

# Formula Growth Alpha Fund

## Third Quarter 2019 Investment Results

### Highlights:

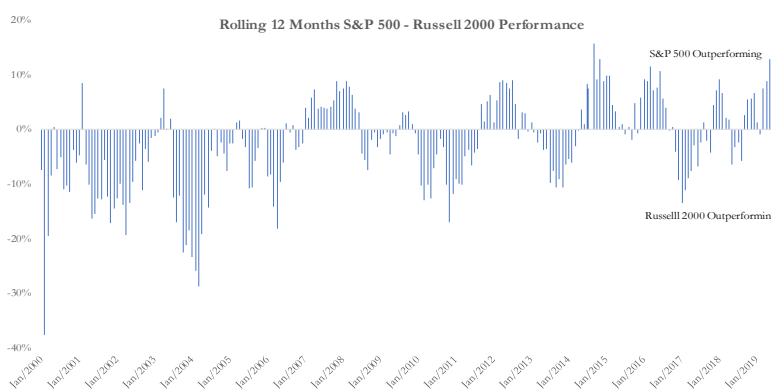
- ◆ During the third quarter of 2019, the FG Alpha Fund had a net return of US\$ 1.8% while the total return of the S&P 500, the Russell 2000 and the HFRI EMN was US\$ 1.7%, US\$ -2.4%, and US\$ 2.5% respectively;
- ◆ The FG Alpha Fund has generated a net return of +6.0% YTD in 2019 despite an average net short exposure to the strong equity market;
- ◆ The U.S. economy faces several binary and highly unpredictable risks and we maintain a defensive positioning entering Q4;
- ◆ The strategy has a compounded annualized net return of US\$ +7.2% since inception with a very low correlation to equities (daily correlation of 0.2 with the S&P500 TR since inception in 2012).

Dear Investors,

The third quarter began on a high note for the U.S. equity markets with the S&P 500 reaching a new all-time high and the Federal Reserve lowering US interest rates for the first time since the 2008 financial crisis. Then, in August, the equity markets suffered as President Trump surprised investors with a 10% tariff on \$300 billion of Chinese imports. In retaliation, on August 23rd, China threatened to impose additional tariffs on \$75 billion of American goods, including soybeans, cars and oil. Finally in September constructive trade war headlines led the equity markets to rally back ending the quarter more or less flat.

The trade war continues to play a prominent role and is currently the key driver of the economy and markets. Further tariffs are due to come into place by the end of the year although it now seems recent discussions between the US and China are progressing. Failure to prevent further tariffs could hurt the global economy and accelerate the growth slowdown in the United States. The Federal Reserve has cut interest rates in July and September trying to extend the economic expansion. While the U.S. economy continues to add jobs, growth is slowing and consumer confidence has declined from elevated levels. September saw the ISM Manufacturing index fall to 47.8%, its lowest level in over ten years, confirming that both the Manufacturing and Agriculture sectors of the U.S. economy are now in a recession. The U.S. consumer on the other hand, accounting for more than two-thirds of U.S. economic activity, is doing well driven by a strong labor market and the lowest unemployment rate in nearly 50 years. Anxiety over the economy, fueled by the media's fixation on recession as well as the impeachment inquiry, are increasing the chances of a Fed rate cut in October. That being said, even with an interest rate cut this month and possibly again on December 11th, uncertainty over U.S./China trade still remains, keeping our positioning cautious.

Yet again this year, smaller cap stocks have been hit harder adding to doubts about strength in the domestic economy. As Formula Growth invests primarily in U.S. SMid equities, the Russell 2000 is our primary investment universe. We continue to see the performance gap widen between small and large caps, despite small caps generally being less exposed to overseas trade wars and the impact of a stronger USD. This divergence between large cap and small cap performance has reached a level that was only seen once before in the last 20 years as observed in the chart below: over the past 12 months the S&P 500 is up +4.3% while the Russell 2000 is down -8.9%, a significant differential of 13.2%. Historically, periods of underperformance experienced by the Russell 2000 have tended to reverse.



