CONTRARIAN HOLDINGS

The Case for Real Assets 2017

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Contrarian Investors, LLC

THE CASE FOR REAL ASSETS

Introduction

In 2005 we wrote "The Case for Silver." At the time, silver was approximately $6 per ounce. Within five years the price approached $50 per ounce.

In 2006 we wrote "The Case for Land." In it we argued that housing and land prices were an enormous bubble and it was time to get prepared for a special opportunity to buy land at very cheap prices. Everybody remembers the housing bust of 2008 and the extraordinary prices in housing shortly thereafter. We were prepared and took advantage of that rare opportunity.

Today we write "The Case for Real Assets." We believe the opportunity in real assets may be more significant and affect more people and capital than both previous cases combined. We hope you find it useful.

What Are Real Assets?

Before arguing the case for real assets, it is important to define what we mean by real assets. Real assets are typically defined as **tangible** assets with intrinsic value. These typically fall into three broad categories:

- Real Estate (residential property, farmland, infrastructure)
- Commodities (corn, sugar, silver)
- Collectibles (wine, art, diamonds)

Why Real Assets?

Real assets have an important and growing presence across the institutional landscape and are increasingly embraced as a foundational asset class alongside stocks and bonds. Real assets offer many attractive benefits.

Most Investors Are Underexposed to Real Assets

Most investors restrict their investment capital to financial assets (stocks and bonds). However, more sophisticated investors often include real assets such as real estate, precious metals, and commodities. Today, because of central bank interventions, some people argue that the prices of stocks and bonds have been arbitrarily manipulated higher. We agree, and therefore believe that allocating capital from stocks and bonds to real assets could be a timely hedge against uncertainty.

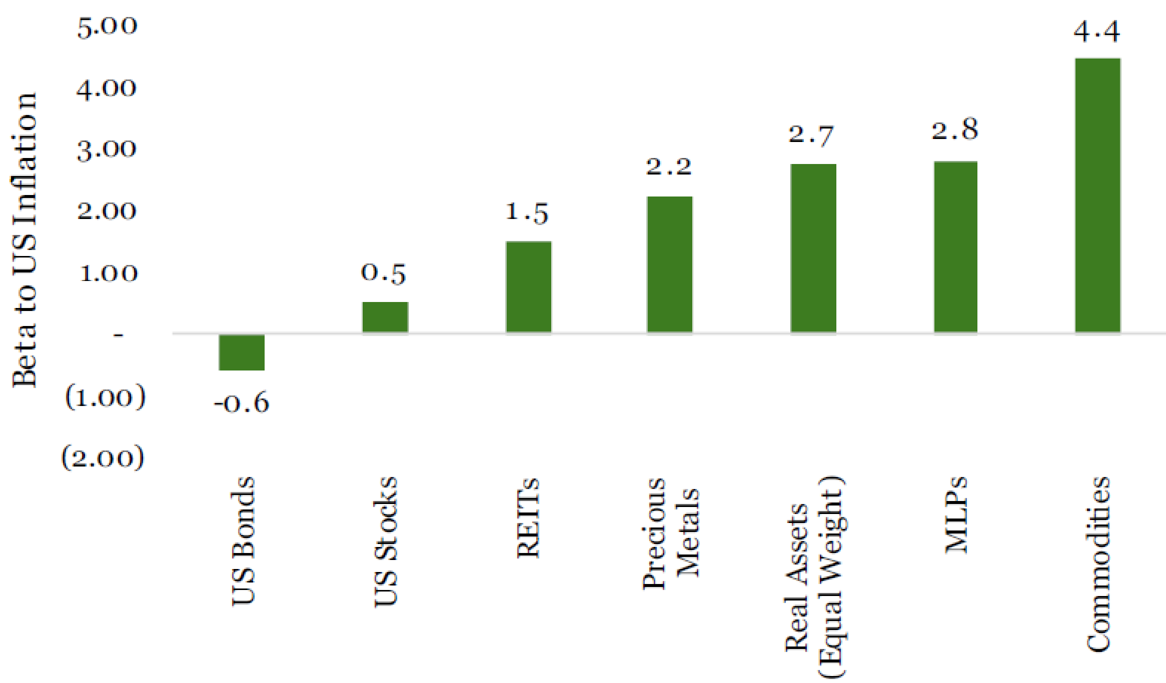
Inflation Protection

History shows that inflation can emerge unexpectedly. High inflation rates are arguably the biggest threat to an investor's well-being. Inflation rates in the developed world have been substantially depressed in the past few years. However, we believe the old saying that "the time to buy insurance is when you don't need it" also applies to inflation risk.

