NORDIC INVESTMENT PARTNERS

Roadmap update 1Q 2023

The interest rate peak is just around the corner

AI and ammonium comments

April 2023

Summary

The fundamentals such as economic activity and corporate performance did relatively well in 1Q 2023. Pace is however slowing

Central bankers continue to be busy trying to cool down inflation via slower demand. It's working but it takes time. And in the meantime it seems inflation is sticky

A year ago it was the Lenin quote ' there's decades where nothing happens and then there are weeks when decades happen' The divide between Western democratic societies and the autocratic societies such as Russia has widened. And it's the new modus operandi for next decade(s). 1Q 2023 didn't bring much new perspective to that.

The political and economic landscape has not been this complicated to manoeuvre for decades and yet the corporate performance updates are pretty good

Consensus is for a economic recession later in 2023, so nothing new there either. At the other side of recession lies acceleration and the current narrative is putting more weight on acceleration in 2024 ie. 2023 slowdown is just an air pocket and we can live with a bit of turbulence

Enjoy the journey but prepare for bumps

2023 roadmap update after 1Q23

Economic activity is expected to decelerate, which in turn will take inflation out out of the global economic system. Illustrated by USA in fig 1.

Consumers all over the world feel the impact on higher interest rates and inflation. Financing a home was almost for free only 2 years ago. Today interest rates makes the financing of homes much more expensive than many imagined. The cools the economy despite need for new homes

Many consumers hold on to their financial war chests. In China consumers had 800 billion USD in 'ready to spend' accounts before Covid-19. Today they have 2.000 billion USD. But they have a 'wait and see' attitude and hence a rapid economic expansion should not be expected in China. The same goes for many other regions. And slower demand growth is good for lower inflation.

The contraction of money supply M2 is the biggest one since 1960 ref fig 2. In theory such a contraction should take any form of enthusiasm out of the economic system. In 1Q23 it mainly hit some banks that saw significant deposit inflows in 2020-22 and then they decided it was a great idea to buy long term bonds for a marginal pick-up in interest rates. That's like picking up coins in front of a steamroller….or as noticed in my earlier updates from 2020; 'bonds used to the risk-free return, but have changed into return free risk'

April 2023

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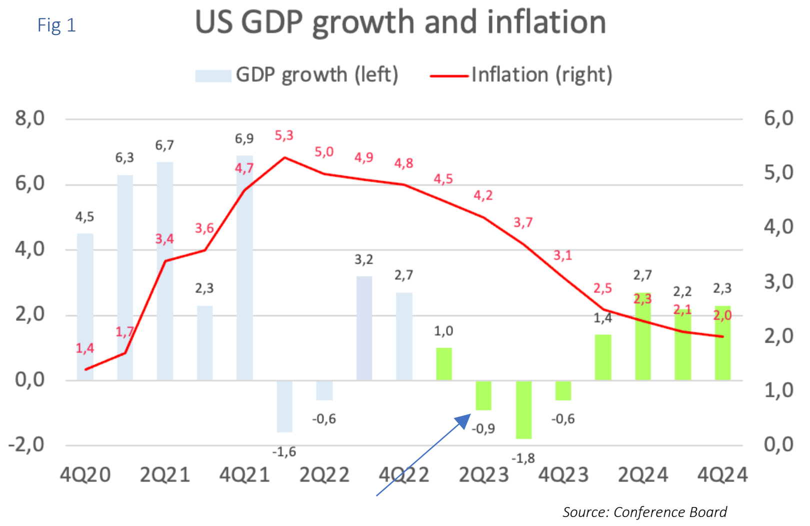
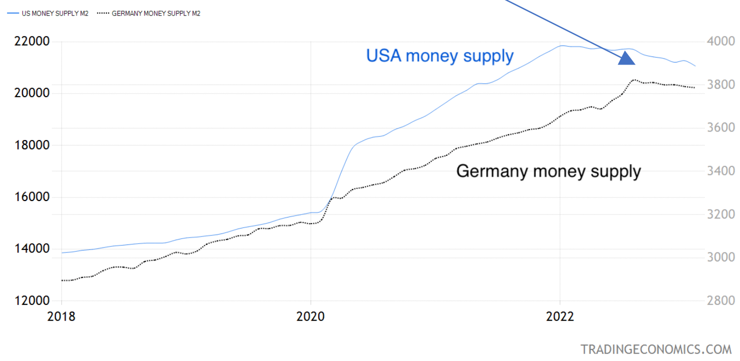
Fig 1



Deceleration is coming

Fig 2



Stock market update

In the long term stock prices follows cash flows and earnings very close. But in the shorter term stock prices can be like a dog in a long leach tied to a vehicle that drives a very long distance. The dog runs all over the place on a daily and weekly basis but eventually it ends up the same place as the vehicle

