NORDIC INVESTMENT PARTNERS

March 2021 update

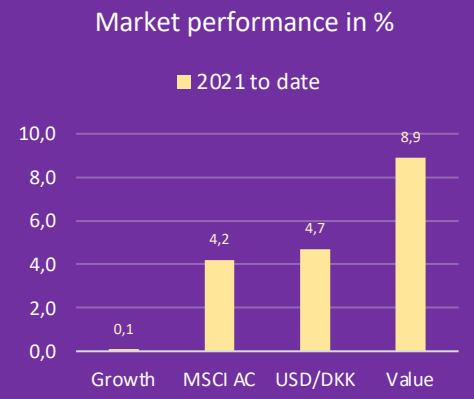
Rotation continues but the long-term pendulum aims for further digitalization

1Q 2021 market performance

The first quarter of 2021 is in the box and it's time to reflect and look forward.

The roadmap for 2021 scenario was for 15% return in 2021 and mainly tilted to the first half of the year. Now, the bond markets decided to factor in higher inflation before its fully visible and bond ETF investors left 1Q 2021 with losses of 10-15%

The higher bond yields had their impact on stocks with huge market cap and a relatively small, but growing business as anchor. The growth should actually get a boost from higher economic activity. The discounting factor for the present value of future cash flows also rose and hence reduced the net present value for the growth category.



Preferences changed over the course of the quarter

After the positive vaccine news in November 2020 financial markets started to look for much higher economic activity in 2021 and 2022.

Since December 2020, the forecast for global GDP growth in 2021 has been lifted from 4.0% to 5.5%. In USA they're giving it a full Monty, so GDP growth should be be highest since early 1980's. High growth obviously triggers fears for bottlenecks and higher inflation down the road.

The high GDP growth is not sustainable for the longer term, but just as the lock-down caused major moves in spring of 2020, then the opening can create some turmoil in 2021 and 2022.

A lot of companies have become much more aware of their own agility over the past year, so once activity picks up then profitability should be able to keep up a good pace too. At least for a few years.

Earnings estimates for 2021 and 2022 have been lifted by 4-5% during 1Q 2021 and the current valuation for S&P500 on the newest data is P/E21 of 22.7x and P/E22 of 19.7x. That's earnings yields of around 5% or unchanged from end of 2020.

There was however a clear shift doing 1Q 2021 as investors sold the previous years winners (the Growth stocks) and bought the losers from the past 8 years (the Value stocks).

No-one knows who will have the market leadership in 6-9 months time, but if interest rates rise to 3% the overall market will go down and due to discounting factors, the Growth segment will suffer the most.

From Raodmap 2021

Source: IMF and OECD

Inflation and NPV of the future

Since early 1980s equity markets have been blessed by declining interest rates.

With rates around 0% it's hard to imagine equities to have any tailwind from that source over the next decades.

In 2021 the commentators have focused on inflation, bottlenecks and unsustainable high government deficits.

US 10-year bonds have increased from 0.90% to 1.70% in a few month, but are still at levels that encourage equities over bonds

Yet, equity need to be observant to interest rates. In 2018 when US 10-year bond provided 3.25% yield (for a few days) it discouraged equities to the extend that stocks fell 2% in the year despite 23% earnings growth that year.

In the 2021 the question is if equity investors will look beyond the inflation jump that will occur this summer simply due to a low base last summer