Real assets offer a hedge against inflation for a variety of reasons, primarily because they are investments in physical resources that represent the value of goods and services which are often inflation-linked. The following chart demonstrates how real assets have historically outperformed equities and bonds during periods of rising inflation.

Notice how commodity futures, REITs, and gold are significantly more positively correlated with unexpected inflation than stocks and bonds.

Exhibit 4: Real assets more sensitive to inflation moves.



Source: Bloomberg, ETF Securities. Data from 12/31/95 to 09/30/17.

Store of Value

Real assets represent tangible value and compared to many financial assets are often more stable and subject to lower volatility than other traditional asset classes.

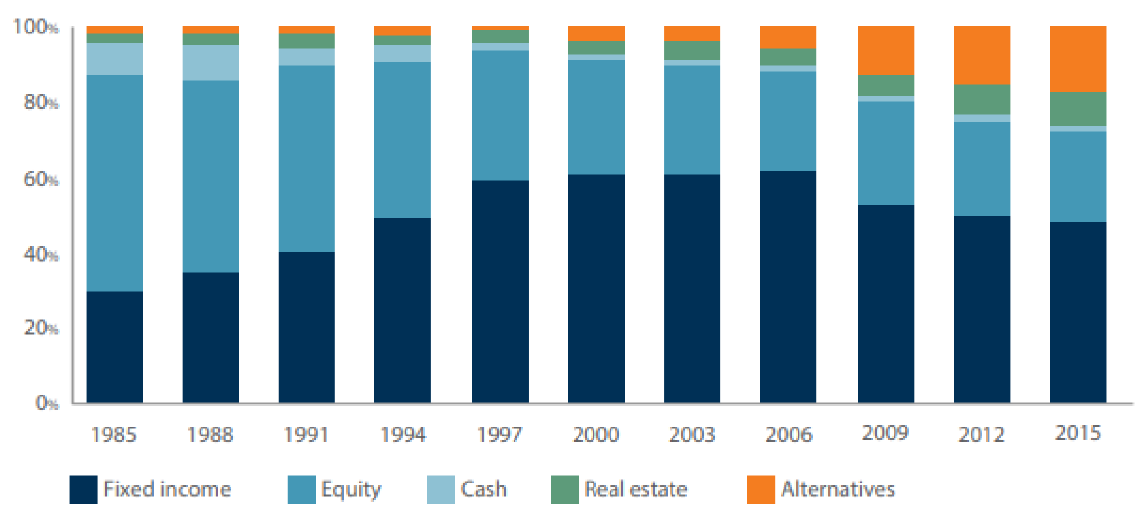
While macroeconomic trends can affect real asset operations, the impact is often relatively low due to the long-term, contractual nature of underlying revenue streams. Real assets can provide investors an opportunity to align their investment objectives and strategy, particularly if their investment timeline extends over decades rather than years.

An Emerging Asset Class

A growing number of global investors and institutions are re-evaluating their asset allocation as they struggle to meet their long-term commitments in our increasingly difficult investment climate. Prompted by lessons from the financial crisis of 2008 and new regulations that force portfolio de-risking, investors are turning their attention to real assets.

Many surveys from recent years show a growing desire among institutions and individual investors to increase their exposure to real assets.[1] The findings confirm that real assets can provide an attractive investment alternative in a time when investors are struggling to fund long-term liability requirements, protect current wealth, and future-proof their portfolios for impending changes in the market cycle.

