NORDIC INVESTMENT PARTNERS

Roadmap 2023

A middle year before things are getting back to normal in 2024-25

December 2022

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Summary

Traditional economics at work

2022 was a reminder of traditional dynamics of the economic system still works as the text books say. Economic stimulation during Covid lock downs caused demand to rise above long term trends and inflation followed.

To remove unproductive high inflation activity levels needs to decline and supplies need to increase. 2022 was characterized by central bank actions to remedy lower demand

2023 will see lower activity levels and subsequent lower inflation. This will eventually lead the central bankers to take to foot of the brake and moving into 2024 the global economic system should be on path for more sustainable growth and inflation.

In periods of lower activity corporate sales and earnings are challenged. Stock markets have new competition from higher interest rates so adding all together 2023 will likely see the downtrend continue and only when 2024 is closer one should see solid returns driven by lower interest rates and growth acceleration

Enjoy the journey

2023 roadmap

Roadmaps can be quite static as the route you see on a map is very different from the actual route. However, without roadmaps it's difficult to navigate and you need to navigate proactively if road conditions, weather or end-destination change substantially

Main components in roadmap 2023

1. Economic growth will decelerate in order to get too high inflation out of the global economic system
2. Monetary conditions will be restrictive until inflation is closer to the 2% target from the current 7-9% levels
3. Corporate performance has shown unusual solid performance since 2020. High inflation hits both the revenue streams but also the cost bases, so 2023 is less predictable. Companies with high pricing power, limited exposure to overall economic activity and relatively few employees should perform well. Software and cutting-edge pharmaceuticals are in that category. Companies with low margins, high debts and lots of employees should be treated with caution.
4. Some of the future growth industries in 2040s have become much bigger over the past year such as renewables and metaverse
5. 2022 valuation contraction of 30% has navigated stock markets into 'accumulation zone'. In late 2022 there was 700 companies globally valued at 5bn$ and more than 10x sales (a steep task for the company to live up to). Due to higher interest rates in 2022 companies with that profile has declined to just 100 companies.
6. Assuming stock market returns follow the expected fundamental performance 6-9 months ahead then 2023 will likely start on a soft note and then build stronger as the year progresses. Consensus earnings are expected to be flattish and valuation levels in late 2022 do not leave much room for further upside when short-term interest rates are approaching 5% in USA and 3% in Europe. The combination of all these factors suggest 2023 will be volatile i.e., 15% downside and upside to 10%. So, by end 2023 we might well be where we are today (end 2022)
7. Risks measured as general market declines happen frequently. 2022 introduced an old risk (war) to the center stage. Check the risk map for more details and scenarios.

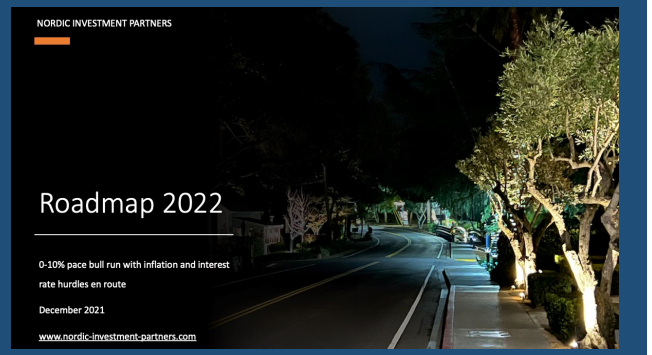
The roadmap is for inspiration and education only. Read the disclaimer in the end of this slide deck

December 2022

2022 review and learnings

2022 brought a lot of new learnings for investors;

1. Inflation rose levels not seen for 50 years. This resulted in rapid withdrawal of accommodative monetary conditions. This fuelled higher interest rates and capital moved out of stocks and to cash
2. Significant valuation contraction due to higher rates and millions of new retail investors burned their fingers
3. Inflation more sticky than expected despite falling prices for some physical categories
4. 2022 performance was below expected as risk scenario #2 for 2022 ‘ central bankers slam the brakes’ unfolded
5. Markets behaved in a rational way given the fundamental changes



2022 roadmap and what happened

2023: get rid of inflation year

High inflation is poison for sustainable long term prosperity , innovation and growth.

The 2022 inflation version has surprised on the upside and central bankers slammed the brakes by ramping up interest rates at the fastest pace for more than 50 years.

The cure will help to reduce inflation and the cost is lower activity and higher unemployment.

Central bankers will probably stay restrictive until they see lower inflation is sustainable.

