Incrementum All Seasons Fund

– in pursuit of real returns –

   

2021 / 03

June / 2Q 2021

Seasonal Reflections

2nd Anniversary Edition

quote(s) for reflection: (sections in this report written and underlined in blue represent active weblinks)

"The large monetary and fiscal stimulus injected in the advanced economies is out of all proportion to the magnitude of any plausible gap between aggregate demand and potential supply. …a combination of political pressure to assist in financing budget deficits, unwise central bank promises not to tighten policy too soon and an expansion of central bank mandates into political areas such as climate change, all threaten to weaken de facto central bank independence leading to a slow response to higher inflation." (Source: Mervin King (former governor of the Bank of England), FT, 8JUN2021)

"The question is, 'Why do policies that have been shown to work so badly still get used so regularly?' I have long maintained that Keynesianism is to Marxism and Socialism what diet cola is to the real sugary beverage. Hence, it falls neatly into the popular, but not working category." (Source: Charles Gave, Chairman, GaveKal, quoted in Steve Blumenthal's On My Radar: Euthanasia of the Rentier, 30APR2021)

"The post WW2 experience of a massive debt build-up which needed to be worked off, for years, via negative interest rates, is comparable to today. From 1945 to at least 1952, US T-bill rates were around 40 bps, the 10 year T-bond was at 2% and AAA corporates traded at about 3%. In 1948, CPI was +8.1%. Real rates were negative by 770 bps on the short end of the yield curve, 610 bps on the long end and we think we have negative rates now? We may not have seen anything yet." (Source: Market Intelligence Report by TIS Group, 17MAY2021)

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worthwhile reads: We will be lost if we panic at every Covid mutation, C. Cavendish, FT, 21MAY2021

I'm Trying To Understand Hedonic Adjustments, Brent X Donnelly, Epsilon Theory, 10MAY2021

Corona hat uns vollends zu digitalen Idioten gemacht, P. Teuwsen, NZZ, 12JUN2021

The demise of the dollar? Reserve currencies in the era of "going big", J. Plender, FT, 25MAY2021

We are entering a time of financial repression, Russell Napier, NZZ, 14JUL2021 (de)

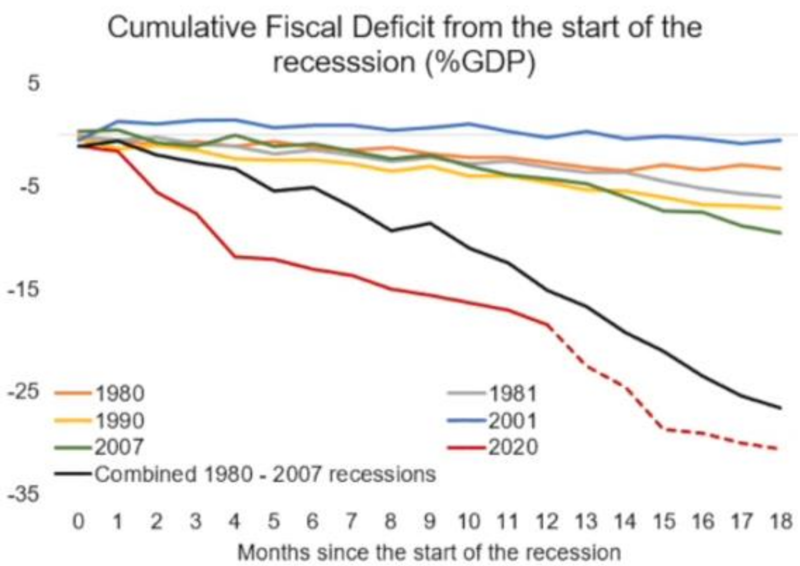
Open Letter To The Fed, by Harley Bassman, The Convexity Maven, 26JUL2021

podcasts & videos: Why We're in the Biggest Financial Bubble in History, Real Vision Interview with Steve Bregman & Mike Green, 6FEB2020

Financial Nihilism, Narrative Investing & the Hyperreality of Markets, Grant Williams interviewing Demetri Kofinas, Hidden Forces, 1JUN2021

Do Schools Kill Creativity, TED Talk by the late Sir Ken Robinson, 7.1.2007

chart(s) of the month / quarter:



Source: USC Student Inv Fd AM Keynote, Stanley Druckenmiller, via CMG, 28MAY2021

"Stock Market Frenzy" Cover: Der Spiegel, 5JUN2021

ENJOY!

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Dear Reader,

Not only is this the 2nd anniversary edition but also the first bi-lingual publication of **Seasonal Reflections**, which also explains its delayed publication, as it seems I have become a bit rusty in the use of my native tongue. For this first bilingual issue, the German edition differs somewhat from the English, as it includes an introduction of **Incrementum AG** as well as the **Incrementum All Seasons Fund** and explains both the origins and reasons for publishing **Seasonal Reflections,** which I thought I can spare readers of the English edition. (In future it should just become a straightforward translation.)

Instead, I am opening this piece with my favourite seasonal picture, which I made during a recent trip to Lake Geneva. We stayed for a couple of days in Vevey, a beautiful little town at the east side of the lake, from where we visited neighbouring Montreux, Geneva, and also undertook a leisurely walk through the nearby wine-growing region of Lavaux, which afforded us this truly magnificent view of the lake and the Alps in its background. Personally, I found this one of the most beautiful summer spots I have ever visited.

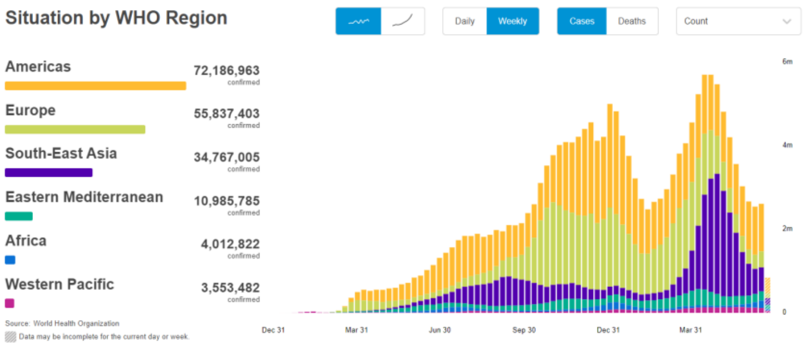
Wine terraces of Lavaux, Lake Geneva, 11JUL2021, HGS own pic

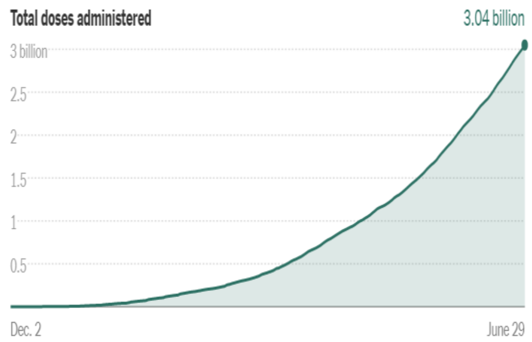
It was interesting to note on this occasion how the world is slowly returning to normal. I found it remarkable that the Swiss (similar to Liechtenstein) displayed few remaining Covid restrictions. Especially mask-wearing was almost non-existent, while 2 weeks earlier in Italy, I had been surprised by the many mask-wearing people at Lago Maggiore. Perhaps a sign of deeper scars of this country's…

Fight Against The Virus

For one and a half years now, the world has been under the influence of the Covid-19 pandemic, and we have all experienced the consequences first-hand. I myself was not knowingly infected and have also by now been fully vaccinated. But like probably every reader, I do know people who have been infected - most of them without major problems, but there are exceptions. Consequently, it is clear that the Covid-19 virus should not be underestimated.

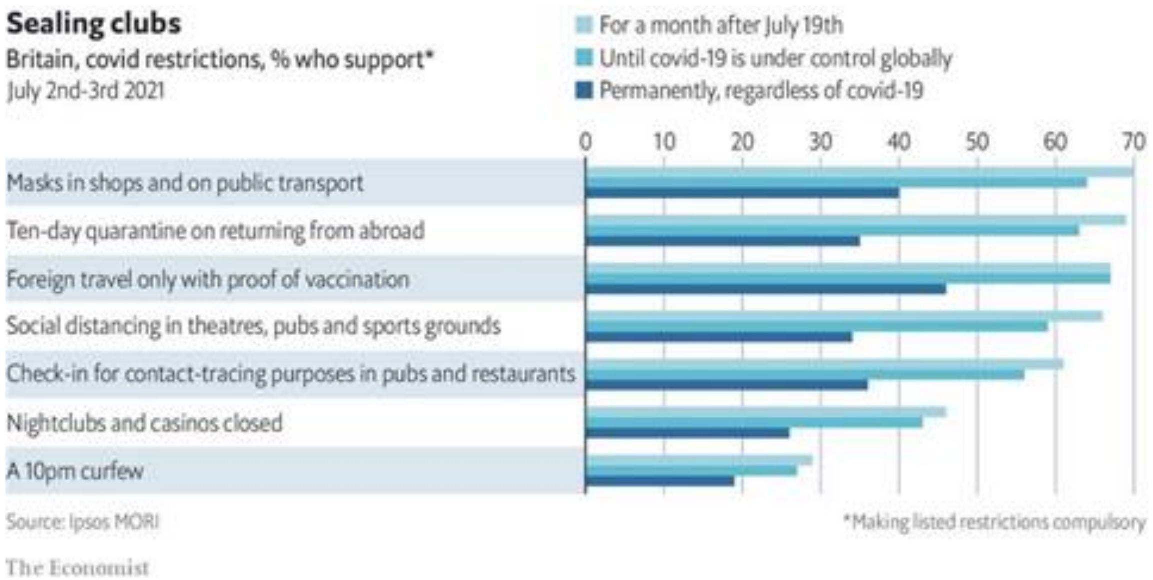
That the outbreak of the pandemic was associated with a lot of concern and fear is consequently also understandable, and I, probably like most readers, have patiently supported the measures taken to prevent the spread of the virus.





Source: World Health Organization (WHO), Data from 29JUN2021 Source: New York Times

By now, however, the world has fought through a second wave of infections and learned how to deal with the virus. Above all, the increasing number of vaccinations gives reason for optimism, even if the delta variant has recently initiated a third wave (check out the links above for an updated picture) and thus stoked new fears as to whether we will be able to finally live with the pandemic. And in this context, fear is the phenomenon that, in my view, deserves some more attention.



Source: Andreas Steno Larsen, @AndreasSteno, Twitter, 11JUL2021

If one looks at British survey results above, which were published in the Economist earlier this month, the fact that about one third of respondents would permanently support the above listed measures speaks for an indeed very pronounced level of fear. (Whether all respondents would rigorously adhere to these measures themselves, is open to debate...)

This fear was primarily fuelled by politics (and media), which early into the pandemic was understandable due to the prevailing uncertainty. True to the motto: better safe than sorry!

