Incrementum All Seasons Fund

– in pursuit of real returns –

2022 / 01

Seasonal Reflections

As goes January, so goes the year…

Dear Reader / Investor,

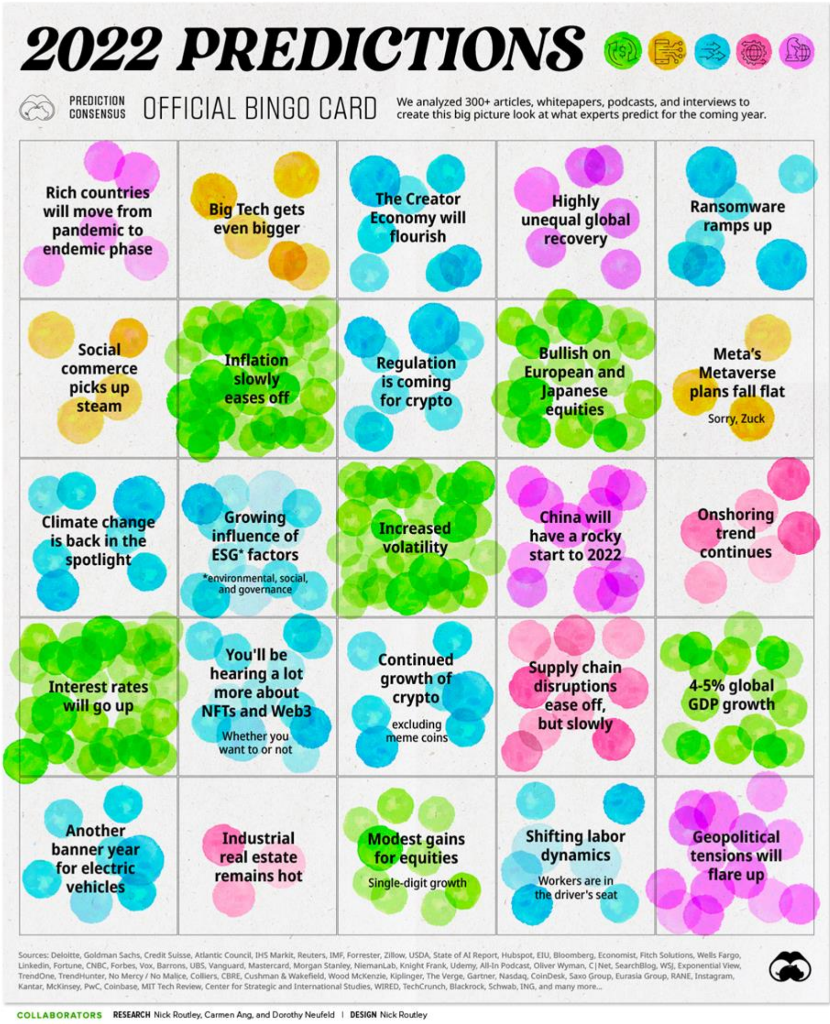
Time has passed in a flash since my last update, and as it has taken me nearly a month to finish this report, winter has almost passed. With the war against Covid seemingly over, we are now witnessing a real war following Russia's move against Ukraine. I can only pray for peace and a will to de-escalate, though right now that prospect looks as bleak as the fog-covered Rhine valley in winter, which sometimes has us forget that we merely need to climb up to find light and winter in all its majesty.

View from Triesenberg, FL, HGS pic

The day I began writing this piece, however, the sky is clear again, and the vista almost begging me to go skiing. However, for investors looking at financial markets, the view is rather murky. January was the worst equity month since the Covid-infected January of 2020, while its intra-month trough of -11.4% for the S&P500 was the worst recorded January drawback in history, even if half of that was recovered by month-end. What made matters worse for diversified portfolios was that bonds also corrected, leading to one of the worst months for conventional 60 : 40 (equity : bond) portfolios. So, will 2022 be a year when the old Wall Street adage *"As goes January, so goes the year"* prove prescient again?

2021 was by most accounts a truly extraordinary year. The second year of the global Covid-19 pandemic, it delivered surprising economic growth rates coupled with what seems for most observers an even more surprising spike in inflation. It also suffered another speculative heat wave in financial and broader asset markets, which I reckon will be one for the history books, and about which I have written comprehensively in prior reports. And just as everyone seemed to think that this party will never end, 2022 delivered a first, though arguably still timid wake-up call.

In a way, that was hardly a surprise, considering the below shown 2022 Consensus Predictions Bingo Card, which displays the relevant financial market predictions in green:



Source: What the Experts See Coming in 2022, Visual Capitalist, 6JAN2022

A comparison of my own expectations for 2022 with the consensus highlights where I see opportunities and risks in financial markets this year and helps to explain the Incrementum All Seasons Fund's (IASF) positioning:

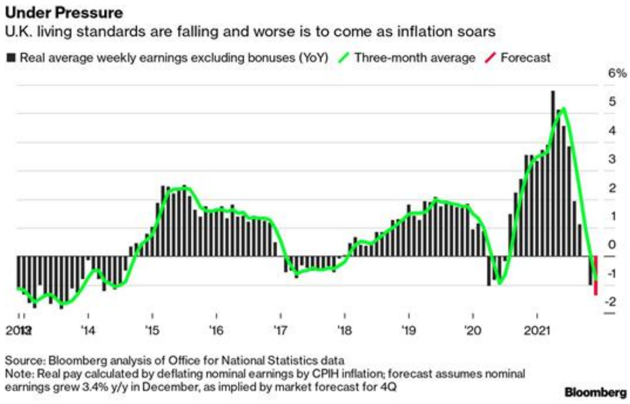
"Inflation slowly eases off" – Yes, maybe, but I see zero chance for a return to 2% in 2022 or anytime soon. In other words, the inflation genie is out of the bottle.

"Bullish on European and Japanese equities" – The word "Relatively" should have preceded that statement. Yes, European, and Japanese stocks are cheaper than US ones, but I doubt that on an index basis they can deliver positive returns this year.

"Increased volatility" is not only already evident, but the inevitable consequence of reduced liquidity amid by now indicated or already announced central bank tightening.

"Interest rates will go up" is probably the most important statement. That they are going up is evident, as January already saw a nearly 30bp increase in 10y yields, while the yield curve flattened, i.e., short-term rates rose even more. At the time of writing (10.2.) this and following another surprisingly strong US consumer price inflation (CPI) print (+7.5% YoY), which so far shows little inclination to reverse course, US 10-year Treasury yields have just breached 2%. These so far minuscule interest rate increases have been primarily responsible for the financial market stress observed so far this year, even though they are not even remotely keeping up with soaring inflation. Personally, I am convinced that by how much interest rates will go up this year is the most important question for investors.

"4-5% global GDP growth" sounds like the usual analysts' optimism, especially when one recalls that inflation acts as a tax on all spending. As the example of the UK shows, inflation is currently rising faster than incomes, and it will take some time for the latter to catch up. Together with higher interest rates and tighter credit these headwinds for consumption make this prediction i.m.h.o unlikely to be achieved, at least on a real (i.e., inflation-adjusted) basis.



Source: Bloomberg, 15FEB2022

"Modest gains for equities", further qualified by the addition *single-digit growth,* is the last on the list, to which I can only say that in more than three decades in the business I cannot recall any year in which the consensus foresaw losses for equities… – So, as far as outlooks are concerned this is as bad as they come.

interest rates (and stock markets) – quo vadis?