Long term inflation will be lower as global activity will only grow 2.0 to 2.5% towards 2035 or almost half the growth level just 20 years ago. Developed economies will grow 0-2% and developing economies such as India will show 4-5% annual growth

By 2030 global GDP in nominal terms will be around 180trl $ with current forecasts vs 88trl $ in 2019

The fundamental forecasts going into 2023

Key economic indicators	Size 2019	2020	2021	2022	2023	2024
US GDP	21.4trl $	-2,8	5,9	1,8	0,5	1,0
Euro area GDP	12.1trl $	-6,3	5,3	3,3	0,5	1,4
China GDP	13.8trl $	2,2	8,1	3,3	4,6	4,1
Global GDP	87.7trl $	-3,1	6,0	3,2	2,1	2,6
Inflation rates						
US inflation		1,3	4,5	6,9	3,5	2,5
Euro inflation		0,3	2,6	8,3	6,8	3,4
China Inflation		2,5	0,8	2,0	2,2	2,0

Source: Conference Board, IMF and OECD. Annual change in percent

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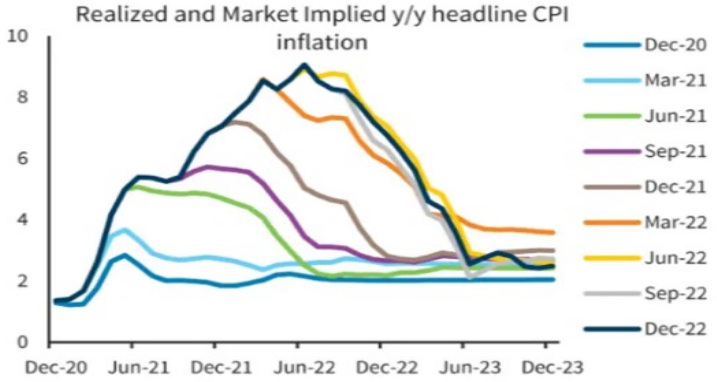
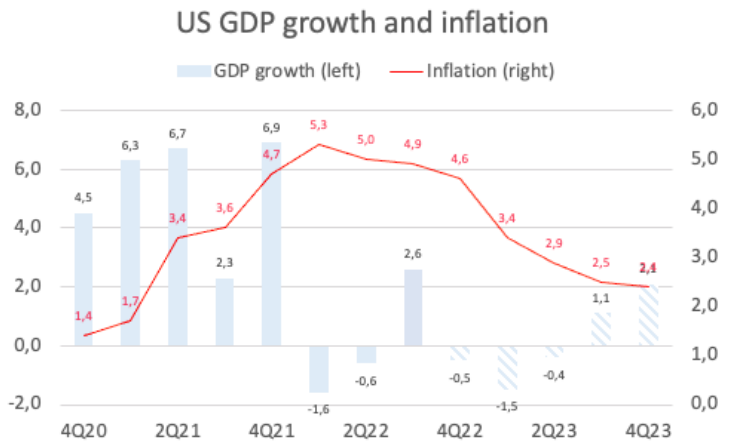


Source: Barclays Research



Source: Conference Board

Earnings and changes in valuation are the key drivers

The corporate world has evolved into higher profitability since 2020. The higher level is expected to be maintained in 2023.

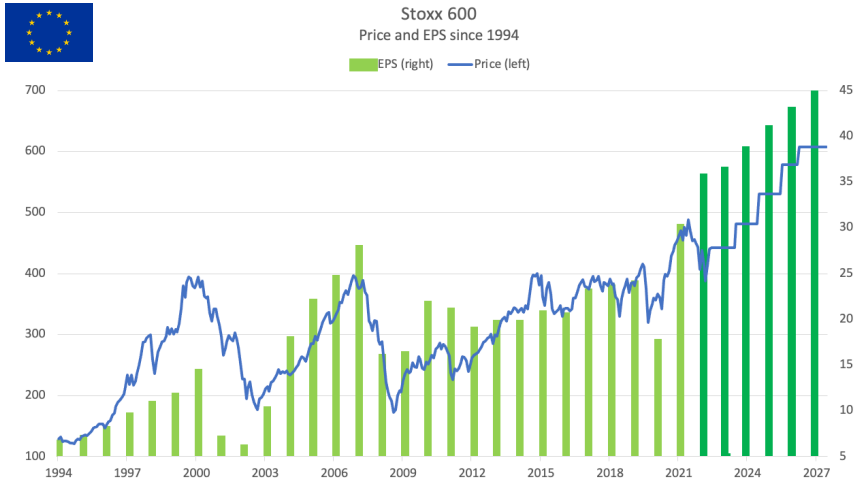
In 2023 consensus forecasts are for 2-4% growth in sales and earnings. The implied underlying performance is hence a volume contraction as reported numbers include inflation.

In December 2022 European and US stocks are valued at 12.3x and 18.0x, respectively. This leaves limited valuation upside in USA

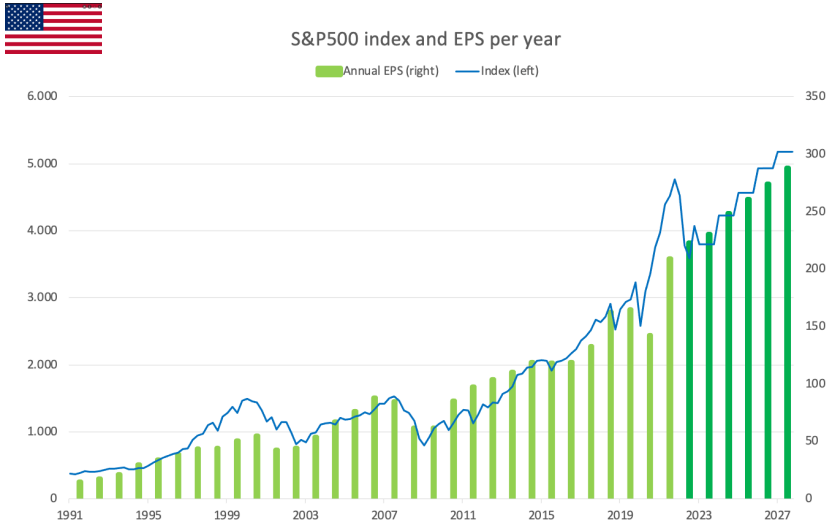
But take a look at 2024 and any weak stock prices in 2023 could be very attractive entry point for the 2024 rebound

