GMP Investment Management
Maximizing Return, Minimizing Risk

GMP Diversified Alpha Fund

Monthly Market Commentary May 2012

For May 2012, the Diversified Alpha Master Fund (the "Fund") generated a negative return of 0.95% (preliminary), net of fees and expenses. Based on the preliminary result for May, for the first five months of 2012, the Fund has generated a positive return of 2.25%, net of fees and expenses. In May, the Fund achieved strong relative performance versus the major equity indices, which saw the S&P500 down 6.27% and the S&PTSX down 6.19%, as we were focused primarily on capital preservation and volatility management.

The index puts that we added at the end of April, as well as the capital allocation change that we made at the time effectively reduced the overall risk posture of the Fund as we moved into May. This allocation change was based on increasing stress in Europe, a divergence in the strength of data relating to U.S. economy, and the relatively low level of implied volatility in U.S. equity indices. This provided a relatively inexpensive entry point to buy insurance for the portfolio. In addition, the Fund's risk exposure was also modified prior to May such that our equity strategy was closer to a market neutral position and our exposure to single name Canadian equities had been reduced.

Once again, the markets were affected by the news emanating from Europe. The will of the people in Europe spoke loudly during the month with the ouster of Sarkozy in France and the election victory of Hollande. With Hollande's arrival, the turmoil in Europe continued and the global capital markets suffered losses. During the third week of the month, the Eurozone Working Group held a teleconference in which officials "agreed to prepare for individual contingency plans if and when Greece exits" from the Euro. This is troubling, particularly when you consider that the individual countries in Europe are effectively powerless, as they continue to share the same currency. In addition to geopolitical and economic headwinds, markets had to absorb large JP Morgan trading losses and the poor execution of the most hyped IPO in years for Facebook. In light of the above, the backdrop for the month can be summarized as challenging.

The impact of the above issues on the global equity markets has been significant; however, not outside of the norms in a deleveraging environment. The likes of Greece, Spain, Italy, Russia, Brazil and even Canada have seen substantial market corrections. **As the Financial Times reports, Euro area banking stocks are actually lower now than they were at the panic troughs after Lehman collapsed nearly four years ago**. The S&P 500 has given up two-thirds of its 2012 gains and is now below its level of a year ago. As this equity market volatility continued, U.S. Treasuries strengthened with the 10-year note yield decreasing to its lowest level in 60 years, equaling the level seen last September when equity market volatility peaked.

Data from the U.S. economy continues to look "stable" with slow growth emerging. At the same time, home prices were up 1.8% in March in the U.S. and new home sales rose 3.3% in April to 343,000 units. The recent Chinese data continues to suggest a slowdown and most European countries (except Germany) are either in or on the verge of recession. Not surprisingly, this picture hammered commodities during May as precious metals hit their respective year to date lows while oil fell through $90 a barrel, down from $110/bbl in March.

While we entered the month hedged, we capitalized on the strong selloff mid-month to add a "risk reversal" position. This allowed us to add index option positions to the portfolio that, in turn, positioned the Fund for the last 10 days of the month with the ability to capitalize on a late month market rally. This was a cost effective way for our unit holders to participate in a late month rally in the event that it occurred. Ultimately, the headline news from Europe prevented any rally from taking place.

Canadian ABCP was the big gainer within the Credit strategy as we effectively traded throughout the various lines of the MAV III tracking notes. The top part of the ABCP structure (the A1's and A2's) were down slightly in May as that part of the structure followed the trend in the credit markets albeit to a much smaller extent. Meanwhile our ABCP hedges all had gains. The high yield credit market was affected by the risk off trade as spreads pushed wider resulting in the market being down 1.2%, the worst monthly performance since November 2011.

The Equity strategy suffered a small overall loss. However, our Put strategy, Tactical and Macro books all generated positive performance in the month. Our Macro strategy made gains as we effectively traded ETFs within that strategy. As expected we lost the premium that we paid for call options on the S&P. However, we still believe that call options offer the best way to partially participate in the sharp rallies that usually accompany these types of markets.

Our risk models continued to be more negative throughout the month. With this in mind, we were diligent and reduced our risk to levels not seen since last November. As we head into June, most of our capital is deployed in either Special Credit Situations or Relative Value Trades. The Fund has less than 10% outright exposure to Equity Markets. We believe this allocation is prudent given that the market is being driven more by government policy than fundamentals.

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