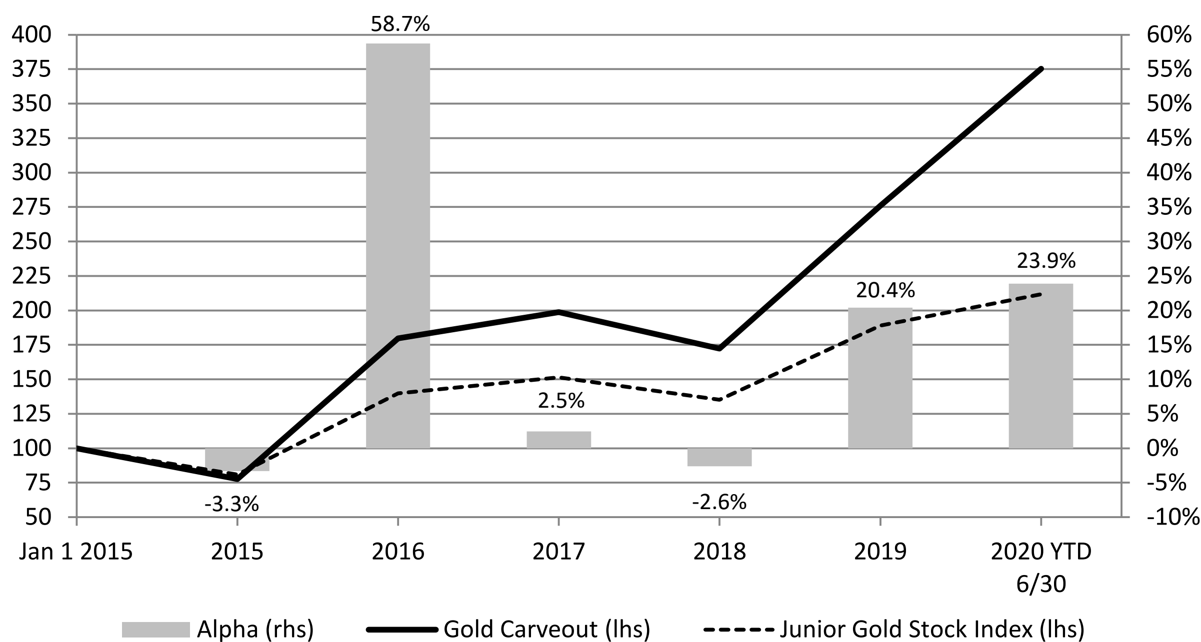
Dear Partners,

Eschler Recovery Fund rose 45% in Q2 2020, net of fees and expenses (B USD share class), and is now up 9.2% year-to-date. This unusual result validates a longstanding strategy of embedding an actively managed gold stock allocation within a traditional deep value portfolio. Top-down, the industry is outperforming the market now. Bottom up, the industry also lends itself to a fundamental stock picking approach. Business quality is uneven and only a small minority of stocks are investable. 2020 year-to-date has seen another solid stock picking result[1]:



In addition to the micro inefficiencies the chart above implies, the overall industry combines still attractive valuation, cash flow growth and low correlation with the rest of the portfolio. As per the table below, Fund profits from precious metals in Q2 2020 exceeded losses in Q1 by a factor of 3x.

	Exposure % of NAV (June 30th 2020)			P&L (bp of NAV)	
Industry	Long	Short	Net	Q2 2020	Q1 2020
Gold - Producer/Developer	19%	0%	19%	1761	-419
Resources - Royalties	17%	0%	17%	1197	-704
Uranium	12%	0%	12%	141	-431
Silver	11%	0%	11%	916	-335
Financial	8%	0%	8%	210	7
Energy	7%	0%	7%	350	-292
TMT	7%	0%	7%	472	-164
Other	6%	0%	6%	-3	0
Consumer Discretionary	0%	0%	0%	70	-192
Macro Hedge	0%	-1%	-1%	-345	164
Total	87%	-1%	86%		

[1]Alpha equals annual totals of monthly gross profit divided by average monthly capital employed. 2020 gross profit is for the six month period ending June 30th 2020. GDXJ US ETF used as industry benchmark. Unhedged in USD.

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Making the strategy work has required conviction, patience and a tolerance for volatility. I expect to draw on this behavioural toolkit as we enter a more febrile leg of the gold cycle. Gold closed Q2 at a record quarterly high in U.S. Dollars, having already breached records in nearly all other fiat currencies. Unprecedented government interference in private enterprise over the past decade -- and especially amidst the current crisis -- has made the case for gold self-evident. I expect more consensus rationalisation of its merits, and, ultimately, a rush into gold by the retail public. Commodities are not like the broader stock market where tops are usually a drawn out process (referred to as "distribution"); instead, they tend to peak on a vertical spike. Gold stocks are still 50% off 2011 highs and may well continue to benefit as this bullish gold narrative translates into further investment inflows.

