Incrementum All Seasons Fund

– in pursuit of real returns –

2022 / 04

Seasonal Reflections

The end of Goldilocks

Dear Reader / Investor,

The summer 2022 edition of my *Seasonal Reflections* starts off with 2 photos shot from the Pizalun observation deck on the high plain of St. Margarethenberg, CH. On this hot summer Sunday, my wife Alexandra and I had decided on an "early" morning hike in the Swiss Alps to escape the heat in the valley.

Pizalun, View N/W, 31JUL2022, HGS pic

The hike is easy, and surprisingly was not busy, while the viewing platform affords beautiful vistas on the upper Rhine valley and its surrounding scenery, that can make one forget the tumultuous times we live in.

Pizalun, View S/W, 31JUL2022, HGS pic

It has been about 3 months since my spring edition, which I opened with comments on the Russia / Ukraine war. When I fetched my weekly Sunday paper (NZZ am Sonntag) from the letter box today, I found that news about the war have already disappeared from the front page and have been replaced by new and more urgent topics, especially the growing threat of an energy shortage this winter, and what Swiss politicians and bureaucrats reckon we may have to do to conserve energy. And on the geopolitical side, Nancy Pelosi's visit to Taiwan is still reverberating, and there is growing concern about an escalating conflict between the US and China. – I may be as wrong here as I was when I assumed Russia would not invade Ukraine, but I don't think China will want to escalate this. They have time and proximity on their side, though the sabre-rattling is part of the diplomatic game.

So, what else is on the mind of an investment manager in these late summer days of 2022? – For me the key economic question is whether the inflation genie is out of the bottle, or whether the authorities by way of engineering a pricing pressure relieving recession can get inflation under control again? And the main arguments that determine the answer to this question were outlined by Credit Suisse strategist Zoltan Pozsar in early August, when he wrote:

*"The low inflation world stood on three pillars: **first**, cheap immigrant labour, keeping service sector wages stagnant in the US; **second**, cheap goods from China raising living standards amid stagnant wages; **third**, cheap Russian gas powering German industry and the EU more broadly. …*

US consumers were soaking up all the cheap stuff the world had to offer: the asset rich, benefiting from decades of QE, bought high-end stuff from Europe produced using cheap Russian gas, and lower-income households bought all the cheap stuff coming from China. All this worked for decades until nativism, protectionism and geopolitics destabilized the low inflation world… …

Central banks went from waging a war against deflationary impulses coming from the globalization of cheap resources (labour, goods and commodities) to 'cleaning up' the inflationary impulses coming from a complex economic war. …

Think of the economic war between the US, China, and Russia as something that will weaken the pillars of the globalized, low inflation world described above – the process will be slow, not sudden, but it will be certain, where ongoing economic 'tits' for 'tats' will have the potential to drive more and more inflation. …

The unfolding economic war between great powers is stochastic and not linear, and what inflation will do in the future depends not only on the shocks that occurred in the recent past, but also on the many shocks that can happen still. These include more sanctions and the further weaponization of commodities, and more technology sanctions and further supply chain issues for cheap goods. …

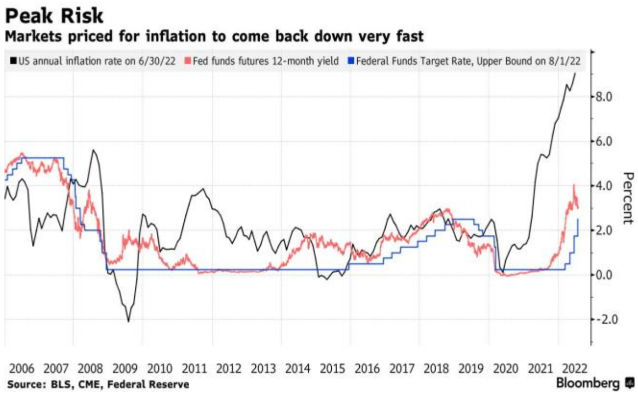
Getting right where inflation goes from here is basically a matter of perspective; do you see inflation as cyclical (a messy re-opening after COVID, exacerbated by excessive stimulus) or structural (a messy transition to a multipolar world order, where two great powers are challenging the might and hegemony of the US). If the former, inflation has peaked. If the latter, inflation has barely started." (As printed in Weirdness Factors by J. Mauldin, 6AUG2022)

That is a great summary, and neatly leads into the current debate among economists and market watchers, namely whether central banks will use tighter monetary policy to engineer a recession coupled with an asset price correction, with the aim to reduce overall demand and thus pricing pressures, or whether they will pivot once recessionary trends will become obvious.

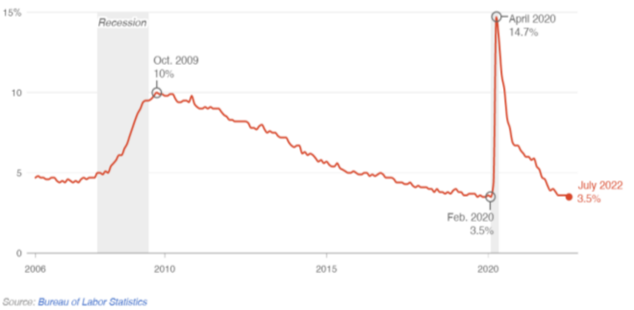
Hedgeye, Cartoon of the Day, 1AUG2022

Regardless the outcome, this is not a great setup for making money in financial markets the old-fashioned way, i.e., with conventional stock and bond portfolio allocations and passive investing.

Regular readers will not be surprised that I find more merit in the structural inflation argument, but I will of course keep an open mind on the issue. What is clear is that central banks have (probably) never been so far behind the curve. In other words, rarely have we seen consumer price inflation exceeding central bank set refinancing rates by such a large margin. This is true for the USA, and even more so for Europe.



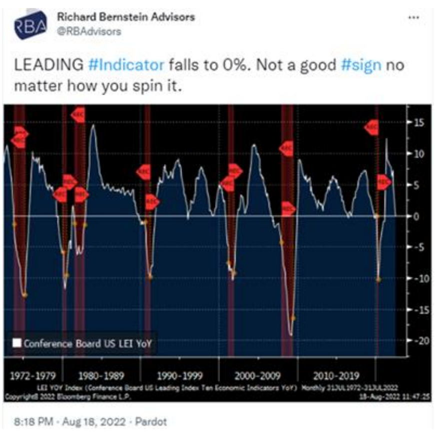
L-Shaped Recession Needed To Conquer Inflation, 2AUG2022



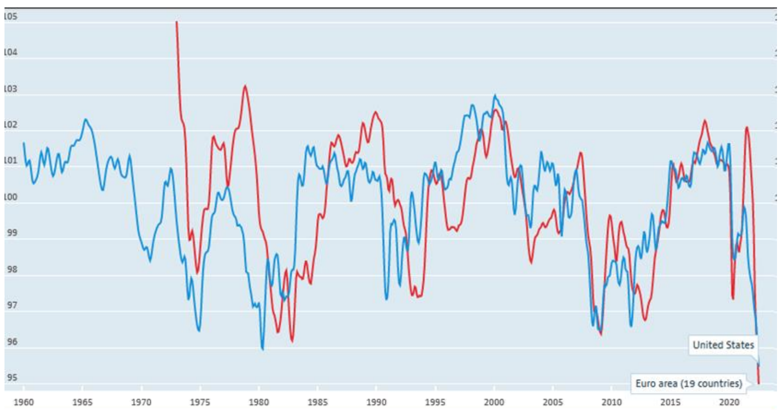
No Dovish Pivot Coming From The Fed, investing.com, 19AUG2022

At the same time, labour markets are still surprisingly tight, leading to rising wage pressures and thus the dreaded wage-price spiral. This puts central banks between a rock and a hard place: On one hand, inflation has become a major concern in society, and they are way behind their goal of keeping prices stable and thus at risk to lose (even more) credibility.

On the other hand, a highly leveraged economy is much more sensitive to monetary tightening, so that things can easily get out of hand. A look at the chart of US leading indicators, or US and Euro area consumer confidence numbers, which have recently plunged, adds further evidence that Western economies are already well on their way towards recession.

