2024 / 02

# Seasonal Reflections

***Voyager One***

Dear reader,

Fields around Herisau / CH, 13APR2024

Spring is a time of awakening and new growth, and I was keenly reminded of that during a mid-April walk around Herisau, Appenzell, Switzerland, where these photos were taken.

Herisau / CH, 13APR2024, both HGS pics

On a spring walk like this, I could almost believe that mankind has been gifted paradise. But I only must come back home and check the daily news, in order to be reminded that we are only lucky and certainly blessed to live in this beautiful, peaceful and prosperous corner of the world.

And as the world seems eager to move ever so slowly and yet inevitably to more aggressive confrontation and war, I recall one of my favourite musicians, Bruce Hornsby (and his Noisemakers), who wrote the song Voyager One in reference to the NASA probe that was sent to outer space in 1977 and is now 15bn miles away, which includes the following lines:

*Voyager One, the NASA probe got to outer space today,*
*With a platter made of solid gold for aliens to play.*
*It makes its trip for all of us, a record of Mankind's song,*
*Ultimately superfluous because we don't get along.*

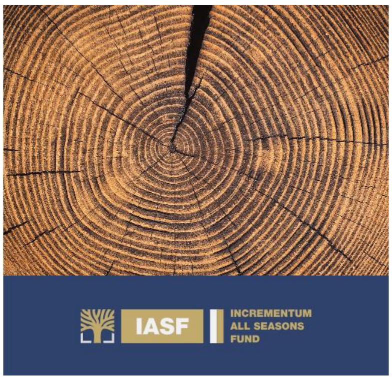
What an apt and timeless statement – packaged and presented by a true master of his art.

Well, before we launch into the actual economic and market stuff, allow me to deal with some housekeeping issues. First of all, while **Seasonal Reflections** will stay on a quarterly schedule, I have decided that our **Incrementum All Seasons Fund (IASF)** webinars will not be held on a strictly quarterly basis. For those who have been following the fund (or reading these pages) for some time, it should be evident that our investment strategy pursues long-term ideas and themes, and thus I believe a quarterly webinar schedule becomes too repetitive. – Quite frankly, this is also a resources issue, as preparing the webinar also takes quite some time. And since **Incrementum AG** will have a busy summer moving office (within Schaan), I have decided to hold the next **IASF** webinar earliest towards the end of the third quarter.

Secondly, I am proud and delighted to inform you that IASF has again been gathering Lipper Fund awards in its category "*Mixed Asset EUR Flex – Global*" (*3 years*), which in the 2024 crop were awarded for Austria and Europe. It seems in Germany, Lipper found another winner, which was Degussa Bank Portfolio Privat Aktiv, that based on Lipper's calculations managed to best **IASF**. We'll try to recover the top spot next year, and by then we will also be competing on a "*5 year*" level, which gives us two chances to score. Although in the end, this is all nice and well for marketing, but it only really counts whether our investors are satisfied with our work and on that score the mood seems to have changed again recently. More on this later in this report.

**Table of contents** (all underlined passages in red are active weblinks!):





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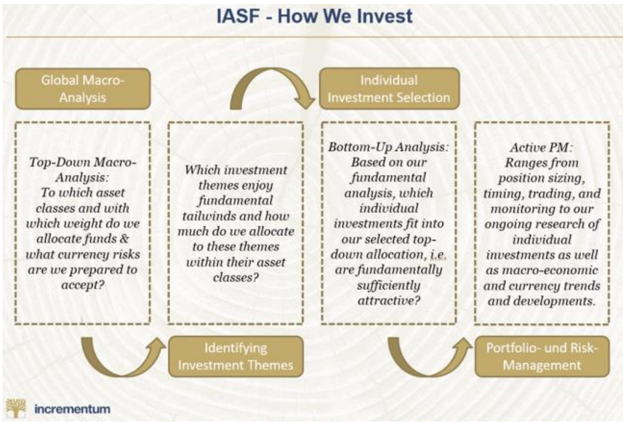
## We worry top-down…

Our investment process starts with and is embedded within our global macro-analysis, which provides the foundation for our asset allocation decisions, and helps us identifying and gauging the strength and relevance of our investment themes. Global macro analysis is important, but perhaps not as crucial as it seems for most investors these days, as at least in **IASF's** case we worry top-down but ultimately invest bottom-up.




And yet, even I am spending quite a lot of time consuming (mostly independent) macro research. But my goal here is not to figure out if, respectively when, the Federal Reserve will next lower interest rates and by how much, or why unemployment rates came in slightly higher than anticipated. Economics is a social science, and over the decades has tried to strengthen its credibility by developing sophisticated econometric models that give an air of precision to its analysis and predictions, which rarely live up to expectations. After all, the economy is not only an incredibly complex system, but it is also subject to fickle behavioural aspects and lacks appropriate and precise measurement tools.


Bloomberg, 2MAY2024

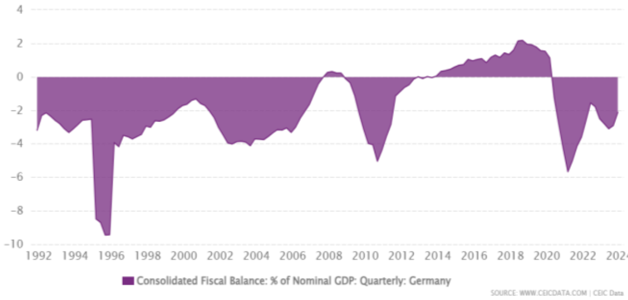
As investors, we are more concerned with the overall direction of macro-economic trends than with each actual step on the path. And when I look at things from a 30000-foot vantage point, it appears that economic growth dynamics have recently been weakening, even though the OECD has just upgraded its 2024 forecasts. At the same time, inflation rates have stabilized at still elevated levels, which points to a stagflationary environment.

To me that suggests that the tailwinds from massive fiscal spending in the West are cyclically lessening, while the private sector is unable (consumer, after running down savings) or unwilling (corporates) to compensate for this.

I have previously acknowledged that we underestimated the impact of fiscal policy on economic growth during Covid, a factor that is still very much at work. The Economist commented with "*Uncle Sam's fiscal folly*" on this as follows: *"If prudence is a virtue, then America's budget is an exercise in vice. Over the past 12 months the federal government has spent $2trn, or 7.2% of GDP, more than it has raised in taxes, after stripping out temporary factors. Usually such a vast deficit would be the result of a recession and accompanying stimulus. Today the lavish borrowing comes despite America's longest stretch of sub-4% unemployment in half a century."* (The Economist, 2MAY2024)

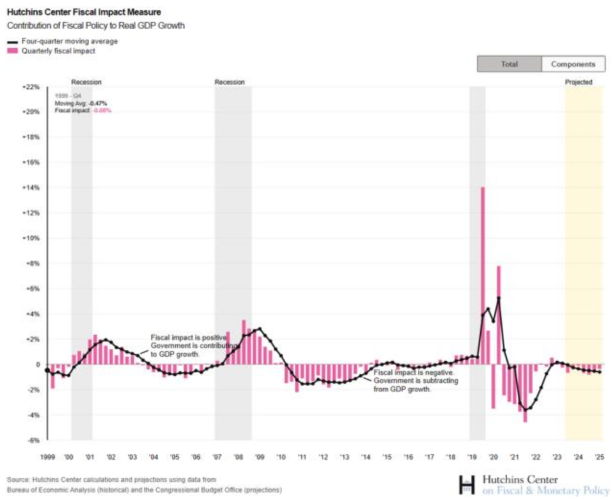
European governments may seem less aggressive in their deficit spending, though to my German readers it comes as no surprise that a lot of it is off-budget / hidden. Germany disingenuously labels such extra budgets as "*Sondervermögen*" ("Vermögen" meaning "wealth" rather than "debt"), which are off-balance sheet (contingent) liabilities and are not counted as part of the government's regular household budget. Such funds are typically directed towards special purposes or projects with clearly limited scope. Examples are the "*Wirtschaftsstabilisierungsfonds*" (EUR 150bn (4.4% of GDP) as initial Covid-Pandemic response in 2020, plus up to EUR 400bn (11.8% of GDP) in pledges), or "*Sondervermögen Bundeswehr*" (EUR 100bn (2.6% of GDP) passed in 2022, after the Russian invasion of Ukraine).

But even excluding these off-budget liabilities, Germany's budget deficit has been ranging from -4.3% to -2.5% in recent years, after a string of budget surpluses from 2012 to 2019. The latter, it must be said, were not the result of fiscal prudence but an increasing share of German government debt carrying negative interest rates during that period.



Germany Consolidated Fiscal Balance: % of GDP by CEIC

In macroeconomics we talk about the fiscal multiplier, i.e. the ratio of change in overall economic output (GDP) from a change in government spending. In (Keynesian) theory USD 1bn in additional spending could create up to USD 4bn additional economic output. – How does that happen, you may ask? Assuming a marginal propensity to consume of 0.75 and USD 1bn in direct transfers to households, on a macro level result in USD 250m in savings and the remaining USD 750m to be (additionally) spent by these households. As the latter in turn becomes income for other private sector entities, these will again save a quarter but spend the remaining USD 562m, which once again provides additional income for other private economic entities, and so on… – That is at least how the theory works, though empirically the strength of the multiplier has been found far more modest.

