Lucerne Alternative Investments Fund

ANNUAL LETTER | FEBRUARY 2021

Lucerne
Alternative
Investments
Fund

2020: Navigating a year to remember

For our annual letter, we review 2020, a year that will be seared into investors' minds for some time and look to identify how the Lucerne Alternative Investments Fund's investment philosophy and investment decisions delivered a **performance of +21.23%**, while the ASX Accumulation Index delivered +1.4%.

This annual performance competes with the top-performing, higher-risk, long-only equity funds. However, LAIF endured approximately a third as much volatility as the index over this time.

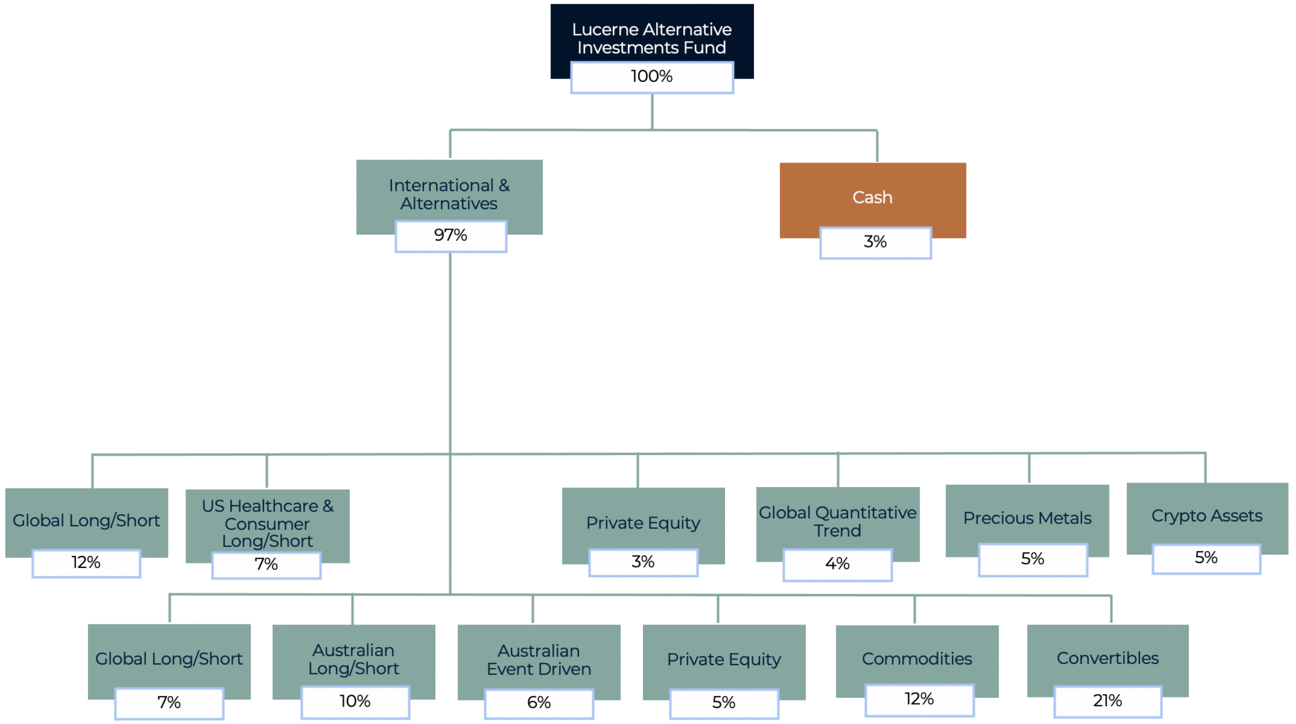
As the market starts 2021 in a bullish mood, the acronym 'TINA' is resurfacing. Standing for 'There Is No Alternative', it is shorthand for the view that investors should buy equities despite rich valuations as they see no return on offer in other asset classes.

