



# Ninepoint Alternative Health Fund

September 2022 Commentary

## Summary

In this month's commentary we review the implications of the Oct 6th announcement from US President Biden re-igniting investor interest with a cannabis executive branch catalyst. Related cannabis legislative discussions review the status of SAFE Banking and what the Mid Term elections may bring to both healthcare and cannabis sectors over the next Congressional Term. In addition, we analyze a policy announcement out of California proposing interstate commerce amongst legal US state cannabis markets. We also review how medical devices as a sector, although exhibiting strong fundamentals are being beaten down like consumer discretionary stocks, yet do not share the weakening trends that sector is witnessing. Finally, we also discuss the recent announcement from Canopy Growth (WEED) exiting the Canadian retail cannabis space, selling or closing all dispensary locations.

## September Commentary

The month of September witnessed continued equity market volatility as investors reflected on the hawkish tone delivered by US Fed Chair Powell and various Fed Presidents since the Jackson Hole meeting of late August. With the realization of a higher cost of capital and decreased consumer confidence, go to consumer discretionary names and tech related growth names are feeling pressure. We are still of the opinion that there are further rate increases to reduce the pressures of inflation that although have come back from its peak in the summer.

In this month's commentary we review the implications of the Oct 6th announcement from US President Biden re-igniting investor interest with a cannabis executive branch catalyst and reviewing the wider discussions around the mid-terms and when and if SAFE Banking gets passed. In addition, we analyze a policy announcement out of California proposing interstate commerce amongst legal US state cannabis markets. We also review how medical devices are exhibiting strong fundamentals yet suffering weakening trends similar to many consumer stocks. Finally, we also discuss the recent announcement from Canopy Growth (WEED) exiting the Canadian retail cannabis space.

As we have stated in previous commentaries, not all sectors should be treated the same nor should all companies within a sector be treated similarly. In addition, we need to manage based on the market we are in, rather than the market we want to be in. No longer can investors rely on buy and hold approaches. We are in a market where stock selection and analysis of the macro economic environment are key to investment decisions. As a result, we are being selective on where the Fund's capital is allocated. Our allocation to healthcare is stabilizing the portfolio, with the healthcare index -2.76% in September, outperforming the NASDAQ Composite -10.4% and SP 500 -9.3%. We continue to see stable growth in our healthcare and wellness names while the US Cannabis sector remains range bound subject to federal legislative changes. At the beginning of October, after the announcement from President Biden with respect to reviewing the scheduling of cannabis in the Controlled Substances Act (see below) the US cannabis sector rose almost 40% in two days.

## Investment Team

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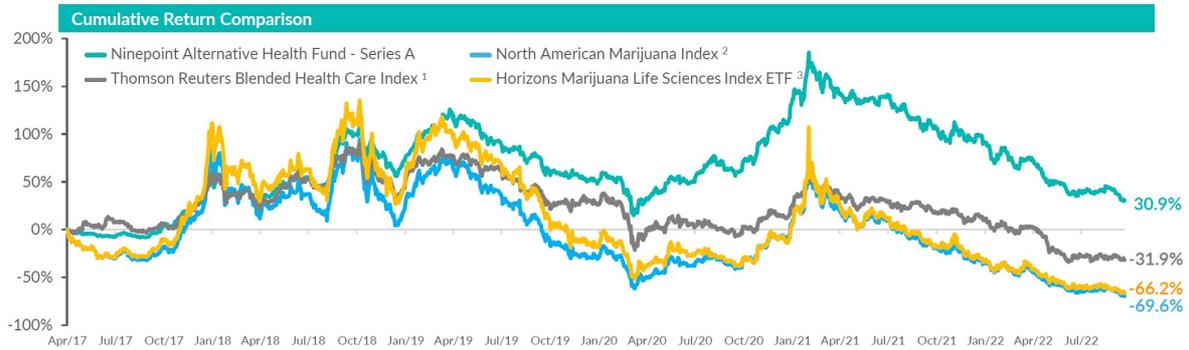
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Chief Financial Officer &  
Portfolio Manager, Faircourt  
Asset Management - Sub-Advisor

# Ninepoint Alternative Health Fund

Cumulative Returns (As at September 30, 2022)



