Incrementum All Seasons Fund

– in pursuit of real returns –




2021 / 04 (DEC 2021)

Seasonal Reflections

What's going on?

quote(s) for reflection: (sections in this report written and underlined in red represent active weblinks)

"I was of the view that the late-1990s stock mania was a once-in-my-lifetime event, and here we are just 21 years later, and I would argue that this market is, broadly speaking, more expensive than what we saw in the tech bubble. Back then, the high valuations were concentrated in the top 40 to 50 stocks. Today, the median stock valuation across the market is the highest it has ever been. At the end of July, the S&P 500 median normalized price/earnings ratio was 34.2. In February of 2000, the month-end peak of the tech bubble, it was 22.2." (Source: Doug Ramsey, CIO Leuthold Group, Barron's, 27AUG2021)

"Bubbles tend to topple under their own weight. Everybody is in. The last short has covered. The last buyer has bought (or bought massive amounts of weekly calls). The decline starts and the psychology shifts from greed to complacency to worry to panic." (Source: David Einhorn, Greenlight Capital, 3Q 2020 Investor Letter, 27OCT2020)

"It may be the greatest error in history to pay extreme multiples for extreme earnings that reflect extreme margins and extreme government subsidies, while imagining those multiples also deserve a premium for depressed rates that reflect depressed growth." (Source: The Folly of Ruling Out a Collapse, by John P. Hussman, Ph.D., Hussman Funds, August 2021)

"Gold and silver miners remain undervalued on a fundamental and relative basis. Gold equities (XAU Index) have operating margins of 30.8x but are trading at 7.2x EV/EBITDA, representing substantially better value relative to broader equity markets. Both the S&P500 index and NASDAQ have operating margins of around 13x but trade at 15.2x and 24.4x EV/EBITDA (all data as at 30 June 2021). These multiples give some idea of the extent of relative undervaluation in the precious metals sector, alongside the fundamental value which we seek as active, value-driven investors." (Source: Bakersteel Precious Metals Fund, Investment Manager's Commentary, 2Q2021)

"At the beginning of February, when GameStop Corp.'s stock price became unmoored from anyone's expectations about future cash flows, I wrote a paragraph that people still tweet at me from time to time: But I tell you what, if we are still here in a month I will absolutely freak out. Stock prices can get totally disconnected from fundamental value for a while, it's fine, we all have a good laugh. But if they stay that way forever, if everyone decides that cash flows are irrelevant and that the important factor in any stock is how much fun it is to trade, then … what are we all doing here?
When people tweet this at me it is because GameStop's price is still pretty much where it was in February (though arguably a bit more justified by actual changes to the business!), and they say "so are you freaked out yet?" And, I don't know, yes? Doesn't it feel like there has been a paradigm shift, a regime change? Doesn't it feel like for the last 80 or so years there has been a dominant view of investing, a first-page-of-the-textbook given, that investments are worth the present value of their expected future cash flows? Doesn't it feel like that world has ended and a new one has begun? I should go buy some Dogecoin." (Source: Money Stuff by Matt Levine, Bloomberg Opinion, 21OKT2021)

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worthwhile reads: The Ship's Captain Died at Sea. Six Months Later, His Body Was Still in the Freezer. The Wall Street Journal, 19NOV2021

Good Luck Trying to Fix the Supply Chain Crisis, Wired, 24NOV2021

A new era of inflation, Bakersteel Research, 25NOV2021

Everything is amazing but nobody is happy by Vincent Deluard, 26NOV2021

podcasts & videos: Year of the Unicorn – Chart of the Week, Prof Scott Galloway, YouTube, 23AUG2021

The Monetary Tipping Point by Incrementum's Ronni Stoeferle at Deutsche Goldmesse, Frankfurt, 1NOV2021

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ENJOY!

Dear Reader / Investor,

Following the inaugural German / English publication of **Seasonal Reflections** at the beginning of August, this is my second step into the new bilingual writing routine. As regular readers know, **Seasonal Reflections** are published quarterly, with the aim to share my thoughts (not only) on economic and market developments, as well as to provide insights into our investment process.

This time I am quite a bit behind in the publication cycle, because in addition to everyday work duties and routines, the last few months have been marked by the passing of my father. Dad was always a very vital person but following the passing of my mum in autumn 2019, first his mental and finally his physical condition had been deteriorating rapidly, and it was ultimately a relief for him to go. For his bereaved family, however, it meant a very painful loss this autumn, which is not easy to digest.

In memory of

Günter Schiefen (1943-2021)

Autumn in neighbouring Jenins, CH, 24OCT2021, HGS

In financial markets, autumn is generally the most volatile season and characterised by frequent price corrections. However, autumn 2021 has so far been unusually warm and sunny for investors. Even October, which is notorious for sharp corrections, has merely reinforced investors' view that there is only one direction for equities and other risk assets, and that is up. I am extremely curious to see how long this assessment will prove to be correct. (More on this further below.)

Meanwhile, regular visitors of our homepage may have noticed that we have recently introduced a new motif representing our **Incrementum All Seasons Fund (IASF)**. As responsible fund manager I have chosen the *tree rings* motif, not only in reference to the **Incrementum** logo, but also because they stand for long-term growth. In addition, tree rings represent the ups and downs of the investment cycle, which occasionally result in painful price drops that leave cracks and scars, which however have always been part and parcel of long-term investment growth. – I hope you like it.

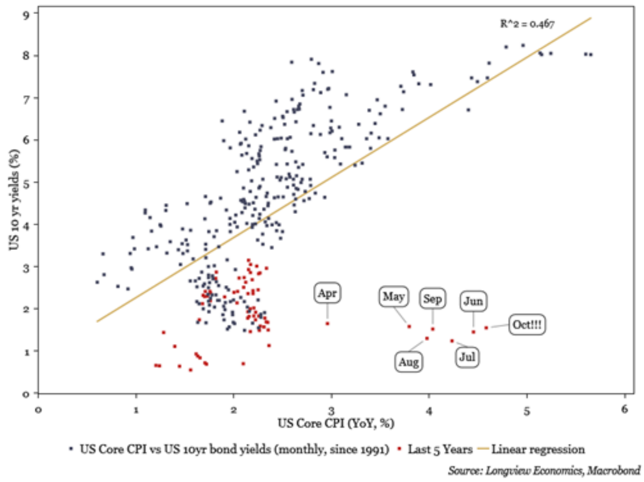
https://www.incrementum.li/en/investment-funds/

an unusually mild autumn 2021

The past few years have been a truly extraordinary time for investors, and nothing describes the challenges and prevailing sentiment for any true investor better than Matt Levine's "*GameStop rant*", which brings up the rear of my opening quotes on page 2. – What has been happening is simply unprecedented, and it raises the question whether investing will ever be done again in a conventional rational economic sense? Personally, I do not doubt this, but I share Matt's frustration, as capital markets appear increasingly detached from underlying economic fundamentals.

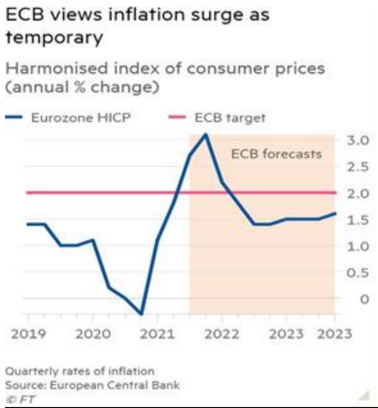
In light of the current economic backdrop, the most important question on investors' (not speculators') minds is whether the recent spurt in inflation is merely transitory or more durable? I have made my case for the latter before in these pages, pointing out that a period of elevated inflation is politically opportune as the most effective way to reduce the real burden of debt at the end of the current secular debt cycle. After all, debt is accounted for in nominal terms. If a period of elevated inflation and thus elevated nominal economic growth is accepted, even if the latter turns out to be negative in real terms (i.e. adjusted for inflation), the debt service burden will gradually shrink.

And with this in mind, I would argue: Watch what central banks do, not what they say! That can be shown in the accompanying chart, which notes all combinations of US Core CPI vs US 10y bond yields since 1991. In it the dark dots represent all monthly combinations until 2016, displaying a clear correlation between the level of core CPI inflation and interest rates. This reflects textbook prescriptions to fight rising inflation with higher interest rates, as a result stimulating savings rather than spending and thus alleviating building pricing pressures.



Source: Longview Econ., @Lvieweconomics, Twitter, 10NOV2021

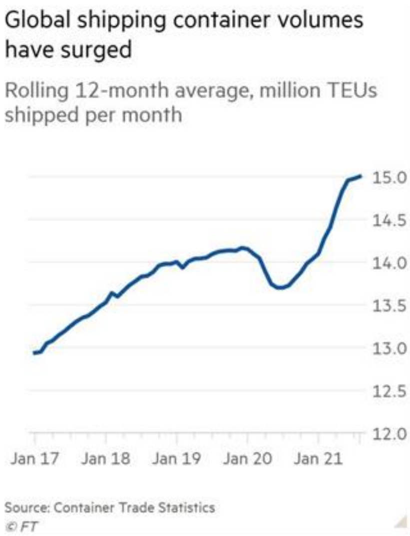
But as the red dots illustrate this relationship has recently broken down. The last five years already saw interest rates deviate to the downside from their traditional trajectory. However, the complete decoupling from soaring US Core CPI numbers since April highlights the unprecedented state of affairs. In our view, US 10y yields have been held below 2%, because there is no longer a real market dictating the yield level that rational private investors would demand in an environment of accelerating debasement of money (aka inflation). Instead, the once free market for government debt has been completely distorted by price- and yield insensitive central bank buying of (mostly) government debt, which ensures bond prices remain elevated and yields low, and with it the current goldilocks environment for risk-taking firmly in place.



