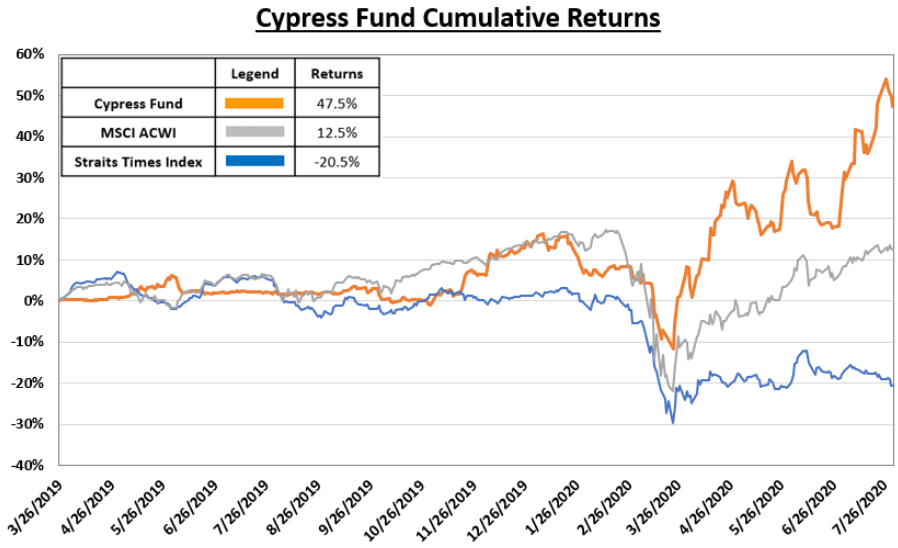
Dear fellow investor,

The fund performed well in the three months since our last investor update in April. The fund made respectable gains in May (+4.5%), gave back these gains and more in June (-6.2%) before an exceptionally strong performance in July (+21.8%). This brings our YTD returns to 28.9% and returns since inception to 47.5%.



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%						28.9%

In our April investor letter, we wrote:

> *Many investors predict the market will retest March lows; others believe that the fretting exhibited by market participants is typical at the beginning of a strong rally, hence the common refrain that a bull market climbs a wall of worry. We lean towards the latter interpretation, although we do not hold this view strongly. For now, we continue to like the current valuations of companies we own, while acknowledging that COVID's longer term impact on the economy and the financial markets could be nasty. We therefore intend to stay nimble and will update you accordingly as our view evolves.*

Since April, global markets have largely climbed this 'wall of worry'. We believe that this 'risk-on' mood has been aided by continued fiscal and monetary largesse, as well as a reduction in uncertainty as investors gradually come to terms with Covid. On the latter point, we are not saying that the Covid pandemic is behind us; far from it, as many countries seem to be experiencing second and third waves of infection. Rather, it appears that we have collectively come to accept Covid as a part of our reality (at least until therapeutics or vaccines are found) and that life must go on despite it. Accordingly, investors have shifted gears, from reducing risk at all costs in March (fear of loss), to figuring out how to generate

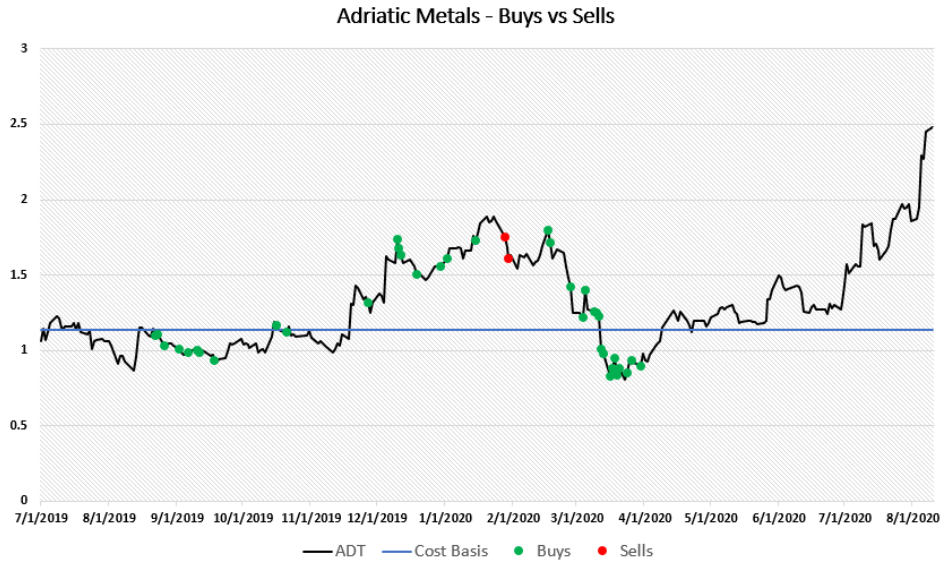
alpha in this new environment (fear of missing gains). We believe this psychological shift is a big reason for the rally in risk assets, and we will explore this idea briefly later on in the note.

