Incrementum All Seasons Fund

– in pursuit of real returns –




2024 / 03

Seasonal Reflections

The Common Knowledge Game

Dear reader,

My summer picture was shot on July 13 from a bridge spanning the river Ill in Strasbourg and towards the European district, with the European parliament and related buildings far in the back. It was my first visit to Alsace in more than 40 years, and I found Strasbourg a beautiful city, which evidently benefits greatly from its resident political business. It reminded me how political power comes with ample financial budgets that yield grand and modern administrative buildings that appear the equivalent of ancient royal castles.

Strasbourg, river Ill & European district, 13JUL2024, HGS pic

I try to stay away from politics as much as possible, but one has to wonder whether (European) democracy is still in service of the people? Or has it instead morphed int a modern game of thrones, where politicians and bureaucrats conspire to justify their mushrooming and well-paid jobs by meddling ever deeper in their voters' affairs, regardless the cost, while average households struggle to make ends meet? – After all, once birthed, bureaucracies only know how to grow…

Perhaps, this is becoming more evident to the European electorate, as increasingly a core friction at the heart of the European Union (EU) project appears to be the extent to which power and authority are stripped from national governments and exercised at the supranational level in Brussels and other EU political centres instead.

But not only in Europe, but in nearly all advanced economies of the West, democracy as we have known it seems to increasingly struggle to deliver a smoothly working political system in service of the people. I began writing this report in mid-July, a couple of weeks following the June 27th presidential debate in the US, which saw a 78-year-old ex-president and convicted felon debate the 81-year-old incumbent, whose physical and mental capacity to hold the most powerful political role globally had been highly doubtful for some time already.

The title of this report was inspired by a great piece from Epsilon Theory founder Ben Hunt, who wrote "Joe Biden And The Common Knowledge Game" in response to the presidential debate. Common knowledge is defined as what everyone knows that everyone knows, and it is probable best described in Hans Christian Andersen's fairy tale "The Emperor's New Clothes".

Many had of course questioned for some time whether President Biden was capable of serving another term, but only when it became common knowledge, i.e., when everyone realized that everyone else was seeing it the same way, all prior support for President Biden's second term broke away. As a consequence, his current Vice President Kamala Harris is now going to take a shot at beating Donald Trump for the arguably most powerful position in global politics, and what looked like a clear win for the MAGA preacher now looks like a very open battle again, which I expect will also influence financial markets over the course of the upcoming autumn.

Another common knowledge moment may have been expressed in the recent sell-off in AI and Big Tech firms. This was the consequence of a growing realization and scepsis among equity market investors that the massive investments into LLM-driven AI are not about to deliver some massively profitable new services and applications. And if that is so, we're up for a volatile rest of summer and autumn in global financial markets.

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

Seasonal Reflections – Changing format & delivery?

Writing these quarterly SR reports has always been important as it allows me to provide both investors and interested readers with regular and comprehensive insights into our thinking, both as far as overall macro-economic and financial market developments are concerned as well as the resulting thoughts and actions concerning **IASF's** investment portfolio.


Incrementum All Seasons Fund
– in pursuit of real returns –

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Liebe Leserinnen und Leser,

Der Frühling ist die Zeit des Erwachens und neuen Wachstums. Daran wurde ich bei einem Spaziergang Mitte April in Herisau im Appenzell erinnert, wo diese Fotos entstanden sind.

Wanderweg bei Herisau/CH, 13APR2024

Herisau/CH, 13APR2024, Fotos HGS

Bei einem Frühlingsspaziergang wie diesem könnte man fast glauben, dass der Menschheit das Paradies geschenkt wurde. Aber sobald ich nach Hause komme und die täglichen Nachrichten lese, werde ich daran erinnert, dass wir wohl vor allem Glück haben oder einfach gesegnet sind, in dieser schönen, friedlichen und wohlhabenden Ecke der Welt zu leben.

Und da sich die Welt langsam und unausweichlich auf immer aggressivere Konfrontationen und Kriege zuzubewegen scheint, wurde ich an einen meiner Lieblingsmusiker, Bruce Hornsby (und seine Noisemakers) erinnert. Er veröffentlichte 2019 den Song Voyager One, der von der 1977 in den Weltraum entsandten gleichnamigen NASA-Sonde inspiriert wurde, und der folgende Zeilen enthält:

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.

Was für ein passender und zeitloser Vers – gespielt von einem wahren Meister seiner Kunst!

1

31st of May 2024

incrementum

SR 2024/02: 30 pages of IASF related info

What has been presenting a challenge though is the actual writing process, as SR reports have typically run at roughly 30 pages per piece, and it can take me up to two months to finish them. The latter is due to the fact that my day-time job is that of a fund manager and not a writer, and my focus is thus directed on achieving the best possible investment results for us investors.

Consequently, composing SR's is often a rather fragmented process, where topics can be fluid (especially early on in the process) and inputs require constant updating. And having just come back from my summer vacation, I have again considered whether it may not be more productive and efficient to write shorter and possibly more concise notes on up-to-date topics in a less regular and ad-hoc fashion.


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Incrementum All Seasons Fund
Special Management
Commentary

FOR ENGLISH VERSION OF THE LETTER, PLEASE SCROLL DOWN

Sehr geehrte Damen & Herren,

wir bedanken uns für Ihr Interesse am Newsletter unseres

INCREMENTUM ALL SEASONS FUND (IASF)

(Die rot gefärbten Textpassagen repräsentieren aktive Weblinks)

Sonderkommentare zum IASF sind grundsätzlich rar, aber dennoch habe ich mich heute dazu entschlossen einen solchen zu verfassen. **Der Grund dafür ist, dass der Anteilswert des IASF nach einer rund einjährigen Konsolidierung in diesem Monat neue Allzeithochs in allen Anteilsklassen (ausser der CHF-R-Klasse) erreichte.**

Wir haben für unsere Anlagepolitik und die Seitwärtsbewegung des IASF-Anteilswertes im vergangenen Jahr durchaus Kritik einstecken müssen. Diese schien jedoch selten zu berücksichtigen, dass wir ein globales Multi-Asset-Absolut-Return-Mandat verfolgen, welches wenig mit den Entwicklungen der allgemeinen Aktienmarktindizes gemein hat und folglich variierende Phasen der Under- wie auch der Outperformance (grau hinterlegte Phasen im Chart unten) aufweist. Aber trotz der Tatsache, dass wir nie 100% in Aktien investiert waren, sondern netto im Schnitt lediglich mit ca. 37%, ist es uns doch gelungen den MSCI World Index und vor allem darauf basierte investitionsfähige ETFs zu schlagen.

These could be in email format like our usual carrying mail as shown here on the left, rather than long-form reports in pdf format. The latter could still be used for semi-annual letters that include the official management report and other fund management related information.

I haven't really decided on the delivery format, as I would like to gauge investors interest in this matter first. May I thus invite our esteemed readers to provide their feedback on this issue by e-mail?

Ultimately, SR are written for you as (potential) investors and thus it is important for us to understand what you would like to see to obtain sufficient clarity and transparency about **IASF** affairs. Therefore, you have my thanks in advance for your valued feedback.

ipse se nihil scire id unum sciat

This Latin phrase, which translates as "*I know that I know nothing*", comes to mind frequently when writing these reports. After all, "*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.*" (Final of my "*8 Investment Lessons*" listed in the appendix to this report.)

Of course, a good investor knows a lot. The investing process is all about gathering information, be it of the macro kind, i.e., trying to discern how the economy and its investment relevant parameters is developing, or the micro-kind, where one analyses individual investments (against their macro backdrop) with the aim to figure out whether the market is potentially under-pricing a security, as well as many other aspects in between. But having a comprehensive set of information does not allow us to forecast how these will impact financial market pricing, as additionally there is a great deal of uncertainty, complexity and interpretation involved. And this is what has ultimately let me draw the headline conclusion.

My dear colleague Stefan Kremeth, Incrementum AG founding partner and CEO, elaborated on this in his "*Stefan's Weekly*" from August 9, which is as all his publications a worthwhile read. In it he reviewed the early August market turbulence, when suddenly "*Interest Hopes*" that had previously dominated investors' perception were overruled by "*Recession Fears*", that put starkly elevated US equity market valuations into sharp relief. He also rightly pointed out that market watchers tend to echo each other and suggested that he "*would not be surprised if market participants looked back at last week's and this Monday's sell-off and realised they might have been exaggerating.*"

I agree with Stefan that the investing business, despite of being academically cloaked in rationality, e.g., the efficient market hypothesis, is actually quite dependent on the emotional state of investors, or what I would call the push and pull of GREED & FEAR.

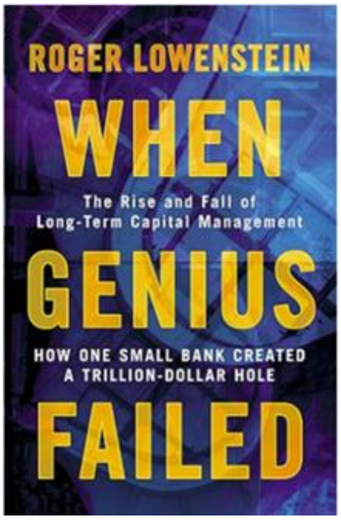
And in any of these emotional states, investors interpret information rather differently, and thus may come to completely different conclusions regarding market or securities pricing.

My favourite G&F cartoon, last found @trader_53, X, 27OCT2022

This also explains why at Incrementum we don't try to build a "house view", but instead allow all our portfolio managers the latitude to form their own individual investment and market views. After all, we don't only have different mandates and investment processes, but are also marked by different experiences and subject to varying emotional setups with which we have learned to navigate the up and down of markets.

And contrary to Stefan, I don't believe that the market correction that began in July is already over, even if since 1960 the month of August has delivered positive average returns for the US stock market and even more so in presidential election years. Working with averages is treacherous, as it may obscure the setup that proves the exception rather than the rule.

MSCI World Index, 12AUG2024, Investing.com



Amazon

But the point I want to emphasize here is that it is quite normal and definitely not a sign of insufficient sophistication to have differing views on the economy and markets. After all, we know very little for sure, and beyond that are dealing with one of the most complex systems in our society. Besides, it is different views that make a market.

And since I have encountered numerous highly sophisticated and even scientifically founded investment approaches (remember LTCM?) in my time, very few of which (if any) have lived up to their expectations*, I view our occasionally different views as a strength rather than a weakness, as it challenges us to double-check our own views.

For me as professional investor, my own processes have developed, matured and ultimately worked well enough over the years. Therefore, I am confident that I will continue to navigate **IASF's** assets safely and for the benefit of our investors, not always in a straight line and with periods of lacklustre as well as exciting performance, regardless of differing inhouse or external investment views and perspectives.

* I am excluding any firm that is capable of exploiting arbitrage opportunities in the markets, i.e., High Frequency Traders like Citadel, Tower Research, Two Sigma or Virtu Financials.

The 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.

Semi-annual management report

As usual, I had the pleasure of preparing the semi-annual IASF management report in July, which will be published in the fund's regular reporting by our fund administrator, IFM Ltd, by late August / early September. As I assume that few investors will actually peruse this report once it is published, I would like to present the draft here to you:

"The first half of 2024 has delivered some at times surprising developments. Geopolitically, we were forced to watch the escalating Israel-Hamas war, while Russia's ongoing war with Ukraine has moved more into the background. As it continues to draw massive funding from US and European governments, it also drives new political formations around China / Russia and the so-called Global South and thus the trend to an increasingly multi-polar world. As a consequence, US-China tensions continue to rise, evidenced by escalating trade wars. Meanwhile, the shift in Europe towards the more extreme right of the political spectrum, as well as the shift left in the UK, or the leading position of Donald Trump in the run-up to the presidential elections this fall, all are the result of growing discontent among the wider population that is fed up with the political establishment. The latter has among others been stoked by the rapid loss of purchasing power that the inflationary spike during the Covid years delivered.

We have long argued that we are in the late stages of a secular debt cycle, which has been extended far beyond its normal life span by zero- and negative rate policies. But with globalization reversing, advanced economies' demographic profiles deteriorating, and a persistent lack of investment in the real economy and its infrastructure, the perceived death of inflation has turned out a rumor out of the category of wishful thinking. This has for now been restricting monetary policy's leeway to goose the economy with easy money, as its official goal is to keep inflation in check, which has remained stubbornly high. Deficit-financed fiscal policy is now the rule rather than the exception and clearly in the driver's seat, and that means rapidly growing government intervention in money and bond markets and the ultimate advent of the full arsenal of capital controls are probably not too far off anymore.