1Q 2023 stock market performance was much better than market observers expected. MSCI world in EUR and incl dividends rose 5.4% and growth oriented industries such as semiconductors rose 25%

Yet, the economy needs to decelerate more before we can be sure high inflation is permanently out of the system

Investors know these dynamics, so there’s clearly an acceptance for flying thru some air pockets with turbulence. Question remains if all investors are prepared for that

1Q 2023 pitstop

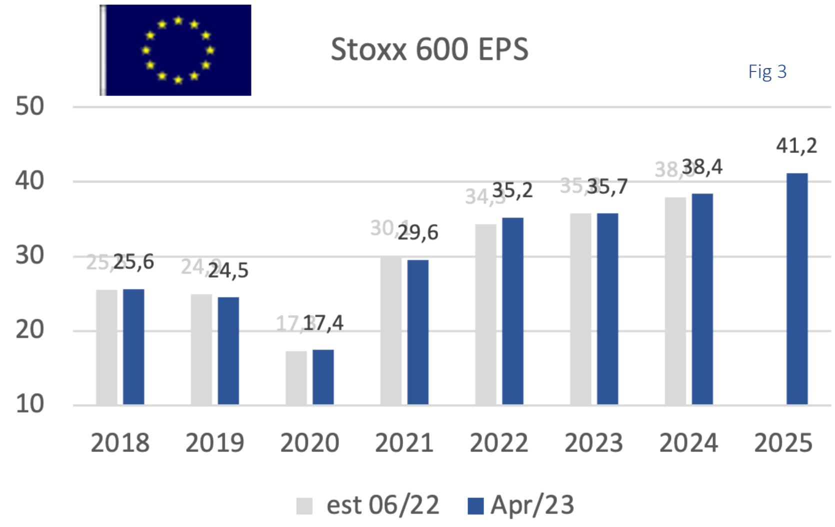
The 4Q 2022 performance updates and the various economic indicators released in 1Q 2023 gave investors confidence that the environment is less bad than many feared in late summer 2022.

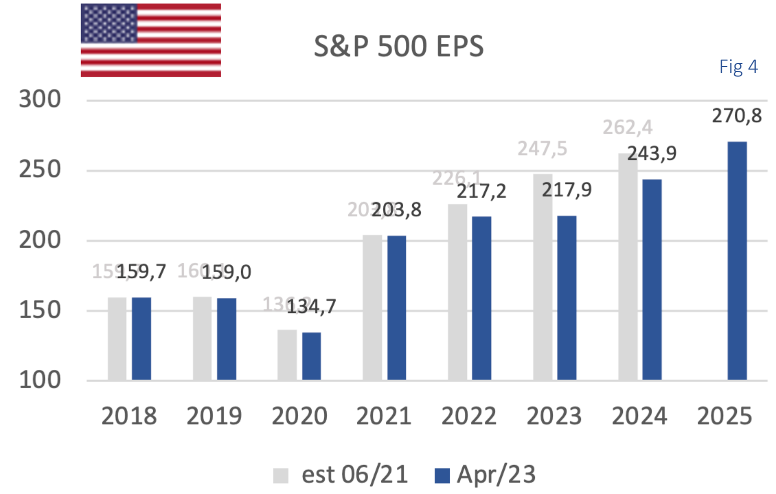
European earnings estimates are almost unchanged from summer 2022 to now ref fig 3. Since summer 2022 Stoxx600 index is up 10%. There is however expected to be quarterly declines in summer 2023, but things pick up again later in 2023 and into 2024. On current estimates Europe trades at 12.9x earnings or an earnings yield of 7.8%, which compares well to the 10-year bond yield of 2.2%

US, on the other hand has seen 2023 earnings estimates reduced by 12% since summer 2022 ref fig 4. S&P500 index is unchanged in the same period. US is also expected to see lower earnings in the coming quarters. US trades at 18.8x earnings or an earnings yield of 5.3%, which compared to US 10-year bonds yield of 3.4% looks less attractive than Europe even when adjusting for 2018-25 earnings growth in US is 7.8% per year vs ‘only’ 7.0% in Europe.

I’ve mentioned it before, but the business climate in US is better than in Europe and US do not have a war in the back garden. So that partly explains the difference in valuation.

Consensus estimates can obviously be wrong, but on average they are reasonably correct in normal years. See roadmap 2023 for more on that.