Inception date: March 26, 2017. Chart shows period between April 11, 2017 and September 30, 2022

Period between April 11, 2017 and September 30, 2022	Annualized Return	Annualized Std Dev	Downside Deviation	Sharpe Ratio	Sortino Ratio	Max Drawdown
Ninepoint Alternative Health Fund - Series A	5.2%	27.4%	16.0%	0.16	0.32	-49.3%
Thomson Reuters Blended Health Care Index <sup>1</sup>	-6.9%	36.5%	21.7%	-0.21	-0.32	-58.7%
Horizons Marijuana Life Sciences Index ETF <sup>3</sup>	-18.4%	60.3%	33.4%	-0.32	-0.55	-84.6%
North American Marijuana Index <sup>2</sup>	-20.0%	54.9%	31.9%	-0.38	-0.63	-80.3%

Performance and fund statistics are based on daily observations.

Effective April 23, 2018, Ninepoint Partners became the Manager of Ninepoint Alternative Health Fund (formerly UIT Alternative Health Fund)

1. The index is 70% Thomson Reuters Canada Health Care Total Return Index and 30% Thomson Reuters United States Healthcare Total Return Index and is computed by Ninepoint Partners LP based on publicly available index information.

2. For illustrative purposes only. North American Marijuana Index is computed by Ninepoint Partners LP based on publicly available index information.

3. HMMJ (Horizons Marijuana Life Sciences Index ETF) is computed by Ninepoint Partners LP based on publicly available index information.

## US Federal Legislative Updates

### Mid Term Elections

The upcoming elections are too close to call (at date of writing) however we can suggest outcomes and related implications when it comes to cannabis and healthcare.

With respect to healthcare policy, Democrats would like to expand the Affordable Care Act, indirectly limiting the profitability for various players in the healthcare sector. Republicans are generally looking to limit expansion while ensuring they don't condone price gouging related to new medications. The recently passed Inflation Reduction Act increased federal oversight to impose price controls on prescription drugs that may have an impact on the pharmaceutical industry. It is estimated that the average cost related to a successful single drug being developed put the costs from laboratory to approval by the Food and Drug Administration at \$2.5 billion. Part of the cost has to do with the fact that almost 90% of drugs entering clinical trials do not make it to approval so returns on successful medications must pay for the R&D costs of those that don't pan out. The Bill just came into effect so it is too early to see how it will be rolled out, however in a Democrat controlled Congress, we could see reduced drug development and pressure from regulators.

With respect to cannabis, a midterm election result where the GOP (Republicans) controls the House would not be positive. It is hard for us to see how cannabis legalization passes in these circumstances. If our assessment is wrong and Democrats keep the House, Democrats will still need to control the Senate and then secure enough Republican votes to defeat a potential filibuster. Currently that means 10 Republican votes. A split between the House and Senate leaves opportunity to negotiate between the party leadership. A Democrat sweep with a resounding win in the Senate (though unlikely) would almost immediately lead to cannabis legislative action.

A GOP sweep likely causes challenges to attain swift passage for significant cannabis reforms as it would potentially mean the return of Sen. Mitch McConnell as majority leader. McConnell is one of the GOP's leading opponents of cannabis legalization.

## If Not SAFE Then What

There has been considerable conjecture about the passing of SAFE Banking in the US Senate over the past 2 years. It appears that Democrats have been their own worst enemies for any successful cannabis legislation as the demands for social equity hurt any opportunity for Republican votes towards SAFE. So, the question is, what happens if SAFE doesn't pass, where are other avenues for legislative change that assist the US cannabis industry.

## US Cannabis Stocks Are Like Coiled Springs

At 3pm Thursday October 6th, President Biden announced major changes from the White House with respect to cannabis. First, the President laid out Executive Orders and Pardons with respect to previous "simple marijuana possession" related incarceration. He is pardoning all prior federal offenses of simple marijuana possession. There are approximately 6,500 people who were previously convicted of simple possession in federal prisons who may be denied employment, housing, or educational opportunities. The pardon will remove this burden. The President then called on Governors to pardon simple state level marijuana possession offenses. This is where the number of people affected is significant and if we assume that Governors (in blue states only) support the initiative, the result will be a significant number of records being expunged.

