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QUARTERLY LETTER
TO OUR CO-INVESTORS

MAY 2022

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Dear co-investor,

The new year began with three major sources of uncertainty that will condition the rest of this year's market performance: the economic situation in China, the impact of the Russian invasion of Ukraine and the measures taken by central banks to curb current high inflation rates. Against this challenging backdrop, our Horos Value Internacional fund returned 1.4% over the quarter, compared to -3.3% in its benchmark index. Horos Value Iberia, on the other hand, was down by 1.9% over the period, in contrast to a 0.5% gain of its benchmark.

As usual, I would like to take this opportunity to update our longer-term performance. Since the inception of Horos (May 21, 2018), Horos Value Internacional has returned 22.3%, below the 55.2% gain of its benchmark, while Horos Value Iberia has returned 8.1%, outperforming the 0.5% return of its index. Moreover, since 2012, the returns of this management team stand at 199% for the international strategy and 167% for the Iberian strategy, compared to 219% and 67% in their benchmark indices, respectively.[1]

We will devote this letter to dealing with these three major sources of current uncertainty and, as always, to discussing the most significant changes in our portfolios.

Thank you for your confidence.

Yours sincerely,

Javier Ruiz, CFA
Chief Investment Officer
Horos Asset Management

[1] The data includes the performance of the portfolio management team in its previous professional period working for another asset management firm (from May 31, 2012 for the international strategy and September 30 for the Iberian strategy, until May 22, 2018 in both cases, when they joined Horos AM). Past performance is not a guarantee of future performance.

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Executive summary

I see an inflation profile which looks like a hump.
— Christine Lagarde.

There is no doubt that it is difficult to find a time when there have been events as relevant as those we have been experiencing in recent months. On the one hand, since last year, as a result of the Chinese government's regulatory crackdown on such important industries as real estate and technology, and impacted by the lockdown measures to combat the current wave of the coronavirus in this country, China is experiencing its worst economic scenario since it began a move away from the communist model towards the current state capitalism. On the other hand, Russia's invasion of Ukraine is exacerbating the problems of the fragile Western energy system, which is heavily conditioned by the disorderly and forced energy transition in which we have been immersed in recent years. As a result, prices of commodities (fossil fuels in particular) have skyrocketed due to severe bottlenecks. Lastly, and very relevant given its direct impact on markets, central banks (especially the Federal Reserve) are initiating the greatest monetary tightening in more than fifteen years because of the high inflation we are experiencing worldwide. This monetary tightening is having a significant impact on the performance of fixed income markets (with declines not recorded in decades for a first quarter) and on those companies whose valuations were discounting cash flows far away from the present time (such as the businesses that took off during the pandemic and many tech companies). All these issues will be discussed in this letter.

In addition, we will discuss the most significant changes that we have made to our portfolios. Among others, we can highlight that at Horos Value Internacional we exited our positions in the metallurgical coal producers **Ramaco Resources** and **Warrior Met Coal**, following the strong performance of their stocks. In addition, we initiated two new positions in the quarter, namely, the civil and military aviation company **Dassault Aviation** and the financial services company **Petershill Partners**. Horos Value Iberia had no exits during the period, but we added two new names: **Applus Services** (inspection, testing and certification) and **Grupo Ecoener** (renewable energy).

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This is what relativity looks like

Time is what keeps everything from happening at once.
— Ray Cummings

The movie Interstellar is certainly my favorite and, surely, the one I have watched the most times only behind the original trilogies of Indiana Jones and Star Wars. It combines my three favorite attributes in one movie: it is directed by a director whose work fascinates me (Christopher Nolan), the story is set in space (one of my frustrated vocations was astrophysics) and it has a brilliant soundtrack, composed by the genius Hans Zimmer.[2] One of the moments that had the greatest impact on me, in this sort of space opera, takes place when one of the scientists accompanying Cooper's character on his mission (the protagonist of the story played by Matthew McConaughey) explains to him the concept of relativity and why every hour spent on one of the planets they want to explore would be equivalent to seven years on Earth. It is only natural that Cooper would be astonished at such a revelation!

Obviously, my own movie tastes don't have to be interesting to anyone. However, I am sure that most people have gone through times in their lives when, perhaps not as much as the extreme example of Interstellar, there are weeks when nothing seems to happen and they fly by and others when absolutely everything happens, as if it were years. Of course, financial markets are no strangers to this peculiar phenomenon. If you trace the history of the stock market, you will easily notice that the indices tend to move relatively calmly for more or less long periods of time, and then suffer periods, usually shorter, of huge volatility. The dotcom crash at the turn of the century and the Great Recession of 2008 are two clear examples of this.

However, it is hard not to think that recent times have been particularly intense in terms of the number and impact of events that are affecting societies, economies and, of course, stock markets around the world. For instance, since the inception of Horos Asset Management four years ago, the portfolio management team formed by Alejandro, Miguel and myself have had to deal with the uncertainties associated with the "Trump Trade Wars," the "death" of value investing, the worst pandemic that humanity has experienced in the last hundred years, the severe global bottlenecks derived from this and driven to the extreme by the massive fiscal and monetary stimulus worldwide, the unpredictable consequences of the disorderly

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[2] For the most curious, in this interview Hans Zimmer explains how he created the striking sounds of the movie Dune: Vanity Fair (March 17, 2022): *How 'Dune' Composer Hans Zimmer Created the Oscar-Winning Score | Vanity Fair*. YouTube. https://www.youtube.com/watch?v=93A1ryc-WW0

and forced energy transition, the foreseeable first major tightening of the Federal Reserve's monetary policy in about fifteen years, China's first major economic crisis since it opted for this model of managed capitalism and, finally, Russia's terrible invasion of Ukraine.

The good news is that, **despite all this noise, our funds' NAVs are close to all-time highs and, more importantly, so is the upside potential of our portfolios.**[3] That said, as we have highlighted in the last two letters, our funds (Horos Value Internacional in particular) have a significant exposure (for better and for worse) to the recent major events outlined above. Specifically, the situation of China's economy and the energy transition, where the war and the sanctions against Russia that are being announced day after day are increasing the fragility of, among others, the energy system of the West. For this reason, I believe it is important to focus this document on these events, their recent impact on our portfolios and our positioning for the future.

I cannot end this section without recalling that it was, precisely, Vladimir Ilich Ulyanov (better known as Lenin) who said:

> *There are decades where nothing happens; and there are weeks where decades happen.*[4]

China, or when excessive control can lead to chaos

Laws are like cobwebs, which may catch small flies, but let wasps and hornets break through.
— Jonathan Swift

As we had the opportunity to discuss in the Q3 2021 letter (see here), the development model of the Chinese society is based on the pillars of what is known as **State capitalism** or **techno-socialism**. This system aims to beat the traditional capitalist model by initially allowing and supporting entrepreneurship, even going so far as to allow the non-compliance with the traditional rules of the game, such as respect for private property or intellectual property. Once a theoretical ideal level has been reached, the Chinese Communist Party enters the scene to "help" this development permeate the rest of society, increasing (in theory) the welfare of

[3] I encourage you to take a look at the annexes to this letter, where you can calmly review this information.
[4] Esparza, P. (April 9, 2017). El épico viaje en el tren con que Lenin regresó a Rusia para liderar la Revolución. *BBC News*.

all. In some senses, Xi Jinping believes that it is time to redistribute this accumulated wealth (the goal of the "common prosperity" program), so he has not hesitated to intervene in the most relevant sectors of the country, such as technology, finance and real estate. However, as we also pointed out at the time, this excessive control may be leading precisely to the system imploding or, at least, escaping the rigid control of the Party.

This risk has become very apparent in the country's real estate sector, following Xi Jinping's attempt to cool it down with the announcement in 2020 of the "three red lines." I will not repeat here how these measures triggered the fall of the giant developer **China Evergrande Group**. However, I would like to update the situation of the sector, given its relevance to the Chinese economy and, therefore, to a significant part of our Hong Kong-listed companies. I will begin, of course, by reviewing the main figures of this industry, although with the caution required when analyzing the data reported by the Asian giant.

On the one hand, government statistics point to a slowdown in new home sales prices, although they are not yet in a downward trend. In fact, the March figure shows a year-on-year increase of 1.5%.[5] This is the lowest figure in seven years, but the reality is that it is still positive. This contrasts with some of the numbers reported by the country's main developers. For example, **Country Garden Holdings** (one of the real estate entities with the largest financial cushion) announced a drop in sales prices of -14% for the months of January and February. Some smaller entities are showing the same trend and, in general, there is talk that many players are offering to dispose of portfolios of assets at significant discounts.[6] Other major developers, such as **China Vanke**, said back in January that the "golden age" of the Chinese real estate sector was over and that they had to prepare for "very hard times."[7]

There are several possible explanations for this apparent paradox. One of them may lie in the **composition** of the country's new home price index, since it is made up of the 70 main Chinese cities and has maintained this composition stable since 2005, when many of today's relevant cities were no more than small towns. Another factor that may be distorting or, rather, detracting from the informative value of the data, is probably to be found in the **heterogeneity** of markets and geographies of the developers' assets. China is a huge country with dynamics that can differ substantially from one area to another—Shanghai is not the same as a

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[5] (April 15, 2022). China March new home prices stall again as COVID damps sentiment. *Reuters*.
[6] Li, C. (March 20, 2022). China Says Housing Prices Are Stable, but Developers See Significant Declines. *The Wall Street Journal*.
[7] Liu, P. (February 14, 2022). Vanke says the 'golden age' of China's property is over as bellwether developer girds for hard times. *South China Morning Post*.