Investing is never boring

Doing the 1Q 2023 update I recalled my old cyclicality model you see on the right (fig 5). The fundamentals tell us we're in a slow down phase, while the stock market tells us we're going into a acceleration phase

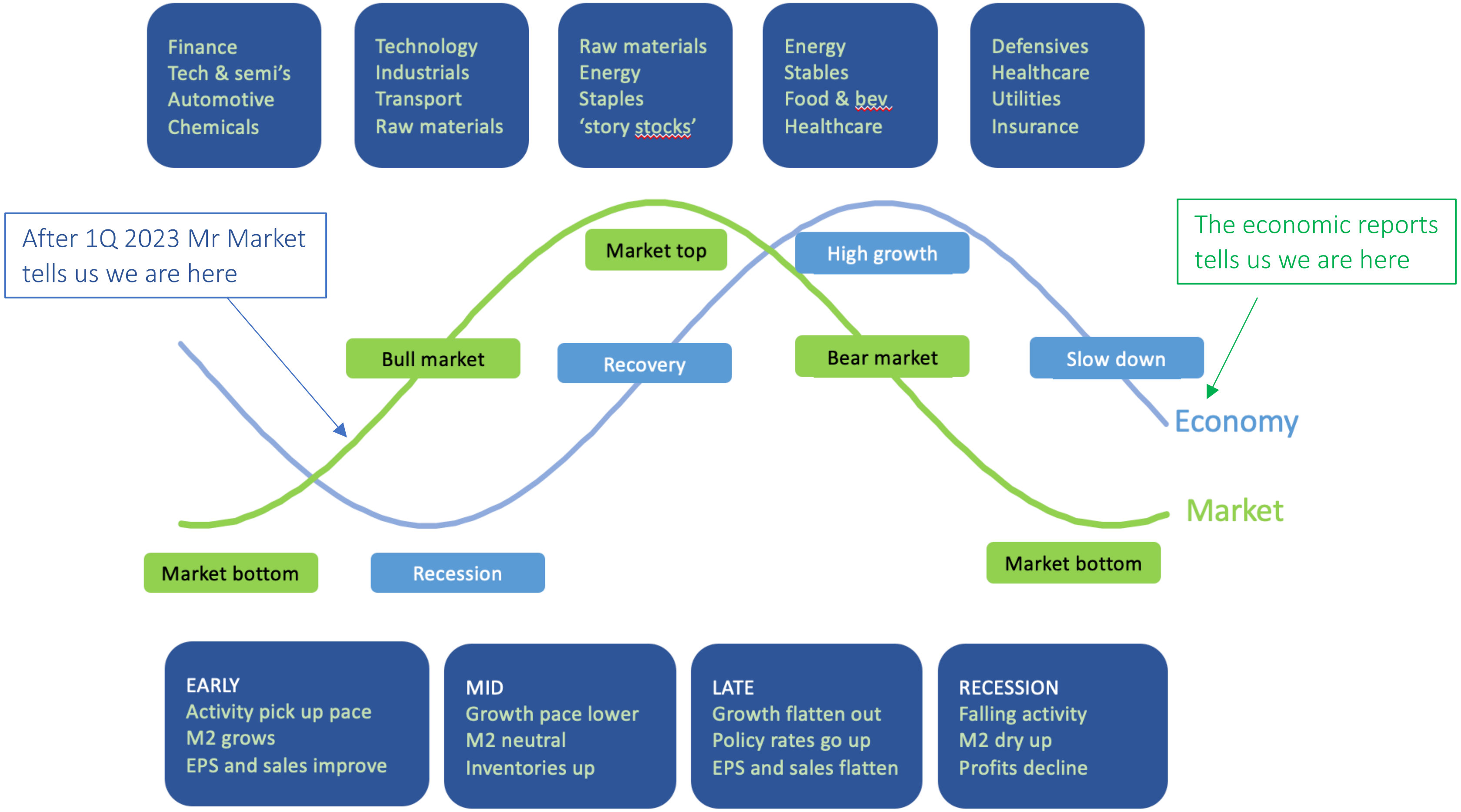
Good exposure to automotive and semi's have provided good returns in the last 6 months just as brewers and healthcare did it a year ago

It's unclear to me exactly were we are, so the 1Q 2023 corporate performance updates could hold the compass for more precise navigation going forward

Samsung Electronics have already provided 1Q 2023 preliminary guidance. It's a mess and a seriously big decline in profits. Yet, they see light at the end of the tunnel for memory chips (DRAM and NAND) in late 2023, so the stock price jumped 4% on the news despite earnings being the lowest since 2009. Some would argue it defies logic, but that's what makes investing so interesting

There's never a normal cycle, but schematics can assist navigation

Fig 5



Source: own design and refined since early 1990s

So far so good

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

With that in mind;

Highly paid market observers expected 2023 to be a lousy first half followed by a very strong second half. And by the end of 2023 we should be more or less where we started

