ALVINE CAPITAL

December 2017

Litigate to Accumulate

Uncorrelated Investments

Key Issue: like many other service industries, the legal world is changing fast in response to competition, technology and new client demands. The old days of fixed billable fees and stable cash flow are over.

Key recommendation: investors looking for genuine, alpha driven strategies that can deliver decent returns should look at the increasing range of options within Litigation Finance. The legal world is becoming accessible for these non-correlated returns.

Reflection on Markets

Alvine Capital has sought to add value in a number of ways. Not only do we try and help our clients with fund selection, but we also face the reality that **macro positioning is the most important part of asset allocation.** If you are in the wrong asset class or mix, returns will inevitably suffer.

When first starting these regular newsletters in 2010 we were emphatic supporters of an over-weight risk-on exposure. Our favoured allocation at that stage was for mainstream western equities. We understood that the global economic recovery was underway, and that Central Banks would lend their comprehensive support. However, having taken what we thought was **the meat out of the trade, from early 2016 onwards we have preached caution.**

Unfortunately, you should be only as good as your last trade. Clearly this was a misreading of the outcome. For that reason **we must firstly apologise, hence '*mea culpa*'**, and secondly **review this critical issue.** What did we miss—the overarching power of monetary policy, investors' long-term equity under-weight positioning post financial crisis, cyclical recovery in Europe, or perhaps man's resilience in constantly finding ways to deliver corporate stories? From social media to the infrastructure of the mobile internet, these newer industries (and the attendant share prices) have thrived.

Whatever the reasons, we were at the very least very premature- or more likely, just plain wrong.

In our defence what we did recommend were strategies that either gravitated beyond pure beta, such as active equity funds, or more likely investment in industries/sectors where the inner workings of the economy would deliver positive returns. **These niches have been in insurance linked securities, specialised Private Equity, music/TV royalties, student and affordable housing, hedge funds, trade finance, private debt and others.**

What we did not do is recommend outright shorts. This mistake in **trying to draw a line in the sand** is a foolhardy strategy

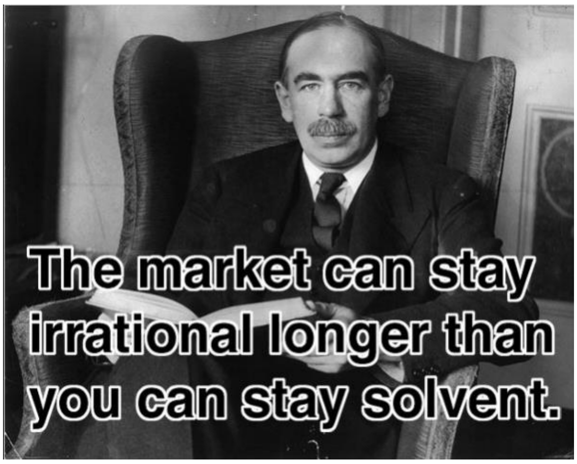
Even great hedge fund titans like Crispin Odey have not been able to pick this market top. Or Albert Edwards, still trying to predict after almost ten years of bearish miss-calls, the next crash. Like a broken watch, he will be right eventually, but at what cost!

[Get Out Now: SocGen Predicts Market Crash, Bear Market For The S&Ps]
Here is his latest…

Latin: ***Mea culpa*, *mea culpa*, *mea maxima culpa.***

1973 Tanslation: I have sinned through my own fault. (compressed the tripple mea culpa in one)

2010 Translation: through my fault, through my fault, through my most grevious fault.



Where Are We Now?

Having pointed out that entry levels for investments do matter in the eventual profitability of the outcome, things look even more stretched as we go into 2018. We don't know the precise cause to upset today's happy bull market, but here are few possibilities;

- Fed, Bank of England excess tightening
- ECB can't manage withdrawal from QE, political crisis in Italy/Germany etc.
- Brexit/Trump trade wars, between EU/UK, US/China or NAFTA falls apart
- Chinese 'Minsky moment'
- Geo-political blow ups from North Korea to Saudi
- Earnings fail to materialise, and high profile corporate failure/scandals (Tesla/Uber?)

