Incrementum All Seasons Fund

– in pursuit of real returns –

Early Winter, late Dec 2019, near Schaan (HGS' pic)

2020 / 01

January 2020

Seasonal Reflections

Happy New Year 2020!

Welcome to a new (golden) decade (https://pixabay.com/images/search/2020/)

Quote(s) of the Month:

"Vale, Paul Volcker, 1927-2019. Inflation tamer and whose opinion about modern banking was illustrated by his quip in mid-2009 that the best example of financial innovation in recent decades was the automatic teller machine." (Source: https://on.ft.com/2RyJMAp, December 9, 2019)

"The "precautionary principle" applied to central banking is "when in doubt, drop interest rates". … Is there no point when we just ignore the leveraged crack heads jonesing for liquidity and generic equity investors who think that rising equity prices are in the Bill of Rights?" (Source: Dave Collum, https://www.peakprosperity.com/2019-year-in-review-part-1/)

"Negative rates are the destruction of money, an economic aberration based on the mistakes of many central banks and some of their economists, who start with a wrong diagnosis: the idea that economic agents do not take more credit or invest more because they choose to save too much and that therefore saving must be penalized to stimulate the economy. Excuse the bluntness, but it is a ludicrous idea.
Inflation and growth are not low due to excess savings, but because of excess debt, perpetuating overcapacity with low rates and high liquidity, and zombifying the economy by subsidizing the low-productivity and highly indebted sectors and penalizing high productivity with rising and confiscatory taxation." (Source: Daniel Lacalle, Why Sweden Ended Its Negative Rate Experiment)

"The problem is that we have redefined capitalism to mean "the stock is up". We have redefined capitalism to NOT mean Smith's invisible hand or Schumpeter's creative destruction or productivity-enhancing and risk-taking investments in the real economy. We have redefined capitalism to ONLY mean financial asset price inflation in the here and now. By any means necessary. So that's what we get. From the Fed, from the White House, from corporate management …

…the tether between taxation and spending – the most important macroeconomic policy relationship for our lives as both investors and citizens – has been severed. … We've had a steady fraying of this cord for about two decades now, ever since Al Gore's idea of a Social Security "lockbox" (where those taxes could ONLY be used for Social Security spending and paying down the existing debt) was met with derision rather than acclaim by both parties. Yes, both parties. By steady fraying I mean over both Republican and Democrat administrations. The political beneficiaries of the fraying are different when it's Republicans doing the snipping or Democrats doing the snipping, but the INTENT – to eliminate the tether between taxation and spending – is the same whether you're George Bush or Barack Obama. Or Donald Trump. Destroying the relationship between taxation and spending is not a partisan thing. It's a power thing. It's a Management thing. …

Management levered up our country and used the proceeds to provide a windfall gain for corporations and the rich. You know … "returning capital to job creators". In exactly the same way that Management might lever up a company and use the proceeds for a big stock buyback. You know … "returning capital to shareholders".

Both of these narratives – "returning capital to job creators" and "returning capital to shareholders" – had a truth to them, an important truth. I believed in the important truth of both of these narratives for most of my adult life! And yes, I'm using the past tense.

Because in the Long Now, the meaning of both narratives has been perverted beyond all recognition.

Both are now part and parcel of the Trickle-Down Lie, that the crumbs that fall off massa's table are crumbs that you wouldn't get otherwise, so let's celebrate all those extra crumbs. Yay, crumbs!" (Snip! (The Long Now, Pt. 4) by Ben Hunt, via Epsilon Theory, December 26, 2019)

"The Nifty Fifty appeared to rise up from the ocean; it was as though all of the U.S. but Nebraska had sunk into the sea. The two-tier market really consisted of one tier and a lot of rubble down below. What held the Nifty Fifty up? The same thing that held up tulip-bulb prices long ago in Holland – popular delusions and the madness of crowds. The delusion was that these companies were so good that it didn't matter what you paid for them; their inexorable growth would bail you out. (Forbes Magazine, 1977, The Nifty Fifty Revisited)

'We will not have any more crashes in our time. … I think the market is very appealing, and prices are low,' said Keynes. 'And where is the crash coming from in any case?'
'The crash will come from the gap between appearance and reality. I have never seen such stormy weather gathering.' (Source: The Raven Of Zürich; The Memoirs of Felix Somary, page 147, recalling a conversation with John Maynard Keynes during a meeting in 1927)

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Dear Reader,

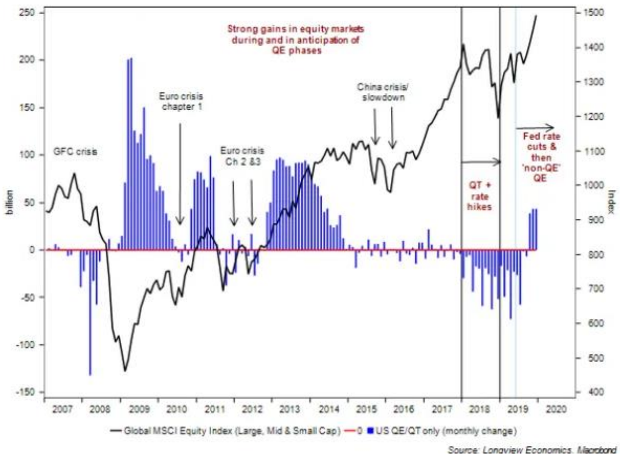
I hope you had a good start into 2020. Here in Liechtenstein the calendar indicates it is winter, though those who expect this to mean lots of snow and ice, might be disappointed. The year so far has been dry, mostly sunny and rather mild, with temperatures rarely dropping below zero. It almost seems like the weather is trying to mimic the complacent Goldilocks-like environment in financial markets.

Since I am a bit late with my first Seasonal Reflections of the year, let's start with

A brief look back at 2019

Reviewing 2019 from an investing perspective shows a year when everything worked: Stocks, bonds, commodities, gold and even bitcoin – in other words, a full risk-on year.

The stock market rallied from its Santa lows in Dec18 into May19, then consolidated until Sep19, before resuming its upward move until the end of the year with another 10%+ rally… – Since the Fed's Sep19 start of "non-/stealth QE", or however you may call it, global equity markets have been soaring. And in typical risk-on fashion credit markets got a decent boost as well.



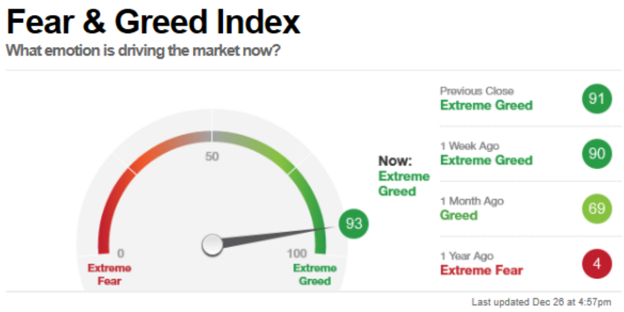
Source: https://www.ft.com/content/4dfac8e4-3174-11ea-a329-0bcf87a328f2

For those still interested in reviewing the major market moving incidents of 2019, please refer to [The big market moments of 2019](). An overview of last year's asset class performance, courtesy of [Visual Capitalist](), is shown on the left.

Meanwhile, for those who prefer a succinct summary of what is driving markets at the turn of the decade, I am happy to let Peter Toogood, CIO of The Embark Group, do the talking, who in a 3:13 minutes [interview on CNBC]() pulled no punches. Here are just a few mouth-watering morsels: *"We just keep pumping, and we just keep pumping, and we just keep pumping…! – … There is no logic to any of this other than chasing the gilded lily. – It's nuts!"* – And as usual my **Quote(s) of the Month** opener also contains a few noteworthy comments on the current state of affairs.

