Issue 2

Altana Investment Thoughts February 2017 – By Lee Robinson

Introduction

As many of you know, we co-invest our own money both directly into third party entities and also through incubating fund managers in whose information advantages we have high conviction. Investments range from VC to growth capital to asset-backed and include listed opportunities. I am fortunate to meet many highly talented investors ranging from entrepreneurs and self-made millionaires [some billionaires] to family office decision-makers. I chair my own deal club of 18 entrepreneurial investors, each of whom in turn have their own networks, thus the opportunity sets are multiplied. Further, I sit on the committee for the financial services network of the YPO, permitting a privileged insight into the future of this industry. Most investors I meet have a common desire to co-invest and through doing so align their interests. They also either do not trust or think little of the financial industry in general, both from a value point of view [fees] and/or service [lack of quality ideas].

As a consequence of some of the meetings I have undertaken recently, I have been asked to collate an overview of some of my investment theses and ideas from the last few months. Please keep them confidential and please contribute your own comments and ideas via email. It is my intention to cultivate a virtuous network of investors and investment ideas, free of conflicts of interest.

2016 in Review

Overall, 2016 was a good year for Altana both on the investment and relationship front. We were profitable in most areas and met a considerable number of new co-investors who offer their own networks, ideas and insights.

Investment success was strong, led by a 7% return net of fees on our corporate bonds UCITS portfolio, with a volatility of 2%. The decision to manage such a portfolio internally derived from a fundamental belief that third party fees to achieve a similar risk/reward profile, in conjunction with the potential for failure of interests to be aligned, were excessive. We continue to enjoy this particularly excellent risk vs. reward opportunity in corporate bonds for the reason that we trade in the secondary market and are paid a premium for the lack of liquidity that exists for holders of $5m or more of bonds, typically with less than three years' maturity. If, like ourselves you are unconstrained in your investments you can trade bonds less than $5m in size you are paid an illiquidity premium but do not suffer from the lack of liquidity should you need to reduce positions. We are in discussions with several families looking to exploit our advantage either through the current low risk UCITS fund we have incorporated, via our 10% higher risk special situations vehicle [see last letter] or via a managed account.

Brexit was kind to our trades and I continue to be baffled as to why more macro hedge funds didn't profit from this trade. Sterling was priced at 1.51 the day before and we saw it going to 1.25 in the next several months due to the current account deficit versus a potential cap at 1.55-1.60. Hence for investors with a longer than one day view, it was an easy risk reward trade. Similarly we felt a Hillary Clinton win would see a small bounce in the US dollar but a much larger one from a Trump victory due to his protectionist and expansionary policies. Both trades were excellent and easy risk rewards. Is it possible that most large funds are focussed on not losing much money to the extent that they miss the big moves, or perhaps it's emotional? Recent large-scale redemptions from some of the largest funds support our view that investors understand that such funds in an environment of lower volatility and less liquidity are not going to find it easy to be profitable. Altana is increasingly of the view that the best opportunities – arising through information advantage and competitive edge - are, by definition not scaleable.

We did very well on currencies overall and continue to believe that getting currency allocations correct is vital in a world of financial repression.

With regard to equities my big calls (as many of you saw from my **video interview**) were Lonmin and a basket of dry bulk shipping stocks, both of which did well and may well be breaking out further to the upside in 2017. My other high risk vs reward investment in Bitcoin was up 110% and the lending side was generating 20%+ returns for rolling over two day loans. This was not without some scares, which we explain below. On the private side most of my investments into companies are travelling in the right direction, albeit (as expected) more slowly than forecast. On the negative side our long volatility trading hedges had negative returns every month bar two in 2016. This is extremely rare as usually there are 3 to 4 very good weeks every year that allow us to break even or profit. Regardless of headlines, markets were very resilient last year. I expect 2017 to be much more volatile though: as I write this the S&P has gone a record 36 days without a 1% or more intraday move. Our trend following inflation system even though it was short bonds, long commodities and long equities, in general suffered losses overall as energy and metals whipsawed against us.

Equally, if not more importantly, we added four very experienced professionals in 2016 all bringing new ideas and aligned with Altana investments. One month into 2017 another four have already agreed to help us, with another two close to signing.

