January 2018

Elixir News

ELIXIROFINCOME.COM

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

William McNarland
Chairman of the Board

"Soon after we crossed over to 2018, the toddler playground turned into an extreme roller-coaster park."

Hi everyone,

We hope the first month of 2018 was a good one! Last month, we commented on how quiet the capital markets were. It was like watching a toddler at a playground. To our surprise, soon after we crossed over to 2018, the toddler playground turned into an extreme roller-coaster park. Elixir is built to profit when volatility is high globally. We were certainly very happy to see this shift.

January's performance ended at 1.84%. Over the last six months, our average monthly revenue has been 2.61%. As the newsletter is published in the middle of the month, we are happy to share that Elixir will have a very strong revenue month in February.

In this newsletter, we are going to talk about how some of our earlier predictions regarding the market became a reality and how Elixir is different from a hedge fund. Normally, we would have included observations from my travels, but I am skipping those in this issue, as I still need to do some additional research.

I hope you enjoy this January newsletter, and please feel free to reach out with any questions or comments. We wish you happy Chinese New Year and Valentine's Day!

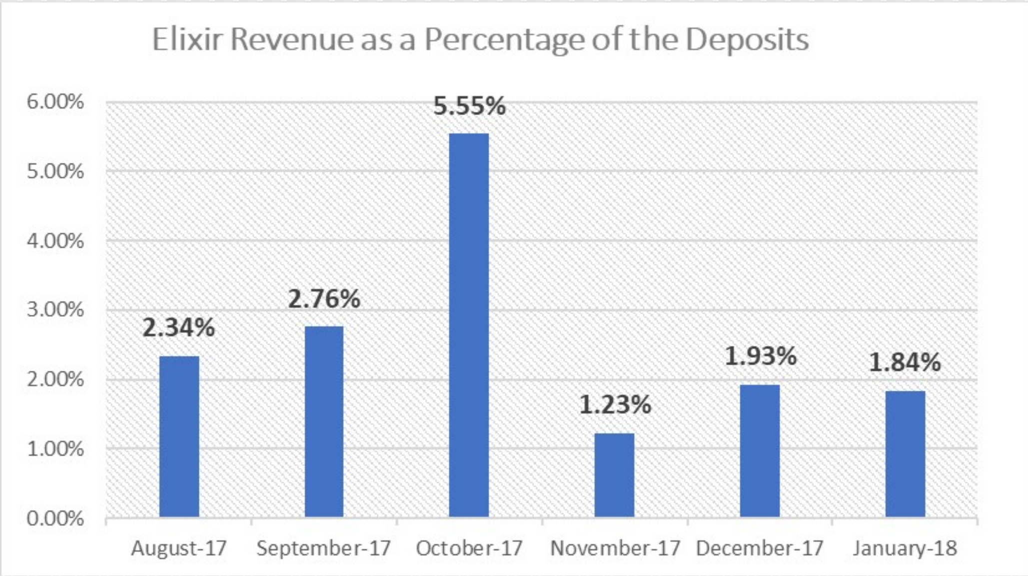
Sincerely,

Bill

ELIXIR'S JANUARY 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 January, Elixir's revenue performance was 1.84%, which is close to the monthly target and within expectations. We feel that 2%per month is an achievable goal for 2018.



GLOBAL MARKET OBSERVATIONS

While Elixir only focuses on income-producing foreign deposits, the value of our investments is influenced by commodity pricing, interest rates, the bond market, the stock market, and general volatility. Looking back at our earlier newsletters, I believe a number of our forecasts have just materialized.

For example, we spoke about our views on Bitcoin in our December newsletter. We expected the upward trend to be reversed when speculative investors run out of money. The Bitcoin selloff has definitely started, as seen in the chart below.

We also commented on the US stock market and oil in our earlier newsletter. We said that due to overvaluation, the US stock market was at a dangerous level and was heading toward correction. Oil would fall because the US is expected to boost its production.

Both of these predictions are starting to happen. The US stock market dropped by more than 10% in early February, which means we are now in an official correction. The price of oil has fallen from $66.50 on February 1 to $57.95 on February 9, as measured by West Texas Intermediate.

