May 2019

Elixir News

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

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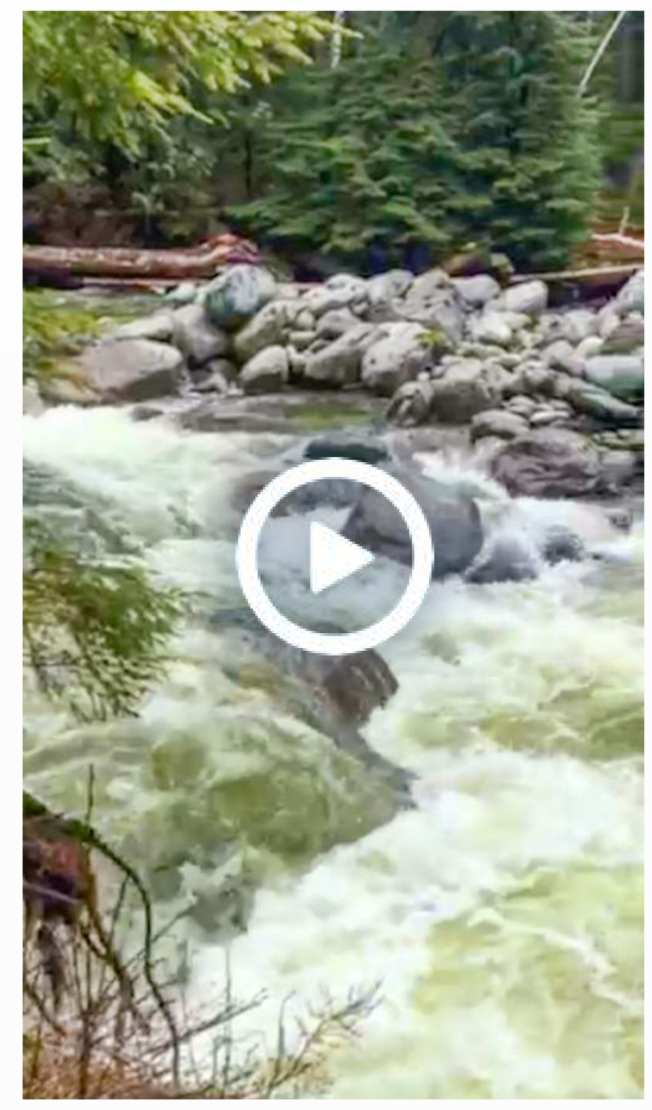
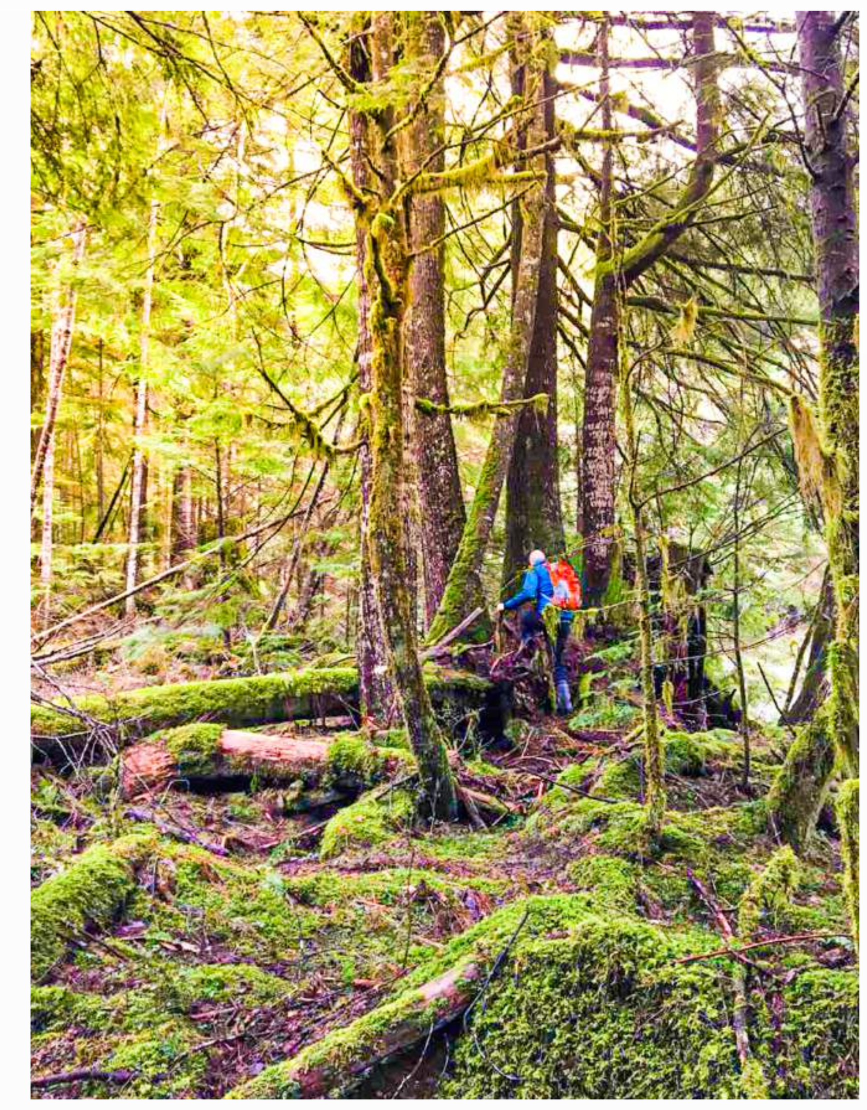




