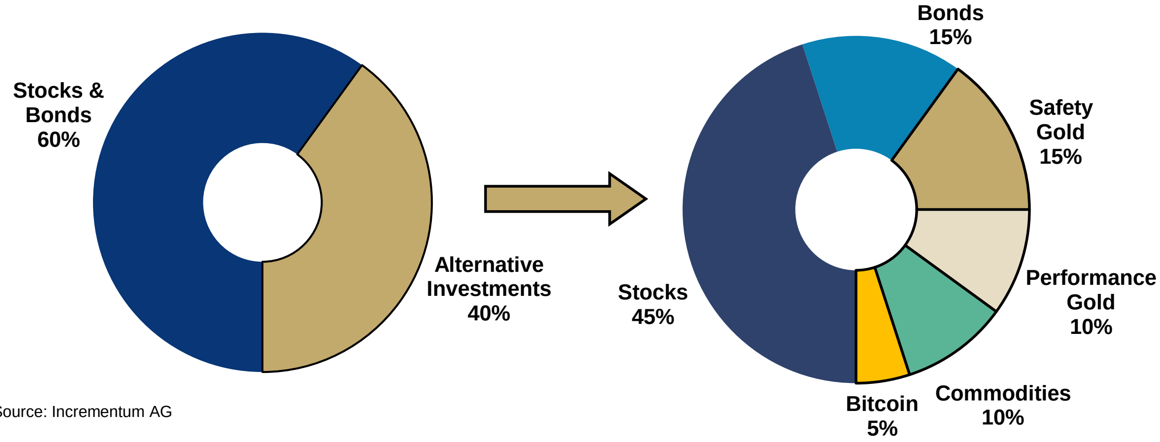
Opportunities in the Commodities Sector:
Repositioning the Incrementum Inflation Diversifier Fund

Dear Investors,
Dear Friends,

The turn of the year traditionally invites us to reflect on the past year and conduct a critical review: **What have we achieved, and more importantly, where is there potential for improvement?**

As you know from our *In Gold We Trust* reports and market commentaries, we are strategically very positive about real, non-inflatable assets such as **gold, Bitcoin, and commodities**. Given the structural overindebtedness of many states, as well as increasing geopolitical and monetary risks, we introduced a new concept for the 60/40 portfolio in our *In Gold We Trust*-report for 2024. This concept highlights our conviction regarding the importance of alternative asset classes such as gold, Bitcoin, and commodities. **In our view, a modern portfolio for long-term investors should be structured as follows:**



Source: Incrementum AG

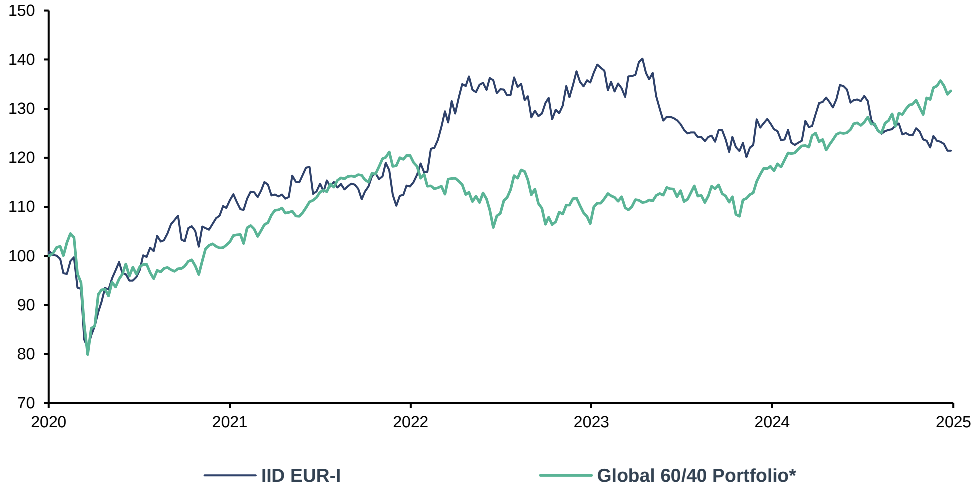
Last year, two of these three alternative asset classes—gold and Bitcoin—delivered impressive performances. Gold rose by 27% in US dollars, while Bitcoin surged by 120%. As expected, this had a noticeably positive impact on our funds with exposure to these areas. Specifically, this resulted in strong performance for the *Incrementum Active Gold Fund*, the *Incrementum Crypto Gold Fund*, and the *Incrementum Digital & Physical Gold Fund*.