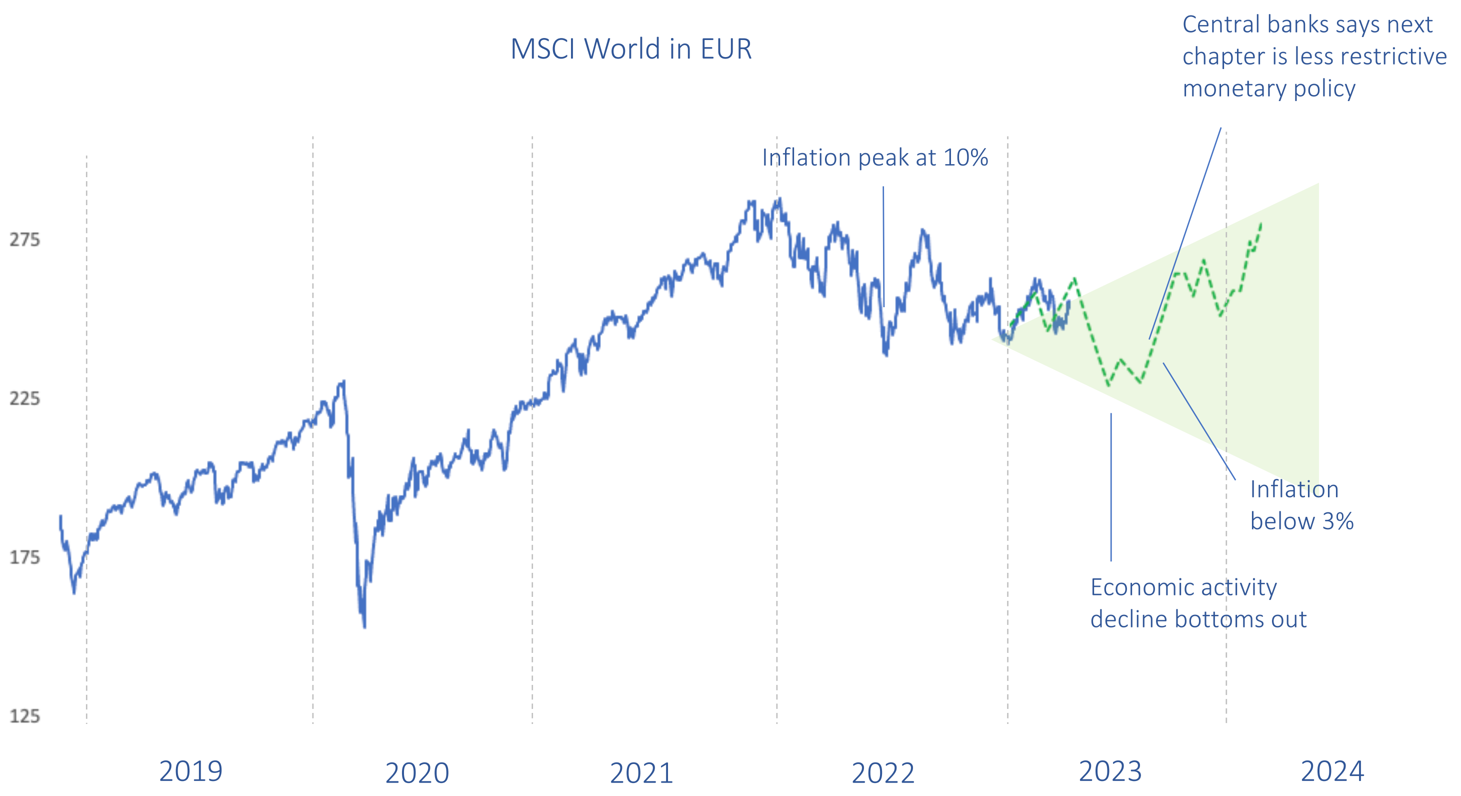
There's more and more algo's making decisions on investment exposures on the same data that I and millions of other use. So the algo's with game theory might be outplaying the humans

Nothing is cut in stone, so check the 'upside' and 'downside' surprises overview in the risk section of Roadmap 2023. There's a section about algo's running amok

Roadmap 2023 found here: link

Updated roadmap 2023 with realized prices in 1Q 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 7% too high going into any given year. 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

