Investor Newsletter, Q3 2023

Key Points:

- Recent market performance has been driven by changes in the risk-free rate rather than changes to economic growth expectations.

- Defensive sectors materially underperformed cyclical sectors despite the market's having been in a downtrend during the third quarter.

- The market seems more concerned about excessive issuance of Treasuries than hot economic data.

- The recent blow-out of the long-end of the curve may reignite the banking crisis. Commercial banks remain "secretly insolvent" due to unrealized losses on long-dated Treasuries.

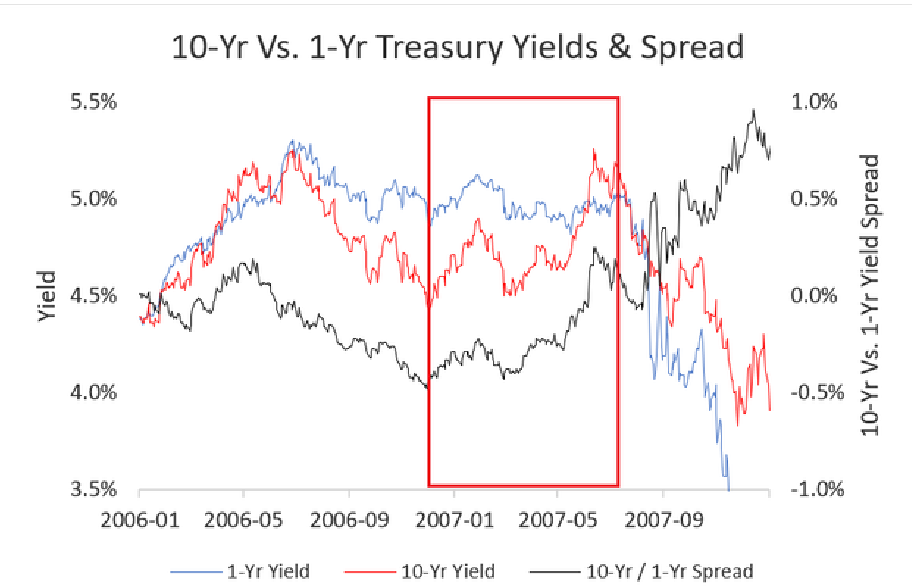
- The Alpha Squared Fund has returned 9.5% YTD vs. 7.2% for its benchmark, while the SRI Fund has returned -3.2% YTD vs. 10.8% for its benchmark. We intend on maintaining our defensive positioning in the Alpha Squared Fund due to macro-risks.

Dear Investors,

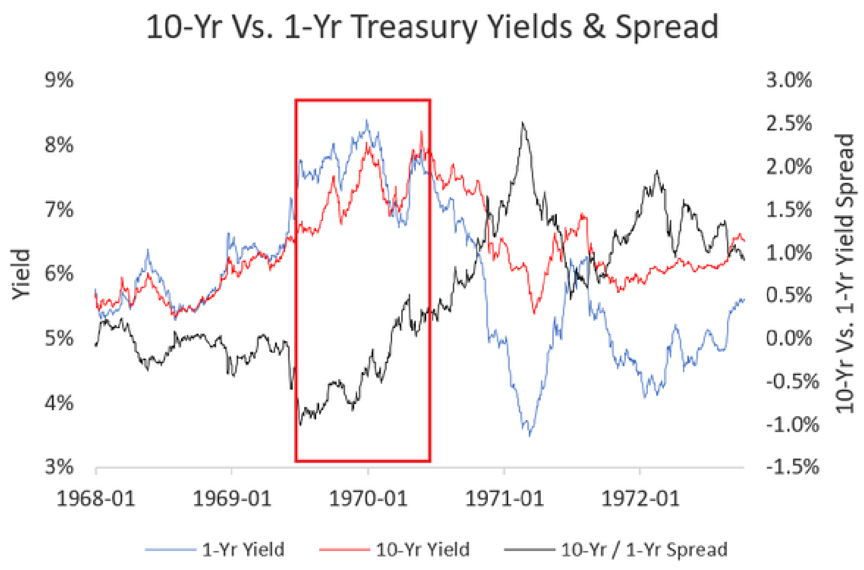
The market has hit a patch of turbulence since our last outreach, but not for the reasons we had anticipated. Rather than suggesting that a recession is imminent, recent economic data suggests resilience. For much of the third quarter, retail sales figures surprised to the upside, the manufacturing PMI has been re-accelerating, and non-farm payroll numbers keep coming in scorching hot. Rather than falling on growth fears, the market has been getting penalized due to a rising risk-free rate. This is a familiar, somber tone, as it was rising rates that drove much of the market's negative performance back in 2022. However, there are important differences between now and 2022 in terms of the behavior of rates that we believe are important to make note of. Additionally, we wanted to re-emphasize our "late-cycle" macroeconomic call, and discuss how we intend to position for it.

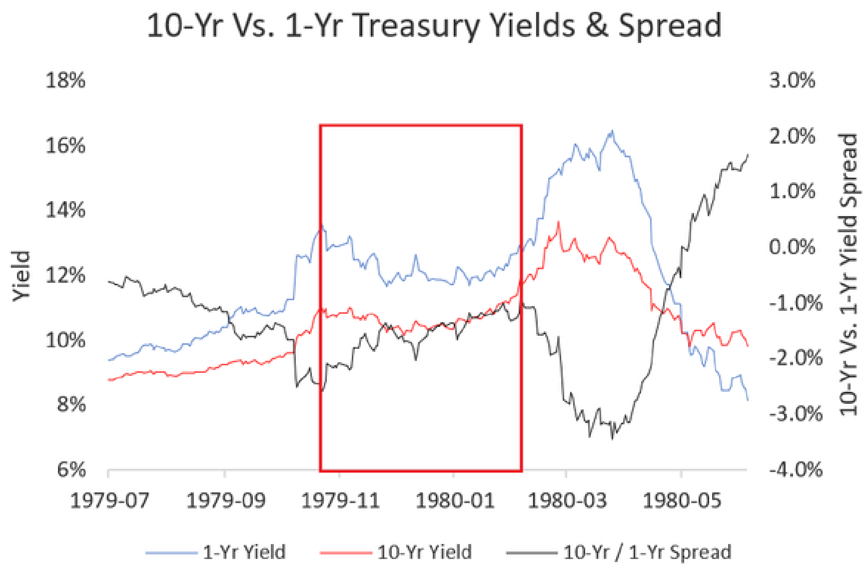
We want to underscore developments in the Treasury market provided highly unusual activity in this space. After having been inverted for more than a year, the yield curve seems to be steepening. Normally, this steepening is a result of both short and long-term rates falling in response to the onset of a recession, with short-term rates falling more aggressively than long-term rates as the Fed steps in to stimulate the economy. This is known as a “bull steepener,” but it’s not what we have been seeing lately. Instead, the yield curve is steepening because both short and long-term rates are rising, with long-term rates rising more aggressively. This phenomenon is known as a “bear steepener,” and is unusual during yield curve inversions. Going back to 1970, there have only been three brief examples of such bear steepeners during yield curve inversions. Thus, we believe it is of value to examine what occurred during those episodes, and what they suggest may lie ahead.

