February 2018

Elixir News

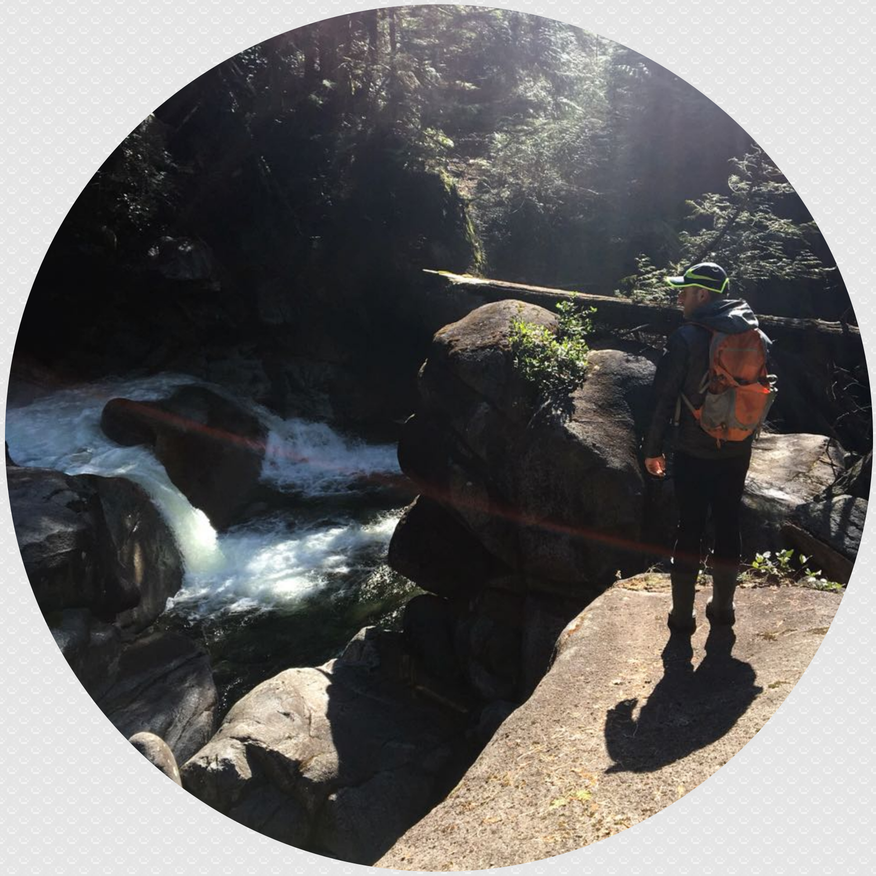
ELIXIROFINCOME.COM

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

Hi Everyone,

It looks like spring weather is finally starting to show in most parts of the country. We are certainly enjoying the warm weather on the West Coast! Elixir had a strong February with a 3.10% revenue performance. Our average monthly revenue is currently at 2.68% since August of last year. We are happy that our average return has consistently exceeded our target of 2% per month, month after month.

In this February issue of Elixir News, we will have a very brief review of the market and a feature article about a new potential opportunity focusing on hybrid exchange-traded funds (ETFs). The report is a proposal to show our Board how we can use a sophisticated strategy to profit off the coming collapse of these hybrid ETFs. I feel obligated to share this report to our existing and potential investors, as the information on the risk profile of these hybrid ETFs must be exposed. Investors must be informed and make educated decision to avoid these types of investment.



Early March, Say Nuth Khaw Yum Provincial Park, BC

I feel obligated to share this report to our existing and potential investors, as the information on the risk profile of these hybrid ETFs must be exposed. Investors must be informed and make educated decision to avoid these types of investment.

