NORDIC INVESTMENT PARTNERS

March 2022 update

What’s next?

www.nordic-investment-partners.com

Finland 15 March 2022

What's next?

The roadmap for 2022 was for modest positive stocks returns due to headwinds from inflation and higher interest rates.

The risk map included Russia/Ukraine conflict, however at same risk level as 'bond market functionality' and 'savers/vs non-savers inequality'.

Three months into 2022 and Russia has changed the narrative and future direction of the roadmap much more than imagined

In my opinion some changes are going to be permanent;

1. Europe's dependency of resources from companies and regimes that do not respect human rights and/or respect for our planet will not be part of the value chain. I.e. oil and gas from Russia will be replaced over the next years
2. Globalization will go slower forward and more sourcing will be localized
3. The first two points means higher procurement cost i. higher prices, so inflation looks like it's more sticky in the makeover process
4. Innovation and digitalization will however be a deflationary factor. This is an unchanged view

There are decades where nothing happens; and there are weeks where decades happen

Lenin wrote the above quote before the 1917 revolution in Russia. Little did he know that it would come back as a boomerang and isolate his own country 105 years later.

Putin and his regime has completely changed how the world will work in the coming decades within a few weeks of aggression against Ukraine.

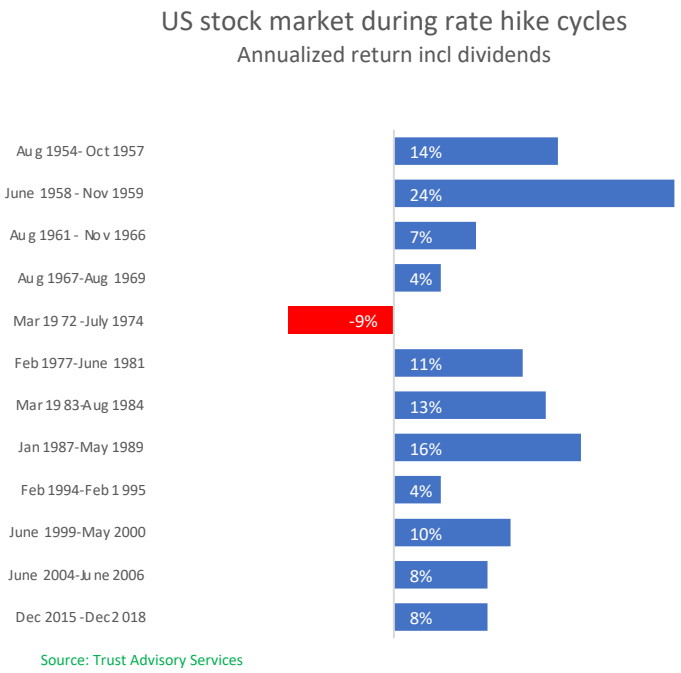
It will be called many things from 'de-globalization', 'home sourcing' or 'faster path to sustainable energy' and it's not going to be easy or without costs.

Inflation is currently coming in at 6-10% level mainly driven by direct and indirect higher energy and logistics costs. To cool things down central banks can slam the brakes (see roadmap 2022 for that scenario link) and on purpose make a recession. That's like early 1970s and early 1980s episodes.

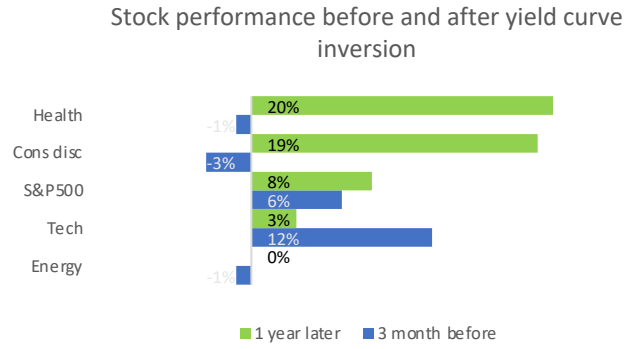
Very few of todays investors have tried the 1970's inflation period on their own skin. The facts illustrated to the right shows investors should not be too concerned about a rate hike cycle. If bond yield jump to 4% we would likely a capital flows from stocks to bonds so watch the bond yield for that to happen.