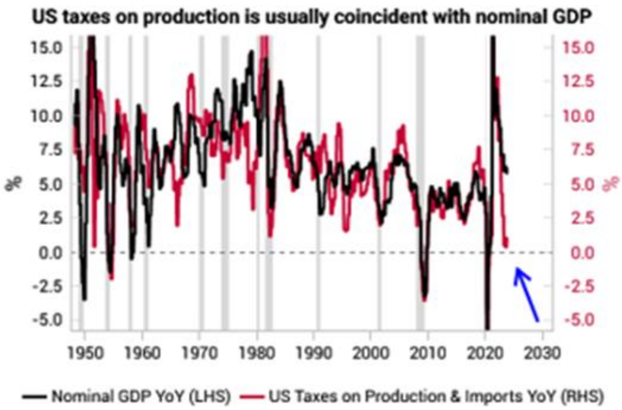


Brookings, Hutchins Center Fiscal Impact Measure, 26APR2024

Another US anomaly and an important reason for persistently elevated public deficit levels is the recent divergence of nominal GDP growth and tax receipts shown in the chart on the right. Most observers believe this is largely explained by generous green tax credits in the Inflation Reduction Act. Others view it as evidence that the economy is weaker than headline numbers suggest, which is increasingly confirmed by coincident growth data.

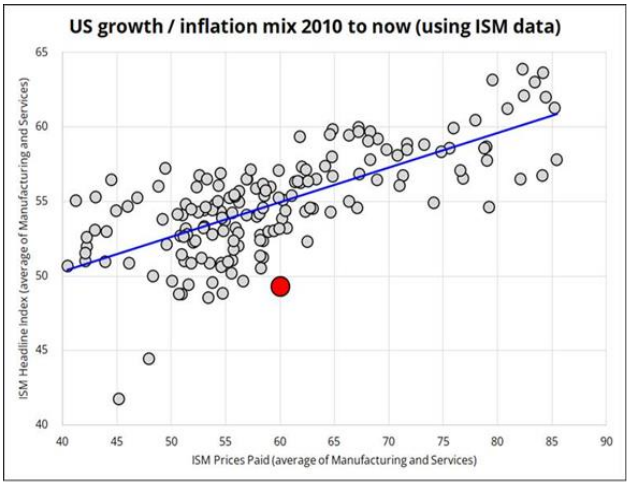
Steno Signals #99, Substack, 12MAY2024

In any case, it is important to understand that this multiplier effect works both ways, as it reflects the second derivative of the change in public spending. In other words, the effect of deficit spending, c.p., on overall growth trends is positive as long as deficit spending continues to grow, i.e. deficits widen. Stable deficits are thus neutral, while a reduction in deficit spending has a negative multiplier. For the US, e.g., the Brookings Institute reckons that the fiscal impulse is now neutral and will be a slight drag throughout the rest of this year and next.



The Variant Perception Blog, 1APR2024

An important consequence of the extraordinary stimulus measures / transfer payments of the Covid years is that initially savings were expanding rapidly, as any loss of income on average was overcompensated by governments' benevolent handouts, while spending was severely curtailed. This effect is quite evident in the chart on the left, as is the subsequent drawdown in these savings, which look all but used up by now.

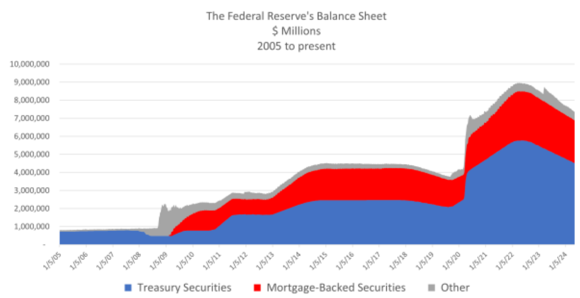



Source unknown; my sincerest apologies to the publisher

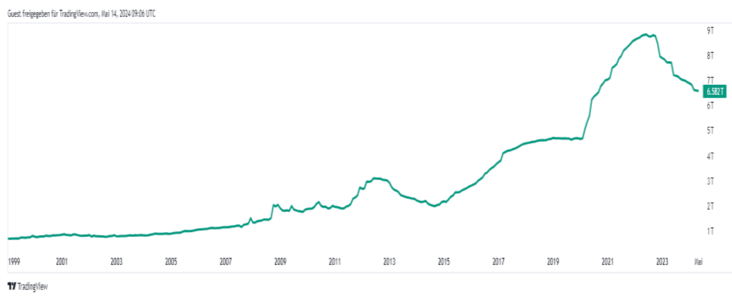
All in all, it thus appears that there are increasing headwinds to economic growth, while price and employment cost data continue to come in strong, and the resulting US growth / inflation mix underscore my earlier stagflation diagnosis. The stagnation part of this assessment is additionally affected by higher for longer nominal interest rates, as they gradually but certainly increase the cost of carrying the debt load in the economy. This is true for the private sector, i.e. households and corporations, but it is also true for the government.

What is vital to understand longer-term is that we have undergone a regime change. In the past and until the onset of the Covid pandemic, it was monetary policy that served as primary policy tool to affect the economic cycle. As its effectiveness diminished with interest rates pushed at or below the zero bound and the introduction of central bank "asset purchases", which in fact were (mostly) government debt purchases, deficit spending fuelled fiscal intervention gained an ever-increasing influence, a trend that was boosted sharply during the Covid years. And while in the past there have always been political forces that advocated for a prudent and balanced budget, the political consensus in this day and age is obviously that debt doesn't matter. In that sense, the Western world has finally turned "*Japanese*", which ultimately risks being a step in the direction of turning "*Argentine*" as the secular debt cycle matures.

For now, however, fiscal rules, and the role of the central bank is to maintain the impression that they are still fighting inflation. But their action is increasingly governed by their main objective, which is to ensure the government can fund itself. That, e.g., has led to yet another reduction in US QT, i.e., a reduction in the pace of central bank balance sheet unwinds. As the charts below show, these balance sheets tend to develop in a "two/three steps forward, one step back" fashion, a process that I expect to continue.




Fed Balance Sheet Assets, American Action Forum, 13MAY2024



Euro Area CB Balance Sheet, TradingView, 14MAY2024

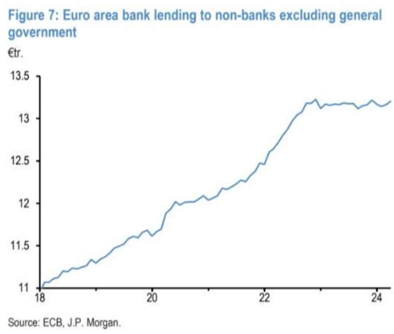
Personally, I believe that the signal effect of changes in the pace of balance sheet contraction is far less important to the private sector than what happens on the interest rate front, as the latter affects it far more directly and obviously. And in light of the political calendar, I expect the Fed will be reluctant to lower interest rates in any meaningful manner this year, considering that they are loath to be seen interfering with the US elections and given that inflation and inflation expectations remain too elevated. But lowering the pace of balance sheet reduction will limit overall supply growth of debt securities which c.p. will reduce upward pressure at the long end of the yield curve.


Annual Change in CPI – US – Financial Times, 14MAY2024


Annual Change in CPI – EU – Financial Times, 14MAY2024

Europe on the other hand is less constrained by political considerations, and here annual inflation rates still retain a downward bias, which is why a first ECB rate cut in June is currently market consensus. But that does not mean that interest rates are on a path to return to pre-Covid levels again, as an inflationary mindset is now firmly established, and a 2% inflation rate will likely turn out a cyclical trough rather than the familiar peak rate going forward.

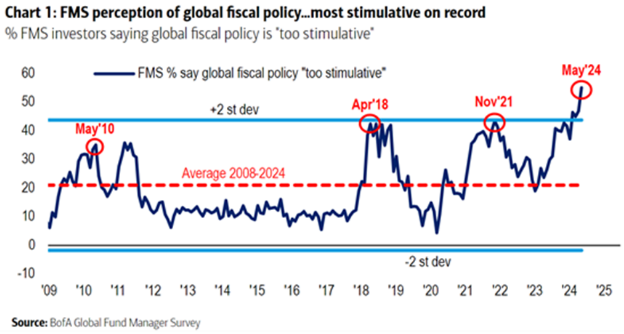
Long-term, it is the amount of credit, not the price of credit that will prove decisive for the trend in inflation. And especially in Europe, the political class has gradually come to realize the power of credit guarantees. Starting with the GFC, the ensuing European debt crisis, and ultimately the Covid years, the working of this magical money machine, which allows targeting money flows to specific sectors and purposes, seems to have worked flawlessly. All it does is create contingent (and off-balance sheet) liabilities, which so far in most cases have remained "contingent".



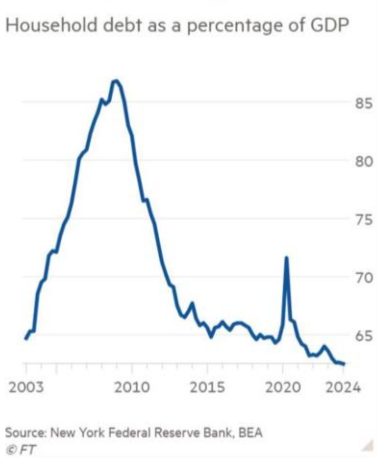

M'tourist Priv. Feed Recap, 14MAY2024

This approach allows the political class to vehemently pursue its pet projects, by directing the banking system (state sponsored as well as private banks) to fund projects that are required to progress industrial policy, and guaranteeing the loans granted in the process. That is actual money creation that directly results in additional economic demand, which is any centralist / interventionist politician's dream.