Hi, everyone,

I trust that you are doing great. By the time you read this update, I should be at my Vision Quest, meditating deep in the forest, by the river that feeds into Granite Falls. Like last year, I expect that three nights in nature, without food and electronics, will inspire and rejuvenate me. I look forward to sharing the highlights with you in the next newsletter.

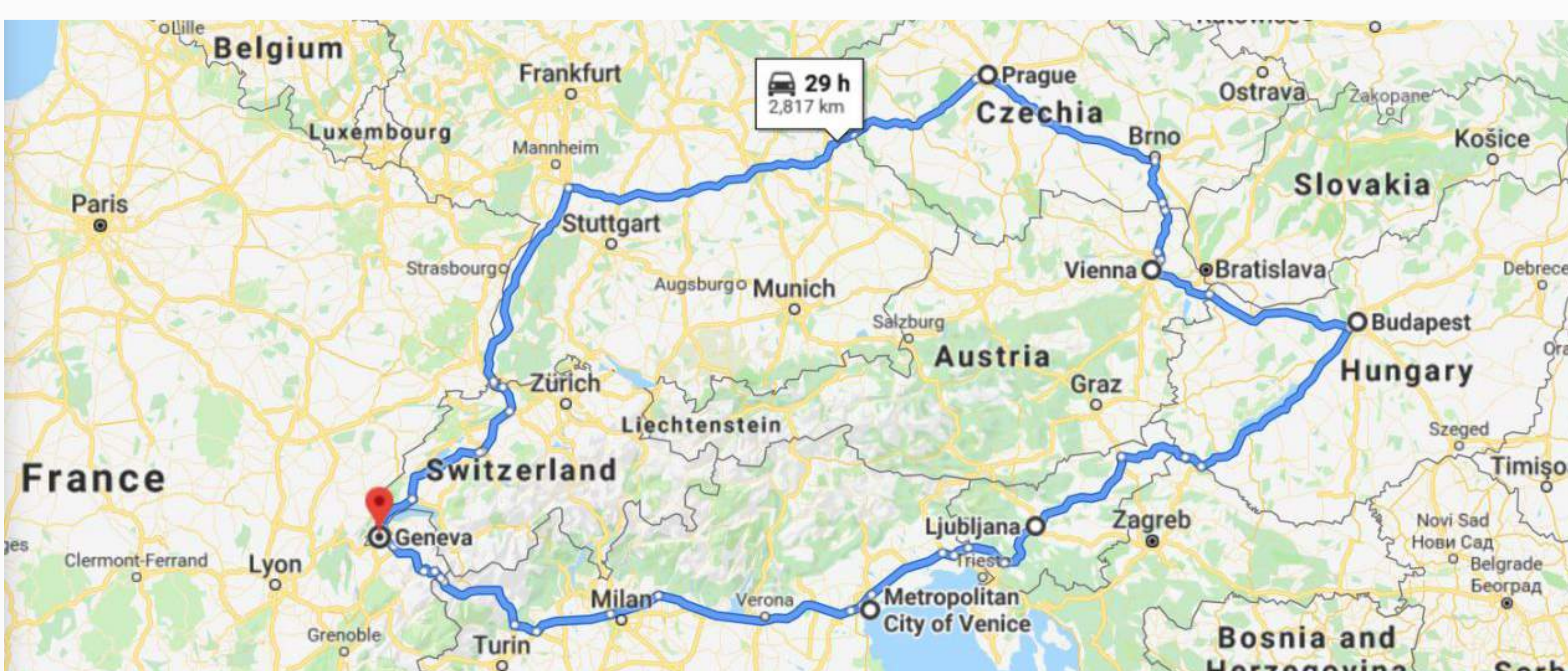
With regards to May's performance, after a long period of market stillness, volatilities finally returned to their normal level. As a result, our trading performance also normalized – and, better yet, showed an overall return of **3.11%** on bonds outstanding (2.73% contributed by proprietary trading). I am pleased to announce that Elixir broke a new revenue record in May 2019!