All models are wrong, but some are useful

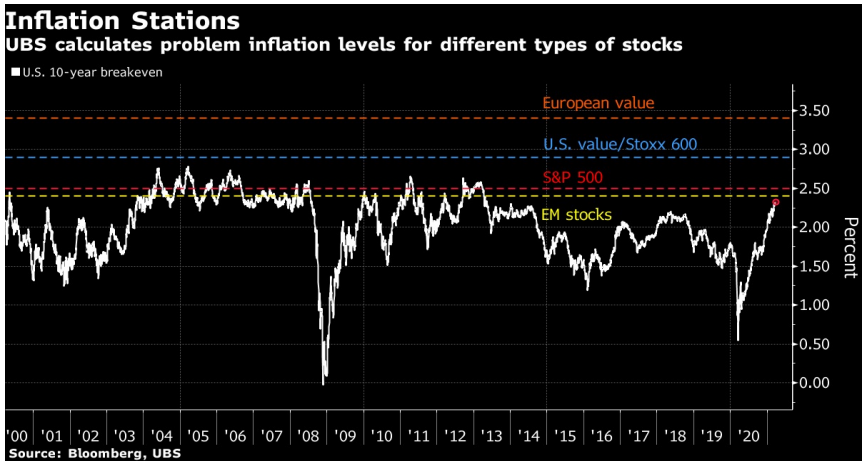
In the figures to the right there's the net present value of future earnings in various growth and discounting scenario's

The base is consensus forecasts for 2021-23 and the 'tail' is earnings (EPS) growth towards 2046. No terminal value is used.

Indices changes constituents all the time, so in theory it's the most dynamic and largest companies in the region that's inside the indices all the time.

Instead of having one model that is most likely inaccurate at best, it's the figures to the right gives intervals for index levels in various scenarios.

Just make your own pick. Please note the relative pessimism about Europe's future implied by the current level



Stoxx 600 at 429 by end March 2021

NPV for Stoxx 600	EPS growth rate					
Discounting rate	2%	3%	4%	5%	6%	7%
3%	573	635	706	788	884	994
4%	506	557	617	686	765	856
5%	449	493	543	600	666	742
6%	401	438	480	529	584	647
7%	361	392	428	468	515	568

S&P 500 at 3.985 by end March 2021

NPV for S&P500	EPS growth rate					
Discounting rate	2%	3%	4%	5%	6%	7%
3%	3321	3596	3901	4243	4625	5023
4%	2996	3233	3497	3791	4119	4486
5%	2714	2919	3147	3402	3685	4000
6%	2469	2647	2845	3065	3310	3582
7%	2469	2647	2845	3065	3310	3582

Navigating sector rotation

Automotive, banks, chemicals and energy have suddenly come back alive in 2021.

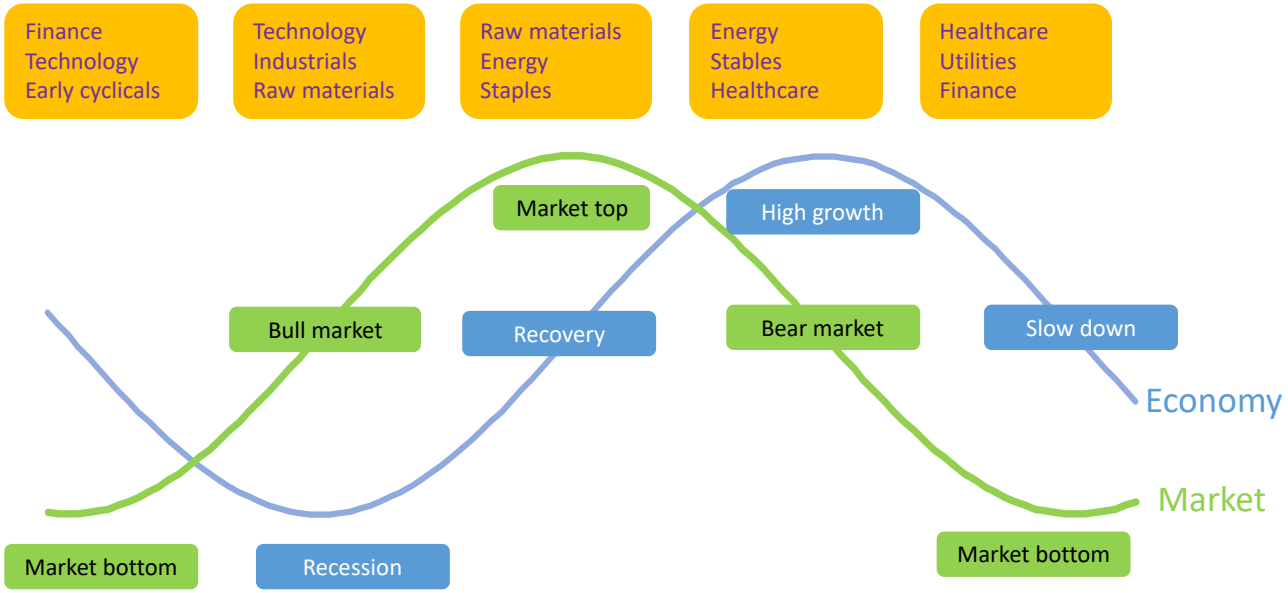
The expected normalization of economic activity and financial markets focus on discounting the future have worked like a textbook since November 2020, when President Trump was voted out of office and the vaccine was approved a few days later.

