The Delbrook Perspective

October 2016

October Fund Performance & Market Commentary

The Delbrook Resource Opportunities Fund posted a -1.4% return in October, versus benchmarks losses of -3.4% and a -4.1% return for the S&P Metals and Mining ETF. This brings the Fund's compound annual return since inception to +22.0% vs. a benchmark return of -5.0%.

The Fund's October performance benefited from defensive asset allocation. Given the market's overall lack of conviction, characterized by each rally and pullback being short lived and highly reactive to the next piece on information from US pollsters or CNN headlines, resisting the urge to chase after short-term momentum trades was crucially important. As such, we continue to insist that our investment decisions are supported by fundamental analysis.

	Oct-16	YTD	Inception
Delbrook Resource Fund	-1.4%	130.1%	74.1%
<u>Indices</u>			
S&P TSX Materials Index	-1.0%	47.2%	13.1%
S&P TSX Energy Index	0.8%	24.5%	-12.0%
S&P TSX Venture Index	-3.4%	47.0%	-13.2%
S&P TSX Global Mining Index	-0.5%	45.8%	-5.9%
S&P Metals & Mining ETF	-4.1%	69.1%	-34.9%
CBOE VIX Index	-1.0%	-6.3%	6.4%
<u>Commodities</u>			
Bloomberg Commodity Index	-0.5%	8.1%	-32.8%
Gold - (US$) Spot	-2.9%	20.4%	2.9%
Silver - (US$) Spot	-6.6%	29.3%	-10.4%
WTI Crude - (US$) Nov 16	-4.0%	26.5%	-43.3%

Therefore, while asset allocation certainly supported the Fund's returns in October, the strong performance of our short positions had an even greater impact on our results.

Going into November, the Fund took a defensive stance and closed out the majority its short positions. Overall, portfolio exposure heading into the US presidential election was relatively neutral, which helped the Fund perform ahead of benchmarks. In our opinion, the immediate spike in bond yields and strength of the US dollar in reaction to Trump's victory looks extended and should moderate. The market fundamentals haven't changed in our view: global growth is slow, yields are still well below historic levels, and geopolitical uncertainty have all become the new norm.

Although we have profited from the run up in base and bulk commodity prices on the back of a Trump win, we believe the market is irrationally exuberant in bidding up prices (such as copper up 22%) in anticipation of *Trumponomics*. It is our belief that the tail wind, which has existed for resource sector for most of 2016, has moderated, and that further short-term gains will be more reliant on security selection than simply asset allocation to the sector. This is great news for active managers who should be able to outperform materially versus those allocating capital to the sector in an ad hoc or passive manner.

Earning Season and Resource Stocks

Heading into the quarterly earnings season, expectations were too high in many cases, likely on account of the optimism that can creep into estimates when commodity prices strengthen. Consensus was fairly accurate on the revenue line (65% of companies beat or met expectations), but lackluster on costs, leading to cash flow misses. Equities, which have had a great run as of late, have generally responded negatively, playing into our thesis that investor patience is short and most are happy to harvest year-to-date returns. With this said, we are content with the asset allocation decisions we have made, specifically raising cash levels to take advantage of opportunities as they appear.

Consolidation: A key thesis going forward

We see sector consolidation as a necessity. It promotes economies of scale, the diversification of risk, stronger capital structures, and perhaps most importantly, it gives investors the opportunity to get behind experienced management teams. Placing quality assets into the care of quality management teams is essential for value creation. Therefore, where it benefits our unitholders, we will continue to act as agents of change to advance this agenda. Look for us to expand more on this topic in the coming months.

A Slower End to 2016

With third quarter reporting behind us, fundamental resource sector news flow is expected to be slow for the rest of the year. With third quarter reporting behind us, the key event on the horizon is the announcement of a rate increase by the Federal Reserve on December 14th. With the increase already priced into the market, we believe the head wind in the precious metals space will moderate and provide an opportunity to add positions at significant discounts to intrinsic value. We continue to see a strong case for exposure to hard assets as a necessary component of diversification in such an environment. The political uncertainty worldwide further supports this claim.

Offshore Fund Launched

Finally, we are happy to announce the launch of Delbrook Resource Opportunities, Ltd., an offshore investment corporation intended to invest alongside our domestic resource fund. We hope to have this vehicle setup and deploying capital in early 2017.

As always, please contact our office at 604.229.1450 with any questions