The Eclectica Fund

ECLECTICA ASSET MANAGEMENT

30 NOVEMBER 2014

Discretionary Global Macro

The investment objective of the Fund is to achieve capital appreciation, whilst limiting risk of loss, by investing globally long and short mainly in quoted securities, government bonds and currencies, but also in commodities and other derivative instruments.

Monthly and Yearly Performance % (€ A Shares net of fees and expenses) **AUM: $78,890,000**

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2002									+0.0	-4.8	-0.1	+0.8	-4.2
2003	+5.2	-8.1	-4.6	+8.8	+16.2	+1.9	+1.8	+4.2	+7.8	+1.9	-3.7	+12.4	+49.9
2004	+4.0	-1.0	+4.6	-4.9	-0.9	-1.7	-0.2	+0.5	+3.4	+5.7	+1.7	-3.0	+8.0
2005	+2.4	+9.7	-2.5	-0.1	-4.8	+3.5	+0.0	+4.2	+8.5	-7.0	-4.8	+5.9	+14.2
2006	+12.7	-8.2	-0.8	+3.6	-5.4	+3.6	-5.9	-2.1	+2.2	-2.1	+0.9	-0.6	-3.7
2007	+0.7	+1.7	-2.9	+0.7	+1.8	+3.7	-1.0	-6.4	+1.8	-1.8	-3.4	+7.5	+1.6
2008	+5.5	+18.0	-15.6	-2.7	-3.9	+2.4	-9.1	-1.7	-5.7	+49.8	+2.9	+0.4	+31.2
2009	+1.9	+3.7	-2.1	-5.4	-0.9	-1.4	-1.7	+0.9	-0.1	-1.9	+3.0	-4.0	-8.0
2010	+3.7	+5.2	-0.2	-0.5	+1.7	+2.5	+0.6	+1.6	-3.1	-1.9	-4.3	-2.1	+2.7
2011	-1.1	-1.0	-0.3	+0.8	+4.6	+0.6	+4.6	+1.5	+3.2	-1.6	+0.5	-0.1	+12.1
2012	-1.3	-1.2	-0.1	+2.7	+0.8	+0.3	+3.1	-0.8	-0.9	-2.4	-0.0	-1.6	-1.7
2013	+0.5	+0.5	+2.6	-0.2	-2.1	-0.3	-1.5	-0.5	-2.3	-0.2	+0.5	+3.1	0.0
2014	-3.1	+2.7	-5.3	-1.3	+2.5	+0.4	-0.9	+0.8	+3.3	+4.0	+5.0		+7.8

Source: SMT. Calculation on NAV basis. AUM as at 30 November 2014.
Exchange Rate €/$: 1/1.2452. Source: Bloomberg.
Performance figures from October 2002 - March 2005 were achieved by Hugh Hendry whilst a partner at Odey AM.

Performance Attribution Summary

- The Fund made +5.0% in November, bringing the net year to date return to +7.8%.

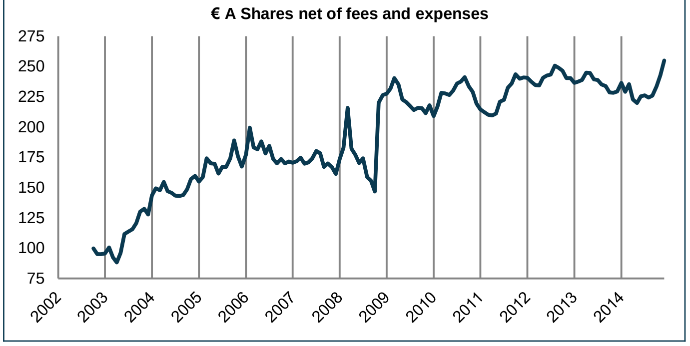
- Long DM equity strategies were the most significant contributors to positive performance, returning +3.4% in total. European index futures were responsible for the bulk of profits as stock markets rallied in anticipation of the ECB following the BoJ's lead in announcing further monetary stimulus sooner rather than later. The DAX component generated a gain of +1.8% before the position size was halved later in the month. Within single name equity strategies, European pharmaceuticals made +1.0% and tobacco stocks added a further +0.4%.

- The rally in Japanese equities, prompted by the BoJ's announcement towards the end of last month, continued into November and was given an additional boost as Abe looked to capitalise on his domestic popularity by calling a snap election, while simultaneously confirming the postponement of a further increase in sales tax. The Fund made a combined +1.4% from Nikkei index futures and holdings in Japanese robotics companies.