Protectionism

One of the constant themes of conversations with some of the most intelligent people in 2016 was denial. Many of us have grown up in an environment of increased globalisation driven by events such as world trade agreements and the fall of the Berlin wall. Over the last two to three years this has gone into reverse, culminating in anti-establishment votes such as Brexit and Trump etc. but everywhere I go I hear conversations that allude to this being an aberration and that the 'ignorant people' will come to their senses. That is not the case. This is a new thought era where politicians need to talk about 'jobs at home' and curbing immigration in order to be elected. We will not wake up and find the anti-globalisation movement has gone away overnight. It has to be seen to fail, and that will take time. At best Trump will enact his populism over the next two to four years. If it fails it will be at the minimum two years from now. Even the effects of Brexit cannot be gauged until three to five years after Brexit is legitimised, which at the earliest will be 2019. We are in a new era, and although we don't like it or think it will work the intelligentsia need to understand, adapt and react. The effects will be higher wages, higher prices and P/E multiples will contract. Countries whose revenues have traditionally been based on manufacturing exports will suffer, so be underweight or short those currencies. More volatility seems likely from a very subdued current base.

Currency views

Post Brexit we are asked more and more about our currency views. We continue to be very bullish towards the US dollar. In a world with too much debt, estimated at over $200 trillion up $57 trillion since 2008, the need to pay US denominated or linked interest drives huge annual demand for dollars. For us the most important dollar driver this year will be whether the Republicans authorise the tax efficient onshoring of (currently) offshore US cash held by corporates. The common myth is that this drives corporates to convert currencies into US dollars before repatriating and that of course being able to repatriate means more money is spent on domestic M&A rather than foreign, which in reality is a small US dollar positive. However the main driver is the movement of US dollars from offshore banks to the US banking system. We must remember that banks are leveraged so every $100 billion moving from, say, the European banking system means 1-2 trillion dollars less of lending unless the banks can replace the capital. If repatriation occurs we expect $:€ to head below parity and gbp:$ below 1.15 this year, with both perhaps approaching multi-year lows. This will have very negative consequences for indebted emerging markets as their reserves will likely fall.

Now that Brexit has been triggered in the UK parliament we think the markets will focus on the wave of European elections – Holland, France, Germany, and then perhaps Italy. Nothing interesting will happen in Brexit negotiations until after the German elections. Given that the market underestimated extreme results in 2016 we believe the market will overprice events this year. Hence the Euro will be sold more aggressively. We currently don't believe the far right will prevail in either France or Holland due to the voting structures but we are concerned that Merkel will not achieve a majority with her coalition partners. Italy of course is the most likely to vote to leave the Euro when an election occurs.

Speaking to family offices - especially those concentrated in real estate - there is an overwhelming majority that believe in the UK long term regardless of Brexit. Coupled with the above we are bullish on sterling versus the Euro for the next twelve months. For all the bad news and lack of growth, the trade weighted euro has been constant over the last five years with little volatility.

Bitcoin

As mentioned earlier, our Bitcoin trading vehicle generated over 100% return in 2016 and is up over 20% in 2017 already. This is despite the hacking incident in August on one of the exchanges that lead to a loss of 5% in our two trading vehicles which is slowly being recovered. Whilst the incident reflects badly on the exchange, a great deal of Kudos goes to them for how they handled the aftermath. They could have shut down, causing greater losses, but instead they carried on and used their profits to repay their clients. Only in times of adversity do you find out who has the highest integrity.

We believe that 2017 & 2018 will be the beginning of major advances is blockchain applications in the real world. This is due to a significant amount of capital invested in the previous three years reaching fruition. Should this be the case, then we believe Bitcoin will be on its way to being accepted as a major global currency. Major global currencies are valued in the hundreds of billions whereas the Bitcoin free float is only $15 billion today. We held a Bitcoin teach-in session at our offices for fifteen potential investors. We can send the presentation and our other live research materials if you are interested. Due to onshore demand we are close to finalising a Luxembourg vehicle that allows units in the fund to be easily bought via your bank or broker.

Our Bitcoin trade finance facility has benefitted from the closing of the Chinese exchanges with current two day rolling lending achieving lending rates of over 25% annualised. Like most of the best opportunities around it cannot be scaled, but we have around $3m spare capacity for anyone interested.

Larger investors

Since Maribel Montero joined us in May last year, we have been meeting many new family offices contacts. Some are very large, managing several billion dollars. What has been interesting to us is that their optimal investment size is also in sub $50m enterprises due to the incredible competition as deals become larger, hence their optimal investment size is typically $5-25m which overlaps with that of Altana and our core group of co-investors. Almost all of the families we speak to consider direct co-investment opportunities, so we have set up a mailing list to exchange co-investment opportunities we are investing. As we make investments, we meet other co-investors who introduce us to yet more and the circle becomes exponentially virtuous. Families especially like the longer term nature of the alignment of interest (a substitute for "Trust") which underpins direct co-investing, and in some cases will translate into their children perpetuating the relationships. This is something with which no banker focussed on their bonus and retiring in the imminent future can compete. Where relevant we have been exchanging names of fund managers in whom we have invested in externally as obviously we cannot be specialists in all the fields in which we want to have exposure. Please keep them coming, as we always want to hear about your investments. We remain committed to our belief in the primacy of information advantage and to working alongside the most suitable partners. Our ideal partners are with people that can:

1. Make decisions
2. Bring their own ideas
3. Help with the heavy lifting involved in due diligence checks, introducing companies to each other, analysing competitors and other special relationships.