This month also marked a special milestone for the company, as we formally started working for our first software development client and officially added a new revenue line item to our income statement.

Later in this newsletter, I will comment on the internal and external changes that contributed to our exceptional trading return in May.

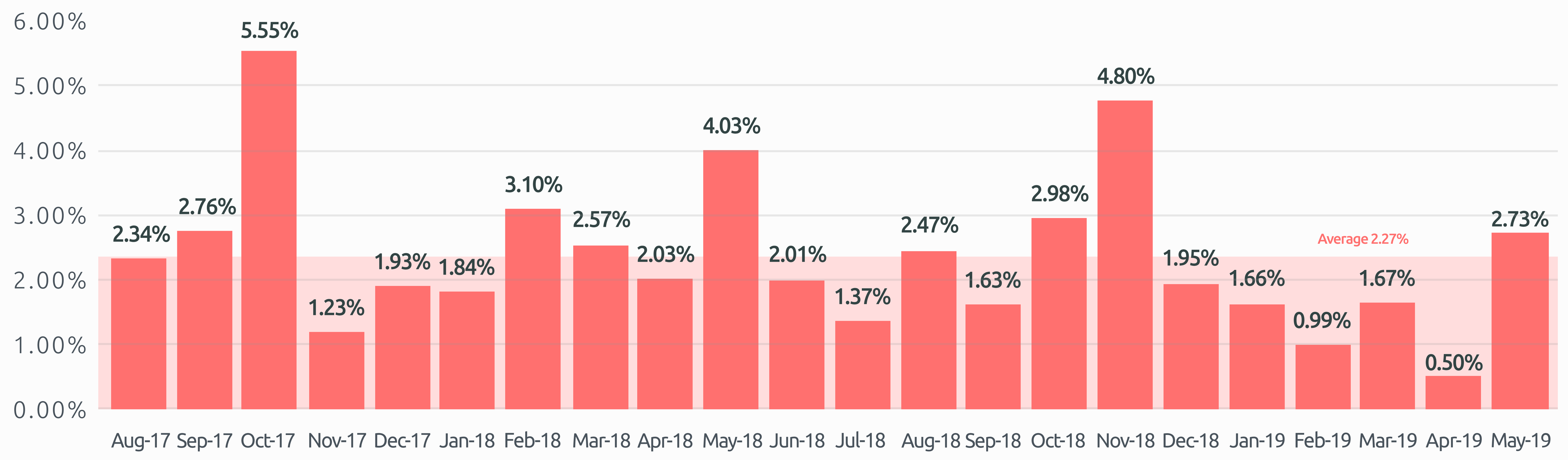
Another highlight for me in May was that Eve and I took an eight-day road trip through six European countries. We drove over 3,000km and visited Geneva, Switzerland; Venice, Italy; Ljubljana, Slovenia; Budapest, Hungry; Vienna, Austria; and Prague, Czech Republic. We also passed France and Germany. While we stopped only briefly in each city, our ground experiences produced some interesting observations and new ideas. I will talk more about the trip and my economic observation later in this newsletter.

Before I dive into details, I would like to remind everyone that Elixir's share price (currently at $50 per share) is **scheduled to increase to $60 CAD per share on July 5, 2019**. The maximum investment per person is 1000 shares.