- In China, the Fund's CNH interest rate "payers" gave back -1.3% on news of a surprise cut from the PBoC. However, with no significant change in our qualitative view, we maintained our exposure. Losses were offset by a gain of +0.9% from a long-standing short against the Australian dollar and a +0.3% profit on a tactical long in Hang Seng CEI futures.

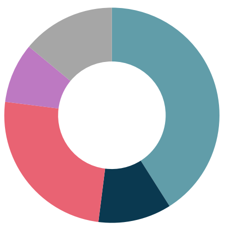
- Elsewhere, our 30-year US treasuries generated a gain of +1.2% (bringing year to date profits on this position to +3.3%) as the slump in the global oil price acted as a brake on inflation expectations and investors continued seek the relatively high yields versus those of America's G7 peers.

Fund Performance Since Inception (Net)



Past performance is not necessarily indicative of future results.
Performance figures from Oct 2002 - March 2005 were achieved by Hugh Hendry whilst a partner at Odey AM.

Current Portfolio Themes (% VaR)*



Strategy Summary		Theme	% VaR*
1	Long US 30y Bond	I/H	13%
2	Long Japanese Equities	JP	11%
3	Long Euro Pharma	DM	7%
4	CNH Interest Rates	CH	7%
5	Long USD vs AUD	CH	7%
6	MXN Receivers	EM	7%
7	Long Robots	DM	7%
8	Long IBEX Futures	DM	5%
9	Long Euro Banks	DM	5%
10	Long Hang Seng CEI Futures	CH	5%

VaR data at 28/11/14.
*Theme or strategy VaR 95/aggregate portfolio VaR 95. Does not account for full effects of diversification.

The Eclectica Fund

Apples are not the only fruit

There are times when an investor has no choice but to behave as though he believes in things that don't necessarily exist. For us, that means being willing to be long risk assets in the full knowledge of two things: that those assets may have no qualitative support; and second, that this is all going to end painfully. The good news is that mankind clearly has the ability to suspend rational judgment long and often.

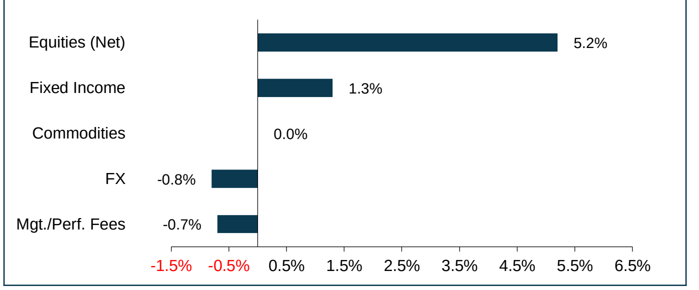
Let me explain - borrowing from a paper my son recently wrote on Platonic realism to do so. He pointed out, for example, that an apple very clearly exists. We can see it, recognise it and touch it. It also always obeys the known rules of the universe: throw it into the air and it will return to earth. Fruit however is a far more nebulous concept. Fruit is not just one recognisable object. The word relates to group of objects that share some physical and chemical traits. You cannot definitively draw "fruit"; we might think we will know it when we see it but it hasn't a single identity.

So far so fruity: you'll be wondering what my point is. It is that similar different forms of reality seem, to me at least, to exist between different asset classes. Equities are more like apples. They exist within quantifiable and qualitative parameters such as earnings valuations and growth. Currencies are a hybrid in that you could point to the notion of purchasing power parity (PPP) as serving as a universal rule of nature in helping to determine the reality of prices (a bit like gravity for the apple). But we also know that more often than not the value placed on them by PPP is not very close to their trading value. Gold, on the other hand, is closer to the idea of fruit. It doesn't seem to conform to any known rules of the investing universe. There is no income and no growth. It is, perhaps, the closest thing an investor has to an imagined reality. You either "get it" or you don't. As a result, apart from the odd occasion when it rallies violently on the back of an imagined future reality (usually hyperinflation), it is commonly ignored by the majority of investors. It can be entertaining and periodically very financially rewarding but, as it is all about faith and stories, it isn't something most of us are that comfortable investing in.

