

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2019			0.2%	0.5%	5.5%	-4.0%	0.2%	0.0%	0.1%	-3.9%	7.5%	7.4%	14.4%
2020	-5.9%	-1.8%	2.6%	13.8%	4.5%	-6.2%	21.8%	14.3%	-2.6%	-6.4%	2.6%	14.8%	58.2%

- The strategy generated gross returns of 58.2% in 2020 with a Sharpe Ratio of 1.3
- We benefitted from hedges implemented in Jan/Feb 2020 as well as increasing our positions in our highest conviction companies in March during market lows
- On the other hand, our position in tankers underperformed; we have reduced our shipping exposure to under 9% of the portfolio
- Our outlook for markets in 2021 is bullish; we see further rallies for equities and other risk assets. Our current hypothesis is that investors are optimistic that a recovery is under way, corporate profits will be higher, and the Fed will keep policy accommodative
- It is possible that we can have an idyllic, honeymoon-like period over the next six to twelve months, at least until widespread roll-out of the Covid vaccines

Dear fellow investor,

As 2020 drew to a close, a common refrain you may have encountered was relief that the year was finally coming to an end and hope that 2021 will bring greater cheer. Truth be told, whenever I heard such sentiments, I could not help but feel a twinge of guilt. After all, my family and I have been spared the worst ravages of the year, and arguably came out stronger from having spent more time together. Alas, many around us have not been as lucky as the virus upended livelihoods and frayed relationships. As we look ahead to 2021, let us be grateful for the little blessings in our lives, and at the same time try to bless those around us.

Musings aside, the Cypress fund's strategy of investing in businesses backed by real assets performed well in 2020. We generated gross returns of 58% this year with a Sharpe Ratio of 1.3 at 40% correlation to the S&P 500. Since our last investor letter in July, we rode the strength of the equity markets to double digit gains in the month of August, gave back some in September and October before closing the year strongly. On average, we gained 10.6% in the months when we were up and lost 4.6% in the months when we were down, outperforming the S&P in both up and down periods. All considered, I think we delivered on our goal of giving you superior, risk-adjusted returns. As a reminder, these figures are gross numbers – they need to be adjusted according to the fee schedule of your share class as well as your time of subscription to the fund.

	Cypress	S&P 500
2020 Returns	58.2%	16.3%
# Positive Months	7 of 12	7 of 12
Average Up Month	10.6%	6.6%
Average Down Month	-4.6%	-5.6%
Volatility	33.4%	25.9%
Sharpe Ratio	1.3	0.9

In our [July investor letter](#), we wrote about Stanford professor Baba Shiv. According to Shiv, human decision-making typically falls into two modes, Type I and Type II:

Type I mindset is fearful of making mistakes. In this mindset, to fail is shameful and painful. Because the brain becomes very risk averse under this line of thinking, individuals with such a mindset seek comfort, typically by minimizing risk and sticking to the status quo. Conversely, the Type II mindset is fearful of losing out on opportunities. When individuals have this mindset, what is shameful is sitting on the sidelines while someone else takes risks and succeeds. Failure is not bad; it can actually be exciting...

In February and March, when Covid was just beginning to spread, investors as a group were clearly in Type I mode.... these investors have switched to the Type II mode, where FOMO (fear of missing out) becomes the bigger driver of investment decisions.

It has been five remarkable months since July. Covid continues to rage on. The number of new cases daily has nearly tripled from under 300k to over 800k, while deaths more than doubled from 6k to 15k. We also had the most tumultuous US presidential election in recent memory, capped off recently by the storming of the United States Capitol. Yet despite these, financial markets have roared along. Shares of Tesla have tripled, elevating Elon Musk to the richest man in the world, while bitcoin rose above \$41,000 a coin, close to \$1 trillion in market cap. We have had good news as well, not least the Covid vaccines from Pfizer and Moderna. Nevertheless, the relentless rally in financial markets despite bad news gives credence to the thesis that investors have put on their Type II FOMO hats, and are paying attention to the good news while looking past the bad.

Investing in Real Assets – A Defensive Approach

At this juncture, it may be useful to provide a recap of the Cypress strategy. While our strong performance in 2020 undoubtedly benefitted from global investors' increasing risk appetites, let me emphasize that our strategy is firstly about risk mitigation, secondly about risk taking. We believe that only with proper risk assessment and mitigation, can we help you participate in the returns offered by the market. Only by first defending well, can we play our best offence.