Investors have generally remained rather sanguine about the financial market outlook for 2022. Consensus envisages a monetary tightening attempt by central banks, but also anticipates that they will back off as soon as a more serious asset price correction is in the books. As markets appear already almost halfway there, that makes the outlook hardly threatening. After all, if the famous Fed Put (option), i.e., central banks stepping in and doing WHATEVER IT TAKES to prevent a serious correction in financial asset prices in order to avoid any negative impact on the underlying economy, is still in effect, then the rally will resume immediately afterwards. Thus, there would seem little reason to sell equities in the first place. After all, TINA, i.e., There Is No Alternative (to equities), continues to rule.

As fundamental investor I have struggled with the Central Bank Put concept ever since it has been floated. After all, markets are cyclical and tend to follow seasonal patterns. Using equity markets as example, coming out of a recession (winter), prices are cheap and with the trough of economic activity passed, funds flow into equities during the market spring. Initially, interest rates remain low and credit conditions benign, supporting the rise in asset prices and valuations during the summer. A strong underlying economic recovery creates jobs and delivers higher inflation, which Central Banks try to halt by hiking rates and tightening credit, while risk sentiment is still strong, causing higher volatility during the markets' autumn. And finally, economic growth slows, and a recession ensues, causing share prices to fall in winter, which central banks counter by easing again. – Wash, rinse, and repeat.

This used to be the fairly predictable seasonal pattern in the economy and financial markets, though with interest rates reaching the zero bound, central bank policy has become increasingly ineffective, as we have extensively described in prior issues.

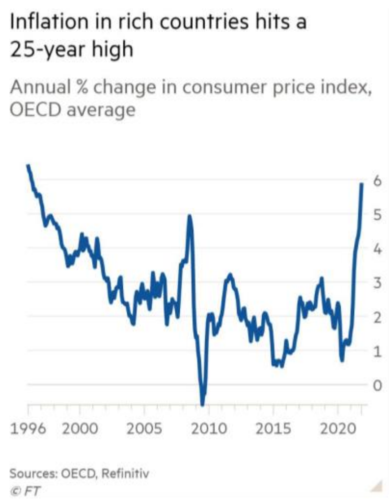
But as each wave of the interest rate cycle got weaker and crested at lower levels, another important consequence became increasingly evident, to which we allude to in the opening chapter on IASF's website.

Financial market seasons have been increasingly influenced by the end of the secular debt cycle and are accompanied by financial repression and long-term negative real interest rates. We aim to tackle these changes with a global, adaptable, all-seasons investment strategy.

Further lowering nominal interest rates during each subsequent cycle encouraged the use of more leverage in the economy, i.e., overall debt-levels rose as carrying cost fell. The same household borrowing cost budget permitted the purchase of a more expensive house, or companies to take on more debt to fund expansionary investments and (far more often) share buybacks, or governments to wave through an endless string of budget deficits. Each time we borrow money we raise our spending capacity beyond what our incomes would permit, but at the expense of our future spending ability which is reduced by the interest cost on the newly added debt.

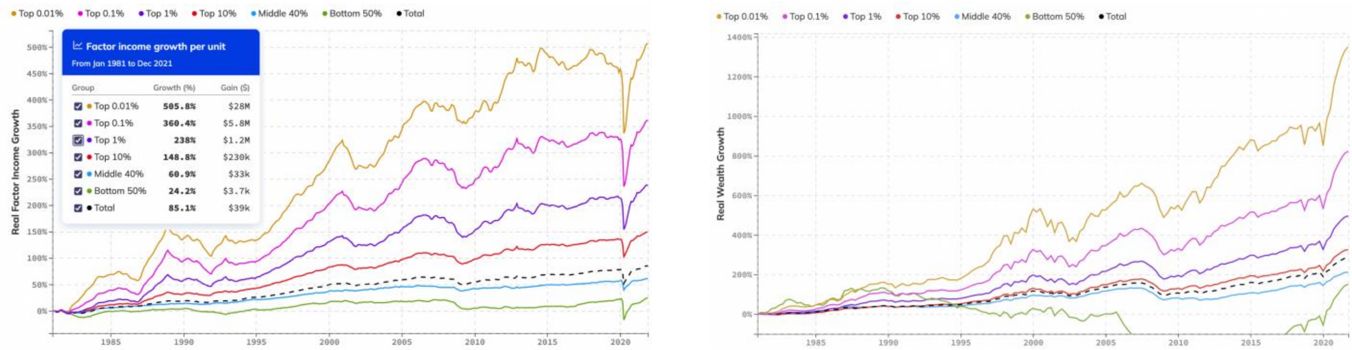
All this was just marvellous as long as it seemed that inflation would never reappear, but now that it has, I wonder whether the Central Bank Put is not about to expire. After all, for at least the past decade central banks could argue that a recession had to be avoided because inflation was regarded as too low, and a growth slowdown risked triggering the dreaded deflationary spiral. However, with inflation rates apparently on their way to the moon, central banks (not only in the US, but also in Europe and other advanced economies) are at risk of losing their credibility as guardians of currency stability and purchasing power. Hence, a recession and related asset price correction may be the only way to prevent run-away inflation.

The chart next to this paragraph is just a month old and already seems somewhat dated, but I think it is sufficient to convey the gravity of the shift we have experienced over the past year. I seem to have written about this ad nauseam, but inflation has ever and will always affect low-income / -wealth households the most. Is anybody seriously assuming that in a context of soaring food, energy, and housing cost, i.e., the very things that dominate low-income household expenditures, will not cause political backlash? Put differently, after decades of asset price inflation, which has caused the wealth gap, especially in the US, to reach the most extreme levels ever, can elections really be won without a promise to stem the rapid erosion of purchasing power?



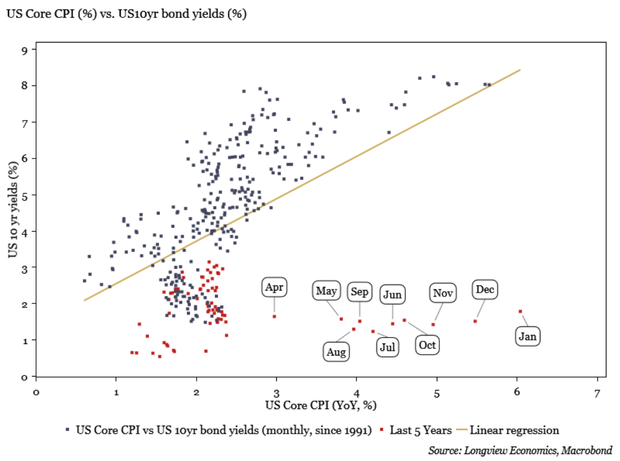
Source: FT Europe Express, 12JAN2022

Personally, I am convinced that in the age of Social Media the below shown graphs will increasingly matter and cause some serious headaches to the political class.



Source: The Big Picture, Barry Ritholtz, 7FEB2022

The argument that central banks will be unable (or unwilling) to sufficiently tighten monetary policy to arrest inflation ultimately rests on the believe that such action will crash asset markets and risk causing a recession and thus cannot be allowed. But as prior monetary largesse has blown an epic asset bubble without doing much for underlying economic growth, central bankers and politicians praying for re-election may just hope that taking away the monetary punch bowl will not cause too much economic damage. Hence, the pain threshold that causes central banks to pivot again to prevent damage to the economy and markets may be higher than anticipated. – This is crucial for investors to consider.



Source: Longview Eco.'s, @Lvieweconomics, Twitter, 10FEB2022

For now, the authorities are desperately behind the curve, as the graph on the left clearly shows. It highlights how over the past 5 years the US Federal Reserve has already pursued an unusually easy monetary policy, though the last 10 months have turned into a completely new ballgame. (By the way, most of what I am describing here is valid in similar form for Europe as well, where politicians and central bankers are also slowly waking up to the fact that inflation may not be transitory after all.)