We don't want to gamble here, and do not believe now is the time for excessive risk. It's better to **keep your powder dry**, and wait for the next buying opportunity. Accordingly, we wish to continue to recommend lightly and less correlated strategies that can deliver sensible risk adjusted returns.

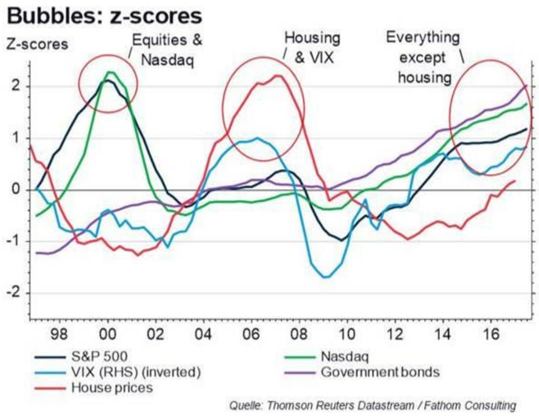
We now turn to a fresh theme: investing in Litigation Finance.

Champerty, No Longer a Barrier

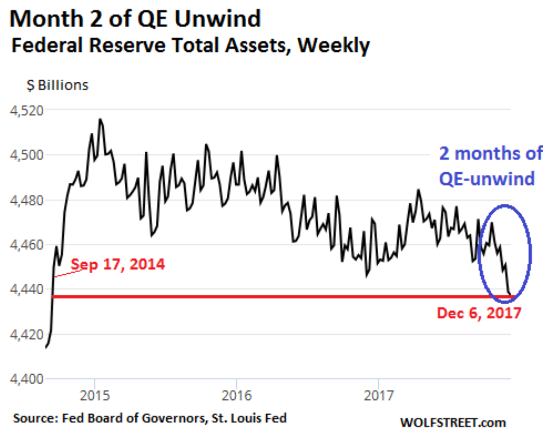
"An illegal agreement in which a person with no previous interest in a lawsuit finances it with a view to sharing the disputed property if the suit succeeds."(Dictionary.com, 2017)

Coming from an **Old French word** ***champart,*** literally a feudal Lord's share of produce' this concept prohibited outside party from participating in legal claims. Historically litigation was seen as vexatious, and hence not to be encouraged.

Another Cycle



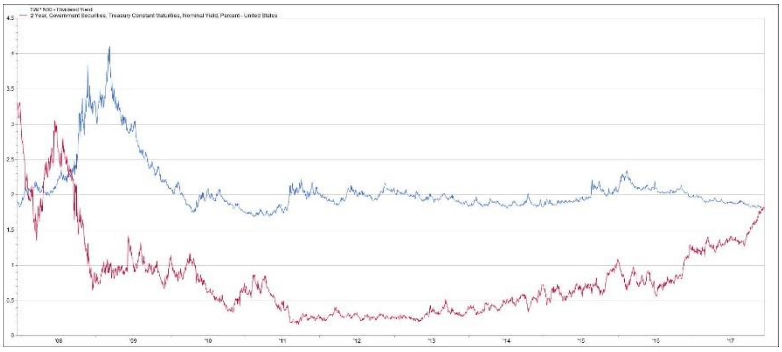
QE Unwinding Already



In modern times increasingly complex interactions between entities have brought the law very frequently into commerce. Simple, common law solutions often can't cope. Hence the acceptance of third party litigants is spreading fast. Some US states—Oklahoma and Maine-- still have an outright ban or force restrictive levels of implied interest or profit. In New York state courts have seen champerty as a means to encourage greater disclosure, and a way of encouraging settlement. Delaware and Minnesota still hold out against it.

Pro-bono and class action law suits have become mainstream for individuals, with corporates now sharing this route.