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tertiary city such as Kunming, even though the latter is home to nearly five million people—so we cannot extrapolate what happens in one city or another to the country as a whole. Finally, we should not disregard the possibility that the Party itself is trying to soften, however it can, the evolution of the general index (by imposing, for example, price controls) to avoid a collapse in public **confidence** and a further downturn in the real estate sector.[8]

In any case, another fundamental variable paints a much more stressed scenario for the real estate market. Specifically, the volume of transactions has suffered a severe decline in recent months, dropping by close to 50% for the country's 100 largest developers in the first quarter of 2022.[9] As a cause and consequence (it is a process that feeds back on itself) of this halt in activity, the main real estate entities in the country have seen how the tap of new financing has been closed—who is going to lend to distressed companies that cannot sell or even finish their projects?. For example, the total value of new offshore debt issuance (targeted at foreign investors) has fallen by nearly 70% in the first quarter of 2022.[10] Obviously, this has triggered a desperate search for liquidity by these entities, divesting themselves of their most saleable assets, possibly at the least desirable time.[11] An example of this trend, which is continuously repeated in the sector, is the sale of the real estate services divisions of these developers. Thus, different transactions are taking place, such as those recently announced by **Yuzhou Group** or **Vanke China**.[12]

However, not all companies are managing to dispose of enough assets. Some are trying to avoid getting rid of their crown jewels altogether. Indeed, as we warned two quarters ago, the greatest risk we saw in real estate services companies was the possibility that their working capital would be severely hit due to the potential delay in collections (or even defaults) from their respective parent companies (developer groups which, in addition to retaining a majority equity stake have important commercial ties with these services companies). Well, this negative scenario has begun to materialize. Thus, although not because of this casuistry, **China Evergrande Group** reported at the end of March that its subsidiary **Evergrande Property Services Group** had seen more than two billion dollars of cash evaporate, after being claimed by lenders who had previously agreed to accept this

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[8] Li, C. (March 20, 2022). *Idem*.
[9] Liu, P. (April 12, 2022). China's developers bid more for land, betting supportive measures will revive property market. *South China Morning Post*.
[10] The contraction would be less than 50% if onshore debt (for domestic investments) is included. Liu, P. (April 8, 2022). Chinese property firms' bond issuances fell sharply in first quarter, Beike's research unit says. *South China Morning Post*.
[11] Ouyang, I. (March 9, 2022). Chinese developers speed up asset sales to state firms amid prolonged debt crisis. *South China Morning Post*.
[12] Kawase, K. (March 31, 2022). Vanke boss sorry for profit drop as other China builders go quiet. *Nikkei Asia*.

money as collateral for default.[13] Both companies, along with **China Evergrande New Energy Vehicle Group**, had unexpectedly announced a trading halt a day before issuing this statement.[14]

It is not the only real estate services company that has suffered a significant deterioration in its balance sheet. Our company **Kaisa Prosperity** published unaudited quarter-end results showing a sharp decline in its cash position, as a result of an increase in its working capital due to delays in collections for services provided to its parent company, the developer **Kaisa Group Holdings**. Specifically, **Kaisa Prosperity** reported that the cash held on its balance sheet had dropped from c. 1.2 billion renminbi to around 375 million renminbi. A reduction of almost 70% in just six months and largely attributed to an increase in the company's accounts receivable. Will **Kaisa Prosperity** recover the money it is owed? Time will tell. For now, the company has set aside some 190 million as provisions for potential defaults by its customers.

As for our other investment in the sector, **Aoyuan Healthy Life**, it announced, as did its parent company **China Aoyuan Group**, that it would not publish its results within the deadline authorized by the Hong Kong regulator. The two reasons given by the company were the impact of lockdowns (due to the current COVID-19 wave in China) and the auditor's request for more information on amounts transacted with related parties. Because of this delay, both **Aoyuan Healthy Life** and **China Aoyuan Group** have had their stocks suspended from trading and will remain so until they release their pending results.

These entities are not the exception to the rule. At the end of March, there was talk of more than 30 companies that had failed to meet the deadlines for publishing their results and, therefore, their stocks were also suspended. Of these, a third belonged to the real estate sector, including (in addition to the aforementioned **China Aoyuan Group**) **Kaisa Group Holdings**, **Fantasia Holdings Group**, **Modern Land (China)**, **Sunac China Holdings** and **Shimao Group Holdings**. A grim outlook, together with the plummeting profits reported by the developers that were able (or willing?) to publish their accounts at the end of the quarter. This situation has led Xi Jinping's government to relax (somewhat) the measures aimed at curbing growth and speculation in the Chinese real estate sector.

Specifically, the People's Bank of China announced in January a (tepid) reduction in the mortgage benchmark rate and in April cut the reserve requirement ratio for the banking sector. It has also approved a bailout plan for struggling financial

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[13] Hale, T. (March 22, 2022). China's Evergrande says lenders have claimed $2bn in cash. *Financial Times*.
[14] Yu, E. (March 21, 2022). China Evergrande Halts Trading in Its Stocks. *The Wall Street Journal*.

institutions and is starting to facilitate the refinancing of the country's most distressed developers.[15] Meanwhile, the finance minister announced in March that he would not extend the property tax pilot program to new cities this year.[16] In addition, more than 60 cities have introduced measures to support the sector, such as subsidizing home purchases, reducing mortgage rates and providing financial assistance to developers. Similarly, it seems that several banking institutions have agreed to extend mortgages to buyers who are directly affected by the strict controls imposed by the Chinese government to combat the Omicron variant of the coronavirus.[17] Lastly, the Chinese government is beginning to play an active role in the recapitalization and restructuring of developer companies. For example, the buyer of **Yuzhou Group**'s real estate services subsidiary is part of **China Resources Land**, a state-owned enterprise (SOE). This transaction is relevant to our interests as shareholders of **Kaisa Prosperity** and **Aoyuan Healthy Life**, because the multiple paid by the buyer can be around 14x earnings, demonstrating, once again, that the market (even when it is a state-owned player) will pay a fair price for these businesses. Also of interest is the strategic partnership agreement between the developer **Kaisa Group Holdings** and two state-owned entities: the developer **China Merchants Shekou Industrial Zone Holdings** and the financial restructuring specialist **China Great Wall Asset Management**. Following this announcement, the developer's bonds rallied in the market.[18]

However, the fragile situation of the real estate sector is not the only headache for Xi Jinping's government. Other factors are creating further uncertainty and discontent among investors, such as the announcement by the SEC (the US Securities and Exchange Commission) in early 2021 of the start of the implementation of the Holding Foreign Companies Accountable Act passed by Congress at the end of 2020. According to this rule, those foreign companies listed in U.S. markets that do not comply with U.S. audit requirements and prevent inspection of audits performed by entities domiciled outside of their home countries, may be delisted within the next two to three years. This measure, although it impacts any foreign country, is clearly aimed at China, as it has always prevented access to such information to foreign authorities and has around 200 companies listed on the U.S. stock exchange.[19] In fact, the Trump administration already forced companies such as **China Mobile** or the oil company **CNOOC** out of

[15] (April 6, 2022). China to Set Up Fund to Rescue Troubled Financial Firms. *Bloomberg*; (April 15, 2022). PBOC cut banks' reserve requirement ratio by 25 basis points to release 530 billion yuan liquidity. *Yuan Talks*; (April 25, 2022). China Allows Banks to Ease Financing for Distressed Developers. *Bloomberg*.
[16] Liu, P. (April 12, 2022). *Idem*.
[17] Huifeng, H. (April 19, 2022). China's rising household debt is shattering dreams of financial freedom, and 'fears are spreading'. *South China Morning Post*.
[18] Liu, P. (April 6, 2022). Debt-ridden developer Kaisa's bonds edge up after firm says it has signed joint venture agreement with state-owned builder, bad asset manager. *South China Morning Post*.
[19] Ouyang, I. (March 11, 2022). Shares of HutchMed and four others named by US SEC's audit list tumble in Hong Kong, Shanghai in knee jerk reaction to regulatory risks. *South China Morning Post*.

the U.S. market for belonging to the so-called "Chinese Military-Industrial Complex."[20]

Although the initial reaction of the Chinese government was passive, it seems that the blacklist published by the SEC, which already includes companies as important as the technology giant **Baidu**, has shaken things up.[21] Thus, at the beginning of April the CSRC (China Securities Regulatory Commission) announced possible changes in its regulation that would allow this inspection by foreign auditors, provided that the companies previously communicate to this body the state secrets that would be exposed, as well as the sensitive information that they might have to hand over, and the subsequent audit is carried out in a framework of collaboration with the CSRC. In short, a move in the direction desired by the SEC, although still far from the optimal result, that is, unrestricted access to information.[22]

While these negotiations between the two regulatory bodies are progressing, Chinese companies have to decide how best to preserve their interests. In this regard, some companies are already listed on the Hong Kong stock exchange, as is the case of the three major technology companies (**Alibaba Group**, **Tencent Holdings** and **Baidu**). Other entities, such as the electric vehicle manufacturer **Nio**, have just started trading on this stock market and the state-owned oil company **CNOOC** debuted at the end of April on the Shanghai market (it was already listed in Hong Kong).[23] However, not all companies have taken this route. For example, **Didi Global** (the so-called *Chinese Uber*) recently announced that on May 23 it will vote at an Extraordinary General Shareholders' Meeting on whether the company will continue to be listed on the U.S. stock exchange. In addition, it communicated that, although it is considering alternatives, it has no plans to list on other markets before its shares are delisted in the United States.[24] Investor reaction was swift, with the company's share price tanking by around 20% in a single day.

In the case of **Didi Global**, the accusation by the Cyberspace Administration of China that its IPO was conducted without completing a state data security audit is having an even greater impact. This has led to significant pressure from the government, cancelling many of the company's mobile apps and hurting its business.[25] All in all, **Didi Global** has collapsed by 87% since its IPO just under a year

[20] (December 3, 2020). US Defense Department adds CNOOC to blacklist of alleged Chinese military companies. *S&P Global*.
[21] (Visited on April 20, 2022). Holding Foreign Companies Accountable Act ("HFCAA"). *U.S. Securities and Exchange Commisison*.
[22] (April 5, 2022). Neopol In-depth: Quick take: The CSRC makes a move, moves a market. *Trivium China*.
[23] Root, A. (March 10, 2022). NIO Stock Debuts in Hong Kong. Its US Shares Are Getting Killed. *Barron's*.
[24] Reuters (April 17, 2022). Didi sets shareholder meeting for May 23 to vote on U.S. delisting. *Nikkei Asia*.
[25] Feng, C., Pan, C., Hu, M. and Xin, Z. (July 6, 2021). Didi Chuxing 'forced its way' to a New York listing, triggering data security review, sources say. *South China Morning Post*.

ago. Although some media commented that **Didi Global** would possibly recover these apps once it was delisted in the United States, it seems that the Chinese government is not very happy with the fines that were agreed between the company and the CAC, which may explain the delay in its potential listing on the Hong Kong Stock Exchange.[26] This is certainly a clear indication of the extent to which China is willing to preserve certain information from the scrutiny of the United States.