Financial markets don't seem to care about this backdrop yet. Global equity markets are dominated by US equities, which account for 72% of the MSCI World Index. The next largest market is Japan with 5.7%... – After Tesla's (temporary) fall from grace (its shares lost 20% in 1H 2024), US equity markets are now dominated by the Mag(nificent)6 (MSFT, AAPL, NVDA, AMZN, META, GOOG), which alone weigh in at 21.5% of the MSCI World Index. NVDA surged 150% during 1H 2024 on the back of its leading position as supplier of critical chips for the AI revolution, which has seen US tech behemoths and aspirational candidates jumping on the AI bandwagon by spending trillions of dollars. It has now risen 745% since the beginning of 2023 and for a brief span prior to its recent correction even carried the crown of most valuable company in the world, (far) more valuable than the entire UK stock market or the whole oil and gas industry.

This has had the predictable result of drawing in even the sceptics and fundamentally orientated investors, as not owning NVDA (and its brethren) simply means one could not keep up with broad equity indices and benchmarks. After all, the Mag6 were responsible for roughly two thirds of the 14.5% 1H 2024 rise in the S&P500, and for an astonishing 113% of the 2Q 2024 rise. This fact points to an increasingly narrow market that is greatly overextended and due a serious correction. After all, and in accordance with Herb Stein's observation "If something cannot go on forever, it will stop".

Beyond US equity markets, we had another star performer, with Japan's Nikkei 224 rallying 18.3% during 1H 2024 on the back of a sharply weaker JPY (-14% vs USD; -10% vs EUR), which puts the real performance into a more sober light. Meanwhile, Europe's STOXX 600 gained 6.8%, while China's CSI 300 lost 2.9%. In currency markets, the EUR lost nearly 3% versus the USD and the CHF nearly 4% versus the EUR, correcting last year's sharp advance. Global bond markets weakened as US and German 10y bond yields rose almost 0.5%, with credit spreads surprisingly narrow still, considering the evident loss of economic momentum. Commodities did well overall, with WTI oil prices up 13.8%, copper 12.5%, and the monetary metals rallying as well (Gold +12.8%, Silver +22.6%).

How did the Incrementum All Seasons Fund (IASF) fare against this backdrop?

On the surface, the result was satisfactory, with the USD-I shares advancing by 6.02% over the first half of the year. Main contributor was our equity long book, where our ENERGY allocation has slightly increased to 23.5% by mid-year and delivered an average 9% total return (in local currency) overall, led by Golar LNG (+39%) and Technip FMC (+30%). GOLD AND PM MINING moved to second place among our equity investment themes, with an allocation of 14.4% (+2.4%-pt vs year-end 2023) and a 10% average return, led by Kinross (+38%). Our SHIPPING weight dropped by 2.5%-pt to 12.8% allocation. Amid an average total return year-to-date of 35%, led by Stolt Nielsen (+67%), it is evident that we engaged in significant profit-taking. OTHER COMMODITY PRODUCERS (6.6% allocation; -1%-pt versus year-end) were broadly weaker (-5% on average), led by Mosaic (-18%).

EMERGING MARKET VALUE (4.4%; -0.7%-pt vs year-end) also contributed negatively (-7.1% on average), led by Ashmore Group (-22%), while JAPAN VALUE (3.8%; +1.1%-pt vs year-end) delivered average gains of 19% in local currency. INFRASTRUCTURE / RE (3.1% allocation and little changed) delivered 12% average total returns, led by Vopak (+32%). GROWTH / TECH (1%) remains minuscule, as it is hard to find value in the sector, and due to our lack of exposure to Mag6 stocks, the average return was -6.2% during 1H 2024. Lastly, our MISCELLANEOUS bucket was little changed, and also detracted from performance with an average total return of -4%. What also dampened performance substantially, was our short US equity index futures position, which cost us around 7% during 1H 2024.

Our FIXED INCOME allocation shrunk by 1% to 3.4%, consisting of USD-denominated High-Yield bonds with an average yield of 9% and a duration of 2.5 years. Our effective currency allocation, i.e., looking at companies reporting in USD as USD based, regardless of what currency they are traded in, and including precious metals producers as equivalent for the metal they produce, saw USD/HKD practically unchanged at 40%, a 3.5%-pt rise in precious metals exposure to 29%, JPY exposure 6%-pt higher at 19%, as we took advantage of the increasingly undervalued JPY exchange rate to increase exposure via currency overlays, GBP mostly unchanged at 6%, and the balance consisting of EUR/CHF/NOK/SEK.

Noteworthy from an investment standpoint are also dividend receipts accounting for 1.5% of average AuM, volatility harvesting income that amounted to 0.8%, and approx. 0.2% in interest income, which have helped to improve the overall result, while we also benefited from USD and precious metals strength overall. And from a general investment management perspective, net asset inflows for 1H 2024 were a negative EUR 2m. However, there has been a distinct and gratifying difference amid the fact that 1Q registered net asset outflows of EUR 6.6m, while 2Q registered net inflows of EUR 4.6m, a trend that seems to continue.

At mid-year, we cannot help but realize that investing has become extremely irrational again, as investors seem to consider US large cap tech stocks to be one of very few perceived safe haven asset classes left out there. This is inconceivable if one looks at underlying valuations, which, e.g., value slowly if at all growing Apple at more than 9 times, or Microsoft at nearly 15 times sales. Such valuations might make sense for small and fast-growing companies, but hardly for corporate behemoths that are worth trillions of Dollars. This goes a long way of showing that these stocks have become mere momentum plays, where rising stock prices beget increasing investment inflows and speculation. As we are old enough to have been professional investors already during the 2000's tech bubble, we have no doubt that "the higher the climb, the deeper the fall" will eventually apply here, too. Of course, we are the first to admit that "eventually" can be a rather ambiguous timing term. But in this regard, it is also important to remember that investment decisions are always done in uncertainty and without hindsight.

Concerning the outlook for 2H 2024, many economists argue that given elevated fiscal deficits a recession is nigh impossible. But interest paid to investors via printed money is hardly stimulative for the real economy, which is where we tend to measure inflation. Thus, we continue to expect slowing growth as wide swaths of private households have yet to fully recover their prior spending power, and Covid-related savings and stimulus measures are drying up. That in turn is leading to reduced but compared to official targets still elevated inflation, which eventually should be felt in the bond market. The recent widening of French government bond spreads may well be a sign that investors are beginning to demand higher risk premiums for buying long-term government paper that for anyone with some common sense is increasingly likely to be repaid in devalued currencies. This in turn will put more pressure on central banks to lower interest rates in order to keep escalating funding cost in cheque, which could create quite some turmoil in foreign exchange markets. Together with the uncertainty surrounding the US presidential elections this fall, this promises higher volatility and hence increased risk premia, which could set up markets for trouble during 2H 2024. We believe that we are well prepared for trouble and aim to protect our investors' funds near-term without giving up the chance for ongoing real returns in the mid- to long-term.

Anyone, who has been investing in IASF for the past five years, will have experienced our track record and will be reassured by the fact that as co-investors we have real skin in the game. For those who have joined us on this journey more recently, we can only emphasize the importance of having a medium- to long-term investment outlook, including the necessary patience. But regardless of what group of investors you may belong to, we sincerely thank you all for entrusting us with managing your money, and we promise to do our utmost to continue to extend our existing track record."

Summer wobbles – or more?

I'm writing this on August 17 and following a financial market episode that by now is mostly seen as an inconsequential wobble in investor sentiment and the resulting correction in positioning.

First, let's have a look at the MSCI World Index (USD) from a long-term perspective:

MSCI World Index (weekly, log chart), investing.com, 17AUG2024

Not much to see here, really. In fact, anyone who has been pursuing a buy-and-hold-strategy over the past 15 years is clearly vindicated by the smoothness of the long-term trend (green support line).

VIX (top panel) and Nasdaq 100 (bottom panel), investing.com, 27AUG2024

Here is a shorter perspective, showing the VIX (Volatility) Index on top and the Nasdaq 100 (NDX) as the market leader index at the bottom: NDX made a high on July 10 at 20690, and over the following 18 days fell to as low at 17435 on August 5 (-16%), which also saw the VIX spike to 65, the highest level since March 2020.

The latter suggests near panic market conditions, due to a combination of

- ✓ worsening economic news (disappointing US Nonfarm Payrolls and ISM Manufacturing data),
- ✓ creeping doubts about the validity of the AI narrative (AI will be the next big growth (and profit) driver for large-cap tech companies),
- ✓ and a broad deleveraging move, triggered by unwinding of JPY carry trades.

But despite of this sharp correction, by now it seems that this was merely a blip, as NDX as much as the broader equity market have already recovered most of the prior losses, while the VIX has plunged back to its former lows. – So, much ado about nothing?

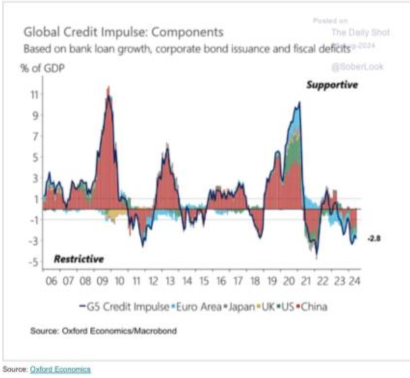
Brent Donnelly, who writes the excellent Friday Speedrun for Spectra Markets, put it this way:

"We are getting more, not less confused.

It looked like NFP, ADP, ISM Manufacturing, and Initial Claims were all pointing to a meaningful slowdown in the US jobs market, but now it looks like we were at least partially fooled by randomness as there was a big hurricane effect in the Unemployment Rate release, ISM Services data came in stonking, Atlanta Fed GDPNow is still at 2.9%, and Initial Claims have oscillated back down. Economists wish they could operate with the comparative ease and scientific rigor of weather forecasters, but they can't. There is no science. Only art." (Brent Donnelly, Spectra Markets, 9AUG2024)

Amen!

The first issue listed above and a key point for us is the question whether the global economy remains in a persistent soft-landing and thus goldilocks state, or whether a cyclical downturn including recession is in the cards. Proponents of the former point to decent wage growth and ongoing deficit spending in major advanced economies, while proponents of the latter worry about slowing growth in China, rising unemployment as well as the negative credit impuls, among others.



@albertedwards99, X, 26AUG2024

Money Printer Goes Brrrrr, investing.com, 30APR2024

Personally, I find it hard to accept that the business cycle is dead, and that the magical money machine of Western governments (the Chinese apparently are keeping their purse strings tied) can create unending prosperity, but so far this has not yet become common knowledge. What I expect to happen is a gradual slide towards zero growth and into a recession, which will then be countered by renewed and aggressive, anticyclical fiscal stimulus. This initial growth slowdown, together with attempts to raise corporate taxes, should be reflected in a worsening earnings outlook, which traditionally results in lower share prices.

The second point made above about a common knowledge moment in the whole AI narrative is harder to pinpoint. But I have read a growing number of analyses highlighting the massive capital outlays required to facilitate the AI-infrastructure built out and questioning whether this will pay off. And the water-shed moment in the narrative shift in my view was the publication of "GEN AI: TOO MUCH SPEND, TOO LITTLE BENEFIT?" by Goldman Sachs Global Macro Research on June 25, which had the following to say in its executive summary:

"Tech giants and beyond are set to spend over $1tn on AI capex in coming years, with so far little to show for it. So, will this large spend ever pay off? MIT's Daron Acemoglu and GS' Jim Covello are sceptical, with Acemoglu seeing only limited US economic upside from AI over the next decade and Covello arguing that the technology isn't designed to solve the complex problems that would justify the costs, which may not decline as many expect."

Goldman Sachs is certainly a high-profile enough mainstream investment firm to cause such a narrative shift, even if they did hedge their bets with their next breath: *"But GS' Joseph Briggs, Kash Rangan, and Eric Sheridan remain more optimistic about AI's economic potential and its ability to ultimately generate returns beyond the current "picks and shovels" phase, even if AI's "killer application" has yet to emerge. And even if it does, we explore whether the current chips shortage (with GS' Toshiya Hari) and looming power shortage (with Cloverleaf Infrastructure's Brian Janous) will constrain AI growth. But despite these concerns and constraints, we still see room for the AI theme to run, either because AI starts to deliver on its promise, or because bubbles take a long time to burst."* – Hmmm, I guess the Mag7, who are all investing heavily into AI, and their peers are just too important customers to state anything too damaging to their share prices.

Overall, 2Q Mag7 results were disappointing and mostly failed to beat the "whisper numbers", leading to some sharp initial share price corrections. It started on July 23 with Tesla's miss on earnings, margins and cash flow, while revenues rose a paltry 2% – hardly the kind of growth rate that justifies trading at 8 times sales and – depending on (gu)estimates – 50 to 70 times earnings.

Tesla (TSLA) chart, investing.com, 22AUG2024

Amazon (AMZN) chart, investing.com, 22AUG2024

On August 1, Amazon reported disappointing revenues and guidance, and with its shares trading at around 40 times earnings (gu)estimates, that caused a sharp initial drop. Also on the weaker side were Microsoft (PE ~35) and Alphabet (fka Google, PE ~25) as well as Apple (PE ~35), where Warren Buffett's Berkshire Hathaway continues to sell off its massive holding.

