

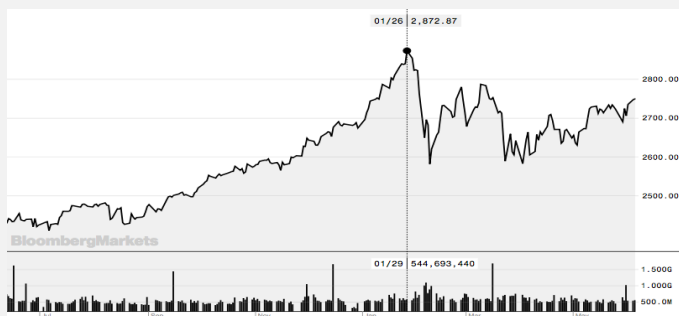


## INVESTING MID 2018

### MARKETS TODAY

- We are a long way into one of the longest bull markets in history. We are certainly a lot nearer the end of this cycle than the beginning.
- There are multiple warnings from market veterans about the inevitable downturn. The potential causes range from too much debt, high equity valuations, Tech companies driving markets, US student loans, strengthening dollar, falling oil, Fed tightening ...
- Along with several geo political factors including inequality, Korea, Syria, new challenges to Europe's leadership, trade wars.
- Our view is that most of these geo-political issues will be brought to some kind of resolution with the passage of time.
- With all these moving parts, it is no surprise that the dynamics of the market have changed considerably over the first half of this year.

### S&P



### UST 10yr yield



### EXERTING OUR INDEPENDENCE

Given we are a truly independent financial advisor, we have used our 'freedom of selection' to source a few innovative solutions that have been incorporated into client portfolios to provide good growth potential and simultaneously have defensive qualities when the downturn comes.

In the interest rate space, we have found a product that delivers a diversified and credit protected exposure, with modest fees, that is generating very healthy returns. See the Owl Rock box below. This is a very elegant solution given the illiquidity in today's bond markets, where central banks are the biggest participants in the market.

We have also been able to show clients a selected number of unique investment opportunities in smaller start-up companies that have huge growth potential. These opportunities can be found on our web site and they have generated a lot of interest from our clients and prospects.

One direct deal we are proud of participating is Symphony. These are a few words below. Arete Capital underwrote some of the latest tranche alongside some major financial institutions - there are others with more interesting opportunities in the pipeline.

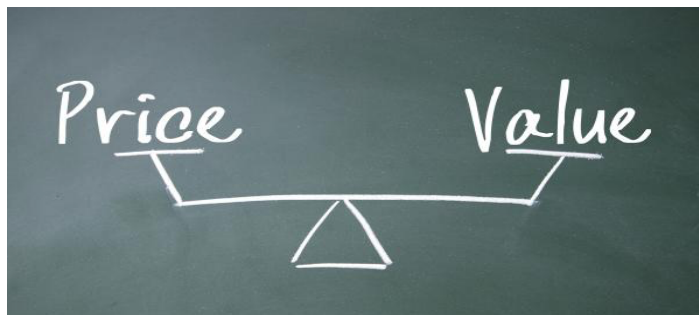
In the world of equities, we are not alone in considering markets, in general, really quite rich! In this environment, we have adopted an approach where we are investing in selected pockets where we see some value or long term growth. We have a few existing modules that are performing very well and we have opened a few new ideas last week. More in a few of the articles below.

## TAKING RISK AT THE END OF THE CYCLE

- Most equity markets have not been able to beat the highs that were posted in Jan18. Equity markets may have seen their peaks this economic cycle!
- The US 10yr Treasury rates have recently broken through 3% and yields have now fallen back, but at the time of writing, yields are close to 3%.
- With equities generally considered expensive, this is not a good time to sit in index related strategies or products.
- We have a few equity modules that have very good performance on a relative and absolute basis. Three modules that have done particularly well are.  
1) Japan, 2) China and 3) Asia ex- Japan.
- At Arete Capital we are advising clients to take on risk in very calculated ways. We have been developing a few new themes where there is potential for strong upside, but a defensive leaning if the whole market heads south.

