Incrementum All Seasons Fund

– in pursuit of real returns –

2020 / 09

December / 4Q 2020

Seasonal Reflections

2020 – Interesting Times

quote(s) for reflection: (sections in this report written and underlined in blue represent active weblinks)

"The Long Now is the Fiat World of reality by declaration, where we are TOLD that inflation does not exist, where we are TOLD that wealth inequality and meager productivity and negative savings rates just "happen", where we are TOLD that we must vote for ridiculous candidates to be a good Republican or a good Democrat, where we are TOLD that we must buy ridiculous securities to be a good investor, and where we are TOLD that we must borrow ridiculous sums to be a good parent or a good citizen." (Source: Once In A Lifetime by Ben Hunt, Epsilon Theory, 29MAR2020)

And related: ***"We live in a world of Fiat Currencies, where central banks add a zero or two or three to reserve balances as part of some sort of magical spell to spur inflation or control inflation or create growth or whatever the hell they're trying to do. None of these spells have accomplished ANY of their intended "benefits" for a decade, which in any other human endeavor would at least give the magicians pause, but in our modern magical thinking world the response is never wait what? but always MOAR."*** (Source: Fiat World by Ben Hunt, Epsilon Theory, 8MAR2019)

"Thanks to Covid-19, government debt is rising rapidly and, for that matter, appropriately. In the face of recurring lockdowns, we are better off allowing companies and workers to enter a period of economic "hibernation" in the hope that, once the virus is under control, they can thaw out. The alternative of multiple business failures and mass unemployment is of no use to anyone. In the process, however, we are in effect borrowing from our collective economic futures. At some point, some of us will be presented with a bill which, if hibernation policies succeed, we will be in a reasonable position to pay. The political process will decide whether that bill comes in the form of higher taxes, more austerity, rising inflation or eventual default. That, I'm afraid, is the deficit reality." (Stephen King, HSBC Senior Economic Advisor, FT, 22OCT2020)

"We review the history of inflationary periods, and conclude that prevailing economic regimes reach their apotheosis, and then change, when the extreme conditions they have created lead to permanent policy change. We believe current extremes in deflation, inequality, debt levels and globalisation may lead to four major transitions in the next decade: from monetary to fiscal; from capital to labour; from globalisation to localisation; and from deflation to inflation. Yes, some disinflationary forces such as technology, debt and demographics are still present, but we conclude policy is the dominant driver of economic outcomes." (Source: Inflation Regime Roadmap, Man Institute, 10JUN2020)

"The speculative frenzy we are witnessing is unlike anything we have seen in terms of its breadth. *The Russell 2000 small cap index gained over 100% from its March lows through year end. Stock option volume is through the roof while the ratio of put to call options has plummeted in recent weeks, signifying extreme emphasis on upside versus downside risk. During a recession year, the NASDAQ surged 45% in 2020, housing prices leapt to new records, and interest rates were pushed to historical lows. Sovereign bond yields of Portugal, Italy, Greece, and Spain, countries which nearly caused a European credit crisis in 2012, all went negative in the last two months. When PIGS fly, yields die. From March 2020 forward, stocks steamrolled through all clear and present dangers to achieve new highs. … While stocks are supposed to represent fractional ownership interests in real businesses, they are rapidly devolving into financial playthings and tools of the central bank.* ***This is no country for old investors."*** (Source: Palm Valley Capital Management 4Q 2020 Investor Letter, 31DEC2020)

"If you bought every company that lost money in 2019 that had a market cap of over $1 billion [of which there were about 261… you'd be up 65% so far this year." (Source: Joel Greenblatt, as quoted by Jim Chanos, according to Grant's Interest Rate Observer, Vol. 38, No. 21, p.5)

"The final parallel between today and 1999 is painful to write about. Asset Allocation positioning is looking stupid today. Our Value bias, our underweight to U.S. equities, and our overweight to EM equities have not worked as we had hoped, as expensive assets have gotten more expensive and cheap assets have gotten cheaper. Our clients are losing patience, exactly as they did in 1999, that eerily similar and painful episode in GMO's history. In fact, this late 90s episode was featured at the Harvard Business School, which teaches its classes using the case method. GMO literally became a case study because Harvard was so intrigued by GMO's insistence on sticking to its conviction about overpriced Growth stocks and internet dot.coms even though the firm had been fired, ridiculed, and pilloried in the financial press (see Exhibit 9). Clients were tired of hearing about mean reversion, tired of hearing about prices and valuations mattering. And they lost patience. Though many held on, just as many fired us. At exactly the wrong time." (Experience of Kindred Spirits in Portfolio Management, Source: Tonight, We Leave The Party Like It's 1999 by Peter Giapinelli, GMO, 4NOV2020)

"Nobody knows when bubbles are going to blow-up. . . [but] this has been unbelievable. There has never been anything quite like it. . . It's been the most dramatic thing that has almost ever happened in the entire world history of finance." (Source: Berkshire Hathaway's Charly Munger, according to ADG, 16DEC2020)

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worthwhile reads: Central Banks Keep Shooting Themselves In The Foot, W White, NZZ, 16NOV2020

The Wages Of Fear, Harley Bassman, Convexity Maven, 2DEC2020

Inflation Will Come Back With a Vengeance, Louis Gave, NZZ, 31DEC2020

podcasts & videos: Super Terrific Happy Hour Ep. 7, John Hathaway interviewed by Grant Williams & Stephanie Pomboy, October 2020

The FED Faces No Easy Choices, Luke Gromen on MacroVoices, 14JAN2021

The Ugly Truth, by Sven Henrich, Northman Trader, YouTube, 3JAN2021

Mind Blowing Charts, by Sven Henrich, Northman Trader, YouTube, 16JAN2021

And as prime example for the fiat world we now live in, there is the "New European Bauhaus" Introduction by EU-President Ursula von der Leyen, Twitter, 18JAN2021

chart(s) of the quarter:

… have taken a leave of absence as I found it impossible to choose from the wide selection presented in the following pages.

ENJOY!

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Dear Reader,

2020 has passed, and in the spirit of the Chinese proverb "*May you live in interesting times*", it fully lived up to its ironic meaning, as it turned out an unusually troubling – and, yes, dangerous – year to have lived through.

I tend to open these letters with photos taken over the period between publishing SR's. Given the significantly restricted mobility 2020, it may not surprise that this one depicts a family of trees in their late autumn state which I must have passed a hundred times this year during walks in the fields surrounding Schaan.

Late autumn in the fields of Schaan, 22NOV2020 (HGS own pic)

Quite frankly, we were blessed to live in the Principality of Liechtenstein in 2020, which consists of small towns and plenty of space surrounding them, always inviting citizens out for walks in fresh air marvelling at the majestic beauty of the young Rhine valley and its alpine surroundings. In the year of the home-office that was a not to be underestimated benefit many of my metropolitan readers may not have been able to similarly enjoy.

Those who are familiar with Liechtenstein know that it is not a region that is prone to natural disasters, though it is regularly plagued by strong Foehn winds, which test the mettle of trees in the Rhein valley. And the above group of trees, which sits unprotected in the middle of the valley, must have faced countless storms in its life, yet remains unbowed in the path of such adversities. I found this an apt metaphor for what mankind was challenged with this past year, and I hope it will come out in a similar state.

2020 – gone viral

At the beginning of this piece, it is inevitable to talk about the virus. Covid-19 may have been discovered in 2019, but it began spreading seriously and globally in 2020. Here in Europe, we (and that includes me) originally assumed this would remain predominantly an Asian problem, similar to outbreaks seen over the past nearly two decades (e.g. SARS in 2002, MERS in 2012). But while China used the full might of the authoritarian state to completely lockdown entire cities, and thus managed to largely contain the virus by the summer, both Europe and North America have been encountering another wave of infections in late autumn / winter of 2020. As a result, and according to data gathered by John Hopkins University, the world has now registered almost 100m infections, and more than 2m people lost their lives as a consequence of / accompanied by an infection with the virus.

Don't worry, I am not going to enter the debate about how serious a threat Covid-19 is. It is indisputable that the virus is potent and has cost many lives. And in future I expect countless hours to be spent and papers produced to analyse the pandemic and judge its handling. At this juncture, however, allow me some general observations:

First of all, and despite of our – particularly in advanced economies - often distorted perception, life is not without risk. Humans strive to control their circumstances, but despite all the progress made, we have not been able to eliminate (fatal) crimes, deaths in traffic accidents, or if we look to the developing world deaths from hunger / malnutrition, to name but a few (and not listing causes of a self-inflicted nature). Although humans will acknowledge that fatal risks exist out there, in my experience we are pretty good at pretending that they will not affect us, which is an important trait, as it avoids an undue preoccupation with fear.

This is where the Covid-19 pandemic differs, as the level of fear related to it is wide-spread and has been fanned both by politics and science, as well as the media, which tirelessly and increasingly mind-numbingly reports daily infection counts and related death numbers on their front pages (or whatever their digital equivalent). Initial uncertainty among our political leadership notwithstanding, I believe this at times irrational fear could have been avoided by a more transparent, consistent, and commensurate approach in dealing with the consequences of the spread of the virus, and an overall campaign based on individual responsibility rather than heavy-handed government intervention.

As I suggested in Seasonal Reflections 2020 / 08, I believe we should not exclusively focus on how we can bring reported infection numbers down, but also on the consequences the measures implemented to achieve that have on society. Can a free Western society cope with demands of complete self-isolation in lockdowns? Why should I not meet with family and friends in a responsible manner, and thus reduce the pressures from being in lock-down and in many cases lonely or stressed with the sudden change in family life and social patterns? - I spoke to an investor recently, who called 2020 a lost year. He is in his high 70s, and thus in a high-risk group, and yet he very much misses visiting his children living overseas. He lives alone and called shopping for groceries the only highlight of his day. Hence, I wonder what pain is inflicted on our elderly, who for their protection (or our convenience) we have often locked away, so that now they can die of loneliness instead? How does it affect the development of our children, when friends and playmates suddenly become a potentially lethal threat one must stay away from, even though they are the same kids they played with unconcerned last year?

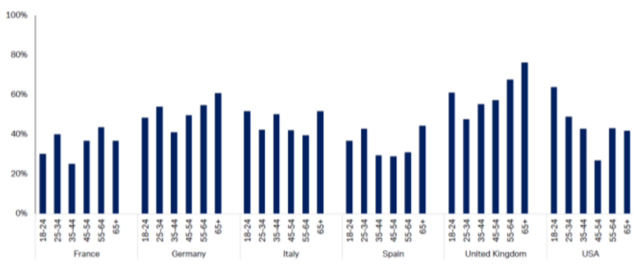
Clearly, Western democracies are struggling to contain the pandemic, and yet in the process have been making great strides in curtailing our individual liberties. But do we really want to live under a nanny state, that in a futile attempt to govern and steer an enormously complex social construct, is increasingly denying us a level of self-responsibility that should be the cornerstone of liberal democracies?

All this is made worse by the level of inconsistency often applied in the process. Living in Liechtenstein, sandwiched between Switzerland and Austria, and not far from my native Germany, it is hard to keep track of the shifting rules in each country. Over the summer and into autumn most restrictions here were loosened again as Covid-19 infections had fallen. But during 4Q 2020 infection numbers rose again, causing a flurry of new, often temporary measures, which were frequently inconsistent with those in neighbouring countries, inviting cross-border excursions to circumvent measures in one's home country. To me this failure of a concerted cross-border strategy provides yet further evidence that the EU as political entity is not working properly, but even the Swiss at different times applied different sets of measures in the various counties (Kantons).

