Altana Investment Thoughts September 2017 – By Lee Robinson

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Introduction

As many of you know, we co-invest our own money both directly into third party entities and also by incubating fund managers when we have high conviction in their information advantages. Our investments range from VC to growth capital to asset-backed and include listed opportunities. I am fortunate to be constantly meeting highly talented investors, ranging from entrepreneurs and self-made millionaires and billionaires to family office decision-makers. I chair my own deal club of 18 entrepreneurial investors, each of whom has their own networks, thus multiplying the opportunity sets. I also sit on the committee for the financial services network of the Young Presidents Organisation, permitting me 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).

I have been asked to collate an overview of some of my investment theses and ideas from the last few months. Please feel free to share these with other sophisticated investors and contribute your own comments and ideas via email.

It is my intention to cultivate a virtuous network of investors and investment ideas, one free from conflicts of interest.

Altana Developments

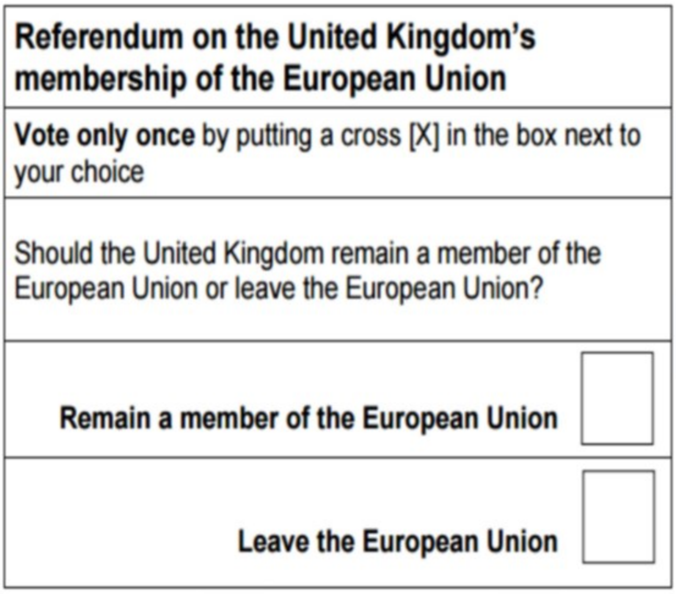
Since our last letter in February a great deal has happened. Over the last 18 months Altana has made incredible progress. We have had multiple interesting meetings with several successful co-investment ideas arising from them and built new relationships. We continue to strive towards better solutions with higher risk-adjusted returns for both our clients and ourselves, as we always co-invest alongside.

We have just created **Altana Volatility Overlay Fund** (AVOF), an option overlay to enhance passive index trackers. Over time, back-testing and experience demonstrate that this increases stock market index returns by around 5% per annum. Another private office has signed a $300m mandate. This option overlay is now available to other investors, so please contact us for the presentation.

Other areas of significant progress:

- The **Altana Corporate Bond Fund** UCITS (ACBF) won the Hedge Fund Journal's best 2016 smaller credit fund with a 7% return. Assets are now $37m and the fund is up 3.6% (for the USD$ share class) over the first eight months of 2017. We have considerable internal capital in this fund (this is my "capital preservation" bucket) and four credit specialists with over 100 years of credit expertise.
- The **Altana Director Alignment Strategy** (ADAS), our new director dealing fund is up 14% since September 2016 and we launched a UCITS version on June 2017.
- The **Altana Digital Currency Fund** (ADCF), our Bitcoin trading fund was up 80% in May alone and nearly 500% YTD. As we are now regulated in Luxembourg, we will imminently launch a Luxembourg vehicle that invests into cryptocurrencies enabling private clients to buy via their advisors through Euroclear. Additionally, **Altana Digital Services** (ADS), our Bitcoin trade finance vehicle that lends US dollars to traders is up over 20% annualised through August 31.
- Several new talented individuals with over 25 years of experience have joined the team.
- Total AUM up to $400m from $100m.
- We are now also regulated in Luxembourg to ensure that there will be no passporting problems post-Brexit.
- Altana presented at the Ira Sohn conference in June, a charity event in which well-respected Fund Managers shared their market insights while raising funds to support paediatric cancer research and treatment.

<u>Brexit Thoughts</u>


Referendum on the United Kingdom's membership of the European Union

Vote only once by putting a cross [X] in the box next to your choice

Should the United Kingdom remain a member of the European Union or leave the European Union?

Remain a member of the European Union

Leave the European Union

On the political front in 2016 we managed to successfully predict Trump winning, and to trade Brexit profitably. 2017 started well as we correctly anticipated that the far right would fail in both France and Holland.