Overall, (not only) investors consider global fiscal policy as "too stimulative", which helps to explain why recessionary expectations continue to be postponed. But recalling what I wrote earlier about the multiplier effect of fiscal spending, I have a hard time believing that growth is not going to slow down over the remainder of the year.

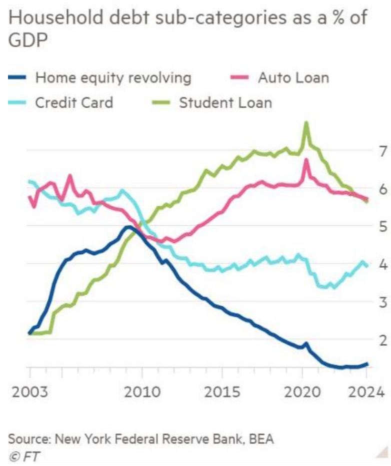


Points of Return, John Authers, Bloomberg, 15MAY2024



Unhedged, Financial Times, 15MAY2024

Of course, some observers argue that private household debt is actually rather low, which should allow consumption to remain strong. However, this is mainly due to the fall in mortgage debt, which is a category mainly taken out by wealthy households. Meanwhile, auto and student loans remain at elevated levels, and credit card debt is also near the highest over the past decade.



Unhedged, Financial Times, 15MAY2024

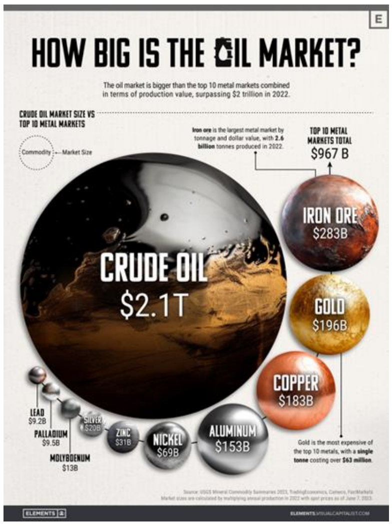
To quote Unhedged' Robert Armstrong from the above linked article: *"Americans, in aggregate, do not have a debt problem (except of course for the debt carried by their government). But aggregation deceives. As we have discussed in this space before, households who are on the lower end of the income spectrum and carry floating rate debt appear to be in real trouble. This is showing up in both delinquency statistics and the earnings of companies that serve the working class and poor."*

This is not just a US phenomenon. The middle class has been continuously squeezed and eroded over the past decade and combined with an ever-growing public sector involvement and rising debt burden, this is not a recipe for a vibrant, dynamic and resilient economy. – And a structurally weak and historically unproductive economy (the promise of AI notwithstanding) in my view is not a recipe for a buoyant stock market.

Now, some may point out here, that economic weakness also leads to disinflation, which should give central banks a reason to lower interest rates again and thus encourage a new round of interest rate induced credit creation. In the past that was certainly the pattern, but price pressures are not only demand- but can also be supply-driven. What are such supply-driven factors?

Well, let's start with the current global economic warfare, which increasingly uses trade tariffs to protect economies from foreign competition. The latest example are heavy import duties on Chinese made electric vehicles and solar cells, which in the US were hiked to 100% and 50% respectively. Quite frankly, apart from the fact that subsidies are generously handed out, e.g., for EV producers both in the US as well as China, these kind of trade wars have never worked. Most likely they result in a tit-for-tat, as China is compelled to consider retaliation measures. But this clearly boosts (import) prices and thus inflationary pressures.

Another factor are commodity-driven price pressures. The most prominent example is oil since it is by far the most important global commodity. Visual Capitalist illustrated this last year with the following comment (and chart): *"The combined market size of the top 10 metal markets amounts to $967 billion, less than half that of the oil market. In fact, even if we added all the remaining smaller raw metal markets, the oil market would still be far bigger."*



Visualcapitalist.com, 30JUN2023

Commodities sit at the foundation of our production and supply chains and as such are irreplaceable. If mining (and recycling) is insufficient to satisfy demand, prices rise. This is the basis of a few of **IASF's** current key investment themes, which now benefit from past underinvestment and resulting supply gaps.

Since I have written about this subject extensively in prior SR editions, please excuse me for not elaborating on this further. But I have little doubt that between government's new fiscal dominance and commodity-driven price pressures, inflation rates will remain far more stubbornly elevated than past cycles would have seen, which in turn will keep nominal interest rates higher than most people currently anticipate.

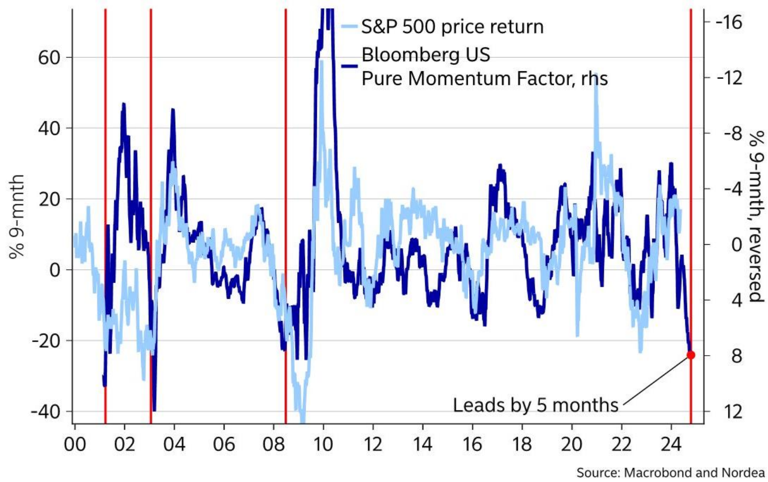
## Financial Markets Resonate A Rather Loud Equity Echo Bubble

When reviewing financial markets, it becomes obvious that they have behaved rather well so far this year. Starting with equities, and at the time of writing these lines (May22), the S&P 500 has continued its post Oct2022 rally (+52% from the cycle lows, +10.5% ytd), reflecting investors' anticipation of an ongoing goldilocks- / soft landing-scenario and mostly ignoring the (geo-)political strive that would normally suggest a higher risk premium to be built in.

S&P 500 Futures, 21MAY2024, investing.com

Personally, I find this (the same picture is true for Nasdaq) difficult to reconcile with the underlying fundamental backdrop, but it does not seem to bother investors much. There are signs, though, that the market's momentum is waning – and when that happens it does not usually bode well for subsequent equity market returns…


@RealAlpineMacro, X, 14MAY2024




@MikaelSarwe, X, 15MAY2024

DAX Futures, 21MAY2024, investing.com

The equity market picture is comparable in Europe, where the German DAX (very similar to S&P 500 +53% since OCT2022 lows; +11% ytd) is also in a firmly established upward trend, which equally hints at a loss of momentum. The same is valid for the broader EURO STOXX 600 (+38% since Oct 2022; +9% ytd), even if overall returns have been somewhat more muted.

We have also seen strong equity markets in Japan (+52% since Jan 2023; +15.4% ytd), whereas China (-19% since Jul 2022; +7.4% ytd) as the largest Emerging Markets index contributor has given investors less reason to celebrate and remains in a solid downward-trend, despite of a recent recovery, which hints at the potential to produce a breakout and play catch-up. But with China increasingly seen as political pariah and subject to heavy trade sanctions and a sharp reduction in foreign direct investments, I am doubtful about the fundamental investment case here.

Nikkei 225 Futures, 22MAY2024, investing.com

CSI 300, 22MAY2024, investing.com

For now, it appears that equity investors are laser-focused on the prospect of lower interest rates, though I suspect they might ignore the fact that equity bear markets usually start following the first central bank rate cut of a cycle…

The Stock Market Will Rise Nearly 10% More This Year, Money Managers Predict in Barron's Latest Poll

Barron's, Week's Magazine, 3MAY2024

And the sell-side does what it always does, namely follow the trend, and play the existing momentum, which is also nothing new. After all, you sell investors what they are ready to buy and right now that is equities, as well as private assets, crypto, meme stocks, etc., i.e., investments that promise outsized returns rather than a preservation of capital.

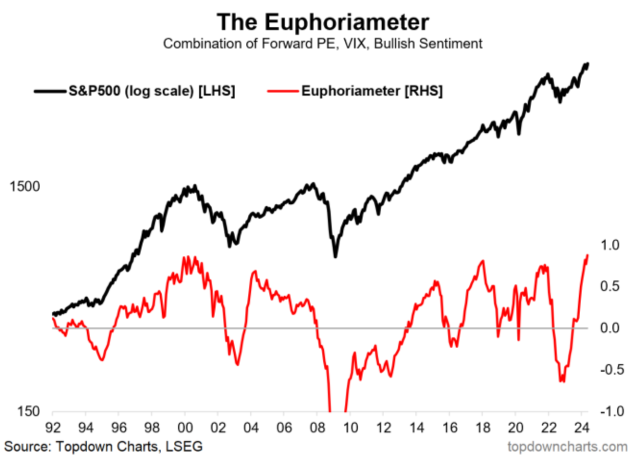
But as I have recently read so fittingly: *"Investors are notoriously mercurial. We chase performance, buy high, sell low, and endlessly pursue fads. Bull markets convince us that we are brilliant, when in reality we are often just pawns in another wealth destroying bubble. Bear markets, on the other hand, force us to do things we had previously convinced ourselves we would never do (namely selling at the lows and stop committing to private investments)."* (Risk Seeking vs. Mitigating, Ted Lamade, CollabFund, 24APR2024) – As much as it appears that the equity boom and bust cycle has been abolished, I think there is a lesson here that will have to be relearned…

But does the perma-bullish mood really surprise anyone? – Since the GFC-crisis lows in March 2009, i.e. over the past 15 years, global equity markets as measured by the MSCI World Index have rallied from a trough at 684 to a recent hight at 3472 index points. This represents an annualized return of 11.3%, which as the chart shows and despite of the occasional hiccups has developed rather steadily over time.

