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Minutes of the Advisory Board Meeting

Incrementum Inflation Diversifier Fund

January 24, 2018

"Inflation on the Horizon & Electrification, the upcoming Megatrend?"

Highlights of the conversation:

Special Guest Gianni Kovacevic:

- Inflation is rising, we can see the effect in commodity prices and the PMI
- Energy is going through a once in a 100-year pivot
- In the long run the US will become the world's largest oil producer
- Saudi Arabia is divesting from oil and focusing on innovation and technology, specifically electrification and green energy
- Copper wins the marathon as the world increasingly moves towards electrification

Heinz Blasnik:

- Currently the macro fundamentals for gold are not good, but the gold price is still holding up
- Owners of gold don't want to sell, as they see higher inflation, or a recession, coming
- Quantitative tightening works with a lag, and I think we will see the effects of it very soon
- Insiders in gold companies are buying a lot of gold stocks, similar to the second half of 2015. This is a bullish sign

Jim Rickards:

- Inflation vs. deflation is at a tug of war; the situation is unstable, and it can break in either direction
- Trump might be close to starting a trade war with China
- I am bullish on Treasuries, especially on a relative basis (vs. Bunds)
- Secretary Mnuchin is implementing a weak dollar policy, and I think we will tip towards inflation

Ronald Stöferle:

- Our proprietary Incrementum Inflation Signal switched to rising inflation in September 2017
- We had monetary inflation, then we had asset price inflation, and now it seems we are entering the third stage, price inflation
- Quantitative easing was positive for asset prices, why shouldn't quantitative tightening be negative?

Mark Valek:

- I believe the beginning of 2016 was a major turning point for inflation
- Gold seemingly bottomed at the beginning of 2016 and has been rising since, a sign that inflation is present
- The dollar seemed to peak in 2017, and has declined ever since, which supports higher inflation

Biography of Our Special Guest – Gianni Kovacevic:

Gianni is an internationally known investor and strategist who specializes in decoding complicated current events. He is a published author who draws from over 20,000 hours of research, and is a sought-after commentator related to wide ranging themes – from the divestment pivot in modern energy, to the rise of a new spending class in emerging markets.

An avid proponent of realistic environmentalism, he has enlightened audiences around the world with his unique brand of storytelling that colorfully demonstrates how the environment and investment often go hand-in-hand. Frequently interviewed by the media, he is known for his algebraic way of thinking when providing solutions to complicated global problems. His new book "My Electrician Drives a Porsche?" was introduced to audiences by way of a one-of-a-kind coast to coast journey across America in an all-electric Tesla, now credited as the world's first zero emission book tour.

Gianni is a graduate of electrical studies from The British Columbia Institute of Technology, and he is an established expert in the analysis of the global energy matrix and in the study of how technology will impact commodities and emerging markets. Fluent in English, German, Italian, and Croatian, he makes his home in Vancouver.

www.kovacevic.com

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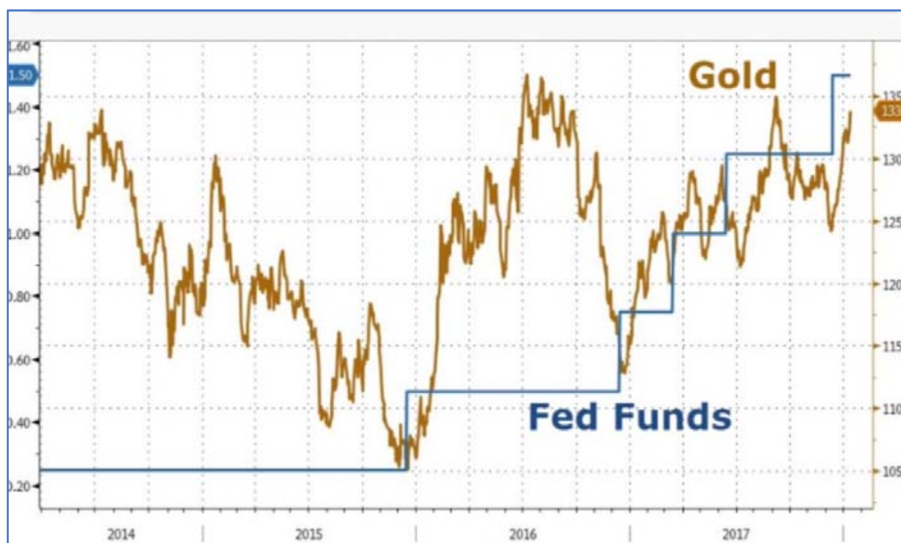
Transcript of the conversation:

Ronald Stöferle:

Gentlemen, thank you for joining us for this quarter's call. Last year was a busy and successful year for Incrementum and I think 2018 is going to be even better. We are already working on the 2018 In Gold We Trust Report; it will be published at the end of May. We also recently published our new crypto report, which gives a very balanced view of crypto currencies and the blockchain technology. We go into detail on many subjects, including legal developments. For example, we cover how cryptos are taxed, which is an important subject to understand. We also have new funds in the pipeline, and we are in the editing phase of our new book. All in all I think 2018 will be an exciting year.