Most recently, the yield curve inversion of 2006/2007 ended in the summer of 2007 with a bear steepener. This bear steepener ended up being quite brief and shallow, lasting from December of 2006 until June of 2007. During that period, there was a re-acceleration in nonfarm payrolls and PMIs. As a result, the broader economic outlook improved during the first half of 2007, and oil prices -which had been falling during the second half of 2006- reversed course and began heading higher. This increase in commodity prices and forward-looking growth expectations put upward pressure on the long end of the curve. Simultaneously, the short end of the curve remained somewhat flat as the Fed had already communicated that it was likely finished with its rate hiking campaign. Of course, the bear steepener immediately switched over to being a bull steepener in the fall of 2007 as the Global Financial Crisis emerged and the Fed stepped in to cut rates.



Going back further, the other two bear steepeners that occurred during yield curve inversions occurred in 1969 and 1979-1980. Both of those bear steepeners occurred because of accelerating inflation. In 1969, the bear steepener occurred alongside accelerating inflation even after the Fed had been hiking rates. Similarly, in 1979-1980, the bear steepener occurred directly after the 1979 Iranian oil crisis, alongside rapidly rising oil prices during a period where the Fed had already been hiking rates.





To an extent, the ongoing bear steepener which began in June could potentially be explained by both an improving economic outlook and a re-acceleration in inflation. Since June, we have witnessed a steady increase in the manufacturing PMI, and have seen a downward trend in initial jobless claims. Simultaneously, we have seen an uptick in the inflation rate driven primarily by energy prices. Like during the 2007 episode, these factors have conspired to put upward pressure on the long end of the curve during a period when the Fed has communicated that it is unlikely to keep hiking rates materially.

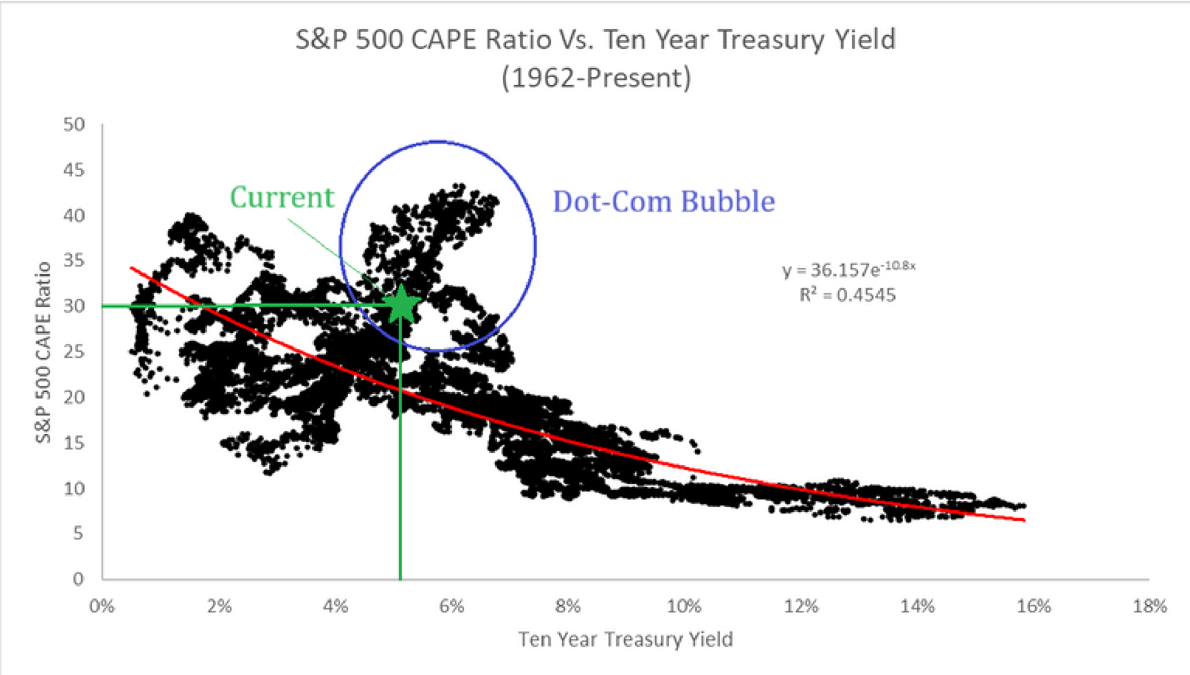
To say the least, stock market reactions to these developments have been curious. While the market trended lower during the third quarter, performance by equity sector was counterintuitive in the respect that traditionally low-beta, defensive sectors fell the most. The only two sectors which produced positive returns were energy and communication services, with traditionally cyclical financials trailing as the third best performing sector. The worst three performing sectors were the defensive utility, real estate, and consumer staples sectors. This underperformance of defensives is likely due to the fact that it was a rising risk-free rate rather than growth concerns that drove the market lower during the third quarter. Going forward, as monetary policy lag kicks-in and economic activity decelerates in 2024, we expect this dynamic to flip, with defensive sectors of the market outperforming cyclicals.

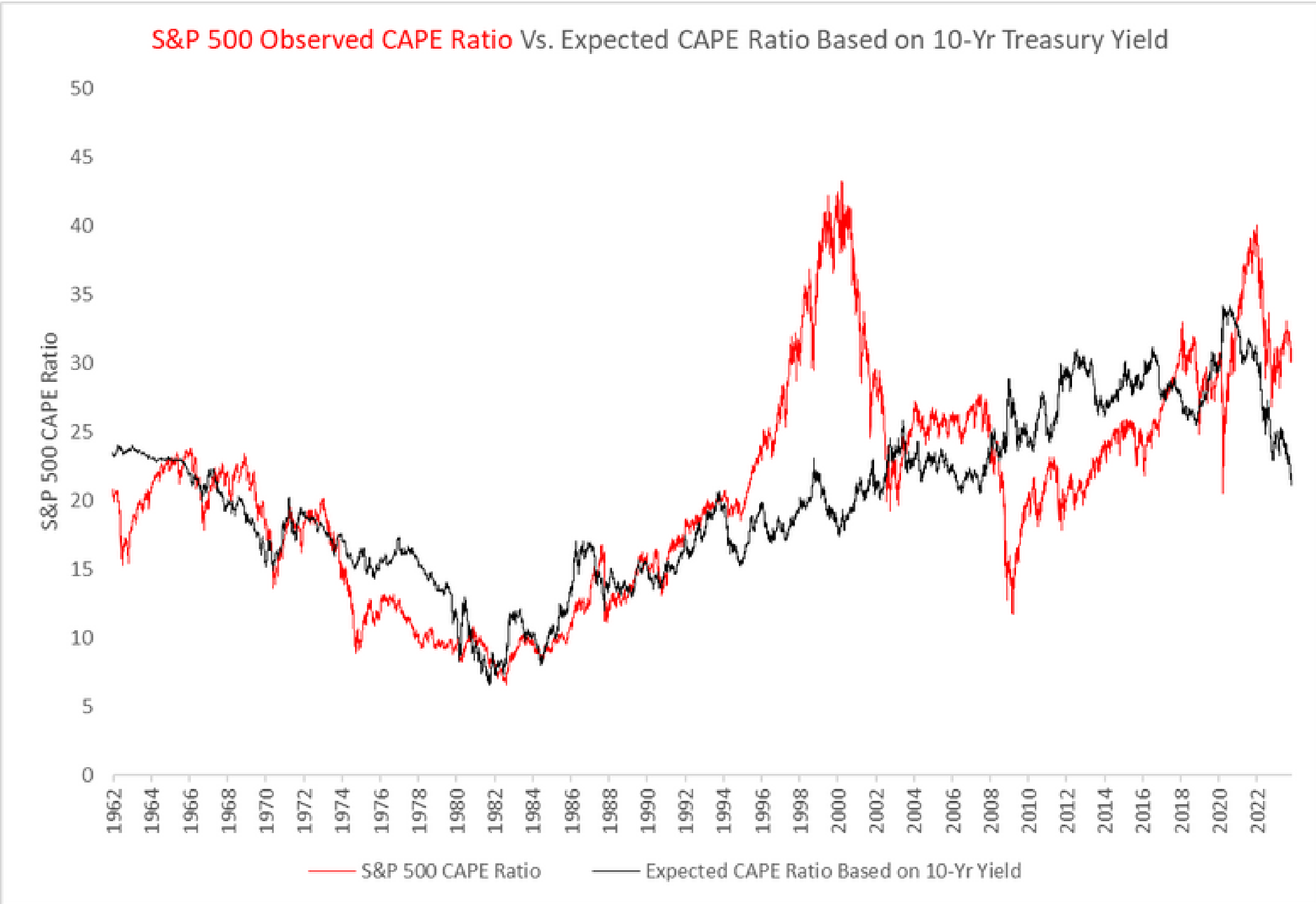
Sector	Q3 Performance
Energy	11.36%
Communication Services	0.75%
Financials	-1.60%
Healthcare	-3.01%
Consumer Discretionary	-5.20%
Materials	-5.21%
Industrials	-5.53%
Information Technology	-5.71%
Consumer Staples	-7.23%
Real Estate	-9.60%
Utilities	-9.95%

