

September 2017

Elixir News



ELIXIROFINCOME.COM

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





THE ELIXIR NEWS

THE EDITOR'S MESSAGE

Hi everyone,

We hope you had a great thanksgiving!

This September 2017 issue of Elixir Newsletter includes Elixir's September performance, commentaries on the global market, highlights of my economic observations in Egypt, Elixir announcements and invitations to events. As a special feature in this issue, we are also including a section called: The Global Investment Education.

Sincerely,

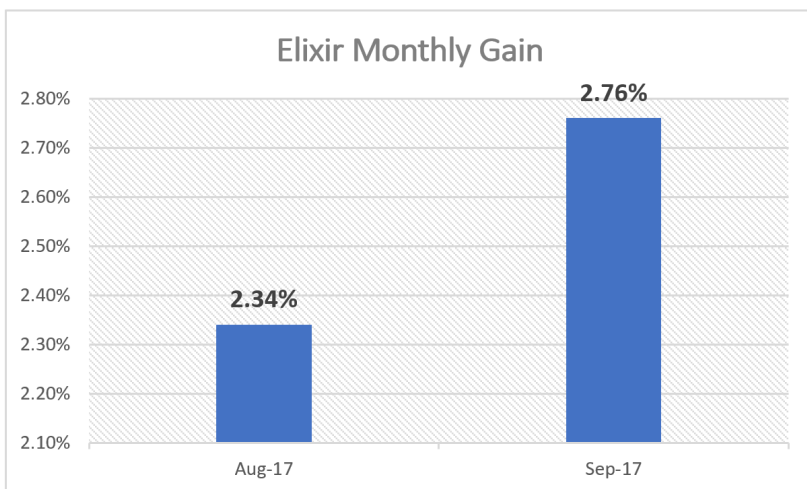


William McNarland, CFA

**September
2017**

ELIXIR'S INCOME PERFORMANCE

The key monthly performance metric for Elixir is the income created from deposits interest and the DDVARH hedge. We have this number audited independently by a third party, My FX Book. The company has direct access to our accounts and can calculate our income performance directly. The goal is to produce 2% combined income from interest and hedge profits each month. For August, Elixir's performance exceeded our target with a 2.76% audited rate.



SEPTEMBER GLOBAL MARKET OBSERVATIONS

I begin this section by quoting from the August 2017 issue of the Elixir newsletter, where I said, "The trend of selling USD will not go on forever as all great parties must come to an end eventually. According to the historical data from the Commitment of Traders Report, the European, Canadian, Australian and New Zealand currencies are extremely overvalued at the end of August [and still are at the time of writing this report]. To protect the investment against the upcoming reverse movement, proceeding without a hedge would be extremely foolish."

Data collected since then indicates that the party has indeed ended. Just as I projected, the above-mentioned currencies have all been corrected and dropped significantly from their overstretched highs.

Country	High Price	High Date	Low Price	Low Date	Percent Loss
Australia	\$0.81	Sep. 8, 2017	\$0.81	Oct. 6, 2017	4.80%
Canada	\$0.83	Sep. 9, 2017	\$0.79	Oct. 6, 2017	4.20%
Euro Zone	\$1.21	Sep. 9, 2017	\$1.17	Oct. 6, 2017	3.60%
New Zealand	\$0.74	Sep. 20, 2017	\$0.71	Oct. 6, 2017	5.00%

For our Canadian readers, I have inversed the pricing of the Canadian/US dollars to be the same format as you see quoted in the Canadian newspapers and television feeds.

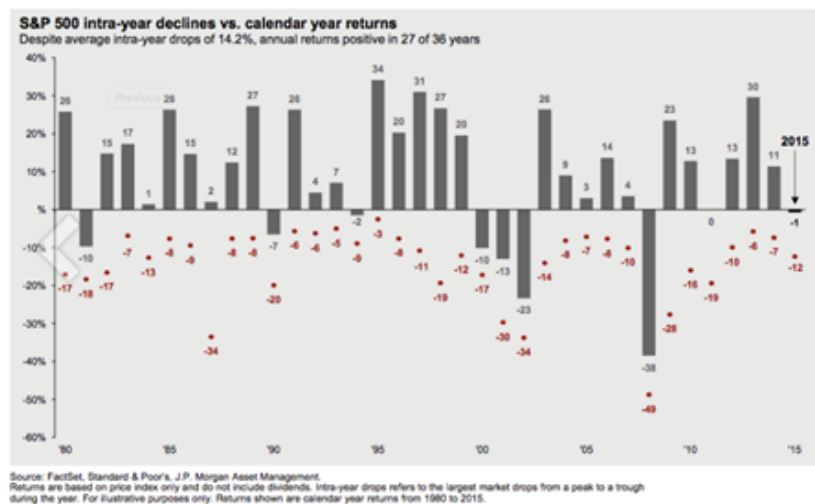
Like a late-night Mexican fiesta, the party may start again this month. In the Global Investment Education section, I will explain one useful tool we use to adjust to this pricing movement.