And how far behind the curve central banks have indeed been falling has been regularly shown with almost any inflation statistic update in recent months, with the latest case causing me to post the following question on Twitter just now. – Investors may begin to realize this already…

Source: Twitter

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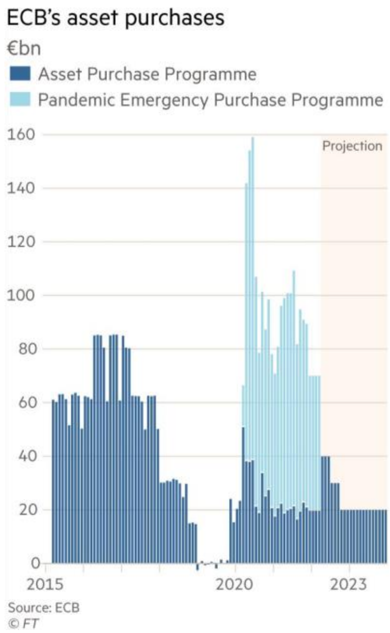
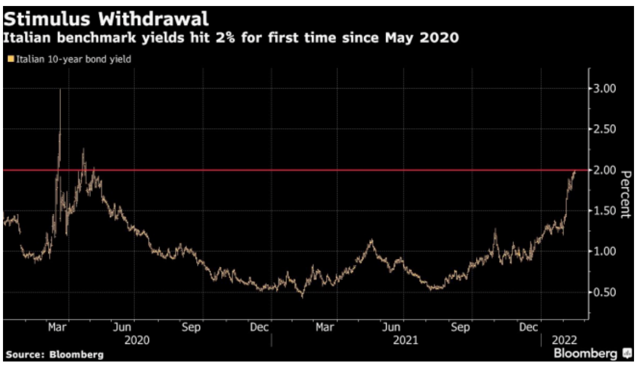
Our core thesis in managing **IASF** is that the inflation genie is out of the bottle, even if amid base effects the rate of acceleration will likely slow down over the coming months. But we reckon they have a snowball's chance in hell to return to the sacred 2% level.



Source: Chart Du Jour, FT, 10JAN2022

Hence, central banks will have to hike interest rates this year and longer duration bonds have yet to respond to the looming halt of central bank bond buying. The Fed is determined to end its bond buying / balance sheet expansion (aka Quantitative Easing, or short QE) by the end of 1Q22. And here in Europe the ECB is also on course to reduce its government bond purchases. Considering that since 2008 ECB QE has indirectly financed 80% of net new debt issuance in the EU, we wonder who will then be the buyer of last resort for government bonds and more importantly at what rates? And what will the primacy of government budget funding do to other asset markets, especially equity prices?



Source: H. Zschaepitz, @Schuldensuehner, Twitter, 16FEB2022

I reckon we are going to find this out soon! Interest rates will not return to positive inflation-adjusted levels for years to come as the financial repression playbook is dusted off once again, but I expect nominal rates to rise more than is currently anticipated by most market watchers. That will be especially painful for more highly indebted countries and hence restrict the ECB earlier than the Fed.

All in all, this helps to explain a) why **IASF** does not own any bonds at this juncture, and b) why we continue to maintain a negative view on long-duration assets like growth stocks, which finds expression in the fund's short Nasdaq position.

no shortage of shortages

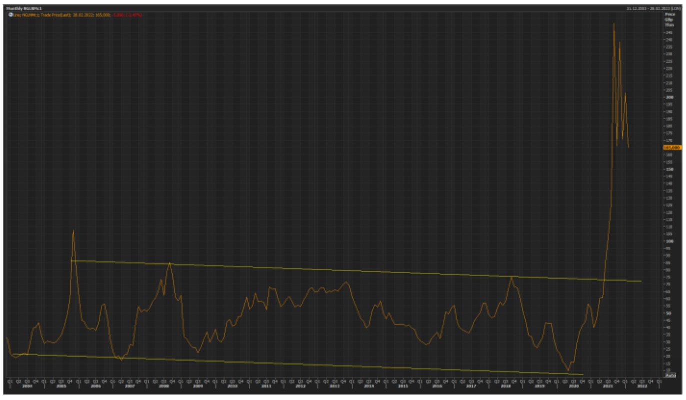
Following growing interest on the subject, I guess this is an appropriate time to talk about commodities, which are probably the most underrated input factor in our modern societies right now.

Our current political agenda is dominated by the green energy transition and the quest to reduce CO_2 emissions to prevent global warming. Last November this culminated in COP26, a global environmental conference with the stated aim to reduce the worst impacts of climate change. The resulting Glasgow Climate Pact was lauded as a global agenda (as it was not legally binding) on climate change, made up of pledges to further cut CO_2 emissions, especially via commitments to reduce the use of coal and to phase out fossil fuel subsidies, the urge to cut greenhouse gas emissions and promises of more climate related financings for developing countries.

Apart from the fact that COP26 failed to yield any meaningful enforceable actions, what we find curious here is that there appears to be a distinct lack of comprehensive cost-benefit analysis, a feature that seems absent in much of our political decision-making these days. I mention this because markets are already signalling a growing shortage of commodities, which are crucial to maintain our standard of living. The table below lists price changes for major commodities over the past and shows that especially energy became significantly more expensive in 2021, while the only commodities experiencing (modestly) declining prices were precious metals (following a very strong performance in 2020).

Source: Visual Capitalist, 11JAN2022

If coal is such nasty stuff that we are determined to reduce its use as energy source, why did its price go up 160% last year? – Well, here in Europe political leaders in most countries have decided to switch off nuclear power plants as reliable base load source, my native Germany being at the forefront of this trend. That means uranium as base load fuel source had to be replaced by something else and that has been natural gas, which as the graph below on the left shows has become far more expensive, and indeed coal, which has also seen prices soar in the process. That in turn had a not entirely unsurprising effect on (German) power prices.

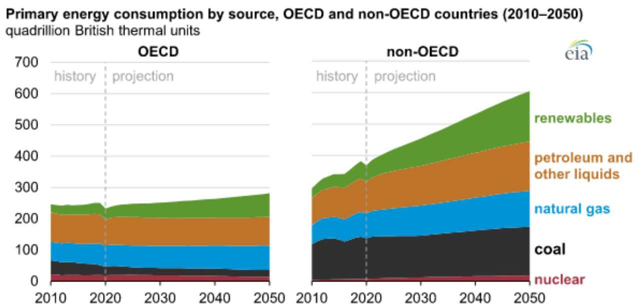


Natural Gas Futures, Intercontinental Exchange, Source: Eikon/Refinitiv

Source: The Case for Peak Hawkishness, The Lykeion, 17FEB2022

Especially the developed world seems to have forgotten that energy is the fuel of civilization. There are probably few investors who have not heard of the Metaverse. Recently, one of the most highly valued companies in the world has changed its name to Meta (fka Facebook), and the younger generation spends plenty of time in front of their computers and gaming consoles, many of them obviously ready to escape into the virtual reality. Cryptocurrencies have been at the centre of investors' attention as well, built on decentralized computer networks that require a growing amount of electric power to run. It almost seems as if we as society are taking cheap electricity for granted.