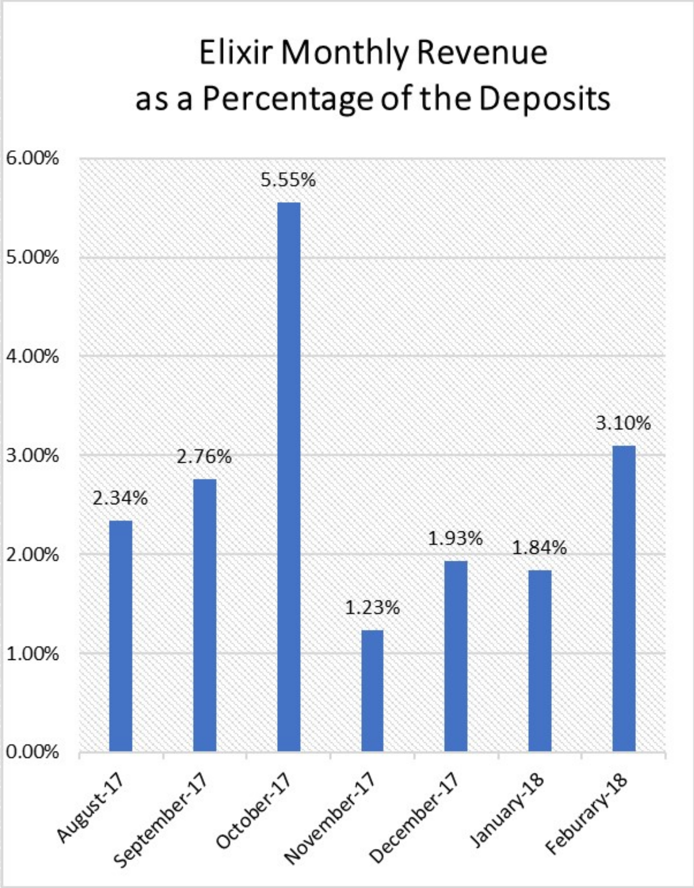
Toward the end of the issue, there is an invitation to all our readers to join us in Mexico in November for the annual Day of the Dead festival. Be sure to check it out and let me know if you are interested in joining. We appreciate your support and look forward to any questions for comments you may have.

Sincerely,
Bill McNarland

ELIXIR'S FEBRUARY REVENUE 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 February, Elixir's revenue performance was 3.10%, which is almost 50% higher than the monthly target and within expectations. We feel that 2% per month is an achievable goal for 2018.



GLOBAL MARKET OBSERVATIONS

In the beginning of February, volatility hit the market hard, and then things slowly returned to normal by the end of the month. The first few days of March came with volatility then, again, died down. What is happening in the market is very similar to 1987, 2000, and 2008. This leads us to believe that volatility will strike in a very big way in the coming months. The market correction on February 5 was only a volatility appetizer.

Having said that, we are very pleased to see a strong February performance at Elixir. It demonstrated that we are prepared not only to withstand but also profit from extreme volatility. We believe that March and the coming months will have a strong potential to produce above-average returns again.

THE INVESTOR'S EDUCATION

FROM ELIXIR LAB: A NEW INVESTMENT POTENTIAL STRATEGY TO PROFIT FROM POORLY STRUCTURED HYBRID EXCHANGE-TRADED FUNDS

At Elixir, our Research and Development division (currently me, lol) is constantly searching for new ideas. Once an idea is developed into an investment thesis, we would test it to learn if it fits our mandate of generating low risk and hedged high yield. A very small-scaled field test will follow suit for those chosen strategies if approved by the Board. Typically, this market field test will go on for a year or two. Once we have a good track record, the strategy will then be executed on a larger scale and will be officially introduced to all investors.

Today, we would like to share a new idea focused on the flawed hybrid ETFs with our existing and potential investors.

Origin and Purpose of ETFs

The original ETFs were very similar to mutual funds. They gave retail investors a low-cost way to own a basket of stocks with one purchase. Typically, the ETFs' management fees were much lower compared to mutual funds. In 1990, the Toronto Stock Exchange launched the first ever ETF, the Toronto 35 Index Participation Units. The fund included 35 different stocks. In 1993, a similar product was launched on the US Stock Exchanges, called the S&P 500 Trust ETF. This fund is still one of the most actively traded ETFs today.

