Eschler Asset Management LLP

Eschler Recovery Fund SP

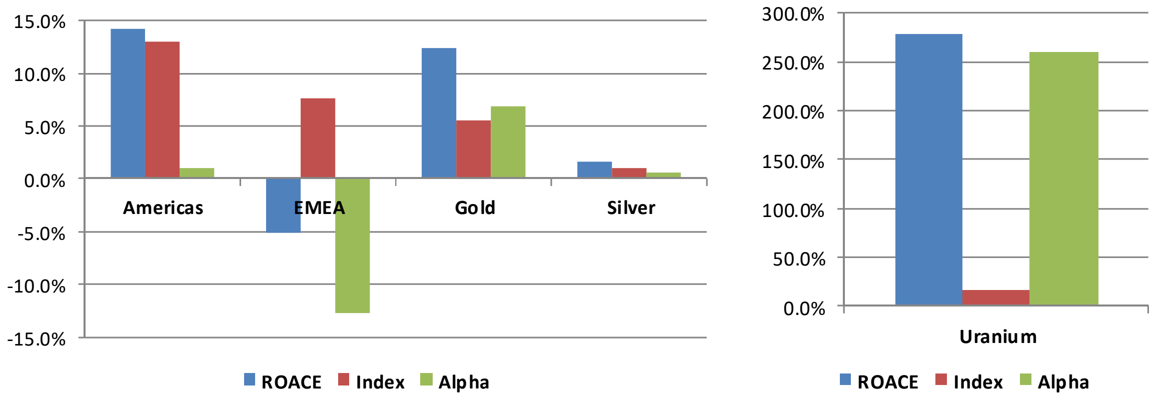
www.eschlerasset.com

Dear Partners,

Recovery Fund ("RF") rose 4.9% net of fees (B share lead series) in 2017 on the back of a strong finish to the year. Total return on average capital employed long was a solid +13% (excluding currency effects). Last year's overall result can be attributed to hedge costs, cash drag, stockpicking and asset allocation. What follows is a quantitative and qualitative assessment of these factors and further insights into my investment philosophy. As always, the goal is provide the same level of understanding of results, strategy and philosophy that I would expect if our roles were reversed.

Over the 5+ years since inception RF has returned +8% p.a. net of fees and expenses. It was an unusual journey with virtually no correlation to the S&P 500 barring one key exception: During the only S&P 500 correction starting in January 2016 RF began a major appreciation in the space of six months. This dynamic was neither surprising nor accidental.

Attribution of returns and alpha by region/industry



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<u>Hedging:</u> For the US stockmarket it's been mostly blue skies for nine years. Forecasts of stormy weather, or merely clouds, have been consistently premature. RF needlessly carried an "umbrella" in the form of exposure to beaten down gold equities as opposed to a large short position. As this soaring market eclipses one valuation record after another, though, having a hedge in place ahead of trouble is prudent. Valuation aside, other signs of once-in-a-generation excess abound. There

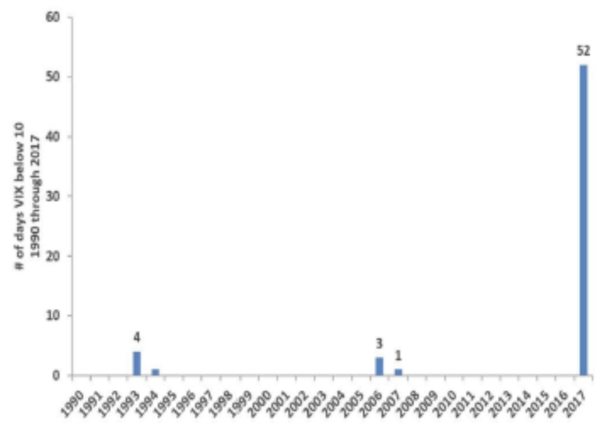
are, to quote British fund manager Neil Woodford, *"…so many lights flashing red that I am losing count"* (Financial Times, 30 November 2017)

This unusual moment of collective greed and market calm masks growing risks below the surface. A cottage industry has sprung up to channel this risk-loving behaviour into various bets on the low volatility environment continuing. From inverse VIX ETFs ("XIV" rose +190% last year!), to risk parity strategies, debt-financed corporate buybacks and pension funds selling options to generate income, artificially suppressed market volatility has, itself, become a flawed signal to press bets even further.

