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- Strong quarter of positive alpha as the fund was up 6.1% gross with a Sharpe ratio of 5.8;
- Volatility down to 4.2% for the quarter, half of the 9.0% annualized for the S&P500;
- Strong drawdown protection against volatile equity markets in August;
- Our deep research process continues to uncover high conviction opportunities.

November 5, 2013

Formula Growth Alpha II Fund

3rd Quarter 2013 Results

Dear Investors,

Quarterly Review

The stock market was once again very volatile in the third quarter, swinging from large gains in July to large losses in August before finishing up with strong returns in September as fears around near term tapering by the Fed vanished after the September meeting. Against this backdrop the Alpha Strategy performed very well, fulfilling its primary mandate to protect capital in negative periods while adding value via our bottom up process. Overall the Strategy had an excellent quarter generating a gross return of 6.1% (US$ 4.4% and C$ 4.3% net) vs. 5.2% and 10.2% the SP500TR and Russell 2000TR respectively.

The Strategy had zero exposure to the market throughout the quarter, the strong return was driven by exceptional stock picking as witnessed by our Sharpe ratio of 5.8. The month of August showed strong drawdown protection as the fund was up 1.5% gross (1.1% net) while the S&P500 and Russell 2000 were down 2.9% and 3.2% respectively. The volatility of the Alpha Fund was well controlled as our annualized volatility in Q3 of only 4.2%, which was half of the SP500 and one third of the Russell 2000. We were also very pleased that the strategy displayed positive returns in down market days.

Entering the 4th quarter, we continue to maintain a cautious stance towards the overall market, the global liquidity binge continues to inflate equity and asset valuations without a matching acceleration in economic activity. Even though earnings are holding steady, the risks to the downside are increasing should we not start seeing increases in company sales. In Q4, we continue to manage the risk of the portfolio while continuing to research and isolate Alpha Long and Short opportunities.

Relative Return Analysis

	3rd Quarter 2013			2013 Year-to-Date			Strategy Inception-to-Date		
	Alpha II	S&P500	R2000	Alpha II	S&P500	R2000	Alpha II	S&P500	R2000
Statistical Analysis									
Period Gross Total Return (US$)	6.1%	5.2%	10.2%	11.1%	19.8%	27.7%	39.6%	39.0%	48.6%
Annualized Deviation of Daily Returns	4.2%	9.0%	12.7%	5.2%	11.3%	14.9%	7.3%	12.2%	16.2%
Sharpe Ratio	5.8	2.0	3.5	2.7	2.1	2.4	2.8	1.4	1.4
Strategy Correlation		12.6%	17.0%		14.8%	22.5%		40.0%	43.0%
Up Market Analysis									
Number of Up Days	43	37	38	117	111	114	262	243	235
Largest Daily Gain	1.0%	1.4%	1.6%	1.0%	2.5%	2.8%	2.7%	2.5%	2.9%
Strategy % Up Capture		29.9%	17.9%		13.3%	10.7%		34.8%	22.5%
Down Market Analysis									
Number of Down Days	21	27	26	71	77	73	176	195	202
Largest Daily Loss	(0.6%)	(1.6%)	(2.4%)	(1.1%)	(2.5%)	(3.8%)	(1.6%)	(2.5%)	(3.8%)
Largest Draw Down from Peak	(0.7%)	(4.6%)	(4.9%)	(3.0%)	(5.8%)	(5.4%)	(6.5%)	(9.9%)	(12.9%)
Strategy % Down Capture		(8.2%)	(10.9%)		(7.6%)	(5.0%)		12.0%	4.9%

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Portfolio Positioning

We entered the quarter with a net exposure of 10.5% and a net beta of 0.19. Following the strong start to the month of July, we rapidly reduced this net exposure to -8.2% (net beta of -.05) by the 2nd week of July. We held this negative market positioning until the markets sold off aggressively in August. The market exposure gradually increased to 7.3% on August 22nd and as the market recovered in late August and into September we once again took down our exposure finishing the quarter at -0.1% as our concerns were growing around potential Fed tapering in late September.

Market and Beta Exposure

	Jun-30	Q3 Avg.	Sep-30
Gross Long	51.3%	61.1%	66.4%
Gross Short	(40.9%)	(60.1%)	(66.6%)
Net	10.5%	1.0%	(0.1%)
Total Gross	92.2%	121.2%	133.0%
Net Raw Beta	0.19	0.06	0.09

Strategy Breakdown

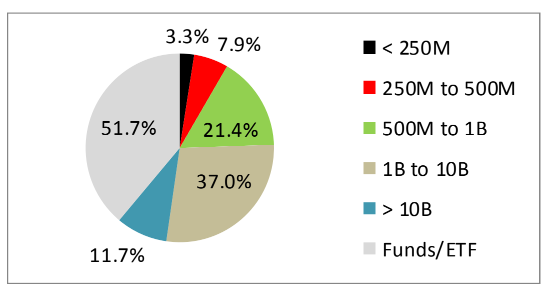
	Jun-30	Q3 Avg.	Sep-30
Pair Trade	0.0%	2.6%	2.5%
Hedge	23.7%	46.0%	51.7%
Alpha Long	51.3%	59.7%	66.1%
Alpha Short	17.2%	12.9%	12.7%