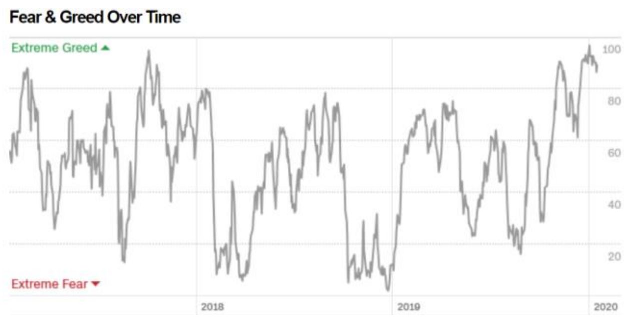
En route to maximum bullishness

The extend of the speculative mood swing experienced in 2019 can be appropriately demonstrated by the CNN Fear & Greed Index, which has been going full throttle for some time:



Source: https://money.cnn.com/data/fear-and-greed/
(note the above pictured measure was taken on 26.12.2019)

What a difference a year makes…. – 13 months ago, at Christmas 2018, extreme fear ruled, with a score at 4. One year later, greed has made a remarkable and (at least as far as your humble scribe is concerned) quite surprising comeback, reaching 97 on January 2. Meanwhile, Investors Intelligence's advisory-services reading show a full 40%-point lead of bulls over bears, which must be considered at least as a yellow warning light for the market….

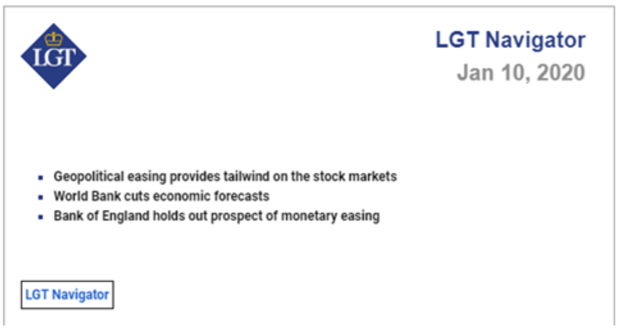


Source: https://money.cnn.com/data/fear-and-greed/

Of course, the above dashboard only provides a snapshot from any given day, and thus it does not allow any historical perspective. That can be found in the graph on the right, which shows that last December we hit highs that exceeded any of those seen over the past three years. That at the very least would indeed suggest caution over the coming weeks, though few investors seem to share this sentiment.

In fact, over the past couple of weeks I have found plenty of evidence that confirms investors' increasingly delusional behaviour.

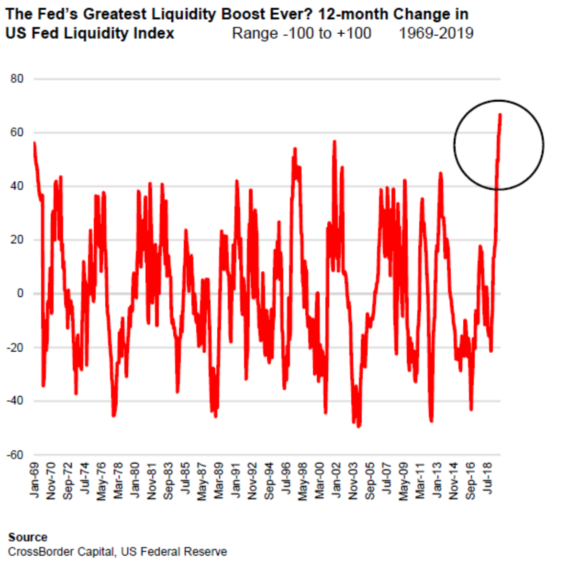
(As a side-note, you may have noted that time references can vary within SRs. This is due to the fact that I typically write them over a period of two to three weeks, and thus keep adding and editing in the process, which explains the various and sometimes diverging time references used.)



Take the January 10th headlines in my former employer's daily LGT Navigator newsletter, which cites *"Geopolitical easing provides tailwind on the stock market"*. This may have been true, though it is remarkable how the earlier "Geopolitical Tightening", referring to the US-Iranian tensions following the killing of military commander Qassem Soleimani, did not yield an equally strong headwind for the stock market.

The other two headlines are equally revealing: *"World Bank cuts economic forecasts"* suggests a deteriorating fundamental economic outlook, which once upon a time used to have an appreciable impact on the health and direction of the stock market. – Not anymore, it seems.

The reason? – Look no further than *"Bank of England holds out prospect of monetary easing"*. This is all that matters today: We just keep pumping, revelling in the newfound riches of soaring asset prices. Case in point: The Federal Reserve's massive liquidity injection following the September spike in repo rates, which is providing the strongest liquidity boost over the past 50 years.



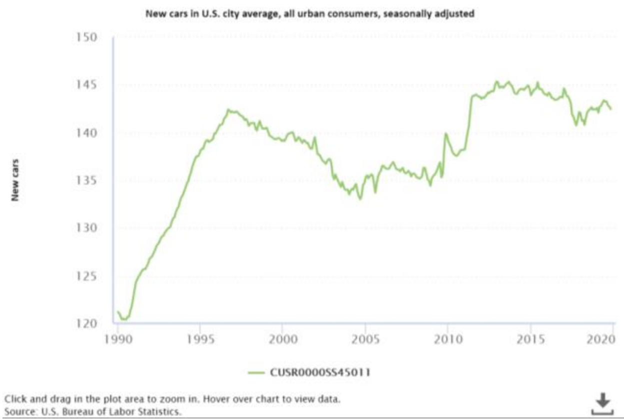
Source: Bloomberg Opinion – Points of Return, January 10, 2020

And so risk appetite remains ravenous, despite of the fact that the investment backdrop at the start of the 2020s serves a menu of mediocre global growth, an apparent deglobalization amid reduced international cooperation and increasing confrontation, coupled with growing political polarization, ageing societies in advanced economies and China, an extended secular debt cycle that has pushed beyond all limits and has received yet another boost through last year's monetary policy U-turn, and what some would call the death of capitalism through growing industry concentration stifling competition. All this is spiced up with prevailing capital market valuations that for most measures are sitting at the highest decile in history. In other words, not an environment that makes me itch to put my hard-earned money at risk.

No inflation? - Really?

Economists and central bankers usually argue that there is too little inflation and even a threat of deflation, which is what they are countering with their growing monetary largesse and intervention in rate markets. In my view this argument can only be made because inflation is not properly measured.

If our Committees to Save the World were honest or applied some common sense, they would realize that INFLATION is staring them into the face. Example: The US BLS in its CPI calculation shows that average new car prices are up 17.5% since 1990 (see graph on the right). But I also read that the average new car price in October last year surpassed USD 34,000 for the first time, which compares to average prices at about USD 15,000 to 17,000 in 1990. That sounds more like a 100% increase to me...