Despite this, none of us should underestimate this anti-establishment trend. If you had asked a bookmaker one year ago for odds that both the Republican and Socialist candidates would fail to reach the second round of the French elections after winning every election since World War Two, then you would have been given odds of over 100-1. Yet the socialist candidate received 8% (and lost his seat in the subsequent local elections), and combined they barely received 25%. In the end the fourth choice candidate Emanuel Macron won by default, with the support of just 24% of the electorate. He is now the next saviour of France, set to reform labour laws, regulation and move France to equal pegging with Germany. Whilst we hope he succeeds, we doubt he will. His approval ratings of 64% in June are now below 40%. Contrast that with the UK, where Theresa May called an election and won 42% of the vote but ending up losing her majority, probably assuring the end of her political career. We certainly got that wrong, expecting her to win a 40+ seat majority. The policy of vote-for-me-because-the-alternative-is-worse (UK Remain campaign, Hillary Clinton, Francois Fillon, Theresa May) does not work. It is now necessary to explain precisely why voting for you is better.

This leaves the UK, and therefore Europe, in a messy Brexit. Theresa May has little authority in her own party and cannot call another election in case she falls back even further. This will mean little progress on Brexit over the coming year. For investors this uncertainty means less UK investment in the expansion of staff and services until there is more clarity. I personally expect to see sterling fall to below 1.15 to the US$ over the coming year due to the slowdown and uncertainty, and that it will fall further if the USA manages to enact tax reform and onshoring of offshore US$. In that scenario, I can see parity being reached. Versus the Euro it is clear that sterling underperforms but at some point investors will realise that the need for European banks to raise capital, the higher costs to export to the #1 European export market of the UK and the increased defence costs will also weigh upon Europe. The Italian elections were always the largest worry due to the heightened xenophobia caused by the influx of migrants from Syria and North Africa. Italy has already voted against the establishment in December of 2016. With the Italian elections coming in March: could they vote for a party that wishes to leave the Euro? We think it will be close but not likely to happen whilst Brexit is being negotiated, but we do expect Euro weakness heading into January 2018.

Listening to the initial rhetoric from the politicians has already highlighted the degree of incompetence involved. From an economic and business point of view the EU stance on a Brexit bill is insane and misconceived. The UK has been a net contributor to the European Union over 40 years, so basic arithmetic entitles the UK to receive money back for their historic contributions, assuming that is the European Union doesn't seek to argue that it has been an unprofitable venture. Both sides would need an audit to ascertain quantum. However, for the EU to have an audit that highlights the waste and identifies the corruption that the Berlin and London governments both currently only *suspect* exists, will never be acceptable to Brussels.

To have to pay the UK to leave would cause the 27 countries domestic political problems. So Brussels is trying to force this through even though the one-off €40-60b "divorce settlement" desired pales into insignificance against an annual €200b export surplus between the UK and the EU. If there is no trade agreement and the WTO tariffs come into place that is a minimum cost of 7% per year or €14b in perpetuity. Most of that will hit the German and French auto sector. Add in to the mix the lack of competitiveness following a weaker sterling, and most likely US and Japanese imports, and the EU is in a difficult situation.

Business wants the politicians to focus on the trade deals to remove uncertainty but the politicians want to keep their jobs. The UK has a stronger hand than the press wants us to believe, but they are playing it poorly and it appears the current UK cabinet is not strong enough to neither lead the process nor provide a vision for the UK post Brexit. The EU is not representing the people's best interests and, as I mentioned earlier, the markets will recognise and punish them in 2018.

Both sides clearly want free movement of skilled labour. The UK majority voted against free movement of unskilled labour nor does most of the European electorate support it. However skilled labour cannot easily move across Europe. Try being a German hairdresser or an Italian dentist if you come from another nation. You have to sit local exams in the local language. Many myths are being peddled.

On the positive side, the passporting of UK financial companies to Europe will likely be resolved. Why? The European banks require capital to strengthen their balance sheets. If there is no agreement between the UK and EU then the EU branches subsidiaries will need additional capital to do business in London and vice versa. This hits the large European banks hard whereas Barclays, Lloyds, HSBC and RBS have largely exited Europe.

The business community needs to be more vocal in the formation and direction of the talks.

Cryptocurrencies

From our last letter:

'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.'

Since January, ADCF, our Bitcoin trading fund is up over 500% gross. We believe we are now at the acceptance phase for crypto currencies and institutions are coming to the party. The wider public is tagging along. Japan has legalised Bitcoin, driving demand, while other countries are following. Our UK bitcoin ATM business, whilst still, small grew revenues 50% between April and June. One of the largest wallet providers – Coinbase – has seen wallet growth from 6m in June to nearly 10m in August. We still think Bitcoin will be materially higher in two years if it is accepted globally and that appears to be the direction of least resistance. It could, of course, crash and we are very wary of the Initial Coin Offerings (ICO). Almost all will fail, or worse are nothing more than scams and Ponzi schemes. To be fair to the many salesmen peddling these ICOs they clearly state the risks: that they are unregulated, that you have no recourse should things go wrong, and that there is a strong chance that you will lose all your money. This is all very reminiscent of the Dotcom boom when companies promised to chase eyeballs with marketing spend, but did it to such a degree that was uneconomic for the majority of ventures.