Fast forward 25 years to today. There are currently more than 100 ETF issuers and over 1,400 individual ETFs in the market. The original ETFs where often praised by great investors, such as Warren Buffett and John Boogle, as an intelligent and low-cost way to own a diversified portfolio of investments. Unfortunately, most of the growth has been in hybrid ETFs in the last few years. These products are very different from the original ETFs.

Hybrid ETFs

The thesis for original ETFs was solid and simple. However, along the way, features such as leverage, inversion, and commodities following were added to ETFs. These hybrid ETFs could include one or multiple above-mentioned features. For example, one hybrid ETF offered at Velocity Shares has a 3x leveraged and inverse relationship with silver. In simple terms, this means if silver increases by 1%, this hybrid ETF would fall in value by 3%.

It is our opinion that all hybrid ETFs have flaws. The product often comes with clear warning labels on its original prospectus. Unfortunately, these warnings are often ignored by investors and result in lost of investment. We have studied the risk return profile of each hybrid ETF and offer some highlights of our research here.

Downward Bias of Many Commodity Hybrid ETFs

The United States Oil Fund (USO) is an example of a commodity hybrid ETF that has not worked out very well for investors. Let's quote Bloomberg for a description of this product: "United States Oil Fund LP is a Delaware limited partnership incorporated in the USA. The Fund's objective is to have changes in percentage terms of its unit's net asset value reflect the changes of the price of WTI Crude Oil delivered to Cushing, Oklahoma, as measured by changes in percentage terms of the price of the WTI Crude Oil futures contract on the NYMEX."

Basically, you pool your money with other investors to purchase oil future contracts. The goal is to profit from the future prices change of oil. The company will charge a management fee based on assets under management for providing the service. Sounds like a reasonable way to invest in oil, right? Or is it?

Let's look at how this fund performed over the long term in real life. A person invested in oil on January 1, 2009 (first business day of the year). The price of oil was $43.72 per barrel. Nine years later, on January 1, 2018, he sold his oil at $59.96 per barrel. In theory, the return should be about 37%. During this period, the price of oil had many up and down swings (see Chart #1 on the next page).

Chart #1

According to Chart #2 below, the price of USO was $33.77 per share on January 1, 2009. By 2018, on the first of day of business, its price felt to $12.33 per share. This means USO's value dropped by 63% even though the price of oil had gone up by 37%!

How did this happen?

Simple, this commodity hybrid ETF has a downward bias due to the structure of commodity future pricing. It is out of the scope of this article to explain the technical details, but the key point for investors is that due to this downward bias, hybrid commodity ETFs are destined for losing money.

Chart #2

Downward Bias of Leveraged ETFs

Many of the new ETFs in the market use leverage. The marketing materials of these investments explain to investors that they can have 2X or 3X the return of an underlying investment. However, what the marketing material doesn't tell you is that when a fund loses value, it is impossible to gain it back.