Category	May - July Returns
Adriatic Metals	22.3%
Uranium	2.5%
Precious Metals	1.5%
Others	-1.1%
Hedges	-1.5%
Shipping	-4.2%
Total	**19.5%**

Drilling down into the portfolio's performance, our best performer has been Adriatic Metals, which contributed a chunky 22.3%. This was followed by our investments in uranium related companies, adding 2.5%, while exposures in precious metals contributed another 1.3%. On the other hand, our investments in shipping companies have been disappointing, subtracting 4.2%. Portfolio hedges further reduced our numbers by another 1.5%. Going forward, we expect to see occasional lumpy contributions to returns (such as Adriatic) as our investment theses play out.

In the rest of this letter, we will discuss Adriatic Metals, why we like the company and how we sized the trade. We will also update our outlook on uranium and tankers, before discussing a new company which we are watching – Babcock International. Finally, we will touch on some of the other issues that are on our minds, including the US presidential elections (read: good for stocks), recent sharp spikes in money supply and Baba Shiv's ideas on human decision making and their investment implications.

I) Adriatic Metals (ASX: ADT, LSE: ADT1)



Adriatic Metals is a precious and base metals explorer/developer that owns the advanced polymetallic Vares project in Bosnia & Herzegovina. We started acquiring the shares of ADT in the last quarter of 2019, substantially increasing the fund's exposure to the company during the March selloff, to over 20% of the portfolio – our largest single exposure. As you are aware, we aim to invest in 6-7 themes spread over 10-15 names, so most of the time, we do not expect to deploy more than 10-15% of the portfolio in any one position. In the case of ADT, a combination of outstanding deposits, substantial insider support

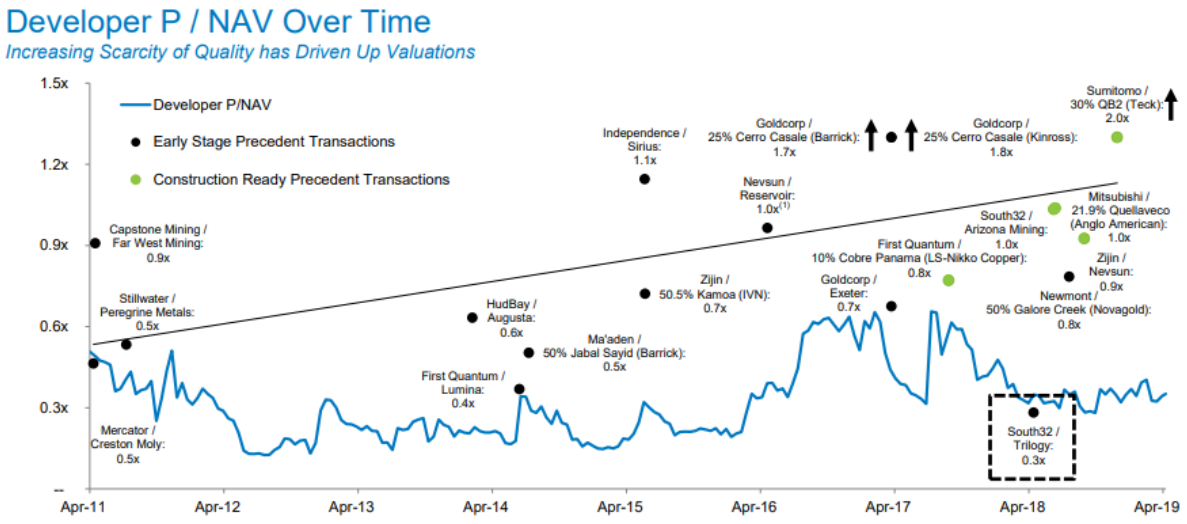
plus relative cheapness to peers meant we were targeting the higher end of the range, assuming entry prices between AUD 1.50-1.80. The crash in March sent the stock falling, at one point dipping under AUD 0.80. Given the absolute bargain that was on offer, we decided to push our holdings above 20%. As you can see from the chart above, we achieved a cost-basis of AUD 1.14 versus prior expectations that was greater than AUD 1.50. Our target price for Adriatic Metals is approximately AUD 5.

