

November 2017

Elixir News



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





THE ELIXIR NEWS

Hi everyone,

We enjoyed catching up with many of you at our Christmas parties in Vancouver, Calgary, Edmonton, and Toronto and look forward to seeing you again in the new year.

After our very strong revenue month in October, we had a more normalized revenue of 1.23% on our balance sheets deposits for November. To date, Elixir's average monthly revenue is 2.97%, which is 0.97% higher than our monthly 2% target. In this November newsletter update, we are excited to announce the appointment of three new independent board members: Ms. Jaclyn Wu, Mr. Chris Boyle, and Mr. Rob Knipf. I also included some writing on oil price, Japanese yen, and credit cycle predictions. Hopefully, you will find it informative.

As we are approaching the end of 2017, we wish you and your family happy holidays and a prosperous and healthy 2018!

Sincerely,

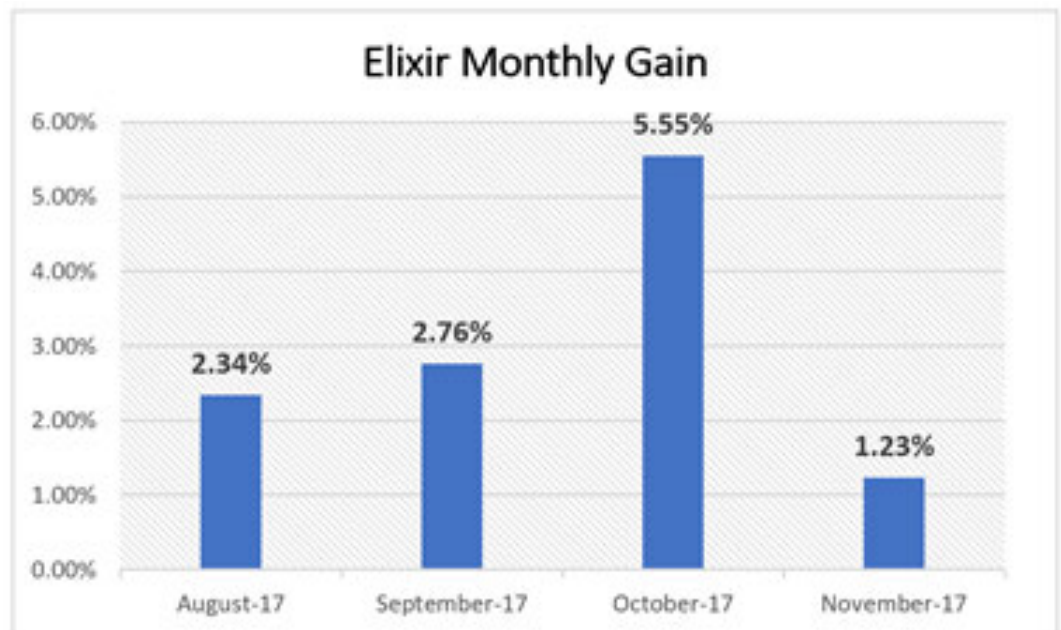

William McNarland, CFA

**November
2017**

ELIXIR'S INCOME PERFORMANCE

Elixir's return target is to produce revenue of 2% of investor 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 performances were 1.23%, which is short of our monthly target but within expectations. We expect December to be closer to the 2% average.



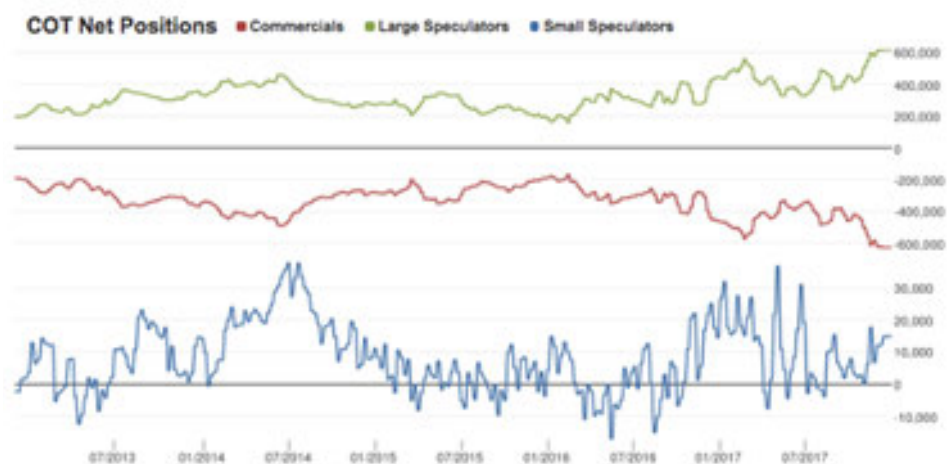


NOVEMBER GLOBAL MARKET OBSERVATIONS

Overall, the global markets were uneventful in November except for the additional rise of oil price, which caught our attention. We quote the West Texas Intermediate Index in our studies. This is the common price quoted in North American media. In the rest of the world, the price of Brent Crude is more widely followed, which is the price of oil used in Europe and Asia.

