Quarterly Report

2

SECOND QUARTER
2016

FRIEDBERG MERCANTILE GROUP LTD.

Contents

Second Quarter Report 2016

FRIEDBERG MERCANTILE GROUP LTD.

MESSAGE TO OUR INVESTORS

I am pleased to present to you a report of the trading activities of our two Funds for the quarter ended June 30, 2016.

The Global-Macro Hedge Fund (GMHF) experienced a minor setback in the most recent three months, losing 1.7% for the quarter though still managing to preserve a 1.6% gain for the year to date. On a year-over-year basis, the Fund maintains a solid 23.7% gain. The Asset Allocation Fund (AA), on the other hand, experienced a scintillating quarter, gaining 10.6% for the past three months, bringing year-to-date gains to a strong 15.5%. NAV stands at a new high since inception, up 12.3% from one year ago. Below I shall discuss the incongruity of results, derived, as we shall show, from their different mandates and degrees of maneuverability. I shall also discuss what this analysis portends for future performance.

Let me first start by pointing out that the disappointing results of the GMHF were due entirely to a weak performance of its equity portfolio. Losses on short positions, which consisted almost entirely of Indian, Chinese, Korean, Singaporean banks and Chinese developers, cost the Fund 870 basis points (bps). Long equity positions had a net negative impact on NAV of 280 bps, mostly caused by wrong-way bets on the Nikkei index and US airline stocks. Altogether, equities contributed a total loss of 1,160 bps. The long equity side recorded some substantial wins, but these were not large enough to overcome losing positions. Evidence of the changed nature of our markets is the fact that gains were recorded in all the other pockets, namely fixed income (140 bps), systematic commodities program (220 bps), discretionary commodities trading (510 bps), and currency trading (110 bps).

After an extremely choppy quarter, US equities remain poised to break into new high ground, a feat that has eluded them for almost two years. Some important groups

The more interesting side of the Fund story this quarter, as alluded earlier, lies in the performance of our other assets. For one thing, the strong position in longterm local-currency Brazilian bonds is paying off. First bought at yields in excess of 14%, they are now trading close to 12%, which has resulted thus far in a gratifying capital gain...

on which we pin our strong expectations for the year to come, like homebuilders, have not as yet broken out of their long period of consolidation, begun almost three years ago. Housing fundamentals remain stronger than ever. The scarcity of single-family homes has reached crisis proportions, and prices continue to rise at more than double the rate of inflation, evincing strong demand (underpinned by the lowest mortgage interest rates in post-war history) and supporting strong profit margins. We have beefed up this position with the acquisition of a substantial position of long-term calls. Our present exposure, delta-adjusted for these options, is 45% of NAV. As prices begin to rise above present levels, exposure will increase rapidly and significantly.

Airlines represented our great disappointment. Despite compelling valuations, airline stocks fell and in some cases came very close to registering 52-week lows. Fears of overcapacity continue to plague this industry, only recently out of a spate of bankruptcies and consolidation. It appears that the temptation to increase capacity in the face of healthy demand is too strong. Our take is that cheap money is partly or mostly responsible for this bad habit. Cheap money leads to misallocation of capital, and the airline industry is a prime example of this phenomenon (as were and are shopping malls). The dream of meeting strong cyclical demand and of buying more energy-efficient planes is made an easy reality by the possibility of buying/leasing planes at minimal costs. Falling energy costs have given the industry a strong lift in earnings and cash flow, but unfortunately, airline executives have made little or no provision for the renewed rise in oil prices — even if only to the $50-$60 level.

Ironically, airline executives hedged their fuel needs when oil traded at more than $100/barrel, but at $30-$50/barrel they have refused to do so. The position in the various airlines was first reduced and then liquidated throughout the quarter. Valuations remain compellingly attractive, but we want to wait until the industry matures a bit longer before considering re-entry.

