



# Special Market Commentary

October 2, 2012

- Macro View
- TSX Venture Technicals
- Fundamental Factors
- AlphaNorth Portfolio Activity



# The Macro View

"We called it before and we are calling it again"

## Historical Macro Calls

It is important to note that we are not perpetual bulls or bears as our view changes with the times. The chart below demonstrates this by outlining our major macro calls since inception of AlphaNorth.

**S&P/TSX Composite and AlphaNorth's Historical Macro Calls**



## Current Macro View

We have been particularly bullish since October 2011. Although we did not predict the severity of the equity market decline in 2011, we successfully identified the bottom in the summer of 2011 which coincided with the spike in volatility as measured by the CBOE OEX Volatility Index (VIX). During that time, we distributed a *Special Market Commentary* which outlined some of the reasoning behind our bullish macro view for equities. We stated: "We believe that the low for the current equity market downturn was set on August 9th, 2011." The low we were referencing was 1,101 for the S&P 500 Index while the S&P/TSX Composite was 11,618.

The TSX Composite and S&P 500 index did briefly breach the August low, but they quickly

rebounded and have trended significantly higher since that time.

Despite the strength in large cap equities since that time, Canadian small caps have performed poorly. We have reiterated in our recent monthly commentaries that it was time to aggressively buy small caps, but few investors acted on this opportunity. Given the recent turn in momentum shown on the following S&P/TSX Venture Index chart along with the positive fundamentals (outlined herein) and the extremely low interest rate environment, the **opportunity to buy low is now**. Investors who buy low make more money than those who wait for the comfort of the herd where they will experience greatly diminished returns.