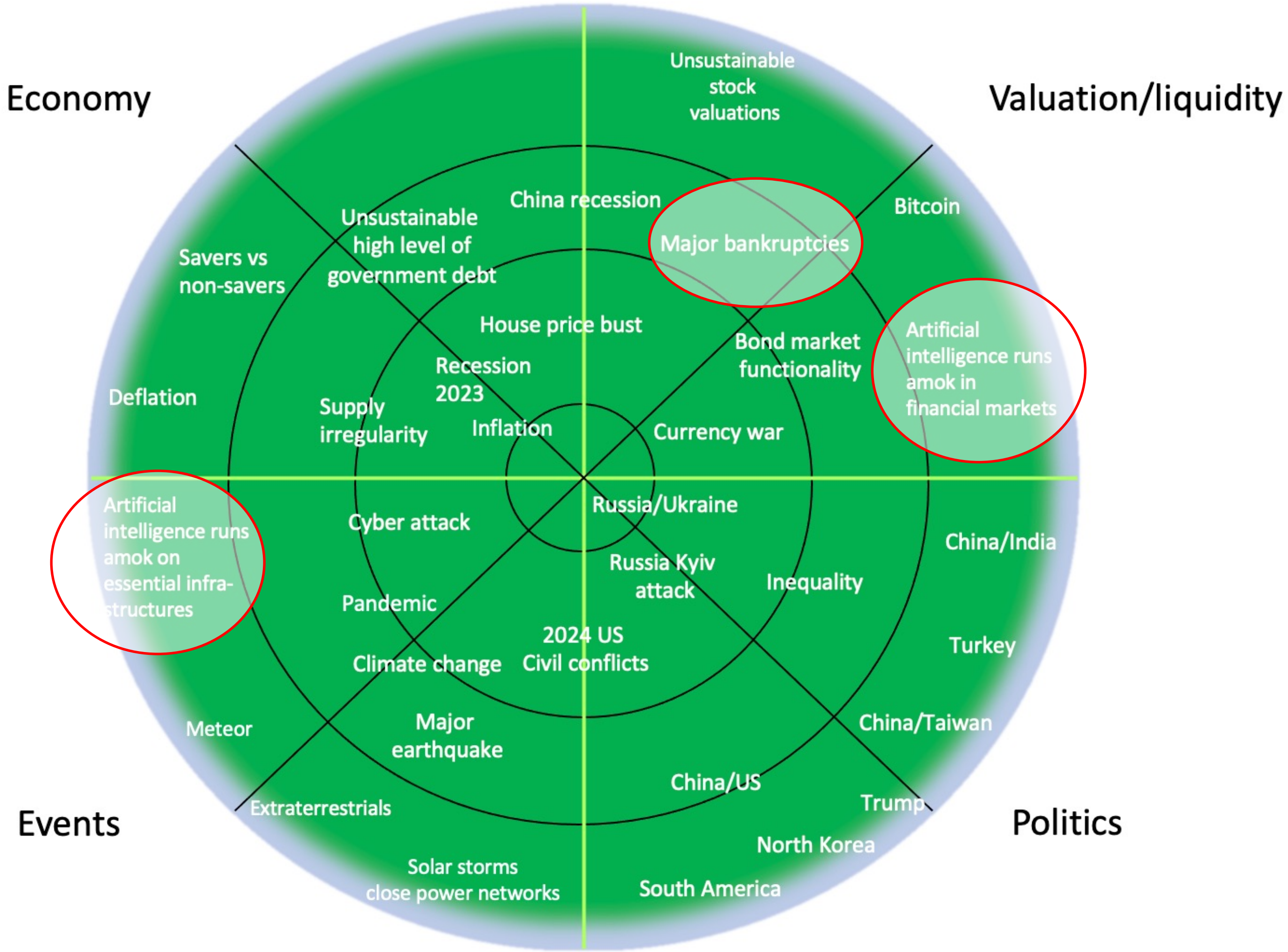


Risk radar observations in 1Q 2023

The main risk event in 1Q 2023 was banking related. Silicon Valley Bank, a almost unknown bank in California and with the same size as Danske Bank, went belly up. And shortly after Swiss bank, Credit Suisse, was forced into a marriage with UBS. Credit Suisse has really good wealth management operations and the worst investment banking activities. In the end the investment bankers suffocated the good parts of the business.

Other moving parts on the risk radar was a slow to no progress for Russia in Ukraine. On a sidenote; in 1946 when UN was formed , the UN charter stated it's illegal to attack another country. That part of the charter was never ratified by USSR and USA. The situation remains very high risk

Another moving part was artificial intelligence. Since ChatGPT launched their OpenAi in 4Q 2022 things have started to move, but so far AI has not caused any disruptions or volatility. Some prominent observers have raised their voice of concern as they see AI as high disruptive to current structures of society. More on that in the next pages



Updates on selected investment themes

Augmented reality shows Saturn in our garden

Artificial intelligence

I've been circling around artificial intelligence and humans vs machines for many years. In November 2022 ChatGPT opened up for individuals to try it out. Only 5 months later the news prairie is on fire with AI news. And AI stocks have soared

AI is likely the innovation that comes every 2-3 generations and changes the pace and direction of how we humans live on Earth (fig 5)

AI comes out of using data and knowledge in a completely new way and the force of innovation from AI is much bigger that many imagine. We're one step closer to singularity

The economics of AI are still small in revenues. In 2021 it was 87 billion $ and its expected to grow to 350 billion $ in 2025 and 1.7 trillion $ in 2023