EXHIBIT 15: RISING INSTITUTIONAL ALLOCATIONS TO ALTERNATIVES AND REAL ESTATE



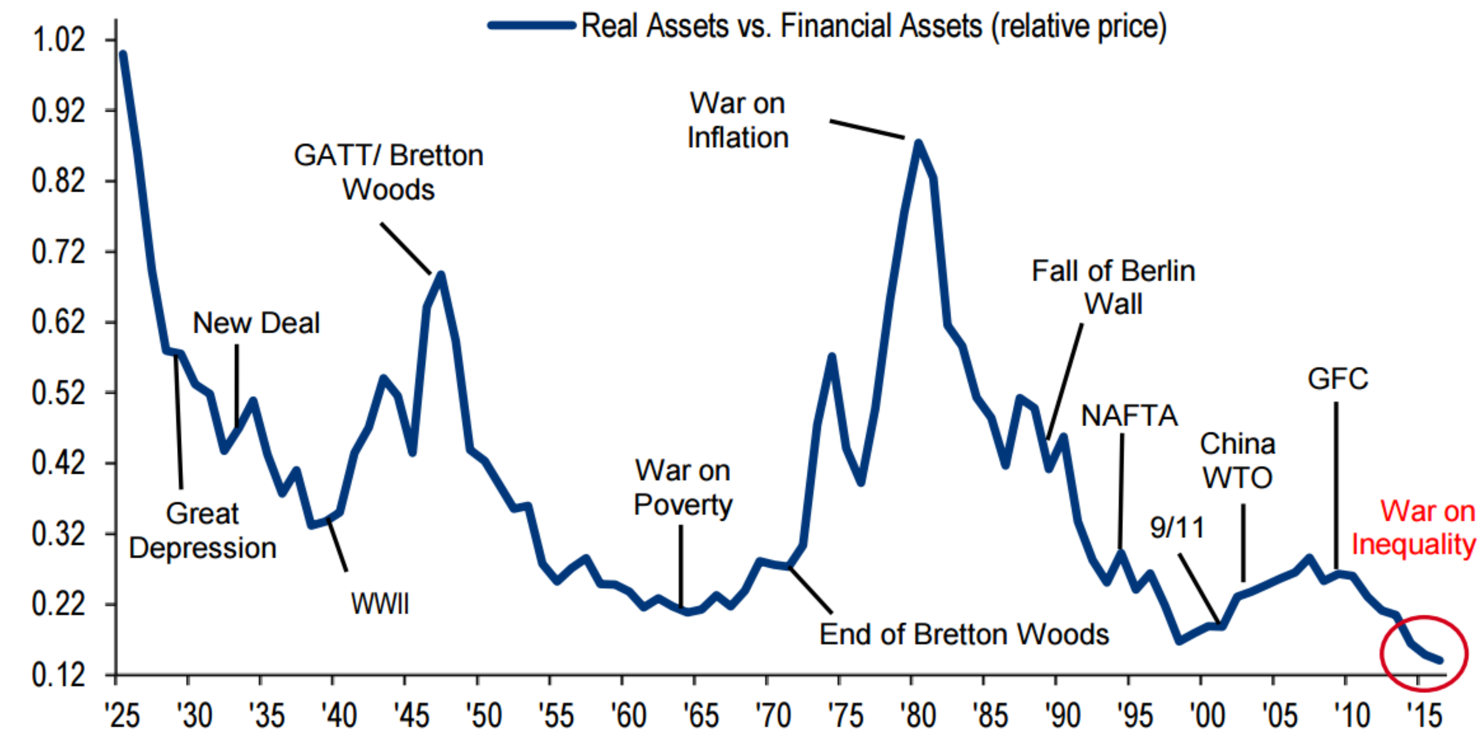
Source: Pension and Investments as of September 30, 2015. Data represent average asset mix of top 1,000 U.S. public defined benefit pension plans since 1991 and average asset mix of top 200 U.S. public defined benefit pension plans from 1984-1991; "Alternatives" includes private equity and hedge fund investments.

[1] Nataxis 2016 Global Survey of Institutional Investors

Historically Cheap vs. Financial Assets

With global financial asset prices at all-time highs, we believe real assets offer a "buy low" investment opportunity. The chart below demonstrates how real assets are significantly undervalued on a historical basis. We believe the prospect of rising inflation as well as attractive relative value signals a compelling opportunity to allocate to real assets.