In contrast, the performance of the Incrementum Inflation Diversifier Fund was unsatisfactory. In response, we conducted a thorough review of both the investment process and the underlying investment case. Given that the commodities sector offers by far the most compelling risk-reward profile among inflation-sensitive assets, and our long-standing inflation signal has delivered the best results in this area, we decided to fully refocus the fund on the commodities segment. We are pleased to outline our considerations and the corresponding adjustments to the fund in detail below.

Background and Objectives of the Incrementum Inflation Diversifier Fund

The *Incrementum Inflation Diversifier Fund* was designed to serve as a portfolio component offering broad coverage of inflation-sensitive assets, thereby diversifying a traditional portfolio consisting of equities and bonds, particularly in periods of rising inflation. Over the past 10 years, the standout cases for this environment were 2021 and 2022. Notably, 2022 was devastating for traditional portfolios. In this challenging environment, the *Incrementum Inflation Diversifier Fund* performed exceptionally well, consistently fulfilling its role as a defensive portfolio stabilizer.

IID EUR-I, and Global 60/40 Portfolio*, in EUR, 100 = 31.12.2019, 01/2020–12/2024



Source: Reuters Eikon, Incrementum AG
*Solactive 60/40 Global Index Total Return

Nonetheless, the long-term returns of the fund have been unsatisfactory. This can be attributed to three key factors:

1. Headwinds for Inflation-Sensitive Assets

Inflation-sensitive assets faced significant headwinds for much of the fund's existence, which weighed on performance.

2. Differeciated Accuracy of the Signal

Our inflation signal, a critical tool for determining investment levels, has generally served well. However, over the past 18 months, it has shown weaknesses. A deeper analysis revealed that the signal's reliability varied by sub-asset class. It performed best by far with the Bloomberg Commodity Index.

3. Underweighting High-Yield Productive Assets

The structural underweighting of high-yield productive assets negatively impacted long-term returns, as these are essential for sustainable yields and fully leveraging the power of compounding.

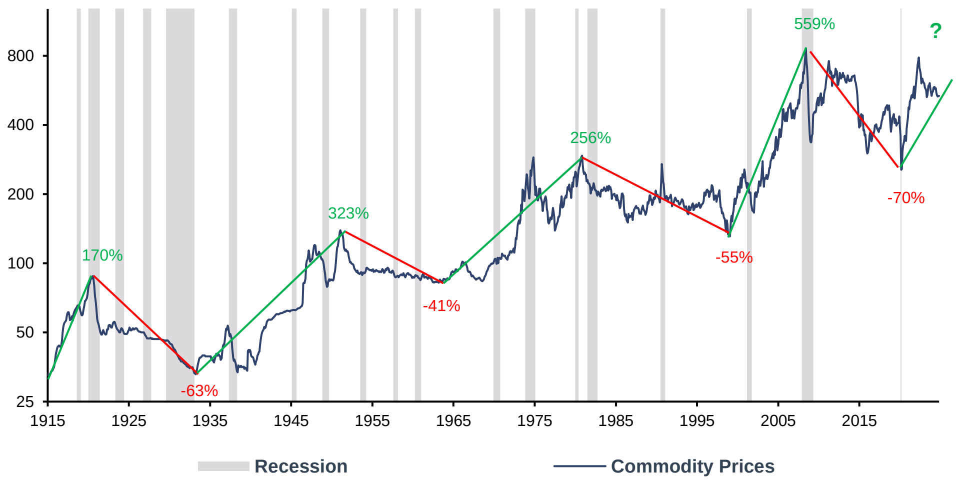
Given this assessment, we decided to strategically realign the fund. Within the investment universe, the commodities sector, in particular, stands out for its exceptional potential to strengthen the fund sustainably. Historically, commodities have proven to be reliable inflation hedges, while structural and geopolitical changes further enhance their attractiveness as an asset class. The following section explores the overlooked opportunities in the commodities sector and explains why we are increasingly focusing on commodities.