In the meantime, however, one can no longer avoid the impression that politicians are primarily focused on CYA, in order to protect themselves (and supposedly their constituents) against all eventualities. I have already written in previous reports on both the patchwork of measures and the (too?) little discussed side effects. The latter range from negative influences on the development of children, to the stress young families experience amid the combination of home office and home schooling, to the growing loneliness of old people for whom social contact with family and friends is the elixir of life.

Especially families separated by national borders (and my family is one of them) suffer from the increased bureaucracy. In recent months, I have come across many examples for this. These include friends and acquaintances who could not see dying parents or relatives and who, in some cases, are still not allowed to visit their families a year later. – When you consider how many people around the world live and work outside their home countries, often in order to feed entire families at home, then you realise what the containment measures also mean.

Source: Marine Traffic

How much humanity has fallen by the wayside is shown by a recent example from international shipping, a sector that is of particular investment interest to **IASF** at the moment, and which I learned about first-hand: It is the case of the Romanian captain of the MV Vantage Wave, who died of heart failure on the high seas on 19 April (no hint of Covid involved).

Under normal circumstances, the deceased would have been disembarked at the next port and taken home by the responsible shipowner for burial. But deaths in times of Covid are suspect, and fear of infection or simply not complying with regulatory requirements has meant that the ship failed to receive permission to disembark the body in Singapore, Malaysia, Indonesia, Thailand, Vietnam, Philippines, Japan or China.

It has therefore been kept in the ship's refrigeration unit for 3 months, along with food for the crew… – Since May 7, the vessel has been anchored in South China, waiting for permission to land and unload. All efforts by the shipowner, the charterer, the family and even human rights organisations to get the body off the ship have so far (as of early July) been to no avail. At this point, provisions are also running low, and the ship has only a few days of fuel left on board. Even attempts to at least secure the ship's supply have failed so far.

(Latest update, due to the fact that writing these reports happens over a longer period of time: The vessel has left Huangpu, China, with the deceased body still on board, heading for Vietnam.)

How is this possible, one wonders? - I think for the decision-makers within the bureaucratic apparatus created to prevent the spread of the virus, the individual case does not matter. Any gratitude for solving such a case will never even come close to outweighing the potential risk of something going wrong and having to assume responsibility. And so, our world which had become fairly open, is once again becoming increasingly isolated and many of our values in dealing with each other are falling victim to the authorities' efforts to exclude all and any risks. Are we prepared to pay this price?

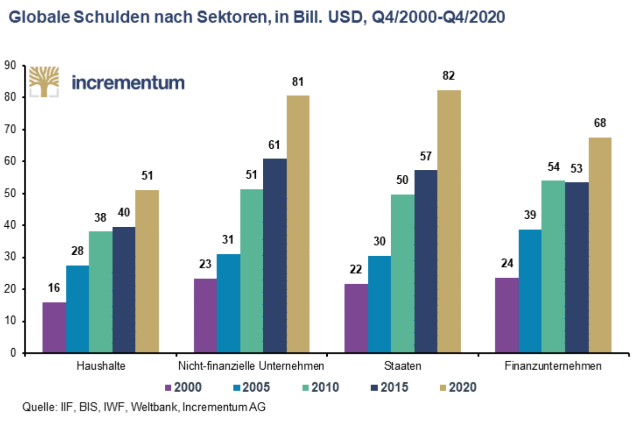
In my view, Covid-19 is now neither an imminent nor an imponderable threat. With the development and distribution of effective vaccines, politicians should thus come to realise that the responsibility for risks regarding the Covid virus can once again be left to its citizens. We cannot continue to subordinate everything else to the fight against the virus, which most likely cannot be completely eradicated, anyway.

The consequences of the measures taken so far are already serious! For politicians, the pandemic was a convenient excuse for throwing overboard all inhibitions regarding the regulation of citizens' lives and the management of our national economies, including the associated fiscal expenditures. In retrospect, the Covid-19 pandemic will therefore prove to be a catalyst for political and economic changes that, in our view, will shape the coming decade.

A Macro-Economic Overview

The most controversial discussion among financial market professionals at the time of writing this is whether the rise in inflation observed in recent months will prove transitory or not. And since this is an important question not merely for investment-strategic considerations, I would like to summarise the broad underlying macro-economic background here as follows:

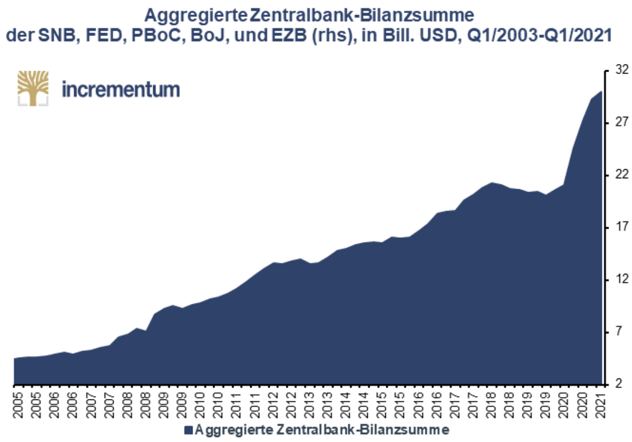
The past decades were characterised by an increasingly interventionist economic policy, in which monetary policy was primarily used to smooth the economic and financial market cycle, in addition to the traditional goal of monetary stability. This was accompanied by a manipulation of interest rates towards and even below the zero bound, which led to a drastic global increase in debt.



Bloomberg Businessweek, 22APR2019

Surprisingly to many (including the author), this caused only moderate increases in the measured prices of goods and services, which led many experts to proclaim the end of inflation or at least its permanent containment. Technical progress and increased productivity growth were cited as reasons for this. Demographic developments (an ageing population leading to increased savings rates) as well as the integration of emerging and developing economies into global production and supply chains also had a dampening effect. In previous reports I have also pointed to statistical changes in the measurement of inflation that have led to an underestimation of the true level of inflation.

Since 2008, monetary policy has increasingly relied on the instrument of direct securities purchases, also known as "quantitative easing" (QE). Advanced economies' central banks primarily bought government bonds, but also mortgage and corporate bonds, with the aim of lowering long-term interest rates. This was supposed to increase lending and with it ultimately overall economic demand. At the same time, these policies were expected to achieve a growth-stimulating *wealth effect*.

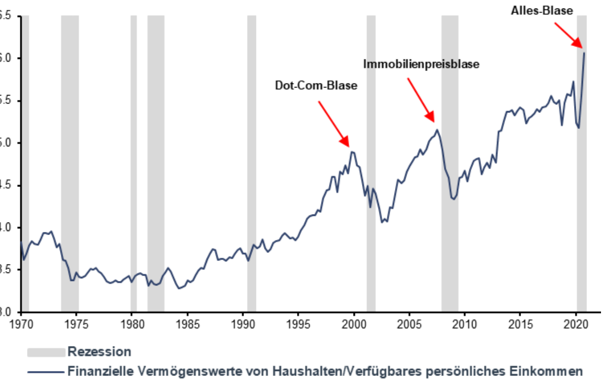


3) Quelle: Murenbeeld, Reuters Eikon, Incrementum AG

At this point you may be wondering what hides behind this *wealth effect*?

The price of any asset depends strongly on the cost of capital. For example, a lower interest rate on a mortgage loan means that the property buyer / borrower can afford a higher loan amount, while annual interest costs remain the same. Falling interest rates have therefore also become the main driver for the worldwide rise in real estate prices. And similarly, in the case of stock markets, a reverse correlation between the development of the level of interest rates (down) and share prices (up) can clearly be registered over the past decades. The *wealth effect* thesis popularised by ex-US Federal Reserve Chairman Ben Bernanke in essence claims that rising asset prices (by making people feel "richer") lead to rising consumption and thus economic growth.

Alles-Blase, Q1/1970-Q4/2020



4) Quelle: Reuters Eikon, Incrementum AG

The above mentioned first goal of expanding lending was obviously achieved, as another look at the chart on page 6 shows. Meanwhile, asset prices have also risen significantly, as the performance of financial assets, but also of real estate and all sorts of collectibles, shows. Hence, the term "*Everything Bubble*" was coined, which is reflected in the increase in financial assets relative to disposable household income as shown in the chart.

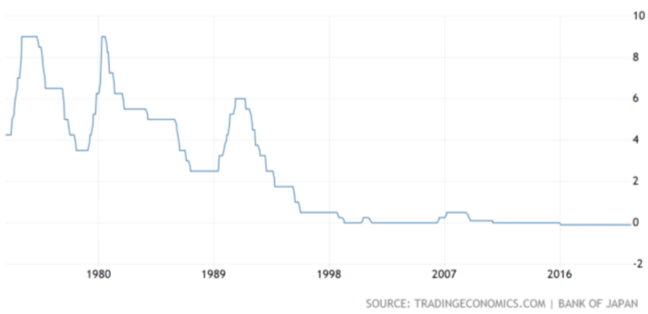
However, below-average economic growth over the past decade suggests that neither rapid credit expansion and the ensuing additional expected demand, nor the effect of becoming nominally richer have led to a significant increase in the propensity to spend. Why is that?

Well, part of the credit expansion fizzled out in short-term consumption, or was used for non-productive endeavours like share buybacks, which do not provide a sustainable growth impulse. And as far as the *wealth effect* is concerned, owners of real estate and securities are mainly found in the affluent part of the population, which tends to satisfy its consumption needs already fully, and thus will not spend more even if they become wealthier. In our view, this policy has therefore failed to achieve its goal and instead contributed to the growing wealth gap.

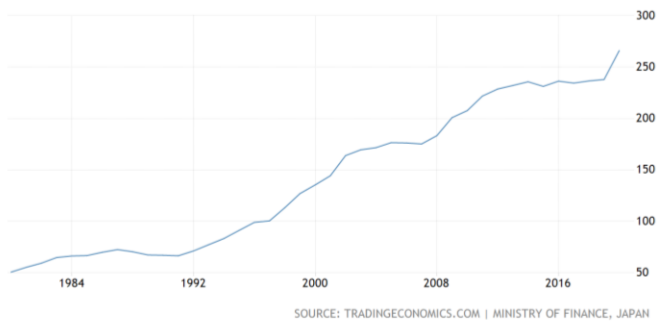
However, having pushed interest rates down to zero and below has had another important effect: if savers can no longer achieve a positive real interest rate (= nominal interest rate minus inflation) in their quest to make provisions for the future, i.e., if their savings constantly lose purchasing power, then this arguably results in two kinds of responses:

The first stems from classic savers, who when realizing that their bank deposits no longer grow through interest, feel compelled to save more to compensate for this - a phenomenon that was observed in Japan for decades. More important, however, is the private investor who is “forced” out of the safe haven of government bonds and thus feels compelled to accept higher risks elsewhere in order to achieve a certain expected minimum return. This crowding-out effect has increasingly diverted investor capital into equities, corporate bonds, but also real estate, where it has exacerbated valuation bubbles.