While we'd agree that the major asset classes are unattractive, we'd question whether there are no alternatives out there at all. In fact, we'd argue that, ironically, the answer is sitting right there in the acronym itself, in the 'A' for 'Alternative'.

Alternative strategies that LAIF has been invested in during 2020 include hedge funds, private equity, quant strategies, precious metals, event-driven strategies, hybrids, and specific sector exposures.

These strategies are able to generate return streams that are less dependent on market conditions and have a reduced correlation to equities. The fund was thoroughly stress-tested in 2020 and suggests that 'TINA' is a fallacy; there is indeed an alternative available for investors and it can provide equity-like returns without equity-like risk.

Thank you for your support for LAIF throughout the year and we look forward to delivering again for our investors in 2021.



*Estimate only. Figures subject to rounding. Please note portfolio allocations are modified regularly.

Don’t be a hero

Back in January 2020, the impact of the devastating bushfires and the possibility of a US-China trade deal were some of the issues front and centre for investors. For most people, back then ‘Corona’ was a refreshing beverage, and while the first ex-China case was confirmed in Thailand on January 13th, equity markets didn’t start their dramatic correction until February 21st.

In our quarterly report to LAIF investors in January 2020, we flagged the risk from COVID-19 saying that the markets looked like *a: “bug in search of a windshield, although you wouldn’t know it, given how much yield chasing has gone on. Many investors appear to have given up on considering risk as they chase past returns in response to extraordinary central bank policy. The market is generally not accounting for risk and the **coronavirus is a case in point**“... While reversals don’t happen frequently, they do happen and their impact can be much more profound for long-term investment results than most care to acknowledge. Furthermore, even if the commonly held narratives were correct, this doesn’t preclude periods when expectations change briefly, and even a brief change in expectations could cause significant damage to traditional portfolios from today’s complacent starting point".*

We signed off to say that: “*Alternatives might be more boring than a highly speculative 20%+ return in a year, but more sustainable returns will allow you to sleep at night rather than worry about when those paper gains will disappear. It is dangerous out there; without a cape and perfect forward vision it is **best not to be a hero**, but instead, take a more balanced and considered position”.*

As it turned out, by not being a hero, it was LAIF that put in the +20% year, well ahead of most competitors.

March 2020 quarter:

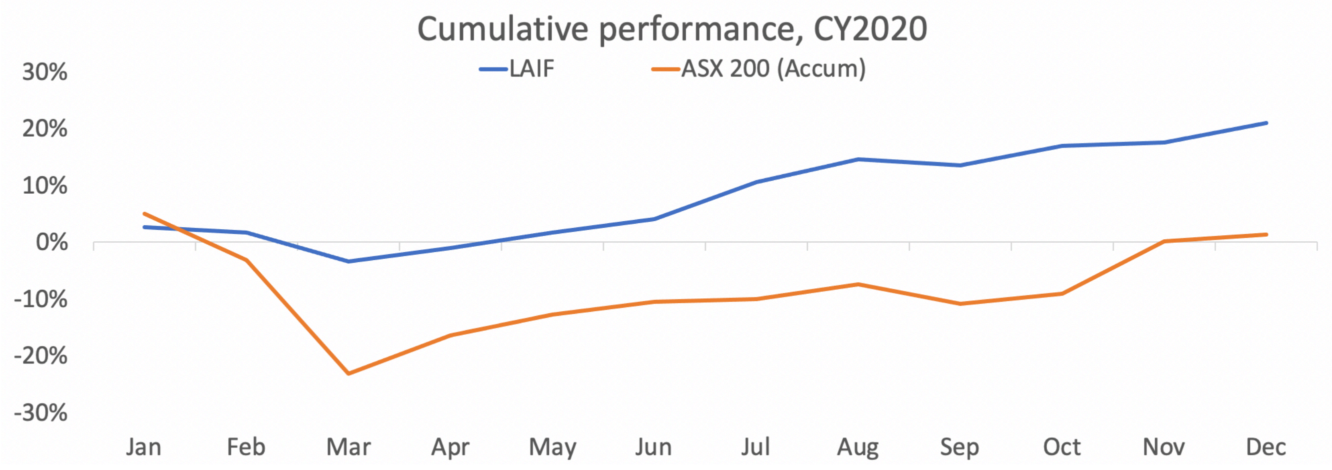
LAIF held its ground in the fastest bear market in history