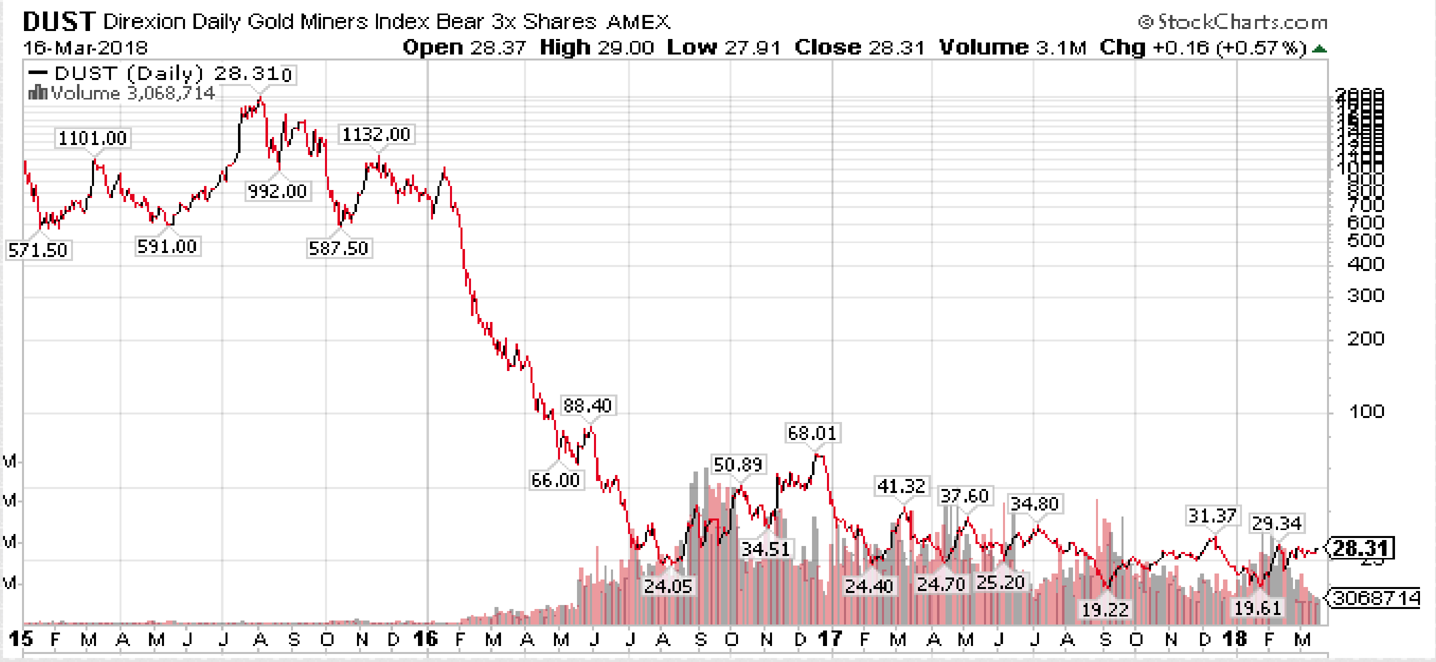
Let's look at a gold company index as an example. Chart #3 below shows the performance of Gold Miners Index over the last three years. The index holds an unleveraged collection of the largest gold miners' stocks in North America. If a person invested in an unleveraged ETF on the first trading day of 2015, when the index price was at $512 per share, and sold it on March 16, 2018, at $600 per share, his total return would be 17%.

Chart #3

Aside from investing in unleveraged ETFs, investors can also choose to purchase leveraged Direxion 3X UP Gold Miners Index (Chart #4) or Direxion 3X Down Gold Miners Index (Chart #5). Table #1 provides a summary of the results compared to the unleveraged option.

Chart #4

Chart #5



Gold Miner Index Level on Jan 2, 2015	$512.27	Direxion 3X UP Gold Miners Index on Jan 2, 2015	$84.00	Direxion 3X Down Gold Miners Index on Jan 2, 2015	$1,300.50
Gold Miner Index Level on Mar 16, 2018	$598.56	Direxion 3X UP Gold Miners Index on Mar 16, 2018	$24.06	Direxion 3X Down Gold Miners Index on Mar 16, 2018	$38.12
Gold Miner Index Return During Above Period	17%	Direxion 3X UP Gold Miners Index Expected Return based on Underlying	51% (3X 17%)	Direxion 3X Down Gold Miners Index Expected Return based on Underlying	-51% (3X -17%)
		Direxion 3X UP Gold Miners Index Actual Return	Loss 72%	Direxion 3X Down Gold Miners Index Actual Return	Loss 98%

Why does this happen? As a simplified example, let's say the stock market rises 10%, falls 30%, then rallies 10%. Without using leverage, this would turn a $1,000 investment into $847. That's not a great performance, but you live to invest another day. You would need a gain of about 18% to make up for the loss.

