

# canadian hedgewatch

MONTHLY REVIEW OF HEDGE FUNDS & ALTERNATIVE INVESTING

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## AlphaNorth Asset Management is 'Best of the Best' in Canadian Alternatives Again

Maximizing Returns for Investors Over the Long Term



HEDGE FUNDS & THE GLOBAL ECONOMIC CRISIS \* TURNING HEDGE FUND SECURITY INSIDE-OUT  
EXAMINING LIQUIDITY AND PORTFOLIO CHOICE \* DISASTER RECOVERY PLANNING AFTER HURRICANE SANDY

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# Smaller Can Be Better: AlphaNorth Asset Management Believes Superior Long Term Equity Returns Are Achievable By Exploiting Inefficiencies In The Canadian Small Cap Universe



Canadian Hedge Watch speaks with Steve Palmer, President and CIO, of AlphaNorth Asset Management about his investment strategy and outlook on markets. Their flagship hedge fund, the AlphaNorth Partners Fund, was recently awarded 1st place at the Fifth Annual Canadian Hedge Fund Awards for the second year in a row.



**Steve Palmer**  
President and CIO



Founded in 2007, AlphaNorth Asset Management is a Toronto based investment manager. AlphaNorth believes that superior long term equity returns are achievable by exploiting inefficiencies in the Canadian small cap universe through careful security selection on both a long and short basis. The firm combines both a bottom-up and top-down strategy with technical analysis in the selection of investments offering the best reward versus risk opportunities. AlphaNorth manages the AlphaNorth Partners Fund which is a long biased small cap focused hedge fund. AlphaNorth also manages the AlphaNorth Growth Fund, an open-ended mutual fund. The Funds objectives are to achieve industry leading returns over the long term.

**CHW** November 2012 marks the 5 year anniversary for the AlphaNorth Partners Fund. As at the October 2012 month-end, the Fund has rewarded investors with an annualized return of 21.3% since inception as compared to (13.9%) and 1.0% for the S&P/TSX Venture Index and S&P/TSX Total Return Index respectively. How would you describe the market environment you have faced since launching the fund?

**Steve Palmer** The challenging equity market over the past 5 years has been best suited to the short biased and market neutral funds. The investment strategy for the AlphaNorth Partners Fund is long-biased small cap which is not optimal for a negative equity environment. Canadian small cap equities, as measured by the TSX Venture Index, have declined 52% since the launch of the AlphaNorth Partners Fund five years ago. Despite the macro challenges, we are extremely pleased to have achieved such strong results for our strategy. Our 5 year performance will be over 20% annualized which likely makes the AlphaNorth Partners Fund the best performing equity fund in Canada over this period.

**CHW** Last month, you were awarded the Canadian Hedge Fund Award for 'Best 3-Year Annualized return' (July 31, 2009-July 31, 2012) for the AlphaNorth Partners Fund. Congratulations! This marks the second year in a row that AlphaNorth has received this award. And Steve, you were also named the #1 performing Hedge Fund Manager in Canada by the Globe & Mail in 2010. Tell us, how do you do it?

**SP** Our goal is to maximize returns over the long term. The best way to do this is to invest in the asset class that offers the best returns over the long term which is small cap equities. We combine a fundamental approach with technical analysis. We select investments on the basis of risk vs reward with earnings or earnings potential being the primary driver of our valuation. We have been fortunate to have identified several situations early which have allowed us to generate substantial returns on those investments. For example, we have had 14 investments since inception of the Fund where we have locked in gains in excess of 500%.

**CHW** Can you give us an example of a company that has performed well for your fund, and why?

**SP** BioExx Specialty Proteins (TSX:BXI) was a big winner for us. We purchased the stock in a private placement in January 2008 at \$0.25 per unit. At the time, there was no analyst coverage and little if any institutional ownership. The company made progress toward an operating facility to extract proteins from canola oil. When the research coverage started with optimistic price targets and the large U.S. funds started buying the stock, it soared to a high of almost \$3.00 in 2010. We scaled out of our position on the way up. This shows the importance of getting in early and exiting when companies go mainstream and expectations are high.

**CHW** You timed that very well. The shares now trade below \$0.10.

**SP** Timing is very important. The majority of small companies will ultimately fail or at least the shares will return to \$0.10. It is very important to realize this and sell at the right time. This is the most difficult part of investing... knowing when to get out!

**CHW** Part of your approach in achieving superior long term equity returns is by exploiting inefficiencies in the small cap market. Can you expand further on what you mean by that?

**SP** We often identify small cap investment opportunities early before they are widely known. Often this is before there is any analyst coverage or institutional ownership. When positive fundamentals of an early stage company are not well communicated to the market, the shares often do not reflect the potential of the company. If we spend time with management to understand a company's prospects in detail, we can often identify securities which are mispriced relative to the current share price. We also have the ability to invest in companies at an earlier stage than most firms.

