NORDIC INVESTMENT PARTNERS

3Q 2022 update

World is in a difficult place

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Review of first 9M 2022

Despite a relief rally in 3Q 2022 the lights went out during September and the start of 4Q 2022 has been volatile

The bear market rally in July and August got its energy from economic data showing moderating activity levels, which was interpreted as good news for cooling of elevated inflation levels. Also, investor sentiment going into 3Q 2022 was the worst for years and investors had positioned themselves very defensively.

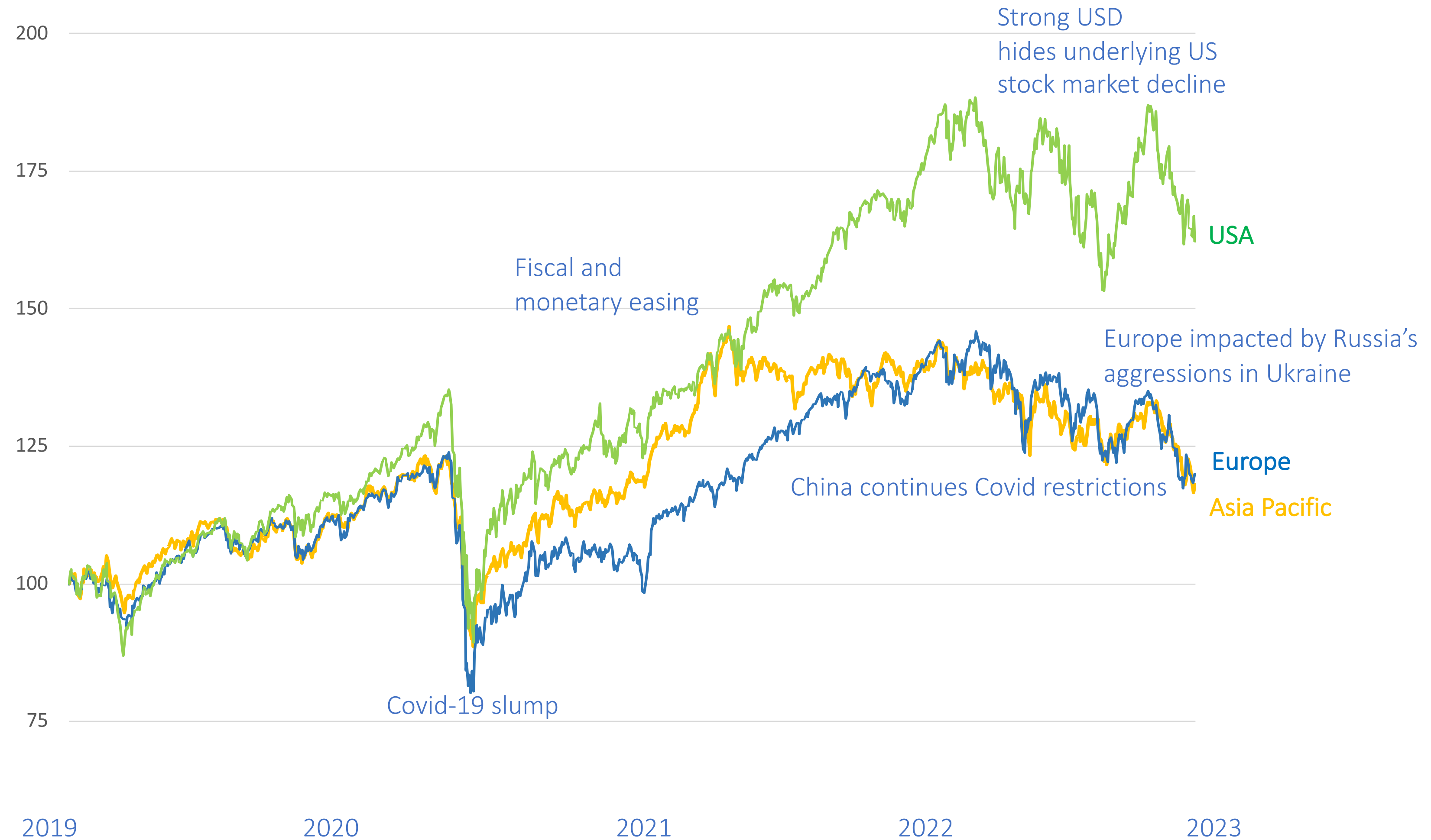
That market situation gave energy to what turned out to be a so-called 50% retrenchment (rising 50% of the difference between high to low observations). The whole relief rally vapourised since mid-August

It's a difficult spot to be in as many investors have serious bruises from the declines since February 2021. Many sub-segments are even getting close to a two-year bear market and 60-80% declines are not uncommon

So where next and what kind of exposures could yield the best returns for the next 2 years?