Our Alpha Long exposure increased throughout the quarter from 51.3% to 66.1% at quarter end as several high conviction positions entered the portfolio and other existing positions were increased in size as our bottom up fundamental research indicated imminent catalysts would emerge and near term price appreciation potential was high. In order to maintain our overall net neutral position, our gross short positions were consequently increased from 40.9% to 64.5% at quarter end. Our Alpha Shorts (individual investment ideas with absolute return potential), began the quarter at 17.2% and hit a low point of 7% on Aug 27th as several names were covered as they hit our target prices during the sell-off. The Alpha Shorts were rebuilt into quarter end finishing the quarter at 12.7% as new positions were added. Our Hedge exposure (individual investments to offset or hedge any residual risk) began the quarter at 23.7% and finished the quarter at 51.7%. This increase was mainly as a result of our increased Alpha Long exposure and a desire to reduce the sector and overall market exposure.

Positions (Period End) and Returns by Market Cap

	# of Longs	# of Shorts	Total	Q3	2013 YTD
< 250M	5	0	5	(0.4%)	2.4%
250 to 500M	7	0	7	0.2%	5.1%
500M to 1B	10	1	11	4.3%	6.1%
1B to 10B	18	17	35	3.6%	5.4%
> 10B	4	4	8	1.9%	1.1%
Funds/ETF	0	6	6	(3.6%)	(8.4%)
Total	**44**	**28**	**72**	**6.1%**	**11.6%**

Market Cap Breakdown (Period End)



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Strategy Attribution

	Q1	Q2	Q3	2013 YTD
Pair Trade	0.6%	(0.1%)	0.1%	0.6%
Hedge	(4.7%)	(0.4%)	(3.6%)	(8.4%)
Alpha Long	6.1%	4.8%	10.9%	23.3%
Alpha Short	(0.4%)	(0.8%)	(1.2%)	(2.4%)

Quarterly Portfolio Attribution

During the quarter, 29 individual names contributed 10 bps or more to overall returns with 4 of these being new positions initiated in the quarter. The quarter also saw very strong contributions from our highest conviction positions with 5 names contributing more than 75bps to overall return. The Alpha Long book had an exceptional quarter contributing 10.9% on average gross exposure of 59.7%. The Alpha Shorts and Hedges cost the fund 1.2% and 3.6% respectively on average gross exposure of 12.9% and 46.0%. The Pair Trading book added 0.1% in the quarter on average exposure of 2.6%.

The major contributors to third quarter performance were the Materials sector adding 1.6%, the Consumer Discretionary sector adding 1.5%, the Energy sector adding 1.0% and the Industrial sector adding 0.9%.

Net Exposure

	Jun-30	Q3 Avg.	Sep-30
Cons. Discr.	1.1%	(1.2%)	(4.5%)
Cons. Staples	(2.6%)	(3.0%)	(2.8%)
Energy	(2.4%)	(1.3%)	1.6%
Financials	2.2%	(0.4%)	1.6%
Health Care	1.2%	0.6%	(0.7%)
Industrials	4.1%	(1.0%)	(2.9%)
IT	4.3%	2.2%	2.7%
Materials	2.6%	5.8%	5.6%
Telecom.	0.0%	(0.1%)	(0.1%)
Utilities	0.0%	(0.5%)	(0.6%)

Attribution

	July	August	September	Q3	2013 YTD
Cons. Discr.	0.1%	0.3%	1.0%	1.5%	4.6%
Cons. Staples	(0.2%)	0.2%	(0.0%)	(0.1%)	(0.2%)
Energy	0.8%	(0.2%)	0.4%	1.0%	(0.2%)
Financials	0.2%	(0.0%)	(0.1%)	0.1%	1.6%
Health Care	0.6%	(0.1%)	(0.1%)	0.4%	0.7%
Industrials	0.5%	0.4%	0.0%	0.9%	2.0%
IT	0.3%	0.2%	0.2%	0.6%	1.6%
Materials	0.2%	0.6%	0.8%	1.6%	1.0%
Telecom.	(0.0%)	0.0%	0.0%	0.0%	0.0%
Utilities	(0.0%)	0.0%	(0.0%)	(0.0%)	(0.1%)

Materials

The Materials sector was our best performing sector in the third quarter adding 1.6% to total return, we began the quarter with net exposure of 2.6% and ended with 5.6%. We have been diligently working on this sector since the beginning of the year which began with us doing a detailed analysis on Freeport McMoran (currently a top portfolio holding) this detailed work naturally led to an extensive analysis of the copper market. Our research led us to conclude that the sentiment regarding copper had been extremely negative towards the middle of the year despite compelling long term supply demand fundamentals beyond 2014. Earlier in the year when copper was $3.80 per pound, we had concerns around downside in the commodity hurting our investment in Freeport, thus we paired off the investment with a short in Southern Copper. When copper prices hit $3.00 in the second quarter we removed the short part of the pair and kept Freeport as a Alpha Long. We concluded that both the commodity and company had strong upside, and this proved to be the correct move as Freeport added 120bps to our total return in the quarter. As our conviction in the copper cycle increased we added a 2nd name to the portfolio, Capstone Mining, which was a strong contributor to Q3 performance adding 41bps total return.