The Overlooked Opportunities in the Commodities Sector

While many investors focus on momentum stocks and new technologies or passively invest in ETFs that disproportionately weight historically high-performing equity sectors, the commodities market remains largely overlooked. Although there were significant gains in commodities around 2022, these quickly faded. Two years later, investor interest in this asset class is at historic lows, making the commodities market extremely attractive from a contrarian perspective for long-term investors.

Historically, commodities have exhibited regular long-term (secular) bear and bull market cycles. We believe the current downturn is merely a correction within a broader, long-term bull market.

Commodity Prices* (log), 01/1915–11/2024



Source: Alpine Macro, Federal Reserve St. Louis, Reuters Eikon, Incrementum AG
*1913-1934 US PPI Industrial Commodities, 1935-1949 Spot Price 28 Commodities, 1950-1969 Spot Price 22 Commodities, since 1970 S&P GSCI

The bullish case for commodity investments is fundamentally supported by a multitude of factors. Structural changes, geopolitical tensions, and macroeconomic dynamics are creating an environment conducive to a renaissance of the sector. Key drivers such as China's role, increasing resource nationalism, chronic underinvestment, fiscal dominance, inflation, and the potential for a new supercycle could significantly boost the commodity market over the long term.

1. China's Role as a Marginal Buyer

China plays a pivotal role in the commodities sector, both as the largest consumer of many resources and as a driver of global demand dynamics. Currently, China's economic weakness is often cited as the primary reason for the recent price downturn in commodities. The property sector—a key consumer of raw materials—remains sluggish, and economic growth continues to fall short of expectations. These developments underline the importance of China's recovery and the broader structural trends shaping the commodity market, making it a compelling case for long-term investors.

CN 10Y, 01/2003–12/2024

Source: Reuters Eikon, Incrementum AG

However, this development is likely to be only a temporary interlude. Given the ongoing economic weakness, China is under significant pressure to implement effective stimulus measures swiftly. The party leadership has already signaled an increasing willingness to provide economic policy support. From a political perspective, fiscal and monetary stimuli will ultimately have to take effect—no matter the cost. The Chinese leadership cannot afford to allow the economy to fall into a prolonged stagnation reminiscent of Japan's lost decades. With access to the "printing press," whether through politically directed credit issuance by state-controlled commercial banks or actual monetary expansion, China possesses the tools to break the current deflationary trend.

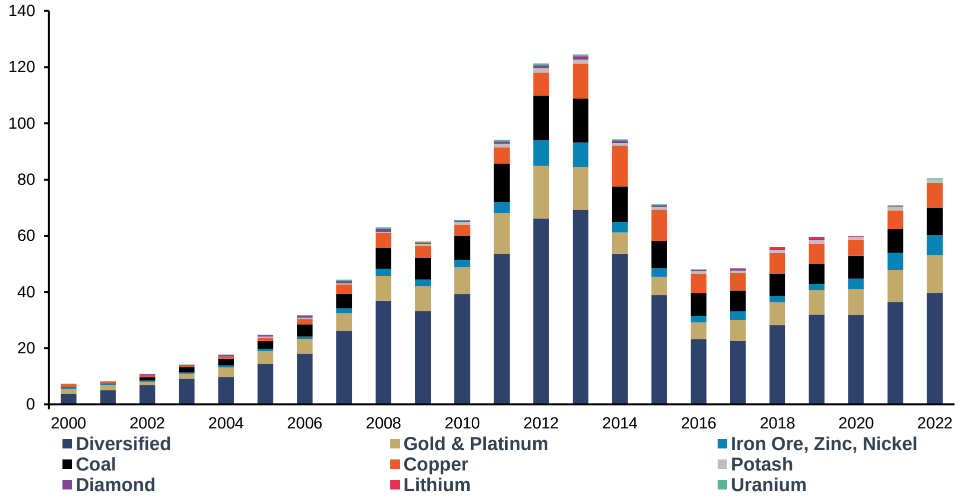
2. Rising Resource Nationalism and Nearshoring

The global geopolitical landscape is experiencing a marked increase in resource nationalism. Countries are increasingly prioritizing the control and protection of their natural resources, driven by a polarized geopolitical environment. This trend is leading to trade barriers and significant disruptions in global supply chains, which, in turn, are pushing up the availability and prices of commodities. A notable example of this phenomenon is the policy stance of U.S. President-elect Donald Trump, who frequently advocated for tariffs as a means to promote domestic industry. His territorial ambitions, such as the controversial proposal to integrate resource-rich Greenland and Canada into the United States, reflect a broader move toward securing critical resources. In the commodities sector, these shifts highlight the need for a business-friendly policy framework to ensure competitiveness. Additionally, nearshoring efforts—relocating supply chains closer to home markets—are further amplifying the strategic importance of commodities, reshaping global trade dynamics and resource allocation.