MSCI World Index, 22MAY2024, investing.com

In other words, a whole generation of investors has been primed to buy-the-dip and invest passively, as this delivers double-digit annual returns, which is why one cannot be bothered with fundamental research, stock picking and active investing. But investing is about anticipation, and thus the question on investors' minds should be whether this regime will continue going forward?

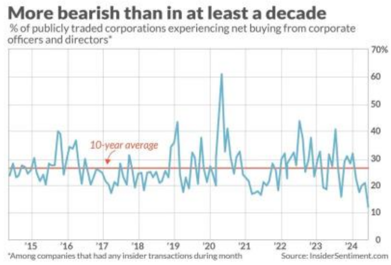
Well, long-term trends notwithstanding, investors' level of euphoria towards a further rise in US equities, which are by far the largest and clearly the leading world stock market, appears rather elevated right now and suggests at least a cyclical correction is in store. At the same time the earnings growth outlook is also cyclically elevated.



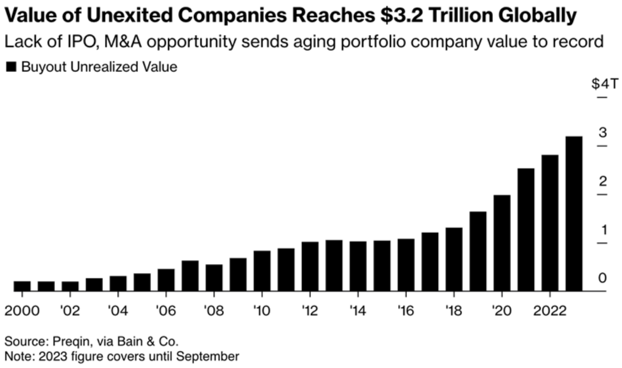

The Weekly S&P500 #ChartStorm, 19MAY2024


The Weekly S&P500 #Chartstorm, 19MAY2024

Such fundamental enthusiasm for the overall business outlook, however, is not confirmed by corporate insider activities. As the chart on the right shows, the percentage of US listed companies that are registering net buying by corporate officers and directors is at the lowest level of the past decade. That suggests that those that should know the underlying companies best are not sharing the generally buoyant' investors mood.



@MichaelAArouet, X, 14APR2024



Bloomberg, 9MAY2024

What I find strange in this environment is that the IPO market has been rather lacklustre over the past few years. As a result of that Private Equity funds are struggling to exit their maturing investments, which has led to a USD 3.2tr built-up in the value of unexited companies globally. (That this equals Microsoft's current market capitalization incidentally underscores the madness of today's Mag7 valuations.)

If risk appetite and capital flows were so unsatiable and plentiful, should the IPO market not be on fire and easily absorbing all those streamlined and profitable former PE buyouts and promising venture capital unicorns? – Or is this rather the result of the increasingly passive market structure, where money is invested in buy and hold index (and near-index) products and strategies, and thus limited new capital inflows meet equally limited actual free floats? – After all, price is made at the margin, and if, e.g., price-insensitive buying in popular AI- and wider tech stocks meets mostly equally price-insensitive holders of a passive nature, the result can be explosive.


Nvidia (NVDA) share price (log chart), 22MAY2024, investing.com

Case in point is NVDA, about which I wrote already last quarter. Last night, the stock reported yet another sales and earnings beat, which saw the shares topping $1000 in after-hours trading. Yes, revenue was up an incredible 262% over 1Q 2023, but the share price has nearly quadrupled since then, and is up nearly 10 times since its Oct 2022 lows.

Of course, the earnings release came with the usual fanfare about the tremendous growth outlook for its chips, but the company is now registering quarterly revenues of USD 26bn (USD 28bn anticipated for 2Q), and the size of these numbers makes it hard to imagine sales growth to continue at this pace. And yet investors are willing to pay 20 times sales for the stock.

The other thing to consider here is that NVDA's revenue represents its customers' cost. A glance at NVDA's earnings release shows that an astonishing 86% ($22.6bn) of revenues were datacentre driven, and the report lists collaborations with Amazon, Google, Microsoft and Oracle. NVDA has managed to position itself as must-go manufacturer for the computer chips that are needed to enable supercomputing for the AI age. What is the risk that these heavy investments into (ravenously electric power-hungry) datacentres will actually pay off? – And what does this say about the cost and earnings outlook of these other Mag7 stocks, whose once asset-light business is becoming increasingly asset-heavy and thus costly to build and maintain, not even considering a whole host of new AI-centred ventures around the globe?

Meanwhile, while investors' in NVDA may delight in their good fortune of riding this bubble and may actually see this as proof of the supremacy of the Western economic and "free" market system, this case also serves as a reminder that there is a darker side to this.

I was reminded of that when I read a tweet by Andy Constan (@dampedspring), published on X (fka Twitter) on May22, who pointed out that "*Employeers had a super quarter taking 7BN of options exercise compensation from $NVDA. The share repurchase resulted in essentially zero share retirement after dilution from the options exercises.*" – As evidence he added the below snippet from NVDA's financial statements, which I have enlarged here for better viewing.

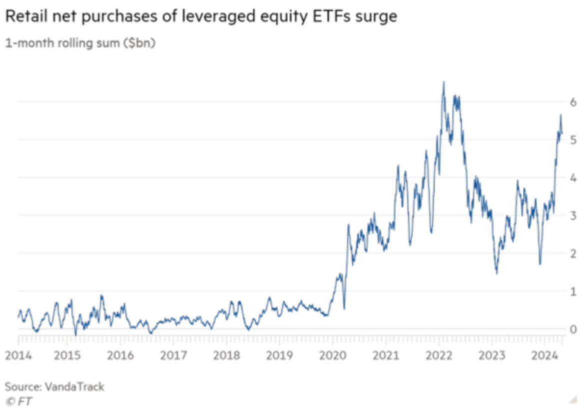
| | Three Months Ended April 28, 2024 | Three Months Ended April 30, 2023 |
|---|---|---|
| Cash flows from financing activities: | | |
| Proceeds related to employee stock plans | 285 | 246 |
| Payments related to repurchases of common stock | (7,740) | — |
| Payments related to tax on restricted stock units | (1,752) | (507) |
| Dividends paid | (98) | (99) |
| Principal payments on property and equipment and intangible assets | (40) | (20) |
| **Net cash used in financing activities** | **(9,345)** | **(380)** |
| Change in cash and cash equivalents | 307 | 1,690 |
| Cash and cash equivalents at beginning of period | 7,280 | 3,389 |
| **Cash and cash equivalents at end of period** | **$ 7,587** | **$ 5,079** |

@dampedspring, X, 22MAY2024

Not that this were a specific issue of NVDA, as this happens in many US tech and other companies with high-flying stock prices. Yes, shareholders can feel rich when they see share prices of their holdings rise. But until they have cashed out, these are merely book gains. The cold, hard cash, meanwhile enriches the managerial class, which is obviously why Silicon Valley has given birth to so many new billionaires. But is this a fair and – to use a popular expression – sustainable system? – I am sure my esteemed readers will form their own verdict on this issue.

Now, you may put this off as the ramblings of someone who has just got it wrong, but I have no problem admitting that I expected investors to be more rational about this. And I certainly have no regrets for not being invested, as I did not and cannot see the fundamentals justify the current stock price and thus company valuation. And with NVDA's share price (as well as the broader Nasdaq 100) at new all-time-highs, I still find it difficult to see this party lasting much longer. Sure, NVDA does all the right things, like taking a page of the 1999 / 2000 playbook of announcing a 10-for-1 stock split, so that its shares become more "affordable", which is of course another time-tested way to prolong a bout of speculation. But even assuming USD 120bn of 2024 revenues that still leaves NVDA stock trading at more than 20 times revenues. Even with gross margins in the high 70s, which to my knowledge have never been sustainable in industry, it is at least as irrational to make an investment now than it was a year ago.

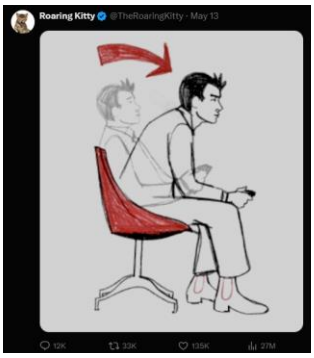
Returning to overall sentiment in equity markets that is clearly reaching lofty levels, which is highlighted by retail net purchases of leveraged equity ETFs as much as BofA Global FMS sentiment readings below.




Financial Times ETF Hub, 4MAY2024


Points of Return, John Authers, Bloomberg, 15MAY2024

Of course, the most obvious sign of the return of rampant retail speculation is the reemergence of the meme stock phenomenon.




