

December 2017

Elixir News



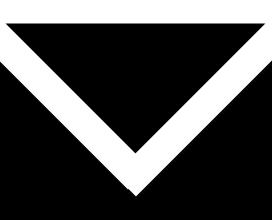
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CREATING INCOME FOR EVERYDAY PEOPLE BY USING TECHNOLOGY TO HARVEST VOLATILITY.









Hi Everyone,

Happy New Year! I hope you had a wonderful time during the holidays, and we wish you a prosperous and healthy 2018!

With the market being relatively quite during the holiday season, Elixir still produced a reasonable income in December at 1.93%. In this update, we will explain where we made most of the money in December. I'm also sharing with you my view on Bitcoin and US inflation/deflation and what it means to the US dollar.

I hope you enjoy reading this newsletter. I am excited about 2018. It's going to be a great year for Elixir and for all of us!

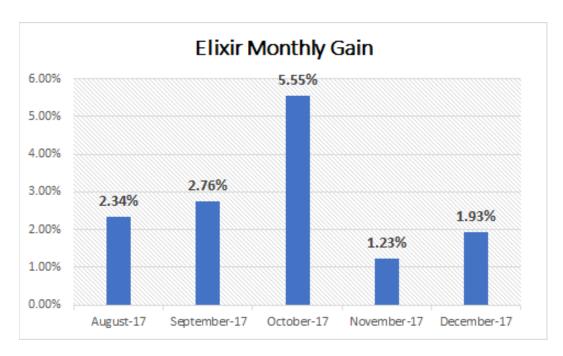
William McNarland, CFA

December 2017

ELIXIR'S INCOME PERFORMANCE

Elixir's financial target is to produce revenue of 2% of investors' deposits each month. Revenue comes from earnings on deposit interest and from capital gains created from rebalancing the DDVARH hedge, which is audited independently by a third party, Myfxbook. The auditor has direct access to Elixir's accounts and can calculate Elixir's income performance directly.

For the month of November, Elixir's revenue performance was 1.93%, which is close to the monthly target and within expectations. We feel that 2% per month is an achievable goal for 2018.



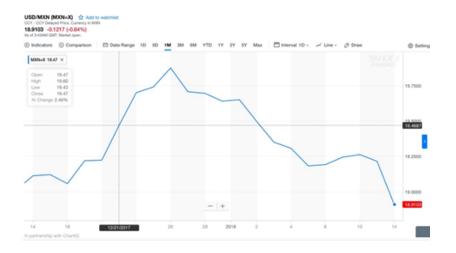


DECEMBER GLOBAL MARKET OBSERVATIONS

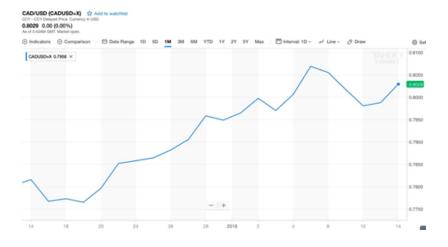
Overall, investments within our mandate were quiet globally except for the Mexican peso. The peso produced a good portion of the return this month and perfectly demonstrated the thesis behind Elixir.

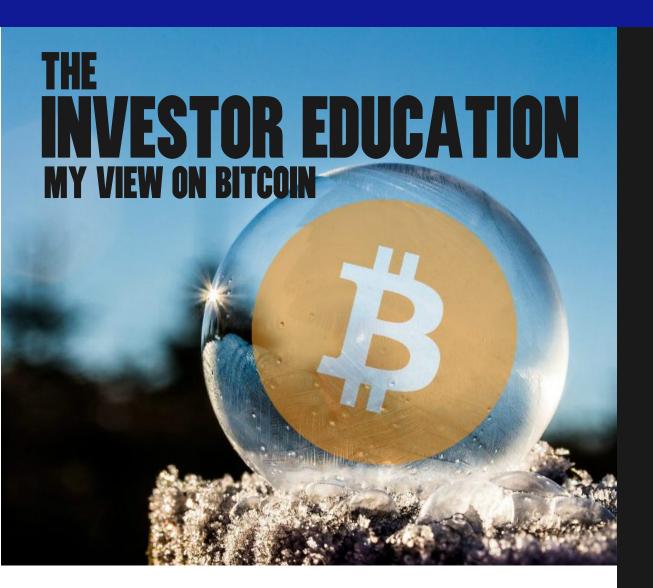
There was no material news regarding Mexico in the last 30 days, yet the volatility of the currency was incredible.