The illustrations on the right gives some indication of what to expect and how to position. Based on yield curve inversion episodes (2-year yield goes above 10-year yield) then healthcare should continue to perform and consumer discretionary (cars, travels, furniture) should start to perform well.

No-one has privileged access to the future so let's see how it unfold.



Source: Trust Advisory Services



Source: ISI Evercore

Quarterly update. 1Q22

Ukraine conflict, inflation at 40 year highs, oil price at 120$ and shortages in lots of places

Where does all that leave us?

There's interestingly enough lot's of good values in the stock market. Employment is good, consumers balance sheets are strong, corporate agility and health is good and the level of innovation is the highest in human history.

Yet it's not very difficult to find stocks that are down 50-80% from recent peaks in 2021. And the total market is also down albeit not a severe episode (see next page) but more a harmless reminder of volatility.

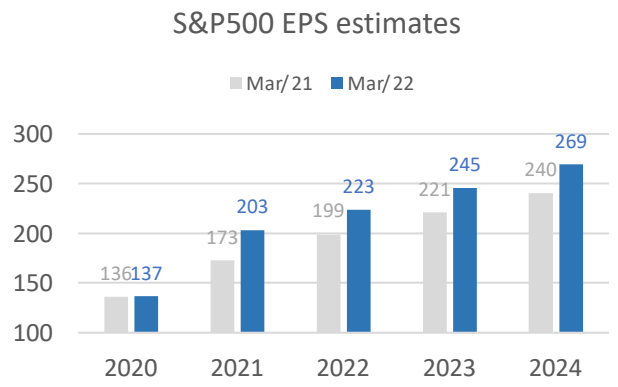
Forward earnings estimates are up 12-17% and only US stocks have reflected this at same level. European stocks albeit closer to Russia lags the fundamental improvement.

If things go more or less as expected today then inflation should not be more than 4% in Spring 2023. If that becomes a fact stock markets should outperform and end 2022 'with a modest positive return'

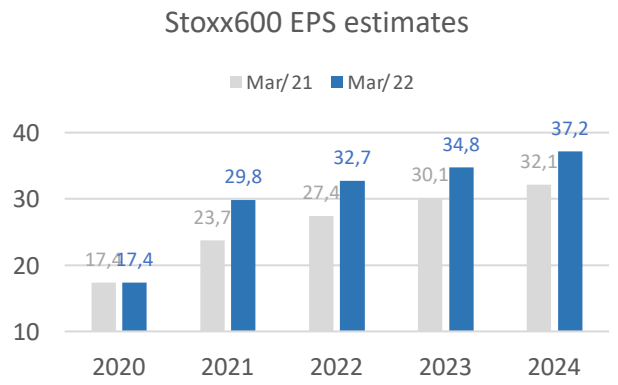
Time will show

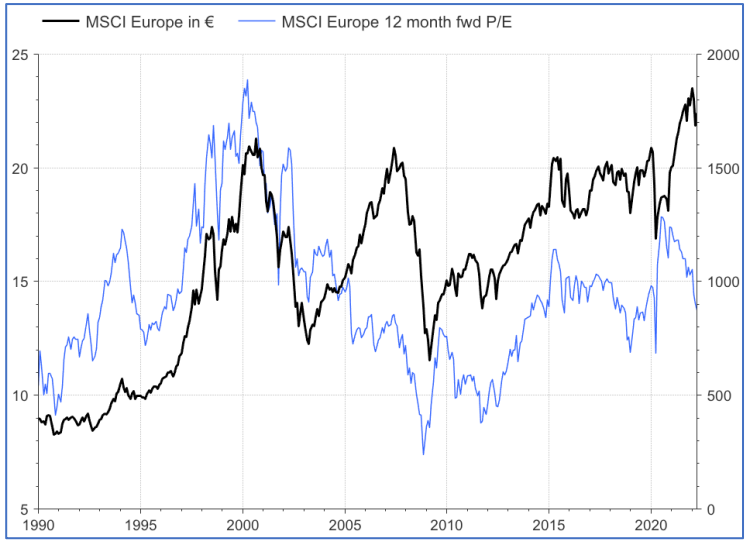
Fundamentals have improved significantly over the last 12 months

