

HOROS

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QUARTERLY LETTER
TO OUR CO-INVESTORS

JANUARY 2022

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Dear co-investor,

The year 2021 was one of the best for managers who practice value investing, mainly due to the strong recovery of companies with cyclical businesses, which had been heavily penalized by the investment community in recent years. In the case of the Horos team, 2021 has possibly been our best year as investment professionals. Evidence of this, although always anecdotal, is that Horos Value Iberia was the top-performing fund of its category, with a return of 26.5% compared to 12.3% in its benchmark index. Horos Value Internacional also posted an outstanding return of 37.6% for the year, beating the 27.5% gains 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 20.6%, below the 60.4% gain of its benchmark, while Horos Value Iberia has returned 10.2%, outperforming the 1.3% gain of its index. Moreover, since 2012, returns stand at 195% for the international strategy and 176% for the Iberian strategy, compared to 230% and 71% in their benchmark indices, respectively.¹

Despite this strong performance in 2021, the new year presents new challenges and sources of uncertainty for investors to prepare for. Certainly, one of them is the energy crisis that many economies are experiencing. In this letter, I will try to explain why this is happening and how we can protect ourselves against it.

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.

Executive summary

Prediction is very difficult, especially if it's about the future.

— Niels Bohr

At the end of last year, what may be the first of many future energy crises was unleashed, especially if our governments (and society as a whole) do not take action. The accelerated and disorderly energy transition, conditioned and driven by the so-called green agenda, is causing serious global bottlenecks in the fossil fuel markets, while at the same time increasing the geopolitical risks associated with this process. Thermal coal, natural gas and oil are experiencing severe strains as a result of underinvestment to increase or maintain their productive capacity. Whether we like it or not, we need fossil fuels to satisfy our energy needs and, if investment in these sectors is not reactivated, we will have to get used to more erratic and higher electricity prices. We will devote the first part of this latest quarterly letter of 2021 to explaining this.

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 **Yellow Cake**, **MBIA** and **Teekay LNG**, following the takeover bid received from Stonepeak. On the other hand, we initiated three new stakes in the quarter; namely, the Chinese real estate services company **Aoyuan Healthy Life Group**, the thermal coal producer **Geo Energy Resources** and the natural gas and oil exploration and production company **Spartan Delta**. At Horos Value Iberia, there were no new additions or exits during the period, only the usual portfolio rebalancing changes.

The dream of predicting chaos

Chaos was the law of nature; Order was the dream of man.

— Henry Adams

One of the most recurring questions that Alejandro, Miguel or I are asked is what we expect from the stock market for the year or, directly, which company we recommend that will have an outstanding performance in the following months. The most common answer that comes to mind at such situations is that we do not have a crystal ball or, if I am a little less patient than usual that day, that if I knew it I would not have to get up every morning to work. These answers are often surprising because most people live under the belief that financial markets can be predicted and that, therefore, a good investor is someone who knows what they are going to do. The reality, of course, is very different. **NO, I repeat, it is NOT possible to predict what the stock market will do** because we are dealing with a complex adaptive dynamic system, as I tried to explain at the beginning of this pandemic (see [here](#)). As a reminder, these systems are characterized by being in continuous evolution and by reacting in a non-linear way (disproportionately) to small changes in some factor that affects them. In addition, the agents operating in the system are continuously adapting to the almost infinite variations that occur at any given time. All this makes them chaotic (irreproducible) and unpredictable (that's why I prefer the short answer of the crystal ball...). Do you know another complex and chaotic adaptive system? Climate.

Indeed, climate is possibly one of the most complex and chaotic adaptive systems. It is simply impossible to model our climate. First-order causal relationships can be extracted, such as that certain gases, like carbon dioxide, contribute to the greenhouse effect. Just as we can state that, holding all other variables constant, a reduction in interest rates (discount rate) leads to an increase in company valuations. However, when we try to model second, third, fourth and subsequent order effects, the model becomes unmanageable and loses whatever predictive power it may have. And this is true for both financial markets and climate. The similarities between these systems do not end here, as both have important subsystems. In the case of financial markets, we have currency markets, fixed income markets, commodity markets or equity markets, to name the most relevant ones. In the case of climate, we have the atmosphere, the hydrosphere, the cryosphere, the lithosphere and the biosphere. Well, these subsystems have the

same properties of a dynamic, complex, adaptive and chaotic system and, in addition, they interact with each other, thus unleashing *the chaos of chaos*.²

A very illustrative example of this can be found in the 29,000 rubber ducks that plunged from a cargo ship into the sea in 1992, after a heavy storm, when the container carrying them overturned. Spanish mathematicians demonstrated last year that the trajectory of these rubber ducks cannot be predicted exactly because it is impossible to determine the behavior of fluids.³ In this particular case, the mathematicians faced the challenge of combining different chaotic systems, such as the oceanic and atmospheric systems.⁴ But why are these rubber ducks so relevant? Because fluid mechanics affects the climate, and if we cannot anticipate its behavior, how will we be able to predict with a high degree of confidence what will happen to the climate?