Meanwhile, my research effort is now more focused on deep value recovery stocks with promising risk-reward *outside* the precious metals complex. As you can see in the table below, new holdings skew toward non-precious metals related ideas. I also exited several precious metals holdings last quarter whose valuations, in my view, had begun to reflect their outlooks.

Top 5 Contributors (bp)		Bottom 5	
Fortuna Silver Mines	+478	Euronav	-130
Maxar Technologies	+472	Paladin Energy	-81
Sandstorm Gold	+414	Peninsula Energy	-54
Pan American Silver	+372	AKITA Drilling	-31
Argonaut Gold	+359	Hecla Mining	-30

New Holdings	Exits
Antero Resources	Sandstorm Gold
Pzena Asset Mgmt	Pan American Silver
Hecla Mining	Allegiant Travel
Pason Systems	Equinox Gold

For the moment, all manner of high-priced, large cap glamour stocks continue to trounce the returns of smaller, low expectation stocks. However, based on evidence over multiple cycles I strongly advocate for the latter as vehicles to capitalise on the highest expected returns going forward.

"People are always asking me where is the outlook good, but that's the wrong question, the right question is: ***Where is the outlook most miserable?"***

John Templeton

My current focus is on smaller, quality businesses trading on 15-20% free cash flow yields based on 2019 results, the idea being that sooner or later their run-rate earnings power will once again catch up with (and exceed) last year's more normal results. When that happens, these types of shares can literally double. Here are two examples, both stocks purchased recently.

Pason Systems is a $480m market cap oil services company that provides software for analysing and optimising the performance of drilling operations and transmitting data between the rig and head office. With 62% market share in the U.S. (and 87% in Canada) Pason has had success increasing penetration per rig and its competitive advantage is found in a responsive service network. Oil Services is a volatile business. Industry shares correlate with the oil price and capex, both of which are under pressure. But the resulting collapse in supply,

particularly in the Permian Basin, may be under-appreciated. Ultimately, the oil price will need to incentivise new supply and capex will recover. I believe this resilient business with 45-50%

normalised operating margins and a net cash balance sheet worth ¼ of market cap can exit the current industry crisis stronger than before. At a recent share price of $C7.80, Pason's trailing pre-tax free cash flow yield of 18% provides a compelling margin of safety. A 7% normalised free cash flow yield would put the shares at $C16, up 110% and merely where they were nine months ago.

Pzena Asset Management is a $375m market cap boutique asset manager managing $30.8bn in pure value equity strategies as of May 31st 2020. The firm is run by Richard Pzena, former head of research at AllianceBerstein, and listed in 2007. This is a quality business with a liquid balance sheet ($21m cash, no debt), ~50% operating margins and high returns on capital. Margins have come down somewhat over the past 10 years (revenue and EBITDA yields as a % of AUM) but this is a profitable business even in the worst of times. With the shares still down 39% year-to-date, Pzena is a straightforward bet on a recovery in the value approach to investing. Using varying scenarios for key performance indicators (assets under management, net flows and EBITDA margins), I calculate a bear case of $3.20 (global financial crisis redux), base case of $8.70 and bull case of $12.90. If my evaluation of risk-reward is directionally correct (perfect accuracy being impossible), the shares offer at least a 3 to 1 base case risk-reward ratio at the Fund's initial purchase price of $4.58.

Looking out three years and assuming 10% compounded performance of Pzena's funds (in line with the 10-year average) and a 15x peak historical EV/EBITDA multiple, upside could be over 4x ($21/share). This is what I am playing for. I don't see a good reason why Pzena will not at least trade back at five year highs above $12 (+150%) at some point in the next several years. The same holds true for Affiliated Managers Group, another Fund holding in the listed asset manager space currently trading 65% below five-year highs. Risks are primarily weak market performance, negative net flows or continued excessive underperformance of the value style constraining the valuation multiple.

The Fund's NAV progression in recent years reminds me of the quote by the late economist, Rudiger Dornbusch, "*In economics, things take longer to happen than you think they will, and then they happen faster than you thought they could.*" Thanks to the last several months, the Fund has overcome a multi-year headwind for the value investing style to compound at 10.3% net of all fees over the past five years.

Theron de Ris
Portfolio Manager
8 July 2020

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