As a result of all of this, many people I know question the threat of the virus and are increasingly frustrated with the shifting attempts by the authorities to get a grip on the situation, which is hardly supportive to compliance. It does not help that many infected people show no or few symptoms, making early comparisons with the Spanish Flu of 1918 – in my personal view – irresponsible fearmongering.

The good news is that the global pharma industry has managed to develop surprisingly effective vaccines in record time, which have become a bright light at the end of this tunnel. But the level of mistrust towards the safety of the new vaccines is clearly elevated, given a fast-track approval process and potential side-effects. As the graph on the right shows, only between 40-60% of the population plan to be vaccinated once the vaccination campaign gets going.

Figure 7: Proportion of residents that plan to be vaccinated against Covid-19 within 3 months of vaccine availability (October data)



Source : dbDIG Primary Research. Note: We run a nationally representative macro study on a monthly basis in France, Germany, Italy, Spain and the United Kingdom where we interview 2,500 individuals (500 per country). We also run a nationally representative macro study on a bi-weekly basis in the USA where we interview 500 individuals per wave. This study looks at a variety of topics including employment status, economic well-being, saving and spending behaviours alongside attitudes towards a variety of topics.

Source: Pretending to See The Future, J Authers, Bloomberg, 20NOV2020

But the rollout of the vaccination process has already been bogged down by bureaucratic inefficiencies and logistical challenges. And when I listen to some politicians, I am becoming increasingly concerned that those who decide to refuse vaccination risk discrimination and thus being nudged towards the "right" decision? But what precedent will this set? The influence of the state is already growing constantly. Politicians increasingly seem to consider themselves elected to fix all of societies' problems (Ursula von der Leyen's #NewEuropeans Bauhaus is just one recent example), but have we not concluded long ago that governments are highly inefficient in the process?

Obviously, there are still many questions concerning the development of the Covid-19 pandemic, and I believe with hindsight it will prove a historic watershed. But for 2021 I am optimistic that Covid-19 will have a still significant though gradually diminishing impact on our lives.

It's The Economy, Stupid!

While the new year will hopefully see the spread of the virus being contained, the economic damage due to Covid-19 and related measures will also come more starkly to light, promising to turn 2021 into yet another challenging year for investors.

In the following I will be looking at Covid-19 from the standpoint of an investment professional, reflecting on the consequences it has had for macro-economic developments. If this seems too narrow, I assure you that I do recognize how difficult it is to comprehend the impact the virus has had on the billions of people around the world, who have no interest in financial markets, stock prices and exchange rates, but have seen their lives and livelihoods threatened or even lost due to the pandemic.

The impact of Covid-19 and its counter measures on economic growth has been staggering. Last quarter, the IMF published the following table on past economic growth and future projections:

Table 1.1 ***(continued)***

(Percent change, unless noted otherwise)

	Year over Year				Q4 over Q4[7]			
			Projections				Projections	
	2018	2019	2020	2021	2018	2019	2020	2021
World Output	**3.5**	**2.8**	**–4.4**	**5.2**	**3.1**	**2.7**	**–2.6**	**3.7**
Advanced Economies	**2.2**	**1.7**	**–5.8**	**3.9**	**1.7**	**1.5**	**–4.9**	**3.8**
United States	3.0	2.2	–4.3	3.1	2.5	2.3	–4.1	3.2
Euro Area	1.8	1.3	–8.3	5.2	1.1	1.0	–6.6	4.8
Germany	1.3	0.6	–6.0	4.2	0.3	0.4	–5.2	4.6
France	1.8	1.5	–9.8	6.0	1.4	0.8	–6.7	4.0
Italy	0.8	0.3	–10.6	5.2	0.1	0.1	–8.0	3.4
Spain	2.4	2.0	–12.8	7.2	2.1	1.8	–10.8	6.6
Japan	0.3	0.7	–5.3	2.3	–0.3	–0.7	–2.3	0.7
United Kingdom	1.3	1.5	–9.8	5.9	1.4	1.1	–6.4	3.7
Canada	2.0	1.7	–7.1	5.2	1.8	1.5	–5.9	4.9
Other Advanced Economies[2]	2.7	1.7	–3.8	3.6	2.3	2.1	–4.2	5.0
Emerging Market and Developing Economies	**4.5**	**3.7**	**–3.3**	**6.0**	**4.3**	**3.8**	**–0.5**	**3.6**
Emerging and Developing Asia	6.3	5.5	–1.7	8.0	6.1	5.1	2.2	3.6
China	6.7	6.1	1.9	8.2	6.6	6.0	5.8	3.9
India[3]	6.1	4.2	–10.3	8.8	5.5	3.1	–4.0	1.4
ASEAN-5[4]	5.3	4.9	–3.4	6.2	5.3	4.6	–2.1	5.2

Source: A Long And Difficult Ascent, Chapter 1, Page 10 of the IMF October World Economic Outlook)

It suggests the hit to economic output in advanced economies has been so bad, that it may take until end of 2021 to recover 2018 levels, even with the support of massive fiscal interventions, where all stops have been pulled out. Here again, the IMF numbers speak for themselves. They show how deficit spending led by advanced economies over the past decade has already subsidized economic growth to a substantial degree, highlighting how we keep borrowing from our future. But 2020 saw an explosion in deficit spending and the level of debt accrual is expected to remain elevated in 2021. Given the amount of debt so far accumulated already, this can only be achieved by pushing interest rates towards the zero bound and holding them there, in order to keep borrowing cost manageable. Any normalization of nominal interest rates would quickly prove this an entirely unsustainable leverage situation.

Table B5. Summary of Fiscal and Financial Indicators
(Percent)

	2012	2013	2014	2015	2016	2017	2018	2019	Projections 2020	Projections 2021
Advanced Economies										
Central Government Net Lending/Borrowing[1]	**–4.9**	**–3.3**	**–2.8**	**–2.5**	**–2.5**	**–2.4**	**–2.6**	**–3.2**	**–12.2**	**–6.1**
United States[2]	–7.3	–4.1	–3.6	–3.2	–3.9	–4.1	–5.2	–5.9	–17.2	–8.0
Euro Area	–3.2	–2.4	–2.1	–1.7	–1.5	–1.4	–0.8	–1.0	–7.3	–4.1
Japan	–7.5	–6.7	–5.4	–4.5	–4.4	–3.6	–3.1	–3.9	–14.2	–7.0
Other Advanced Economies[3]	–1.9	–1.5	–1.3	–1.3	–0.6	0.0	0.3	–0.6	–7.7	–4.5
General Government Net Lending/Borrowing[1]	**–5.5**	**–3.7**	**–3.1**	**–2.6**	**–2.7**	**–2.4**	**–2.7**	**–3.3**	**–14.2**	**–6.8**
United States[2]	–8.0	–4.6	–4.1	–3.6	–4.4	–4.6	–5.8	–6.3	–18.7	–8.7
Euro Area	–3.7	–3.0	–2.5	–2.0	–1.5	–1.0	–0.5	–0.6	–10.1	–5.0
Japan	–8.6	–7.9	–5.6	–3.8	–3.7	–3.1	–2.5	–3.3	–14.2	–6.4
Other Advanced Economies[3]	–2.1	–1.5	–1.3	–1.2	–0.6	0.1	0.1	–0.6	–10.7	–5.9
General Government Structural Balance[4]	**–4.0**	**–2.8**	**–2.3**	**–2.1**	**–2.4**	**–2.4**	**–2.9**	**–3.6**	**–11.0**	**–5.6**
Long-Term Interest Rate[5]	**2.4**	**2.4**	**2.1**	**1.6**	**1.2**	**1.6**	**1.9**	**1.2**	**0.6**	**0.7**
United States	1.8	2.4	2.5	2.1	1.8	2.3	2.9	2.1	0.8	0.7
Euro Area	3.0	3.0	2.3	1.3	0.9	1.2	1.3	0.6	. . .	. . .
Japan	0.9	0.7	0.6	0.4	0.0	0.1	0.1	–0.1	0.0	0.1
Other Advanced Economies[3]	2.1	2.6	2.3	1.7	1.4	1.5	1.7	1.1	0.9	1.0
Emerging Market and Developing Economies										
Central Government Net Lending/Borrowing[1]										
Weighted Average	–0.4	–0.5	–1.2	–2.2	–2.4	–1.8	–1.2	–1.5	–4.4	–2.9
Median	–2.4	–2.9	–3.1	–3.2	–3.2	–2.9	–2.6	–2.5	–6.6	–4.9
General Government Net Lending/Borrowing[1]										
Weighted Average	–1.0	–1.7	–2.5	–4.3	–4.7	–4.1	–3.7	–4.8	–10.4	–8.8
Median	–2.3	–2.7	–3.1	–3.3	–3.1	–2.8	–2.3	–2.3	–7.2	–5.0
Growth of Broad Money										
Weighted Average	14.4	14.1	12.2	13.2	10.8	11.5	15.9	11.8	11.3	10.8
Median	11.4	11.6	10.4	10.2	8.8	8.8	8.1	8.8	4.9	8.9

Note: The country group composites for fiscal data are calculated as the sum of the US dollar values for the relevant individual countries.
[1]Percent of GDP.
[2]Figures reported by the national statistical agency are adjusted to exclude items related to the accrual-basis accounting of government employees' defined-benefit pension plans.
[3]Excludes the United States, euro area countries, and Japan.
[4]Percent of potential GDP.
[5]Annual data are period averages: for the United States, 10-year Treasury bond yield at constant maturity; for Japan, 10-year government bond yield; for the euro area, weighted average of national 10-year government bond yields.

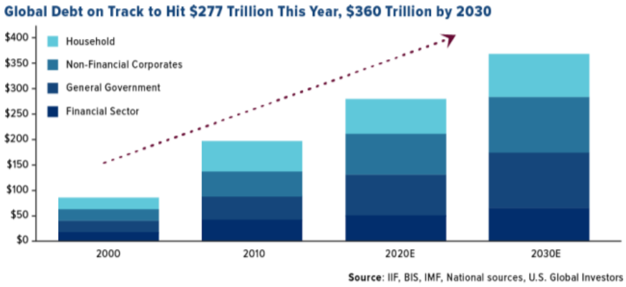
Source: A Long And Difficult Ascent, Statistical Appendix, Part B, Page 6 of the IMF October World Economic Outlook)

For **IASF** investors and regular readers of Seasonal Reflections this is obviously nothing new. On **IASF**'s website, the opening comment sums up the dilemma: *"Financial market seasons have been increasingly influenced by the end of the secular debt cycle and are accompanied by financial repression and long-term negative real interest rates."*

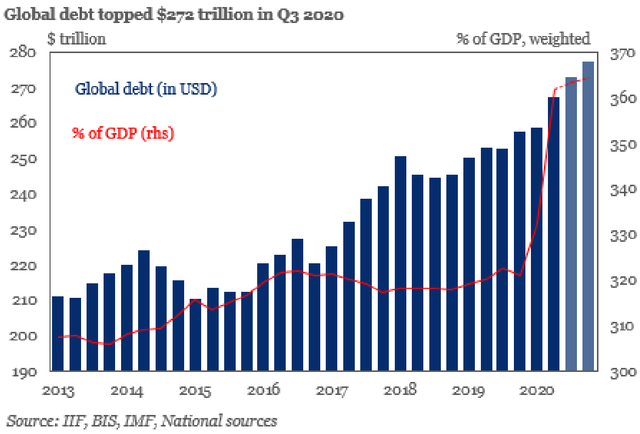
The deep malaise the Western world has gotten itself into – and at an accelerated pace since the advent of Covid-19 – is pointedly accentuated by the two opening quotes from Epsilon Theory's Ben Hunt. The second quote specifically refers to our fiat currency world, and their high priest central bankers, who wield tremendous influence, although their policies have for decades failed to achieve their goals, and the only consequence they have drawn from this is to debase fiat money even faster. Having made this argument in these pages many times, I do not want to repeat it. But for first time readers who like to better understand the interplay between monetary policy action, the economy and financial markets, I recommend Northman Trader's Sven Henrich's "The Ugly Truth", which I also listed among worthwhile podcasts / videos on page 3.