Real innovation comes from brand new ideas; ''the electric light did not come from the continuous improvement of candles''

2023 – the year of AI

When IBM launched the PC in August 1981 it was big news. Internet and smartphones in the following decades added to the markedly changed way humans interact. 2023 looks to be the break thru year for AI. The impacts will be very visible and to illustrate it here's a summary of 2019 article on how AI would change the way financial markets work;

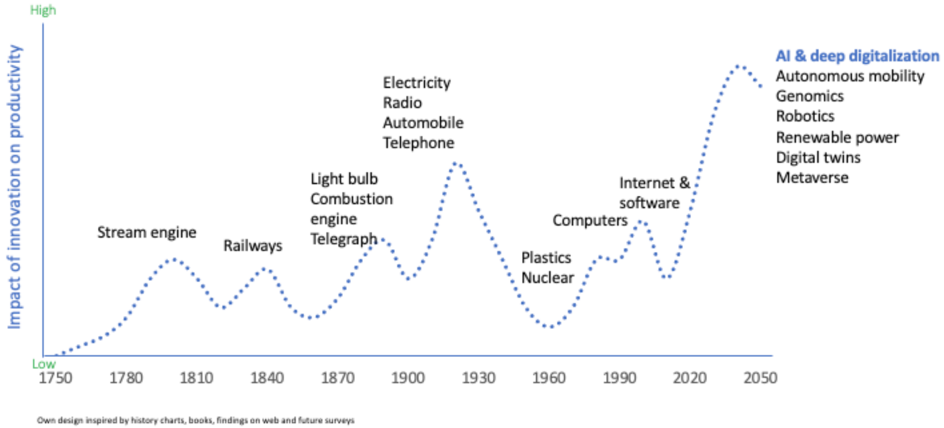
1990s First parallel processing data analysis to figure out price patterns based on price and volume. Alpha came from traditional sell side research, flow information, morning calls etc.
2000s quantitative approach with fundamental data into the soup. Alpha came from additional info from expert networks and surveys
2010s more of the first two. Alpha came from almost live data from credit cards, geo surveillance, web-scraping etc
2020s data from all the ingredients from 1990-2010s is so massive that only superfast computers can figure out what's going on. AI makes investment decisions

Where does this trend leave human investors?
It takes an experienced investor a long time to get under the skin of a business. AI can do a large chunk of that work in milliseconds.
In my view AI cannot yet figure out the understanding of the people running the business – motivation, smartness, uniqueness etc.
So, Alpha will come from better understanding of 'soft data' aspects in investing. At least until AI catches up on those data

Alpha is risk adjusted return above general market returns

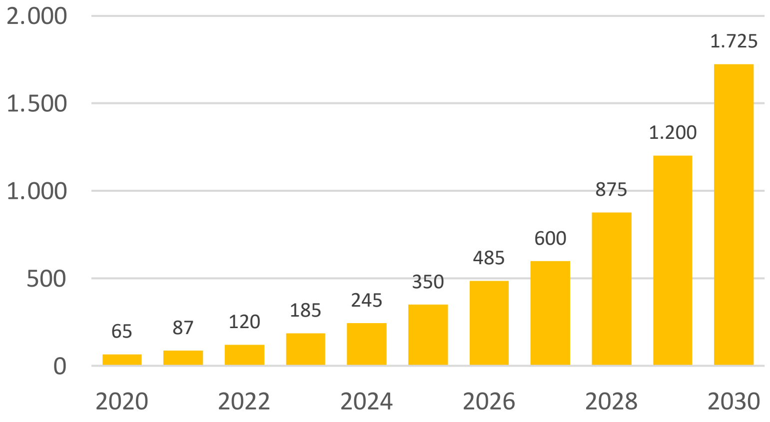
Commercial introduction of new innovation

Fig 5



Artificial Intelligence market forecast

Revenues in bn $



Sources: Precedence Research, Grandview Research
Revenues coming from hard- and software as well as sale of AI services

Ammonia and hydrogen

In Roadmap 2023 there was a section about the biggest investment in human history; the massive move out out fossil fuels to non-fossil energy sources with lower CO2 and pollution footprint

In 1Q 2023 I attended an annual energy conference in Oslo. Over the past 10-12 years the non-fossil fuel presentations have steadily seen more and more interest. However, due to the rapid transition from Russian fossil energy to other fossil sources, several fossil fuel related businesses saw strong new interest in the 2023 version.