With Nvidia reporting on Aug28, Meta (PE ~25) has so far been the only exception, as Mark Zuckerberg managed to talk up the benefits of AI, though his CFO remarked that they do not *"expect our Gen AI products to be a meaningful driver of revenue in '24, but we do expect that they're going to open up new revenue opportunities over time that will enable us to generate a solid return off of our investment."*

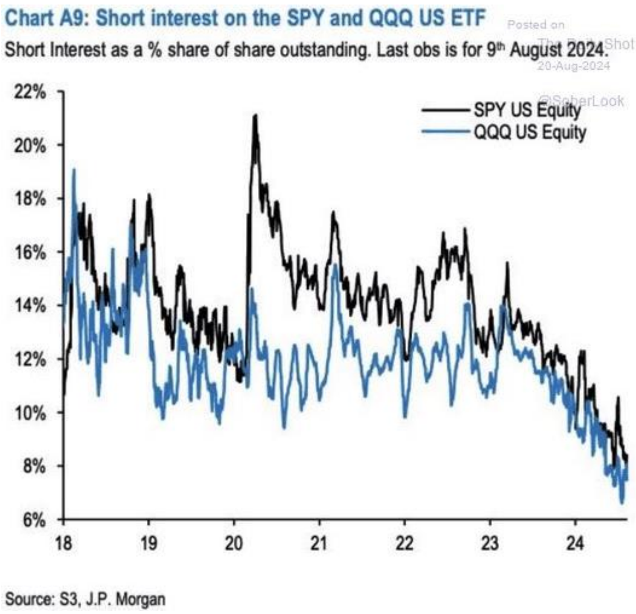
Meta (META) chart, investing.com, 22AUG2024

All this was good enough for a 10% initial share price jump and new highs since…

And so, we continue to live in a world where all news is good news for Big Tech, which saw the Mag7 as well as Nasdaq 100 bounce hard from their late July / early August lows. And yet, the technical picture does not convince me that in the short-term NDX has much further to run, and the fundamentals remain as challenging and demanding as I have ever seen them.

Nasdaq 100 (NDX) chart, investing.com, 22AUG2024

And as investor I am convinced that we all must eventually realize how untethered from fundamentals this whole Big Tech rally has become. As Sven Henrich put it so succinctly recently: *"Everybody is long, and nobody is short."*



@NorthmanTrader, X, 20AUG2024

Thus, the positioning is as lopsided as these things get, and the sentiment best described by a recent headline in Barron's:

"The Nasdaq put an exclamation point on its day by jumping another 0.4% in the final minutes. At 17,876.77, it marked its fastest exit from correction territory since 2011. Wall Street watchers count a correction as a 10% decline from a prior peak. It entered correction on Aug. 2, then kept falling through Aug. 7. It's now up more than 10% since Aug. 7.

What comes next for the Nasdaq? Historically, a good amount of green. The Nasdaq averages gains one week, two weeks, three weeks, one month, tree months, six months, and one year after exiting a correction, according to Dow Jones Market Data. A year after exiting a correction, the index is up 86% of the time, averaging a gain of 23.6%. Not bad." (Barron's Review & Preview, 20AUG2024)

And this is how investing works these days. We just look back at historic trading patterns, and any similarity or average is already a good enough reason to buy the dip, not only as far as the invincible Mag7 and their aspiring tech peers are concerned, and without any consideration for the fundamental backdrop. – This is clearly not my cup of tea.

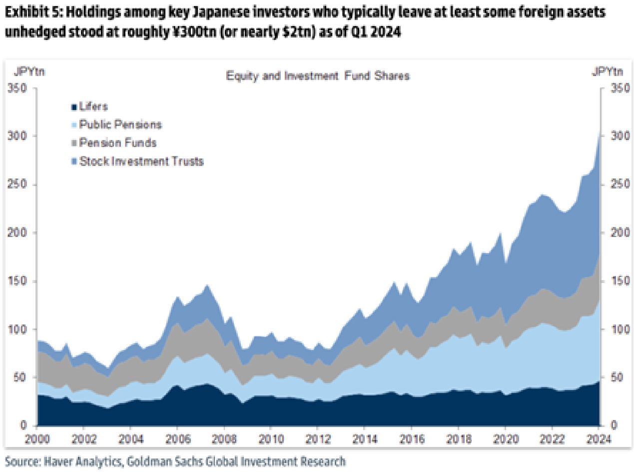
@hey_madni, X, 1JUN2024

And don't get me wrong. Of course, we live in the digital age. And the USA in particular, which has seen its position as dominant global power eroding, clings to the promise of technology to improve our lives, overall productivity and competitiveness. But as much as the digital world has changed all our lives, as we are increasingly glued to our smartphones and enthralled by the power of social media, we still live in the real world. Nothing illustrates this better than the advertisement shown on the left. Even Nvidia chips and the required server farms are made from metals and materials and require energy and labor to be produced and erected.

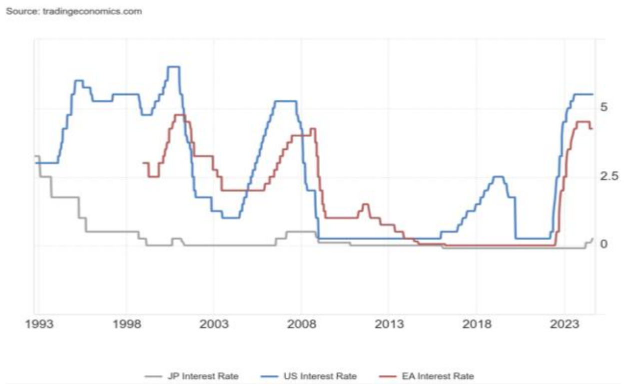
Tech has been the equity market leader for a long time now, and thus I believe – as always – that investors need to focus on where the puck is going, not where it has been, which is why I continue to remain convinced that the time is ripe for a change in market leadership.

Be that as it may, the last point to address concerning the stock market's summer wobbles is the JPY carry trade.

The original meaning of a carry trade refers to investors borrowing low-yielding currencies and investing (or lending out) the proceeds in higher yielding currencies, with the difference being the (in this case positive) carry. – But as far as the JPY is concerned, I believe the phenomenon is far more wide-ranging and thus also the amounts involved. Anecdotally, I have come across carry trade size estimates (from credible sources) ranging from USD 3 to 10 trillion, with the example cited on the right estimating only Japanese investors' exposure.



Chartbook, by Adam Tooze, 20AUG2024



JPY, USD and EUR central bank policy rates, Trading Economics

USD/JPY Exchange Rate since 1994 (log chart), investing.com

The reason for this gargantuan size is that after almost 3 decades of near zero Japanese interest rates (the BoJ lowered rates to 0.5% in 1995, and they haven't exceeded that level ever since), not only has it been a safe bet to use JPY for low-cost borrowing (domestically and internationally!), but it has increasingly enticed / forced Japan's giant pension funds, savings pools and households to invest money offshore. And while during the first half of that stretch periodic weakness in the JPY was followed by periods of significant strength, the JPY has been going mostly downhill (higher in the chart above on the right is "weaker", similar picture for EUR/JPY) ever since its highs in 2012.

This also enticed international investors to borrow JPY at cheap interest rates to fund asset purchases of all couleur, incl. Japanese shares. Not only did this promise higher returns, whether in fixed income or the stock market, but was additionally spiced up with foreign currency gains where JPY loans were used to fund investments in other currencies.

Japan's Topix Index, Reuters

Between July 11 (high) and August 8 (low), the Japanese Topix index lost a stunning 25%, which is nothing short of a crash and suggests that the prior rise in Japanese equities had attracted an increasing amount of (JPY funded) overseas investments. But this is not merely a Japanese equity problem, because if the JPY were to strengthen further, it could cause a serious global deleveraging event, which could make the recent correction look like child's play.

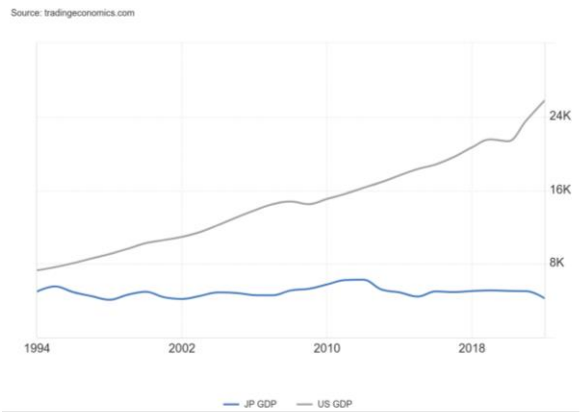
(By the way, I have chosen the longest chart for Japanese shares to show how the recent rally was rejected around the December 1989 highs – 36 years later – and how overextended the post-2012 rally has become.)

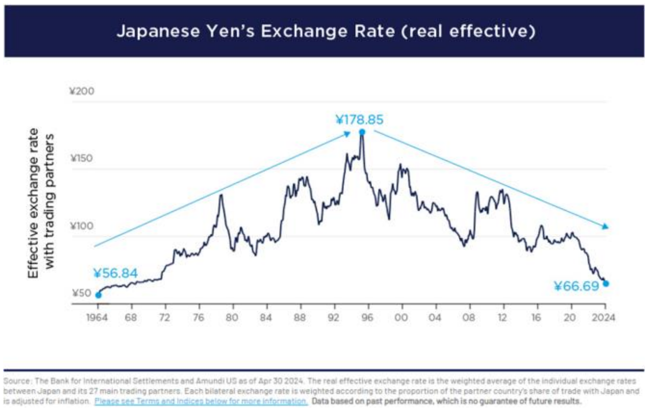
But what could cause such a global deleveraging event, you may ask?

Well, Japan's ultra-easy monetary policy may have helped to finally break out of a decade-long deflationary period, but it has also left Japan poorer than one might think. If one looks at the GDP chart on the right, this does not become evident.

Real Gross Domestic Product, Japan, until 1Q24, St Louis Fed

But looking at Japan's GDP in USD-terms and comparing it with US GDP delivers a far more sobering picture. While in 1994 US GDP (in USD terms) was merely 1.5 times Japan's GDP, it is now 6 times as large. In fact, Japan's GDP in USD terms is now lower than it was 30 years ago.

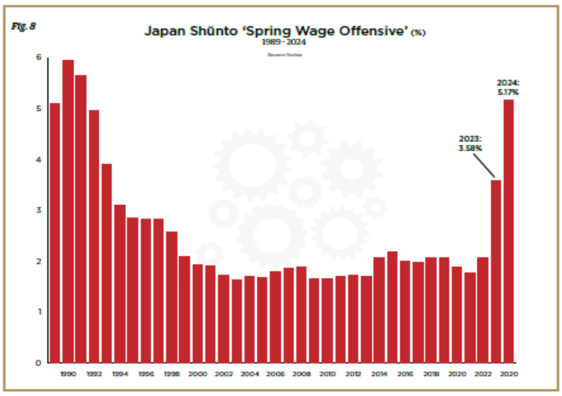




JP GDP (in USD) vs US GDP, [Trading Economics](), 1994-2022 [Amundi Asset Management](), 31JUL2024

And this is due to the dramatic devaluation of the Japanese currency since 2012, which in Real Effective Exchange Rate (REER) terms, which the [World Bank defines]() as *"nominal effective exchange rate (a measure of the value of a currency against a weighted average of several foreign currencies) divided by a price deflator or index of costs"*, has lost almost two thirds of its value since the mid 90's. This, ladies and gentlemen, is the difference between "nominal" and "real", and I am certain this will be a lesson many will have to learn again going forward.

What are the consequences, you may ask?



Japan National Consumer Price Index (CPI) YoY, [investing.com]() Japan's Shũnto Wages, [Things That Make You Go Hmmm...](), AUG24

A decrease in a nation's REER is an indication that its exports are becoming cheaper and its imports more expensive, increasing its trade competitiveness but also fuelling inflation due to higher import prices. This has led to CPI rates exceeding 4% last year for the first time in three decades, and has obviously succeeded in starting a wage-price spiral, as the above chart on the right, courtesy of [Grant Williams excellent TTMYGH newsletter]() this month, illustrates.

Trashing one's currency destroys purchasing power, and I doubt even the traditionally stoic Japanese will accept this without any complains. And this is why the Bank of Japan has recently hiked its policy rate to 0.25% and according to many observers is on course to raise it towards 2%.

