

Monthly Commentary 2nd February 2022

The year did not start well for most financial assets, with both equities and fixed income getting hit hard in January. World equities were down almost 5% and the FTSE 100 was the only exception as it rose 1%. Developed market sovereign bonds were down between 1 and 2% while investment grade corporates were hit even harder (3-4%). Commodities ex-precious metals were the only bright spot, rising almost 10%. The USD was strong and Bitcoin fell 17%.

What does the January market behaviour tell us for the rest of the year?

Many pundits have suddenly become very cautious about equities and some suggest that this might be the beginning of a bear market. We are more circumspect and prefer to focus on the big picture. That is, what is happening to the economy and corporate earnings? On that front, they both seem healthy and we have every reason to believe that the markets will not tank. In fact market pullbacks and mini-panics like the one we have seen in January are, as Jason Zweig of the Wall Street Journal says, *“the indispensable hygiene of markets, the natural way overvalued assets come back into line, making future returns more attractive”*. And he goes on to say *“if stocks always went up, they would be riskless – and their returns would end up being paltry. The short-term pain of loss is the price we pay for the potential for meaningful long-term gain”*.

Looking at the markets rationally, following the latest market wobbles, the valuations of US, European and UK markets are now back to pre-pandemic levels. This shows that as the markets rose, earnings have been even stronger. It also gives us comfort that, based on forward statements by companies, earnings should still rise on aggregate by mid to upper single digits this year, which is quite impressive after the huge gains made in 2021.

Bottom line: Don't panic! Yes, portfolios are down across the board this year, and they might still have further to fall. You are not alone. Almost all global investors' portfolios are down this year, even those managed by the most prestigious banks. Like us, other managers did not panic and sell. And like them, we are sticking to high quality holdings and prudent allocation based on each client's risk profile.



Crypto thoughts and a fund idea

In the last year we have received a lot of interest from clients about investing in crypto assets. We had generally been reluctant to accommodate them as we are agnostic.

Yet crypto is always in the news. January was not only a bad month for stocks and bonds but also for the crypto market. In fact since it peaked last year, the total value of the crypto market has fallen from about \$3 trillion to less than \$2 trillion. This is a dramatic fall, but does it bode badly for the future of this asset class?

While we are by no means experts, we believe that the size of this market will grow multiple times from here. At Elgin we are keen to embrace new technologies, new ideas and areas of future investment growth, and to do so prudently and with our eyes wide open.

With institutions becoming increasingly involved in the crypto space, the opportunity is far larger than the few coins you may have heard of such as Bitcoin and Ethereum. There are literally thousands of coins and tokens. The digital universe covers phrases such as the Metaverse, NFTs and Smart contracts. Being at the beginning of this growing space, it bodes well for future growth and the possibility of above-market returns for the foreseeable future. Indeed we shall not be surprised to see total crypto assets surpass that of gold, which is currently around \$11 trillion. So the runway is long...

As Elgin is by no means an expert in the field we have been looking at ways to access the space in as broad and diversified way as possible. It is not easy to access most of the securities as one needs specialised accounts, using often-opaque structures. We believe we have overcome this and have thus far identified a fund that we believe ticks most of the boxes. This fund is widely spread and allows our clients to access institutional level assets across the spectrum of the new crypto and blockchain investment space.


Below is what we have found in a nutshell:

Summary. Crypto currencies, digital assets and blockchain offer a rare opportunity for investors.

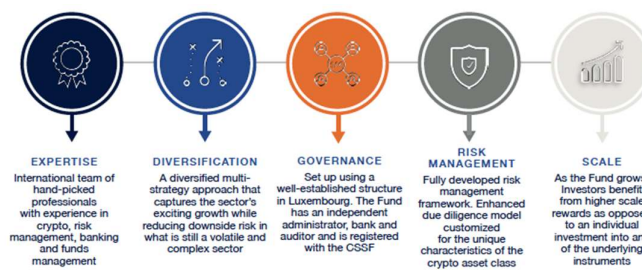


-  Attractive long-term growth prospects offering VC-like returns in a liquid asset class at a time when increased efficiency in public markets has impacted investors ability to outperform markets.
-  Nascent asset class with significant structural inefficiencies allows for huge potential for returns.
-  Distributed ledger technology and digital assets have disruptive potential across all sectors of the economy and society for value creation at a large scale.
-  Institutional adoption of crypto technology continues to grow with governments and traditional banks entering the space.
-  Truly uncorrelated to any other asset class providing a unique and powerful source of diversification.

The Challenge. Investing in this space has challenges, as with any new disruptive technology:

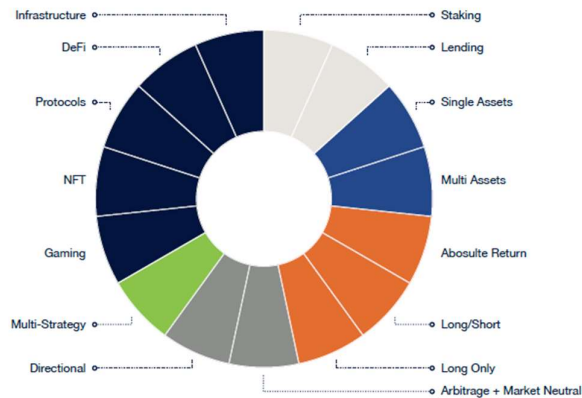
-  Extreme Volatility: Crypto currencies are extremely volatile and subject to sudden and violent drawdowns with non-fundamental price movements.
-  Complexity of Direct Access: Direct investment in the space is subject to high complexity and inefficiency. Adapting to rapidly changing market environments is critical.
-  Significant Operational Risk: Crypto assets are subject to a unique set of exchange, custody, security and counterpart risks and challenges.
-  Concentration Risk: Investing solely in a single asset or manager will add volatility and risk of permanent loss and misses the broad multi-facet potential of the asset class.

We have identified a fund that seems to rise to these challenges and allows access to the asset class. Using an institutional grade risk filter to select the most investable funds and put them into one diverse investment vehicle, the fund bridges the gap between FIAT currency (\$ and Euro), and the emerging technology of digital asset classes:





Diversified Exposure. The below graphic highlights how diverse the digital asset sector is and the areas that the fund invests into, which is essential in this new asset class. It is far less risky than trying to invest in specific names in each sub-class.



Q&A

Should I be investing in crypto markets?

Being an asset class that is not only “here to stay”, but with a large growth potential, it would be another diversified asset as part of your total assets

How much of my liquid assets should I invest in crypto?

This depends on your overall risk profile. A rule of thumb in asset allocation for gold has been up to 5%. We think this is reasonable exposure.

What is the time horizon for this investment?

While very promising, the crypto space is extremely volatile. So we would suggest at least a three year horizon, and preferably 5 years.

What has the fund done up to now?

Since launch in December 2017 it has produced close to 50% annualized returns, with a maximum drawdown of 58%. This is by no means a prediction of future returns, though we would still expect double digit annual returns over the next 5 years. To put it in perspective, in the same period Bitcoin has achieved 29% annual returns, with a maximum drawdown of 81%



What is the minimum investment into the fund?

USD/EUR 10K.

How often does it trade?

Once monthly.

How do I access this fund?

Being in the crypto world, it is not possible to buy this fund using the custodians that we currently use. As such, we have identified a secure fund platform (Capital International Group) in the Isle of Man <https://www.capital-iom.com>. We can help you open an account, as we do with Interactive Brokers. Another advantage of such an account is that we can eventually suggest other funds that we like, or even manage your whole portfolio.

Next steps?

If you are interested in crypto and need more information, please contact your advisor or contact us directly

The Elgin Team

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