On the other hand, a triple-leveraged stock market ETF would turn into a gain of 30%, a drop of 90%, and a gain of 30%. Your original $1,000 investment would plunge in value to just $169. Now, you would need a rally of 492% just to get back to even. That's why leveraged ETFs are so dangerous. Of course, this is a simplified example, and the market doesn't generally move 10%-30% in a day, but even smaller ups and downs can have a devastating effect over time.

The more volatile the underlying investment, the higher the downward bias becomes. To further demonstrate this point, on the next page you will see four charts that show the audited return of four pairs of different Direxion 3X leveraged hybrid ETFs. Each pair includes an UP and DOWN variety. Notice that the annual returns since the inceptions of all eight funds have lost significant value, no matter whether the fund is set up for an UP or DOWN direction.

(To see the original charts and get more information on these products, please visit Direcxion Investments at www.direxioninvestments.com/products)

Direxion Daily FTSE China Bull and Bear 3X Shares

MONTHLY QUARTERLY

As of February 28, 2018

YINN Daily FTSE China Bull 3X Shares

	1M %	3M %	YTD %	1Y %	3Y %	5Y %	Since Inception	Inception Date	Expense Ratio * (Gross / Net %)
NAV	-30.68	6.49	1.38	77.12	-4.88	15.51	-1.17	12/03/2009	1.39 / 1.34
Market Close	-30.07	6.58	2.35	78.21	-4.62	15.72	-1.08		

YANG Daily FTSE China Bear 3X Shares

	1M %	3M %	YTD %	1Y %	3Y %	5Y %	Since Inception	Inception Date	Expense Ratio * (Gross / Net %)
NAV	30.33	-20.03	-14.36	-59.50	-39.98	-48.20	-42.71	12/03/2009	1.18 / 1.09
Market Close	30.26	-19.62	-14.33	-59.46	-39.96	-48.1[illegible]	-42.70		

Since Inception

-1.17

-1.08

Since Inception

-42.71

-42.70

Direxion Daily Natural Gas Related Bull and Bear 3X Shares

MONTHLY QUARTERLY

As of February 28, 2018

GASL Daily Natural Gas Related Bull 3X Shares

	1M %	3M %	YTD %	1Y %	3Y %	5Y %	Since Inception	Inception Date	Expense Ratio * (Gross / Net %)
NAV	-33.21	-27.54	-34.13	-52.01	-79.34	-72.50	-60.48	07/14/2010	1.14 / 1.06
Market Close	-33.31	-27.52	-34.23	-51.98	-79.38	-72.49	-60.49		

GASX Daily Natural Gas Related Bear 3X Shares

	1M %	3M %	YTD %	1Y %	Since Inception	Inception Date	Expense Ratio * (Gross / Net %)
NAV	36.87	15.78	32.91	14.05	-51.74	12/03/2015	1.83 / 1.08
Market Close	36.98	15.39	32.89	13.67	-51.79		

Since Inception

-60.48

-60.49

Since Inception

-51.74

-51.79

Direxion Daily Russia Bull and Bear 3X Shares

MONTHLY QUARTERLY

As of February 28, 2018

RUSL Daily Russia Bull 3X Shares

	1M %	3M %	YTD %	1Y %	3Y %	5Y %	Since Inception	Inception Date	Expense Ratio * (Gross / Net %)
NAV	-6.62	32.52	25.72	49.89	7.28	-30.26	-36.85	05/25/2011	1.24 / 1.28
Market Close	-6.40	32.59	25.67	50.40	7.44	-30.31	-36.83		