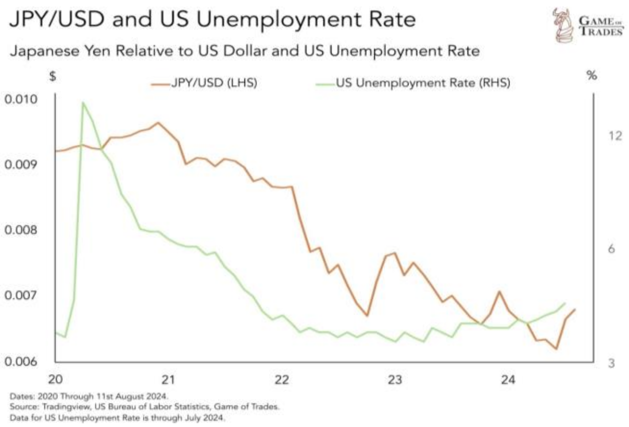
Still not much, you may say. However, at the same time US and European rates are set to decline, and for the US rates are expected to go down at least towards 3%. – Remember that carry? – Rather than a >5% interest rate differential between US and Japanese money market rates, this is expected to fall to 1%, which represents not much of a cushion to compensate for exchange rate fluctuations, and thus the risk of cross currency investments…

Personally, I remember well that Japan appeared too expensive for me to visit during the mid-90s when I moved to Asia. Now, a lot of my Asian friends remark on how cheap Japan has become for us as foreigners. – How will that feel for Japanese wanting to travel overseas, or more broadly when they reflect on the soundness of their currency?

As usual, and amid the push of greed and fear, financial market prices tend to overshoot on the upside as well as the downside (I know, this is hard to imagine with equities right now), and thus I believe the relative appreciation of the JPY versus its international fiat currency peers has merely started. If my expectations prove correct, this will have consequences for international capital flows and likely accelerate the deleveraging process that started in July this year, and which I expect will prove problematic for asset prices, beyond the recent summer wobble.

Of course, history can only be a guide and does not provide any degree of certainty for my conclusion, but I found the following thread on X by @GameofTrades convincing: *"The Japanese Yen recently surged by a record 10% within just 5 weeks. We've only seen this type of move 2 times in the last 30 years: Sept 1998 & March 2008. … In all 3 cases, the US stock market saw aggressive declines: - 20% drop in 1998; - 60% drop in 2007; - 10% drop (so far) in 2024."*

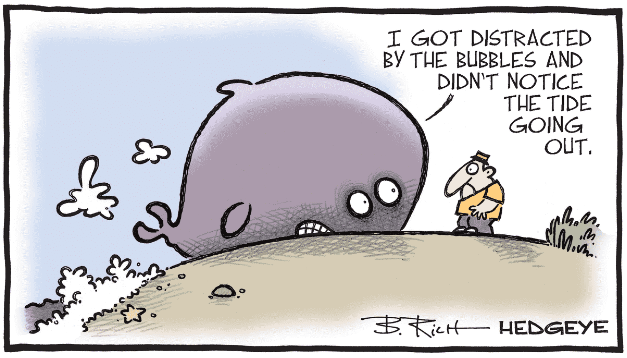
@GameofTrades, X, 19AUG2024



@GameofTrades, X, 19AUG2024

Needless to say, I am aware that I know nothing (for sure), but as a fundamentally driven investor I would be irresponsible not to heed these risk factors. After all, it is easy to make money, but it can be much harder to keep it. – I have experienced financial market bubbles before and have no doubt that we are in bubbly market territory again, which is why I advocate caution to anyone who thinks otherwise.

They also point out the close positive correlation between the US unemployment rate (leading) and the USD/JPY exchange rate. And with the former picking up recently, triggering the so-called Sahm Rule, which stipulates that any 0.5% increase in the US unemployment rate is usually (and so far has always been) followed by a recession, there is likely more JPY strength in the cards, as Japanese investors repatriate funds from the US.



Hedgeye, Cartoon of the Day, 13AUG2024

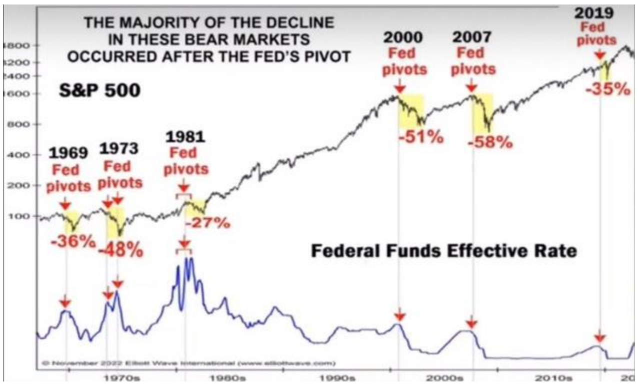
How have we dealt with all this for IASF?

By now, we are entering the last week of August, and I would thus like to describe how we are positioned and what has worked and what not since our mid-year review on page 6.

Yesterday, Fed Chair Jerome Powell, in his eagerly anticipated speech at the annual central bankers' gathering in Jackson Hole, confirmed that the Federal Reserve is ready to cut interest rates.

Quite predictably, this caused equity markets to rally once again (S&P 500 +1.2%), while US 2-year Treasury yields fell to 3.91% (close to uninverting, with the 10-year yield at 3.80%), and the USD Index dropped another 0.8%. Equity markets have been discounting lower interest rates for a long time now, and I would not be surprised if this ends up a case of "*buy the rumour, sell the fact*".

S&P 500 (SPX), investing.com,24AUG2024



@StealthQE4, X, 11AUG2024

James Aitken of Aitken Advisors in a blog post on August 16 already explained it this way:

"The determination to add risk after the big wobble has been astonishing to watch: it's almost as if the wobble in everything from the Nikkei to momentum stocks never happened. … The best explanation I have heard for this remarkable snap back is 'the computers want their stocks back.'"

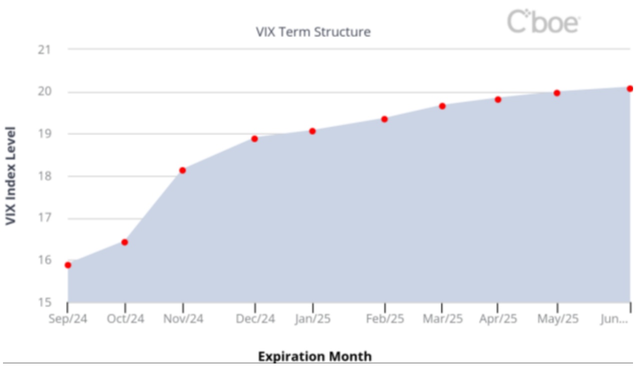
In the same post James also said: *"the primary challenge for investors in this noisy, too often hyperventilating ('emergency rate cuts now!", 'it's all the BoJ's fault!') world is to remain calm, confident, energised, focused, knowledgeable, anticipatory, and always in control. – It is easier said than done, and the last three weeks have been a stern test of that mindset."*

To which I feel compelled to add: That is always the main challenge for investors! – And they have to do this in the knowledge that they can only control themselves but not how the market behaves, and of course they have no way of KNOWING it in advance either.

I am saying this to drive home the point that the art of investing is to know yourself and how you respond to the constant reminders that no matter how much time, effort and resources you invest to gather and evaluate information in our profession, you will still often be wrong in your assessment and resulting investing conclusions.

One important reason is that in our world of "passive investing", security selection based on an evaluation of the security's underlying cash flows and assets has gone out of style. It is no coincidence that the word "*investing*" is frequently substituted by the word "*trading*" these days. The former implies the bottom-up analysis of a security and its underlying, with the aim to figure out whether the value of the assets securitized through it is higher than the market price paid, and if / whether there are any shareholder distributions that compensate a holder for the time required to wait for the market to price that security efficiently. The latter is discerning trends, seeking out technical signals as well as trading and fund flow patterns, usually in relation with macro-events and -data, in order to guide capital allocation into indices and (their) derivatives, which is where computers excel.

Currently, the latter is dominated by the short volatility trade, which is best illustrated by a look at the VIX (Volatility Index) Futures Term Structure (derived from the Implied Volatility of Options on the S&P 500 Index), which is shown in the graph on the right. It plots futures prices for the VIX index for the various monthly expiration dates, and most of the time is in steep contango (i.e., upward sloping).



CBOE VIX Term Structure, 24AUG2024

This means that with the VIX spot index at 15.86, and the October / November futures at 16.43 / 18.13, one can harvest a positive carry of 3.5% / 12.5% by selling the respective Oct / Nov future and waiting for the respective expiry to close it at spot, PROVIDED c.p. (ceteris paribus) conditions apply. Of course, that is only very rarely the case, but since the VIX futures curve is mostly in contango, this has been a great way to make money.


SVXY, last 2 years, investing.com, 24AUG2024

Evidence is provided by the ProShares Short VIX Short-Term Futures ETF (SVXY), which pursues such a strategy, i.e., and according to ProShares it *"provides short exposure to the S&P 500 VIX Short-Term Futures Index, which measures the returns of a portfolio of monthly VIX futures contracts with a weighted average of one month to expiration."*

Based on this short volatility strategy SVXY has over the past two years practically doubled, and for most of the time advanced rather steadily. – Perhaps we should include that into **IASF's** portfolio as well…?

But a look at the long-term graph and / or a recollection of the Volmageddon shock of 2018 puts things into the right perspective.


SVXY, last 10 years, investing.com, 24AUG2024

The risk of volatility shorting was evident when from 2015 to February 2018 SVXY rose more than 8-fold – only to lose 90% in one day (5FEB2018). A few leveraged short volatility ETFs even went to zero on that day. Another smaller earthquake occurred in FEB 2020, when during the Covid crash SVXY lost more than 75%. Thus, this is hardly an "investment" for the faint-hearted, but when "investors" are inclined to speculate this can draw in huge funds.

Actually, **IASF** also engages in the short volatility trade when we sell options. However, we do (and are only allowed to do) this on a fully covered basis, i.e., when we sell Calls we must own the underlying, and when we sell Puts we must have the cash to buy the underlying.

Meanwhile, shorting VIX futures, like any other short volatility trade, including the myriads of structured products, which are typically sold in the wealth management industry, generally leads to more aggressive risk taking in the market. After all, lower volatility implies higher price stability and thus encourages investors to leverage their portfolios. This is, e.g., done in so-called Target-Volatility- or Risk-Parity-Funds, which all use volatility as a guide for how much risk they can take. Lower volatility = more risk taking: What could possibly go wrong?

I apologize for having started on a tangent here, but these things define today's market structure and how securities and investors behave, and they also make the investing environment so much more complex and unpredictable. For anyone, who is keen to delve deeper into the subject of passive investing and volatility depression, I recommend Blockworks Macro conversation with Mike Green, who has done a lot of research on the subject.

How has that affected **IASF** (including end of August results)? – Not much on the short side, which delivered small gains in July and an equivalent drag in August, despite of the initial sell-off into August 5, which has been fully recovered since and some. While S&P 500 and DAX futures finished August higher versus June, Nasdaq 100 futures still closed lower, which thus had practically a zero impact on the portfolio.

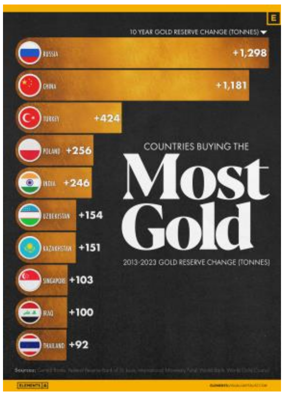
Another "computer" trade that has been initially resumed following the August 5 sell-off was the JPY carry trade.

Accelerated JPY short covering had initially driven the USD towards its lows of 142 on AUG5, but subsequently saw it strengthening again until mid-August (150). Since then, however, it has fallen towards 146 again, though that was partially due to USD weakness rather than JPY strength. But overall, the JPY gained 9.1% / 6.3% / 3.9% against USD, EUR and CHF since mid-year, thus proving risk mitigating.

EUR/JPY, USD/JPY, CHF/JPY, 2024, investing.com, 30AUG2024

In our view the best days of the JPY carry trade are over, as traders and speculators were reminded that exchange rates are not merely a number on the screen but are also supposed to reflect the value of a currency, and if that is drastically undervalued it will attract long-term investors, even if it offers a relatively low interest rate.

Apart from the still clear undervaluation, an important reason for our 20% JPY exposure was that despite of its traditionally rock-bottom interest rates, the JPY is a typical risk-off asset, i.e., it has often gained during periods of market stress, simply due to accelerated repatriation.