2y treasury yield now above S&P 500 dividend yield for the first time in a decade



In the UK there are now few barriers to Litigation Finance, as courts have seen the sharing of costs as a way of providing greater access to justice.

Lord Neuberger, the president of the UK Supreme Court, said *that "access to the courts is a right and the State should not stand in the way of individuals availing themselves of that right."* (Rose, 2016.)

Costs and Cash Flow - Use of Capital

As of 2016 there were estimated to be 1.3 million US practising attorneys equal to 40 per 10,000 of the total population. This is three times the number even as late as the 1960's (Potts, 2017). The cost of paying for all these lawyers has obviously had to keep pace, meaning that everyday access to law has become more and more of a luxury.

Billing by hour had been the traditional way of remunerating legal work. This concept is designed to keep lawyers focused on the long-drawn out preparation often required, rather than seeking to cut corners by taking ownership of a case. The client pays, but his legal brief assumes a 'neutral' stance and is rewarded by effort/thoroughness rather than by the eventual success of the matter.

Corporate clients still want the large part of their interaction with the legal world to be on a **confidential, one-to-one basis, when hourly charging fits the kind of discreet advice being sought.** A great deal of this sort of contract/M&A/HR etc., nitty gritty work will continue to sit within the traditional ambit of remuneration.

"Billable hours...billable hours..."

When approaching Litigation different realities have to be faced by potential participants. Many factors such **as timescale, costs and commitment** have to be weighed up in a potentially uncertain way. Companies are far more likely to baulk at this un-predictability which does not sit well with normal corporate planning.

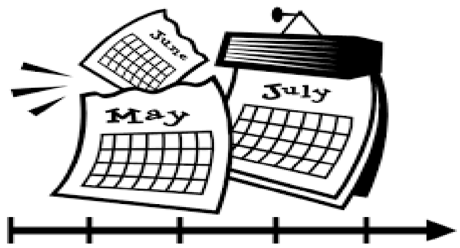
Hence the attraction of specialist Litigation firms, that can assist on a case by case basis. Those teams can then bring in appropriate, and often phased, financial support, as well as the necessary overall assistance-- witness training, comprehensive search etc.-- to make sure the litigation can proceed.

"Companies continue to insist that their legal departments innovate to reduce their overall legal spending, especially in connection with Litigation" (Practical Law Company, 2012)

Risk Mitigation/Sharing, Opportunism

Potential litigants have other issues to consider as well as up-front costs. The overall risk of litigation can cover both the potential upside of the claim, as well as the sheer grunt work involved in bringing a lawsuit to fruition.

In joining forces with a genuine partner, who shares the economic interest, the workload can also be carefully managed. At different stages of the claim both parties will be able to assess the risks, and hence how certain are they to proceed.



Average lawsuit takes 25 months to get to trial

Modern litigation is a process that involves preparation, detailed discovery, claim filing and eventually court work. Interested parties can pursue a more opportunistic approach when the case is being shared, and handled by a professional litigant.

Litigation finance *"encourages legal departments to think like a plaintiff by looking at potential claims as an asset that can be turned into cash."* (Practical Law 2012)

Litigation Funding-Wide Range of Structure

Both backers and plaintiffs can deploy a range of support that helps to manage, and incentivise all concerned.

Complete pro-bono work is rare, with all sides normally preferring a spread of profit to flow to the financer. Key issues are always to mitigate the downside in terms of losing cases costs, while preserving all opportunities to settle.

Can Legal Cases be Predicted?

Asking a lawyer for straight advice is a difficult one. Obfuscation, stroke caveats will always be the answer. In fairness the law is not completely predictable, and even the strongest cases can fail at the last hurdle. Difficult judges, unreliable witnesses and the sheer complication of many commercial cases make the business a tough one.

The continental system of contract based law is more certain than an Anglo-Saxon world where case law has evolved over time.