AlphaNorth  
Special Market  
Commentary

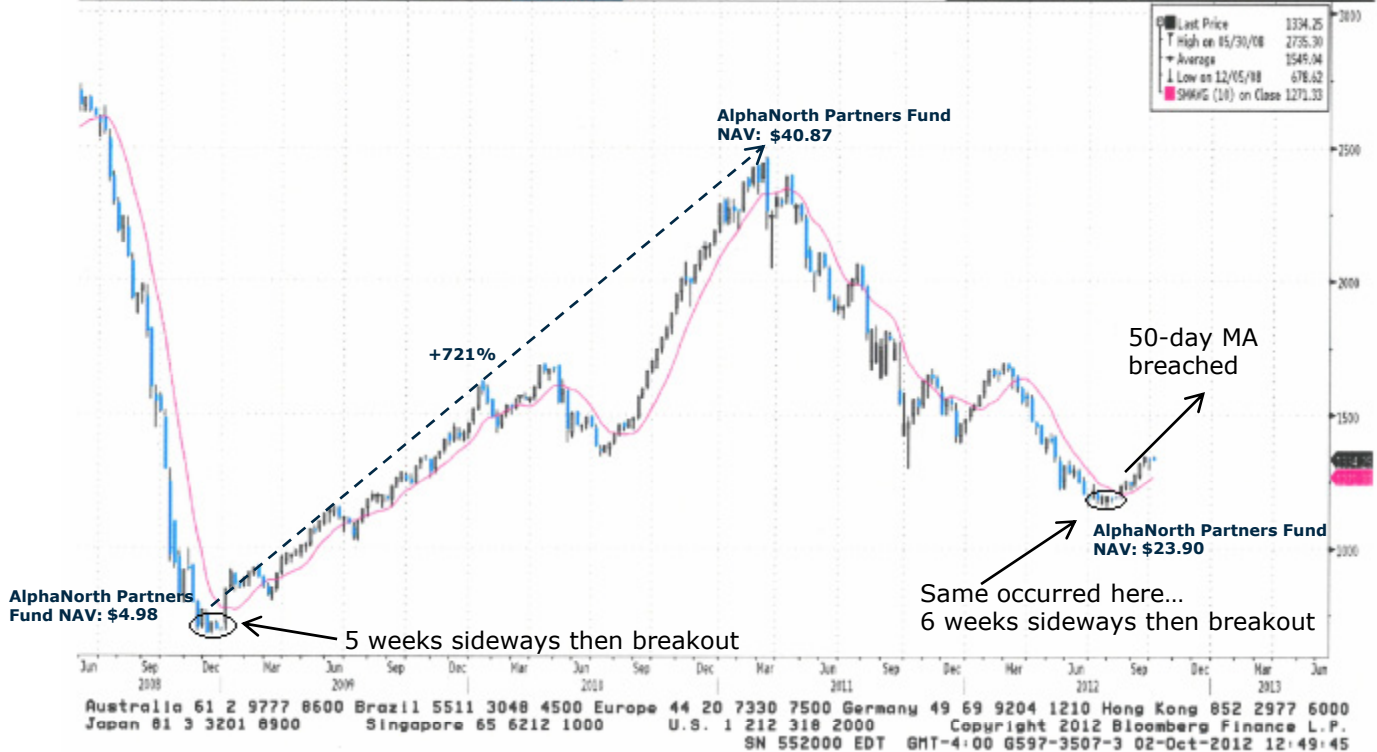
# TSX Venture Technicals

"Similar Scenario to Q4 2008"

## S&P/TSX Venture Index

SPTSXVEN ↑ 1334.25 -4.45 1319.77 / 1348.72  
At 12:49 Vol 0 0 1338.70 H 1349.32 L 1334.02 Prev 1338.70

SPTSXVEN Index 95) Save As 96) Actions 97) Edit 98) Table Candle Chart  
10/12/2007 - 10/02/2012 Last Price Candle Compare Mov. Avgs 10 No Lower Chart CAD  
1D 3D 1M 6M YTD 1Y 5Y Max Weekly Security/Study Event



## Technical Observations

- The chart above shows the S&P/TSX from the 2008 financial crisis to present.
- In Q4/08, the TSX Venture index traded sideways for 5 weeks after hitting its low before breaking through the 50 day moving average.
- In summer 2012, the TSX Venture index traded sideways for 6 weeks after hitting its low before breaking through the 50 day moving average in August 2012.
- The momentum has clearly turned in favour of Canadian small cap equities.
- Bond yields have likely bottomed after hitting all time lows of 1.38% for the US10 Year. Rising yields will have a negative impact on bond returns.
- From the lows in 2008 to recovery, the AlphaNorth Partners Fund NAV rose from \$4.98 in November 2008 to \$40.87 in April 2011. At the low in July 2012, the AlphaNorth Partners Fund NAV was \$23.90.

\*AlphaNorth Partners Fund NAV taken as at month-end November 2008, April 2011, July 2012. NAV's and returns presented are for Class A shares on a compound annual return basis stated net of all fees except for since inception returns which are cumulative.

# Fundamental Factors

*The media has been spooking investors by highlighting all the negative economic news ... notwithstanding this the S&P/TSX Composite has increased 66% since the financial crisis low.*

*There are many **positive** factors.*

## Supporting Fundamental Factors

- Relative to bonds, equities have rarely been cheaper as the spread between the forward earnings yield and bond yields is over 5% (this is almost 2 standard deviations above the average)
- Companies have high cash levels
- The forward Price/Earnings ratio is currently 12x as compared to the 25 year average of 15.2x
- U.S. housing market is improving (median price of existing homes +9.4%, building permits are at a 4 year high, rising housing starts, inventories down to 6.4 months, Case-Shiller Home Price Index has risen for the past 5 months)
- Strong auto sales (+17% year over year)
- Europe....steps to resolution/containment has resulted in lower yields
- China government stimulus will begin to reinvigorate growth
- Employment improving (US unemployment has steadily improved from peak of 10% in 2009 to 8.1% currently)
- Quantitative easing initiatives worldwide will be supportive for economic growth

## Supporting Contrarian Indicators

There are numerous contrarian indicators which correlate well with equity market lows:

- Investor sentiment is extremely negative as reflected by significant outflows from Canadian equity funds over the past decade (every year since 2002 has experienced outflows totaling approximately \$38 billion; \$3.1 billion outflow in first half of 2012 alone)
- A recent study indicates that Wall Street strategists currently recommend a 44.4% exposure to equities as compared to the long term average of 60-65%; this is the lowest since 1985; historically, extreme low levels have been highly correlated with lows for equities



# How we are positioned

## OUR FOCUS

We are focused on companies which are well funded with strong management.