These themes are explained in the accompanying articles. They are

- True value stocks with a potential catalyst for change
- Robots
- Japans new corporate landscape



## DEEP VALUE

- We have selected a portfolio of 16 stocks where we see true inherent value.
- There are many of these stocks in Japan/ Korea where historic cross holdings have often resulted in a non-realisation of the companies true valuation. A positive revaluation requires a catalyst to change the status quo.
- The true value in all of these stocks will not get realized, but the risk reward is in an investors favour and if only a few mis-valuations are partially realized, the portfolio is expected to do quite well.
- The selection surprisingly includes a few large conglomerates where the group could benefit from realising the true value in a subsidiary or reducing the discount to sum-of -the-parts valuations.
- We have incorporated a few deep value companies in other Asian countries into the mix.

## ARETE DIRECT DEALS : SYMPHONY

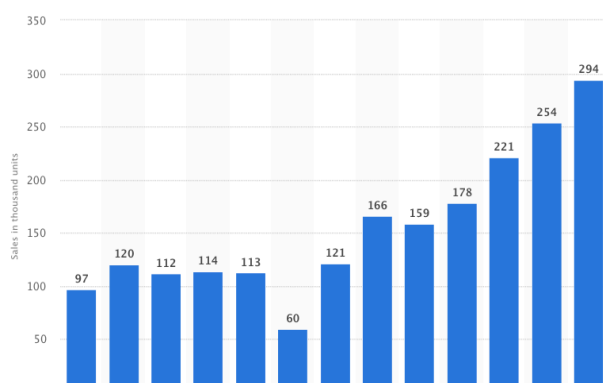
- As part of the Arete Direct Deals program, we have acted as arranger for clients to fund USD 18m into Symphony Communications Services ("Symphony") Series D Round. Symphony has raised a total of c. USD 300m over the past four years.
- Symphony is a secure cloud communication service replaces multiple sources of unsecured, low security platforms used by large corporations and SMEs.
- A few of the c. 20 large companies that have invested in Symphony: Google, GS, UBS, CS, JPM, HSBC, Morgan Stanley, Black Rock. Many of these companies are also customers of Symphony, including JP Morgan, Goldman Sachs, etc.
- There are over 320,000 users in the Symphony ecosystems, as the company seeks the benefits of "network effects".



## ROBOTS

- The world has already entered an age where new generation robots can see and feel while performing their tasks. Today's robots can adapt and are a far cry from the very repetitive tasks performed by robots of only a decade ago.
- We believe this greater uptake of this new generation of robots is only just starting. Robot sales really started growing 6yrs ago.
- Asia's rate of adoption is high, helped by the fact skilled worker salaries have multiplied given the industrial revolution taking place in China. Three of the four biggest robot manufacturers are based in Asia.
- We believe there are a few stocks that will benefit from this robot revolution that is happening now.

WORLD SALES OF INDUSTRIAL ROBOTS 2004-16



## NEW CORPORATE LANDSCAPE IN JAPAN

- The diet made a significant change to the corporate tax code a few weeks ago. This has been barely reported, but could lead to a M&A surge, unlocking some long held value in many Japanese companies.
- There are many big companies with unretired treasury shares, that are an excellent purchasing currency under the new rules.
- There are many companies in Japan with other company stakes, cash and free cash flow comprising the majority of their market valuation – so you get their daily operations for cents on the dollar!
- A very interesting window of opportunity to take positions in companies with deep value with the tax treatment changes as the catalyst to make the change.



## PORTFOLIO INTEREST RATE RISK

- With the relative illiquidity in today's bond markets, one really needs a substantial sum of money to invest in the interest rate space in any sensible portfolio. This is due to much wider price spreads from dealers and yields that are still near their historic lows.
- One option for smaller interest rate investments is to look at bond funds, that give you the required exposure and diversification. Of course management fees and sales commissions eat a substantial portion of the expected returns given the prevalence of low yields.
- We are proud to have offered a very elegant solution to this predicament in the form of Owl rock. This is exposure to a direct lender in the US that is delivering exactly what it said it would: 10-12% per annum returns with exceptionally low fees.
- A few of our clients followed our advice and they are benefitting from some excellent returns in this space.