Source: I/B/E/S

Index earnings and performance contribution



Source: I/B/E/S



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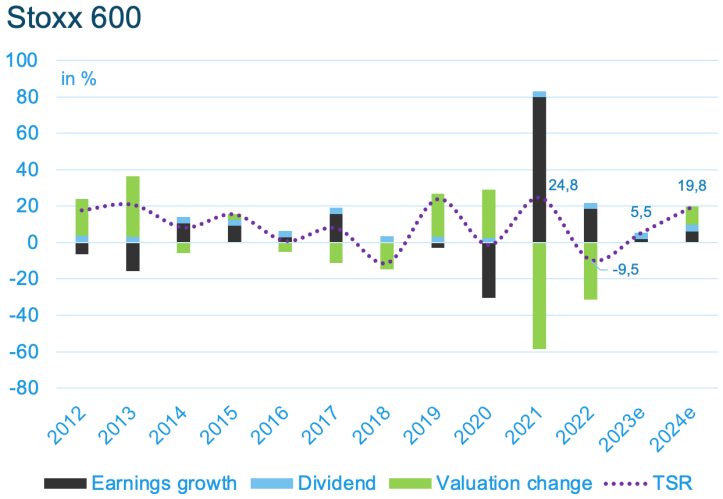
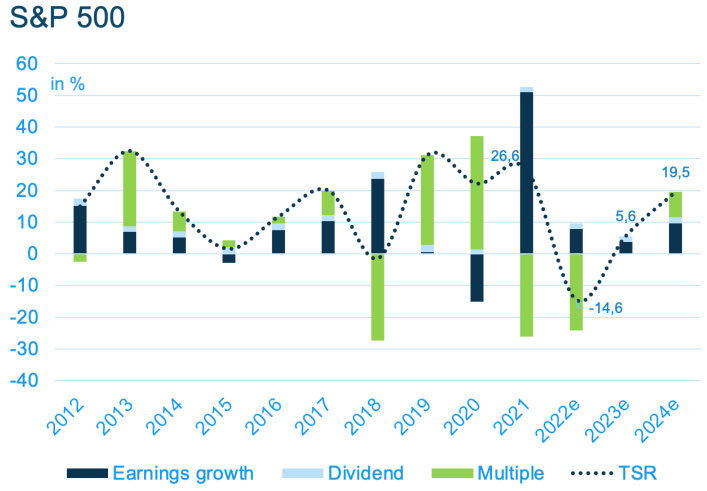


The components explaining the annual performance



Minus 15% to plus 15% return in 2023

Forecasting of one year returns in stock markets can be a bit waste of time even if you were 90% certain of how earnings would be. On a 12 month view stock prices goes random and it takes 17 years to have close to 100% correlation between stock price and earnings performance.

With that in mind;