Financial markets and investors of course love zero interest rates as well as central banks creating trillions in new liquidity to buy financial instruments (aka QE), and they equally celebrate increasingly interventionist and expansionary fiscal policy action.

Never has this been more evident than in 2020, when the worst economic crisis since WW II yielded a roaring financial market rally. To me it became clear in 2014 already that the only remaining path was to-do-whatever-it-takes to perpetuate this global Ponzi scheme, although I misjudged investors' response.



Source: US Global Investors, Investor Alert, 20NOV2020



Source: IIF, @IIF, Twitter, 20NOV2020

In hindsight, when one contemplates debt dynamics and the failure of the system to respond to them, it is no longer surprising that investors have been willing to completely ignore this issue. After all, central banks are ready to step in to stop any wave of default by limitless "asset" (mostly debt) purchases (aka QE). And if you can rely on your friendly central banker to provide unlimited funding at practically zero cost, no level of debt will seem to be too high to not be justified, regardless of its quality.

In that context, it never ceases to amaze me to see how much time and effort is spent in our day and age on the subject of "*Sustainability*", which has resulted in tons of regulations to nudge the private sector to not merely follow its own interest but act responsibly towards the environment and society overall. But who subjects the public sector to similar scrutiny and rigor, asking the obvious question whether the above trends are sustainable and demanding a credible answer to it?

2020 has shown plenty of evidence that our political leaders regard the populace they govern increasingly as their subjects, rather than viewing themselves as servants and fiduciaries to them. This trend has been supported by an ever-shrinking level of accountability demanded from our political and increasingly our economic leaders, who have little to no real skin in the games they are playing. I find it increasingly troubling to hear the narrative that listed companies have been looking too much after their shareholders' interests, because it completely fails to mention that there is an even bigger beneficiary. It is the managerial class that has benefited from far too generous stock option programs creating countless billionaires in the process, which will remain billionaires even if the short-term sugar highs they have helped to create for their companies share prices evaporate. Eventually, it is society as a whole, and thus we all as well as future generations, who will have to deal with the fallout of their action. And one fallout is the ongoing debasement of money and related inflation.

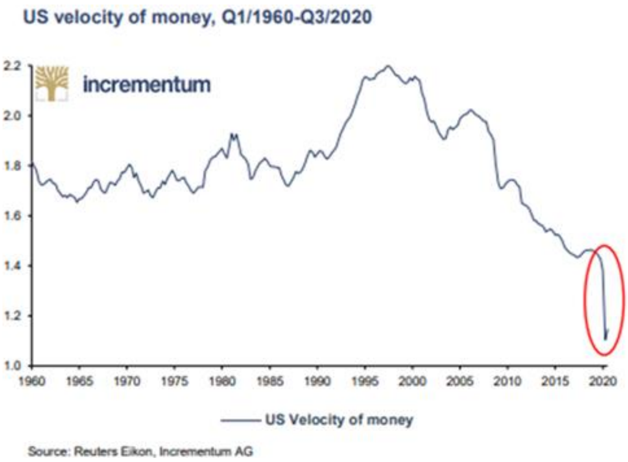
Inflation? – Inflation is dead! We need to worry about deflation!

Yes, that has been the prevailing narrative for a long time now. It rests on a narrow view of inflation, which is measured by consumer price levels. Apart from the statistical issues that plague their "measurement", on which I wrote in SR 2020 / 01, page 5ff, this does not take into consideration that inflation may well show up elsewhere.

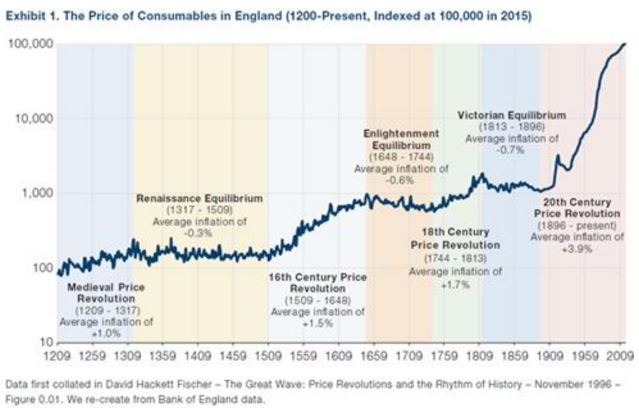
Of course, I recall how I foresaw the threat of inflation already a decade ago, when in the wake of the US housing crash and the ensuing Global Financial Crisis the Fed's initial quantitative easing (aka QE, or in plain English, fabricating trillions of dollars by the stroke of a computer key) was expected to lead to surging consumer prices.

Despite of 3 more rounds of multi-trillion-dollar QEs this eventually failed to materialize. As key reason for the inflation no-show economists have cited the collapse in velocity, in other words the circulation rate with which money is used in our economic system, which has been more than offsetting the Fed's relentless binge printing.

But might we have actually had higher inflation?



Source: Incrementum Inflation Special Report, 30NOV2020



Source: Inflation Regime Roadmap, p3, Man Institute, 10JUN2020

Needless to say, this is exactly what I believe has happened. We have encountered inflation, but the vast majority of it was of the asset, rather than the goods and services price kind, while even the latter has been distorted by the composition of the inflation basket or the hedonic adjustments made to prices.

The true long-term inflationary picture for example in the UK has been neatly shown in the graph on the left.

As an example for the underreporting of actual inflation as recently as last year, I would like to quote from the FT Alphaville column from 17NOV2020, headlined How hidden is inflation? :

"As we have argued in the past, official measures may be underestimating the degree to which prices for the average consumer are still rising. The reason being that the pandemic has upended our spending habits.

Why does that matter? Inflation is calculated using a basket of goods and services said to represent the spending patterns of the typical consumer. What's included — and the weight attributed to each item — changes once a year. This year in the UK, for instance, vegetable crisps, cocktails in a can and self-tanning products went in, while MP4 players went out (a decade too late, we might add).

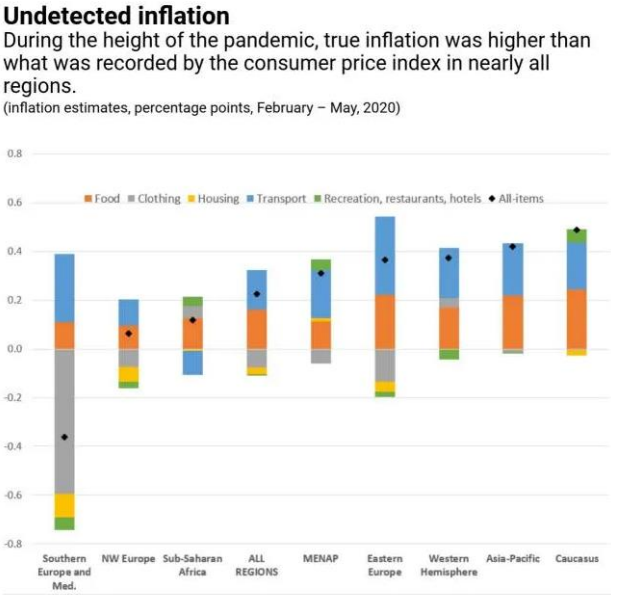
But neither the index in the UK, nor indices elsewhere have been recalculated since — meaning the official measures overestimate the benefit to the average consumer of dirt-cheap plane tickets and underestimate the impact of rises in food prices. To address this, the National Institute of Social and Economic Research in the UK has created a lockdown CPI.

But how significant are the disparities globally? According to IMF research published last week, they're big.

The research, which was — like this earlier attempt to quantify "true" inflation by Harvard's Alberto Cavallo — based on credit and debit card payments, covered eight geographical regions. It looks at the difference between a Covid-19 measure of inflation and official estimates between February and May, when first waves were upon us.

In seven of the eight regions, official measures underestimated price pressures for the average consumer. Inflation got lost in the supermarket, with the underestimation of food costs among the biggest contributors to the disparity — alongside the overestimation of the impact of lower transport costs. Here's a chart which does a great job of summarising the findings."

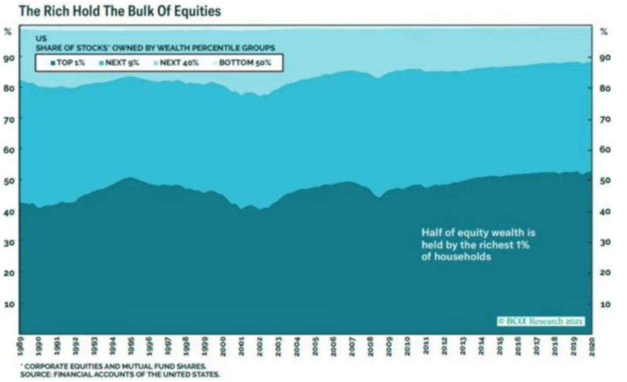
So, this suggests that last year's CPI numbers, just on the basis of how they are constructed, were underestimated by 0.1-0.5 percentage points in most major regions of the world.



Source: How hidden is inflation?, FT, 17NOV2020

Such actual higher than reported inflation also goes a long way in helping to explain the deterioration in real living standards for the bottom 80% of income earners in the developed world, on which I have also commented in previous SR (e.g. here and here).

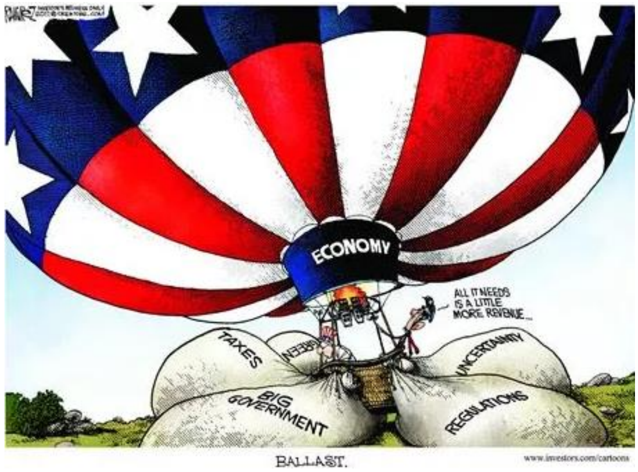
A more important reason for rising inequality, though, is the rise in (financial) asset prices, which has clearly benefited the owners of such assets. In the USA for example the richest 10% of households own nearly 90% of stocks, which makes them the prime beneficiary from the bubble in financial assets over the past decades.