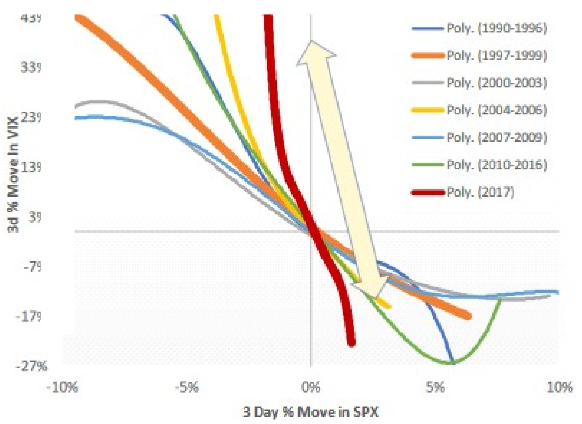
Long volatility hedges with payoffs dependent on this circular dynamic breaking offer unusual opportunity that RF has taken advantage of. For the buyer, long volatility positions remain costly to hold. Think of the seller of insurance on the proverbial floodplain: For a period he luxuriates in copious cash inflows from the buyer but when the rain comes he transfers it all back, and more, to the buyer. RF is the buyer. Should even the most *minute* tremor (a ~5% sell-off) hit the S&P 500 RF's hedge gains will easily outpace cumulative losses to date.

It speaks volumes that *the S&P 500 has now gone without such a 5% correction for the longest duration on record*. In the chart below (right) consider how sensitive S&P 500 implied volatility has now become to a market sell-off. The position does depend on delayed gratification—consider in the chart below (left) the record number of days the VIX stayed below 10 last year. But in that sense it fits right in with the value investor's behavioural toolbox. It is now a particularly convex hedge for a long-biased portfolio with a much smaller notional footprint than a large short book.

Number of days VIX index is below 10*



SPX Implied Volatility Sensitivity to Market Moves**



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Cash drag: RF began the year 80% invested (82% long by 2% short) and it was only in the September to November period that intelligent uses for the cash materialised. Against the backdrop of the Dow Jones Industrials' blistering 27% return, holding cash felt costly.

> *"From a business perspective, how much better to be actively deploying capital, even if the investments are mediocre, than to be stalled in neutral; the employees keep busy, while the clients confuse decisions with diligence, activity with insight, and a fully invested posture with a worthwhile portfolio."* (Seth Klarman quoted in the Baupost 2004 Year End Letter).

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*Bloomberg
***Volatility and the Alchemy of Risk*, page 4; Artemis Capital Management LP, October 2017

Stockpicking contributors:

On the plus side RF's holding of **uranium equities** returned approximately 90%. After exiting a profitable toehold position in January, further analysis later in the year increased my conviction to redeploy into this forgotten industry.

Biglari Holdings, initiated in August, returned profits of over 40% on cost. Headed by investor/operator Sardar Biglari, BH is a holding company with interests primarily in restaurants and insurance. It is a complex and controversial company where the intrinsic value is not readily apparent. Modelling out the value suggested the purchase price was a 50% discount to intrinsic value. My conclusion was that Mr Biglari would be incentivised to simplify the corporate structure and realise the value trapped in the holding. A catalyst in this regard materialised at year-end with the decision to create a dual-class share structure.

Goodwin Plc, a family-owned and operated British engineering company, is another new holding initiated in May which returned 27%. This under-earning growth business received mention in the mid-year letter.

The largest holding, Toronto-listed **Fairfax Financial,** returned 3.2%, lagging growth in book value per share, which itself was held back by a strong Canadian dollar (Fairfax reports in U.S. Dollars). For more on the investment thesis see the 2016 letter. The prospects for Fairfax are exciting in coming years. For now, the company is digesting deals and needs to replenish and redeploy its cash-rich investment portfolio. Bring on a bear market!