The big news for investors and US MSO's (multi-state operators) was that the President directed Health & Human Services Secretary Becerra and Attorney General Garland to initiate a review of how marijuana is scheduled under federal law. Currently, marijuana is a Schedule I controlled substance, at the same level as heroin and at a higher level than fentanyl. We believe this announcement is an important development for US cannabis and could snowball into multiple industry tailwinds. The President's proposal opens the door for marijuana to be re-scheduled to a less restrictive classification, which we believe could be a significant catalyst. Re-scheduling gets cannabis unlocked from a funding standpoint; it becomes accessible for universities and labs to do research and removes a federal prohibition on foundations and other large institutions to support said research.

## Controlled Substances Act Schedules

Schedule	Definitions	Examples
Schedule I	High abuse potential with no accepted medical use; medications within this schedule may not be prescribed, dispensed, or administered	Heroin, marijuana, ecstasy, gamma hydroxybutyric acid (GHB)
Schedule II	High abuse potential with severe psychological or physical dependence; however, these medications have an accepted medical use and may be prescribed, dispensed, or administered	Morphine, codeine, hydrocodone, hydromorphone, methadone, oxycodone, fentanyl, methylphenidate, pentobarbital
Schedule III	Intermediate abuse potential (ie, less than Schedule II but more than Schedule IV medications)	Hydrocodone/acetaminophen 5 mg/500 mg or 10 mg/650 mg; codeine in combination with acetaminophen, aspirin, or ibuprofen; anabolic steroids; ketamine
Schedule IV	Abuse potential less than Schedule II but more than Schedule V medications	Propoxyphene, butorphanol, pentazocine, alprazolam, clonazepam, diazepam, midazolam, phenobarbital, pemoline, sibutramine
Schedule V	Medications with the least potential for abuse among the controlled substances	<i>Robitussin AC, Phenergan</i> with codeine