Equity market reactions to economic news releases have also been less than intuitive since the end of the second quarter. For example, on October 5th, the U.S. Nonfarm Payrolls report came in at 336,000 vs. 170,000 expected, supporting the “higher for longer” narrative. One would have expected that enormous beat to have triggered a massive rise in Treasury yields that would have put pressure on equities. Sure enough, yields spiked, but the equity market’s reaction to the news was almost the opposite of what one would have expected. Instead of falling due to the rise in yields, the stock market rallied heavily, led by interest-sensitive information technology stocks. On October 11th, the U.S. PPI and Core PPI numbers both came in decidedly hotter than expected, at 2.2% YoY vs 1.6% YoY expected for the PPI, and 2.7% YoY vs 2.3% YoY expected for Core PPI. One would have expected yields to soar and interest rate sensitive sectors of the equity market to underperform. Once again, the opposite happened, with the Nasdaq jumping on the hot inflation news and leading both the S&P 500 and the Dow Jones for the day. A similar, muted reaction occurred after the hotter-than-expected CPI release on the morning of October 12th. After reacting neutrally to the hot inflation print that morning, the stock market sold off sharply in the afternoon of October 12th. As it would turn out, that sharp selloff coincided with a lackluster 30-Yr Treasury auction. Dealers ended up having to pick up 18% of supply for that auction, vs. the 11% they would normally. Further, the spread between the lowest bid versus the average bid was the lowest since November 2021, pointing to insufficient demand.

The point is, the market doesn't necessarily seem concerned about hot economic news like it was in 2022. If anything, equity market responses to hot economic data have been positive rather than negative in recent experience. Instead, the market seems more concerned about failing Treasury auctions and the implications for long-term rates. The Treasury market has been getting inundated with supply recently, which hasn't been able to find demand. This imbalance of supply and demand for Treasuries has been sending yields higher, and in particular has been causing the long end of the curve to blow out.

This rise in yields has materially eroded the equity risk premium. Historically, there has been a strong inverse relationship between the S&P 500's CAPE Ratio and the 10-Yr Treasury yield. According to this historical relationship, considering the 10-Yr Treasury yield is currently around 5%, one would expect the S&P 500 to be trading at a CAPE Ratio close to 21. Instead, the S&P 500 is trading at a CAPE Ratio close to 30. Thus, we are skeptical that the equity market has fully priced in the increase in yields we have seen up to this point, especially year-to-date. In general, other instances where the S&P 500 was trading at much higher values than expected based on the 10-Yr yield -such as the Dot-Com bubble and the 2022 top- coincided with poor forward-looking returns, and so we believe a degree of caution is warranted in our positioning.



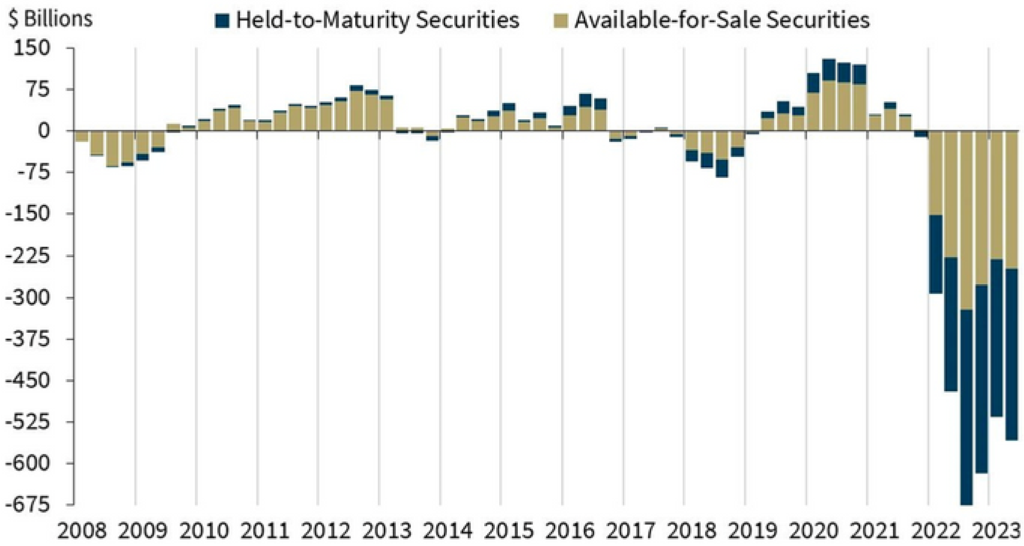


Additionally, this rise in yields has coincided with an exceptional selloff in Treasuries. From its March 2020 high to its most recent low last week, the iShares 20+ Year Treasury Bond ETF ($TLT) has sold off 54%. To put the magnitude of that selloff into perspective, the decline in long-dated Treasuries since 2020 is now deeper than the decline in the S&P 500 during the Dot-Com bear market (50%), and nearly as deep as the decline in the S&P 500 during the Global Financial Crisis (56%). Moreover, this drawdown in long-dated Treasuries is more than twice as deep as any past drawdown in Treasuries. To say the least, the ongoing selloff in Treasuries is unprecedented.