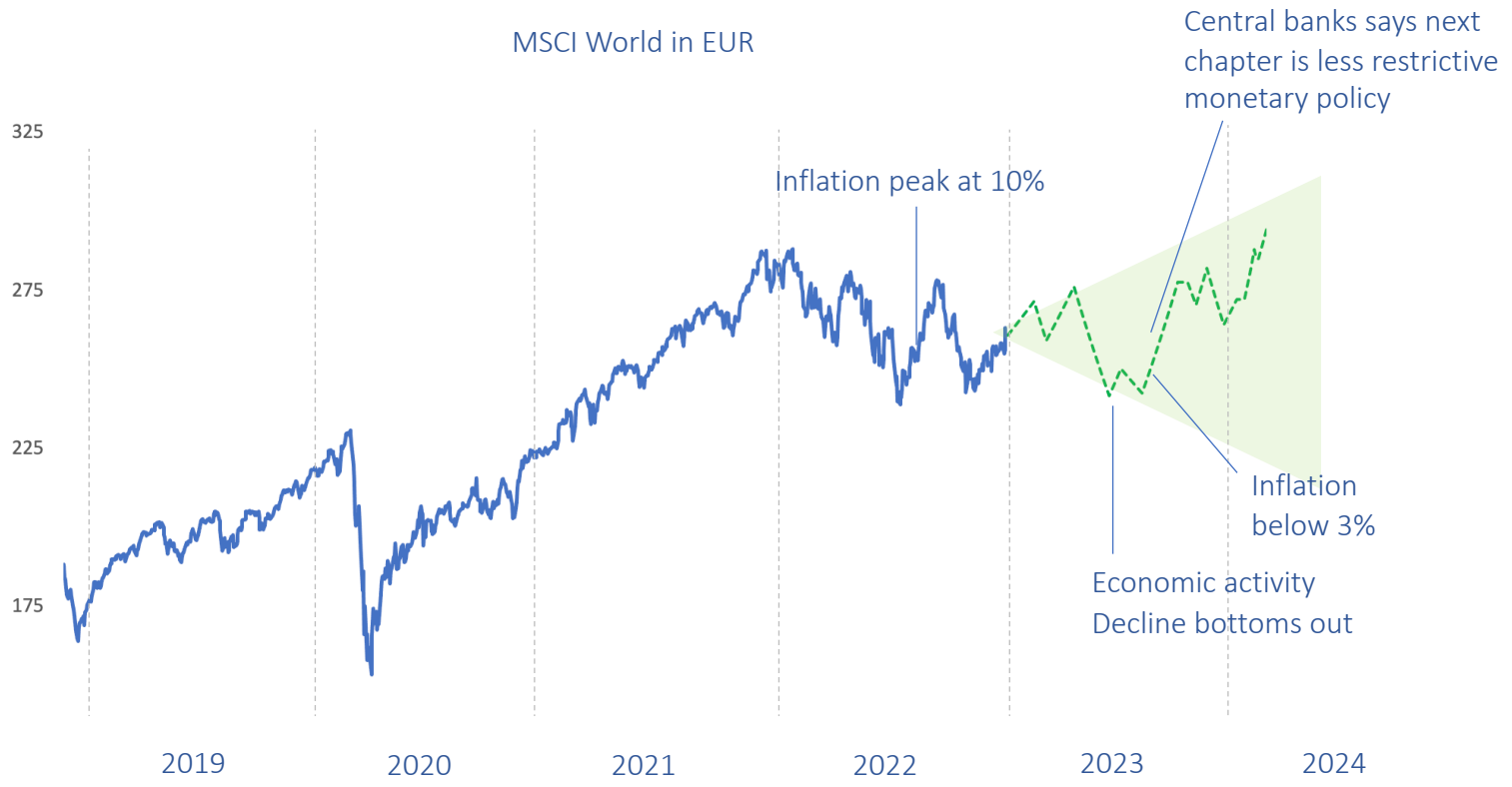
2023 consensus is for a volatile period with up to 15% decline and then followed by a rebound so 2023 ends more or less unchanged.

The fight against inflation will reduce earnings in the shorter term, however once inflation is sustainable low then central banks will ease and activity levels improve again. It's most likely a 2024 scenario but it should not surprise if it starts getting reflected in stock prices in the later part of 2023.

Nothing is cut in stone, so check the 'upside' and 'downside' surprises overview in the risk section

Roadmap for stock prices in 2023

Consensus earnings growth 2023 is expected to be 2-4% and it's normally 2%-point too high. Including recession years like 2001, 2008 and 2020 estimates are then 7% too high going into any given year. So if there's no deep recession in 2023 estimates are roughly correct and supportive for higher stock prices in the second half of 2023 when short term interest rates start to decline



Risk radar 2023

Risk is basically volatility and investors should always be mentally prepared for a 20% drop

The factors that really move things negatively are;

1) Recession in economy or earnings. In many cases this factor is triggered after a period excessive growth