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Consumer Discretionary

The Consumer Discretionary sector was our 2nd best performing sector in the third quarter adding 1.5% to total return. We began the quarter with net exposure of 1.1% and ended with net exposure of –4.5%. We became more cautious on the consumer as our channel checks were pointing to an incrementally tougher environment in August/September likely driven by a squeezed middle class and concern around the government shutdown. Our best performing stocks in the quarter were Goodyear Tire (136bps) and Carmike Cinema (98bps). Our worst performing stock was a short position in Sturm, Ruger & Co. (-28bps).

Energy

Energy was our 3rd strongest performing sector in the quarter adding 1.0% to total return. We began the quarter with net exposure of -2.4% and finished at 1.6%. We continue to prefer a neutral posture in the sector as we have concerns on potential downside to oil prices. At the same time, the sector remains a great place to add value through stock picking as continuous news flow and dynamic medium sized exploration and production companies allow for strong value add. In the quarter, our top performing stock was Sanchez Energy, which added 108bps to total return. Sanchez is a name we have followed closely since its IPO in 2011 and has recently hit the inflection point of strong oil production growth which caused a large re-rating in valuation.

Industrials

The Industrial sector was our 4th best performing sector in the third quarter adding 0.9% to total return. We began the quarter with net exposure of 4.1% and ended with net exposure of –2.9%. Our best performing stock in the quarter was HD Supply Holdings (26bps). Our worst performing stock was Accuride Corporation (-10bps).

4th Quarter Outlook

We continue to maintain a neutral posture as we head into the fourth quarter. There is no doubt that the liquidity being provided by the central banks continues to fuel asset prices. Even though there are bright spots in the U.S. economy, housing and car sales to name a few, our concern is that these increases in asset prices are not being matched by equally rising profits. The liquidity binge and flat sales growth has resulted in an increase in the valuation multiples that investors are willing to pay for future earnings. Bullish investors may argue that this re-rating in U.S. equities is justified and could continue given the very low level of interest rates. However, without a strong acceleration in the economy and a resulting increase in company sales volumes, the market is more vulnerable for a correction.

Even before the political events in Washington around the debt ceiling, there were signs that the economy was not accelerating beyond its 2% run rate like many economists had expected. The damage from the government shutdown will only increase the likelihood that the economy remains in a slower growth environment for the near term as politicians have yet again only kicked the proverbial can down the road. While investors are currently celebrating the continuance (for now) of ultra-accommodative Fed policy, we feel that the only path to sustainably higher stock prices is through an economic acceleration while anything else only increases the negative tail risks of the market. As bottom up investors we will be well positioned to pick up any trend changes to the U.S. economy through the hundreds of channel checks and our very close contacts with our portfolio companies.

Thank you for your confidence,

Formula Growth

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Notes & Disclaimers

- Performance figures reported represent the US$ performance of the Formula Growth Alpha II Fund L.P. (the "Fund") and are based on an investment in the Fund made on January 1, 2012, the date of the Strategy's inception. Gross performance figures are presented after reduction for any investment and fund accounting related expenses, net interest, other expenses and the reinvestment of dividends, and include any gains or losses from "new issue" securities. Per the Fund's High Water Mark provisions, net performance figures take into account a 1% Management Fee and a 20% incentive allocation. Performance results for particular investors may vary from the performance stated herein as a result of, among other things, the timing of their investment(s) in the Fund, different management and incentive allocation terms and the respective investor's eligibility to participate in "new issue" securities.
- Performance attribution figures reflect summations of the respective profits and losses divided by the average of the beginning and end of month total gross Fund assets, and are not inclusive of expenses, management and incentive fees/allocations. Other income/expense items such as stock lending fees, interest income/expense, dividend income/expense, administrative fees and other portfolio related fees may or may not be included. Performance attributions should be considered approximations and are calculated to the best of our knowledge.
- Beta is calculated by Formula Growth Ltd. using the Bloomberg system and is the trailing 6 months daily returns versus the S&P 500 unadjusted (raw).
- Exposure represents the market value of all equity securities and single-equity-backed instruments (i.e. derivatives) as of the date of this statement. Exposure numbers exclude currency hedges.
- Sector and industry classifications are determined by Formula Growth Ltd. using available sources such as Bloomberg. Exposures based on these figures should be considered as approximations and are calculated to the best of our knowledge.
- Market Capitalization represents the relative market capitalization of long and short positions on a U.S. dollar adjusted basis using available sources such as Bloomberg. Exposures based on these figures should be considered as approximations and are calculated to the best of our knowledge.
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- Performance estimates are presented only as of the date referenced above and may have changed materially since such date.
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