*We prove that there can be no algorithm that solves the problem, it is not a limitation of our knowledge, but of the mathematical logic itself.*⁵

In fact, as proof of the impossibility of climate prediction, the **Intergovernmental Panel on Climate Change (IPCC)**, the main body dedicated to the study of climate change, has since 2001 used the term projection instead of prediction, when showing the results of its simulations.⁶ To make matters worse, the complexity of data measurement means that even the most recent historical study of temperatures, although increasingly reliable, is far from infallible and is subject to continuous revisions. Not to mention the analysis of temperatures thousands of years old, for which we do not have instrumental measurements and we depend on paleoclimatology for the reconstruction of this information (using models to obtain data that feed, in turn, other models, which adds even more uncertainty and sources of error to any attempt at prediction). All this ignoring the fact that the concept of average global temperature faces a measurement problem (there is no sort of global thermometer) and that there is a strong local component in climatic conditions, so that variations in temperatures and their consequences are far from

² I borrowed the phrase "the chaos of chaos" from Miguel Iglesias (physicist, meteorologist and climatologist) after listening to his excellent talk with biochemist Luis I. Gómez: #Liberdiálogos – Desde el exilio (May 9, 2021). *Charla con Miguel Iglesias. La ciencia del clima*. YouTube.

<https://www.youtube.com/watch?v=tF3By7myPus>

³ In fact, the Navier-Stokes equations, which describe the motion of fluids, remain one of the six great unsolved mathematical problems of the millennium.

⁴ #Liberdiálogos – Desde el exilio (May 9, 2021). *Idem*.

⁵ Varela, Pau (May 6, 2021). Researchers obtain solutions for a fluid capable of simulating any Turing machine for the first time. *Centre de Recerca Matemàtica*.

⁶ Madrid Casado, Carlos M. "Filosofía de la ciencia del cambio climático: modelos, problemas e incertidumbres". *Revista Colombiana de Filosofía de la Ciencia* 20.41 (2020): 201-234, <https://doi.org/10.18270/rcfc.v20i41.3193>

being homogeneous.⁷ In short, there is no full certainty about the temperature history we are dealing with, nor about the global temperature at any given moment and, much less, do we have the capacity to predict the future climate.

All of the above should lead us to a very cautious approach to the predictions that are made about any system of these characteristics, be it the financial markets or the climate. However, this has long since ceased to be the case and, strangely enough, part of the blame lies with a Nobel Peace Prize winner.

An increasingly inconvenient truth

I don't want you to be hopeful. I want you to panic.

— Greta Thunberg

In 2006, Al Gore, former vice-president of the United States and candidate for the US presidency in the 2000 elections, starred in the documentary *An Inconvenient Truth*, which sought to show the world the risks of climate change and man-made global warming. In addition to stirring people's consciences, the documentary helped Gore receive the Nobel Peace Prize a year later (shared with the IPCC). Subsequently, various environmental activist groups, such as Extinction Rebellion, Fridays For Future, the Sierra Club or 350.org, as well as influential personalities from all fields and even a Swedish girl (now an adult) called Greta Thunberg, who is known worldwide, have taken over from Gore in their warning about the devastating consequences of climate change that man is causing with his current lifestyle.

This latter statement obviously entails a belief in a major impact of human activity on the climate and the need to do whatever it takes to put an end to it. However, although it may surprise you, this sense of urgency and recourse to the alarmist headline are not recent. I still remember spending hours skimming the red volumes of the fascinating issues of the Spanish magazine *Muy Interesante*, which my parents collected at the time, when I was barely ten years old. I was very impressed by an issue that detailed why the south of Spain would become a desert at the beginning of the 21st century. You will agree that it is not a very reassuring message for a child of that age. However, I do not mention the anecdote for this

⁷ *Idem.*

reason, but because today this catastrophic prediction has been postponed a hundred years, specifically until the year 2100.⁸

Such exaggerated errors and subsequent revisions in climate forecasts are by no means the exception to the rule, as the following examples demonstrate. In the late 1960s, for example, the New York Times quoted a scientist who was horrified that "everybody will disappear in a cloud of blue steam [from pollution] in 20 years," if something was not done about it immediately. In the 1970s, there was constant talk of the risks of climate change caused by the use of fossil fuels, to warn of an impending new ice age! In the late 1980s, headlines warned of devastating droughts and the risk of a sea level rise that would submerge the Maldives or parts of New York by 2020. Also for that year, a Siberian climate in Great Britain or an ice-free Arctic was predicted in 2004. In fact, Al Gore also prophesied an ice-free Arctic by 2013.⁹

These failed predictions clearly demonstrate three things. The first is that we have an uncanny ability to reboot our minds and ignore the fact that predictions, whatever they may be, rarely come true—I can tell you this as someone who is sick and tired of hearing about them. Secondly, as we discussed in the previous section, predicting the future behavior of complex and chaotic systems, such as climate or financial markets, is futile. We should therefore be very cautious when making these estimates or, at least, be very aware of their limitations. The third, perhaps the most worrying of the three, is that the use (and abuse) of alarmism is very common and usually hides interests that are far removed from science.

Considering the above, would it be better to forget about what is happening with the climate, since its future behavior cannot be predicted? Of course not. Following the analogy of financial markets, we do not need to be able to anticipate their performance to be reasonably successful. We "only" need to focus on what we do know for sure (investing at cheap valuations pays off) and move away from mere speculation (what the stock market is going to do). Well, with climate, what we do know is that human activity has increased the concentration of carbon dioxide in the atmosphere and, therefore, has increased the greenhouse effect, contributing to global warming. What we do not know, and it is a matter of speculation, is how significant this impact is and what we can expect in the future. Not surprisingly, the IPCC itself works in its reports under various scenarios of carbon dioxide emissions and their theoretical impact on temperatures and climate. Despite all this uncertainty, climate change and, more specifically, what to do about it, has

⁸ Vaughan, A. (October 27, 2016). Climate change rate to turn southern Spain to desert by 2100, report warns. *The Guardian*.