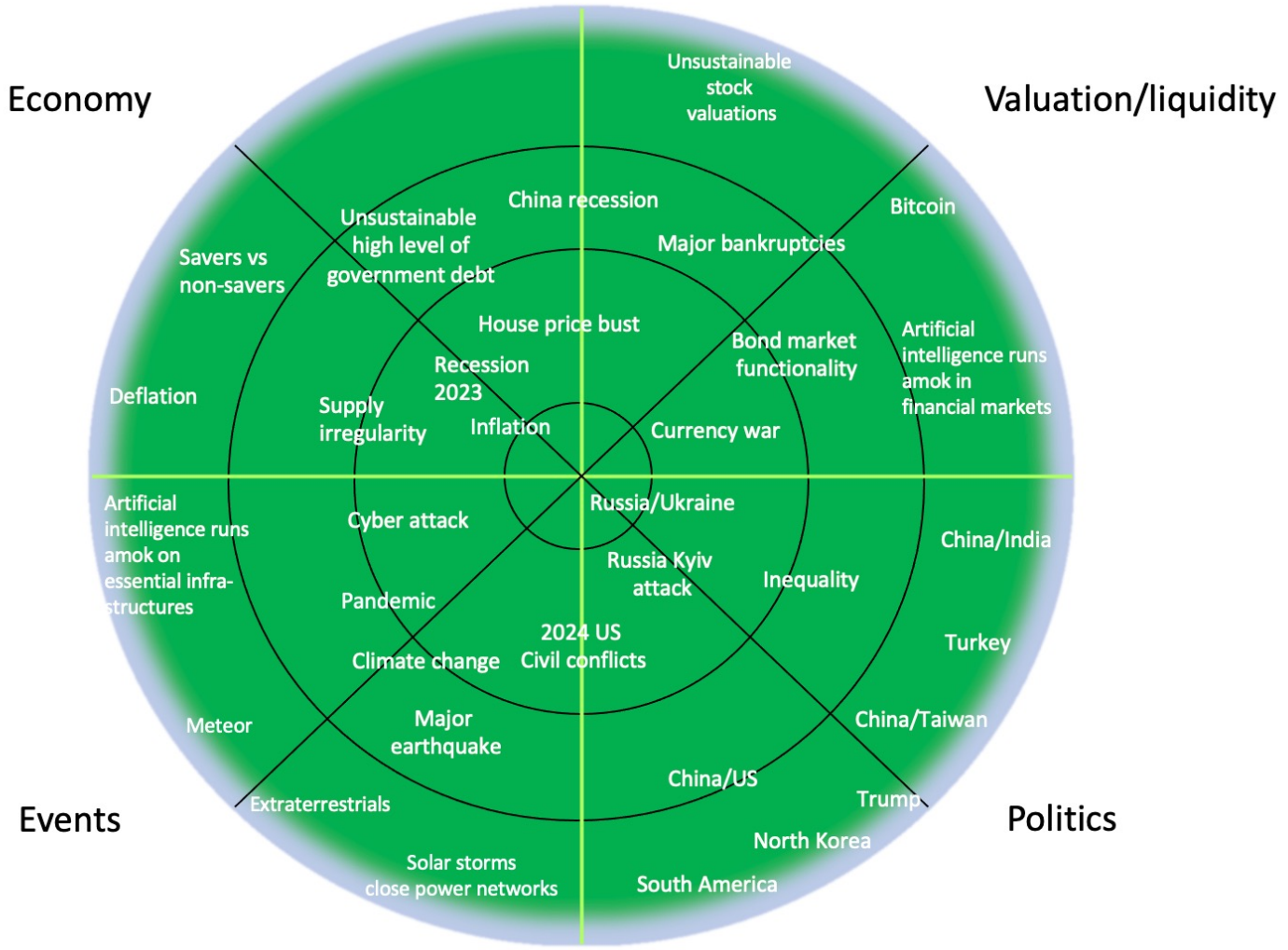
2) Valuations get out of sync with reality and then normalize as seen after the TMT bubble in 2000. Some segments in late 2021 was priced excessively

3) Shock to the system like pandemic, war, terror , Earthquake or lack of trust in the financial system

The main worries for 2023 are the same as in 2022 i.e 1) clumsy central bank tapering leading to higher volatility than necessary and 2) inflation gets sticky

Another main worry is a Russian Spring offensive against Kyiv going wrong and Russia goes tactical nuclear

The radar screen to the right gives some suggestions for risk factors to keep in mind



Alternative routes

Upside surprises

Roadmaps are fine to give some sense of direction. It is however guesswork being very specific about road conditions along the route.

The middle of the road forecast a downward first half 2023 and then a rebound in second half, so 2023 ends more or less unchanged in global stock markets.

If inflation cool off faster than anticipated and energy flows normalize then economic activity will improve faster than currently anticipated and earnings would increase too. Such a scenario would potentially make 2023 into a 10-25% return year and corporate earnings are stronger than expected this could trigger a 10-20% year

Positive surprises and what to do

Event	How it unfolds	Action plan
Global stocks rise more than 15%	Inflation decline occurs faster than estimated and central bankers take the foot off the brakes by summer 2023.Earnings grow 3% in 2023. Bonds and stocks rise 10-20% within a few months	Monitor monthly inflation numbers, unemployment, money supply and earnings. Stocks move solidly above 200-day trend lines which confirm the foundations for a sustainable rally
Global stocks rise 25-40%	Inflation vaporize and deflation word becomes part of the narrative again. Institutional investors with lots of cash on the sidelines must relocate towards growth stocks. Earnings grow 8-10% in 2023. The 40% rise happens throughout the year	Same monitor as above, but it happens faster and there's stampede to get positioned in the only asset providing long term real returns; profitable growth companies. Valuation gets stretched in this scenario, but bull run of this kind can last much longer than you imagine
Asia and Europe takes the lead with 25-30% jump	Asia and Europe are at attractive valuations, but investors sees no triggers to unfold the value. China opening after Covid and lower energy prices in Europe are keys to unlock the potentials as earnings grow 10%	This can happen in 1H 2023 so monitor general news flow and energy prices. Exposure via index fund if you don't have single stocks you prefer.
Healthcare science breaks the ageing code, and 100 year lives becomes a reality for many	Longer lives will force millions to save more for later in life. Stocks will be the obvious choice and markets roar upward	Monitor general media. Keep this event as a small blip on your radar. Pension funds will struggle, and preventive healthcare will benefit
Fusion energy becomes commercial	Fusion energy (same process as the Sun) is considered the energy solution after 2050. Scientist make break thru discovery and commercial roll-out starts in 2028	Unlimited energy for 'free' set motion in massive decarbonation. Lots of current energy assets become worthless
Metaverse for business unfolds	Apple, Meta, Microsoft and Zoom fight to get first with a user-friendly digital communication platform	Follow the tech news. Metaverse requires tons of semiconductors so monitor those stocks for detection of increased demand growth

Alternative routes

Downside surprises

Roadmaps are fine to give some sense of direction. It is however guesswork being very specific about road conditions along the route.