ADS, our Bitcoin trade finance facility has benefitted from the closing of the Chinese exchanges and the investor frenzy over crypto currencies. Daily rolling lending rates of over 25% annualised have been achieved year to date. Sadly like most of the best opportunities around it cannot be scaled, but we have around $3-5m spare capacity for anyone interested.

Investors

With the help of Maribel Montero and the recent addition of Oleg Desh, we have been meeting many new family offices contacts and reviewing new direct co-investments. Some were good but overvalued and we have begun to send the best ideas to the wider group. Almost all of the families and HNWIs consider direct co-investment opportunities, so we have set up a mailing list to exchange opportunities we are either investing into, or seriously considering investing into. As we make investments, we meet other co-investors who introduce us to yet more and so the circle becomes virtuous exponentially. Families in particular like the longer term nature of the alignment of interest (a substitute for "Trust") which underpins direct co-investing, and in some cases will lead to their children perpetuating the relationships. This is something with which no banker considering their bonus, and hoping to retire in the imminent future can compete. Where relevant we have been exchanging names of third party fund managers in whom we have invested, as we cannot be specialists in all the fields in which we want to have exposure.

Please keep ideas 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 those who 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.

We now have over 130 co-investors with whom we share ideas and due diligence. It is clear to us that the HNWI/Family office co-investment space has grown dramatically since the financial crisis and is at the top of the banking industry's list of differentiators. Several groups have grown and are becoming ever more sophisticated. We all face issues of sourcing, filtering and how to avoid the wrong people and investments. We believe, and several others agree, that the current platforms for ideas from banks or online are not good enough. They post average, overpriced and often downright desperate ideas upon which (usually) they expect to earn a fee (which can create conflicts). Due diligence and selection is needed by investors to reduce the list to a lower number of higher quality ideas. The blockage is at this stage. We are working with other groups to build a filtering function that gives different levels of due diligence on the concept, people and valuation. Members can share views and questions allowing them to quickly see if a proposal is worth investigating further. The plan is to build a team of 5-6 people initially to create the functionality for the members then expand to offer to third parties. We have identified some of the team members.

We'll be reaching out to you this quarter with the capital raise but if you are interested in being a founder member then please feel free to contact myself, Maribel or Oleg directly.

Technology

We are continuously amazed that, outside the tech industry, no other industry has a chief technology officer on the board. Tech is now an integral part of every company at operational, marketing, and social media levels. This needs to change and fast. Our CTO sits in on all management meetings. In the past often CFOs became CEO but I see a future in which the CTO is more important than both. As investors, we must push companies to address this problem.

In the last letter, we discussed the slowing down of microprocessor speeds and energy efficiencies as well as disruptive technology. We are often asked why we are so interested in new technology especially that with the power to disrupt. One area overlooked when disruptors grow is that incumbent companies fall greatly in value presenting great shorting opportunities. Take Gamestop in the USA or Game in the UK. Going into a physical store to buy games when you can now download these in seconds is clearly not going to work. Two years ago Gamestop was valued at $4.5B, versus just under $2B today. Game has gone bankrupt (twice I believe). In a world where almost every industry is under pressure from technology there is plenty of money to be made from shorting stocks.

We discussed recruitment in issue 1 of this newsletter, and recently at the YPO fintech conference several well respected private equity houses claimed they are seeing more viable ideas in insurance tech this year than the last six combined. Imagine being able to insure your car only for the duration of time in which you actually drive it, or your house only when you are not in it. This “focused and specific” insurance would greatly reduce your premiums. When it comes to car insurance, the older and wealthier drivers subsidise the younger and usually less wealthy drivers. Pay as you go will drive up premiums for the less wealthy drivers so that they will not be able to afford to drive. Keep an eye on insurance companies over the next three years. Less premiums and fewer customers are not a recipe for share price appreciation.

We find investing in new ideas a great source of information and education.

Conferences

Ira Sohn is a charity set up to help with cancer research, specifically paediatric cancer. Every year they organise conferences and ask top fund managers to speak about their favourite trade. They have raised over $75 million to date. Attendees pay an entrance fee and are encouraged to give a share of any profits gleaned from the trade ideas to the charity. My good friend Justin Hilbert of Churchill Capital organised the first ever Sohn conference in Monaco. I was asked to be one of eight speakers. After some gentle ribbing about why I didn’t present the Bitcoin idea, I went on to discuss the mining company Lonmin, one of my largest positions. I believe it can go up 10-20 times. The video is around 10 minutes and can be seen on our website.