**CHW** What is the typical composition of the AlphaNorth portfolio?

**SP** We have a balanced approach for the AlphaNorth Partners Fund. Investments are comprised of roughly 50% junior resource and 50% technology and life sciences.

**CHW** In your opinion, which sector represents the best opportunity right now in the Canadian small to mid cap equity space.

**SP** In the short term we favour the resource sectors. The junior resource equities have been hit the hardest in the latest downturn due to concerns about global growth rates, particularly in China.

**CHW** Many retail investors believe small cap equities are too risky. How do you respond to that?

**SP** It depends on your definition of risk. If it is in relation to volatility, then yes, small caps are volatile over the short term. There is also risk associated with achieving longer term financial goals. If this is your characterization of risk, it is high risk to own bonds in the current environment. Investors who own bonds today are basically locking in a loss of purchasing power. I consider that high risk. What is the bigger risk, a near certain loss of purchasing power or some short term volatility? Chasing low volatility investments is not a way to build wealth. The analogy that I like to use is that it is like driving in circles around the block in order to avoid an accident rather than driving to where you need to go.

**CHW** What do you do to mitigate risk? What is your hedging strategy?

**SP** When we believe the market is vulnerable to a correction, we purchase bear ETFs, increase cash levels and selectively short individual companies. With a small cap portfolio, it is not feasible to liquidate a substantial portion with the thought that we can precisely identify the bottom and buy back all our holdings.

**CHW** Have you ever had substantial short positions?

**SP** Yes, on two occasions we were particularly bearish. In February 2008 we hedged out some of the systematic risk by employing the 200% inverse ETFs for the TSX 60 index and US Financials index. These inverse ETF positions comprised 25% of the portfolio at that time. In addition, we had a 5% short position in a U.S. bank which ultimately went to zero. Given the levered nature of the ETFs, we were hedged accordingly. Also, during the early part of 2010 we raised 10% cash and purchased levered bear ETFs. This proved to be quite timely as the market corrected in the spring of that year.

**CHW** The AlphaNorth Partners Fund has experienced exceptional returns over the long-term despite the financial crisis of 2008. And now, we have been facing another prolonged period of challenging equity markets from March 2011 to present where the S&P/TSX Venture has declined approximately 50%. What is your philosophy and strategy for managing the portfolio during this particularly difficult period?

**SP** Our strategy was to be consistent and not change the way the portfolio was managed. Many times we have seen managers capitulate and always at the worst time.

**CHW** Going forward, where do you think the equity markets are headed?

**SP** Although we did not predict the severity of the decline in 2011, we did successfully identify the bottom in the summer of 2011 stating that the low for the equity market downturn was set in the summer of that year coincident with a spike in the volatility index which is a gauge of investor fear. At that time we published a report which summarized the reasoning behind our bullish view. This report entitled 'Special Market Commentary' is archived on our website. We were correct in that the broader market has rebounded and trended significantly higher since that time. There are a number of factors that point to a significant rebound in the markets. I would highlight the economy, fundamentals, earnings, sentiment and seasonality. To go into further detail I would encourage you to visit our website or meet with Skye Collyer, our VP Sales and Marketing for more information.

**CHW** As you're very well known for your expertise in the small cap space, how about your current views on the Canadian junior equity markets? Will junior markets boom again?

**SP** We believe the S&P/TSX Venture index bottomed in June of this year. We believe the current environment for Canadian small caps is very similar to Q1/09 where sentiment was at a negative extreme, valuations were greatly depressed and investors were focused on the seemingly insurmountable macro issues. Historically, periods of significant decline like we have recently experienced are often followed by substantial gains.

**CHW** Last year, you also launched an open-ended mutual fund, the AlphaNorth Growth Fund. How does this fund differ from the strategy of the AlphaNorth Partners Fund?

**SP** The AlphaNorth Growth Fund has a similar investment style and methodology but focuses on larger companies, in the \$100 million to \$1 billion market cap range. This provides for better liquidity which is required with a mutual fund. I view the AlphaNorth Growth Fund as a small/mid cap fund whereas the AlphaNorth Partners Fund is more of a micro/small cap fund.

**CHW** Finally, what is the overall outlook for the next 5 years?

**SP** We are very excited about the prospects going forward. We have a very bullish outlook for Canadian small caps over the short and medium term. Small cap equities have come through a prolonged period of underperformance. The S&P/TSX Venture Index has declined by over 50% since March of 2011. When small caps turn after such a period of underperformance, the returns can be quite dramatic. It is always after these periods that we have achieved our best returns.