With that said, let's start the discussion. In the last advisory board Ben Hunt mentioned how quantitative tightening would lead to inflation, rather than deflation, which I believe is correct. Our Incrementum Inflation Signal changed to rising inflation last September and it seems like markets are becoming more concerned about inflation. An observation I find interesting is that yields are rising while the dollar is weakening. Luke Gromen, who we had as a special guest on one of our advisory boards last year, tweeted and effectively asked "*How can the Fed raise rates and simultaneously weaken the dollar to get out of the corner they painted themselves into? Simple - just let the 5-yr old USD/gold pseudo peg break (i.e. let gold rise), & the markets will take care of the rest as gold rises.*"

As rates have been rising, so has gold



Gents, what are your views on all this?

Jim Rickards:

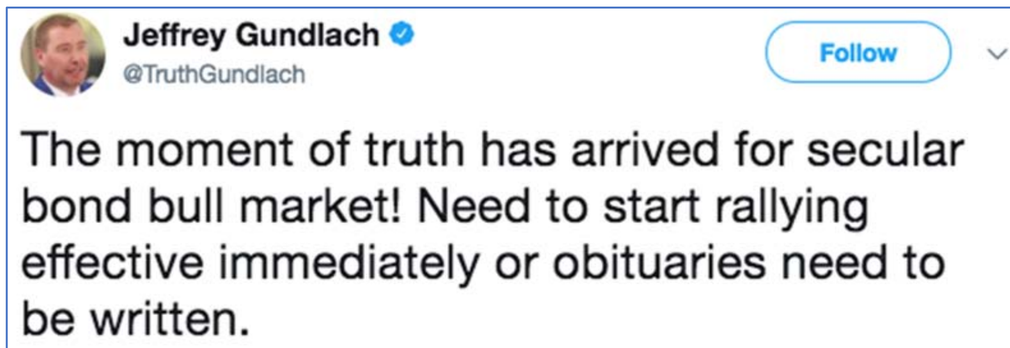
The tension between inflation and deflation persists, and the reason is because the world is in a naturally deflationary state. This deflationary state is caused by demographics, the reduction in the cost of technology, and debt deleveraging. Debt deleveraging is deflationary because people use their money to pay down debt, instead of spending. An example of this is 2014 when the oil price crashed; economists thought it would boost the economy because lower gas prices would give consumers more money to spend, but instead consumers saved their money and used money to pay down debt instead.

This deflationary state is making it difficult for central banks to generate inflation; they are not able to reach their inflation targets.

We have the inflationary and deflationary forces pushing against each other and currently it seems like the situation is stable. But the reality is that it's not stable, and it can break in either direction.

What will cause it to tip one way or the other?

Bond yields are currently very low, and Bill Gross and Jeff Gundlach are saying the 30-year bond bull market is over. I disagree. Especially compared to German bunds US Treasuries look very attractive. I am therefore a buyer of Treasuries at these rates.



Source: Twitter

Another important factor is that Trump might be close to imposing tariffs on China. The reason he didn't do it in his first year was because his advisors told him they needed China's help in the fight against North Korea, but now there is some evidence that China is actively assisting North Korea in avoiding the sanctions against them. Consequently, Trump might start the trade war against China that he has been itching to start ever since he became president. Such a trade war would be a drag on economic growth and on capital flows.

We have the President's State of the Union address coming up and he'll address the trade wars head on, I expect more sanctions on steel and aluminum. By the way, the steel sanctions will hurt Europe more than they will hurt China because Europe is the biggest steel exporter to the US. And

it's looking more and more as if Trump will terminate NAFTA, not forever, but as a way to re-negotiate. All these factors are further drags on growth.

Secretary Mnuchin recently basically said that if we trash the dollar our exports will be cheaper, and our balance of trade will improve as a result of our imports being more expensive. And the fact that imports are more expensive will feed through the supply chain of pricing, which will lead to higher inflation, which is what we want. Therefore, whether you look at it from a pro inflation or pro exports standpoint, reducing the balance of trade deficit and thereby enhancing economic growth seems like a pure win for the US in terms of its inflation and economic growth.