RUSS Daily Russia Bear 3X Shares

	1M %	3M %	YTD %	1Y %	3Y %	5Y %	Since Inception	Inception Date	Expense Ratio * (Gross / Net %)
NAV	-0.24	-32.36	-27.73	-52.77	-58.58	-44.6[illegible]	-43.60	05/25/2011	1.18 / 1.1[illegible]
Market Close	-0.06	-32.37	-27.78	-52.68	-58.62	-44.59	-43.59		

Since Inception

-36.85

-36.83

Since Inception

-43.60

-43.59

Direxion Daily Junior Gold Miners Index Bull and Bear 3X Shares

MONTHLY QUARTERLY

As of February 28, 2018

JNUG Daily Junior Gold Miners Index Bull 3X Shares

	1M %	3M %	YTD %	1Y %	3Y %	Since Inception	Inception Date	Expense Ratio * (Gross / Net %)
NAV	-21.82	-10.48	-27.45	-58.84	-39.5[illegible]	-60.42	10/03/2013	1.18 / 1.18
Market Close	-21.55	-10.12	-27.03	-58.58	-39.38	-60.35		

JDST Daily Junior Gold Miners Index Bear 3X Shares

	1M %	3M %	YTD %	1Y %	3Y %	Since Inception	Inception Date	Expense Ratio * (Gross / Net %)
NAV	17.32	-8.52	17.11	-13.41	-79.62	-75.64	10/03/2013	1.07 / 1.10
Market Close	17.28	-8.54	17.07	-13.39	-79.61	-75.61		

Since Inception

-60.42

-60.35

Since Inception

-75.64

-75.61

The High Risks of Hybrid Volatility ETFs

The most dangerous ETFs are those whose underlying investments are exposed to large volatility swings. Instead of stocks, bonds, or commodities being the underlying investments, these ETFs' underlying investment is volatility itself.

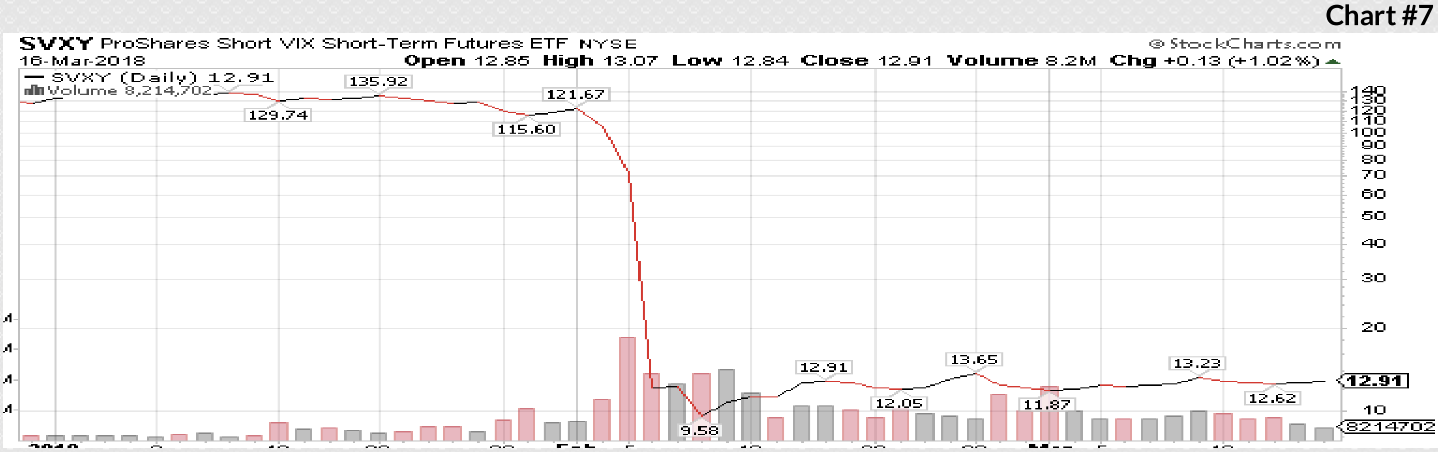
One index that measures the current volatility in the market place is called VIX, or Fear Gauge. A long-term chart of its wild swings is shown in Chart #6 below. If the underlying investment increases or decreases in value by 50% or more in a day, then catastrophic loss would occur.