A central plank to our investment philosophy is that **the avoidance of significant drawdowns is critical for generating long-term compounding**. You need a 50% gain to recover from a 33.3% fall, making it a very challenging hole to get out of, and making compounding near impossible.

As the pandemic sent billions of people into lockdown, the market experienced its quickest bear market in history; it took just 16 days to achieve what the GFC did in 188 days. By the end of the March quarter, the ASX 200 accumulation index posted a return of -23.10%.

This precipitous fall was perhaps the ultimate test of whether LAIF would deliver on its objective of avoiding a market plunge. Pleasingly, LAIF almost completely side-stepped it and **finished the quarter with a return of -3.43%**.

Avoiding the fallout from one of the worst quarters on record has demonstrated beyond a reasonable doubt that LAIF ‘does what it says on the tin’, in delivering strong risk-adjusted returns with a low correlation to the equities market.



At the time, there was some surprising optimism that COVID-19 would be resolved relatively quickly. Yet we wrote in the March quarterly that:

*"The global pandemic is still being underestimated by investors, despite it dominating the news and our lives. The consensus appears to be expecting this to be a short-term issue that will quickly be resolved once the "curve is flattened". In contrast, our analysis suggests that there may not be any easy or quick fix to the coronavirus crisis, although we hope there is. Better testing and social adaptations will likely be introduced, but public and social adaptations of some sort **may be required for over a year**"*

And this is where much of the global population finds itself today. The Emergencies Chief at the World Health Organisation (WHO) even warned recently that 2021 could potentially be more challenging than 2020.

The longer-term macro headwinds that could stem from the pandemic that we cited in the March quarterly included:

- Slower real growth, which is typical after a pandemic.
- Low consumer confidence and higher saving rates.
- More socialist and/or nationalist and populist leaders.
- Geopolitical and military conflict will become a greater possibility.
- De-globalisation is likely at least in part
- Taxes may rise, and wages and subsidies may increase at the expense of capital.
- Stagflation may become a more likely outcome over time.
- Fiat currency debasement is likely to be accentuated

While LAIF remains well-positioned to mitigate these risks, we argued that most of this bodes very poorly for traditional portfolios like your average super fund, which we correctly predicted would perform weakly.

June 2020 quarter:

Our annual mandate in a quarter

LAIF enjoyed a successful June quarter, gaining a 7.75%. As the fund is intended to have a low correlation to equities it did not participate in the remarkable 16.48% post-crash bounce the ASX200 accumulation index experienced over the three months.

All the same, the gain in LAIF over this quarter is still more than our annual mandate of RBA cash rate +6% and importantly was achieved with steady gains of 2.54% (April), 2.65% (May), and 2.36% (June).

In our June quarterly, we looked at how we achieved an absolute return of 6.9% over FY'20 while experiencing little drawdown. This was in stark contrast to most super funds, which as predicted, eked out low single digits at best, or lost ground by a similar amount at worst.

In mid-2020, the pandemic was spreading aggressively, companies and whole industries were grinding to a halt, and the global economy had plunged into recession, yet.. markets were rallying. The question on everyone's minds at the time was: What is going on and how should an investor reconcile this dramatic divergence in realities? At the time, we wrote:

"Prices have become divorced from their fundamentals. We refer to this as a bubble, quite possibly the greatest bubble the world has ever seen given the circumstances. This has occurred due to the rather extraordinary and persistent monetary stimulus applied by central banks and the US Federal Reserve, in particular, combined with the large global fiscal stimulus the pandemic has necessitated to provide social safety nets. Naturally, investors have happily extrapolated these supports and in many cases are speculating on them continuing indefinitely".