According to the text book and the inaccurate schematic model on this slide 2021 will probably continue to favour banks and energy.

However, the underperformance in healthcare and stables is getting noticed by some observers already. The market looks 6-12 month ahead. Once we're into 2022 the economic activity will still be good, but the growth rate will lose pace. That could be the signal for stable companies trading a attractive valuations to take the lead.

Business cycle roadmap works like a textbook in 2021

If investing was so easy as the model below illustrates, we would all be tremendous wealthy. The reality is that the median investor makes a return that is below the index returns over time. MSCI World has returned 7-8% per year over the past 50 years. At that rate and with 2.000$ saved every year the investor/saver would have 1.5 million $ before taxes. According to Credit Suisse Global Wealth Report you must have 1.0 million $ in wealth to part of 'Global top 1%'. The model below will not do the trick, but its useful



Source: inspired by own model made in 1990s

A big opportunity or melting ice cubes?

Value stocks are characterized as the lower valued stocks in the stock market. In 1Q 2021 Value stocks are priced at 15.5x forward earnings and 2.8% dividend yield, while the Growth stocks are priced at 30.5x forward earnings and 0.7% dividend yield

If you just arrived from the Moon you would probably go for the Value segment as you get much more for the money. But it's a snapshot picture and it doesn't catch the next 10 to 20 years of growth and value creation.

Value stocks might well outperform Growth stocks in 2021 and 2022 as Global GDP growth above 4% historically have coincided with Value stocks outperformance (figure to the right).

However, Value stocks with a large weight of Financials (23%), Healthcare, Energy and Materials will likely grow less than their Growth brothers with a large weight in Technology (35%), Consumer Discretionary, Communication and hardly any exposure to energy and Materials