Technology

Even a curmudgeonly bear would have to say kind words about the incredible number of disruptive technology in the world- from DNA sequencing, virtual reality, drones, 3d printing, blockchain and robotics. These would not have been possible without the incredible innovations in microprocessors over the last thirty and ten years. I regularly recommend Clayton Christianson's book 'The Innovators Dilemma' (1997) as the best framework within which to view disruption.

In such a world of boundless optimism one of the most interesting reports of late is from my good friend Andy Lees. Andy put out a report highlighting the breakdown of several assumed technology laws, the most famous being Moore's law regarding doubling the speed of microprocessors every 18 months. As transistors have become smaller and smaller, imperfections per 1000 products have increased and the energy produced is limiting their efficiency. Clearly if the growth has reached a plateau then this has huge impact on the pace of technology growth.

The other area of discussion has been cyber security and personal privacy especially amongst the older and wealthier of our contacts. I would strongly recommend you to not use major search engines. We use www.duckduckgo.com. They don't track your searches, have very user friendly icons for different types of hedge funds and you don't get inundated with advertisements.

Conferences

I was kindly invited to speak at the Club b conference in Barcelona and met many of you over the 3 days. For me it was my first time attending and I have to say it was an excellent conference. My thanks to Peter Fletcher and his team. The conference is founded on the thought –

'if I give you a dollar and you give me a dollar we both have one dollar but If you give me an idea and I give you an idea then we both have two ideas.' Simply wonderful.

The topics were diverse, thought provoking and, refreshingly, there was a strict no selling policy in force. This enabled attendees to share ideas and concerns, ask good questions and offer their views in a safe forum of peers. I hope to be invited back. A month later I was at the Milken conference in London which was unfortunately a disappointment perhaps due to my own high expectations. The speakers were mostly living in the bubble of denial that I alluded to in the section on protectionism, the talks were too long with little interaction and there was a strong element of sales rather than dialogue.

In the same week was the Ira Sohn conference. Several fund managers speak for fifteen minutes on their favourite idea and ideally if you follow their idea and invest successfully you are encouraged to donate a portion of your profits at your own discretion to the various good causes supported by the Ira Sohn charity. They have raised over $75 million to date to fund paediatric cancer. I have been asked to be part of the committee that will help organise the first ever Monaco version of the conference. If you know any good speakers or wish to attend then please contact me separately. Finally, on a much smaller scale, many thanks to those who attended our drinks event held at Salamanca's office in early February.

Asset Backed and Direct Lending Opportunities

Through our network of successful entrepreneurs and businessmen, we share co-investment ideas in seed, development and asset-backed investments. We share the burden of due diligence work and offer the option to others to invest alongside us. In addition to our Bitcoin trade finance, we have recently participated in two more mezzanine loans against a portfolio of commercial real estate, one in the UK and another in Central Europe – mostly Prague and Budapest but with rents all paid in euros. Riposte, the peer to peer lending fund we helped to seed has been running smoothly for four months achieving gross lending rates of 14% which, after some delinquencies and fees we hope will give us 8-10% net.

As we keep saying, most of the best returns are not scaleable and are attractive due to liquidity and size constraints. The Eurostoxx dividend anomaly is a good example which I will address separately. We are currently looking closely at a number of other similar opportunities and will happily send more details to those interested.

Private Ventures

As ever this is not a dull space. We are seeing numerous ideas, many with frankly ridiculous and unrealistic valuations given the downside risk. That is not to say they lack quality, but there is a presumption amongst some entrepreneurs that they should receive the public level valuations of further developed companies at an early stage. If they themselves are committing sizeable co-investment capital then that can perhaps be substantiated. We prefer to invest when there is true client traction even if that means that the valuation is higher. In 2015 we met an exciting new business raising around €300,000 at a low valuation. We didn't participate. In 2016 they returned, having grown the business to 500 clients, had built out a 10 person sales team and proof of concept in two national regions. They were looking for €750k at a €7m valuation to grow the business to multiple regions nationally. We were able to analyse real numbers, from margins to cost of client acquisition to churn and make more realistic assumptions. Consequently we invested.

The challenger bank, Redwood, of which I am a shareholder and on the advisory board, will find out if it is approved in the next 4-6 weeks. An external investor has publically committed to invest £30m at a £90m valuation, subject to final PRA approval.