3. Structural Supply Deficits and Chronic Underinvestment (Capex Cycle)

The commodities markets have been grappling with structural supply deficits for years, driven by chronic underinvestment. Over the past 15 years, the consumption of key resources such as natural gas, iron ore, and copper has grown by approximately 40%, while capital expenditures in the sector have fallen to their lowest levels in 15 years.

Top 40 Mining Companies CAPEX Expenditure, in USD bn, 2000-2022



Source: Clocktower, Incrementum AG

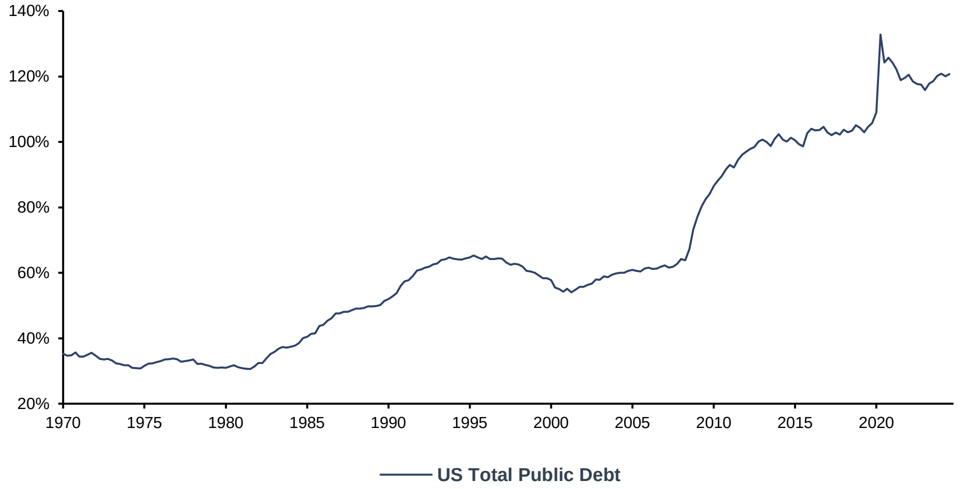
At the same time, commodity production has become increasingly capital-intensive. High-quality resources are being depleted, forcing a shift to lower-grade deposits, which require significantly more investment to extract and process. This dynamic has constrained supply growth even in the face of rising demand.

Despite the economic slowdown in China and the strength of the U.S. dollar, commodities have shown remarkable resilience over the past 18 months. This resilience is not due to booming demand but rather to significant supply constraints. These constraints are the result of years of underinvestment since the last commodity boom in 2011, setting the stage for potential price increases as demand eventually picks up.

4. Fiscal Dominance and Inflation

A key macroeconomic driver for the future development of commodity prices is the growing fiscal dominance in many Western economies. With debt levels reaching unprecedented heights—such as the United States' national debt at 124% of GDP—governments are under increasing pressure to manage this burden. Reflationary policies and inflation-driven growth are emerging as tools to reduce the real value of these liabilities.

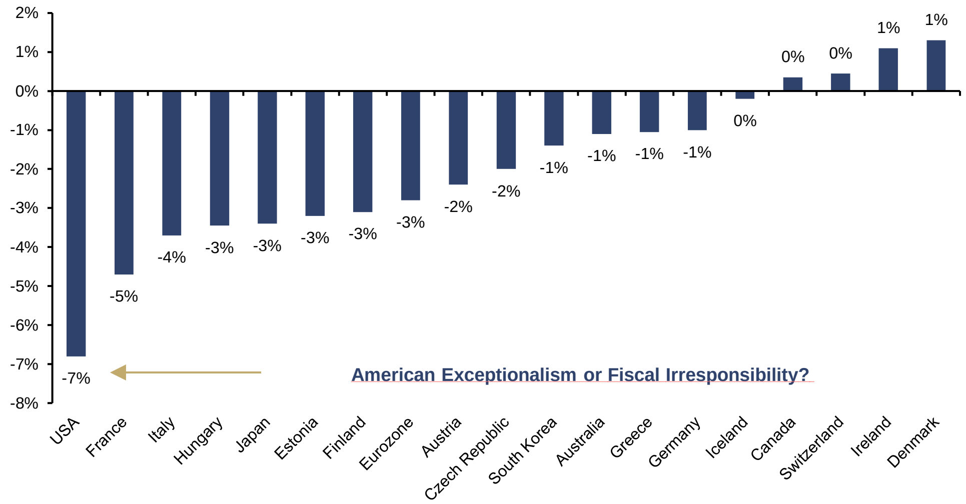
US Total Public Debt, in % of GDP, Q1/1970–Q3/2024