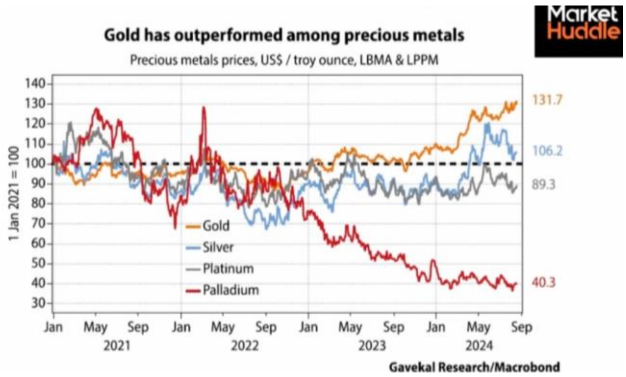


Visualcapitalist.com, 21AUG2024

This can be similarly said for gold as the true hard currency, where annual dilution via new gold mining is about 1.5%, and over the past century has fluctuated between 1-3%. Gold does not pay any interest, and yet anyone from central banks to high-net-worth individuals and retail investors seem to be buying it right now, amid its scarcity but also lack of counter-party risk. It is also noteworthy that about 2/3 of all physical demand comes out of China and India.

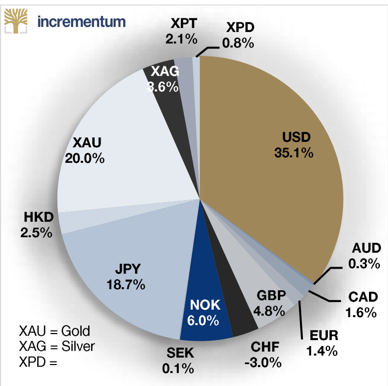
@jessefelder, X, 30JUL2024

In precious metals, we were certainly early, and being early can sometimes mean long and frustrating waits, but we know how important patience is in the investing business. We now have 14% exposure to precious metals miners, which we don't intend to increase much further as we have another 14% exposure to the metals (two thirds of that gold), which we regard as an ultra-high conviction positioning.



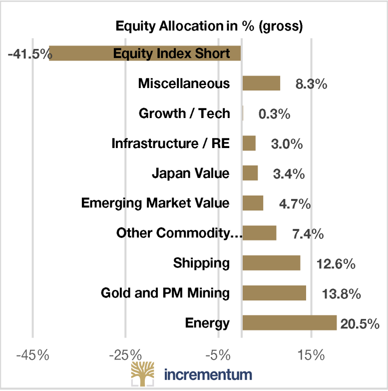
The Market Huddle with Louis-Vincent Gave, 25AUG2024

However, as the chart above shows, gold has clearly worked best, whereas silver has been less exciting overall and rather weak since its highs in May, and platinum is similarly disappointing. We have only recently began to accumulate palladium, and our position is still very small. However, since the end of June, our gold gains were almost eaten up by corresponding losses in the other precious metals and of course a weaker USD.



IASF Currency Allocation

That brings me to another culprit for the recent NAV correction, namely the softer USD, which from its June close at 1.0713 has lost 3.1%. With nearly 40% exposure to USD and related currencies (HKD, as well as CAD, which with a loss of 1.7% has held up better), this has been a significant drag to overall portfolio performance since mid-year. Together with a weaker NOK, which lost 2.4% since its mid-year close at 11.42, it is quite clear that currency allocation was a significant drag to portfolio performance.



IASF-Equity- / Theme-Allocation

What happened on the long side of **IASF's** portfolio, and especially in our equity themes?

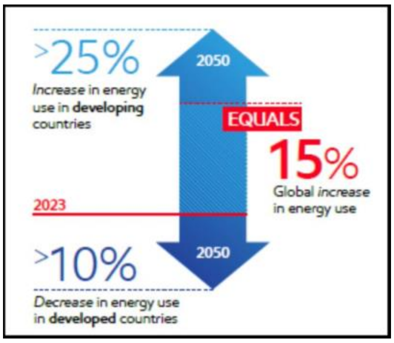
Well, as readers and investors know, we have placed an emphasis on value, hard asset plays and commodity producers in our main equity themes (see table on the left with data from end of August), which given the worsening economic outlook have at least partly faired rather poorly.

First, let's look at **ENERGY**:

This is the largest equity theme allocation to the portfolio, and as far as our thematic exposure is concerned, thus carries our highest conviction. And on a weighted average, we have lost 9% on average on our holdings in this bucket in local currency terms over the past two months. Why?

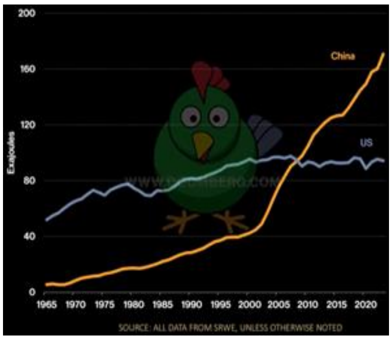
Well, today's equity market pricing is rather rigid and predominantly top-down driven. The increasing availability of computing power, and the ability to identify quantitative patterns, has led to a standardization of the economic and market cycle. And a slowing economy with rising unemployment suggests the potential for a recession, which in turn is assumed to cyclically reduce demand for energy (and commodities).

But when we look at the overall fundamentals of the sector, it is also worth noting that energy demand is less economically sensitive than one might conclude when looking at the recent fall in energy share prices. In addition, and as I have pointed out in these pages before, energy demand in developed / advanced economies is on a different growth trajectory as in developing / emerging economies, as projected recently, e.g., by Exxon Mobil in the graph on the right.



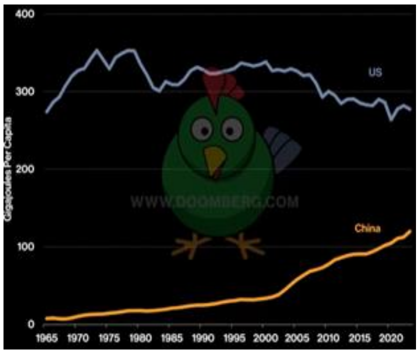
@Josh_Young_1, X, 27AUG2024

Of course, this is a rather long-term forecast, made by an oil producer, which is obviously also a rather biased observer.



Total Energy Consumption, USA & China

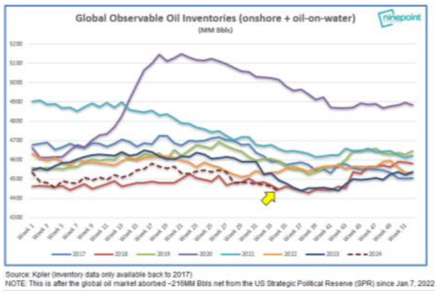
However, this is also confirmed by independent analysts like Doomberg, who in a recent presentation showed these two charts, which highlight the energy consumption trajectory for the US and China and the still remaining per capita gap.



Energy Cons. per capita, USA & China

India, Indonesia, Bangladesh, Vietnam, Brazil, or the rapidly growing African countries are far further behind China in their development process, which underscores the challenge energy security (individually as well as for the planet) represents in the years to come. But investors care little right now.

They also care little for the fact that *"global oil inventories are at their lowest seasonal levels in recorded history. This is in spite of absorbing ~216MM net barrels from the US Strategic Political Reserve (SPR) and weak Chinese demand. This is not bearish."* – Indeed. The same could be said for many other developments, like the recent Libyan production shutdown, which takes 1m barrel per day off the market.



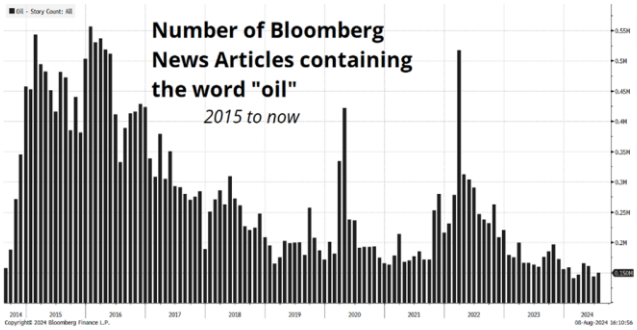
@ericnuttall, X, 27AUG2024

All this, however, does not trouble investors, who don't seem to regard the crucial production and value creation of the energy industry as relevant as that of the Mag7, who rely on energy as their main input factor. – Go figure!

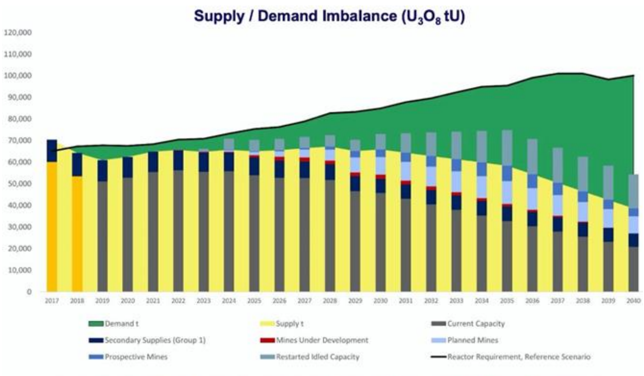
We also keep pointing out that like most commodities, oil, gas, coal or uranium represent depleting resources, and politically there are strong incentives against investing in the replacement of existing reserves. The FT reported on August 28 for example about the state of the pledges made during the COP26 UN climate change conference in Glasgow. At the time, a group of countries forming the Clean Energy Transition Partnership (CETP) promised to switch USD 28bn of investments into fossil fuels to clean energy. The reality check from last year revealed USD 15bn in actual reductions, which was achieved without the US, which *"has continued to pour billions into oil and gas finance"*. (FT, 28AUG2024)

It seems not only OPEC members' lack discipline… – though the US behaviour helps ensuring that domestic Natural Gas prices stay as low as USD 2-3, whereas in Europe and Asia they are 4-5 times as expensive. This certainly is a great way to support one's competitiveness…

Sorry, I digress, but in the short-term it seems that nobody talks about oil anymore…



Brent Donnelly, Spectra Markets, 9AUG2024



Growing Mine Supply Gap (Source: The Nuclear Fuel Report – Global Scenarios for Demand and Supply Availability 2019-2040)

@chigrl, X, 26AUG2024

The same can be said for Uranium, where the physical supply / demand balance is just starting to gape. But neither constant news flow related to the renaissance of nuclear power as "clean" energy, including the rapid built-out of the global reactor fleet, nor bad news out of the world's leading producer, Kazakhstan, which just had to report projected output cuts at Kazatomprom's quarterly earnings report, seem to be considered by investors.

And for the climate crusaders, I would like to conclude with the following *question insufficiently debated in public* to ponder: *"should humanity sacrifice global standards of living now in the hope of preventing future climate catastrophes or should it rather set aside the resources needed to react to any negative consequences from elevated CO2 levels in the event they manifest. The latter adaptation option avoids the preemptive wasting of trillions of dollars should the foundational doomsday assumptions prove wrong, or the preemptive solutions not work. This model is vigorously opposed by climate activists under the central argument that only rich nations can afford to adapt, forcing poorer countries to bear the brunt of the upcoming dislocations. Meanwhile, those same countries are burning every molecule of oil, gas, and coal they can get their hands on to climb out of said poverty and are thereby responsible for more than 100% of the growth in carbon emissions in the past two decades."* Doomberg, Leaving Las Vegas, 26AUG2024

But of course, politicians always have elections to win, and this is best achieved by promising change, even if those promises can rarely be kept…

John Wood Group Plc (WG), investing.com, 29AUG2024

Returning to **IASF's** portfolio, the worst performer in our **ENERGY** basket since mid-year has been consulting & engineering group John Wood (-35%), which suffered its second Private Equity offer rug-pull in 15 months. The first offer at GBP 2.40 was cancelled by Apollo in May 2023, while this time it had stood at GBP 2.30 by Dubai's Sidara and was cancelled on August 5, *"in light of rising geopolitical risk and financial market uncertainty at this time"*.

Over the same period, Wood has been showing steady progress on its turnaround plan, which has recently been evidenced by its 1H 2024-Trading Update (among others via EBITDA margin increase from 6.8% to 7.4%, and confirmation of upgrade to its medium-term outlook as initially announced during 1Q 2024-Trading Update), as well as ongoing sales of non-core businesses like yesterday's announcement of the disposal of two non-core subsidiaries. All this has gone a long way of improving the company's balance sheet. Although this has arguably been one of our most frustrating equity holdings, fundamentally one cannot deny that things are moving in the right direction, and that in relation to its peers (and thus in the eyes of possible acquirers) the shares are significantly undervalued.

Though this was the worst performer, we saw other double-digit declines among our natural gas producers, large offshore drillers, and our uranium exposure. But overall, our energy holdings are cheap, have solid asset underpinnings, enjoy mostly rising or high free cashflows, and reward patient investors with similarly rising distributions (dividends and share buybacks).

Our second largest equity theme is **GOLD AND PM MINING**, which has shown a 10% weighted average return, and where after some profit-taking we now hold a 14% allocation. For regular readers it is not new that we are bullish for the precious metals' price outlook and thus for the miners, and together with our exposure to the metals itself (s. page 23), this remains a high conviction bet.