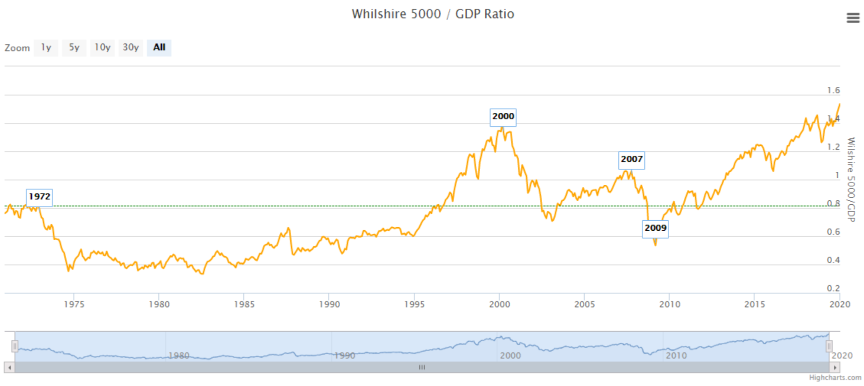
(This is how the average car used to look in [1990](#)… - anyone out there, who would rather drive this than its modern-day equivalent?)

How does one explain such a difference? By so-called hedonic adjustments, i.e. the systematic reduction in reported price inflation to account for improvements in quality and added features, things like Adaptive Headlights, Cruise Control, or Driver Alertness Detection Systems. In the eyes of statistical agencies these all make this a far better product, which is why we have to pay more. Thus, if we bought a car with the technical features from 1990, it should merely set us back about USD 19,000. This is regardless of the fact that such a car no longer exists, and we therefore have no choice but to pay double.

Needless to say, the same adjustments are made for other technologically advanced consumer goods, e.g. household appliances, computer, smartphones, etc, all similarly understating true inflation.

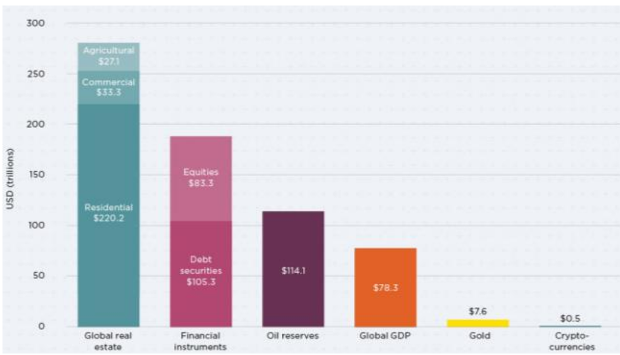
What might common sense otherwise register as missing in commonly used inflation measures? Well, I talked about the failure to consider actual housing cost properly in my Seasonal Reflections from November 2019 ([page 4](#)), though this focused on European CPI numbers. The same can be said with what is in the US called “owners’ equivalent of rent measure”, which replaced actual housing costs in the early 1980s by looking at supposed rental market rates instead of the true cost of owning a home.

This leads us to the mother of all inflationary developments over the past decades, i.e. the bubble in asset prices: Warren Buffett for example is known for using stock market capitalization versus GDP (or GNP) to gauge inflation in the price of US equities, a score that is pushing records right now.



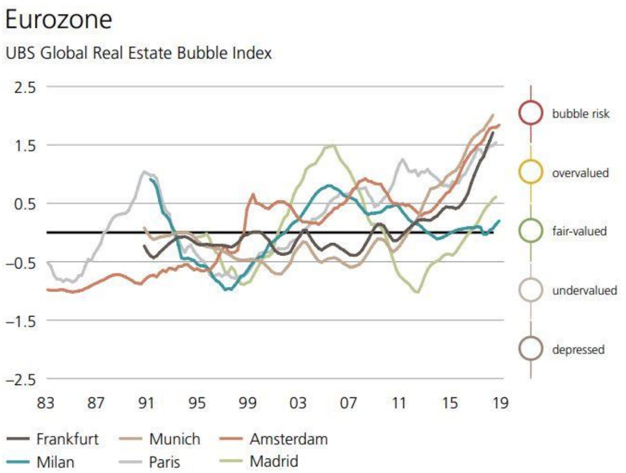
[US Market Cap to GDP](#)

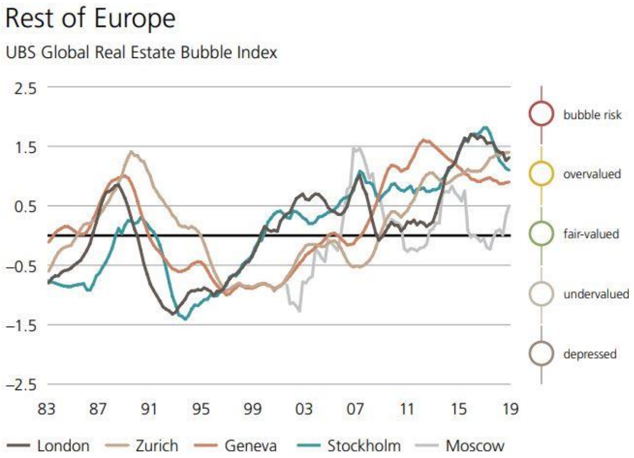
Or how about real estate prices? – When was the last time you heard someone talking about cheap real estate??? – I did not find any historical value chart, but Savills reckons that global real estate was worth USD 280tr in 2017, i.e. about 3.6 times global GDP. (By the way, consider the “gold” dwarf in comparison…)



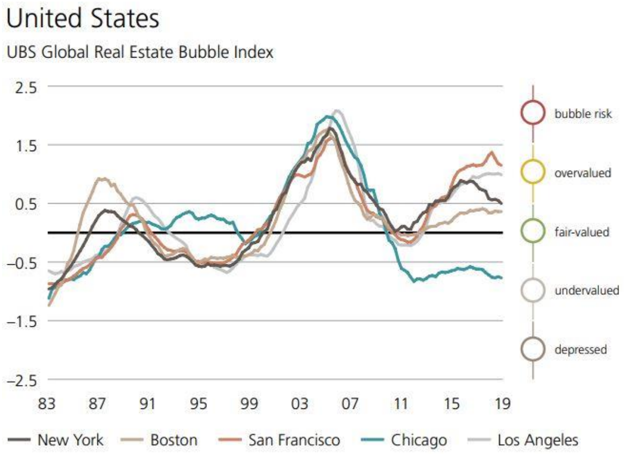
Source: [Savills](#)

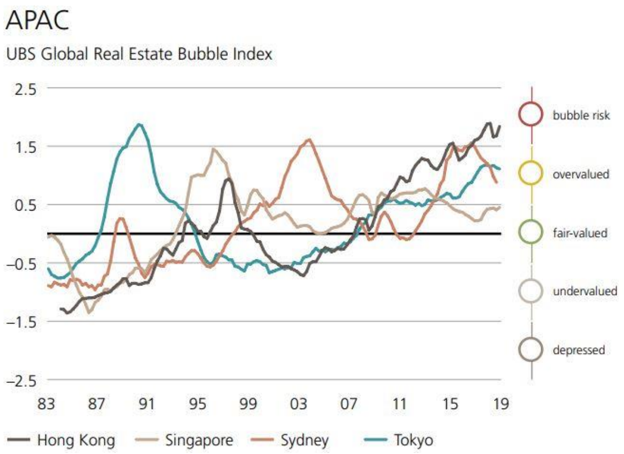
And according to the [September 2019 UBS Global Real Estate Bubble Index](#), there are few markets not in overvalued or bubble territory.





In Europe, there is no major market that would qualify as undervalued or even depressed, and only Milan is considered fairly valued by UBS analysts. And the picture in the US and Asia Pacific is similar as the charts below show.





(All four regional real estate bubble index charts can be found in the before mentioned UBS report.)