Chart 2: Real Assets at all-time lows relative to Financial Assets

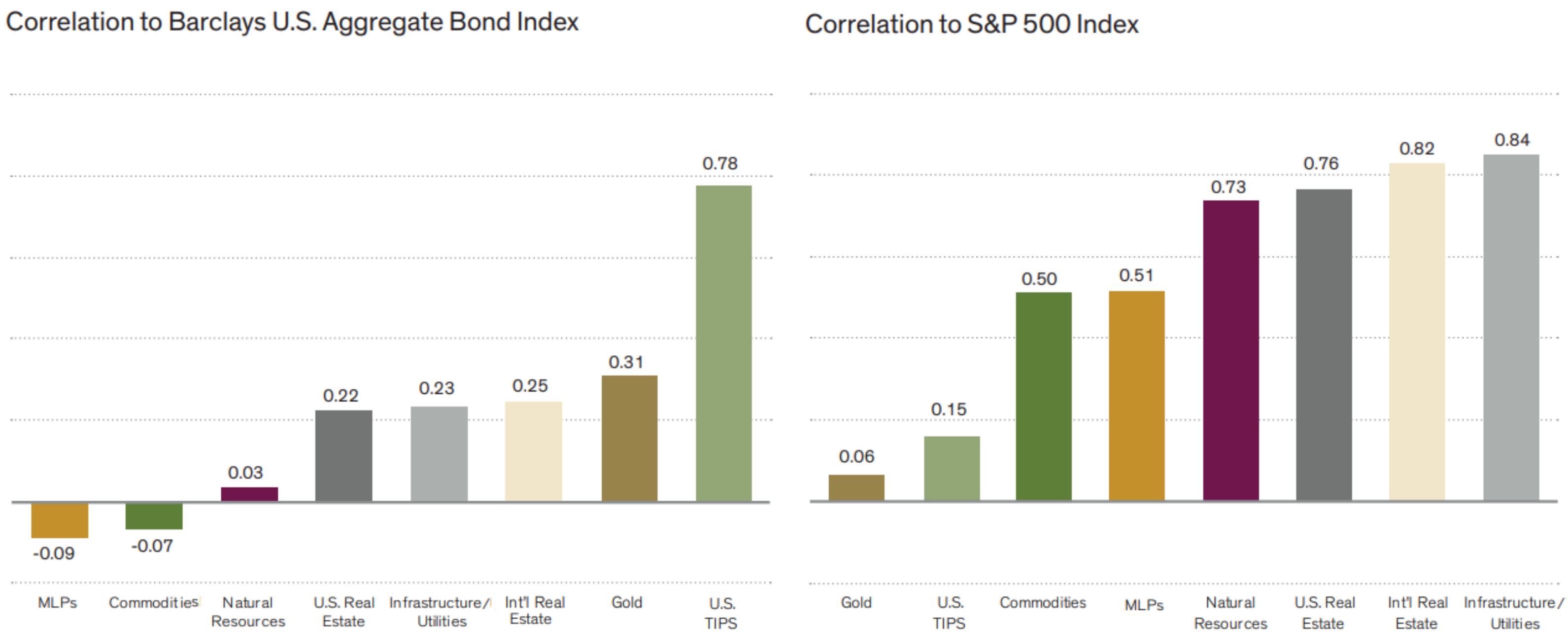


Source: BofA Merrill Lynch Global Investment Strategy, Global Financial Data, Bloomberg, USDA, Savills, Shiller, ONS, Spaenjers, Historic Auto Group. Note: Real Assets (Commodities, Real Estate, Collectibles) vs. Financial Assets (Large Cap Stocks, Long-term Govt Bonds)

Low Correlation with Traditional Assets

For most investors, diversification is especially appealing as traditional asset classes have become increasingly correlated with one another in recent years. We believe that because of central bank manipulations and excess liquidity, financial assets have become dangerously correlated to one another. The next chart demonstrates how **real assets historically exhibit low correlation with financial assets.**

2 / MOST REAL ASSETS HAVE LOW CORRELATIONS TO BONDS— AND LOW TO MODERATE CORRELATIONS TO STOCKS



Source: QMA. Calculated by eVestment using data presented in eVestment and Morningstar software products. Time period: 7/1/2005 to 6/30/2015. In this table, real assets are represented by these indexes: S&P GSCI® Index (commodities), S&P Global Natural Resources (natural resources), S&P Global Infrastructure Index (infrastructure), FTSE NAREIT All Equity REITs Index (U.S. real estate), S&P Developed ex-U.S. Property Index (international real estate), LBMA Gold Price PM Index (gold), Barclays U.S. TIPS Index (U.S. TIPS), and Alerian MLP Index (MLPs). The indexes used for illustrative purposes only. All indexes are unmanaged. An investment cannot be made in an index. Past performance does not guarantee future results.

COMMODITIES

Commodities are a real asset at the center of many global macroeconomic trends currently impacting financial markets. They will continue to play an important role over the next decade. In the form of futures contracts, commodities have unique qualities which can make them a positive, liquid contribution to the real asset portion of a diversified portfolio.

Why Commodities?

Can't Go to Zero

Commodities can't "go to zero." Enron did, General Motors almost did, and Apple could. The stock price of any corporation could potentially fall to zero and U.S. Treasury bonds could default if the government cannot print enough money to honor them. But this can't happen to a commodity because there will always be demand for commodities. Plus, there is no risk of management fraud or a reckless board of directors.