It is difficult to predict how it will all end, but this uncertainty is depressing the stock prices of the most affected companies. For example, the index of Chinese companies listed in the United States (**NASDAQ Golden Dragon China Index**) has declined by around 55% over the last year. Of course, this is not the only relevant factor to take into account. The Chinese government's regulatory crackdown and the strict restrictions imposed by the country's zero-Covid policy are also contributing negatively to the business performance of many companies and, therefore, to their stock prices. In fact, April is on track to become the worst month in the last six years. Hence, the Chinese stock market regulator has said that it will take measures to strengthen the country's capital markets (moving forward in the connection between the Shanghai market and those of Hong Kong and London, for example) and has also issued a ("Chinese-style") statement asking company directors to buy back their own shares (even issuing debt for this purpose) and to implement employee share incentive schemes.

Additionally, in this same statement, it has asked social security funds, pension plans, trusts, insurance companies and asset management companies to increase their exposure to the stock market. All of this with the goal to reflate or, at least, stabilize equity prices.

> *[The CSRC] encourages major shareholders, directors, supervisors and executives to hold listed companies' shares for the long term, and to stabilise stock prices actively by increasing stakes when their companies' stocks experience big drops.*[27]

How has this cocktail of negative news affected our investments in Hong Kong-listed companies? Obviously, not in a positive way. On average, our companies have dropped by 16% in the first quarter of 2022.[28] Unsurprisingly, our property services companies are two of the worst performers. Specifically, **Kaisa Prosperity** declined

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[26] (April 22, 2022). Didi's Fate in Limbo As Officials Object to Proposed Penalty. *Bloomberg*.
[27] Ouyan, I. (April 12, 2022). China's securities watchdog renews call that firms buy back shares, asks major shareholders to support stock prices amid sluggish stock market. *South China Morning Post*.
[28] This average number does not include our investments in **Keck Seng Investments** (-1.4%) or **Nagacorp** (2.8%), as their businesses do not have a relevant exposure to the Chinese economy.

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by 31% and **Aoyuan Healthy Life** by 24% in the period. The watch manufacturer and distributor **Time Watch Investments**, impacted by the country's economic slowdown, and the technology platform holding company **Naspers**, badly hit by the regulatory changes in China and the sanctions against Russia (remember that it has a very significant exposure to the technology company **Tencent Holdings** through **Prosus** and that it also controls the main classifieds platform in Russia), also fell by more than 20% in the quarter.

This is what fragility looks like

It is far easier to figure out if something is fragile than to predict the occurrence of an event that may harm it.
— Nassim N. Taleb

I do not intend in the following paragraphs to elucidate the motives that led Russia to invade Ukraine (I am not an expert in geopolitics). I would not like the following lines to seem frivolous or insensitive either. The tragedy that the Ukrainian country is experiencing is something impossible to explain in words and we are a long way from knowing the consequences of this conflict. However, as investors (and citizens) we need to try to understand how the war is affecting the various industries and economies, either as a direct consequence of the invasion or as a result of its second-order effects (e.g., the sanctions imposed on Russia), so that we can prepare ourselves as best we can.

As many of you know (and we have reminded you in recent years), **Nassim N. Taleb** is one of the thinkers whose work has had the greatest impact on the way we invest. Concepts such as *convexity* or *free options* are always present in the way we analyze the different situations we face as investors, as they are ways to significantly increase the margin of safety of our investments. This time, I would like to focus on a more general (and popular) concept of Taleb's philosophy: **antifragility**.[29]

To explain this powerful idea, Taleb compares it with two other concepts, namely, fragility and robustness. In essence, for Taleb, fragile is something that is negatively affected by shocks. Robustness, on the other hand, remains unchanged or stable in the face of these stresses. Finally, Taleb defines antifragile as anything that, far from being harmed by shocks, benefits from them. Specifically:

[29] Taleb, N. N. (2013). *Antifragile. Things that Gain from Disorder*. Penguin.

Some things benefit from shocks; they thrive and grow when exposed to volatility, randomness, disorder, and stressors and love adventure, risk, and uncertainty.[30]

Taleb draws on different academic fields and traditions to develop these ideas throughout his research. For example, if we look at Greek mythology, the sword of Damocles would serve to explain fragility, the phoenix rising from the ashes would be similar to the concept of robustness and, finally, the Hydra of Lerna would be an antifragile being, as it grows two heads every time one is cut off.

Why is it interesting to understand the idea of antifragility? Because Russia's invasion of Ukraine has highlighted two fundamental things. The first is that **the energy system of the West, especially in Europe, is extraordinarily fragile** and, far from being able to resist or benefit from the war shock, it has been seriously affected. The second piece of evidence is that **there is one asset that has become antifragile in this type of environment; that is, commodities.** Indeed, the fact that Russia is such an important country on the global energy scene is contributing to increasing the bottlenecks in commodities, driving their prices sharply higher. We already warned about these concerns in our previous quarterly letter, when we denounced the dangers inherent in the disorderly and forced planning of the energy transition in which we are currently involved (see **here**). Therefore, as in the section on China, we will devote the following lines to updating how the different economies have reacted to the current environment.

The war that ended the green agenda?

What Russia is questioning is Ukraine's right to exist.
— Nicolás de Pedro

After disappointing early measures that seemed more intended to make it appear that the West was retaliating against Vladimir Putin's government, in late February the United States and Europe approved a strong package of financial sanctions, including disconnecting Russian banks from the SWIFT (Society for Worldwide Interbank Financial Telecommunications) system and freezing the assets of Russia's central bank. This second sanction is particularly severe, as it prevents the Russian government from accessing half of its foreign exchange

[30] *Idem.*

reserves, making it extremely difficult for its central bank to control the exchange rate. In the words of Joe Biden, President of the United States himself:

> *These economic sanctions are a new kind of economic statecraft with the power to inflict damage that rivals military might.*[31]

The initial impact of this freezing of bank reserves was, unsurprisingly, a plunge of around 50% of the ruble against the dollar. However, capital controls and other measures aimed at (compulsorily) increasing the demand for the country's currency have led it to recover, for the time being, all the ground lost as a result of the sanctions (it is actually ironic that the ruble is one of the few currencies that has appreciated against the dollar in the last year). Apart from the sustainability of the current exchange rate of the ruble and the economic impact that the freezing of foreign exchange reserves will have on Russia, this economic sanction has second-order effects whose consequences we cannot yet foresee. The reality is that **by using the two most important world currencies (the dollar and the euro) as financial weapons, both have ceased to be neutral assets in the financial market**, so that governments in other currency areas will tend to reduce their exposure to these currencies, especially in the case of those countries most susceptible to sanctions in the future.

> *The illusion that these state currencies are neutral and universal currencies has been shattered forever and this will necessarily affect the future evolution of their demand and, therefore, of their value.*[32]

Subsequently, as Russian attacks in Ukraine have intensified and spread, the pressure through sanctions on Russia has been increasing, with measures ranging from freezing the assets of Russian oligarchs to the decision not to purchase certain commodities from this country.[33] Obviously, the increasing and varied sanctions, the instability (for lack of a better word) in the Black Sea area, and even civic pressure, have generated an environment of uncertainty that is unbearable for many global companies, making it impossible for them to do business in Russia and Ukraine. Take, for example, the case of **AerCap**, the aircraft leasing company in which we have been shareholders for many years. Well, as a result of sanctions issued by the European Union and the United States, **AerCap** cannot accept payments from any Russian airline, so 5% of its fleet (in terms of net book value)

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[31] Pop, V., Fleming, S. and Politi, J. (April 6, 2022). Weaponisation of finance: how the west unleashed 'shock and awe' on Russia. *Financial Times*.
[32] Rallo, J. R. (March 4, 2022). ¿Peligra la hegemonía monetaria del dólar tras las sanciones contra Rusia? *El Confidencial*. [Own translation from Spanish]
[33] Funakoshi, M., Lawson, H. and Deka, K. (updated on April 22, 2022). Tracking sanctions against Russia. *Reuters*.

has "suddenly" stopped generating revenue. Also noteworthy is the example of **Naspers**, where the technology platform company has decided to financially separate itself from its subsidiary Avito, Russia's leading classifieds company.[34] Finally, the automobile manufacturer **BMW** has also announced that it is suspending rail shipments of its vehicles to China, for fear of losing the goods and the refusal of many insurers to cover goods transiting through Russia or neighboring areas.[35]

However, as mentioned above, commodities and the related companies, including those in our portfolios in recent months, have benefited greatly from the current geopolitical scenario. Therefore, it is worthwhile to briefly review the different dynamics that have been unfolding over the course of 2022 in some of the commodities to which we have exposure.

THE CASE OF OIL

If there is one commodity where the potential bottleneck had not quite materialized, it would certainly be crude oil. The ingredients were there, but some event always ended up postponing the inevitable tightening that would boost its price. However, the Russian invasion has acted as the catalyst that has uncovered the current supply risks in this market. Why? Because of the approximately 100 million barrels per day produced (and consumed) in the world, around 11 million barrels are sourced from Russia. Of those 11 million barrels, 5 million are for domestic consumption and the rest, which includes 2 million in petroleum products, is exported, mainly to Europe.[36] Historically, an oil deficit of around 1% usually translates into triple-digit oil prices, so any supply disruption coming from Russia could send prices sharply higher.[37] It is not surprising that Brent oil went from around 77 dollars at the end of 2021 to 130 dollars at the beginning of March (at the time of writing, it is hovering around 110 dollars).