The major regions in global stock markets

MSCI data in EUR and incl dividends



Sources: MSCI data and own design

Forward fundamentals

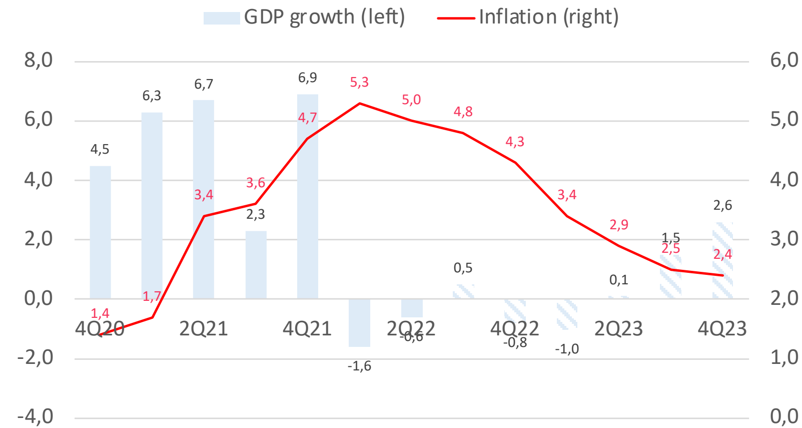
Economic activity levels shows signs of cooling of, which is the right road for lower inflation in 2023 and 2024.

Global economic activity is 95 trillion USD in nominal terms. IMF sees a cooling from the 6.0% GDP growth in 2021 to 3.6% in 2022 and 2023. That's down from above 4.0% in early 2022. And advanced economies are expected to grow just 1.1%. However, in nominal terms (including inflation) we're in record territory and should be able to pass 100 trillion USD in 2023 partly helped by inflation.

Lower activity levels will hit businesses, but the slowdown is well advertised, so businesses say they are well prepared. Opex, capex and inventory have been adjusted and credit facilities have been updated.

This could actually lead to a period with above expected cash flows.

If that's the case, how will the cash flow be used? The businesses on average say M&A will get more focus. And if nothing is found then stock-buy backs would make sense as stock prices have fallen to levels where it is accretive. This will be more visible in coming months

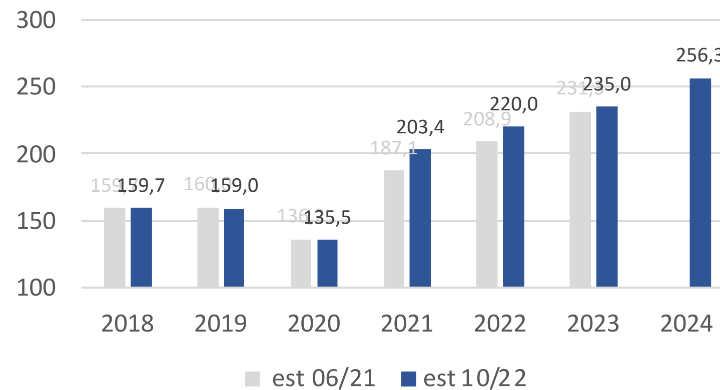


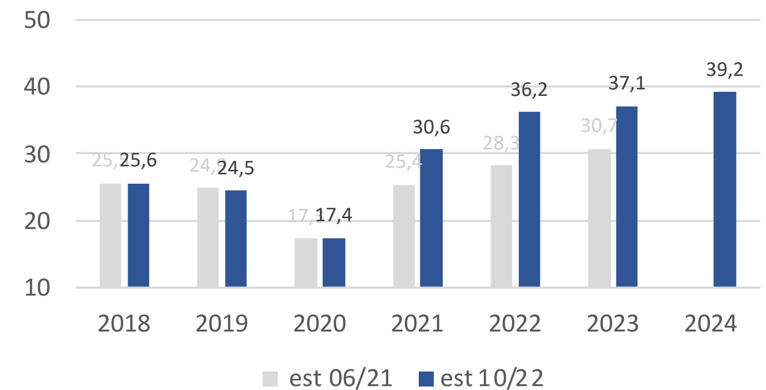
Forecasting on quarterly and annual basis is a moving target exercise. And it's almost never correct. But it serves a purpose as it provides some kind of direction.

It's up to anyone to have opinion and differ on consensus forecasts. The current earnings forecast have been raised since last summer and have only seen smaller reductions in recent months.