The argument is based on our long-term stagflationary macro-call, i.e., an extended period that sees **stag**nating growth combined with ongoing and elevated in**flation**. This is driven by the 3 D's:

- Demographics (shrinking labor force leads to upward pressure on wages / salaries)
- Deglobalization (*"Hyper-efficiency is deflationary. The return to resilience, as confidence in hyper-efficient systems falls, is inflationary. Unless confidence in hyper-efficiency returns, our course is set."* (@Peter_Atwater, X, 1AUG2024). Globalization and offshoring of labor was a move towards efficiency; reshoring is just the opposite.)
- Depreciation (Strong currency = deflationary and vice versa)

Such a scenario will ultimately see real assets and commodities coming back in favour again and drive investment returns as a consequence. This is valid for energy, other commodities, but also precious metals, and especially gold, which is still widely regarded as **the** monetary asset.

Now, make no mistake, precious metals miners have been a terrible investment over the past 20 years, as the graph on the right proves. Sure, from October 2000 until March 2008 the FTSE Gold Mines Index went up fivefold. But despite of higher highs in 2011, it has so far still not reclaimed the March 2008 level, and 16 years later the index is still 24% lower. – Ouch!

FTSE Gold Mines Index, investing.com, 29AUG2024

One could easily write a book about the reasons, but in the interest of time (and finishing this report), this is the classic case of a commodity boom-bust-cycle, where the rapid rise in precious metals prices in the first decade of this century, led to all the excesses cyclical industries can produce (including wasteful corporate management as well as reckless spending on resource development and M&A). Today, the industry is far leaner, many companies have gone under, and investors have probably been disappointed once too much and just don't care anymore.

And what happens during such longer-term cycles is that valuations go from crazy (not dissimilar to what we have also repeatedly seen in Tech) to dirt-cheap, while the financial industry has completely lost interest. How many analysts still cover the sector or when have you last read / heard about a new gold mining fund being launched (outside of Incrementum AG, of course, with our new Active Gold Fund)? And with the prevailing pessimism, the remaining analysts are loath to include higher precious metals prices in their forecasts, always fearing that these will only prove temporary. An analyst friend recently calculated the average gold price used for earnings forecasts in the industry as \$2169 for 2024, \$2216 for 2025 and \$2077(!) for 2026 – at a time when the price of gold has been steadily climbing above \$2200 since March, sitting at \$2510 at the time of writing this. This suggests a lot of upside earnings and cashflow surprises for the industry going forward.

Having said that, we have been taking some profits in majors like Agnico Eagle (+22% since mid-year) as well as developers like Skeena Resources (+42%), in order to rebalance our exposure to the sector, and we continue to regard this as a very attractive medium-term investment theme, which is still in its very early innings.

A poor performer over the past two months has also been **SHIPPING** (12% allocation), where we had lightened up exposure considerably during 2Q.

Over the years, this has been a phenomenal performer for **IASF**, and in terms of the duration of the current up-cycle, I reckon we are past halftime already, which means share price corrections and consolidations are becoming more frequent and extended. This is also attributable to the fact that a significant part of the value creation is not reflected in share prices anymore. As an example, take a look at the table below, which was published in Pareto Securities' Golden Ocean's 2Q 2024 results review:

DRY BULK	Share price	NAV/shr	# shares	M.cap	Net debt /GAV	P/NAV	EV/GAV	P/E 2024e	P/E 2025e	EV/EBITDA 2024e	EV/EBITDA 2025e	ROE 2024e	P/B 2024	Dividend yield 2024e	Dividend yield 2025e
2020 BULKERS	kr 134	kr 149	22.9	293	21%	0.90x	0.92x	6.8x	6.2x	5.6x	5.6x	53%	1.9x	30%	18%
BELSHIPS	kr 19.7	kr 27.9	253.1	475	54%	0.71x	0.87x	9.3x	4.6x	7.2x	5.1x	22%	1.7x	10%	15%
GOLDEN OCEAN	**$12.6**	**$14.6**	**200.0**	**2,522**	**30%**	**0.86x**	**0.90x**	**9.7x**	**7.1x**	**7.6x**	**6.3x**	**14%**	**1.3x**	**10%**	**14%**
HIMALAYA SHIPPING	$7.6	$9.9	43.9	335	61%	0.77x	0.91x	7.7x	4.9x	9.4x	7.1x	27%	2.0x	10%	16%
STAR BULK CARRIERS	$21.1	$31.5	115.3	2,507	22%	0.67x	0.76x	5.3x	4.5x	4.9x	3.9x	21%	1.0x	16%	20%
Average Drybulk				**6,132**	**32%**	**0.78x**	**0.87x**	**7.8x**	**5.5x**	**6.9x**	**5.6x**	**27%**	**1.6x**	**15%**	**17%**

Source: Pareto Securities

Golden Ocean Quarterly Review, Pareto Securities, 28AUG2024

It shows some of the major dry bulk firms Pareto follows, 3 of which we own as well, and their basic valuations, and in the last two columns lists the dividend yields for 2024e and 2025e, which are all in double-digit territory. Remember that when a dividend is declared, and the necessary funds removed from a company's balance sheet, the stock goes ex-dividend, i.e., it falls by the calculated extraction of funds per share to satisfy the dividend distribution. In other words, focusing merely on the share price, neglects the impact that dividend distributions have on total shareholder returns. – And I guess you'll agree with me that if the above dividends are distributed as forecasted, and the companies' share prices remain unchanged, investors' could still feel well rewarded.

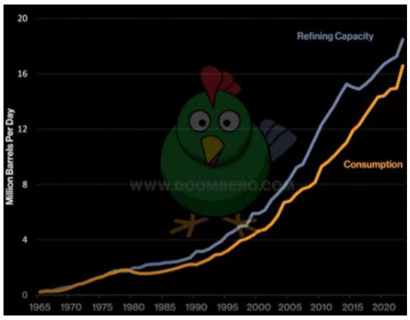
Recently, the sector has suffered from the market's distaste for everything China and steel-related. The argument among Western observers seems to be that with China's growth slowing and given its further rising debts, the country is just about to collapse and its currency to implode. But last I looked, China's GDP was still expected to rise by 4.5%-5% this year and next, and it has used the funds invested well, given its still leading position as Workshop Of The World. And here we are no longer talking about textiles, toys and trinkets, but cars, energy transition essentials and nuclear power plants.

That has led the country to register monthly(!) trade surpluses of USD 100bn, chiefly with other Emerging Market economies, a currency that has held its own versus the mighty USD, and interest rates on its government debt in the low 2% area (for 10y paper). That does not have my own alarm bells ring.

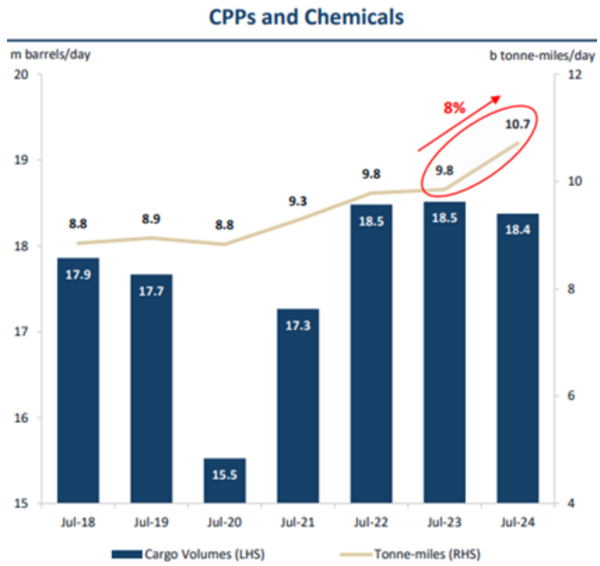
USD/CNY Spot, investing.com, 29AUG2024

Meanwhile, for anyone interested in a deeper dive into the topic, Louis-Vincent Gave of GaveKal Research recently gave his refreshingly different perspective on China (and his Structural Inflation stance) via The Market Huddle on AUG24.

International trade thus remains alive and well, and China's hunger for imports as well as exports are as ravenous as ever. I mentioned energy already above. Here it is important to note that the growing oil and related fuel demands globally are satisfied by refineries in China and the rest of the developing world. After all, our advanced societies can no longer support such dirty industries, so we have them being built elsewhere, and just import the resulting clean and finished products.



Doomberg, 28AUG2024

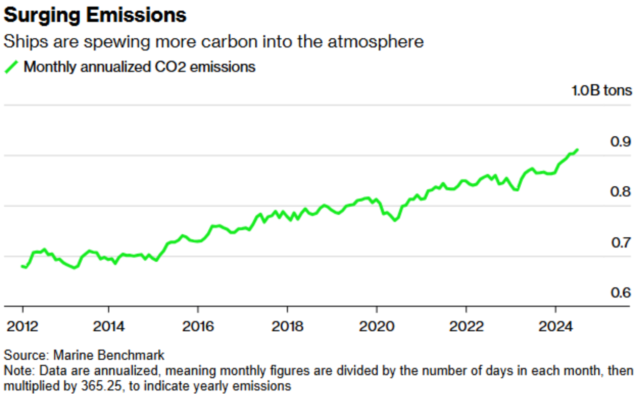


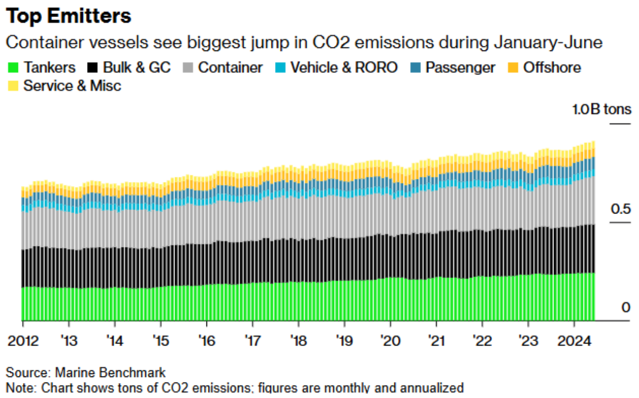
Hafnia 2Q24 Investor Presentation

One consequence can be seen in the graph on the left, which e.g., shows the recent trend of cargo volumes and more importantly tonne-miles per day in Clean Petroleum Products (CPP) and Chemicals, both typically coming out of refineries. While volumes have not changed a lot, the transport distance per tonne has increased quite significantly, thus requiring more vessel capacity to facilitate transportation. This has obviously supported (clean) tanker rates, which have risen to such attractive levels that cannibalization from the crude tanker companies has begun.

Of course, reduced Panama Canal throughput and the avoidance of the Suez Canal, about which I have written extensively earlier this year (SR-2401, p.19 ff), also still remain an important factor in the growth of tonne-mile demand. At the same time, the overall supply and demand situation in the tanker sector remains favourable. The orderbook-to-fleet ratio for product tankers is approaching 20% by now, but for deliveries until 2028. At the same time, vessels in the crude sector are getting increasingly old, and their orderbook to fleet ratio remains relatively low at only 9%. Thus, industry observers anticipate increased scrapping levels (i.e., retirement of vessels). The picture is similar for dry-bulk vessels, which is why we continue to have nearly our entire exposure to these two sectors.

Broad investor interest remains elusive, however, and it is hardly helped by these kind of headlines (and charts): Shipping Gets Even Dirtier as Houthi Attacks Fuel Longer Voyages





Bloomberg, 22JUL2024

It's the kind of headline that attracts attention in this day and age, though all major shipping companies are committed (and required by law) to reduce emissions and are making significant investments to achieve this, and continuing to pass through the Suez Canal risks both life and cargo. Suggestive headlines like this are born out of the desire to have one's cake (not only cheap but also vital imports) and eat it, too (since teleportation has yet to be invented, maritime shipping is the next best alternative).

Our **OTHER COMMODITY PRODUCERS** bucket (7%) was essentially flat on average, as negative performance by the major diversified players (Glencore & Rio) as well as Bunge was compensated by the rally in OCI shares.

The company is undergoing a major restructuring by selling its US businesses (Fertiglobe, IFCo and Texas Blue) for total proceeds of USD 8.5bn, of which at least USD 3bn is going to be returned to shareholders during 2H24. The remain co will be the No. 1 green methanol producer globally as well as a leading European nitrogen producer, which owns the only ammonia import terminal in Europe.

OCI NV, investing.com, 30AUG2024

Even following its sharp August rally, OCI's market cap is still only EUR 6bn. Up to nearly half of the current share price is sought to be distributed in dividends following closing of those deals, and conservative valuations still leave room for significant further upside.

The next largest theme is **EMERGING MARKET VALUE** (5% allocation), which has experienced a solid two months since mid-year (again, on average and in local currency terms). The majority of our holdings are Hong Kong / Greater China equities (incl. BABA and CKHH), but also include a small position in a Brazil ETF (0.8% of AuM) as well as a UK based EM asset manager.