@TheRoaringKitty, X, 13MAY2024

This echo of the loosening of animal spirits during 2021 seems to have been kicked off by a May12 tweet by @TheRoaringKitty on X, which showed a gamer leaning forward in his chair, apparently a sign that he is getting serious. This after a near 3-year hiatus from X, which had ended with a short clip of sleeping kittens…


@TheRoaringKitty, X, 17JUN2021

The result was a more than tripling in former short squeeze darlings GME and AMC over the course of one day and the stock market opening on the next. Both counters had already been massively diluted post 2021, as they used their unexpected status as investors' darlings to multiply their share count, which I reckon explains why the famous rocket to the moon 🚀 this time seemed propelled by a slingshot.

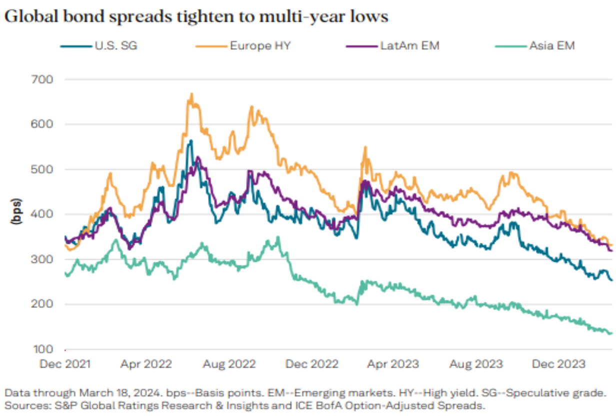
GameStop (GME), 23MAY, investing.com

I'm mentioning this here to underscore the level of speculation and willingness to take risk in certain parts of the market. But "*We have a very odd market where what's popular can trade anywhere and any dopey reason make a stock price surge. On the other hand, there also are many companies where it seems like no amount of good news really matters.*" (Bill Fleckenstein's Daily Rap, 23MAY2024)

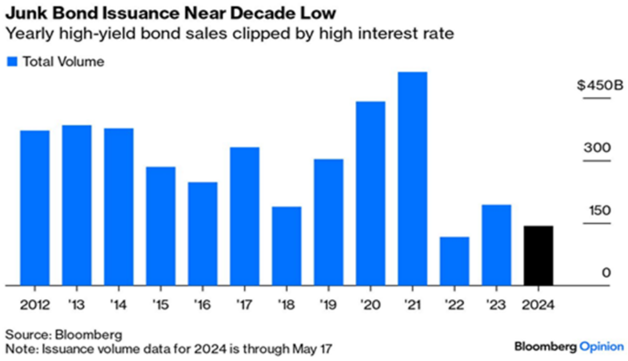
Why do I focus so much attention on US equity markets, you may ask? – Well, US markets are the (big) dog, and the rest of the world's equity markets are its tail. In other words: Where the US markets lead, the rest of the world follows.

What about bond markets? – Interestingly, 10-year government bond yields (US/GE-10y = 4.47%/2.58%) are still sitting below last year's peak levels (5%/3%), likely reflecting the cyclical reduction in inflationary pressures. However, in light of the ongoing fiscal deficit spending in both the US and Europe (and Japan) and the fact that I expect 2% inflation will become the new trough rather than the old peak level, these are hardly attractive yields.

Meanwhile, US credit spreads have only been as tight as they are today twice before – namely (and according to David Rosenberg, @EconguyRosie, X, 23MAY2024) in 2000 and 2007. That means high-yield bonds are practically priced for no defaults even though business bankruptcies have surged +35% in the past year to the highest level since 3Q2020. And once again, this is not just an US phenomenon, as bond spreads have been tightening globally.




Points of Return, Bloomberg, 20MAY2024

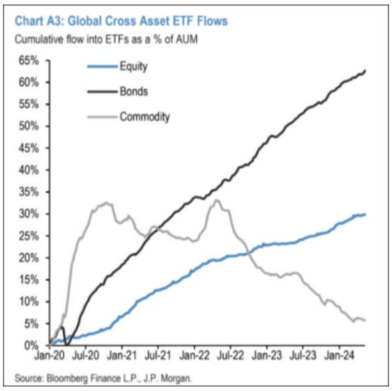


Points of Return, Bloomberg, 20MAY2024

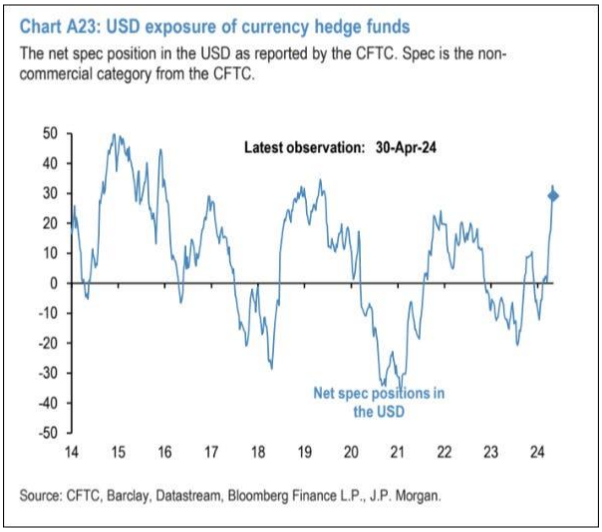
Meanwhile, in an eery similarity with the before-mentioned dearth in the equity IPO market, new issue activity in junk bonds is also near a decade low. One might conclude that this is due to potential issuers hesitating to come to market as they wait and hope for the arrival of Fed rate cuts. But another reason might be that there simply is insufficient appetite for new issues at currently depressed spreads.

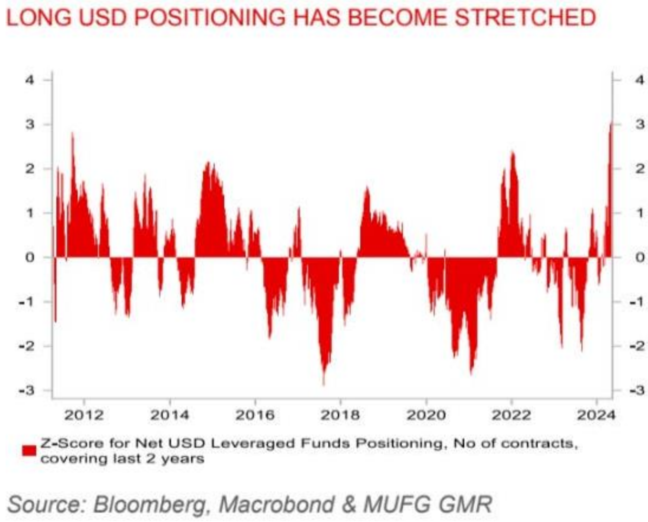
All in all, there is little reason to "invest" in bonds these days, unless one clings to the old playbook, which based on the Great Moderation causing (consumer-, not asset-price) inflation to almost become extinct, had been prolonging a secular downward interest rate cycle until it reached zero. But investors must now use a new investing playbook, which is why I continue to find little value in bonds. For anyone interested in getting familiar with the new playbook, I recommend reading the 18th edition of Incrementum's In Gold We Trust-Report, The New Gold Playbook.

This new inflationary investment playbook will favour gold, precious metals, and commodities. The former have recently made headlines for spiking higher, with gold even reaching new all-time-highs (in nominal terms), and the before-mentioned IGWT-Report has all the reasons why. Meanwhile, commodities as an asset class (incl. precious metals) have suffered a sharp reduction in investor flows, as the Cross Asset ETF flows in the chart on the right show. However, an asset class that is out of favour but supported fundamentally by constrained supplies is not a bad place to be in, so I reckon the grey chart will soon pick up again.



M'tourist Priv. Feed Recap, 14MAY2024

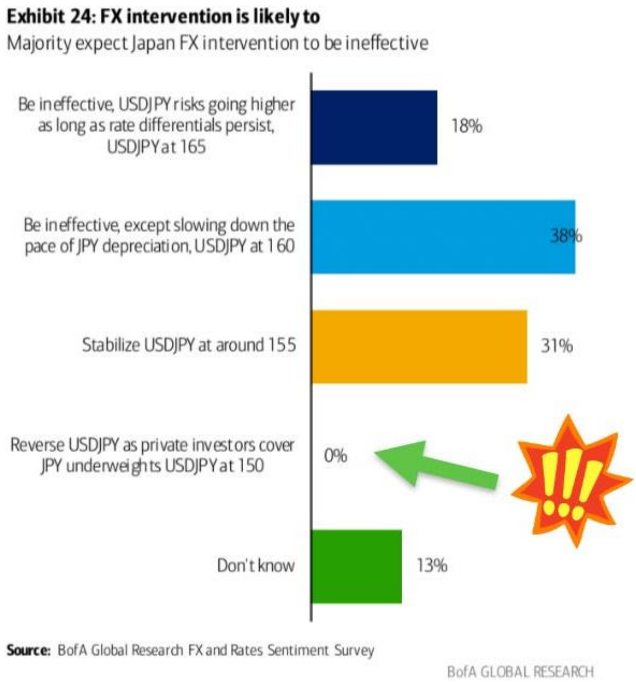



M'tourist Private Feed Recap, 14MAY2024

A quick look at currencies shows that the USD remains the market's favourite currency. It is still supported by its reserve currency status, even if that is slowly eroding, as China is working hard to establish the CNY as alternative currency. And it also benefits from a positive interest rate gap and related positive cost of carry, which has provided more short-term support.

