ODEY
ASSET MANAGEMENT

Odey International Fund
Fund Update | 31 December 2019

Total returns

At 31 December 2019	1 month %	3 months %	6 months %	1 year %	3 years % p.a.	5 years % p.a.	Inception % p.a. (Jul 2014)
Odey International Fund	10.97	8.64	-6.50	-11.10	-0.18	-12.23	-7.63
MSCI World Index Daily TR Net Local	2.28	7.48	9.13	27.34	11.80	9.23	9.13
Outperformance	**8.69**	**1.16**	**-15.63**	**-38.43**	**-11.98**	-21.46	**-16.76**

Monthly returns*

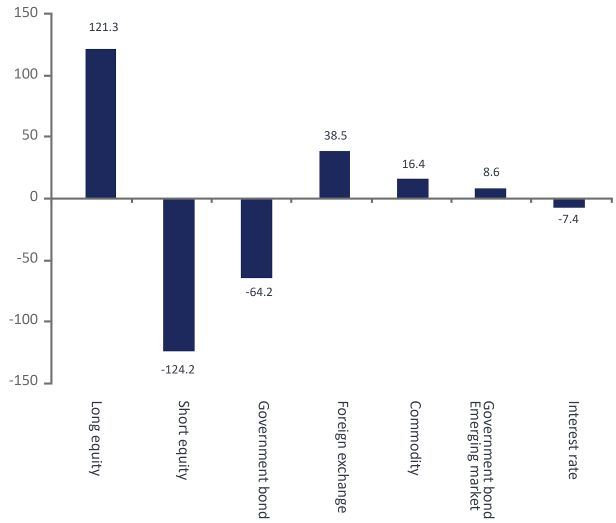
Year	Jan %	Feb %	Mar %	Apr %	May %	Jun %	Jul %	Aug %	Sep %	Oct %	Nov %	Dec %	YTD %	Idx YTD %
2019	-0.48	-8.29	-0.15	-5.46	12.14	-1.59	2.52						-11.10	27.34
2018	-3.32	6.59	3.16	4.24	0.52	4.60	1.97	-1.50	9.30	6.98	0.41	2.75	41.19	-7.38
2017	2.12	-3.12	-3.83	-4.74	3.92	-0.39	-8.84	1.35	-5.90	1.63	-1.27	-3.19	-20.76	18.48
2016	4.99	-8.85	-18.42	-8.18	3.59	4.34	-4.64	-6.07	-3.26	-5.92	-5.73	-1.64	-41.43	9.00
2015	3.61	-6.53	3.78	-18.18	4.48	0.31	1.35	5.99	5.99	-12.18	-0.95	4.73	-10.60	2.08

*Performance of the Odey International Fund since inception on 29 July 2014

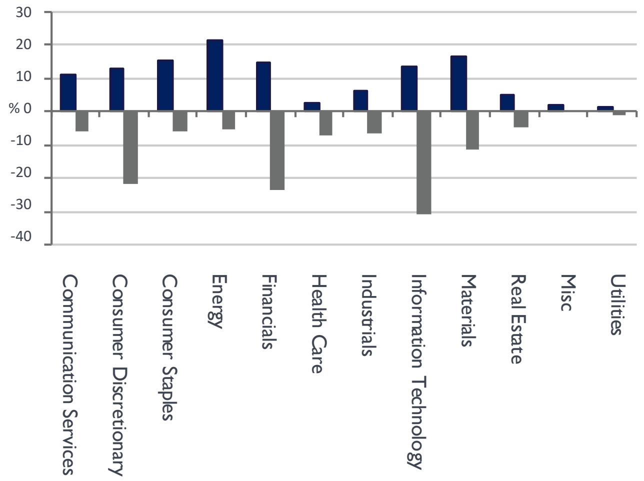
Top 10 holdings

Rank	Security	Strategy	Notional exposure (%)
1	Long Gilt Future Mar20	Short	-26.8
2	JPN 10Y Bond(Ose) Mar20	Short	-20.5
3	Aust 10Y Bond Fut Mar20	Short	-17.0
4	IRS: Fix/Float ICE LIBOR GBP 6 Month	Short	-7.4
5	Banco Macro	Long	7.2
6	SLC Agricola	Long	6.5
7	Melexis	Short	-6.2
8	Netflix	Short	-5.4
9	Tesla	Short	-5.0
10	Hertz Global Holdings	Short	-4.9