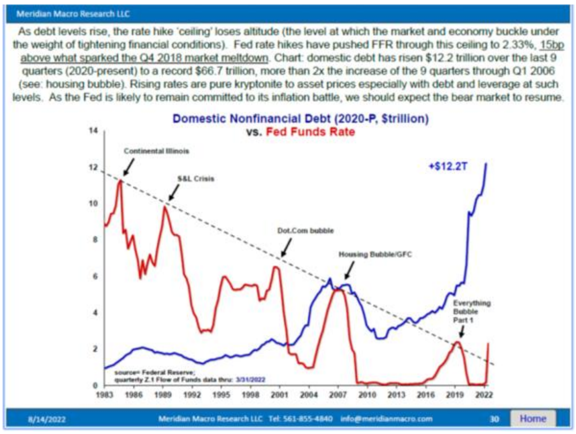


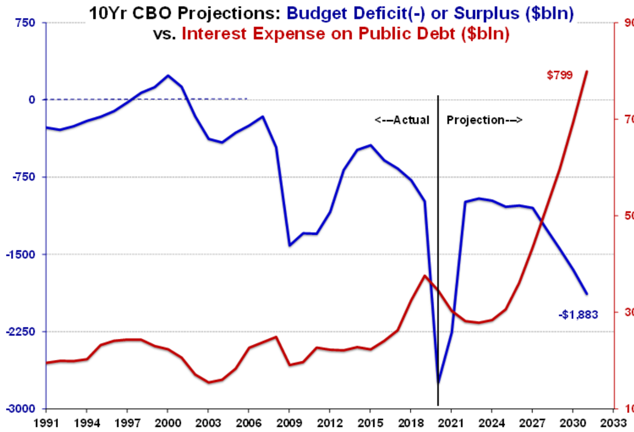
US Leading Indicator: @RBAdvisors, Twitter, 18AUG2022



US and Euro area consumer confidence: @TheMarketDog, Twitter, 23AUG2022

The effect of elevated leverage cannot be underestimated. As stated on IASF's homepage, we are convinced that *"Financial market seasons have been increasingly influenced by the end of the secular debt cycle and are accompanied by financial repression and long-term negative real interest rates".* – These debt related dynamics can be illustrated by the following charts, again using the US as example:



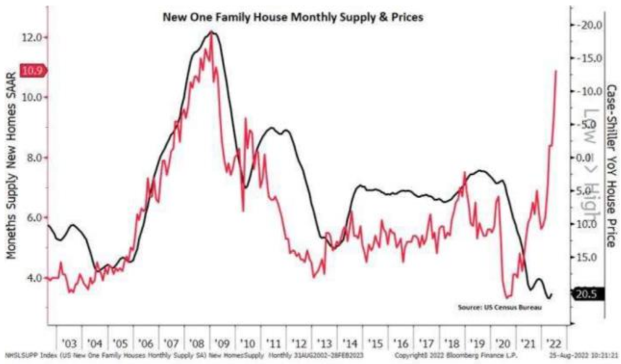


Meridian Macro Research LLC (both)

In a nutshell, as interest rates fell over the past more than three decades, debt levels have been gradually rising. For most of that period, the rising stock of debt did not become more expensive to finance, as interest rates (i.e., cost of carry) were brought down progressively by global central banks. But over the past few Covid-induced fiscal stimulus impacted years, debt levels have been rising at an accelerated pace, while the interest rate trend has now bottomed and reversed. The crucial difference can be seen in the chart on the right above, which shows how over the past two decades the US fiscal budget balance has turned consistently and increasingly negative, while more recently the interest expense on public debt has begun to rise and is expected to explode going forward.

And the same effect is not only at work in our public budgets but also on the private side, affecting companies as well as households. As a consequence, e.g., *"The supply of new homes in the US now ranks at levels which have signaled a US recession is underway or about to get underway.*

The supply of US homes is about to reach the same levels as 2008-2009, around 14-15 months. Accompanied by higher mortgage rates and tighter credit, this suggests home prices for all those newly minted homeowners, are about to fall. Negative equity for US homeowners is not something we have seen recently. Could it make a comeback? I do not see anyone talking about this." – Neither do I!



www.intelligencequarterly.com/

This is merely one example to demonstrate how financialized and hence vulnerable our economies have become, as record high debt levels are secured by extremely price-inflated assets. In the private sector, this financialization of our economies is evident in the proliferation of car leasing, consumer credit (buy now, pay later!), and maxed out mortgages. To cite the as ever brilliant Ben Hunt:

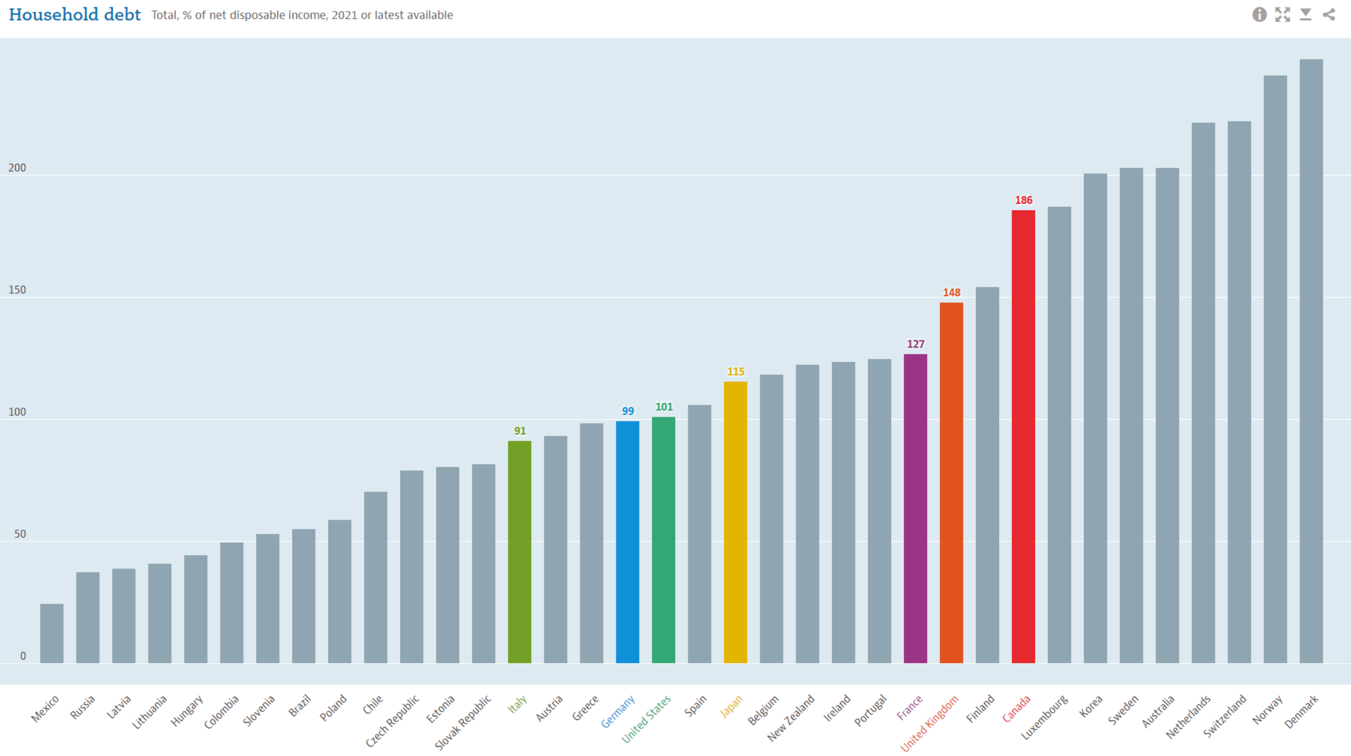
"The modern company world provides essentially limitless credit for anything that's intangible or depreciates quickly, anything that lets the non-rich FEEL rich. How about a nice dinner out? New smartphone? Maybe a vacation? You deserve it! …

We are told that "experiences" and "education" are the highest goals in life, and that debt in service to these behaviors is no debt at all, but is rather an "investment" in living our best possible lives. I tell you this is a lie. Or rather, it is a non-truth in service to the corporate arm of Fiat World, where reality is declared by assertion, where we are told that inflation is "zero in July" and 6 months of declining real GDP is no big deal if we don't call it a "recession", where we are told that massive wealth inequality and the preservation of tax breaks for private equity billionaires are necessary for "job creators", where we are told we must vote for ridiculous candidates to be a good Republican or a good Democrat, where we are told we must buy ridiculous securities to be a good investor, and – most importantly for the Nudging Oligarchy – where we are told we must borrow ridiculous sums to be a good parent or a good spouse or a good person. …

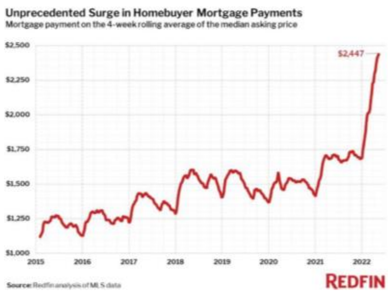
The result is a permanent burden of debt for most Americans, a cradle-to-grave connection with their lenders that rivals the cradle-to-grave connection with their government." (Source: Narrative And Metaverse, Pt.4 – Carrying The Fire, by Ben Hunt, 17AUG2022)

This statement is widely applicable to the rest of the developed world as well, and it resonates strongly with me. As part of the first Gen X cohort and guided by parents from a generation that still knew the value of personal savings as a means of self-reliability and -responsibility, I have always found the thought of buying a car, let alone consumer or household items, on credit rather disturbing. Save now, buy later, has always been my motto!