ELIXIR MONTHLY

PROPRIETARY TRADING REVENUE AS A PERCENTAGE OF THE BONDS OUTSTANDING



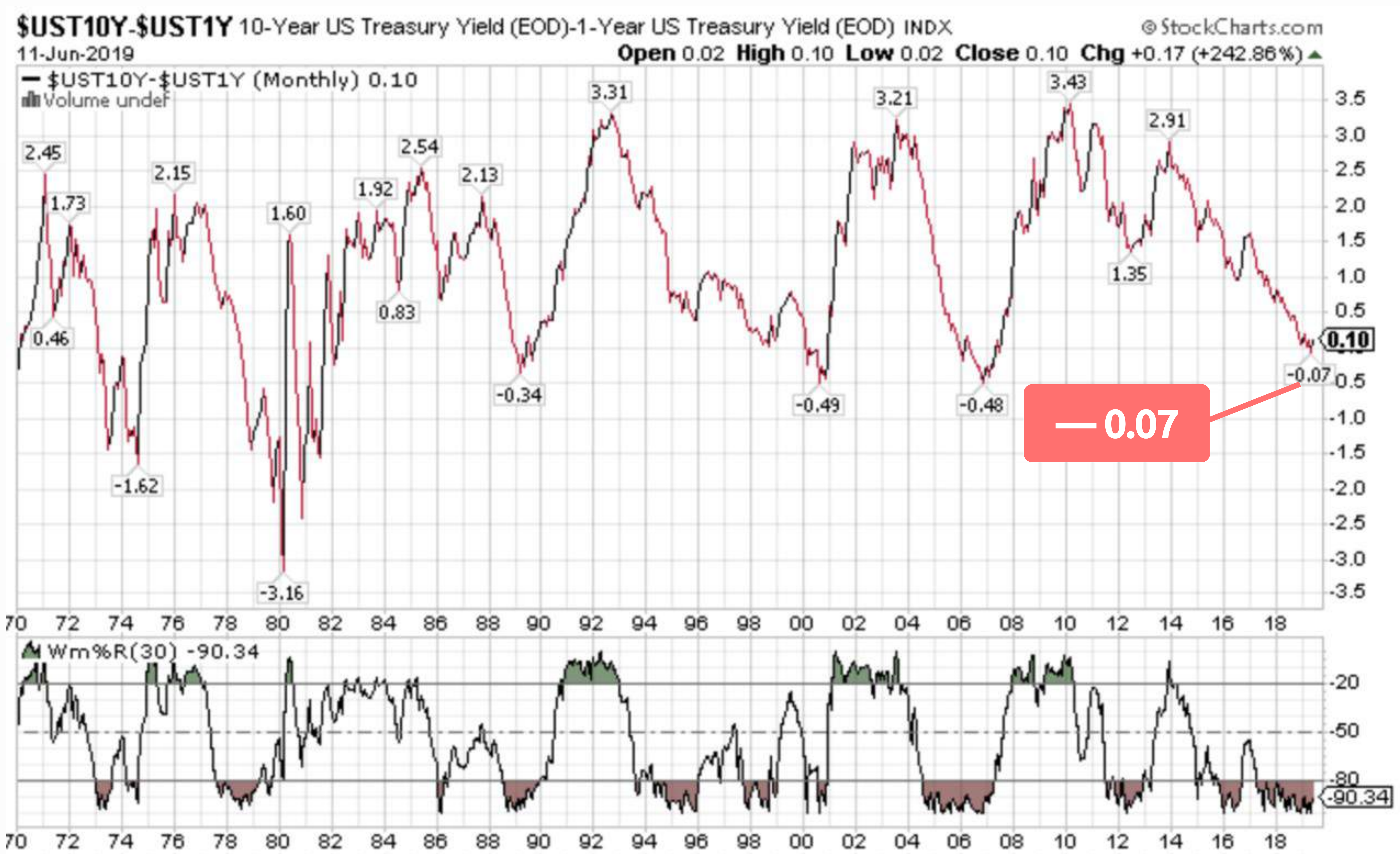
The above target trading performance in May stemmed from three primary factors. First, fear-driven volatility returned to the capital market, enabling us to trade profitably again. Second, hedge funds unwound their short positions on commodities, allowing us to sell off our positions. Lastly, new trading strategies were added to our mandates, creating more income opportunities.