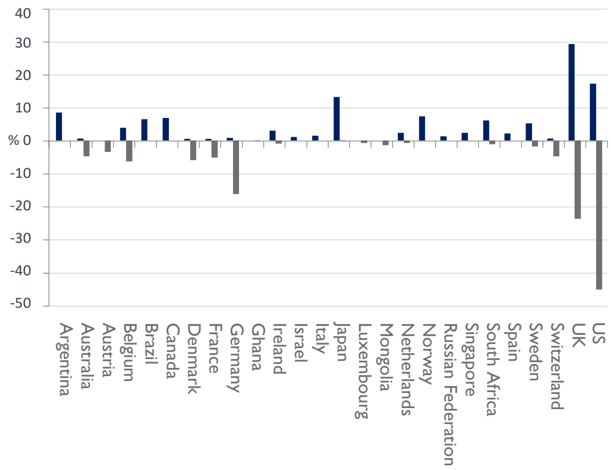
Asset allocation



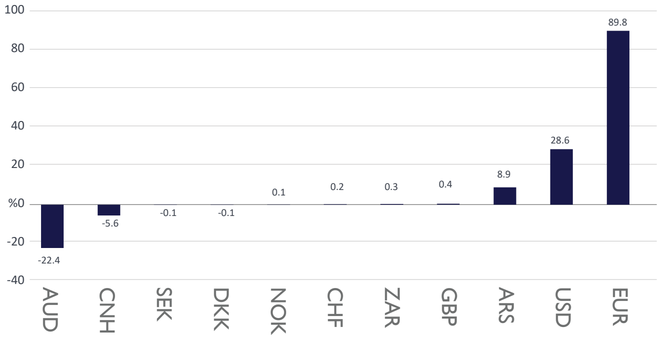
Allocation by industry



Allocation by country



Currency exposure



Manager's commentary

'The words of Mercury sound harsh after the songs of Apollo'

Just giving you a rest from my words alone, I felt that Andrea Badelt's recent piece was much more eloquent. We are now tasting the last intoxicating draughts of this longest ever bull market. All predators have been slain. The world economy which weakens into monetary easing whilst stockmarkets catch up with bond markets in their rating. To be fair, no one should be in any doubt that this will ultimately end badly. But not now?

From: Andrea Badelt, Eriswell Capital Management LLP

'The big danger for 2020 is still the productivity stall'

2020 opens with many classical threats to financial markets: war in the Middle East, oil spike, nuclear conflict, simmering trade tensions, political instability, global energy inequality, and Brexit, etc.

What should we make of this?
Despite these risks being generally well analysed, there is a marked tendency for investors to overplay farfetched financial contagion scenarios, which historical precedent suggests are much less likely than commonly imagined.

On the other hand, financial crises tend to be driven by factors beyond the scope of conventional process-driven risk management techniques which don't lend themselves to breathless live reporting and, most curiously, which are beyond the scope of our collective imaginations. Just such a factor exists today.

Risk management can actively increase systemic risk
Financial risk management concerns itself with the management of significant but unlikely adverse events. It is an inexact science where no single technique provides a full solution; value at risk (VAR), extreme value theory (EVT), and adverse scenario analysis all play a part. It is well accepted that VAR-based tools are more concerned with the management of short-term volatility than protecting against extreme events. Which has in the absence of something more imaginative led to an overreliance on adverse scenario analysis with its inbuilt bias towards preventing a repeat of past crises: 1987 Crash, 1997 Asian Crisis, 1998 LTCM/Russian default, 2000 Tech Bubble, 2008/09 GFC, etc.