As background, ADT's Vares project consists of two high-grade polymetallic deposits, located at Rupice (greenfield) and Veovaca (brownfield). Bosnia boasts a long history in mining – Veovaca produced over 250 thousand tonnes per annum in the 80s. With the Bosnian war and the bankruptcy of Energoinvest, ownership of these concessions transferred to various parties, before being eventually acquired by Eastern Mining. Adriatic Metals was set up in 2017 specifically for the purpose of acquiring Eastern Mining for the Vares project.

In November 2019, the company released its Preliminary Economic Analysis (PEA), which presents the first snapshot of project scope, size and potential economics of investors. The results of this PEA indicate an NPV of USD 917 million; our cost basis translates into a market cap of USD 140 million, or roughly 15% of NPV. Below, we explain why we believe this investment has precisely the type of asymmetric payoff profile that we like.

Downside Protected by large NPV Discount and Substantial Sandfire Ownership

Adriatic Metals, probably due to its Bosnian jurisdiction, was trading at rock bottom valuations of only 15% of NPV. Note that the shares of junior miners always trade at a fraction of NPV (or NAV, blue line in the below chart) and these range from 10-15% up to 60% of NPV, while majors can trade at substantial premiums. Acquisition deals naturally command a premium, ranging from 40% to 200% of NPV, with precious metals and construction-ready projects selling at the higher end of the range (black and green dots below). While substantial risks still exist that can derail Adriatic's path to eventual production, we like that we are paying historically low valuations for it.



Besides its cheapness, Adriatic also benefits from a large cornerstone investor in Sandfire Resources (ASX: SFR) that will likely provide a backstop bid. Sandfire had invested in Adriatic's IPO and thereafter

has consistently increased its holdings via purchases in the secondary market – to date they own over 16% of the company. In addition, Sandfire's mines have only 2 to 3 years left in production and they desperately need to replenish their reserves – Adriatic would be a welcome addition. Finally, Sandfire has nearly USD 300 million (and growing) in firepower on its balance sheet for just such an acquisition. While we would never invest in a company based just on the speculative view that its largest institutional shareholder may acquire it, it certainly helps provide us with the comfort that there is a good support bid that exists and hence limit our downside.

Upside Optionality – Expanding Resource, Acquisition Upside and Rebrand as Silver Producer
We have previously highlighted how important that the companies we invest in benefit from optionality. Adriatic fits the bill because there are so many ways for shareholders to 'win'. At current prices, we see another ~100% upside in the share price. In a truly blue sky (albeit low likelihood) scenario, the company can trade above AUD 20.

a) Expanding Resource. The November PEA produced an NPV of USD 917 million for ADT. Since then, a number of developments suggest that the NPV may materially grow when the firm completes its pre-feasibility study (PFS) later this year. Firstly, additional drilling and geologic surveys suggest that the resource at Rupice could grow ~50% from that assumed in November last year. Secondly, ADT is in the process of acquiring Tethyan Resources in an all-share transaction. Tethyan is an explorer in Serbia with a similar sized but lower grade resource and this merger would put Adriatic on the pathway towards becoming the leading precious and base metals producer in the Balkans. The new, bigger company would also be more attractive to the majors looking to replenish declining reserves.

b) Acquisition Upside. In the previous chart, we see that acquisitions of early stage developers can range from 0.4-1.7x NAV. Adriatic trades at ~0.34x NAV today, so an acquisition at the low end implies additional 20% upside. Besides Sandfire, which knows the company intimately, we know that a number of majors with far deeper pockets (the likes of Zijin, Teck, Lundin) are already kicking the tires. For shareholders, a very positive outcome would be a bidding contest over the next few months after the company releases its PFS.

