October 2020

Elixir News

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

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Hi, everyone.

Since we last wrote to you in mid-October, the market has gotten a lot more volatile, due mainly to the US election, the strong resurgence in COVID-19, and the recent vaccine news. In October, the US stock market ended down 2.5% for the month but saw a range of returns that measured 10% from high to low. As soon as the US election results started coming in, the US stock market shot up 9.23% from its position on November 1. Volatility has been significant, which is very good news for Elixir.

S&P 500 Daily Oct 1-Nov 9, 2020

Under the economic outlook and market observation section, we will help investors digest the latest economic data, provide further evidence supporting our deflationary theory, and share some underpriced asset opportunities that we finally see in the market. This newsletter's feature article discusses how we've improved our algorithm based on the lessons we've learned and the observations we've made this year in the capital market.

On the corporate side, we had a successful shareholders' update on November 5. We want to extend our appreciation to all the investors who participated in the video conference. We hope that this pandemic ends soon and that we can hold our next update meeting in person. In the meantime, all investors are more than welcome to call us for updates or if they have any questions.

Sincerely,
Bill and Eve McNarland

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Economic Outlook and Market Observation

October was a strong month for Elixir due to ongoing market turbulence driven by the US election, the rise in COVID-19 cases, and a promising vaccine. In addition, three other observations recently caught our attention. First, updated data is showing a continued worldwide decline in economic activities. Second, renewed data further supports our deflation theory. Third, we are finally starting to see some underpriced asset opportunities on which to execute. I'm excited to present our algorithm's findings in this section.

1 THE GLOBAL ECONOMY IS NOT OUT OF THE HOLE YET.

In its November 6 news release, the US Bureau of Labor Statistics reported that total nonfarm payroll employment rose by 638,000 in October and that the unemployment rate declined to 6.9%[1]. We organized the data in the news release into the following charts to put the current US employment situation into perspective.

Oct vs. Sept 2020	October	September	MoM
Unemployment rate	6.90%	7.9%	**1.00%**
Unemployed (persons)	11,100,000	12,600,000	**12%**
Temporary layoff (persons)	3,200,000	4,600,000	**30%**
Long-term unemployed (persons)	3,600,000	2,400,000	**-50%**
Labor force participation rate	61.70%	61.40%	**0.30%**
Employment-population ratio	57.40%	56.60%	**0.80%**

Oct vs. Feb 2020	October	February	8-Month Comparison
Unemployment rate	6.90%	3.50%	**-3.40%**
Unemployed (persons)	11,100,000	5,800,000	**-191%**
Temporary layoff (persons)	3,200,000	800,000	**-400%**
Labor force participation rate	61.70%	63.40%	**-1.70%**
Employment-population ratio	57.40%	61.1%	**-3.70%**

