GMP Investment Management
Maximizing Return, Minimizing Risk

GMP Diversified Alpha Fund

Monthly Market Commentary September 2012

The Diversified Alpha Master Fund (the "Fund") ended September up 53 bps (preliminary), net of all fees and expenses. This brings YTD performance to +4.60% and since inception to +29.87% (preliminary). U.S. equity markets extended their forward progress during the month, building on the weak volume rally that drove equity returns in August.

With an eye on the rear view mirror, we can now observe that the first three quarters of the year have been filled with surprise, particularly as we observe U.S. equity market performance versus the global economic landscape. U.S. equities, particularly large caps, have been on fast forward, while the global economy continues to sputter. The most recent two months of performance have been on the back of the "QE-infinity" announcement and forward-looking hope that the Fed will remain there to save the day. The overwhelming reaction to QE3 has been an expectation of asset inflation. This should be good for all hard assets. The corporate credit market that has been on fire all year, might well remain on fire with this new injection of additional QE fuel. While the earnings, employment and housing backdrop appear unstable or weak, QE3 could provide the necessary surge to propel asset prices (and equities) forward through year-end. While QE3 makes this all possible, this is a difficult market to trade as this policy driven action is unpredictable, and provides for price reaction that is contrary to what prudent economic analysis would have you believe. With the latest Fed action targeted at buying an additional $40 billion of mortgage backed securities, we are faced with the nagging question as investors: can this global debt problem really be solved by exacerbating the same behavior that caused the problem in the first place?

U.S. manufacturing posted an increase in September with a PMI of 51.5. This is more robust than expected, and is the first reading above 50 (expansion territory) since May of this year. This is relief from the depressed August levels. Trade activity remained below 50, indicating that global demand has not resumed at a robust pace.

As we look more broadly beyond the Fed and U.S. monetary policy, recent economic data continues to reveal significant weakness in both Europe and China. As we write this commentary, Chinese factory activity remained in contraction territory, joined by weak manufacturing activity in Taiwan and Indonesia. The HSBC Taiwan PMI fell to 45.6 in September, the lowest level in 10 months at the same time as Indonesia's PMI fell to 50.5, bordering on contraction there as well. China's economy showed persistent weakness with the anticipated September PMI being fairly strong, but the actual result roughly in line with August at 49.8. This is the second consecutive month of a sub 50 reading for China. A recent Reuters poll predicts that China's economic growth could ease to 7.4% in Q3, which would mark the seventh consecutive quarter of slowdown, before picking up to 7.6% in Q4. Of less surprise, Eurozone manufacturing put in its worst performance in the quarter, with Markit's PMI at 46.1, while August unemployment was unchanged versus July and remained at 11.4%. Combine this data with other economic data and several economists are convinced that the European bloc has now fallen into another recession in the quarter just ended.

On the U.S. political front, the shift of sentiment towards an Obama second term gained momentum. While we are still a month away from the election, most polls agree that Romney lost traction coming out of the conventions. Investors are mindful of Obama pitted against a Republican-controlled House, which last year led to the budget battle that ultimately cost the U.S. its top credit rating and panicked investors. Trader and fund managers alike have started to tell investors that it is time to prepare for an Obama victory in November.

U.S. equity markets started the month strong on QE anticipation, and stalled in the 3rd weak of the month. Since the announcement of QE3, news from major bellwether corporations (like Caterpillar) across key sectors have been weaker. Apple forced equity markets lower during the 3rd week of the month after being the catalyst to propel the markets higher at the beginning of the month in anticipation of the I-phone 5 launch. Weeks later, preliminary sales data disappointed (although strange to report that 5 million units delivered in the first weekend of sales is disappointing) and their replacement map application fell short of expected utility. Apple stock was hit hard going in to month end. Crude fell during the month, briefly to below $90 a barrel. New home sales also fell 0.3% on a monthly basis compared to estimates of a 2.2% gain.

The Fund had a decent month of performance, generating positive performance in Credit , Protection and in our Macro strategy. This was offset by a small losses in our Equity and Quantitative strategies. We had strong performance in our ABCP and corporate bond books. ABCP saw advancing prices this month on the back of positive developments in that asset space. The credit position that caused a mark to market loss in August rallied back during September. We increased our weighting to 30% in Equities given our optimism around the additional stimulus in the market. This increased weighting was mostly reflected through index, ETF and index option positions. All of our sub-strategies in Equities were positive this month, offset by negative performance in 2 short positions. In terms of portfolio construction, our positions continue to reflect our cautious "policy driven" optimism. The majority of our positions are liquid and we continue to use options to reflect our positions given the relatively cheap prices that are a result of low implied volatility.

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