How does the Cypress strategy play defence? By investing in businesses backed by real assets. Real assets-owning businesses protect investor downside because there will be recoverable value through sales of these assets even in a worst-case scenario, whereas asset-light businesses offer no such consolation. In addition, we erect a second line of defence by scouring for those companies trading at substantial discounts to net asset value, the proverbial margin of safety. In the majority of our investments, we would recover more than our invested capital if the companies were liquidated today.

However, in investing (and in life), it is not enough to play defence. In order to generate strong returns for you, we also need the courage to pursue our convictions. In previous investor letters and webinars, we have highlighted some of our favoured investment ideas, for example in nuclear energy, tankers and specialty engineering, where we think there is the potential to compound your money multiple times. In

future letters, we will also touch upon some of the newer themes that we are committing capital to, including farmland and structured financing vehicles.

All investors want large upside with limited downside but this is extremely hard to achieve. While we cannot see the future, here at Cypress we try to implement a strategy that offers a reasonable chance at achieving this for you. By first having a solid defence (buying deep-value, asset-backed businesses), we derive the courage to play offence (investing in businesses with large upside).

Via Negativa – Minimising Investment Errors by Focusing on What is Knowable

Via negativa is a Latin phrase used in Christian theology to explain a way of describing God by focusing on what He is not, rather than what He is; understanding God's positive qualities is a task deemed impossible for the finite minds of humans. *Via negativa* can also be used to describe a similarly "inverted" way of leading one's life; instead of focusing on what one ought to do, pay attention also to what *not* to do, what bad habits to eliminate, what traps to avoid.

In investing, one needs to both hit winners and avoid losers. However, too often investors dedicate all their resources trying to find the next Google or Amazon (for which they are willing to pay high prices), while neglecting to protect their portfolio against the reality that for every Facebook, there are countless MySpace, Friendsters and the like that destroy capital.

Case in point, bitcoin. As the mother of cryptocurrencies make new price highs this month, we once again hear claims about the potential for bitcoin to become digital gold, achieve widespread adoption as a medium of exchange, and the eventual influx of institutional capital, etc. While these are all plausible outcomes, they are *all forecasts*. Each is a statement about what *could be*, instead of what *already is*.

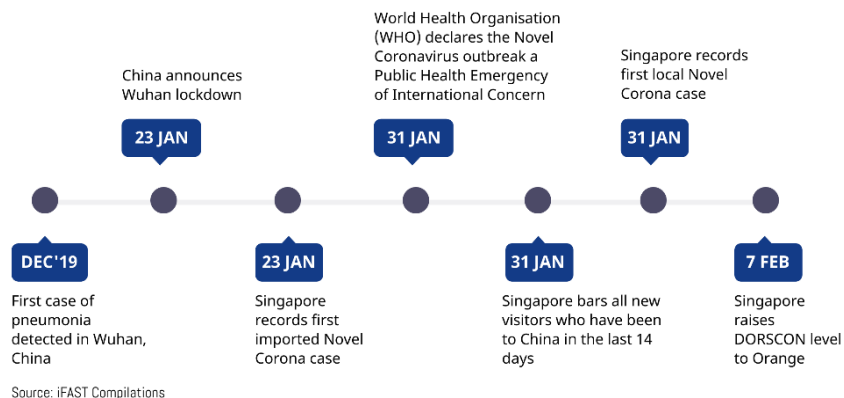
Contrast with the Cypress strategy of investing in asset-backed companies. Instead of spending the majority of our time forecasting the future, we attempt the slightly easier task of analyzing what a company is worth today. This is made easier because the companies we invest in derive the bulk of their value in the hard assets they own, thus reducing our reliance on forecasting future business prospects and cashflows. The former is eminently knowable (using comps, replacement value, market value), while the latter is assumptions-dependent and predicated on superior foresight. By focusing on real assets, we see more, while predicting less. After all, we believe our job as investors is not to see the future, but to see the present very clearly.

Hedging and "Upgrading" the Portfolio Amidst Covid

Coming back to the portfolio, in January 2020 we made the decision to increase hedges in the book in response to the escalating Covid pandemic. We entered 2020 with optimism and began the year by increasing risk; this changed very quickly. On the early morning of Thursday 23rd Jan, Chinese state media announced what amounted to a quarantine of 11 million people in Wuhan, to start at 10am the same day. Later that same day, the quarantine was expanded to 23 million people in 7 cities; in addition, Beijing, Wuhan, Zhejiang and Macau announced that Lunar New Year celebrations and other large public gatherings had been cancelled. Confirmed infections and deaths escalated in China and the first

overseas cases were announced. Over the holiday weekend and into the following week, a drumbeat of bad news hit financial markets hard – by 31st January, S&P 500 was down 3%, crude oil was down 8% and Vix had rallied nearly 50%.

