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So, about that volatility that was never going to come back?

During the first three months of 2018 the average daily move in the S&P 500 index, up or down, was 80 basis points ("bps"). To add a bit of perspective to this number, that same figure for the preceding quarter was 20bps. On average, that is a four-fold pick up in daily volatility. Said another way, a day that saw the market fall by three quarters of a percent was considered a quiet day by the new standards of volatility.

The choppiness was punctuated by four of the S&P 500's twenty largest daily point losses ever, with one of the largest daily point gains thrown in for good measure. Now those figures don't mean all that much without context but they certainly made for some jarring headlines, particularly given the Soma-esque tranquility enjoyed for much of the last half decade or so.

Perhaps we're being a tad greedy, but the Dark Horse didn't hold up quite as well during the quarter as we would have hoped. While our results certainly outpaced our Canadian benchmark, we were disappointed in how poorly a handful of our long positions performed. While aggressive and indiscriminate selling played a role in this dynamic, we were more meaningfully impacted by company-specific disappointments that couldn't entirely be pinned on Mr. Market. The few hits we took in our long book were offset by great performance from the short book, the benefit from our equity hedges and a couple of decent wins in the long book.

Most of these laggards from our long book were securities that we had begun trimming or were approaching prices where we would have targeted exiting. Clearly we were not as decisive in our actions as we should have been in retrospect. We have since been more forceful in our efforts to clean up some of the fund's lesser lights in anticipation of much better opportunities to come. Whether those opportunities are currently being presented to us or if even more exciting opportunities await is the subject of this quarter's letter.

At a Crossroads: The Return of Mayor Ford and what that may mean for markets.

There was a time that Toronto's late Mayor Rob Ford was a fairly constant presence in these letters. More than once, we used his overindulgences as a metaphor for the excesses we were seeing in the Canadian capital markets. We were certainly early in that call for caution regarding market valuation. Compared to the blockchain and weed-fueled benders of recent times, the markets of Mr. Ford's hard partying days[1] seem like quaint church picnics.

Earlier this week, Mr. Ford's name was brought back into the news cycle and – with that – back into our narrative. Not surprisingly, *Run this Town*, a movie about the Mayor's tumultuous life in office is currently being shot in Toronto. What is surprising is that the actor cast as the Patron Saint of Ford Nation is Damian Lewis.

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[1] Would you believe the first reports of the crack smoking video were five years ago?

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Best we illustrate this visually:

This guy….

is playing this guy.

Here we have a dashing and refined leading man masquerading as, not to speak ill of the dead, something slightly less so. Clearly the esthetic transformation will be something of a challenge. The bigger test, however, could be getting a classically trained Englishman to authentically pronounce the word "Toronto" as a one-syllable word[2].

For much of the Dark Horse's now 9 plus years of operation, the markets have done the opposite of what *Run this Town*'s casting director has done. Instead of hiding something handsome and talented behind a few prosthetic chins and a gaudy NFL logoed tie, the stock market has done the contrary – showcasing the mediocre as the fabulous.

Great businesses were priced beyond perfection, good businesses were priced as great businesses and steaming pieces of garbage were promoted as growth by acquisition stories. For investors like us, it became increasingly difficult to find any value beyond a small roster of highly nuanced, complicated and underfollowed names. That list seemed to shrink by the day as such companies

[2] As it should be. "tor-AWN-toh" is for Americans. "Turonno" is for Canadian newscasters. Something akin to "Traw" or "Tron" is reserved for true locals, as in "Tron's gonna beat the Bruins in 7".

were picked off (i.e. taken private) or eventually caught the eye of market buyers and invited to join the full-priced party.

Mr. Lewis' unorthodox role has us pining for what used to be in the aftermath of the 2008 credit crisis. Those brave enough to deploy capital during the darkest days were able to acquire the most wonderful of companies at prices usually reserved for failing enterprises. It was an *all you can eat* buffet of once in a lifetime opportunities, with far more egregious examples of hidden quality than having *Sgt. Brody* play Doug's little brother. That era was akin to having one of the Helmsworths pretend to be Grimace, Kate Upton as Steve Bannon or (apropos for playoff season) Mike Fisher playing Mike Ricci.

Those investors who lacked the liquidity or fortitude to go all-in during the depths of 2008 and early 2009 were still afforded wonderful values in the following few years, particularly outside of the large cap space. Some of the bargains we received in the first few years of the fund's existence would be unfathomable by today's valuation standards.

The sudden and extreme volatility we've seen emerge in the last couple of months may have created a *crack* in time and space, offering us at least a partial glimpse back into this world. While the impact to the overall indices has been muted (both the S&P 500 and S&P/TSX Composite currently sit approximately 6-7% off their respective highs), there are pockets of the market that have sold off substantially. Investors, for the first time in a long while, appear unsettled.

This has brought us to a bit of a crossroads. After a sustained period of underperformance by Canadian small-cap equities, exacerbated during the last couple months of intensified volatility, we are seeing numerous stocks bordering on being legitimately cheap. Not 2016's "12 times EBITDA isn't relatively crazy" cheap – legitimately cheap. Seeing such drastic drops in some stock prices has us wondering whether now is the time to take the bridle off the Dark Horse.

But what of the risks, both those obvious and not so?

Interest rates are ticking higher, credit terms are showing some signs of tightening and housing prices are starting to falter. A near decade's worth of accommodating tailwinds appear to be weakening. We are stock pickers, first and foremost, but need to be confident we are operating in an environment where stock picking actually matters (i.e. it's not just "everything up" or "everything down") before taking a more aggressive stance.

In addition, we simply can't ignore that bloated orange and ever-present abscess that seems to be everywhere. A man who somehow retains support and, even, popularity despite his undeniable wretchedness. In this new world where he and the vile he produces are revered, how can we have any faith that the old rules apply regarding absolutes such as right and wrong or truth and fiction? In the absence of these pillars how we can confidently expose any more of our investors' capital?

But, enough about Ed Sheeran.

Our working thesis is that better opportunities will be forthcoming, but they are not yet here in the sort of numbers that should get investors overly excited. While some stocks have fallen dramatically, we are far from a point of complete capitulation. There is certainly true absolute value on offer but not quite enough for us to rush headlong into meaningful higher net long exposure. The smattering volatility we have seen is likely just the first act, with more fireworks to follow.

Recent price action has provided a nostalgic reminder of what one was and, perhaps, what could be coming. In the meantime, our long book remains focused on situations with defined, near-term catalysts. These catalysts, once they happen, will be impossible to overlook no matter how deep in a *drunken stupor* the market may find itself.

We would be remiss in not sending our thoughts out to the Humboldt Broncos – the team, their families and all the rest of us who have felt the pain of this horrific tragedy. As parents (and as a hockey Dad, in particular), we can only imagine the loss and suffering of those in and around the Humboldt Broncos community.

Saskatoon native and Maple Leafs Head Coach Mike Babcock said it better than we ever could:

> *"You gottta embrace each and every day…and each and every day with your family, you better enjoy it".*

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Sincerely,

Anthony Hammill Lee Matheson

About Ewing Morris:

Ewing Morris & Co. Investment Partners Ltd. is a value driven Canadian investment firm established in September 2011 by John Ewing and Darcy Morris. Our aim is to achieve preservation and growth of capital for our limited partners by focusing on inefficient markets. We do this by relying on fundamental analysis, high conviction and the use of flexible capital. We manage equity and credit strategies with a focus on North American small-capitalization companies and high yield bonds. We manage investments for individuals as well as charitable organizations, institutions and corporations.

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