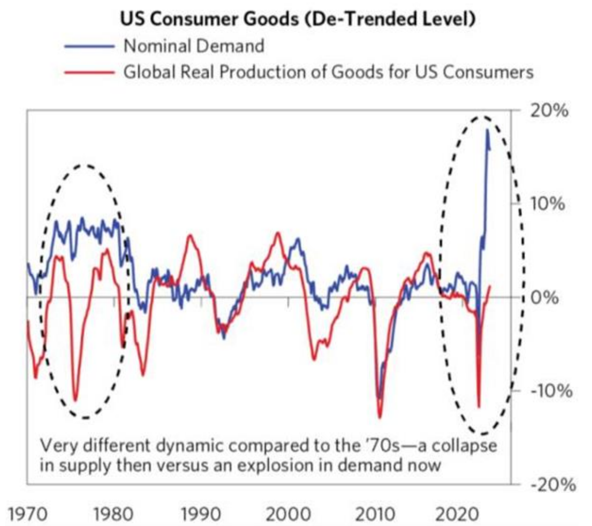
Source: Financial Times, 26OCT2021

The official argument for allowing this relationship to collapse in the way it has is that current inflationary pressures are merely transitory. This is seen as a result of soaring commodity prices as well as logistic and supply chain cost, which have been boosted by Covid-pandemic related distortions but are expected to normalize as the cycle reverts to its mean. The chart on the left illustrates how the European Central Bank (ECB) anticipates its preferred measure of EU consumer price inflation to develop over the course of the coming years. – Nothing extraordinary to see here, i.e. don't worry, everything will go back to normal.

But is the recent acceleration in prices merely due to Covid-related supply shocks and bottle necks? – If one looks closer under the hood, it becomes evident how much demand has been soaring, partly because households have reallocated part of their budgets that used to be earmarked for travel and leisure services towards goods consumption.



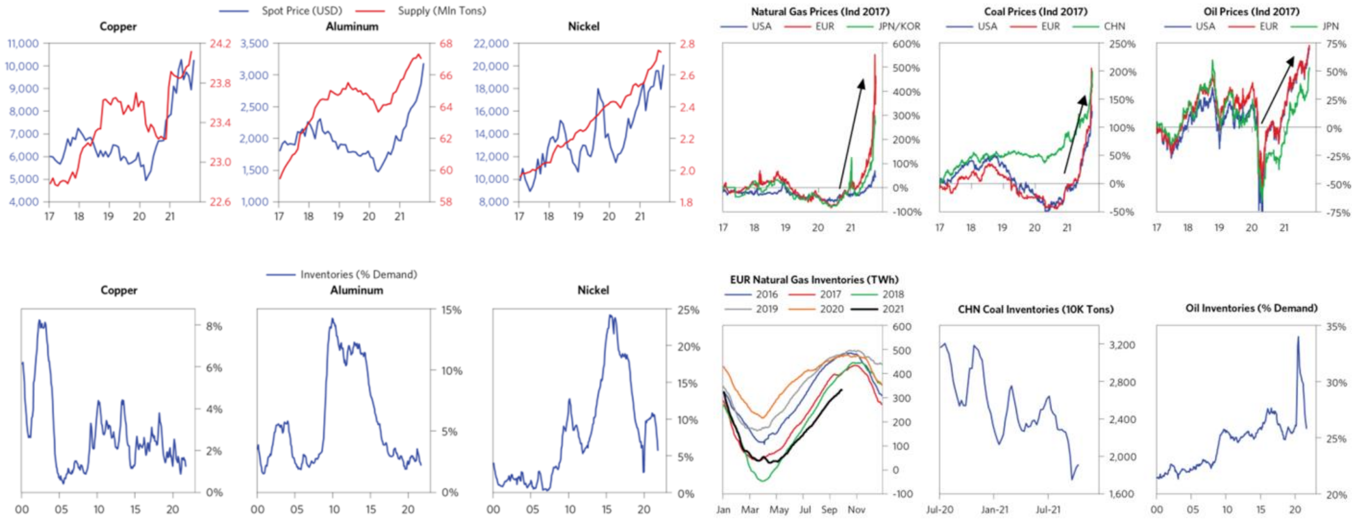
Source: Supply chain stress reflects high demand too, Financial Times, 9NOV2021



Source: It's Mostly a Demand Shock, Bridgewater, 19OCT2021

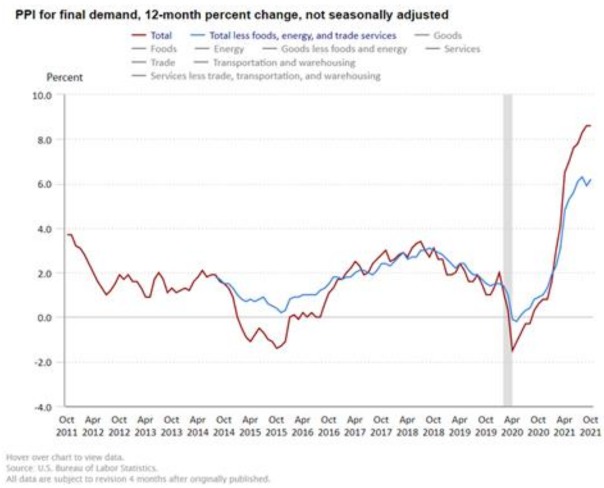
The other reason is heavy Covid-related transfer payments. The world's largest hedge fund manager Bridgewater Associates made the case for the demand-driven nature of the current bout of inflation in an article last month, which I believe is worth reading. They argue: *"Governments transferred a massive amount of cash to households, more than offsetting lost income from COVID. Household balance sheets are now in a materially better state than they were pre-pandemic."* – It appears that not only in economic textbooks, demand in excess of supply leads to inflation.

For those who care for a closer look, pressures are building everywhere in the production chain, beginning with raw materials, where prices are soaring while inventories have been depleted:

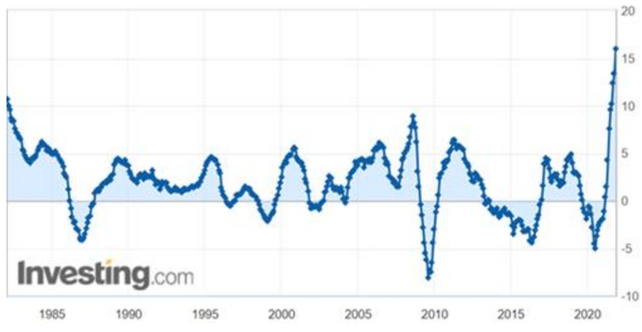


Source: [It's Mostly a Demand Shock](), Bridgewater, 19OCT2021

Not surprisingly, global producer prices have been responding to escalating demand and input cost by increasing at a record pace, too.

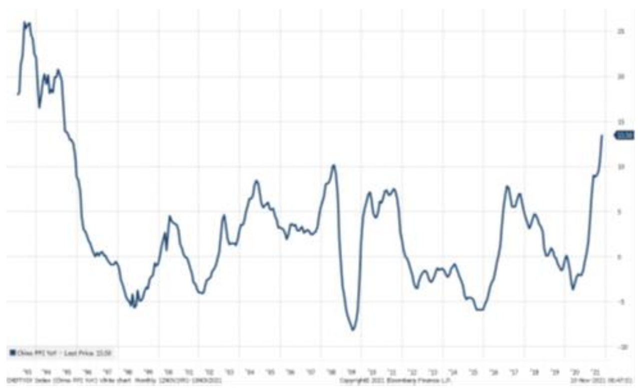


US Producer Price Index, Source: [US Bureau of Labor Statistics]()



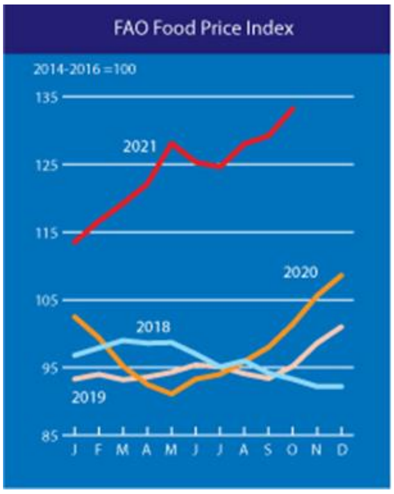
Eurozone Producer Price Index, Source: [investing.com]()

Here, it is noteworthy that the main beneficiary of globalization and outsourcing of the past few decades, and hence one of the main sources of deflationary pressures in global goods production, China, has recently begun exporting inflationary pressures to its major clients in the rest of the (developed) world, who I reckon will struggle mightily to replace the Workshop of the World anytime soon.