Source: Reuters Eikon, Incrementum AG

Fiscal stimuli, including state-funded infrastructure projects, green investment initiatives, and expansive economic support packages, play a central role in this strategy. These measures not only drive reflation but also directly increase demand for commodities, which are essential for infrastructure development and the energy transition.

Budget Surplus/Deficit, in % of Nominal GDP



Source: OECD, Crescat Capital LLC, Incrementum AG

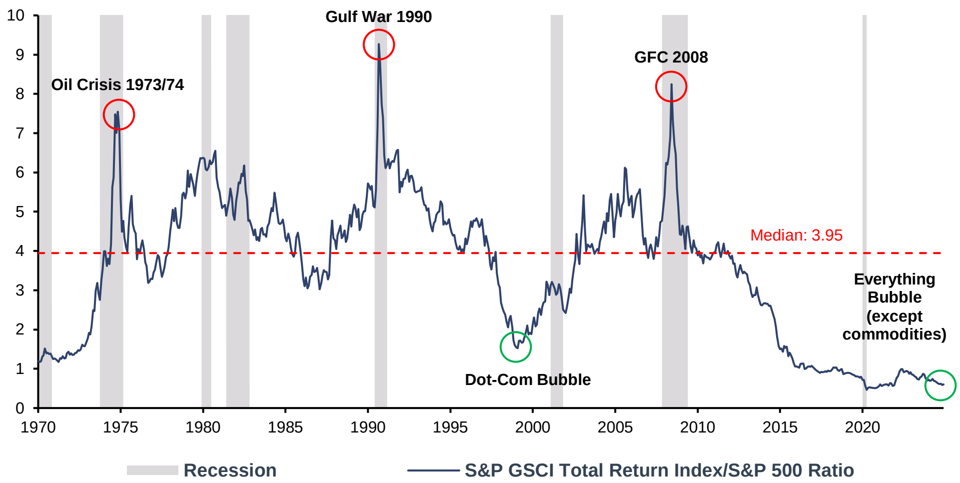
A historical parallel can be drawn with the 1970s, when expansive monetary and fiscal policies triggered multiple inflationary waves. Particularly, the second wave of inflation in 1974, which peaked at over 12%, highlights the close connection between inflation and commodity prices. In the current environment, there is a risk of prematurely declaring victory over inflation. Should a new inflationary wave emerge, commodities are likely to regain their prominence as a hedge against inflation, further underscoring their strategic importance and long-term growth potential.

5. Potential for a New Commodity Supercycle

The combination of geopolitical tensions, rising resource nationalism, chronic underinvestment, and the energy transition points to the beginning of a new commodity supercycle. These dynamics are creating a growing mismatch between supply and demand at a time when investor allocations to commodities are at historically low levels. According to the Bank of America Global Fund Manager Survey, the weighting of commodities in institutional portfolios is currently at its lowest point since June 2017. In our view, this represents a classic contrarian indicator, highlighting the negative sentiment of major market players toward commodity investments and suggesting significant upside potential.

Furthermore, the relative performance of commodities compared to equities signals promising opportunities. As structural and macroeconomic factors increasingly align in favor of commodities, the sector appears poised for sustained growth. The potential for a supercycle—characterized by prolonged periods of elevated commodity prices driven by demand outpacing supply—reinforces the attractiveness of commodities as a key component in long-term investment strategies.