While most investment strategies are predicated on central banks continuing to defy ever-stronger deflationary forces, LAIF's approach is to avoid this reliance on an unpredictable group's (central banks) pursuit of an unpredictable strategy (ongoing monetary easing). We wrote:

"A favourable result can, however, be achieved with a multi-strategy approach which genuinely diversifies a portfolio by combining skilled and complementary active approaches. Such an approach can target and actively manage and mitigate market risks to achieve relatively consistent positive results and low drawdowns, which is exactly what many investors need".

September 2020 quarter:

LAIF's best quarter to date

The September quarter was another strong one for LAIF, gaining 9.0%, while the equity market consolidated the move of the previous three months, ultimately slipping -0.44%, again illustrating the low correlation between the fund and risk assets.

Underlying this performance, and demonstrating how it is achieved during a flat equity market, three strategies within the fund that contributed strongly to performance over this time included convertibles (+3.10%), crypto assets (+1.87%), and precious metals (+1.0%).

Gold had a strong quarter, breaking above US$ 2000 and hitting a new all-time high. While this put it in the media spotlight, precious metals have been in the portfolio since mid-2019, enabling LAIF to benefit from the whole rally, rather than just these latter stages.

We took the opportunity during the September quarterly to review the five-point mission statement for the fund that we laid out in July 2019. In summary, LAIF seeks the following goals:

- We are less risky (volatile) than an equity investment
- We will protect substantively from market falls
- We can make attractive absolute returns regardless of whether markets make money or not and are more likely to surprise to the upside
- We will probably outperform traditional portfolios and equities over time despite lower risk levels
- We are a core portfolio holding and are also valuable as a portfolio diversifier and defensive asset

As argued in the quarterly, the team saw us achieve those goals, and, importantly, that we are on track to continue to do so.

December 2020 quarter:

Finishing the year strong

The December quarter was another robust quarter for LAIF that met our annual mandate in three months, with a +6.73% gain.

Impetus from the news of effective vaccines and US election results were strong drivers for the market. November was a record month for the market, underwriting a 13.7% gain over the quarter for the ASX200 accumulation index. LAIF is intended to be lowly correlated to equity markets so did not rally in line with it, and, in fact, barely moved during November, showing how great a diversifier the fund can be.

LAIF's 6.73% gain in the December quarter brought the final CY'20 performance to 21.23%. The seven strategies that contributed most to this result over the twelve months were commodities, convertibles, crypto assets, event-driven, US healthcare, Australian long-short, and precious metals.

Market sentiment as 2021 gets underway is remarkably bullish, and there are frequent signals of top-of-the-market behaviour from inexperienced players and complacency from the broader market. The market appears to have a short memory, with the dramatic events of not even twelve months ago seemingly forgotten already.

The consensus appears to be that central banks will be able to maintain their monetary support and that governments will continue their dramatic fiscal support and 'have the market's back' come what may. This view underwrites a positive view from most strategists but is one we don't agree with. The new year often starts with a flush of optimism, and most outlooks were rosy this time last year too.

Ultimately, however, predicting twelve months in markets is pure speculation, and no one has a clue how 2021 will pan out. Rather than trying to predict unpredictable forces, we prefer instead to remove the uncertainty of a binary outcome by using LAIF's multi-strategy absolute-return approach which is designed to create its own good fortune, and which we believe has demonstrated its ability to deliver in the toughest of years.

LAIF: Ready for an uncertain 2021

We think equities will endure more volatility through 2021, and beyond. We have already seen the VIX at its highest level in nearly three months as amateur traders successfully take on larger players through price manipulation of stocks including Gamestop, and now entire commodities such as silver, triggering wider impacts across markets.

More importantly, the ongoing global pandemic and the myriad challenges of a global vaccine rollout are likely to underwrite volatility for a long time yet. While life is closer to normal again in much of Australia, the US economy is decelerating and Europe is facing a double-dip recession.