But that this is not a common habit is shown in the chart on the following page, which lists household debt-to-GDP ratios for various OECD countries, which range from 24% (Mexico) to 248% (Denmark). What is remarkable about the chart, is that its left-hand side is dominated by developing economies which tend to have higher interest rates and no social safety net, while the right-hand side is crowded by advanced economies, who have been enjoying a long period of ultra-low nominal interest rates as well as varying degrees of the helping hand of social security services. The latter also tend to have experienced rather forceful bull markets in residential housing, which has caused significant demand for mortgage loans.



Household Debt-to-GDP ratios, Source: OECD

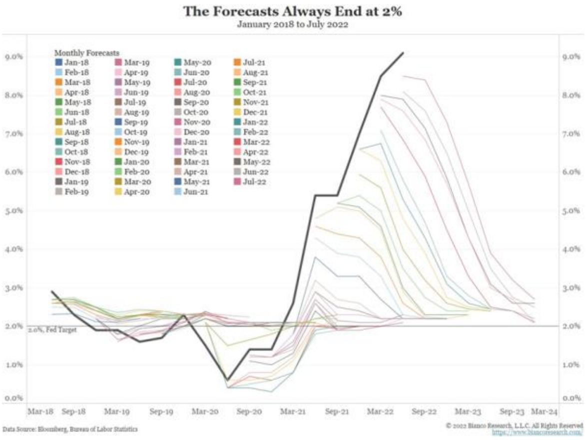


@GRDecter, Twitter, 24AUG2022

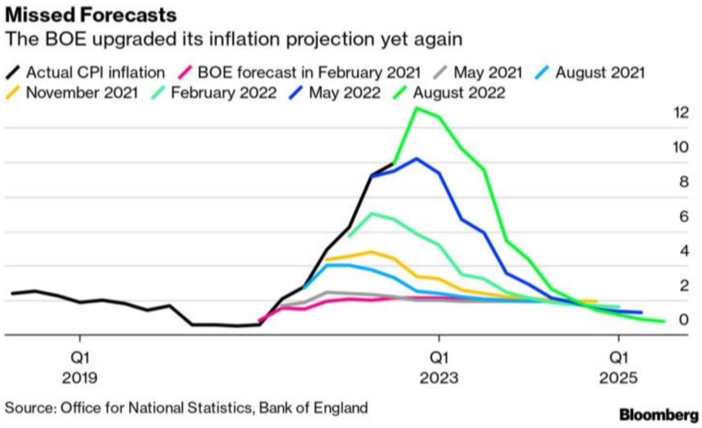
The resulting monetary policy dilemma thus is further complicated by the fact that too much tightening may not merely slow down the economy, but may also cause another housing crisis, if reduced affordability amid rising mortgage rates (see accompanying chart for US example) leads to forced selling of the housing stock, in turn reducing pledged security and thus causing significant stress for the banking system.

Hence, this may well turn out the ultimate test of our monetary mandarins' fine-tuning skills, and I would argue that given the response time-lag of policy decisions, central banks are at risk to prove their ultimate inaptitude at managing the economic cycle and may even cause it to become more volatile. This line of reasoning has many now to subscribe to the cyclical inflation outlook, as laid out by Zoltan Pozsar in the opening chapters, arguing that central banks will overdo their tightening, thus causing a deeper than anticipated recession, which through the corresponding demand destruction will cause inflation to disappear again.

If one was looking for evidence to support the view that the bulk of the economics and analysts' profession remain convinced that the current inflationary period will prove transitory, this can be found in the charts below (exemplary for inflation projections in the US and UK).

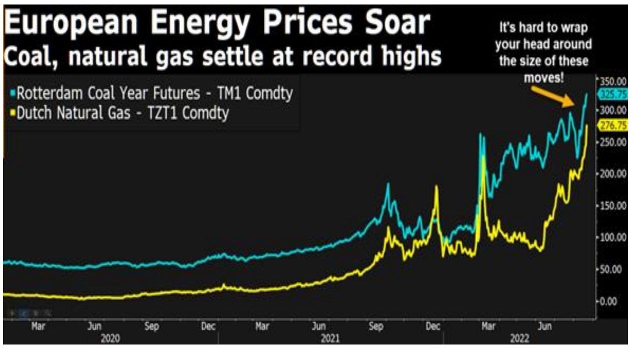


@biancoresearch, Twitter, 19AUG2022



Bloomberg

So, if the experts are right, by late 2024 things will be back to the old 2% inflation level, and we all continue like before… – If only it was not for this kind of stuff: *"UK inflation is on course to hit 18.6 per cent in January — the highest peak in almost half a century — due to soaring wholesale gas prices, according to a new forecast from Citi based on the latest market prices."* (Financial Times, 22AUG2022)



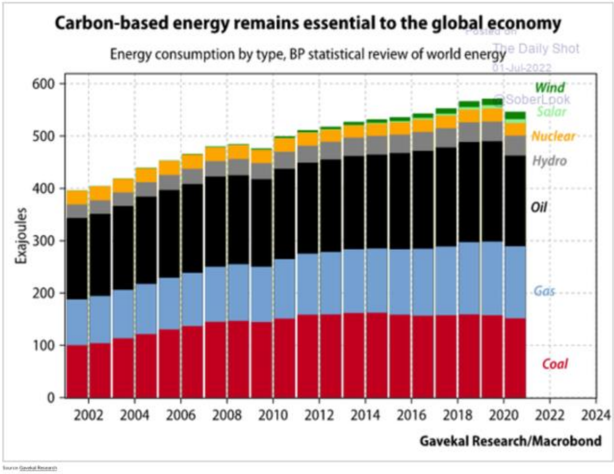
Macro Tourist Private Twitter Feed Recap, 22AUG2022

This neatly brings us to another widely discussed subject, which concerns energy prices. Leaving aside the politically convenient myth that rising energy prices are merely a result of Putin's Russia waging economic warfare, which certainly contributed and is hardly surprising considering how the US and other Western nations cut Russia off its foreign exchange reserves, this is something that cannot be fixed by monetary policy.

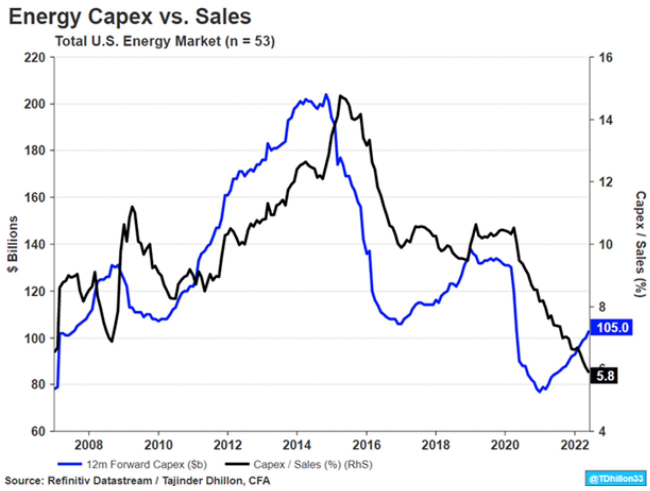
Brent Crude Oil Future, investing.com, 31AUG2022

Instead, we are dealing with serious supply side constraints, which were already evident in the rising upward trend for oil (and gas) prices following their Covid lows. The latter (incl. an infamous negative oil price print) were the result of "artificial" demand suppression due to lock-downs and travel restrictions.