Source: Twitter

I think this is a naïve strategy because the problem is of course that this type of currency war invites retaliation. Europe is currently in a difficult place. They are currently at the taper stage, i.e. two years behind the US. This tapering will strengthen the Euro. China actually likes that the US is weakening the dollar because they have a soft peg to the dollar and as long as they maintain the peg the Yuan will devalue as well.

Putting this all together I think we are tipping towards inflation and I would not underestimate what Secretary Mnuchin is saying.

US Dollar burns after Mnuchin comments that indicate that Trump admin has abandoned strong Dollar policy. Dollar Index DXY plunges to lowest level since 2014.

Source: Bloomberg

Mark Valek:

At Incrementum we don't pay too much attention to inflation expectations because we think they are baked into prices already, but we do look at inflation sensitive assets and try to get a picture of the general price momentum. We also believe the major turning point for inflation was in the beginning of 2016. For example, commodity prices have been increasing for the last two years. Gold is another sign that inflation is picking up, having seemingly bottomed in the beginning of 2016 and having increased since then. Moreover, the dollar peaked in 2017, and is quite far off its high. All these signals are pointing towards higher inflation, which gives us confidence that this might be the start of another leg up in inflation.

Gianni Kovacevic:

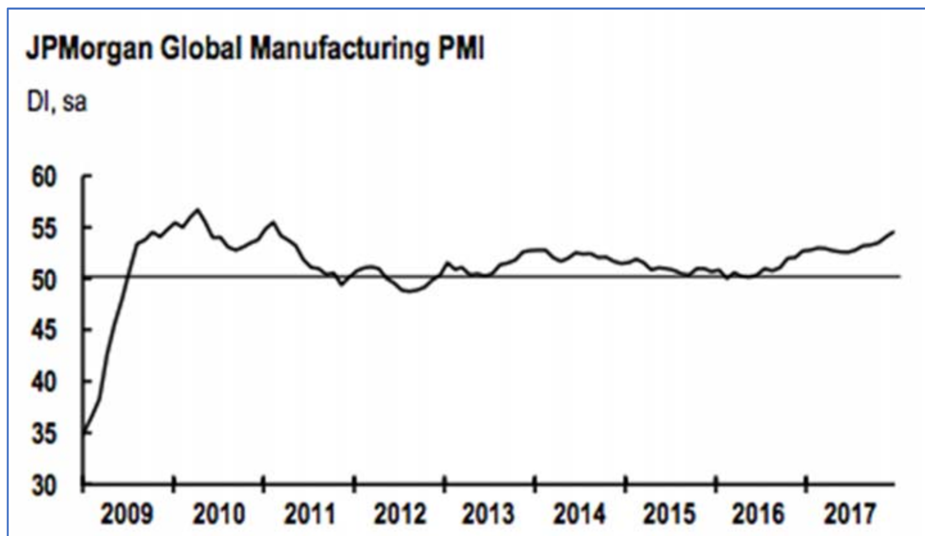
In my world there are two types of consumers. There's the middle class, and then there's what I call the spending class, which are people in places like Jakarta, Bangkok, Mexico City etc. They are not wealthy by Western standards, but they do have an economic footprint that continues to

increase and emulate those in the developed West. If they drive a car 500 miles, it's no different than if an American drives that car in Beverly Hills.

Global economic output is around $80 trillion and the US and China make up about 40% of global output or GDP. But looking at GDP is like looking in the rearview mirror, and if that is all you do, you'll end up in an accident. I think it's better to look at PMIs which is a forward-looking signal. One of the things that affect both GDP and PMI is oil; gasoline prices might not be such a big deal for someone in Houston, but if you live in Jakarta and you drive a Toyota truck, it is a big deal. Except for the 2008 dip, oil was around $100 for almost a decade. We are now consuming almost 100 million barrels per day, which equates to about $3.5 trillion spending per year. When oil dipped to $40 dollar per barrel it equated to about $1.5 trillion for all global spending. Therefore, when oil dropped it was like a 2.5% silent tax break or "helper" for the global economy. It might not have been a big helper for someone in North America, but it was for someone in the new spending class.

I think we have seen rising cost levels, e.g. copper is up 60%, and oil has doubled. I travel a lot and I see that prices have been going up. And the PMI confirms this view as it has been rising month after month. I think that eventually the chickens will come home to roost.