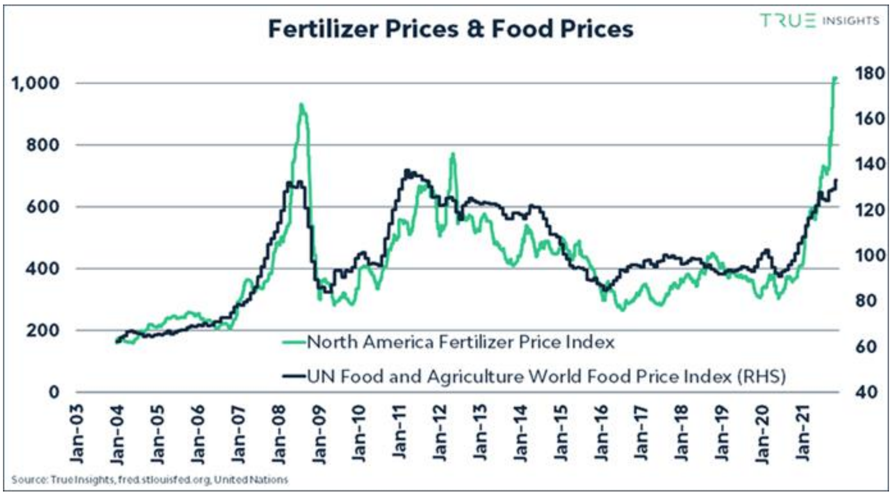


China PPI, Source: [Saxo Market Call Presentation](), 10NOV2021

Another underestimated inflation driver is global food prices, and what we have witnessed on that front this year is also quite extraordinary. I have shown the below FAO Food Price Index (FFPI) in these pages before. In October 2021 it averaged 133.2 points, up 3.9 points (3%) from September and 31.8 points (31.3%) from a year ago and sitting at the highest level since July 2011.

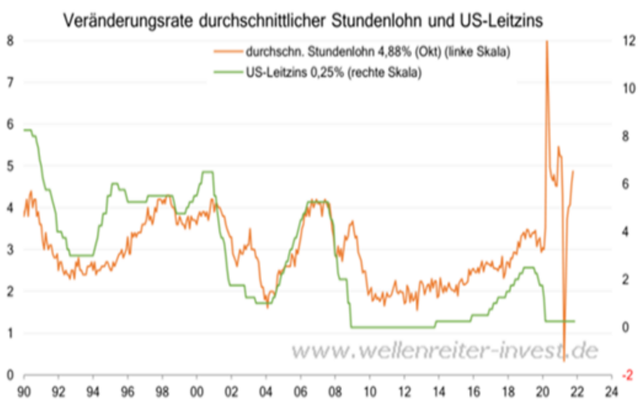


Source: UN FAO Food Price Index



Source: Avid Commentator, @AvidCommentator, Twitter, 6NOV2021

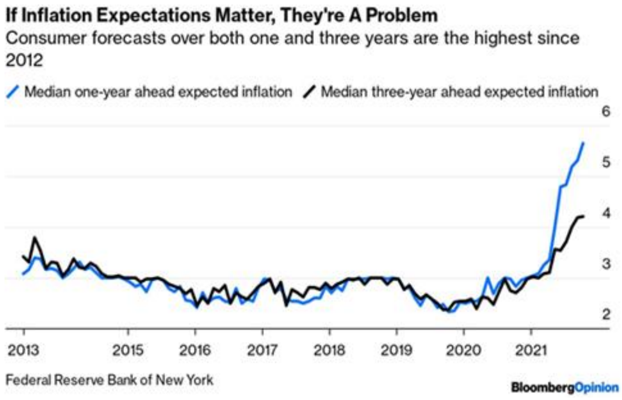
Rising food and energy cost (for the latter see the three charts at the top right hand of the previous page) are affecting households painfully. And observing the relationship between fertilizer and food prices, while realizing that fertilizer production is highly energy intensive, suggests it is unlikely that this food price trend will reverse anytime soon. Combined with soaring housing prices and cost (i.e. rents) the world over, individual households will have to secure better wage growth, which has already been tracking higher, in order to compensate for the loss in household income purchasing power so far.



Left chart: Growth in average hourly earnings via Fed Funds Rate; Source (both): www.wellenreiter.de, 16NOV2021

Recently, US average hourly earnings have thus been rising at a record pace, while the highest percentage of US small businesses in 30 years is planning to raise wages over the coming quarter. That smells like a classic wage-price-spiral, even if the Fed is keeping interest rates firmly tied to the floor.

A necessary ingredient for the labour force to demand higher wages, apart from a tight labour market (check!), is rising inflation expectations (check!). This may well cause the inflation genie to get out of the bottle, and thus create a problem for investors and markets, that so far has been mostly ignored: How do we convince savers / the bond market to accept deeply negative real (i.e. inflation adjusted) yields for longer?



Source: Bloomberg Points of Return, J Authers, 10NOV2021

If bond yields were allowed to track inflation higher, it would risk bankrupting not only many private debtors but also exceedingly highly indebted governments, while also threatening to reverse the relentless ascent of global asset prices, which is why this is not an acceptable policy option.

Instead, global central banks and governments will have to continue to intervene in markets to keep interest rates from rising meaningfully. Meanwhile, workers are realizing that they have been left behind, as they barely partook in the productivity miracle of the past decades, the benefit of which accrued predominantly to capital. Trying to catch up will be clearly inflationary and politically opportune.

Source: Michael A. Arouet @MichaelAArouet, Twitter, 16NOV2021

As a result, I expect that inflationary pressures will remain elevated, while global growth eventually slows down, as the purchasing power of money is reduced, leading to a stagflationary (i.e. economic stagnation plus inflation) period. As the Fed has recently confirmed, central banks will initially ~~pretend~~ attempt to tighten monetary policy, but quickly realize that they cannot afford to do so, as it risks losing control of the bond market (interest rates aka funding cost).

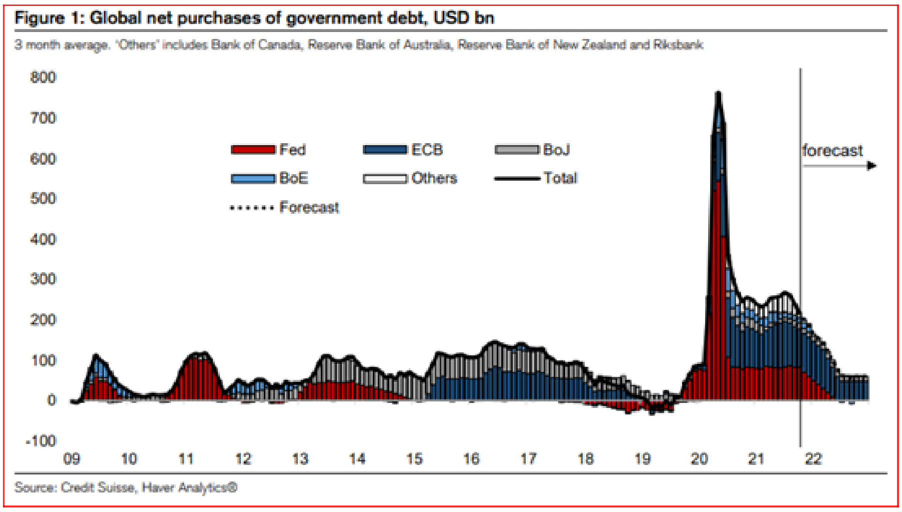
The main tool they have been using to control interest rates at the long end of the yield curve are the so-called QE (Quantitative Easing) programs, which at this point in time still amount to bond purchases of up to USD 120bn per month by the US Fed, and EUR 80bn per month by the ECB. How this all works is explained memorably by ECB Chief Economist Peter Praet in a tweet I came across on Nov10, which at 1:30 minutes length is a must-watch.

When the central bank uses newly created money to buy government debt, it crowds out private investors who need to look elsewhere to deploy their investment funds. As such, *"Inflation has long been here – evident not in consumer prices but asset and securities prices. The Fed's balance sheet has expanded to over $8 trillion (it grew 10x from $870bn in 2007), including securities purchases it has made pouring capital into investor hands, lowering the cost of capital and discount rates and raising valuations everywhere."* (Source: Josh Wolfe, @wolfejosh, Twitter Thread, 14NOV2021)

The financial asset market excesses have been evident for some time but keep getting worse and worse. To quote again from Lux Capital's quarterly letter: *"In just the last 12 weeks, during Q3, startups raised more cash than startups did during the entire 1999-2000 dotcom boom and bust. The total was nearly $160 bn, double last year's Q3 and more than any full-year amount ever before 2018. … It was common for founders to fake it before they made it, with bluffing and bluster. But in the current moment, founders' focus is pre-empted with pitches to them from investors of why they should take more money, open or extend rounds or do secondary transactions."* (Source: Josh Wolfe, @wolfejosh, Twitter Thread, 14NOV2021)

Despite of the described asset bubble phenomena, central banks have continued to support the bond market with asset purchases. Back in 2013, a mere mention of tapering was enough to send real yields far higher (and stocks lower), an experience that has led to support remaining in place ever since and to be revved up whenever financial markets or the economy display some wobbliness. Consequently, from time to time there ~~is pretence~~ are attempts to reduce QE, which is when asset prices get into trouble, and we are just entering such a phase.

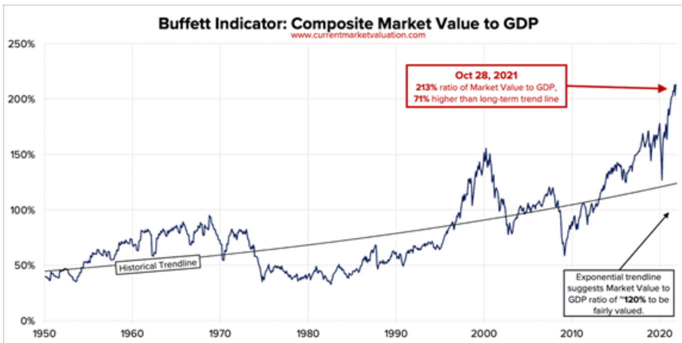
Global liquidity is tied closely to central bank QE, which is expected to subside going forward, and as the chart on the right shows this tends to front run the direction of world asset prices.