But by now, the world has gradually reopened. And since all human industry and development requires energy, demand has been rising in line with economic growth and is expected to do so for years to come. Meanwhile, as the chart on the left below shows, the world's (rather than merely advanced economies') energy consumption is still predominantly fossil fuel based.



[Chartbook](#) by Adam Tooze (on Substack), 10JUL2022

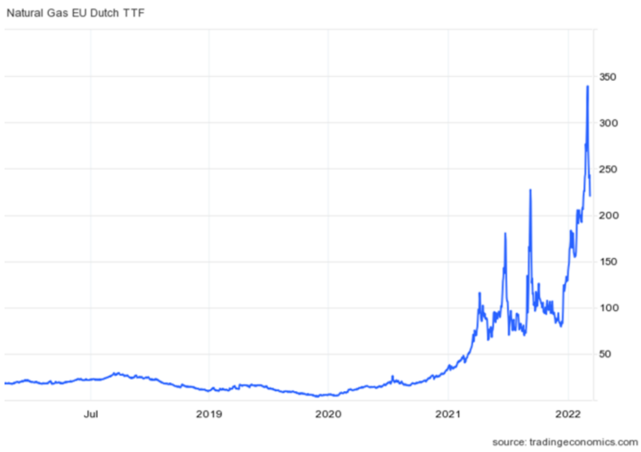


[Refinitiv Lipper Alpha Insight](#), 21JUN2022

At the same time, the conventional energy industry has gone through a tough stretch since 2014, when the last major investment boom in the US shale industry caused oil prices to drop to levels that made it uneconomical to continue to invest in reserve replacement. Here it is important to note that the cost of extracting a barrel of oil / cbf of gas / ton of coal (as well as pound of uranium) is not only based on the pure extraction cost, but also the cost of replacing that with newly discovered resources. Having said that, if you are a commodity producer with an already affirmed reserve base, you can of course produce and survive for a while by exploiting this existing resource base and just covering extraction cost. However, given civilizations overall need for energy that is not exactly a sustainable approach, as we are currently in the process of finding out.

As happens regularly in cyclical industries, depressed selling prices for oil, gas, or coal, due to a prior investment boom, have led the industry to reduce investment into adequate replacement of their depleting resource, which by now has turned into supply constraints. Such margin- (or lack thereof) driven underinvestment has been further enhanced by a politically desired and promoted energy transition away from fossil (and nuclear) fuels towards renewables, which has systematically discouraged and effectively penalized investments into these conventional energy sources. The resulting shortage of supply should thus be unsurprising.

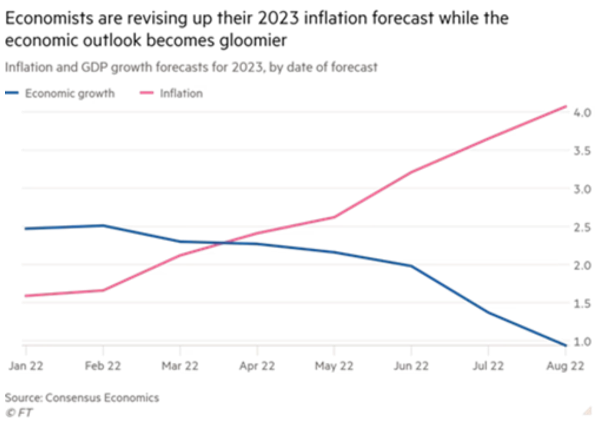
Together with what we would now label supply chain issues (e.g., Russian energy exports have been reduced and re-routed to Asian / African customers, while new imports had to be sourced from places as far away as the US), this has caused panic in Europe, which is illustrated by the Natural Gas price chart. It shows how EU gas prices which used to be in the EUR 20 / MWh vicinity have spiked to well beyond EUR 300, and at the time of writing this were still at more than 10 times pre-Covid levels.



EU Natural Gas, Dutch TTF (EUR / MWh), 1SEP2022

Well, here are a few fun facts to put the relevance of natural gas into perspective:

ACER (EU Agency for the Cooperation of Energy Regulators) Gas Factsheet



Financial Times, 30AUG2022

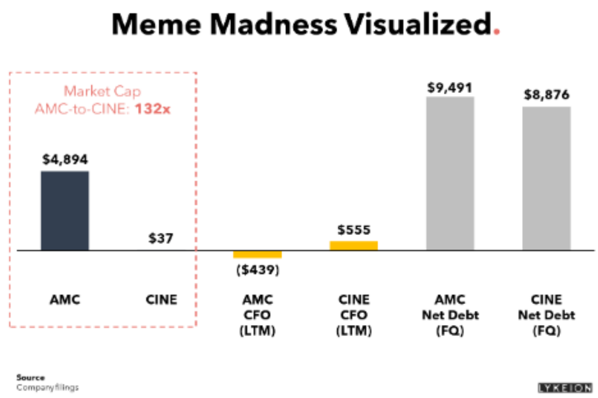
The above numbers give us a rough idea about the hit Europe has taken from soaring gas prices alone, which should be easily in the hundreds of billions of Euros. And as the price of oil and coal as other major primary energy sources have also risen sharply this year, this essentially acts like a tax on consumption and investment. Hence, it is hardly surprising, that economists are revising their inflation outlook up and growth outlook down.

There are 2 points I want to make here, which deal with the implications for investors and financial markets:

The first is how treacherous an investment environment this makes, considering where we are in the market cycle. The latter is summarized by GMO's founder, Jeremy Grantham's, recent commentary titled ENTERING THE SUPERBUBBLE'S FINAL ACT, which I recommend reading. In short, he sees the recent rally in US and global stocks as a typical bear market rally within a deflating super-bubble. And indeed, the stock market rally from the June lows meets the criteria for a typical bear market rally, i.e., both in scope but also amid the often-observed echo bubble effect, where prior themes that drove the bubble are taken up again. This echo bubble showed up with another round of meme stock madness, which was neatly summarized by Lykeion next to this chapter. In Meme Madness Visualized they have put cinema operator AMC (meme stock) in contrast with its competitor Cineworld Group (filing for bankruptcy), and the comparison should suffice to make the case that the spirits of 2020/21 have at least been revived.

At a 30,000 foot view, AMC operates 11,041 screens on about $2.5 billion of annual revenue ($226k per screen). CINE operates 9,500 screens on $1.8 billion of revenue ($190k per screen).

They both carry about the same debt load, but CINE has been able to generate significantly more cash flow in the last twelve months (LTM) reported (Note: CINE LTM is as of 12/31/21 and AMC is as of 6/30/22, their last reporting periods respectively, so the figures will be different once CINE reports next month). But AMC is burning a lot of cash…

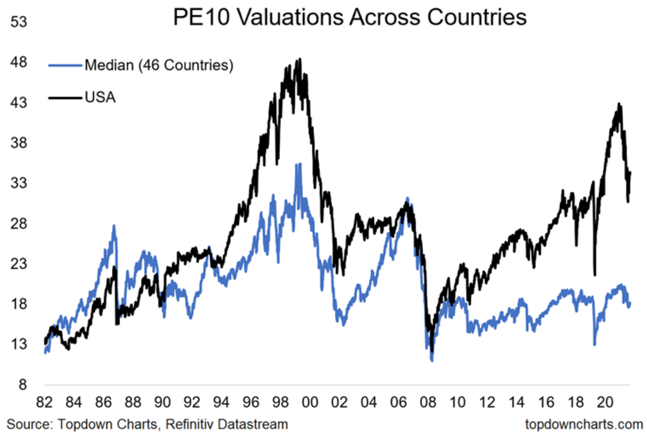


Enter the madness: CINE is going to file for bankruptcy, while AMC's market cap is now 132x that of CINE.

The company that generates more cash at similar debt levels is going bankrupt. The other is worth almost $5 billion.