c) Rebrand as Silver Producer. Even before the recent shoot up in the prices of precious metals, silver miners trade at pretty high valuations – up to 2x NPV for early stage companies and 20x earnings for producers. Silvercrest Metals, a precious metals explorer in Mexico, with an attractive deposit at a similar stage of development, is currently trading at 1.8x NPV. Note that while ADT has a polymetallic resource, gold and silver will contribute close to 60% of revenue once it is in production, so it is not a stretch to reposition the company as such. Based on the PEA, the company will produce close to USD 400 million in EBITDA in 2023/2024. In a precious metals bull market, getting a 10x multiple on earnings (USD 4 billion valuation) is entirely feasible.

In conclusion, Adriatic Metals comes with good downside protection, while offering investors substantial upside optionality. Our base case is that the company will be acquired by a major after a bidding process at a P/NPV closer to 0.6-0.8x, or further gains of ~100% from here. Should the company decide to develop the mine themselves, there is a chance for truly incredible gains (>800%) over the next 3 to 4 years.

II) Uranium / Tankers

These are still two of our favoured investment themes, which we have covered in some detail in our previous letters. We continue to add to our investments in the uranium space, although we have trimmed back some of our tanker exposures given that the market did not respond as positively to strong earnings as we had expected.

On uranium, spot prices have so far plateaued at the USD 32-33/lb level, which was reached amidst numerous mine shutdowns due to Covid. More recently, Cameco, the world's second largest producer, announced that it is planning to restart its Cigar Lake mine in northern Canada in September. In the near term, this will reduce the amount of uranium oxide that Cameco needs to buy in the spot market, so may act to dampen further price increases. Production by Kazatomprom, the world's largest producer, is still suspended for the time being.

On tankers, Q1 as expected was a blowout quarter, as demand for floating storage drained supply from the tanker fleet, resulting in record high charter rates. Okeanis Eco Tankers (OSE: OET), Euronav (BB: EURN) and Hafnia (OSE: HAFNIA), three of the companies we own, paid Q1 dividends of 8%, 8% and 6% respectively (not annualized). Since then, Euronav has also been returning capital via stock buybacks, which are accretive to shareholders since the shares trade at discounts to NAV. They will be announcing Q2 earnings in the coming weeks; these will also be strong and more dividends can be expected. Despite their good operating performance, their share prices have languished. In light of this, we have trimmed our exposure somewhat in order to reallocate to other sectors. Note that we still think the discounts to NAV will go away. Okeanis has an explicit "Discount Control Mechanism" which they could activate in Jan 2021 to close this gap. Should the shares continue to trade so cheaply, they will sell vessels at NAV and use the proceeds to repurchase stock (at 50% of NAV).

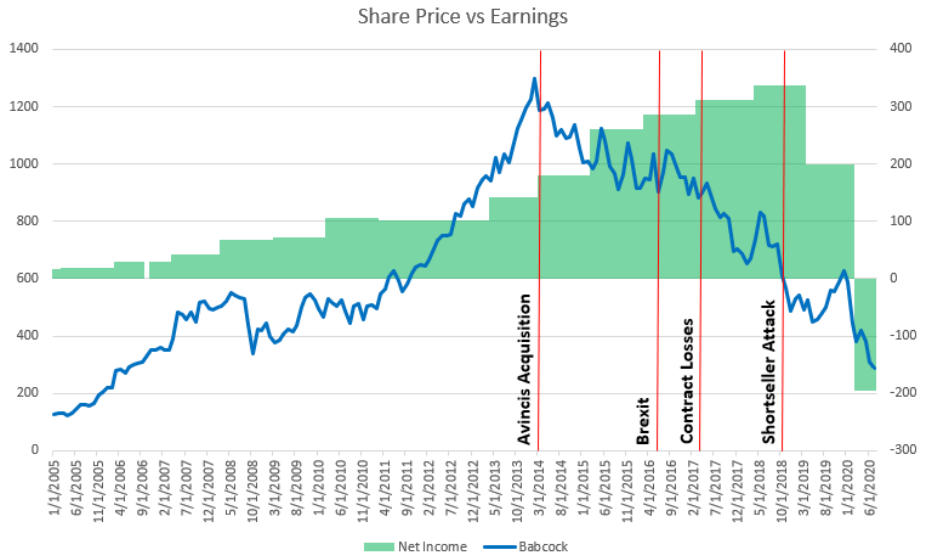
III) Babcock International (LSE: BAB)

