GMP Investment Management
Maximizing Return, Minimizing Risk

GMP Diversified Alpha Fund

Monthly Market Commentary March 2012

For March 2012, the Diversified Alpha Master Fund (the "Fund") generated a positive return of 0.76% (preliminary) net of fees and expenses. Based on the preliminary monthly results for March, for the first three months of 2012, the Fund is up 3.62% net.

We have been close to fully invested in the Fund throughout 2012. We carried forward our "risk-on" bias through March. As market confidence improved through the month, volatility fell with the VIX below 15 for the first time in months. This confidence helped to propel U.S. and Global equity markets upward. However, the Canadian markets did not fair as well as gold stocks and cyclicals suffered declines. As you may recall, we have been commenting on the inherent risk in the investment grade and sovereign debt credit markets throughout the first 3 months of this year. This risk is reflected in the long end of the U.S. Treasury market losing 2% in the month. Greece found it's latest "solution" during March, which included a $138 billion debt write down. As you move through the various details of this latest round of restructuring, the newest update is that Greece will have more than 225% of its projected (and shrinking) GDP in gross external debt.

March started out with negative news from China, including the Chinese government cutting growth expectation to 7.5%. Chinese PMI also surprised to the downside later in the month as it slipped below the critical 50 level. Due to these factors, cyclical stocks quickly priced-in a hard landing in China. That said, unlike commodity-related equities, commodity prices shrugged off these issues and barely moved. A continued slowdown in Chinese growth will definitely continue to weigh on pro-cyclical equities. We are monitoring this risk very closely and reduced our exposure through the a reallocation of capital as well as employing some macro hedges.

As previously mentioned, there was a significant divergence in performance between Canadian and U.S. equity markets in March. Commodity stocks sold off, which impacted Canada while U.S. financials and Apple drove the American markets higher. Gains through the month took a pause during the third week, but rallied through the final week on the back of Fed Chairman Bernanke's most recent comments. Investor reaction was positive for both risk assets as the market continued to predict additional accommodative policy, which may include additional quantitative easing (QE3 perhaps?). We are reminded of the dual mandate of the Fed: keep inflation in check and foster policy that leads to maximum employment. On the latter, the Fed recognizes that it still has work to do.

On the overall risk front, the VIX bounced around the relatively low levels of 14-15 while equities rallied and high yield stalled. Short term equity enthusiasm is high, notwithstanding longer dated index options predicting higher risk. In the last 6 weeks, the high yield market has stalled, and appears to be pausing before the equity markets (see chart). This is consistent with our view that high yield has potentially rallied too far based on an excess of fund flows to this market.

While the Fund performed positively, we had divergence in our Strategy performance during March. Credit performed very well across all sub-strategies, with our favoured trade, Canadian ABCP, rallying strong. In addition, the net long strategy generated a positive return with short positions in several coal bonds and a merchant electric generation company and long positions in stable high yield credits in a tight technical market were responsible for the outperformance of the strategy relative to the overall high yield market.

At the same time, our Equity strategy had negative performance. Strong performance in Apple, Perfect World and First Horizon were offset by losses in long positions on Crew, Celtic, Trilogy and Paramount as cyclicals had a tough month. Our Quantitative strategy was negative on the month due to the underperformance of the Canadian market and our current long bias towards the TSX60.

We continue to monitor the market for risk indicators that will affect our capital allocation. In the near term, we remain "risk-on", while carefully adhering to our strategy of capital preservation and management of volatility.

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 March, 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 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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