But to what extent do the two sides want to stop trading Russian oil? It depends on the specific case. Countries with hardly any trade relations with Russia, such as the United States, were quick to announce that they would stop importing oil from the country led by Putin.[38] However, other economic areas, such as Europe or China, are not in the same situation. The Old Continent needs to import around 9.5

[34] We will discuss the impact on both companies in more detail in the portfolio changes section.
[35] Kastner, J. (April 26, 2022). BMW and Audi suspend shipments by train to China. *Nikkei Asia*.
[36] Johnston, R. (March 29, 2022). Oil's Russia-Sized Hole—Part 1. *Commodity Context*.
[37] (April 24, 2022). The Energy Shortage is About to Get Bad . . . Shamone. *Open Insights*.
[38] Wilkie, C. (April 7, 2022). Congress passes ban on Russian oil and gas imports, sending measure to Biden. *CNBC*.

million barrels per day to meet its energy needs. Of this amount, around 25% comes from Russia. Therefore, it is not at all easy to do without this oil and look for other alternatives. China is another economic bloc that requires high imports. Specifically, the Asian country imports slightly more than 10 million barrels per day, about 20% of which comes from Russia.

In view of the dependence of the three main economic areas of the world on Russian oil, we now have to examine how each of them is reacting to the situation. In the case of the **United States**, we have already mentioned that they have decided to stop importing Russian oil. Now, this oil (and its related products) accounts for 8% of US imports. Where are they going to look now to replace that? Internally? Not likely. In fact, in an unexpected turn of events, it is not out of the question that the United States will relax sanctions on Nicolás Maduro's regime and resume purchases of oil from **Venezuela**.[39] Of course, there is also now an urgency (especially on the European side) to reach the nuclear agreement with Iran and end the sanctions imposed on it by Donald Trump, in order to free up the Islamic country's oil production capacity.[40] It is clear that, at the present time, there are the bad and then the very bad actors.

As for Europe, its dependence on Russian oil is very obvious, which is why they have not (yet) launched any measure banning direct imports today. On the contrary, the **European Union** has adopted a plan that aims to reduce fossil fuels purchased from Russia to zero by 2030.[41] That said, it seems that Germany, the country most reluctant to embargo Russia, is starting to give in and some news is expected in the coming days in this direction, with which Europe would join the United States and other countries such as the United Kingdom in banning the import of Russian oil.[42] In the meantime, Europe approved in mid-March a series of sanctions, including a ban on buying oil from the Russian state-owned oil giant **Rosneft** as of May 15.

The measures already announced, as well as the uncertainty about possible future sanctions and, additionally, the fear of being portrayed as the oil buyer financing the Russian invasion is beginning to be felt in the Russian oil market. On the one hand, this last month the number of barrels imported by Europe without an identified buyer has skyrocketed. Specifically, in the first three weeks of April, Europe is estimated to have purchased 11 million barrels without an identified

[39] Parraga, M. and Spetlanick, M. (March 9, 2022). U.S. ties easing of Venezuela sanctions to direct oil supply. *Reuters*.
[40] Sinaee, M. (April 23, 2022). EU Foreign Policy Chief Calls For Fresh Effort In Iran Nuclear Talks. *Iran International*.
[41] McWilliams, B., Sgaravatti, G., Tagliapietra, S. and Zachmann, G. (March 17, 2022). Can Europe manage if Russian oil and coal are cut off? *Bruegel*.
[42] Pancevski, B. and Kantchev, G. (April 28, 2022). Germany Drops Opposition to Embargo on Russian Oil. *The Wall Street Journal*.

recipient.[43] On the other hand, the selling price of Russian oil has been trading for weeks at a discount of around 35 dollars against the Brent benchmark, when historically they traded with only a few dollars spread. In fact, news recently leaked out that **Rosneft** had not found a buyer for a large batch of oil, which shows that, albeit slowly, the world is beginning to turn its back on Russian oil.[44] Even some commodity brokers, whose historical lack of "political positioning" made them natural buyers in any market, have announced that they will stop buying Russian oil as of May 15.[45]

However, not everyone is willing to give up buying Russian oil, and even some do not hesitate to increase their imports, taking advantage of the price discount. Such is the case of the two large Asian economies, **China** and **India**. It is estimated that, since the beginning of the invasion of Ukraine, the number of oil tankers coming from Russia has increased by c. 35% in the case of China and by more than eight times in India, compared to the figures for the same period in 2021. In the words of Nirmala Sitharaman, India's Finance Minister:

> *I would put my country's national interest first. ... First of all, fuel is available, and available at a discount. Why shouldn't I buy it?* [46]

On the other hand, it is worth noting that China has initiated a purchase program for Russian oil using yuan instead of dollars, which also puts on the table the risk of a lower demand for dollars (or euros) in the future, if this currency starts to be used as a financial weapon.[47]

However, despite this increase in demand from China and India, the reality is that Russian oil production is falling. The Russian Finance Minister himself announced that he expects a contraction of more than 17% by 2022, although it is not very clear whether he uses the year-end of 2021 as a baseline or annual averages.[48] Regardless of this, the output decline raises several questions: Will Russia be able to find a market to return to the output levels of a few months ago? How easy will it find it to increase production again? Where will the oil needed by the West come from, if the current sanctions environment persists? On this last question, one might think of OPEC as a candidate to replace this oil. However, the fact is that they have been unable to increase their production for some time now, not even to

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[43] Hirtenstein, A. (April 21, 2022). The West Is Still Buying Russian Oil, but It's Now Harder to Track. *The Wall Street Journal*.
[44] Wallace, J. and Hirtenstein, A. (April 26, 2022). Russia Tried to Sell a Huge Slug of Oil. Nobody Wanted It. *The Wall Street Journal*.
[45] Hunter, A. (April 26, 2022). Trafigura to Stop Buying Oil From Russia's Rosneft Before May 15. *Bloomberg*.
[46] Imahashi, R. (April 21, 2022). Who is buying bargain Russian oil in Asia? *Nikkei Asia*.
[47] (April 7, 2022). Russia Coal and Oil Paid for in Yuan Starts Heading to China. *Bloomberg*.
[48] (April 27, 2022). Russia Says Its Oil Output May Drop as Much as 17% This Year. *Bloomberg*.

the levels they themselves have agreed upon. OPEC members themselves have recently warned that *considering the current demand outlook, it would be nearly impossible to replace a loss in volumes of this magnitude*.[49]

We are left with U.S. shale oil as a second alternative. However, as we pointed out in our previous quarterly letter, the green agenda is hindering the needed investment growth in the U.S. industry. Although it is true that, at current prices, activity is increasing, the truth is that it is still far from desirable levels. Another factor is holding back the necessary increase in U.S. oil production, namely, the lack of labor, drilling equipment and materials.[50] After a period of underinvestment, it is not so easy to get back to earlier peak output rates:

> *It's almost like the industry thought we were driving a car with a five-speed transmission—but we went to shift from fourth to fifth gear and that fifth gear just wasn't there.*[51]

What is the very short-term solution that governments have found to this mess? Indeed, the release of strategic petroleum reserves.[52] However, this is not a sustainable solution to the structural supply deficit that may be coming if crude oil production restrictions in Western countries are not relaxed and, of course, if OPEC is still unable to increase its output.

> *Delusional dreams are beginning to collide with reality, and we guarantee you reality will win.*[53]

Unsurprisingly, our three holdings in the oil sector have benefited significantly from the current market environment. For example, the Canadian oil and gas producer **Spartan Delta** gained more than 60% in the first quarter of 2022. Also, the geophysical and geothermal data services company **TGS** rose by 56%, while the company that owns offshore rigs, **Shelf Drilling**, was up 60% in the same period.

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[49] (April 12, 2022). OPEC tells EU it's not possible to replace potential Russian oil supply loss. *Asia Nikkei*.
[50] Eaton, C. (April 28, 2022). In the Top U.S. Oil Field, a Battle for Materials Crimps Growth. *The Wall Street Journal*.
[51] McCormick, M. (March 27, 2022). 'You can't just turn on the taps': bottlenecks hit hopes of US oil output surge. *Financial Times*.
[52] (April 7, 2022). IEA countries to tap 60m barrels of oil on top of 180m by U.S. *Nikkei Asia*.
[53] Open Insights. *Idem*.

THE CASE OF NATURAL GAS

If the Russian impact was very evident in the oil market, it is even more so in the case of **natural gas**. Let us remember that Europe (as well as other economic areas) decided some time ago that natural gas would be the necessary fossil fuel to facilitate the energy transition. However, as we also highlighted, paradoxically Europe refuses to exploit its shale gas reserves, which has led it to rely on imports to meet its energy needs. The problem with this approach? About 45% of these imports come from Russia, which has become a real headache for Europe and explains why gas is not making it into talks of potential sanctions on Russia.

Obviously, Europe wants to start cutting its dependence on Russia, but this is no simple task. To replace this gas, it needs to increase imports of liquefied natural gas (LNG). In particular, the United States has announced its willingness to increase exports to the European market. However, this solution poses two short-term problems. On the one hand, there will not be sufficient global LNG production capacity for the next few years to help cover this hole left by Russian gas. According to a study by the **Credit Suisse** research team, by the middle of this decade the natural gas market could have a deficit of 100 million tons per year.[54] On the other hand, LNG needs sufficient import terminals and regasification plants to be consumed. In both cases, billions of euros of investments and several years are needed. As another example of nonsense, Spain has a huge excess of regasification capacity (inherited from the years of public spending excesses that led to the boom in combined cycle power plants) that could be used by Europe to convert imported LNG into gas.[55] But here is another big problem. Spain is a kind of energy island within Europe. A gas pipeline (the so-called Midcat) needs to be developed to transport this gas beyond Spain borders. In 2019, it was decided to abandon this project as it was not in line with the criteria of the green energy agenda. Perhaps this is a good time to rethink preferences. Although, of course, we will always have the possibility of dispensing with air conditioning this summer, as Mario Draghi, Prime Minister of Italy, commented a few weeks ago.

> *Do we want peace or air conditioning?* [56]

Russia is well aware that it has the upper hand in this market, which is why it is trying to make the most of this card. Specifically, at the end of March Putin

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[54] Stapczynski, S. (April 7, 2022). Global energy upheaval threatens years of natural gas shortages. *Bloomberg*.
[55] Proto, L. (February 8, 2022). Historia de un derroche estratégico: así nos volvimos los reyes del gas licuado en Europa. *El Confidencial*.
[56] Tadeo, M. [@mariatad]. (April 7, 2022). *Draghi on energy embargo: «Do we want peace or air conditioning?»*. Twitter. https://twitter.com/mariatad/status/1511958436992454658.