Looking ahead, it is our opinion that the currency market will experience high volatility, the stock market will also follow a downward trend, and the USD deposits and bonds will increase in value. The price of key industrial commodities, like oil and copper, will have a volatile fall. We also believe that the value of the Mexican peso, South African rand, and Turkish lira will be lower later this year.

In summary, we are very excited that volatility has resumed in the global market and look forward to writing you next month to share our performance for the month of February.

THE INVESTOR'S EDUCATION

FIVE REASONS WHY ELIXIR IS NOT A HEDGE FUND

People often confuse Elixir as a hedge fund. The truth is that Elixir is almost the exact opposite of most hedge funds both philosophically and structurally. This article talks about the five main differences between Elixir and a hedge fund.

#1 Trend Following vs. Against the Trend

Let's discuss this point with a simple self-check question first. Say you like real estate; would you invest your money in Vancouver, where the price has been going up significantly over the years, or would you prefer its polar opposite, the City of Calgary, instead? If you choose Vancouver, you have a similar investment philosophy as most trend-following hedge funds. If Calgary is your preference, then your investment guidepost is the same as Elixir.

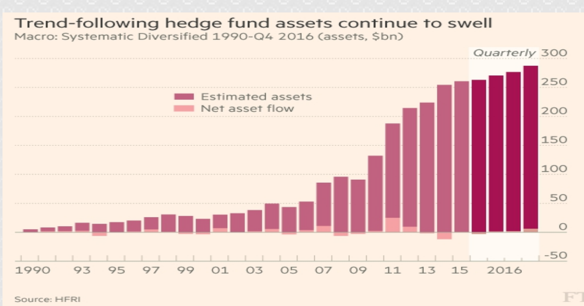
A well-known company that shares Elixir's investment philosophy is Warren Buffett's Berkshire Hathaway. Buffett often buys companies that have fallen in value and out of favor with investors. The difference between Berkshire Hathaway and Elixir is that they buy stocks and we buy foreign deposits.

On the other hand, most hedge funds are trend followers. Hedge funds buy stocks, real estate, commodities, or foreign deposits as their value appreciates. Hedge funds invest along with the trend because they will profit from riding the price higher.

The world's largest hedge fund company is Bridgewater Associates. On January 24, 2018, the founder, Ray Dalio, was asked to share his views on the US stock market. "We are in this Goldilocks period right now. Inflation isn't a problem. Growth is good. Everything is pretty good with a big jolt of stimulation coming from changes in tax laws. If you are holding cash, you're going to feel pretty stupid."

We can see clearly that Dalio was extremely optimistic about the US stock market and was confident in Bridgewater's ability to continue profiting from riding the bull trend. On the contrary, in our past newsletters, we have warned our investors and readers to move out of the US stock market and prepare for a significant drop. We all know what happened on February 5, just two weeks after Dalio gave his quote.

One thing to point out is that, based on HFR indices and index data, the amount of assets being managed by trend-following hedge funds has gone up tremendously since the last recession (see chart below).



This means two things. First, a large amount of capital can support a trend to stay longer and go higher, and second, when capital runs out, the trend will fall much harder. Due to this, it was anticipated that the market would bounce back after February 5, but we still believe a much bleak future for the US stock market is yet to come.

#2 High Leverage vs. Low leverage

Typically, trend-following hedge funds use a large amount of leverage, 20 to 25-to-1. Elixir's investment mandate would only allow a maximum 4-to-1 leverage. High leverage not only amplifies mistakes, but more importantly, it does not allow hedge funds to hold positions long enough for correction. To further explain how high leverage could cause hedge funds to blow up, we have compiled three famous examples.

Example 1: Long Term Capital Management - 1998

This hedge fund was established in 1994. It blew up in 1998. The firm was trading $1.25 trillion USD dollars at its peak. During the 1998 Russian and Asian Financial Crisis, Long-Term Capital Management did not expect that the Russian and Asian bonds could fall in value so much. With 25-to-1 leverage, they lost the equity value of their positions very quickly. As they did not have the margin to support their holdings, they had to sell all their positions at a loss. The collapse of this one hedge fund created a selloff in the global marketplace. If they were using low leverage, they would have had the equity to support their margin requirements to hold and wait for the bond values to return to normal levels.