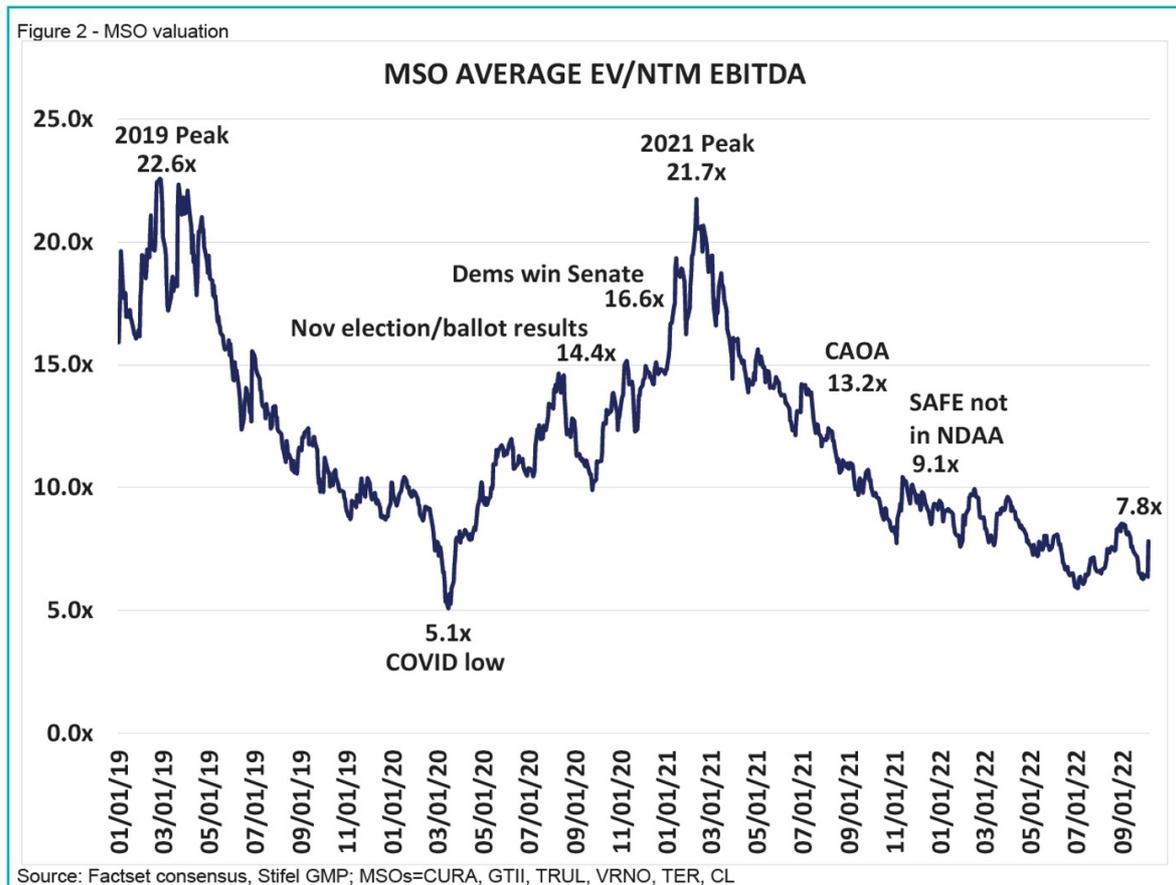
Source: DEA, Echelon Capital Markets

By requesting a review of scheduling, the President has the ability to either go around Congress or at least push it towards action as it debates what SAFE Banking provisions to pass. With this announcement, the President also provides cover to more progressive Democrats with expungement being a major social equity initiative and the launch of re-scheduling will reduce the risk related to plant touching. The result is that the White House makes it easier for SAFE to pass in the meantime during the re-scheduling process that could take time (1 yr + not months). That clears a path for banks to lend to state legal cannabis companies; it paves the way for institutional investors to participate in the sector and potentially allows for listings to take place for US multi-state operators. Downgrading cannabis to a Schedule III substance would be even more significant for US cannabis businesses. The impact would be substantial from a cash flow perspective as the onerous

levies related to IRS 280E taxation, (which only applies to groups that deal with Schedule 1 & 2 controlled substances) would be removed.

As we have stated previously, US cannabis companies are oversold to extremely discounted valuations. The chart below illustrates the valuation metrics at key times during Congressional debates over cannabis legislation since 2020. From peak expectations when the sector traded at 21x EV/EBITDA to recent valuations on average where US cannabis stocks traded at 8x. The announcement from the President illustrates what can happen with a significant legislative catalyst. On the news, the leading US MSO's were up 35-40% over two trading days.