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approved a decree that would oblige European buyers of Russian gas to pay in rubles instead of euros. In the event of non-compliance with this condition, Russia would not supply gas to the offender.[57] In case there were any doubts as to whether Russia would follow through on its threat, in late April it turned off the gas tap to Poland and Bulgaria for their refusal to pay for their supplies in rubles.[58] The European Union's first reaction was to state that this implied a breach of contract, as payments were agreed in the European currency and, furthermore, it warned European companies that paying in rubles would violate the economic sanctions passed against Russia. This warning comes after several companies have announced their intention to comply with the Russian decree.[59] But why this Russian interest in having payments settled in rubles? Because the mechanism would re-engage the Russian payment system (and its central bank) with the rest of the world, allowing it to access financial resources that are currently denied to it.[60]

Understandably, as a sign of an extremely tight market, the European benchmark gas price rose by 250% in the weeks following the beginning of the Russian invasion and, even today, remains at historically very high levels. Of course, the renewed uncertainty related to possible supply disruptions only adds to the stress and volatility in this market. Meanwhile, **Spartan Delta** (whose performance has already been mentioned) and **Golar LNG** have benefited greatly from this situation. Let us recall that **Golar LNG** is dedicated to the conversion of natural gas into LNG through its FLNG infrastructure, to LNG storage and regasification through its FSRU (an asset that has seen its attractiveness skyrocket in this environment) and to LNG shipping through its stake in **Cool Co**. All in all, **Golar LNG** doubled in the quarter.

THE CASE OF THERMAL COAL

Certainly, the stress on the natural gas market has resulted in an even tighter market for the fossil fuel most reviled for its high carbon dioxide emissions, that is, **thermal coal**. Russia accounts for approximately 18% of the global market for this commodity, so any attempt to isolate its output from global trade has strong repercussions in this sector. That is particularly the case if lower imports of Russian natural gas are *necessarily* associated with an increase in global coal consumption.

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[57] Reuters staff. (March 31, 2022). TEXT-Putin's decree on Russian gas purchases in roubles. *Reuters*.
[58] Onoszko, M., Martewicz, M. and Okov, S. (April 26, 2022). Russia to Cut Gas to Poland and Bulgaria, Making Energy a Weapon. *Bloomberg*.
[59] Pop, V. and Bounds, A. (April 28, 2022). Russian gas payment demands in 'breach' of sanctions, EU warns. *Financial Times*.
[60] Neilson, D. H. (April 29, 2022). Ruble payments. Who get to set the terms of sale? *Soon Parted*.

It is not difficult to understand how increased demand, coupled with reduced supply, leads to higher prices for this raw material. Indeed, in the first quarter of the year, Newcastle coal rose by c. 100%, although at one point its price had climbed by more than 200%. It is ironic how the most questioned and criticized commodity by the green agenda is also one of the most antifragile commodities in the current context.

Again, contrary to the narrative and the negative sentiment towards the coal sector, the reality is that its global consumption has reached record highs in 2021. **Never before has so much coal been consumed**. In fact, the International Energy Agency (IEA) estimates that in 2022 coal consumption will grow by 2% and will remain stable until 2024. However, these estimates were made at the end of last year and the IEA has already said that it will, for the first time in its history, revise its numbers in mid-July. Obviously, it is more than likely that coal demand estimates for the coming years will be revised upwards.[61] What is the reason for this unexpected increase? On the one hand, the already mentioned shift from other fossil fuels, such as natural gas, to coal, either because relative prices favor coal or because of the search for less energy dependence on Russia. On the other hand, countries that suffered electricity blackouts last winter, like China, cannot afford it to happen again, so they have opted to limit their exports, increase the domestic supply of coal and/or the country's thermal power generation capacity.[62] India has also announced an increase in coal imports until 2025, as it will not be able to increase its domestic production capacity sufficiently until then.[63]

Of course, apart from the increase in Chinese and Indian domestic production, it does not seem likely that any of the major producers in developed economies, such as the United States or Australia, will increase their supply to ease this persistent bottleneck, so it is expected that thermal coal prices will remain higher than historical averages for the next few years.

> *I don't know if I even have an extra 200 tons. There physically isn't the production capacity.*[64]

As we highlighted in our previous quarterly letter, we continue to have direct exposure to thermal coal through our investment in the Indonesian mining group **Geo Energy Resources.** The company has benefited from this context and returned

[61] Wade, W. and Stapczynski, S. (April 25, 2022). Russia's War Is Turbocharging the World's Addiction to Coal. *Bloomberg*.
[62] *Idem*; Xue, Y. (April 26, 2022). China's addition of new coal-fired power plants hurting global efforts to phase out dirty fossil fuel, report shows. *South China Morning Post*.
[63] Varadhan, S. (April 28, 2022). EXCLUSIVE India tells its states to step up coal imports for three years - sources. *Bloomberg*.
[64] Wade, W. and Stapczynski, S. (April 25, 2022). *Idem*.

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close to 40% during the quarter. Meanwhile, although with somewhat different dynamics, our investments in the metallurgical coal companies **Ramaco Resources** and **Warrior Met Coal** also had strong returns and we sold both of them during the period.

THE CASE OF URANIUM

To conclude this section on the impact of the Russian invasion on energy commodities, let us turn to **uranium**. We have discussed in the past why nuclear energy should be included in any energy policy program that seeks to reduce carbon emissions into the atmosphere. However, for reasons we will not repeat, nuclear power has not been very popular. Perhaps the current situation may help to change that. For example, shortly before the Russian invasion, the European Union decided to include nuclear energy within the so-called green taxonomy (although there are already European legislators trying to veto its inclusion).[65] Other economies, such as China, are continuing with their plan to increase their nuclear fleet.[66] Japan, the country that suffered the Fukushima accident in 2011, is discussing reducing regulatory requirements to facilitate the overhaul of the nuclear reactors that have not yet been restarted since that time, in an attempt to reduce its dependence on foreign energy.[67]

In addition to stronger demand, there is a new risk on the supply side. Specifically, in the uranium enrichment phase of the nuclear fuel cycle (a necessary service, in most reactors, to be able to use uranium as fuel). Why? Because **Russia accounts for 43% of the world's uranium enrichment capacity**.[68] I think one can imagine the impact that any cut in the supply of this service could have on the uranium market. Obviously, the cost of long-term enrichment contracts was quick to react to this risk, rising by around 70% in April alone.[69] The uranium spot price was also under upward pressure, rising by 40% in the first quarter of the year.

Our exposure to the sector, as you know, is through **Sprott Physical Uranium Trust**, which buys uranium for storage. As you would expect, this holding also benefited from the current context, with a 35% return in the first three months of the year.

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[65] Abnett, K. and Jessop, S. (March 30, 2022). EU lawmakers move to reject green gas and nuclear investment rules. *Reuters*.
[66] Tabeta, S. (April 22, 2022). China greenlights 6 new nuclear reactors in shift away from coal. *Nikkei Asia*.
[67] Oda, S. and Reynolds, I. (April 26, 2022). Japan's Leader Says Nuclear Power Should Be Reconsidered as Energy Costs Soar. *BNN Bloomberg*.
[68] Lee, J. (March 23, 2022). How Ukraine War Enriches Uranium Miners. *The Wall Street Journal*.
[69] Quakes, J. [@quakes99] (May 1, 2022). *[...] Long-term SWU UP +$50 to $120 for record 1-month price spikes for SWU [...]*. Twitter. https://twitter.com/quakes99/status/1520578695160733696.

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The great dilemma

It's absolutely essential to restore price stability. Economies don't work without price stability.
— Jerome Powell

The inevitable consequence of the Russian invasion of Ukraine is the acceleration of the inflationary dynamics that were already underway months ago. Thus, price increases continue to break levels not seen in decades. In March, the annual inflation rate in the eurozone was around 7.5% (close to 10% in Spain) and in the United States it reached 8.5% (the worst figure since 1981). This possibly reflects the fact that we have entered, at least in some industries, what is known as a **seller's market** dynamic, in which sales take place rapidly and prices remain high or, as in the current scenario, rising. In this context, dealers do not have the capacity to increase inventories because production capacity cannot be increased to desirable levels, which keeps the market under pressure. This is a market that contrasts radically with the one we had until a few months ago, in which consumers were in charge (**buyer's market**), sales took much longer, prices remained low or even fell, inventories built up above what was necessary and production capacity was even idle.[70] A 180-degree turnaround that has led the Federal Reserve to rethink its monetary policy of the last fifteen years.

As we highlighted in our previous quarterly letter, the Fed (like the European Central Bank) considered inflation to be transitory, probably because it attributed it entirely to the bottlenecks resulting from the economic recovery after the global economic shutdown in the worst of the pandemic. However, the reality is that today's high inflation rates are also driven by the demand side of the economy. Indeed, massive monetary and fiscal stimulus, in the first instance, and wage growth (perhaps more so in the U.S. case) in the second instance, can end up locking in high prices for long, causing central banks' inflation targets to be greatly exceeded. We should not be surprised, therefore, by the latest statements by Jerome Powell, chairman of the Federal Reserve, in which he said that they will have to accelerate interest rate hikes even more and will have a difficult job not to derail the economy in the process:

[70] Neilson, D. H. (April 26, 2022). Seller's market. Toward a theory of lopsided market. *Soon Parted*.

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I don't think you'll hear anyone at the Fed say that that's going to be straightforward or easy. It's going to be very challenging. We're going to do our best to accomplish that.[71]

How is this U.S. rate hike cycle going to impact the market? The answer could take hundreds of pages, given the ramifications and second-order effects that this move will have. However, it is worth pointing out how it is affecting two asset classes that have performed extraordinarily well in recent years: government bonds and tech stocks.

Until a few months ago, the ultra-loose monetary policies of almost all central banks, combined with very low inflation, pushed yields on up to 40% of sovereign bonds into negative territory. This is unusual and can only be explained by these two factors and a relentless and voracious demand for liquidity. Today, "only" 10% of these bonds remain with negative yields.[72] The expected rise in interest rates and inflation have triggered a sell-off in bonds, resulting in the worst start to a year for this asset in decades.[73] **The risk-free asset has literally ceased to act as such**.

