July 2019

Seasonal Reflections

(Pictures of Rothiemurchus Centre Café Logo (left) and original Incremetum Logo (right)

Summer has arrived, and as this is a busy season for nature, so it has been for me.

Since my last reflections I have officially joined Incrementum AG in early June, following a short trip to Scotland's Whiskey heartland, where I spent a few days with my wife Alexandra and good friends exploring the country but also the art of Whiskey distillation, including a tour at Glenfiddich. Though the weather initially was as rough as one would expect from this harsh Northern UK region, I can only recommend a visit to this beautiful country.

At Loch Morlich I also discovered that the original Incrementum brand and logo seems to have been an inspiration even for the folks at Rothiemurchus Centre Café (see top of the page similarities), where we spent a very pleasant afternoon break with our gracious hosts Marie and Michael over traditional tea and scones, enjoying an unexpected balm of late spring sunshine.

Spring Blossoms

Professionally, the last couple of months have been incredibly exciting, challenging and just about as good a time as I have had in many years. It has now been four weeks since I joined Incrementum as Partner and Fund Manager of the Incrementum All Seasons Fund (IASF, fka Incrementum Permanent Fund or IPF). On its evolution I reported already last month, and today I am pleased to confirm that during the first four weekly subscriptions the fund's AuM have risen from USD 1.7m to above 30m.

Over 40% of that was injected via a contribution-in-kind on June 19, which allowed investors to transfer securities into the fund that I had previously managed and advised them on. I am extremely grateful for all those who have been willing to entrust me and us at Incrementum with managing their funds, and I look forward to continue doing this based on our stated goal of achieving real, as in purchasing-power-enhancing, returns.

For the sake of full disclosure, I can also confirm that I have personally invested CHF 2m (partly cash, partly contribution-in-kind) into the fund, which ensures I have skin in the game.

The contribution-in-kind exercise was not without operational hiccups, given the unusual character of the exercise in today's Private Banking environment. Therefore, I am particularly grateful for the support of LGT Asia in the process, without which this would not have been possible. Personally, I received the confirmation of credit of IASF units in lieu of the securities transferred into the fund only today and it seems other investors have had similar confirmations.

LGT Asia was also kind enough to remind me of the advent of a new SFC regulation on 'complex products' which comes into effect on July 6. It seems that IASF, whose revised prospectus I had tried to keep as flexible as possible, is classified as "derivatives fund" and thus a "complex product", given that we are allowed to invest up to 100% of the fund's NAV in derivatives. In the past I have rarely made any use of derivatives in the investment process and though the fund offers a better platform to do this, this will mostly be for hedging / covered option writing purposes, so that this is hardly what I would consider a complex product / strategy. But these are the rules and like the weather we can only seek to adapt to them. However, I can confirm that LGT Asia has undertaken a basic due diligence process and thus will allow further subscriptions (redemptions are never a problem) beyond the introduction date of the new rule. Meanwhile, I will consider whether a change of prospectus to address this is worthwhile.

So far, except for the first SR Notes and the initial 2Pager "Evolution from IPF", marketing for IASF has been non-existent. Please remember that I have been less than 4 weeks with Incrementum, and my focus in June was mainly on asset gathering. Active portfolio management has only begun this week, following the booking of securities from the "contribution-in-kind" exercise. This was mainly attributable to the fact that a UCITS fund is subject to a number of investment restrictions / limits which are meant for the protection of the underlying investor and are generally listed under Article 32 of the prospectus (page 55). They include among others individual issuer limits and counterparty limits. The latter drove us to deposit the incoming cash over the first 2 weeks with different banks as well as to buy a position in short-term Treasury bills, the former became a challenge during the contribution-in-kind process, as we had to anticipate exactly what was coming in, which was not easy given the number of parties involved (i.e. ultimate delivering investors, the delivering bank (in this case LGT), the receiving bank (LLB), and the fund administrator (IFM), who had to approve and audit the whole exercise). This explains why the fluctuations in IASF's NAV over the first three weeks of June were mainly due to variations in FX rates. I will report further below on how this is changing.