Global PMI ends 2017 at near seven-year high



Source: JP Morgan

Heinz Blasnik:

Monetary inflation is declining, but price inflation seems to be picking up. I have personal anecdotal evidence that prices are rising, for example certain electronic gadgets are getting more expensive, rising in price 10%-20% over the last two years. As I have mentioned before, when money is printed the economy changes structurally, and it will create bottlenecks in the economy, and we are seeing the result of this in certain consumer goods today.

With regards to the dollar I am surprised that it has been persistently weak, and I don't know many people who expected this weakness because the Fed is on a tightening path (which should normally lead to a stronger dollar).

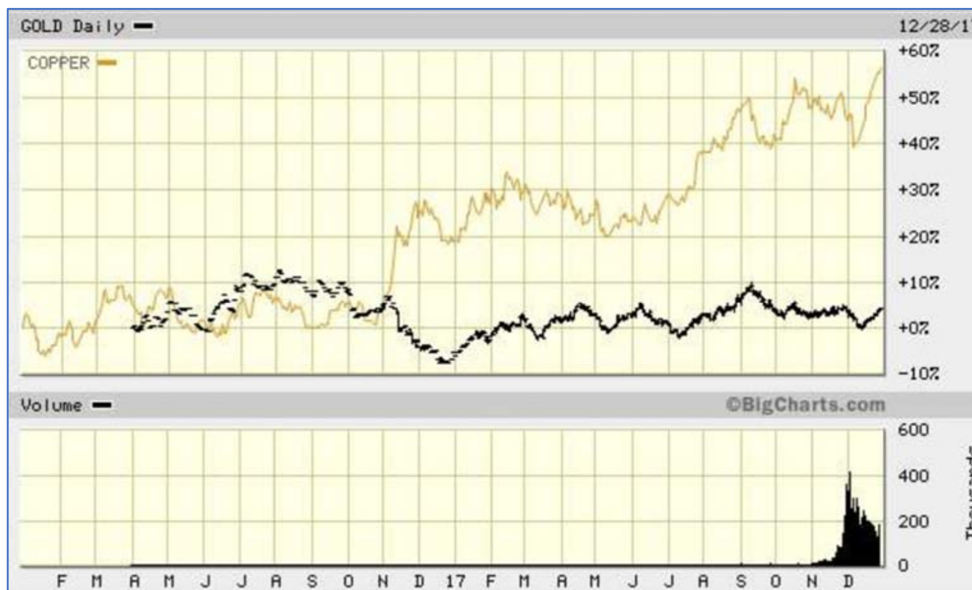
Briefly on gold, I think the fundamental macroeconomic drivers are not really bullish. It is only the weak dollar that is bullish for gold. If that is the case, why is gold strong? Current holders of gold are not selling, i.e. reservation demand is strong, and I think it's because these holders see some future developments that make them not want to sell, either higher inflation or a future recession, or perhaps both.

Ronald Stöferle:

Heinz mentioned the divergence between monetary inflation and price inflation, which acts with a lag. We have seen monetary inflation in the last few years, then we have seen asset price inflation and now, as according to Rothbard, it seems like we are entering the third stage, which is always consumer price inflation. It's basically developing very much like in the playbook. And we shouldn't forget that we have an inexperienced Federal Reserve for the next few months. This transition period should be a stress test for markets. We should not forget that quantitative tightening will increase in the months ahead . **And if quantitative easing was positive for asset prices, why shouldn't quantitative tightening be negative?**

Gianni I'd like to hear your thoughts on the energy space, especially copper. It's often said that copper has a PhD in economics. Copper has actually decoupled a lot from gold, and other industrial metals also made their bottoms at the beginning of 2016.

Copper has decoupled from gold



Source: CopperBank

And it also seems we are back in a bull market for oil. A few months ago we talked about how everyone was bearish on oil, the consensus was that oil will trade between $45-$55 over the next couple of years because of US shale oil. Nobody expected a big break out in the price, but now we are seeing it. But still nobody is really getting excited about oil.