In the September newsletter, we talked about the importance of using Commitment of Trader Reports as an indicator of future movements, commodities, and currencies. We closely track oil and gold, as they are large proponents that effect the pricing of Canadian and Australian dollars. Also, commodities like oil and other agricultural commodities typically change in value inversely to the US dollar due to their global use but global pricing in US dollars.

Hedge funds and speculators have never been so bullish (see green line on chart below) on the price of oil in the last five years even though oil's price has increased in value by over 25% since this summer. On the other hand, commercial users, represented by the red line on the chart, have a complete opposite view. They are busy trying to take advantage of this two-year high price and hedge out their production.



As with all extremes, at some point, this trend should reverse, especially in the US, which is expected to produce more oil while the price stays high or increases. This will eventually put pressure on the price. With that said, we think oil will return to the \$50 range in the coming months enough to protect our portfolio.

THE INVESTOR EDUCATION HEDGING WITH JAPANESE YEN DEPOSITS



In previous Elixir newsletters, we made reference to the importance of hedging risk with Japanese yen deposits. Investors often ask us: Why Japanese yen?

The popular understanding of Japan is that the country has had decades-long poor economic growth. Its aging population and strict immigration policies continue to be dead weight to its economy. Yet during times of crisis, even when the country itself is in the middle of it, the Japanese yen always increased in value. For example, when North Korea fired a missile over Japan in late August this year and when a tsunami hit Fukushima in 2011, the yen went up in value during both events.

History tells us that the Japanese yen will repeatedly increase in value whenever fear enters the global marketplace. But why?

Large use of yen margin loans to finance North American debt and equity

Warren Buffett said it best: “When you combine ignorance and leverage, you get some pretty interesting results.” When the market reaches the late stage in the credit cycle or after long run-ups in the value of real estate or the stock market, investors all over the world tend to take on maximum leverage. This is because investors have seen their assets increase in value for several years in the cycle. They are confident that the good run will continue. Overconfidence causes investors to finance equities or debt with 95% loan-to-value leverage (20-to-1 leverage or more).

The next question is the key. Where do investors borrow their money from? With low interest rates since Japan’s big recession in 1998 (see chart below), the Japanese yen has been used as an excellent lending source for decades.

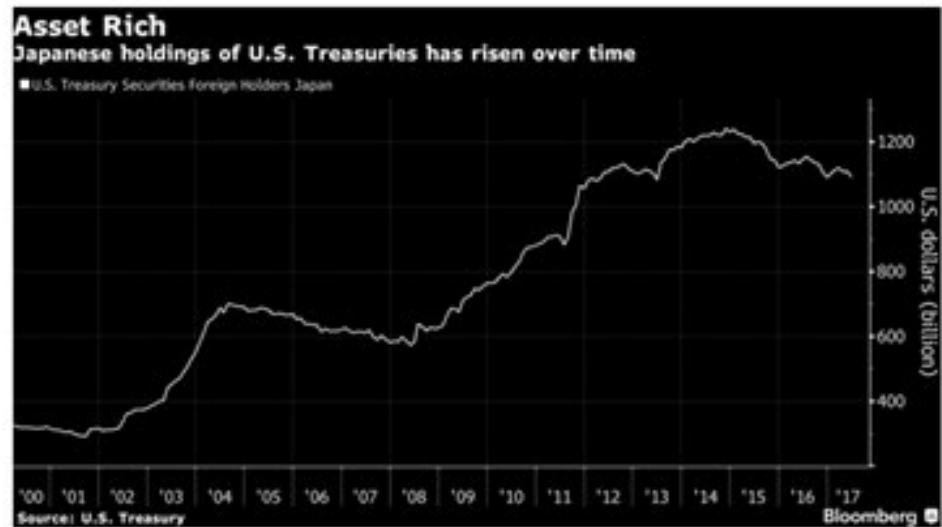


When margin calls force investors out of their leveraged positions, they still must pay back the loans with the proceeds of the assets that were sold for collateral. In the case that people borrowed Japanese yen, they must buy back Japanese yen to repay their loans. Therefore, the demand for Japanese yen increases and so does the value of the currency. This is the main reason why whenever the economy goes crashing down, like in 2008/2009, the Japanese yen goes up in value significantly.