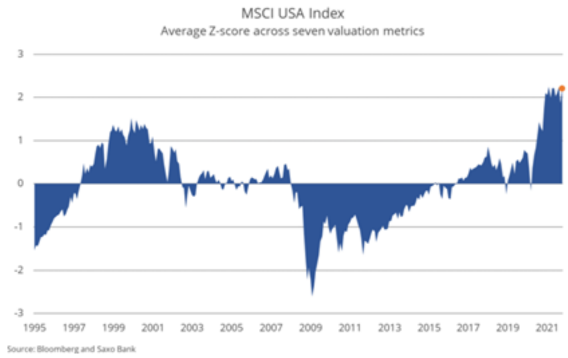
Source: Conundrum 2.0, John Authers, Bloomberg, 16NOV2021 & If the flows go on forever, Robert Armstrong, Financial Times, 27OCT2021

All this suggests trouble ahead for risk asset markets.

What is fascinating under the described circumstances is how little especially equity markets are willing to anticipate any of this. Especially US equity market valuations are sitting at record levels, both as far as the (Warren) Buffett indicator is concerned, as well as considering broader valuations sets.



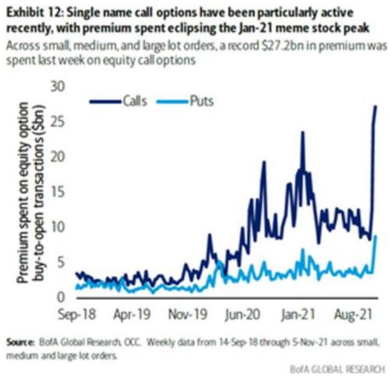
Source: currentmarketvaluation.com



Source: Saxo Market Call Presentation, 1NOV2021

And as shown below, and despite of this, equity investors are clearly in speculation mode, which confirms my previous suggestions that equity markets, especially since the advent of the pandemic and the resulting cash infusion to private households and corporations, have turned into The Grandest Casino. The ever keenly observant Jim Grant highlights how much the stakes have risen with the following observation in the October 29 issue of Grants Interest Rate Observer: *"Thus, in 2020, the Depository Trust* (i.e. the US agency tasked with settlement, storage and processing of all US securities transactions) *processed securities valued at $2.33 quadrillion — that is, with a "q." It cleared an average of 173.4 million shares of stock a day, with an average daily value of $1.698 trillion."*

These numbers are simply mind-boggling and have likely risen further this year. One must merely look at the blow-out in option trading volumes over the past year to understand that speculation has reached completely new spheres. As the graph on the right shows, single (equity) call option premiums paid essentially to gain leveraged access to rising underlying share prices have quintupled to more than USD 25bn per week and are far exceeding the level of premiums paid for put options, which would typically be used for hedging purposes.



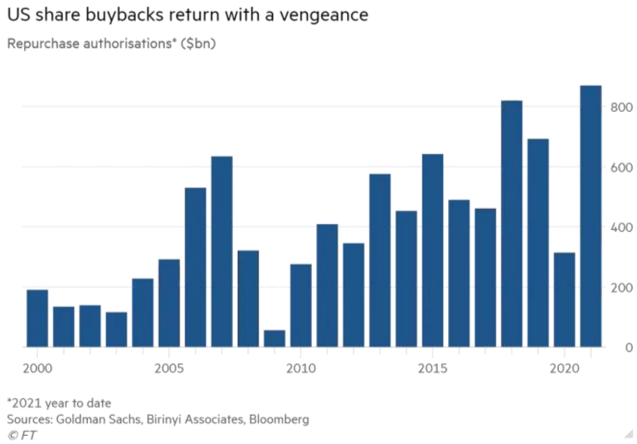
Source: FT Unhedged, 11NOV2021

To quote from the October newsletter of the Pangolin Aviation Recovery Fund: *"The key drivers to stock price are money flow, sentiment, and fundamentals. Right now, sentiment and money flow are doing all the driving while fundamentals are hibernating in a remote cave somewhere. We are a stickler for fundamentals, and we see no other way in our approach to investing. Whilst money flow and sentiment can change overnight, fundamentals are deep-rooted and tangible."* Well said, James and Mohshin; I could not agree more!

A look at overall money flows into US equities shows how utterly unprecedented the situation is:

On the right is a 20-year chart of 3-months rolling average net flows into US stock funds (data from EPFR), which lately have been oscillating between USD 5bn and 10bn per week. Today's extraordinary state of affairs is best described by the fact that from 2001 to the end of 2020, accumulated US equity fund flows were actually negative to the tune of USD 126bn. (For some time now, the marginal buyer have been corporate buyback programs). So far in 2021 net fund inflows have amounted to USD 306bn.

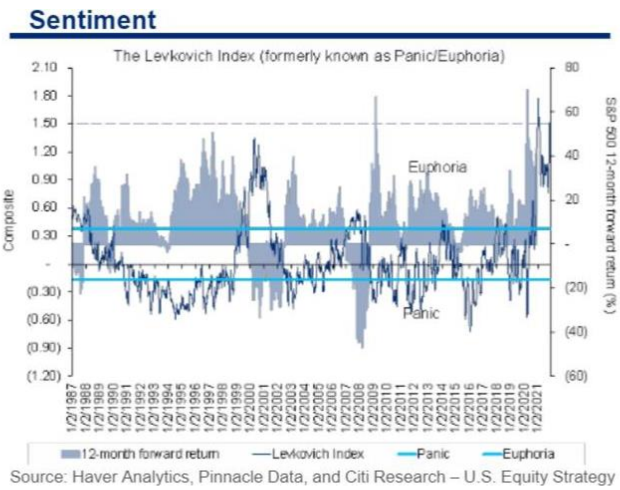
Source: If the flows go on forever, Financial Times, 27OCT2021



Source: Financial Times, 11OCT2021

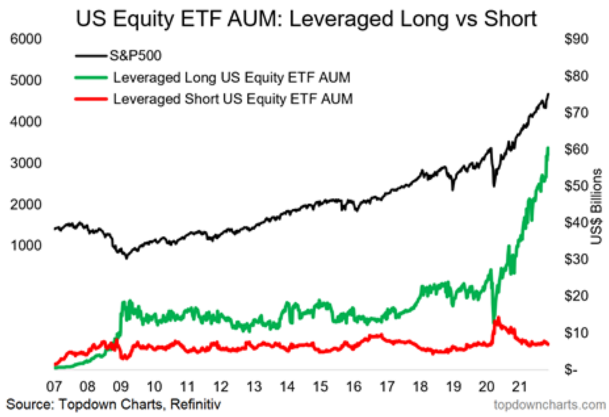
As shown on the left, record high corporate buybacks in absolute (USD-) terms remain price supportive overall, but they are not making much of a dent anymore. Although total buyback authorizations are expected to cross the USD 1tr line this year, in view of a total market cap of approx. USD 40tr for the S&P500 this returns only approx. 2.5% to shareholders. Bearing in mind that a majority of buybacks is used to offset newly issued share and option grants, the net impact is even less meaningful.

Liquidity is still plentiful but will be less so as the announced tapering of central bank QE programs progress. Investors' sentiment, meanwhile, is at extremely optimistic levels. On the right is *"Citigroup's Levkovich fear/euphoria index, which is based on a bunch of things like short interest, margin debt, and the put/call ratio. It is way up into euphoria territory, at a level that has reliably presaged bad returns in the past. To use a weary Wall Street cliché, there is no wall of worry for stocks to climb."* – Indeed!

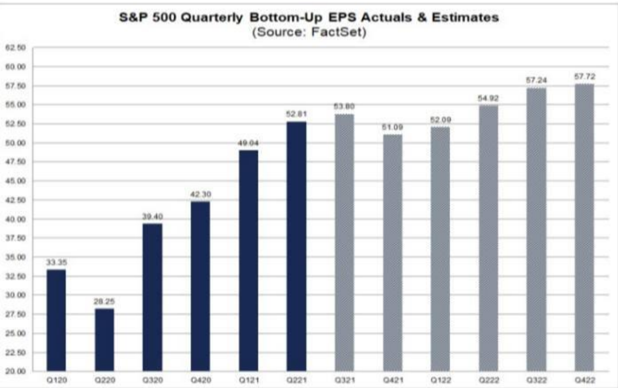


Source: Unhedged, Financial Times, 22NOV2021

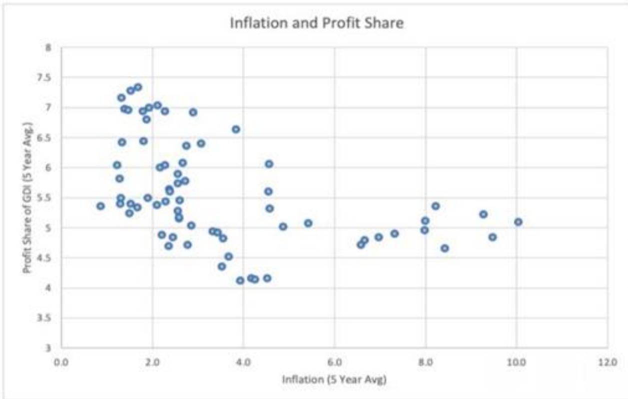
This is also expressed by the amount of leverage in the market. Not only is margin debt once again at record highs (Ned Davis Research calculates levels at 4% of US GDP, which far exceeds levels seen at the 2000 and 2007 peaks), but fund flows into leveraged ETFs are also accelerating and as the graph on the right shows clearly tilted towards the long side. That means investors are increasingly willing to leverage up return potential and take ever higher risks.