Stockpicking detractors:

Geospace Technologies, a seismic equipment supplier to the oil & gas industry, fell 25%. Results finally inflected upward in the most recent quarter, while the share price fell (and ended the year below depressed book value), setting up an excellent risk-reward in 2018.

Long-term micro-cap holding **Mobile Streams Plc**, a provider of direct-to-consumer mobile games, fell 34% as the company experienced growing pains in India. These issues appear surmountable and the company is at a major juncture: Operating costs are down substantially (employee count is down from a peak of 50 to 10, just the key technical and marketing people remain) while the company has struck billing and revenue share agreements *with five of the six largest mobile operators in India* in the past 18 months! It's now all about achieving cash flow breakeven in India. CEO Simon Buckingham has also replaced the Chairman, a positive step. Argentina has stabilised at a low level. Shares languish somewhat below RF cost but have strong net cash backing. If they get India right the current share price will be a distant memory.

Bank of Cyprus, the dominant, independently owned bank in Cyprus, fell 14% and trades at half of (recapitalised) tangible book value and 6x 2018 forecast EPS. Asset quality keeps improving every quarter and the Cypriot economy is strong.

It strikes me that the above companies' operations are stable-to-improving and the share prices may be ultra-sensitive to any positive news. There's meat on these carcasses!

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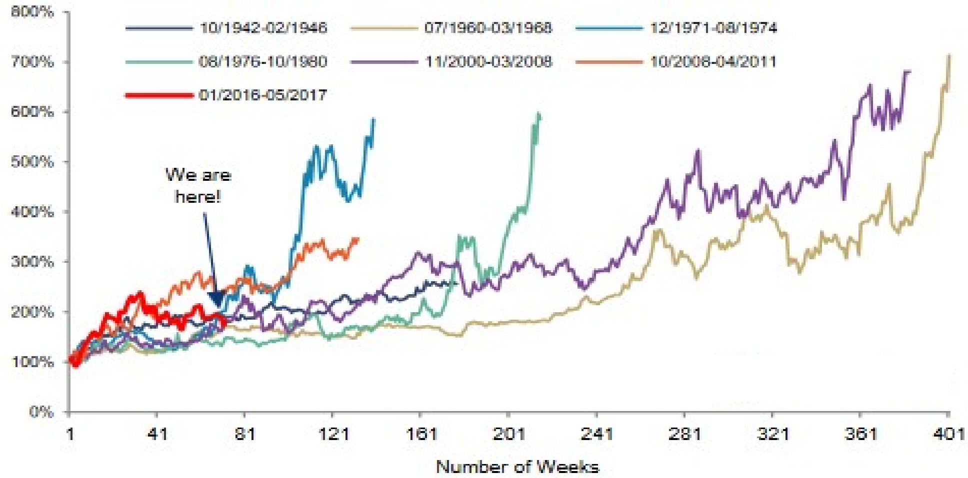
Asset allocation: RF's unusually large holding in precious metals equities produced solid alpha but absolute returns were modest. Return on average capital invested in gold shares was +12.4% (690bp above the gold equity index) and in silver shares was +1.6% (60bp above the silver equity index). The precious metals industry is now in a recovery phase, climbing such a large wall of worry. The +73% cumulative return of this industry (Amex Gold Bugs Index) over the past two years is one reason, an important reason, why NAV has risen 50% in that time. Unlike in many other industries, fundamentals in precious metals exceeded share price growth in 2017--an encouraging set up for the coming year.

It's hard to believe but 2017 was the fifth year RF held this position. Over that span (the majority of which was a bear market) it has delivered double digit compounded returns on capital. Readers interested in exploring the rationale for this idea might read the 2014 letter to shareholders together with the most recent Q3 update.