And we wonder why J. Powell hasn't signaled a pivot yet…

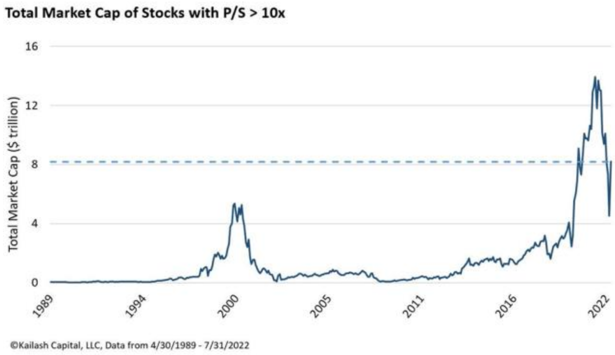
Madness Visualized, Lykeion, 31AUG2022



Off-Topic ChartStorm, by Callum Thomas, 11AUG2022

And how much the growth-theme dominated former bubble is still echoing even in professional investors' minds, can be seen from the table in this Twitter link: by @ecommerceshares, Twitter, 26AUG2022, which shows Goldman Sachs' list of top holdings of 589 hedge funds. This list continues to be dominated by FAAMG (Facebook, Amazon, Apple, Microsoft, Google) names, which is still responsible for the extraordinary valuation gap between US and other world equity markets.

More generally, the GS list also shows that despite of the carnage in lesser growth names (of ARKK status), there has been no real change of leadership yet in the current equity market regime, as growth and mega-tech continues to dominate. This is also reflected in the still sizeable share of companies (almost 10% of world equity market capitalization) that trades in excess of 10x expected sales / revenues.



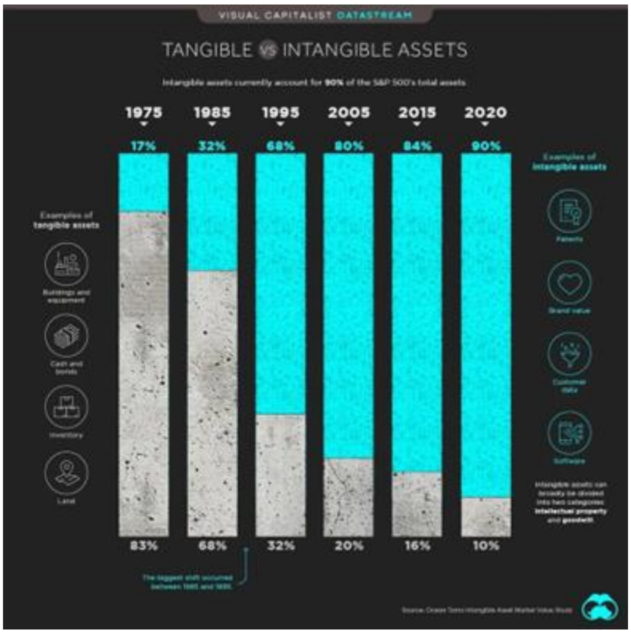
Off-Topic ChartStorm, by Callum Thomas, 11AUG2022

The second point is that it is far too early to abandon IASF's focus on energy and related hard asset names, or to close out our US equity market short positions.

US Profits Soar With Widest Margins Since 1950, 25AUG2022

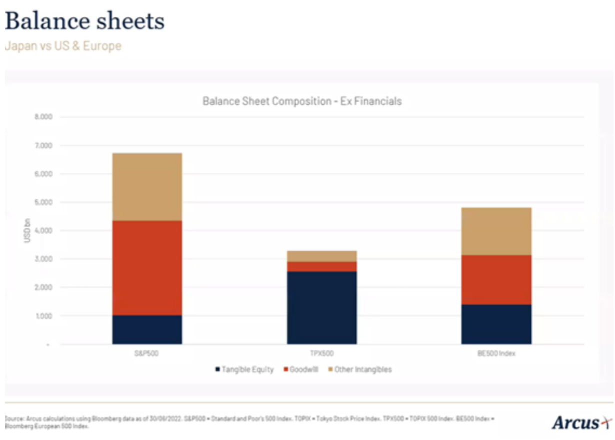
As to the latter, it remains justified in a still rising interest rate environment and given the huge valuation gap between US stocks and their global peers (as shown on the bottom of the previous page). Sure, US profit margins have so far held up surprisingly well, but recessions are a proven way to cause a reversion to the mean, which would make US equities even more expensive at present price levels.

In addition, with persistently falling interest rates and increasing leverage, the balance sheet composition of US publicly listed companies has almost completely reversed over the past 45 years. While in 1975 only a small fraction of US assets represented goodwill or was otherwise intangible in nature, this has completely turned with tangible assets in 2020 making up merely 10% of assets.



Visual Capitalist, 12NOV2020

It does not need much imagination but merely some common sense to expect that in a high(er) interest rate and inflationary environment this development is likely to (at least partially) reverse again.



Arcus Update Asia – Q2 2022 Webinar

And for anyone wondering whether this is only a US phenomenon, the graph on the left will help. It shows the composition of the active side of corporate balance sheets for the US S&P 500, Japan's Topix 500, as well as Bloomberg's European 500 Index, according to Arcus Investment Ltd, and based on Bloomberg data from 30JUN2022. Evidently, the composition is similar, though far less pronounced for the top 500 European firms, while Japan's balance sheets are much more dominated by tangibles.

@JeffWeniger, Twitter, 18AUG2022

And as far as IASF's current thematic allocation is concerned, the value argument is still massively supportive to maintain our energy, shipping, and other hard asset exposure, notwithstanding the fact that these are also very cyclical sectors, which in our view is more than discounted already.

And with a likely recession ahead at a time when inflation remains stubbornly high (aka Stagflation 2.0), company earnings will be under significant pressure, which is why it will be important to have exposure to sectors that enjoy structural tailwinds, while at the same time maintaining market short positions to keep the overall equity risk reduced.

So much for my current thoughts about the macro-economic backdrop for investors, which I thought is best described as The End Of Goldilocks. (The Goldilocks economy we enjoyed over the past decades was neither too hot nor too cold, same as the porridge Goldilocks eats in the home of the 3 bears in an old English fairy tale.)

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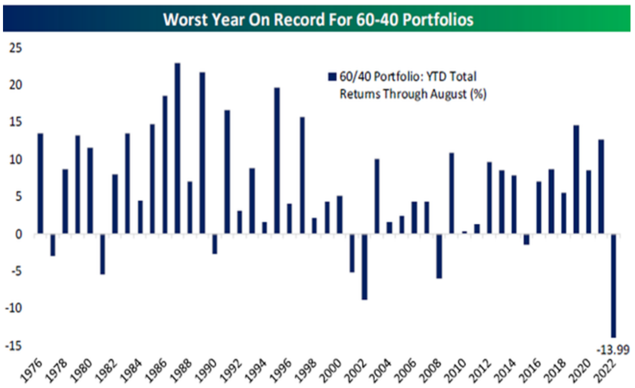


@bespokeinvest, Twitter, 2SEP2022

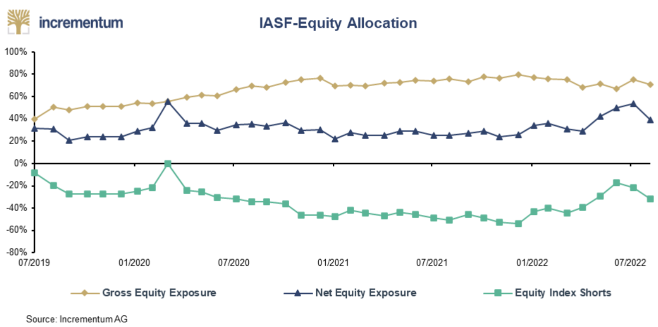
Clearly, investors have been dealt a poor deck of cards this year and have mostly been struggling with it. The reason for that struggle is that investors (both professional and private) have been conditioned to pursue growth over value, technology over basic stuff, trend over bargain hunting, and passive over active. That has worked for so long, that the pricing of risk has become rather inadequate for a radically changing set of circumstances.

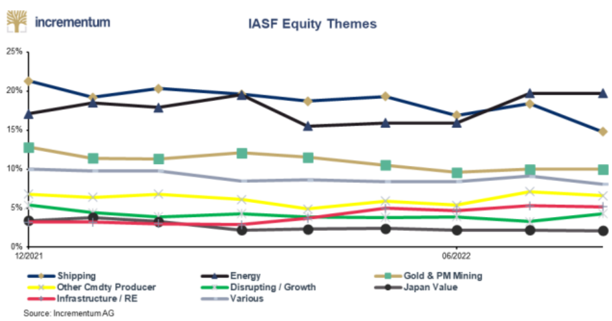
I have been regularly reminded of this when going through IASF's book of holdings and talking to investors. But before we go into details, please note that:

Any investment analysis, views, and outlook included in this document are based upon current market conditions and reflect the opinion of the author. All information was compiled from sources believed to be reliable, but no representation or warranty is made as to their accuracy or completeness. Seasonal Reflections are issued to registered subscribers for information and entertainment purposes only and must neither be seen as an attempt to solicit an investment in individual securities nor in the Incrementum All Seasons Fund. Past performance is no guarantee for future results, and the value of the fund may go up as well as down. If you seek investment advice, please consult a licensed investment advisor, or do your own due diligence.