Source: chartstorm.substack.com, 14NOV2021



Source: Unhedged, Financial Times, 22NOV2021

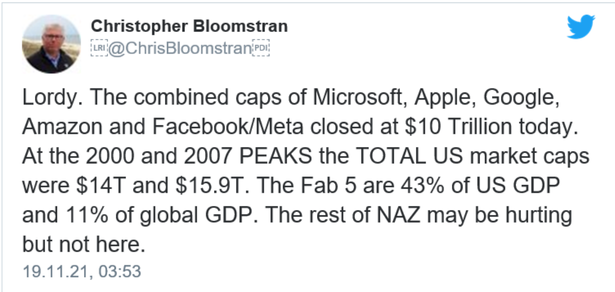


Source: Financial Times, 20OCT2021

And all this occurs at a time when US quarterly earnings estimates are expected to take a breather following their rapid ascent over the past year, which fits well with the economic backdrop of rising prices and margin pressures and slowing growth momentum. In the past, inflation exceeding 5% p.a. has yielded a significantly reduced profit share of GDP, which fundamentally makes sense considering the accompanying supply constraints and input and labour cost rises discussed earlier. In addition, elevated inflation will eventually lead to tighter monetary policy and financing conditions. And even if we expect that this will be far more cautiously done, the impact will still matter given the record leverage in the system. – Of course, investors' may simply continue to ignore all fundamentals and push valuations ever higher anyway, but every bubble has its limits and I doubt it is different this time…

While valuations are extended everywhere, they are nowhere as lofty as in US equity markets. European markets have also had a good year, but overall valuations are significantly lower, while Emerging Market equities have been underperforming for a decade and are priced for an even more sober outlook.

The difference is explained by the dominance of Big Tech in US markets, which is neatly summarized in the tweet below:


Christopher Bloomstran
@ChrisBloomstran

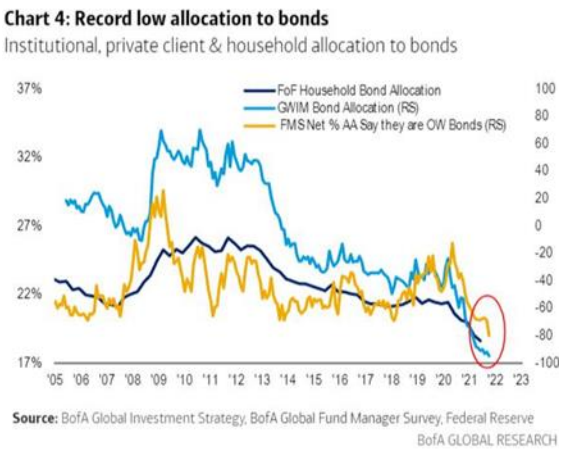
Lordy. The combined caps of Microsoft, Apple, Google, Amazon and Facebook/Meta closed at $10 Trillion today. At the 2000 and 2007 PEAKS the TOTAL US market caps were $14T and $15.9T. The Fab 5 are 43% of US GDP and 11% of global GDP. The rest of NAZ may be hurting but not here.

19.11.21, 03:53

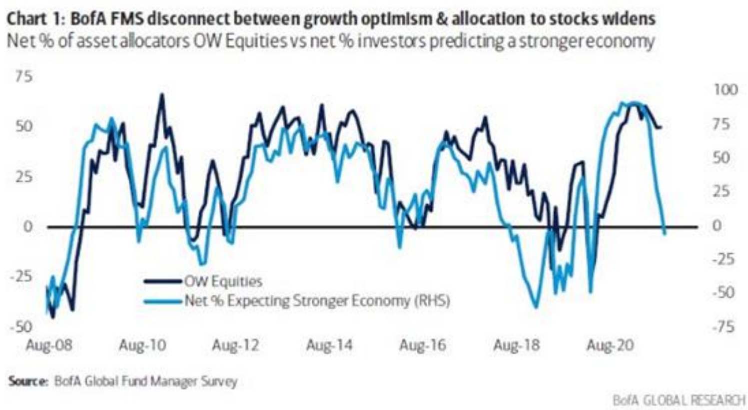
Source: Michael A. Arouet, @MichaelAArouet, Twitter, 19NOV2021

Investors' behaviour is responsible and on display again right now, as at the time of writing these pages, Covid cases are surging again especially in Europe but also in the US, and with the first countries responding again with lockdowns, investors have reflexively bought into the titans of the digital age once again, no matter their prices, while selling off energy stocks after a strong rally so far this year.

With that the first part of the great rotation trade out of bonds into equities and alternative assets has played out as can be expected given the prevailing interest rate environment and negative real yields that are likely to last the decade. It is just taking a break right now. Meanwhile, it remains to be seen whether investors will simply ignore expectations of a slowing economy, because of – you know – TINA (There Is No Alternative – to equities, that is…)



Source: If the flows go on forever, Financial Times, 27OCT2021



Source: Liz Ann Sonders, @LizAnnSonders, Twitter, 20OCT2021

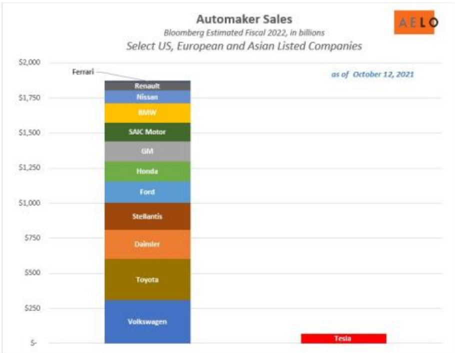
For a seasoned and value-orientated investment manager like myself, it is in fact shocking to experience for the third time this century record levels of speculation (after 2000 and 2007). And that this sentiment is shared by far smarter investors is demonstrated in the three opening quotes on page 1 of this report.

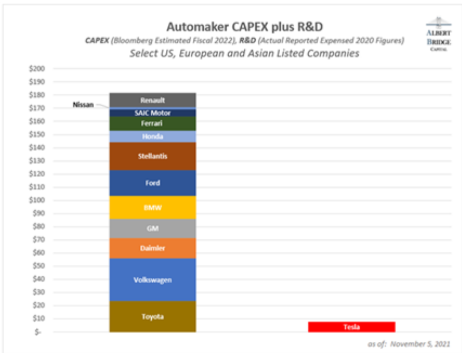
Whether it is

- a cryptocurrency market cap that according to coinmarketcap.com has grown to USD 2.6 trillion, thus exceeding the value of US currency in circulation (USD 2.2 trillion), now counting 14,708 cryptos listed on 431 (mostly unregulated) exchanges,
- or this year's boom in SPACs (Special Purpose Acquisition Corporations), which is even allowing a certain Donald T. to fund his new "truth" (and revenge) media channel,
- or the meme stocks phenomenon, which has let broken businesses like GameStop (13-bagger ytd), AMC Entertainment (19-bagger) or Avis Budget (8-bagger) go all the way to the moon,
- or the craziness of a red-hot IPO market, which was last epitomized by Rivian, another hopeful among the growing list of EV producers, which has yet to register any meaningful sales, but on the fifth day of its official listing reached a market cap of USD 160bn (+130%),

the level of speculation is truly awesome.

I cannot finish these thoughts without a quick check on the posterchild of the current bubble, which of course is Tesla, a company that after octuplicating (i.e. going up 8 times, and yes, I admit it, I had to look this word up) last year has added another 60% this year to become not only a trillion+ dollar company, but also worth considerably more than the entire listed US, European and Japanese automotive sector combined. Never mind that Tesla commands only a tiny fraction of its competitors' sales or Capex and R&D. Never mind, that the stock trades at approx. 24 times sales and about 200 times earnings, and is worth twice as much as Berkshire Hathaway, whose earnings exceed Tesla's sales.





Source: Michael A. Arouet, @MichaelAArouet, Twitter, 12OCT2021 Source: Drew Dickson, @AlbertBridgeCap, Twitter, 5NOV2021

What a crazy time to be an investor: *"An entire generation has not seen a downturn, has not experienced widespread loss from widespread leverage across sprawling interconnected systems, has not run back to safe haven occupations or embraced tomes of value investing or timeless classics warning of rampant speculation, or devils taking the hindmost or of the madness and delusions of crowds. Jonathan Swift said reason is a very light rider and easily shook off."* (Source: Josh Wolfe, @wolfejosh, Twitter Thread, 14NOV2021)

how have we managed?

Before we delve into more details to answer this question, allow me to get this out of the way:

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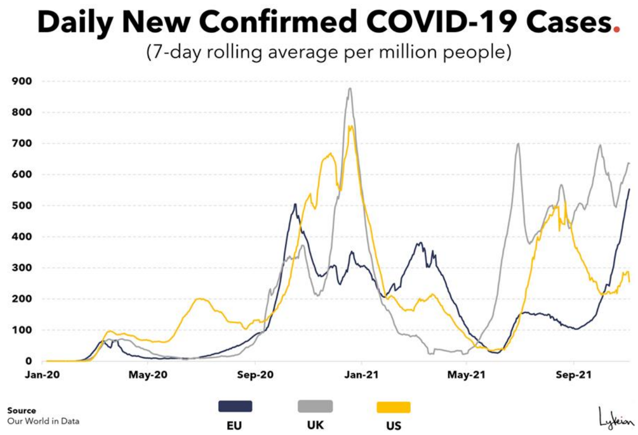
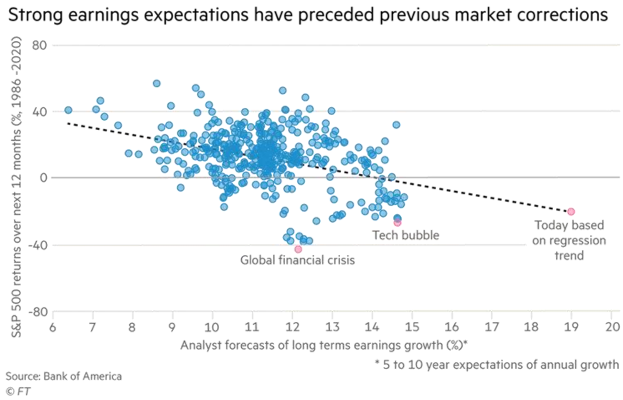
At the time of writing this (Nov26), markets are once again suffering from Covid, spooked by another wave of infections this month, especially here in Europe, as well as overnight news of the mutant Omicron variant that might be able to evade vaccines and is spreading more quickly than the Delta variant. Financial markets did not like this one bit, with government bond yields and stocks (especially value and economically cyclicals) plummeting in early trading.