Gold: Disney for grown ups

But here's the thing. Every now and then asset classes trans mutate. And recently I have been asking myself if the equity market might have taken on the characteristics of the gold market. As I see it, investors have been living in a world in which markets have transcended reality since early 2009. In the first three years - until Draghi's "do whatever it takes" speech in the summer of 2012 - gold was the poster child of this phenomenon. For me it became the financial equivalent of Disneyland or perhaps a Platonic simulacrum (a false likeness). It is real and tangible, but it only represents reality when viewed from a particular perspective; in this case, what its believers saw as the inevitable inflationary consequences of central banks printing money. However since Draghi spoke, the role of market Disneyland has increasingly been taken on by the

Monthly Performance Attribution (% NAV)

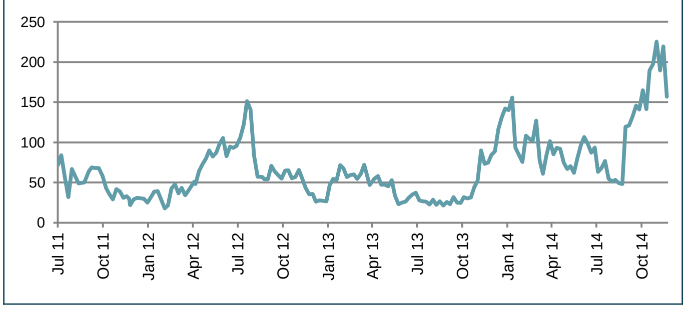


Asset Allocation		% NAV Long	% NAV Short	% IVaR
Equities	Cash Equities/Futures*	130.0	-6.3	90.1
	Index Options (Premium)	0.2	-0.0	
	VIX Puts	-1.8	0.0	
FX	Forwards**	38.3		9.5
	Futures*	28.8		
	FX Options (Premium)	0.6		
	FX Forwards Spreads (DV01)	-4.4	1.4	
Commodities		-	-	0.0
Fixed Income (DV01)		-14.8	1.6	0.4

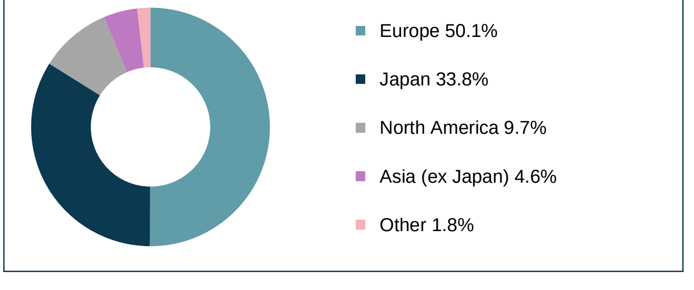
*Futures shown on a delta'd basis.
**% NAV figure represents one side of each position.
Investing in commodity interests involves a substantial risk of loss.

Portfolio VaR	bps
95% Monte Carlo 1 Day VaR	157

Fund VaR History (95% 1 Day) bps



Position Summary by Currency (% IVaR)



equity and fixed income markets. So the S&P has massively outperformed what has proven to be a tepid recovery in nominal GDP and a global real economy that is beset by deflation; just this month, European swaps contracts began to price in near term deflation. Yet equity markets are ignoring that reality in favour of the idea that the deflationary fall out from the collapse in the oil price will almost certainly mean even more monetary accommodation. The worse the reality of the economy becomes, the more we take on the reflexive belief in further and dramatic monetary expansion and the more attractive the stock market looks.

What is one to do with such a situation? In my view there are really only two responses. On one hand we have today's bears. Remember the film *The Matrix*? Morpheus offered Neo the choice of two pills - blue, to forget about the Matrix and continue to live in the world of illusion, or red, to live in the painful world of reality. They, as the "enlightened", chose red, and so are convinced that they understand everything which has become illusory about today's markets. Their truth is Austrian economics. They know that today's central bankers are spinning a falsehood of recovery; they steadfastly refuse to be suckered in by the euphoria of a monetary boom; and they are convinced that they will therefore be spared the consequences of the inevitable crash. Everyone else, currently drugged by the virtual simulation of prosperity and its acolyte QE, will be destroyed, leaving them alone, to re-invest when markets finally get cheap. They will once again be masters of the universe.

The truth? You have to reject it

This sounds good. Really good. I have long thought of myself as one of the enlightened. My much thumbed copy of Kindelberger's *Manias, Panics and Crashes* aided and abetted my thinking as I correctly anticipated and monetised profits from the crisis of 2008 for example. But it isn't always good. Kindelberger has been absolutely detrimental to my investment performance for the last six years and as a result I have changed. I still believe that the attempt by central bankers to prevent the private sector from deleveraging via a non-stop parade of asset price bubbles will end in tears. But I no longer think that anyone can say when. Look back on the last five years and I think that it is indisputable that mass injections of loose monetary policy have both fuelled asset prices and staved off further crisis. I am also absolutely persuaded that the global economy remains so fragile that modern monetary interventions are likely to persist, if not accelerate. They will therefore continue to overwhelm all qualitative factors in determining the course for stock prices in the year ahead.