Lets say S&P500 earnings in 2023 will not be 235 USD but rather 210 USD, which equal a mild recession. Also, inflation start to decline towards 2.5%, then interest rates should level off in USA at the current 4.5% level.

That would be a very constructive basis for stock prices, but we are not there yet





Sources: Refinitiv and Conference Board

The road forward

Based on the fundamentals on the previous page one can make a updated roadmap with two main scenarios (illustration to the right).

Using the S&P500 2023 earnings number of 210 USD and with moderating inflation it would not be unfair to apply a 6% earnings yield requirement for US stock market. That would imply 16.6x next year earnings and provide a target for S&P500 of 3.500. The current level is 3.700, so a modest downside provided it's mild recession.

After 2023 comes 2024 and first glimpse of earnings for that year is above 250 USD. If that's the reality in 2024 and inflation is closer to 2%, then the forward multiple will be 20x i.e. S&500 could potentially rise to 5.000 or above the 2021 peak.

The current risk/return profile is hence the best it's been since 2Q 2020 when Covid raged and economic visibility was very low

We could also be headed for a deep recession and that is currently not reflected in stock prices.

It will be much more clear in early 2023 how things develop, so stay tuned and take on the risk you find appropriate for you

All models are wrong, but some are useful

Sources: MSCI data and own design

2022 surprises

There's plenty of commentary about the highest inflation for two generations.

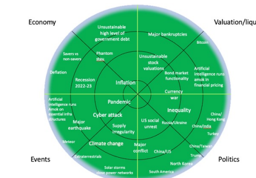
High inflation and central banks slamming the brakes was on the risk map for 2022. Now it's a fact and amplified by Russia's aggressions in Ukraine, which has reduced the supply of fossil fuels to Europe

A though winter is most likely ahead and it will be characterized by high costs for electricity and heating. This in turn will reduce discretionary spending for big ticket items such as jewellery, cars, furniture etc

Roadmap 2023 is the early phase of being formed, but there's unfortunately a new large risk factor associated with geo-political tensions

A major conflict in Asia like China taking on Taiwan could cause a 20-30% global activity reduction. The ripple effect of Japan and South Korea taking sides with Taiwan could potentially cause supply and economic disruption in proportions no living person has ever seen before

Geopolitical risks have increased to 60-year highs in 2022



Risk radar 2022 from December 2021

From Risk radar 2022 negative surprises section

Event	How it unfolds	Action plan
Stocks decline 10-15%	Inflation keeps running at 3-5%, central bank tightening and fear of an earnings recession due to higher wages and continued supply chain disruptions	10-15% correction occur almost every year. All the new investors since 2020 have not tried it before and get afraid. As they run for the exit. Pick up good exposures at good prices
Stocks decline 20-30%	Central banks slam the brakes and stocks tank as you suddenly can get 5% return on a 10-year bond	This will happen slowly at first and then fast. Move a larger portion to cash. Once there's 25% fall and the media narrative is ultra negative. Then you start to redeploy the cash
Retail investors pull back	Higher wages motivates more people to work and the armies of home-based daytraders decline	Could be motivated by more factors, but as Wall Street has become Main Street this is a risk factor to be monitored. Lower trading activity increase short term volatility
Geopolitics. Russia/Ukraine and China/Taiwan or India	General news flow and these events are to some extend expected at some point.	You cannot prepare for this long time in advance. But have it on radar screen and avoid direct exposures
Financial markets collapse due to algo/robot trading running amok	Daily trading is dominated by machine trading. It will happen as lightning from clear sky	Stock exchange authorities must pull the power plug from all connected computers and stop trading activities
Climate change accelerates	Hottest summer ever recorded in Northern Hemisphere triggers violent weather systems	Unfortunately, this should not b a surprise. Things like this move like glaciers and when they crack you should not be in their way
Cyber attack on global internet infrastructure	Internet stop working as a cyber attack blocks all the main fiber roads	You can't prepare for this. All electronic payments stop, financial markets stop, news flows ex radio stop. Major havoc before functionality is restored. Cyber security gets much higher priority afterwards

Sources: own design

One more thing

Nordic Investment Partners makes investment analysis that can be used for asset allocation and form investment decisions. This information is shared on web-page, a few individuals as well as Nordic Value Conference and similar events

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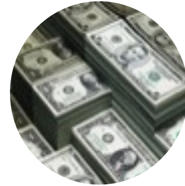
Key investment view towards 2035



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 regions 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 current decade. 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 advanced economies. There will be mny pockets of innovation growth and that's where Nordic Investment Partners focus the research

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. Family trusts use this investment method and perspective

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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