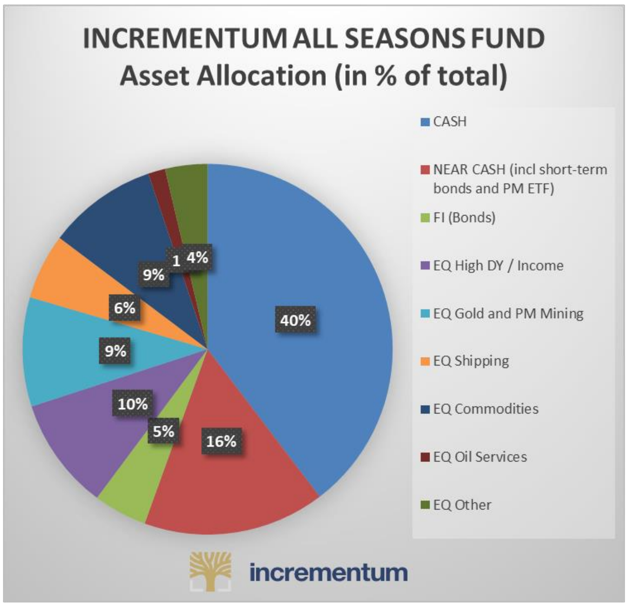
Meanwhile, reverting to my initial point made on the lack of marketing, we have yet to update the company's website, where so far my advent has not yet been registered. But a first amateur photo was made this week (professional photo shoot is planned for August), and I have provided a brief bio in German and English which I expect will show up on www.incrementum.li over the course of next week. The fund itself is still listed under its old name "Incrementum Permanent Fund", which we are also in the process to change. Meanwhile, I would like to refer investors to https://www.ifm.li/Default.aspx?lang=en, which is the homepage of IASF's fund administrator, where all information on the (old and) new share classes can be found under the following links:

- USD "D": https://www.ifm.li/FundStammdaten.aspx?nid=8555&groupnr=8555&lang=en&id=366320
- EUR "D": https://www.ifm.li/FundStammdaten.aspx?nid=8555&groupnr=8555&lang=en&id=366319
- CHF "D": https://www.ifm.li/FundStammdaten.aspx?nid=8555&groupnr=8555&lang=en&id=366321

I expect it will take at least until the end of 3Q 2019 to get this all into shape and properly amended, and I would like to thank all investors for their patience and understanding in the process.

Some Thoughts on Investment Strategy

By the time I am writing these lines (June 28), IASF actual allocation is moving into the direction I currently deem most appropriate. Current asset allocation is as follows:



Liquid funds still make up for 56% of portfolio value, a number which is going to come down over the coming weeks as further investments are made. I have made initial small investments into physical gold and silver ETFS, which currently account for slightly over 6% of the portfolio, and together with T-bill and note investments of less than 1 year maturity are listed under the near cash category, which can be easily converted into liquidity. Bonds offer scarcely any value, which explains an allocation of less than 5%, and thus few opportunities for reasonably reliable and secure income generation. Consequently, the bulk of IASF's risk investments is currently in equities, which account for approx. 39% of the portfolio.

On the equity side valuations remain elevated and the equity bull market looks exceedingly stretched. Investors are increasingly turning passive and their decisions are governed by monetary policy decisions more than actual underlying investment fundamentals. Hence, my strategy is to focus on undervalued stocks or sectors which may benefit from cyclical tailwinds.

Source: FT, https://markets.ft.com/data/indices/tearsheet/charts?s=AW01:FSI

One equity theme is high dividend yield stocks (10% allocation), which promise a decent stream of income to investors. This includes investments in the Invesco Morningstar US Energy Infrastructure MLP ETF, which currently yields about 8.8%, or Hutchison Port Holdings Trust, which currently yields approx. 9% based on its extremely depressed NAV (trades at slightly over half of book value). The portfolio also holds a number of high-yielding telecom stocks, incl. BAT, Singapore Telecom and Telefonica.

The second largest equity theme is gold and precious metals mining stocks (9% of the portfolio), which led by Gold Fields Ltd, Newmont Goldcorp and Wheaton Precious Metals provides meaningful upside potential as precious metals prices enter a new bull market.