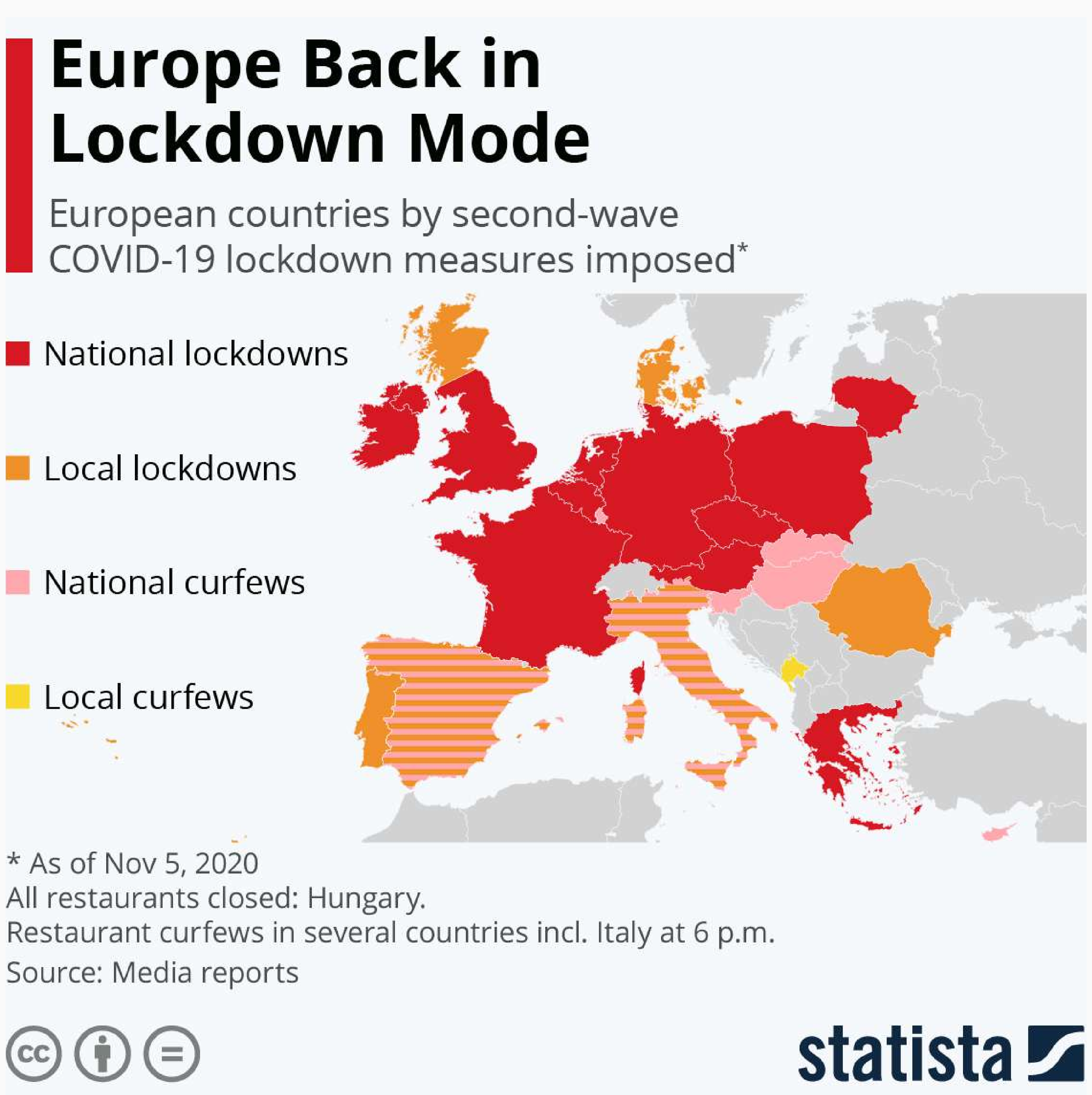
Industry	Jobs added in Oct since Sep	Jobs added by industry as % of total jobs added in Oct	Total Job Loss Oct vs. Feb
Leisure and Hospitality	271,000	29%	**-3,500,000**
Professional & Business Services	208,000	22%	**-1,100,000**
Retail Trade	104,000	11%	**-499,000**
Construction	84,000	9%	**-294,000**
Health Care & Social Assistance	79,000	9%	**-950,000**
Transportation & Warehousing	63,000	7%	**-271,000**
Other Service Industries	47,000	5%	**-436,000**
Manufacturing	38,000	4%	**-621,000**
Financial Services	31,000	3%	**-129,000**

As you can see, despite the 1% unemployment rate improvement in October, the number of long-term unemployed (those jobless for seven months or longer) worsened by 50% to 3.6 million, accounting for 32.5% of total unemployed. Typically, the longer people are out of work, the harder it is to find a job.

Another concerning observation from the October unemployment data is that although 1.5 million jobs were added, 1.4 million were originally temporary layoffs, with notable job gains occurring in leisure and hospitality, professional and business services, retail trade, and construction. It's highly likely that these rehired workers will face a new round of layoffs soon as COVID-19 hammers the US again.