1 In May, investors finally felt less confident after four long months of overconfidence. According to the Daily Sentiment Report, 85% of "dumb money" was confident on April 30; by May 31, 2019, this number had dropped drastically to 48%. I believe that this round of fear was caused by the escalation of the US-China trade war and bond investors continued strong signal of a recession that will arrive sooner rather than later.

At the beginning of April, the market anticipated that the trade war would wane, based on positive remarks that Chinese officials made on April 5. However, the trade talks took a sharp turn on May 5, when President Trump said that, on May 10, he would increase tariffs on 200-billion-dollar worth of Chinese imports, from 10% to 25%. Three days later, China added tariffs on $60 billion of U.S. goods in retaliation. After over 300 days of negotiation, the world's two largest economies hadn't reached an agreement. Consequently, investors began to worry about the future and fled to safe assets – thereby creating volatilities and income opportunities for Elixir in the market.

Another reason why equity investors became fearful in May was that bond investors maintained their bearish view of the economy. In our **March 2019 newsletter (page 3),** we noted that government bond investors, being the most intelligent investors in the market, are locking in long-term US bonds and selling their short-term positions. Bond investors often use this strategy to protect their income when they expect interest rates to drop in a coming recession.

Let's turn back the clock 14 months. In our **March 2018 newsletter (page 3),** I predicted that a recession would afflict the US and Canada in 6 to 18 months. As seen in the chart below, the yield spread between 10-year and 3-month US bonds has been on a downward trend since 2017 and, recently, finally became negative. The US bond yield curve has inverted at last!



While the inversion took longer than I expected, I believe that my original prediction regarding the recession timeline could still hold up, as the 1981, 1991, 2001 and 2008 recessions all happened shortly after the bond yield curve inverted.

Nevertheless, it seems that equity investors have finally realized that a recession is coming soon. Hence, they have become fearful.

Interestingly, this round of fear hasn't quite stuck, as the market rallied at the beginning of June. My guess is that bullish investors still feel strongly that if central banks lower the interest rate, the economy won't collapse. To that, I can only say: I'm not surprised. A few rallies will always take place before every recession. However, the reality is, while the recession may be late, it will never be absent.

2 In addition to FX trading income driven by market volatilities, we made good money in commodities trading.

In March and April, we bought large positions in extremely underpriced agricultural commodities such as corn, wheat and soybeans. In May, due to excessive rainfall that caused late planting in the US, all the aforementioned commodities shot up in value by over 20% within a few days. However, natural interference was not the only factor driving this round of price increases.

They were also triggered by forced buying pressure from hedge funds and other machine-driven strategies that, to avoid margin calls, had to unwind their short positions within a short time frame. Again, I can't comprehend why hedge funds and machines took on record short positions when, adjusted for historical inflation, these commodities were clearly underpriced. Nonetheless, we were happy to help them unwind their positions in a hurry by selling all our corn, wheat and soybeans to them for a handsome profit.

3 Internally, we added new, profitable strategies to our investment mandate in May. First, let's review the evolution of Elixir's investment mandate. When the company was founded in July 2017, we traded only first-world-country currencies. In early 2018, we added commodities and US government bonds to the mandate. These investments are backed by real supply and demand. We stay away from individual stocks because promotion and speculation can easily manipulate stock prices. Determining the true value of an individual stock is much more difficult than determining the true value of currencies, bonds and commodities.

That said, because our algorithms have improved, we now feel confident enough to add exchange-traded funds (ETFs) to our mandate. ETFs are collections of stocks, commodities, volatility, bonds and other instruments.

We want to include ETFs in our mandate because occasionally (like in March and April 2019), our algorithm has trouble identifying low-cost, low-risk opportunities on which to execute within our mandate. If we give our algorithm more options to consider, we create additional income opportunities that fit our risk parameter. This is a much safer strategy than adding leverage to trade-mandated assets that are less likely to earn a return.

In some cases, using ETFs to gain exposure to certain currencies and commodities could be more efficient than our current practice. For example, trading coffee through an ETF offers more accessibility and maintains more flexible terms than does the traditional contract for differences that we currently use. ETFs also allow us to trade volatility as an asset class. This will be a great income opportunity as volatility returns to the market. Instead of buying and selling ETFs, we would apply an option strategy to enter the trade more effectively in terms of cost, liquidity and performance. We would not use the option for leverage; rather, we would use it to boost effectiveness and profitability.