We continue to view Japanese equities favourably. In our estimation, Japanese stocks are being hurt by policy errors, in particular the absurd negative-interest-rate stance adopted by the Bank of Japan and its refusal to use the forex market as a monetary tool. Negative rates have damaged banks (now trading at less than 50% of book value), hurt savers and pension plans and promoted real estate speculation, all without accomplishing their oft-stated goal of bringing inflation up to a 2% annual rate, while also causing an unexpected and invisible, for now, pattern of poor corporate decisions. Pegging the exchange rate at present levels and backing the peg with unlimited resources would increase money supply at an accelerated pace and raise the price to the desired target. Over time, Japanese inflation rates should converge on US rates. When the present QE efforts are finally abandoned — note that we say when and not if — stock prices will duly lift off.

The more interesting side of the Fund story this quarter, as alluded earlier, lies in the performance of our other assets. For one thing, the strong position in long-term local-currency Brazilian bonds is paying off. First bought at yields in excess of 14%, they are now trading close to 12%, which has resulted thus far in a gratifying capital gain (we hedged out the currency exchange — wish we had not — so net income is smaller than the yield). The political situation in Brazil remains in a state of flux, with daily indictments of government and congressional leaders, though below the surface, important policy measures are being passed and implemented. More important for our bet, monetary policy remains extremely tight, with the bank rate 500 bps above official inflation but more probably running 700 bps above underlying inflation. Moreover, inflation numbers, in our opinion, will decelerate quickly in coming months and easily exceed Bank expectations on the downside. This means that, very soon, interest rates will start falling at an accelerated pace.

Commodity prices have begun to rise from their post-2009 lows, in some instances, with great vigour. Our systematic manager — who has been directed by us to be long only since the beginning of the year — has caught a good many upside moves. We are encouraged and now believe that the upward trend will continue and make an important contribution to this coming year's results.

Our discretionary trading program, which trades only the two most liquid commodity futures on the board (gold and oil), did extremely well. Earlier this year we closed out our old short position in oil with spot prices trading at around $36/barrel. Recently, taking advantage of the Brexit hype, we liquidated our substantial long position in gold at rising prices ($1,316 to $1345). This is not an indication that we believe gold prices will be heading back into a bear market. Not at all. In fact, we think that gold will exceed $1,500/oz. over the next year. It is just that we believed that near-term prices overreacted and overreached for all the wrong reasons. As for its impact on the world, Brexit will prove to be almost a non-event. Far more critical is the impact that inflation (now coming) and rising interest rates will have on debt. Current levels of debt, sovereign in particular, cannot support normalized rates of 3% to 5%. Defaults are sure to mount in coming years. Forget Brexit; what will happen to Portugal, Italy, France, Spain, and Belgium?

The inflation (or reflation, if you like) theme is intriguing enough to have led us to acquire a position in natural gas and natural gas liquids (such as propane and ethane) companies in June. The stocks of these companies were beaten down to absurd, almost bankruptcy, levels in the great energy crash of the past two years, but the fundamental background for these commodities has improved substantially in recent months. The position represents a concentrated bet (28% of NAV), although it is spread over 11 names.

As debts in Asia continue to rise faster than income, problems in its banking sector will continue to mount. Non-performing loans, off- and on-balance sheet, are thought to be many times greater than acknowledged by regulators. Shares of banks and closely dependent developers should experience heavy losses in many Asian countries though it remains, as always, difficult to pinpoint the time of reckoning. We will continue to monitor these positions closely for important inflexion changes. It should be noted, however, that positive global winds are more likely to affect the Fund favourably than negatively, as our equity position, at quarter end, was net long 90% of NAV.