S&P500 forward estimates have been upped 12% over the past year. Stocks are up 13% in the same period



Stoxx600 forward estimates have been upped 17% over the past year. Stocks are up 6% in the same period





The nerdy corner

Since Omicron entered the theatre in November 2021 stock markets have declined. Measured on MSCI World in DKK it fell 11% from peak to bottom. By end march 2022 its down 4% from November 2021 peak.

There's an ever increasing number of algo's investing and trading the overall stock market and algo's use historical patterns to detect and predict future moves. But it's not clear if algo's generate excess return. Sometimes the run havoc.

The first known algo break-down was in 1987, when markets crashed 20% in one day and the stock exchanges had to implement 'circuit breakers' – a fancy word for pulling the plug on the computers.

Looking at the daily pricing data for the last 62 years and checking for patterns it's clear that you should go 'all in' when the rolling quarterly returns are at minus 30% or lower. It means you only have 6 working periods over the 62 year period ….

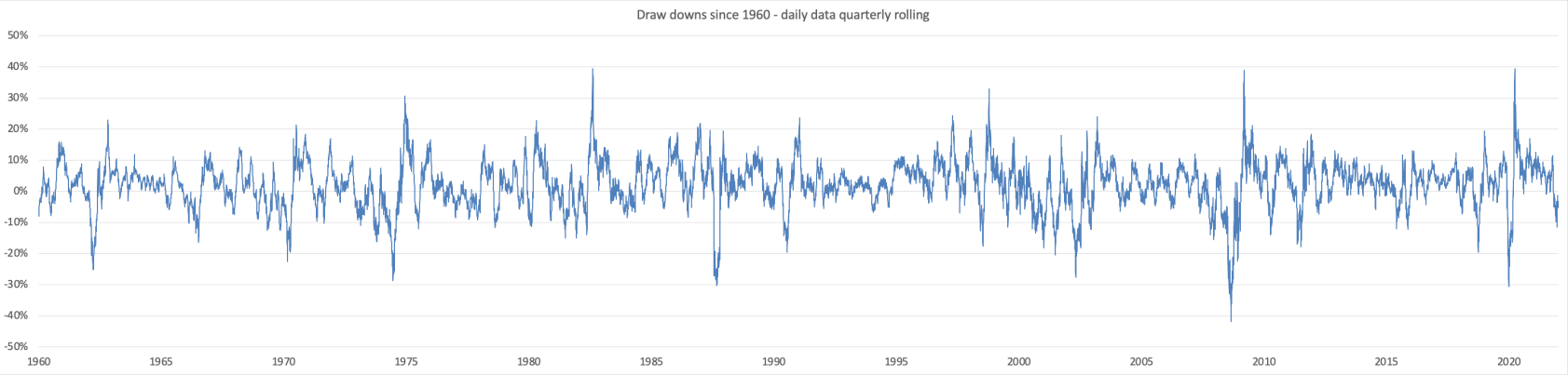
Selling the peaks when rolling return is 30% or higher is not a good strategy and the draw down data didn't see the 1973, 1987 and 2000 peaks

