

# Lucerne Alternative Investments Fund

QUARTERLY REPORT | JUNE 2021



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## June 2021 Quarterly Report

The Lucerne Alternative Investments Fund enjoyed another strong quarter and its fifth consecutive positive one. While the June NAV has not been finalised, our estimate of -0.5% for the month would bring the June quarter performance to 4.1%, and FY21 performance to 31.8%.

Heading into FY22 global economic growth is strong and equity markets continue to test all time highs, yet we believe some significant risks are waiting in plain sight for complacent investors.

The International Monetary Fund is currently projecting robust global growth of 6% in 2021 followed by 4.4% in 2022 as the major economies continue to recover from the impacts of COVID. However, as we have seen across the globe in recent months and are witnessing in Australia right now, risks remain of subsequent waves of COVID caused by more transmissible variants such as the rampant Delta strain. Australia's near nationwide lockdown is highlighting that the economic recovery will not be linear or straightforward.

### **Vaccinations and Global Economies**

While more than 50% of the adult populations of North America, EU and East Asia have had their first jab, India, Oceania and Central America are yet to crack 25%, and Africa and Central Asia are yet to reach even 10% of their populations. In total, there are still 5.2 billion people who are still yet to have their first vaccination. As long as there is a large unvaccinated population the virus has the opportunity to spread and mutate.

As such we should anticipate new and potentially more aggressive, variants to continue to emerge. There is the possibility that existing vaccinations are not effective against future variants. As well as being a humanitarian goal, reaching herd immunity on a global basis is therefore critical to beat the virus while we can.

Despite this risk of subsequent waves, a recurring observation made by the investment committee (IC) in recent meetings has been that the equity risk premium associated with subsequent waves has been lower each time. For example, the recent second wave in India saw the S&P BSE Sensex Index sold off by just 10%, and then fully recovered over the next two months, before going on to set new all-time highs. The ASX has likewise so far shown little impact from the recent spate of lockdowns, despite the multi-billion-dollar weekly cost to the economy.

Investors are showing confidence in their nation's ability to navigate the challenges, and their governments and central banks' ability to mitigate the economic impacts. At present we are seeing strong economic growth, and very encouraging leading indicators such as the Purchasing Managers Indices (PMI's). A value of 50 is neutral for a PMI index, and values typically range between 45 (recessionary) to 55 (expansionary), so values above 60's for the US and EU, as well as Australia, are very robust and unusually high.

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Manufacturing PMI   G20							
World	Europe	America	Asia	Africa	Australia	G20	
Country			Last	Previous		Reference	Unit
<b>Switzerland</b>			69.9	69.5		May/21	points
<b>Netherlands</b>			69.4	67.2		May/21	points
<b>Germany</b>			64.9	64.4		Jun/21	points
<b>United Kingdom</b>			64.2	65.6		Jun/21	points
<b>Euro Area</b>			63.1	63.1		Jun/21	points
<b>United States</b>			62.6	62.1		Jun/21	points
<b>Italy</b>			62.3	60.7		May/21	points
<b>Australia</b>			61.8	61.7		May/21	points
<b>Spain</b>			59.4	57.7		May/21	points
<b>France</b>			58.6	59.4		Jun/21	points
<b>South Africa</b>			57.8	56.2		May/21	points
<b>Canada</b>			57	57.2		May/21	points
<b>Saudi Arabia</b>			56.4	55.2		May/21	points
<b>Indonesia</b>			55.3	54.6		May/21	points
<b>Brazil</b>			53.7	52.3		May/21	points
<b>South Korea</b>			53.7	54.6		May/21	points
<b>China</b>			52	51.9		May/21	points
<b>Russia</b>			51.9	50.4		May/21	points
<b>Japan</b>			51.5	53		Jun/21	points
<b>India</b>			50.8	55.5		May/21	points
<b>Singapore</b>			50.7	50.9		May/21	points

Source: Trading Economics (2021)

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### Inflation – here to stay or gone tomorrow?

Inflation, a topic of intense focus of market commentary in recent months and an ongoing risk that LAIF's IC is monitoring as it pertains to its portfolio of investments. Discussion focusses on whether it is transitory or structural, the impact of the base effects and how sticky the specific subcomponents driving the rise are likely to be. The market is likely to grapple with this for some time based on the pathway of economic data, as well as that of COVID's subsequent waves and the vaccination programs.

Viewing this dynamic through a 'risk-on / risk-off' lens, the 'risk-on' proponents would see the inflationary pulse as likely to be transitory and look through a few months of raised data caused by short-term effects and supply chain disruptions. The 'risk-off' camp, however, see central bank dovishness as misplaced and are concerned that the inflation genie could escape from the lamp. This situation would likely force the hand of the US Federal Reserve and other central banks, to tighten sooner than they have guided, triggering another 'taper tantrum' while potentially knee capping the economic recovery.

The not insignificant risk of such a scenario is seemingly at odds with the complacency in the market demonstrated by the continued low reading on the CBOE volatility index, currently sitting at very relaxed 17. This has continued at these lows for risk expectations since our last quarterly report.