On November 10, COVID-19 hospitalizations in the US reached an all-time high of nearly 62,000 [2]. In some states, hospitals are nearly full. A full or partial lockdown is inevitable, which would directly affect US unemployment again.

While the US's situation becomes dire, its leaders are too busy fighting for the throne, and little is being done to contain the spread. In contrast, as of November 5, new lockdowns and restrictions had been implemented in most of Europe [3]. Many Canadian provinces also announced their shutdown policies during the second week of November.



Many small and medium-sized businesses in the States barely survived the first wave of COVID with the help of stimulus programs: three phases of congressional stimulus working out to $8.3 billion, $192 billion, and $2.5 trillion. When and how would the second lockdown be carried out in the States? When would the second round of stimulus be distributed? Would the stimulus package be large enough to keep people employed?

The specifics of these material market-influencing events remain unknown. With a contested election and divided politicians, we feel pessimistic about the odds that a decent-sized stimulus package will roll out quickly.

Outside of the US, the EU adopted an $857 billion stimulus package in late September to help its less-wealthy member nations [4]. However, to receive the grant, the applying country must submit a detailed spending plan to be scrutinized by all EU nations. The spending proposal is, of course, subject to amendments and rejection. Today, nearly two months later, we have been unable to find any follow-up reporting on this stimulus package. We assume that no one has successfully received funding.

Some feel optimistic about the Pfizer vaccine news release on November 9. However, excitement could quickly wear out due to logistics limitations. To remain effective, the vaccine would have to be kept at -70°C, and freezers are in short supply globally. Thus, the length of time it would take for the vaccine to be widely distributed, and thereby lead to the resumption of normal economic activities, remains unknown. This winter will undoubtedly be challenging for the economies of Europe and North America. As the purchasing power of these two continents declines, the economy of the rest of the world will also suffer.