Cyclical

Legendary investor Jeremy Grantham once said, "I believe the only things that really matter in investing are the bubbles and busts."[2]

Bubbles and busts are the natural phases of commodity price cycles. In a bubble, prices go high enough to incentivize many sellers to sell, but are too high for buyers to come into the market. The bubble bursts, and the market often overreacts. This forces the price pendulum to swing too far in the opposite direction and creates a bust.

As these cycles are natural and frequent, we believe the optimal strategy is not to try to time the bottoms and tops, but rather to **buy the busts and sell long before the bubbles burst.**

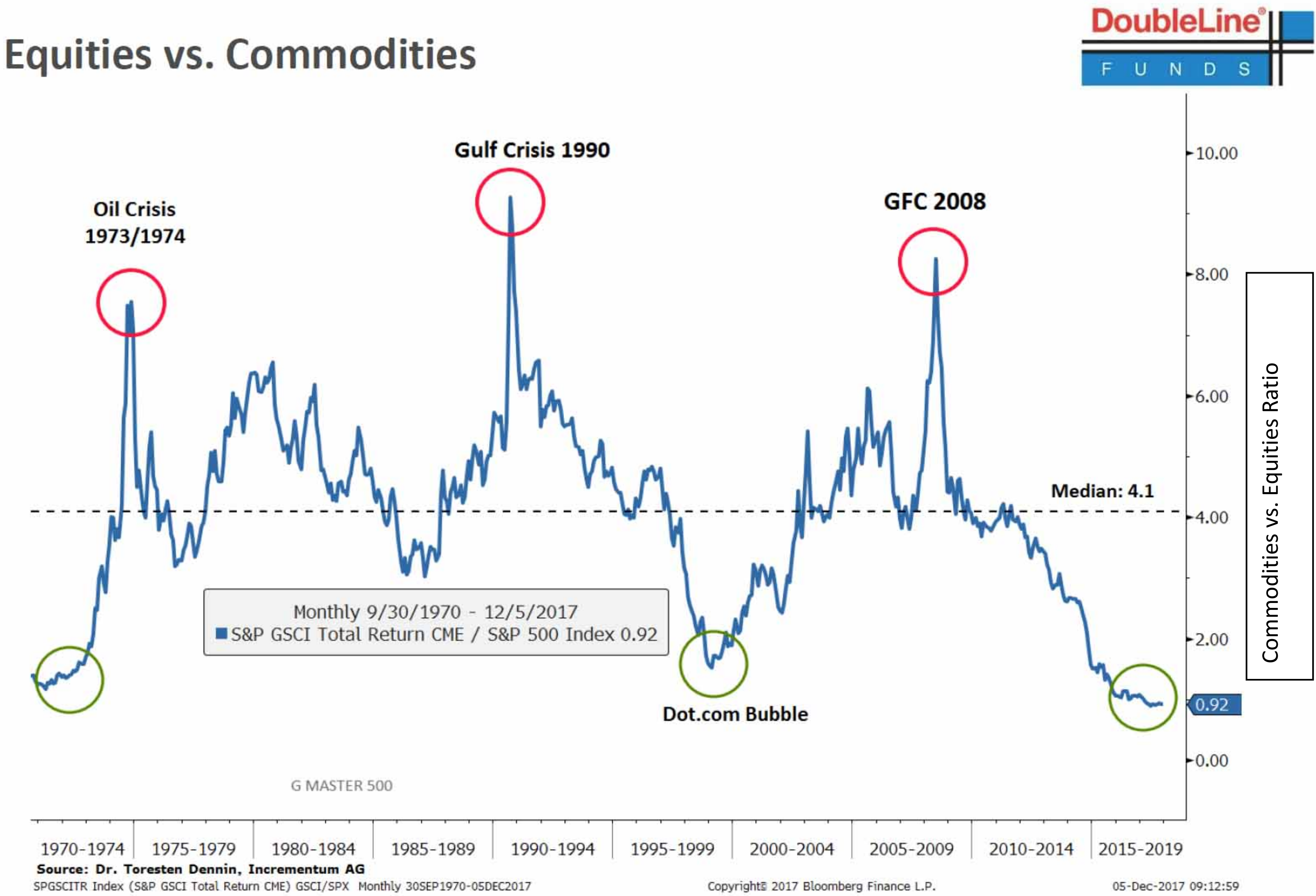
[2] Mr. Grantham has not approved or endorsed the strategy or views expressed in this document.

