Most often after periods of junk rallies, comes a "normalization" where higher quality stocks outperform and overbought low-quality stocks stall out, leading to gains for our approach. We enter Q2 with the Fund risk on, and overweight sectors that benefit from inflation like energy and materials, and financials where multiples have meaningfully declined as the market responds to flattening yield curves and rising concern of inflation. We remain underweight expensive technology as well as bond-proxy utilities and REITs.

EHP Global Multi-Strategy Alternative Fund

The Fund was down -5.3% for the quarter in what was a difficult environment for the strategies the Fund invests in. As a "fund of funds", the Fund holds interests in a number of our EHP alternative mutual funds, with a tactical approach to rotating assets to more defensive strategies as markets become more volatile, and our risk triggers are hit. The Fund entered Q1 in the mid-range of our risk ranges, with a blend of strategies reflecting some risk-off global markets but with strength in North America. The Fund moved to a fully risk off positioning by the end of January as all markets declined and triggered a further defensive tactical shift. The quarter was a challenge for all of our strategies as described above in the individual fund descriptions, with shorts causing losses in most funds as lower quality, higher beta stocks outperformed quality ones despite volatile equity markets. As of the end of the quarter, markets globally had regained enough ground to add back some risk and move to more of a blend of core and defensive strategies, although credit sub-strategies remain in cash. Whether or not this market rally is a short-lived one in a larger bear market, or the start of a new uptrend, we cannot know until after the fact, but as always, we respect our risk management process.

Specialty Funds

EHP Multi-Asset Absolute Return Fund

The Fund was up 6.2% over the quarter (Founder's Class, which remains open to new investors), with gains led by commodity trend, crowdedness, and carry, followed by cross-asset trend and fixed income carry. Short-term trend and volatility in equities and currency value were detractors to performance due to intraday whipsaws and currency valuations becoming further stretched in the quarter.

In commodities, performance benefitted from multiple sources of return including trend, crowdedness and carry, supported by continued flows into inflation hedges and geopolitical instability which affected energy, grains, and metals, as well as short-term trend and volatility in energy. In equities, short-term trend and volatility were detractors to performance for the quarter, as we experienced several intraday whipsaws. In currencies, trend was a contributor to performance while value was a detractor. In fixed income, we continued to benefit from the trend lower in bonds while carry also contributed positively to performance as we capitalized on one of the worst quarters on record for global fixed income.

Heading into Q2 of 2022, we are well positioned to continue to provide an active inflation hedge and diversifying absolute returns to replace bonds or equity. Equity positioning is currently risk-on, while we are ready to take advantage of an anticipated higher volatility environment. Current positioning in bonds, based on trend and carry, is biased short with a relative preference for higher yielding Australian and UK bonds versus Canadian and Japanese bonds. In currencies we favour the value and trend of USD and JPY versus EUR and AUD. Commodity carry, trend and crowdedness currently favour the long end of curves over short, with a relative preference for energies, metals, and livestock over agricultural, providing continued inflation protection. As always, the Fund will actively adapt positioning to changes in markets and volatility that will inevitably come with developments regarding supply, demand, inflation, central banks, COVID, and geopolitical tensions.

EHP Global ESG Leaders Alternative Fund

The Fund launched February 1, 20212 and finished the quarter with a NAV per Class F unit of $9.983. As per National Instrument 81-102 regulations, return calculations can only be shown after one year of track record.

The Fund's objective is to select longs from a universe of global stocks that are considered "ESG leaders" in their sectors as defined by MSCI. From this universe of ~700 global companies, we apply our time-tested approach of buying those that score well on value/quality, momentum, and low volatility measures. Our shorts comprise global stocks that are expensive, declining and volatile, and excludes any company considered an ESG leader as defined by MSCI. More details on MSCI's methodology can be found here:

https://www.msci.com/eqb/methodology/meth_docs/MSCI_ESG_Leaders_Methodology_Nov2020.pdf

The Fund launched at the lower end of its risk range, and enters Q2 with broad global indices just below levels that would cause the Fund to add back risk. The pace of the market rally in the last two weeks of March has been remarkable, but virtually all market rallies after larger corrections start with a "dash for trash", as the most beaten down stocks or those with highest beta are bought by those who are short, or those who seek "bargains". It is impossible to tell until after the fact if a rally is a "bear market rally" that ultimately reverses, or whether it's the start of a new bull run, but as always, we respect our gearing process, and add back risk as the signals dictate. Most often after periods of junk rallies, comes a "normalization" where higher quality stocks outperform and overbought low-quality stocks stall out, leading to gains for our approach.

Disclaimers

Returns are for "F" class units of the Funds, are annualized and since inception unless otherwise noted, and are net of fees and expenses. Statistics are calculated using monthly returns. Partial year returns are unaudited. Index statistics use total return indices. The composition of the Funds' portfolio could differ significantly from the index due to the investment strategy employed, and includes differences such as use of credit strategies, use of equal weight positions, use of short positions, varying fund net exposure, varying currency exposure, and investing in small capitalization stocks. Unless otherwise noted, all values are in U.S. dollars. Source for all index data: Bloomberg.

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