A TIMELINE OF THE WUHAN CORONAVIRUS OUTBREAK



On 17th Feb, we sent out an [interim note](#) to investors to share our reactions to the developing pandemic. We wrote:

In order to protect your portfolio, we began layering into broad index hedges in the final week of January; we also reduced long exposures over the course of the following weeks. Coming into 2020, we had a net long exposure of around 80% of NAV; as of today, that is reduced to approximately 40%.

While the Cypress Fund's strategy is not predicated on short-term trading, we resolutely believe that proper risk mitigation is fundamental to long-term investing success. Given the still unknown but potentially wide-ranging impact of the virus, the one-way rally in risk assets in the fourth quarter of 2019 going into early January, and the sharp sell-offs after the holiday weekend, it seemed to us that risk was asymmetrically skewed to the downside. So while a quick recovery is always possible, this would likely be capped at recent highs; on the other hand, there was still a trapdoor underneath us that may or may not open, but if it did we were likely in for a painful drop. Accordingly, we felt the prudent decision was to put on broad market hedges for your portfolio.

The importance of psychology in investing cannot be overstated. Loss aversion, the tendency to prefer avoiding losses to acquiring equivalent gains, is a well-known trait. Early 2020 was a time when potential losses seemed to vastly exceed potential gains, exacerbating this effect. Beyond the dollar profits that hedging potentially provides, it also plays an important role in generating psychological profits, for example by allowing us to be patient when reducing our long exposures as opposed to feeling that we had to sell at any price. This psychological well-being allowed us to start adding small amounts of risk in our favourite companies in March even as markets were in freefall.

The two largest positions in the portfolio now are Adriatic Metals (ASX: ADT) and Nexgen Energy (TSX: NXE), both of which we bought more of amidst Covid. Even though we believed that these were (and

are) good investments, it would have been difficult to buy more in March if not for our hedges. We also took the opportunity to exit some companies in the period following the March sell-off; some of these we have discussed and include conventional oil and gas producers given the collapse in energy prices. Hence we were “upgrading” the portfolio – taking the opportunity afforded by the market sell-off to acquire more of the companies that we like at attractive prices, while exiting those that we did not, eg those most at risk to the crisis.

Investments in Crude Tankers Have Been a Drag on Returns

Unfortunately, our investments in crude tankers have been a drag on performance this year. In March, we had issued a trade idea to invest in owners of crude oil tankers. The thesis was simple. Charter rates for the largest tankers (VLCCs) had spiked from \$30k/day to nearly \$200k/day, in response to Saudi Arabia ramping up crude production, leading to increased demand for crude storage and transportation. Tanker companies had sold off substantially post-Covid and were trading at massive discounts to net asset value, but were now generating copious cashflow thanks to very high charter rates and so offered the potential for large price gains in addition to fat dividends. In addition, the longer-term supply-demand picture is very favourable for vessel owners – the order book for new tankers are at two-decade lows, while the average age of the existing fleet is quite old and more ships will be and are being scrapped. It had everything we look for in an investment:

- i) Hard assets (Ships)
- ii) Discounts to NAV (30-40%)
- iii) Favourable supply-demand story (Low order book; aging fleet)
- iv) Catalyst (Saudi production)

This theme worked for a couple of months until May, after which charter rates started falling due to OPEC+ production cuts and tanker companies started dropping. At one point, the portfolio had nearly 20% exposure to shipping companies (including some product tankers and LPG firms); since then, we have reduced it to under 9%. Excluding dividends, the loss on these positions come up to 4%. From a fundamental perspective, we still like the supply-demand picture and companies’ deeply discounted valuations. However, the market does not seem to agree, thus we have cut our exposure to a smaller size for the time being.

Picking a Roadmap for 2021 – GMO’s Jeremy Grantham vs Legg Mason’s Bill Miller

Humans are notoriously poor at forecasting, yet we cannot avoid it because we make implicit forecasts about the future with every decision we make. Like the cartographers of old, our attempt to map out the investment landscape in 2021 is guaranteed to be inaccurate. Yet this imprecise sketch can still be valuable as a guide to navigate the markets. Importantly, we need to recognize that should markets deviate from this rudimentary map, it is more likely that our map is wrong and needs to be corrected and not the other way round, ie expecting the market to follow our map.