Source: Mind Blowing Charts, Northman Trader, 16JAN2021

With the pandemic having wrought havoc on the global economy, and under the joined forces of monetary and fiscal policy in the pursuit of job and economic growth as well as a minimum inflation target, I have no doubt that over the coming years, we all will experience more inflation, as fiscal policy will be used to increase real demand in the economy as well as for redistribution purposes. A great layout of the choices facing society and its ruling politicians in the years to come is provided in the January 14 MacroVoices podcast (by the way one of the best economic and market podcasts I have so far come across) with Luke Gromen "The Fed Faces No Easy Choices", which is worth listening to.

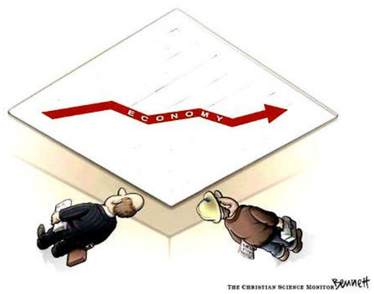
So, where does that leave us at the onset of 2021? – The world is still firmly in the grip of the pandemic, which is fought with lockdowns that slow down the economy. Meanwhile, central banks are keeping interest rates at zero by buying trillions of government debt to keep the cost of carry for the growing debt mountain bearable and to avoid a tsunami of defaults. The official aim is to have unemployment rates reach and inflation rates exceed target levels (to make up for lost ground in the debasement process), and hence their willingness to continue to prime the pump will be near unending.



Source: Michael Ramirez, Townhall.com, 16AUG2011

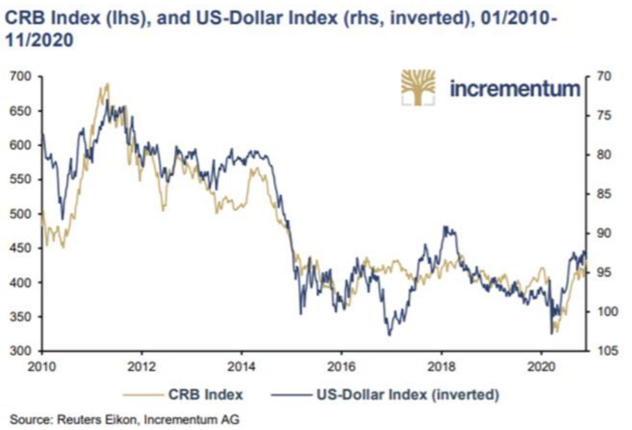
Ultimately this mainly supports Wall Street and its associates, while it is euthanizing the rentiers. And here I am not referring to the uber-rich (no pun intended), but those who (have) spent a lifetime working and saving for their retirement in order to not depend on government handouts, and who now find that there only choice is to eat up their capital or join the speculative frenzy in today's market, as the risk-free return has been manipulated to zero and below, and cannot go up (at least in real terms) for a long time…

Governments seem to have realized that interest cost will remain near zero, and thus have thrown all remaining fiscal prudence overboard, spending like drunken sailors to get growth going again. – Success so far is still pending…



Meanwhile, the world looks rather different from the perspective of investors, who had plenty to cheer about in 2020, than from those who have no money to put aside for chasing the latest hot cakes in The Grandest Casino. Personally, I find numerous examples that indicate that we are in the largest financial market bubble in my 30 years in the business. But there are few who agree with that, as the recent push back on Jeremy Grantham's "Waiting for the last dance" shows.

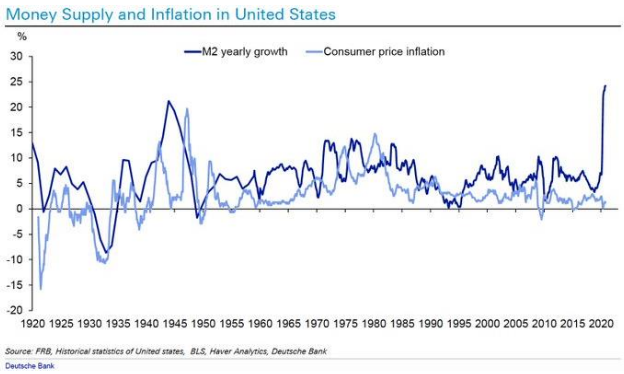
All in all, worrying about deflation seems to be yesterday's battle; in a reopening post-Covid global economy, I expect inflation to surprise on the upside. Reasons are manifold:



Last year we saw a turnaround in the until then firmer USD trend, which I believe is a result of waning confidence in the world's reserve currency. As the graph on the left shows, a weaker USD has a high level of correlation with rising commodity prices, which in turn will be a growing source of cost-push inflation. And evidence for rising commodity prices is widespread, though as the graph suggests it may have quite some way to go.

Inflationary pressures also result from increasing geopolitical tensions, which are impacting global supply chains. Until recently, price and quality were the most important consideration in any corporate supply chain. Now we have moved to a world where safety of delivery matters most, even if the cost is higher. This is a dramatic paradigm shift, as it adds up to a huge hit to productivity. Productivity is under attack from everywhere, from regulation, from ESG-investors, and now it is also under attack from security considerations, and the corporate sector will do what it can to pass these costs on. (How successful this can be done will also determine the trend in corporate profitability…)

This would only not be inflationary if on the other side central banks were acting with restraint. But of course, we know that central banks are printing money like never before. The chart on the right illustrates the US example. Historically, there has been a high degree of correlation between money supply and consumer price inflation. Will it be different this time?



Source: Holger Zschaepitz, @Schuldensuehner, 5DEC2020

Then there is the aspect of fiscal taking over from monetary policy. While the latter caused inflation predominantly in asset markets, fiscal policy works through transfer payments, loan guarantees, or direct spending, which are all designed to boost real economic demand and thus c.p. lead to higher prices. In addition, it will seem increasingly politically opportune to fight inequality, i.e. to help lifting the living standards of those who are still waiting for the benefit of trickle-down economics. Keywords here are UBI (Universal Basic Income) or MMT (Modern Monetary Theory), who all advocate for more government intervention and ultimately redistribution. All of this will be inflationary in nature!

For those keen to dive deeper into the subject, I refer to the recently published Incrementum Inflation Special Report which delivers a far more comprehensive analysis on the subject. But one thing is certain; the official narrative that there is no inflation seems plainly ridiculous, especially if one includes asset price inflation in the equation. And this is definitely relevant.

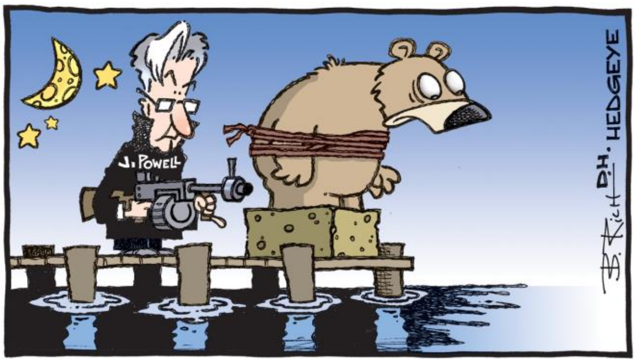
Source: Hedgeye, 21Jan2021

After all, our USD, EUR, or CHF certainly do not afford us the same type of living space - rented or owned - than they did 5, 10, or 20 years ago. This is where asset price inflation clearly has been driving inequality and has effectively diminished the purchasing power / living standards of all those that are not (financial or real estate) asset owners. We at Incrementum expect that loss of purchasing power to accelerate in coming years, and believe it is essential not only for investors to be prepared for this.

Financial markets – Bubble, Bubble, This is Trouble

Reflecting on an extraordinarily humbling year 2020 for **IASF** and its management team, I cannot help but conclude that we might have been needlessly complicating too many things by looking at underlying economic conditions and valuations.

In the end the only thing that mattered was central bank asset purchases, as well as a tsunami of fiscal stimulus unleashed at the same time to counter the virus induced economic shock. As a result, we are now firmly into Mario Draghi's famed **"WHATEVER IT TAKES"** territory, both for monetary and fiscal policy, as all prior restraints on money printing and fiscal spending have been shattered.



Source: Hedgeye

Source: Hedgeye

Trying to figure out the development of Covid-19, as well as its impact on the real economy, how deep a recession we may be facing, or how high unemployment rates may rise, and how that may affect corporate profitability, ultimately turned out an utter waste of time. Instead, the only argument in a self-reflexive manner has become that there is more liquidity and more stimulus just beyond the horizon, which is all that "investors" need to see to continue to pile into risk assets at ever increasing prices.

I have witnessed similar (pig-, or in this case bull-flying) behaviour during the dot-com-bubble well over 20 years ago, and back then I admittedly was as puzzled by it than I am now. But recalling that prior experience also urges me to wonder whether the ongoing liquidity and stimulus wave can continue to push the market higher? – Or asked differently:

Source: Hedgeye

Source: Wellenreiter, 17.12.2020

Will there be a point when fundamentals matter? Because earnings growth estimates are priced for perfection, which will be hard to deliver on as indicated in the previous chapter.

Source: Hedgeye

After all, there is only so much you can squeeze out of a lemon…

Of course, I am convinced that if inflation rates pick up next year, no central bank in the world is going to turn away from their zero / negative interest rate regimes and QE-to-infinity policies, as this would simply risk an implosion of the existing Mount Everest-like debt berg. And fiscal policy is also not going to change because politicians will be reluctant to stop giving out freebies in their quest to run the economic machine perfectly AND save the planet. And since all restraints have been broken in the fight against Covid, there will always be reasons to continue on the path of deficit spending until the economy has recovered, and the labour market is back to full employment, and the environment is saved, and we can all live happily ever after.

Source: Hedgeye

For now, we have been witnessing the single biggest economic calamity in 2020, and yet financial markets have soared to new highs, which essentially has severed any residual connection between financial asset prices and underlying economic fundamentals. This has taught investors that it is no longer important to care about fundamentals, like revenues, cash flows, earnings, net asset values, etc.

If you ask me how much crazier this can get, I can only answer that nobody knows! But with real interest rates negative as far as the eye can see, major asset allocators will continue to reshuffle their allocations away from fixed income towards the riskier (equity-like) range of the investment spectrum. This in turn promises regular volatility outbreaks similar to those witnessed in recent years (1Q20, 4Q18, etc).

Source: Hedgeye

So, what can your fund manager do? In my and our view, we also can only conclude that fixed income has become widely uninvestable! Meanwhile, on the equity side, it would seem that the right strategy for **IASF** is to focus on value, i.e. businesses where share price valuations are justified by underlying fundamentals. In addition, we can also consider exposure to industries that are likely to experience cyclical tailwinds, which the market currently underappreciates. This way we are more likely to ride out any unforeseen market shocks (I know, I know, these are a thing of the past…).

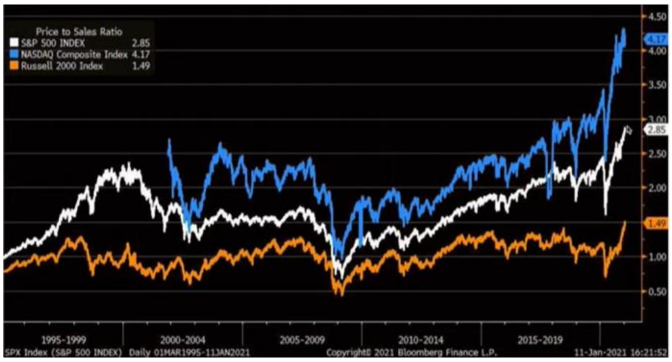
But more on this further below.