It is also well accepted that diversification – the foundation of risk management – can be counterproductive at a macro prudential level. For example, between 2003 and 2007, and again between 2013 and today, the trend towards increased risk diversification exerted and is exerting a downward pressure on asset price volatility generally.

Everything looks safe during this low volatility period, but hand in hand comes an increased risk that difficulties within a particular asset class swiftly spillover to other unrelated assets and jurisdictions; the so-called contagion channels.

What might trigger such a crisis today?

Probably not a big shock event
To answer this question, we must first step away from the collective obsession with sudden adverse events. True, most sudden events tend to be bad news: wars, terrorist attacks, unexpected Fed move, imposition of new tariffs, SARS outbreak in China, etc. Like Iran this week, they attract vast media coverage but tend to affect asset prices by less than one might expect.

By comparison most things that happen gradually over time are good: prolonged recession-free period, an extended peace, improving education, medical advances, etc. In economic terms, the most powerful driver is just such a slow-burn factor, the 'magic of productivity', i.e. the ability to produce more and more from the same economic inputs.

Human's irrational dread of catastrophe fuels an irrational fear of sudden losses (Kahneman/Tversky), which in turn creates a ready market for the prophets of doom. At times of heightened tensions – like today – these voices appear across the media with warnings of impending disaster, ostensibly based upon their savvy reading of geopolitical events and market trends. In practice, it is more to do with their skill in weaving narratives which arouse our sense of horror. Fears which are subsequently magnified by our innate difficulty in distinguishing between 1-in-a-million chances and a 1-in-a-hundred ones.

For this reason, these prophets of doom are invariably wrong, assets remain hooked in the objective reality, and investors talk about climbing the wall of worry. Pretty much what we are seeing today.

While not the answer to what might cause a financial crisis, these excessive worries have a dangerous side effect.

A masked factor has developed behind the scenes.
Tversky made much of humans' inherent irrationality in dealing with probabilities and contingent probabilities. For example, we intuitively think of the risk of two adverse events occurring simultaneously as very unlikely, even if we know that flipping a coin once doesn't change the odds of a second flip. This is a big problem in finance, not for want of maths skills, but because when probabilities become correlated, as they inevitably are where collective risk diversification has taken place, then the chance of one adverse event leading to another, however unlikely this may seem if separately evaluated, increases significantly. The outcome in cases where such contagion channels exist is much worse than a statistician might judge based upon past data alone.

In other words, a second risk can become obscured behind the perceived unlikelihood of a first big headline news story such as Iran.
And especially – as is the case today – if that second risk is a slow-burn non-newsworthy factor which can also evade detection by many conventional risk systems by actively supressing volatility. Even more dangerous is when this second risk can also evade extreme value analysis through lack of historical precedent.

Most potent of all are those factors with the potential to first magnify asset prices to the point of actively fomenting asset bubbles, then decimating them as growth and corporate earnings stutter.

Enter the entrenched productivity stall: and the persistent misunderstandings as to its ultimate destiny in liquidity trap conditions.

The slow burn obscured factor: wonder and danger of productivity.
<u>The Wonder:</u> while possessing no momentum in a literal sense, productivity's steady G-7 post-1880 annual growth rate of 2–2.5% certainly suggests the existence of an underlying constant, the 'productivity metronome' (Refs).

Recessions temporarily interrupt this trend, although in normal circumstances the 2–2.5% productivity trend continues in background. Technology, science, and medical progress continue to offer new efficiency savings through improved technology, better public health, and increased knowledge. Which sets the scene for the v-shaped recoveries which propel the post-recession economy, not only back to its original level, but upwards to regain its long-term productivity trend (Fig 1).