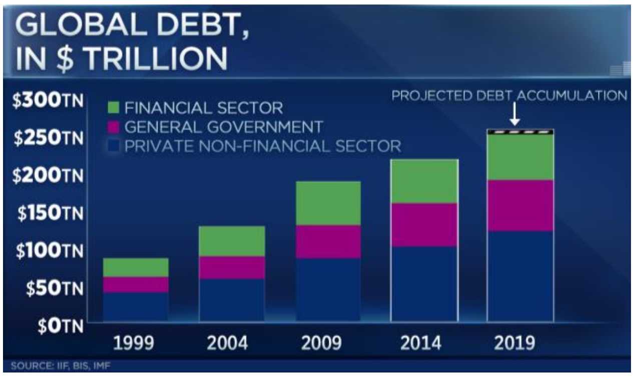
But of course, that is not what central bankers or politicians want (us) to see, or what they would openly regard as in any way inflationary in nature, even though it clearly represents a starkly diminished purchasing power of money.

Blowing bubbles – and living on borrowed time

And neither does the majority of investors seem to spot any inflationary tendencies, or god forbid, any hints of an asset bubble. Thus, let's quickly recall What Is a Bubble? *"A bubble is an economic cycle characterized by the rapid escalation of asset prices followed by a contraction. It is created by a surge in asset prices unwarranted by the fundamentals of the asset and driven by exuberant market behavior. When no more investors are willing to buy at the elevated price, a massive sell-off occurs, causing the bubble to deflate."*

The underscore is mine and highlights what is most relevant for our present circumstances, and I have spent many pages in this and prior Seasonal Reflections on presenting evidence in this regard: In short, asset price valuations are historically mostly in their highest decile, if not the highest ever, driven by exuberant market behaviour of the kind that considers any news as good news.

To me this represents the most important aspect of our present setup, and thus I would like to reiterate it: The world's advanced economies have been experiencing far more inflation than is actually shown in commonly used inflation metrics, and this is evidenced both in real life expenditure cost for the household sector, as well as the huge asset price bubble that is now the Everything Bubble, which in my view represents the most important reason for the growing (income and) wealth gap.



Source: CNBC

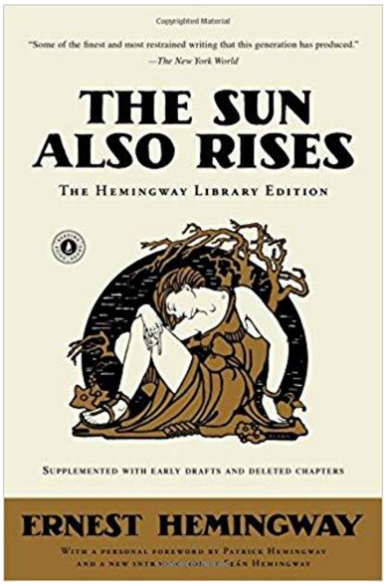
The dire consequence of monetary policy on steroids and the biggest threat to our financial and monetary system is the resulting tsunami of debt, about which I have also been writing about regularly in these pages. According to an International Institute of Finance report released in November 2019, global debt levels hit a record high of over USD 250tr in 1H 2019, sitting now at well over 320% of GDP. The more recent advance was driven mostly by the US and China.

This is the direct result of central banks' manipulation of interest rates towards the zero bound and below, which has been providing the room for an ever-extending degree of leverage in all sectors of the economy. It is also a consequence of the fact that ***"the tether between taxation and spending – the most important macroeconomic policy relationship for our lives as both investors and citizens – has been severed."*** (see Quote of the Month by Epsilon Theory's Ben Hunt in the opening section)

Just think about this for a moment: What is debt? – Essentially it is the result of spending money today that one expects to earn tomorrow and might instead have spent then. It means pulling future spending on consumption and or investment forward to the present. If I decide today to buy a new TV set or a fancy car but have not saved money to do so, I can borrow and thus incur a debt obligation. This allows me to enjoy watching that TV or driving that car today but obligates me to pay interest on that debt and additionally amortise it tomorrow. Ceteris paribus, this leaves me with less money to spend going forward. Thus, funds borrowed and spent today increase economic growth, but they slow future potential expenditures amid growing debt service cost, if the borrower has to ultimately balance budget, which at least applies to all borrowers that do not eventually plan to enter bankruptcy procedures.

The collateral for money lent can be income and / or available assets, which explains how inflated asset prices can help the expansion of debt levels: Higher real estate prices or investment portfolios offer more collateral and thus a chance to further increase existing debt levels, which is something the private sector has made plenty of use of. And again, additional debt funded demand provides a short-term economic boost but there is a clear statistical relationship which shows a diminishing marginal productivity of debt, i.e. the higher the existing debt burden the lower the additional growth impulse from an additional unit of debt funded spending.

For governments to live beyond their means by raising expenditure levels (spending) over and above their income levels (taxation) is actually the easiest, because they hold the power of taxation and thus can mortgage potential future tax income ad infinitum, which governments around the world have been doing for decades. It is simply a different way of living beyond one's means, and if full repayment is expected even government debt will have to be paid back eventually, thus leading to lower growth going forward. Here central bank policy of bringing down short-term interest rates towards the zero bound (and below), while targeting the long-end of the yield curve with their active intervention in bond markets (QE), have also helped to significantly reduce the cost of carrying an increasing debt burden and thus merely aided governments' profligate behaviour.



There was a time when I considered this only short-term emergency measures which responsible governments (to their broad constituents) and central banks would be able to reverse at some point, thus preserving our current financial and monetary system, but that time has passed. I am convinced that we have gone well beyond the point of fixing the system, which is essentially broke.

The reason why it has not yet collapsed is that trust among the majority of participants is still holding firm, and it is extremely hard to judge how long it will take to get sufficiently eroded. The subject of trust was dealt with in the In Gold We Trust Report 2019, and readers are invited to peruse it further in those pages. As far as the process of going bankrupt is concerned, however, it is worth to recall E. Hemmingway's apt description in "The Sun Also Rises", which yields the following exchange: *"How did you go bankrupt?" Bill asked. "Two ways," Mike said. "Gradually and then suddenly."*

Gradually, and then suddenly… – This is how these things have always gone, not only in the private but also in the public sector, and for the latter in particular when the tether between income (taxation) and expenditure (spending) has been severed, and I expect this to be no different this time around. It is merely a question of time.

There are in fact a number of high-profile investors who share the very same concerns, though the vast majority argues that these do not matter. What matters to the latter group is short-term performance, tracking or outperforming benchmarks, and recording paper profits. These investors may reason that they only focus on cashflows and dividends of their investments, and thus should be save, conveniently forgetting in the process how they keep paying higher and higher prices for the same underlying cashflows, dividends and intrinsic values.

(The disconnect between market prices and underlying fundamentals should be plain for all to see…)

Source: Zerohedge

If they are wealth managers they may also rationalize that this is what their clients want, though I believe it should be their responsibility to educate their clients about the risk of financial market bubbles, the (financial) hurt their past demise has often delivered, and the utter unpredictability of how this particular version will eventually fare. Whether it will be a crash, a more extended bear market, or simply a major sector reshuffling I cannot say, but this is in my view the backdrop any investor has to deal with at the start of 2020.

Consequently, my aim is to position the Incrementum All Seasons Fund (IASF) portfolio in a manner that helps it to first and foremost preserve capital over the expected conclusion of the current market cycle. Recalling former Citi boss Chuck Prince, who in an interview with the Financial Times in July 2007 was quoted: *"When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing"*, I have had a great time at this party but have stopped dancing and decided to leave, though the music is still reverberating. I know that I may have missed another hour or perhaps merely a few more minutes of frantic partying, but leaving is still the most responsible course of action.