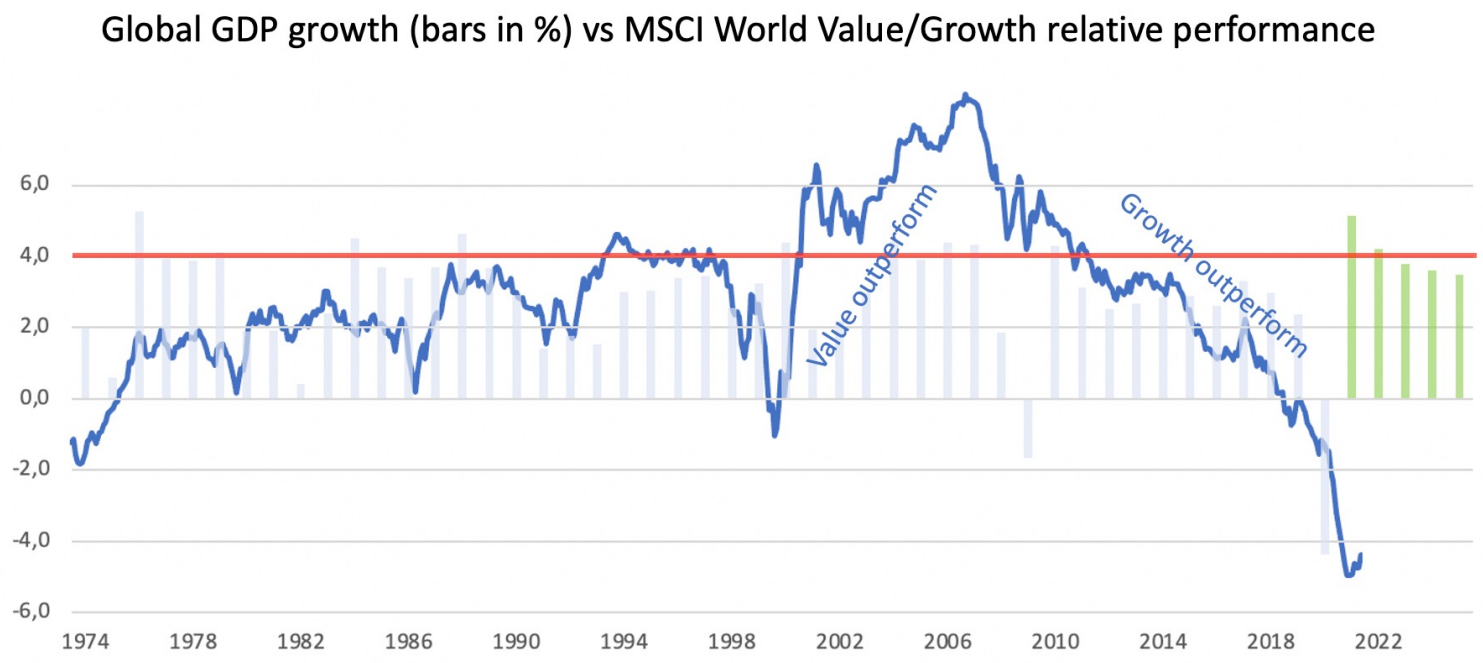
Quite a few Value stocks have a business that will be challenged in coming decade and hence they are melting icecubes

Ice cubes should only be held when weather permits

The accumulated knowledge of financial markets try to figure out how the world will look many years out. The largest components in MSCI World Growth are Apple, Microsoft, Amazon, Tesla, Nvidia and the like. The MSCI World Value constituents are dominated by JP Morgan, Berkshire, Procter & Gamble, Bank of America and Exxon. All companies are well established in their respective markets, however the Value segment have intuitively more of a turtle profile vs the Growth stocks that have a faster and more agile profile.

As example, financial services are in the midst of a major change towards digitalization and it's far from certain the current incumbents will dominate in 2030 or 2040. Hence, a Value investment strategy should be very cautious to the major changes that's going on in how world works.

AC Vision Fund focus on identifying and investing in Growth profile companies, but only when their valuation is reasonable



Exponential growth will move the rotation pendulum back to growth sooner or later

The way business has been conducted in the past centuries has been productivity driven. From small farms and simple crafts like the black smith making a horseshoe has evolved into mass production, marketing of consumer products and globalizations. That process has created tremendous wealth as the work streams have been optimized.

Imagine you had to make your own car. I wouldn't get anywhere for decades. However, if I could buy a toolkit, materials and 3D print the car it could probably be made in a few months. But it would most likely still be more expensive than a mass produced car.

We are getting to the point in human history, where technological achievements will move the needle towards higher productivity and lower costs.

Hence there's higher probability for lower inflation going forward than the current focus on higher inflation just around the corner

Technological achievements will change economic fundamentals

The accelerating pace and diffusion of technological change has taken control of an ever-growing fraction of the economy. The technology fraction of the economy used to be small. The exponential growth is however unstoppable and hence it's about to change the economic fundamentals as the rapid and exponential price deflation known from the tech sector spreads to almost everything.