**CHW** Thank you for talking with us today, Steve.

**SP** Thank you for allowing me this opportunity. \*



AlphaNorth  
Asset Management

# FUND FACTS

## AlphaNorth Partners Fund

### Investment Strategy

The AlphaNorth Partners Fund is a long biased small cap hedge fund focusing primarily on Canadian companies. The investment objective is to achieve industry leading long term capital growth through superior selection of principally Canadian securities. AlphaNorth believes that superior long term investment returns are achievable by exploiting inefficiencies in the Canadian small cap universe through careful security selection on both a long and short basis. The firm combines both a bottom-up and top-down strategy in the selection of investments offering the best risk/reward characteristics. AlphaNorth employs various technical analysis techniques, which have proven to be successful, to assist in the timing of buy/sell decisions.

### Performance\*

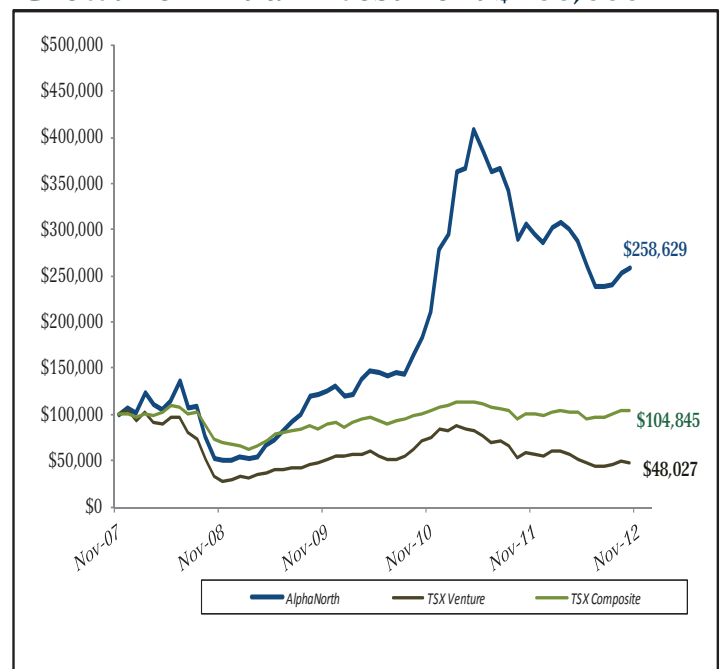
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2007												7.4%	7.4%
2008	(5.0%)	21.6%	(10.1%)	(5.6%)	8.1%	19.2%	(20.7%)	0.7%	(29.1%)	(31.9%)	(4.9%)	0.7%	(53.3%)
2009	9.0%	(3.5%)	4.0%	21.2%	9.0%	14.1%	11.5%	9.0%	19.1%	1.2%	4.1%	3.7%	160.6%
2010	(8.5%)	1.7%	14.0%	6.4%	(1.6%)	(2.7%)	2.6%	(0.4%)	14.2%	11.3%	15.4%	31.9%	113.6%
2011	5.8%	23.0%	0.9%	11.7%	(5.7%)	(5.7%)	1.0%	(6.5%)	(15.6%)	5.6%	(3.8%)	(2.9%)	2.4%
2012	5.6%	2.0%	(2.4%)	(3.9%)	(9.9%)	(7.9%)	(0.1%)	0.9%	5.3%	1.8%			(9.5%)

### Fund Terms

Inception	December 1, 2007
Fund Assets	~\$75 million
Fund Type	Alternative Strategies (Long biased small cap)
Eligibility	Accredited, Registered accounts (RRSP/RRIF)
Management Fee	Class A—2.0%, Class D—2.5%
Performance Fee	20% (high watermark with no reset)
Minimum Investment	\$150,000 (subsequent \$25,000)
Subscriptions	Monthly
Redemption	Monthly with 90 day notice
Redemption Fee	Class A—none; Class D—3% yr 1, 1.5% yr 2
Lock-up	None
Auditor	Deloitte
Administration	Harmonic Fund Services
Prime Broker	Scotia Capital
Fund Codes	AAM100 (Class A) AAM200 (Class D)

\*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. The information contained in this document is not a solicitation to sell any investment products and is for discussion purposes only. Please refer to the Offering Memorandum for complete details of any investment products offered by AlphaNorth Asset Management. There is no guarantee of performance and past performance is not indicative of future results. Returns subsequent to 2011 are unaudited. The inception date is December 1, 2007. TSX returns sourced from Bloomberg.