<u>When productivity stalls:</u> economic productivity (output/hr) is different to technology progress. The glue that normally binds the two is when the technological/scientific progress can create new more productive jobs to hoover up the workers displaced by efficiency savings elsewhere. However, every 60-100 years this glue 'mysteriously' fails and the so-displaced workers are forced into lower-paid, less-skilled work. At this point the economy enters a productivity stall which tend to persist for 20 years or more.

During such periods fiscal and monetary policy both play a role, the latter by stimulating households' and corporates' innate preference to inter-temporally forward-shift consumption, investment, and profit. The hope is that economic productivity' will soon restart. This was the story of the Europe/US in 1873-1896, Japan 1986-2018, and Europe/US 2008 è ?

There is currently little visibility as to where all these well-paid more productive jobs will come from.
Which is a BIG PROBLEM because the credit-based intertemporal forward-shift in consumption is finite. That said, the current thinking within Western central banks (despite the ECB's repeated denials) is that improved DM private sector balance sheets no longer pose a risk and that central banks can safely manage government debt much higher if necessary (Refs). In the same vein, these central banks believe that China possesses the necessary fiscal space to smooth any blowouts in its ballooning private sector debt (Fig 2).

Do you believe that central banks can safely walk the debt monetisation tightrope?

The ballooning debt tightrope.
Neither do the debt experts introducing the excellent new World Bank book *"Global Waves of Debt"* (well worth a quick read):

"After a decade of slow growth and low interest rates, the world is awash in debt—issued by households, corporations, and especially governments. It is tempting to believe that with interest rates as low as they are today, including in emerging markets, much higher debt levels are sustainable indefinitely.

This book's impressive review of history and theory cautions against complacency and argues for proactive policies to buttress macroeconomic and financial stability. All analysts of the global economy's past trajectory and future prospects will want to read this book.

Hopefully, policymakers in authority, whether madmen

or not, will do so as well-before the next crisis hits."
Maurice Obstfeld, Berkeley University

One is remined of Jean de La Fontaine's, "The frog that wished to be as big as the ox":
"This world of ours is full of foolish creatures too;
Commoners want to build chateaux;
Each princeling wants his royal retinue;
Each count his squires.
And so it goes."

The frog never realised it was about to explode and La Fontaine's analysis applies equally well to today's credit fuelled economies (private and government credit).

Conclusion
Western central banks' 'worst case' scenario is spiralling inflation, unexpected and severe rate hikes, and deep recession. They don't see that outcome as particularly likely and neither do we. The trouble is that the difference between their 'base case' and 'worst case' scenarios is largely irrelevant today.

For the base case is simply managing government debt up to a level where there is no longer a credible way out. Our in-house ZLB models certainly foresee no credible outcomes where a restart in productivity growth is accompanied by a continuation of near-zero natural real interest rates. Can you?

Finally, the 'best case' scenario revolves around ample new well-paid jobs within thrusting new frontier industries. This seems farfetched at best.

No change to any of our recommendations for now, timing this will not be easy.

Wishing you a Low-risk, Prosperous and Happy 2020!

-Andrea

From: Crispin Odey

Dear Andrea,

Yet again you really get to the truth. It is as you say not that there is a sudden crash. What happens is that we wake up to the fact that none of this debt can be paid back. Too few life boats on the titanic. We see it in microcosm when Tullow realises that they do not have the cash flows to pay back the debt. Nothing to do with the interest rate. It is the redemption yield that was never accrued and paid back and has now become dependent on a single repayment which is only payable if the asset is sold. To whom?

The assets are priced now not off some combination of interest and principal maturity repayment scheme but interest affordability alone, so the price is too high. People start to disbelieve in the repayability!

As you say it is the way in which the kicking of things down the road means everything gathers unresolved. My point is that by halting the debt deflation cycle, the clearing of mistakes is not allowed. In a way everything becomes as it always has been In Third world countries. Loans are really equity tied to the regime. It has nothing to do with capitalism so no surprise that productivity growth disappears. You stagger on for years and then like soviet Russia, people get bored of no growth, no improvements in living standards and rebel. But they don't realise that growth is only achievable if you have the war between the new and the old. If the political establishment, because of democracy, always is on the side of the consumer not the employer and the old. This only happens when the political establishment, because they need to please their voters, always support the new cheaper way of doing things against the threatened old technology and its incumbent employer. Consumers win, not employers.