Source: Markets Update, The Lykeion, 26NOV2021

We will monitor how things develop over the course of the coming week, but at this point in time I do not expect that this will change our overall assessment and positioning. Covid-news notwithstanding, we are heading into a period of attempted monetary tightening, with the goal of getting inflation under control, while growth is slowing, and corporate profits and earnings estimates are extremely elevated. As the graphs on the following page show, analysts expect record high LONG-TERM annualized earnings growth of 19% for companies in the S&P 500, which makes a perverse kind of sense as today's extended valuations can only be justified by extremely high secular profit growth. And as the FT also found such elevated profit growth expectations have historically correlated with subsequent equity market corrections.



Source (both): earnings forecasts are perilously high, Financial Times, 26NOV2021

As always, only time will tell whether this will play out similarly. But even if market action during 2H21 looks like the growth-to-value-rotation has been reversed, these types of relative setbacks are inevitable in a secular trend (and narrative) change that will take years to fully settle. (The same way as it took years for the Tech sector to reach its current dominance among asset allocators.)

	USD-D	EUR-D	EUR-P	CHF-D
latest NAV:	**124.97**	**120.75**	**118.22**	**119.14**
November Performance (%):	-4.68%	-4.81%	-4.84%	-4.69%
June-To-Date 2021 (%):	**-4.41%**	**-4.61%**	**-4.76%**	**-4.54%**
Since Launch p.a.:	9.42%	7.91%	8.03%	7.33%

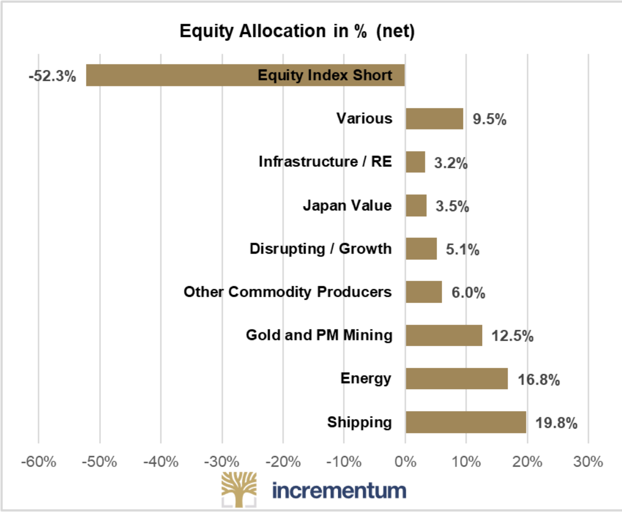
So, with this in mind, let's review what happened since our last **Seasonal Reflections** published in July:

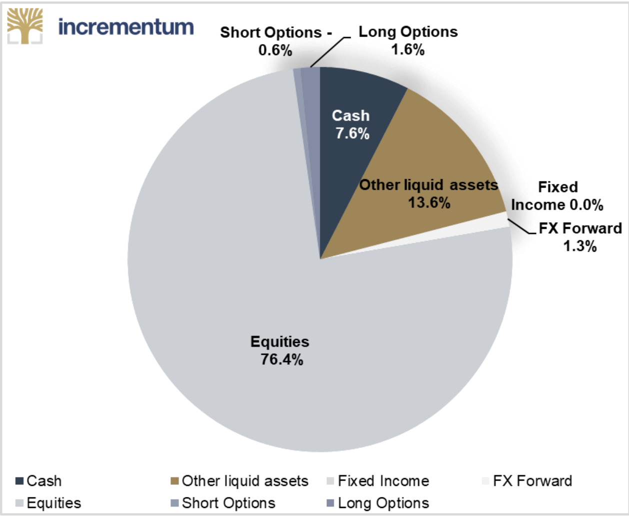
By the end of November, **IASF** has suffered a setback in its NAV compared to mid-year, which was entirely accrued in November, most of it actually on the last trading day of the fund (Nov26). The reason is that significant 1H21 gains in **SHIPPING** and **ENERGY** stocks could not be repeated during 2H21. In fact, especially in **SHIPPING** we have lately seen meaningful profit-taking, despite of an increasingly attractive fundamental picture, while **ENERGY** overall still contributed positively. The same can be said for our **GOLD AND PM MINING** basket, while losses accrued in our **DISRUPTING/GROWTH** segment, as valuations outside Big Tech have contracted sharply. The rest was a mixed bag. Another important drawdown factor were our short positions in S&P500 and Nasdaq, which cost us approx. 5% of portfolio value since the half-year mark.

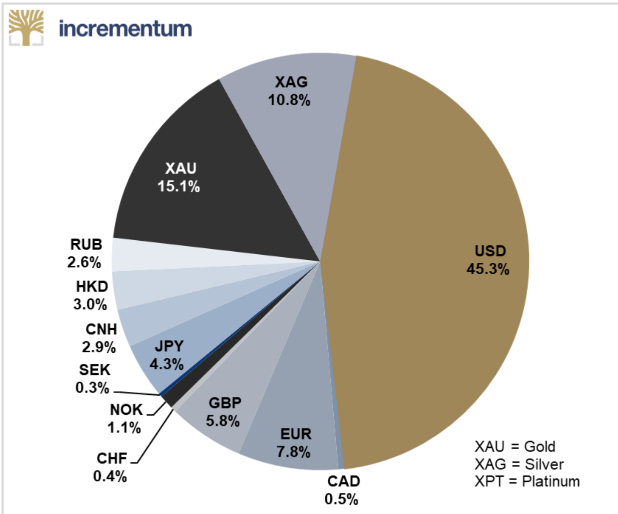
All in all, this results in a NAV decline since mid-year, though year-to-date performance remains decent.

	USD-D	EUR-D	EUR-P	CHF-D
Latest NAV:	**124.97**	**120.75**	**118.22**	**119.14**
November Performance (%):	-4.68%	-4.81%	-4.84%	-4.69%
2021 Performance (%):	**18.12%**	**16.75%**	**16.37%**	**16.77%**
Since Launch p.a.:	9.42%	7.91%	8.03%	7.33%

As regular readers know, we present the following graphs on our monthly factsheets to highlight **IASF's** overall investment exposure. Compared to the mid-year 2021 allocation, **EQUITY** exposure has risen by 5.8% gross, while it has remained mostly unchanged at 24.1% net (after the deduction of IASF's short equity index positions). Among our sector themes, **ENERGY** and **GOLD AND PM MINING** exposure have gained 1.5%, **DISRUPTING/GROWTH** +1.8%, **JAPAN VALUE** +2.1%, with all other thematic allocations unchanged.







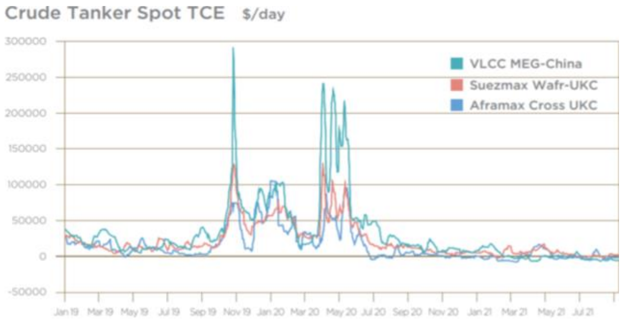
As the graphs above show, **IASF** has no exposure to bonds, while cash and other liquid assets add up to approx. 21% of total assets, which is down from 29% at mid-year. Our net options position has also increased by 1%. Meanwhile, FX allocation in the (EUR-based) fund has seen a 19% increase in **USD** exposure to 45%, at the expense of the portfolio's **EUR** exposure, which is 33% lower at 8%. The balance is due to the unwinding of **GBP** and **JPY** hedges, and more recently a small allocation to **CNY** and **RUB** (2.5% each). Both the USD (43% of total portfolio assets) and CHF (9%) share class are hedged to the underlying EUR investment portfolio.

We have also been reasonably active selling mostly short-term single equity options around our existing portfolio positions, which has resulted in net income of approx. 2% since mid-year.

What else is there to say concerning IASF's risk exposure?

Obviously, our favourite investment themes have not changed a great deal so far this year. We still like **SHIPPING** as a hard asset play, where our largest exposure is in tankers and dry bulk, plus some minor exposure to selected container and one LPG stock.