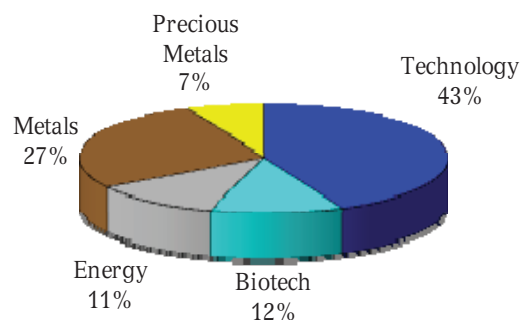
### Growth of Initial Investment \$100,000



## Performance Analysis

	AlphaNorth Partners Fund	S&P/TSX Venture	S&P/TSX Composite TRI
<b>Returns *</b>			
1 Month	<b>1.8%</b>	(1.5%)	1.1%
YTD	<b>(9.5%)</b>	(11.5%)	6.5%
1 Year	<b>(15.4%)</b>	(18.6%)	4.5%
2 Year	<b>18.8%</b>	(17.9%)	1.8%
3 Year	<b>28.8%</b>	0.6%	7.4%
Since Inception (annualized)	<b>21.3%</b>	(13.9%)	1.0%
Since Inception (cumulative)	<b>158.6%</b>	(52.0%)	4.8%
Best Month	<b>31.9%</b>	11.4%	11.5%
Worst Month	<b>(31.9%)</b>	(35.3%)	(16.7%)
Advancing Months	<b>61.0%</b>	48.3%	55.9%
Standard Deviation	<b>40.2%</b>	34.3%	1.3%
Sharpe Ratio	<b>0.50</b>	(0.44)	(0.1)
Beta		0.94	1.73

## Sector Allocation



## Company Profile

Founded in 2007, AlphaNorth Asset Management's goal is to achieve superior long term returns for investors. Our value added approach combines the successful track record and investment experience of Steven Palmer and Joey Javier who have worked together as a team since 1998 in the investment industry. Presently, AlphaNorth manages the AlphaNorth Partners Fund, a long biased small cap focused hedge fund, the AlphaNorth 2011 Flow-Through LP, the AlphaNorth 2012 Flow-Through LP, the AlphaNorth Rollover Fund and the AlphaNorth Growth Fund.

### Key Personnel:

**Steven Palmer** is the President and CEO of AlphaNorth Asset Management. Mr. Palmer started his career in the investment industry in 1995 on the sell side of the business before transitioning to the buy side in 1997. Most recently, from July 1998 to August 2007 he was employed as Vice President - Canadian Equities at one of the world's largest financial institutions where he managed the Canadian equity assets of approximately \$350 million. Mr. Palmer managed a pooled fund focused on small capitalization companies from inception in 1998 to August 2007 achieving returns that were ranked #1 in performance by a major fund ranking service in their small cap pooled fund category (35.8% annualized over 9 years as compared to 10.0% for the S&P/TSX Composite and 13.0% for the BMO Weighted Small Cap Total Return Index) over the same period. Mr. Palmer also managed a large cap fund which was ranked in the first quartile for the following time periods: one year, two year, 3 year, 4 year, 5 year and 10 year. Mr. Palmer earned a BA in Economics from the University of Western Ontario and is a CFA.

**Joey Javier** is Vice President and Secretary of AlphaNorth Asset Management. Mr. Javier started his career in the investment industry in 1997 as an Equity Trader for one of the world's largest financial institutions where he worked together with Mr. Palmer as the equity team. Mr. Javier was responsible for all equity and money market trading as well as back-up for the fixed income portfolio manager. Mr. Javier has a BA in Economics from York University.

**Steven Palmer and Joey Javier founded AlphaNorth in August 2007 and have a superior track record of working together as a team since 1998.**

## Disclaimer

Returns are presented for Class A and are the historical annual compounded total returns including changes in share value and reinvestment of all dividends and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. The opinions, estimates and projections ("information") contained within these reports, unless indicated otherwise, are solely those of AlphaNorth Asset Management ("AlphaNorth") and are subject to change without notice. AlphaNorth makes every effort to ensure that the information has been derived from sources believed to be reliable and accurate. However, AlphaNorth assumes no responsibility for any losses or damages, whether direct or indirect, which arise out of the use of this information. AlphaNorth is not under any obligation to update or keep current the information contained herein. The information should not be regarded by recipients as a substitute for the exercise of their own judgment. Please contact your own personal advisor on your particular circumstances. Investment funds are not guaranteed, their values change frequently and past performance may not be repeated. Views expressed regarding a particular company, security, industry or market sector should not be considered an indication of trading intent of any investment funds managed by AlphaNorth. These views are not to be considered as investment advice nor should they be considered a recommendation to buy or sell. Commissions, trailing commissions, management fees and expenses all may be associated with investment funds. Please read the prospectus or offering memorandum before investing.