Dividend Yld	P/E Ratio	P/B Ratio	EV/Sales	EV/EBITDA
6.80%	12.30	1.00	1.49	5.91

IASF – EM Value bucket, average valuations

Since June our holdings saw an average return of 10%, while remaining (too) cheap.

The same can be said for our **JAPAN VALUE** bucket (3.5% allocation), which suffered a nearly 4% loss on average, which was more than compensated by the JPY's appreciation.

Meanwhile, valuations here also still look very reasonable in our view.

Dividend Yld	P/E Ratio	P/B Ratio	EV/Sales	EV/EBITDA
2.59%	10.11	0.68	0.68	5.65

IASF – Japan Value bucket, average valuations

Our **GROWTH / TECH** bucket is tiny, with a remaining allocation of 0.3%. We have weeded this out over the course of the year and will continue to do so. During 2Q we had added PayPal and Xometry, as short puts on both were exercised, which we both "lost" at a decent profit through the exercise of short calls in August. We will keep our eyes open for opportunities in this area, but don't track anything yet with conviction.

Lastly, there is our **MISCELLANEOUS** bucket, which currently has an allocation of 8%. Here all those stocks end up, which we decide do not belong into one of the before-mentioned theme baskets. This was as usual a mixed bag, with the more cyclical stocks weaker, most notably Cleveland Cliffs, which is one of America's largest steel companies, and in our view the best managed as well. We're currently in the red on this one to the tune of almost 20%, which incidentally reflects the option premium harvested since 2021 in the name, and based on today's holding size (highest so far at 1.4%).

CLF is unique in that under current management it has been transformed into the most integrated steel supply chain in North America, spanning iron ore mines, coke production facilities and a growing steel production business (No 2 behind Nucor).

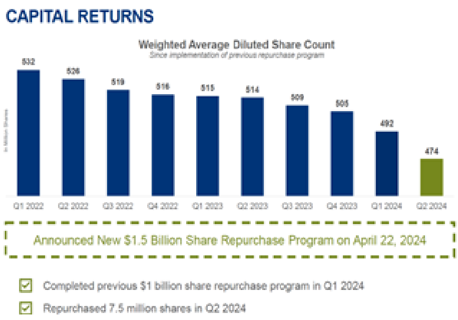
Cleveland Cliffs Inc, investing.com, 30AUG2024

Recently, the share price has had a tough time, with steel prices falling towards cyclical lows and its failure to acquire US Steel. Instead, in July they acquired Canada's Stelco, which is one of the lowest-cost steel producers in North America, near cyclical lows at 4.8x EBITDA. Stelco is extremely well run and complements CLF's existing business, while delivering further economies of scale.

At a time when the political winds advocate reshoring of important production, and slapping heavy tariffs on imported steel, building a vertically integrated North American steel company, which is on friendly terms with the unions, seems not a bad idea.

CLF 2Q2024 Presentation

Of course, in the short-term that does not eliminate the cyclical element, and with adjusted EBITDA in 2Q less than half what it was last year, the share price has taken a beating. In such an environment, the company focuses on cost reductions and the ongoing business transformation, while continuing to buy back shares.



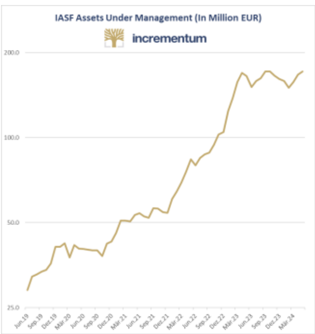
CLF 2Q2024 Presentation

In short, we consider this a long-term holding for **IASF.**

The same can be said for the rest of our miscellaneous collection. That includes Dole Plc, which has seen its share price soar amid ongoing business improvements and investors apparently waking up to its rather attractive valuations. Having said that, we recently took some money off the table following an over 30% rally over the course of two months, though we maintain a decent position.

Dole Plc, investing.com, 30AUG2024

Missing from the recount is our small bond allocation, which amounts to 3.3% allocation in corporate USD bonds with a modified duration of 2.4 years and an weighted average 8.9% yield to maturity.



IASF portfolio flows, 31.8.2024

I will conclude this section as usual with a look at portfolio flows. After EUR 6.6m outflows during 1Q, these have completely reversed, and amid EUR 3.2m inflows in July and August are now net positive at EUR 1.2m. – We are grateful for the trust expressed herein by our investors, and as usual ask them for patience during times of consolidation.

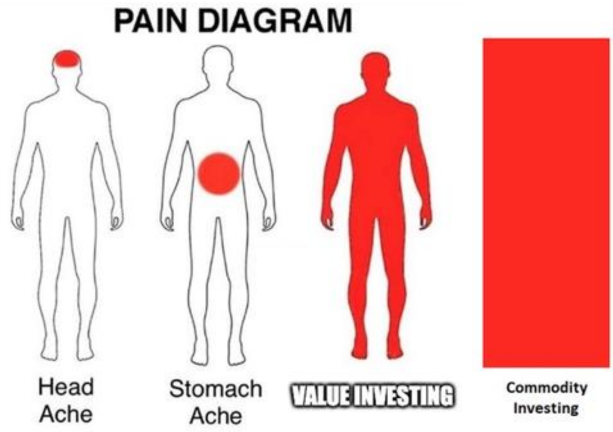
A historic picture of overall AuM development is shown (by log chart) in the graph on the left.

CONCLUDING REMARKS: THIS IS NOT INVESTMENT ADVICE!

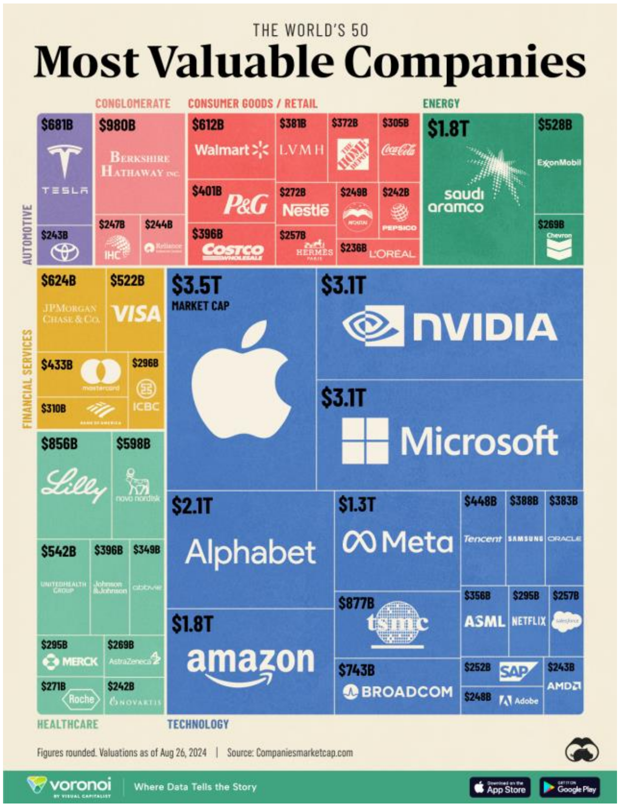
As the author of this newsletter and the fund manager responsible for the Incrementum All Seasons Fund, I must point out to readers that any views expressed in this report, particularly those relating to the individual investments or the investment strategy of the fund, are biased and not tailored to 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.

Another lengthy letter has come (almost) to the end. I am writing this on the last day of August, and with the knowledge that summer so far has not been great for our investors, as **IASF's** NAV has continued to consolidate following the highs in May (detailed graphs can be found in the Appendix).

For us as value investors with high commodity exposure, we actually can relate strongly to the PAIN DIAGRAM on the right…



@Josh_Young_1, X, 28AUG2024



Visual Capitalist, 28AUG2024

This summer 2024 edition of my Seasonal Reflections offers as comprehensive an insight as I can provide into **IASF's** portfolio composition and the reason for our positioning. Of course, the past couple of months have been frustrating, as we have seen the fund's NAV consolidating, as thematic equity performance was rather mixed and the expected rotation from long duration into hard assets and value has yet to play out in seriousness.

The table on the left, which shows *The World's 50 Most Valuable Companies* helps to explain why: We actually own none of these, as we have failed to identify good value among them. And in fact, we have essentially been short the by far largest sector (Tech) on the same valuation grounds, an assessment that has yet to be confirmed by the market.

Now, some may say that we are plain stupid, as the Mag7 have been by far the most profitable stocks for investors ever. And it may appear like that is true if one considers the attention they receive in the financial news and the dominance they have reached in global markets and indices. This is why the below table might be of interest, which I have taken from a recent study under the title "Which U.S. Stocks Generated the Highest Long-Term Returns", authored by Hendrik Bessembinder, Arizona State University, July 2024.

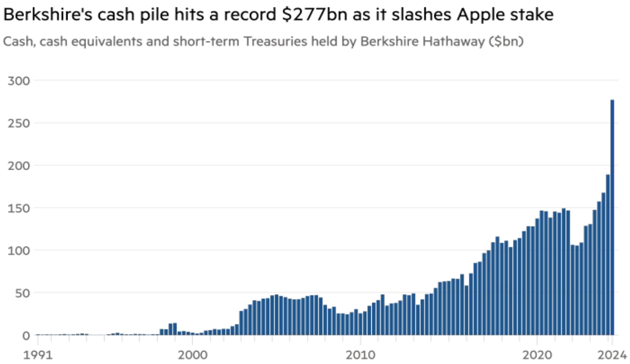
Table 2: CRSP Common Stocks with the Highest Cumulative Returns

Company Name (Most Recent)	First Return Date	Last Return Date	Years	Cumulative Gross Wealth Per Dollar	Cumulative Compound Return (%)	Annualized Compound Return (%)
ALTRIA GROUP INC	31-Dec-25	29-Dec-23	98.00	2,655,290	265528900.62%	16.29%
VULCAN MATERIALS CO	31-Dec-25	29-Dec-23	98.00	393,492	39349084.13%	14.05%
KANSAS CITY SOUTHERN	31-Dec-25	13-Dec-21	95.95	361,757	36175578.11%	14.27%
GENERAL DYNAMICS CORP	28-Jan-26	29-Dec-23	97.92	220,850	22084880.36%	13.39%
BOEING CO	5-Sep-34	29-Dec-23	89.32	212,206	21220526.33%	14.72%
INTERNATIONAL BUSINESS MACHS COR	31-Dec-25	29-Dec-23	98.00	175,437	17543644.18%	13.11%
EATON CORP PLC	31-Dec-25	29-Dec-23	98.00	151,173	15117167.57%	12.94%
S & P GLOBAL INC	14-Feb-29	29-Dec-23	94.87	128,787	12878643.34%	13.20%
COCA COLA CO	31-Dec-25	29-Dec-23	98.00	123,724	12372265.06%	12.71%
PEPSICO INC	31-Dec-25	29-Dec-23	98.00	86,360	8635937.80%	12.30%
ABBOTT LABORATORIES	1-Mar-37	29-Dec-23	86.83	78,038	7803730.36%	13.85%
UNIVERSAL CORP	11-Nov-27	29-Dec-23	96.13	70,318	7031700.72%	12.31%
DEERE & CO	29-Jun-33	29-Dec-23	90.50	69,886	6988538.63%	13.12%
HERSHEY CO	1-Dec-27	29-Dec-23	96.08	69,099	6909822.15%	12.30%
WYETH	29-Apr-26	15-Oct-09	83.47	57,024	5702341.59%	14.02%
JOHNSON & JOHNSON	25-Sep-44	29-Dec-23	79.26	54,281	5427968.94%	14.75%
ARCHER DANIELS MIDLAND CO	31-Dec-25	29-Dec-23	98.00	51,811	5181049.17%	11.71%
C V S HEALTH CORP	27-Sep-28	29-Dec-23	95.26	46,939	4693845.60%	11.95%
U S T INC	31-Dec-25	5-Jan-09	83.02	43,963	4396203.50%	13.74%
EXXON MOBIL CORP	31-Dec-25	29-Dec-23	98.00	40,273	4027183.13%	11.43%
NORTHROP GRUMMAN CORP	10-Dec-51	29-Dec-23	72.05	39,495	3949426.66%	15.82%
TRANE TECHNOLOGIES PLC	31-Dec-25	29-Dec-23	98.00	39,238	3923693.49%	11.40%
F M C CORP	22-Apr-31	29-Dec-23	92.69	37,001	3699995.48%	12.02%
CATERPILLAR INC	2-Dec-29	29-Dec-23	94.08	36,903	3690210.17%	11.83%
BRISTOL MYERS SQUIBB CO	8-Sep-33	29-Dec-23	90.31	34,867	3486607.85%	12.28%
TOOTSIE ROLL INDS INC	31-Dec-25	29-Dec-23	98.00	34,401	3440011.10%	11.25%
PFIZER INC	17-Jan-44	29-Dec-23	79.95	28,990	2898900.69%	13.71%
KROGER CO	26-Jan-28	29-Dec-23	95.93	28,345	2834362.61%	11.28%
WALGREENS BOOTS ALLIANCE INC	15-Feb-34	29-Dec-23	89.87	27,053	2705196.76%	12.03%
EMERSON ELECTRIC CO	5-Sep-44	29-Dec-23	79.32	24,098	2409682.63%	13.57%

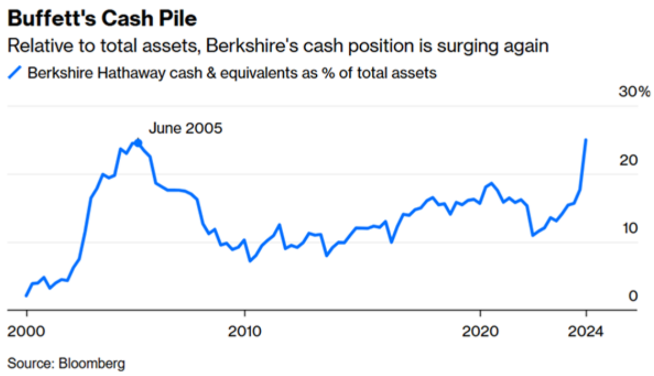
The interesting thing is that the true compounders have spanned decades, and they don't include any of today's Mag7 and except IBM I could not spot any major tech company. I suppose this is because today's tech behemoths are still relatively young enterprises (and in fairness, the Abstract of the report states that *"The highest annualized compound return for any stock with at least 20 years of return data was 33.38%, earned by Nvidia shareholders."*), but I assume it also is due to the fact that it is so hard to always be at the forefront of technological change (IBM may well be a perfect example for this).