The implications of this drawdown in Treasuries are vast, and mostly negative. As a direct consequence of the Fed's rate hiking campaign and the subsequent selloff in Treasuries, U.S. commercial banks are now sitting on roughly $600 Billion in unrealized losses on Treasuries. With that in mind, the question then becomes "does it matter that the U.S. banking system is secretly insolvent?" We got a partial answer to that question back in March with the failure of Silicon Valley Bank. While the Fed stepped in and a further crisis was averted, that mini episode provides us with a host of insights. Firstly, it suggests that the "secret insolvency" of the U.S. banking system doesn't matter until it matters a whole lot. In particular, the rapid failure of Silicon Valley Bank demonstrated just how abruptly seemingly safe institutions can find themselves in a world of trouble. Secondly, the Fed's response to the crisis demonstrated just how quickly it would likely fold if it believed a major, systematic failure of the U.S. banking system was imminent.

Going forward, we see this "secret insolvency" among U.S. commercial banks as a major risk factor. In addition to experiencing unprecedented losses on Treasury securities, U.S. commercial banks are also experiencing rapid deposit flight. Money market funds now offer vastly higher interest rates than savings accounts at commercial banks. Accordingly, depositors have been withdrawing their funds from commercial banks in droves. To stem this deposit flight, commercial banks will be forced to pay higher rates on deposits. However, doing so will present liquidity problems. Most commercial banks issued loans at fixed rates much lower than the rates they'd have to pay on their deposits. Commercial banks may be forced to realize some of their losses on their Treasury holdings to account for both the outflows of deposits they're experiencing and if they experience liquidity issues stemming from deposit / loan rate differentials. We view this situation at commercial banks as perhaps the greatest risk to the economy at this point in time, provided a re-emergence of the banking crisis could easily precipitate a credit event not horribly unlike what unfolded during the Global Financial Crisis.

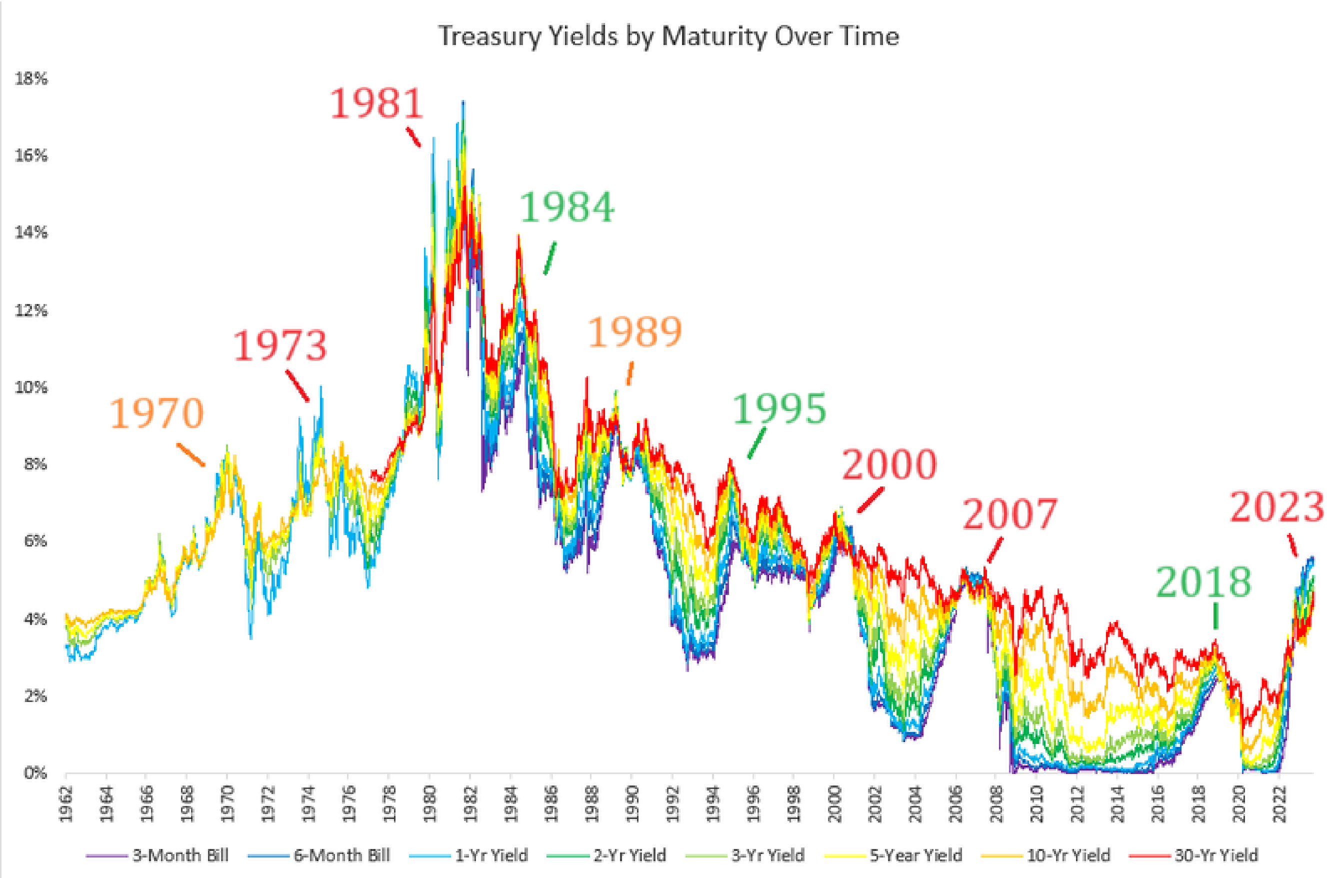
Unrealized Gains (Losses) on Investment Securities



Source: FDIC.

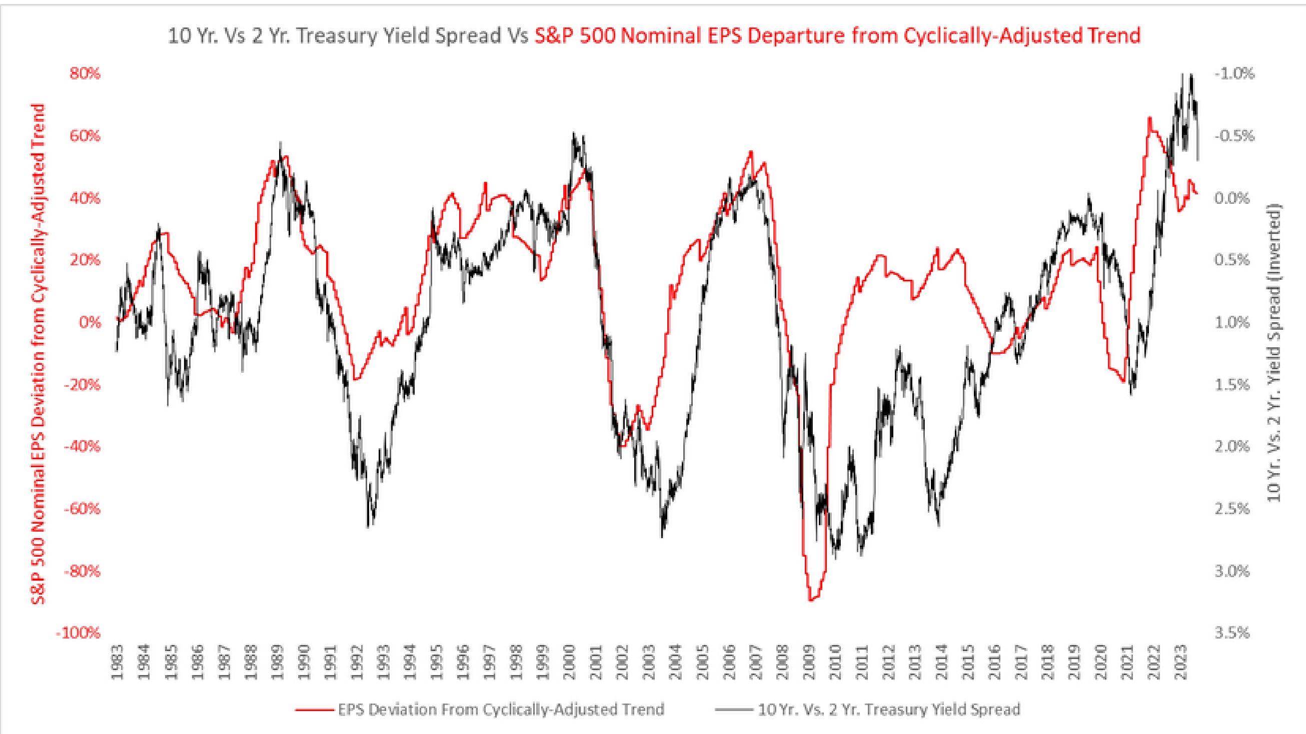
Note: Insured Call Report filers only. Unrealized losses on securities solely reflect the difference between the market value as of quarter end and the book value of non-equity securities.