In this September issue, I would like to talk about the US stock market. Even though Elixir's focus is on foreign interest earning deposits, we must consider the trend and performance of the US stock market to adjust our hedging in case of increased volatility in the global currencies.

"U.S. stock-market indexes posted solid gains and closed at all-time highs..."

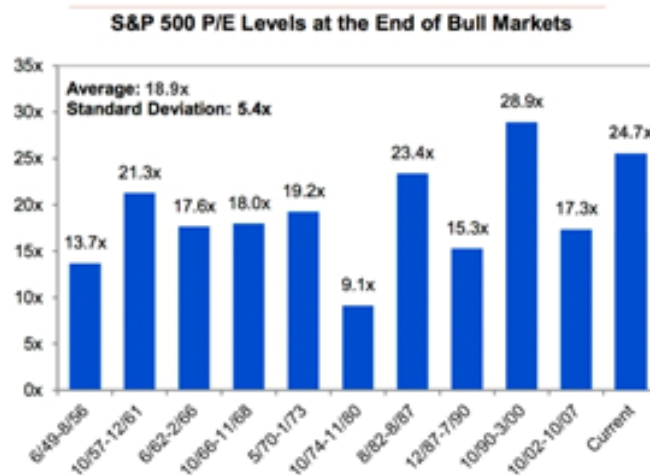
MarketWatch on October 5, 2017.

I like the party analogy; it seems to work appropriately every time I want to use it. I believe this bull market party is coming to an end. Here are four historical charts to support my view.



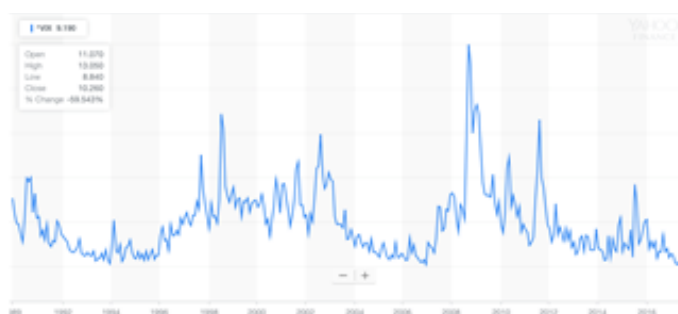
The S&P 500 measures the maximum drop in the US stock market each year since 1980. Note from the chart that even though most years are positive, there are still always negative drawdowns annually. Since the 80's, the average drawdown has been 14.2%.

Today, the US stock market is at an all-time high, history tells us that we will have a significant drop at some point in the next year. My concern is that we may experience more than a correction and actually experience a bear market. According to CNBC, the average bear market lasts 15 months, and stock typically decline 32%.



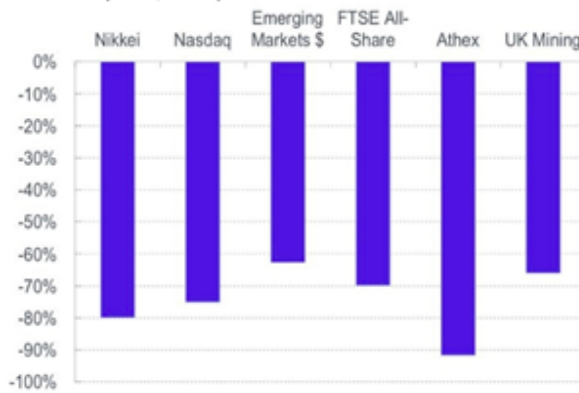
This second chart shows the valuation of the S&P 500 right before a bear market starts. As an example, between 2002 and 2007, companies were valued 17.3 times their earnings on average. Then, in 2008, the correction came, and a bear market started.