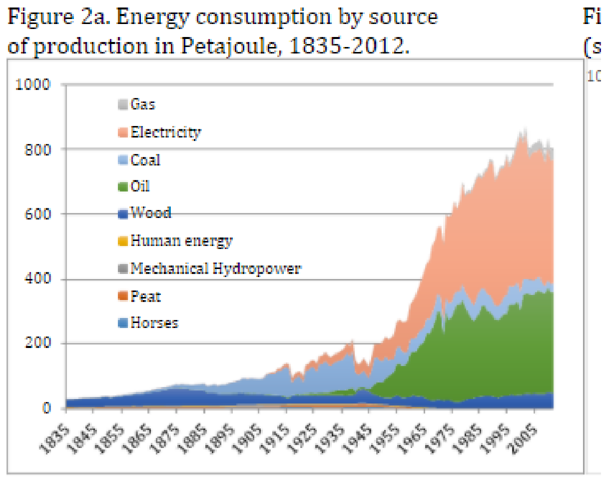
In this context it might be useful to check out these two graphs, which display expected primary energy consumption by source for OECD and non-OECD countries from 2010-50 as forecasted by the US EIA. What is evident here is that energy demand will be driven by developing, not advanced economies. To quote from the accompanying commentary:



Source: U.S. Energy Information Administration (EIA)

"…we project that, absent significant changes in policy or technology, global energy consumption will increase nearly 50% over the next 30 years. ***Although petroleum and other liquid fuels will remain the world's largest energy source in 2050****, renewable energy sources, which include solar and wind, will grow to nearly the same level."* (Source: U.S. Energy Information Administration (EIA); emphasis mine)

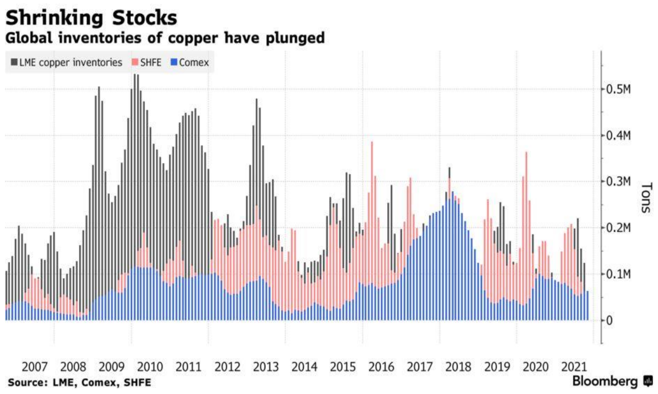
Hence, despite of expected rapid growth in renewable energy sources, fossil fuel demand will continue to rise, driven by developing economies as they enter the steepest part of the energy intensity curve. – How energy demand rises with the development of an economy is shown in the example of Norway on the right. Use this as blueprint for a country like India, which is rapidly urbanizing and where people strive to advance their living standards to include motorized transport, air conditioners, etc, and the driving force for overall energy demand becomes obvious.



Sources, Lindmark and Minde (2018) and Grytten (2020)

Source: Energy Intensity and the Environmental Kuznets Curve

And yet in advanced economies we intentionally pursue policies that aim to prevent new developments of fossil fuel resources. The goal here is to make fossil fuels more expensive, which as a result is supposed to make renewable energy more competitive. But what happens when a lack of investment into new exploration leads to a shortage of crucial energy fuels? – We know that energy demand is rather price inelastic, i.e., shortages if they develop will result in the available supply going to the highest bidders. Who will suffer from this? – Those (countries and people) that can least afford to pay such high prices.



Source: Bloomberg, 19OCT2021

This is not only the playbook for energy. As advanced economies we have for example decided to favour EVs over traditional ICE powered vehicles. That alone requires not only massive amounts of copper, zinc, lead, and cobalt for battery production, but also a revamp of our electric grid which is equally commodity intensive. As a result, copper prices have doubled over the past two years, while global inventory levels have fallen to very low levels.

FAO Food Price Index, Source: UN FAO

Meanwhile, rising labour, machinery and fertilizer cost, and the ongoing shrinkage of arable land have had food prices approach 50-year highs in inflation-adjusted (i.e., real) terms, as the graph on the left shows. As mentioned earlier already, this represents a painful tax hike for low-income households, and an inflation-driver that monetary policy is unable to reverse.

So, the combination of reduced investment in commodity exploration and production and rising demand has led to soaring prices for crucial commodities, whether it is in the energy space, where OPEC has been unable to fulfil its production quotas, and international oil majors have for years been underinvesting into reserve replacement and thus will experience lower production going forward, or in other commodity areas, e.g., industrial metals and agricultural commodities. And as present geopolitical circumstances remind us, we have also neglected to ensure the reliability of our supplies (Russian oil and gas comes to mind). And in relation to my earlier chapter, this promises that commodity price-driven inflation pressures will remain high and thus further debase the purchasing power of our money, whether it is EUR, CHF, or USD.

the role of ESG

One way commodity producers have been cut off from necessary capital to maintain their reserve levels and thus future production capacity was through the introduction of ESG (Environmental, Social, Governance) standards and related regulations, which in turn have spawned a major trend in sustainable investing.

Once upon a time, (portfolio) investments were determined solely by the economic return they generated for the investor, i.e., how they increased the invested funds through expected distributions and growth in net asset value. This solely rational economic investment approach was initially somewhat restricted by *"ethical investing"*, which was derived from religious values. In Islam, for example, there is a ban on lending money at interest, which led to modern Sharia-compliant investment approaches. Predominantly based on Christian values is the principle of avoiding investments in "sinful" companies and sectors, such as manufacturers of alcohol, tobacco or weapons, or operators of casinos, or distributors of pornography. Although this brought about a slight restriction of the investment universe, “ethical investing” did not alter the exclusively return-oriented investment selection.

However, over the past decades this ethical approach has morphed into what is now labelled *"socially responsible investing"*. In a New York Times article more than 50 years ago, economist and Nobel laureate Milton Friedman still dared to criticise calls for more "social responsibility" on the part of companies and managers. Anyone who takes the trouble to read the article will find that it represents a rather more liberal spirit than the one prevailing today. In fact, with its emphasis on self-responsibility and accountability it seems almost radical: *"This is the basic reason why the doctrine of "social responsibility" involves the acceptance of the socialist view that political mechanisms, not market mechanisms, are the appropriate way to determine the allocation of scarce resources to alternative uses."* – Well said!

A reflection of his time is also the recurring reference to the inflationary theme prevalent at the time, as well as the belief that corporate profits that are too low could lead to a manager's dismissal by shareholders. Fifty years later, the pendulum seems to have swung to the other extreme in every respect.

Other passages sound quite familiar as well: *"But precisely the same argument applies to the newer phenomenon of calling upon stockholders to require corporations to exercise social responsibility (the recent G.M. crusade, for example). In most of these cases, what is in effect involved is some stockholders trying to get other stockholders (or customers or employees) to contribute against their will to "social" causes favored by the activists. Insofar as they succeed, they are again imposing taxes and spending the proceeds."* - Plus ça change, plus c'est la même chose.

Milton Friedman's philosophical reflections left a deep mark, as despite of possible ethically induced selection restrictions the past decades of the last century were strongly characterised by the idea of *"Shareholder Value"*. This provides for unrestricted profit maximisation for the benefit of shareholders and had a formative influence on the stock market boom in the 1980s and 1990s. Since the turn of the century, however, this view has slowly changed and has increasingly given way to the idea of *"Stakeholder Value"*, which stipulates that companies should also pursue responsibilities other than profit maximisation.

