FULCRA
ASSET MANAGEMENT INC.

January 22nd, 2016

Fulcra Credit Opportunities Fund
(Formerly the Fulcra Focused Yield Fund)

Q4 2015 Commentary

We will not soon forget the volatility and commodity rout that characterized 2015, our only loss year. As a whole the fund was down 6.38%[1]. In the table below we highlight the sectors that contributed to the Fund's 2015 result.

Sector	2015 Portfolio Impact (bps)
Consumer Discretionary	+141
Shipping	+38
Healthcare	+22
Communications	+28
Financial	-194
Energy (non O&G)	-194
Oil & Gas	-151
Basic Materials	-147
Industrial	-134
Consumer Goods	-13
Total	**-604**

The pure commodity influenced sectors of oil & gas, energy (non-oil & gas), and basic materials were the biggest detractors to performance over the year. The negative contribution from oil & gas may not seem as big as expected. However, this sector includes oil & gas service companies, and in December the fund saw a big boost (+1.87%) from the Fund's long standing position in Tuckamore. While Tuckamore is a holding company of four companies, the majority of the cash flow comes from its Clearstream Energy Services business.

The dramatic drop in the price of oil from a year ago to $30 today, highlights the difficulty in predicting the future price of commodities. Any long exposure to commodities and the companies that produce them has been a very damaging experience.

The Capital Cycle

The commodity rout over the last 14 months emphasizes the importance of capital cycle analysis.

As described powerfully in "Capital Account" by Marathon Asset Management, the boom-bust nature of cycles and the embellished stories can drive the valuation of companies substantially above and below their intrinsic values. Portfolio managers at Marathon, write about their research supported scepticism of the tech / telecom bubble that defined capital markets in the late 1990s and 2000s.

While Marathon was able to patiently avoid these stocks, despite underperforming their peers, the outcome of the capital cycle is equally as dramatic on the way down as it is going up. This allowed Marathon to pick up the scraps of telecom companies left for dead after the rout.

Seeing WTI today at $30 versus $107 in June 2014 draws parallels to the tech / telecom bust 15 years ago. While we were sceptical of this rise in the oil price and underweight the sector, we had exposure that hurt us in 2015. However, of the 8 positions of oil & gas producers we own (total exposure to the sector is currently 3.40%), two are priced at such low levels that the reasonably high probability of

[1] Class B, net of fees

receiving 2 to 4 more coupon payments, given the hedges on their production, creates an effective cost base of zero for new buyers of the fund.

In our opinion, the pummelling of energy bonds draws parallels to some of the “net net” telecom stocks (a rare situation that can occur during periods of extreme stress when stocks trade at the value of the company’s working capital) that Marathon picked up through the wreckage of the Tech bust. To be sure, the determinants of value are different, but the severity of the fall of some energy bonds is so severe that there is now mathematically almost no downside. While we are actively following some select energy credits, the overall current negative sentiment in credit markets has also increased the risk premiums of other more certain bond investments.

Going Forward

In the current environment, the risk premiums on all investments increases. Even those from the relative certainty of mergers and acquisitions. While this category of investments has always been a source of ideas for us, we plan to search for more of these opportunities given their relative safety, defined time structure and high return prospects.

A recent example, are the 4.25% bonds of Corus Entertainment due February 2020. The Fund purchased this bond, at an average price of $105.25, shortly after Corus announced the purchase of Shaw Media for $2.6 billion on January 13. The bonds are not callable yet the indenture limits Corus’ ability to raise the required debt to pay for the majority of the $2.6 billion price. Corus doesn’t want this to happen. So, once the transaction closes, to which we attach a very high probability, Corus will be required to tender for the bonds. If we use the pricing mechanism (make whole) to determine the tender price and an expected closing date of the end of May we come to a bond price of approximately $110. This translates to an annualized return of over 17% for a four and a half month holding period.

The first two weeks of 2016 has seen the high yield corporate bond market get off to its worst start to a year since 1990. This leaves the average high yield bond now yielding over 10% for the first time since late 2008. While caution is warranted during periods of elevated outflows from high yield ETF’s and mutual funds, it is in times like these that the risk of investing is in fact being minimized. Lower prices increase the margin of safety of investing by minimizing downside risk yet increasing prospective returns.

With cash of 19%, a yield to maturity of 11.5%, and a growing universe of attractive investments on the rise we are cautiously optimistic that we are entering a period where there is an opportunity to seed the Fund with exceptionally priced investments.

Best regards,

Matt Shandro
President, Fulcra Asset Management Inc.