Chart #6

In the beginning of February this year, we experienced a spike in volatility where the short-term volatility gauge raised from a reading of 9 to over 36 in just two days. This short-term spike devastated some inverse volatility ETFs.

As an example, the Pro Shares Short Volatility EFT lost 90% of its value in one trading day! (See Chart #7) Imagine how shocked investors must be seeing their investment disappear in one day. In my view, these exotic ETFs are financial weapons of mass destruction.

Chart #7



After seeing the poor performance of these hybrid ETFs, a natural question would be why not just short them?

The Risk of Shorting Leveraged ETFs

There are two main concerns around shorting leveraged ETFs. The first concern is that leveraged ETFs can work well (but not perfectly) when the market is long-growth and up-trending with very little downward volatility.

For example, the original Direxion 3X S&P 500 Bull shares were released at the perfect time, November 2008. The stock market was at rock bottom due to market meltdown. The 3X Bull shares went up 29% on average every year. It would have been very painful to short something that went up in value for nine years. As a side note, this ETF's opposite pair, its bear shares, went down 45% per year during the same period. The 16% annual spread between the bull and bear share demonstrate again the flaw in leveraged ETFs.

This example of a leveraged ETF works well and is a rare case, but I think it is unlikely that anyone would be have brought the shorting idea forward in 2009, when the market was at an extreme low level. Compared to shorting an UP ETF that has no limit to how high it can go, it would make sense to short an inverse leveraged ETF, as it can only go to zero, and the risk would be limited to 100%. But even with this protection, the next concern eliminates the opportunity.

The second main concern is the dealer's annual interest cost that investors must pay to process their short trade. Interest rates on shorting leveraged ETFs can go up to 50% annually. Paying to hold onto a trade is not something we would be interested in doing.

While shorting may not be the best way to profit from the flawed hybrid ETFs, there are certainly other ways to do it. Let's look at an okay strategy and an excellent strategy.

The Okay Strategy

#1 Call Option or Insurance Market

At Elixir, we are looking at selling call options or insurance on UP leveraged ETFs. Basically, this means selling insurance to the exchange and absorbing the risk if an ETF increases in value. The thesis assumes that the stock market will fall or not increase in value over the next six months. Elixir will sell insurance, and if we are correct, we get to keep the insurance premium. Here is an example of how the numbers would work.

ETF TICKER	SPXL
ETF Name	Direxion 3x Bull S&P 500
Price Per Share	$46
Margin Required	$20
Time Frame	6 Months
Call Option Payment	$8
IRR	80%

This is a good idea but not a great one. Although the current stock market is overvalued, it could still go up for a while. I would not have much comfort selling call option or insurance in a market that keeps on rising. First, there is no cap to the potential losses, as investments can go up 100%, 200%, 300%, or higher. It would be safer to invest at a market low with the same strategy using a DOWN ETF. Then, your risk is capped at 100%. Second, it would be better to find call option time frames that are multiyear instead of just for six months. A longer term means more money upfront and more safety due to additional downward bias. Third, when the market has high volatility, stocks are down, people are scared, and call option premiums are at a high level. Right now, the call option or insurance premium is low.

The Excellent Strategy

#2 Combining Call Options, Leveraged, Inverse, Commodities, or Currency ETFs and a Hedge

The first step of this strategy #2 is to identify an inverse leveraged commodity ETF that meets the following criteria. First, the specific underlying market is at an extreme low level. Second, volatility is high, and third, a hedge is available.