In May, our small investment in ETFs and ETF options profited because risk returned to the capital markets. The existence of this new strategy in our mandate allowed us to earn additional profits that, in the past, we would have left on the table.

I end this section with a summary observation of Elixir's trading performance based on our 22-month track record. During times when everyone is greedy and overconfident, we typically underperform. However, when people are fearful and paying for their greed, we achieve terrific returns.

Perhaps words such as "everyone" and "people" are too general. I suggest replacing them with "trend-following hedge funds and their machine-driven strategies." With this substitution, my conclusion is much more accurate.

On May 15, Eve and I landed in Geneva and began our eight-day European road trip. Our intent was to gain a true sense of the European economy as well as to assess the economic vitality of countries whose currencies we are currently trading or are considering adding to our portfolio. These currencies include the Euro, Swiss Franc, Hungarian Forint and Czech koruna. I found these ground surveys to be extremely useful, as they challenged and tested our "naturally biased" views and the data on paper. Ground surveys like these often inspire new ideas, as well.

In the future, we will write comprehensive reports (like the one we did on Mexico in the October 2018 Newsletter) about the countries we visited, as well as about Sweden and Norway (which I visited in January). In this newsletter, I will share general highlights from my ground observation.

While Canada is a multicultural nation, many of its investors don't pay much attention to Europe. I believe that this is because of the influence of the US media and the physical distance that separates the new world and the old. Many people I talked to seemed surprised to learn that Europe is the world's largest economy in terms of GDP. I understand this reaction. All available data is about the European Union (EU) only and, according to The World Bank National Accounts Data, the EU's GDP ranked below that of the United States in 2017. However, bear in mind that when we talk about Europe, we are referring to a larger European economic zone which is closely interconnected through trading. It includes first-tier developed countries such as Norway and Switzerland and up-and-coming countries such as Belarus and Ukraine. Again, these countries are not part of the EU.

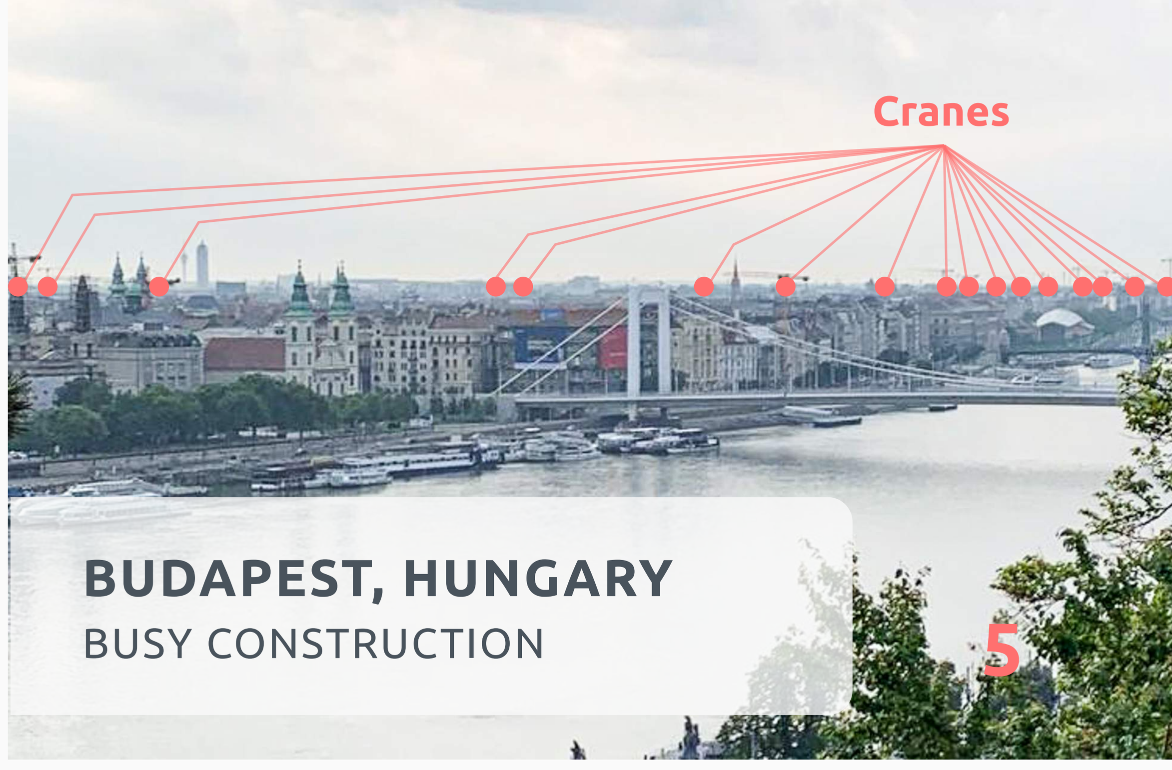
The road trip was certainly a good reminder of the size of the European economy. Before the trip, I was looking forward to the no-speed-limit, 800km-highway that spans southern Germany. The reality was disappointing, as I averaged only about 130km/h. Why? Because of all the huge transport trucks hogging the road. I've never seen that many trucks anywhere (which is saying a lot, considering that I've driven in all 50 US states and all 10 Canadian provinces)! Based on the license plate stickers, I saw trucks from every country in the EU plus the above-mentioned counties and more (Turkey and Russia).