The Playbook: Current precious metals bull market benchmarked against the rest



Source: In Gold We trust, June 1st 2017, Incrementum

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Putting it all together: How to turn 15% into 5%

(Cue chuckles from the passive crowd):

		Note
ROACE	15.0%	Return on average capital employed excluding portfolio cash
FX	-1.8%	Back out positive impact of foreign currency gains
Cash Drag	-2.5%	Opportunity cost of holding cash
Hedges	-3.9%	Long volatility roll cost (in the quietest market ever!)
Commissions	-0.3%	Long-term approach and small balance sheet keep these low
Manager fees	-0.7%	Total fees very low when returns mediocre!
Fund costs	-1.0%	RF runs efficiently despite its small size
Net return	+4.9%	

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Had you told me five years ago that RF's current portfolio would serve up generous helpings of gold and silver miners, development stage uranium companies and various other cyclicals I would have been incredulous. But my approach is to keep an open mind about what constitutes a great investment and respond to the opportunity set. Observing capital abandoning cyclical areas of the market, were there reasons why it might return? From Silver to Cyprus to oil services, hunting for investments left behind by crisis has been a useful way to generate ideas. By way of this iterative approach as opposed to some master plan, today RF is late-cycle in composition: energy, materials and financials feature prominently.

A recent white paper from asset manager GMO reinforced the rationale for this portfolio evolution. To read "*The Case for Natural Resource Equities*" (Sept 2016) by Jeremy Grantham and colleagues was to have my mind read, to put quantitative and historical structure around the thesis.

Grantham's supply/demand argument in favour of a long-term commitment to commodities is less original than the fascinating insights into why public resource equities (materials and energy) counterintuitively make so much sense (more so, I might add, at certain points in the cycle!). First, he notes that public equities offer cheap, liquid exposure while harvesting the equity risk premium and avoiding the negative yields from rolling some futures contracts. He also quantitatively illustrates how resource equities, while volatile in the short-term, outperform in the long-term; how they provide diversification to the broad stockmarket and how these benefits increase with time; and how they significantly increase purchasing power in inflationary periods.

Of particular interest to me are his observations about the behavioural biases against resource equities. He notes that due to their volatility many investors simply avoid resource equities causing them to trade at a discount (and thus to outperform long-term). This has resulted in, for example, the S&P 500's exposure to energy and materials dropping by more than 50% in past years. In particular value-biased investors, averse as they are to the risks in commodity investing, are most likely to be underexposed. This implies less stockpicking competition in this area.

These insights explain why RF's resource sector holdings might be mispriced: *They are exposed to exogenous, volatile factors outside management control, and thus victims of investors' current behavioural biases against them*. My job has been to identify those businesses with managements who exercise tight oversight over what they can control, keep liquid balance sheets and are not afraid to invest counter cyclically to build value. These teams have strong trackrecords and run assets with unappreciated earnings power.

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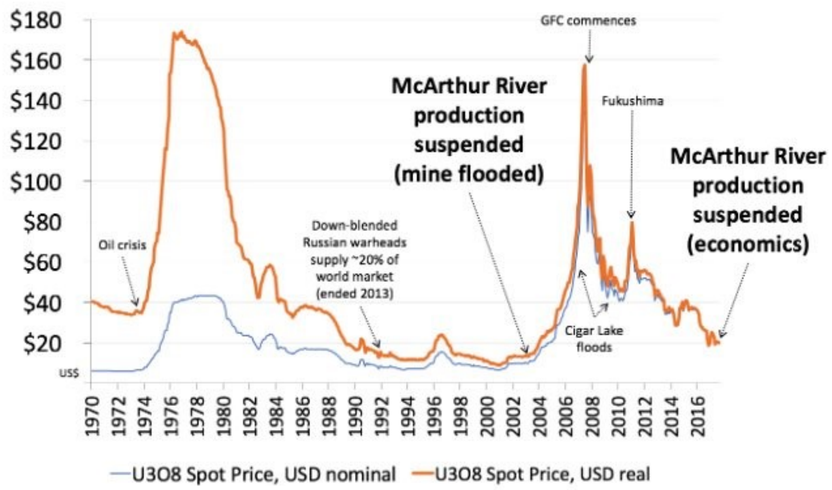
The uranium industry may be as good an example as any of the opportunity described above. The industry is prone to the most unimaginably gigantic cycles. This is because during upcycles supply *and demand* are inelastic to price. The uranium cost to run a nuclear reactor is tiny compared to the capital and operating cost so when utilities decide to secure strategic supply they really pay up. On the supply side, it takes a decade or more to bring a uranium mine into production and the incentive price to build new mines is twice the current contract price of $31/lb. With spot uranium reaching $18/lb last fall from a peak of $130/lb in 2007, the industry is right near, if not past, the bottom.