The chart below shows how the price dropped in a one-month period, and we were excited to buy deposits and earn 6% annual interest. The peso kept dropping in price for no reason, and we kept buying more. Within the month, the price had returned up to its previous staring point, and we sold our position for a gain close to 6% in addition to the 6% annual interest payments we received during that time. Note: the chart is inversed, as Mexican pesos are quoted in US dollars.



Last month, we commented on the divergence between the Canadian dollar and the price of oil, and since then, the Canadian dollar has increased in value by 3%, as seen in the chart below. Oil has yet to fall, but all signs point toward oil's return to the \$50 range soon.





These days, Bitcoin seems to be an extremely popular topic that has been coming up a lot in my social and professional conversations lately. I understand the buzz considering its price went up from \$963 per coin on January 1, 2017, to \$14,112 a year later. 17 times increase in value over a one-year period is enough to get any investor excited. And of course, I have been asked multiple times to share my view regarding this non-traditional currency. So, here goes.

Would Elixir consider investing in Bitcoin or any other cryptocurrencies?

No. Bitcoin does not meet Elixir's investment mandate. There are three important criteria we look for in our investments:

- Liquid deposits from investment-grade rated countries.
- Deposits that produce income while we wait for them to increase in value.
- Deposits that allow us to borrow at a low or negative rates.

Bitcoin does not come close to meeting any of these basic criteria.

Outside of Elixir, what is your view on Bitcoin?

There are hundreds of articles out there about Bitcoin. It's very easy to find information about how Bitcoin works, the ethics and social issues around it, and the two complete opposite views on its future. I would like to simply talk about three points that are relevant to me.

First, if I had to become involved with Bitcoin, rather than buying the currency, I would consider investing in companies that are offering services to cryptocurrencies or those who make use of the blockchain technology.

Regarding this particular point, Bitcoin, to me, is similar to how I view e-commerce.

More and more consumers are purchasing goods and services online. The demand for e-commerce is real. Due to this, we have seen countless e-commerce startups. The reality is that some startups will make it, but most won't. So instead of taking on the high risk and invest in a startup, we would rather invest in traditional and mature companies that service the irreversible trend of shopping online. Companies that are in packaging or freight and logistics are my top picks, as they are a lot less risky than investing in a startup.

Second, I like to buy things when they're cheap. Last week, I noticed that tomatoes cost four times the amount that they were priced at in the summer. Therefore, I decided not to stock up on them until the price comes back down. The idea is the same for Bitcoin. Bitcoin is expensive, so it's not for me. The high price is also unsustainable. The notion of buying high and selling low doesn't work for me either.

Third, despite Bitcoin being a bubble, the blockchain technology is a real asset. The Bitcoin bubble will burst, just like the dot-com bubble. But after the crash, the blockchain technology will continue serving its purpose and creating value, just like we are still using computers today, nearly two decades after the dot-com crash.