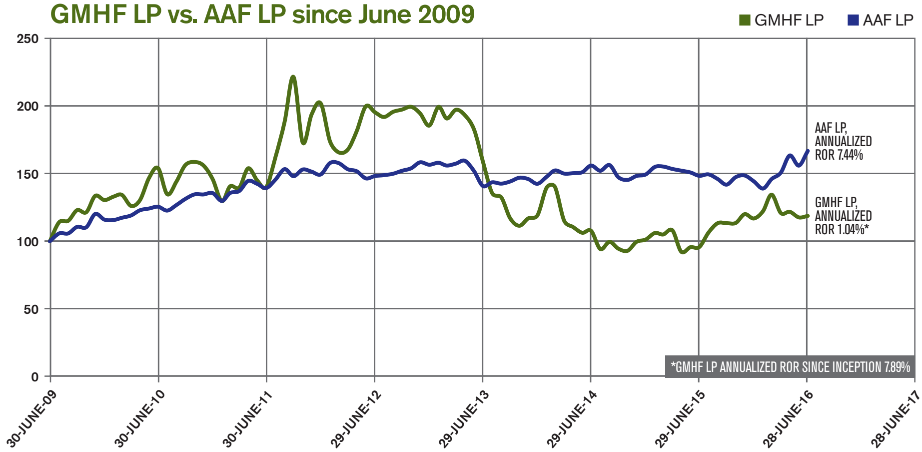
Let me discuss the Asset Allocation Fund performance. By attribution, fixed income contributed 170 bps (it made almost the same contribution to NAV as it did to the NAV of the GMHF, and that's because the percentage allocation to Brazilian bonds was very similar); commodities, primarily gold, contributed 290 basis points (a smaller position than in GMHF, compensated by a large position in gold mining equities); and equities contributed 680 basis points. The gain in equities, in contrast to the loss experienced by GMHF, can be explained by two factors. The Asset Allocation Fund owned a relatively large position of gold mining companies, specifically Agnico Eagle (3.7% of assets), Newcrest Mining (3.5% of assets) and VanEck Vectors Junior Gold Miners ETF (17.9% of assets). I chose to buy gold miners because I thought that miners had a greater upside potential than bullion (though, admittedly, I did not suspect the difference would turn out to be so substantial). I did not do the same for GMHF because I judged the trading liquidity of these shares to be inadequate, especially prior to their big move. And this is one of the crucial differences between the two funds. The GMHF is, post leverage, more than 10 times larger than the AA; for it to acquire a relatively similar position, it would require much more liquid conditions. Our rule of thumb is that we enter only into positions for the GMHF that can be liquidated within two trading days without affecting prices (which means that, effectively, our trading cannot represent more than a very modest percentage of daily trading). In retrospect, this is an unfortunate consequence of the constraints that size places on a manager. These shares increased 48.1%, 31.9%, and 52.3% respectively during the quarter.

The second factor explaining the difference between the two Funds is that AA did not short Asian banks and developers; it did not do so, because it is precluded from going short. The conservative nature of the Fund saved it from the substantial losses suffered by GMHF with respect to these positions. In sum, trading constraints and mandated conditions explain almost 100% of the Funds' different results.

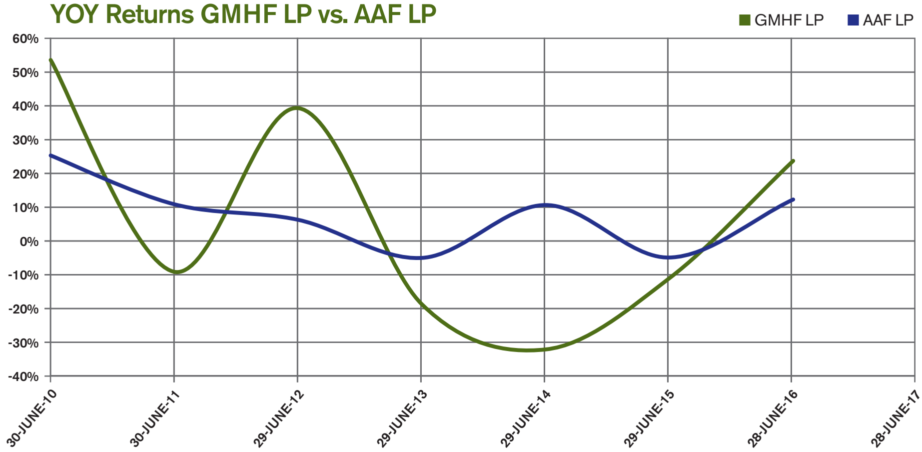
Can these differences persist, and if so, should investors be switching from the more speculative to the less speculative fund? To answer this question we need to make one more observation: a mandated difference between the two Funds not discussed above is leverage. AA has a strict limit: positions cannot exceed the Fund's net asset value; it does not enjoy the benefits of leverage. GMHF, on the other hand, can and does enjoy the benefits of leverage. Theoretically, a fund can leverage more than 30 times its capital. It is constrained only by margin requirements, which can be as low as 3%. In practice, the average hedge fund doesn't generally exceed a leverage ratio of 5x. Our experience indicates that we ought not to go beyond 3x, and it is to that limit we have been restricting ourselves since early 2015 *(see accompanying charts)*.