By 2030 or so most large companies will be defined as tech companies as their products and services are driven by digitalization. Check the Roadmap for 2021 for more details

Mass production will not go away, and it will be even more automated and hence drive prices lower. As example; a Ford A in 1903 was sold for 3.000$ per horsepower (it had 8 horsepower so only very wealthy people could afford one). By 1927 the price per horsepower had fallen to 500$ making for bigger volumes and good profitability. Same for PCs. My first IBM was 24.000 DKK for a machine with black/white screen and 20MB of total memory….Memory prices have declined significantly, and screen quality is not even remotely comparable and for 24.000 DKK in 2021 you get the top-end machines

The increased efficiency of 3D printing will reduce production costs. The genomics and DNA profiling will catch inherited chronic diseases early and assist reduce healthcare costs and for better treatment.

Traditional businesses like banks, mining, shipping that dominate the Value segment will continue to exists, however the companies that do not change their digital business model will become obsolete as robo-miners, self-sail ships and transaction fintech take the most lucrative parts of the value chains.

Shortage of chips – the key industry for the digitalization trend

Over the past 20 years the global semiconductor industry has consolidated. The memory segment is the largest with 150 billion $ sales in 2021 in an industry with total sales of 500 billion $, up an estimated 20% in 2021.

The memory segment is dominated by three players; Micron, Samsung Electronics and SK Hynix.

The memory market is characterized by high unit volume growth at 15-20% per year for DRAM and above 30% for NAND

The manufacturers get better and better all the time, so they meet the unit growth with more supply and hence prices tend to decline 5-10% per year. The underlying industry revenue growth is hence 10%.

2021 and most likely also 2022 looks to be outstandingly good years as capacity expansion is only done against customer commitments to buy the new capacity, so the shortage will last and memory revenues will grow 20-25%

Accelerating prices for memory chips

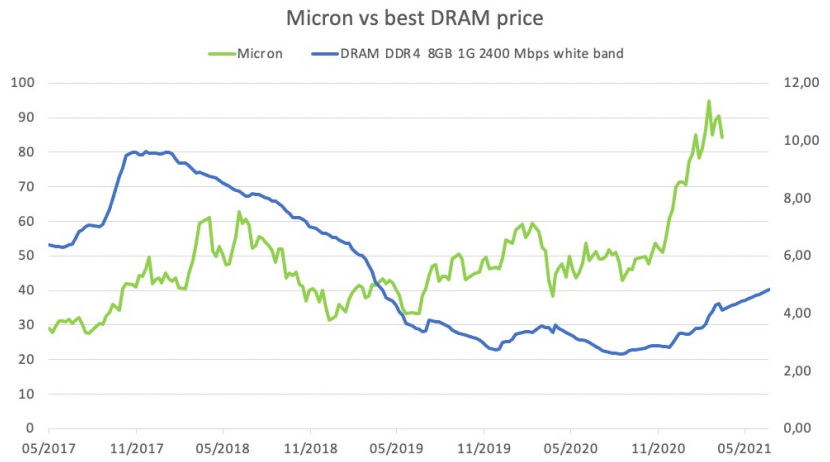
Covid-19 has changed the world in many ways. One of them is the rapid digitalization change that accelerated the trend. Just think on-line meetings in 2021 vs that activity in 2019 and imagine the technology that make the whole thing go smoothly.