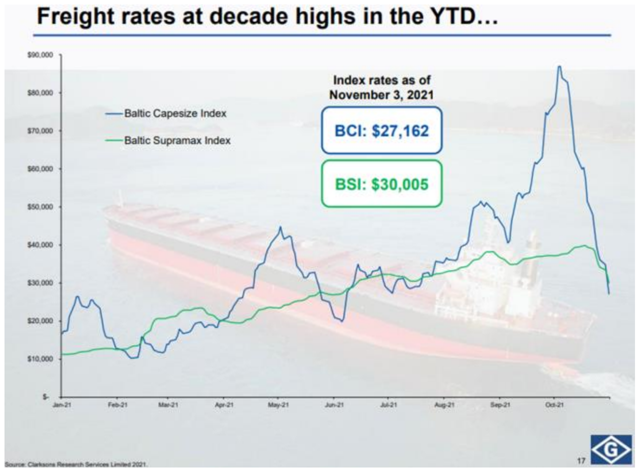
Tanker stocks have suffered from a prolonged pricing drought since the 1H20 rate bonanza, as oil supply is still being curtailed by OPEC, and demand continues to be held back by Covid-related lockdowns and (travel) restrictions. This has left 2021 earnings and share prices at multi-year lows, although the outlook for 2022 is promising.



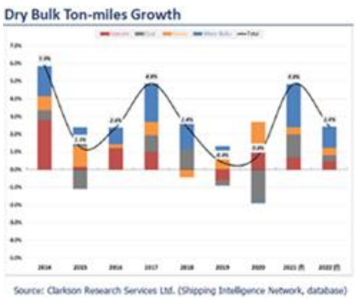
Source: Mid-Year Shipping Outlook 2021, SSY, Aug2021

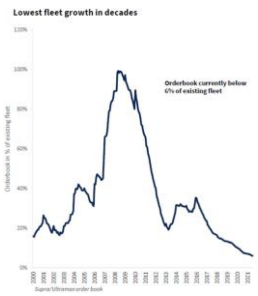
As with other shipping segments, tanker owners have seen their asset values benefit from increased pricing for second-hand tonnage, which reflects rising new-built cost plus a lack of availability of yard-space. This, however, has held back vessel scraping, which however due to tougher upcoming environmental regulations is expected to pick up towards the second half of next year, which in turn should bode well for a shipping segment that has one of the oldest fleets.

Compared to that the situation looks far better in dry bulk, which led by the more volatile Capesize vessels has been enjoying a fantastic rate environment. We have four holdings with which we have taken exposure to this market segment, and all of them are trading at low single-digit PE ratios and offering high double-digit free-cash flows and dividend yields, as investors are already discounting the next cyclical downturn for this sector. Personally, I regard this as far too pessimistic a stance.



Source: Genco Shipping & Trading, 3Q Results Presentation





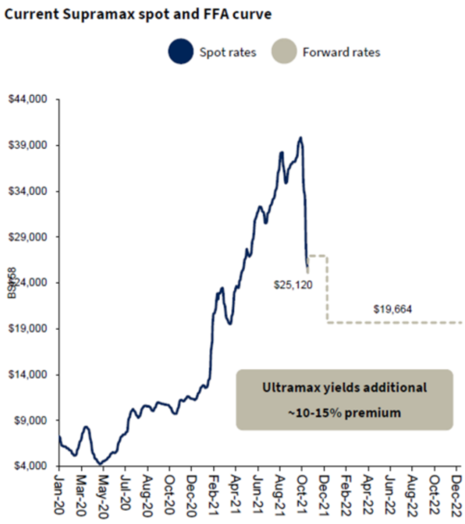
Source: Star Bulk (left) and Belships 3Q Results Presentations

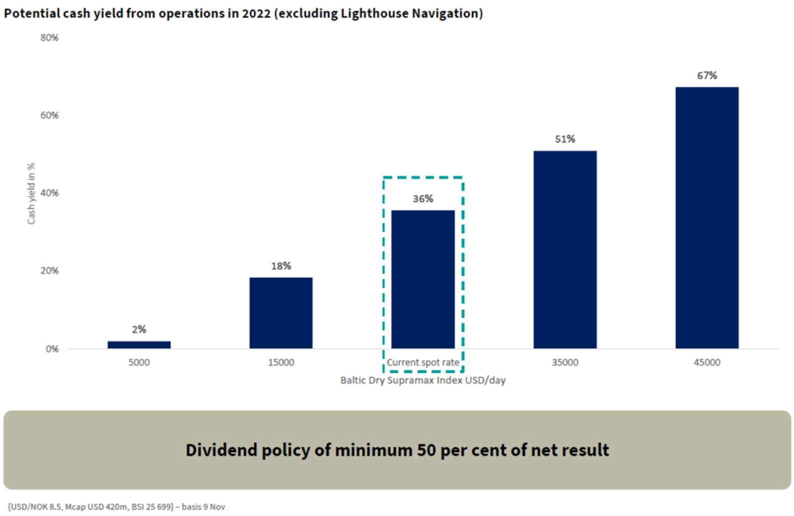
My main reasons are further growth in ton-miles (i.e. anticipated voyage length for the sector, as it makes a difference whether e.g. China imports its iron ore from Australia or Brazil), as well as decade low fleet growth ahead of new environmental regulations that will make older vessels uneconomic to sail.

In order to provide some insights on the current valuations in this sector, let's have a brief look at one of **IASF's** larger positions, which is Oslo listed Belships ASA.

The result of a 2019 merger with Frode Teigen's Lighthouse Group, Belships is one of the fastest growing companies in the sector. Since the merger it has expanded its fleet from 7 to 30 vessels, while rejuvenating (average vessel age now 4 years) and streamlining it (all Ultramax vessels now). The company's fleet, together with approx. 40 chartered-in vessels, is operated under Belships' commercial arm Lighthouse Navigation, which has been yielding superb value-add to the company's overall results.

To put the current environment into perspective and according to Belships 3Q results presentation, Ultramax vessels over the past 10 years have been earning on average $11,800 per day, which compares with a current cash-breakeven rate of $10,500 for Belships' modern fleet. In other words, it was a lost decade for the sector that on average was barely able to break even. However, this has clearly changed this year with spot rates reaching peak levels above $40,000 per day during 3Q, and forward rates indicating a still very healthy $20,000 over the course of 2022.



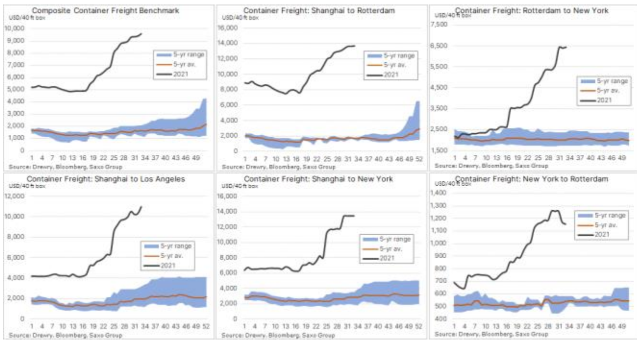


Source (both): Belships 3Q 2021 Results Presentation

As Belships has already covered 50% of its available ship days for 2022 at an average rate of $23,000, and considering forward rates only slightly below that level, the company is on course to generate a cash yield of 30% for next year from its fleet alone (before any contributions from Lighthouse Navigation). And yet, the shares of this well-managed company, which offers increasing cash flow visibility, trade at merely 3-4x 2022 earnings, about 0.7x NAV, and are expected to deliver a double-digit dividend yield. This view is obviously shared by majority shareholder Frode Teigen, who has been buying shares in the open market recently.

Actually, the last super-cycle for the dry bulk sector was 15 years ago, and few investors can imagine a repeat, despite of currently favourable fundamentals. And yet one just need to look at the container sector, which has shown what can happen when demand exceeds available supply for something as crucial as global shipping capacity.

"The $48.1bn in Q3 container shipping profits was almost 50% higher than total FANG profits and the 42.7% net income to revenue margin was almost three times higher. Compared to earnings behemoths Apple and Microsoft combined, container shipping industry profits were still almost 15% higher with a profit margin that was almost 30% higher underscoring just what a terrific, record year carriers have enjoyed, with the sector on track to post combined profits in the region of up $200bn." (Source: splash247.com, 22NOV2021)



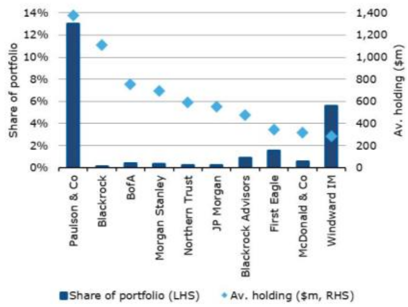
Source: Ole S Hansen, @Ole_S_Hansen, Twitter, 20AUG2021

We are still some way off seeing something as crazy in dry bulk, but I do expect a higher for longer rate environment for the sector. And the valuation difference is still astounding, as the 12 largest container shipping companies combined are worth less than 10% of Apple's entire market capitalization.

Source: Hedgeye, 22JUN2021

It is similar for gold and precious metals miners among my favourite sectors, although it has been a frustrating year, as precious metals prices can barely seem to catch a decent bid, despite of the highest inflation rates and lowest real yields in decades. However, as investors we can handle a flat tire, as it is not the speed but the direction we are going in that concerns us most.