The middle of the road forecast a downward first half 2023 and then a rebound in second half, so 2023 ends more or less unchanged in global stock markets.

If inflation is too sticky and central bankers continue to push the brakes the dynamic economic system will come to a grinding halt. Activity decline is not supportive for company performance and stock prices decline in large scale. Interest rates rise to levels most investors find attractive and capital move to bonds and cash.

Real estate will suffer and consumer confidence gets hurt as their house savings seems to go up in the thin air

Negative surprises and what to do

Event	How it unfolds	Action plan
Stocks decline 10-15%	Inflation keeps running at 3-5%, central bank tightening and earnings drop 10-15% 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 continue to hold the brakes and inflation is sticky. Earnings decline 15-25% from 2022 peak. Happens slowly over the year	A majority of investor are aware of this scenario and cautiously positioned. Once there's 25% fall and the media narrative is ultra negative, then you start to redeploy the cash
Retail investors continue to pull back	The excesses in 2020-21 was driven by retail investors in lock down. Losses and limited experience reduce the armies of home-based day traders	This started in 2022 (Dave Portnoy journey) and the crypto collapse in made even more people loose money and motivation. Individual stocks that capitulate to levels way below fair price can be picked up
Geopolitics. Russia/Ukraine war goes on with Russian spring offensive	General news flow but read both sides to understand what's really going on.	You cannot prepare for this long time in advance. But have it on radar screen and avoid direct exposures
Too much government debt cause a run on the bank	High interest rates make a major government default and algo trading volumes explodes upward, while yields rise to 10-20% levels as debt markets are illiquid	Central banks try to stop the stampede but public trust in governments is severely impacted. A long deep reset recession follows. Gold and land are the main assets to hold in this scenario
Climate change accelerates	Hottest summer ever recorded in Northern Hemisphere triggers violent weather systems	Unfortunately, this should not be a surprise. Things like this move like glaciers and when they crack you should not be in their way
Oil goes to 200$	Inventories are low and if economic activity surprise on the upside energy consumption could rise significantly and over summer oil is 200$. China opening is the key driver.	This is a low probability scenario. If it becomes a reality, it will be met with a recession that dampen economic activity. Also, it would stimulate renewable investments even further

Long term scenarios and themes

Virtual reality and digital parallel universes are a new form for human interaction in the future

Performance pockets of the future

Most economic overviews are made on a country basis. When looking at global GDP growth it's broken down into regions or large countries. It's logic as it's much easier defining a country with a border than trying to define a global industry.

Finding out which are the largest industries takes time and there's a lot of different data sources that need to be put together just to get o a rough estimate.

Based on the country approach the global nominal economy is expected to grow from roughly 97 trillion $ in 2021 to around 240 trillion $ in 2042.

Inflation is expected at around 2% and real GDP growth at 2.5%. The real GDP growth is again a combination of 1% labour force growth and 1.5% productivity growth. The labour force only grow due to emerging economies (India and Africa) as developed economies including China will have stagnant to declining labour forces.

50.000 billion $ in new industries in 2042

Over the next 20 years the value of global economic activity, measured as nominal GDP or revenues in trillion $, is expected to grow 125-150 trillion $ from the current run-rate of 100 trillion $.

Most of the added economic activity will come from emerging economies with increased affluence (Africa and Asia in particular) and will fall into the traditional buckets such as construction, healthcare and education.

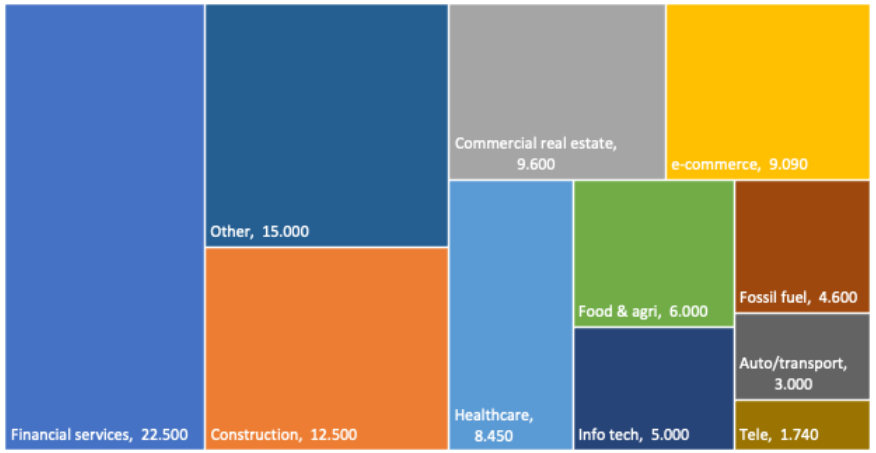
About 50 trillion $ of the new nominal GDP will come from new industries. For illustration, the smartphone industry can be used. In 2004 smartphone revenues was zero. Hardly any phones in circulation vs the 4-5 billion in circulation today and with subscriptions it's a total revenue stream of estimated 1.700bn $

Over the past year two areas of future revenue buckets have grown significantly; metaverse and renewables/electrification of everything.