We are now in a better position to answer the above questions. To the first question: can differences persist? The answer is, yes, they can. One might think that GMHF would perform better in down markets given its flexible mandate, the fact that it can go short. True. But it can also do better in strong markets, and the reason is leverage. At 3x it can easily outperform AA. The reason it has not done so since inception *(see accompanying chart for a comparison of the two Funds since 2009)* is that GMHF committed near fatal errors in the 2012-2014 period, ratcheting leverage to 7x and more in the mistaken belief that it could "balance"

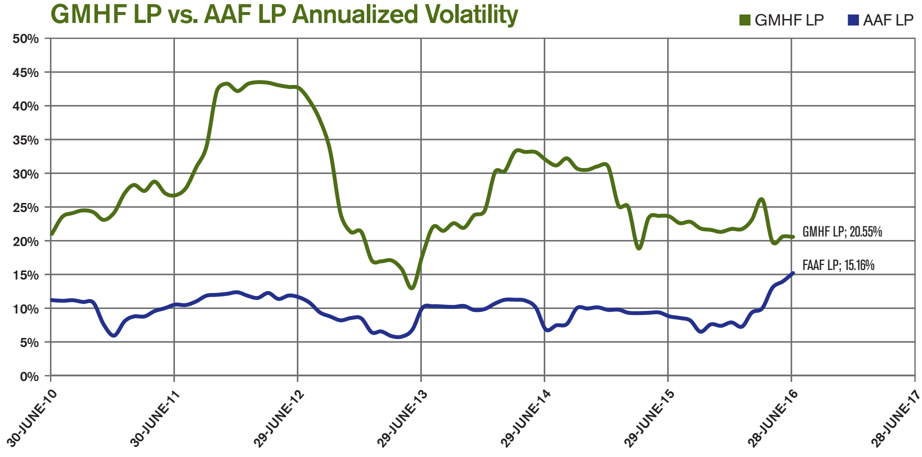
GMHF LP vs. AAF LP since June 2009



YOY Returns GMHF LP vs. AAF LP



GMHF LP vs. AAF LP Annualized Volatility



the book between shorts and longs thought to be inversely correlated without taking on overall market risk. This has been discussed at length in past letters, as has the metamorphosis of our trading style. One might argue that a fairer comparison of the two Funds should begin at the point where GMHF adopted a more conservative stance, lowering leverage to a more “comfortable” level. This occurred in the second quarter of 2015, when we chose 3x as our leverage target, though substantial progress in that direction had already been achieved a little earlier.

Using the more recent dates, the comparison is more favourable to GMHF. What is undeniable is that, precisely because of the difference in leverage, the amplitude of year-on-year returns is noticeably less pronounced for AA than for GMHF.

In sum, the two Funds share the same manager and the same outlook for financial markets. That’s a given. The difference in their investment results will persist, however, owing to the different conditions that apply to the two Funds, among them the options to leverage and to short, available to one Fund but not the other, and to size limitations that naturally constrain a larger Fund. These differences in performance will almost certainly occur during down markets but are likely to occur during up markets, too. Year-on-year returns will vary less sharply for the AA; that is, it will certainly be a less volatile Fund.

I end by urging our unit holders not to be swayed by past performance. It is truly and conclusively no indicator of future results. In the end, the manager must be right about markets more times than he is wrong. And to remind all, it is not only the bet one makes that matter but also how one makes that bet. It is the latter that will have the strongest impact on performance.