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

The conference was a success and the charity raised over $100,000, hopefully more with additional donations if the trades are successful.

Private Ventures

As ever this is not a dull space. We see numerous ideas, many with frankly ridiculous and unrealistic valuations given the downside risk. Naturally, we wish all entrepreneurs we meet the best of success as we understand the higher risk, rollercoaster adventure they have embraced. Entrepreneurs are amongst our favourite people.

The newest UK challenger bank, **Redwood,** of which I am a shareholder and on the advisory board, was formally approved by the PRA in April and opened its doors August 29. An external investor has publically committed to invest £30m at a £90m valuation. Congratulations to the whole team. If anyone reading this is looking for an asset backed loan, I can effect an introduction.

We are working with the same group on a joint venture with one of China's largest internet based companies. More updates to follow as this develops. We are certainly working through a higher quantity of opportunities due to the expanded network and the addition of Oleg Desh to the DD team.

Asset Backed and Direct Lending Opportunities

We are working with **Bridge Invest** to participate in bridge lending opportunities secured as senior and first charge against UK property. Loans are typically of 6-10 months duration with returns of 1% per month. Bridge Invest always invest alongside us pari passu. Lower risk senior loans have great co-investment appeal.

We have agreed with Bridge Invest that we can elect the paymaster to control the HSBC bank account so as to remain fully in control of our money. Bridge have successfully sourced and funded multiple loans with a cumulative value £10m since 2015, generating on average 9% net returns from each loan which annualise around 12%.

We are setting up meetings in Monaco and London in September and October, so you can ask further questions. If you are interested or would like to meet them separately, then please contact us.

We have been looking at wine trading for over three years as buying and selling wine on exchanges has opened up the opportunity to compete in a previously closed industry. Wine is a great inflation hedge as it contains many contributors - labour, land, fertiliser, transport - that are all positively correlated with inflation. Investors hold wine for that reason and, of course, to sell or drink it in 5-25 years. However many wine investors, like me, are not wed to the wine we hold. We are indifferent to which quality Bordeaux wines that we have in storage. If someone could profitably buy and sell my portfolio 2-3 times a year but still give me similar wines when I wanted to drink or sell them then I would be delighted. Essentially I would be able to drink fine wine for free. Sounds like a dream come true. We have paired up with **Cru wine** to do exactly that. You can even roll in your current portfolio of wines. Like Bridge, Cru are young and hungry to succeed taking risk without an initial salary. As always, we are backing them with our own money.

Finally an update on **Riposte**, the US peer-to-peer lender we have backed. They are now nine months into operations and generating 14% gross yields which, after delinquencies and fees, should be 8-10% net returns for a diversified pool of consumer loans with under three year duration. All is running smoothly with the quality of loans they are choosing consistently hitting targets for top quintile returns. They are attracting interest from very large institutions. Not only do we like the risk adjusted returns, the quality of information about the state of the US consumer is very enlightening and will be a leading indicator for our other investments.

Outlook

My currency views and fears over Italian elections are outlined above. We continue to believe that we are late in the cycle in the US expansion. The US ten year bond yield has fallen from over 2.6% to 2.1% despite three interest rate hikes. Gold has broken above the $1300 level suggesting a large move to the upside. Gold sentiment is the worst in years: there are large shorts, and platinum positioning is negative which is rare and creating a record short position on exchanges. Large outflows from the gold ETFs has not stopped the rise in demand: admittedly some is from India which was badly disrupted by the removal of old notes from circulation late last year, typically the busiest gold buying season in India.

Both gold and US treasuries are well-followed liquidity bell-weather indicators that are pointing to further deflation and hence more QE. Our own monthly inflation report, whilst it has some positives, is mostly indicating deflation is coming. Auto and retail sectors in the US and UK are in free fall as the consumer discretionary income continues to fall. Europe has had its first really good year of economic data in over a decade but it is hard to see the export machine of Europe doing as well if the US and UK are not importing. We have seen clusters of Hindenburg omens in US stocks and outside 5-10 names the S&P 500 has been performing poorly. Central bank QE has fallen from a monthly rate of $350B at the peak in April to $100b in June. Margin debt has now fallen for the last two months, which usually precedes bear markets. The American Association of Individual Investors' survey showed the lowest cash allocation since Jan 2000.

Now is the time to switch to long-short managers rather than long only, to reduce duration on credit and especially cyclical industries. My personal view is that volatility will go higher between now and year end.

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

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

Please 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 and support.

Best,

Lee Robinson

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