## US MSO Valuation Metrics



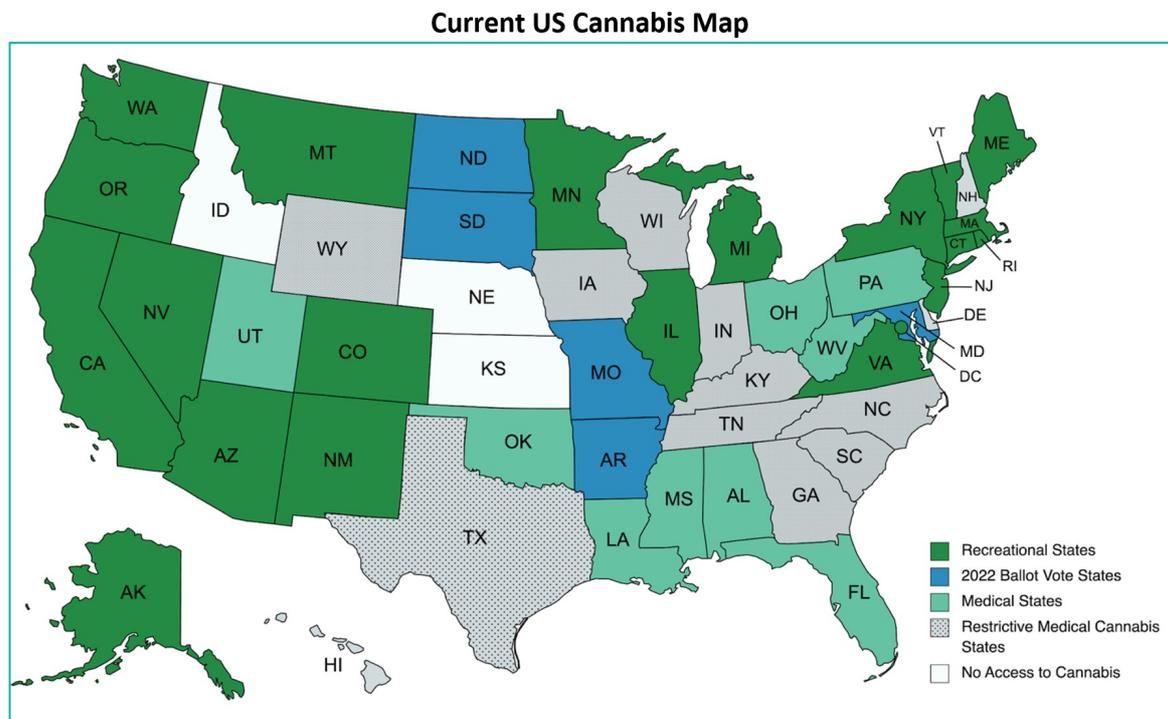
While this is a significant and exciting announcement for the sector, we caution investors that this is the beginning of a process that will take months or possibly several years. We believe the important impacts of this announcement near term for the sector are **i**) it brings the debate and negotiation over cannabis reform to the forefront in Congress with the threat of the White House moving forward without Congress in essence rendering Congress mute on the subject; **ii**) it serves as a significant reminder to institutional investors that federal cannabis reform is inevitable, and the positive momentum generated will help relieve some of the capital constraints being faced by the industry as investor interest has been hampered by regulatory hurdles.

## Cannabis on the Ballot

Similar to what we saw in 2020 with five states legalizing adult use/recreational cannabis through ballot initiatives, the upcoming mid-term elections offers additional states that have the opportunity to vote in favour of adult use sales. Voters in Arkansas, Maryland, Missouri, North Dakota, and South Dakota are all involved in ballot initiatives. South Dakota already voted for adult use legislation during the 2020 elections however a state court found the voter-approved legalization measure was invalid. The ballot initiative this time rectifies any

uncertainty.

In 2021, five states enacted adult-use legislation, resulting in a total of 19 states in addition to the District of Columbia that have legalized cannabis markets. The states voting in favour of cannabis this November would make cannabis legal in half of all US States. More importantly, state legalization would be making inroads in three historically Red (Republican) states that could assist in the wider discussion of legalization at the federal level.