⁹ Herrezuelo, A.D. (September 27, 2019). 50 años de predicciones fallidas de Eco-Apocalipsis. *Señales del fin*.

become an uneven battleground, between a majority that claims that the science is very clear about the devastating scenarios that await us because of human activity—if we do not drastically reduce our carbon emissions—and a minority that, just by raising its voice against this alarmism, is branded as “climate change denier.” While the former is given a voice in government agencies, the media and social networks, among others, the latter are censored without any consideration.¹⁰

It is a situation that strongly reminds me of that experienced by those investors, brilliantly characterized by Michael Lewis in his book (and later movie) *The Big Short*, who were betting on a housing crash back in 2005 and 2006, when the whole world seemed to be going against them.¹¹ In this case, possibly some of the most prominent voices on the minority side of the climate change debate are **Michael Shellenberger, Roger Pielke Jr., Bjorn Lomborg, Alex Epstein or Steven E. Koonin**. On the one hand, this group agrees that climate change exists (something that should not be discussed, since there have always been natural causes prior to man) and that humans are a relevant factor in it. On the other hand, and here comes the big difference, these authors argue in their writings that the scenarios of future devastation are totally unfounded and that the effects—in terms of human lives and economic costs, for example—of natural disasters, generally attributed to anthropogenic climate change, when adjusted for population size and wealth, have been actually diminishing.¹²

In fact, the IPCC, which (let me emphasize this) is the official source on which both sides rely to draw their conclusions, says that compared to other factors such as demographics, technology, regulation, trade and others, climate has and will have a relatively small impact on the economy.¹³

Economics has been called the “dismal science,” and I once joked to a prominent economist that the compounding of climate and economic projections is a “doubly dismal” enterprise.¹⁴

¹⁰ An example is the recent case of Roy W. Spencer, former NASA Senior Climate Studies Scientist, whose blog is no longer eligible for advertising revenue due to Google's decision. Spencer, R. W. (January 7, 2022). “Unreliable and harmful claims”: This website has been demonetized by Google. www.drroyspencer.com.

¹¹ Lewis, M. (2011). *The Big Short*. New Directions.

¹² Shellenberger, M. (2020). *Apocalypse Never*. Harper; Pielke Jr. R. (January 15, 2021). Global Disasters: A Remarkable Story of Science and Policy Success. *The Honest Broker Newsletter*; Lomborg, Bjorn: “Welfare in the 21st century: Increasing development, reducing inequality, the impact of climate change, and the cost of climate policies.” *Technological Forecasting and Social Change*. Volume 156, July 2020, 119981, <https://doi.org/10.1016/j.techfore.2020.119981>; Epstein, A. (2014). *The Moral Case for Fossil Fuels*. Portfolio; Koonin E. S. (2021). *Unsettled*. BenBella Books.

¹³ Pethokoukis, J. (December 30, 2021): What do we know about climate change? My long-read Q&A with Steven Koonin. *AEIdeas Blog*.

¹⁴ Koonin E. S. (2021). *Idem*.

Who is right? Honestly, what I think about this should not be relevant for anything or anyone. Personally, I believe that what we should be concerned about is how this alarmism is being used as a kind of blank check to justify and impose an energy model that is clearly fragile and with important consequences that we cannot underestimate, neither as a society nor, of course, as investors. We will devote the rest of this letter to this topic.

What is seen and what is NOT seen of the green agenda

What is essential is invisible to the eye.

— The Little Prince

At the end of December of last year, electricity prices in the main European economies reached levels that were *several* times higher than the usual average prices. For example, the price per megawatt hour in the Spanish wholesale market reached 400 euros on December 23rd, an **increase of more than 500% over the summer**. A spike that, of course, has caught everyone off guard and has raised several questions about the approach that many economies are following in their particular energy transition. But what is behind this steep rise in prices? Although there are several causes that have triggered this price shock and although it is always tempting to blame (all) our energy woes on Russian President Vladimir Putin, the reality is that we have an underlying structural problem that can make volatility and much higher electricity prices at certain times of the year become commonplace.

Indeed, the energy mix planning, with a target of cutting carbon emissions by a certain amount, is becoming another example of how **interventionism and central planning can unleash unintended and undesirable consequences for society as a whole**. The brilliant French liberal economist Claude Frédéric Bastiat warned about this very clearly in the mid-19th century in his essay *What Is Seen and What Is Not Seen*.¹⁵ In this writing, Bastiat explained how some effects of human actions can go unnoticed and lead us to support harmful government measures that, had we understood their real results, would never have been adopted.

Well, in the energy transition planning of recent years, both the population and political leaders, ignoring other interests they may have, have focused their attention on the ultimate desired outcome of this planning (a reduction in carbon

¹⁵ This essay, and other works by Bastiat, can be found in Bastiat, F. (2018). *Selected Essays on Political Economy*. Econlib. <https://www.econlib.org/library/Bastiat/basEss.html>

emissions or *what is seen*), disregarding its consequences (bottlenecks or *what is not seen*). Under this pretext, **an outright demonization of fossil fuels has begun and renewable energy has been exalted as the savior of the planet**. A clear example of the consequences of this approach, for instance, can be found in the energy crisis that Europe is currently experiencing.