Example 2:
JWM Partners - 2008

Strangely, the original principals of Long-Term Capital Management were able to raise new capital and start a new fund in 1999, JWM Partners. They traded the same strategies with less leverage this time around. JWM Partners was successful until it blew up in the 2008 global financial meltdown. Although they have reduced their leverage, their trading thesis was not improved to weather a market shock.

Example 3:
Amaranth Advisors - 2006

To date, Amaranth Advisors had the largest loss in hedge fund history. The firm had $9 billion USD of assets under management and lost $6 billion of them in one week. The story was a fascinating one, though we will only give a synopsis here. If you would like to read the full story, I would highly recommend the book *Hedge Hogs: The Cowboy Traders Behind Wall Street's Largest Hedge Fund Disaster*.

The main character of the Amaranth Advisers story involved a young Canadian, Brian Hunter. Brian is one year older than me, so I am keenly interested in how he caused such a shocking disaster in 2006 when he was only 31 years old.

Brian earned a master's degree in mathematics from the University of Alberta in Edmonton. In 1999, he started working at the natural gas hedging division at TransCanada Pipelines in Calgary. Two years later, with this specialized and niche work experience, Brian was able to land a job at Deutche Bank trading natural gas in New York City. During 2001 and 2002, the business unit earned Deutche Bank $69 million USD. In 2003, Brian was promoted to become the head of the unit at only 28 years old. In his first year of leadership, the unit lost $400 million in a single week using extreme leverage, and he was fired from his job.

Somehow, despite his disturbing track record, he was recruited by Amaranth Advisors in early 2004. At that time, Amaranth Advisors, a hedge fund that specialized in bond trading, was looking for ways to increase their return. Their strategy was to hire Brian and started energy trading. Around a year after he joined Amaranth, Brian was given permission to work remotely. He moved back to Calgary and rented office space from Regus. Amaranth allocated significant capital for Brian to trade. He took large bets on the price of natural gas rising in the fall of 2005. When Hurricane Katrina unexpectedly hit the US Gulf Coast and destroyed the natural gas infrastructure, the price of natural gas almost tripled in value unexpectedly. He was considered a hero at Amaranth and was given more capital to trade.

One year later, in the fall of 2006, Brian put on the same trade with the thesis that natural gas would rise in value and used even more leverage than before. Luck wasn't on his side this time, and the US experienced one of the warmest winters on record in 2006. Natural gas crashed in value. Brian lost $6 billion USD in one week, which accounted for 67% of Amaranth's total asset. A few months later, the price of natural gas normalized. If he could have held on the position, Amaranth would have made a profit, but instead, the company went bankrupt at the hands of a 31-year-old trader.

All three cases taught us one thing: high leverage doesn't give hedge fund managers the time to wait for their investment positions to bounce back in value. Without the equity to support their margin requirements, they have no choice but to sell off their investments and absorb the lost. Elixir is on a very different path compared to hedge funds in this regard. Our leverage caps at 4-to-1, which means we can afford to wait.

#3 Expense vs. Income

As mentioned earlier, with low leverage, Elixir would never be forced to sell a deposit. We can simply earn interest on the deposit while we wait for it to bounce back in value. At Elixir, holding a deposit means earning interest income. Contrarily, most hedge fund holdings are required to pay to hold their positions. Waiting for hedge funds is painful and costly.

#4 Long Holding Time vs. Short Holding Time

Typically, trend-following hedge funds would try to hold on to an investment for as long as a trend is rising. They would also sell out at a loss if they feel that trend has moved against them. At Elixir, we put every deposit up for sale the moment we can have a 1% to 3% profit. Since Elixir's inception, our average deposit holding period is only 12 days.

#5 Structure difference

Aside from the previous four investment philosophy differences, Elixir and hedge funds are also very different structurally. Elixir is a company. We offer investors the ability to participate as bond holders and potentially as equity holders. The plan is to take Elixir public down the road. The shareholders of Elixir are responsible for returning the principal and interest owed to bondholders regardless of performance. Hedge funds operate more like mutual funds because they charge a management fee regardless of performance and do not have any responsibility to return the principal back to investors.

In future newsletters, I will write about the similarities between Elixir and some other fintech companies in the market.