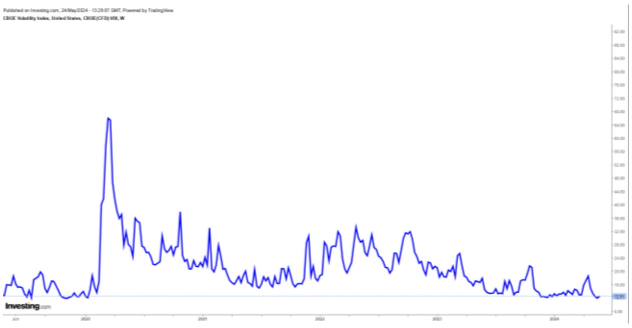
On a purchasing power parity basis, the majority of its international currency peers remain cheaper, though none as much as the JPY, which is estimated to be 40% undervalued. But in the same way as the USD has benefited from being stronger for longer, making investors' reluctant to exit a currency that has proven so strong, the opposite is true for the JPY, which is widely (and one could argue excessively) used as a funding / carry currency. Recent attempts of intervention by the Japanese authorities have had little effect on investors' sentiment (and positioning). But the interest rate gap is bound to shrink over the coming year, and I expect that to lead to a repatriation of funds back to Japan, which would clearly benefit the JPY.



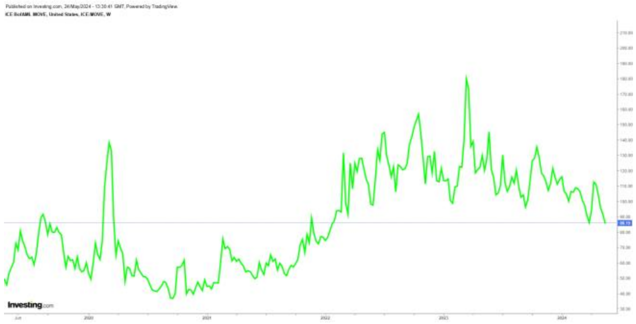

M'tourist Private Feed Recap, 23MAY2024

Well, as usual, I'm running out of time and thus would like to conclude this section with a few broadly stroked comments.

As we have seen above bond markets have been well behaved recently, while equities have been on a tear in an extended echo bubble of the pre-2022 run and currencies have been very well behaved. Financial markets clearly show elevated risk-on sentiment, which is also underscored by record low VIX (US equity options derived volatility) and MOVE (bond derived volatility) indices.



CBOE Volatility Index (VIX), 24MAY2024, investing.com



ICE BofA MOVE Index, 24MAY2024, investing.com

At the same time, the risks facing financial markets are the result of ongoing geopolitical struggles between the two main superpowers, where I personally don't yet see the risk of outright war (outside those ongoing regional conflicts), but where a progressive deceleration of the global economy amid a weakening fiscal push is likely. Growing remilitarization efforts also do not help. After all, we cannot delude ourselves, that *"judged in purely economic terms, aircraft carriers and missile silos and nuclear attack submarines are all just giant wastes of labor and material. Just because it's economically harmful to maintain a powerful military doesn't mean you shouldn't do it. But you also shouldn't delude yourself into thinking it isn't economically harmful."* (Global Political Analysis, ECR Research, 23MAY2024)

Coupled with exceedingly high import tariffs and other trade barriers, less efficient production through on- or friendshoring (US production is far less efficient than China's), and ongoing logistic and transportation bottlenecks, that does not paint a favourable picture for the advanced economy outlook. And I have not even touched on the subject of near-term EU parliamentary elections in early June, which are widely expected to see far-right parties gain substantial support on the back of broad discontent regarding issues that range from immigration, via the mandated energy transition, to the ongoing expansion of the wealth gap. And this promises merely a warm-up to the US presidential elections in early November, which in my personal view may well become a new low point in the history of democracy. – It may be time to check on those seatbelts…

## ... we invest bottom-up

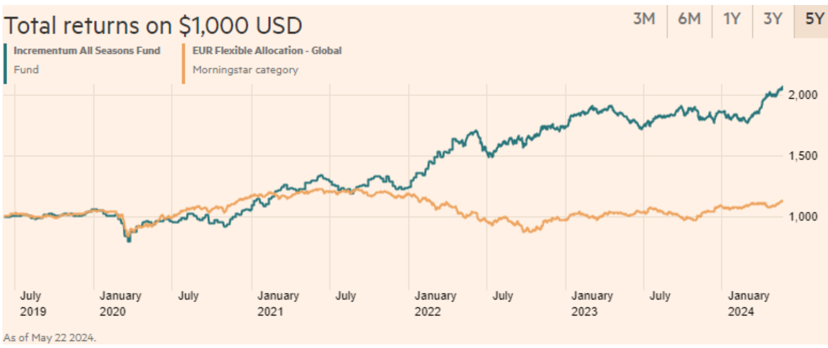
**Again: Any views, analyses and forecasts contained in this document are based on current market conditions and reflect the opinion of the author. All information has been compiled from sources believed to be reliable. However, no representation or warranty is made as to its accuracy or completeness. *Seasonal Reflections* are issued to registered subscribers for informational and entertainment purposes and do not constitute a recommendation or solicitation to buy any security or the Incrementum All Seasons Fund. Historical performance is no guarantee of future results, and the value of the Fund may go down as well as up. If you would like investment advice, please contact an authorised investment adviser.**

*When momentum is on your side, people focus on your strengths and forgive your weaknesses. When the momentum stops, they scrutinize the whole thing. (This is true for stocks, funds, people, and even essays.)"* – Packy McCormick, Substack, 19DEC2023

I am not sure how much momentum my esteemed readers are still experiencing after those first 18 pages, but I hope it will carry you a little further still into this investment review.

First of all, I am glad to note that our **Incrementum All Seasons Fund (IASF)** has recently gained some considerable momentum again, which after a nearly 1-year consolidation period has lifted its NAV to new all-time-highs.

With the fund's 5-year anniversary looming (on June 6), I have taken the liberty to snatch a chart from the Financial Times' market section to illustrate this.




FT Markets Data, IASF USD-I, Summary


FT Markets Data, IASF USD-I, Performance

As reported on April 16, we thus doubled our founding USD investors' money in just under 5 years, which is the only benchmark we set ourselves going forward.

**Historic performance, rolling in %** (at 22.05.2024)

| | YTD | 1 Year cumulative | 3 years p.a. | Since inception p.a. |
|---|---|---|---|---|
| Fund | 10.16% | 12.27% | 16.27% | 15.52% |

Snippet from IFM Daily Factsheet, 23MAY2024


We also had the pleasure of being awarded new Lipper Fund Awards for 2024 for **IASF** as best Mixed Asset Fund in the category EUR Flex – Global over 3 years in Europe and Austria.

Other notable awards were a 11th place in the German weekly WirtschaftsWoche ranking and a highlighting and evaluation in Börse Online's Euro spezial on "portfolio management funds", apart from the obvious (Morningsstar classification) ...

It has to be said, though, that this has come with a higher degree of risk as well, which is why I regularly point out that (potential) **IASF** investors need to have a longer-term investment horizon. In the fund management industry we typically use the Sharpe Ratio to measure risk-adjusted returns, which puts past (or expected) excess returns (i.e. those over the risk-free rate) over a certain period in relation to the standard deviation (or volatility) of these returns. A Sharpe Ratio above 1 is seen as very good, and we at least come close to that.

| | 1 Year | 3 Years | Inception |
|---|---|---|---|
| Annualised Volatility | 11.33% | 13.64% | 15.56% |
| Sharpe Ratio | 0.52 | 0.97 | 0.86 |
| % Positive | 59.17% [1] | 56.33% [3] | 56.92% [3] |
| Worst Period | -2.27% | -3.55% | -11.35% |
| Best Period | 2.26% | 5.80% | 9.12% |
| Maximum Drawdown | -7.30% | -12.91% | -24.93% |
| Number of observations | 240 | 544 | 648 |

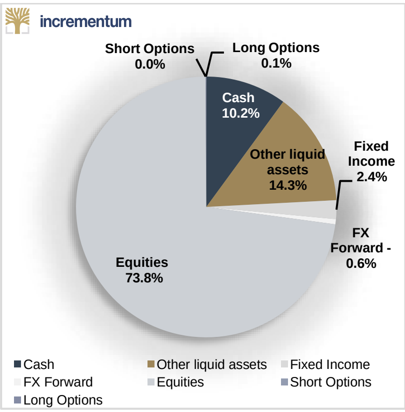
legend
1 daily
3 weekly

IASF Measures of Risk, IFM (Fund Administrator), 24MAY2024

| SRI according to KID 07.05.2024 | 1 | 2 | 3 | **4** | 5 | 6 | 7 |
|---|---|---|---|---|---|---|---|

Overall, and according to EU regulations, **IASF** is assessed carrying medium risk.