According to the data in this chart, the average over-value benchmark is 18.9x since the 50's. Today, companies are traded at 24.7x on average (Amazon is close to 250x!). It seems that companies' valuation is very stretched, and the market needs to drop significantly to return to a somewhat normal valuation. This adds to the prediction that we will experience a bear market instead of a correction



This third chart shows the expected volatility index (VIX), which measures the current fear or potential risk on the horizon of market investors. As an example, in the chart, you can see that investors' fear level was very low in 2007 but spiked in 2008. Today, the VIX is trading at an all-time low. This shows tremendous complacency or overconfidence in stock market investors. As history indicates, overconfidence and complacency is often followed by disasters.

Max Drawdown (Price, Local)



Source: Citi Research, Datastream, MSCI

The fourth chart, Max Drawdown, shows many bubbles in the past and is a reminder of how much equity markets and popular stocks could drop. Losses can take decades to recover when individuals buy stocks or the whole market returns to its peak.

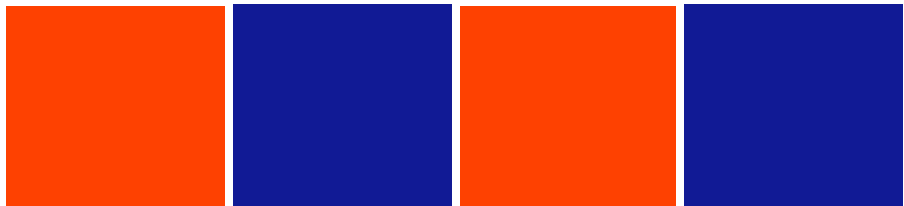
Historically, when the US stock market goes into a bear market, it causes significant corrections to the Australian dollar, Canadian dollar, New Zealand dollar, South African rand, and even the Euro to a lesser extent. Because of this, at Elixir, we are actively monitoring the US stock market and adjusting our hedge as needed.

THE GLOBAL INVESTMENT EDUCATION

In this section, I would like to talk about the rise and fall of our Canadian dollar. Some may have noticed that our dollar went up by 13.5% from May to September and dropped 4% three weeks after that peak. First, I'm pleased to let Elixir's investors know that we predicted this upward and downward trend, and our hedges profited from it. Second, I would like to talk about why trends like this happen and how our hedge systems were able to predict and profit from it.

Currencies seem abstract to many people, but in fact, they are very similar to commodities and follow the same supply and demand principle. When the supply is fixed, higher demand means a higher price, and vice versa.

Commodities are easier to understand. So, we use a commodity, silver, as an example to explain the price movement cycle first. The demand for silver generally comes from two groups of buyers. One group buys because they have a need. We call them commercial users. Cellphone manufactures buy about 70% of the annual supply of silver because the metal is a component of their products. The other group buys because they are trying to profit from the price change. We call the latter group speculative investors. Hedge funds are speculative investors, for instance.



Let's say the price of silver starts low at \$12 per oz. Speculative investors are not interested. They worry that the price would further go down to a single digit. On the other hand, manufactures love the low price and start stockpiling. High demand quickly drives the price of silver up. As the price goes upward, more and more speculative investors join in to buy, as they feel confident that silver will continue to go up. Eventually, driven by the real and "artificial" demand, the price of silver is now at \$20 per oz.

The manufactures stopped buying a long time ago, and when the last of the investors have invested their funds, the demand stops. Naturally, the price starts to fall. When prices start falling, the speculative investors get worried and rush to sell out their positions, which causes the price to fall even more.

The price of silver would not stabilize until the manufactures need to replenish their stock. When they start buying again, price would go up again. Typically, manufactures buy in large quantities when the price is low. Therefore, the price movement cycle for a commodity like silver takes a long time.

As a rule of thumb for commodity trading, buy when the commercial users are buying and ignore the noise from the investment community.