The Old Continent as a whole has been reducing energy production from fossil fuels in recent years, while at the same time increasing the share of wind and solar energy in its energy mix. The problem with this transition is that it cannot be completed overnight (it takes decades) and, additionally, renewable energies are intermittent in their generation, so they require another source of baseload power as backup. Although it seems that sentiment may be changing, European leaders decided some time ago that nuclear energy should not play this backup role.¹⁶ Therefore, the remaining alternative is natural gas, a fossil fuel that emits half as much carbon dioxide into the atmosphere as coal.¹⁷ However, instead of opting resolutely for domestic production (exploiting, for example, our shale gas reserves), Europe has preferred to shoot itself in the foot and allow its gas production capacity to continue its natural decline. Meanwhile, imports from countries such as Russia or Algeria via gas pipelines and from other producers, such as the United States in the form of LNG (liquefied natural gas) transported in LNG tankers, have *necessarily* increased.¹⁸ In this way, **Europe has been exposing itself to greater geopolitical risks**—by depending on countries such as Russia or Algeria—**and market risks**—by competing for U.S. LNG with other economies.¹⁹

The fragility of this model has become very evident in recent months. On the one hand, after a colder than usual winter in 2020, both Europe and Russia started the spring of 2021 with a level of natural gas inventories below the average of recent years. This stress was compounded by a hotter summer (higher energy demand due to increased use of air conditioning) and lower-than-average wind power production in the UK and southern Europe—showing, again, the problems associated with the intermittency of renewable energy generation—which prevented the replenishment of these inventories. On the other hand, with low natural gas inventories in Russia and with geopolitical tensions at an all-time high (potential Russian invasion of Ukraine and paralysis of the necessary Nord Stream 2 pipeline), Europe has had to increase its LNG imports, competing with other countries with a particularly intense appetite in recent months, such as Brazil and

¹⁶ (January 10, 2022). EU needs 'colossal' investment in new nuclear, says commissioner. *World Nuclear News*.

¹⁷ (October 28, 2021). How much carbon dioxide is produced when different fuels are burned? *U.S. Energy Information Administration (EIA)*.

¹⁸ Epstein, A. (October 9, 2021). Talking Points on how Europe's fracking bans have contributed to its natural gas crisis. *Energy Talking Points*.

¹⁹ Juan Ramón Rallo (December 22, 2021). *¿Por qué los precios europeos de la electricidad y del gas están en máximos históricos?* YouTube. <https://www.youtube.com/watch?v=I-BF5RhDMRI>

China. The first due to the very low hydroelectric power production achieved throughout 2021 (due to lower rainfall) and the second due to the terrible domestic bottlenecks experienced during these months, which began with the strong recovery of its energy demand (following the economic recovery) and intensified as a result of the country's nefarious energy policy—with closures of coal production capacity and subsidized and/or capped prices—leading to a shortage of coal, major electricity blackouts and the government pressuring the electricity sector to buy as much fossil fuel as possible for the winter.²⁰

The outcome of this series of unfortunate events? Skyrocketing prices of fossil fuels, such as natural gas and coal, reaching record levels in European and Asian markets and driving up the cost of electricity, with major consequences.²¹ For example, we have seen the bankruptcy of dozens of electricity suppliers in the United Kingdom, where the height of absurdity was the German company **E.ON** sending its customers a pair of socks to encourage them to use less heating this winter and thus reduce carbon emissions (it has already apologized for doing so).²² Similarly, many European industrial companies, such as **Nyrstar** (a zinc producer and processor), have had to shut down or interrupt production because of unsustainable energy costs.²³ Likewise, countries such as Norway have on several occasions increased the amount of the electricity bill subsidized to their citizens in response to this price increase.²⁴

The case of Germany is even more flagrant. In 2011, following the accident at the Fukushima Daiichi nuclear power plant in Japan, the country decided to gradually shut down its nuclear power plants and replace them with wind and solar energy, setting ambitious (and expensive) climate targets for the following years, including a drastic reduction in carbon emissions. More than ten years later, after investing 440 billion euros in renewables and paying one of the most expensive electricity bills in the world, Germany is very far from meeting those targets and is highly dependent on coal—necessary to cover all its energy needs and back up the intermittency of renewable energies—which leads it to emit between six and ten

²⁰ Myllyvirta, L. (October 7, 2021). The Real Reasons Behind China's Energy Crisis. *Foreign Policy*; Goehring & Rozenowajg 3Q21 Market Commentary: *The Energy Crisis is Here*; Juan Ramón Rallo (October 1, 2021). *¿Por qué está sufriendo China unos apagones eléctricos sin precedentes?* YouTube. <https://www.youtube.com/watch?v=BKoLiFlsaeU>

²¹ Wilson, T. and Hume, N. (December 20, 2021). European gas prices shoot to new high as energy crunch worsens. *Financial Times*.

²² Wilson, T. and Thomas, N. (January 18, 2022). Together Energy becomes latest UK supplier to go bust. *Financial Times*; Maruf, R. (January 14, 2022). British energy company apologizes after sending thousands of customers socks during heating crisis. *CNN Business*.

²³ Cotizalia/News agencies (October 15, 2021). Sidenor, Arcelor y la Naval de Reinosa: el coste de la luz para las acerías del norte. *El Confidencial*; (December 16, 2021). Nyrstar to place French ops under care and maintenance due to high electricity costs: newsbreak. *MetallBulletin*.

²⁴ Capar, R-I. (January 19, 2022). Norwegian government and SV reach agreement on raising the electricity subsidy from 55 to 80%. *Norway Today*.

times more carbon than economies such as France or Sweden, where they have maintained their nuclear fleet.²⁵ Far from rectifying (in fact, Germany is still opposed to nuclear energy being considered green energy in Europe), the German climate minister (Robert Habeck) recently announced the launch of a "gigantic" emergency program to achieve the emissions target set for 2030.²⁶ Among the program's measures is the goal of doubling the market share of renewable energies in eight years (from 40% today to 80% in 2030) and reducing the country's energy consumption by 20%-25%.²⁷ In the words of the minister himself, one of the difficulties of the plan lies in making it clear to the people that "drastic changes need to be accepted for the good of society." We will see if they accept them...