The engineering skills in fossil fuel industry are very useful in parts of non-fossil fuel energy. I got a deeper insight into ammonia – a good energy carrier made out of nitrogen and hydrogen, and it can be used directly in some engines or it can be converted into hydrogen that fuel trucks, busses and eventually also cars

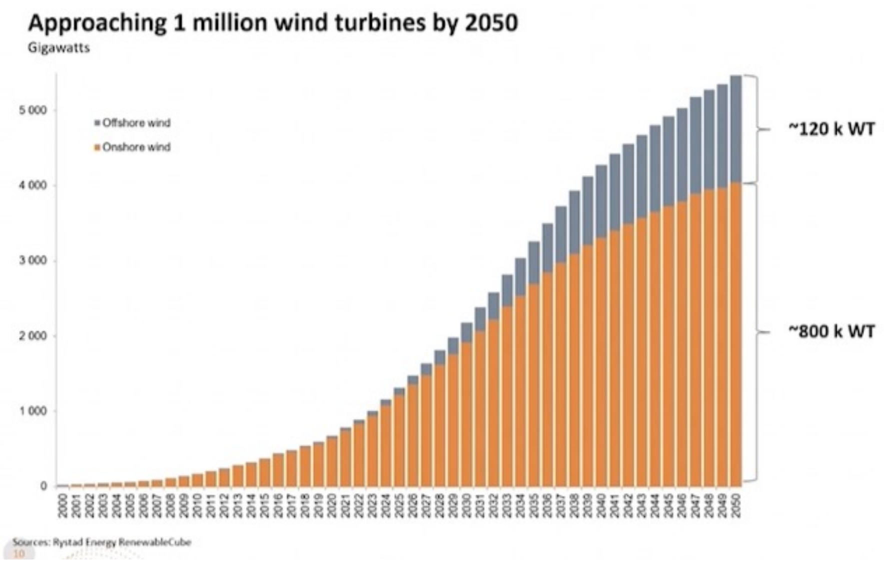
It's early days for cash flow

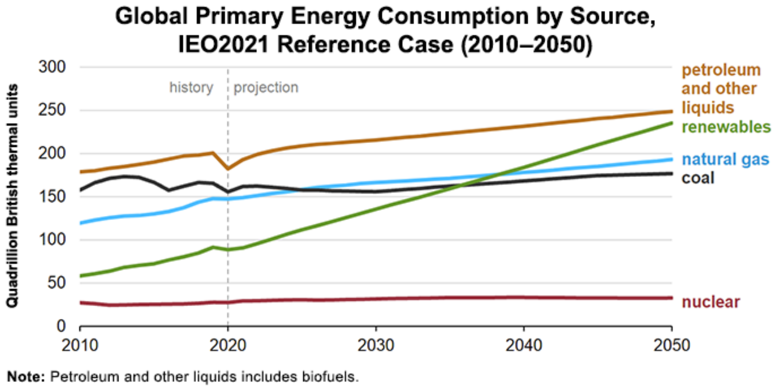
Several non-fossil power sources such as hydro, nuclear and wind can produce power 24-7. Demand for power varies over the day, week and year. Storage and distribution of non-fossil power including solar power posed a challenge vs the traditional large coal power plant with high-voltage grid distribution.

Ammonia contains lots of energy and stored under pressure and/or cooled down it can function as an energy carrier such as fuel oil, diesel and coal that is transported from production locations to the end users

Its early days and positive cash flows from ammonia/hydrogenas daily energy sources are way out in the future. And it's going to be a commodity so it's not even sure it's going to be an interesting industry. There is however lots of opportunities in the ecosystem such as storage tanks, electrolyzers for hydrogen, new engines for vessels and heavy machinery, wind/solar power production equipment, small nuclear power plants etc.

The hunt goes on to identify a business that stand to benefit from the energy transformation in something that resembles the way Microsoft and Intel became the biggest winners of IBM's PC launch in 1981. It's a hard nut to crack and it's not done yet. Give me a call if you an idea





Note: Petroleum and other liquids includes biofuels.

Source: U.S. Energy Information Administration, International Energy Outlook 2021 (IEO2021)

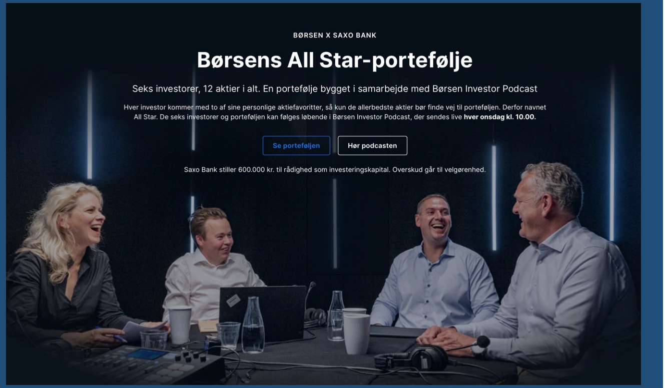
Alibaba 102$

I'm part of Børsen Investor podcast where we comment on current financial news, access listed companies as investment and run a portfolio of 12 companies – the Børsen All Star portfolio. Any gains on the Saxo Bank sponsored portfolio goes to charity

In 1Q 2023 I sold Mercedes with a 20% gain and after a short while I invested in Alibaba, so here's a bit more on Alibaba

Podcast in Danish found here. It's also about Novo Nordisk, TGS, 1Q 2023 reporting season and liquidity in the financial system:
5 April 2023 podcast

Børsen podcasts are lots of fun



Is China getting more business friendly?