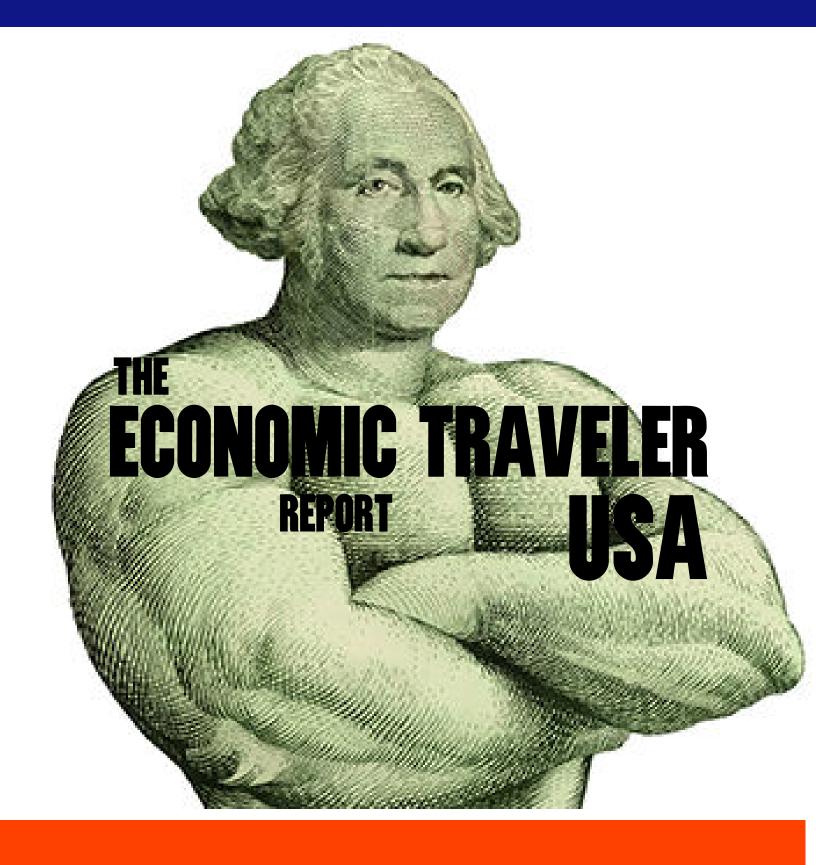
Why not short and profit from the fall of Bitcoin?

There are two exchanges that started offering future contracts with three different expiration dates in December 2017. I looked into them in detail. Here are my two reasons why I would not want to consider this option.

First, with commercial demand, investors could somewhat establish a baseline for price, just like I know that oil should cost roughly in the range of \$40 to \$60 USD per barrel based on actual global demand. That's not the case for Bitcoin, which increased in price by 17 times in one year. Considering there is no new development, there is no reason for the steep increase in value. The price of Bitcoin is determined solely by irrational investors. One person explained to me that Bitcoin is worth 10,000 times more than today's price because it would replace all global currencies by the end of 2018. His predicted value of Bitcoin is based on the value of global money supply divide by the outstanding float of Bitcoin. When people like this are investing, it is scary to short against them. Not to mention speculative bubbles can grow much bigger and take longer to burst. It is way too risky to short Bitcoin.

Second, the margin requirements are ridiculously high. To short one bitcoin for \$15,000 USD, people would have to put up \$30,000 USD in security. I would much rather invest \$30,000 in a diversified and conservative strategy like Elixir than take on extreme risk to short one Bitcoin.

Having said this, I would be interested in profiting from Bitcoin's future fall if options become available. I would buy Put options, but they are not currently available.



US Inflation: The Missing Case

Typically, when the unemployment rate is low, the pressure on increasing wages should cause inflation to rise. The US unemployment rate is at about 4% now, which is close to an all-time low. However, the US inflation rate reported was only between 1.6% and 2.2% during the last six months. This number is also very low. I am not usually one to trust economic statistics produced by governments, including First World countries, as they are often manipulated to show a picture the government wants to present.

My wife and I spent some down time in San Diego and Orange County during the holiday season. What I have seen in Southern California seems to match the reported inflation rate. I did not see any evidence of inflation compared to years past. In fact, I saw some evidence of what economists are most worried about: deflation. Here are some of my observations.

Groceries

An example I look at is Kellogg's Corn Flakes. A study has collected the price of this corn flake product from grocery store ads since 1907. The price of the product has always been just slightly higher than the official reported inflation rate, so I usually use this as a good independent indicator for inflation. In 2014, the average sale price was \$4.19 for 18-ounce box. Today, I went to Walmart, and the same product was \$3.83 (not on sale). From my experience, Walmart's regular prices are not cheaper than its average competitor's flyer sale price. A 40-cent drop is a sign of deflation in corn flaks.