For templates, we decided to look at what other experts are saying. Both GMO's Jeremy Grantham and Legg Mason's Bill Miller are renowned investors with long and impressive track records. This is what they are saying:

Jeremy Grantham, [Waiting for the Last Dance](#), 5 Jan 2021:

The long, long bull market since 2009 has finally matured into a fully-fledged epic bubble. Featuring extreme overvaluation, explosive price increases, frenzied issuance, and hysterically speculative investor behavior, I believe this event will be recorded as one of the great bubbles of financial history, right along with the South Sea bubble, 1929, and 2000....

The "Buffett indicator," total stock market capitalization to GDP, broke through its all-time-high 2000 record. In 2020, there were 480 IPOs (including an incredible 248 SPACs2) – more new listings than the 406 IPOs in 2000. There are 150 non-micro-cap companies (that is, with market capitalization of over \$250 million) that have more than tripled in the year, which is over 3 times as many as any year in the previous decade. The volume of small retail purchases, of less than 10 contracts, of call options on U.S. equities has increased 8-fold compared to 2019, and 2019 was already well above long-run average.

Bill Miller, [4Q 2020 Market Letter](#), 5 Jan 2021:

I would characterize the current state of the market as one of optimism that a solid recovery is underway, that corporate profits will be higher in the next year, that inflation will stay low, that the Federal Reserve will continue to provide significant liquidity to the economy and will keep short-term rates at zero, that long-term rates may rise but not sufficiently to derail the recovery, that no adverse Fed policy changes will occur until the economy has achieved full employment... that stock market valuations, as the saying goes, look high and are high, but are not as high as they look given the aforementioned economic conditions.

Where I think the consensus may be wrong is that 2021's economic and profit growth could be considerably higher than is now priced into stocks and bonds, leading some groups that have trailed the market for years, such as banks and energy, to move from laggards to leaders. If growth is stronger than believed, the scarcity value of high growth companies will diminish and the rotation to value continue. This does not mean I think many of 2020's market winners will become losers, rather that the market's gains will be much more broadly distributed than in recent years.

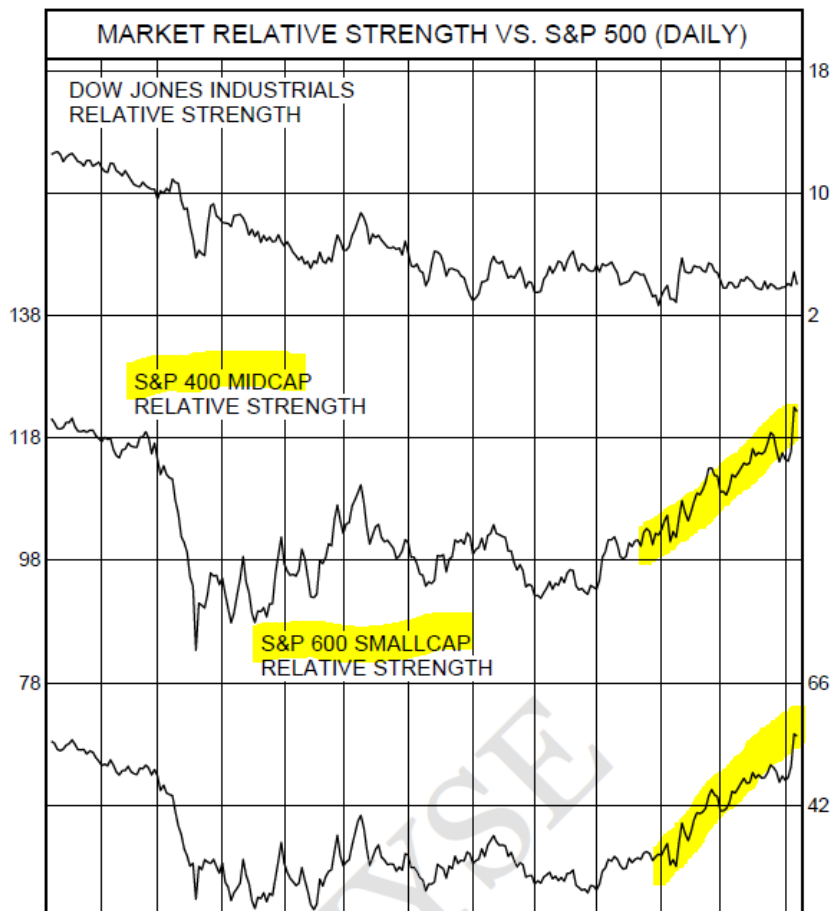
Both Jeremy Grantham and Bill Miller make reasonable claims. Instead of relying on narratives and rhetoric to support our case, let us we try to interpret what the market may be telling us. Can we find evidence from the financial markets that is either supporting these claims or else refuting them?