Under the heading "*Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'*" this culminated in 2019 in the stipulation of the following principles of corporate governance by one of the largest employer organisations in the US:

"While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders. We commit to:

- *Delivering value to our customers. We will further the tradition of American companies leading the way in meeting or exceeding customer expectations.*

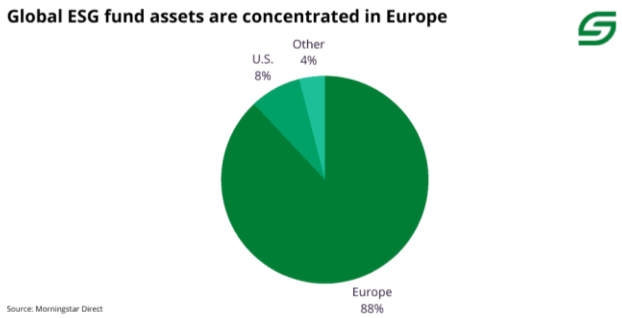
- *Investing in our employees. This starts with compensating them fairly and providing important benefits. It also includes supporting them through training and education that help develop new skills for a rapidly changing world. We foster diversity and inclusion, dignity and respect.*
- *Dealing fairly and ethically with our suppliers. We are dedicated to serving as good partners to the other companies, large and small, that help us meet our missions.*
- *Supporting the communities in which we work. We respect the people in our communities and protect the environment by embracing sustainable practices across our businesses.*
- *Generating long-term value for shareholders, who provide the capital that allows companies to invest, grow and innovate. We are committed to transparency and effective engagement with shareholders.*

Each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country."

And so, an exclusively shareholder- and thus owner-oriented approach turned into a socially responsible approach to corporate governance, in which long-term value creation for the owner / investor suddenly landed in last place among the goals being pursued.

One important outcome has been the trend to sustainable investing, which increasingly requires investors to observe and take ESG related efforts of their portfolio companies into consideration.

According to SustainFi/Morningstar global sustainable fund assets reached USD 3.9tr as of last September. This was 136% higher than year-end 2020, and more than 3 times the level registered at the end of 2019. The majority of these assets is held in Europe, and they are managed via 7,486 funds (up from 4,153 in 2020), highlighting the popularity of the theme.



Source: SustainFi.com

Performance-wise, the MSCI World ESG Leaders Index enjoyed a 25.3% return in 2021, thus handily beating the 21.8% advance of the MSCI World Index over the same period, which is expressed in slightly higher valuations overall. That combination of strong performance and ethical reassurance is sufficient to explain the torrent of inflows into the sector.

Perhaps not surprisingly, six out of the top ten holdings in the MSCI World Index are also among the top ten holdings in the MSCI World ESG Leaders Index, which in itself is evidence for the kind of inbreeding the past decade of passive investment growth has delivered.

TOP 10 CONSTITUENTS

	Index Wt. (%)	Parent Index Wt. (%)	Sector
MICROSOFT CORP	7.48	3.76	Info Tech
ALPHABET A	2.74	1.38	Comm Srvcs
TESLA	2.66	1.33	Cons Discr
ALPHABET C	2.63	1.32	Comm Srvcs
NVIDIA	2.06	1.04	Info Tech
JOHNSON & JOHNSON	1.53	0.77	Health Care
PROCTER & GAMBLE CO	1.31	0.66	Cons Staples
HOME DEPOT	1.30	0.66	Cons Discr
VISA A	1.29	0.65	Info Tech
MASTERCARD A	1.15	0.58	Info Tech
Total	24.15	12.14	

Source: MSCI World ESG Leaders Index, latest Factsheet

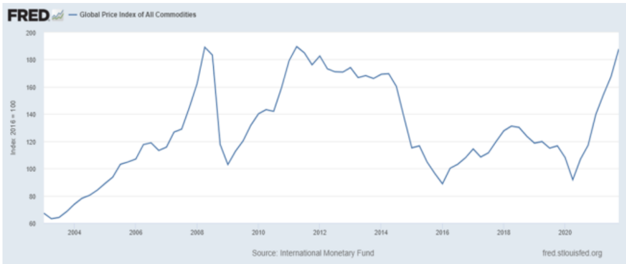
TOP 10 CONSTITUENTS

	Float Adj Mkt Cap (USD Billions)	Index Wt. (%)	Sector
APPLE	2,889.14	4.89	Info Tech
MICROSOFT CORP	2,220.13	3.76	Info Tech
AMAZON.COM	1,363.50	2.31	Cons Discr
ALPHABET A	814.76	1.38	Comm Srvcs
TESLA	788.26	1.33	Cons Discr
ALPHABET C	782.03	1.32	Comm Srvcs
META PLATFORMS A	746.75	1.26	Comm Srvcs
NVIDIA	612.15	1.04	Info Tech
JOHNSON & JOHNSON	453.55	0.77	Health Care
UNITEDHEALTH GROUP	445.59	0.75	Health Care
Total	11,115.88	18.82	

Source: MSCI World Index, latest Factsheet

What is clearly missing from both lists are any kind of commodity producers, whether it is major oil and gas companies or the diversified miners. In fact, these are mostly companies of the digital age, not companies that help providing the necessary inputs to build our economies and fuel growth.

And so, the global energy and mining industry has fallen on hard times in recent years. After the last commodity cycle peak in 2011, prices fell for four years and crawled along the bottom of the barrel for another four, which brought even a number of large companies close to bankruptcy.



Source: FRED Economic Data, St Louis Fed

That was partly due to the fact that as always in cyclical industries the prior bull markets had sown the seeds of the subsequent bear market, following the old saying: *"The cure for high prices is high prices"*. At the same time, though, low commodity prices implied to investors and society at large that commodities are in ample supply, which is why the need to secure sufficient supply stability and investment into reserve replacement was hardly given any thought. As the above-mentioned inflows show, investors have widely shunned the sector and preferred to pour money into all manner of green strategies. Meanwhile, major investors have excluded sectors like oil and gas extraction from their investment mandates, e.g., Norway's (and the world's largest) sovereign wealth fund, which started withdrawing from coal in 2015 and decided to offload USD 10bn worth of oil and gas stocks in 2019. And even a small firm like Incrementum is required by law to formulate its stance towards sustainability / ESG, which we have done with a Statement published on our website last year.

Thus, as traditional commodity producers face ever stricter environmental regulations and cumbersome project permitting processes, they are in many cases cut off from conventional project financing and generally shun by the investor community. Is it any wonder that this has done little to promote the required reserve replacement investments? – As a result, ongoing growing commodity demand meets increasingly tight supplies, which has laid the foundation for a super bull market in commodity prices, which in turn has sown the seeds for a period of economic stag(-nation/in-)flation.

all seasons investing

At the time of writing this chapter (Sunday, 27FEB), it has only been a few days that Russia has begun its war with Ukraine, an act of aggression that has resulted in a broadside of sanctions against it from the US and the rest of Europe. However, it is telling that the first round of sanctions specifically excluded energy. After all, stopping the flow of energy from Russia to Europe is impossible when you are faced with the following realities:

@antoguerrera, Twitter, 24FEB2022

I reckon this is the appropriate moment to admit that I did not anticipate a full-scale Russian invasion of Ukraine to be the most likely outcome following many weeks of postering and sabre-rattling. Personally, I still wonder what caused Vladimir Putin to dare such an exceptionally risky military strike, which after the first few days and even considering limited visibility hardly seems like it is going as planned. All we can do now is pray for this war to come to an end swiftly and with minimal casualties. But even in the most optimistic case of a short-term resolution, Russia's aggressive move will not only intensify the global energy crisis (and general commodity shortage) but also trigger a new round of arms build-up, which will further strain government resources that would better be deployed elsewhere. And as such it is not only a terrible and tragic development but also opens up the path to stagflation.

With all of this born as backdrop in mind, this seems like a suitable opportunity to talk about All Seasons investing, as I understand it and thus as it is important for investors in the **Incrementum All Seasons Fund (IASF)** to understand. All Seasons investing is more than the exploitation of quantifiable seasonal market patterns (*"Sell in May and Go Away"* comes to mind), or any other quantitatively determined cyclical economic or market patterns. Instead, we acknowledge the inherent cyclicality in life as much as in investing, while (as the sudden war in Ukraine proves) as investors we have to accept a certain degree of inevitable unpredictability of events which does occasionally make life so surprising and investing so challenging.