Year	Price/Size	Price Pe	er Ounce
1938	\$0.07 8 oz	\$	0.0100
1948	\$0.12 8 oz	\$	0.0150
1958	\$0.18 8 oz	\$	0.0250
1968	\$0.39 18 oz	\$	0.0216
1978	\$1.15 24 oz	\$	0.0470
1988	\$1.49 18 oz	\$	0.0820
1998	\$2.29 18 oz	\$	0.1270
2008	\$2.99 12 oz	\$	0.2491
2012	\$3.79 12 oz	\$	0.2100
2015	\$4.19 18 oz	\$	0.2320
2018	\$2.58 12 oz	\$	0.2150

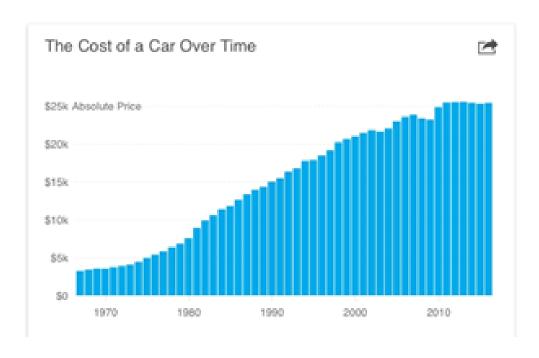
Source: Foodtimeline.org

Restaurants

In early December, McDonald's announced that it brought back the dollar menu in the US.A cheeseburger is now offered for \$1 USD along with many other items at reduced rates. It's not the first time that we've seen McDonald's reduces its price. In 1991, they cut the price of a cheeseburger to \$0.69, just above the company's production cost. The original price of a cheeseburger was 19 cents back in 1955. If you take that price and adjust it according to inflation, the fair price of the cheeseburger in 1991 should have been \$0.97, a 28% discount for the consumers. Historically, that was the lowest price ever for the cheeseburger. Today, the discount is 43%, which is the new lowest record for McDonald's cheeseburger price in history. Why would McDonald's cut prices during a period of expected inflation and full employment? And McDonald's isn't the only company to examine; if you look through flyers regularly, you may notice that many of McDonald's competitors are also lowering menu prices this year.

Cars

The chart below shows that the average price of a new car in the US has not changed in the last few years. Typically, the price of cars follows inflation.



Stamps

It is interesting to note that the price of a post card stamp in the US has fallen over the last few years whereas these stamps have always increased in price historically.

Conclusion: These observations have led me to believe that the actual US inflation rate is lower than the 2% reported by the US government. I would even go further to say that we are potentially heading toward a deflation. The risks and concerns regarding deflation are outside the scope of this article, though; the most important issue to Elixir is what would happen to a country's currency during deflation.

Currency performance should be the opposite of inflation. The higher the inflation is, the less valuable the currency is because the deposits in that currency will have less purchasing power. For example, if you deposited \$100 USD in your bank in 2016, that money could buy you 100 apples. During 2017, inflation went up by 5%. This means by the end of 2017, your \$100 dollars could only buy 95 apples.

Conversely, if the US has lower inflation than reported and is potentially experiencing deflation, we would expect the US dollar to strengthen in value due to its added purchasing power.

YEAR	US Post Card Stamp PRICE IN CENTS
1898	1
1953	2
1958	3
1963	4
1968	5
1971	6
1974	7
1975	8
1976	8
1978	10
1981	12
1982	13
1985	14
1988	15
1991	19
1995	20
2001	21
2002	23
2006	24
2007	26
2008	27
2009	28
2011	29
2012	32
2013	33
2014	34
2015	35
2016	34
2017	34

This is an ongoing story unfolding that we are watching closely and expect to comment on much more in the future.