How to manage money in such circumstances?

Before I continue, allow me to remind all readers that these Seasonal Reflections are not meant as solicitation to invest in certain assets and particularly not in the Incrementum All Seasons Fund. As responsible fund manager and co-investor in the fund, 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 only, 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 are seeking investment advice!

Ok, with the disclaimer out of the way, how have I dealt with the before described setup? Remember, the goal is 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 rather 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.

Before I go into further details on overall portfolio allocation and results, I have decided to respond to an Incrementum All Seasons Fund investor, who has recently asked me to provide an occasional concrete example on actual investments made, in order to better illustrate my portfolio management style and decision making. I trust that with the above disclaimer (and the reminder further below) in place, and the additional confirmation that the following refers to the history of an actual and existing fund portfolio holding, namely Transocean Inc, none of my readers will consider this investment advice, which it clearly and unequivocally is not.

Portfolio Investment Example: Transocean Ltd (for illustration only)

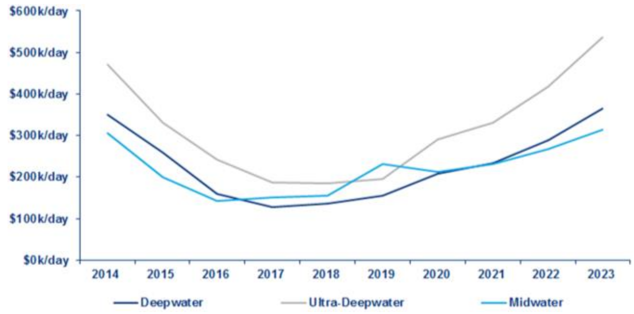
Transocean Inc (RIG US); Source: Reuters Eikon

At the time when I took over management of the fund (and turned it into the All Seasons Fund), it held a position of 3,486 shares at USD 6.12 already. In late June it received an additional 67,700 shares of the world's largest offshore oil drilling contractor delivered into the portfolio at a price of then USD 6.18. The company's share price development in recent years, like that of most of its peers, has been a sorry tale, with the shares trading at a fraction of its 2008 highs.

What made me decide to hold / own this position?

Transocean (RIG) is a 100-year old market-leading offshore oil services company. I consider it a hard asset play, as it owns a fleet of predominantly (ultra-)deep-water (UDW) and harsh environment (HE) oil and gas drill ships and floaters, which are long-lived assets that are expensive to build and replace.

Offshore oil and gas drilling activities have suffered in recent years from a lower oil price environment, plus competition from US onshore and unconventional tight oil (shale) businesses, which have attracted a significant share of overall energy related investments. As a result, day-rates which oil companies are paying for the use of Transocean's and its peers' vessels and equipment have collapsed.

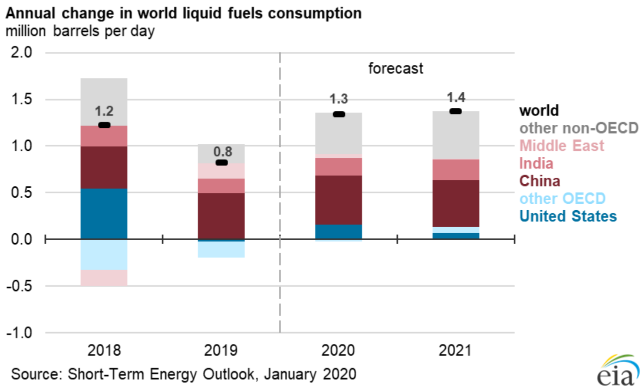


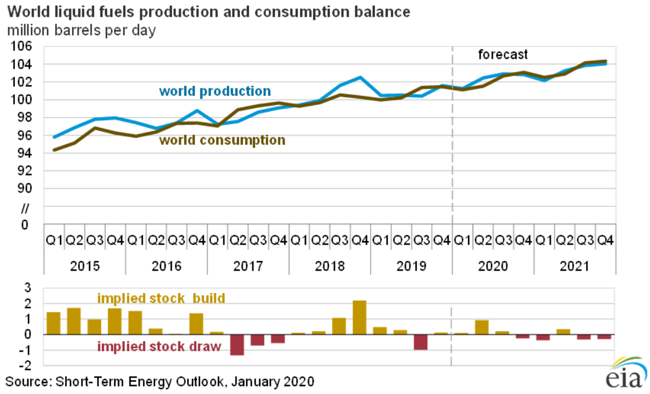
Source: Wood Mackenzie

This resulted in a number of loss-making years, and together with the cost involved in "stacking" rigs that cannot find employment, caused management to halve the company's fleet over the past 5 years. At the same time, this exercise was used to refocus business on UDW and HE rigs (94% of its fleet vs 45% in 2014), while significantly reducing the average fleet age from 21 years to 10. This metamorphosis was driven by above mentioned market / pricing pressures that allow only the most technologically advanced rigs to earn reasonable returns at current rate levels. The fact that it still leaves Transocean's fleet almost as large as its two next biggest competitors combined (47 rigs versus 28 for Seadrill and 27 for Valaris) indicates that this kind of capacity retrenchment was not a company specific development.

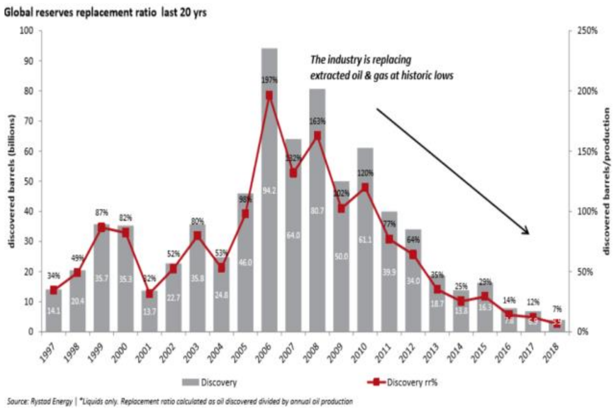
To help refocusing on UDW and HE rigs, and likely driven by a premature bet on a turnaround in day-rates, Transocean also made two, in hindsight relatively expensive acquisitions (Songa Offshore and Ocean Rig), which have left the company saddled with a fairly heavy debt burden. This is important to note here, as IASF also holds a position in the company's senior unsecured 9% 2023 USD bonds. With more than USD 3.2bn in available liquidity and USD 10.8bn in contract backlog, and the 2023 bonds one of the nearest maturities, I am comfortable to hold the bonds despite of their junk (B-/Caa1) rating.

Amid the shrinking of its fleet, coupled with a dismal pricing environment, Transocean's revenue has declined by 60% since 2016, which helps explain the share price's prolonged and deep slump. But at the same time, it has managed to keep its EBITDA margins in the high 30s. Meanwhile, it is encouraging that offshore production break-even levels have fallen by a third since 2016 to USD 43 per barrel of oil, while average approval time for new offshore projects has shortened by a quarter to 3 years.

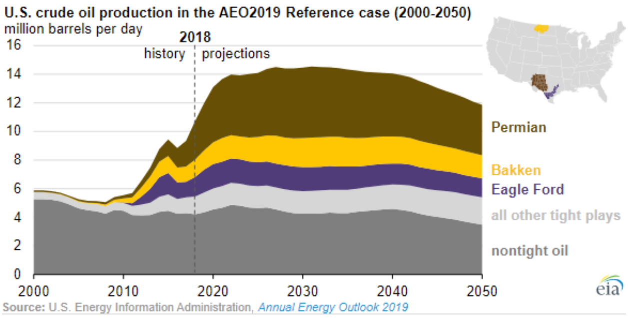




And this is why I think this is an industry / company worth investing in: Oil and gas demand globally is still growing. According to the [US Energy Information Administration] (EIA), global liquid fuels consumption is expected to grow to 102.1m barrels per day in 2020, which is a 1.3% advance, following 0.8% growth in 2019. For 2021 demand growth is expected to reach 1.4%. However, world production is slowing, as the E&P industry has woefully underinvested in replacement of extracted oil and gas, resulting in a reserve replacement ratio at a long-term low.