Even absent a re-emergence of the banking crisis, numerous indicators go to suggest that the U.S. economy is likely to enter a recession. We would like to reiterate the efficacy of yield curve inversions in predicting recessions. Not all past hiking cycles triggered recessions -the 1983-1984, 1988-1989, 1994-1995, and 2016-2019 hiking cycles coincided with “soft landings”. However, as can be seen in the chart below, all four of those hiking cycles failed to produce yield curve inversions. By contrast, hiking cycles which resulted in prominent yield curve inversions such as the ones proceeding the Global Financial Crisis, 1982 recession, and 1974 recession all coincided with hard landings.



What's more, the frequently cited "resilience" of the U.S. economy should come at no surprise considering the yield curve remains inverted. As a reminder, there is a strong inverse relationship between the yield curve and S&P 500 earnings, and a strong positive relationship between the yield curve and the unemployment rate. To the extent that the yield curve remains inverted, we should expect the economy to appear "resilient". Only when the yield curve steepens materially should we expect cracks to start to emerge in economic data.

If anything, the economy has been surprisingly non-resilient considering the ongoing yield curve inversion and lag with which monetary policy affects the economy. As a reminder, there is generally a nine-quarter delay between monetary policy actions and their maximal effect on earnings. Thus, it is curious how earnings began falling so early this cycle -before the Fed even began hiking rates and before the yield curve even inverted. On a similar note, bank lending standards have tightened and PMIs have fallen considerably ahead of schedule this cycle as well. Nevertheless, earnings remain well above their cyclically-adjusted trend, and the Fed's contractionary monetary policy campaign should begin to adversely impact earnings starting in the second or third quarter of 2024 based on this historical lag.



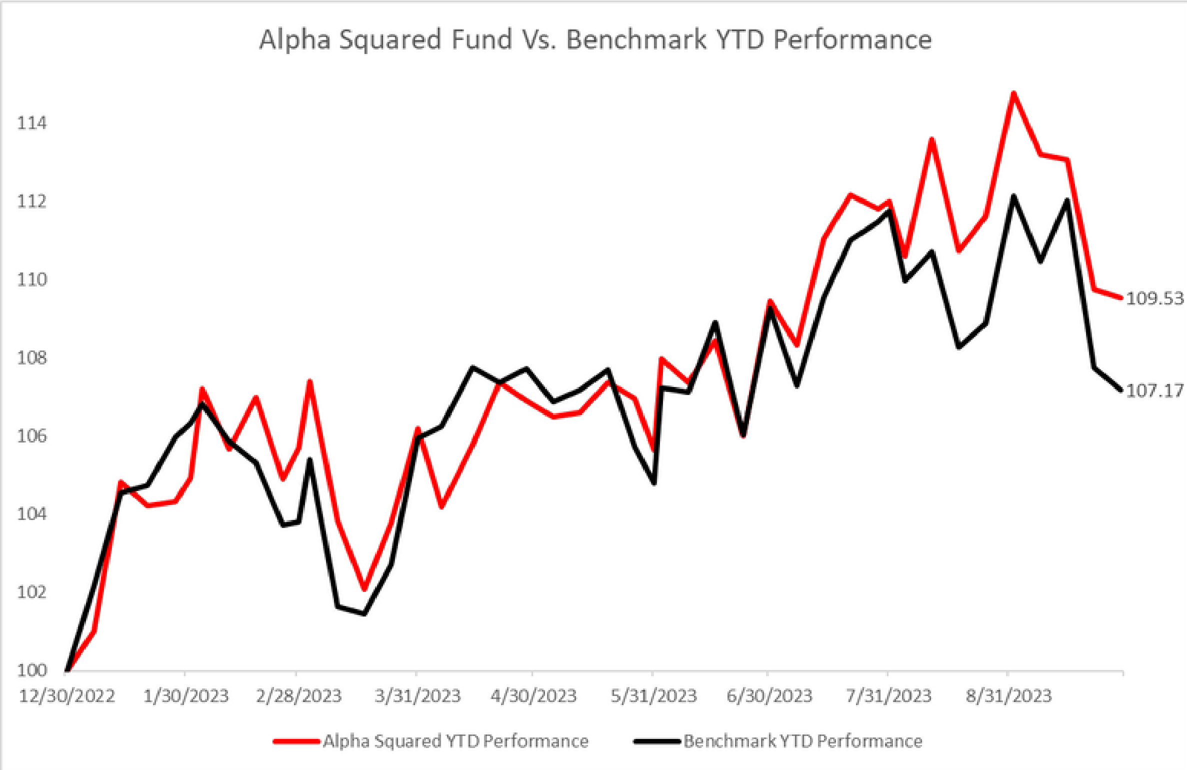
Performance Update:

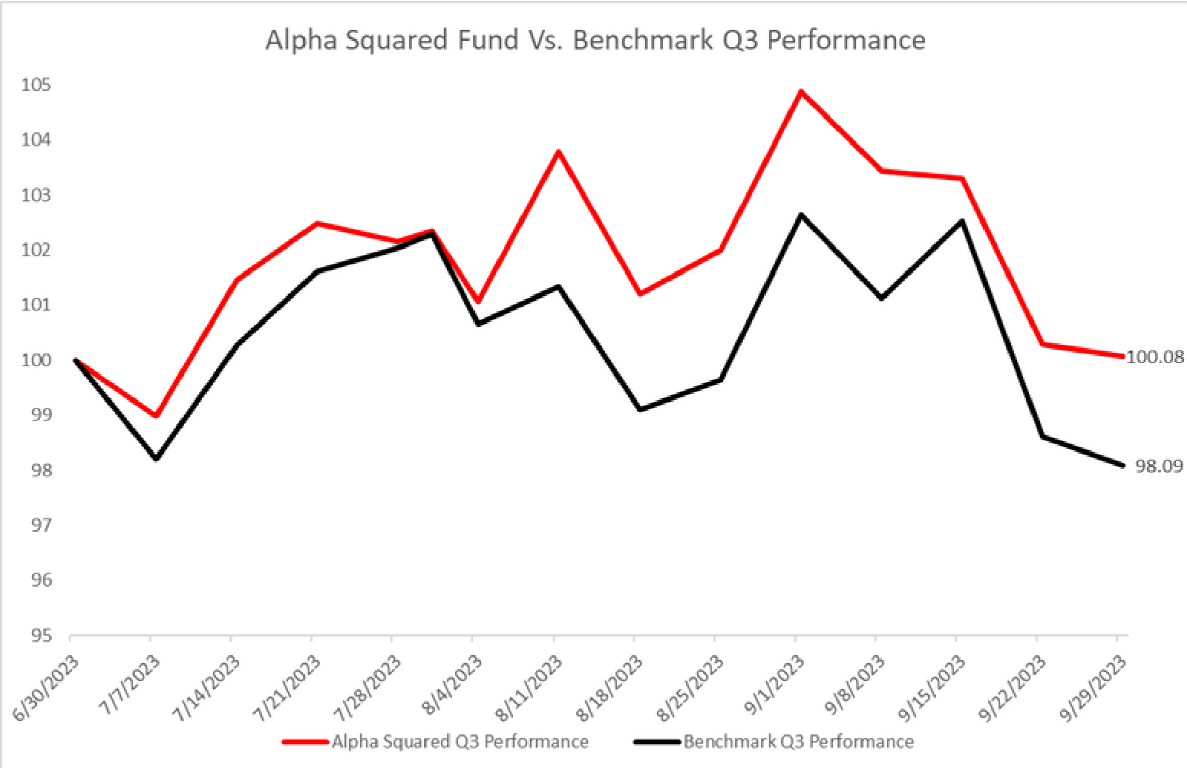
Alpha Squared Fund:

The Alpha Squared fund solidly outperformed our benchmark during the third quarter, delivering a 0.08% return vs a -1.91% return for the benchmark. (40% S&P 500 and 60% S&P TSX). The Alpha Squared fund has therefore continued to outperform our benchmark year-to-date, having delivered a 9.53% YTD return vs. 7.17% return for our benchmark.

During the third quarter, our biggest winning positions were Sterling Infrastructure and Energy Transfer, which delivered 32.6% and 10.5% returns for the fund in Q3, respectively. The biggest underperformers in the Alpha Squared fund were Enphase Energy and Clearway Energy, which delivered -28.8% and -26.2% returns respectively. Both Enphase Energy and Clearway Energy have been participants in the recent downtrend among renewable energy stocks. We believe this correction is overblown and remain convicted in the long-term prospects for the industry.

Going forward this year, we intend on maintaining our portfolio's sub-market beta as a means of reducing our risk to generate alpha during a period we anticipate may prove difficult for equity markets. Accordingly, we will be overweighting defensive sectors such as consumer staples, utilities, and healthcare. By contrast, we will be underweighting traditionally cyclical sectors such as semiconductors, financials, and consumer discretionary. Within financials, we will remain exceptionally underweight commercial banks due to the afformentioned risk of “secret insolvency” within the sector. Moreover, we intend on remaining underweight the information technology sector relative to our benchmark due to concentration risk within the benchmark indexes and the relatively high valuation at which the industry trades.


Alpha Squared Fund Vs. Benchmark YTD Performance
114
112
110
108
106
104
102
100
12/30/2022
1/30/2023
2/28/2023
3/31/2023
4/30/2023
5/31/2023
6/30/2023
7/31/2023
8/31/2023
109.53
107.17
Alpha Squared YTD Performance
Benchmark YTD Performance


Alpha Squared Fund Vs. Benchmark Q3 Performance
105
104
103
102
101
100
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98
97
96
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6/30/2023
7/7/2023
7/14/2023
7/21/2023
7/28/2023
8/4/2023
8/11/2023
8/18/2023
8/25/2023
9/1/2023
9/8/2023
9/15/2023
9/22/2023
9/29/2023
100.08
98.09
Alpha Squared Q3 Performance
Benchmark Q3 Performance

Alpha Squared Sector Weightings:

Alpha Squared Fund			
Sector	Fund	Benchmark	(+/-)
Healthcare	7.9%	5.5%	2.4%
Energy	14.6%	12.6%	2%
Materials	9.4%	8.1%	1.3%
Real Estate	3.7%	2.4%	1.3%
Consumer Staples	6.1%	5.2%	0.9%
Utilities	4.3%	3.5%	0.8%
Consumer Discretionary	4.9%	6.5%	-1.6%
Industrials	8.9%	11.5%	-2.6%
Financials	19.7%	23%	-3.3%
Information Technology	10.1%	16.1%	-6%
Cash	5.8%	0%	5.8%

Alpha Squared Holdings:

Security	Base Value	Weight	Sector
COMM SERV SELECT SECTOR SPDR	$ 120,959	4.6%	Communication Services
SPIN MASTER CORP	$ 63,955	2.4%	Consumer Discretionary
NIKE INC	$ 62,612	2.4%	Consumer Discretionary
ALIMENTATION COUCHE-TARD INC	$ 91,858	3.5%	Consumer Staples
PEPSICO INC	$ 67,160	2.6%	Consumer Staples
TC ENERGY CORP	$ 37,039	1.4%	Energy
TOURMALINE OIL CORP	$ 106,360	4.1%	Energy
iShares Energy ETF	$ 104,240	4.0%	Energy
ENERGY TRANSFER LP	$ 41,916	1.6%	Energy
SHELL PLC	$ 84,005	3.2%	Energy
BANK AMER CORP	$ 88,624	3.4%	Financials
INTACT FINANCIAL CORP	$ 104,775	4.0%	Financials
ROYAL BANK OF CANADA	$ 93,740	3.6%	Financials
TMX GROUP LTD	$ 118,105	4.5%	Financials
MSCI INC	$ 94,878	3.6%	Financials
DANAHER CORP	$ 63,460	2.4%	Health Care
VEEVA SYSTEMS INC	$ 72,567	2.8%	Health Care
MEDTRONIC PLC	$ 71,673	2.7%	Health Care
ISHARES S&P/TSX CAPPED	$ 53,112	2.0%	Index
ATS CORPORATION	$ 147,307	5.6%	Industrials
ISHARES S&P GLOBAL INDUSTRIALS	$ 77,942	3.0%	Industrials
CGI INC	$ 84,540	3.2%	Information Technology
ENPHASE ENERGY INC	$ 42,797	1.6%	Information Technology
iShares US Technology	$ 71,681	2.7%	Information Technology
ROPER TECHNOLOGIES INC	$ 60,768	2.3%	Information Technology
FRANCO-NEVADA CORP	$ 39,127	1.5%	Materials
XMA	$ 201,826	7.7%	Materials
BSR REIT	$ 41,202	1.6%	Real Estate
EQUINIX INC	$ 54,973	2.1%	Real Estate
NORTHLAND POWER INC	$ 51,100	1.9%	Utilities
CLEARWAY ENERGY INC	$ 60,323	2.3%	Utilities
BMO MONEY MARKET FUND	$ 99,800	3.8%	Cash
	$ 51,592	2.0%	Cash
	$ 2,626,014	100.0%	