Our forecast, and the direction taken by our portfolios, is for accelerating inflation over the coming months. This phenomenon will take markets and officials by surprise, and I believe that it will change the world we know today. Financial repression will continue to be the order of the day, partly because central bankers will remain in intellectual denial and partly because of fears that rate normalization will bring economic activity tumbling down. The early part of this period of accelerating inflation should prove beneficial to many assets, among them commodities and well financed equities. Coming out of denial — beyond our investment horizon — will be painful and very damaging to debt-burdened sovereigns and corporations. But here we may be getting a bit ahead of ourselves...

We look forward to a very good second half of the year.

Thank you for your continued trust.

ALBERT D. FRIEDBERG

Friedberg Asset Allocation Funds

Friedberg Asset Allocation Fund Ltd.
Friedberg Asset Allocation Fund

The Fund is a multi-strategy fund whose investment objective is to seek significant total investment returns, consisting of a combination of interest income, dividend income, currency gains and capital appreciation. Allocations are reviewed periodically.

MODEST RISK: Absolute return.

Performance[1] as of June 30, 2016

	NAV	Quarterly	Year over Year	Two Years	Three Years	Five Years
Friedberg Asset Allocation Fund Ltd.	1,583.87	11.23%	13.20%	3.67%	5.94%	3.80%
Friedberg Asset Allocation Fund	16.63[2]	10.57%	12.29%	3.38%	5.76%	3.64%
CSFB/Tremont Hedge Fund Index[3]		N.A.	-5.37%	-0.02%	1.96%	2.62%

PERFORMANCE ATTRIBUTION

Fixed Income	1.54%
Equities	6.29%
Commodities	2.73%
TOTAL	10.56%
S&P 500 (total return)	1.90%

[1]Net of fees
[2]NAV adjusted to reflect distributions reinvested in the fund
[3]Compounded annual rate of return through May 2016

Friedberg Asset Allocation Funds

Capital allocation of the Friedberg Asset Allocation Fund Ltd. as of June 30, 2016 is as follows:

INVESTMENT		CURRENT ALLOCATION	TARGET
FIXED INCOME		19.80%	19.00%
Brazilian NTNF 10% Jan. 1/25	*19.80%*		
EQUITIES		57.90%	58.00%
U.S. Homebuilders	*16.80%*		
U.S. and Australian Gold	*25.00%*		
Greek Banks	*3.20%*		
U.S. NGL & Natural Gas	*8.90%*		
U.S. Miscellaneous	*4.00%*		
FUTURES		22.00%	23.00%
Platinum	*2.10%*		
Gold	*19.90%*		
CASH / MONEY MARKET		0.30%	0.00%
		100.00%	100.00%

Friedberg Asset Allocation Fund Ltd.

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2016	-3.94%	5.15%	3.28%	8.82%	-4.95%	7.51%							16.04%
2015	3.45%	0.31%	-1.31%	-0.74%	-1.03%	-1.67%	0.74%	-2.21%	-2.67%	3.79%	0.91%	-2.86%	-3.49%
2014	3.55%	3.30%	-1.58%	0.25%	0.32%	3.29%	-2.41%	2.93%	-5.79%	-1.39%	2.06%	0.78%	4.94%
2013	0.91%	-1.21%	0.89%	1.47%	-5.07%	-7.09%	1.98%	-0.95%	1.22%	1.99%	-0.80%	-2.20%	-8.94%
2012	5.10%	-0.08%	-2.83%	-0.77%	-3.22%	1.21%	0.40%	0.72%	1.43%	1.24%	2.83%	-1.16%	4.70%
2011	-4.11%	4.18%	1.11%	5.56%	-1.67%	-1.98%	4.65%	5.15%	-2.86%	3.31%	-1.05%	-1.58%	10.52%
2010	-0.27%	0.99%	0.56%	3.47%	1.10%	0.99%	-2.23%	3.36%	3.91%	2.57%	-0.06%	0.83%	16.14%
2009						0.38%	2.62%	0.09%	2.91%	0.53%	7.15%	-3.63%	10.13%

*** PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS ***

Friedberg Global-Macro Hedge Funds

Friedberg Global-Macro Hedge Fund Ltd.
Friedberg Global-Macro Hedge Fund

A multi-strategy fund. Allocations are reviewed periodically.