Japan's asset-rich balance sheet

I like to use a simple example to begin explaining this point. Let's say your friend has a house in Vancouver. The house is worth a million dollars, and he has a mortgage of half a million dollars. The Vancouver real estate market is doing really well, and your friend's house is increasing in value every year. You have a house in Edmonton that is also worth a million dollars; although the Edmonton real estate market is flat, you are mortgage-free. Who is in a better financial position? You are. Even though you are in a flat real estate market, your paid-off house puts you in a better financial position.

Japan is similar to you in that scenario. According to the CIA World Fact Book, Japan's net foreign assets are worth \$3.2 trillion USD, which is 1.5 times larger than China, ranking second on the list. Japan has also been the world's largest creditor for 23 years in a row. The chart below shows its increasing holdings of US Treasuries as an example of this wealth.



Source: Bloomberg

With a strong balance sheet, it is very unlikely that Japan would have issues repaying its debt. For this reason, many strategic investors would choose to invest in Japanese yen during periods of uncertainty.

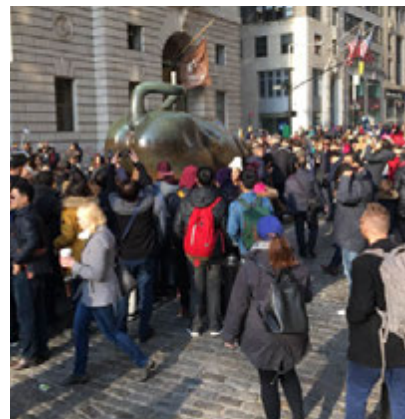
Given the two main reasons above, the Japanese yen is considered to be a safe investment when economic crises happen. At Elixir, we use Japanese yen deposits as a hedge and, at the same time, take advantage of its low interest rate for borrowing. When borrowing, we make sure that we use low leverage in the range of 3 or 4-to-1 so that we never get into the “interesting” situation described by Warren Buffett.

For those who are interested in a technical explanation on the topic, I would recommend the study “How Safe are the Safe Haven Assets?”, conducted by Kateryna Anatoliyevna Kopyl and John Byong-Tek Lee (2016), in *Financial Markets and Portfolio Management*. The journal is the official publication of the Swiss Financial Analysts Association, *Financial Markets and Portfolio Management*.

The following is a quote from the abstract: “The aim of this paper is to examine which of the assets commonly believed to be safe havens do, in fact, protect investors during periods of severe financial instability. Using a broad dataset of 32 assets over the period of 1964-2014, we examine the relationship of these assets with the US equity market during financial crises to determine which of them are safe havens for US investors, hedges, or speculations. We find that the US Treasuries and Japanese yen are the strongest safe haven investments in months characterized by large declines in market value or excessive volatility.”