A hardly unintended consequence of this by now globally widespread and deeply rooted zero interest rate policy is that even highly and increasingly indebted countries have been able to avoid bankruptcy. A classic example is Japan, a highly developed industrialised nation that has been pursuing a zero-interest rate policy for more than 20 years, which has made a national debt of meanwhile 260% of GDP possible.



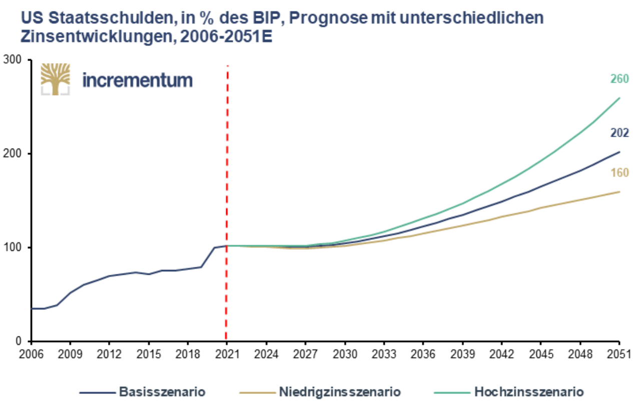
Bank of Japan Interest Rate, Source: Tradingeconomics.com



Japan Government Debt to GDP, Quelle: Tradingeconomics.com

However, at the zero-interest rate bound and with the increasing use of bond purchases by central banks, the efficiency of monetary policy in steering economic activity has clearly diminished. Disappointing economic growth and increased wealth inequality have therefore led to growing demands for higher government spending. According to concepts such as *Modern Monetary Theory* (MMT), these should be financed by the printing press. Contrary to all historical evidence, proponents of these "modern" economic policy approaches believe that such essentially central bank-funded deficit spending can be achieved without the emergence of inflationary tendencies. – Kind of like wanting to have your cake and eat it, too...

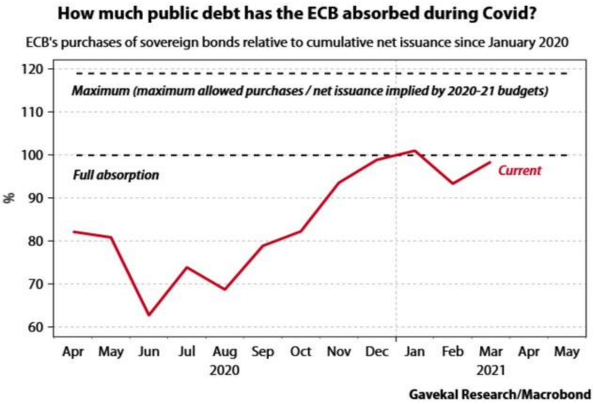
Until 2019, the overall broad resistance to such debt-financed fiscal spending policies, which – and this is in the nature of such things – go hand in hand with increased state intervention in the economy and the lives of citizens, was still rather formidable. However, it was decisively broken in 2020, when the fight against the Covid-19 pandemic justified even the most drastic government interventions and support measures.



5) Quelle: CBO, Incrementum AG

For the USA, the effect can be seen in the chart above, which shows the significant jump in government debt in relation to gross domestic product. Since then, government spending programmes are no longer measured in billions, but in trillions... – Incidentally, the forecasts of further government debt dynamics shown above come from the Congressional Budget Office (CBO), an arm of the US Treasury Department. Even such politically coloured forecasts suggest a net new debt of USD 3 trillion in 2021, which corresponds to more than 13% of US economic output (and follows hard on the heels of last year's 15% debt-to-GDP growth).

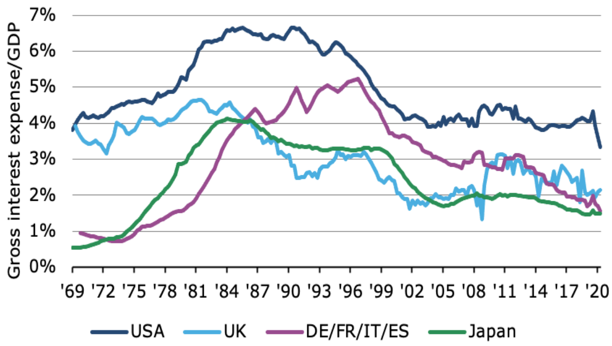
And not surprisingly, the situation in Europe is similar...



Source: Adam Tooze, @adam_tooze, Twitter, 13JUN2021

There, between January 2020 and March 2021, a net 1.3 trillion in new government bonds were issued to finance the pandemic response. Over the same period, and as the chart on the left shows, the European Central Bank (ECB) made net purchases of government bonds amounting to 98.5% of this amount, thus effectively shouldering almost the entire financing. – One might ask why we did not come up with this idea earlier?

This last phase in the debt cycle, which has now been accelerating for decades, has only lasted so long because central banks (which still like to call themselves independent) through their monetary policy have manipulated the most important price of an economy to zero. The persistent decline in interest rates has meant that steadily rising absolute debt levels effectively cost less.



Source: Klement on Investing, 28APR2021

This is great news for government budgets, but it has also had the side effects described above, namely that private indebtedness has been increasing more and more, and thus the probability that these debts can be repaid at some point has decreased further. And even if the timing cannot be exactly predicted, the direction of development is, in our view, without alternative! There are countless empirical studies on how sovereign countries deal with over-indebtedness. This is the case when the state has persistent structural deficits, i.e., its revenues are systematically lower than its expenditures, even at full employment.

Such over-indebtedness of the state is ultimately resolved either through bankruptcy and related debt write-offs or by inflation. A debt write-off is disruptive and favours the debtor over the creditor. When Greece undertook a partial "debt restructuring" in March 2012, the private sector was pressured into a partial debt waiver: 100 euros in a Greek bond had paid attractive interest, but after all was said and done investors ended up with a new basket of Greek bonds that in total were only worth about 50 euros, paid much less interest and had much longer maturities. Creditors lost what the debtor gained (lower debt as well as interest rates). Anyone who recalls how difficult it was to get this restructuring off the ground will probably agree that this is almost unthinkable, e.g., on a pan-European basis.

And this is exactly the reason why in the majority of cases government over-indebtedness is cleared by inflation. Inflation causes nominal growth (and thus tax revenues) to rise more strongly without this being accompanied by a real (as in inflation-adjusted) increase in these macro variables. It is thus a hidden form of tax that lowers the real debt burden of the state and thus helps to avoid insolvencies and write-offs on a large scale. The cost are borne by the private sector, especially the saver, through diminished purchasing power.

Source: Hedgeye

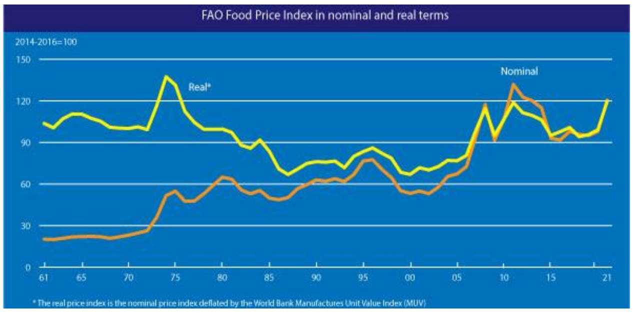
Inflation – Merely A Transitory Phenomenon?

It is undisputed that inflation has become an issue again in 2021, and the adjacent chart speaks a clear language in this regard. However, central bankers consider these developments to be temporary and mainly attributable to the so-called base effects, as prices today compare with those of a year ago, which in many areas, especially energy, were quite depressed by the first Covid wave and its consequences.

Quelle: Financial Times, 16JUL2021

I don't want to go into too much detail here, as this is a complex argument, but present inflationary tendencies are, in my view, driven by two main factors: One is developing cost pressure (cost-push) from the commodity side (energy, but also metals to agricultural commodities), coupled with covid-related disruptions in global supply chains, which translate into significantly increased transport and logistic costs as well as component shortages.

The energy sector, for example, has been reducing its investment budgets for years, i.e., the substitution of produced quantities by the development of new reserves (reserve replacement) has been cut back more and more, so that the supply potential threatens to fall behind potential demand growth. With the high weighting of energy prices in the measurement of the general price level, inflation-dampening effects thus are in our view an unlikely occurrence in the near- to mid-term future.

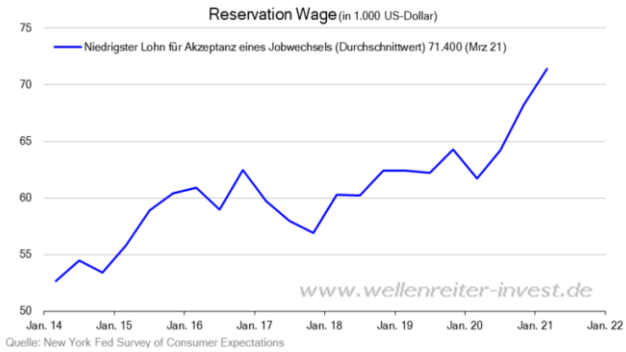


Source: FAO Food Price Index, until June 2021

Another important and highly visible factor is the rise in global food prices, which boosts inflationary pressures especially in emerging and developing countries. However, this also plays a role in advanced economies, as rising food cost mainly and disproportionately affect low-income households.

Together with growing political pressure aiming at a reduction of the widened wealth gap, this may well sow the seeds for increased wage demands and resulting additional cost pressures. After all, inflation is nowhere as obvious as in the buying of groceries and daily necessities, which thus has a special influence on all-important inflation expectations.

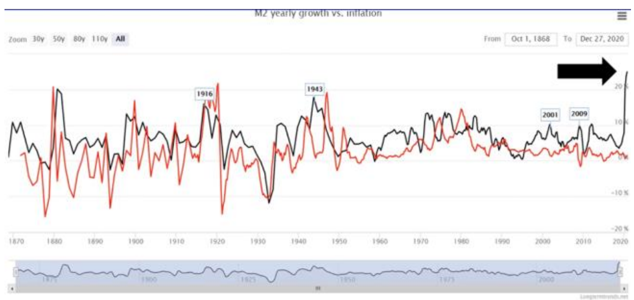
Indications of rising wage cost pressures are provided, for example, by the chart on the right. This summarises the results of regular consumer surveys by the New York Fed regarding the expected minimum wage that might induce a possible job change. The recent rise in wage expectations is clearly discernible and is also reflected in corresponding statements from the business sector.



Source: Der Wellenreiter, 21JUL2021

The second inflation-driver is overall demand for goods and services. Here, additional price pressure has also emerged due to pandemic-related increases in government spending as well as the reopening boom after the relaxation of Covid containment measures (keyword catch-up effects). However, demand growth must be expected to slow down in the second half of the year due to the gradual phasing out of fiscal support measures, which is one of the main arguments for a merely temporary rise in inflation. A potential third Covid wave and renewed lockdowns and containment measures could have a further dampening effect with regards to overall demand.