Performance[1] as of June 30, 2016

	NAV	Quarterly	Year over Year	Three Years	Five Years	Ten Years
Friedberg Global-Macro Hedge Fund Ltd.	3,612.37	-1.51%	24.40%	-8.17%	-2.41%	7.44%
Friedberg Global-Macro Hedge Fund	20.84[2]	-1.70%	23.68%	-9.15%	-3.21%	N.A.
CSFB/Tremont Hedge Fund Index[3]		N.A.	-5.37%	1.96%	2.62%	4.16%

PERFORMANCE ATTRIBUTION

Fixed Income		1.40%
Equities		-11.60%
Longs	*-2.8%*	
Shorts	*-8.70%*	
S&P Options	*-0.10%*	
CD's		0.10%
Commodities		2.20%
Gold		5.10%
Currencies		1.10%
TOTAL		-1.70%
S&P 500 (total return)		1.90%

[1]Net of fees
[2]NAV adjusted to reflect distributions reinvested in the fund
[3]Compounded annual rate of return through May 2016

Friedberg Global-Macro Hedge Funds

Friedberg Global-Macro Hedge Fund Ltd.

Monthly Performance (%) Net of Fees

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2016	4.54%	9.86%	-9.79%	0.72%	-3.39%	1.30%							2.05%
2015	4.75%	-1.16%	2.73%	-14.00%	3.14%	0.08%	11.12%	6.69%	-0.21%	0.16%	5.70%	-2.68%	15.09%
2014	17.06%	0.30%	-17.58%	-3.84%	-3.35%	1.27%	-12.07%	5.19%	-4.38%	-1.53%	7.09%	1.60%	-13.70%
2013	7.65%	-3.74%	3.04%	-1.90%	-5.62%	-13.17%	-14.23%	-1.28%	-11.27%	-4.80%	4.84%	1.87%	-34.43%
2012	-15.04%	-5.20%	1.64%	8.84%	11.22%	-2.12%	-0.69%	1.00%	0.84%	0.70%	-2.43%	-5.29%	-8.72%
2011	-10.28%	7.67%	-0.71%	9.53%	-5.06%	-3.23%	15.96%	16.22%	18.69%	-21.76%	11.47%	4.60%	40.86%
2010	2.99%	0.36%	-7.34%	3.76%	13.22%	4.75%	-13.76%	6.95%	9.11%	1.69%	-1.61%	-6.16%	11.36%
2009	-5.85%	-3.88%	3.65%	-7.15%	14.97%	-7.85%	9.47%	1.97%	5.02%	-2.21%	9.56%	-3.34%	12.02%
2008	7.18%	9.57%	-1.04%	-6.48%	4.51%	8.58%	-0.24%	-6.85%	4.18%	-5.96%	5.85%	19.06%	41.52%
2007	-1.01%	1.07%	-3.44%	-1.28%	-0.80%	1.57%	10.06%	2.80%	-1.33%	5.89%	7.91%	3.00%	26.27%
2006	1.88%	1.06%	-1.81%	2.07%	-0.75%	1.27%	2.04%	-0.09%	-0.56%	3.10%	2.43%	0.54%	11.64%
2005	1.04%	0.84%	-1.13%	1.31%	1.06%	2.47%	0.08%	0.95%	2.75%	-1.38%	2.56%	2.20%	13.41%
2004	4.03%	3.44%	1.36%	-7.84%	-0.39%	0.27%	1.02%	1.90%	1.45%	1.67%	2.76%	3.24%	13.09%
2003	3.11%	3.06%	-4.58%	-1.15%	9.26%	-3.77%	-8.04%	2.91%	5.49%	1.69%	1.49%	1.10%	9.76%
2002	-1.46%	2.04%	-2.22%	4.41%	5.41%	6.16%	-2.42%	4.45%	2.80%	-6.70%	0.32%	7.56%	21.17%
2001											0.00	-0.40%	-0.40%

*** PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS ***

Friedberg Global-Macro Hedge Funds

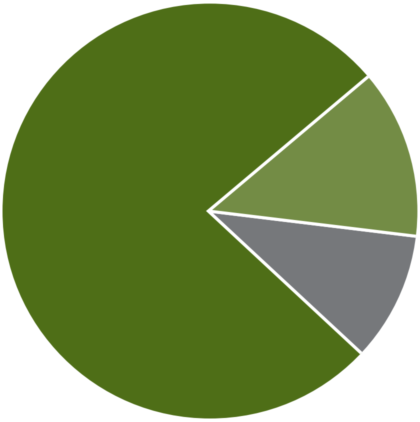
Global-Macro Hedge Fund Ltd. (Cayman)

Breakdown as a Percentage of Total Assets
AS OF JUNE 30, 2016

U.S. and Global Equities*	77%
Commodities	10%
Fixed Income	13%

Total assets/net capital: 2.47x

* Contains long/short equities



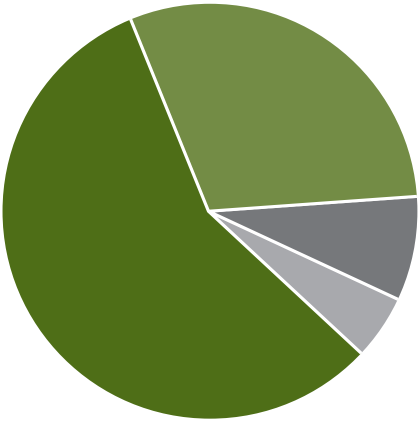
Global-Macro Hedge Fund Ltd. (Cayman)

Breakdown as a Percentage of Total Assets
AS OF MARCH 31, 2016

U.S. and Global Equities*	57%
Commodities	30%
Fixed Income	8%
Currencies	5%

Total assets/net capital: 3.00x

* Contains long/short equities



Closed Funds

Fund	Inception Date	Inception NAV	Liquidation Date	Liquidation NAV	Size of Fund at Liquidation	Annual % Rate of Return
Friedberg Diversified Fund	13-Sep-96	10.00	31-Oct-06	48.43	$4,642,228	16.90%
Friedberg Global Opportunities Fund Ltd.	13-May-97	1000.00	28-Feb-05	501.89	$5,700,000	-8.46%
Friedberg Equity Hedge Fund L.P.	15-Feb-98	10.00	31-Oct-06	22.12	$6,784,836	9.50%
Friedberg International Securities Fund	31-Mar-98	10.00	30-Nov-05	11.49	$4,500,000	1.83%
Friedberg Futures Fund	8-May-98	10.00	31-Oct-06	19.59	$1,126,409	8.10%
Friedberg Global-Macro Hedge Fund L.P.	31-May-02	10.00	31-Oct-06	19.00	$30,691,202	15.64%
Friedberg Equity Hedge Fund Ltd.	16-Oct-96	1000.00	30-Apr-07	2951.78	$31,540,284	10.81%
Friedberg Currency Fund II Ltd.	6-Mar-97	1000.00	30-Jun-08	1019.23	$35,599,879	0.17%
Friedberg Total Return Fixed Income Fund Ltd.	2-Oct-96	1000.00	31-Jul-09	2155.93	$94,686,020	6.17%
First Mercantile Currency Fund	7-Sep-85	10.00	30-Dec-09	8.29	$848,443	N.A.
Friedberg Foreign Bond Fund	19-Aug-96	10.00	30-Jul-10	9.84	$13,336,465	6.91%
Friedberg Total Return Fixed Income Fund L.P.	19-Feb-97	100.00	28-Dec-11	325.47	$11,776,462	8.27%
Friedberg Forex L.P.	13-Jun-91	10.00	28-Dec-11	11.78	$2,558,382	2.66%
Friedberg Currency Fund	3-Jan-95	10.00	30-June-13	8.41	$1,932,936	-0.93%

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FRIEDBERG
MERCANTILE
GROUP LTD.

FRIEDBERG MERCANTILE GROUP LTD.

Brookfield Place, 181 Bay Street, Suite 250
Toronto, Ontario M5J 2T3
Tel: (416) 364-2700
Fax: (416) 364-0572
E-mail: funds@friedberg.ca

www.friedberg.ca