2 LONG-TERM INTEREST RATES DECLINE AFTER PANDEMICS, AND THE LIST OF COUNTRIES IN DEFLATION IS GROWING.

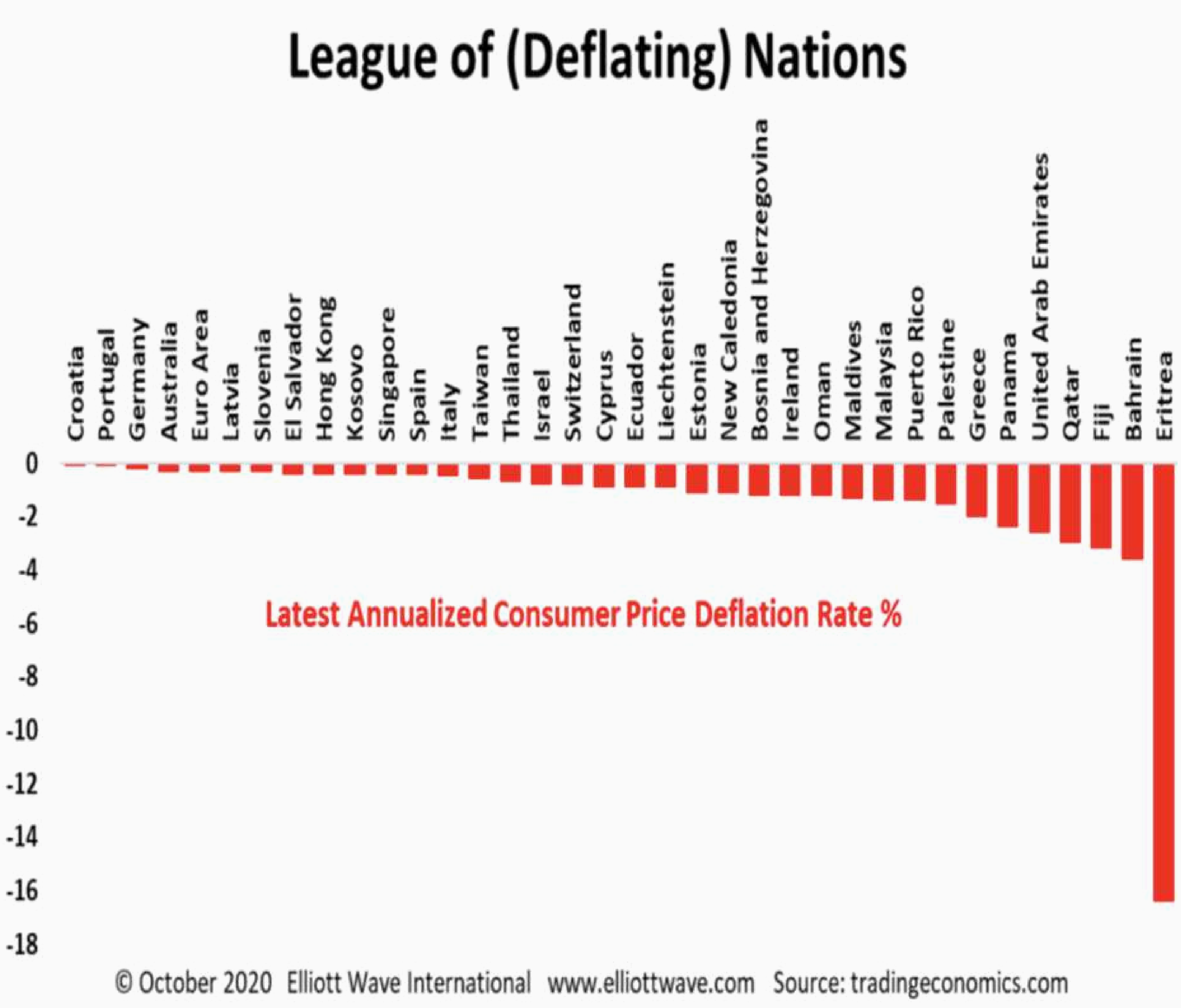
For its report "Longer-Run Economic Consequences of Pandemics," [5] released in June 2020, the economic department of the US Federal Reserve of San Francisco studied 19 major pandemics since the 14th century to evaluate the effect on long-term interest rates.

Here is the report's conclusion: "Following a pandemic, the natural rate of interest declines thereafter, reaching its nadir about 20 years later. At about four decades later, the natural rate returns to the level it would be expected to have had the pandemic not taken place...History shows that real neutral rates can be depressed for 5 to 10 years."

When the interest rate stays low, deflation occurs. This study of interest rates after pandemics certainly strengthened our thesis that the world is heading towards a long deflation—and not inflation—period. In the August newsletter [6], we provided an extensive discussion of our rationale for deflation.

Deflation is extremely damaging to the economy and would drag down all asset prices (expect for bonds). David Gyori, Executive Director at Banking Reports, wrote a detailed piece called “A Dozen Dangers of Deflation” [7] . I highly recommend that interested investors have a read.

Sadly, many countries are already facing deflation. According to Trading Economics [8], 19% (36) of the 185 countries (or economic regions) within their data coverage are currently in deflation. When central banks' 2% inflation is used as a benchmark, 51% (94) of countries are now below 2% and trending towards deflation. Among G20 nations, 29% are experiencing deflation (Germany, Italy, Singapore, Switzerland, and Spain), while 66% are now below the 2% inflation benchmark (EU, Australia, Canada, China, France, Indonesia, Japan, UK, US, and the Netherlands). To put this data in perspective, when Elixir fully rolled out in 2017, only five countries (Chad, Saudi Arabia, Togo, Aruba, and Brunei Darussalam) out of 185 were in deflation and none of these were in the G20.



3 THERE ARE PROMISING OPPORTUNITIES FOR ELIXIR.

Before we get into specific asset opportunities, I would like to comment on the equity market in general. It seems that, when fall started, investors’ positivity declined. We came to this conclusion when we looked at how the market reacted to Q3 earnings.