The quote *"Inflation is always and everywhere a monetary phenomenon"* originates from Nobel laureate Milton Friedman, and points to the importance of an expansion of the money supply as driver for inflation. If that still bears any weight, then the chart on the right plotting US M2 growth vs inflation speaks louder than any words.

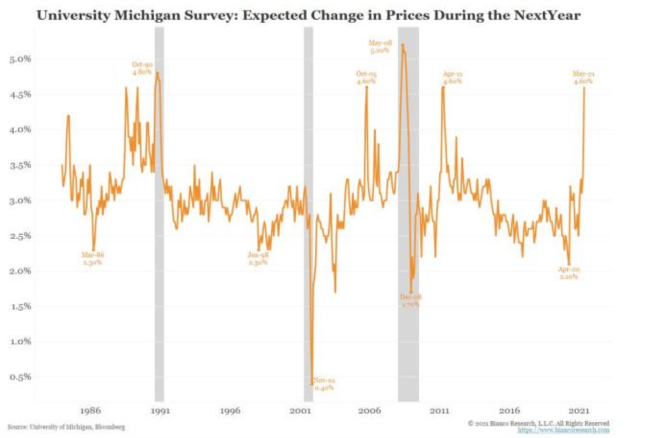


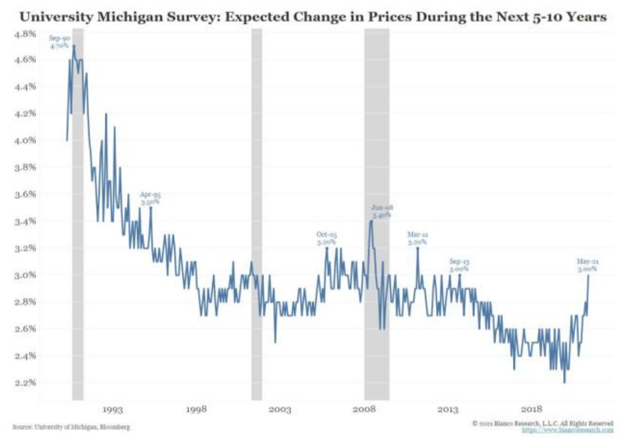
Source: Global Independence C, Presentation Snapshot, 25JUL2021

But conventional understanding of inflation may be too narrow, anyway, as it is limited to prices of goods and services. After all, the past credit boom has triggered an increase in asset prices, which resulted in both real estate and general asset price inflation.

A sustained increase in goods and services prices, in turn, is strongly determined by inflation expectations of private households and companies. On the household side, in addition to rising prices in supermarkets and at petrol stations, expectations are shaped by rising rents, which are tracking rising property prices. This is another area, where private households, which in the past were only marginally affected by asset bubbles, are now clearly feeling the loss of purchasing power. This in turn fans rising inflation expectations and thus higher wage and salary demands, which are an essential factor for sustained inflation dynamics.

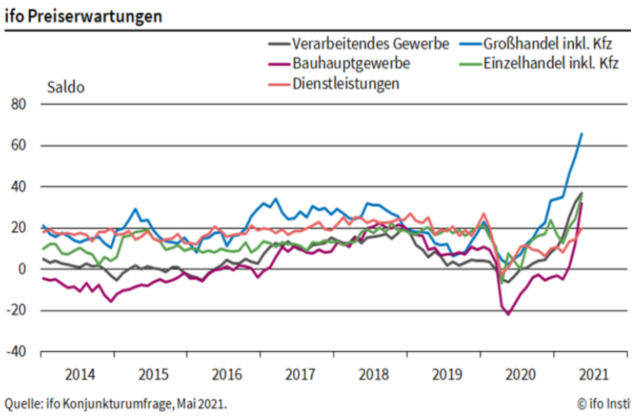
Consequently, household expectations of changing prices have been picking up, as the University of Michigan survey results below show:



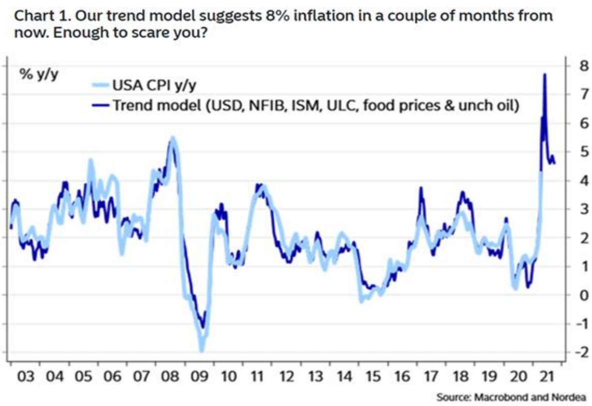


Source: Jim Bianco, @biancoresearch, [Twitter](), 30MAY2021

The corporate sector is similarly responding with rising inflation expectations.



Source: Der Wellenreiter, 4JUN2021



Source: A 3bps inflation scare! WOW, JUST WOW!, Nordea, 14MAY2021

In the US, some observers expect consumer price increases of 8% over the course of the year (see chart above on the right). Even though this is likely to prove a short-term exaggeration, all signs point to higher inflation levels in the long term than those we have become used to over the past decades.

Proponents of a persistently low inflation environment counter this with the observation that long-term interest rates have recently fallen back sharply after a 1Q rise and deduce that investors have a keen sense of a coming economic slowdown which may lead to a renewed collapse in reported inflation and inflation expectations.

Financial Markets – Recklessness or prudent foresight?

Before we continue, allow me to get this out of the way:

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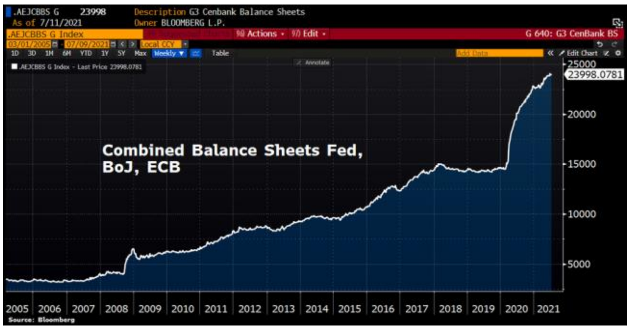
The recent decline in long-term interest rates on 10- or even 30-year bonds is indeed remarkable. US 10-year government bonds rose over the course of the year from 0.92% to 1.78% in March, before first gradually and most recently dropping with an accelerated pace to a July low of 1.04%, confirming many market participants in their view that the rise in inflation is only short-term in nature.

I think this is a reckless interpretation. For one thing, this movement was nowhere as pronounced as in the US. In Germany, for example, 10-year Bund yields only rose from -0.57% to -0.07% in May before sliding back to -0.4% recently.

On the other hand, bond markets are the catchment basin of the central banks' gigantic bond purchases, whose stated purpose is to manipulate long-term interest rates towards zero. In other words, without these price- and yield-insensitive QE purchases, long-term interest rates would have long since been at a much higher level.



Source: Holger Zschaepitz, @Schuldensuehner, Twitter, 11JUL2021

How high? – Well, a private investor seeking to secure a low-risk source of long-term income by buying government bonds would at least want to preserve his purchasing power over the life of the bond. Historically, long-term bond yields have averaged about 2% above expected inflation, a spread that can be seen as a risk buffer for the increased price volatility and uncertainty caused by the long duration of these bonds. Even if the presently rising inflation momentum reversed and inflation rates settled around 2% in the long run, this would mean (nominal) yields in the range of about 4% (positive!), and this only for the financially strongest countries. Several Eurozone countries, but also Japan, would probably be classified as insolvent at such or even more elevated interest rates....

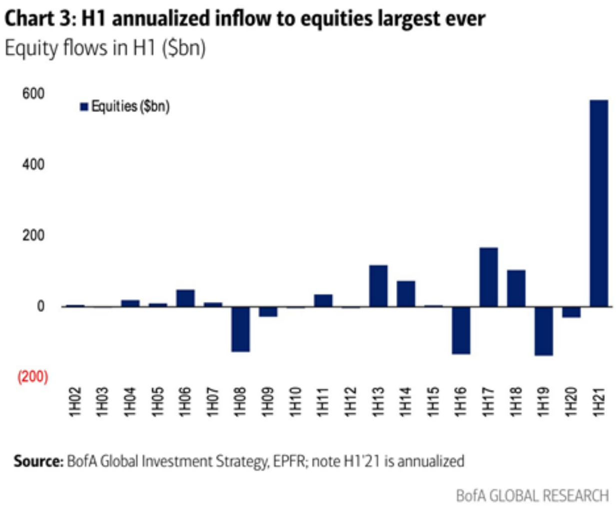
If you doubt the argument (which by the way was also convincingly made by Robert Armstrong in his "Unhedged" column in the FT on 28JUL2021), you may want to ask yourself whether you hold your savings in government bonds of your country, and if not, why not? – In my opinion, no freely and rationally acting investor will accept the guaranteed loss of purchasing power that comes with holding long-term sovereign bonds to maturity at current yields, especially considering interim price risks. Apart from central banks, only institutional investors remain active in sovereign bond markets, led by banks, insurance companies and pension funds, which are often obliged by regulatory requirements to invest in sovereign bonds. Consequently, I see technical and market structural reasons as being responsible for the recent decline in yields and expect the interest rate trend to turn around again in the second half of the year.

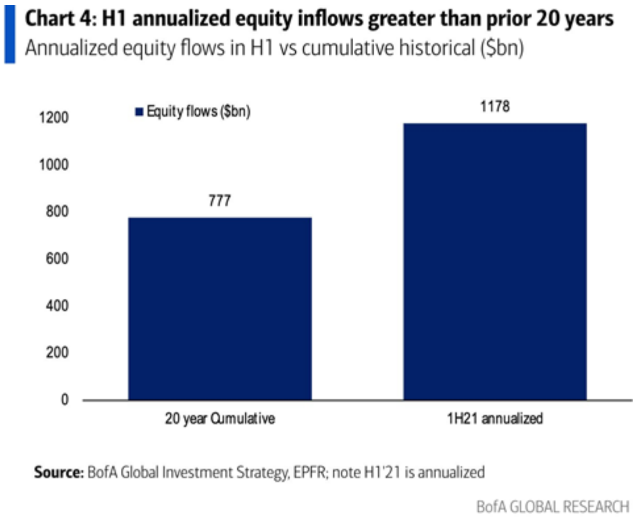
In general, the first half of the year was one of the craziest I have ever experienced in financial markets. Concerning bond markets, it is also worth mentioning that yield spreads for corporate and high-risk bonds have dropped to record low levels again. One could get the impression that investors have thrown all considerations of credit risk overboard and that it is now only the yield that matters. This would not be surprising, considering that they were repeatedly saved from major write-downs in the past by central bank interventions.