I am writing this to emphasize that good value and thus investment performance can be found outside of today's vogue stocks, which is what we try to do at Incrementum. – And for anyone who might feel like despairing about our stubborn short position, it is probably also worth remembering that even the stock market moves in cycles. This cycle has arguably been extended well beyond the usual age, as we have not seen a true bear market since 2007-09. After all, the Covid crash of 2020 was more than recovered before the year was out, and 2022 also proved a relatively brief affair, which reinforced investors' urge to buy-the-dip (see MSCI World Chart on page 10).

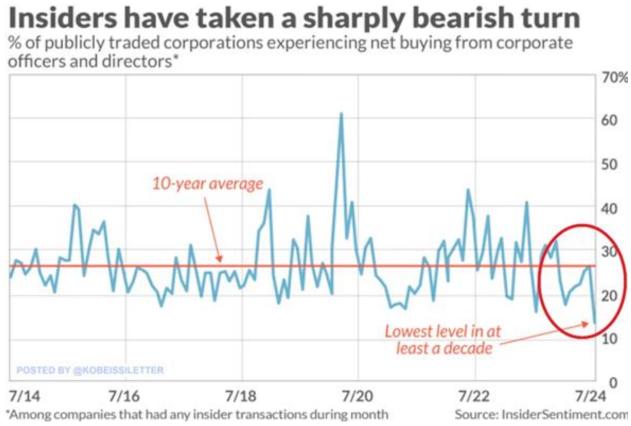
And though other regional markets in Europe, Japan or Emerging Markets have also done well since the GFC, the US has become the go-to-market with today's leadership stocks and the momentum to attract global speculators like moths to the flame. – And yet for those that care to look, the signs that US stocks are no longer regarded as attractive investment propositions among those that should know them best are hard to deny.



Berkshire Hathaway halves stake in Apple, FT, 3AUG2024

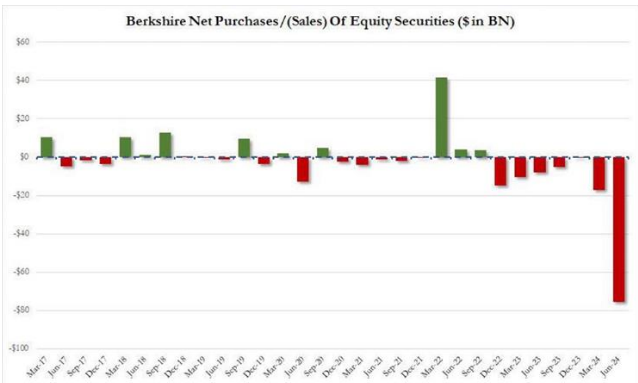


Bloomberg, 5AUG2024



@KobeissiLetter, X, 26JUL2024

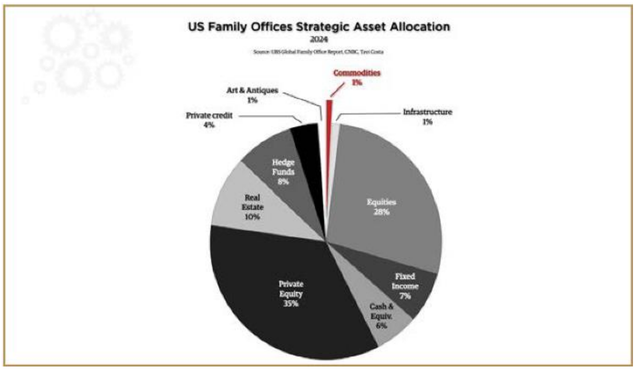
There has also been a lot of ink spelled lately on the sage of Omaha's soaring cash pile, helped not only by Warren Buffet's ongoing Apple stock liquidations. If US stocks are so attractively valued, why is Warren preferring to put Berkshire's cash into US-T-Bills? – As the graphs below shows, BRK's cash is not only soaring absolute but also relative to total assets, and he has clearly accelerated sales recently.



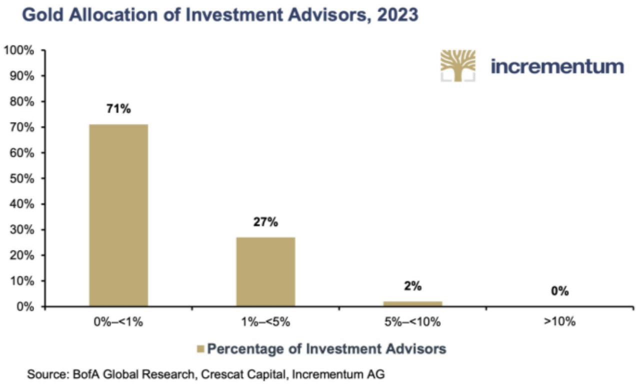
@JacobKinge, X, 4AUG2024

I am convinced the sentiment pendulum as always has gone too far to one side as not to swing back the other way. Reversion to the mean is an inherent feature of financial market pricing, and we have a long way to go in terms of Big Tech, but also Private Assets, to revert to the mean and even to fall out of favor.

On the latter I could devote an entire SR edition on its own, I guess, but at this stage I would only like to remind my readers that the last time Private Equity (Assets) proved troublesome for investors was 2008, when the lack of liquidity and proper mark-to-market accounting caused serious losses and pain. Today's exposure to this asset class is far larger and widespread.



Who are you?, Grant Williams, TTMYGH, 22JUL2024



In Gold We Trust Report 2024, p.18

I'll close these final thoughts with a chart from this year's *In Gold We Trust Report*, which provides an overview about the recommended gold allocation by investment advisors (in the US) in 2023, which speaks for itself. How much in a minority we are with our **IASF** gold allocation can easily be discerned. But we like to be contrarian, even if it involves being early, as this is always where one can find the best value.

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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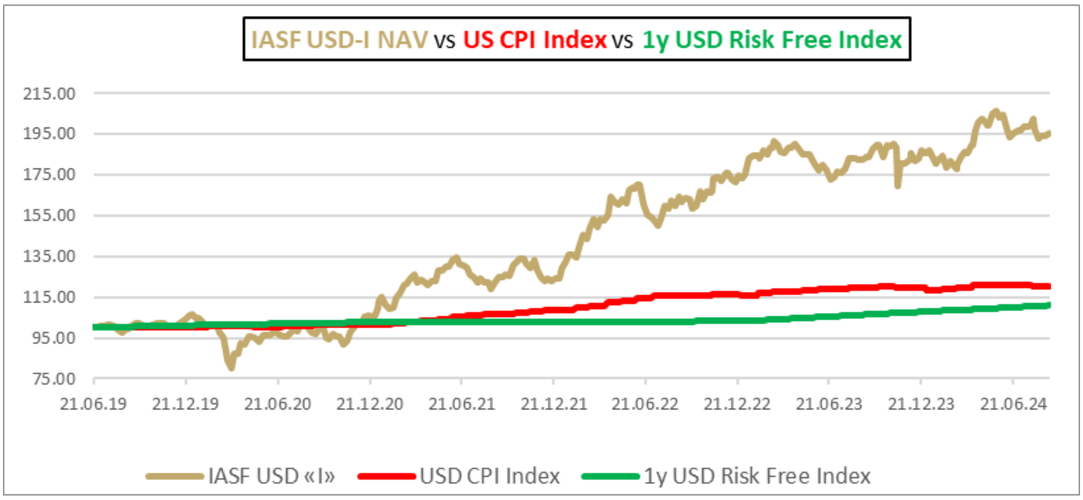
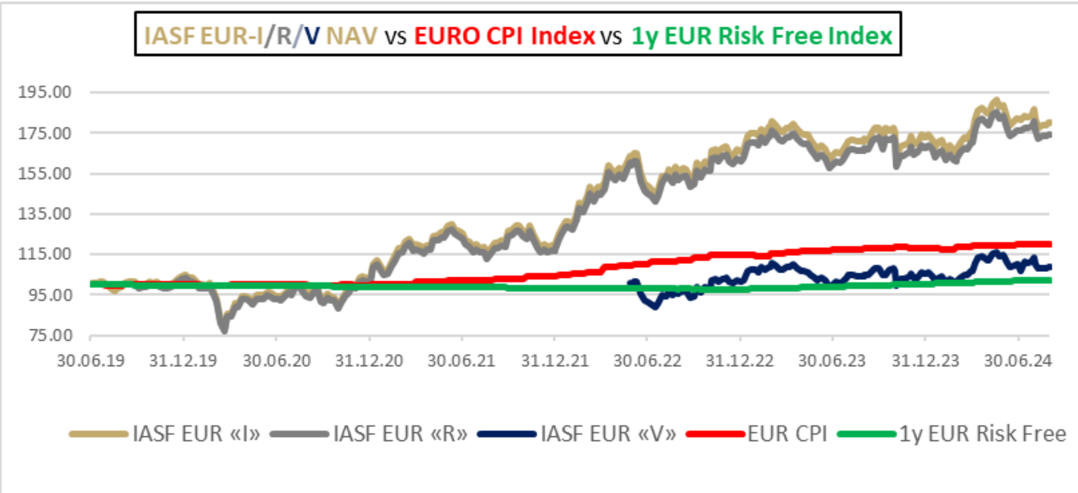
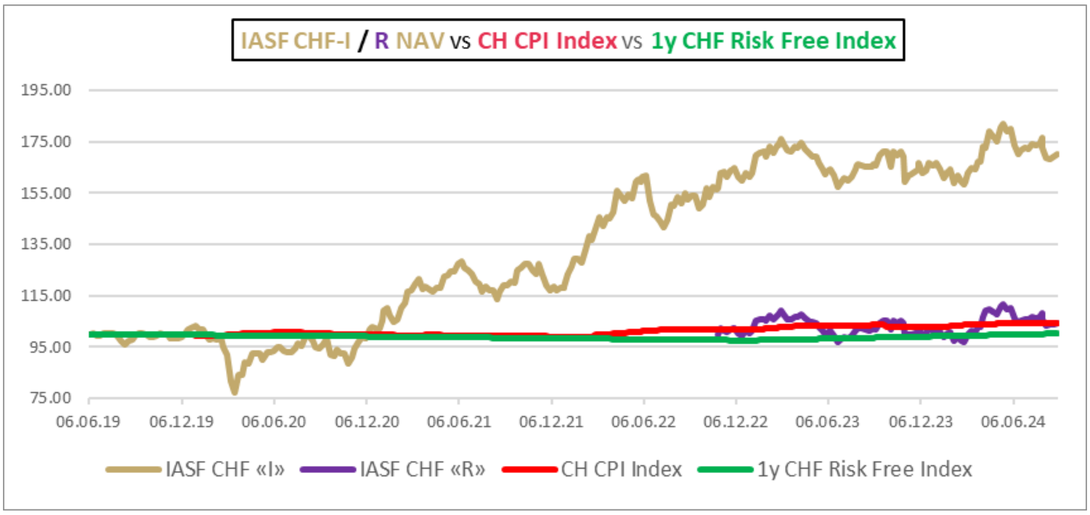
Appendix *







* Graphs display NAV (I- and R-shares) of IASF performance until last valuation date (**30 AUG 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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