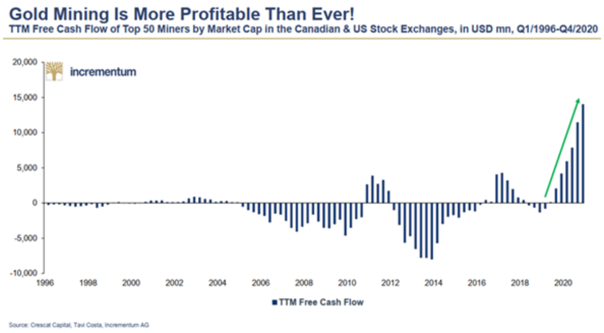
Prevailing sentiment was nicely illustrated by this chart (and the related article), which illustrates how small overall gold allocations have become: *"In most institutional portfolios, gold is either non-existent (e.g. Vanguard, DFA, Berkshire Hathaway) or such a small allocation that it scantly warrants attention. The table taken from research by a group of Australian researchers shows that the institutions that hold the largest amount of gold ETFs typically hold less than 1% of their AUM in gold. And in these cases, the gold holdings are part of a specialised portfolio or a dedicated gold fund. Unlike 10, 15 years ago, gold has become a sideshow again, as was the case throughout the 1980s and 1990s."*



Source: Institutional investors don't care about gold anymore, via KoI, 11NOV2021

The dismal sentiment towards the precious metals mining sector is attributable to it having been going nowhere (even if not in a boring fashion) for two decades. Clearly, it has been far more exciting and rewarding to invest in Apple, Tesla or Bitcoin. And yet, something extraordinary has happened as the chart below on the right shows, namely precious metals companies have found religion, and after a decade of wasted cashflows and expensive acquisitions they are managing their businesses for cash.

FTSE Gold Mines Index, Source: investing.com



Source: #IGWTChartbook2021, Twitter, 16NOV2021

Currently, few seem to care about this fundamental shift – and for now this is just another example for the ignorance and neglect with which participants consider underlying fundamentals. Those who care to take a closer look (like BakerSteel as precious metals mining managers obviously have done as shown in their quote at the bottom of page 1), can only conclude that the precious metals mining sector is a fundamentally highly attractive investment theme. And this is where we prefer to be…

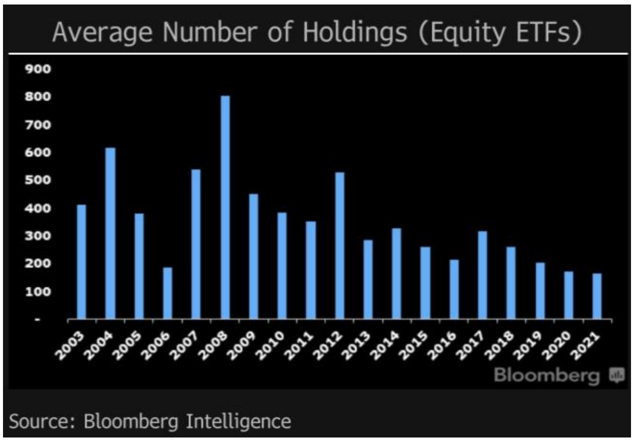
REMINDER: As responsible fund manager for IASF all my views expressed in this report, and particularly those concerning fund holdings must be considered biased and are not tailored to my readers' individual needs. Although I use great care in writing this commentary, it reflects my personal views and opinions, and as all I do as a fund manager is subject to a great amount of uncertainty, you should not rely on it for accuracy. Thus, always consult a licensed investment professional if you seek investment advice! And remember that past performance is no guarantee for future returns, and all investments involve risk including the loss of principal.

closing remarks

2021 has been such an extraordinary year for investors on so many levels that it is hard to summarize even in a lengthy missive like this one. At the time of writing these closing comments, it once again feels almost like something is going to give. Bitcoin and other crypto currencies were hit hard over the (first December) weekend, responding to a few weeks of fairly dramatic selling in long duration / growth equity names outside the big 5 names.

The latter is best illustrated with a look at the ARK Innovation fund, which over the past month has lost 25%, and more than 40% since its all-time highs in February this year. Technically, this looks at risk of accelerating to the downside, which should have negative ramification for Nasdaq as well and provide a renewed boost to the growth-to-value rotation.

ARK Innovation ETF, Source: investing.com



Source: Weekly S&P500 ChartStorm, 28NOV2021

Whatever happens over the remainder of the year, the graph on the left shows how markets have become ever more concentrated with ever fewer stocks being held in equity ETFs that can satisfy overall liquidity requirements. At the same time, passive investing favours the same few mega cap growth stocks that dominate US markets, and there is plenty of evidence that (leveraged) hedge funds have done the same. What if this goes far enough to begin a cycle of forced liquidations?

As always only time will tell the answer, as the financial system is still flooded with liquidity. For **IASF** a poor November has reset the long book to very attractive levels again, and we are optimistic for the rest of the year, barring any unforeseen shocks. The most likely contender here might be bad news from the Covid-Omicron front, which at the time of writing however looks like it will not be as bad as initially feared. We will as usual remain vigilant and respond appropriately if deemed necessary.

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 & enjoy the upcoming holidays!

Best regards,
Hans

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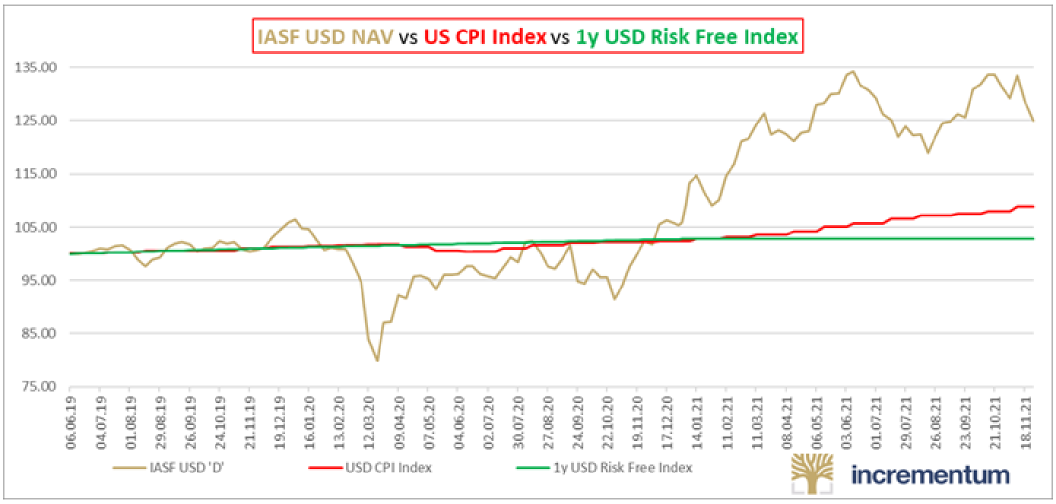
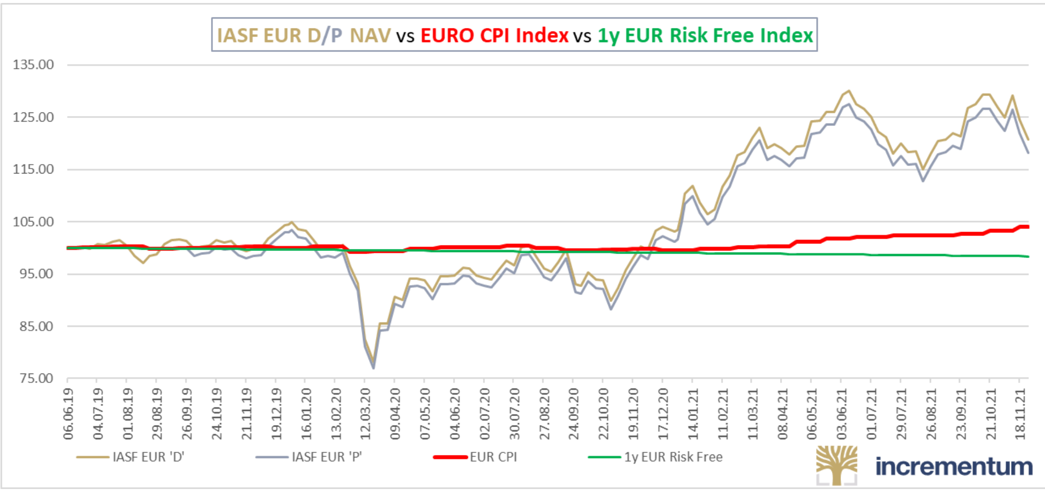
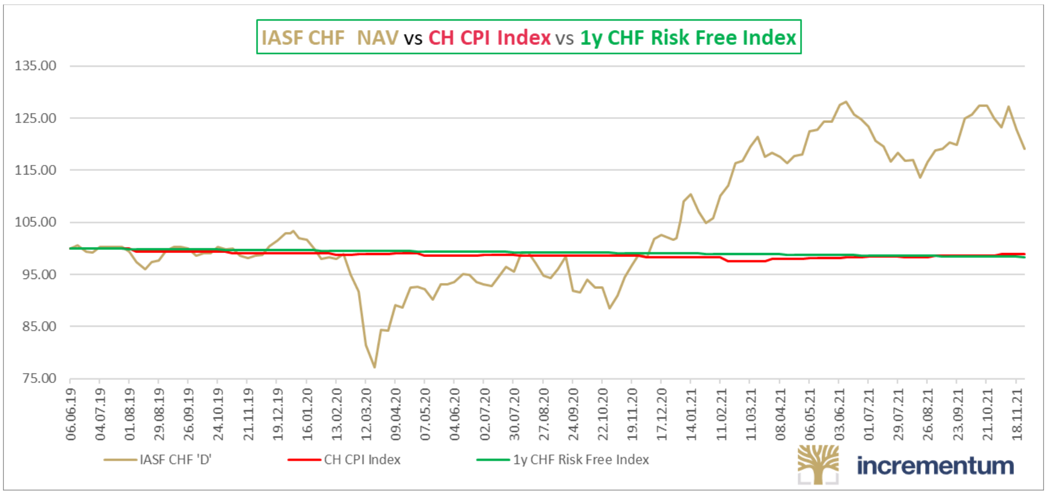
Appendix *







* Graphs display NAV of IASF performance until last valuation date (**26NOV2021**), compared to the relevant CPI (Consumer Price Inflation) level as well as the respective risk-free 1y-government bond yield 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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