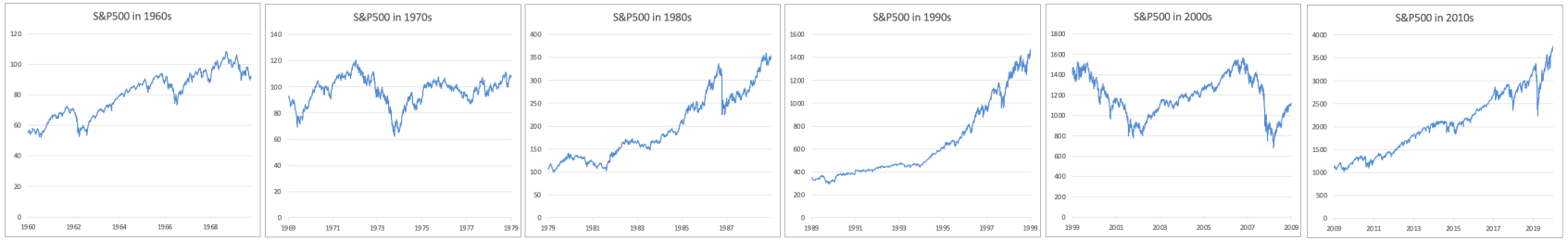
No-one has privileged access to the future

The volatility seen in 2022 has been a harmless reminder that stock markets are volatile. Investors should always be mentally prepared for a rainy day. On-one knows if inflation and geopolitcal conflicts or other things will knock stock markets down by 20-30% from recent highs, however the below illustration gives you some indication of how you should navigate in volatile times.

Each decade has its know characteristics in the history books like 1960s hippies, 1970s oil crisis, 1980s yuppies and 1990s tech boom. Stepping aside and just look at the drawdowns of more than 25% i.e not caring about whats going on elsewhere could have made some pretty good investment returns. Algo's have no emotions about the news flow and they are on work every day, so the future drawdowns might be impacted by algo's activity. And given the high inflation and the new world order the stock maket performance suggest something else than human sentiment is at work in 2022.

Below is each decade and the 2010s have been extended with the first 2 years of 2020s. That pattern could look like the 1997 episode, but only time will tell. its going to be interesting to see how 2020s looks in 2030.





A few thoughts about the overall market

2022 has continued the media rhetoric's about a stock market bubble and resemblance to the events in 1999 to 2001

A bubble is defined a period when valuations are higher than justified by the underlying fundamentals and a substantial decline in stock prices is inevitable

The big difference between the events 20 years ago and today is fundamentals. In 2022 the fundamentals and valuations are on a much sounder basis

There's a few overvalued segments such as pure play electric car makers and some pockets in the software that are valued beyond realistic long term growth and profitability levels.

But the overall market is not in bubble territory and a major market decline is a buying opportunity.

Hence nothing is really broken

Media has been quick to bring doomsday sayers into the spotlight

Virtual event

Will rising inflation pop the equity bubble?