Arguably, especially the last statement may not reflect the experience of many investors over the past decade, when the embedded Central Bank Put and aggressive balance sheet expansion, coupled with the growing financialization of our economies and accompanying indexation of investing, created a perfect, low risk / volatility environment, where investors merely had to buy the dip and otherwise hold, or HODL as they say in crypto space. But this particular confluence of factors is extremely unlikely to be sustained going forward.

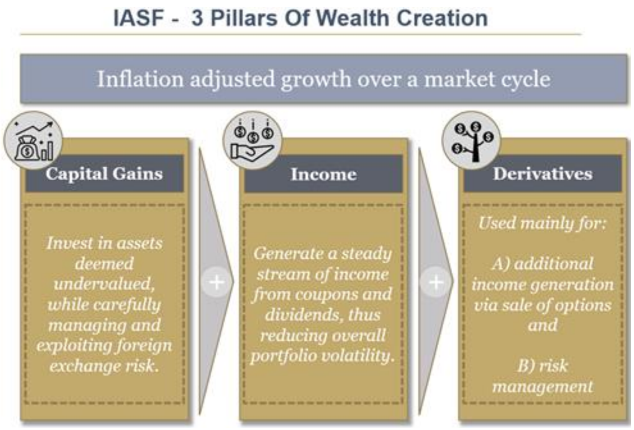
Hence, we would argue that we have been entering a more tumultuous period of change that will give a global, active, flexible, benchmark-unconstrained quest for absolute returns, irrespective of the prevailing financial market season, a better chance to achieve absolute real (as in inflation-adjusted) returns. – How do we go about achieving that?

First of all, we are investment generalists, not specialists. We look at the underlying political, economic and market backdrop first to determine which asset classes deserve to be included in the fund's portfolio. Generally, these are cash, bonds, stocks, and commodity related investments.

Mostly relevant to determine what is worth finding a place in our portfolio are fundamental observations: Is an asset class cheap, i.e., does it have a favourable risk-/return outlook, given the before mentioned political, economic and market backdrop, and if so which particular sectors or investment themes appear especially promising? – Currently, we favour equity and commodity related investments on the risk side, while holding about 20% cash to give us optionality in case of unexpected opportunities. Here investors should note that as a European UCITs fund structure, **IASF** is not allowed to use leverage.

What is cheap is not always as easy to determine as it sounds, and if mere quantitative analysis were sufficient, quant funds would rule the investing world. But they do not, and I have seen enough value traps in my career to last a lifetime. A sector theme may look cheap, but which individual investments do we choose? – Some investors prefer ETFs to gain exposure to certain investment themes, but we clearly prefer individual stocks, because we have learnt that there is a huge gap between the top and worst performers in a given sector. Quality and consistency of management plays a major differentiating role here, as well as countless other factors. Our aim is not to work out in Benjamin Graham style the intrinsic value or exact margin of safety of an investment. The father of value investing postulated that *"An investment operation is one which, upon thorough analysis, promises safety of principal and an adequate return. Operations not meeting these requirements are speculative."* Though we can relate to this, it also brings an old proverb to mind, namely *"It's difficult to make predictions, especially about the future."* – With this in mind, we generally make investments that following our due diligence promise a priori safety for principal and an adequate return, though that *promise* is not always kept.

As investment managers we base our allocation process on three pillars of wealth creation, on which we ultimately rely on for accruing value within **IASF**. First, there are capital / price gains, which are the main source of value accretion in our modern day and age, and which mainly derive from the individual portfolio holdings, as well as from related exchange rate fluctuations, which in a global investment portfolio cannot be underestimated.



Secondly, there is regular income from individual investments, be it interest income (exceedingly rare presently) or dividends. In 2021, the fund had no interest income, but earned EUR 1.13m in dividends, which amounts to 2.5% of average capital used.

Thirdly, there are derivatives, which create value in two ways. On the one hand, through the sale of options and the resulting collection of option premiums. In 2021 this was mainly done on / around **IASF's** existing stock holdings, as well as to a small extend through the sale of FX options and yielded about 5% of total NAV in the process. On the other hand, **IASF** uses FX forwards to manage its foreign exchange risk, as well as equity futures to manage its equity or interest rate risk, and that also affects returns. Last year, this partial hedging of overall equity market risk was particularly costly, with a negative contribution of approx. 11% of NAV, while currency hedging has had a positive return overall.

Given the highly uncertain nature of financial markets, the art of investing is to have the majority of your return resources delivering as expected, thus overcompensating any unexpected negative return contributions. That has worked reasonably well last year, as the table below on the left shows:

	USD-D	EUR-D	EUR-P	CHF-D
latest NAV:	124.34	119.91	117.36	118.34
December Performance:	-0.50%	-0.70%	-0.73%	-0.67%
Full Year 2021:	17.52%	15.93%	15.52%	15.99%
Since Launch p.a.:	8.84%	7.31%	7.32%	6.76%

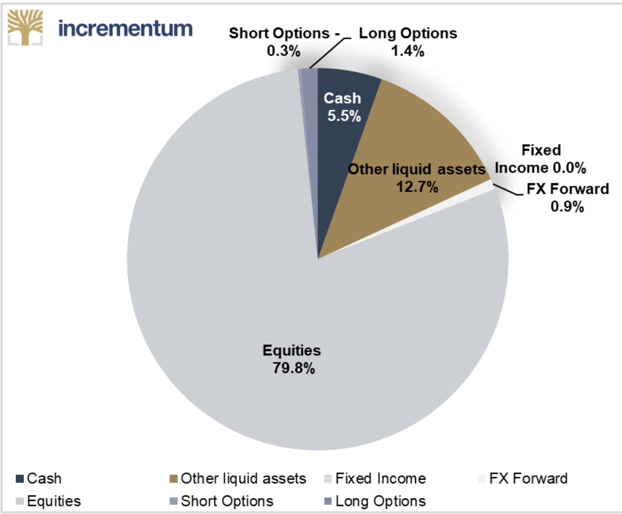
IASF Performance 2021

	USD-D	EUR-D	EUR-P	CHF-D
Latest NAV:	143.88	139.03	135.99	136.63
February Performance:	5.74%	5.75%	5.72%	5.68%
2022 Performance:	15.71%	15.95%	15.87%	15.46%
Since Launch p.a.:	14.29%	12.86%	13.57%	12.14%

IASF Performance 2022

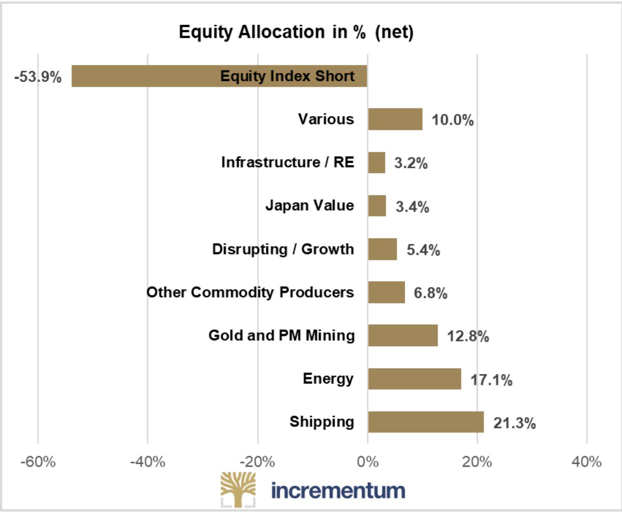
And it has worked even better so far over the course of 2022, as the table above on the right with end of February results shows. More details on monthly performance and return contributions can as usual be found in **IASF's** monthly factsheet on our homepage.