S&P GSCI Total Return Index/S&P 500 Ratio, 01/1971–12/2024



Source: Torsten Dennin, Lynkeus Capital, Reuters Eikon, Incrementum AG

<u>Strategic Implications for the *Incrementum Inflation Diversifier Fund*</u>

At the outset, we identified the portfolio challenges faced by the fund's investment strategy. Based on our analysis, we have drawn the following key conclusions:

1. Shifting Headwinds for Inflation-Sensitive Assets

The headwinds faced by inflation-sensitive assets over the past two years are expected to subside. Among these assets, the commodities sector appears particularly promising. While inflation-linked bonds offer limited return potential and low current yields, investments in commodity equities and corporate bonds present attractive dividends and coupons. Despite recent challenges, we are confident that these asset classes now offer immense potential.

2. Refining Signal Reliability

Our analysis has demonstrated that the Incrementum inflation signal is a reliable indicator for broad commodity markets. However, it has shown limitations with commodity equities due to their correlation with general equity markets and the heterogeneity of sub-sectors. This insight has directly informed our new allocation strategy.

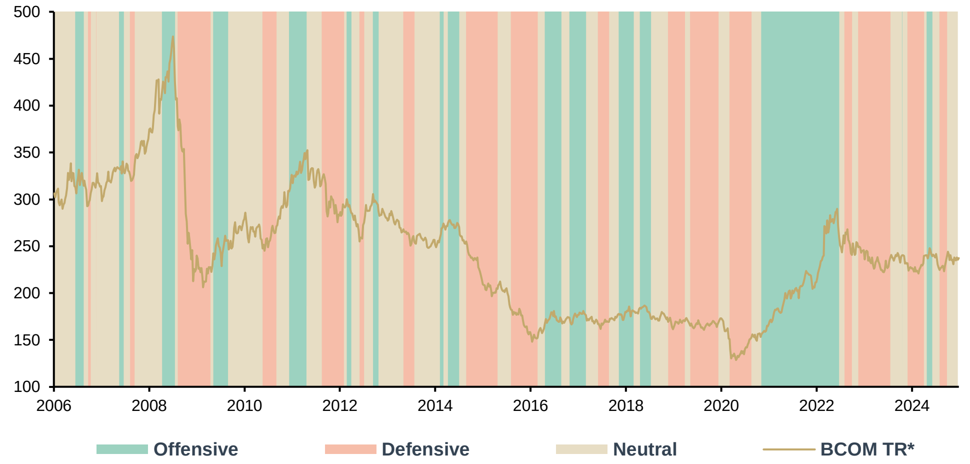
3. Underweighting of High-Yield Productive Assets

The realignment addresses the structurally low recurring yield of the portfolio by strategically weighting high-yielding commodity equities and corporate bonds, which are designed to generate sustainable returns.

Ad 1) To capitalize on the current highly attractive valuation phase in the broad commodities sector, we have decided to reposition the fund. **The *Incrementum Inflation Diversifier Fund*, previously active across a wide range of asset classes, will now transition into the *Incrementum Active Commodity Fund*. The fund will focus exclusively on investments in the commodities sector.**

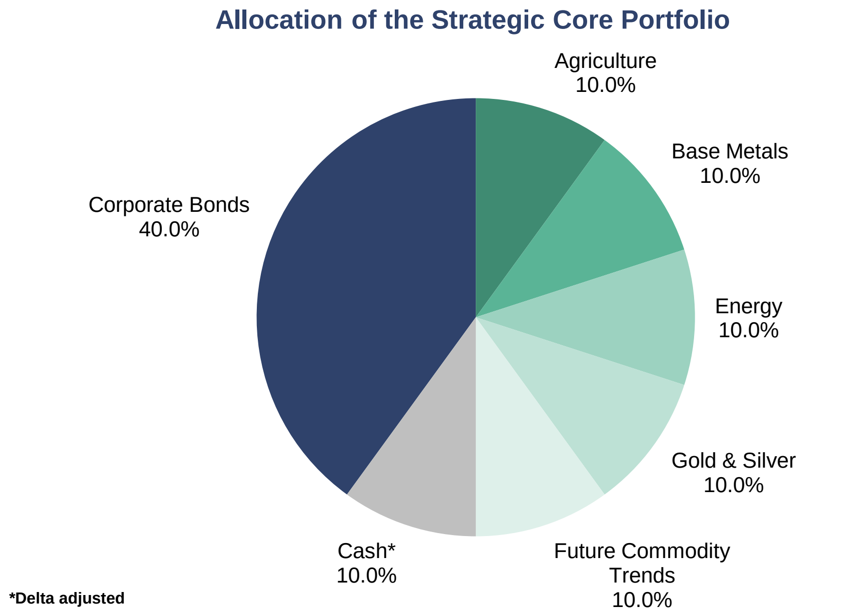
Ad 2) Over the past decade, the *Incrementum inflation signal* has proven to be a valuable tool for anticipating inflation trends and informing investment decisions. However, 2023 saw two false signals that prematurely indicated the start of a new inflationary wave. A detailed analysis revealed that the inflation signal is particularly reliable for broad commodity markets, whereas its effectiveness with commodity equities is limited due to their higher beta and sector-specific volatility. **Going forward, the inflation signal will be used exclusively to manage exposure to commodities via the Bloomberg Commodity Index Future.**