Buy Low Opportunity

Everybody wants to buy low and sell high. As commodity prices have fallen dramatically from their highs over the past decade, we believe today is an opportunity to buy low. While there can be no assurance that prices won't go even lower, we ascribe to the old traders' adage that "the cure for low prices is low prices." In other words, a weak market will eventually clear once prices have fallen far enough.

We believe **certain commodities present a "buy low" opportunity**, and in the words of Warren Buffet, "we simply attempt to be fearful when others are greedy, and to be greedy only when others are fearful."[3]

The following chart demonstrates how cheap commodities are compared to today's overvalued equity markets.



[3] Mr. Buffet has not approved or endorsed the strategy or views expressed in this document.

Emotion - Greed & Fear

In addition to price drops, busts always generate emotions of fear and panic. We are always looking for situations with specific commodities that include either despair or euphoria.

There are several methods of gauging sentiment in commodity markets:

- Public survey data
- Commitment of Traders (COT) data
- Proprietary sentiment tracking software

Greed

In commodities, greed works the same way it does in other asset classes. Rising prices attract attention. Attention attracts new buying. New buying raises prices. This is how bubbles are made.

Greed can be exacerbated in commodities because of leverage. In stocks, you can buy a stock on margin by putting up 30% of the purchase price. So the leverage can be about 3:1.

In commodities, whether it is cash or futures, that percentage is often somewhere between 0% and 1%. So the leverage can be 100:1 or more.

Fear

Fear can become an issue in every asset class. As prices fall, many participants, especially speculators, wonder how low prices might go and begin to fear how much money they might lose if prices fall too far.

Interestingly, in commodities, **you can have greed and fear working at the same time. It is rare, but it happens.**

For example, if the price of wheat is rising every day and rising rapidly, the greedy will join the parade and want to buy. However, if you're a high-ranking member of a government like China's or Egypt's who worries about civilian uprisings, rapidly rising wheat prices could create enormous fear.

Why? Because rapidly rising prices can mean two things: first, the cost of bread will rise, possibly to a point at which your citizens can no longer afford it. Second, and worse, rising prices might signal a shortage of wheat.

Dictators get killed by rebellious people who can't afford or find enough bread. Fear of uprisings and rebellions can drive governments with deep pockets to start aggressively buying wheat.

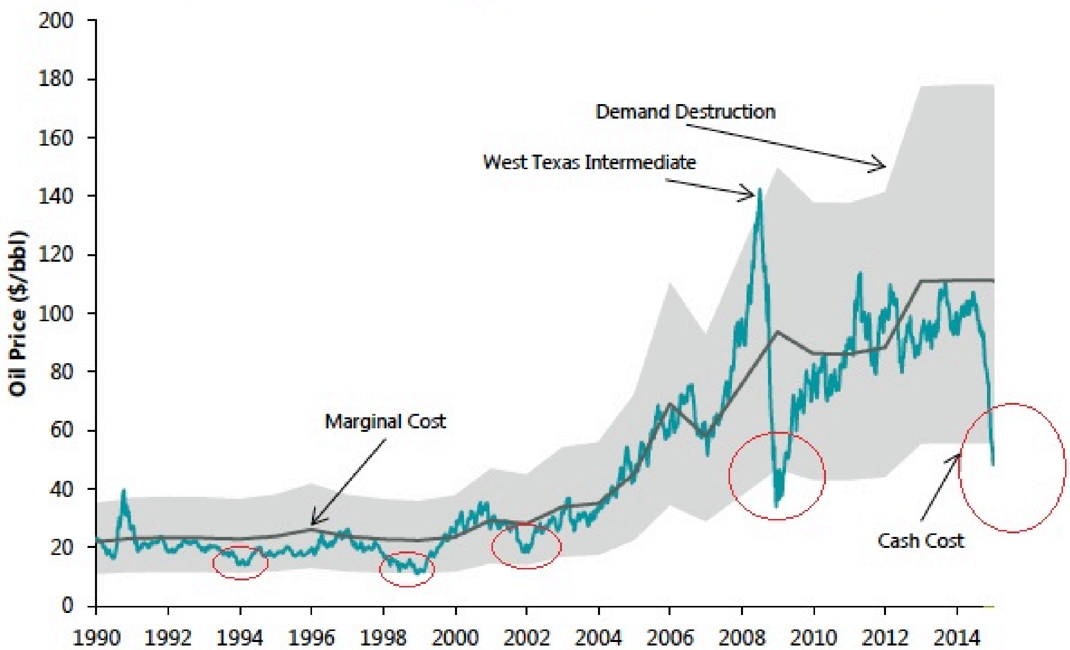
Understanding the emotions of the market place is extremely important to identifying potentially optimal times to buy or sell a certain commodity.