What despite of a loyal and faithful investor base we have to accept as consequence is the occasional mild dressing down from investors, reminding us how much better they have done elsewhere in those uber (again, no pun intended) hip growth areas, or sometimes even in plain vanilla passive equity index products.

Yeah, I know, and I also wish I had bought Tesla stock at their lows of USD 70 from last March. Boy, that would have been more than a ten-bagger in less than a year. But how could we justify risking our investors' money on such a gamble?

Besides, do our investors see what we are seeing? – In terms of overall market valuations, ...

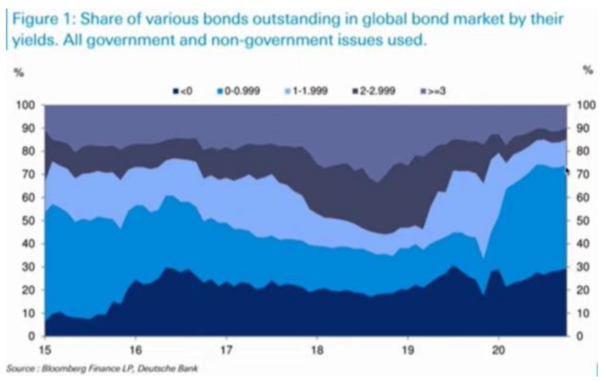
Source: [Mind Blowing Charts](), Northman Trader, 16JAN2021



Source (both): [Mind Blowing Charts](), Northman Trader, 16JAN2021

... which are marked by ridiculously elevated price-to-sales ratios (on the assumption behind a price-to-sales ratio exceeding 10, I traditionally refer to former Sun Microsytems (not Microsoft 😉) Scott McNeely's quote, which can be found on page 15 of [SR 2020 / 07]()), ...

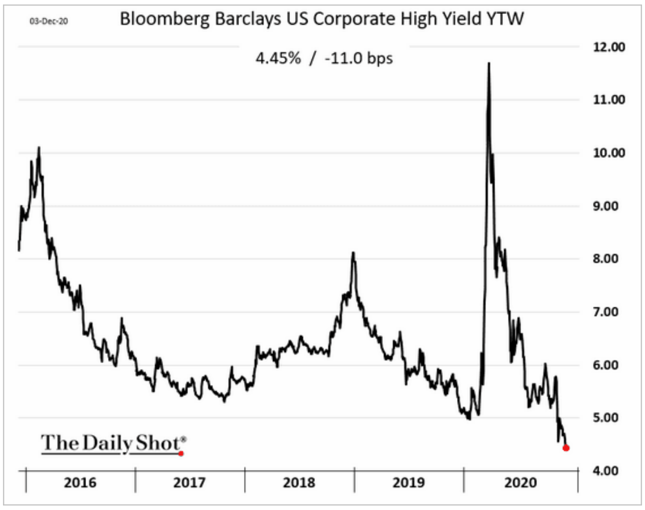
... clearly extraordinary price-earnings ratios, ...



Source (both): [Mind Blowing Charts](), Northman Trader, 16JAN2021

… which are even topped by the incredible fact that nearly 30% of all outstanding bonds in the world yield less than 0%, which by the way guarantees a loss in nominal terms if held until maturity date. Meanwhile, well over 70% yield less than 1% (**nominal!** - see chart on bottom of previous page on the right).

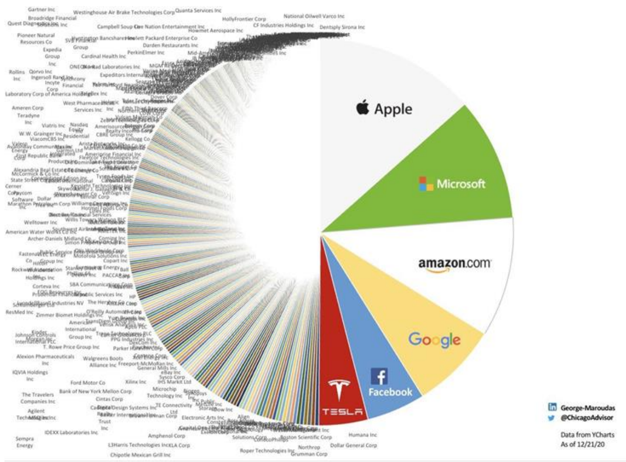
My esteemed colleague Ronnie Stoeferle tweeted on December 7: *"The yield on US high-yield (aka junk) bonds hit a record low… while even CCC is trading at multiyear-lows…"*, accompanied by the following 2 charts, which show that even the riskiest portions of the bond market offer historically low yields:



Source (both): Ronnie Stoeferle, @RonStoeferle, Twitter, 7DEC2020

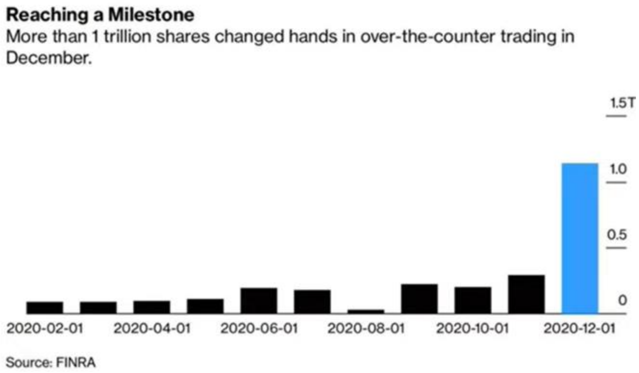
Do investors realize the mind-boggling speculative excesses, particularly in equity markets? Arcus Investment Ltd's Mark Pearson coined it the "**2020 Momentum Mania**" in their 3Q2020 call, when he listed conditions similar to those described in Liaquat Ahamed's Pulitzer Prize winning masterpiece "Lords of Finance" about the 1928-1929 boom, which feature:

- *the progressive narrowing in the number of stocks going up* (and resulting concentration; for evidence, see S&P500 composition in accompanying pie chart),
- *the nationwide fascination with the activities of Wall Street,*
- *the faddish invocations of a new era, and most important,*
- *the suspension of every conventional standard of financial rationality,*
- *and the rabble enlistment of an army of amateur and ill-informed speculators, …*



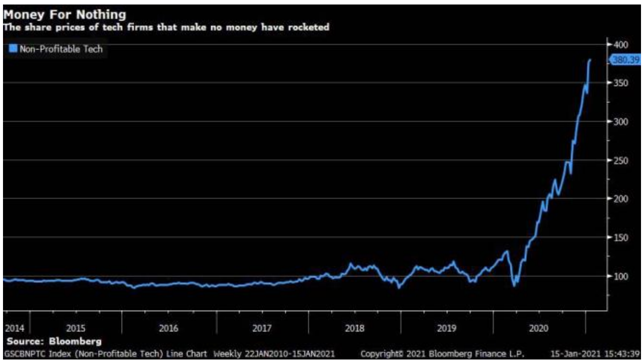
Source: Sven Henrich, @NorthmanTrader, Twitter, 22DEC2020

… which have been gambling in out of the money-call options and at exploding volumes.

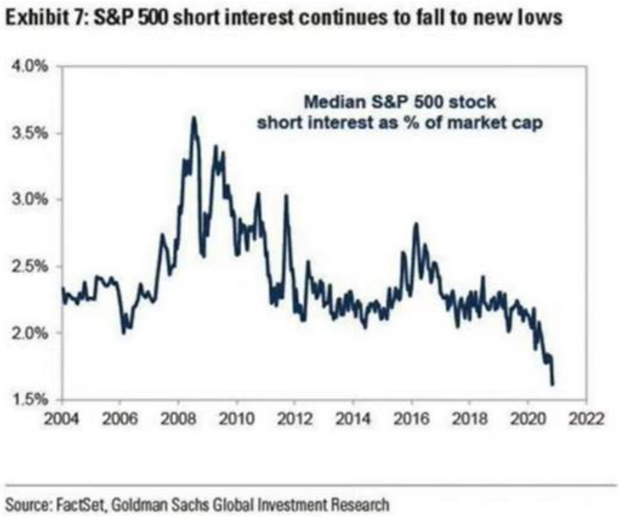


Source: [Mind Blowing Charts](), Northman Trader, 16JAN2021

While speculators have been piling into shares of firms that are not making any money, the pros have given up shorting stocks.

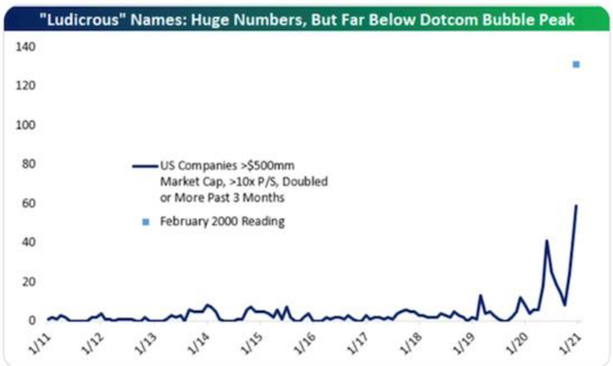


Source: Liz Ann Sonders, @LizAnnSonders, [Twitter](), 19JAN2021



Source: [Mind Blowing Charts](), Northman Trader, 16JAN2021

Meanwhile, the @bespokeinvest "ludicrous" indicator sums up the heated sentiment nicely, as it records the number of US companies with a market cap exceeding USD 500m, which trade at 10 times or more trailing sales, and whose share prices have at least doubled over the preceding 3 months. As the chart shows, there are now more than 60 of those.



Source: [Bespoke]()

Or in summary: *"The market displayed every classic symptom of a mania"* (Liaquat Ahamed in [Lords of Finance]())!

At the same time, Jesse Felder in a Twitter post recently referred to a new Bloomberg article, which highlighted that *"In the first two weeks of the new year, a total of 1,000 insiders sold their own stock and 128 bought shares, leaving the sell-to-buy ratio poised for the highest monthly reading in data going back to 1988."* – Under normal circumstances record insider sales should give investors' pause for thought…

Source: Jesse Felder, @jessefelder, Twitter, 20JAN2021

But none of what we are currently witnessing qualifies as normal.

Ok, I know you will have got my point. However, I want to conclude with an interesting comparison, which shows the top 10 S&P 500 components from the peak of the last inflationary period in 1980 versus last year's top 10 ranks.

1980

Company	Rank	Maket Value (in millions)	Weighting
Int'l Bus. Machines	1	$39,604	4.27%
American Tel & Tel	2	$35,676	3.85%
Exxon Corp	3	$34,856	3.76%
Stand'd Oil,Indiana	4	$23,365	2.52%
Schlumberger, Ltd	5	$22,331	2.41%
Shell Oil	6	$17,990	1.94%
Mobil Corp	7	$17,163	1.85%
Standard Oil of Cal	8	$17,020	1.84%
Atlantic Richfield	9	$15,030	1.62%
General Electric	10	$13,883	1.50%

2020

Company	Rank	Maket Value (in millions)	Weighting
Apple Inc.	1	$2,255,970	6.80%
Microsoft Corporation	2	$1,681,610	5.07%
Amazon.com, Inc.	3	$1,634,170	4.93%
Facebook, Inc. Class A	4	$656,668	1.98%
Tesla Inc	5	$668,905	2.02%
Alphabet Inc. Class A	6	$526,920	1.59%
Alphabet Inc. Class C	7	$577,888	1.74%
Berkshire Hathaway Inc. Class B	8	$317,883	0.96%
Johnson & Johnson	9	$414,310	1.25%
JPMorgan Chase & Co.	10	$387,335	1.17%

Source: S&P; based on year-end data

Source: Fortune Financial Blog, 12JAN2021

It shows that while in 1980 a majority of the top ten S&P 500 components came from the energy sector and related industries (what we would call hard asset stocks), today a majority are technology or technology related. Personally, I am more than willing to go on record with my expectation that we will go full circle on this, and I am convinced it will not take 4 decades to get there.