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Our investment process remains fundamental bottom up. Since the beginning of the summer, our many meetings with company management teams have led to few long positions with enough upside to justify investment. This, in combination with a large number of overvalued short ideas facing potential downside, has resulted in the portfolio becoming positioned defensively. Over the past few months we owned a larger than usual number of stocks trading at very low valuations (long GARP / value-oriented stocks) and we were short stocks trading at very expensive multiples (short momentum). This positioning was a head wind for our portfolios throughout most of this year as the U.S. equity markets pushed to new highs on the back of the leading most expensive stocks while positive investment flows limited gains on some of our short positions.

This bottom-up positioning however paid off in September. Aside from our positioning, we also had stock specific news that worked in our favor in the month helping our performance. In some cases, we believe there is still room for individual stocks to move closer to our fundamental price targets, while in other cases, we are harvesting gains and reallocating to new opportunities.

### Fund Positioning & Attribution

In Q3, the strategy had a strong performance from the short side with several solid winners as the combination of high valuation and disappointing results delivered sharp price corrections. Our alpha shorts contributed +3.0% while our alpha long positions and portfolio hedges detracted -0.9% and -0.2% respectively. Sectors contributing the most for the quarter were industrials (especially building materials with housing performing well), consumer discretionary and communication services while materials, health care and energy were the largest detractors.

Recent company management meetings are confirming a slowdown in corporate America. U.S. corporate profit margins are compressing and earnings forecasts have fallen since the beginning of the year. While most investors are aware that this is happening, many believe that rate cuts should be enough to revive the equity market. With interest rates already at low levels, we are questioning how much of an impact further rate cuts could have. Our portfolio exposure remains conservative entering Q4. Our research process will continue to probe corporate management teams while keeping an eye on macro events and adjust the portfolio dynamically if warranted.

### Outlook

The U.S. economy faces several binary and highly unpredictable risks: the late October Fed meeting, growth slowing, impeachment hearings on President Trump, the 2020 elections approaching, etc. The US-China trade tension is currently the main source of concern weighing on U.S. growth. Corporate America is firmly in the late-cycle phase and risks of an approaching recession are growing. We think global economic momentum has likely peaked and that trade-policy friction is negatively influencing corporate confidence. We expect this Q3 EPS reporting season to see a greater influence from the weak macro backdrop, and thus higher volatility in the coming months. The opportunity set for stock picking on both the long and short side of the portfolio is compelling.

For more information regarding our firm and products, please visit our website at [www.formulagrowth.com](http://www.formulagrowth.com).

On behalf of the team at Formula Growth, please allow us to take this opportunity to sincerely thank you for your continued support.

Formula Growth Limited

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**Formula Growth Alpha Fund**  
**Class F (US\$) Monthly and Year-To-Date Net Returns (US\$ Returns)**

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2019	5.6%	0.7%	(1.1%)	0.7%	(1.6%)	(0.1%)	(1.7%)	(0.7%)	4.3%				6.0%
2018	(1.3%)	1.0%	1.2%	2.1%	(0.2%)	(0.1%)	(0.8%)	(1.4%)	(1.3%)	(0.5%)	0.1%	(3.0%)	(4.1%)
2017	1.0%	(0.4%)	1.3%	(0.6%)	1.7%	1.3%	(0.2%)	0.7%	1.1%	(0.9%)	(2.0%)	0.8%	3.9%
2016	(5.4%)	1.4%	5.2%	0.2%	0.7%	(0.6%)	1.3%	1.8%	2.4%	0.0%	(0.8%)	2.2%	8.4%
2015	0.1%	2.5%	1.4%	2.3%	1.0%	(0.7%)	(1.1%)	1.4%	(1.3%)	0.6%	1.2%	(0.4%)	7.1%
2014	1.6%	2.2%	1.4%	1.4%	3.4%	0.0%	(1.3%)	1.1%	(1.2%)	(4.4%)	(1.2%)	0.0%	2.7%
2013	1.1%	(1.1%)	0.8%	(0.8%)	2.1%	1.1%	1.8%	1.1%	1.5%	4.6%	(0.9%)	0.3%	11.9%
2012	7.0%	6.6%	0.9%	(1.6%)	(1.5%)	(1.8%)	0.1%	0.7%	1.4%	0.9%	2.2%	5.5%	21.9%