Though inventories have swamped the market post-Fukushima demand has been growing for six years and, as always, materially exceeds mined supply (the gap being made up by dwindling secondary supplies). Today, more nuclear reactors are in operation globally than pre-Fukushima and even the Japanese reactors are slowly coming back online too (5 today, 18 targeted by early 2019). 30 reactors globally are coming online in the next two years off a global base of 440 and many of these burn more uranium than older models. China targets 20% of its primary energy from non-fossil sources by 2030 and India targets 25% from nuclear by 2050. These two countries' plans alone could increase the global reactor fleet by 67%. The carbon-free, baseload power that nuclear provides is in demand globally.

But it's the supply side that deserves acute attention right now: The two largest, lowest-cost, global suppliers are finally dramatically curtailing production. Kazakhstan, 40% of global mined supply, has announced cuts totalling 30% of production in the past year and is shifting away from spot sales as it prepares to go public. Cameco has suspended production this year at its largest mine, McArthur River (10% of global supply!) until the spot uranium price surpasses $40/lb. Global mined supply this year falls to 130 million pounds from 150 million last year while demand will be at 220 million pounds (from 180 million last year) in several years. Secondary supplies in the form of inventories, down-blending and underfeeding are shrinking as well. Tectonic changes!



Source: Energy Fuels

While the uranium industry is collectively losing money today, over one billion pounds of utility demand comes off contract in coming years. The 7-10 year contracts with utilities signed in the 2005-2010 period are starting to roll off now. Higher uranium pricing is a really good bet at this stage as utilities return to the market. Meanwhile, the industry has been decimated with equity market cap a tiny fraction of the peak. Share prices would be multiples of current levels if spot pricing reached the full incentive cost of production ($60/lb). It is a question of when, not if, that occurs. There's a lot more to this story but this, in short, is the rationale for RF's investment in the uranium industry.

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Each year I enjoy referencing the various investing legends that have inspired me such as John Maynard Keynes, John Templeton, Prem Watsa and others. Sure these gentlemen are expert stockpickers but to my mind that's not actually what sets them apart as investors. So what is it? It is primarily the ability to execute big asset allocation plays when the odds are in their favour, and to see them through. Independence of mind, the ability to act decisively and in size and the way they organise their life are key.

Think of Warren Buffett's buying spree during 1973/74 or 2008; John Templeton's all-in play on Japan; Prem Watsa's bet against mortgages in 2008; or Peter Palmedo's lonely decision to set up Sun Valley Gold in Idaho in the 1990s. It wasn't just picking great stocks. It was, more often than not, applying the value philosophy to identify top-down mispricings and being in the position to deploy sizable long-term capital that made the real difference.

Their modus operandi was key -- whether structuring for permanent capital (Buffett, Watsa); intentionally isolating themselves from the crowd (Templeton famously moved to the Bahamas); or self-selecting their investors by enforcing infrequent, but meaningful, communication.

Again, Jeremy Grantham of GMO compellingly articulates why the above investors keep finding these excess returns from asset allocation: Unlike with value investing at the micro level, where competition and quants eroded the historical alpha from buying cheap stocks, the massive macro-level divergences in 2000 and overpricings in 2007/2008 (not to mention in today's market!) showed no increased market efficiency at all:

> "*In contrast to the increased acceptability and lowered career risk that had narrowed the value opportunities at the micro level, there was still nowhere to hide at the asset class level. You go to cash too soon and your business or career melts away, you stay too long and you are seen as useless. In short, investing at the asset class level remains dangerous to career and profits and is, hence, inefficient, thereby allowing for occasional great opportunities with the old attendant caveats*." (GMO Quarterly Letter: Q3 2017)

Can identifying large macro or industry inefficiencies, deploying capital decisively and sticking with a position now yield *greater* excess returns than micro-level value-based stockpicking? It is an interesting question, which part of RF's strategy is attempting to answer. To see this through, our investors will make a huge difference: Accepting and committing to the vicissitudes of a long-term investing journey will ensure staying power and mutual benefit.