Despite the potentially unsustainable situation if the winter worsens, the European energy crisis is still, as is often said, a First World problem. The consequences for the Third World of the green agenda could be much more dramatic, given its huge dependence on fossil fuels for subsistence. Imposing on them an energy model such as ours, as is being done, by cancelling projects or closing the tap of financing for the construction of thermal power plants or for the exploitation of fossil fuel deposits, could mark the destiny of these countries forever. **Societies need very large increases in energy consumption to develop** and, with current levels of poverty in many countries, to cut them off from the cheapest, most reliable and versatile sources of energy (fossil fuels) is to condemn them to remain in their present precarious situation.

*Darkness kills human potential and electricity nourishes it.*²⁸

We cannot lose sight of the fact that today there are **about 3.3 billion people who consume less electricity annually than a refrigerator**—of which about 1 billion do not even have access to electricity—or that about 2.6 billion still rely on wood or for heating or cooking.²⁹ Climate change is simply not on their list of problems. As Magatte Wade, director of the Africa Center for Prosperity at the Atlas Network,

²⁵ Fernández Ordóñez, M. [@fdezordonez]. (January 6, 2022). *German energy ridicule...They spend more than 400 billion euros on renewables and manage to emit 6 times more than France and 10 times more than Sweden. In addition to the most expensive electricity in Europe* [Tweet, own translation from Spanish]. Twitter. <https://twitter.com/fdezordonez/status/1479163891091394560>

²⁶ Appunn, K. (January 12, 2022). Germany to launch emergency programme for "huge, gigantic" 2030 emissions target task. *Clean Energy Wire*.

²⁷ Wacket, M. (January 11, 2022). Germany must reduce final energy consumption by 20-25% to hit 2030 targets. *Reuters*.

²⁸ Bryce, R. (2020). *A question of power*. PublicAffairs.

²⁹ Bryce, R. (2020). *Idem*; Epstein, A. (January 6, 2022). The ESG movement is anti-energy, anti-development, and anti-America. *Energy Talking Points*.

pointed out in a recent Wall Street Journal column, "We Africans are willing to do our share to help fight climate change. We don't want to pay with our lives."³⁰

Surely, everything we are experiencing should be a warning to rethink the speed of this energy transition. Unfortunately, it doesn't look like this is where things are headed.

An unsolvable imbalance?

Embrace high fossil fuel prices because they are here to stay.

— Amrita Sen

One of the basic lessons one learns in an Economics degree is that supply and demand determine the price of a good or service. It is also explained to us that, in the face of increases in demand (and price), the capacity and speed of reaction of supply will be determined by its elasticity (the more elastic the supply, the faster it will react, and vice versa). Well, **in the case of fossil fuels, global energy planning has substantially increased, at least so far, the *inelasticity* of their supply.** As we highlighted at the beginning of 2021 (see [here](#)), commodities, including fossil fuels, have been cleaning up the excesses of the past and adjusting their supply for years, to a point where we were convinced that they would not be able to meet the expected demand, which is always resolved with a significant price increase that encourages a subsequent increase in supply. This is the essence of capital cycles, and it is in commodities that this phenomenon is most clearly seen. For this reason, we had a significant allocation to this theme in our portfolios. In the course of 2021, our investment thesis was proven right, as commodity prices rose sharply, resulting in an average return of more than 70% for all our investments in this sector. Despite this, we maintain (with some changes) a very significant allocation to commodities in our investment funds. Why? Because **the sector's classic capital cycle has been compounded by the impact of the energy transition, which may prolong the situation of high prices for several years to come.**³¹

³⁰ Wade, M. (November 26, 2021). The COP26 Plan to Keep Africa Poor. *The Wall Street Journal*.

³¹ As a complement to this section, we highly recommend the October 2021 newsletter (see [here](#)) from the investment fund manager Strategic Investment Advisors Group (SIA).

THE CASE OF THERMAL COAL

A very clear example is **thermal coal**. Its role as the fossil fuel that emits the most carbon dioxide has made it the ugly duckling of the climate change narrative. For this reason, many countries (mostly among the richest in the world) have been reducing their production capacity in recent years, to a greater or lesser extent. For example, since 2010, the United States has already announced the closure of more than half of its coal-fired power plants—the shale gas revolution has also played a role.³² However, not only have governments been accelerating the reduction in thermal coal production with their regulatory changes, but there is also continuous pressure from the financial markets to accelerate this process. On the one hand, major asset managers such as **BlackRock** have announced in recent years their commitment to divest from coal-producing companies.³³ On the other hand, many financial institutions (banks, insurance companies...) have set themselves the future goal of not lending money or insuring these businesses, thus increasing the capital cost of operating coal mines and thermal power plants. In particular, it is estimated that more than one hundred financial institutions have already announced their commitment to end their exposure to thermal coal.³⁴ Finally, activist campaigns seeking divestment of thermal coal assets have also surfaced in companies such as the German power utility **RWE** or the commodity mining and trading company **Glencore**, to cite recent examples.³⁵ Added to all this is the commitment of the sector's own companies, such as the **BHP** conglomerate, which have also been divesting their thermal coal assets to focus their efforts on "cleaner" raw materials.³⁶

In the face of this supply crunch for thermal coal, demand remains much more stable than one might expect. The reason? While the more developed countries can "afford" to abandon coal and switch to other cleaner sources, countries such as China, India and other South Asian economies will need this cheap, accessible and reliable (so far) fuel to meet their huge present and future energy needs. However, since 2011, the two large Asian countries have accounted for 95% of the global capacity increases of coal-fired power plants, with coal-fired power generation

³² Bryce, R. (2020). *Idem*.