Market tops (which Grantham believes is imminent), while impossible to time precisely, tend to offer some warning signs. On this matter, I want to quote [Lowry Research](#), which describe the process as such:

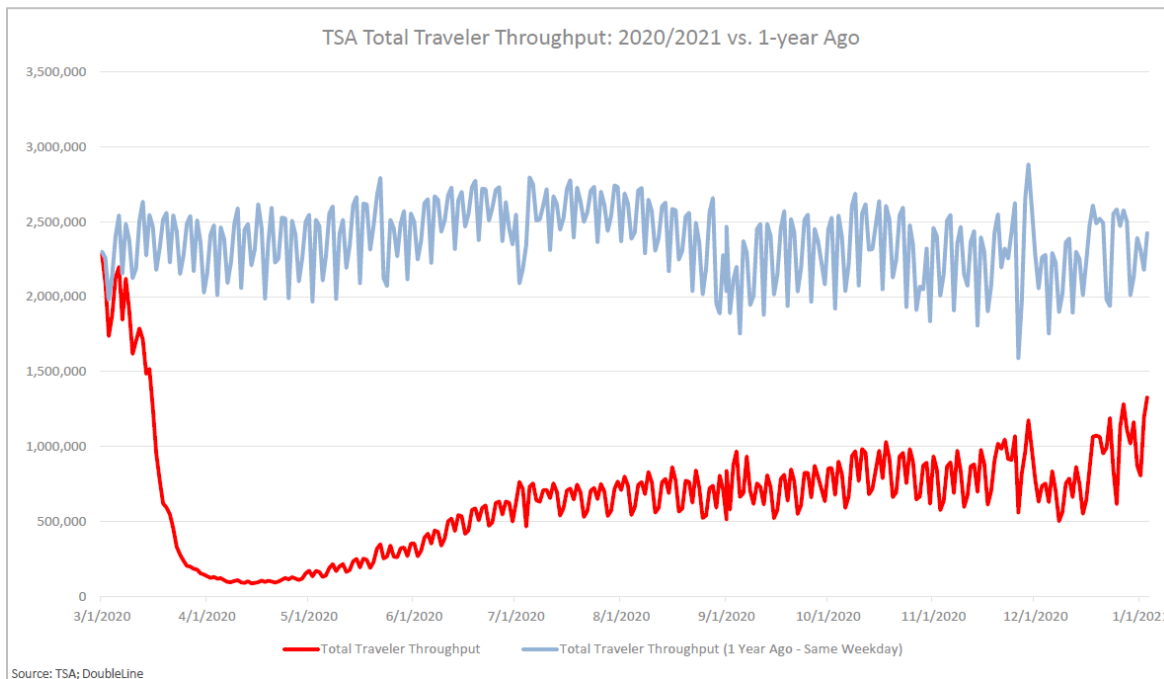
The period leading up to a major market top shares a number of similarities with the Autumn season as it transitions into Winter. That is, in Autumn the leaves begin to fall from the trees in a very gradual process – nearly imperceptibly – one at a time, until the trees are eventually bare at the onset of Winter. It is no different near major market tops. Individual stocks begin to roll over into their own Bear markets, one at a time, usually beginning with the less noticeable small-cap and mid-cap stocks. An important consideration in this gradual process of erosion is that small-cap stocks generally make up about 40% to 50% of the stocks traded, while mid-caps typically make up about 30% to 40%. Big-caps generally account for only about 10% to 15% of common stocks traded. Thus, as a mature Bull market rallies through a series of higher highs in the big-cap price indexes (such as the DJIA and S&P 500), investors often see that a growing majority of stocks may already be in downtrends. At the final high in the big-cap indexes, a relatively small number of heavily weighted big-cap stocks can deceive investors into believing that the broad market is still in a healthy uptrend.

Our experience is consistent with Lowry's observations. And instead of portending impending doom, markets seem to be suggesting the opposite. A variety of metrics we track show that the market rally enjoys broad participation and is not just driven by a small group of stocks. For example, small and mid-cap stocks are leading this charge, which is more typical of the early innings in a bull market than the later stages. Other indicators we pay attention to are sending the same message.