Quarterly earnings announcements provide investors with information about how well a public company performed against analysts' consensus. Typically, if a company does worse than the consensus expectation, its stock will go down, while if it does better, its stock will go up.

According to FactSet, "64% of the S&P 500 companies reported results for Q3 2020, 86% of S&P 500 companies had reported a positive EPS surprise, and 81% have reported a positive revenue surprise. If 86% is the final percentage, it will mark the highest percentage of S&P 500 companies reporting a positive EPS surprise since FactSet began tracking this metric in 2008. [9] "

Bear in mind that FactSet is not saying that earnings are outstanding; the research firm is simply indicating that these S&P 500 companies' reported earnings were much better than expectations. To our surprise, the S&P 500 went down by 9% despite the above-expectation performance between October 13 and 31. The unusual decline in index value could mean two things. First, investors have run out of money to act on new, exciting news. Second, investors are shifting away from the overly positive sentiment we witnessed in the summer.

With the corrections that we’ve seen in October, the following opportunities have finally surfaced: coffee, cocoa, Russian Ruble, US bonds, and certain stocks.

Coffee and Cocoa

Coffee is revisiting five-year lows in price. The cost to produce coffee in Latin America is about $1.05 to $1.91 per pound, depending on the country. Currently, coffee is sold for $1.03 per pound on the exchange.

The reason for the price decline is similar to what it was last year. Brazil had very successful crops, and a strong supply brought down the price of this commodity. In 2019, we bought coffee at about $1 per pound, and the cost of coffee rallied by 30%, even though farmers in Brazil were still planning to grow large crops the following year. Based on experience, we think that the current low price would bounce over a short period (weeks or months).

When a commodity's prices are less than the production cost, the result is not sustainable for producers. Eventually, on a long-term basis (months or years), farmers will not be motivated to produce more coffee, and pricing will return to normal. So, on a short- and long-term basis, owning coffee is a good investment.

Cocoa's story is similar to that of coffee. Although cocoa has not yet declined to a multi-year low, it is revisiting the low prices we saw earlier this year. Cocoa is on our radar for close monitoring but it's still too early to purchase.

The Russian Ruble

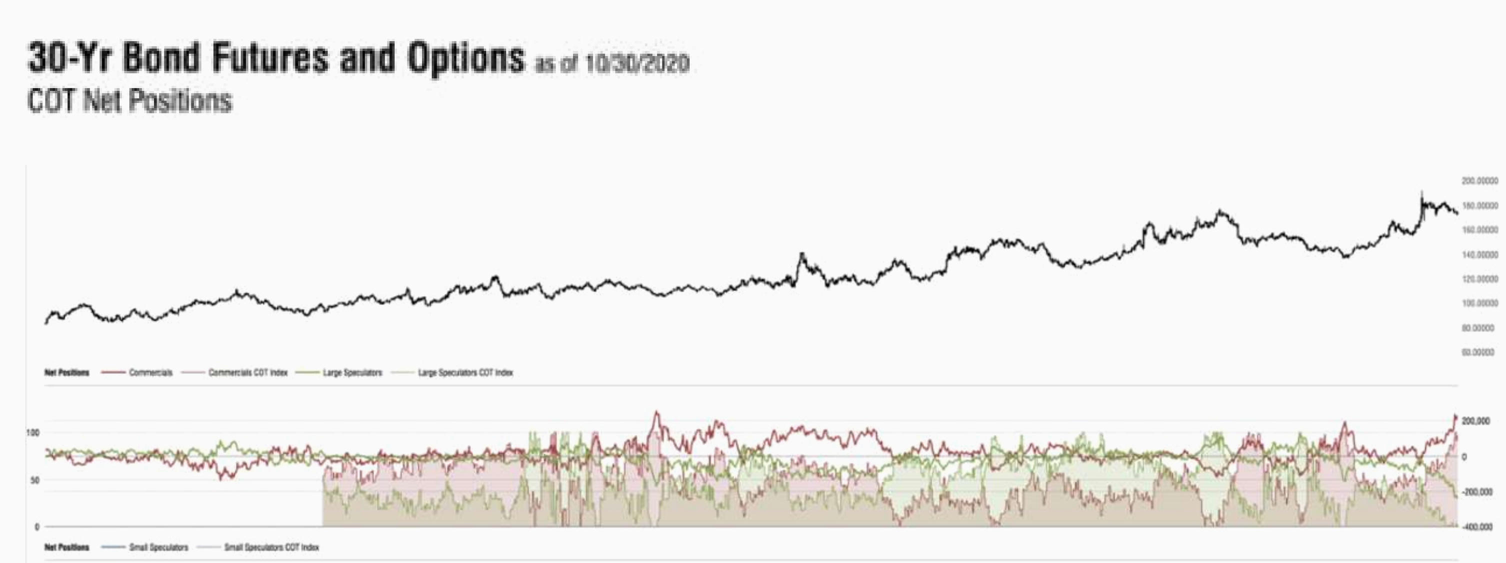
The Russian Ruble is currently at slightly lower prices than its March 2020 low, which is the weakest on record compared to the USD since it became freely traded 25 years ago.