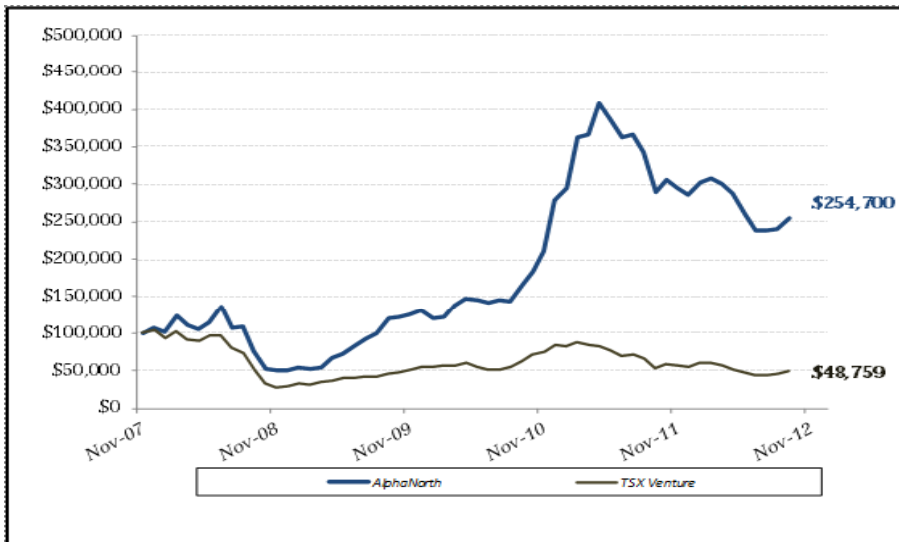
### AlphaNorth Partners Fund

Class A: AAM100 / Class D: AAM200

- Flagship fund: long-biased small cap hedge fund investing in Canadian micro to small cap companies
- Launched December 2007
- Fully invested
- Balanced Portfolio: 50% resource/ 50% technology
- Short positions currently represent 1% of NAV

### AlphaNorth Partners Fund vs. S&P/TSX Venture Index \*

#### Growth of Initial Investment \$100,000



#### Performance Analysis

	<b>AlphaNorth Partners Fund</b>	S&P/TSX Venture	S&P/TSX Composite TFI
<b>Returns *</b>			
1 Month	<b>5.7%</b>	7.6%	3.4%
YTD	<b>(10.8%)</b>	(10.1%)	5.3%
1 Year	<b>(12.1%)</b>	(9.0%)	9.2%
2 Year	<b>24.3%</b>	(11.6%)	2.6%
3 Year	<b>28.7%</b>	1.5%	5.5%
Since Inception (annualized)	<b>21.3%</b>	(13.8%)	0.8%
Since Inception (cumulative)	<b>154.7%</b>	(51.2%)	3.7%

\*Performance taken as at September 30 2012. Monthly performance at September 30, 2012 is published estimate pending finalization by the administrator. Returns presented are for Class A shares on a compound annual return basis stated net of all fees except for since inception returns which are cumulative.