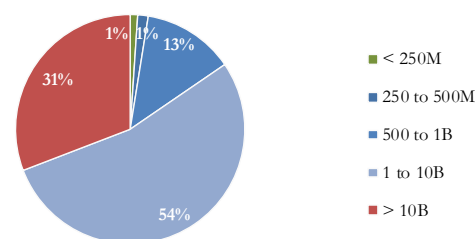
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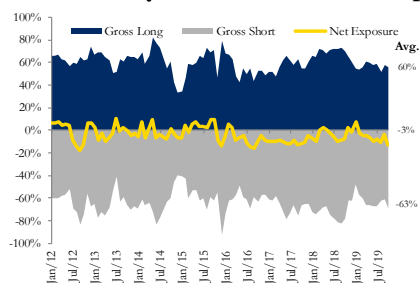
### Market and Beta Exposure

	Jun-30	Q3 Avg.	Sep-30	2019 Avg.
Gross Long	58.9%	54.9%	56.2%	55.4%
Gross Short	(66.9%)	(62.2%)	(69.4%)	(61.6%)
Net	(8.0%)	(7.3%)	(13.2%)	(6.2%)
Total Gross	125.8%	117.1%	125.7%	117.0%
Net Beta	0.06	0.09	0.04	0.00

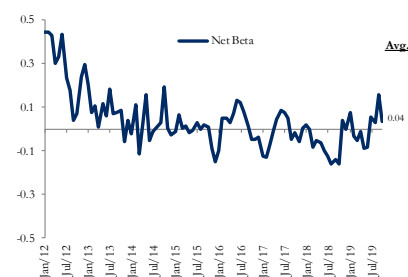
### Market Capitalization Exposure Breakdown



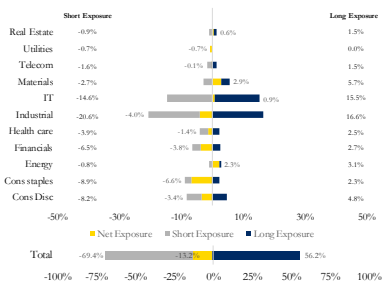
### Portfolio Neutrality in Terms of Dollar Exposure



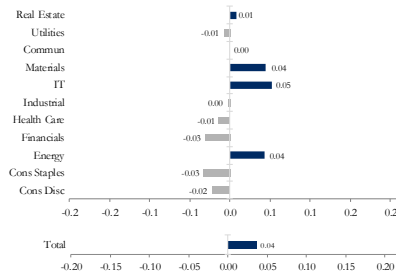
### Portfolio Neutrality in Terms of Beta Exposure



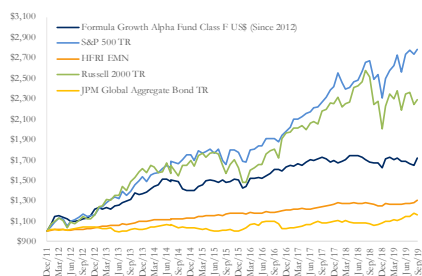
### Sector Neutrality in Terms of Dollar Exposure



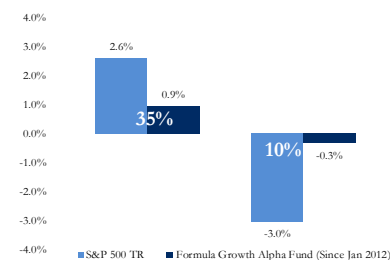
### Sector Neutrality in Terms of Beta Exposure



### Cumulative Return vs Peers, Stocks and Bonds



### Participation in Market Upside & Downside



Graphs above are either as at September 30th 2019 or since inception of the strategy. Please see Notes & Disclaimers on page 5. Do not hesitate to contact us should you have any questions.