Performance and Risk Metrics:

YTD	Alpha Squared Fund	Benchmark
Gross Return	9.53%	7.17%
Standard Deviation	6.03%	7.24%
Sharpe Ratio	0.54	0.34
Beta	0.89	-
Alpha	3.14%	-
Tracking Error	0.93%	-
Information Ratio	2.55	-

Since Inception	Alpha Squared Fund	Benchmark
Gross Return	6.06%	8.97%
Standard Deviation	11.23%	11.71%
Sharpe Ratio	0.30	0.46
Beta	0.89	-
Alpha	-1.67%	-
Tracking Error	1.06%	-
Information Ratio	-3.19	-

Performance metrics are reported gross of fees. All metrics are reported on an annualized basis, except for YTD return and YTD alpha. Benchmark is 60% S&P TSX and 40% S&P 500.

SRI Fund:

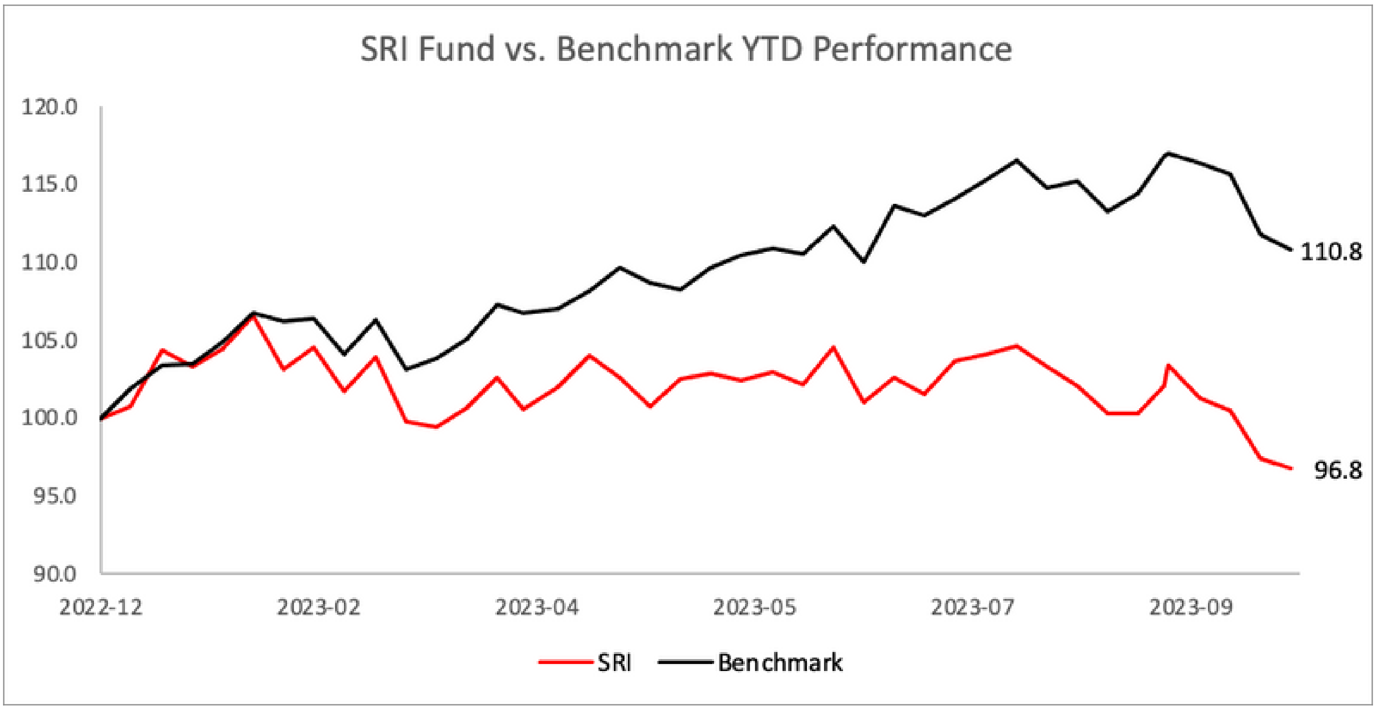
As a reminder, the SRI Fund has a mandate to invest in socially responsible companies that we believe will provide high risk adjusted returns for our investors. In Q3, 2023 the SRI Fund returned -5.7%, vs -2.4% for our benchmark. This underperformance was largely due to our overweight exposure to struggling renewable energy sector. Indeed, sentiment in renewables has turned overly pessimistic in our view and we maintain our long-term conviction for the industry.

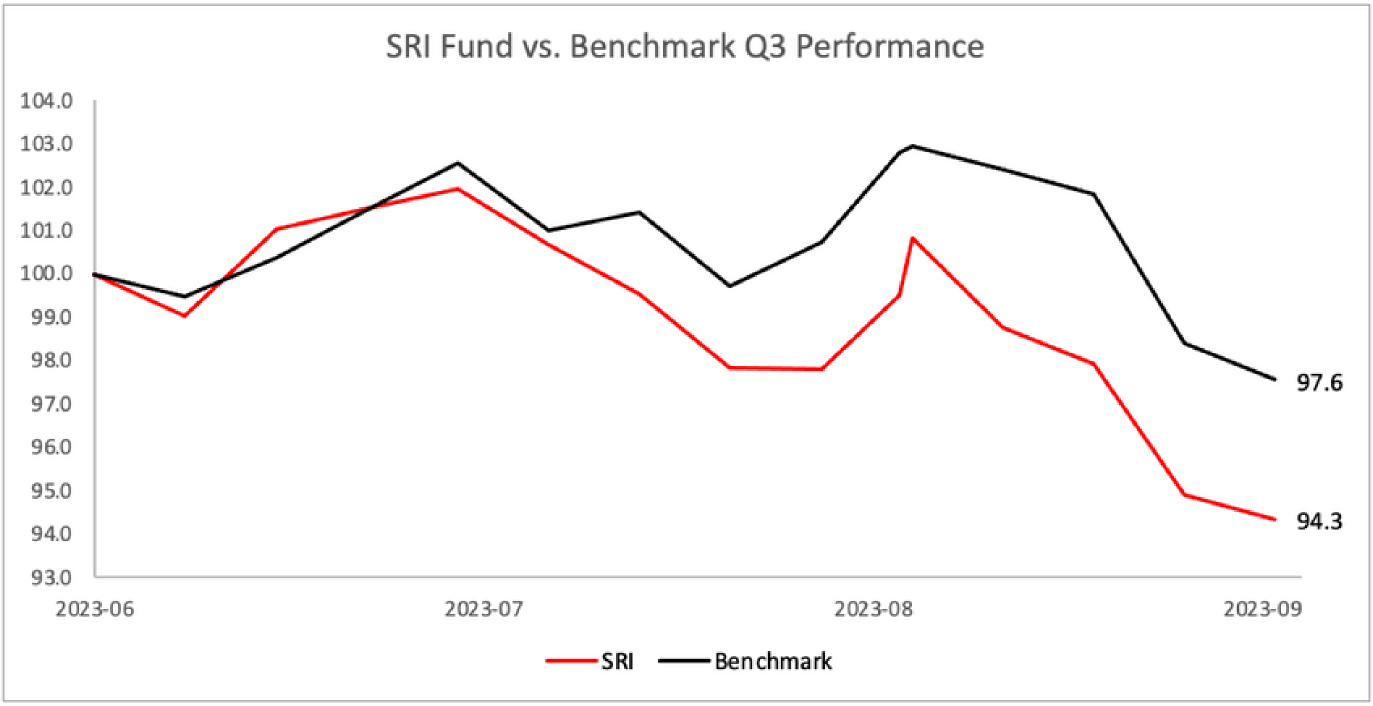
Our best performing stock in Q3 was Western Digital Corporation, returning 21.4%. The American computer drive manufacturer and data storage company beat revenue expectations and continues to innovate across their product lines. We maintain our position in the stock and believe the company is ideally positioned to become a leader once demand for hard drives and flash inevitably rebounds.