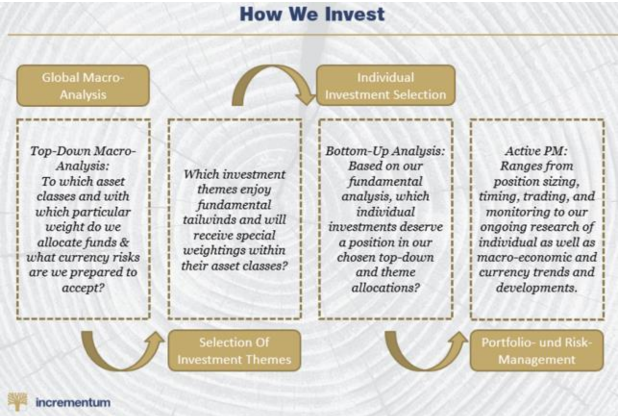
And on with the program:

One question that is often asked is what will cause me to change our overall allocation? – That suggests that there is one single event or trigger that could make that happen. Instead our investing process encompasses constant e(-and re-e)valuation of economic, market and individual company circumstances, and thus all changes are actually made gradually, as the charts in relation to IASF's equity allocation below show.





Of course, we have benefited from a strong performance (not only) in our leading ENERGY and SHIPPING allocations, with four of our shipping and five of our energy stocks more than doubling in price year-to-date. And given this overall strong thematic performance, some investors have been querying whether it is not time to exit from these volatile and cyclical businesses, especially in light of the above-described darkening economic outlook. But we believe it is still too early to consider this.

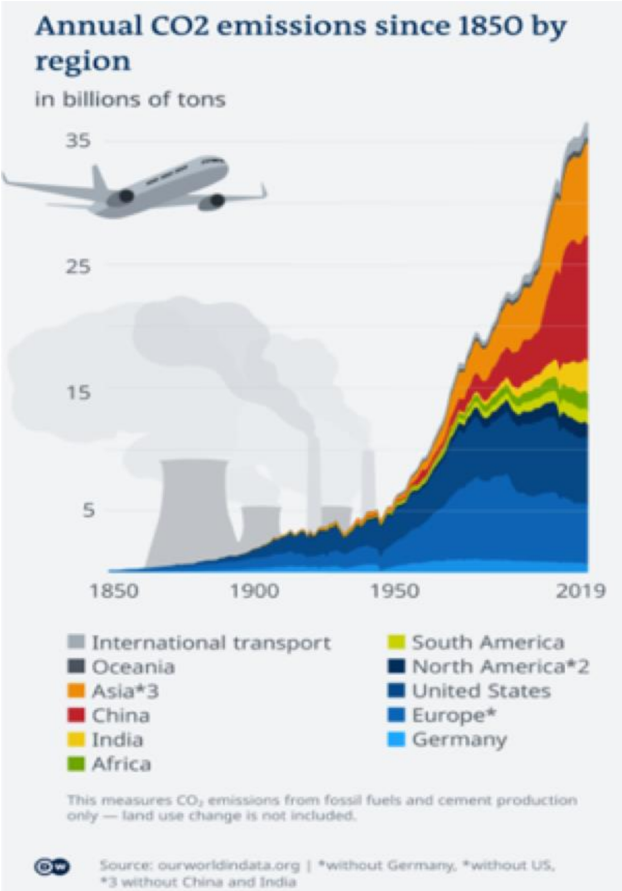


Looking at the macro-economic picture, our shipping exposure is still a suitable inflation-hedge as replacement cost keep rising. In addition, a very low order book coupled with an ongoing need to transport oil or dry bulk cargo in light of, e.g., rising ton miles amid Russia's altered oil export destinations, or China's expected economic growth stimulus through increasing investments, still provides a favourable sector backdrop.

And as far as energy is concerned, I am convinced that the world will have to relearn the importance of energy, because at the base of anything we do was something that was grown (a process that is actually transforming the energy of the sun) or mined, which requires energy, too. And even what we grow these days requires additional energy (e.g., natural gas for fertilizer, or fuel for machinery used), in order to merely maintain current efficiency levels of global food production.

But as always when you have something that is cheap and plentiful, as energy has been over the past decade, it is easily taken for granted, which is a huge mistake we have made especially in advanced economies. Cheap and plentiful energy made us believe that the pinnacle of human civilization is technological applications like the internet, broadband, and everything that has been built upon and around this. That is why we find predominantly tech companies in focus among ESG investors, as they seem rather less polluting than a dirty coal mine (and the Social and Governance factor has always played second fiddle). But perhaps we have never asked ourselves what happens e.g., in a Google search. It's free, right? – But approx. 8.5bn Google searches per day require a lot of energy. One such Google search revealed that one Google search is equal to turning on a 60W light bulb for 17 seconds. Of course, Google points out all the advantages it has over its competitors, and how little energy it consumes, and that it has a zero-carbon footprint. This is achieved through carbon offsets, a concept about which John Oliver in his Last Week Tonight show on August 22 had quite a lot to say. But that all sounds great, until one considers how much energy and material goes into building out the electric grid or power plants that provide the electricity, we have all come to rely upon.

Personally, I am convinced that we have simply failed to invest enough in the exploration, production and distribution of energy, a failure which in advanced economies that rely on energy to the highest degree, was even politically encouraged. I am all for a transition towards sustainable energy sources, but I think we failed to conduct proper feasibility studies, combined with a sober cost-/benefit analysis, before going on a very expensive path of “greening” our economies.



Chartbook #143

Take a look at the annual development of CO_2 emissions by region in the graph to the left, which shows the biggest growth over the past few decades in China / Asia and note that *“Shifting industrial production from the West to Asia helped to drive the huge surge in Asian CO_2 emissions. “Helped” is the operative word here. The basic drivers of Asian economic growth have been domestic, above all, the gigantic process of urbanization and the incorporation of hundreds of millions of people into the urban workforce. That is what drives steel and cement production in China.”* (Source: Chartbook #143, by Adam Tooze)

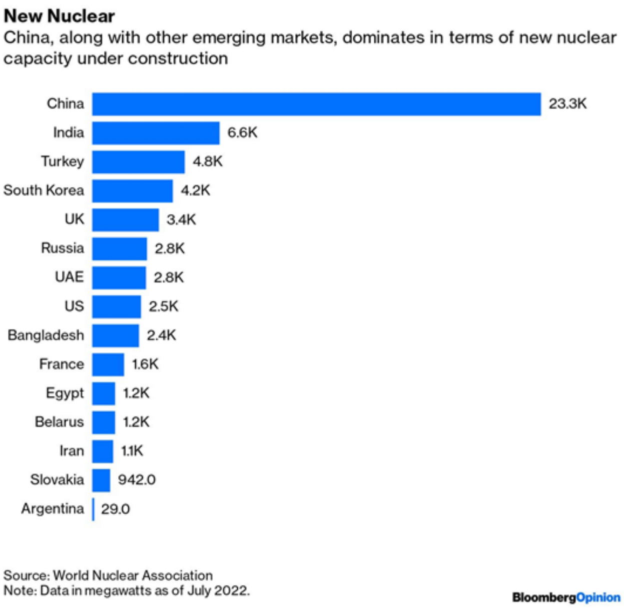
Yes, but that process would not have happened without the West’s massive foreign investments to ultimately enjoy cheaper consumer goods imports. And now, in our desperate need to secure clean sources of energy, we are driving prices to levels that force the rest of the world to resort to the cheapest and dirtiest energy in their own fight for survival. - That’s great climate policy!

