Incrementum All Seasons Fund

– in pursuit of real returns –




5 Questions For New Incrementum Partner and IASF Manager Hans G. Schiefen (by Dr. Christian Schärer, Partner Incrementum AG)

Hans, allow me to officially welcome you as the 5th partner at Incrementum AG in Schaan, Liechtenstein. Ever since you joined Incrementum in June last year, you have been busy with the launch of your Incrementum All Seasons Fund project, which has had an excellent start so far, with AuM approaching the USD 50m mark. By way of introduction, can you tell our readers a bit about your background and why you decided to join Incrementum?

Thanks for your kind words, Christian.

I was born and raised in Germany, as the eldest of three sons of a farmer's family. My father had inherited a small dairy farm and together with my late mother worked hard to grow and expand it. As a result, money was a scarce resource in my youth. Therefore, I guess it is hardly surprising that I developed an early passion for investing.

It all started in my late teens, when I first put my then rather modest savings into a couple of Veba shares, which as one of the big utilities in Germany at the time offered not only over 7% dividend yield, but also the additional prospect of capital gains. That felt like I had my money work for me. Naturally, I developed a curiosity about what made stocks move, which got me hooked on the challenge that in my view drives every investor: How to read financial markets and asset prices and profit from it.

In 1989, I founded the first Investment Club in my hometown, which over the following 6 years under my stewardship accrued DEM 60,000 in AuM with a somewhat chequered performance record to boot. As much as the inevitable ups and downs in the value of the club's investment portfolio turned out a source of frustration, it helped me to gain many early insights and an essential degree of humility towards the investment process and its numerous variables. Unsurprisingly, the losses were particularly painful because they were real and affected my own hard-earned savings, as well as those of family and friends who had put their faith in my stewardship of the portfolio. This proved an early lesson about my responsibility as investment manager, and how true alignment of interest sharpens the mind and reigns in speculative notions. Since then I have always felt that co-investment should be an integral part of any client / wealth manager relationship, a principle I have adhered to throughout my entire career.

Given my keen interest in financial markets it is hardly surprising that I ended up studying business, and later obtained a MSc in Economics at University of Cologne. My investing interest was reflected in my thesis about the newly developing derivatives markets, as well as in the fact that I became an active member of the university's Investing Workshop, which gave me another early platform to develop real life investment experience.

Following my tertiary education, I spent the past 3 decades working as a professional wealth manager. The foundations for my career were laid in Düsseldorf at Deutsche Bank, which during my time was still a proud organization and undisputed market leader in my home country. This helped me gain exposure not only to investment advisory and discretionary portfolio management, but also to the bank's trading and credit business. And while I developed my first professional client relationships, I also learnt that expertise is essential but integrity and trust the foundation on which they are built.

In 1995 I decided to move for a year to Hong Kong to gain overseas and Asian market experience. I was quickly mesmerized by the energy and dynamics at the Fragrant Harbour, and in 1996 decided to join HSBC Trinkaus & Burkhardt, one of Germany's oldest merchant banks. I worked at their Hong Kong office for more than 7 years, the last 3 as Managing Director. This allowed me to build up an Asian high-net-worth client base, as well as to manage my first fund. Hong Kong was also where I met my wife, Alexandra, and where our two daughters were born.

The early 2000s did not only inflict the first major bear market of this young century on investors, but also delivered an initial wave of industry regulation. It made me realize that I could not manage a business, service its clients and be in charge of investment management, all at the same time. In 2003 I therefore decided to accept an offer from LGT, the Private Bank owned by the Princely Family of Liechtenstein, to aid them in their Asian expansion plans. Over the ensuing 16 years I had the honour of working for LGT, and in the process moved with my family to Liechtenstein in 2006. Here I worked at LGT's headquarter in Vaduz until 2019, looking after a portfolio of mainly Asian and European high net-worth clients, and managing assets both on an advisory as well as a discretionary basis.

But Private Banking is no longer what it used to be. The past couple of years have seen a tsunami of new rules and regulations, mainly in client due diligence to prevent money laundering, as well as in the area of investment suitability. This has increasingly forced Private Bankers to recommend products and strategies that are chosen or structured by specialist investment teams. At the same time, it has boosted the use of managed products and led to a growing standardization of investment portfolios. All this has come with mushrooming bureaucracy that seeks to satisfy ever growing Compliance requirements, which for me was increasingly taking the joy out of working in such an environment.