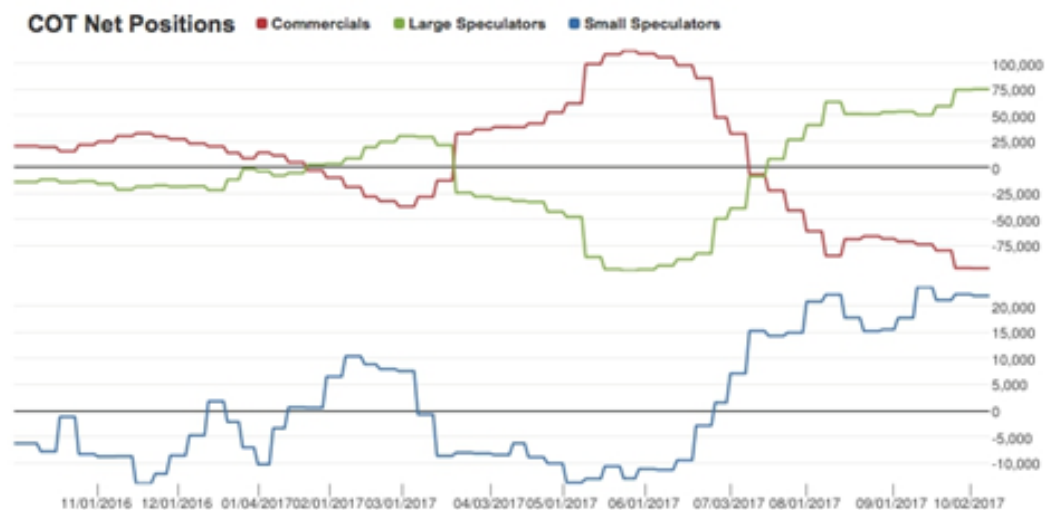
In the currency market, the commercial users are groups that need future currency purchases for their businesses. For example, Canadian Tire stores in Canada need to purchase most of their inventory from the United States and China. They need US dollars to do this, so they are considered commercial users. They would prefer buying US dollars when the price is low. Speculative investors are just trying to profit from the currency moving in either direction.



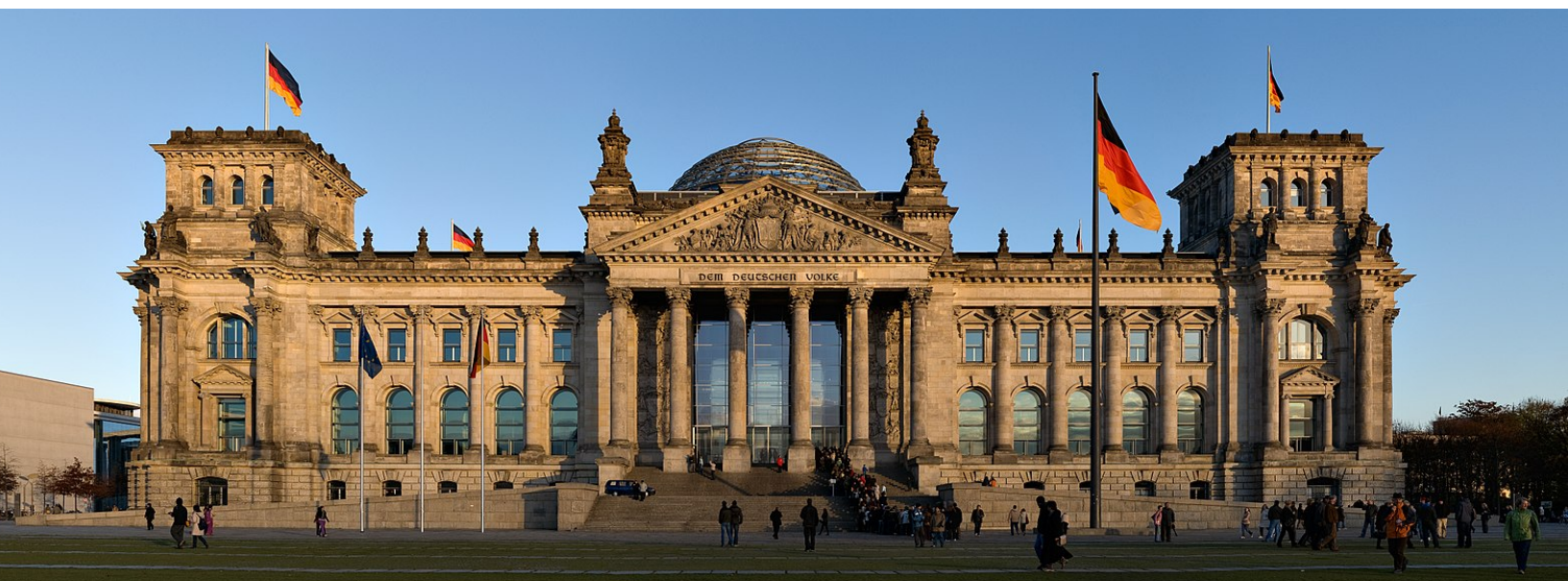
So here is what happened with the Canadian/US dollars from May until September this year. Until May, the largest number of speculative investors in the last five years were trying to profit from the fall of the Canadian dollar. Then, the commercial users stopped buying US dollars because they were too expensive for them, and the speculators ran out of funds. These factors essentially ended the fall of the Canadian dollar and sent the currency on an upward trend.