At the same time, more and more capital has been pushing into shares and other risky investments. In the first half of the year in particular – and especially in the first quarter – stock markets set new standards for speculative excesses, about most of which I reported in my February SR No. 1.

The IPO boom, SPACs (Special Purpose Acquisition Companies, i.e. listed companies that have raised capital to merge with privately held companies, which benefit from reduced disclosures), "meme stocks" (shares hyped up in social media channels), but also excesses in the field of cryptocurrencies, NFTs, or the success of the "free trading" app Robinhood prove that retail investors have become massively involved.

As is so often the case, speculation is most prominent in the USA, and as always it drags the rest of the world along with it. Experts at BoA / EPFR have calculated that global equity funds recorded inflows of USD 580 billion in the first half of the year. This not only dwarfed all prior 1H inflows, but on an annualized basis even the accumulated inflows of the past 20 years…



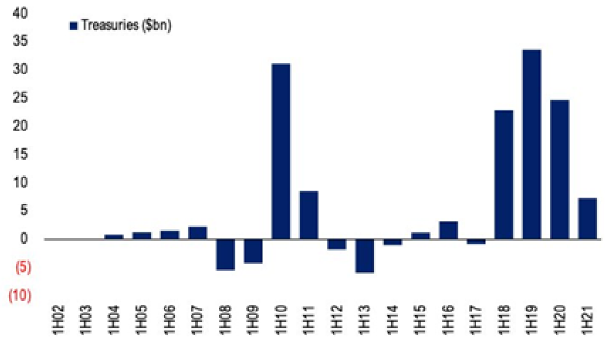


Source: Financial Times, 5JUL2021

The reason? Low / non-existent interest rates, best illustrated by a total of USD 12 trillion in (nominally, i.e., before inflation) negative-yielding bonds. This makes equity investments appear to be the only remaining alternative - at least among liquid financial assets. The boom in private equity / private credit, as well as in real estate or art prices, shows that investors are also looking for alternatives in less liquid markets. However, since we are dealing with financial markets here, I would like to refer you to the following charts:

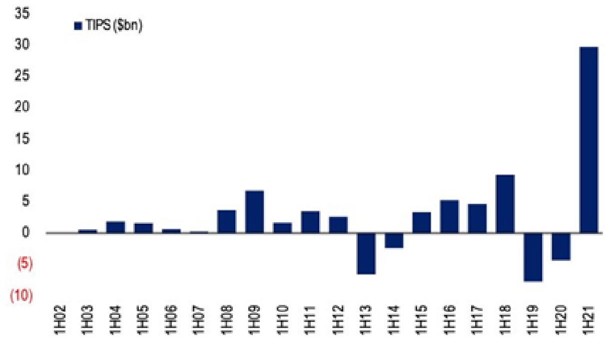
The first pair at the top of the next page shows inflows into US government bonds (falling) and US inflation-linked bonds (TIPS, record inflow). Our concern that we are in an inflationary phase is thus obviously shared by bond investors.

Chart 5: H1 annualized inflow to Treasuries falls to recent lows
Treasuries flows in H1 ($bn)



Source: BofA Global Investment Strategy, EPFR; note H1'21 is annualized
BofA GLOBAL RESEARCH

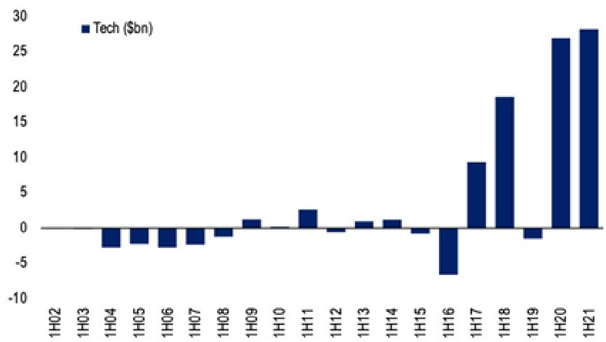
Chart 6: H1 annualized TIPS inflows greater than prior 20 years
TIPS flows in H1 ($bn)



Source: BofA Global Investment Strategy, EPFR; note H1'21 is annualized
BofA GLOBAL RESEARCH

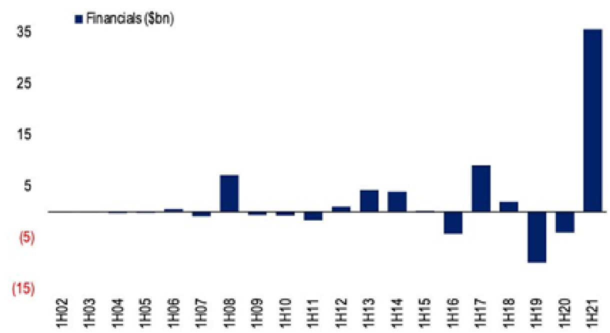
On the equity side, it is not surprising that the largest inflows were in the technology sector (already THE magnet for new investments since 2017), as well as in the financial sector (especially in Q1 due to a steeper yield curve).

Chart 7: H1 annualized inflow to tech largest ever
Tech flows in H1 ($bn)



Source: BofA Global Investment Strategy, EPFR; note H1'21 is annualized
BofA GLOBAL RESEARCH

Chart 8: H1 annualized financials inflows greater than prior 20 years
Financials flows in H1 ($bn)

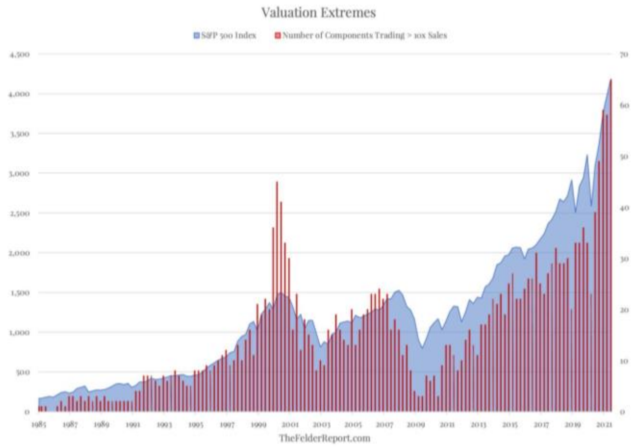


Source: BofA Global Investment Strategy, EPFR; note H1'21 is annualized
BofA GLOBAL RESEARCH

Quelle: Robin Wigglesworth, @RobinWigg, Twitter, 2JUL2021

Please keep in mind, though, that inflows into the market do not actually take place. Every purchase of a share on the secondary market is always matched by a seller, i.e., the buyer pays the share price for the purchase of a share at which the seller sells the same share, for which he receives the buyer's money in return. The price development on the market is thus primarily determined by the willingness of investors to pay ever higher prices in a bull market or to accept lower prices in a bear market. And even if the supply of shares changes, e.g., through IPOs or share buybacks by companies, it is essentially investors' risk appetite that ultimately determines price formation in the market, which in turn is influenced by investment alternatives / opportunity cost. Perhaps, this helps illustrating how the price-insensitive buying by central banks spills over and causes broad asset price inflation.

This resulting inflation in the stock market is best shown by the development of general / widely used fundamental valuation ratios. The usual candidates are, for example, the price-to-earnings (PE) ratio, or also price-to-book (PB) ratio. Here, it is particularly noteworthy that more than 60 companies in the S&P 500 now have a market capitalisation of more than 10 times annual sales, a number that was not reached even during the technology bubble at the turn of the century.



Source: Greg, @GS_CapSF, Twitter, 13MAY2021

It was this particular level of valuation excess that former Sun Microsystems CEO Scott McNealy referred to in a famous Bloomberg interview in March 2002 when, referring to his company's stock having been valued at 10 times sales at the height of the tech bubble in 2000, he quipped: *"At 10 times revenues, to give you a 10-year payback, I have to pay you 100% of revenues for 10 straight years in dividends.*

Source: Wikipedia

That assumes I can get that by my shareholders. That assumes I have zero cost of goods sold, which is very hard for a computer company. That assumes zero expenses, which is really hard with 39,000 employees. That assumes I pay no taxes, which is very hard. And that assumes you pay no taxes on your dividends, which is kind of illegal. And that assumes with zero R&D for the next 10 years, I can maintain the current revenue run rate.

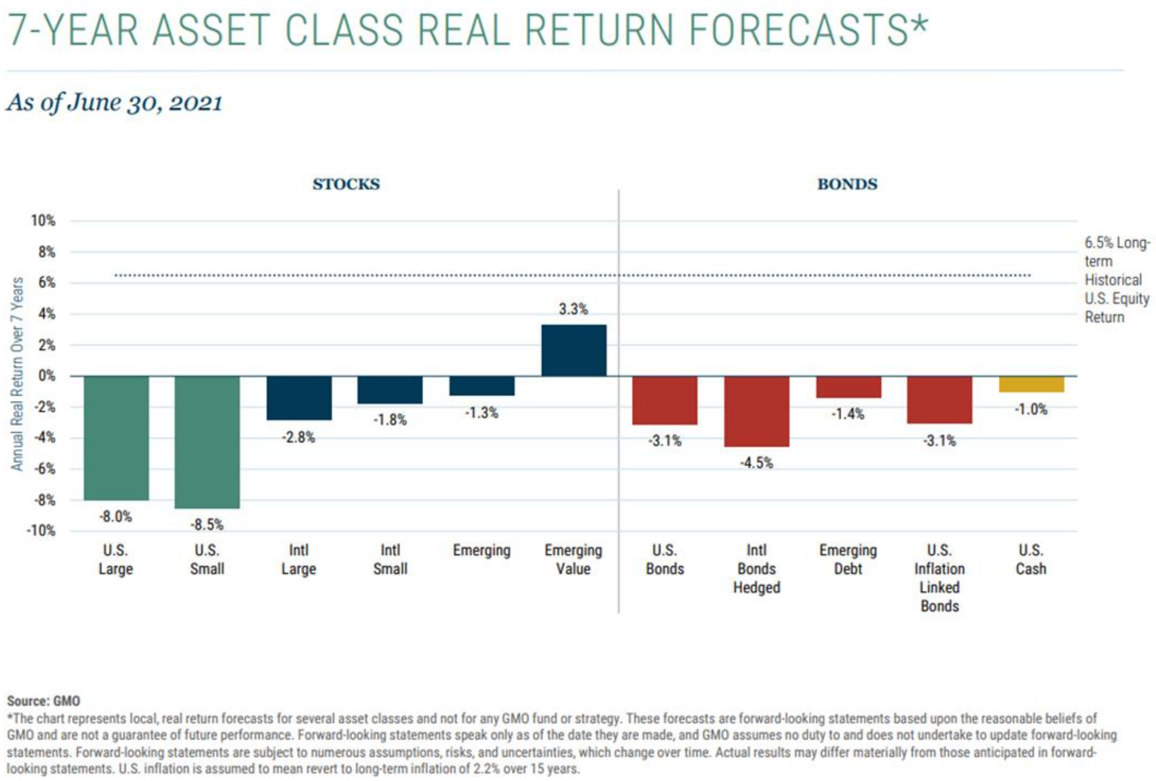
Source: The Felder Report, 26OCT2017

Now, having done that, would any of you like to buy my stock at $64? Do you realize how ridiculous those basic assumptions are? You don't need any transparency. You don't need any footnotes. What were you thinking?»