It's all very well for corporate treasurers to hitch a free ride by version of external funding, but how confident can investors truly be of backing winners?

Alpha Strategy

It should go without saying that this is a pure alpha play, there is no market beta or coupon like income to collect. Cases have to be judged entirely on their merit, and then worked out with potential plaintiffs. This requires the right experience and team of obviously legal background. Only the very best lawyers can adjudicate the soundest prospects.

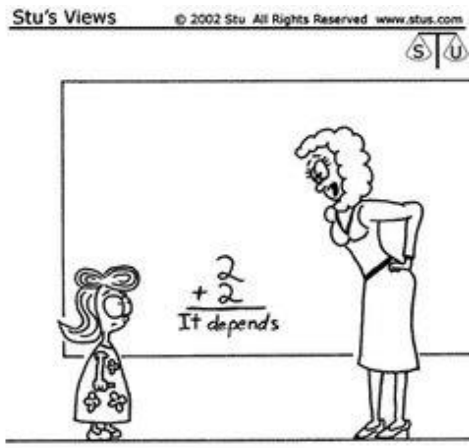
The best news is there are an abundance of cases. Modern economic interaction seems to have produced a rich seam of disputes, while the changed corporate outlook, as indicated, ensures plenty of demand for financial support to manage litigation. **There are such things as skilled lawyers who can excel at litigation**, rather than just generalists often found at big established firms.

Having a day in court is rarely seen as advantageous. Partners that finance this sort of work will be taking a dispassionate overview of the risks involved, and the complete opposite of vanity or angry litigation that can characterise some flawed cases.

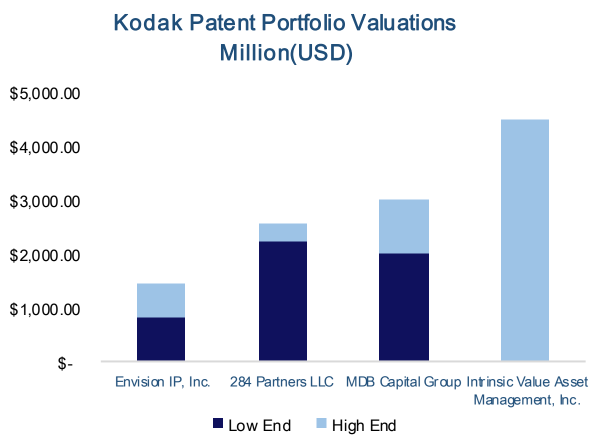
Other Legal Related Opportunities: The Asset Value of Patents

Being prepared to fight out legal rights in court can also open up the value of Patents, and other intellectual property. In an increasingly complicated tech world, the many opportunities to enforce genuine patent protection can sometimes be best afforded by finance professionals backed up with the right legal team.

New investment vehicles are emerging to acquire these rights, or even entire companies that own a substantial number of patents. A systematic analysis of the embedded value, which will often mean taking on internet giants, can deliver generous profits. Opportunities can also be found in additional sectors such as energy, biotech and others.



"Suzie, this is math, not the law."



Even this old technology asset has value

Conclusion: An Additional Model of Corporate Outsourcing

"If you want to glimpse the future of the law business, consider Microsoft's announcement this summer that it will start hiring outside legal services almost exclusively under alternative fee arrangements. Citing a desire to get the best value from its law firms, and emphasizing the importance of law firms being "very much our partners on this project," the tech giant envisions a range of new relationships with outside counsel that flout the hegemony of the traditional billable hour." (Burford Capital, 2017)

The world is changing fast, and the **concept of doing everything in house is part of that.** Legal work that can be compartmentalised and hence spun out of the main enterprise will be increasingly seen as a potential asset, rather than a cost.

Law firms that wish to survive are adapting their models to increasingly share risk, and then bring in outside capital. Investors that want to participate are being rewarded with strong un-correlated returns.

As this new legal world evolves, other themes such as portfolios of patent related assets can be brought into play.