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I'm happy to announce that Mikael Henriksson has joined the team. Mikael is the founder and CIO of Cognition Investment Partners, a fundamental macro asset manager. Mikael's broad multi-asset scope and investment approach will bring additional insights to market strategy, fundamental macro developments and risk management. An engineer by training, Mikael was most recently at Farallon Capital Management in San Francisco and will join Eschler as a non-executive director. I'm also pleased to announce that Casey McDonald has joined me on the board of Eschler Global Fund SPC as independent director and chairman. Casey is an experienced governance professional and partner at fund governance firm Calderwood. I look forward to working with both Mikael and Casey and benefiting from their counsel.

A few amendments to the terms of investment: To better align fund terms with the objectives of the strategy the notice period for redemptions has been increased from quarterly with 30 days' notice to quarterly with 65 days' notice. Subscriptions from new investors into the zero management fee Class B USD shares will now be subject to a US$ 5 million minimum (for the avoidance of doubt existing investors in the B share class are not subject to this minimum). The Manager has set aside US$ 10 million of capacity in the New Series Class A USD shares at a management fee of 0.5% first come, first served for subscriptions from 1 October 2017.

Eschler deploys a lean operating model that would not function properly without the collaboration of a number of partners. Thanks go to David Kowitz for providing office space and Frances Roberts for office assistance; Edgefolio for hosting Eschler's brand-new (and very well received) "Fund Portal". Steve McGuiness at March Compliance for his guidance with compliance and regulatory permissions; Claire Cummings, the fund's recently appointed legal counsel; Mainstream for fund administration and transfer agency; Richard Reading at Baker Tilley for fund audit; GPP for custody and brokerage; Rees Pollock for accountancy and LLP audit; Arbor Financial for portfolio management software; Toby Crake at Kumquat for IT and hardware support and, last but not least, my wife Lara Eschler de Ris for her counsel.

I'm pleased to announce that the 2017 audited financial statements are now available.

Thank you to my fellow shareholders for your ongoing trust. I look forward to updating you on progress in one years' time (if not before).

Theron de Ris
25 January 2018

Disclaimer

Source of Data: Eschler Asset Management LLP, unless otherwise stated
Date of data: January 2018, unless otherwise stated