With more than 30 years of investment experience, the tech bubble and its bursting provided some of the most formative experiences of my professional career, and I recall only too well how detached from any fundamentals investors had become at the time. The chart at the top of this page suggests that history rhymes, and today's generation of investors is repeating the same mistake of completely ignoring fundamental data and context. – Will it end differently?

Just like at the turn of the century, current valuation levels indicate that investors are not interested in corporate profits or dividends. In my opinion, this is the direct result of the zero-interest rate policy of the last decade. Investors are by now used to the fact that their "investments" no longer yield regular returns. And so, the most far-fetched growth prospects are rewarded with ever higher prices. But this ignores a fundamental investment insight. <u>When I buy an asset / ownership stake in a company and thus its future expected cash flows and liquidation value, my return ultimately depends on the price paid.</u>

Based on fundamental market assessments and assuming that the US inflation rate settles at 2.2% over the long term, Boston-based investment manager GMO publishes the following estimate of annual returns for individual asset classes over the next 7 years:



Quelle: GMO

Dear readers, your eyes do not deceive you: Based on the prevailing fundamental valuations, GMO analysts expect e.g. large-cap stocks in the USA to achieve ANNUALISED LOSSES of 8% over the next 7 years. This is also relevant in the context of the IASF's portfolio positioning. More on this later.

However, this runs contrary to investors' expectations. According to a recent global survey by Natixis, investors expect an average long-term 14.5% return above inflation. Even investment professionals, albeit more moderate in their expectations, assume long-term real returns of 5.3% p.a. Against a backdrop of record low and negative real interest rates on fixed-income investments, and e.g. according to Investopedia a historic nominal S&P 500 return of around 8% p.a. since 1957 (when the index was increased to 500 securities), these expectations appear to be completely unrealistic.

All Seasons Investing – How Do We Manage Our Investors' Funds?

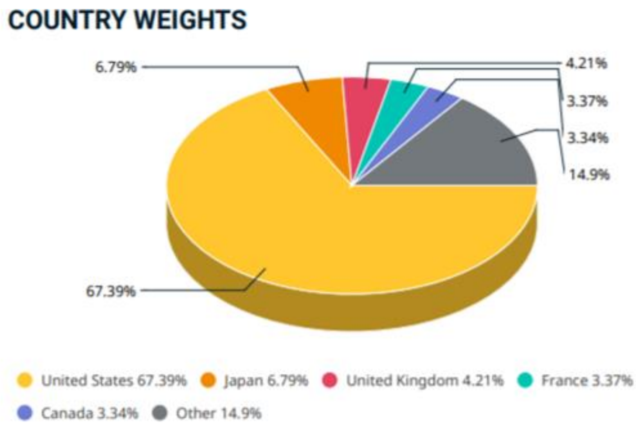
This subject is mainly for the benefit of new readers (also of the German version) but will hopefully also serve as a useful update for existing investors and readers, as it provides a solid basis for understanding our investment approach in the environment highlighted above.

On the **Incrementum** homepage we describe the fund management mandate as follows: ***IASF pursues a holistic, global investment strategy, which covers all major asset classes, and flexibly manages its underlying portfolio assets in line with the prevailing financial market season****. As fund managers we pursue a theme- and value-orientated, rather than an index- and momentum-based investment approach, which is why we do not use benchmarks in our portfolio management process. For our investors we provide full transparency, both about our strategic and tactical portfolio positioning, as well as overall developments in broad socio-economic and political terms that may influence our allocation decisions.* ***Our goal is to achieve real, i.e., inflation-adjusted growth in the value of invested assets,*** *and we have committed our own capital into the fund to emphasize our alignment of interest with investors.*

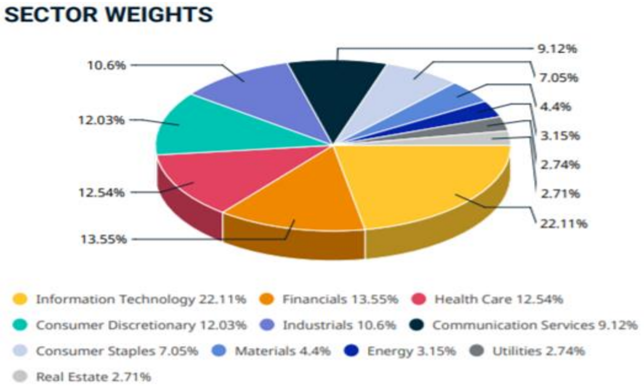
But how do we deal with this in practice? - Well, the macroeconomic background described on the first pages leads us to conclude that in 2021 bonds are virtually un-investable and equities historically expensive, while most international currencies are being systematically debased.

For financial investors like us, this means that there is indeed no alternative to an investment mix of equities and cash/liquidity.

As already reported, from a global perspective and on an index basis (i.e., on average), US equities are by far the most expensive. At the same time, according to MSCI they represent more than two-thirds of global market capitalization.



Source: MSCI World Index Factsheet, June 2021



TOP 10 CONSTITUENTS

	Float Adj Mkt Cap (USD Billions)	Index Wt. (%)	Sector
APPLE	2,299.30	3.97	Info Tech
MICROSOFT CORP	1,941.03	3.35	Info Tech
AMAZON.COM	1,472.49	2.54	Cons Discr
FACEBOOK A	836.40	1.44	Comm Srvcs
ALPHABET C	738.87	1.28	Comm Srvcs
ALPHABET A	734.34	1.27	Comm Srvcs
TESLA	521.93	0.90	Cons Discr
NVIDIA	495.26	0.86	Info Tech
JPMORGAN CHASE & CO	474.63	0.82	Financials
JOHNSON & JOHNSON	433.05	0.75	Health Care
Total	9,947.29	17.18	

Quelle (alle): MSCI World Index Factsheet, June 2021

Unsurprisingly under these circumstances, the list of the world's 10 largest-capitalized stocks is made up entirely of U.S. equities, and the top 8 are all in the technology sector, which accounts for nearly a quarter of the world's total equity weight. This is what makes investing in today's environment so challenging: not being invested in (US) Tech has been a huge handicap when trying to achieve even index performance, which in turn has caused many active fund managers to go out of business in recent years.

This brings me to another important point. Global equity markets are now dominated by passive investing. In other words, there is no longer an active investment process, in which stocks that offer the best potential are selected. Instead, investors put their money into investment vehicles, that simply and cheaply replicate stock indices. These can be country indices such as the S&P 500 or the DAX, or sector-index vehicles that track, e.g., an index of pharmaceutical stocks, or theme indices such as particularly innovative companies. The vehicle used is predominantly the ETF (Exchange Traded Fund), i.e., a collective investment vehicle (= fund), which invests all cash flows proportionally to the underlying index. – How this works and how easy and profitable it is, shows the result of my web search engine…

What is passive investing?

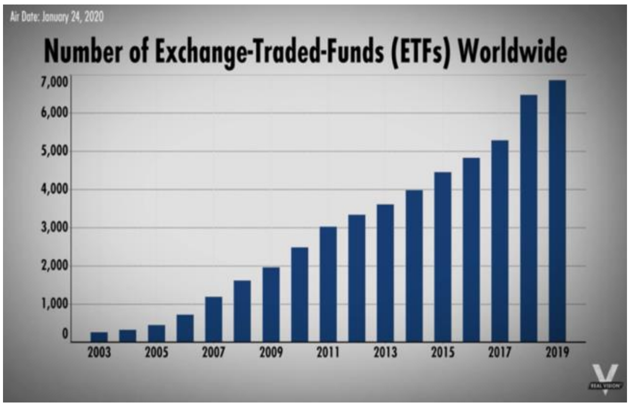
Simply put, passive investing means deploying capital prudently and over the long term on the stock markets. Investors who pursue this strategy hold on to their securities even during stock market crashes or peaks. They do not try to read the prices and make additional profit through speculation. The return they get is what the market gives and how it performs. However, it is imperative to invest in numerous stocks in a broadly diversified manner, as this is the only method that can reflect the market.

Experts speak of active investing when investors not only buy shares, funds, or ETFs, but also closely observe the price trend and check key figures. They select individual stocks that they believe will perform excellently. If the growth curve slows down, they take profits; if the price collapses, they limit losses. Active investors therefore know the financial market inside out and buy or sell regularly in order to generate a better return if possible.

Source: Commerzbank.de (Text on the left translated by Deepl)

I do not want to dwell too much on the pros and cons of these two approaches here, not least because we obviously see ourselves as active investors, but merely point out that the vast majority of all portfolio investments today are quasi-passive. This is done not only through direct index investments, but also through the many "active" investment vehicles that permit only very small deviations from their so-called benchmark (i.e., the reference index that is supposed to make a comparison with one's own investment performance possible) and are thus disguised index-trackers.

The phenomenal growth of passive and quasi-passive investment vehicles worldwide has led to an increasing and unhealthy concentration in equity markets. This is primarily due to the growing size of many ETFs. In order to be able to handle potentially huge fund in- and outflows with the required proportionality to the index, the trading liquidity of the underlying investment universe is of critical importance.



Source: RVTV Interview with Steve Bregman, 24JAN2020

This means that only the largest and most liquid shares can be included in the respective investment universe. This is not only unhealthy from an investment point of view since, share valuations no longer play a role in passive investing. But it is equally unhealthy from an economic point of view, as investors money is predominantly flowing to a shrinking number of companies whose cost of capital is thus becoming more and more attractive compared to their smaller competitors, who are not or far less represented in passive vehicles. If you would like to learn more about this topic, I highly recommend the Real Vision TV interview with Steve Bregman linked below the chart above.

This in turn opens up the opportunity for **IASF**'s long-term mandate to achieve extraordinary returns in equities that are little or not at all represented in passive vehicles, or to focus on allocations that deviate significantly from major indices. The selection of investment themes is always based on our macroeconomic analysis and the assessment of future macroeconomic developments. For example, our investment in shipping stocks, based on the expectation of a cyclical / reopening boom, but also due to their inflation-sensitive nature, proved to be a driver of this year's fund performance.