Source: Hedgeye

In fact, I would not be surprised if over the next 10 years commodity producers and hard asset stocks were going to crowd out the tech giants everyone is currently chasing with such wild abandon. – Time will tell!

Source: Hedgeye

Let me conclude with a quote of the opening chapters from the already on page 14 mentioned piece by GMO's Jeremy Grantham "Waiting for the last dance", which as always is well worth the full read. The following extract, however, perfectly summarizes my own sentiment at the start of 2021:

"The long, long bull market since 2009 has finally matured into a fully-fledged epic bubble. Featuring extreme overvaluation, explosive price increases, frenzied issuance, and hysterically speculative investor behavior, I believe this event will be recorded as one of the great bubbles of financial history, right along with the South Sea bubble, 1929, and 2000.

These great bubbles are where fortunes are made and lost – and where investors truly prove their mettle. For positioning a portfolio to avoid the worst pain of a major bubble breaking is likely the most difficult part. Every career incentive in the industry and every fault of individual human psychology will work toward sucking investors in.

But this bubble will burst in due time, no matter how hard the Fed tries to support it, with consequent damaging effects on the economy and on portfolios. Make no mistake – for the majority of investors today, this could very well be the most important event of your investing lives. Speaking as an old student and historian of markets, it is intellectually exciting and terrifying at the same time. It is a privilege to ride through a market like this one more time." (Source: Waiting For The Last Dance by Jeremy Grantham, GMO, 5JAN2021)

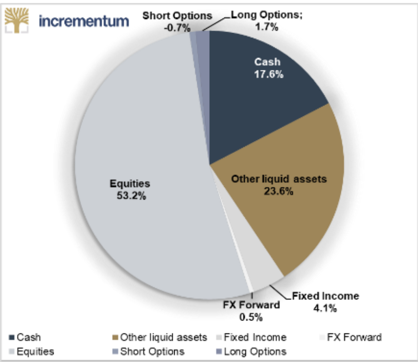
2020 IASF Portfolio Management Review

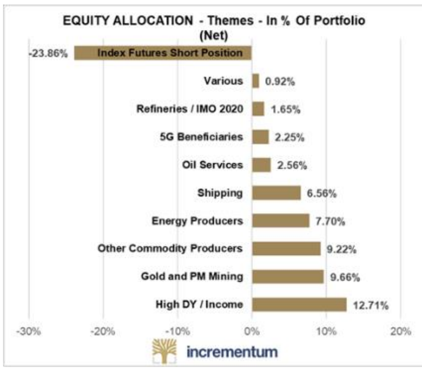
In recent investor calls I was asked to provide more insight into the management of **IASF**, a request, I am happy to comply with, as it will help investors to better understand the challenges we faced as fund managers in 2020, but also provide more transparency about our investment approach and how we implement this within the portfolio. **But before I continue, let me remind all readers:**

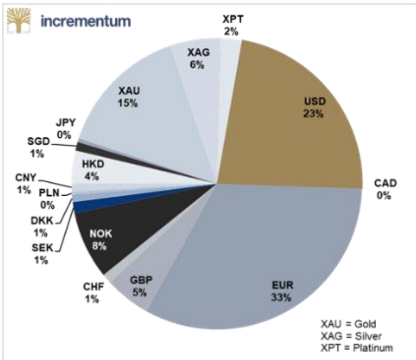
Any investment analysis, views, and assumptions included in this document are based upon current market conditions and reflect the opinion of the author. All information contained in this newsletter has been compiled by the author from sources believed to be reliable, but no representation or warranty is made by the author or Incrementum AG, as to its accuracy or completeness. The Newsletter is issued to registered subscribers for information purposes only and must neither be regarded as an attempt to solicit an investment in individual securities or asset classes mentioned, nor in the Incrementum All Seasons Fund. Past performance is no guarantee for future results, and the value of the fund may go up as well as down. If you seek investment advice, please consult a licensed investment advisor or do your own due diligence.

When I reviewed my SR – 2020 – Issue No 1 from almost exactly a year ago, I had stated our fund management goal as *"to achieve a long-term increase in real purchasing power, and even if I am "leaving the party" it does not mean that the fund has gone all into cash. The main reason is that both cash and high-quality fixed income only offer negative real returns (i.e. lower nominal returns even than reported(!) inflation). The other is that I continue to find value in equities, though hardly in those areas that are driving overall index performance. As a result, about half of the Incrementum All Seasons Fund's investments have been allocated to equities, though that allocation has been partially hedged via short futures contracts and additional longer-dated options."*

The basic content of this statement remains unchanged one year later, as we find ourselves in a similar position. But before I elaborate further on this, let's have a look at the allocation overview prevailing a year ago, which is provided below (Source: Seasonal Reflections, 2020/01):







Allocations back then reflected the fact that the FTSE Global 100 had just registered a 29% gain in 2019, and equity markets for all intend and purposes looked extremely stretched, both from a momentum as well as valuation point of view. Given a 53% gross equity allocation (30% net, after deducting the existing short positions), I felt comfortable enough to state we "*have of course positioned the portfolio in risk assets, but with a defensive bias, and I am confident that it will prove rather robust and resilient in any risk-off move.*"

That obviously proved way too optimistic, considering an 18% NAV drawback during 1Q2020, which actually was slightly worse than the commensurate quarterly drawdown in the FTSE Global 100, and this despite of the various hedges incorporated. This was mainly due to the high-beta nature of our equity book at the time, which as the Equity Theme table above shows was predominantly allocated towards economically cyclical and commodity names, which sold off drastically during 1Q2020 as the full degree of Covid-19 related demand destruction became obvious.

These are times as a fund manager when it feels you are chasing your own tail, as every further step in a correction lower makes actual macro-economic developments and the resulting outlook fully priced in, and yet as seasoned investors we know that markets tend to exaggerate price moves. Witness the crazy valuations afforded to tech names, and the end-of-the-world valuations for energy stocks last year, and you will know what I am talking about. One can try to trade these or broadly stick with one's overall allocation, relying on the inevitable rebound. We chose the latter and suffered for it, as the hardest hit sectors in our long equity book really only started to seriously recover in November last year.

That does not mean that the portfolio was not actively managed. Our 2020 trading sheet records nearly 700 individual transactions (including FX spot and forward transactions for cash and risk management purposes), of which about 20% were option related (incl. option exercise entries). It is a notable achievement that **IASF** generated approx. EUR 2m, or nearly 5% overall performance contribution through the sale of covered stock options (calls and puts) on over 40 different stocks over the course of the year, which were mostly sold on a 1-2 months at- or out-of-the-money basis.

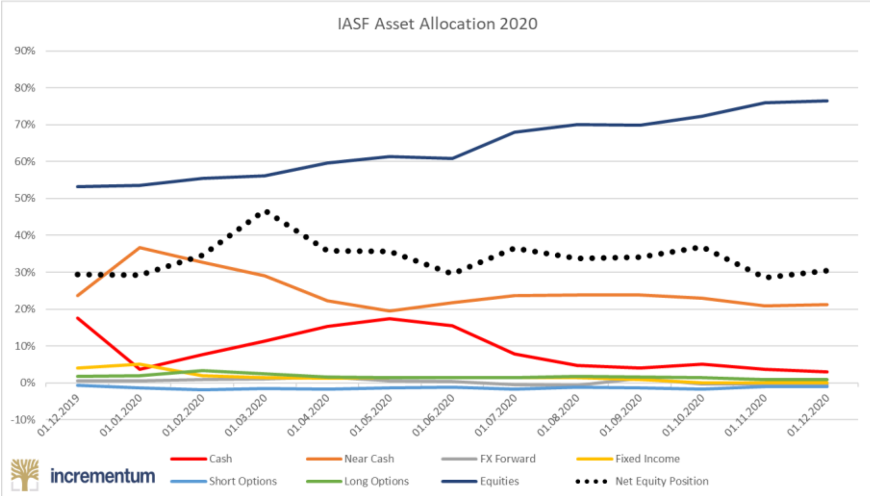
Energy names delivered the most significant contribution, as we sold predominantly puts into the market weakness during 1Q 2020 and calls into strength towards year-end. **Antero Resources** short options were the top performer, generating almost EUR 300k over the full year (more on this name later). Other top premium earners were **Gold Fields** (EUR 200k), **Pretium Resources** and **Peabody Energy** (EUR 130k), **Teekay Tankers** (EUR 120k), **Scorpio Tankers** and **Marathon Petroleum** (EUR 110k each) and **International Seaways** (EUR 100k).

We also entered 7 long option positions, namely:

- January 2021 call option on **Pretium Resources**, strike: USD 10, which has by now been exercised, though at a total loss of about 10% when figuring in the call premium paid.
- December 2020 put options on **Apple**, strike: USD 560, which were sold at a 40% gain.
- Call options on three tanker stocks bought in Aug/Sep, expiring during 1Q2021, the premiums of which were all funded by the sale of corresponding put options. One position closed in Jan, with the call delivering more than 30% profit on the strike, while the put expired worthless.
- December 2020 Put options on **Tesla**, strike: USD 500, bought in late November, around the time of the S&P500 inclusion. We had anticipated some profit-taking following the index inclusion, which however did not materialize, and the position was a complete write-off.
- In November we also closed a **EUR Call / USD Put** option acquired in November last year, again at a decent profit. This position was taken on as part of IASF's FX risk management, as we expected a weaker USD.

Conclusion: Though more work-intensive and done to a far more regular and frequent extend, our short options delivered an excellent performance contribution, while our long options broke about even. And yet, 2020 overall portfolio performance was marginally in the red. – Why was that?

The accompanying chart displays **IASF's** asset allocation over the course of the year (monthly, Dec19 to Dec20). It shows the sum of **cash** and **near cash** falling from 42% to about 24% at year-end 2020. This was the result of the gradual increase in the **gross equity** allocation from about 53% to 76% over the course of the year.