What about the other asset class that has attracted the most attention from the investment community in recent times? Here we can distinguish three major groups. First, those companies without earnings that had convinced investors of their great future growth prospects, pushing up their valuations to irrational levels. A clear example of this, which we mentioned almost two years ago (see **here**) is **Zoom Video Communications** ("Zoom"), whose market cap exceeded that of companies such as IBM or came close to that of **Cisco Systems**. Well, from the time we wrote about this odd situation until today, **Zoom** shares have collapsed nearly 80%. **Peloton Interactive** or **Beyond Meat** are other companies whose valuations we did not understand and whose share price has also declined drastically in the last year and a half.

In the second group we find companies with high quality businesses (generally technology platforms), but whose valuations were pricing in an ideal world. This is why we have not invested in them over the last few years. Such is the case of **PayPal Holdings** or **Netlix**, with share prices plummeting by nearly 75% from the highs reached last year. Finally, in the third group we find the major technology companies, whose competitive advantages are difficult to attack. Even though they generally do not trade at outrageous valuations, their multiples have

[71] Cox, J. (April 21, 2022). Powell says taming inflation 'absolutely essential,' and a 50 basis point hike possible for May. *CNBC*.
[72] Buttonwood (April 23, 2022). A requiem for negative government-bond yields. *The Economist*.
[73] Landsman, S. (April 7, 2022). Wild inflation will hurt all financial assets, market researcher Jim Bianco warns. *CNBC*.

significantly expanded, making it difficult for us to invest (or even reinvest) in them. Such is the case of **Alphabet**, **Microsoft** and **Amazon**, where share prices have dropped more than 30% from their highs.

It is not surprising that this combination of sharp stock declines has led to the **worst stock market start to a year for the S&P 500 since 1939**.[74] But why are these companies, which were the darling of investors, also performing badly in terms of their share price? For one simple reason: their sensitivity to interest rates. Consider that the valuation of businesses depends on their future cash flows discounted to the present. To discount these flows, a rate is applied which, to put it very simply, depends on the return on assets perceived as risk-free. The higher the interest rates, the higher the return offered by these risk-free assets and the higher the discount rate required. Therefore, if interest rates rise (or are expected to rise), company valuations are negatively impacted. This is especially true for those businesses that generate little cash today and the market expects them to generate a lot of cash in the future. Hence the severe losses in companies that promised a lot of cash generation in the future (such as **Zoom**) or those that, although already generating cash, were expecting strong future growth (as in the case of **PayPal**).

This is not to say that we should stay out of these businesses. Time will tell if the market has excessively punished these companies—in some cases, it is beginning to seem so. However, it is a warning of **how much of an impact a monetary environment totally different from the one we have experienced as investors over the last fifteen years can have**. Especially when the leaders of the world's main economic organizations themselves doubt their own effectiveness in managing it:

> *We are acting like 8-year-olds playing soccer chasing the ball.*[75]

Main changes to our portfolios

Portfolio rebalancing sounds boring, but it's a powerful investment strategy.
— Ilana Polyak

The following is a summary of the most significant changes to our funds' portfolios:

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[74] La Monica, P. R. (May 2, 2022). The S&P is having its worst start to a year since 1939. *CNN Business*.
[75] CNBC Television (April 21, 2022). *CNBC's Sara Eisen hosts IMF's debate on the global economy — 4/21/22*. YouTube. https://www.youtube.com/watch?v=sVsToALst_k&t=1s

HOROS VALUE INTERNACIONAL
Stake decreases & exits:

COMMODITIES (20.4%)
Holdings discussed: Sprott Physical Uranium Trust (3.1%), Ramaco Resources (exited) and Warrior Met Coal (exited)

This quarter we sold our entire stakes in **Ramaco Resources** and **Warrior Met Coal**. The reason is purely due to their lower upside potential after a very strong performance. In the case of **Ramaco Resources**, as we mentioned in the previous quarterly letter, its high volatility allowed us to realize high returns on two different occasions (we exited the position and then re-entered it) in a short period of time, demonstrating the importance of rebalancing positions in our portfolio.

It is important to note that, at the current price of metallurgical coal (the product sold by these two companies), the upside is still very attractive. However, our approach to the commodities sector will, as with other investments, always be prudent and assume very conservative long-term normalized price levels for metallurgical coal. The margin of safety is everything in any investment, but probably even more so in the commodities sector, where excesses occur both on the downside, when no one wants to know anything about the sector, and on the upside, when the asset becomes fashionable. We do not believe that we have reached the latter, but prefer to look for more attractive alternatives inside and outside our portfolio.

We also significantly trimmed our stake in **Sprott Physical Uranium Trust**, the vehicle of the Sprott management company that buys uranium for storage. As we have seen in the commodities section above, uranium has rallied sharply over the past two months as a result of the Russian invasion of Ukraine. As with metallurgical coal, we are adjusting our position based on an upside potential that uses relatively conservative normalized uranium prices for the future.

OTHER
Holdings discussed: AerCap (4.0%), Power REIT (1.4%) and Millennium Sustainable Ventures (0.4%)

AerCap is one of the companies most obviously impacted by the sanctions imposed by the international community on Russia. The company announced on March 31 that 5% of its fleet (measured in terms of net book value) had direct exposure to Russian airlines and that, therefore, in compliance with the European Union and

U.S. sanctions, it was no longer leasing its aircraft to these customers. The problem, of course, lies in the recovery of these aircraft and the subsequent search for customers for them. Up to the release of the earnings report, **AerCap** had recovered 22 aircraft and 3 engines out of 135 aircraft and 14 engines leased to airlines in this country. However, it seems unlikely that the company will be able to recover the rest of its fleet in the short term, as the Russian government has ordered its airlines to keep these aircraft for use on domestic routes.

This (nationalization?) challenge to take delivery of the aircraft has led **AerCap**, as well as its competitors, to initiate claims processes for substantial amounts of money with insurers. In the specific case of **AerCap**, the company has claimed around 3.5 billion dollars, a figure that would cover the potential hole that these aircraft would leave in the company's balance sheet, in the event of losing them forever. Obviously, a long process is to be expected in which both parties will argue that they do not have to take responsibility for this loss. We cannot rule out some kind of government support, since the sanctions are imposed by governments and the company does not stop operating its business voluntarily. In the meantime, the market has reacted negatively to the situation, which explains the sudden reduction in our fund's **AerCap** weighting at the end of the first quarter.

As for **Millennium Sustainable Ventures** ("Millennium"), the stock price has been hit hard driven by the poor performance of the sector, following the sharp decline in the sale price of cannabis. In addition to this, the continued delays in the development of its main asset have further weakened the company's short-term earnings expectations, significantly stressing the company's balance sheet. These reasons, coupled with the stock's lack of liquidity, prevented us from increasing our stake on the dip. The same applies to **Power REIT**, the entity that owns the greenhouses where cannabis is grown, as it has to deal with this sector weakness and given its current high dependence on **Millennium**.

Stake increases & new stakes:

FINANCIALS AND HOLDING COMPANIES (29.5%)

Holdings discussed: CIR (3.7%) and Petershill Partners (2.7%)

Petershill Partners ("PHP") is an investment firm managed by Goldman Sachs Asset Management and specializes in the management of independent alternative investment vehicles. **PHP** acquires minority stakes in these entities, thus providing capital to help drive their growth, in addition to providing strategic advice. The company leverages the experience and network of **Goldman Sachs** to offer its services. It currently has holdings in 23 asset management firms, giving it exposure to four alternative investment areas: private equity, private credit, private real assets and absolute return.

PHP went public in October 2021, with a valuation of around 5 billion dollars. However, the relative illiquidity and low initial interest in the stock saw it fall as much as 40% from the IPO price, which is when we took the opportunity to initiate our position. The reasons? It is a business with low capital employed, well managed, with a current net cash position (albeit with a reasonable debt target for the next few years) and an attractive growth profile that we are still acquiring at a multiple of around 6x its 2024e normalized free cash flow. Certainly, a market inefficiency that we do not expect to last over time.

We also increased our exposure to the Italian holding company **CIR** following its recent correction. We believe that this entity, controlled and managed by the Benedetti family, is taking the right steps to generate value for its shareholders. A recent example is the various announcements of share buybacks in recent months, which take advantage of the low implied multiple that the market is giving to the residential care home operator KOS, the holding company's main asset and a high-quality business that currently has utilization rates far from their historical levels due to the pandemic, but which is beginning to show significant signs of progress.

OTHER

Holdings discussed: Naspers (4.8%) and Dassault Aviation (2.3%)

Dassault Aviation is a French aerospace company that manufactures both civil (private jets) and military aircraft. It is a family-owned company, controlled by the Marcel Dassault Industrial Group (c. 62% of the shares and c. 77% of the voting rights). Specifically, within the military aircraft division, **Dassault Aviation** produces Rafale fighter jets and maintains, repairs and upgrades its historic Mirage aircraft. We believe that the international sales success of the Rafale will generate a lot of long-term value for the company. So much so that the company's military order book is currently at record highs. Meanwhile, the civil aviation business specializes in the manufacture of Falcon aircraft, whose maintenance provides an important source of recurring revenue for the company.

In addition, **Dassault Aviation** owns 24.6% of the **Thales Group**, the French multinational company specialized in defense and technology, which operates three business lines: defense and security, aerospace and digital security. The stake in the **Thales Group** has a long history (the bulk of it was acquired in 2009) and is the

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result of a strategic alliance, as the **Thales Group** provides **Dassault Aviation** with the equipment and technology required in the manufacture of many of its products, such as the Rafale fighter aircraft.

We initiated our position in mid-February, just a few days before the Russian invasion, for three fundamental reasons. One is the solid performance of the management team led by CEO Éric Trappier, who has been with the company since 1984 and has been CEO for almost a decade. Another reason is the significant internationalization of sales of its Rafale fighter jet and the third reason, of course, is valuation. Roughly speaking, if we exclude the value of the **Thales Group**'s stake and the company's cash position, at the time of our investment the market was valuing **Dassault Aviation**'s civil and military aviation business at a multiple of about 5x its normalized cash flow for 2024e. This multiple seems unjustifiably low to us given the company's good prospects, even before the expected escalation of global defense spending following the Russian invasion.