As a result, I began exploring my options. I realized that I had to exit the Private Banking industry if I wanted to return to my independent investment management roots. Fortunately, I had been reading Ronni and Mark's "In Gold We Trust Report" for a few years already and thus decided to establish contact. After exploring a few alternatives I came to realize that Incrementum's organization as a partnership, coupled with its scope of genuinely independent research, portfolio and fund management services offers the ideal environment to refocus on my investment management passion, and thus redeploy my investment experience for the benefit of our investors.

And this is what I have been doing since June 2019, Christian, and I can say it has been great fun so far, especially because after nearly three decades as an employee, I appreciate the chance to participate in this truly entrepreneurial undertaking and to help Incrementum fulfil its potential.

Thanks for the extensive background, Hans. At Incrementum we are all experienced hands in the wealth management business, with plenty of banking industry expertise, which makes you such a good fit. And with a similar vision about the business and good personal chemistry we are delighted you decided to join us, and we look forward to mutually develop our overall business in the years to come.

One already significant part of this and your main responsibility is the Incrementum All Seasons Fund. May I ask you to tell us what the fund is all about and why you decided to set it up like it is?

Sure, as I mentioned earlier the wealth management industry has changed tremendously since I joined it nearly 30 years ago. Services that were once truly tailor-made have been moved to the factory floor, and the business has been increasingly commoditized. This has delivered exceedingly cyclical results for investors, where gains in bull markets are often lost during the ensuing bear markets.

One of the main reasons for this is that private investors are required to select a pre-determined risk/return profile. In the most basic form these profiles are what is commonly known as "conservative", "balanced" or "dynamic" portfolio type. The idea is that investors should only assume portfolio risks that are appropriate to their ability to afford such risks. This is generally sold as an advantage to the investor, though in my view it has also led to a significant reduction in portfolio allocation flexibility. As a result of this, portfolios are now managed around a fairly narrow strategic investment allocation, with the aim of relative gains versus pre-defined benchmarks. In addition, regulatory requirements concerning product due diligence and suitability have led to portfolios with the same risk category across the industry becoming increasingly similar. Unfortunately, I have not seen much industry pushback against this. After all, as Maynard Keynes once remarked, it is better for reputation to fail conventionally than to succeed unconventionally.

Together with the systematic depression of the risk-free rate of return by central banks, this has helped fuel the parabolic rise of passive investing over the past decade, which by most accounts already exceeds well over 50% of all assets under management. I believe that this creates many long-term opportunities for a patient, fundamental and absolute return-driven investor. And since I have always been advising and managing broad investment portfolios and mandates it may not surprise that I decided to launch and manage a strategy fund, rather than a specialist vehicle:

The Incrementum All Seasons Fund pursues what I call a holistic, i.e. global, active, benchmark-unrestrained, multi-asset investment strategy. The aim of this long only and unlevered strategy is to expand the purchasing power of investors across the market cycle.

Why "All Seasons Fund"? – Well, financial markets move in cycles around long-term trends, which are the result of investors' willingness to accept a higher risk premium on a given set of fundamentals during the market's summer (boom) than during its winter (bust). Sir John Templeton famously referred to this behavioural element when he noted that bull markets are born on pessimism, grow on scepticism, mature on optimism and die on euphoria. – Of course, financial market seasons are far less regular than our solstice dependent meteorological seasons. An old market saying observes that the stock market takes the staircase up and elevator down, and there can be different seasonal patterns for different asset classes.

Consequently, IASF pursues an active management approach, covering equity, fixed income and commodity markets, as well as alternative assets. My challenge and our task at Incrementum are to constantly monitor and appropriately rebalance portfolio allocation in light of the developing market seasons, and this with total flexibility in terms of exposure to those asset classes.

That helps explain the fund's goals, but how would you describe your management style, Hans? What governs your allocation and selection decisions?