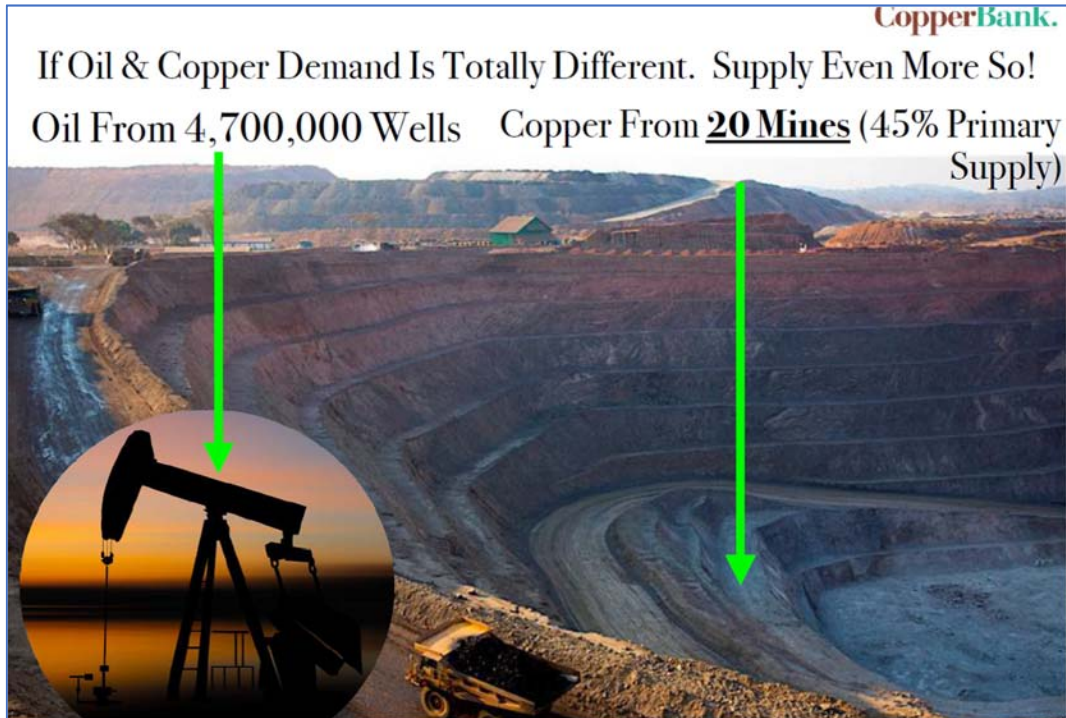
Gianni, what are your thoughts on the energy space?

Gianni Kovacevic:

I think energy is going through a once in a 100-year pivot, which I know is a strong proclamation. Many governments are saying that we have to get off fossil fuels, which is an easy prescription to write, but a very hard one to actually take.

I suggest that big oil, mainly OPEC, capitulated on November 27th, 2014 when Saudi Arabia said it would no longer be the swing producer. The idea was to lower the price of oil to make it uneconomic for horizontal fracking. But this did not work because frackers became more efficient and reduced their cost of drilling. OPEC has now curtailed production by about 2m barrels per day and this shortfall has been met with an increase in production in the US. This is not sustainable in the long-run because the US will become the world's largest oil producer. So, what do you do if you are one of the six or seven countries in the world with 100 years left of oil reserves? You have to make a strategic plan around being in the energy space. With Vision 2030 Saudi Arabia plans to divest a portion of oil revenues into innovation and technology focused in energy - which means electrification. Green energy equals more "deluxe" forms of electricity and that requires even more copper per application. Another pincer on oil demand is governments around the world saying that the internal combustion engine must become more efficient, i.e. use less fuel, or 100% electric, which requires 3 to 4X more copper.