In the end, democratically elected politicians in the West ultimately are incentivised to think short-term, i.e., always in view of the next election, and thus all we get is quick fixes. A recent example for these is *“… the Biden administration’s whole approach to* The Taming of the Pump*? Releasing close to 200 million barrels of crude — the same dirty crude that the same administration wants kept in the ground, eventually. Asking Saudi Arabia to produce more of that same dirty crude. Finally stooping as low as asking the U.S. oil industry to produce more of the same dirty crude. …*

Fossil fuels will be around for as long as there is no alternative that compares well on all the important aspects simultaneously: reliability, affordability, and availability. I suppose this is one more fact our decision-makers are going to learn the hard way. Unfortunately, the rest of us are going to learn it in an even harder way." (The big energy embarrassment, 19AUG2022, Irina Slav)

The fact is we don't have a coherent global energy policy. Western politicians are playing for the crowd, which is still made to believe that it can maintain its top of the world living standard, without any impact on the environment. That's why we are building a lot of very expensive solar and wind power generation capacity, but we neither have an electrical grid that can handle the intermittency that this entails, nor do we seem to have thought a lot about how we deal with the eventual waste. Case in point: Solar panels are mainly made of polysilicon, which through a highly energy-intensive process have so far been produced – yes, you may have guessed it – in China (mainly with energy from cheap coal). They are also made of glass and aluminium, and contain chemicals such as cadmium and lead, as well as tellurium and antimony, some of which are highly toxic. Once a solar panel's useful life has come to an end, in most parts of the world, it is destined to end up in landfills… – Come to think about it, we don't even know what to do with all the EV battery packs that will eventually become worn out. There is of course always hope for progress in recycling, but at what cost that may be possible remains to be seen.

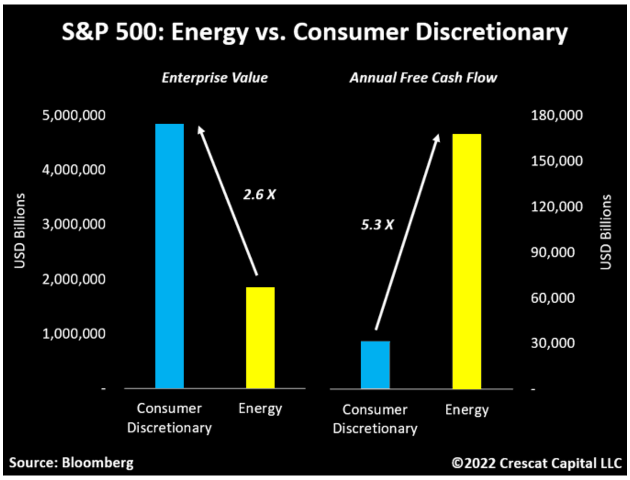
Or take the recent decision of the German government to keep two of its three remaining nuclear power plants for a few months on emergency standby, rather than extend their operation for a couple more years to provide reliable baseload power. Meanwhile, if there is an electricity shortage this winter or anytime afterwards, Germany can always buy (mainly nuclear power derived) electricity from France (if Paris can spare some). All the while, the nuclear industry, driven by the need for reliable CO_2 free baseload power, is experiencing a global renaissance. And the chart does not even include the most recent decision of Japan to reactivate part of its nuclear fleet…



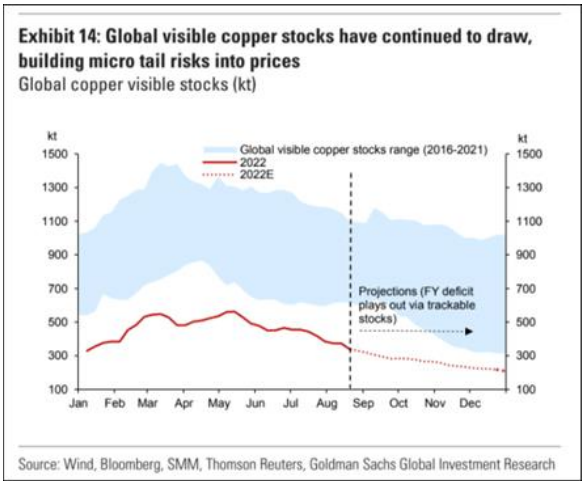
Rejuvenating the reactors, Bloomberg Opinion, 19AUG2022

At Incrementum we are convinced nuclear power will remain a vital part of the world's longer-term (and sustainable) energy mix, and thus IASF also has exposure to uranium miners in its energy theme basket. For our German readers who want to learn more about the industry, I highly recommend my colleague Dr. Christian Schärer's, columns "bemerkenswert" and "fremdgelesen", on his Uranium Resources Fund website.

Having said that, as the world lacks a coherent energy policy, but prefers haphazard and uncoordinated responses to how things unfold, energy remains a dominant IASF theme. But a favourable macro-backdrop is only part of the investment equation, as it must also be seen against prevailing valuations, which are still far from discounting an overall very constructive outlook. @TaviCosta illustrates this point: *"The consumer discretionary sector is now worth 2.6 times the size of the energy sector, while the latter generates over 5 times more in free cash flow."*



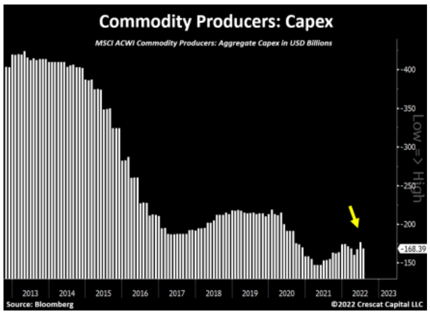
@TaviCosta, Twitter, 22AUG2022



The same is valid for OTHER vital COMMODITIES, especially battery metals like copper, which amid the growing electrification trend is in increasingly high demand, and to which IASF has built some exposure, too. But global production is not keeping up, both due to a lack of overall investment, but also geopolitical reasons, as countries like Russia are sanctioned, while political changes, e.g., in Chile are negatively affecting copper output and exports, and thus foreign investments.

Some investors compare the recent commodity price boom with what happened during the last major boom that peaked in 2007/08. But to quote resources investment experts Goehring & Rozencwajg: *"Today conditions couldn't be more different than those preceding the GFC.*

Commodities and natural resource equities have never been cheaper and more out of favor relative to financial assets. In 2020, energy and materials made up less than 2% of the S&P 500 compared with 20% in 2008. Because of the 2010-2020 commodity bear market, capital spending for almost all extractive industries has been severely curtailed. For example, in the energy industries, capital spending in the S&P 500 has fallen from $320 bn per year to less than $100 bn today and, as you will read in the "Incredible Shrinking Super Majors", what capital remains is not being spent efficiently.



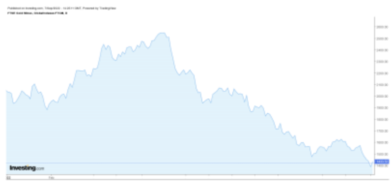
@TaviCosta, Twitter, 29JUL2022

Given this backdrop, which far exceeds the extremes of 1929 (at least concerning valuation), even a severe economic contraction that rivaled what happened back in the 1930s should still offer excellent returns in commodity, and commodity related investments." (Why Resources During A Recession, 18AUG2022, Goehring & Rozencwajg)

I rest my case!

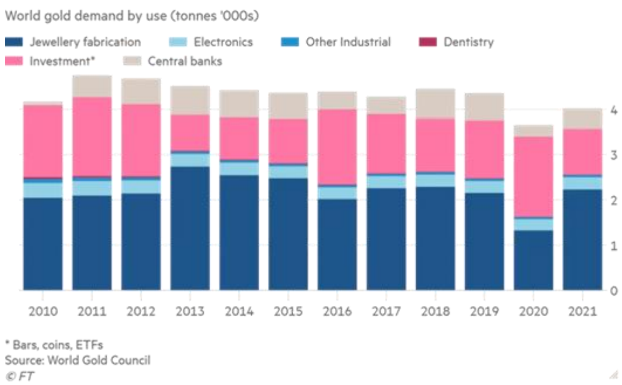
Lastly, a few comments on IASF's GOLD AND PRECIOUS METALS (MINING) exposure, which has been an overall drag to this year's performance. As of the time of writing this (6SEP2022), gold, silver and platinum have lost -7%, -22.4% and -11.2% in USD. However, IASF is a EUR based investment vehicle, with the USD and CHF share classes fully hedged, and amid the weak EUR our exposure in physically backed ETCs has seen price changes of +8.1%, -10.8% and +0.4%, which means that across the board these diversifications of the fund's cash balance have brought about a small gain (as the gold position is by far the largest) and helped us avoid paying negative interest rates. – So far, so good.

But thus far, it has been a rougher year for the precious metals' miners. As the graph on the right shows, from its 2021 close the FTSE Gold Mines Index first rallied 23% until April 18, before falling a stunning 44% until September 6, leaving the index nursing a year-to-date loss of a painful 31%.