First of all, I have always been a value investor. This means I understand that investing, other than speculating, requires evaluating a planned investment based on a set of fundamental valuation measures like P/E-, Price-to-Book- or Cashflow Ratios, as well as their potential development which perhaps the market and thus the majority of investors perceive differently. The number of variables and uncertainties in this process make this a serious challenge.

In addition, I have a contrarian tilt, i.e. I prefer to invest in assets that are out of favour. A good example was my accumulation of so-called "old economy stocks" during 1998 and into 2000. As a result, I had had no exposure to an insanely expensive TMT sector, making the year 2000 one of my best relative years ever, as my own not even fully invested equity portfolio gained 20%, while the MSCI World Index lost 14%. And presently, I find such a contrarian approach offering promising prospects once again.

And given my interest in macro economics and politics, my allocation decisions are also often trend-based. This is particularly important for guiding the fund's currency risk exposure or the course of interest rates. In our increasingly politicised world, where the long arm of the government and its agencies display a rising tendency to intervene in what were once free markets, I believe this is of growing importance to the investment allocation and selection process.

The fund's mandate also allows me to deploy derivatives to manage investment and portfolio risk exposure, as well as for the purpose of generating option premium income.

Last but not least, I have always found cash an important part of my allocation, as it provides me with optionality when appropriate opportunities arise, which is particularly important in an unleveraged strategy. Even the zero to negative interest rate environment has not made me change my mind in this regard. And looking back this has been one of the main reasons why my investors could always sleep calmly amid comparatively benign portfolio volatility.

I call this a holistic portfolio management approach, because there is no pre-set formula or mechanistic process involved. The last of my *8 Investment Lessons* is: *"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 an art rather than a science."* This is contrary to the commonly sold formalistic, even scientific endeavour, but I have yet to find an investing formula that has consistently delivered excess returns across the cycle and thus stood the test of times.

I hope this provides more insights into my overall investment approach, Christian. Perhaps I may add that I have made a meaningful personal investment into IASF to ensure true alignment of interest. And as much as I desire to see my investment gain in value, I am equally aware how important it is to avoid significant drawdowns. After a decade of soaring financial asset prices most investors seem to have forgotten the lessons from the last financial market winter. Thus, I believe investors' focus must now be on capital preservation rather than on squeezing out a few more drops of potential return.

That certainly provides more transparency about your investment approach, Hans. I believe it also illustrates how the Incrementum All Seasons Fund as an absolute return-driven global investment strategy fits into and complements Incrementum's overall range of wealth management products and services. But after you have presented us with some hints on this subject before already, may I ask you to elaborate a bit more on how you view the economic and investment backdrop at the turn of the decade?

With pleasure, Christian. Frankly, this is one of my favourite topics, and I provide plenty of input on the subject in my "Seasonal Reflections" investors letter, which can be found in the journal of the Incrementum homepage. After all, I believe it is of paramount importance for investors to realize that we are heading for a period of what I believe will bring about significant instability and change.

Today's investment backdrop serves a menu of mediocre global growth, apparent deglobalization amid reduced international cooperation and increasing confrontation, coupled with growing political polarization, ageing societies in advanced economies and China, an extended secular debt cycle that received yet another boost through recent monetary policy action, and lastly the death of capitalism through growing industry concentration stifling competition. All this is spiced up with prevailing capital market valuations that for most measures are sitting at the highest decile in history. In other words, not an environment that makes me itch to put my hard-earned money at risk.

Looking at the individual courses of that menu, the current economic growth cycle has been the weakest in decades, although some argue that what it has lacked in vigour it has made up in duration. Remember, economic growth is a function of labour force and productivity growth. While the former is predictably weak amid prevailing demographics, the latter has also slowed, despite of the technological disruption that has spawned so many fast-growing, yet often profitless enterprises.

Globalization as the process of integrating national economies into a global market economy has been reversing amid the mushrooming of trade disputes that no longer aim for free and uninhibited exchange of goods and services, but instead look to restrict the same with the aim to gain more favourable conditions at the expense of trading partners. 2019 as the year of the US-China trade war provides plenty of evidence for an era of cooperation turning towards confrontation.

I also see a growing trend of political polarization in the democratic world. Evidence of that can be found in the rise of the far left and right across Europe, which is coupled with the rise of populism and populist leaders, and more generally in the lack of common ground politicians are willing to seek. A prime example is the United States, where the third president in the country's history has been impeached, which prior to presidential elections is likely to further widen the political divide.