- ◆ Alpha longs: An investment strategy which involves taking long positions in stocks that are expected (in the opinion of the managers) to increase in value by more than 30% over approximately 12 to 18 months.
- ◆ Alpha shorts: An investment strategy which involves taking short positions in stocks that are expected (in the opinion of the managers) to decrease in value by more than 20% over approximately 12 to 18 months.
- ◆ Short positions: The sale of a borrowed security, with the expectation that the stock/security will fall in value and the re-purchase will result in a positive investment result.
- ◆ Pair trades: An investment strategy whereby an initial investment is made in a stock/security either long or short with a corresponding direct offset, or hedge, against the primary risk of the initial investment.
- ◆ Hedges: Hedging is the practice of taking a position in one market or stock/security to offset and balance against the risk adopted by assuming a position in a contrary or opposing market or stock/security.
- ◆ Correlation: Correlation in the investment industry is a statistic that measures the degree to which two securities move in relation to each other. Correlation is computed into what is known as the correlation coefficient, which has a value that must fall between -1 and 1. A perfect, positive correlation means that the correlation coefficient is exactly 1. This implies that as one security moves, either up or down, the other security moves in lockstep, in the same direction. A perfect, negative correlation of -1 means that two assets move in opposite directions, while a zero correlation implies no relationship at all.
- ◆ Sharpe ratio: The ratio measures the excess return (or risk premium) per unit of deviation in an investment asset or a trading strategy, typically referred to as risk.
- ◆ Batting average: Number of positions on which we have a positive return divided by the total number of positions we held during the period.
- ◆ Slugging average: Average contribution of positions on which we have a positive return divided by the average contribution of positions on which we have a negative return for the period.
- ◆ Upside/Downside Capture: Upside market participation since inception is calculated as the average performance of the fund when the benchmark has a positive month while the downside market participation is calculated as the average performance of the fund when the benchmark has a negative month.
- ◆ HFRI Equity Market Neutral Index: The HFRI Equity Market Neutral Index consists of funds with net equity market exposure no greater than 10% long or short on average and it is denominated in U.S. dollar. Chicago-based Hedge Fund Research Inc. is a global leader in the creation of indexation and analysis of hedge funds.
- ◆ JPM Aggregate Global Bond Index: The JPM GABI consists of the JPM GABI US, a U.S. dollar denominated, investment-grade index spanning asset classes from developed to emerging markets, and the JPM GABI extends the U.S. index to also include multi-currency, investment-grade instruments. JP Morgan is a global financial services bank.