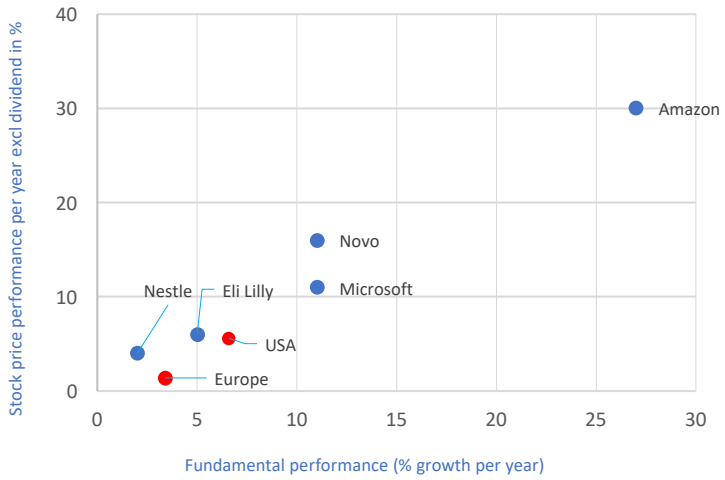
Jan 26, 2021

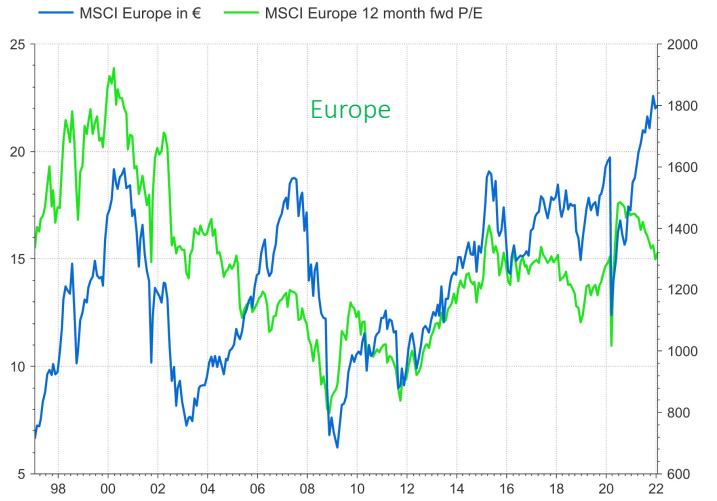
Long term is the key word

Earnings yields in Asia and Europe are not in bubble territory as their earnings yields are 7% earnings yield vs 5% in USA and 3.8% for Nasdaq100.

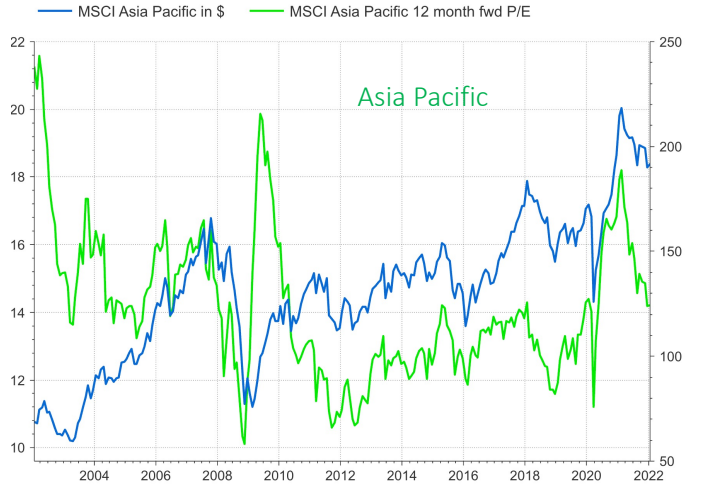
The media hullabaloo inspired me to look at long term performance correlations and they're giving long term investors comfort.
I ran a few companies to check stock price performance vs fundamentals (sales, EBIT and EPS) over 21 years starting close to the IT bubble peak in 2000.
The scatter chart below tells that the stock price follows the fundamental performance. Even very expensive stocks in 2000 did quite well provided they are long term fundamental growers. The message is clear; think long term, be patient, go for growth and not least pick the right companies, sectors and regions

Performance since 2000:





With P/E's around 15x Asia and Europe are not in bubble territory



The growth versus value pendulum

I've mentioned it many times; the stock market is like a dog with a long leach tied to a stagecoach. The stage coach goes from one end of the country to another and the dog is running around sniffing and peeing, but it will eventually end up the same place as the stagecoach it's tied to.

The performance box on the previous page illustrate the thinking.

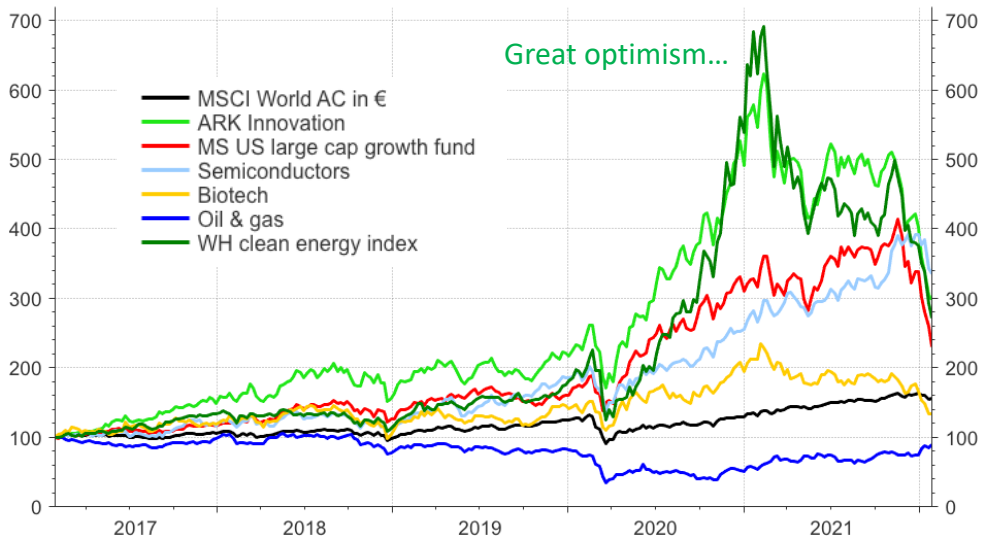
A lot of companies focused on parts of the economy that will grow significantly over the next 15-20 years saw massive price appreciation in 2020 and significant price declines in 2021 and in the start of 2022 these companies have seen their stock prices falling out of bed.