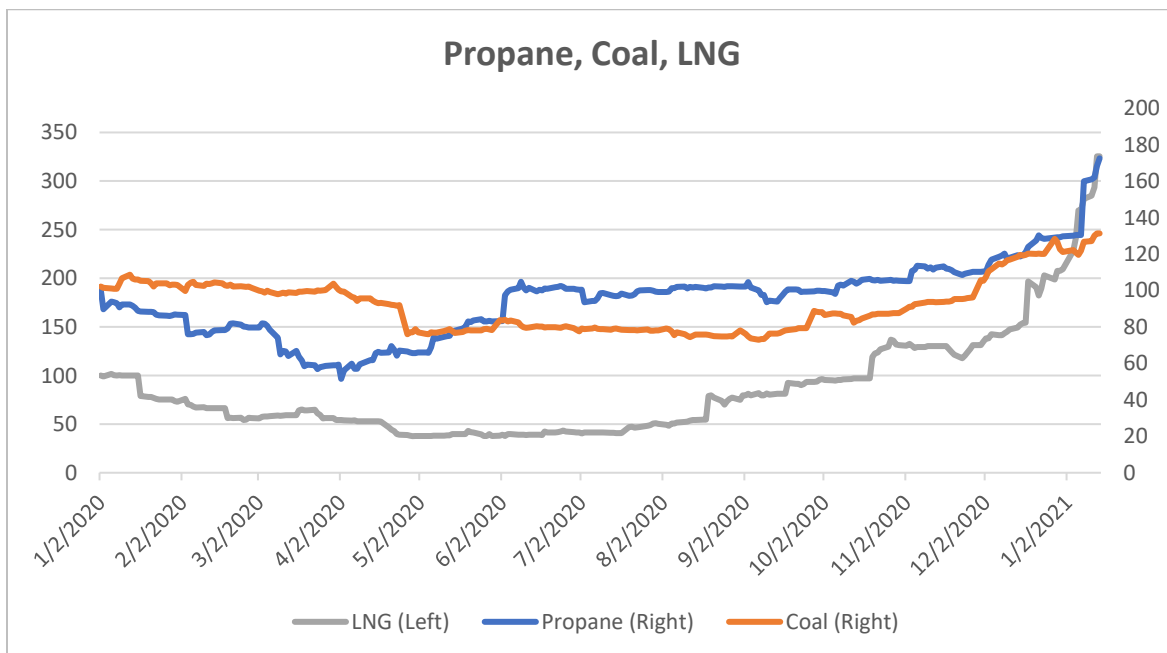
Small and mid-cap stocks have been outperforming the S&P 500 since September. From Lowry Research.



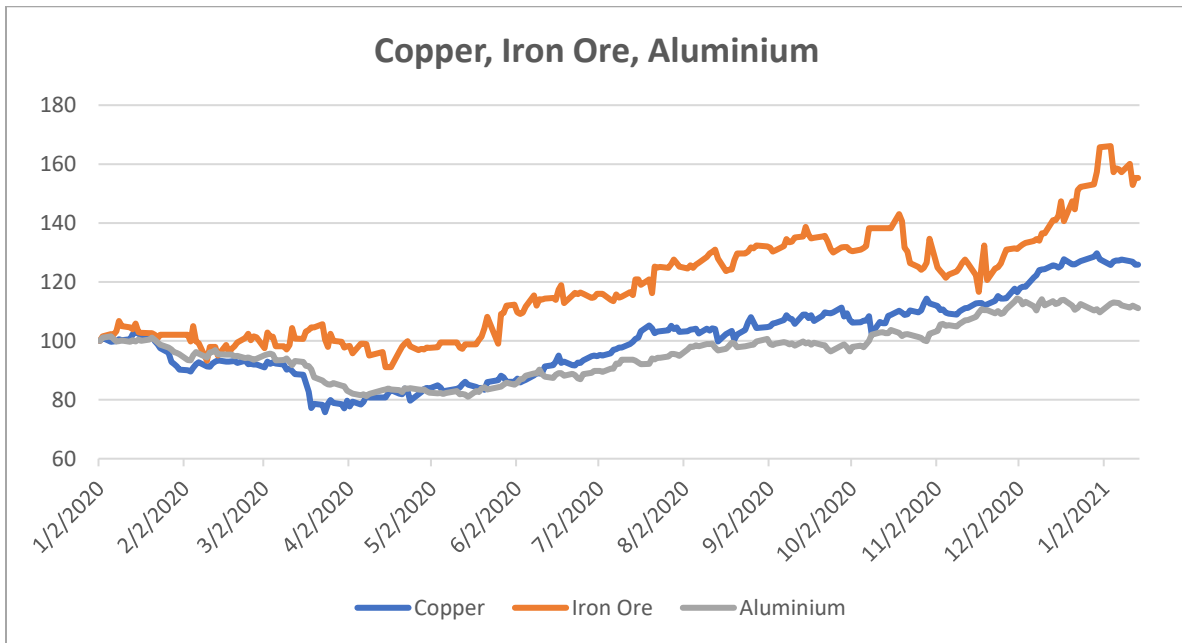
Borrowing a chart from [Doubleline Capital's](#) recent webcast, traveler throughput in the US has been recovering since March, but versus figures from a year before that, it is still at very depressed levels. Is this a sign of substantial pent-up demand that could be unleashed should things open up, or does it reflect the moribund economy?