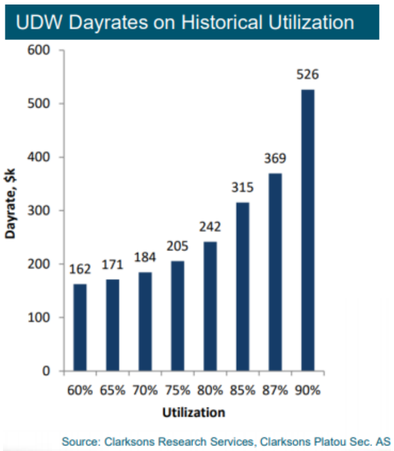


Source: Transocean



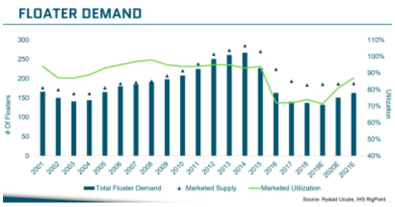
Meanwhile, US tight oil (shale) production, which over the past decade has delivered more than 100% of total non-OPEC production growth, is expected to register slower growth going forward (see EIA chart). In fact, a number of independent analysts argue that US shale production will peak earlier and decline faster than commonly anticipated.

As a result of last year's oil price advance and related improved cash flows and profitability, the oil and gas industry is therefore expected to invest more into offshore oil exploration and production over the coming years, as the potential for further US shale production growth looks increasingly limited. This is also evident by the fact that the number of offshore project approvals have nearly tripled since 2016.



Source (both graphs): [Transocean]

Bearing in mind the significantly reduced fleet size (about 1/3 since 2011), overall utilization is already growing (see graph below), though many rig owners have been compromising on rates.



Transocean has been more disciplined in its own pricing, and yet capacity is expected to rise towards 80% by 2021. As the graph on the far-left shows, rising capacity utilization typically leads to exponential rate growth once utilization rates approach the 90% level, something the offshore drillers have in common with the shipping industry.

Transocean, which has suspended its dividend to preserve cash, currently has a market cap of a mere USD 3.8bn, and with net debt of USD 7.5bn the company's Enterprise Value is USD 11.3bn. EV/EBITDA is 10.5 currently, but expected to fall to 8.7 in 2021, while revenue is forecast to grow 5% this and 10% next year. Its shares trade at a mere 32% of its already written down book value, suggesting that investors seriously doubt the reported value of its long-life and modern assets.

As the graph on the right shows, after marking a low in August Transocean's share price has recently been trending higher. And coming back to the initial positioning in the stock described at the beginning of this chapter, it is now basically back to the levels where the fund got its first shares delivered in in June (last price on January 17: USD 6.15). Thus, it hardly looks worth the effort, doesn't it?

Transocean Inc (RIG US); Source: Reuters Eikon

Ok, so far I have used this example to highlight a number of aspects of my fund management process: Why I like the energy space, what attracts me to this particular part of the energy space, and why I feel comfortable in owning the stock, i.e. not only fundamental ratios and charts, but also the story behind it and the potential value creation I expect it to deliver going forward.

IASF TRADING RECORD: TRANSOCEAN

Transaction Date	No of shares	Price	Value (USD)	P&L (USD)	Comments
06.06.2019	3'486	6.12	-$21'334		initial holding
25.06.2019	67'700	6.18	-$418'386		delivery from new investors
15.07.2019	28'814	6.10	-$175'765		Purchase
29.07.2019	20'000	5.35	-$107'000		Purchase
31.07.2019	-20'000	6.10	$122'014	$15'014	Sale
02.08.2019	20'000	5.35	-$107'000		Purchase
06.08.2019	30'000	4.80	-$144'000		Purchase
14.08.2019	30'000	3.91	-$117'300		Purchase
21.08.2019	-30'000	4.80	$144'000	$26'700	Sale
11.09.2019	-30'000	5.80	$174'000	$30'000	Sale
10.10.2019	40'000	4.15	-$166'000		Purchase
06.11.2019	-40'000	5.55	$222'000	$56'000	Sale
20.11.2019	40'000	4.51	-$180'400		Purchase
05.12.2019	-40'000	5.40	$216'000	$35'600	Sale
BALANCE	120'000		TOTAL:	$163'314	

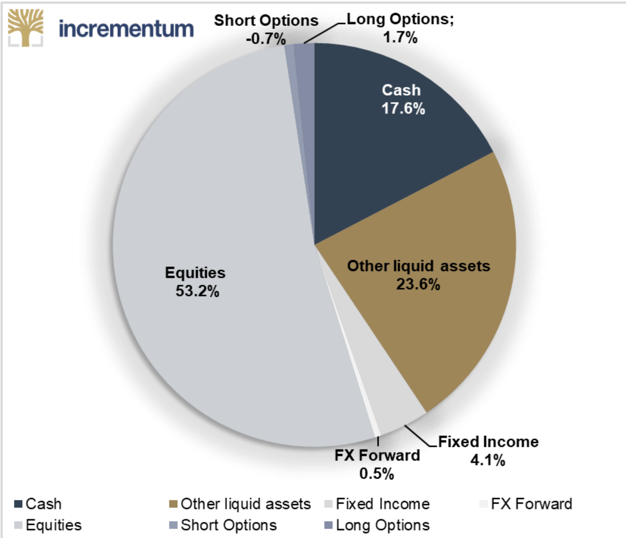
Source: HGS (applying his rudimentary Excel skills)

But it also showcases how I am extracting additional value for the fund by trading around its core positions: Following the initial delivery of shares and my decision to build a position, I bought additional shares to bring it to a more meaningful size of the portfolio. The position has grown in absolute terms in line with the fund's AuM growth and taking advantage of the stock's underlying volatility IASF has traded positions around it, generating realized gains of USD 160k in the process (22% return on static holding).

Arguably, this was the most active stock I have been trading in 2019, but I have done similar trades in other fund holdings. For illustration purposes I am planning to include similar investment review cases in future Seasonal Reflections. But remember that **none of this is meant as solicitation to invest in certain assets, especially not into Transocean shares or the Incrementum All Seasons Fund. All my views expressed in this report, which of course include those listed further below, must be considered biased and although I use great care in writing this commentary, it clearly reflects my personal views and assessments. Therefore, if you are seeking investment advice you should always consult a licensed investment professional!**

How to manage… – Reviewing end of 2019 positioning?

Returning to the original question about how I manage the Incrementum All Seasons Fund in the earlier described challenging economic and market environment, I will always start with what I believe is an appropriate asset allocation given the prevailing investment season. Since highly rated bonds yield next to nothing and especially do not offer an inflation-adjusted positive yield, **Equities** are the main risk asset class the fund has exposure to, accounting for 53% of assets at year-end 2019. Meanwhile, **Cash** (bank account balances) accounted for 18% and **Other liquid assets** (fixed deposits, bonds with less than 1-y maturities, and precious metals ETC's) made up 24% of the fund's assets.