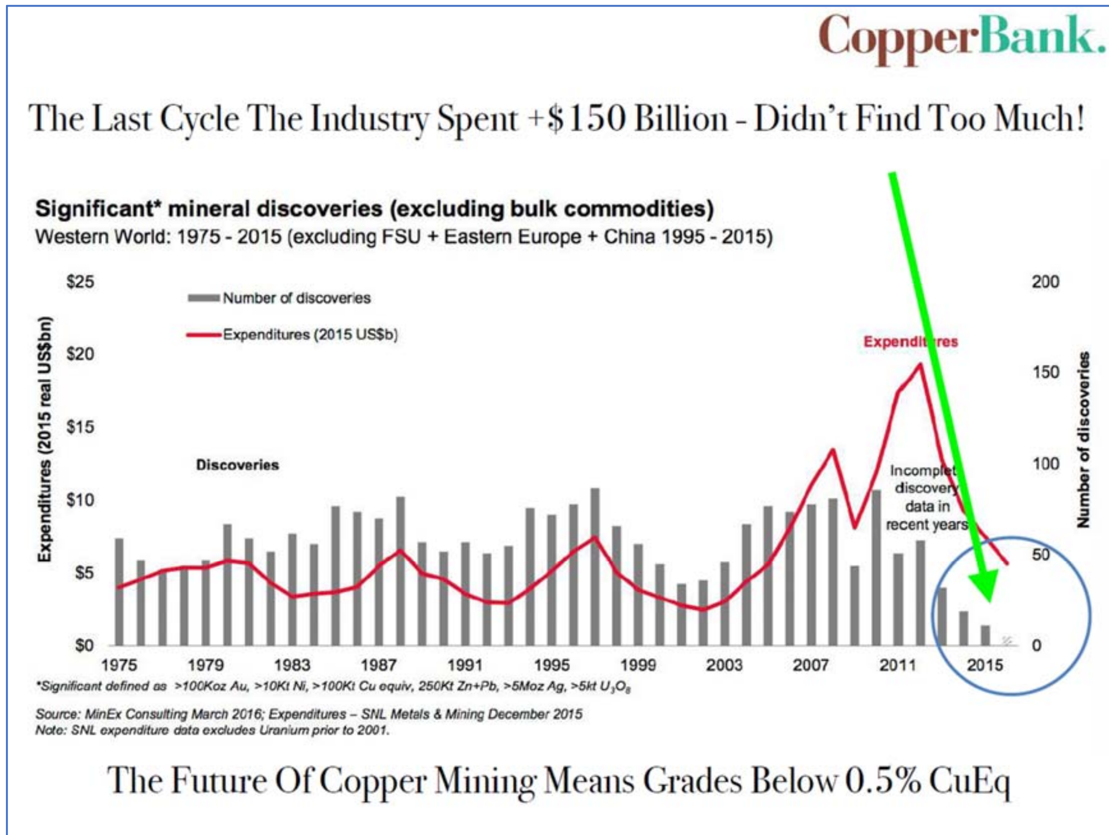
Therefore, if future demand is totally different between oil and copper, where do current and future supplies come from? Has there been a horizontal fracking renaissance in the copper space? No! Currently 50% of primary copper supply comes from 25 copper mines, mostly commissioned 70 or 80 years ago. More importantly the people who make the big decisions on copper can fit around a dinner table. Compare that to oil where the world's oil supply comes from 4.7m wells, where the decision makers could fill up a whole hockey stadium.



Source: CopperBank

We are not building copper mines. I don't see any way that we can satisfy the copper demand that we will see in the next 20 years, other than higher copper prices. There has been no scientific advancement in the way we extract copper, grades are getting lower, deposits are deeper and future supplies will need to come from countries that don't have an historical understanding of copper mining.

Therefore, I think copper will be the winner as a result of electrification, I think it will grow at a CAGR of 4-5% over the next 20-30 years. Traditionally, since 1900, it grew at about 3%-3.5%. Aluminum will also do well, but I think lead is a loser because in the future batteries will become more efficient and lead is not a part of that equation.



Source: CopperBank

And I think demand for oil as a transportation fuel stops growing sooner than many consider. According to the IEA and economists of many of the big oil companies, the demand for oil should continue to grow to between 105-115 million barrels per day in 2040. On the other side of the spectrum there are those who factor in technology, innovation, fuel switching, customer behaviour etc., that collectively act as a pincer taking demand away from oil and envision consumption at only 70 or 80 million barrels per day.

I don't know where we will end up, but I'm guessing somewhere in the middle. The key is that I do not see any scenario where demand for oil grows by 50% in the next 20 years. The question is when will we reach terminal decline? Because when we get to that stage it will decline, perhaps gently, but surely in perpetuity. Oil will still be very important for the global economy because it goes into many products, 45% of every oil barrel that is cracked is used for plastics, polyester, rubber, so-called enhanced products, but there will be a move away from using oil for transportation due to efficiency and new consumptions behavior.

Interestingly the Norwegian state pension fund and Saudi Arabia have pledged to invest a trillion dollars out of their future oil revenues; they are divesting from oil. And they are investing into green energy which means electrification. They are the single largest contributors to

the global divestment movement. They have no choice. Appreciate for a moment how quickly the oil business changed due to horizontal fracturing.

The first frack wells - vertical and for natural gas - were drilled in 2002 in the US after the marriage of Devon Energy and George Mitchell's company; seven of these wells were drilled in the first year. In 2003 they drilled 55 wells. For reference sake, Saudi Arabian oil supply comes from 3,000 wells. By the time we reached 2015 the North American frackers had drilled 150,000 wells, which is an astounding number. This is a game changing technology. It allows these "frackers" to go to old formations and extract more oil. Today 90% of the wells drilled are horizontal frack wells, only 10% are conventional wells. The question is what will the 6 or 7 countries that have 100 years of oil reserves remaining do in this situation? They don't want to see $100 per barrel because then the oil importing countries will accelerate fuel switching policies quicker than they might have done originally.