That is not around in today's world. Today the world is leveraged going into this low return environment and most probably, the returns are not going to cover interest and principal. How long will people wait patiently?

Then governments also start to misbehave. As we know, it is only a small percentage of the population which understands wealth creation. Politicians are not amongst them. Why should we believe they will get it right when they have so little understanding?
For the bear, the problem is that there is now no transmission mechanism for this to make itself felt.

-Crispin

From: Andrea Badelt

Hi Crispin,

You are so right. A threat that supresses volatility-based risk systems and lacks recent precedent, leaving the heavy lifting to theoretical ZLB/productivity models and their ilk. Either way, the danger is plain enough, liability levels violating the value of the assets upon which they are secured. Losses are now all but certain come deflation and falling asset values or inflation and higher rates.
There is a final harsh beauty to this virus; "It is difficult to get a man to understand something, when his salary depends on his not understanding it." To the extent that our esteemed central-bank-spießers are sounding like intellectually desiccated drug addicts …just give me that damn money printer man one last time! Except those printers are already whirring!

Speak in the very near future.
-Best, Andrea

Fig 1: UK Productivity: 1830–2010

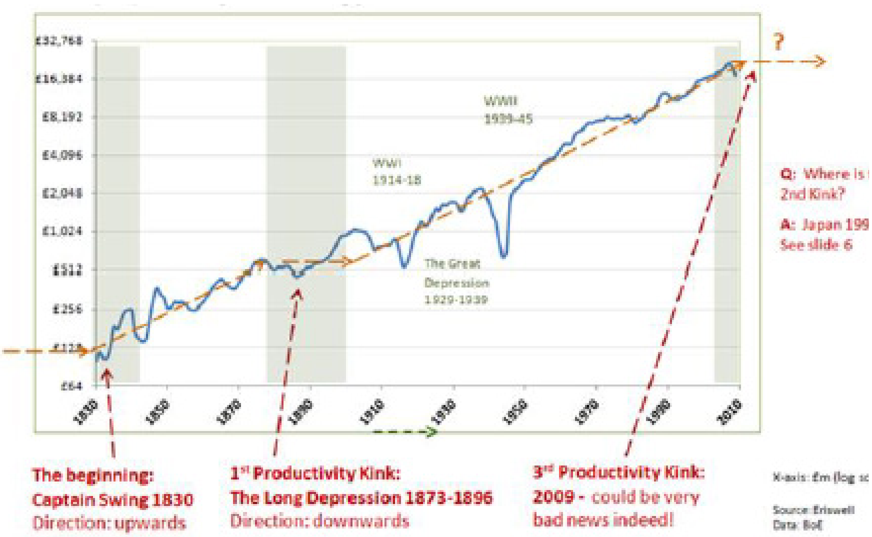
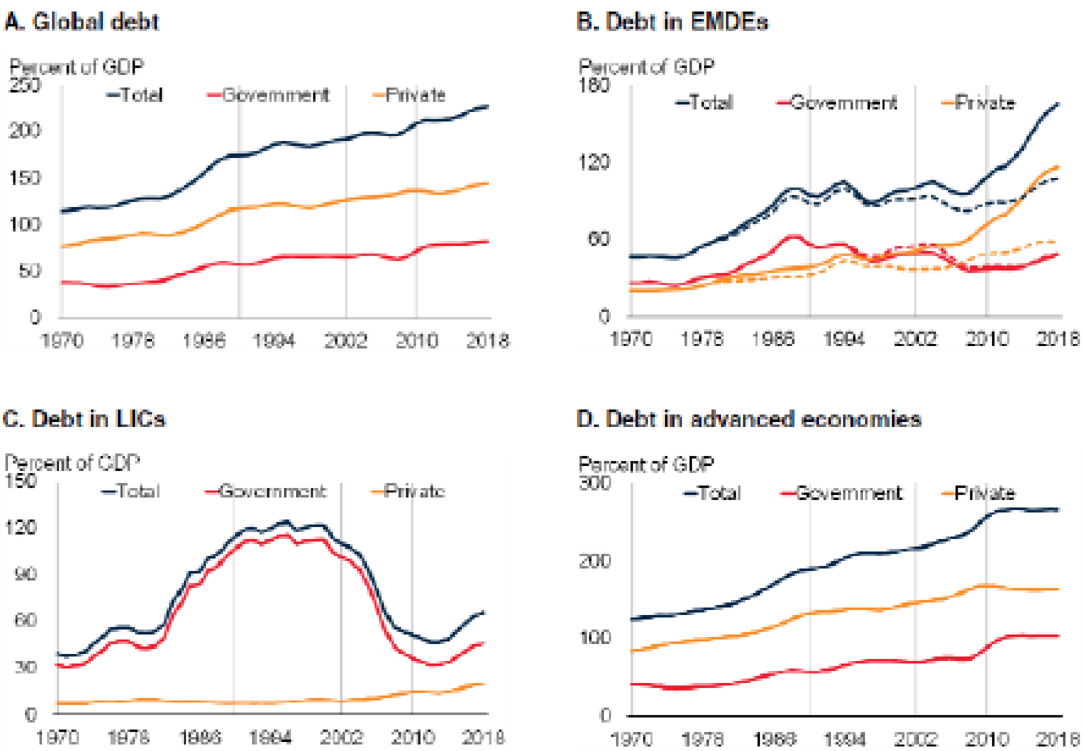