Meanwhile, and to further illustrate how our investment approach is applied in real life, **IASF's** overall asset allocation at the end of 2021 is shown on the right, which is still more or less unchanged by the end of February (equity holdings are -3.6%, in favour of cash).



IASF's asset allocation at year-end 2021

Those scrutinizing the description to the chart will notice that Fixed Income is obviously on leave of absence, as **IASF** currently (and for the past year already) has had zero allocation to this asset class. The reason is that high quality, investment-grade (government and corporate) bonds offer deeply negative real (i.e., inflation-adjusted) returns, while low quality, below investment-grade (or junk) bonds are even less investable given the still very tight yield spreads over benchmark government bonds. As investor I always liked the predictability of fixed income, though I fear it will be a few years before this may play a bigger role in our asset allocation again.



IASF's equity themes at year-end 2021

As I pointed out earlier, based on the prevailing macro-backdrop and outlook we seek to identify investment themes that we feel offer attractive risk-/reward ratios, which at the end of 2021 were ***Shipping***, ***Energy***, ***Gold and Precious Metals Mining***, ***(Other) Commodity Producers***, ***Disrupting / Growth***, ***Japan Value***, and ***Infrastructure / Real Estate***. There is a residual equity bucket, labelled ***Various***, which contains individual stocks that do not fit into the above categories, but seem to offer good value or represent interesting turnarounds.

For each of these investment themes we invest into a number of individual stocks to achieve further diversification, while allowing for active management and the harvesting of option volatility premiums to generate regular cashflows within our third pillar of value accretion. As generalists we can of course not do in-depth research for each of our potential portfolio holdings, and thus rely heavily on external (paid-for) research sources in the process. In addition, we apply a soft cap to each sector at 20% and a hard cap at 25%. This is essential for overall risk management purposes, while still providing us with the opportunity to express a high degree of confidence in a particular theme.

Lastly, there is FX exposure, which as it is also a source of alpha generation for **IASF** we manage actively, which means that at times we may hedge non-EUR currency allocation and at other times we may not, always depending on whether we expect our decisions to be value accretive to the portfolio.

In summary, *"**IASF** pursues a holistic, global investment strategy, which covers all major asset classes, and flexibly manages its underlying portfolio assets in line with the prevailing financial market season. As fund managers we pursue a theme- and value-orientated, rather than an index- and momentum-based investment approach, which is why we do not use benchmarks in our portfolio management process. For our investors we provide full transparency, both about our strategic and tactical portfolio positioning, as well as overall developments in broad socio-economic and political terms that may influence our allocation decisions. Our goal is to achieve real, i.e., inflation-adjusted growth in purchasing power for invested assets, and we have made a substantial commitment of our own capital into the fund to emphasize our alignment of interest with investors."* (Source: Incrementum's IASF homepage)

I trust this helps to provide more transparency to our All Seasons investing strategy, which is suitable for high net-worth investors with a longer-term investment horizon, who are willing to entrust an experienced management team with a mandate to grow their wealth and purchasing power.

management review and commentary to be published in IASF's annual report 2021

2021 was marked again by the global Covid 19 pandemic. While the first half of the year was still characterised by hopes for an end to the pandemic as a result of the introduction of newly approved vaccines, the second half ended with the rapidly spreading new Omicron variant, which sparked renewed uncertainty in financial markets. In addition, the world experienced increasing geopolitical tensions, especially between China and Taiwan and more recently Russia and Ukraine, which caused additional nervousness.

Economically, 2021 was an exceptional year. On one hand, growth was boosted by Covid-related government support measures, especially in the first half of the year, and on the other hand, global supply chains were under enormous pressure, which contributed meaningfully to the ascent of inflation rates toward levels not witnessed in decades. Unfortunately, monetary authorities regarded these inflation dynamics as merely transitory in nature for too long, maintaining their extraordinarily expansive monetary policy. Characterised by zero or negative interest rates coupled with massive amounts of bond purchases, this helped to ensure that long-term interest rates remained at a surprisingly low level until the end of the year. Thus, despite of a CPI inflation rate of 7%, 10-year US government bonds ended the year with a yield of only 1.5%, and German Bunds continued to show negative yields (-0.2%) while CPI rose to 5.3%. We believe that this discrepancy is mainly attributable to central banks' ongoing bond purchases, as well as the still wide-spread expectation among investors that inflation will soon revert to the familiar 2% level. On the latter we clearly disagree, as we fail to find sufficient fundamental reasons to justify such a roundabout move.

Against this backdrop equity markets had an exceptionally good year. The FTSE Global 100 Index recorded an annual increase of 26% in USD (30% in EUR). The main drivers were the leading US stock markets (US equities accounted for more than 61% of the MSCI World (ACWI) Index at year-end), with both S&P500 and Nasdaq 100 up 27% each. The 2021 equity market vintage was characterised by rarely experienced speculative excesses. Meme stocks like GameStop (GME; went from $14 to 300 and back to 100) or AMC Entertainment (AMC; from $2 to 60 and back to 16) will go down in the annals of stock market history. The IPO market and SPACs (Special Purpose Acquisition Vehicles) boom also surpassed anything previously experienced. Meanwhile, European stock markets also recorded a remarkable rise of 22% (measured by the EuroStoxx 600), while Japan's Nikkei 225 clearly lagged with a 5% increase. Chinese investors, on the other hand, suffered losses (CSI 300 -5%).

European investors benefited from the weakness of the EUR last year, both against the USD (7%) and against GBP (6%), CHF and NOK (4%). Among the major currencies relevant to us, only the JPY weakened against the EUR (-4%), which we similar to other foreign currency exposure did hedge opportunistically. The firm USD was also a reason for the disappointing performance of precious metal prices in view of the accelerating inflation dynamics. The losses for gold (-3.5% against the USD) were still limited, while they were more pronounced for silver (-11.7%) and platinum (-9.3%). In contrast, other commodity prices developed much more positively, with the price of crude oil, for example, increasing by about half and that of copper by about a quarter.

Against this overall market background, 2021 turned out a good year for Incrementum All Seasons Fund (IASF) investors as well, even if strong NAV gains during the first half of the year were slightly diluted during the second. Overall, the fund benefited from an equity weighting with a particular focus on shipping and energy, which together accounted for around one-third of total fund allocation. Both sectors recorded strong price gains, especially in the 1st half of the year, while the 2nd half was repeatedly (and especially towards the end of the year) marked by profit-taking. The fund's 3rd largest stock theme was precious metal producers (approx. 10%), a sector that delivered a rather disappointing performance in 2021 (FTSE Gold Mines Index -13%). The ups and downs of the investment business were also highlighted by our disruptive technologies/growth theme (approx. 5% allocation), where the 1st half of the year was characterised by exceptional gains and the 2nd half by significant losses. This provided further evidence of how much our modern investment industry is dominated by passive investment flows.

When looking at IASF's overall performance, it is important to note that we have been hedging the fund's gross equity allocation, which has been around 75%, with an approximate 50% short equity index position in Nasdaq and S&P 500 throughout the year. On the one hand, this reflects our realisation that the aforementioned equity indices are significantly overvalued. On the other hand, we have been convinced that last year's rise in inflation would not be transitory, and thus lead to a more restrictive central bank policy, reflected in a significant reduction in bond purchases and corresponding increases in interest rates, which however seems to have been delayed until 2022. Consequently, we expected 2021 to be a more difficult year, especially for equities with a long duration, i.e., in particular large American growth and mega cap equities, which explains the choice of short positions that we continue to hold. Moreover, as bond markets remain highly unattractive for (real) yield-oriented investors amid persistently negative real interest rates, we expect a continued rotation into hard asset and value stocks, which make up the bulk of IASF's long position. We want to emphasize here that the aforementioned short position, which cost the fund approx. 14% performance in 2021, is by no means of strategic nature. Instead, we plan to gradually reduce it as we did during the Covid crash in Q1 2020 if or better when the equity market corrects sufficiently.