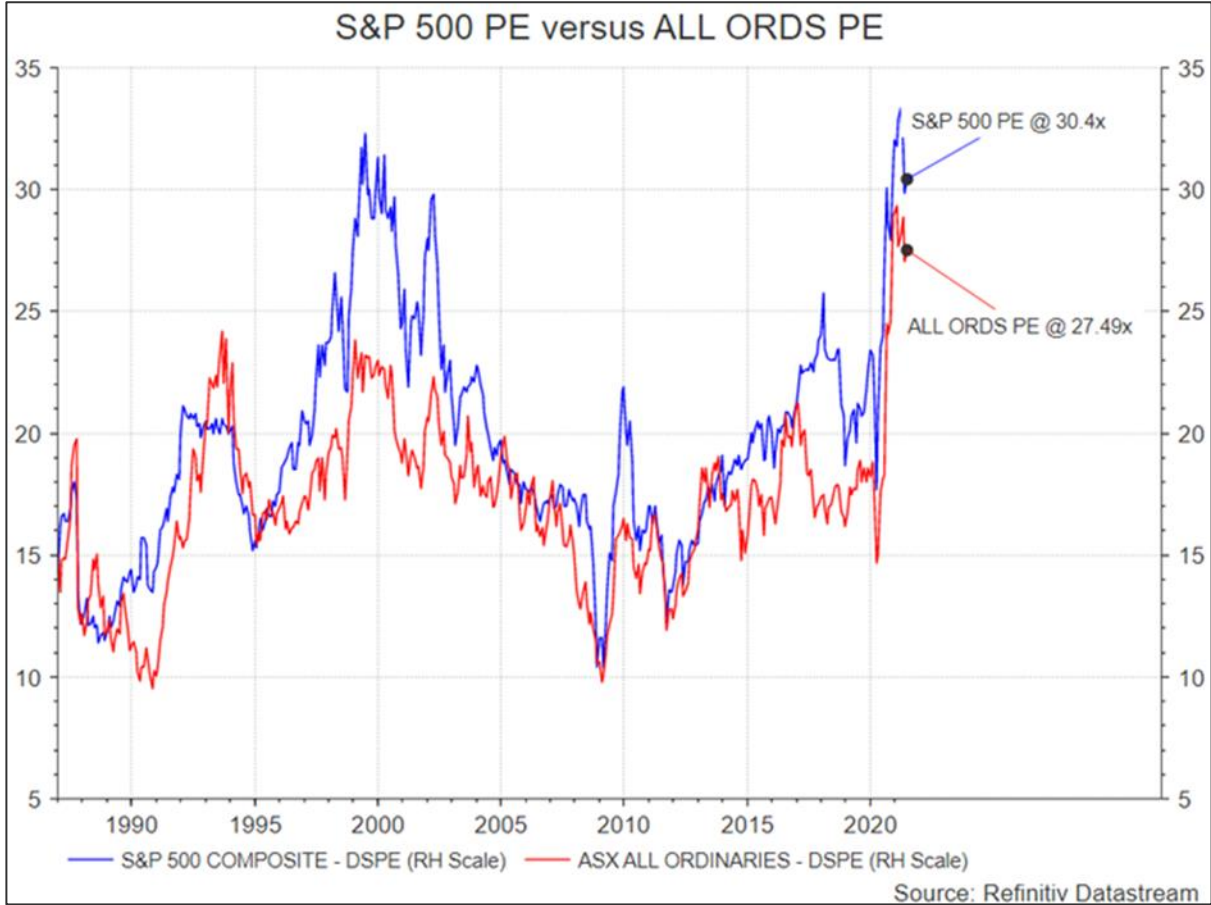


Source: IRESS (2021)

In this context, we remain alert to the possibility of a market correction and the Investment Committee continues to position the Lucerne Alternative Investments Fund to withstand drawdowns. Conversely, the volatility we anticipate from such an environment should create dispersion that offers fertile ground for active managers. While the rising tide has lifted all boats, a shake-out would present the opportunity to continue to differentiate LAIF's risk adjusted return approach to the fully risk- on investors.

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The below chart highlights the exuberance the market is feeling right now. Coupled with the prospect of lower for longer as it pertains to interest rates and the expectation of a transitory inflation spike, both the US and Australian equities markets are trading at price earnings multiples not since seen the tech bubble. This is one of the metrics supporting the IC's cautious outlook and the positioning of the portfolio.



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### LAIF Investments Activity

Our underlying managers are well and truly aware of the current risks and are taking steps to mitigate them. The long-short funds within LAIF have been performing strongly recently and would be well placed to benefit from the market stalling because of their underlying strategies. To ensure the Fund is positioned to withstand future shocks while still participating in any continued bubbles that cheap money and strong (irrational?) confidence provides, the IC has been particularly active in recent months.

The fund has performed very strongly over the last 12 months and some investments have increased in value such that their weighting is disproportionate to the original risk the IC was prepared to allocate to these investments. Therefore, several underlying investments have been reweighted to their original weightings while new allocations have been made to asset classes that we believe will smooth returns while retaining the gains made and protecting the portfolio should our scenario of risk-off take hold.

Further, the IC would like to assure investors that we are conscious of the typically meaningful weighting many would have to long only equities markets and the benefit that would continue to accrue to those portfolios should the risk-on activity continue. LAIF is not designed to compete with long only equities markets but provide a diversifying allocation in portfolios that will support returns when volatility or sell downs occur – as LAIF did admirably in early 2020 and through the 2021 financial year.

If you, or someone you know, would like to talk with us, please do not hesitate to contact us at [laif@lucernepartners.com](mailto:laif@lucernepartners.com) to arrange a call. Alternatively it is now possible to invest directly by clicking [here](#).

Thank you for your interest in LAIF, and we wish you safe investing for the quarter ahead.

**The Lucerne Alternative Investments Fund**

**July 2021**

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