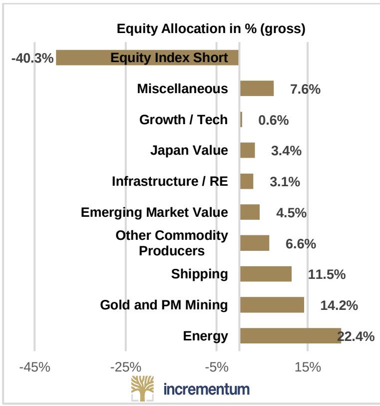
I will now review **IASF's** portfolio as of May 24, in order to provide my readers with the most updated information on record:




**IASF asset allocation**, 24.5.2024

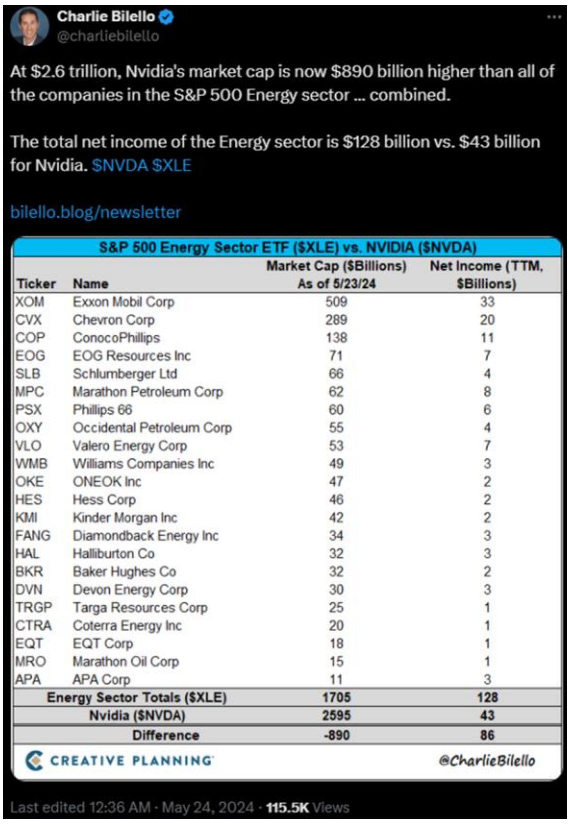
The last available NAV valuation dates from May 23, when the USD-I shares were valued at USD 203.31 per share, which represents a return of +9.46% ytd and 103.31% since inception.

Meanwhile, the latest **IASF** portfolio and investment theme allocations are shown on the left and right.




**IASF equity themes**, 24.5.2024

How does that compare to our last report, which was based on year-end numbers?


Charlie Bilello
@charliebilello

At $2.6 trillion, Nvidia's market cap is now $890 billion higher than all of the companies in the S&P 500 Energy sector ... combined.

The total net income of the Energy sector is $128 billion vs. $43 billion for Nvidia. $NVDA $XLE

bilello.blog/newsletter

S&P 500 Energy Sector ETF ($XLE) vs. NVIDIA ($NVDA)

| Ticker | Name | Market Cap ($Billions) As of 5/23/24 | Net Income (TTM, $Billions) |
|---|---|---|---|
| XOM | Exxon Mobil Corp | 509 | 33 |
| CVX | Chevron Corp | 289 | 20 |
| COP | ConocoPhillips | 138 | 11 |
| EOG | EOG Resources Inc | 71 | 7 |
| SLB | Schlumberger Ltd | 66 | 4 |
| MPC | Marathon Petroleum Corp | 62 | 8 |
| PSX | Phillips 66 | 60 | 6 |
| OXY | Occidental Petroleum Corp | 55 | 4 |
| VLO | Valero Energy Corp | 53 | 7 |
| WMB | Williams Companies Inc | 49 | 3 |
| OKE | ONEOK Inc | 47 | 2 |
| HES | Hess Corp | 46 | 2 |
| KMI | Kinder Morgan Inc | 42 | 2 |
| FANG | Diamondback Energy Inc | 34 | 3 |
| HAL | Halliburton Co | 32 | 3 |
| BKR | Baker Hughes Co | 32 | 2 |
| DVN | Devon Energy Corp | 30 | 3 |
| TRGP | Targa Resources Corp | 25 | 1 |
| CTRA | Coterra Energy Inc | 20 | 1 |
| EQT | EQT Corp | 18 | 1 |
| MRO | Marathon Oil Corp | 15 | 1 |
| APA | APA Corp | 11 | 3 |
| | Energy Sector Totals ($XLE) | 1705 | 128 |
| | Nvidia ($NVDA) | 2595 | 43 |
| | Difference | -890 | 86 |

CREATIVE PLANNING @CharlieBilello

Last edited 12:36 AM · May 24, 2024 · 115.5K Views

@charliebilello, X, 24MAY2024

On the asset allocation side, cash and liquid investments have risen by 5% to 24.5%, at the expense of equities (-3%) and bonds (-2%).

Our equity themes have seen our leading **ENERGY** allocation practically unchanged at 22.4%, though underneath there have of course been some activities. We cut positions in Antero Resources, BW Energy, Cameco, Suncor and Vital Energy, while adding Vermillion Energy. Overall, our allocation to the energy services sector rose at the expense of oil and gas producers, while our uranium exposure remains more or less unchanged at 4.6%. Our current 21 holdings have delivered 10% average return year-to-date, and trade at 17 times earnings, 1.4 times book, 7.9 times EV/EBITDA and 2.5% dividend yield. – And I find it truly remarkable that NVDA is currently valued 52% higher than all S&P 500 energy sector stocks…

**GOLD AND PM MINING** is now our second largest theme (14.2%) and our current holdings have delivered a 15% return ytd on the back of the recent strength in precious metals prices, which bodes very well for future profits and cashflows. Return dispersion has been extremely wide in our selection, ranging from -37% for i-80 Gold (though we have averaged this still small position, which is actually down only 20% since purchase) to +58% for Calibre Mining.

We cut one position recently (Wesdome Gold Mines (WDO) on a +65% intra-year gain) and added two so far this year (B2Gold and Royal Gold). Our current 19 holdings trade at an average 38 times earnings, 1.7 times book, 11.6 times EV/EBITDA and 2.8% dividend yield.

WDO, 24MAY2024, investing.com

After some more meaningful profit-taking our **SHIPPING** book has now slipped to third rank I our theme list (11.5% allocation). We have experienced yet another powerful rally so far this year, and as a result share prices have become more expensive and in many cases are now trading above NAV, which suggests we are in the late stage of the cycle, unless this turns out a rare super-cycle. Though we think that there is still a chance for that, we are mindful of the extreme cyclicality of the sector and thus have decided to lighten our load significantly.

Now, a 3% reduction in overall exposure compared to our allocation at the end of 2023 might not seem that meaningful, but it has to be considered against an average total return ytd of 38%. There is quite some talk in shipping circles of hedge fund managers having rediscovered the sector, which may also explain the uniformity of the move, with all our remaining holdings delivering positive results ytd, led by Stolt-Nielsen (+67%) and Golden Ocean (+60%). The laggard has been Pacific Basin (+9%), which we reckon is still suffering from a HK / China discount.

The main part of our profit-taking has taken place this month, and we sold down especially our tanker exposure, which is now down to 5.6%, with dry bulk being the second largest sector (5%). Both sectors still have an extremely favourable supply outlook considering the advanced age of the fleet.

GSL, 24MAY2024, investing.com

We still maintain small exposure to the gas sector (1%) but have just eliminated our last container play. Global Ship Lease' (GSL) share price has recently soared on the back of a spike in container rates, and although this is a well-managed company with a solid lease book, we are worried about the flood of new container vessels coming to market over the coming two to three years.

With that our remaining 13 holdings trade at an average 10 times earnings, 6.5 times EV/EBITDA and 6.7% dividend yield, with still the cleanest balance sheets I have ever seen in this sector over my time in the business.

Our smaller themes have also seen minor changes. We have cut our exposure to **OTHER COMMODITY PRODUCERS** by 1% (now 6.6%) by eliminating a third of our number of holdings (Grieg Seafood and Mowi, our salmon farmers, as well as Lundin Mining and Yara) in an overall attempt to increase portfolio concentration. On the back of lacklustre trading of our fertilizer stocks overall performance has been likewise (+2% ytd), but our remaining holdings are attractively priced (PE 16, EV/EBITDA 6.2, DY: 5.7%), especially considering the cyclical trough our three fertilizer holdings are going through.

**EM VALUE** has also been reduced by 0.6% to 4.5%, as we cut two smaller positions here as well. Our largest holding herein is CK Hutchison Holdings, which is a HK listed conglomerate that has global (mostly non-EM and thus non-China) business exposure (Utilities, Infrastructure, Ports, Telecom, Retail, etc), trades at approx. 30% of NAV, with a PE of 6 and EV/EBITDA of 7.4, and yet seems to stay perennially out of favour. As the dividend yield alone (at 6.1%) is bond-like, we are willing to give this more time. Meanwhile, **INRFASTRUCTURE / RE** remains practically unchanged (3.1% allocation), though we decided to cut our loss on Hutchison Port Holdings Trust.

Mitsbsh Gas, 24MAY2024, investing.com

**JAPAN VALUE** is now back up at 3.4%, after we took profits in some holdings (partial sale of Mitsubishi Gas and Mitsubishi Materials) and added a few new and still small positions.

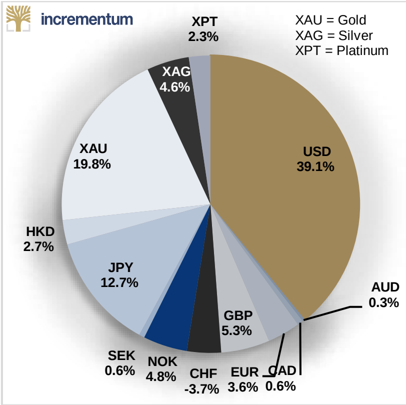
Mitsbsh Mat, 24MAY2024, investing.com

Our average **JAPAN VALUE** holding trades at 8 times earnings, 0.75 times book, 6.6 times EV/EBITDA and 2.5% dividend yield, and has delivered a total return of 18% ytd.

Our residual investment in **GROWTH / TECH** is hardly worth mentioning anymore as it accounts for a mere 0.6% of the portfolio. We have also cut quite a number of holdings here and will further do so in order to be more concentrated in this area as well.