Marginal Cost of Production

When dealing with commodities, we believe **value begins when the price drops below the marginal cost of production.** We define the marginal cost of production as the price where the least efficient producer has to choose between continuing to operate at a loss or voluntarily (or involuntarily) reducing or ceasing production.

When producers halt production, future supply is reduced. As most commodities are directly or indirectly consumed by people, and the number of people in the world continues to grow, demand continues to grow. If demand grows and supply shrinks, sooner or later prices should ultimately increase. In our estimates**, some commodities are currently trading at prices below their marginal cost of production today.** These types of situations don't happen every day.

Exhibit 5: Marginal Cost of Production Suggests Much Higher Oil Prices Over the Long Term



Source: Bernstein. Data as of Dec. 31, 2014.

The Law of Supply & Demand

In a free market economy, **the law of supply and demand is fundamental and immutable**. Commodities are especially sensitive to changes in supply and demand.

Many commodities are currently depressed partly because of record-breaking global supply. For most of these commodities, however, new production is required every day, every month, and every year, meaning that global supplies vary annually and are extremely sensitive to supply shocks.

Today there are approximately seven billion people in the world. This number grows every day, and with it, the demand for commodities. Commodities are vital to life. Millennials can live without an iPhone, but they can't live without corn, sugar, or the silver used to make their iPhones.

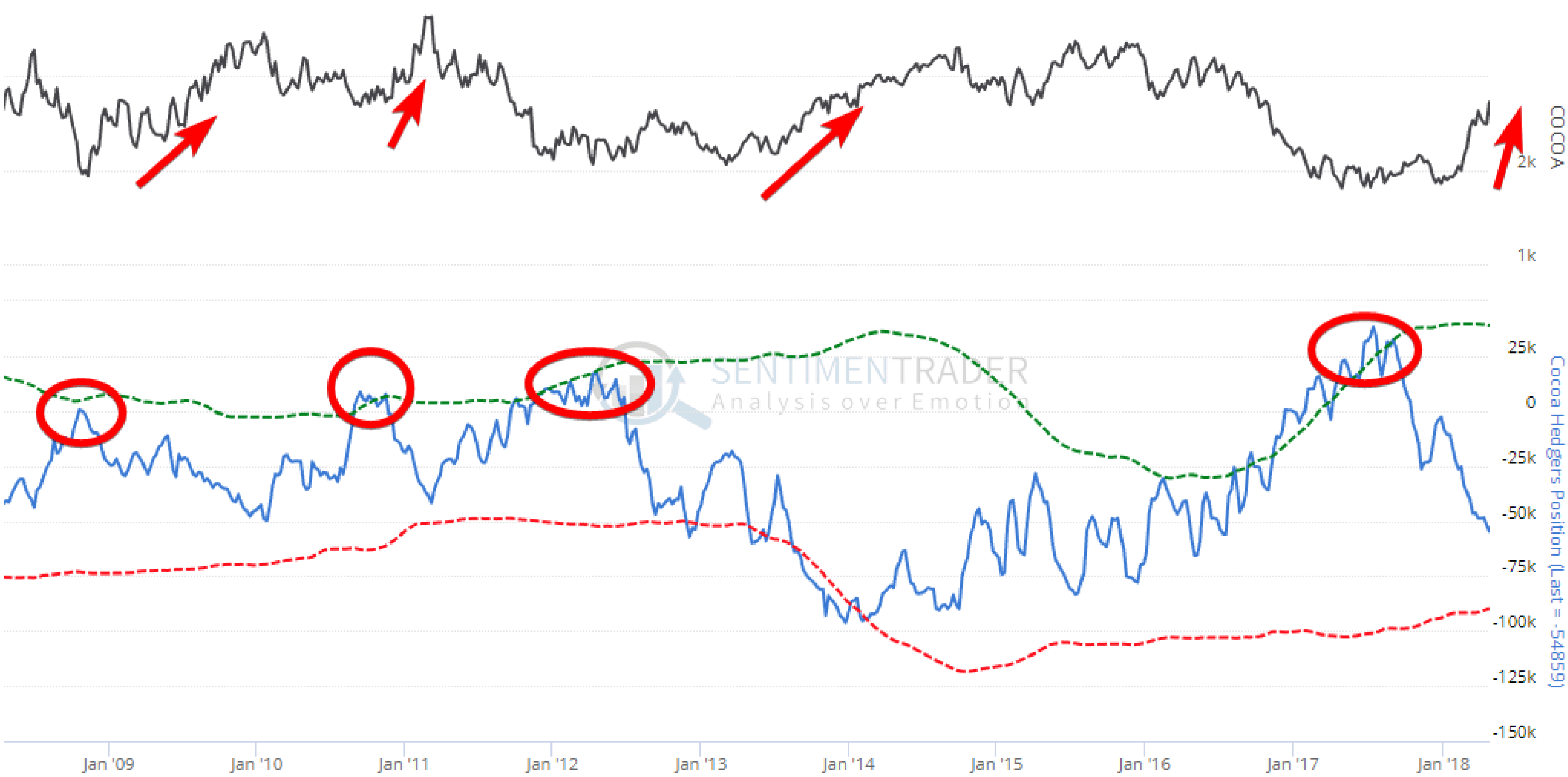
With the existence of many potential supply disrupters, and with demand for commodities growing yearly, **we believe supply and demand could be a positive support for commodity prices.**