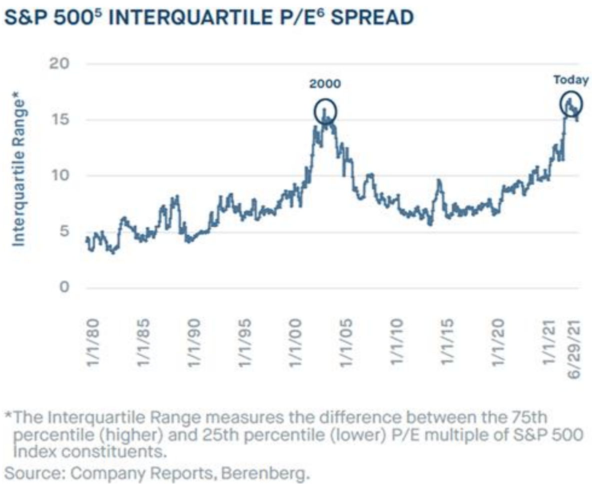
Passive investing is also always associated with a long-term buy & hold approach, which in our view is the direct result of a decades-long equity boom, in which every correction, no matter how sharp, turned out to be an attractive opportunity to reinvest. A NZZ commentary from July 25 on this topic therefore concluded with this advice: *"If you pursue a long-term investment strategy, the right time to invest in equities is always the same: now."* - I personally consider this hazardous advice.

Historically, the best time to invest in equities has not always been “now”. The Dow Jones Industrial Index, for example, needed 30 years to surpass its 1966 nominal high (the post-1966 bear market alone lasted more than 16 years) and the Japanese Nikkei 225 has not yet reached its 1990 all-time high (the post-1990 bear market lasted almost 2 decades). Even for long-term investors these are periods that are too hard to hold through.

Dow Jones Industrial Index, Source: macrotrends.net

Nikkei 225 Index, Source: macrotrends.net

With this in mind, we see ourselves as profoundly active investors who position themselves flexibly in line with market cycles and are guided by fundamental data and valuation ratios when selecting individual investments. We are not afraid to actively manage IASF’s portfolio, be it by trading top positions (keyword: rebalancing) or by using derivatives (keyword: selling options).



Source: Third Avenue Value Fund, 21Q2-Quarterly Letter

Particular opportunities currently arise from the fact that the average view of broad equity indices hides an unusual valuation dispersion. As the chart for the S&P 500 shows, the only time the most expensive relative to the cheapest segment of the market has been similarly overpriced in the past 40 years was during the TMT bubble. The most expensive quarter of the market is thus 15 times more expensive than the cheapest quarter on a price-to-earnings (P/E) basis, creating opportunities for value-oriented investors.

This opens up attractive equity investment opportunities for **IASF** as long-term investor, despite markets that are expensive on average. In this process, we do not rely solely on our own analysis when selecting stocks but have subscribed to a number of research services that help us achieve the fundamental transparency necessary for a solid investment case.

Another important aspect for a global investment portfolio is management of its currency risk. Exchange rate fluctuations have not been very pronounced in recent years, mainly due to the fact that all major central banks are pursuing similar (zero interest rate and QE) policies. Due to growing monetary expansion and the expected long-term increase in inflation, we hold a not insignificant part of the fund's liquidity in precious metals-linked investments. We also have small positions in liquid trend-following and quant funds, from which we expect positive long-term returns as well as an additional diversification effect for the overall portfolio.

In principle, we consider all asset classes for investment, but are relatively limited in commodities due to the restrictions on UCITS funds. Here we can only take positions indirectly via shares or certificates.

All in all, an investment in the **IASF** is suitable for long-term investors who are looking for an active, fundamentally oriented "all seasons" investment approach, with the aim of achieving an increase in the purchasing power of the invested funds through benchmark-independent and flexible management over the course of the market cycle. If you have any further questions, please do not hesitate to contact me at any time.

Incrementum All Seasons Fund – 2021 Half Year Review

So how did our investment management approach perform in the first half of the year? (The corresponding fund management commentary concerning monthly developments can be found in the respective **IASF** factsheets). - The results are summarised as usual in the following table:

	USD-D	EUR-D	EUR-P	CHF-D
latest NAV:	**130.73**	**126.59**	**124.13**	**124.81**
June Result (%):	0.51%	0.43%	0.40%	0.38%
Year-To-Date 2021 (%):	**23.56%**	**22.39%**	**22.19%**	**22.33%**
Since Launch p.a.:	13.95%	12.18%	11.40%	13.19%

As the overview on the previous page shows, the first half of the year delivered a very good result. Note here that due to its weekly valuation schedule on each Thursday, or the next workday if it was a public holiday, the last effective valuation day was June 24. The basis for this was already laid in the first quarter, which stood out with an NAV increase of approx. 15%, while the 2nd quarter was also very satisfactory with an increase of more than 6%.

Economically, the world experienced a strong growth spurt during the reporting period, driven on one hand by a growing number of covid vaccinations and the related gradual reopening of the economy, and on the other hand by the continued enormous fiscal stimulus in the form of transfers, tax relief or credit guarantees. Not surprisingly, this led to increasingly rising inflation figures over the course of the year. These were driven to unexpected heights not only by very strong aggregate demand, but also by the supply side (e.g., shortages of semiconductors, rising commodity prices and logistics costs) and, as described above, there are indications that these inflationary tendencies will not prove to be merely transitory.

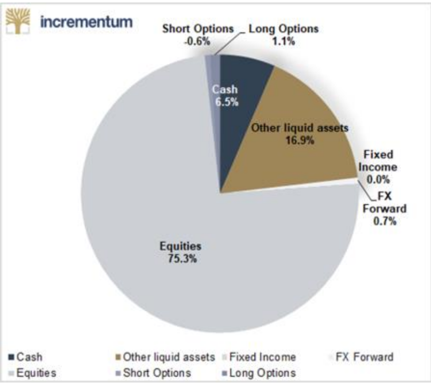
In financial markets, bond markets experienced a relative roller-coaster with a rise in long-term yields over the first four months, and a subsequent fall since. Global equity markets, meanwhile, enjoyed massive inflows, especially from the retail sector, with US markets clearly leading the way due to their size and importance. Speculative excesses were rife: The Reddit-driven boom in so-called meme stocks, speculation in SPACs (Special Purpose Acquisition Companies), the ups and downs in cryptocurrencies and the phenomenon of NFTs (Non-Fungible Tokens) set new standards in this regard. Over the course of the first half of the year, broad stock markets as well as their valuations consequently reached new highs, while it must be noted that the discrepancy between leading US stocks and stocks in Europe, Japan or Emerging Markets remains extraordinarily large.

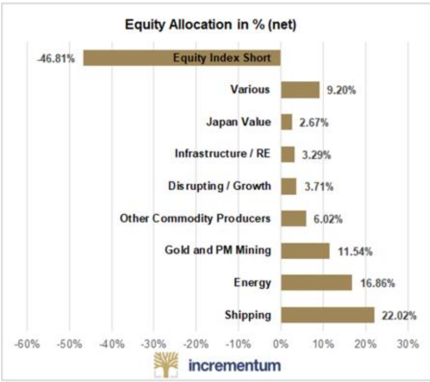
Against this background, **IASF** proved to be favourably positioned. A roughly 75% equity allocation had its thematic focus in the areas of *Shipping*, *Energy*, and *Gold and Precious Metal Producers*, which together accounted for about 45% of portfolio allocation. The first two investment themes delivered exceptionally good results, while the latter made a decidedly negative contribution. However, for us as long-term investors the most relevant observation is that fundamental valuations remain attractive, and the outlook for all three sectors is still decidedly positive. In addition, the less heavily weighted themes of *Disruptive Technologies / Growth*, but also *Infrastructure / Real Estate*, or *Japan Value* also delivered decent results. Overall, it can be noted that the majority of equity investments has been made in inflation-sensitive stocks. In the shipping sector, for example, our tanker allocation experienced a difficult freight rate environment, but like all other shipping stocks benefited from the significant increase in secondary market prices and thus NAVs.

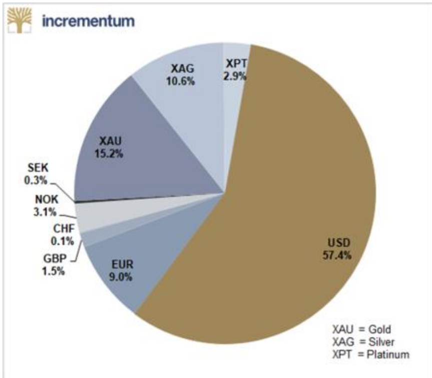
Since we assume a medium to long-term rotation out of long duration / growth stocks into hard asset / value stocks and expect a significant correction potential due to speculative excesses and extreme valuations especially in the leading US stock markets, we have sought to cushion the setback potential anticipated by a broad market correction with an approx. 45% short position in US Nasdaq (approx. 2/3) and S&P 500 (approx. 1/3). However, such a setback has so far failed to occur, which cost us approx. 5% portfolio performance over the reporting period.

Our "vol harvesting" program through the sale of options delivered decent results, contributing approx. 3% to performance in the first half of the year. Foreign currency management also added value, particularly as we unwound our USD hedges by April / May, just in time to benefit from the firmer USD experienced since. Overall, our tactical portfolio positioning for the Incrementum All Seasons Fund has proven to be appropriate for the environment.

The end of June IASF portfolio allocation looks as follows:







Compared to the end of the 1st quarter, our equity allocation increased by approx. 5% gross and 3.5% net (after deduction of the short position) to 28.5%, at the expense of cash / liquidity. There have been only small deviations in the equity theme baskets, all of which were below 2%. On the currency side, the USD has a weighting of 57%, which is more than 32% higher than at the end of Q1 and came at the expense of the EUR allocation. The other currency weights have shifted only marginally.

REMINDER: As author of this newsletter and responsible fund manager of the Incrementum All Seasons Fund, you should consider all views expressed in this report, especially those concerning the fund's investments, as biased and not tailored to the individual needs of my readers. Although I write this commentary with care, it reflects my personal views and opinions, and since everything I do as a fund manager is subject to great uncertainty, you should not rely on its accuracy. Therefore, always consult a licensed investment professional if you seek investment advice! And remember that past performance is no guarantee for future returns and that all investments involve risk, including loss of principal.

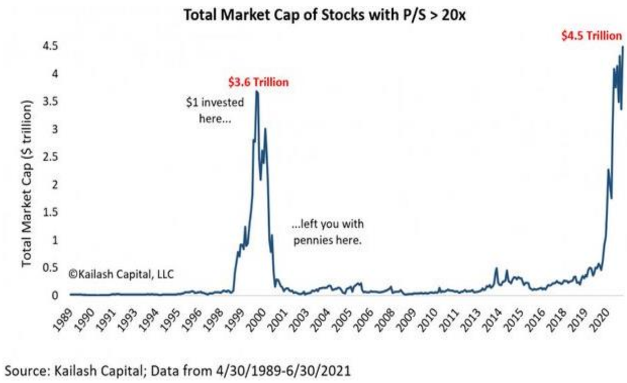
In Closing

Hardly surprising to my existing readers, I have failed again in keeping this **Seasonal Reflections** edition from mushrooming, as it has turned out again to be much longer than I had intended. Whether despite of the length, I was able to arouse readers' interest in capital markets and the workings of the economy, or managed to outline the investing challenges in this day and age, including providing you with some new ideas and valuable viewpoints, I can only leave to your judgement. In any case, I have strived as always to provide an honest and blunt analysis and share it with my readers, as I am convinced that conventional investment approaches will prove less and less viable in the future.