Ronald Stöferle:

Jim, what is your view on the topics that we have just discussed?

Jim Rickards:

I don't have too much to say about copper, but I will definitely look more into it after hearing Gianni's thoughts, which I found very convincing. The bigger theme of electrification is a very powerful trend and I think it is here to stay. I've had some dealings with Saudi Arabia recently and they are pursuing their Vision 2030 plan seriously, it's not for show. They understand that the days of oil are numbered.

Gold is going up in dollar terms despite the Fed's tightening. The Fed had a very tentative foray into tightening; they tightened in December 2015 and again in December 2016. That is two rate increases in a year after not having made any rate increases in nine years. But since then they have kept the regular tempo. They raised in June, September and December of 2017. And I think they are on track to raise in March again. I expect complete continuity with Yellen from the new chairman, Jay Powell.

I would not underestimate the impact of quantitative tightening, I think it will affect asset prices, but with a lag. It is a very serious danger. It started at a slow tempo, but it ramps up every month. Remember what quantitative tightening is; you are destroying money. This has never happened before. This is a giant experiment, and there is no precedent. And it's happening concurrently with rising interest rates. In my view the Fed is underestimating the tightening impact.

My question is how can gold be rallying with all these headwinds? And can you imagine what will happen with gold when the headwinds turn into tailwinds? I think the Fed will flip flop and eventually ease again. I think we are in the third great gold bull market of my lifetime. The first was in the 1970s, the second one was 1999 to 2011 and the third one began in December 2015. There have been several rallies and drawdowns since December 2015; there's been a lot of volatility and gold investors are disappointed. But the facts are that we are in year three of a bull market that I

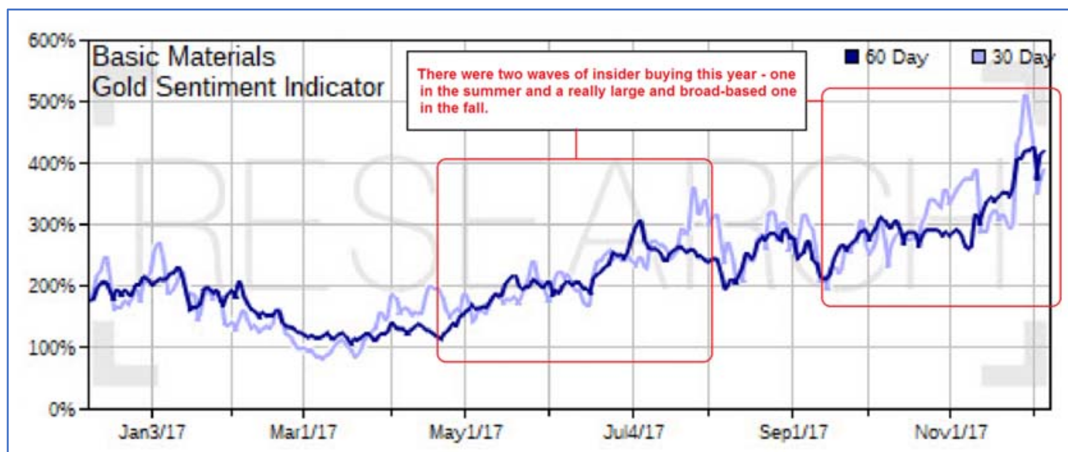
believe will go for another five years or more. And I think an amplifier of the bull market will be when the Fed realizes that they have tightened too much too soon and will have to flip to easing again.

Heinz Blasnik:

Jim, I am on the same page as you when it comes to the Fed and tightening. And I think we will soon see the impacts of quantitative tightening increasing because there is a delay in the settlement of redeemed mortgage backed securities, i.e. the effects of quantitative tightening that has already taken place have yet to appear in the data. I think we will see this show up on the Fed's balance sheet soon. Consider also that money supply growth declined dramatically even before QT started.

And just a final note on gold; from a technical perspective a breakout in gold will be quite significant because the recent consolidation in gold has been in such a wide range and has taken so long. In many ways the current situation is very reminiscent of what happened at the end of 2015. You have insiders at gold companies buying like crazy - we have rarely seen them buy that much, it doesn't happen often in this sector. And the situation in the options market for gold stocks is precisely the same that I saw in late 2015 and in the first week of January 2016. Nobody is interested. Nobody is buying any calls and trading volume is very low. Consequently, I am quite bullish on gold at the moment, despite the dubious macro-fundamentals.

Insider Activity according to INK Research: Lately insider buying at gold companies has basically "gone off the charts" compared to historical standards.The spike in insider buying in the gold sector this fall (which went hand in hand with the decline in prices) was already the second one this year, but it attained extraordinary proportions.