I don't know if the dogs are now behind the stagecoach instead of far in front, but they are getting to levels where long term investors start doing some serious due diligence.

It's impossible to predict short term moves, so the fallen growth stocks might well fall another 20-30%, but could also see significant rebounds if inflation data shows signs of cooling off

Stay tuned

Some amazing performances in future oriented exposures



AC Vision Fund focus on the growth pockets of the future. Consequently, the fund by definition should have exposure to genomics, renewables, EV's and other companies high sales growth and no earnings and valued at 20-50 times sales.

The GARP strategy is like a safety belt and roadmap for taking other routes when the driving gets too dangerous.

The performance in 2021 and 2022 is evidence that the strategy works in the shorter term.

The major innovation and productivity shift we are already living in will not stop just because inflation and interest rates rise.

But the 50-60% decline on the aggregate level and 80-90% price decline in single stock levels open up good entry points.

And just for illustration; AC Vision Fund invested in **Nikola**, the EV truck maker, when it was a SPAC and sold it around 80$ (market cap 27 billion $) just after it was a normal listed company. The episode took only 5 weeks. Fast forward to 2022 and Nikola now have analyst coverage that forecast 3bn $ sales in 2025 and breakeven. Yet, the stock price is down 92% from peak and market cap is now 3 billion $.

Pharmaceutical industry update

The pharmaceutical industry is approximately 1.400 billion USD and grows 5% per year from 2021 to 2026.

The performance of the overall drug market got a significant boost in 2020-21 from Covid vaccines coming to market. The vaccine revenue streams are however expected to fall significantly in the coming years as the vaccine shots gets cheaper and less frequent.

Cancer/oncology is the largest segment followed by diabetes treatment. Related to the diabetes treatment market is treatment of NASH – non-alcoholic fatty liver, which is correlated with lifestyle diseases such as overweight.

Work to reduce obesity and diabetes could also have positive feedback loop in the form of fewer people with cancer. So some of the leaders in diabetes, obesity, NASH etc like Novo Nordisk, Gilead and Eli Lilly could be in for a significant increase in their addressable market during 2020s

Cancer drug market

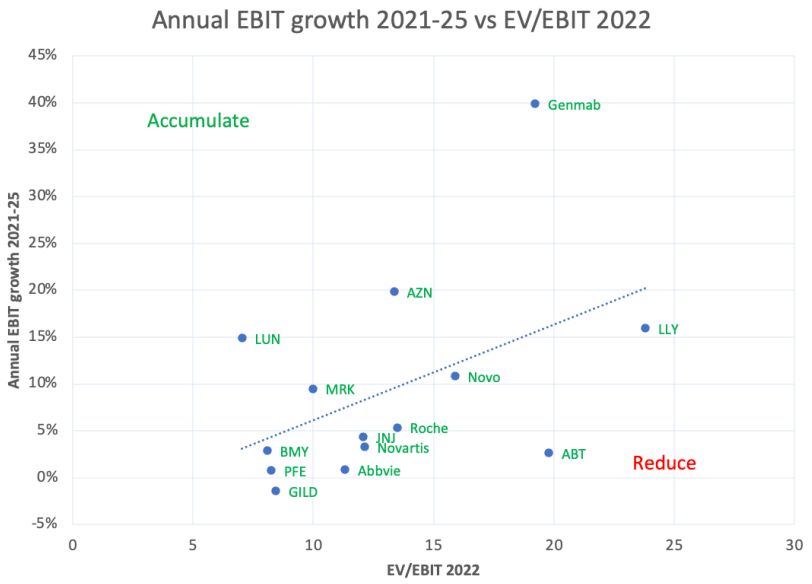
The single biggest drug segment is cancer treatment. The risk of getting cancer rise with age, so the older populations in most countries pose an issue on healthcare spending in the coming decades.