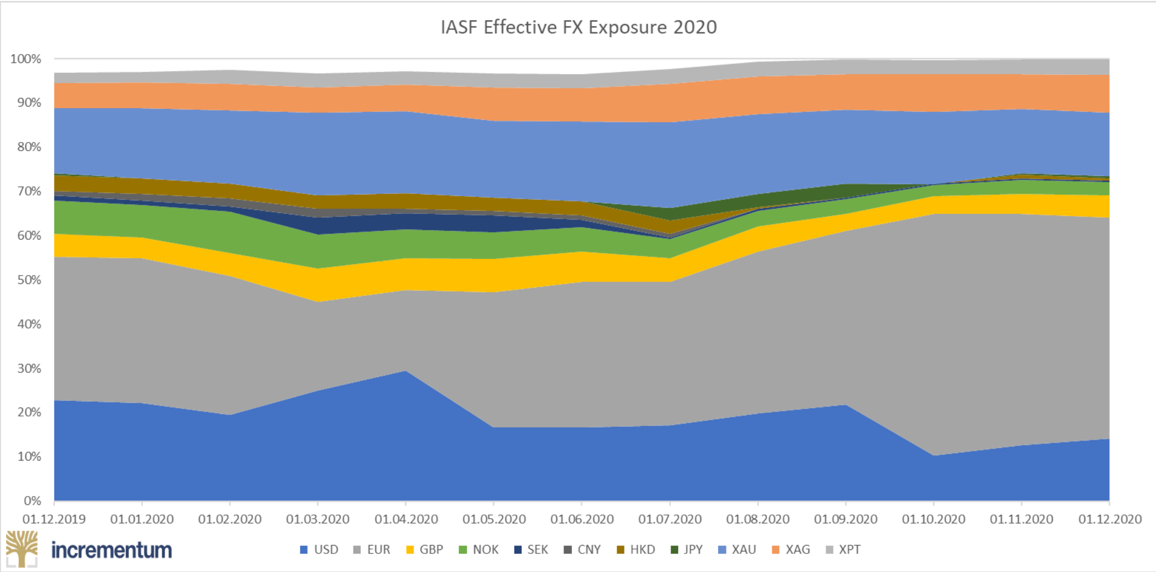


And yet the portfolio's **net equity** allocation has been fluctuating mostly between 30% and 40%. The difference between the gross and net allocation is due to **IASF's** equity index short positions, which for most of the year have been about equally split between S&P500 and Nasdaq shorts. As equity markets recovered from the March lows our short futures position, which actually had been closed down to zero over the course of March (lowest close was executed at 2320 S&P500 points), was gradually built up again (beginning at 2630 on March 26) in order to reduce the volatility of our equity book, and quite frankly because we were not convinced the market would be able to deliver the kind of recovery / rally it subsequently has. Overall, these short positions have cost **IASF** about 10% performance over the last three quarters of 2020. In other words, had we opted for less caution the fund would have delivered a very nice gain last year.

Hindsight, they say, is 20/20, or as we say in German: Hinterher ist man immer schlauer! (Translates something like "With hindsight one is always wiser.") – Did I as fund manager in charge regret having made that decision? – Sure, many times. But remember this is a dynamic process. At any given time of the journey, we felt that taking up these short portions was the right thing to do in order to protect the fund's assets in case the market hits another air pocket. So far it hasn't, and yet we want to be prepared. Because this is not a sprint but a marathon, and there can be no doubt that we are nearer to the peak than the bottom of the market cycle.

There is another important aspect here: This strategic positioning allows us to place a relative bet on our equity long positions, which are heavily biased towards cyclical, value and hard asset plays, to perform better than the tech- and growth stocks-heavy weighted short index position, which in light of the picture drawn in earlier chapters of this report should not come as a surprise. But it obviously requires patience, as so far it has yet to pay off. November, December and the first half of January provided a glimpse how this could work for **IASF**, but if the global economy remains in lockdown for longer, our positioning may risk a setback.

A quick word also on foreign exchange allocation. As the graph below shows, **IASF** has prudently managed its FX allocation, accepting a higher **USD** allocation during the first quarter, when the **USD** benefited from safe haven flows.



From 2Q onwards we have been reducing **USD** exposure gradually, mainly hedging it back into **IASF's** main portfolio currency **EUR**. The other large allocation is the fund's **XAU** (Gold), **XAG** (Silver) and **XPT** (Platinum) exposure, which is held through Exchange Traded Notes as well as the fund's exposure to gold and silver producers (on a look-through basis).

For investors who are holding CHF or USD units in the fund, I would like to emphasize that we systematically hedge the underlying EUR exposure of the main investment portfolio back into CHF and USD, in order to ensure that all three currency share classes move in synch. The difference in absolute performance over time merely reflects hedging cost, which still are in favour of USD investors.

Ok, time to conclude this section, but not before I have spoken about...

IASF's 2020 Hits and Misses

Given the length of this piece, I'll keep this focussed on the fund's long equity book:

MISSES: Here the **Energy** sector rules supremely. Not counting option premiums and based on average entry and year-end cost, the worst performance was our realization of a more than 70% loss on **Transocean**, which figured prominently in last year's SR 2020 / 01, and thus was the most bitter decision we had to take last year. But as I say: Always go to the funeral! – Why did we sell the stock? – Quite frankly, the main reason was not that we felt it could not survive, though the 2020 oil price shock and the subsequent slashing of exploration budgets certainly did not help the investment case of the largest and highly geared offshore oil services company. The decision to cut it was finally made after almost all major competitors (e.g. Diamond Offshore Drilling (with USD 12bn in total debt), Noble Corp (4bn), Valaris (1bn), Seadrill (3bn), etc.) had filed for bankruptcy / entered debt restructuring over the course of the year. This made us realize that even if Transocean holds out, they are still carrying a huge (approx. USD 11bn) and high interest-bearing debt burden, which the competition will have got rid of once they emerge from restructuring. Thus, we felt it was better to exit the position, as long as the shares were still worth something.

Another big MISS was **Peabody Energy**, given its own debt load and the plunge in coal prices last year. By year end the stock, which we had already trimmed over the course of the year, had registered a two-thirds share price loss. Given the extreme volatility, and the ongoing prospect of a cyclical recovery in coal prices, we are retaining the balance for now (only 0.6% portfolio weighting), but have been continuously selling options against it, which cushioned the blow suffered on the share price significantly. The company remains very highly leveraged, and a lot of things could still go wrong, but we feel that the worst is priced in.

Other big losses year-over-year in the energy category were racked up by **Royal Dutch** or **Cenovus Energy** (fka Husky Energy), which both gave up about 40% last year. **Invesco's US Energy Infrastructure MLP** was down 38%, though we averaged our holding over the course of the year, leaving actually "only" a 22% loss (not counting dividends). – Please note that these year-end results already were significantly improved compared to the March lows. It is also important to realize that we did actively manage our exposure and thus you will also find some **Energy** names mentioned among the HITS category further below.

Ok, the other major sector exposure is **Shipping**, which was increased significantly last year (from 7-18%). Additions came mainly in tanker stocks, where we used the extreme volatility to earn significant option premium income for the fund, while building up exposure to a crucial global logistics sub-sector, which has suffered a long cyclical decline, but shown signs of life over the past couple of years, when seasonal rate spikes helped tanker owners to reap significant cashflows and earnings, and thus to pay commensurate dividends.

All of IASF's (oil) tanker stocks are currently trading at low single-digit PE's (arguably the result of the floating storage-driven rate bonanza during 1H2020), at significant discounts to book value / NAV (ranging from 20% to 65%), with greatly strengthened balance sheets compared to a few years ago, and excellent interest coverage. Sure, dividend yields, which in some cases were in double-digit territory over the past four quarters (e.g. DHT distributed USD 1.35, representing a 19% yield on IASF's entry cost, Frontline distributed USD 1.70 (20% yield), Euronav USD 1.66 (17%)), have been coming down but they did provide an effective buffer to share price weakness especially into 2H2020.

The latter was due to the lack of rate recovery experienced this winter, which in turn is due to the reluctance of OPEC to increase production (they even cut again recently). And while China was driving volumes during 1H2020, it has recently reduced its pace somewhat. Overall, we are currently experiencing a cyclical trough in volumes and rates, while capacity will be shrinking amid an ageing fleet and low order book, which seems a good recipe for a cyclical upswing in tanker rates and share prices. But 2020 has seen some MISSES in the sector where **Frontline** shares lost a third of their value, **DHT**, **Scorpio Tankers** and **Teekay Tankers** about a quarter each, while **Euronav** was down 15%. Dividend income (as well as option premiums earned) of course have reduced these losses significantly.

Other loss contributors last year were **BT Group** (-24%), **Singapore Telecom** (-22%; sold already), or **Nokia** (-14%).

Ok, time to move over to **IASF's** **HITS**:

The **Energy** sector did not only deliver losses, but with **Antero Resources**, a major independent US integrated natural gas producer, with major acreage in the Marcellus and Utica shales, also one of the main HITS. The company has suffered from the low US gas price environment of the past few years, and as a result is highly leveraged. However, they have been shrewdly managing their hedge book, taking advantage of gas price spikes to sell gas forward at accretive prices. We established first positions in late 2019 and accumulated more into the sell off during 1Q 2020. By year-end, our holding had delivered a 140% gain on our average purchase price, not counting the significant premium income from selling options in the name (17 transactions with more than EUR 290k in premiums earned). We have used the strong advance in the share price towards year-end and into 2021 to lighten up on our position, which however remains one of IASF's largest equity holdings. Other notable winners in the **Energy** category were in the uranium space (**URF** +36%; **Cameco** +27%), but also in oil services (**SLB** +15%; **Technip FMC** +54%). And thus, even in the hardest-hit sector last year, **IASF** managed to make some money.

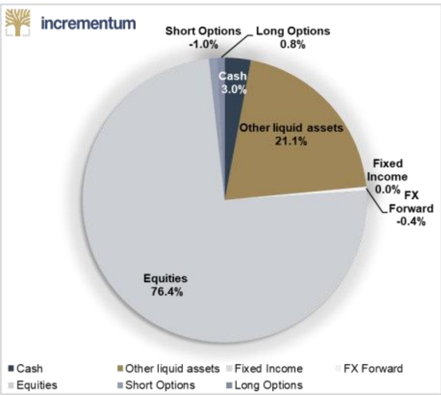
Of course, the Gold and PM Mining sector featured prominently in the **HITS** section. **ASA Ltd**, a US-based closed-end fund managed by Merk Investments, was actually the star performer with a 60% advance over the year. **Pan American Silver** gained 43%, and **Gold Fields** 40%. The latter also earned IASF nearly EUR 200k in additional option premium income. All gold stocks obviously rose significantly last year, and **IASF** has used the rally to rebalance its position over the course of the year.

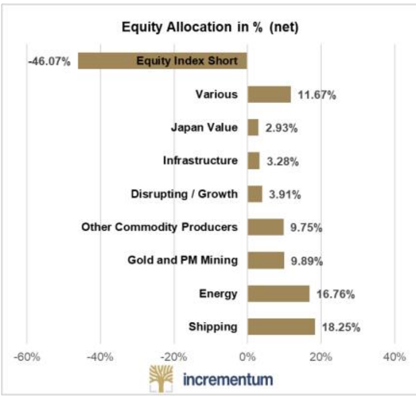
Let's move to the HITS in **Shipping**, which should not be forgotten. Here **Stolt Nielsen** (+12%) and **Pacific Basin** (+8%) deserve to be mentioned, as well as **BW LPG** (quick 15% over a month-long trade), **Avance Gas** (17 individual (small) sale and purchase transactions between March and October, yielding about 20% average return) and **FlexLNG** (+40% on positions bought in Aug and sold from Oct-Dec), which by year-end were all sold again.

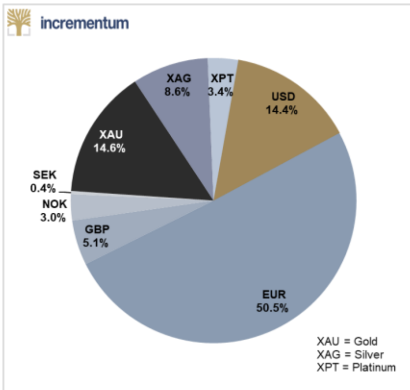
In **Other Commodities**, **Cleveland Cliffs** (+110%, not counting option premiums), and **Lundin Mining** (+46%) were the major winners, but also **BlackRock World Mining Trust** (+36%) deserves a mentioning.