³³ It seems that the commitment had its fine print: Jolly, J. (January 13, 2021). BlackRock holds \$85bn in coal despite pledge to sell fossil fuel shares. *The Guardian*.

³⁴ (January 20, 2022). Finance is leaving thermal coal. *Institute for Energy Economics and Financial Analysis (IEEFA)*.

³⁵ Hume, N. (November 30, 2021). Activist calls on Glencore to spin off coal assets. *Financial Times*; Mundy, S., Temple-West, P. and Shimizhuishi, T. (December 15, 2021). The German activist following in Engine No 1's footsteps. *Financial Times*.

³⁶ Hume, N. (November 7, 2021). BHP reaps up to \$1.35bn from Australia coal mines in fossil fuels retreat. *Financial Times*.

reaching 62% and 72% of the energy mix in China and India, respectively.³⁷ China, in fact, after the energy crisis it has experienced in recent months, has raised its thermal coal production to record levels, which shows that coal is far from being a fuel that is going to disappear.³⁸ In the case of India, the country expects to more than double its installed capacity of coal-fired plants by 2030.³⁹ As its environment minister pointed out at the latest United Nations Climate Change Conference (COP26): "How can anyone expect that developing countries make promises about phasing out coal and fossil fuels subsidies" when "Developing countries still have to deal with their poverty reduction agenda."⁴⁰ And this is in spite of the serious problems of pollution suffered by these countries due to the use of this fossil fuel. This is further proof, however shocking it may seem, of the so-called **Iron Law of Electricity**:

When forced to choose between dirty electricity and no electricity, people will choose dirty electricity every time.⁴¹

This persistent imbalance has become more than evident this past year, driving dramatic spikes in the price of thermal coal in all its markets, up to 460% for Newcastle coal and 320% for China's ZCE coal from their 2021 lows. This situation, as well as the long-term dynamics we expect for its market, has led us to initiate a position in the thermal coal mining sector. Specifically, as we will detail in the portfolio changes section, through **Geo Energy Resources**.

THE CASE OF NATURAL GAS

Although with a better demand outlook, the imbalance in the markets for other fuels, such as natural gas, oil and uranium, also threatens to become persistent. For one reason or another, it seems that everything that is not labeled as green ends up facing supply constraints.

Let us start with natural gas. This fossil fuel is living a golden age as a result of one of the greatest technological revolutions of our time: liquefied natural gas (LNG). Indeed, the ability to convert gas into liquid has made it possible to transform a market with local dynamics or subject to long-term contracts (with prices usually

³⁷ Stringer, D. and Singh, R. K. (November 15, 2021). At 14 Million Tons a Day, India and China Still Addicted to Coal. *Bloomberg*.

³⁸ Singh, S. and Xu, M. (January 17, 2022). China coal output hits record in Dec and in 2021 -stats bureau. *Reuters*.

³⁹ Stringer, D. and Singh, R. K. (November 15, 2021). *Idem*.

⁴⁰ Hook, L., Hodgson, C. and Pickard, J. (November 13, 2021). India and China weaken pledge to phase out coal as COP26 ends. *Financial Times*.

⁴¹ Bryce, R. (2020). *Idem*

indexed to oil) into a much more global and dynamic one, with spot market prices under continuous review. In this "new" market, three economies in particular have flourished, benefiting from their huge natural gas reserves: Qatar, Australia and the United States. This growing supply has found buyers all over the world. On the one hand, Europe has increased its consumption, as we have seen, because it is a fossil fuel preferred to thermal coal. On the other hand, as we have also highlighted, the energy needs of countries such as China and India have also boosted and will continue to boost their demand for natural gas. In fact, it is estimated that China will increase the share of this fuel by 50% in its energy mix (double-digit growth) and that India will grow its share by two and a half times by 2030.⁴²

However, the tentacles of the green agenda are also beginning to be felt in the natural gas market. In the United States, for example, a country on its way to becoming the largest exporter of LNG in the world, the Biden government is continually hindering the exploitation of fields and the development of infrastructures in the country that would allow the transport and export of U.S. shale gas, since it is a fossil fuel.⁴³ In this country, the absurdity is such that the New England area has an electrical grid that has been close to collapse on several occasions, due to its refusal to develop an infrastructure that would allow it to consume natural gas from the Appalachian Basin (the most prolific in the world and located only a few hundred kilometers from this area). The result of this supposedly environmental policy is that New England needs to import liquefied natural gas from markets where it competes with Europe and Asia (thus paying much higher prices than in the United States) and using fossil fuel to transport it via LNG tankers in the process.⁴⁴ The European case is even more nonsensical since, in addition to banning shale gas production, Europe is trying to put a stop to the construction of LNG import terminals.⁴⁵ In short, **the United States has huge reserves of natural gas that it could export to the world, but its government is making it difficult to develop gas pipelines and export terminals. And Europe desperately needs natural gas that does not come from Russia, but it does not want to produce it, nor does it facilitate its importation.**

As with thermal coal, financial markets are also playing their part in this forced supply crunch. The giant **ExxonMobil**, for example, is undergoing an activist campaign by Engine No. 1, which aims to shift the company to a business model

⁴² Bernstein (September 20, 2021).