Ageing societies are not a new problem, but their implications have been left unaddressed for far too long. Now many retirement schemes in the advanced world are at a point, where promises made to the older beneficiaries will have to be reneged, and / or future generations will have to carry an increasingly heavy burden via increased contributions or higher taxes. I doubt the wider population is conscious of this predicament. And though I am not arguing that this will end up in revolution, its eventual resolution will affect broad society and likely play into the hands of populist political leaders.

The extremely extended secular debt cycle is perhaps the most obvious example of the inability of our current political class or even systems to deal with structural problems. We all remember the promises made after the 2008/09 recession and Great Financial Crisis: Debt was too high and had to be brought down to achieve more stability for our economies and the global financial system. Almost a dozen years on, global debt according to the IMF has increased by two thirds, and the increase occurred across all sectors of the economy, though most dramatically on governments' and corporations' balance sheets and now sits at 320% of GDP, not even counting unfunded and off-balance sheet liabilities.

How did that happen? Initially, it was driven by governments bailing out the financial sector and supporting the economy via good old Keynesian fiscal support, while global central banks manipulated the cost of capital towards zero and below, to reduce the cost of carrying the accumulated debt burden and, yes, to incentivize more borrowing. However, one decade later what was supposed to be emergency measures to stabilize the economy and financial system have still not been exited.

Instead we have economists and politicians talking about a global savings glut as a reason for reduced interest rates, as if there had not been the creation of nearly USD 20 trillion in central bank money that was used to buy mainly government bonds and also other financial assets, regardless of their price. If I remember my Economics 101 correctly, increasing demand with a given supply, in this case of financial assets, increases price and thus decreases the available yield or return. Printing central bank money is not creating savings, even if a Dollar, Euro or Yen added to the system is indistinguishable from any other already in it. It is merely a debasement of a currency's investment and thus ultimately purchasing power.

All this was done with the objective to depress the level of interest rates and keep the debt binge from collapsing. But ultimately it has just kept us borrowing even more from the future, all the while creating financial market bubbles that now have become too big to fail. This all was achieved at the cost of prudent savers, who abstain from today's consumption in order to build up reserves for their old age or emergencies, so that they do not have to rely on the government's or broader society's support. It has also contributed meaningfully to the widely decried wealth disparity, as financial asset owners have seen their wealth grow disproportionately to economic growth. At the same time the systematic depression of available investment yields has caused financial investors to bid up real estate prices. In the wake of this process rents have been soaring, making housing less and less affordable for the majority of people.

Meanwhile, the corporate sector has used cheap financing for a rush of M&A activity, which is supposed to increase profit and shareholder value, but has also led to an increase in market concentration with the inevitably negative effect on the level of competition. Financial engineering has become all the rage, as many companies have used up their entire cashflow in recent years to buy back their own shares, resulting in a giant equity-for-debt swap, which has weakened companies' balance sheets but enriched managements through their share price linked stock option programs.

In the wake of these developments the ratio of zombie companies, i.e. companies that can merely cover their operating and debt service cost from available earnings and cashflow, has according to the Bank for International Settlement risen to 12% of all publicly listed companies, and this while we have the lowest nominal yields in 3000 years of recorded history. If interest rates were to rise in any meaningful way, it would conceivably cause a wave of bankruptcies and result in a depression…

Sorry, Christian, if I got carried away here, but I have no shred of doubt that future generations will study recent times for the follies undertaken in order to kick the can down the road, in the process making the eventual systemic breakdown more likely, even inevitable. But perhaps all this had to happen exactly like this, because now the world is in a state that can only end in a complete financial and monetary reset, as I believe we have gone beyond the point of no return for any intrinsic system fixes. As Hemmingway already astutely observed the path to bankruptcy evolves gradually and then suddenly.

You may argue that this is a rather pessimistic view, but I strongly refute this. Hyman Minsky taught how stability breeds instability, and we could witness this numerous times in the past, the last time in 2008. The impending 'Minsky Moment' risks affecting investors more seriously than anything we have seen in the past. And as much as hope is not a strategy in investing, it should not be one in politics. Personally, I believe in calling a spade a spade, and when I look at the inability of our political leadership to address the above mentioned structural issues, and if I take into account present financial market valuations I expect 2020 to become a far more challenging year than its predecessor.

