GMP Investment Management
Maximizing Return, Minimizing Risk

GMP Diversified Alpha Fund

Monthly Market Commentary February 2012

For February 2012, the Diversified Alpha Master Fund (the "Fund") generated a positive return of 0.78% (preliminary). For the first two months of 2012, the Fund is up 2.82%.

We carried forward our "risk-on" bias through February. Both equity and credit markets globally, but particularly in North America, showed continued price momentum throughout the month. These markets have been on an impressive run year to date, where the price appreciation for the S&P500 has continued virtually unabated. In fact, we have not seen a 1% correction in the broader equity market yet in 2012, which puts this run into statistically rarified territory. By comparison, there were 47 days in 2011 that saw a drawdown in excess of 1%. Since 1927, there have only been 11 occurrences where we have had a 40 day positive run without a 1% correction. The themes that have driven this strength are four fold: (i) continued strong profitability from North American corporations; (ii) rising consumer confidence on the back of consistent economic and employment data; (iii) sustained confidence (or rather lack of overtly negative news) relating to the debt crisis in Europe; and (iv) continued easy monetary policy. That said, this price run has us evaluating the most prudent risk-adjusted posture for the Fund, as we look to maximize the risk adjusted return profile for our investors. 76% of the OEX (the S&P100) components are in overbought technical territory. Over the last decade when the market is in this range, it has pulled back, on average 4%, prior to returning to its ascent. We anticipate that this market will follow suit. Again, the timing of these pullbacks is always uncertain, but the likelihood is real.

We continue to adhere to the long risk bias suggested by our quantitative models. When you account for individual names and index exposure, the Fund is close to its maximum long equity exposure. The Fund is long credit through the Canadian ABCP and marginally long in through the high yield loan book. While our models suggest continued risk exposure is appropriate, we are mindful of the extended price position that risk assets have moved to so quickly. In particular, the High Yield market has risen to levels that cause us concern. Given the current risk/return profile of the High Yield market, the Fund has minimized its exposure. This view flies in the face of the yield chasing behaviour of retail investors at large, as High Yield funds and ETFs have been the asset class of choice for the last six months thereby driving yields lower. These low rates are allowing corporations to refinance existing debt at very attractive coupons which in turn is positive for the equity value.

The Equity strategy made gains this month across all sub-strategies. Returns were lead by pro-cyclical investments in industrials, technology, energy and consumer discretionary sectors. Strong individual performances were seen in Apple, Nordson, Paramount Energy, Target, Cummins, Foster Wheeler and Athabasca Oil Sands. The portfolio remains biased towards continued economic growth with high weight across pro-cyclical sectors.

The Credit strategy generated positive returns as a small net long strategy and the Canadian ABCP, strategy were responsible for over 80% of the positive move in our Credit book for the month. These gains were limited by small losses in selected shorts we had in our High Yield strategy. On the month, the High Yield market established a 7% yield level, only 25bps from the all time low yield level of 6.75% established right before the credit crisis of 2008. While we don't believe that an impending correction in high yield is necessarily coming in the near term, we believe that the risk to own high yield paper at these levels is much higher than the reward that a 7% coupon offers investors.

Quantitative Investing had a positive month in February. Early in the month we were essentially max long equities and then we reduced exposures in the last week. Leading into March we are cautiously long equities and given the correction in gold and silver at the end of February, we are basically flat precious metals. Overall our momentum models suggest to be long equities; however, some mean reversion models are kicking in leaving us small long positions with tight stops. We will increase our long positions over time or with a consolidation of the markets.

We continue to search for cracks in this price rally across all risk assets. Though the Fund has been positioned well so far during 2012 to capitalize on the rally that continued through February, we continue to prioritize capital preservation and volatility management. We will not hesitate to reallocate capital and apply appropriate risk mitigating techniques in order to protect investors capital when the appropriate. While it may appear to be a normal bull market, investors must not forget that this type of rally is typical of all deleveraging cycles and thus should remain vigilant.

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