Europe sees a lot of trade activity within its borders, which is great news for Elixir. In the past, we've focused on trading between European currencies and North American currencies (for example, Euro/Cad and USD/CHF [Swiss franc]). Now, I clearly see the opportunity to trade European currencies among each other (for example, CHF/NOK [Norwegian krone] and Hungarian Forint to Czech koruna). Currently, through our counterparties, we have access to 12 European currencies: the Czech koruna, Danish krone, Euro, Hungarian forint, Norwegian krone, Polish zloty, Pound sterling, Romanian leu, Russian ruble, Swedish krona, Swiss franc and Turkish lira. Although the European currency pairs aren't readily available at the counterparties, we can synthetically create them through our technology. The potential is very exciting!

On a separate topic, in September 2004, Greece admitted that it had faked economic data so that it could join the EU. I don't believe that this shocked many people. It has been commonly suspected that some European countries fudge their numbers so that they can join – or stay in – the EU. During this trip, I became a little suspicious about the Czech Republic.

PRAGUE, CZECH REPUBLIC
NO NEW DEVELOPMENTS

GENEVA, SWITZERLAND
SOME DEVELOPMENT



BUDAPEST, HUNGARY
BUSY CONSTRUCTION

Ljubljana, Slovenia

What I saw compared to what I read as an analyst didn't seem to match. While I wish to do some further digging, from what I saw on the ground, I don't believe that the Czech economy is as diversified and non-tourism-dependent as what the nation presents on paper.

For example, the roads are in poor condition and I didn't encounter as many new development projects as I expected (See the Budapest/Prague comparison photo we took on the trip). The Czech economy seems to be heavily dependent on tourism, as both domestic and international travelers fill Prague's streets. Some might think that a conclusion based on only the situation in Prague is a hasty one. However, remember: We drove about 400km throughout the country. Signs of a sluggish economy were everywhere. We didn't see many factories or development in rural areas, and much of the scenery seemed to be from the Soviet era. For us, one thing about the Czech tourism industry really stood out. When we left Austria and entered the Czech Republic, we immediately saw casinos, brothels, duty-free liquor shops and even family resorts with water parks. The sight of brothels and kid-friendly resorts next to each other was certainly striking. We hadn't encountered such a busy tourist-oriented border crossing throughout our entire trip.

In contrast to the Czech Republic, Slovenia was a pleasant surprise. I don't know if any of our readers have been to Slovenia, but it's a delightful place. It's modern and clean and it has a young English-speaking workforce. In addition, the capital city of Ljubljana is a tech hub.

Eventually, we'll gain access to currencies from other emerging European countries. We're trying to determine which country will become the next Slovenia. Countries on our radar include Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Georgia, Iceland, Moldova, North Macedonia, Serbia and Ukraine.

I hope you have found this issue of the newsletter to be insightful. Please feel free to reach out.

Sincerely,
Bill.

William McNarland, CFA
Elixir Technology Inc.
Chairman of the Board & CEO

VIENNA, AUSTRIA
HUAWEI IS POPULAR IN EUROPE

LJUBLJANA, SLOVENIA
YOUNG VIBRANT TECH HUB

VENICE, ITALY
WAY OF LIFE

VENICE, ITALY
WAY OF LIFE