Russia has a debt/GDP ratio of only 56.6% [10] compared to countries like the US (122.5%) and Canada (128.8%). The country also offers a current overnight interest rate of 4.5% [11], which means investors get paid a positive cash flow while waiting for the Ruble's price to increase. The Ruble's decline was attributed to low oil prices, political uncertainty in the US, and continuing struggles with COVID-19 [12]. These matters would eventually work out. After the March 2020 low, the Ruble increased by 10% in value by June 2020. It would be reasonable to expect a 2% or 3% increase while earning daily interest. Therefore, a small position of the Russian currency may be prudent at this time.

30-Year US Treasury Bonds

The 30-Year US Treasury Bond is an attractive opportunity, as it is very oversold. Based on 25 years of available data from the Commitment of Traders' report, we haven't seen commercial investors being so bullish on 30-year bonds, nor speculators being so bearish.

Speculative investors bet that the economy will do very well after the pandemic is behind us, and interest rates will quickly increase. Commercial investors believe that the road to economic recovery will take much longer, and interest rates will stay low. Right now, investors receive 1.6% annually to invest in this opportunity while they wait for bonds to increase in value.



Individual Stocks

We are starting to identify some out-of-favour, inexpensive, yet valuable companies—for example, the largest North American oil company, Exxon. Exxon was the world's most valuable company in 2013. Since then, nothing material has changed in its business. Its revenue rose and fell with the price of oil. Although the oil-and-gas sector is out of investors' favour compared to the technology sector, we are still heavily dependent on the dinosaur juice and its related products, at least for the foreseeable future. So, Exxon is not going anywhere.

Currently, at $33 per share, Exxon is close to its $30 per-share bottom of March 2020. Since its March bottom, Exxon rallied up to $54 in June. We believe Exxon will soon see a new bottom, and a rally of 10% to 20% should be easy to obtain. The company pays a 10% dividend yield, which is excellent considering that many companies face financial challenges. A small position in Exxon is prudent for our portfolio.

It is nice to finally see some compelling values in equities. We found ten out-of-favour companies with strong balance sheets, pay dividends, and historic low prices. These are great opportunities to trade in and out of, and if we get stuck owning them, we can afford to wait while earning dividends.

Feature Article: **Improvements to Our Algorithm**

As you know, we began developing our algorithm over 10 years ago, in the fall of 2008. The market reaction to the subprime mortgage crisis inspired me to create a tool that would identify promising opportunities in the capital market.