BCOM TR*, and Incrementum Inflation Signal, 01/2006–12/2024



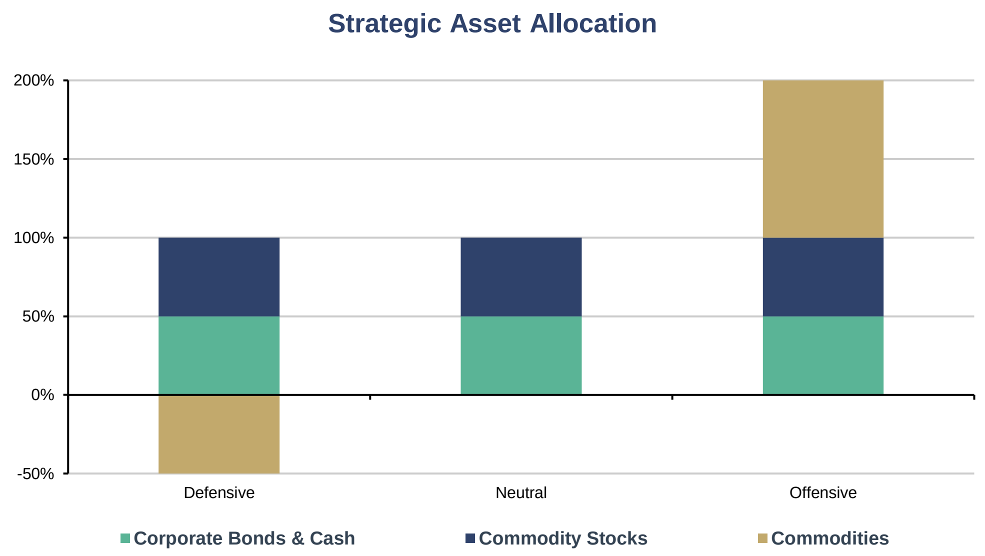
Source: Reuters Eikon, Incrementum AG
*Bloomberg Commodity Total Return Index

Ad 3) To address the issue of insufficient recurring income and underweighting in productive assets, the fund will build a core portfolio comprising commodity equities and corporate bonds from the commodities sector.



The strategic cash portfolio consists of 40% corporate bonds from the commodities sector, 50% commodity equities equally weighted across the sectors of agriculture, base metals, energy, gold & silver, and future commodity trends, as well as cash. In the "future commodity trends" segment, the focus is on identifying equities from niche markets considered particularly promising. Examples include companies in the fields of water management, rare earths, and timber.

The strategic core portfolio is complemented by active commodity management, systematically guided by the Incrementum inflation signal. This approach adjusts the total exposure strategically, reducing it to 50% in a defensive scenario and increasing it to 200% in an offensive scenario..[1]



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[1].Less a delta-adjusted cash allocation of up to a maximum of 10%.