So, while the proponents of the 'TINA' philosophy may be prepared to resign to another year like 2020 with whipsawing equity markets that end up back where they started, we believe instead that the Lucerne Alternative Investments Fund provides **an alternative** for investors seeking equity-like returns without equity-like risk.

2020 gave us the chance to demonstrate that this is possible and we look forward to delivering again for our investors in 2021.

it is now possible to invest directly by clicking here, or if you would like to talk with us, please contact us on laif@lucernepartners.com to arrange a call.

On behalf of the whole team at Lucerne Alternative Investments Fund, we wish you safe investing through the year ahead.

Lucerne Alternative Investments Fund,

February 2021

Disclaimer

Summary of information: This presentation contains general information only and should not be considered to be comprehensive or purport to comprise all the information that an investor should consider when making an investment decision. This presentation is not a prospectus, disclosure document, product disclosure statement or other offering document under Australian law or under any other law. The information in this presentation remains subject to change without notice. Lucerne Investment Partners is not responsible for providing updated information and assumes no responsibility to do so.

Not financial product advice: This financial information provided in this presentation is for information purposes only. The information contained in this presentation is not a financial product, investment advice or a recommendation to acquire securities and has been prepared without taking into account the objectives, financial situation or needs of any person or entity. Before making an investment decision prospective investors should consider the appropriateness of the information having regard to their own objectives, financial situation and needs, and seek legal, taxation and financial advice appropriate to their jurisdiction and circumstances.

No liability: The information contained in this presentation has been compiled in good faith using sources believed to be reliable. However, Lucerne Investment Partners and its affiliates and each of their respective directors, agents, officers, employees and advisors expressly disclaim, to the maximum extent permitted by the law, all liabilities (however caused, including negligence) in respect of, make no representations regarding, and take no responsibility for, any part of this presentation and make no representation or warranty as to the currency, accuracy, reliability or completeness of any information, statements, opinions, conclusions or representations contained in this presentation.

Existing relationship: Lucerne Investment Partners and its affiliates may have an investment banking or other relationship with the companies that are the subject of this presentation and may trade in any of the securities mentioned in this presentation either for their own account or the accounts of their clients. Lucerne Investment Partners and its affiliates therefore may at any time have a long or short position in any such securities, related securities or in options, futures or other derivative instruments based on those securities.

Future performance: This presentation contains certain forward-looking statements and opinions. The forward-looking statements, opinions and estimates provided in this presentation are based on assumptions and contingencies which are subject to change without notice, as are statements about market and industry trends, which are based on interpretations of current market conditions. Forward-looking statements, including projections, forecasts and estimates, are provided as a general guide only and should not be relied on as an indication or guarantee of future performance and involve known and unknown risks, uncertainties and other factors. Past performance is not necessarily a guide to future performance and no representation or warranty is made as to the likelihood of achievement or reasonableness of any forward-looking statements or other forecast.

Not an offer: This presentation is not, and should not be considered as, an offer or solicitation to buy or sell securities or any other financial products. Neither this document nor any of its contents will form the basis of any contract or commitment to act as a securities broker or dealer in any jurisdiction by any person or company that is not legally permitted to carry on the business of a securities broker or dealer in that jurisdiction.

This presentation must not be disclosed to any other party and does not carry any right of publication. Neither this presentation nor any of its contents may be reproduced or used for any other purpose without the prior written consent of Lucerne Investment Partners.

Monetary values: Unless otherwise stated, all dollar values are in Australian dollars (AUD$).

Confidential: This document contains information that is strictly confidential. You must not directly or indirectly disclose to any person or copy, use, publish or record in any form any part of this document.

Lucerne Services Pty Ltd AFSL 481217

Lucerne
Alternative
Investments
Fund

LEVEL 32, 8 EXHIBITION STREET, MELBOURNE

+61 3 8560 1440

LAIF.COM.AU

LINKEDIN