⁴³ Epstein, A. [ImproveThePlanet]. (October 6, 2021). *Alex Epstein interviews natural gas CEO Toby Rice on America's strangled natural gas potential*. YouTube. <https://www.youtube.com/watch?v=kyn4bpHrB6k>

⁴⁴ Doomberg (December 30, 2021). New England is an energy crisis waiting to happen. *Doomberg*.

⁴⁵ Dezem, V. (December 30, 2021). German Gas Terminal Faces Headwinds as Major Investor Steps Back. *Bloomberg*.

that leaves a smaller carbon footprint. This dispute has led **ExxonMobil** to rethink the exploitation of the Rovuma (Mozambique) and Ca Voi Xanh (Vietnam) natural gas fields.⁴⁶ Both fields are badly needed to meet the (growing) future global demand for this fuel. Other conglomerates in the sector, such as **Chevron**, **BP** or **Royal Dutch Shell** ("Shell"), have also announced a change in their strategy to reduce greenhouse gas emissions, which may involve less investment in fossil fuels, including natural gas.⁴⁷

Therefore, in the natural gas market we are faced with a growing and buoyant demand that may not be fully satisfied in the medium term, generating imbalances and stresses such as those we are currently experiencing, in which, for example, throughout 2021 the benchmark price in the United States (Henry Hub) rose by 150% (in Europe or Asia the increase was much more dramatic, due to the dynamics we have mentioned). For this reason, we are invested in the sector through the company **Golar LNG** and **Spartan Delta** (a new addition to the portfolio).

THE CASE OF OIL

The oil market situation is also beginning to look very similar to that of the rest of fossil fuels. On the consumption side, oil demand remains stubbornly resilient, despite the continuous mantra that we are close to reaching peak demand (remember that years ago there was talk of peak supply), which leads organizations such as the International Energy Agency (IEA) or the Organization of the Petroleum Exporting Countries (OPEC) to revise their estimates upwards, virtually every year. For example, the IEA has just announced a significant upgrade in its demand estimates for 2022, in view of the low impact that the new variant of the coronavirus is having on oil demand, which will lead it to exceed pre-pandemic levels this year.⁴⁸

However, the interesting part is, once again, on the supply side. On the one hand, as in the natural gas market, the U.S. shale oil revolution radically changed the production map (and geopolitics) of this fossil fuel, making the United States the main producer of crude oil. However, after several years in which the operators of these wells prioritized production over profitability, it seems that their supply has

⁴⁶ Matthews, C. M. and Glazer, E. (October 20, 2021). Exxon Debates Abandoning Some of Its Biggest Oil and Gas Projects. *The Wall Street Journal*.

⁴⁷ Matthews, C. M. (January 18, 2022). Exxon Pledges to Reduce Carbon Emissions From Operations to 'Net Zero.' *The Wall Street Journal*.

⁴⁸ Perkins, R. (January 19, 2022). Global oil demand to surpass pre-pandemic levels in 2022 as omicron fears subside: IEA. *S&P Global Platts*.

become more inelastic, focusing now on reducing debt and increasing shareholder returns, thus limiting their investments in new production.⁴⁹ For example, the number of operational wells is 40% below the 2019 figure (prior to the pandemic), even though the oil price is 25% higher than at that time. Likewise, as we have already highlighted, regulatory pressure is also playing a role in the quest for a greener energy mix for the United States.⁵⁰ In fact, President Biden has even publicly pressured OPEC and Russia to increase their production, infuriating the industry.⁵¹ In short, for one reason or another, **U.S. oil producers now seem to require a price higher than the historical average to substantially increase their supply again**, moving away from their role as "swing producer" of recent years.

In addition, as we also pointed out in the case of thermal coal and natural gas, oil companies are no strangers to activist campaigns seeking an acceleration in the energy transition and in the reduction of greenhouse gas emissions. **Shell**, for example, has among its shareholders **Third Point**, the financial institution whose assets are managed by Dan Loeb, the well-known U.S. investor. Loeb, in a letter sent to the company's Board (published in October last year), demands that the oil and gas conglomerate breaks up into two different companies: LNG, renewables and marketing businesses on one side, and extraction, refining and chemical operations on the other. Under this scheme, Loeb argues that **Shell** will no longer have potential conflicts of interest between its divisions and will be able to generate higher returns for its shareholders, while at the same time reducing its carbon emissions.⁵² This formula is very similar to the one recommended by Larry Fink (**BlackRock**) for the big oil producers ("super-majors"), under which a sort of "bad bank" would be created with fossil fuel assets and work would be done from this new entity for their gradual disappearance.⁵³ However, apart from these pressures to separate their fossil fuel businesses, all the major companies in the sector have drastically reduced their investments in recent years and the forecasts for the coming years show that this change in their strategy could be permanent.

Therefore, it does not look like U.S. shale oil production and that of the large independent publicly listed players will react significantly to higher oil prices. But what about the rest of the oil producers? While OPEC production may have its own problems (drone attacks, military conflicts, political instability, social unrest, etc.) that could lead it to fall short of the desired quotas, the real source of medium-

⁴⁹ Doomberg (December 12, 2021). There's not enough oil. *Doomberg*.

⁵⁰ Duesterberg, T. (August 13, 2021). Biden's Plan To Outsource The U.S. Oil And Gas Industry. *Forbes*.

⁵¹ Ellyatt, H. (November 16, 2021). U.S. shale has a message for the Biden administration: Ask us to increase oil production, not OPEC. *CNBC*.