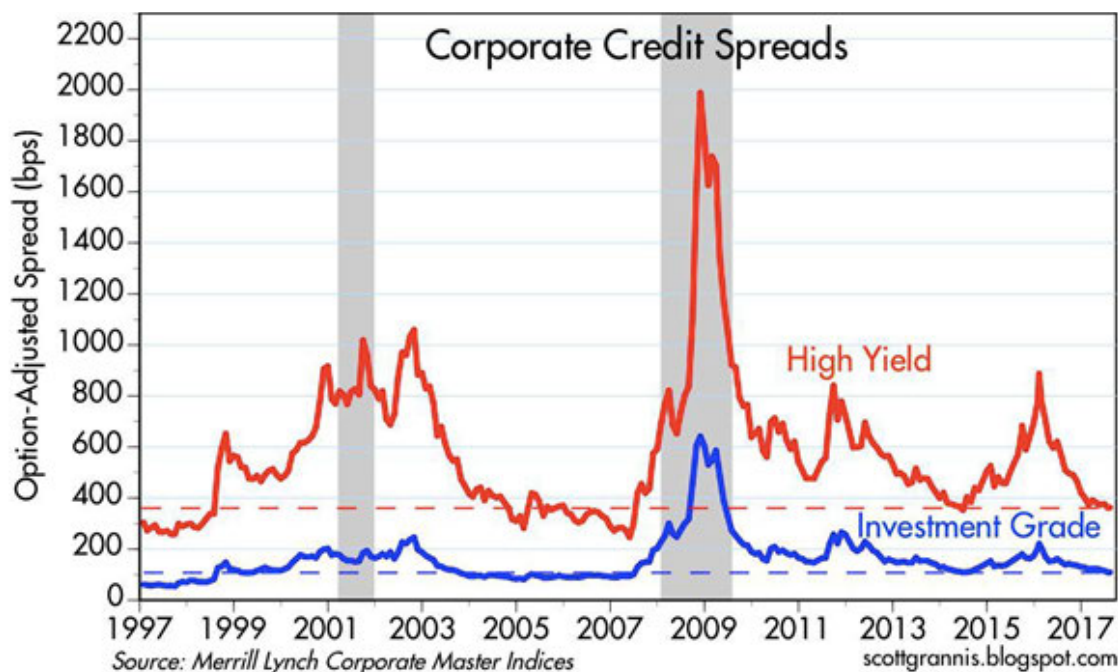
THE ECONOMIC TRAVELER REPORT NORTH AMERICA



This month, I traveled a lot domestically in North America. Based on what I have seen and heard, I am of the belief that we are at the end of a credit cycle.

During my career, I have experienced four credit cycle events: the Asian financial crash in 1997; the dotcom boom and bust of 2001; which was closely followed by the fallout of September 11, 2001 terrorist attacks; the 2008 great financial recession; and the brief contraction from the European debt crisis in 2011. These crashes had one thing in common: they were all periods of significant growth that eventually ended in a reversal.

A credit cycle is a cycle involving the access to credit by borrowers. The chart below shows the main credit cycles after the 1997 Asian financial crisis. The red line in the chart represents the amount of additional interest costs in bases points over the borrowing costs of US Treasuries that companies have to pay. (A basis point is 1/100th of a percent). You can see that the red line hit 2,000 in the fall of 2008. This means that companies had to take debt at a 20% higher rate than the US government. Prior to this, in 2007, large companies could borrow at 2% above the US government. Now, fast forward to current year in 2017. As indicated in the chart, it is easy and cheap for large companies to borrow money.



For small companies that are lending in the asset-backed space, there has been tremendous contraction in rates as well. I had a meeting in New York last week with a large asset-based lender to small companies. The principal told me that his rates have gone down 1% each year, from 16% in 2009 to 8% in 2017.

Through my career, I have also found one other clue that indicates where we are in the credit cycle. I call it my loyalty indicator. During difficult times, like 2008 and 2009, airplanes and hotels are empty. To boost revenue, companies offered many perks to attract customers. During easy credit times, on the other hand, hotels and airlines have lots of customers, and often, perks are discontinued. When perks are discontinued, it is often an ominous sign that a recession or tough times are coming.

Here is what I have noticed with two groups that I regularly use, Intercontinental Hotels and Air Canada. For the last 13 years, I have had Royal Ambassador (secret black card) status with Intercontinental Hotels. It looks like I am going to lose my status this year, as staying 141 paid nights in 2017 is not considered enough to qualify for their top-tier status. Over at Air Canada, to qualify for their top 100k status, the airline has introduced additional spending requirements and have provided less opportunities for upgrades to business class.

We all know that there is great future risk when credit is cheap because when reversed, it can be very damaging to the economy, the stock market, and emerging markets. Both data and my observation point to the end of credit cycle. Overall, I am very cautious about the economic situation over the next couple of years. Having said that, however, it is not necessarily a gloomy future for all companies. When someone loses money, someone else always makes money. At Elixir, we are aware of the coming turbulence, and we build our hedge strategically to protect our position and to profit from any potential contraction in the economic situation globally.

NEW BOARD MEMBER ANNOUNCEMENT

This month, we have appointed three additional independent board members. We are proud to introduce Ms. Jaclyn Wu, Mr. Chris Boyle, and Mr. Rob Knipf.

Jaclyn Wu

is an experienced entrepreneur and a sophisticated investor. With a bachelor's degree in economics from Simon Fraser University, a certified financial planner designation and a chartered life underwriter designation, Jaclyn has been sharing her knowledge on investment management and retirement, estate, and tax planning with her clients for over ten years. Jaclyn is based in the metro Vancouver area and is fluent in Cantonese and Mandarin.

Chris Boyle

is a serial entrepreneur and has been working with business owners and medical professionals to build tax efficiency and wealth generation through education and proper planning since 2006. Chris is based in Edmonton, Alberta.

Rob Knipf

is also a serial entrepreneur. With dual master's degrees in sociology and business administration from Western University and John Hancock University, respectively, his business portfolio includes both domestic and international financial transactions. Rob is based in London, Ontario.

This brings our current board to seven, and we expect to announce one or two more independent directors by the beginning of 2018.