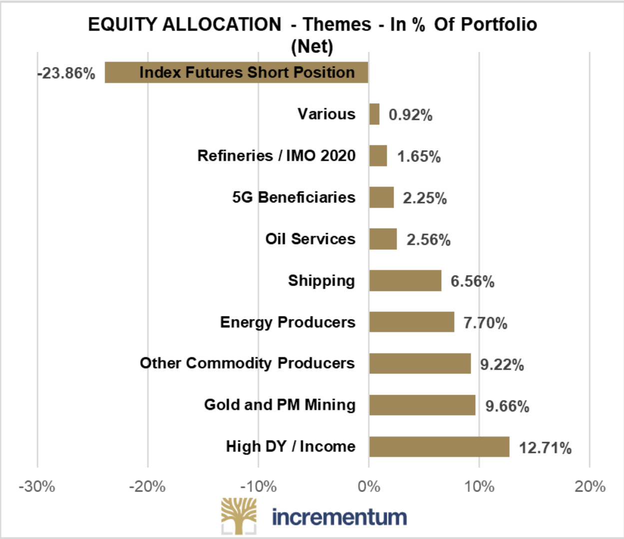


IASF Allocation, 31.12.2019

The residual balance was made up of the fund's **Fixed Income** exposure, which consisted of the before mentioned Transocean bond, as well as another high yield bond from the same sector (total of 4% exposure), and the value of the fund's derivatives holdings, which consist mostly of **Long Options**, minus the present value of **Short Options** positions, and the current accrued value under the fund's **FX Forward** and swap contracts.

On the derivatives side, the fund has been using short futures positions on the S&P500 (21% of underlying) and EuroStoxx600 (3%) to hedge approx. 24% of overall equity market risk. This has obviously been a major drag to portfolio performance so far, given that rising equity markets have led the fund to bleed constant margin debits. However, this has and will reduce the fund's overall (gross) equity market risk, while I am confident that my stock selection over time will outperform the broad market and thus be able to add value, regardless of the further direction of equity indices.

The Long Option exposure consists of a long-dated EUR Call option to reduce currency risk in a EUR account that carries a large USD foreign exchange risk, as well as additional long-dated S&P500 Puts which are supposed to further reduce the risk of a larger equity market correction. But I have been far more active (over 20 individual trades) on the Short Option side over the past few months, where I have been selling mostly equity put and occasionally covered call options on stocks I was happy to add to or sell from the fund's portfolio, but also foreign exchange options, in order to generate option premium income that helps compensate negative interest charged on the fund's EUR (and CHF) cash holdings.

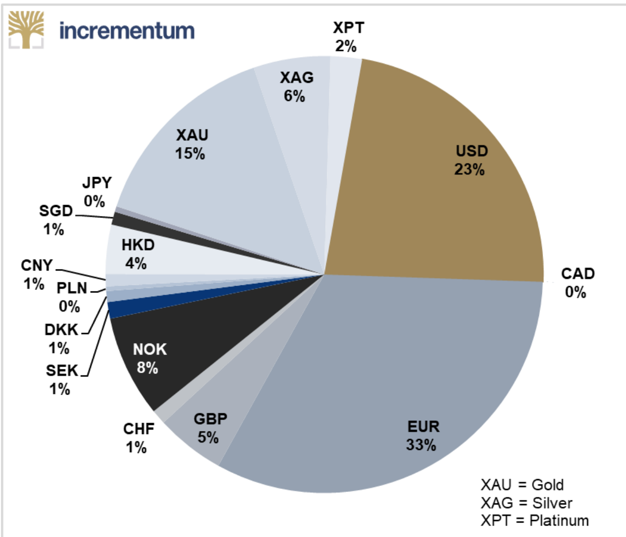


IASF Equity Allocation, 31.12.2019

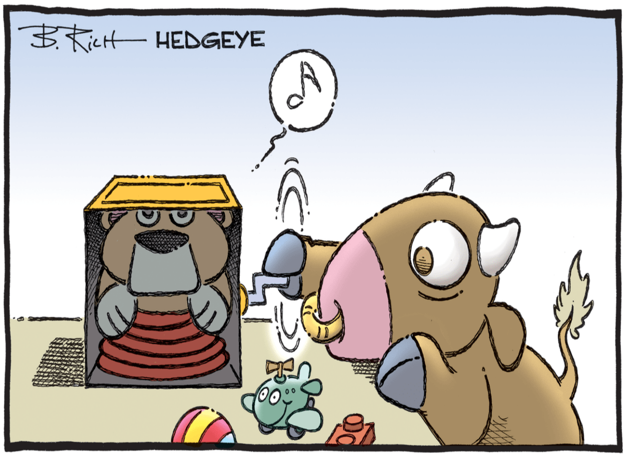
As far as IASF's equity exposure is concerned, I have classified exposure according to investment themes. One important theme in a yield-starved world is generating income via dividend payments. The fund's 13% exposure to this group consists mainly of UK, Hong Kong and Singapore stocks which do not levy any withholding tax on dividends and yield a weighted average of close to 7.5%. The second largest group are precious metals miners, accounting for close to 10% exposure in the fund. Noteworthy following my comments on Transocean above are also the fund's Energy Producers, which are not only attractively valued, but also offer a 4.6% gross dividend yield.

Here it is important to note that this is not a fixed allocation, but constantly developing in accordance with valuation levels and available opportunities. Generally, the equity portfolio is not (yet) very concentrated, with position size ranging between 0.5% and 3%, though I would not mind going up to 5% given high enough conviction level. – By the way, this only refers to risk assets; the fund's exposure to precious metals via ETCs is not affected. Here the largest allocation is nearly 8% to a Gold ETF.

This brings me to the last section, which is FX allocation. As you can see from the accompanying pie chart the portfolio is rather well diversified. The largest position is EUR (33%), which is the fund's base currency, followed by a 23% exposure each to USD and precious metals. The latter consists of gold (XAU), silver (XAG) and platinum (XPT) ETFs, as well as the relevant precious metals mining exposure. The remaining 20% exposure consists mainly of NOK (8%), a "high"-yielding EUR-near currency, GBP (5%), which reflects GBP-based equities held, and HKD (4%), which due to its USD-peg can actually be added to the USD allocation.



IASF Currency (FX) Allocation, 31.12.2019



Source: Hedgeye

All in all, I 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. For me this is the difference between speculating and investing: Rather than looking into the rear-view mirror and mindlessly following the crowd, I have positioned the portfolio in areas that I expect to do well going forward. I would not be surprised if 2020 turned out just the year to prove what this is worth! – After all: *"Predicting rain doesn't count, building an ark does."* (Warren Buffett in fiscal 2001 letter to Berkshire Hathaway shareholders)

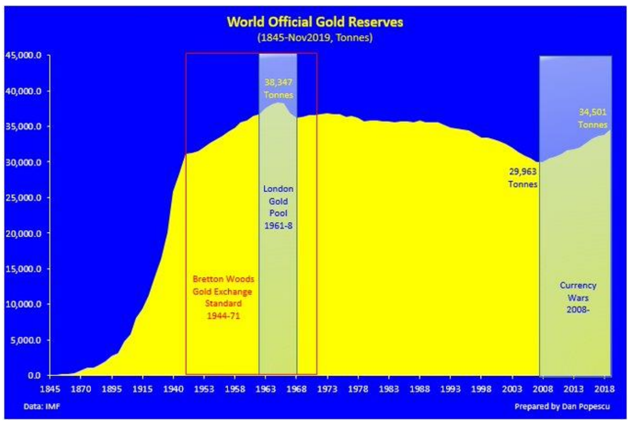
In December 2019, IASF actually reaped the benefits of this positioning, as the fund's NAV enjoyed a decent year-end rally. For your information, I am listing below the latest NAV valuations as of December 31 for the four separate share classes (D-shares were launched on Jun6, P-share on Sep26, all at 100.00), followed by their December monthly performance in brackets. You can easily access the last monthly report on the Incrementum website, or by clicking on the red links below:

USD-D:	USD 106.08 (+5.3%)	EUR-D:	EUR 104.49 (+4.7%)
CHF-D:	CHF 102.96 (+4.5%)	EUR-P:	EUR 103.02 (+4,7%)

It's a (golden) wrap!