FTSE Gold Mines Index, investing.com

With precious metals miners the third largest IASF sector theme with a double-digit percentage portfolio exposure, that has hurt. Some of the decline is explained with companies reporting surprisingly poor results (Newmont and Pan American Silver come to mind), and the sector overall was affected by weaker precious metals prices (especially silver) and rising inflationary pressures (energy is a major production cost driver, as is labor and machinery), resulting in overall margin pressure.



Financial Times, 2SEP2022

However, that type of nearly unprecedented share price decline seen over the past few months is mainly the result of shrinking valuations amid investors' cooling interest in precious metals, which is also expressed in the lowest investor demand since 4Q20/1Q21.

The question is: What could revive demand?

As I have pointed out in the first part of this commentary, we continue to be in a stagflationary scenario, in which gold miners have historically been one of the best asset classes. However, so far investors are still not discounting this scenario as a longer-term condition. In fact, the prevailing view is that either inflation pressures will ease quickly amid a growth slowdown / recession brought about by hawkish central banks, or central banks will pivot and resume monetary easing again, which would support more traditional risk assets. Personally, I fear sharply increased counterparty risk, if the monetary tightening process has staying power, which would be good for gold. But I can also not discount the prospect of a central bank pivot (i.e., abandoning their tightening path), and when that happens it should be the final wake-up call that debt monetization is unstoppable.

For now, our gold and precious metals allocation has been a drag to IASF's portfolio, but we certainly are patient in our investment approach, and I have no doubt that it will provide a boost to assets in the not-too-distant future.

As usual, this has already become far too long a commentary, but I hope my readers have enjoyed these late summer reflections. Autumn is around the corner, and for investors that has often been a treacherous period. We have so far managed our investors' funds well, and thus are trying to stay vigilant rather than elated in order to avoid any close encounter with the angry bear.

Hedgeye, Cartoon of the Day, 10AUG2022

As always, I welcome readers' feedback by e-mail, and sincerely thank you all for your interest and our investors for their trust and support.

Greetings from Schaan, Liechtenstein!

Best regards,
Hans

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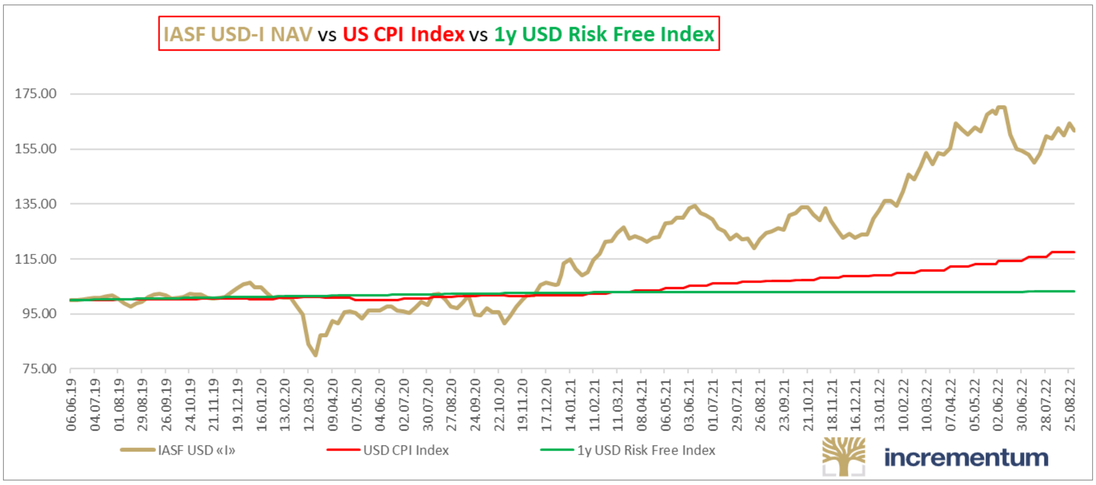
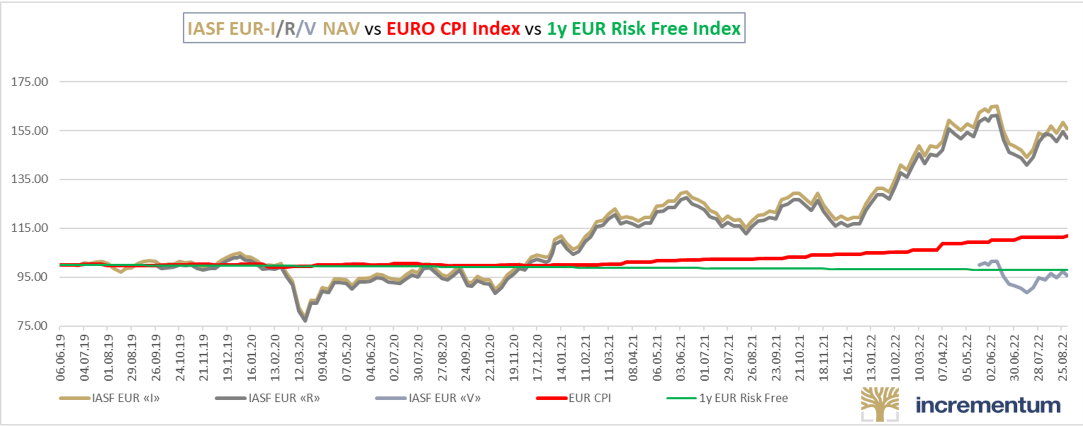
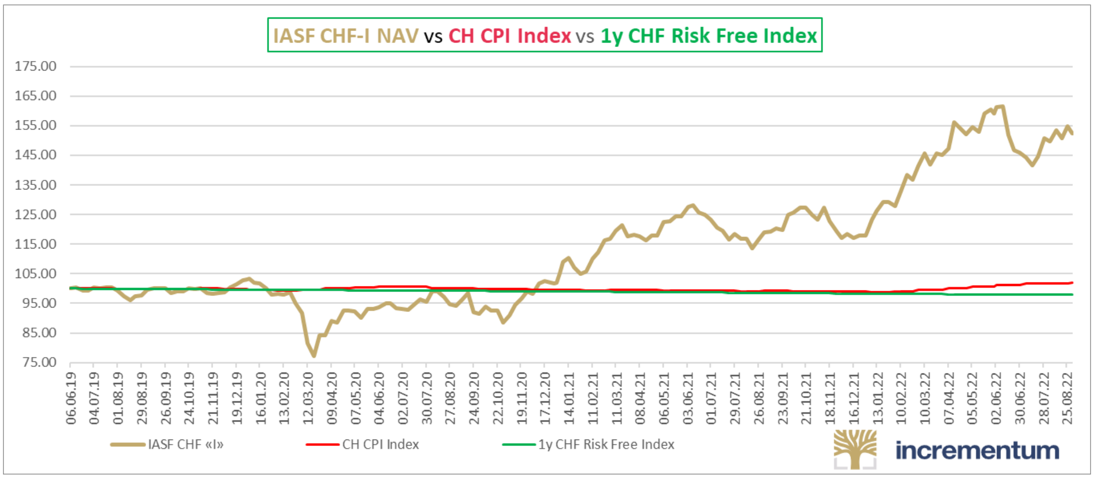
Appendix *







* Graphs display NAV of IASF performance until last valuation date (**31AUG2022**), compared to the respective risk-free 1y-government yield, as well as the relevant CPI Index in respective currency as a proxy for the loss of purchasing power from the start of the investment period (6Jun2019 for 'I' shares; 26Sep2019 for EUR-R shares; 20MAY2022 for EUR-V shares) on an indexed basis.

IASF PM Shaped By 8 Investment Lessons

1. Capital markets, like the economy, are inherently cyclical in nature, and you must always know where you are in the cycle, while not hesitating to "Be fearful when others are greedy and greedy when others are fearful." (Quote: Warren Buffett)
2. Prices paid determine future returns, i.e. the higher valuations are, the lower future return expectations must be (and vice versa), which is the essence of value investing.
3. Capital preservation is the conditio sine qua non, and a consistent and long-term investment strategy is more important than short-term momentum chasing.
4. As a result you must always know when you trade, or when you invest.
5. The most basic and effective risk management tools are proper diversification and the ability to hold cash.
6. Hard assets are preferable to intangibles, distributions to accruals.
7. Look for the incentives: True alignment of interest works in investors' favor.
8. There is no magic formula for successful investing: Consider both macro- and micro-economic issues, be diligent, flexible, patient, keep an open mind, and realize that investing will always remain more of an art rather than a science.

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