GMP Investment Management
Maximizing Return, Minimizing Risk

GMP Diversified Alpha Fund

Monthly Market Commentary January 2012

The Diversified Alpha Master Fund had a strong month of performance in January, up 2.02%.

We started the month with a strong "risk on" bias within the Fund. Continuing the trend started in December 2011, the Fund deployed more of the cash that we had been holding for the previous six months. Our quantitative models, which analyze risk and return probabilities, directed the Fund to increase its market exposure at this point in the deleveraging cycle. This change was fueled in part by continued strong earnings growth for S&P 500 companies and a decrease in market volatility. As of January 30th, S&P 500 earnings growth stood at 8.26% on the back of revenue growth of 8.8%. That strong top and bottom line growth was kept in check by increased analyst expectations as only 60% of companies beat expectations versus 68% for the last three quarters of 2011. The index which tracks the U.S. leading economic indicators rose during the month. In spite of improved economic data, inflation remains low, thereby providing the U.S. Federal Reserve ample room to leave rates low for a prolonged period of time. On January 25, the Fed declared that inflation will run at or below the levels consistent with the committee's dual mandate of fostering price stability and maximum employment. Most Western economies are facing two key problems, surplus labour as manufacturing jobs move to less developed markets and too much government debt. This leaves monetary policy as the only tool available to public policy makers. In a typical deleveraging cycle, this results in periods of asset inflation followed by periods of correction. We believe that we are in a period of asset inflation.

This backdrop was favorable for equities and we achieved strong performance in our Equity strategy for the month. Given the current risk reward scenario, additional capital was allocated to the Equity strategy. The Fund made positive gains in our technology and energy stock exposure. Despite losses in some Canadian energy names, which seemed to lag the market, the Equity book saw strong performance in the pro-cyclical Aggressive book. Large gains in Crocs, Banro, Apple, Freeport MacMoran, Crew Energy and Timken more than made up for the losses seen in Athabasca Oil Sands and Peyto. Our Defensive strategy generated positive performance, helped by the rebound in its large gold position. The Catalyst book saw a small gain as strong performance in Walter Coal and Legacy Oil+Gas was largely offset by a loss in Celtic. Despite profitable pairs in gold, technology and energy, the Pairs strategy suffered a modest loss on the month. Gains in the Strategic book were driven by gains on Kobo and API Technologies. As expected in a strong month, the Short strategy incurred a modest loss.

The Credit Strategy also generated strong performance in January. As the U.S. high yield market rallied, yields continued to fall from a recent high of 9.00% yield to worst (YTW) at the end of November. For the month, the HY market average YTW declined an additional 73bp. With the high yield index trading at approximately 7.5%, we have elected to significantly reduce risk from the long side in the HY bond portion of the Credit strategy. There was a strong bid in the market for Canadian ABCP as non-Canadian investors entered the market aggressively in the month. At this point in the market, the Canadian ABCP continues to provide a much superior risk adjusted return against all other credit products.

The month was also favorable for our Quantitative strategy. Gold, S&P/TSX and silver tactical trading strategies generated positive performance. Although the Fund is “risk on” relative to where it has been positioned for the last nine months, we continue to monitor and manage risk dynamically. We will reallocate capital and apply appropriate risk mitigating techniques in order to protect capital and manage volatility when appropriate.

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