The second-best performing stock in the SRI Fund in Q3 was CBOE Global Markets, up 15.1%. CBOE owns and operates four options exchanges. The stock benefited from a 10.1% YoY growth rate, driven by increases in derivatives trading, which tends to increase in times of uncertainty. As explained earlier in this report, we anticipate significant macro and market uncertainty going forward, and thus expect CBOE to continue to capitalize on higher than expected trading volumes.

The two worst performing stocks in the SRI fund for Q3 were Canadian Solar (-33.3%) and Chargepoint (-42.8%), with both stocks negatively impacted by the change in sentiment surrounding renewables. Chargepoint was also negatively affected by Tesla, one of their main competitors in the EV charging space, which won a contract with North American Hilton Hotel properties to install 2,000 superchargers. While concerning, we don't believe this is an indication that Chargepoint can't compete with its larger rival. Indeed, despite the setback, Chargepoint revenues still increased 39% YoY. The company is also finding ways to cut costs and run more efficiently. Overall, we believe the stock is significantly undervalued at current levels.

The Biden administration's recent $3.5bn power grid investment is an important tailwind for the sector and will support the infrastructure needed for renewable adoption to increase. Moreover, valuation in the space now looks very compelling and we view signs of government support in North America and Europe as very encouraging. Thus, despite the sector's recent underperformance, we intend to maintain our fund's exposure to renewable stocks as these companies are essential to solving society's ongoing energy and environmental crises.


SRI Fund vs. Benchmark YTD Performance
120.0
115.0
110.0
105.0
100.0
95.0
90.0
2022-12
2023-02
2023-04
2023-05
2023-07
2023-09
110.8
96.8
SRI
Benchmark


SRI Fund vs. Benchmark Q3 Performance
104.0
103.0
102.0
101.0
100.0
99.0
98.0
97.0
96.0
95.0
94.0
93.0
2023-06
2023-07
2023-08
2023-09
97.6
94.3
SRI
Benchmark

SRI Sector Weightings:

Sector	Fund	Benchmark	(+/-)
Financials	19.8%	13.1%	6.7%
Health Care	16.4%	13.9%	2.5%
Communication Services	10.7%	9.2%	1.5%
Real Estate	3.6%	2.5%	1.1%
Materials	3.5%	2.5%	1.0%
Utilities	3.1%	2.5%	0.6%
Consumer Staples	7.0%	6.8%	0.2%
Energy	0.1%	1.3%	-1.2%
Consumer Discretionary	8.5%	10.9%	-2.4%
Information Technologies	23.1%	28.6%	-5.5%
Industrials	2.4%	8.6%	-6.2%
Cash	1.9%	0.0%	1.9%

SRI Holdings:

Security	Base Value	Weight	Sector
SPDR S&P 500 FOSSIL FUEL RES	$189,698.04	8.21%	All
ALPHABET INC	$106,243.68	4.60%	Communication Services
NETFLIX INC	$70,961.61	3.07%	Communication Services
WALT DISNEY CO/THE	$52,050.31	2.25%	Communication Services
ETSY INC	$22,613.85	0.98%	Consumer Discretionary
LOWE'S COS INC	$118,019.87	5.11%	Consumer Discretionary
TAPESTRY INC	$34,594.30	1.50%	Consumer Discretionary
PEPSICO INC	$113,854.19	4.93%	Consumer Staples
VIZIO HOLDING CORP	$34,172.50	1.48%	Consumer Staples
CBOE GLOBAL MARKETS INC	$91,236.64	3.95%	Financials
CHUBB LTD	$126,656.71	5.48%	Financials
MASTERCARD INC	$128,464.88	5.56%	Financials
ROYAL BANK OF CANADA	$86,176.20	3.73%	Financials
AXSOME THERAPEUTICS INC	$80,317.59	3.48%	Health Care
ISHARES GLOBAL HEALTHCARE ETF	$193,445.67	8.38%	Health Care
MEDTRONIC PLC	$78,397.61	3.39%	Health Care
CHARGEPOINT HOLDINGS INC	$38,972.75	1.69%	Industrials
ADVANCED MICRO DEVICES INC	$109,680.97	4.75%	Information Technology
CANADIAN SOLAR INC	$53,236.35	2.30%	Information Technology
ENPHASE ENERGY INC	$73,099.26	3.16%	Information Technology
ROPER TECHNOLOGIES INC	$150,591.71	6.52%	Information Technology
WESTERN DIGITAL CORP	$92,784.41	4.02%	Information Technology
FREEPORT-MCMORAN INC	$75,624.12	3.27%	Materials
NEXUS INDUSTRIAL REIT	$42,967.44	1.86%	Real Estate
WEYERHAEUSER CO	$35,110.12	1.52%	Real Estate
BORALEX INC	$66,734.66	2.89%	Utilities
Cash	$43,916.87	1.90%	
Total	$2,309,622.31	100%	

Performance and Risk Metrics:

YTD	SRI Fund	Benchmark
Gross Return	-3.23%	10.82%
Standard Deviation	13.46%	10.82%
Sharpe Ratio	-0.74	0.84
Beta	1.02	-
Alpha	-18.98%	-
Tracking Error	7.97%	-
Information Ratio	-1.76	-

Since Inception	SRI Fund	Benchmark
Gross Return	4.80%	9.93%
Standard Deviation	19.52%	16.70%
Sharpe Ratio	0.16	0.53
Beta	1.03	-
Alpha	-6.08%	-
Tracking Error	8.89%	-
Information Ratio	-0.58	-

Performance metrics are reported gross of fees. All metrics are reported on an annualized basis, except for YTD return and YTD alpha. Benchmark is 80% S&P 500 Fossil Fuel Free Index and 20% S&P/TSX Fossil Fuel Free Index

On behalf of the current MMF cohort and program alumni, we would like to thank you, our investors, for your continuous support over the years. The experience, skills and knowledge gained from our time at DCM could not have been achieved at any other academic institution, and none of this would be possible if not for your continued trust in our firm. Your support means everything to us.

We hope you enjoyed reading this newsletter.

Best,

James Thayer, 24
Alpha Squared Fund Strategist

Daniel Buhler, 24
SRI Fund Strategist

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