Well, I hope you did find this letter worth spending your time reading, not only as an existing investor but also as someone who has registered and thus documented his or her interest in receiving it.

I would like to wrap this up with a final chart which may prove a good indication for a major investment theme in the upcoming Chinese Year of the Rat: Despite of their reluctance to openly communicate their interest, central banks have been buying nearly 20% of the world's gold supply in 2019. After they had been net sellers of gold from 1971 through 2008, the tide has turned since, with the world's official gold reserves now approaching the highest levels since the Nixon era. This clearly shows that gold continues to retain its monetary value.



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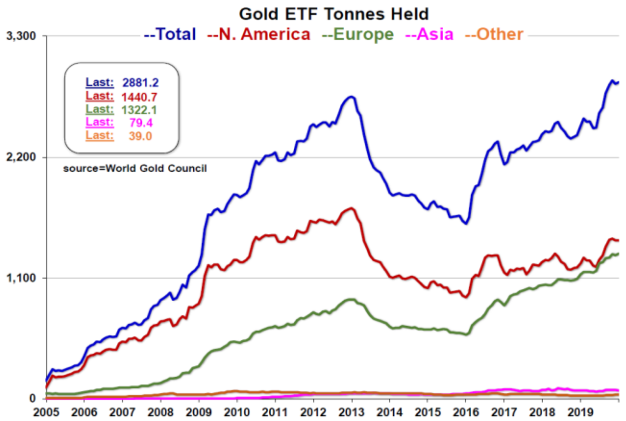

Source: [Meridian Macro Research LLC]

At the same time demand from the private sector, reflected via Gold ETF holdings, is also on the rise, because in a zero-interest rate world the absence of any yield on gold has led to a disappearance of opportunity cost. (Asia and others clearly prefer buying the physical metals, rather than using a ETF.) – I will refrain from making forecasts on the gold price outlook but remain completely convinced that gold (and silver) are monetary metals, which offer investors a suitable diversification in today's world of ongoing monetary debasement.

In closing, allow me to wish all my Chinese friends

Kung Hei Fat Choy / Gong Xi Fa Cai

May the year of the rat turn out a most happy and prosperous one!

Source: [www.unsplash.com]

Greetings from Schaan, Liechtenstein!

Best regards,

Hans

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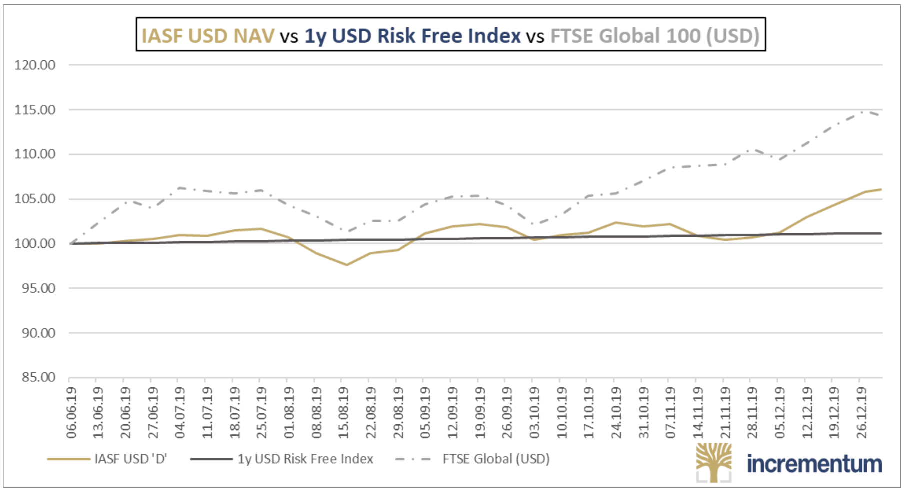
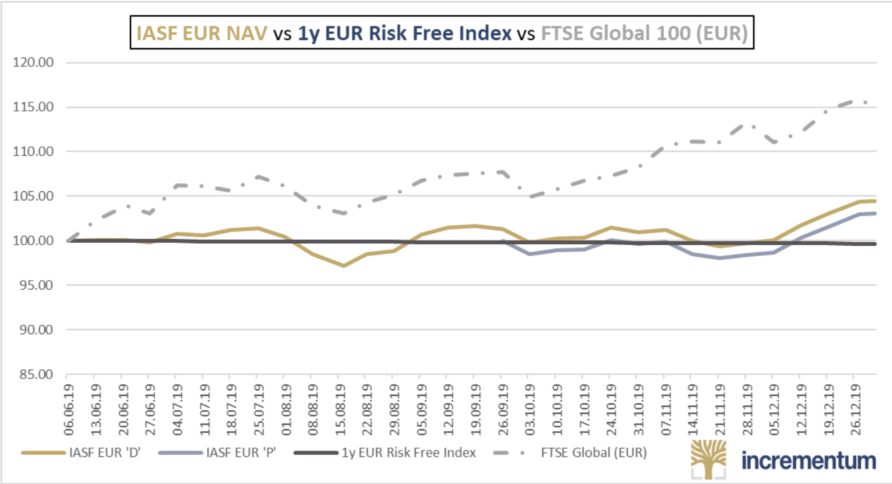
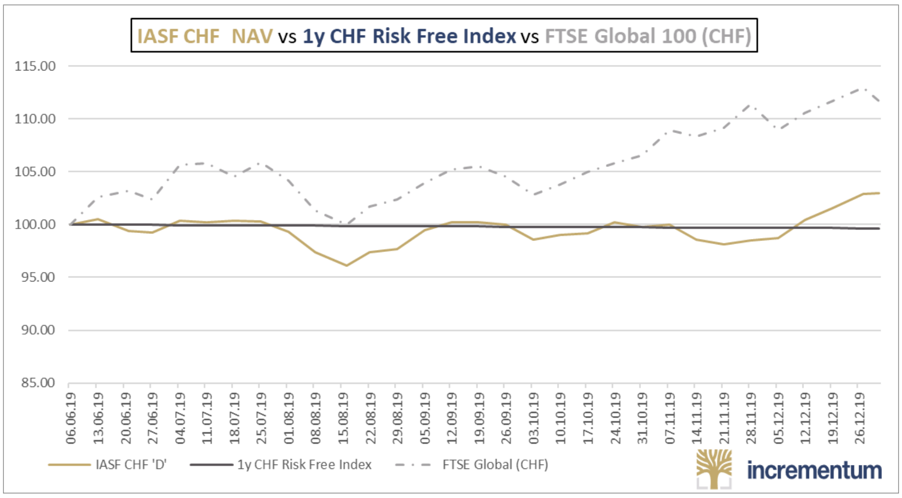
Appendix *







* Graphs display NAV of IASF 'D' shares as of last valuation date (**31DEC2019**), compared to the respective risk-free 1y-government yield as well as the FTSE Global 100 Index in respective currency as a proxy for overall 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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