So I have come to embrace the French philosopher Baudrillard's insight. "Truth is what we should rid ourselves of as fast as possible and pass it on to somebody else," he wrote. "As with illness, it's the only way to be cured of it. He who hangs on to truth has lost." The economic truth of today no longer offers me much solace; I am taking the blue pills now. In the long run we will come to rue the central bank actions of today. But today there is no serious stimulus programme that our Disney markets will not consider to be successful. Markets can be no more long term than politics and we have no recourse but to put up with the environment that gives us; the modern market is effectively Keynesian with an Austrian tail.

My suspension of disbelief on all this has won me many detractors. These investors reject my notion of imagined realities and prefer to speculate instead on movements in capital markets in a manner similar to making propositions about chemistry, biology, or physics: they describe a cold, rational, mind-independent reality and focus on the inevitable outcomes; they have no interest in fanciful flight paths. I think they are missing the key to success: the fact that markets are vulnerable to forces far more variable and subjective than the tenets of stock valuation. In this new imagined reality there is every chance that risk markets grind higher for much longer. The Fund, you will be pleased to hear was up another 5% in November. Year to date returns are now almost 8%.

The Phantom Menace

To conclude I thought that I would expand upon our present Platonic thinking on the Chinese equity market. China is set to record its weakest growth in GDP in 25 years. Yet it seems to have entered a bull market and may be where we deploy much more of our risk capital next year. That's because the recent exuberant run up in onshore Chinese equities seems to me to amply demonstrate the power of imagined realities. Earlier this year, the shocking reality of falling property prices across China began to emerge such that even the official Chinese government economic data series had no choice but to admit it was happening. On the assumption that insolvency was all but inevitable international investors (Eclectica amongst them) began to fear a surge in bad debts at the major Chinese banks and sold. Financial stocks took a beating and the major banks started to trade at a steep discount to their reported book value.

At this point, the situation in Chinese capital markets began to resemble that of Europe back in the summer of 2012 when Spanish and Italian government bond yields came to exceed 6%. The capital markets were effectively betting on the ECB failing to contain the crisis. With Spanish and Italian government bonds now trading below 2%, this has proven a bad bet. The interesting question to ask today, however, is not who lost money on the bet, but who made money? Institutional fixed income managers that had little or no discretion but to own such assets did, but the returns on offer evaded the majority of discretionary global macro managers. Why? They were looking at qualitative truth factors such as enduringly weak economic growth, political backsliding on structural improvements and a systematic failure to control the size of fiscal deficits. They shouldn't have been: despite all this the market has relentlessly ground higher on the basis of the imagined reality that the ECB will overcome all institutional objections to the contrary and will buy sovereign European bonds *en masse*.

The Eclectica Fund

30 November 2014

The easy money has been made here. So my question today is whether we will see a similar prolonged bull market in Chinese equity markets, one that the hyper-realist discretionary global macro community will dismiss as they cite worsening qualitative concerns and fret about an impending property crash? I think so. The valuation of Chinese equities today suggests that once again capital markets are betting against the success of the local monetary authorities. They are probably wrong. The Chinese state is the largest shareholder in the Chinese financial system. That surely makes its ability to stave off a liquidity crisis pretty much limitless. One more thing strikes me: the more I examine the obvious similarities with today's China and Japan back in 1989, the more I wonder why no one is speculating that the renminbi might go on to match the yen's strength in the 1990s or suggesting that sovereign CNY bonds might one day be priced as JGBs now are. Perhaps that is a discussion for next year.

Fund Information

Fund Details		Fees, Costs & Redemption Structure	
Investment Manager	Eclectica Asset Management LLP	AMC	2% (B/C Shares)
Fund Manager	Hugh Hendry		1% (I Shares)
Administrator	SMT Fund Services (Ireland) Limited	Performance Fee	20% (B/C Shares)
Fund Structure	Cayman Islands OEIC within a Master Feeder structure		15% (I shares)
Inception Date	30 September 2002	Exit Fee	1% exit fee on redemptions within 12 months
SMT Dealing Line	(+353) 1 603 9921	Minimum Investment	€100K or equivalent in £/$100K (B/C Shares)
SMT Dealing Fax	(+353) 1 647 5830		€50M or equivalent in £/$50M (I Shares)
SMT Dealing Email	**smtSHSdealing@sumitrustgas.com**	Dealing (B/C/I Shares)	1st of each month
Eclectica IR Telephone	+44 (0)20 7068 9969	Dealing Notice	7 days before dealing day for redemptions
Eclectica IR Email	**IR@eclectica-am.com**	Currency Classes	€/£/$