Professionals vs. Amateurs

In our opinion, commodity markets are less opaque than many other financial markets. Commodity markets are unique in that one can ascertain capital flows, market positioning, relevant supply and demand data, and a host of other information for free.

One of our favorite sources of information is the Commitment of Trader (COT) data provided by the Commodity Futures Trading Commission. This data, unique to futures markets, provides valuable insight into the relative market positioning of "smart money" (professionals) versus "dumb money" (amateurs.)

Understanding the relative positioning of smart money versus dumb money, combined with many of the other factors listed above, can provide a valuable trading edge. An example is shown below with Cocoa positioning. "Smart money" surges can sometimes precede major price rises or declines.



THIS TIME IT'S NOT DIFFERENT

Every few decades, the economy's major players develop bulletproof confidence in the efficiency of markets and the health of the economy. Known as "this-time-is-different syndrome," this unrealistic optimism afflicted bankers, investors, and policy makers before the 1930s Great Depression, the 1980s Third World debt crisis, the 1990s Asian and Latin American meltdowns, and the major 2008-2009 global downturn. Conditions differed, but the same mindset – a dangerous mix of hubris, euphoria, and amnesia – led to each of these collapses.

We believe that this time is not different. We believe those arguing that low interest rates and high equity valuations are here to stay will be proven wrong. We believe a day of reckoning is coming and that increasing exposure to real assets like commodities could be a timely opportunity.

Debt & A Day of Reckoning

Global debt is approaching $200 trillion today. Ominously, nearly 29% of that debt has been accumulated since the financial crisis erupted in 2007. (This number doesn't even include unfunded programs that many people are relying on such as the United States Medicare, Social Security, and Medicaid programs. Nor does it include unfunded corporate and government pension plans.)

We believe debt is one of the principal causes of economic problems, malinvestment, and even speculative bubbles. We believe a day of reckoning is inevitable and will likely affect paper assets more significantly than real assets.

Reckless Central Bank Policies

In response to the financial crisis that began in 2007, central bankers enacted what was arguably the greatest experiment in monetary policy history. We are in uncharted waters. We know of no prior historical example in 5,000 years of financial history when interest rates have been so low (even negative) for so long.

Investors are loaning money to what we consider unprincipled, politically motivated, morally and financially bankrupt governments and even, in some cases, paying them for the privilege to do so. **If we had a choice today between only being able to invest in financial assets (stocks and bonds) and real assets, we would choose the latter.**

CONCLUSION

We believe that prices for financial assets have been manipulated higher in a reckless experiment to try to stimulate the economy and to compensate for trillions of dollars in debt. In a distorted market, we are trying to de-emphasize financial assets and look for value in real assets.

- Most investors are under exposed to real assets
- Inflation protection
- Storage of value
- An emerging asset class
- Historically cheap versus financial assets
- Low correlations with financial assets

In particular, commodities are a unique real asset that could provide extra benefit to one's portfolio in the coming years.

- Commodities can't go to zero
- Cyclical
- Buy low opportunity
- Presence of extreme emotions
- Prices below the marginal cost of production
- The law of supply & demand
- Market positioning lopsided

The attraction is clear. We believe the need to diversify beyond stocks and bonds will take on greater importance in the years to come. Our research suggests that adding real assets as a core component to investors' long-term investable assets may offer complementary diversification potential, inflation protection, storage of value, potentially long term capital appreciation, and a host of other benefits.