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INVESTMENT PARTNERS LTD.

August 1, 2016

Dear Friends and Partners,

As of July 31st, the Flexible Fixed Income Fund has returned 10.5%, net of fees, since inception. The Fund returned 2.2% in July. When we launched the Ewing Morris Flexible Fixed Income Fund LP on February 1st, 2016, the high yield bond market had a 10% yield. Since February, the market's yield has fallen to 6.85%, which means the price of bonds have increased over this time (bond prices rise when yields fall).

The decline in corporate bond yields reflects the perception among credit investors that companies are far safer today than they were six months ago. With the exception of energy companies, which benefit from oil's rebound, we do not think the world is meaningfully different today than it was six months ago. In the spring, we believed credit market valuations were cheap and offered a great opportunity, but the speed and extent of the ensuing rally has surprised us. A repeat performance of the past six months is highly unlikely in the second half of the year.

Despite the market rise, we continue to find attractive individual investment opportunities having purchased three of our five largest positions since May. We have realized gains in the resource sector while shifting the portfolio to more stable industries like consumer products and utilities. As of month-end, the Fund is 92% invested and carries a yield of 5.8%.

The case study of our recently exited investment in Precision Drilling illustrates our approach:

Following the chaos of early February when oil reached its lows of $26 per barrel, oil moved sharply upward in early March, which led to large price moves in energy services equities as shorts were covered and hopes of improved oilfield activity were rekindled.

Precision Drilling was no exception as its stock rallied 40%, retracing to levels last reached in October 2015. Its market capitalization was $1.8 billion which implied that equity markets did not doubt Precision's solvency.

On the other hand, Precision Drilling's 2021 bonds traded around 70 cents on the dollar - 15% lower than its levels in October of 2015 - which demonstrated concern on the part of creditors that Precision Drilling could ultimately go bankrupt. Debt investors and equity investors appeared to be at significant odds with each other regarding the future of the company.

The opportunity we capitalized on in March was our purchase of Precision's bonds at a very pessimistic level of 71.5 cents and, at the same time, we hedged the credit risk of the company by shorting the company's over-optimistically priced stock at $6.30.

This strategy is called "capital structure arbitrage" which is routinely practiced by very few in Canada. Ewing Morris is a specialist in this discipline and we apply this skillset to the Flexible Fixed Income Fund. In capital structure arbitrage, equity hedges can be thought of as insurance against the prospect of bankruptcy.

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In the case that oil prices stayed low – we believed that the bonds at 71.5 cents were already priced on a bankruptcy "recovery value" basis and had very little left to fall. On the other hand, our work on the company's equity indicated that the stock hedge should be effective; if oil prices remained weak, it was highly likely that the stock would be dragged lower by the company's high debt load and a continuation of weakening field activity. It is for these reasons that we had confidence that our downside was limited and the position had great potential to produce strong risk-adjusted returns.

In the alternate case of higher oil prices, the equity hedge would have been a drag on returns, but we view the prospect of this loss on a hedge as acceptable since it eliminates a significant amount of risk.

In July, we sold the bonds at 92 cents - a near 30% return on a fixed income investment, while the stock was down about 5% despite an increase of more than 10% in the price of oil. Unlike other investment strategies which rely on events or themes that play out over quarters or years, it took only a few months for Precision's capital structure to come back into coherence. In this case, the insurance actually contributed to return while also reducing risk.

Case studies like this disprove the theory that greater risk is required to increase returns. In the yield-starved world in which we currently invest, it is this uncommon type of risk management that may be most effective to produce acceptable returns without bearing undue downside exposure.

Thank you for your investment in the Ewing Morris Flexible Fixed Income Fund LP.

Cordially,

Randy Steuart

Randy Steuart
Flexible Fixed Income Fund Portfolio Manager

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About Ewing Morris & Co. Investment Partners Ltd.:

Ewing Morris & Co. is a value driven Canadian boutique investment firm established in 2011. The Ewing Morris Flexible Fixed Income Fund LP invests in carefully selected, primarily high yield, fixed income securities while controlling risk through cross-capital structure hedging.

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