Let's use Velocity Shares 3x Inverse Silver ETF as an example. (We would not execute this yet, as silver is not at a decade low, but it is a good example of how the trade would work.) There are several reasons why we picked this ETF. First is because its underlying is silver, which is a commodity that has industrial demand. The price of silver can only fall so far, and it is used by many manufactures in different industries. At some point, manufactures start to order much more silver, which keeps the price from falling endlessly. This provides downside protection. Second, the commodity inverse ETF naturally has a downward bias. Third, more downward bias is added with 3X leverage.

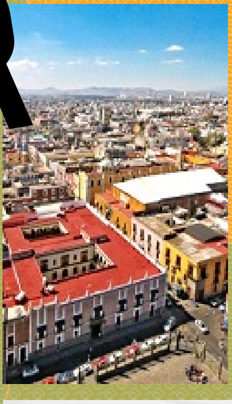
So, to execute on this trade, we would consider selling two-year-long term call options insurance when silver is falling and at multiyear low. Our thesis is that the market price of silver will stabilize eventually due to it industrial demand. The inverse ETF will not increase in value over the next two-year period if silver stabilizes. In addition, we would be protected by the natural downward bias from the commodity and leverage aspects of the ETF. Additionally, we would buy a partial hedge by shorting a small amount of silver contracts for difference.
Without a hedge, the trade would require a margin deposit of 50%, and the option pays about 40%. This would provide an internal rate of return (IRR) of about 40% per year. But the trade could be unwound early if silver increases in value and volatility decreased, which could lead to an IRR of closer to 100%.

Adding a partial hedge and using contracts for difference protects our trade against extreme events. It is much more efficient than ETFs and has no downward bias. It is my belief that using a partial hedge would allow us to achieve an IRR in the mid 20s with very little risk.

CONCLUSION

The poor construction and downward bias of commodity, inverse, and leveraged hybrid ETFs make a compelling case to design this partially hedged, call option strategy. The strategy would allow us to potentially gain exposure to underlying commodities and create an income stream. It fits Elixir's investment mandate of earning income with low risk. With the Board's approval and if the right timing comes along, we will begin field testing with a very small capital allocation.

The ELIXIR Economic TRAVELER



Mexico City & Puebla

Oct 31 - Nov 3, 2018

The Mexican peso is a very important asset in Elixir's investment portfolio. Its volatility has created some impressive return for us over the last seven months. Most people have been to parts of Mexico that is tourism focused. Rarely would people visit the country's economic power cities, such as Mexico City and Puebla. When you spend some time in these cities, you will realize how real and vibrant the Mexican economy really is! After scouting the two cities with my wife personally last year, we have decided to organize our very first Elixir Economic Traveller tour to Mexico City and Puebla, Mexico.

These two cities also happen to offer unique cultural and sightseen experiences. There is so much to see and experience in Puebla, and we are only including some general highlights here. The city is the fourth largest in Mexico and located about a two-hour drive southeast of Mexico City. The city's golden age was during the Spanish colonial era in the 14th century. A walk around downtown is like travelling back in time to 14th-century Spain! With 366 magnificent churches and many other historical sites, the downtown area has been named as a World Heritage Site. The city is also surrounded by brilliant natural scenery. The Popocatépetl Volcano and Tuliman Cascades are only a couple of hours' drive away.

THE BEST TIME TO VISIT THESE TWO CITIES IS DURING HALLOWEEN AND THE DAY OF THE DEAD CELEBRATIONS. IF YOU ARE READING THIS, YOU ARE INVITED TO JOIN US!

We are still fine tuning the details but would like to share a general itinerary and costs. The plan is to arrive on October 31 and leave on November 3 from Mexico City. There are many airlines that fly direct from Vancouver, Calgary, and Toronto to Mexico City. Typically, fares start at $500 in economy seating. We will be staying in luxury hotels. The cost for hotel accommodations will be about $200 CAD per night, including breakfast and an evening cocktail party. With some ground transportation and an English-speaking guide, the total cost would be approximately $1,500 per person.

If you are interested in joining us, please email me for details.