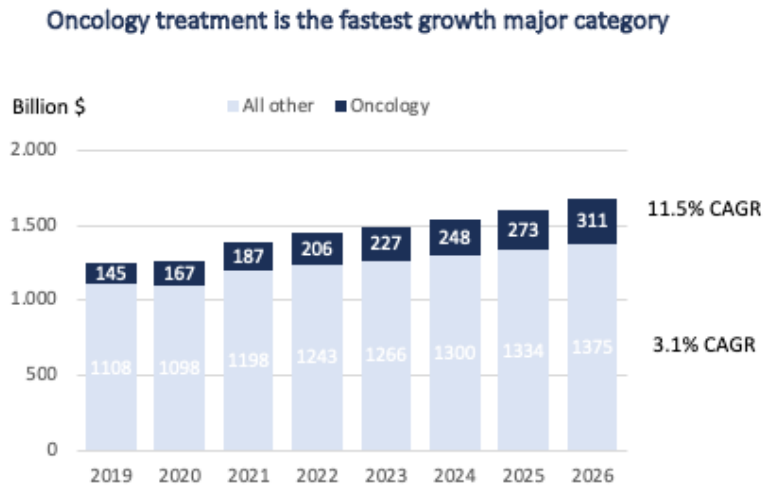
Fortunately, cancer treatment is getting better and better. In the past the treatment consisted of a mix of physical operations to remove the infected tissue and then kill the cancer cells with poison (chemotherapy). A very tuff cure.

Fortunately, treatments that use the body's own immune system are rolling out fast and the survivability increases. The new cancer, or oncology treatments, boost the annual revenue growth of 11% per year in the cancer treatment drug segment. This is by far the fastest growth in any major drug segment.

The figure on the upper right of this slide shows annual earnings growth vs current valuation. And can in overall terms be used as a screener for investment ideas.

(this is part of an annual update for AC Vision Fund)





Source: IQvia

Roadmap 2022 follow up

In roadmap 2022 there's a section on upside surprises. One of them is about fusion energy becomes commercial in 2028

We are not there yet, but in January 2022 China's nuclear fusion reactor in Chengdu managed to have the process going for 17 minutes – a world record far beating the CERN with 400-600 seconds processes

The 'unlimited free energy' is getting closer, which would be very good news for our planet.

Even though its good news for planet Earth there was not much news about this in the general news flow. Maybe because geopolitics still play a role and if China get the upper hand vs USA the global power balance would move even faster to the East

AC Vision Fund has tried to find investment exposures towards fusion energy, but so far without success.

The Chinese are ahead in fusion energy

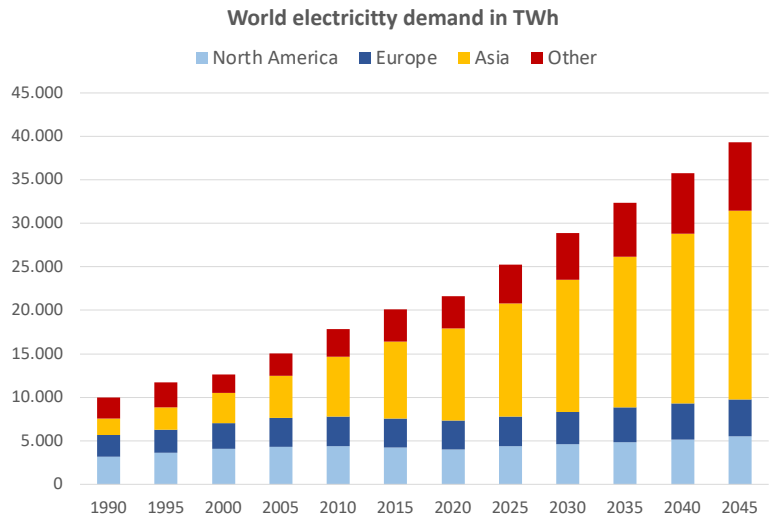
Over the last 30 years global electricity demand has doubled. It's mainly driven by Asia that have met the demand increase with fossil fuels.