Wow, that is indeed not a pretty picture, Hans. And I guess it is one reason why you fit well with Incrementum, because we are authentic and always try to look beyond the immediate financial market action at the bigger picture of political, economic and financial developments, and here in particular systemic issues. Everyone who has read Ronni's and Mark's "In Gold We Trust" reports knows that they discuss many of those issues as well, wondering what the ultimate consequences will be for investors and society at large.

Of course, it is one thing to analyse and discuss potential outcomes, but you are also an investment manager, and thus I guess my final question is how are you dealing with the before described backdrop in your investment management process?

Well, Christian, one other lesson I have had to painfully learn is that it is impossible to predict how far bubbles can expand. There have been many signs in recent years that risk asset prices may have reached a turning point, but they were all misleading. Consequently, anyone who like me has been harbouring similar concerns has likely encountered the claim of being too pessimistic or even a perma-bear. I guess this is attributable to the fact that most investors merely look at short-term performance, and especially after a long bull market hardly at the circumstances and contributing factors as well as their sustainability. Hence, the before described growing tendency to invest into passive and leveraged products. This is typical for any late bull market, and the current one is already the longest on record.

But I can assure readers that regardless of my overall view on the political and market backdrop, I have never hidden only in cash – not even during periods, when cash still yielded any meaningful nominal or even real positive return. And this is because although I am aware that stability breeds instability and eventually leads to crisis, it is extremely difficult to time this process.

Perhaps more importantly, even at the height of the longest bull market in risk assets ever, there are always pockets of the market or even whole asset classes that have been neglected and thus present decent value: If we look at equities today, US markets are the most expensive, while Europe and Emerging Markets trade at far more reasonable valuations. Similarly, the valuation gap between growth and value stocks is at its widest ever. Looking at equity sectors, commodity stocks have been in a deep slump over the past few years and thus are unloved and arguably far cheaper than high-flying growth stocks. Both from a value as well as a contrarian point of view commodity producers, shipping companies, refineries, etc, all present opportunities to acquire assets which I expect will experience a significant rise in replacement cost over the coming years. After all, global debt levels are too high to not be inflated away.

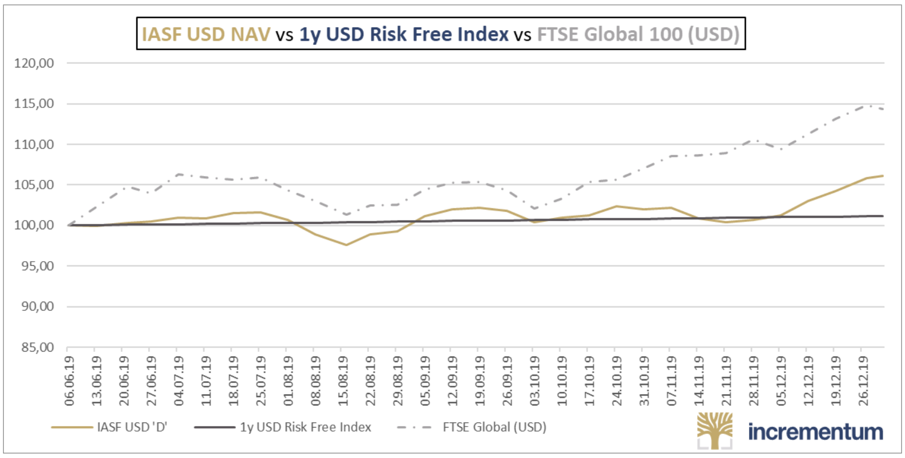
Overall, my aim is to position the Incrementum All Seasons Fund in areas that I believe will benefit from allocation shifts towards real assets. The fund currently holds net equity exposure of less than 30% (gross exposure is slightly over 50%), which is additionally hedged by long dated put options. The largest sector concentration is in gold mining, energy, other commodity, shipping and 5G related stocks, and the portfolio yields substantial income from dividends. The fund also holds 5% in corporate bonds, with the remaining balance mostly in cash and near-cash investments.