Finally, Livesmart - the data driven proactive health business we conceived and incubated has received approval for a fund raise of £500,000 under the UK's tax efficient EIS scheme with 90% of the money already committed. Even more heartening, Livesmart had its first £50,000 contract awarded in December from a major media company, followed by several others including a three year £100,000 per annum contract. Livesmart had originally forecast only £0.5m of sales in 2017, targets which look likely to be comfortably exceeded. The Global Head of Strategy for Health at AXA, Damien Marmion, has personally invested and is now a strategic advisor.

Not only are these disruptive new ideas leading to profitable buying opportunities, they are highlighting short ideas for the listed incumbents that will likely go out of business or become distressed. We find investing in new ideas a great source of information and education. Naturally we wish all the entrepreneurs we meet the best of success as we understand the higher risk, rollercoaster adventure they have embraced. Entrepreneurs are amongst our favourite people.

Acceleration Deals

As seasoned hedge fund managers and investors, we have found ourselves discussing how best to produce absolute and relative outperformance across a selection of fund managers. Managers seem with increasing frequency to disappoint across the cycle. We believe that the best way to mitigate downside and increase returns from investing with fund managers is to take a share of both the management and performance fees. We have found many very exciting emerging managers who are willing to offer a share of their fees in return for our early investment. For certain risk/reward profiles, we recommend looking for substitutes with greater upside via such an investment in the fund's structure.

Investors typically receive 10-20% of the manager's gross fees in exchange for $20-50m of acceleration capital. If we take the more conservative 10% number then with a typical 1.5% and 20% fund that grows to $500m the increased annual returns are as follows:

Annual Performance	0%	5%	10%	20%
Extra return	3.8%	6.3%	8.8%	13.8%

Clearly not all funds will grow as quickly or at all but some will grow to even larger sizes. Even if only 20% achieve such growth, then a portfolio of such investments will add 1-3% outperformance annually to your investments. By closing those that don't grow (cutting losses) and replacing with better prospects the Altana Accelerator vehicle will aim to achieve a higher success ratio. Additionally, we have negotiated an exemption to maintain an investment in a fund that is over $100m thus the capital can be redeployed in parallel to retaining a share of the enhanced fees, thus providing an essentially riskless cash flow stream.

We are launching our Director Alignment Strategy which goes both long and short US stocks based on director dealing patterns. Altana raison d'etre is to co-invest alongside smart people. Without doubt US insiders (Directors working for a firm) have access to the best information on the companies that they work for and typically are clever people, thus making this strategy a perfect fit for Altana. The strategy generated over 20% in 2016 of which over 12% occurred since we started trading with real capital in September 2016.

<u>Education Club -UPDATE</u>

The education of our children is a topic that often comes up in meetings. We all want the best for our children, yet many of us can see that the traditional education systems are out of touch with the modern era. Further, the needs for those inheriting wealth are also different and often complex. Robotics and automation are moving at exponential rather than linear rates. Competition for jobs and roles for graduates and young adults is at its fiercest and not abating.

Progress has been made. We are drawing up a list of life skills and the people to teach them for our children, many of which I'd like to attend myself and I certainly wish I knew them when entering adult life. Additionally we are setting up an intern exchange system so the members can place their children in short term internships that are becoming essential as part of their courses and to gain a job interview.

<u>Real Assets</u>

Following on from the wine investment we discussed in our first edition, we have since met other interesting real asset experts.

One of these was the owner of Bullion Vault, the UK's number one private gold trader. Bullion Vault allows you to buy your gold online and store it in several locations including Singapore, London, New York and Toronto. I personally signed up and would recommend the service.

Secondly, we came across a contemporary art advisor that can advise on building portfolios, negotiate the price for buying and selling as well as access many up and coming artists. They were realistic in their account of how some of the investments don't make material money but a meaningful number go on to make several multiples of their purchase prices. This emphasises the need to speak with experts. Finally another group that are originally from Christies explained how they get the best deals from auction houses when clients are selling valuable assets. We like the alignment of interest in that they are rewarded in line with your success and as always expertise in selling should never be underestimated. The ability to sell (as opposed to buy) is the mark of a professional in any industry.

Fun

Everyone needs a little fun. Many of us want a special experience on a special occasion, maybe our favourite artist or actor to host an event or to work with our chosen charity. For myself and I am sure many others, we are put off by our lack of knowledge. One of the recently introduced private investors runs a business that takes all the headaches such as finding the right agency, negotiating the price, and organising the event in a transparent manner.

To follow up on any of the ideas please feel free to contact us.

Previous Investment thoughts, information on inflation and some thought provoking videos are available on:

http://www.altanawealth.com/news/

Please keep this note confidential but feel free to contribute your own thoughts and comments via email as we love to exchange notes and ideas. As always, we welcome your ideas.

Best,

Lee Robinson

lee.robinson@altanawealth.com