Over the next 25 years global power demand is going to double again and to meet this demand we need to find other sources not least to bring down humanity's CO2 footprint and particle emissions.

Solar, wind and nuclear can fix some of it but not all.

Consequently, instead of playing old fashioned geopolitical power games humanity should use swarm intelligence to get the fusion energy train up to full speed.

There's a reason bee's do not live alone – one bee cannot figure out how to build a beehive



Source: enerdata.net

China's Artificial Sun Just Broke a Record for Longest Sustained Nuclear Fusion

Superheated plasma reached 126 million degrees Fahrenheit for 17 minutes

China's Experimental Advanced Superconducting Tokamak (EAST), also known as the Chinese Artifical Sun, has operated since 2006. MU CHEN/Barcroft Media via Getty Images

In a new world record, China's "artificial sun" project has sustained a nuclear fusion reaction for more than 17 minutes, reports Anthony Cuthbertson for the *Independent*. In the latest experiment, superheated plasma reached 126 million degrees Fahrenheit—that's roughly five times hotter than the sun, which radiates a scorching 10,000 degrees Fahrenheit at the surface and about 27 million degrees Fahrenheit at its core.

One more thing

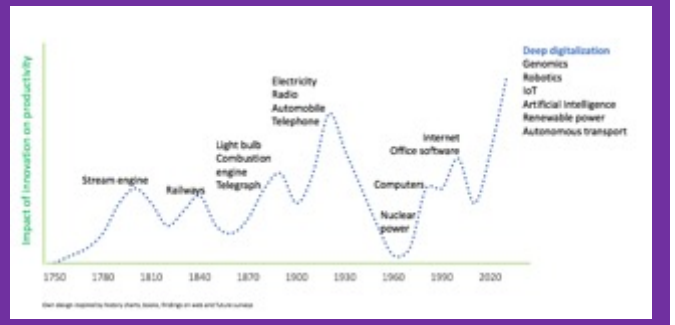
Human innovation has completely changed the Earth over the past 200 years.

Better healthcare, living standards and communication has made Earth smaller and the human population will soon reach 8 billion.

The way humans used to use Earths resources is unsustainable hence there's a big need for innovation in renewable energy, recycling, farming and transportation as well as digitizing almost anything.

It can be quite time consuming to invest in these trends and that's where the strategy fits in.

The fund aim to generate more than 10% return per year via prudent investments in structural growth companies and trends



Key investment view towards 2035

Economic pace since 2010 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. Some region run large surpluses and more than enough to finance the government deficits elsewhere. A shift of power is happening at glacial speed.

Global economic growth has been declining from 6% in 1960s to around 3% in 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 will be in lead as those economies grow double the speed of developed markets. There will be pockets of innovation growth and that's where Nordic Investment Partners focus the research that is used by AC Vision Fund

There's nothing wrong with modest GDP growth, but many investors have been accustomed to 8% annual earnings growth, while the realistic forward growth towards 2035 is more likely to be around 4%. Dividends of 2% comes on top. Annual swings are likely to remain in the 15-20% interval, so the occasional declines will continue, but recoup times will be longer

In an investment world with that overall outlook Nordic Investment Partners have since 2017 focused 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 strategy avoid long term sun-set industries despite some of them are deep value from time to time.
Advice Capital Vision Fund use the investment method.

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 as humans tend to run in flock

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