In the 2022 roadmap metaverse was estimated to be 2 trillion $ in 2041 and renewables was estimated to be 6 trillion $ incl power. Fast forward 12 months and metaverse is now 10.5 trillion $ and renewables incl power 11 trillion $

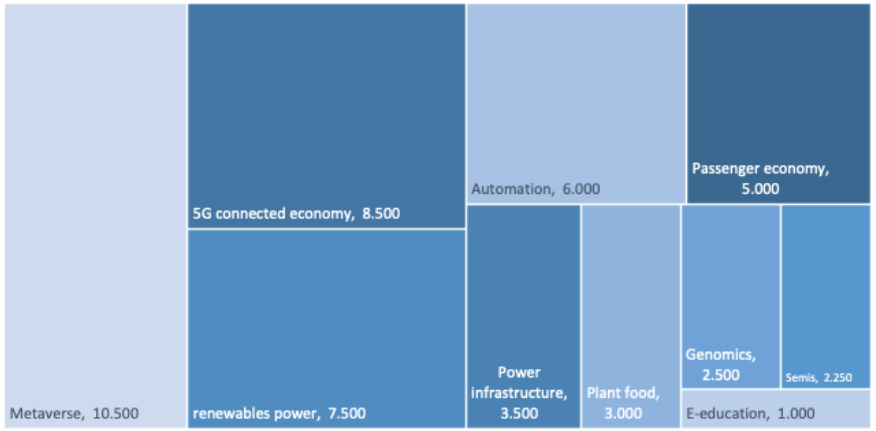
Estimated largest global industries in 2021

In billion $



Additional GDP contribution in 2042 vs 2021

Size increase in billion $



Sources: own design and many sources such as Allied Research, BNEF, Intel, Ericsson, Illumina, BCG, McKinsey, IMF a.o.

Moving away from fossil fuels

Human consumption of fossil fuels (in essence its old plants, trees and animals left in the ground for more than 200 million years) started in volume 170 years ago.

One liter of oil requires 25 tons of fossils and put away for 200 million years. A tall tree of 15 meters and diameter at bottom of 75 cm weigh 8 tons, so it takes 3 big trees to drive your non-electric car 10-12 kilometers.

Current daily volume is 100 million boe (barrel oil equivalent) or 6 billion liters of oil. And with 8 billion people on earth that's clearly unsustainable in the long run.

CO2 and particle emissions have only made it more urgent to change into sustainable energy sources.

Human prosperity over the last 170 years comes to a large extend from the use of fossil fuels and the system we have created works for now, but it need to changed – and fast.

The biggest investment in human history

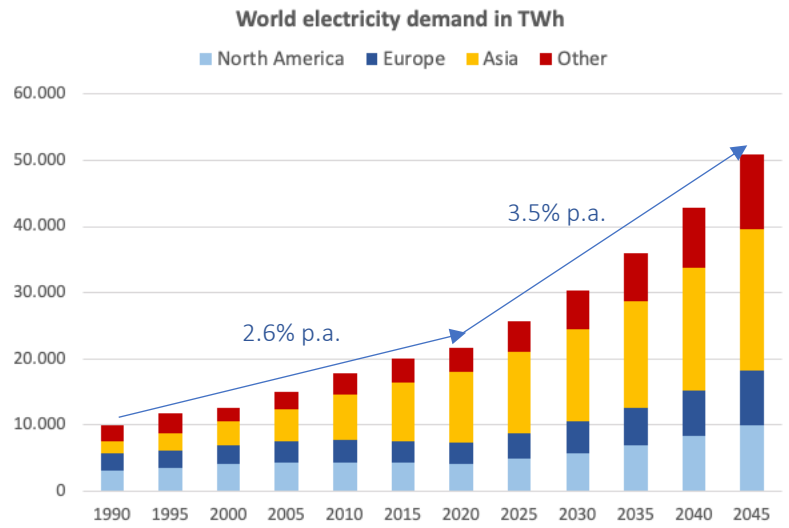
A sustainable source of energy is highly needed as the use of fossil fuels is unsustainable in the long term due to depletion of reserves and harmful side effects when the fuel is burned.

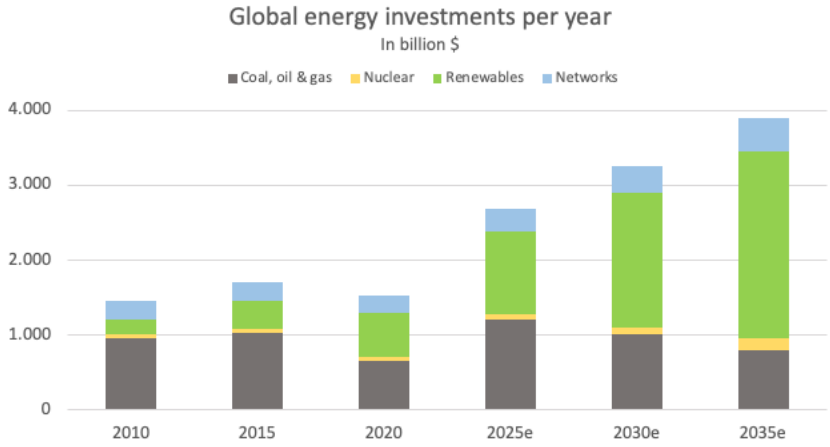
Fortunately, human innovation has already invented several sustainable alternatives and the next 20-30 years will see a massive makeover of the global energy system when the sustainable system is built. Accumulated it will be the biggest investment ever made by the human race. BNEF estimate it to be up to 195 trillion $ or 2x current annual global GDP.