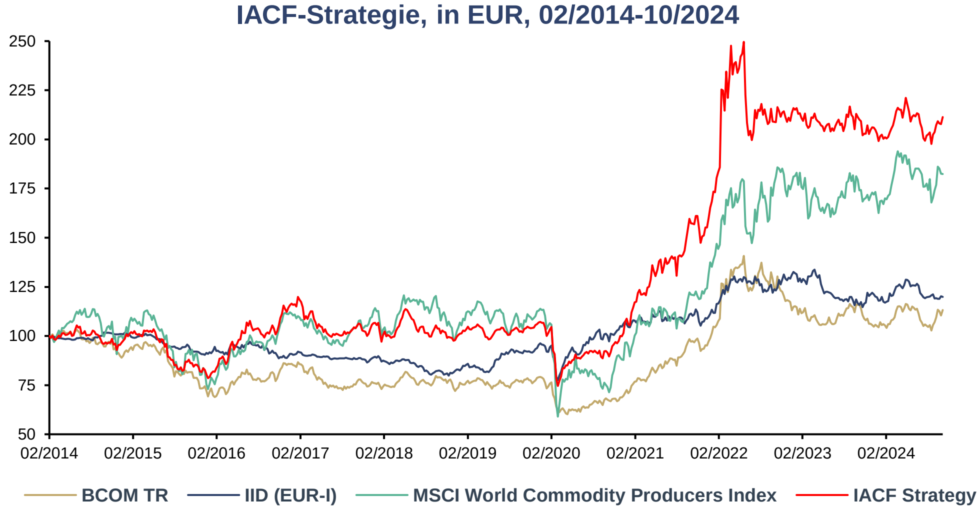
Conclusion:

The strategic allocation consists of three components:

- **A strategic exposure of 50% in commodity equities:** Diversified, equally weighted equities across five sub-sectors: agriculture, base metals, energy, gold & silver, and emerging commodity trends (e.g., water management, rare earths, and timber).
- **A strategic exposure of 40% in corporate bonds**: Investment-grade corporate bonds in the commodities sector, providing yield and reducing volatility.
- **A tactical commodity exposure -50% to +100%:** Managed via the Bloomberg Commodity Index Future using the Incrementum inflation signal.

This combination of strategic investments and active commodity management offers a **compelling risk-return profile, as demonstrated by backtests, has the potential of outperforming both the Bloomberg Commodity Index and traditional commodity equity indices**.

IID (EUR-I), BCOM TR, MSCI World Commodity Producers Index, and IACF-Strategie, in EUR, 02/2014-10/2024



Source: Reuters Eikon, Incrementum AG
Past performance is not indicative of future results.

Furthermore, the adapted strategy also gives the fund a **stronger "buy-and-hold" character**, which is particularly appealing to long-term commodity investors. Overall, the risk-return profile is expected to remain similar to the previous strategy. **However, the SRI may potentially increase from its current level of 3 to 4 in the coming quarters.**

We are aware that the calendar years 2023 and 2024 were disappointing for our investors, primarily due to the strong disinflationary environment, which is now gradually subsiding. **Since its inception, the fund has outperformed the broader commodity market, as measured by the Bloomberg Commodity Index TR, while maintaining significantly lower volatility.**

Our stated goal remains to sustain and significantly expand this outperformance in the future. With the realignment of our strategy, we are more confident than ever that we will achieve this and that the fund will deliver an even more attractive risk-return profile for our investors.

Performance and Risk Metrics Comparison (in EUR), 02/2014–10/2024

	IIDF (EUR-I)	BCOM TR	MSCI World Commodity Producers Index	IACF Strategy (Backtest)
Performance	**20.31%**	**13.95%**	**82.46%**	**160.25%**
Performance p.a.	**1.74%**	**1.23%**	**5.77%**	**9.34%**
Annualized Volatility	**9.65%**	**14.59%**	**23.40%**	**15.21%**
Sharpe-Ratio	**0.21**	**0.14**	**0.35**	**0.65**
Max. Drawdown	**-23.80%**	**-41.69%**	**-51.15%**	**-30.52%**

Source: Reuters Eikon, Incrementum AG
Past performance is not indicative of future results.

The implementation of the new allocation is being carried out gradually throughout January, ensuring that the portfolio is fully aligned with the new structure by the end of the month.

We are confident that the fund's realignment reflects the changing market conditions and offers attractive long-term return opportunities. We hope you share our confidence in this strategic decision and recognize the opportunities it presents. The commodities sector currently offers rare opportunities to benefit from structural and macroeconomic trends, which strongly support our commitment to this asset class.

We are, of course, always available for a personal discussion. As this represents a significant strategic realignment, we are happy to take the time to explain the changes in detail and address any questions you may have. Please do not hesitate to contact us to arrange a meeting.

We wish you a successful and prosperous start to the new year and all the best for 2025!

Warm regards,

Ronald-Peter Stöferle und Mark J. Valek

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