Part of the negative performance contribution from the fund's equity short position was offset by our vol harvesting (i.e., option selling) strategy, which was responsible for about 5% of the NAV increase in 2021. We mainly traded equity options, with the energy sector in particular (and here Antero Resources and Peabody Energy) generating the highest revenues this year. Overall, our active management of the portfolio was reflected in more than 600 individual transactions during the year. Further information on the fund is available in IASF's investor letter Seasonal Reflections, as well as the monthly factsheet, which can both be found on the Incrementum homepage.

In retrospect, it seems almost surreal how easy it was to make money in financial and especially equity markets over the past two years. The higher the risk taken by investors, the higher the profits, and every buying the dip increased them further. However, the fact that an increased risk also corresponds to a greater loss potential seems to have been forgotten, as well as the fact that asset prices move in cycles, a lesson that will surely have to be relearned. IASF's management team is aware of this cyclicality, which is why we have described our goal for the fund as achieving real, i.e., inflation-adjusted, NAV growth over the market cycle. We have clearly achieved this goal in the 2.5 years under our management so far, and we are confident that we will be able to build on this result in 2022, despite of what we expect will be a stormier stock market.

We would like to take this opportunity to thank all investors for their trust and patience, as well as our business partners, especially our fund administrator and custodian bank, for their support in the past year, and we look forward to an exciting, hopefully profitable, but certainly very interesting investment year 2022.

closing remarks

I apologize for the delay in this winter edition of my Seasonal Reflections. Writing these is important, but not of primary priority.

At the time of finishing this piece, Russia has gone to war with Ukraine, and the future looks even more uncertain than it usually does. I pray for both sides of the conflict to aim for de-escalation and a swift return to peace, though in early March this sadly looks rather unlikely.

There are so many implications for investors that I could probably write another 10 pages about it, something that considering the delayed state of this publication I would rather avoid. Apart from the scary prospect of WW III, these recent developments will only heighten prevailing shortages, especially in energy, but also in agricultural commodities. Strategically, supply security will be an issue for most governments in the world to consider. And the war in Ukraine is raising the prospect of even further inflationary pressures, which will further reduce the economic growth outlook, thus making a stagflationary environment even more likely.

The good news for our investors is that **IASF** has had a great start into 2022, both on an absolute and relative basis, and I am glad to see my investment approach bearing fruit and delivering the purchasing power gains we are aiming for. With inflation still on the rise achieving this will not be any easier going forward. However, we are confident that we can steer our investors funds calmly and manage them competently through this tumultuous season.

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

Greetings from Schaan, Liechtenstein!

Best regards,
Hans

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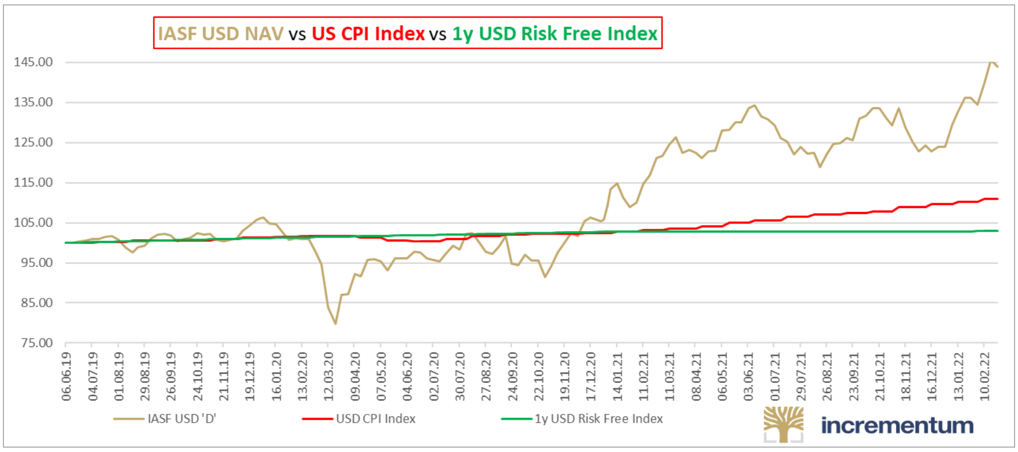
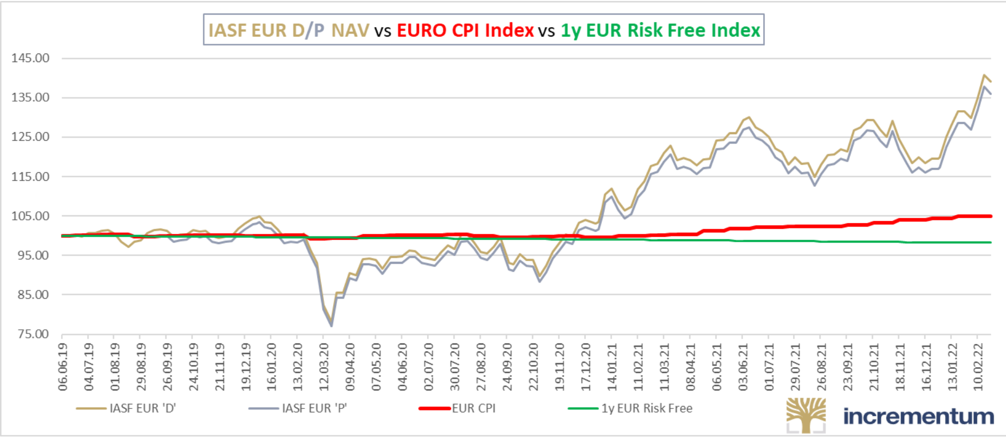
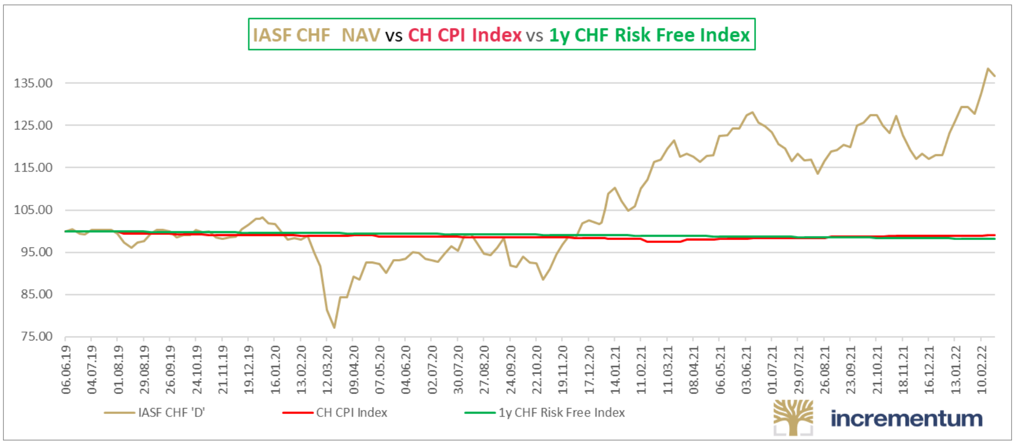
Appendix *







* Graphs display NAV of IASF performance until last valuation date (**24FEB2022**), 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 'D' shares; 26Sep2019 for EUR-P shares) on an indexed basis.

IASF PM Shaped By 8 Investment Lessons

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

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