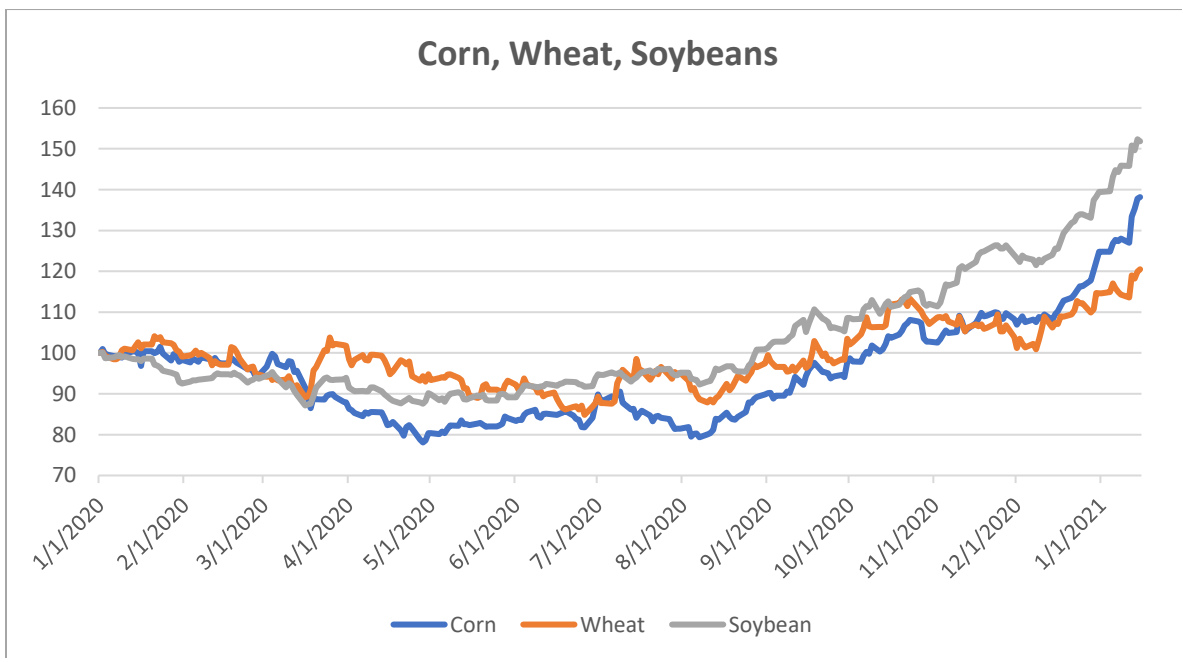
In our opinion, markets seem to think there is substantial pent-up demand. In the energy space, most are aware that crude oil and natural gas prices have moved higher. So have more esoteric products like LNG, propane and even coal:



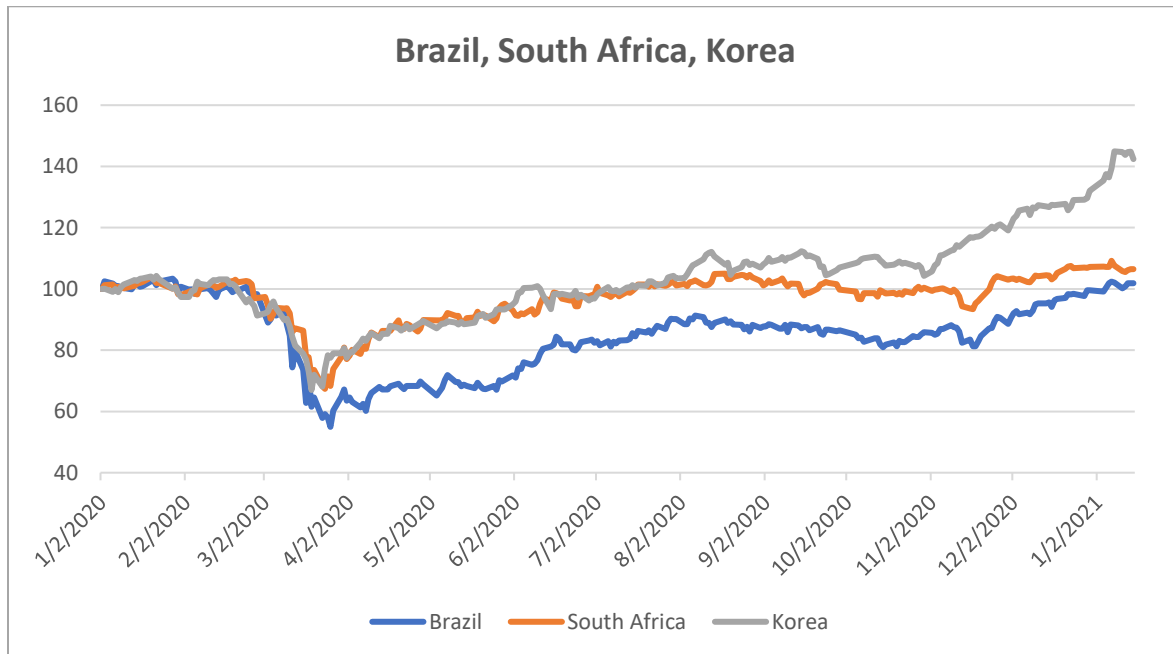
Likewise, industrial metals have been rallying strongly:



As have agricultural commodities:



Emerging market equities have also been beneficiaries:



In the US, 10-year bond yields recently broke above 1%, a figure that could not be breached last year. This could be a sign that fixed income investors see more growth ahead (and hence higher interest rates).



Inflation is also corroborating the stronger growth narrative. Since March, 10-year inflation expectations implied by TIPS (Treasury Inflation Protected Securities) has risen from 0.50% to over 2%.



From equities to bonds, commodities to FX, different asset classes seem to be hinting at the same message – investors are optimistic a recovery is underway. Again, maps need to reflect the terrain; we should not force the terrain to fit the map. Given this, we believe the more accurate roadmap to use as we navigate 2021 should be Bill Miller’s and not Jeremy Grantham’s. This will be our framework until markets tell us otherwise.

Honeymoon Period for Markets until Vaccine Rollouts?

We also see the possibility of a honeymoon period over the next six to twelve months when markets can bask in the warm glow of announced vaccines without having to face the reality of what life could be like after we achieve herd immunity. In Singapore, the government has secured enough doses for citizens and long-term residents and the first vaccinations took place in December. Still, it will take at least until the third quarter of this year before the entire population can be vaccinated. Elsewhere, it will take more time. Ironically, we think that the longer it takes to roll out vaccinations in the developed world, the better it is for risk assets. Recall that the enthusiasm that greeted the Pfizer/Moderna vaccine announcements was in part due to the hope that we can finally return to life before Covid. As long as vaccinations are still being rolled out, it remains plausible that the economy can pick up where it left off and this hope can keep markets buoyed. However, once a large percentage of the population is inoculated, reality will put this belief to the test. How markets will react is anybody’s guess.

Concluding...

We had a good run in 2020. Early in the year, we were lucky to have hedged the portfolio before the markets got hit by Covid risk-reduction, and then were able to increase stakes in the companies that we really liked at very attractive prices. While the performance of some of our investments have been lackluster, our focus on buying asset-backed businesses at substantial discounts protected us from suffering too serious damage. Looking ahead to 2021, the market seems to be saying that investors are optimistic about growth this year (is it because the economy is fundamentally healthy, or thanks to aggressive policy post-Covid, we do not know), and have pushed up the asset classes most sensitive to

this growth. From a tactical perspective, we are thus more inclined to be buyers, especially in the event of market declines, rather than sellers as the market rallies. At a macro level, we remain concerned about the very stimulative monetary and fiscal policies globally and so continue to believe that our real asset-focused strategy is the prudent approach going forward. As always, we are grateful to you and your family for your support. Thank you for reading and we look forward to hearing your questions and comments. I wish you all the best for 2021!

Sincerely,

A handwritten signature in blue ink, appearing to be 'Yongchuan Pan', with a stylized, cursive script.

Yongchuan Pan
16 Jan 2021

CYPRESS PORTFOLIO BREAKDOWN