Regarding **Naspers**, we substantially increased our stake in the South African holding company following the sharp decline in the stock price in recent months, which was mainly due to three reasons. The first is the poor market performance of the Chinese technology giant **Tencent Holdings**, of which **Naspers** controls nearly 30%. It should be pointed out again that the Chinese stock market and, in particular, its technology sector, has experienced a very challenging time for more than a year now, following the increased interventionism of Xi Jinping's government. Added to this is the uncertainty associated with the entities that are also listed in the United States, for the reasons already mentioned and the economic impact of the widespread lockdowns to combat the pandemic in which many Chinese cities find themselves. The second reason is the impact of the economic sanctions on Russia and, more specifically, the financial separation of **Naspers** and its subsidiary Avito—Russia's leading classifieds platform—which could be worth around 5% of **Naspers'** total value. Finally, as we have also discussed, the rise in interest rates is having an impact especially on those businesses whose expected cash flows are further away from the present. Such is the case of many of the technology platforms owned by **Naspers**, which are leaders in emerging markets and industries, but whose current cash generation is almost zero.

Against this backdrop, we decided to increase our position because we believe that **Naspers'** current valuation is possibly at one of the most attractive points in recent years, even if we are very conservative about Tencent's future and the value of the other platforms.

HOROS VALUE IBERIA

Stake decreases & exits:

COMMODITIES (11.6%)
Holdings discussed: Atalaya Mining (2.9%) and Aperam (2.0%)

In the first quarter of the year, Horos Value Iberia did not exit any position. However, we did the usual rebalancing adjustments in the portfolio, leading to a lower exposure to natural resource companies in particular, such as the stainless steel producer **Aperam** and the copper producing company **Atalaya Mining**. We took advantage of their positive market performance at the beginning of the year to trim our stakes and reinvest the proceeds in two new opportunities, as well as to increase our position in other more attractive ideas within the portfolio.

FINANCIALS AND HOLDING COMPANIES (19.1%)
Holdings discussed: Corporación Financiera Alba (1.4%)

The same reasoning led us to significantly reduce our stake in the March family's investment holding company, **Corporación Financiera Alba**. In fact, its share price is near all-time highs, in contrast to the depressed stock prices of other companies in the current market environment.

Stake increases & new stakes:

COMMODITIES (11,6%)
Holdings discussed: Applus Services (2.3%)

Applus Services ("Applus") is one of the world's leading inspection, testing and certification companies. **Applus'** services contribute to providing its clients with higher quality and safer assets, infrastructures and operations. To provide this service, the company has more than 25,000 employees and a presence in more than 70 countries. **Applus** operates in different sectors, although it has a historically high exposure to the automotive and oil and gas industries. For this reason, in recent years it has been increasing its efforts to increase revenues from other areas, such as laboratories and businesses involved in the energy transition. **Applus** has four divisions: Energy & Industry, Laboratories, Automotive and IDIADA.

The first one, Energy & Industry, is the most cyclical of the four and where we expect a significant recovery in the coming years, following the capex collapse in the oil and gas sector since 2014. At current prices, there is a clear need for increased investment and we think **Applus** should benefit from this. Meanwhile, Laboratories and Automotive units should continue to grow profitably over the next few years. The last one, IDIADA, is the most uncertain at the moment. This division encompasses the operation of a technology center for the automotive industry located near Barcelona, whose concession expires in 2024. Doubts about the potential non-renewal are clearly affecting the **Applus** share price, as IDIADA accounts for 10% of the group's operating result. Even valuing this division at 0 from 2024 (a scenario we do not see as the most likely), we would be buying this excellent business at around 11x its normalized free cash flow from 2024e, when its peers have always traded at much higher multiples.

OTHER

Holdings discussed: Catalana Occidente (7.1%), Ibersol (3.3%) and Grupo Ecoener (1.6%)

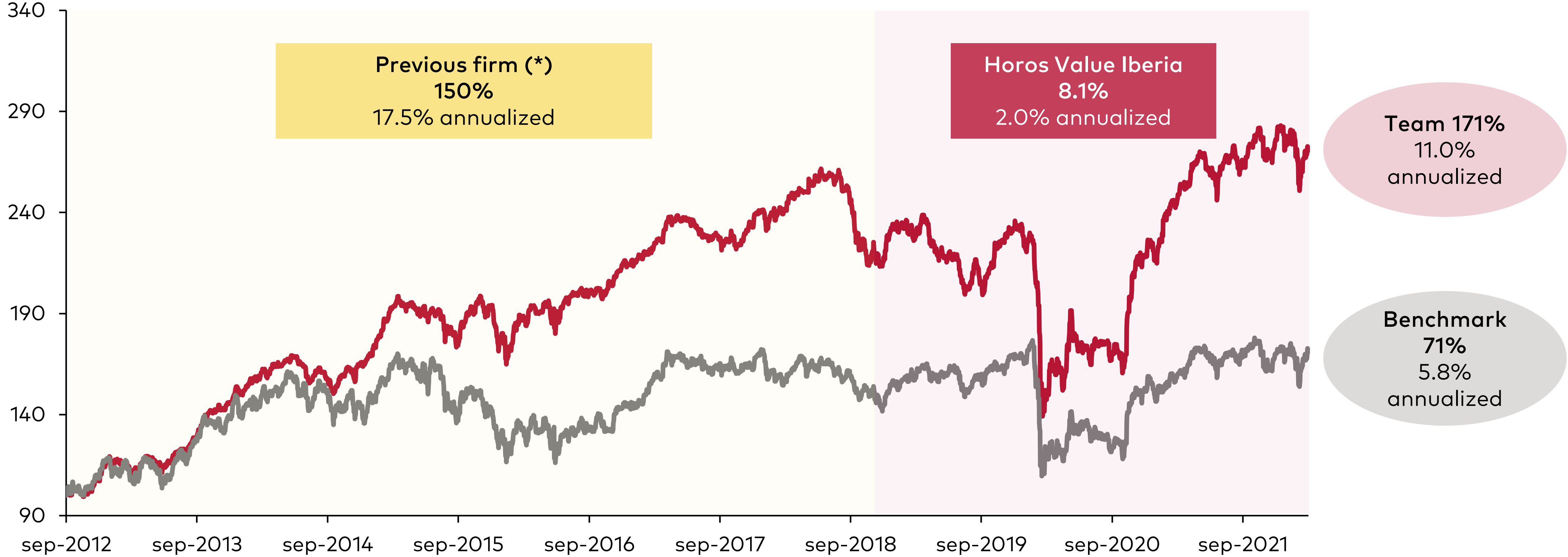
As was the case during the worst of the pandemic, we once again have **Catalana Occidente** as the top position in our Horos Value Iberia fund. We find it hard to understand that the market values this company at less than 7x current earnings, when the company continues to surprise positively every quarter with its results, both in the traditional business area (where its diversification into different segments once again proves its worth) and in credit insurance (where the combined ratios remain at extraordinarily low levels). In our opinion, the management team's historical aversion to share buybacks should be turned on its head. At the current stock price, such a transaction would arguably create the most value for its shareholders. That said, we are delighted to once again take advantage of this historic opportunity that the market is offering us.

Grupo Ecoener ("Ecoener") is a La Coruña-based company specializing in the construction and operation of renewable energy projects. It operates three different technologies: wind, solar and hydro. At the end of 2021, **Ecoener** had assets in Spain, Guatemala and Honduras. In 2022 it will also begin operating in the Dominican Republic and Colombia. Although it has more than 30 years of history, **Ecoener** went public on May 4, 2021, raising 100 million euros to finance its business plan. **Ecoener** is a family-owned company, controlled by Luis de Valdivia (Chairman and CEO), who holds a 71% stake. At the price at which we have invested, the market is not giving any value to the company's significant pipeline of new projects, nor to the cash generation of its current projects.

Finally, we substantially increased our stake in the Portuguese restaurant company **Ibersol**, following the offer launched by Restaurant Brands Iberia ("RBI") to take over the Burger King restaurants managed by **Ibersol**. Specifically, RBI could offer around 250 million euros for these restaurants, leaving an implicit valuation for the rest of **Ibersol** of 15 million euros at the time of writing. As a reminder, the "rest" includes, among others, more than 100 Pizza Hut restaurants and more than 50 KFC restaurants that could generate more than 35 million euros of EBITDA. Of course, we do not know exactly the amount that the company will get when this transaction is closed, but the inefficiency seems very clear to us now.

Returns

Historical returns of the management team in the Iberian Strategy



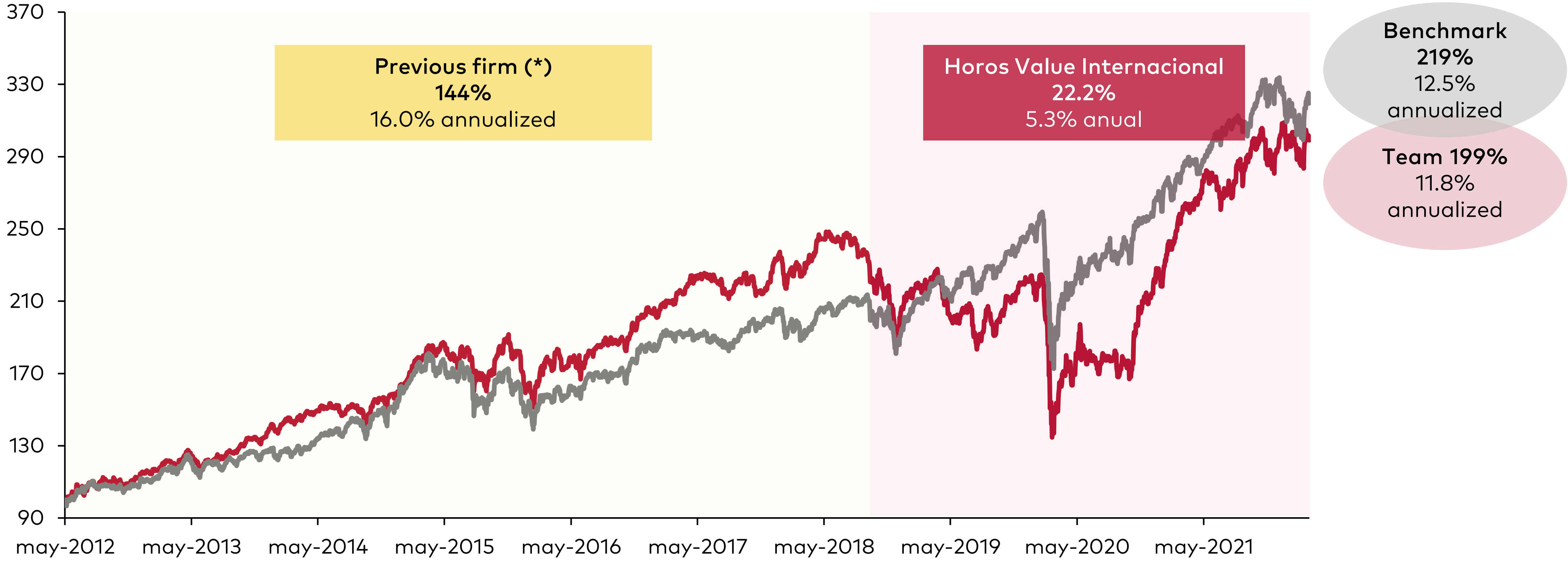
Data cover the period between the 30th September 2012 and 31st March 2022.