- ◆ Performance figures reported from January 1st 2014 onwards represent the US\$ net performance of the Formula Growth Alpha Fund (the "Fund") after all fees and other Fund expenses. Prior returns represent the US\$ net performance of the Formula Growth Alpha II L.P. and are based on an investment in the Fund made on January 1, 2012, the date of the Strategy's inception. The Formula Growth Alpha II L.P. was launched in May 2011. In January 2012, significant changes were made to the risk management and portfolio management guidelines. As risk management and portfolio management guidelines established in January 2012 are relevant only to the current strategy of the Formula Growth Alpha Fund, the statistics do not include the 2011 performance figures which are available upon request. In January 2014, the Formula Growth Alpha II Fund structure was changed from a Canadian Limited Partnership to a Canadian Mutual Fund Trust and the name of the fund was changed to the Formula Growth Alpha Fund.
- ◆ Gross portfolio returns discussed 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.
- ◆ All performance figures contained herein are unaudited estimates and subject to change. Certain information contained herein may have been provided by third party sources including Bloomberg, and, although believed to be reliable, has not been independently verified and cannot be guaranteed. Performance estimates are presented only as of the date referenced above and may have changed materially since such date.
- ◆ Market index information shown herein, such as that of the S&P 500 TR, Russell 2000 TR, JPM GABI and HFRI EMN Indices, are included to show relative market performance for the periods indicated and not as standards of comparison, since these are unmanaged, broadly-based indices which differ in numerous respects from the portfolio composition of the Fund. Market index information was compiled from sources that Formula Growth believes to be reliable. No representation or guarantee is made hereby with respect to the accuracy or completeness of such data. The current month's HFRI EH: EMN return is that of the HFRX EH: EMN which is used as a proxy for the HFRI. For more information regarding the indices, please consult <https://www.hedgefundresearch.com>.
- ◆ The analyses, opinions, and conclusions of Formula Growth contained in this report include certain statements, assumptions, estimates and projections that reflect various assumptions by Formula Growth concerning anticipated results that are inherently subject to significant economic, competitive, and other uncertainties and contingencies and have been included solely for illustrative purposes. No representations, express or implied, are made as to the accuracy or completeness of such statements, assumptions, estimates or projections or with respect to any other materials herein.
- ◆ Performance attribution figures and returns for individual securities, including ETFs, 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/allocation. Performance attributions should be considered approximations calculated to the best of our knowledge.
- ◆ Individual securities selected for discussions are not meant as a complete attribution of portfolio returns. The Manager can be contacted for more complete attribution.

- ◆ 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 letter/report. 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 include ETFs and should be considered as approximations calculated to the best of our knowledge.
- ◆ Market Capitalization represents the relative market capitalization of long and short positions on a United States dollar adjusted basis using available sources such as Bloomberg. Exposures based on these figures do not include ETFs and should be considered as approximations calculated to the best of our knowledge.
- ◆ Formula Growth Ltd. serves as the investment manager for the Fund. Investors should consult the Offering Memorandum (the "Memoranda"), which is available upon request, for more information on the investment strategy, complete disclosures and the terms and conditions relating to an investment in each Fund.
- ◆ Any investment in the Fund is speculative and involves substantial risk, including the risk of losing all or substantially all of such investment. No representation is made that the Fund will or is likely to achieve their objectives, that any investor will or is likely to achieve results comparable to the estimated performance shown, will make any profit at all or will be able to avoid incurring substantial losses. Past performance is not necessarily indicative of future results.
- ◆ The Fund has monthly liquidity provisions for redemptions and subscriptions. There is no secondary market for the interests in the Fund and none is expected to develop. There are restrictions on transferring interests in the Fund. Formula Growth Ltd. has total trading authority of assets within the Formula Growth Alpha Fund.
- ◆ The Fund's fees and expenses may offset its trading profits. The fact that Formula Growth Ltd. is eligible to receive an incentive fee or allocation may create an incentive to make investments on behalf of the Fund that are riskier or more speculative than would be the case in the absence of such priority allocation of profits.
- ◆ The Fund may be denominated in a currency that is not the currency of your own jurisdiction and thus may be subject to any fluctuation in exchange rates between your investment in the Fund and the currency of your own jurisdiction. Such fluctuations may have an adverse effect on the value, price or income return of your investment.
- ◆ The Fund is subject to conflicts of interest. Please review the "Risk Factors" and "Conflicts of Interest" sections in the Memoranda.
- ◆ This document is intended only for the person to whom it has been delivered by Formula Growth Ltd. This document is provided for informational purposes only, may not contain certain material information about the Fund, and is not an offer to sell or a solicitation of an offer to buy any interest or shares in the Fund. Any investment decision in connection with the Funds should be made based on the information contained in the Memoranda. This document is the property of Formula Growth Ltd., is strictly confidential and may not be reproduced or redistributed nor may any of its contents be disclosed to any other person under any circumstances. This document is not intended to be, nor should it be construed as, financial, legal, tax, accounting or investment advice or recommendations.