In November 2020 Alibaba founder, Jack Ma, expressed himself very clearly about the Chinese government and bureaucracy. Shortly after China stopped Ma's planned IPO of financial services firm Ant Financial. And Jack Ma wasn't heard of until recently

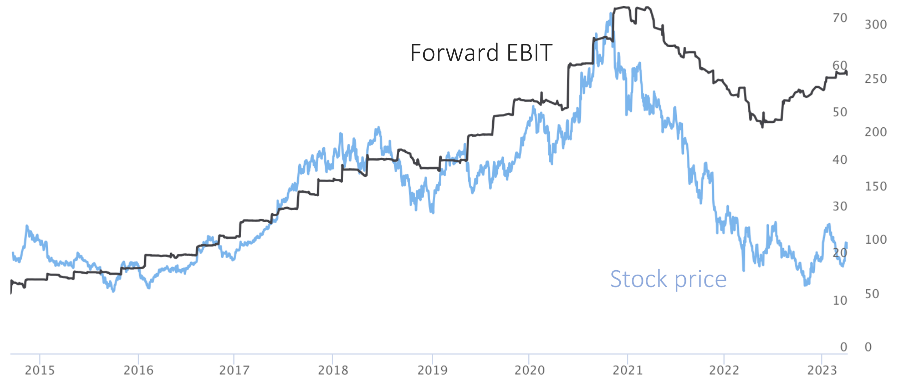
In March 2023 Alibaba said it will split or sell 5 of its 6 divisions. And from the political system came messages that point towards a more friendly business regime. It's not certain, but this could be the first sign that President Xi sees business as more essential to China's prosperity than he has done in the past 2-3 years.

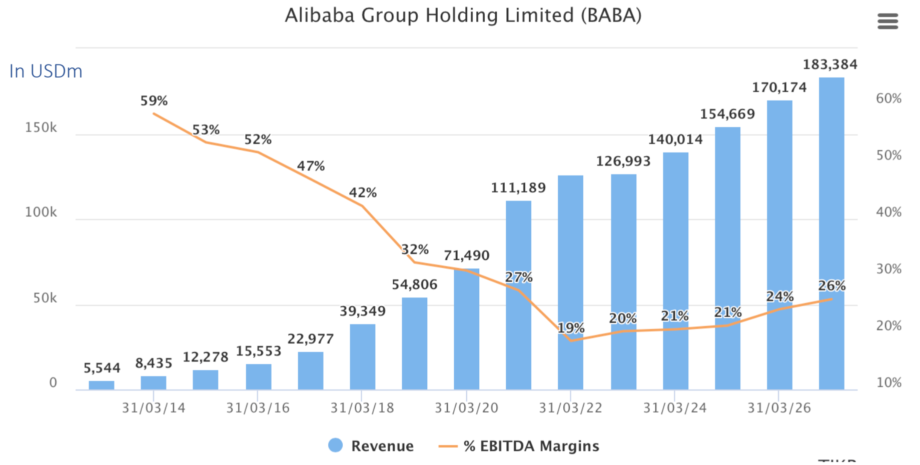
Alibaba is mainly an e-commerce platform in China with 130 billion $ in sales and operating earnings of 15 billion $.
Alibaba is valued at 270 billion $ and they have net cash 50 billion$ i.e EV/EBIT is 14.7x.

According to consensus Alibaba grows 12% per year from 2021-27 and measured on 2025 EPS it trades at only 10x. Similar financial profiles trade at 15-25x in Europe and USA, so good potential in Alibaba

Risks include disappointment from modest Chinese consumer sentiment in 2023 and a political environment that can change their mind without warning. Financial and valuation risks are low given the 50 billion $ net cash position and a forward P/E of only 10x

Alibaba stock price and forward EBIT





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

This deck 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

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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 stimuluses have created imbalances such as government debts. Unsustainable government debt levels will likely continue as policy makers are not motivated to think long term. Some regions do however run large surpluses and more than enough to finance the government deficits elsewhere. A shift of global power is happening at glacial speed.

Global economic growth has been declining from 6% in 1960s to around 3% in 2020s. 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 the lead as those economies grow double the speed of advanced economies.

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, I 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; so called GARP investing. This investment approach has been rewarding in the past and is expected to be so in the future too. The strategy avoids long term sun-set industries despite some of them are deep value from time to time.

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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