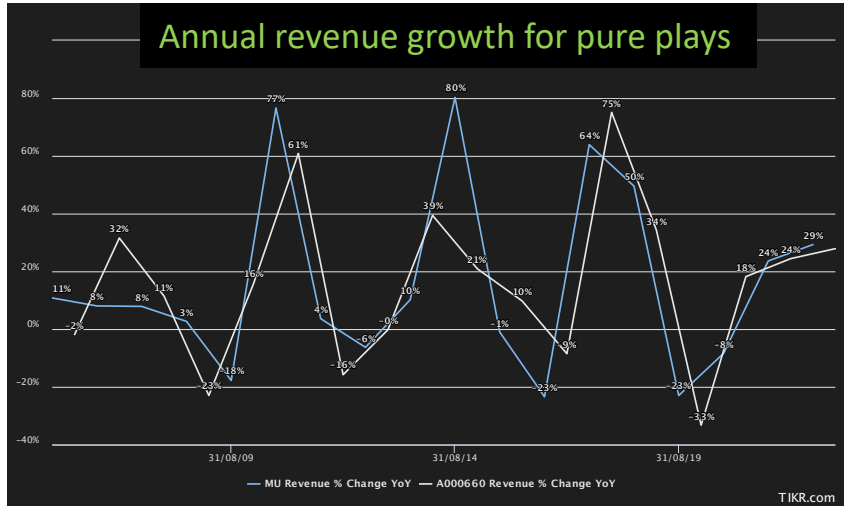
The accelerated digitalization has and will continue to significantly increase the demand for semiconductors. Not least memory. In 2000 memory chips was 10% of the total semiconductor market, in mid-2000s it was 20% and todays its 30% and heading for 40% over the next decade

The standard 8GB DRAM spot price in March 2021 is 4.12$ and up from 3.00$ in the summer of 2020. The current demand is 22 billion units and new capacity is not coming to market in size before 2022-23. Hence, prices will continue to rise and hitting close to 5.00$ in late 2021 or early 2022.

It takes 15 weeks to produce a 176 layer chip, so there will not come more chips to the market fast despite higher prices. And the higher prices is the same as higher sales and gross margin for the manufacturers, so 2021 and 2022 will be very profitable years for the manufacturers.

The demand phenomenon goes for other types of chips too and the most known shortage in 2021 is automotive chips. Global car production in 1H 2021 will be at least 1.2 million units lower than otherwise simply due to shortage of chips.





One more thing

If you find this presentation of interest please do not hesitate to reach out

For corporate strategy, investor relations profiling or inspiration speech at leadership gatherings pls contact

www.nordic-investment-partners.com

For investment participation in AC Vision Fund please contact

www.advicecapital.eu

Key investment view towards 2030

Economic pace in 2010s have been highly dependent on fiscal and monetary stimulus provided in the aftermath of the 2008 crisis. The stimulus have however created imbalances such as government debts. This will probably continue even as it gets beyond sustainable in some countries

Global economic growth has been declining from 6% in 1960s to around 3% in late 2010s. Productivity and population growth points towards lower economic growth in the coming decades. The underlying growth in global affluence will however continue and with Emerging Markets in lead as those economies grow double the speed of developed markets

There's nothing wrong with modest GDP growth, but many investors have been accustomed to 8% annual earnings growth, while the realistic forward growth is more likely to be around 4-5%. Dividends of 2% comes on top. Annual swings are likely to remain in the 15-20% interval, so the occasional declines will continue

In an investment world on those conditions Advice Capital Vision Fund focus on identifying companies and business clusters with unique multi-year structural growth drivers and then invest in these when growth/profitability/valuation triangulation justifies it. The investment focus in Advice Capital Vision Fund is on identifying, holding and harvesting multibaggers based on these principles. Good stewardship and ESG applies to the companies invested in.

The traditional business and inventory cycle still applies, so from period to period growth and inflation will change. In a world with evermore data and analytics the efficiency of eco systems will likely reduce the magnitude of economic swings as end-to-end value chains reduce slack and inefficiency. Risks of financial mis-allocation of capital is the same

DISCLAIMER

This document and its contents is for informational and educational purposes and should not be considered investment advice

There’s no warranty for accuracy, completeness or timeliness in the information. As such there’s no liability for errors, omissions, misuse or misinterpretation of any information contained in the document

It is subject to business confidentiality and may not be made accessible or handed out to third parties without the consent of Nordic Investment Partners

Violations of the provisions of business confidentiality may result in sanctions being imposed