Babcock International is a UK-based specialty engineering company that we are closely watching. The stock has been crushed and offers investors a chance to own a hard-to-penetrate, long duration, stable margin business at close to 20% implied yields. We think this is a UK sovereign-like risk that is trading at frontier market prices.

The company is a leading provider of critical, complex engineering services across three verticals – defence, civil nuclear and emergency services. In defence, they are the number 2 contractor to the UK government for the armed forces. Internationally, they have also established a presence in countries like Canada, Australia and France. In civil nuclear, they are involved across the entire life cycle of nuclear reactors, from new build construction to operational support to eventual decommissioning. In emergency services, they are the number 1 provider of aerial firefighting and medical services in Europe and Australia.

We like Babcock because they operate in highly technical fields with high barriers to entry, have longstanding, trusted relationships with their customers and benefit from visibility of long-term contracts. Until recently, Babcock has done a remarkable job, growing earnings every single year from under GBP 20 million in 2004 to over GBP 330 million in 2018 (green bars in chart below).

What then explains the lackluster share price? In 2014, Babcock acquired helicopter firm Avincis for over GBP 1.7 billion just before the collapse in crude oil. Offshore oil and gas-related businesses accounted for nearly 31% of Avincis business, and the market punished the firm for this ill-timed acquisition. Shortly after, the UK's 2016 referendum on Brexit also did not help. They have also had a few contracts shortened for reasons outside of their control, plus a scathing shortseller attack in 2018.



Earlier this year, Babcock's CEO retired. The incoming CEO, David Lockwood, seems to be wiping the slate clean, announcing over GBP 500 million of exceptional items, including nearly GBP 400 million of goodwill impairment related to the Avincis deal. If not for these non-cash charges, the company would still be making over to GBP 200 million. At today's price of around GBP 2.80, we think the company is trading at 65-70% of intrinsic value and roughly a 5x multiple to forward earnings. We do not yet have a position in the company as we expect more impairments to come from Lockwood as well as some negative hits from Covid. In more sanguine times, we expect a company like this to trade closer to mid or high-single digit yields, as a higher risk alternative to government bonds. Quite a bit of upside from here.

IV) Other Observations

US Presidential Election and Impact on Stocks

Just about everyone has an opinion on the outcome of the US presidential elections; many even go on to prognosticate about its impact on stock market, taxes, US-China relations, oil prices, etc. What do the numbers say? Ken Fisher's shared some of these figures in his article "Don't Let Politics Blind You To November's Secret Market Win". In summary, stocks usually do well in presidential election years and the year after. I quote parts of it wholesale below.

> *Republicans believe Joe Biden winning will whack stocks. Democrats presume re-electing Donald Trump is double trouble. A clear secret: they're both wrong. The S&P 500 typically shines in presidential election years regardless, rising 83% of the time, averaging 11% returns in back-end loaded fashion.*

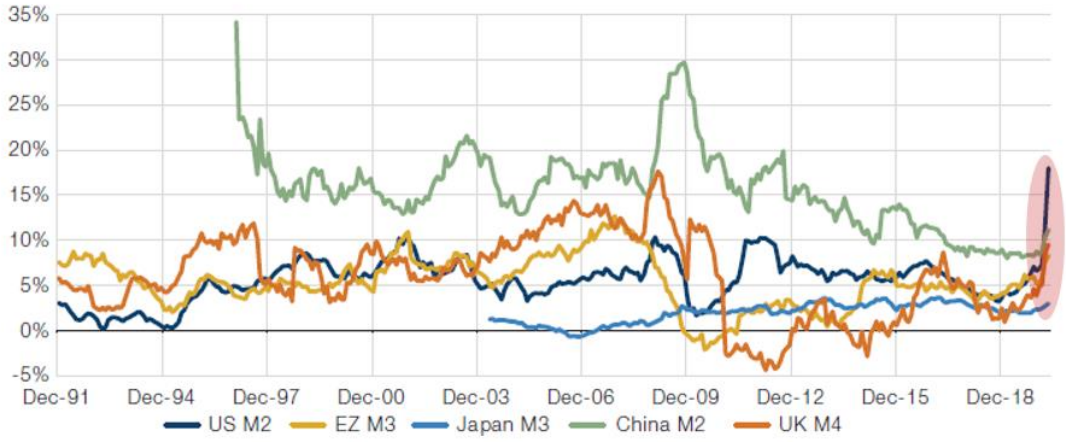
When a Democrat has won, investor fears dampen election-year returns—just 7.4% on average in the S&P 500''s life. When Republicans won, higher hopes boosted election-year averages to 15.2%. But inaugural years flip-flop that. Democrat inaugural years are great and Republican ones lesser.