And then there is the newly established **Disrupting / Growth** category. These are usually smaller-sized positions (0.2-1% of total assets) in new technology companies that have the potential for disruption and high growth. One example would be **Magnite** (MGNI, fka The Rubicon Project), which has developed an automated advertising platform that allows to better match global brand advertising with individual viewers. **IASF** bought a small position in March (0.2% of NAV), which we exited by Nov/Dec last year at an average more than 120% gain (not counting option premiums earned in the process). The stock has continued to rally, but we are happy to have more than doubled our money. Another example is **Quantafuel AS** (0.25% holding), a Norwegian listed company that has developed a new green technology that allows recycling of plastic waste in a chemical (rather than) mechanical process. It is testing this in collaboration with BASF, and if successful will address a huge potential market. The share price gained 17% since our first purchase in October last year. Meanwhile, **Mohawk Group** is a leading tech enabled consumer products platform, which some see as a potential challenger to Amazon's online business. **IASF** bought a 0.35% stake in August, which it has partly sold with a 50% profit, with the rest of the holding up 122% by the end of last year.

Well, I hope that this allows investors a better understanding on how we have deployed our capital. Year-end allocations are shown below for your easy reference.







The game is investing, and it is a long game. The first rule of the game is protecting investors' funds, i.e. to avoid material drawdowns. This proved the biggest challenge last year in a truly crazy market. I have been managing money for more than three decades, and whenever I start feeling that I may have figured it out, humiliation is just around the corner. That was what happened in February / March, when we reduced our index hedges to zero, but seeing the pandemic was serious and deadly, and the economic cost likely staggering, hesitated to deploy sufficient cash into new investments. In addition, we rebuilt our index shorts far too early, as we simply lacked the imagination that financial markets could so completely decouple from fundamentals.

IASF Quarterly NAV Change

4Q 2020 (25.9.-31.12.)

EUR-D	103.43	11.08%
USD-D	105.80	11.64%
CHF-D	102.03	10.99%
EUR-P	101.59	10.98%

And yet, in the end we just about recovered the earlier year losses, and **IASF** has had an encouraging start into 2021.

IASF Year-To-Date NAV Change

1.1.2020 - 31.12.2020

EUR-D	103.43	-1.01%
USD-D	105.80	-0.26%
CHF-D	102.03	-0.90%
EUR-P	101.59	-1.39%

Even after 30 years of going through the ups and downs of financial markets, I admittedly am still struggling to handle the regret issue. Mind you, it has become far better than in the early days, but I cannot get that voice in my head to completely shut up, when it reminds me where I went wrong (bought / sold too early / too late). – Could we have done better? – For certain. But still a lot of things worked well last year, and it is important to see both good and bad decisions (which by the way only become good or bad with the benefit of hindsight).

And one more thing to mention: Despite of the challenging year, **IASF** registered net asset inflows over the course of 2020, and ended the year with a new AuM high of EUR 42.8m / CHF 46.2m / USD 52.2m. I am extremely grateful to all **IASF** investors for their faith, trust, and patience, and I promise you that we will continue to look after your funds with the utmost care and diligence.

And now, with nearly 30 pages written, it is time to end this with the usual reminder:

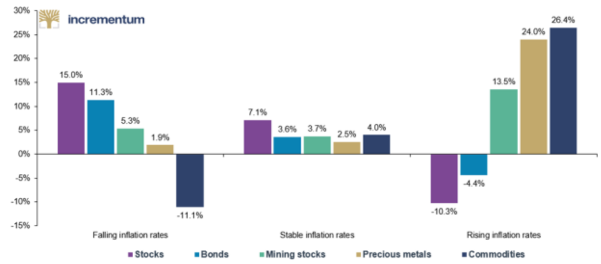
REMINDER: As responsible fund manager for IASF all my views expressed in this report, and particularly those concerning fund holdings must be considered biased and are not tailored to my readers' individual needs. Although I use great care in writing this commentary, it reflects my personal views and opinions, and as all I do as a fund manager is subject to a great amount of uncertainty, you should not rely on it for accuracy. Thus, always consult a licensed investment professional if you seek investment advice! And remember that past performance is no guarantee for future returns, and all investments involve risk including the loss of principal.

closing remarks

At the beginning of 2021, we find the world still in a Covid-19 induced deep economic malaise, which however the optimist in me expects we will get under control over the course of this year. What we cannot return from is the path of debasing our currencies through out-of-control monetary and fiscal expansion. As there is no free lunch, I am certain there will be a price to pay for the irresponsible behaviour of the past decades. At Incrementum we are convinced that inflation will make a comeback, and that will have a profound impact on society as well as individual behaviour.

I also expect this to have a similar impact on investor behaviour. If our expectations turn out correct, past inflationary environments suggest that we will have to drastically change how we allocate funds. While falling inflation benefits stocks and bonds, and punishes precious metals and commodities, that picture turns completely around during periods of rising inflation. This is the nature of cycles!

Asset performances in different inflationary environments



Source: Wellington Asset Management, Incrementum AG

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IASF is positioned accordingly and will actively manage funds through the difficult transition period, always with its focus on preserving and increasing its investors' real purchasing power.

For now, I would like to thank all my readers for their interest and patience. And although it is late, I still like to take the opportunity to wish you all a great year 2021, with best of luck, good health, and success in all your endeavors.

As always, I appreciate any feedback by e-mail, and wish everyone a great weekend ahead.

Greetings from Schaan, Liechtenstein!

Best regards,
Hans

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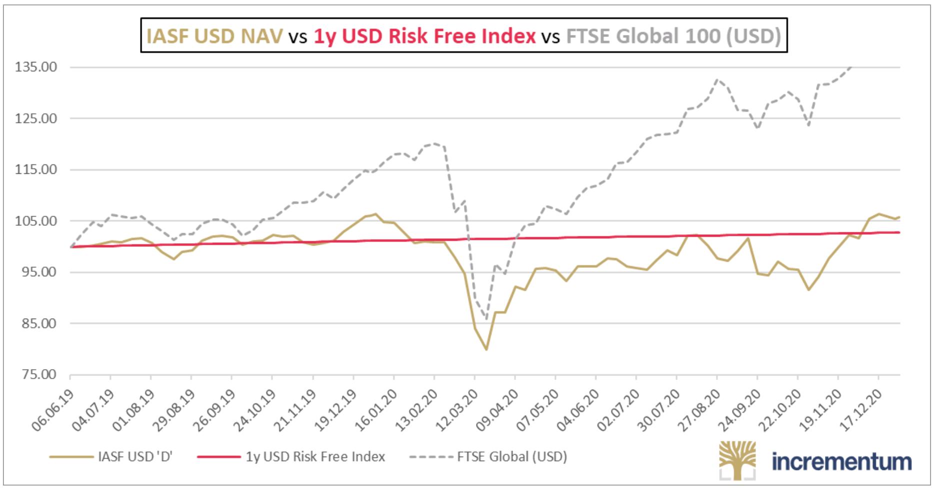
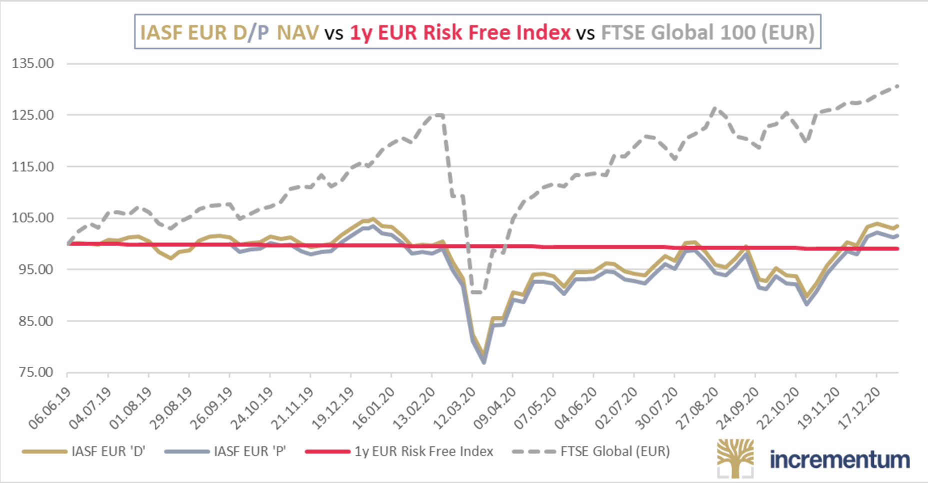
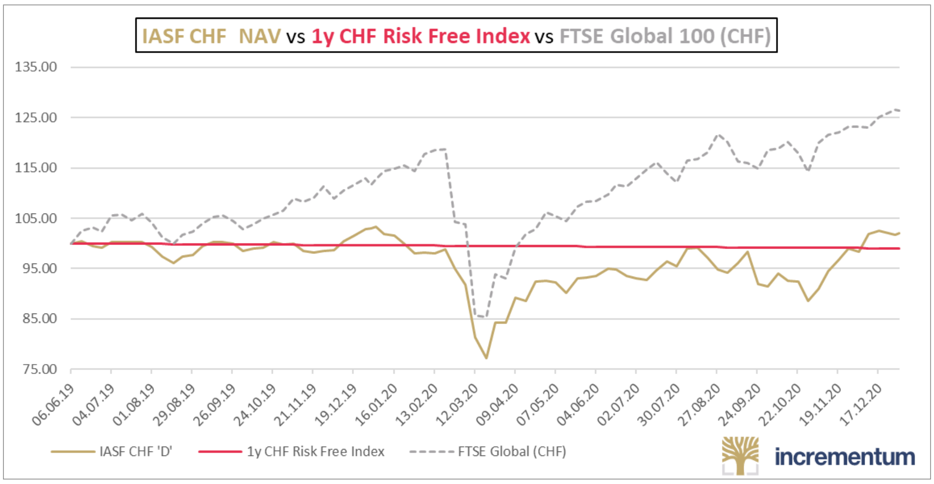
Appendix *







* Graphs display NAV of IASF performance until last valuation date (**30DEC2020**), compared to the respective risk-free 1y-government yield, as well as the FTSE Global 100 Index in respective currency as a proxy for broad equity market performance from the start of the investment period (6Jun2019 for 'D' shares; 26Sep2019 for EUR-P shares) on an indexed basis.

IASF PM Shaped By 8 Investment Lessons

1. Capital markets, like the economy, are inherently cyclical in nature, and you must always know where you are in the cycle, while not hesitating to "Be fearful when others are greedy and greedy when others are fearful." (Quote: Warren Buffett)
2. Prices paid determine future returns, i.e. the higher valuations are, the lower future return expectations must be (and vice versa), which is the essence of value investing.
3. Capital preservation is the conditio sine qua non, and a consistent and long-term investment strategy is more important than short-term momentum chasing.
4. As a result you must always know when you trade, or when you invest.
5. The most basic and effective risk management tools are proper diversification and the ability to hold cash.
6. Hard assets are preferable to intangibles, distributions to accruals.
7. Look for the incentives: True alignment of interest works in investors' favor.
8. There is no magic formula for successful investing: Consider both macro- and micro-economic issues, be diligent, flexible, patient, keep an open mind, and realize that investing will always remain more of an art rather than a science.

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