The original algorithm's foundation was built on three essential elements: history, sentiment, and money flow. As a brief recap, "history" refers to long-term, inflation-adjusted pricing data. This data helps us determine whether an asset's price is high or low today. "Sentiment," also known as "popular opinion," refers to investors' overall attitude towards a particular asset or financial market. "Money flow" provides data on commercial buyers' trading trends. Before we pull the trigger on purchasing an asset, we also look at the historical asset volatility. This measurement tells us how likely it is that an unpredictable event would affect the asset in which we are considering an investment. Our algorithm takes data from all these sources and produces a confidence rating to guide our investment decisions, including FX, commodities, bonds, and equities. We always look for ways to improve our algorithm's accuracy, particularly so that we can better time our investment execution.

This year, risky assets reacted to the COVID-19 pandemic in a truly remarkable and unique way. In studying available historical data, we have never seen a bear market rally that is this intense. 2020's V-shaped stock market recovery between March and October will undoubtedly be remembered as history being made in the capital market. Analysts worldwide, including myself, were busy trying to understand and learn from this unique market phenomenon.

A few months ago, two new data tools became available and have proven to be useful in predicting the great bear market rally we just experienced.

In short, these tools could help us identify short-term (days and weeks) bottoms and tops, as well as medium-term (weeks and months) major bottoms. Like everything, these tools are works in progress. They have benefits and limitations. We want to share this information so that our investors will know how we'll make our trading decisions going forward.

Tool 1 VIX CORRELATION TO PRICE AFTER A MATERIAL DECLINE

Our first tool stems from Ron Meisel's work on VIX correlation to the price after a material decline. Meisel was founder of the Canadian Society of Technical Analysts and was head of Technical Research at BMO Nesbitt Burns.

Meisel's focus was on proving that the VIX's correlation to asset price can be used as an indicator of pricing bottoms. The theory is not hard to understand. When the price of an asset is falling, fear (VIX) will trend up. When price continues to fall, but fear is stalling or declining, then a bottom is forming. While the theory seems like common sense, it wasn't proven until Meisel completed the data collection and analysis. Data shows that the theory was particularly accurate for the 2020 market bottom in March, September, and October.

The theory works well in predicting major pricing bottoms and pricing trends over the next number of months, particularly during times of high market volatility. Knowing that a major bottom is coming is very useful in adjusting our investment portfolio. That said, the theory has limitations. It does not predict turning points in tops and is not effective for predicting pricing movements in the short term (daily or weekly).