Source: INK Research, http://www.acting-man.com/?p=52029

Ronald Stöferle:

Gentlemen, I think we'll end it there. We've been able to cover a wide array of fascinating topics. Thank you very much for joining the conversation, we will see you next time.

Appendix: Permanent Members of our Advisory Board:

Zac Bharucha

Zac began his career in finance at the investment bank Kleinwort Benson and later became an equity portfolio manager at Philipps and Drew Fund Management. He then moved to AMP Asset Management where he was responsible for managing more than GBP 1bn of institutional assets. Afterwards, he moved to M&G in London. Since 1998, he has developed absolute return strategies and specialized in equities and commodities. After 25 years in asset management, he retired from professional life in 2011 and wrote his first book about market timing.

Heinz Blasnik

Heinz is an independent trader and market analyst for the consulting firm Hedgefund Consultants Ltd, as well as an author on Austrian economic theory for the independent research house Asianomics in Hong Kong. Heinz also publishes the blog www.acting-man.com, on which he analyses developments in the financial markets and the economy from an Austrian perspective.

James G. Rickards

Jim is the author of the international bestsellers *Currency Wars* and *The Death of Money: The coming collapse of the international monetary system*. He is portfolio manager at the West Shore Fund. During his career, Jim has held senior positions at Citibank, Long Term Capital Management and Caxton Associates.

Dr. Frank Shostak

Frank is chief economist at AAS Economics. He has over 35 years of experience as a market economist and central bank analyst. He holds a PhD, MA and BA honours from South African universities. He was professor of economics at the Witwatersrand University in Johannesburg. He is one of the world leaders in applied Austrian School of Economics and an adjunct scholar at the Mises Institute in the US.

Rahim Taghizadegan

Rahim is the founder and director of the institute for value based economics, an independent research institute in economical and philosophical issues in Vienna. He is bestselling author and a popular speaker internationally. Rahim studied Physics, Economics and Sociology in Vienna and Lausanne. He has worked in the fields of economics, space research and journalism. He has also taught at the University of Liechtenstein, the Vienna University of Economics and Business Administration and the Universität Halle an der Saale.

Ronald-Peter Stöferle, CMT

Ronni is partner of Incrementum AG and responsible for Research and Portfolio Management.

He studied Business Administration and Finance in the USA and at the Vienna University of Economics and Business Administration, and also gained work experience at the trading desk of a bank during his studies. Upon graduation, he joined the Research department of Erste Group, where he published his first "In Gold We Trust" report in 2007. Over the years, the Gold Report became one of the benchmark publications on gold, money, and inflation.

Since 2013 he has held the position as reader at scholarium in Vienna, and he also speaks at Wiener Börse Akademie (i.e. the Vienna Stock Exchange Academy). In 2014, he co-authored the book "Austrian School for Investors" and in 2018 "Die Nullzinsfalle" (The Zero Interest Rate Trap). Moreover, he is an advisor for Tudor Gold Corp. (TUD), a significant explorer in British Columbia's Golden Triangle.

Mark J. Valek, CAIA

Mark is partner of Incrementum AG and responsible for Portfolio Management and Research.

While working full time, Mark studied Business Administration at the Vienna University of Business Administration and has continuously worked in financial markets and asset management since 1999. Prior to the establishment of Incrementum AG, he was with Raiffeisen Capital Management for ten years, most recently as fund manager in the area of inflation protection and alternative investments. He gained entrepreneurial experience as co-founder of Philoro Edelmetalle GmbH.

Since 2013 he has held the position as reader at scholarium in Vienna, and he also speaks at Wiener Börse Akademie (i.e. the Vienna Stock Exchange Academy). In 2014, he co-authored the book "Austrian School for Investors" and in 2018 "Die Nullzinsfalle" (The Zero Interest Rate Trap).

About Incrementum AG

Incrementum AG is an independent investment and asset management company based in Liechtenstein. Independence and self-reliance are the cornerstones of our philosophy, which is why the four managing partners own 100% of the company. Prior to setting up Incrementum, we all worked in the investment and finance industry for years in places like Frankfurt, Madrid, Toronto, Geneva, Zurich, and Vienna.

We are very concerned about the economic developments in recent years especially with respect to the global rise in debt and extreme monetary measures taken by central banks. We are reluctant to believe that the basis of today's economy, i.e. the uncovered credit money system, is sustainable. This means that particularly when it comes to investments, acting parties should look beyond the horizon of the current monetary system.

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