Policy makers agree on direction but not on speed of the energy transition. Companies need to be motivated too via returns on invested capital that in the long run that exceed the cost of capital.

There's plenty of investment opportunities in this playing field and it used to be Europe that was ahead, but China and US seems to be taking the upper hand in several segments.

Current listed investment opportunities in the renewable space have a combined market cap of 500 billion $. That's the same as Johnson & Johnson or total market cap of Copenhagen Stock Exchange. Peanuts compared with the revenue streams coming in the direction of renewables such as infrastructure providers and wind-and solar parks





Sources: EIA, DNV, GS, BNEF a.o – own design and estimates

Metaverse

Human interaction on distance has evolved from traditional phones since 1880s, to mobile and to on-line video meetings. The next big chapter is semi 3-dimensional on-line interaction called metaverse

It can be applied in business meeting, in gaming, entertainment and social gatherings.

It's still early days for metaverse as software, hardware and governance need to be ironed out.

Meta (former Facebook) holds 80% market share in the headset market for metaverse, but they will not be alone as Apple, Microsoft, Sony, Google, Huawei and maybe even Disney want to have integrated user platforms

On the governance side there's discussion on how many identities each person can have i.e. a work-, social- and/or gaming avatar

Daily life will become more digital, not less

Since summer 2021 when Facebook started to articulate the metaverse more precisely and later in 2021 changed it's name to Meta things have started to take off.

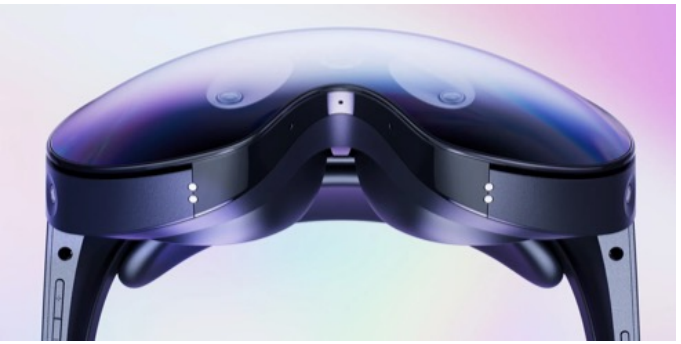
There's lots of reports out on how big this digital reality universe will be. So far Citigroup takes the lead with an estimate of 12.000 billion $ in metaverse related revenue streams in early 2030s. Up from zero in 2021.

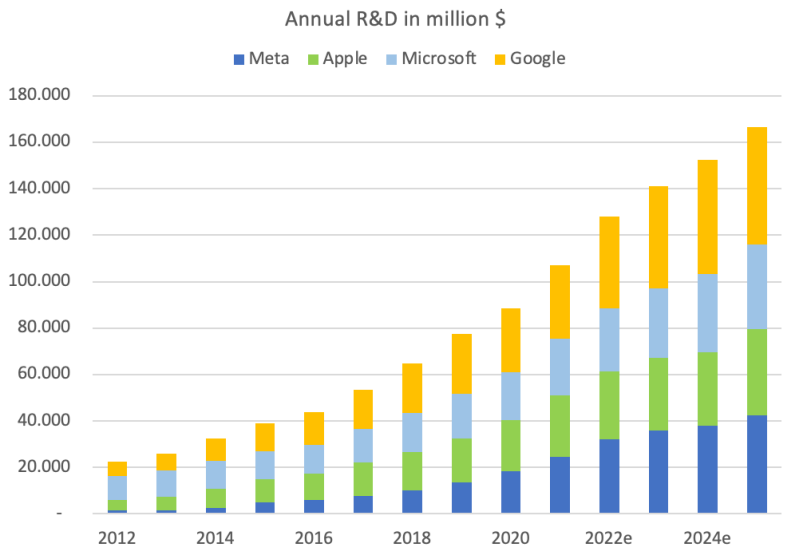
Users are still on the sidelines as the user experience is still not optimal. However, Meta's multi billion-dollar investment is a unique bet on the future. Meta is however not alone but as proportion of total R&D Meta outspend the others for a leadership position in the digital future.

Assume Meta can make 20% ROIC (historical is 36%) on accumulated R&D and capex, then Meta EPS in 2025 would be 25-30$. At 20x multiple is 300-500$ stock vs the current 115$. Metaverse can be difficult to comprehend and if Meta is the metaverse winner it's not reflected at all in the current stock price.

And just an observation; Metas R&D budget 2022 of 33 billion $ is double the combined defense budget Denmark, Norway and Sweden…

Meta Oculus Quest Pro for 1.600 $





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

It is not investment advice and remember take a look at the disclaimer on next page

NIP's research and analysis can also be used by listed companies in their strategic considerations and external profiling

NIP provide advisory services either as retainer or on ad-hoc basis.

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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 mew pockets of innovation and 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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