And lastly, our **MISCELLANEOUS** bucket has shrunk by 1% (to 7.5%) as we cut Fagerhult and Ericsson, while adding one new position. This is our opportunistic bucket, though it has not yielded any meaningful return this year yet (essentially flat). Still, we like our holdings and I am convinced they will do well in the long run.

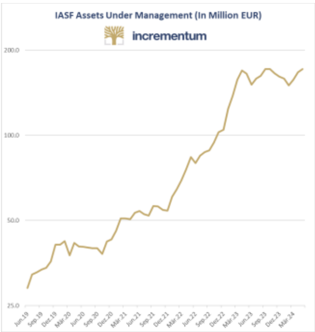
Overall equity market direction this year is reflected in our equity short positions, which we essentially use to cushion the portfolio against any unexpected downside and position it to benefit from a renewed rotation out of growth / momentum into value / hard assets, and as always in a bullish market have cost us return potential (approx. 4% of AuM).




**IASF currency allocation**, 24.5.2024

On the other hand, we have generated (mostly) dividend and interest income of 1% of AuM so far this year, as well as 0.7% of net option premiums received from our covered options selling.

We also hold a total of 6 corporate bond holdings, which amount to 2.4% of AuM, with an average yield to maturity of 9% and a duration of 2.2 years. The majority of our liquidity is held in our PM ETCs (14%), while the remainder (10%) is sitting in plain vanilla cash in various currencies. **IASF's** overall currency allocation is shown in the familiar chart on the right.




**IASF portfolio flows**, 24.5.2024

I will conclude this section as usual with a look at portfolio flows. Overall, these have been negative this year, with approx. EUR 4m in net outflows. More than that occurred during 1Q, but the flow has reversed since April, a trend which has continued in May (+1.8m EUR until 24.5.).

A historic picture of overall AuM development is shown (by log chart) in the graph on the left.

All in all, not a bad year so far, and personally and as investor I am satisfied with how the fund has performed.

## CONCLUDING REMARKS: THIS IS NOT INVESTMENT ADVICE!

**As the author of this newsletter and the fund manager responsible for the Incrementum All Seasons Fund, I must point out to readers that any views expressed in this report, particularly those relating to the individual investments or the investment strategy of the fund, are biased and not tailored to their individual needs. And while I take care in writing this commentary, I cannot vouch for the accuracy of every statement made here. *Seasonal Reflections* are issued to registered subscribers for informational and entertainment purposes only and should not be viewed as an attempt to solicit investment in individual securities or in the Incrementum All Seasons Fund. So, if you are looking for investment ideas or advice, always consult an authorised investment professional! And remember that past performance is no guarantee of future returns and that all investments involve risk, including loss of principal.**

I admit it feels a bit stupid to end with the third disclaimer, but as they say – better safe than sorry! After all, I have been writing these ***Seasonal Reflections*** (and VSP Reports in the old days) as a means to inform all our investors (clients) about the state of their investment in **IASF**, how we view the state of economy and markets and how this is influencing our tactical portfolio positioning. I have often been asked by investors to also show some concrete examples in the process, which on the other hand could easily be regarded by some readers as investment advice. For anyone tempted to do so, I would use Grant Williams line from his podcasts *"Nothing we discuss (here) should be considered as investment advice. … Please do your own research or speak to a financial advisor before putting a dime of your money into these crazy markets."*

So, I don't know about your momentum, but mine is clearly waning… – I can only hope that our investors are a bit more satisfied than they appeared to be when I finished the winter edition. But same as back then, I conclude by emphasizing that investing is a long-term endeavour, and that I am convinced that our positioning of **IASF's** funds will continue to generate attractive inflation-adjusted returns in the medium- to long-term.

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

Greetings from Schaan, Liechtenstein!

Yours sincerely,

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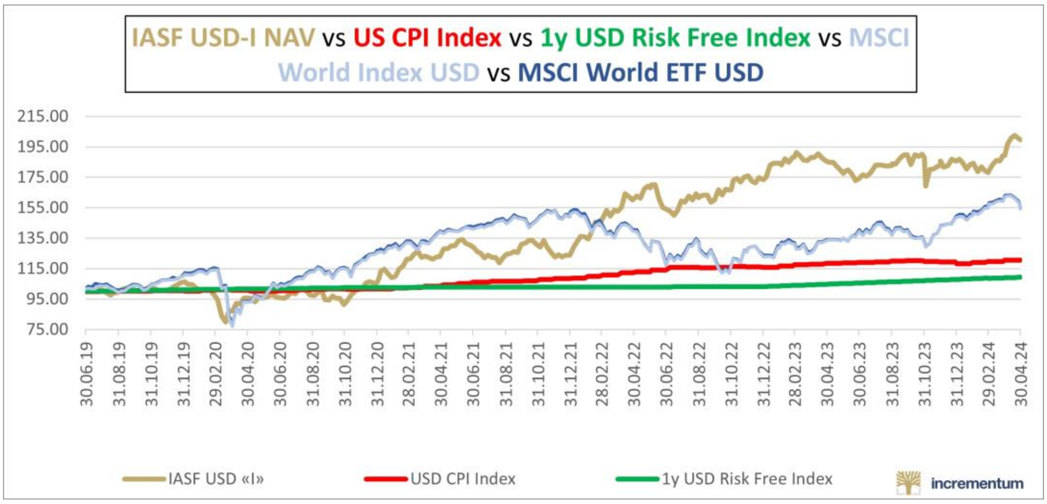
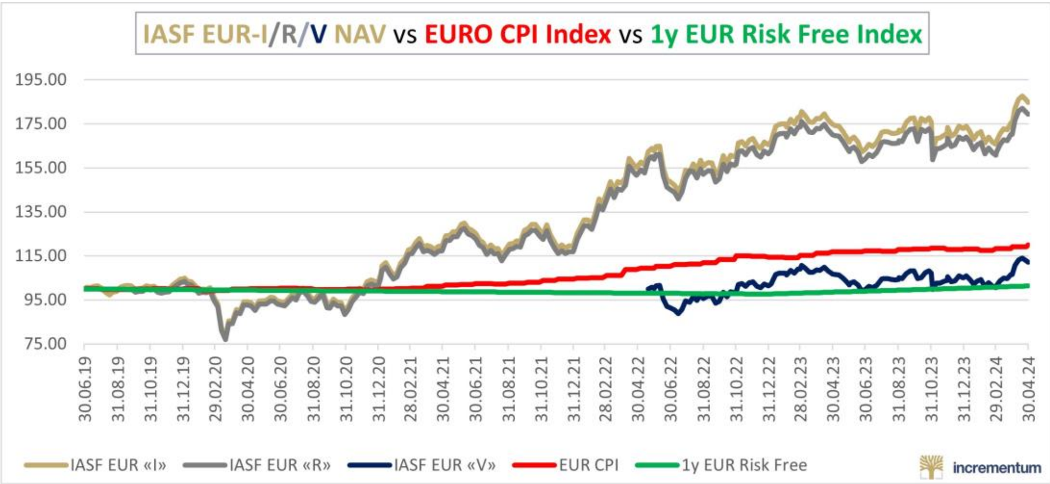
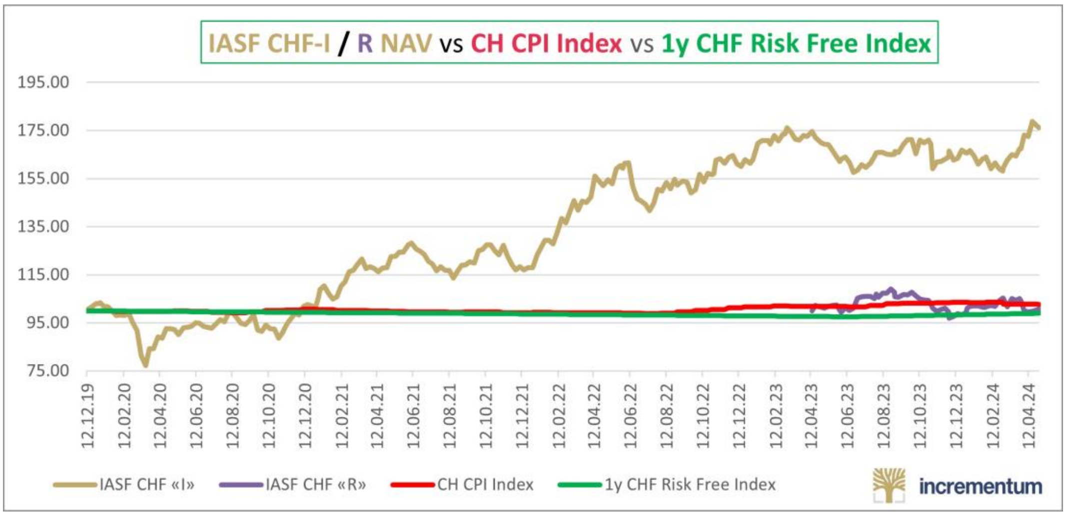
NEW ADDRESS FROM JUNE 13, 2024: Incrementum AG, Im alten Riet 153, 9494 Schaan, Liechtenstein

## Appendix *




* Graphs display NAV (I- and R-shares) of IASF performance until last valuation date (**30 MAY 2024**), 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; 2NOV2022 for CHF-R 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." (Warren Buffett)
2. Prices paid determine future returns, i.e., the higher valuations are, the lower future return expectations must c.p. 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 usually more rewarding 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 perfect investing. Hence, 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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