Fig 2: Evolution of Global debt



About Odey Asset Management

Odey Asset Management is a highly regarded London-based investment firm managing around $5.9 billion for institutions, private banks and individual investors. Since inception, founder and Chief Investment Officer, Crispin Odey, has built a strong investment and research team that contribute to the delivery of superior portfolio performance.

About the Fund

Managed by Crispin Odey, the Odey International Fund is an Australian-domiciled global long/short, absolute return unit trust that aims to deliver investors long-term capital appreciation by investing predominantly in equities and equity-related securities. The Fund invests in Odey Asset Management's long-standing and successful flagship strategy, Odey European Inc., which Crispin Odey established in 1992.

About Crispin Odey

Crispin Odey
Founder, Chief Investment Officer

- Established Odey Asset Management in 1991 to focus on active investment management with a focus on generating superior returns.
- One of the UK's most respected professional investors having delivered exceptional returns for investors over the long term.
- Heads the investment management team which comprises over 30 investment professionals.
- Prior to founding Odey Asset Management, Odey managed the Baring European Growth Trust and Continental European pension funds at Barings Asset Management and Framlington Fund Managers.
- Graduated from Christ Church, Oxford, in 1980 where he read History and Economics.

Key features

Manager
Odey Asset Management

Responsible Entity
Copia Investment Partners

Product inception
The Fund is a 'feeder fund' for the Odey Swan Fund, a UCITS[1] vehicle that is modelled on Odey's flagship and longest-running strategy, Odey European Inc., which began in 1992.

Suggested investment time frame
At least 5 years

Risk level
High

Minimum investment
$10,000

Management fee
1.36% p.a. (including GST and net of RITC)

Performance fee
20% (including GST and net of RITC) of the amount the Fund outperforms its hurdle

Performance hurdle
Positive return

High water mark
Yes

Platform availability
Asgard, BT Wrap, Federation Alliance, Macquarie Wrap, netwealth

[1] UCITS or 'Undertakings for Collective Investments in Transferable Securities' provides a single regulatory framework for an investment vehicle which means it is possible to market the vehicle across the European Union without concerns about the country in which it is domiciled.

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