One important point I would like to add here (after the inevitable disclaimers above) is that a large part of my personal savings, together with my investors' money, are invested in the **Incrementum All Seasons Fund**. All investment decisions for the fund are therefore not made with the aim of creating a well-marketed investment product, but solely to grow my personal capital together with that of my investors over the long term.

Those who have been investing with me for a long time know that I have always been very sceptical about the boom of the past years due to its lack of foundations. After all, financial markets have been buoyed by a tsunami of liquidity in recent years, which has caused the associated valuation bubble to grow ever larger.

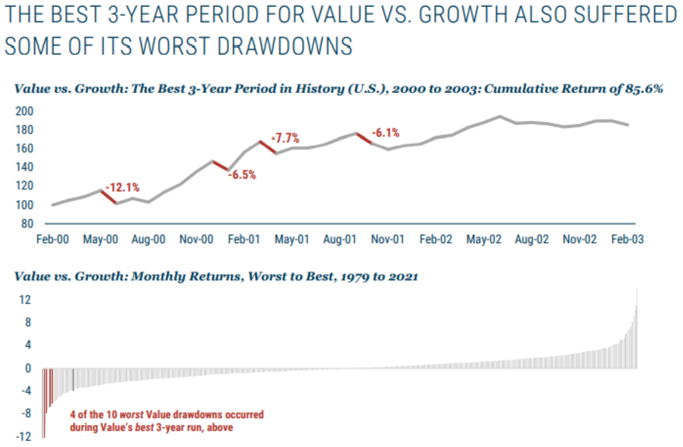
The argument one is often confronted with in such cases is that it is not a bubble when everyone is talking about a bubble. But this also reminds me of the late 90s when I, like many others, warned of the bubble forming in stock markets. And in the end, we were right, and having missed out on the last hurray of the technology, media and telecom bubble were at least partly compensated by strong gains in previously neglected corners of the market.



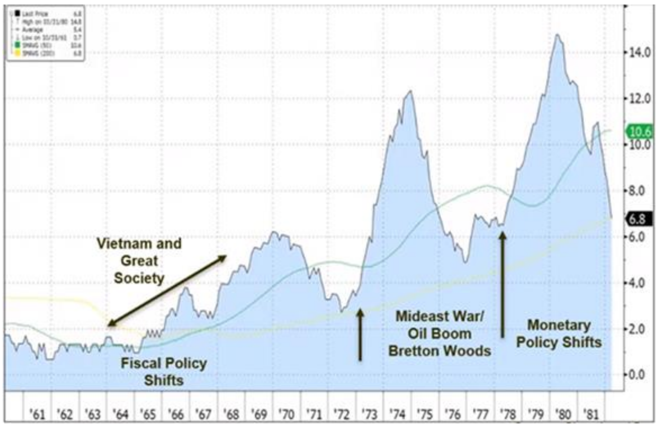
Quelle: Tiho Brkan, @TihoBrkan, Twitter, 24JUL2021

And today? – A growing fraction of active investors, advisors and asset managers only have known the great bull market of the past twenty years. Even the Great Financial Crisis of 2007/08 proved to be quite short-lived. Moreover, politicians and central bankers have constantly reaffirmed their view that they can reliably manage market corrections. But the tools to do so have become ever weaker, and the side effects ever more pronounced. What if "*Whatever It Takes*" is no longer acceptable?

As I write this, **IASF** has just experienced a sharp correction. The reason is an anticipated slowdown in economic growth, and the fact that quantitative models suggest the fall in government bond yields is evidence of the transitory nature of the current rise in inflation. But anyone who follows this line of argument ignores the fact that the once free "interest rate market" is now deliberately manipulated, which is why I simply cannot trust this signal.



Source: GMO Asset Allocation Insights, July 2021



US-Consumer Prices in the 60s and 70s (Source: Bloomberg)

A change in the long-term investment regime or Monetary Climate Change, as we see it at Incrementum AG, does not happen overnight, but is always subject to correction phases in which the old regime gains the upper hand for a short period of time and investors return to the tried and tested. But when I look at the path, e.g., that US consumer prices took in the 1960/70s (chart above on the right), I wonder if this will not be the pattern for the 2020s. And if this is the case, then I think we will see plenty of further return potential and excellent investment opportunities for **IASF** ahead.

As always, I would like to take this opportunity to invite my readers to send me feedback by email and to thank you for your interest as well as my investors for your trust and support.

Best regards from Schaan, Liechtenstein!

Hans G. Schiefen

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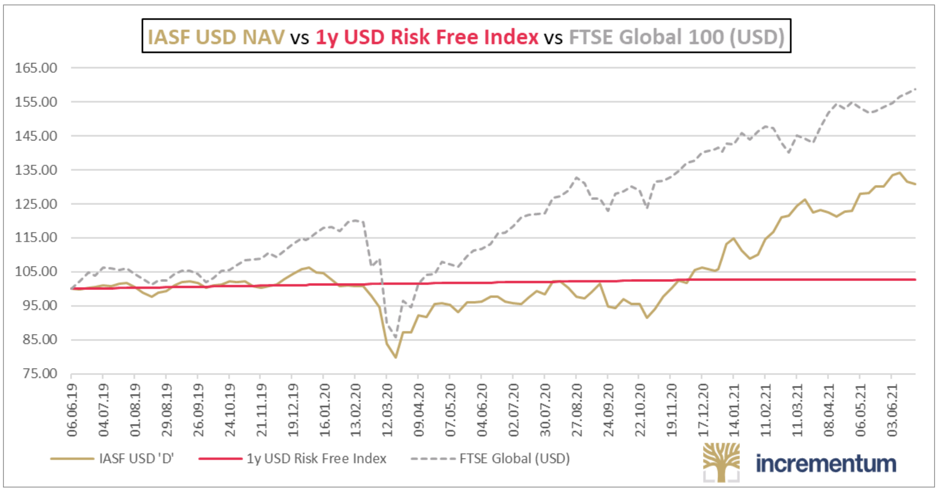
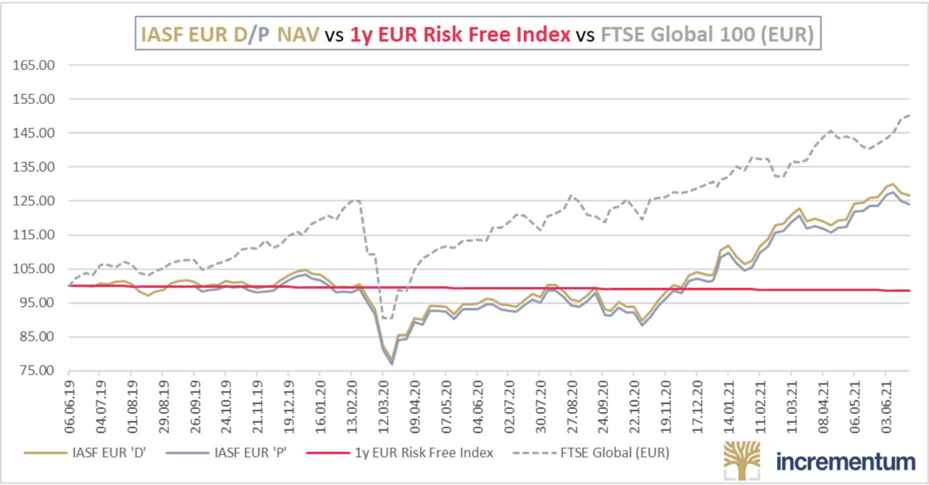
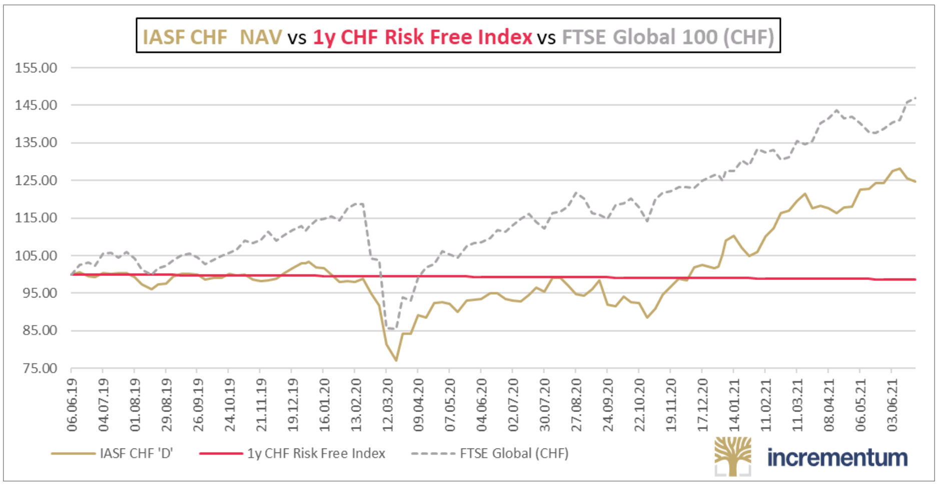
Hans G. Schiefen
Partner & Fund Manager IASF
Incrementum AG
Im alten Riet 102, 9494 Schaan (LI)
Tel.: +423 237 26 67 (o), +41 78 828 1339 (m)
Mail: hgs@incrementum.li
Web: www.incrementum.li & http://ingoldwetrust.li

Appendix *







* Graphs display NAV of IASF performance until last valuation date (**24JUN2021**), compared to the respective risk-free 1y-government yield, as well as the FTSE Global 100 Index in respective currency as a proxy for broad equity market performance from the start of the investment period (6Jun2019 for 'D' shares; 26Sep2019 for EUR-P shares) on an indexed basis.

IASF PM Shaped By 8 Investment Lessons

1. Capital markets, like the economy, are inherently cyclical in nature, and you must always know where you are in the cycle, while not hesitating to "Be fearful when others are greedy and greedy when others are fearful." (Quote: Warren Buffett)
2. Prices paid determine future returns, i.e. the higher valuations are, the lower future return expectations must be (and vice versa), which is the essence of value investing.
3. Capital preservation is the conditio sine qua non, and a consistent and long-term investment strategy is more important than short-term momentum chasing.
4. As a result you must always know when you trade, or when you invest.
5. The most basic and effective risk management tools are proper diversification and the ability to hold cash.
6. Hard assets are preferable to intangibles, distributions to accruals.
7. Look for the incentives: True alignment of interest works in investors' favor.
8. There is no magic formula for successful investing: Consider both macro- and micro-economic issues, be diligent, flexible, patient, keep an open mind, and realize that investing will always remain more of an art rather than a science.

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