Source: COWEN

### California Governor Signs Interstate Commerce Bill

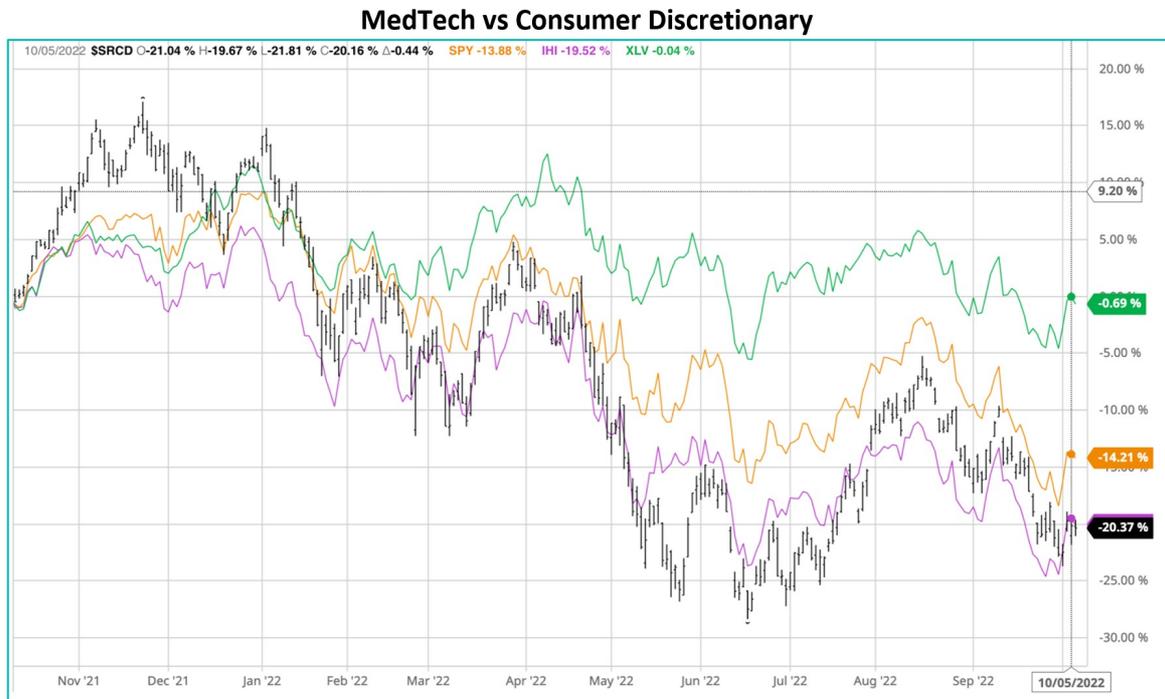
As has been the case with all significant cannabis legislation in the history of The United States, the most significant positive changes have come at the state level. One of the most important steps in creating a truly national market is the establishment of interstate commerce. Current popular opinion suggests that interstate commerce cannot occur until significant federal legislation takes place and even then, interstate commerce would take years to negotiate with different state markets. The potential for Interstate commerce though could become a reality sooner than many anticipate. California Senate Bill 1326 passed in the last few weeks allows California to enter agreements with other adult use or medical states upon either an indication of tolerance from the U.S. Department of Justice or an opinion by the California Attorney General that doing so will not place the state in legal jeopardy.

Add to that, on the east coast is New Jersey, a recently opened recreational market that is a growing yet supply constrained market due to regulatory delays and limits on single license holders. New Jersey Senate President Nicholas Scutari, who was a vocal proponent of adult-use legislation, has recently introduced S3012, an interstate commerce bill that uses similar language to CA in outlining legalities and implications. The implications of two states that could work co-operatively on bringing about interstate commerce in the cannabis space are large, and so this will be an interesting development to watch.

### MedTech vs Consumer Discretionary

We have written often about medtech within the healthcare space as providing stable growth since the end of the pandemic, a resilient sector with significant demand from delayed or cancelled procedures since early

2020. What is interesting is that these stocks are trading similar to consumer discretionary stocks, yet the macro environment for medtech is completely different. On one hand we have consumer discretionary where consumers are feeling inflationary pressures with higher food prices and given higher interest rates higher rates on credit cards and indebtedness. There is room for discretionary items. However, medtech is an area where demand is strong, is partially covered by Medicare and Medicaid and people have already suffered with pandemic closures. We see an opportunity to own medtech, an underappreciated sector at this time.



Source: Bar Charts

### Canopy Growth Getting Out of Retail in Canada

In yet another sign of weakness for the Canadian cannabis industry, Canopy Growth (WEED) once the highly valued, largest and most well recognized cannabis company listed on NASDAQ has entered into two agreements to dispose of its 28 cannabis dispensaries operating under the Tweed and Tokyo Smoke banners. One of the transactions involves OEG Retail Cannabis, that will receive 23 retail locations in Manitoba, Saskatchewan and Newfoundland/Labrador in addition to IP related to the Tokyo Smoke brand. OEG already owns the franchise rights to Tokyo Smoke in Ontario acquiring those rights in 2019. OEG is controlled by Daryl Katz, owner of pharmacy chains and of course the Edmonton Oilers.

Retail operations have been a drag on WEED financials, accounting for approximately 40% of all operating expenses, while generating gross margins in the 15% range, much lower than the cultivation related margins seen from other Canadian operators. It is management's assessment that there will be ongoing savings that should help the company achieve better financial efficiencies.

### Options Strategy

Since inception of the option writing program in September 2018, the Fund has generated significant income from options premium of approximately \$4.40 million. We will continue to utilize our options program to look for attractive opportunities given the above average volatility in the sector as we strongly believe that option writing can continue to add incremental value going forward.