*Previous firm returns correspond to the management team performance achieved in their previous professional stage, where they worked for a different asset management firm. This "previous stage" corresponds to the period between the 30th September 2012 and 22nd May 2018.

Past performance is no guarantee of future performance. The Fund's investments are subject to market fluctuations and other risks inherent to investing in securities, so the acquisition of the Fund and the returns obtained may vary both upwards and downwards and an investor may not recoup the amount initially invested. Decisions to invest or divest in the Fund must be made by the investor in accordance with the legal documents at all times, and in particular on the basis of the Regulations and the Fundamental Data for the Investor (DFI) of each Fund, accompanied, where appropriate, by the Annual Report and the last quarterly Report. All this information, and any others, will be available to you at the headquarters of the Manager and through the website: www.horosam.com

Returns

Historical returns of the management team in the International Strategy



Data cover the period between the 30th May 2012 and 31st March 2022.

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Top 10 Holdings
Horos Value Iberia

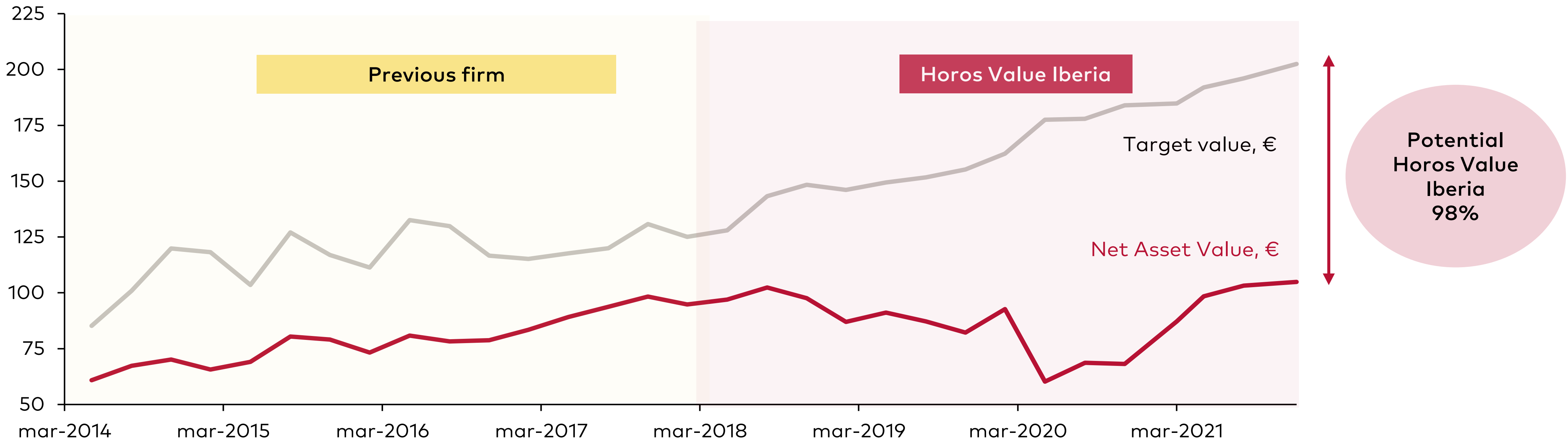
Holding	%	Theme
Catalana Occidente	7.1%	Financial
Semapa	7.0%	Financial
Merlin Properties	6.7%	Real estate and construction
Horos Value Internacional	6.4%	Financial
Iberpapel	5.0%	Industrial
Sonae SGPS	4.9%	Distribution
Gestamp	4.4%	Industrial
Elecnor	4.3%	Industrial
Renta Corporación	4.0%	Real estate and construction
Alantra Partners	3.7%	Financial

Top 10 Holdings
Horos Value Internacional

Holding	%	Theme
Naspers	4.8%	TMT
Fairfax India	4.4%	Financial
Catalana Occidente	4.4%	Financial
Semapa	4.2%	Financial
Aercap Holdings	4.0%	Financial
CIR	3.8%	Financial
BMW	3.5%	Consumer cyclicals
Sonae SGPS	3.4%	Distribution
Sun Hung Kai And Co	3.3%	Financial
Teekay Corp.	3.2%	Oil & Gas

Upside Potential

Target value vs. Net Asset Value of the **Management Team**



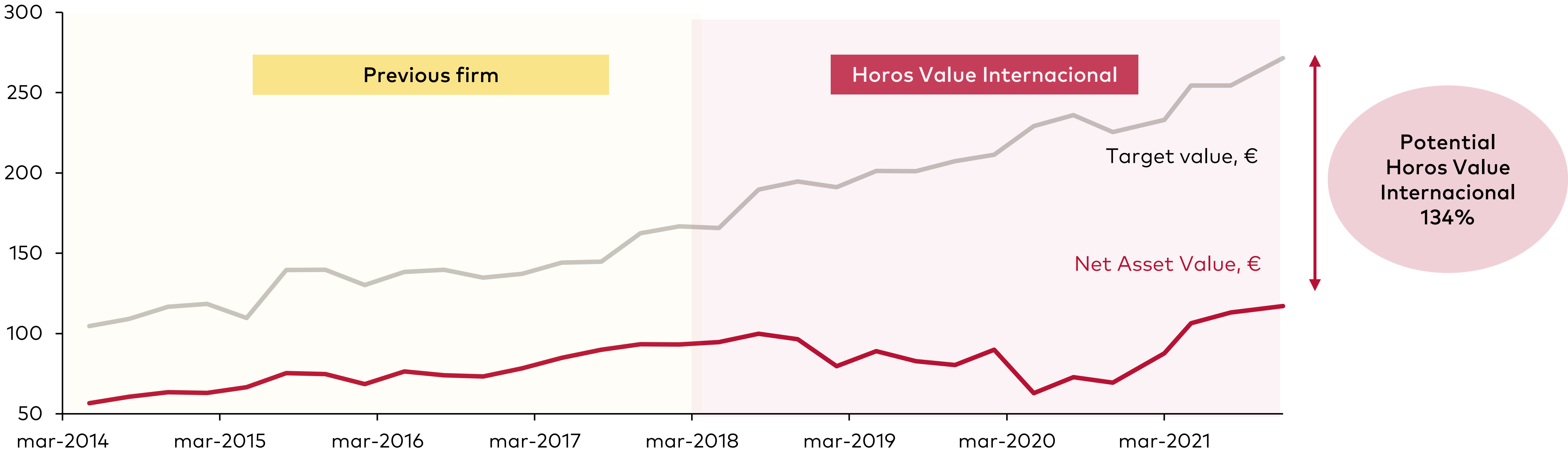
Data cover the period between the 31st March 2014 and the 31st March 2022.

Previous firm data correspond to the period when the management team worked for a different asset management firm. For the NAV calculation, this previous firm performance has been used, and as a base for retrieving the simulated NAV within this period, the NAV of Horos Value Iberia at 23rd May 2018, the day when the management team joins the project.

For the target value calculation, we perform an individual assessment of each Investment included in the portfolio. Specifically, we make a three-year estimate of the value of each company in which we invest. To do this we calculate, in a conservative way, the future cash flows we think the business will generate over the next three years in order to estimate the company future value (understood as market capitalization adjusted for net financial position). Subsequently, with this data we estimate the EV/FCF multiple (future value of the company divided by its normalised free cash flow, adjusting the latter for extraordinary items) at which each company would be priced. Finally, as a result of the qualitative analysis we do on each company, we assign an exit multiple to each investment (how much we think each business is worth trading at) and compare it with the previous figure to estimate the potential or attractiveness of the investment. Occasionally, given the nature of the investments, other generally accepted valuation methods would be used such as sum of parts, discounted cash flow or price to book value multiples.

Upside Potential

Target value vs. Net Asset Value of the **Management Team**



Data cover the period between the 31st March 2014 and the 31st March 2022.

Previous firm data correspond to the period when the management team worked for a different asset management firm. For the NAV calculation, this previous firm performance has been used, and as a base for retrieving the simulated NAV within this period, the NAV of Horos Value Internacional at 23rd May 2018, the day when the management team joins the project.

For the target value calculation, we perform an individual assessment of each Investment included in the portfolio. Specifically, we make a three-year estimate of the value of each company in which we invest. To do this we calculate, in a conservative way, the future cash flows we think the business will generate over the next three years in order to estimate the company future value (understood as market capitalization adjusted for net financial position). Subsequently, with this data we estimate the EV/FCF multiple (future value of the company divided by its normalised free cash flow, adjusting the latter for extraordinary items) at which each company would be priced. Finally, as a result of the qualitative analysis we do on each company, we assign an exit multiple to each investment (how much we think each business is worth trading at) and compare it with the previous figure to estimate the potential or attractiveness of the investment. Occasionally, given the nature of the investments, other generally accepted valuation methods would be used such as sum of parts, discounted cash flow or price to book value multiples.