Presidents never get as much done as they promised. Perceived anti-business Democrats accomplish less than feared—a positive surprise generating big, 16.2% average returns in their first year. The reverse holds for Republican presidents. High hopes for pro-business policies fade as less materializes. Stocks average just 2.6% in their first years.

…we get either a re-elected Republican or newly elected Democrat—both bullish for 2020 and 2021. Over election and inaugural years, re-elected Republicans have averaged 13.1%—with most gains coming early. Newly elected Democrats average 15.9%, driven by big inaugural years. It should be a good time for stocks.

Does Rising Money Supply Spell Inflation?

In our last investor letter, we touched briefly upon how Covid and its impact on global supply chains might bring about higher inflation. Inflationistas will also point towards the unprecedented quantities of monetary easing that has been conducted by central banks globally, which have been further expanded due to Covid. More recently, it also came to our attention that the incredible amounts of fiscal stimulus (via direct handouts as well as new government-guaranteed bank lending programs) has resulted in very sharp spikes in broad monetary aggregates across a number of countries (red circle below). Such increases in money supply have in previous periods been associated with spikes in inflation. On the other hand, those in the deflation camp will argue that these spikes are transitory, and that ultimately inflation will still be tied to growth. In the short term, growth is hurt by Covid; in the medium to long term, growth will be held back by poor demographics and rising levels of indebtedness. We do not know how this will shake out, but we will be paying close attention.



Decision Making and Its Impact on Investing

Baba Shiv is an American marketing professor and an expert in the area of neuroeconomics at Stanford's Graduate School of Business. I recently came across an idea of his which has interesting parallels with investing.

Baba conceptualized how people make decisions (through their view of failure) into two modes of thinking: Type I mindset and Type II mindset. The 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.

Most of us are constantly shuttling between the two modes, sometimes choosing to limit downside because we are afraid of failure, at other times choosing to take risk because we fear missing opportunities. There are two interesting observations here. The first is that in both mindsets, action is motivated by fear, only the object of the fear is different. The second, explained by Baba, is that under periods of high stress and pressure, the Type I mindset is dominant. Only after the stress has been alleviated and replaced with comfort, can a Type II mindset kick in.

In February and March, when Covid was just beginning to spread, investors as a group were clearly in Type I mode. We experienced sharp drawdowns in all asset classes as investors chose to cut risk first and ask questions later. Since the March lows, we have had a big rally in financial markets and the S&P 500 is close to regaining all-time highs. While it may be easy to conclude that buying at the March lows is clearly superior to buying now, it is not the same as saying that buying now is therefore necessarily a bad idea. Using Baba Shiv's framework, one could argue that the rally has likely generated a sense of comfort and well-being, at least within some segments of the investing population. If this is so, some of these investors will have switched to the Type II mode, where FOMO becomes the bigger driver of investment decisions.

Concluding…

For now, we are still positioned as cautious bulls. We think that investors are choosing to look past the fear and uncertainty due to Covid to the investment opportunities that are arising because of it. In part, this is because the rally has calmed nerves, so risk taking is once more in vogue. In the very near term, markets seem overstretched, so we are increasing our hedges, but further out we are still more inclined to own risk. As always, we stay vigilant and will update you as necessary. Thank you for reading and we hope this update has been helpful.

Sincerely,

Yongchuan Pan
11 Aug 2020