Cross asset volatility, collectively, currencies, fixed income, high yield, and treasuries continue to misbehave. We believe the current bout of weakness, sour sentiment, and historic spike in rates are part of full cycle investing and should be monitored. While anxious in the near term, periods of extreme volatility often set up

attractive entry points for high conviction plays that suffer from short-term drawdowns as intermarket correlations peak. History of bear markets is there are observable deterioration across various macro economic variables before we achieve a bottom. The bottoming of the market is a process and not a point. We also need to see lower levels of trending volatility and accelerating volume signalling to us a healthier investing environment. For market direction to change, we will need to see a macro trend reversal, usually driven by a catalyst event like a drastic change in Federal Reserve rhetoric that causes the market to reposition for a different policy regime and which brings renewed enthusiasm and capital into risk assets. Yield curves flatten and inverts while headed into a recession and then steepens while in a recession. For now the market risk is to the downside. Patience remains our core allocation. Every spike in equity volatility (VIX) and the related spikes in volatility of volatility (VVIX) has been an opportunity to monitor correlations within health care/cannabis.

Our current interpretation of cross asset volatility indicators and daily trading volume metrics indicate to us, for the time being, we will be selective traders of our preferred option trades, especially on decelerating volume and deteriorating fundamentals. We need to see lower levels of trending volatility and accelerating volume signalling to us a healthier investing environment. Volatility spikes are trending and as such we have been quite selective on our trades, tilted more towards large cap, lower beta health care to execute on, for now. During the month we used our options strategy to assist in rebalancing the portfolio in favor of names we prefer while generating approximately \$54,000 in option income. We continue to write covered calls on names we feel are range bound near term and from which we could receive above average premiums. Examples of such trades include Pfizer (PFE). We also continue to write cash secured puts out of the money at strike prices that offered opportunities to increase our exposure, at more attractive prices, to names already in the Fund including AstraZeneca PLC (AZN), Procter & Gamble (PG), Abbott Laboratories (ABT), UnitedHealth Group Inc. (UNH), Merck & Co Inc. (MRK), and Perrigo Company PLC (PRGO). Perrigo, the largest manufacturer of over the counter (OTC) health products in the U.S., is benefiting from consumers trading down to store brands during this period of elevated and sticky inflation. It has several tailwinds over the next few quarters, including the benefit of implementing price increases to offset elevated cost pressures, the infant formula shortage, new OTC product launches, and a return to a typical cold/flu season.

**Charles Taerk & Douglas Waterson**

The Portfolio Team

Faircourt Asset Management

Sub-Advisor to the Ninepoint Alternative Health Fund

Ninepoint Alternative Health Fund - Compounded Returns<sup>1</sup> as of September 30, 2022 (Series F NPP5421) | Inception Date - August 8, 2017

	MTD	YTD	3MTH	6MTH	1YR	3YR	5YR	INCEPTION(ANNUALIZED)
FUND	-8.9%	-33.5%	-2.9%	-24.5%	-36.8%	-5.3%	7.1%	7.5%
TR CAN/US HEALTH CARE BLENDED INDEX	-3.6%	-39.1%	-3.0%	-32.5%	-42.8%	-19.6%	-7.7%	-7.9%

Statistical Analysis

	FUND	TR CAN/US HEALTH CARE BLENDED INDEX
Cumulative Returns	45.0%	-35.0%
Standard Deviation	28.1%	31.0%
Sharpe Ratio	0.3	-0.3

<sup>1</sup> All returns and fund details are a) based on Series F units; b) net of fees; c) annualized if period is greater than one year; d) as at September 30, 2022. The index is 70% Thomson Reuters Canada Health Care Total Return Index and 30% Thomson Reuters United States Healthcare Total Return Index and is computed by Ninepoint Partners LP based on publicly available index information.

**The Fund is generally exposed to the following risks. See the prospectus of the Fund for a description of these risks: Cannabis sector risk • Currency risk • Cybersecurity risk • Derivatives risk • Exchange traded fund risk • Foreign investment risk • Inflation risk • Market risk • Regulatory risk • Securities lending, repurchase and reverse repurchase transactions risk • Series risk • Specific issuer risk • Sub-adviser risk • Tax risk**

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