# How we are positioned

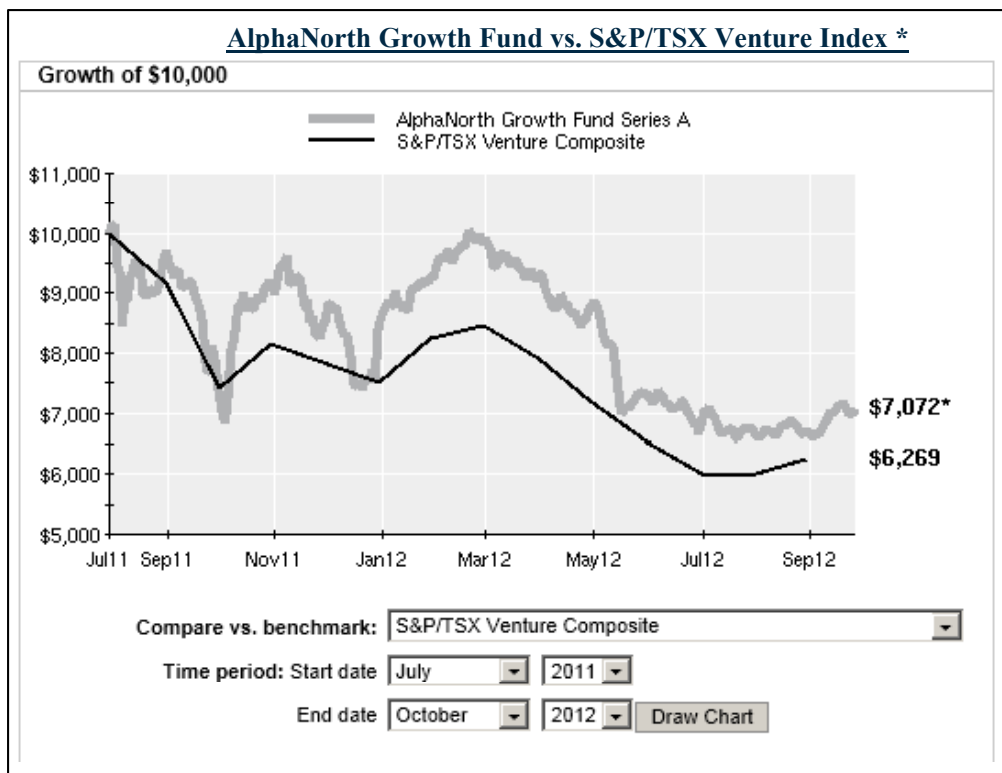
## OUR FOCUS

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## AlphaNorth Growth Fund

Series A: ANF010 / Series F: ANF011

- Open-ended mutual fund
- Investing in small to mid capitalization Canadian companies
- Launched July 2011
- Fully invested
- Overweight resources: 56% materials/22% energy



## AlphaNorth Flow Through Limited Partnerships: AlphaNorth 2011 Flow-Through LP

- Fully invested
- Sector weightings: 25% energy, 35% in metals, 40% precious metals

## AlphaNorth 2012 Flow-Through LP

- Fully invested
- Sector weightings: 25% energy, 37% in metals, 39% precious metals

## Portfolio Activity

Some examples of what we've been buying lately

### BSM Technologies

(TSXV: GPS) \$0.75

Market Cap: \$21 million

- Growing revenue at 30% while earnings could increase 100% in 2012
- Price/earnings multiple of 8x 2013 earnings
- Building cash (\$3m approx.) and buying back stock
- Valuation is less than half the closest comparables despite higher growth

### Orbite Aluminae

(TSX: ORT) \$3.10

Market Cap: \$558 million

- Near term production (Q1/13) of high purity alumina
- Fully financed with \$60m current cash
- Multiple other business lines each of which justifies a higher stock price including rare earth extraction, smelter grade alumina, licensing technology, red mud remediation
- Earnings potential of \$50-100 million in the next couple years from only the initial high purity alumina plant

### Lachlan Star

(TSXV: LSA) \$1.53

Market Cap: \$132 million

- Current gold producer in Chile
- \$13 million cash
- Expanding production from 50,000 oz per year to 75,000 in 2013
- Cost reduction initiatives underway which could result in earnings of nearly \$0.50 in 2013....implies a current P/E of 3x

\* Source: Globefund. Performance and NAV taken as at month-end September 30, 2012.

# Conclusion

*We believe Canadian small cap equities are heading materially higher.*

*Don't miss out!*



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