Tool 2 ELLIOTT WAVE ANALYSIS FOR SHORT-TERM TIMING DECISIONS

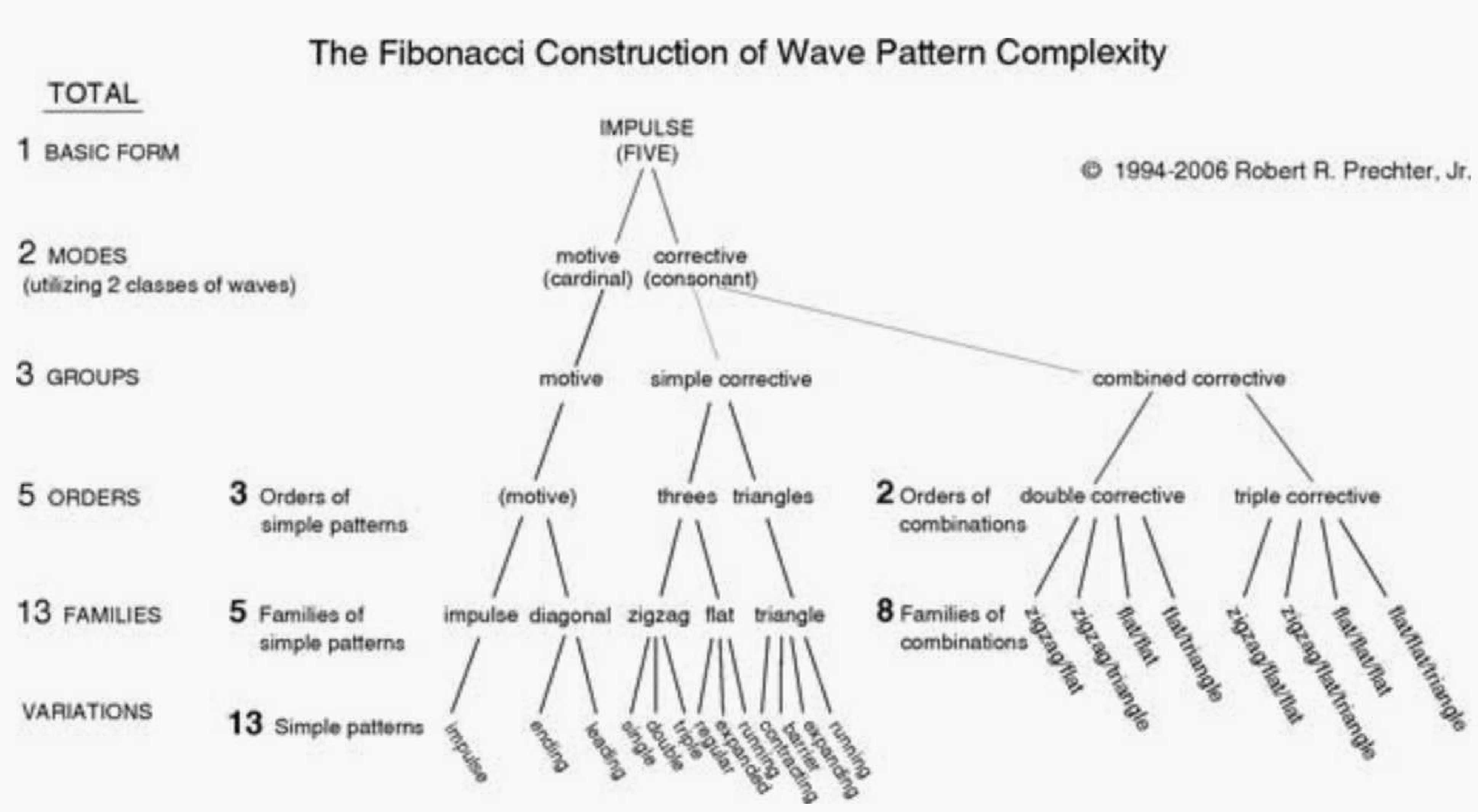
Many institutional investors use Elliott Wave Analysis to help predict the long-term pricing trends in markets (FX, commodity, bonds, and equities). In short, Elliot Wave Analysis believes that investors' emotions come in waves and that this wave pattern can be used to predict pricing directions. Ralph Elliott created the principles behind Elliot Wave Analysis during the Great Depression. He became famous when he accurately predicted the 1935 stock market bottom, as well as a new bull market that would last for 80 to 90 years.

In the past, investors used Elliott Wave Analysis primarily to make 20- to 30-year pricing projections. However, with the increase in computing power and advancements in technology, the tool can now be used for hourly pricing forecasting.

Here is an example of how Elliott Wave Analysis complements our existing algorithm.

Back in May, June, and July, our algorithm was indicating an over-priced market. According to historical pricing data, investor sentiment, and money flow, the market should have reached a top in May or June. Some were confident that the early June correction would be the turning point. However, based on its wave pattern, Elliott Wave projected that the rally should last longer. Sure enough, the equity market kept going higher in July and August, while the S&P 500 climbed to a new historical high at the beginning of September.

Elliott Wave is a complementary tool for our other three indicators in the algorithm. On a short-term basis, it helps us refine the timing of trade execution when history, sentiment, and money flow align for a specific asset. However, the tool is not without its shortcomings. Material news events cause irregularities in the pattern, which makes Elliott Wave unreliable for a short period of time. For example, interest rate decisions, presidential elections, a new vaccine—these events would temporarily throw off the accuracy of its predictions.



Final Remarks

We believe that these two new components will boost our algorithm's accuracy, particularly in refining the timing for trade executions. They will help increase our risk-adjusted return. Our focus now is to work on software automation, to add them to our algorithm software.