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The following is a brief summary of only some of the risk factors which may apply to the Fund: Investment and Trading Risks in General: the Fund’s capital may be lost in its entirety. The Fund’s investment program will utilize investment techniques such as leverage, options and other derivatives, practices which can, in certain circumstances, maximize the adverse impact to which the Fund may be subject. Futures: Futures price are highly volatile and this may lead to substantial risks and returns. A relatively small price movement in a futures contract may result in immediate and substantial gains or losses for the Fund. Future trading at times may be illiquid. Due to regulatory requirements, the Fund may be unable to take futures positions in particular futures or may be forced to liquidate positions in particular futures. Stock Index Options: The Fund may purchase and sell call and put options on stock indices listed on securities exchanges or traded in the over-the-counter market. Successful use by the Fund of options on stock indices will be subject to the Investment Manager’s ability to correctly predict price movements in the direction of the stock market generally or of particular industries or market segments. Short Sales: The Fund will engage in “short sale” transactions. In a generally rising market, the Fund’s short positions may be more likely to result in losses because the environment would be more conducive for the securities sold short to increase in value. A short sales involves the theoretically unlimited risk of an increase in the market price of the securities should short. Leverage: The Fund expects to use significant “leverage”, or borrowing and will pledge its assets to financial institutions to achieve this. Borrowing will tend to magnify the profits or losses of the Fund and subject the Fund to a “margin call,” pursuant to which the Fund must either deposit additional funds with the broker, or suffer mandatory liquidation of the pledged securities to compensate for the decline in value. In the event of a sudden precipitous drop in the value of the Fund’s assets, the Fund might not be able to liquidate assets quickly enough to pay off its margin debt. Hedging Transactions: The Fund may utilize options and swaps for hedging purposes or as part of its trading strategies. Hedging transactions may limit the opportunity for gain; also the Fund may not be able to achieve the intended hedge and protect its assets against declines in the value. Currency Hedging: the value of unhedged assets of the Fund will fluctuate with the U.S. Dollar exchange rates as well as with price changes of the Fund’s investments in the various local markets and currencies. Forward Currency Contracts: The Fund may enter into forward currency contracts, swaps or other forms of derivative instruments for purposes of hedging currency exposure. Forward currency contracts, swaps and other derivatives are subject to the risk of non-performance by the counterparty. Forward currency contracts, swaps and other derivatives are not guaranteed by an exchange or clearing house or regulated by any U.S. or foreign governmental authority. It may not be possible to dispose of or close out a forward, swap or derivative position without the consent of the counterparty, and the Fund may not be able to enter into an offsetting contract in order to cover its risk. Options: The Fund may invest in, or write, options. The purchaser of a put or call option runs the risk of losing his entire investment in a relatively short period of time if an option expires unexercised. The uncovered writer of a call option is subject to a risk of loss should the price of the underlying security increase, and the uncovered writer of a put option is subject to a risk of loss should the price of the underlying security decrease. Swaps and Derivatives: The Fund may invest and trade in swaps, contracts for differences (CFDs), “synthetic” or derivative instruments, certain types of options and other customized financial instruments. Swaps and other derivatives are subject to the risk of non-performance by the swap counterparty, are not guaranteed by an exchange or clearing house or regulated by any U.S. or foreign governmental authority. It may not be possible to dispose of or close out a swap or other derivative position without the consent of the counterparty, and the Fund may not be able to enter into an offsetting contract in order to be able to cover its risk. Illiquid Assets: The Fund may invest in instruments for which the markets are limited and illiquid. Consequently, it may be relatively difficult for the Fund to dispose of investments rapidly at favourable prices.

Emerging Markets Securities. Investing in securities of issuers based in emerging markets involves risks and the Fund will be exposed to the consequences of potential political, economic, social and diplomatic changes in such markets. Limited Liquidity: There is not expected to be any secondary market for Shares of the Fund. The Directors of the Fund have the power to suspend redemptions or to compulsorily redeem Shares at the Directors’ discretion in certain circumstances. Absence of Regulatory Oversight: the Fund is not registered under the U.S. Investment Company Act of 1940, as amended (the “Investment Company Act”), or any other similar law of any other country or jurisdiction (other than registration with the Cayman Islands Monetary Authority). Accordingly, certain provisions of the Investment Company Act will not be applicable. Performance Fee: the payment to the investment manager of a fee based upon the performance of the Fund may create an incentive for the Investment Manager to cause the Fund to make investments that are riskier or more speculative that would be the case in the absence of such a fee. Prime Broker Risks: the Fund will rank as one of the unsecured creditors of the prime broker and, in the event of the insolvency of the prime broker, the Fund may not be able to recover such equivalent assets in full. The Fund will be subject to the risk of the inability of the prime broker to perform with respect to transactions, whether due to insolvency, bankruptcy or other causes. Systemic Risk: Credit risk may also arise through a default by one or several large institutions that are dependent on one another to meet their liquidity or operational needs, so that a default by one institution causes a series of defaults by the other institutions. Lack of Diversification: concentration of the Fund’s assets may tend to result in more rapid changes in the Net Asset Value than would be the case if the Fund were required to maintain a wider diversification among industry sectors, securities and type of securities and other instruments, and may result in the Fund’s returns being volatile. Conflicts of Interest: The Investment Manager may, from time to time, face conflicts of interest relating to its dealings with the Fund. Valuation of Fund Assets: The Fund’s securities will be valued by reference to their market price, but when no market exists for an investment or the market price does not fairly represent the value of the investment, the Directors will value such investment as they reasonably determine. The Fund is not required to have such valuations independently determined. The foregoing summary list of risk factors does not purport to be a complete enumeration or explanation of the risk involved in an investment in the Fund. Prospective investors must read the entire Offering Memorandum of the Fund and consult with their own legal, tax and financial advisors before deciding to invest in the Fund