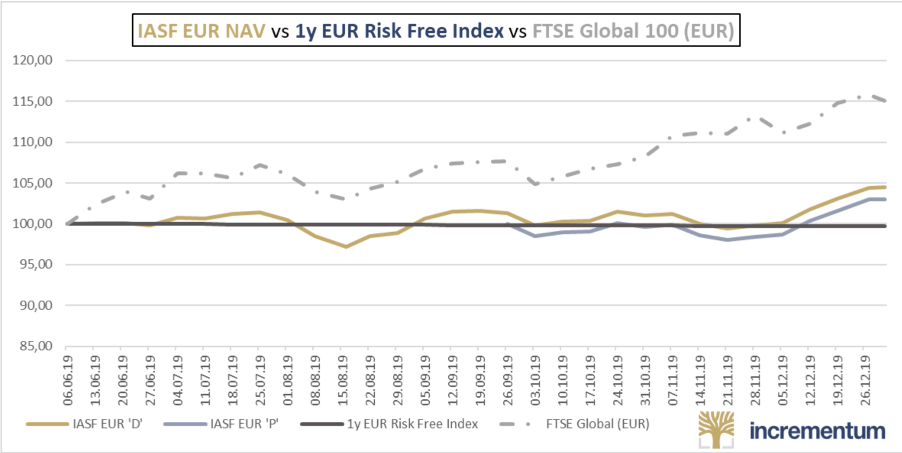
On the FX side, the underlying fund investment portfolio is EUR based. Actual EUR exposure is 35% right now, with USD following at 20% (after hedging), Gold 15% (including gold mining stocks), NOK 8%, GBP and Silver 5%. Obviously, we do expect a not insignificant risk of further serious fiat currency debasement in 2020, which is reflected in an outsized precious metals exposure. Here I can wholeheartedly say that at least for now and the medium-term **In Gold We Trust**! Meanwhile, the fund's USD and CHF share classes are fully hedged against the underlying EUR portfolio.

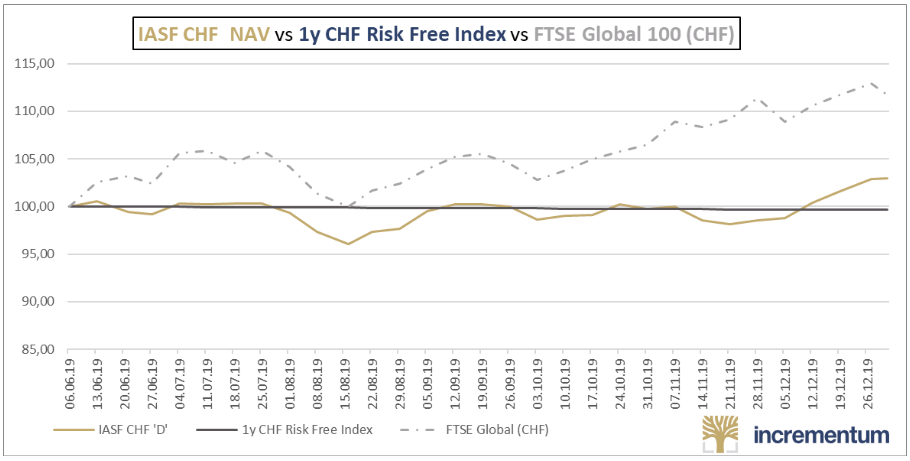
So much on the fund's current positioning, Christian. Investors are welcome to contact me in order to get more detailed insights into the actual portfolio composition. But none of this is set in stone. If we feel that larger changes are appropriate, we will make them, always with the fund's ultimate goal in mind to preserve and enhance investors' purchasing power over the market cycle, and thus to guide them safely through the at times tumultuous investment seasons.

Thanks for your elaborations and time, Hans. It seems the Incrementum All Seasons Fund is well positioned, even for a potentially far more volatile and disruptive 2020. I wish you luck and a steady hand in steering the fund through the inevitable seasonal turns.

Appendix *







* Graphs display NAV of IASF 'D' shares as of last valuation date (**31 Dec 2019**), compared to the respective risk-free 1y-government yield as well as the FTSE Global 100 Index in respective currency as a proxy for overall 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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