When the speculators sensed the rise of the Canadian dollar, they reversed their position and ended up investing the largest ever speculative positive position in the currency. This action further helped the Canadian dollar, and by September, the currency's value had increased by 13.5%. Of course, at this point, a new cycle began, and we saw the 4% drop in the Canadian dollar's value in the last 30 days.

At Elixir, we use the Commitment of Trader Reports issued by the US government to monitor the position of both commercial and speculative investors. Thanks to the US Commodity Futures Trading Commission, the largest currency and commodity traders in the world are required to report their positions, which can easily be tracked.



The chart above is a screen shot of the report on the Canadian dollar going back one year. The red line represents the commercial buyers, and the green is large speculators, like hedge funds. It's easy to see how they completely changed from one overstretched position in May to a completely opposite overstretched position in September. This Commitment of Traders is one of the reports that we closely monitor. It covers global trends, including those countries that Elixir has an investment position in, such as Canada, the United States, Japan, New Zealand, Australia, Britain, Europe, South Africa, and Turkey.



THE ECONOMIC TRAVELER REPORT

Last month, I talked briefly about my ground observation over Germany's immigration policies, particularly regarding refugees entering the country and how that could have an impact on the political scene in Germany and, in time, influence the German GDP and Euro. My view has certainly been verified by the result of the German federal election in late September. With 94 seats, the far-right AfD party was elected to be the third largest party in the Bundestag, while the party wasn't even voted into the parliament four years ago. I am not surprised by the rise of the AfD party and would continue to monitor German political activities.

EGYPT IS TIRED. //

In late August, I had the opportunity to spend some time in Cairo. My flight flew over the Giza pyramids at sunrise, which efficiently allowed me to skip spending a day to go see them. I had never been to Egypt before. Upon my return, my friend, who is also a well-travelled fellow financial analyst, asked me if Cairo was a romantic place to travel to. He has never been there, and I assume his fantasy about the country came from Hollywood movies. Personally, Egypt is not going to be a place I would like to visit anytime soon, and it is certainly not romantic enough for me to take my wife there. From what I've seen, the country has a vibe of being very tired, which is not surprising considering its repeated political and economic challenges.

All that opening paragraph is beside the point. My point of visiting Egypt was because the Egyptian deposits pay 19%, and the currency has fallen 70% in the last four years. I want to find out if Elixir should invest in Egypt.

The decision to not invest came easily after comparing Egypt to its neighbouring country, Turkey, in which Elixir has a small investment of less than 3%. I will write about Turkey in depth another time; below is only a highlighted assessment of some key criteria.



Category	Turkey	Egypt	Comments
Interest Rates	8%	19%	The 19% certainly catches attention.
Confidence Level in Future Economic Performance	Very high at 10%	Runaway inflation at 32% annually	We do not have confidence that Egypt has a viable plan to reduce its current 32% annual inflation rate. Turkey's annual rate of 10% is still very high, but we have confidence in the country's plans to reduce it.
Credit Rating	Increased to investment grade by one rating firm	Rated as deep junk status	We only invest in countries close to or at investment grade. In addition to the rating, it is also important to view the trend. Egypt is getting worse, and Turkey is getting better.
Deposit Liquidity	Same day	Take days or weeks to have a deposit returned	We require liquidity for our investments.
Deposit Location	Our deposit is held in Canada.	Our deposit would be held in Egypt.	We require our deposit not to leave Canada or the United States.
Deposit Entity Regulation	Our deposit is in a Canadian institution regulated by Canadian regulations.	Our deposit would be in an Egyptian financial institution regulated by Egyptian regulation.	We require our deposits to be regulated by Canadian or US regulators.
Currency Hedging	Multiple tools to hedge the currency risk	None	We require the ability to easily hedge a country's currency.

I would conclude my view of Egypt as an interesting place to visit for its cultural and historical heritage and a future economic story to watch. Although the deposit rate is still attractive, the country is premature for Elixir to invest at this present time.



EVENTS AND ANNOUNCEMENTS



We will be hosting a number of dinners in **Richmond, Edmonton, Calgary and Toronto** to discuss some economic observations from recent trips to Mexico City, Frankfurt and Johannesburg. Details of each event will be sent via email at a later date.

We will be updating information regarding the trip to **Mexico City**. At the moment, the trip is delayed till January 2018.