A similarly sized allocation (9%) has been made to other commodity stocks. Commodities are at their most undervalued levels compared to equities and will eventually benefit from the desperate attempts of the powers-that-be to reflate the economy. As monetary policy options are proving increasingly impotent, fiscal stimulus will become the favourite policy tool. Whether the result is large-scale infrastructure spending programs or outright helicopter money, commodity prices will benefit. Currently commodity prices are still near previous cycle lows, and a dearth of capital investments over recent years is increasingly showing supply side effects that are also expected to provide a boost to commodity prices. The largest positions here are BlackRock World Mining Trust, which still trades at over 10% discount to NAV, and pays a net 5% dividend yield, Royal Dutch Shell and Husky Energy, Cameco and Glencore.

Shipping stocks (6%) are another interesting theme. They represent real / hard asset investments with long-life character and thus inflation protection characteristics. In addition, the sector has undergone one of its worst cyclical downturns in history and is only slowly turning corner. This should be helped by positive supply-side effects due to the upcoming IMO 2020 low sulphur rules, which require shipowners to replace cheap traditional bunker fuels with low sulphur marine diesel. As fuel cost are one of the main factors in shipowners / -operators equations, this may well lead to more slow-steaming ahead next year, which would represent a supply cut and should thus support shipping rates. Largest positions are Hong Kong listed bulk vessel owner / operator Pacific Basin, Norway listed chemical tanker owner Stolt Nielsen, and Denmark's AP Moeller Maersk. (Going with the IMO 2020 changes, I am also planning to build up some exposure to refinery stocks.)

Although most market participants continue to cling to the ever-expanding monetary and asset price bubble, there are a number of factors that suggest its days are counted. Among them are clear indications that global economic growth is slowing. Whether this is due to the evolving trade war between the US and ~~China~~ the rest of the world, or the increasingly obvious malfunctioning of no longer unconventional monetary policies (see https://www.mi2partners.com/tftd-catalog/2019/6/19/central-bank-scorecard-june-18-2019 for a brief comment), or demographics (increasingly ageing societies …), or perhaps the fact that for decades the actual loss of purchasing power was misrepresented in inflation statistics, or a combination of these and other factors, does ultimately not matter!

Source: https://app.hedgeye.com/insights/76212-cartoon-the-day-waterfall?type=cartoons

What matters is that global equity (and general risk asset) markets are near this cycle's peak, and even if one can sometimes get the impression that this time around the cycle has been abolished, I have (in line with Investment Lesson No.1) no doubt that it will end like all previous ones have. This is why a high cash allocation, tail-risk protection via precious metals exposure, and also the occasional short position (on June 28 IASF had a short position in S&P500 and Stoxx600 futures of 8%) makes sense.

Gold at least seems to have re-entered a new bull market following the breakout above the USD 1350-70 resistance. As Richard Russell would remind his readers: *„There is no fever like gold fever"*, though I guess we are still a long way from even mildly elevated temperature.

Closing Thoughts

Yesterday I watched the new season's opening press conference at my favourite football club Schalke 04. New coach David Wagner began his speech with telling everyone how glad and proud he is to work for such a great club. And in consideration of last season's dismal performance he added that he is looking forward to working with the whole Schalke team and is aiming for them to have fun and for the Schalke squad to play successful football again. As far as the achievability of this goal is concerned, he added: "How quickly? – I don't know! – How successful? – To be honest I also don't know yet! - … But I know that it requires far more hard work than talk." – I could very much relay to how he felt.

I know existing investors in the fund have had a disappointing season so far, and now that I have come in as a new manager everyone will ask "How quickly can you turn this around and how good will your future game / performance be?" - And as David Wagner I cannot answer these questions with any degree of certainty, because "There is no magic formula for successful investing" (Investment Lesson No. 8). However, I do promise you that I will work hard to achieve the targeted results, while dealing carefully with the responsibility I have been given both for investors and my own money invested into IASF.

Greetings from Liechtenstein,

Hans

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