⁵² Deveau, S. and Hurst, L. (October 27, 2021). Activist Investor Loeb Takes Shell Stake, Pushes to Break Up Company. *Bloomberg*.

⁵³ Tett, G., Nauman, B., Temple-West, P. and Edgecliffe-Johnson, A. (February 24, 2021). BlackRock's Fink proposes a 'bad bank' model for fossil fuels. *Financial Times*.

term uncertainty—apart from the possible invasion of Ukraine by Russia—is to be found in deepwater production, where well decline rates are very high and if investments remain depressed, the reopening of the capacity closed in recent years could be very complicated and costly.⁵⁴ Therefore, we could also face, on this side, an additional source of future supply constraint.

Therefore, the bottleneck situation is becoming a reality. In fact, some analysts expect that by the end of 2022 the demand for oil will exceed the sector's pumping capacity (not only the amount produced), something that did not even happen during the two Oil Crises of the 1970s.⁵⁵

If demand remains at higher levels, this would result in tight supply in the years ahead, raising the risks of higher and more volatile prices.⁵⁶

For now, as an appetizer of what could be ahead and supported by the rise in thermal coal and natural gas prices, oil prices are up more than 55% in the last twelve months at the time of writing (end of January), which has led several countries, including the United States, to release strategic oil reserves without much success.⁵⁷

In short, taking all the above into account, Horos remains invested in the sector through the oil services company **TGS**, the oil and gas production company **Spartan Delta** and, to a more residual extent, the offshore drilling contractor **Shelf Drilling**.

THE CASE OF URANIUM

As you probably know, we have been invested in this theme for several years, so we are not going to repeat our investment thesis here (see [here](#)). We continue to believe that, despite the refusal of many Western countries, such as Germany, which prefer to use natural gas (a greenhouse gas emitting fossil fuel) over nuclear energy citing the problems of nuclear waste management (when the environmental risk is minimal), countries such as China, India and those of Southeast Asia, again, are going to increase their nuclear power capacity in the coming years because, quite simply, it is one of the best ways to reduce the anthropogenic impact on climate (it emits virtually no greenhouse gases) and is an excellent backup for meeting the future energy needs of these countries.

⁵⁴ Marcus, J. (January 22, 2022). Yemen rebel attack on UAE throws challenge to the region. *BBC*.

⁵⁵ Goehring & Rozencwajg: *Idem*.

⁵⁶ International Energy Agency (IEA). (December 2021). *World Energy Outlook 2021*.

⁵⁷ Puku, T. and Leary, A. (November 23, 2021). U.S. Joins With China, Other Nations in Tapping Oil Reserves. *The Wall Street Journal*.

You can't have it both ways. If they say this [climate change] is apocalyptic or that it's an unacceptable risk, and then turn around and rule out one of the most obvious ways to avoid it [nuclear power], they're not only inconsistent, they're being dishonest.⁵⁸

On the other hand, I would like to emphasize that nuclear energy, in the face of the fear or ignorance that surrounds it, is the safest source of energy in the world, whichever way you look at it. In fact, two of the three accidents that are always mentioned as a reason to avoid it (Three Mile Island in 1979 and Fukushima in 2011) did not cause any deaths directly attributable to that event.⁵⁹ As for Chernobyl, it was a combination of several unique factors (an extremely weak economy, now obsolete technology, safety and plant design failures, etc.) that should not be used today as an argument against nuclear power.⁶⁰

As a reminder, we currently maintain an allocation to the sector through **Sprott Physical Uranium Trust**.

THE CASE OF RENEWABLE ENERGIES

Finally, unlike in the previous cases, demand is playing a much more important role than supply in renewable energy for the reasons we have argued throughout this letter. We have already noted how capital markets and financial institutions are putting pressure to promote (impose) this disorderly energy transition, in which the production of fossil fuels is being rapidly cut. However, their role does not end here. In the case of renewable energies, the pressures and flows obviously go in the opposite direction. On the one hand, by encouraging public and private financing of this type of projects ("green finance"). For example, in November last year, the Central Bank of China announced cheap financing for banks that lend money to the development of renewable energy.⁶¹ It is not the only central bank that is acting in this direction. The European Central Bank has announced that it will include the fight against climate change into its monetary policy framework, which will affect, among other things, the type of assets it acquires or accepts as collateral, benefiting those that contribute to combating the anthropogenic impact on climate and vice versa.⁶²

⁵⁸ Shellenberger, M. (2020): *Idem*. [Own translation from the Spanish edition]

⁵⁹ *Idem*.

⁶⁰ Operador Nuclear (April 25, 2019). Chernobyl no es un argumento válido contra la energía nuclear. *El periódico de la energía*.

⁶¹ Xue, Y. (November 11, 2021). Cheap green loans funded by China's central bank could accelerate clean, energy saving projects, analysts say. *South China Morning Post*.

⁶² Press release by the European Central Bank (July 8, 2021). *ECB presents action plan to include climate change considerations in its monetary policy strategy*.

On the other hand, the green agenda is also driving capital flows into those vehicles and entities that are characterized as meeting environmental, social and governance (ESG) criteria. Without getting into the benefits of these investments, the reality is that more and more voices are warning of a possible bubble in this area. In a report last year, the Bank for International Settlements (BIS) compared the current situation of ESG assets with those experienced by railroad stocks in the 19th century or dotcom companies at the end of the 20th century. In both cases, the great excitement around these emerging sectors attracted a rapid and huge amount of capital, which inflated their valuations to unsustainable levels and then led to the inevitable bursting of their bubbles.⁶³ Other subsequent studies, such as that of the Swiss Institute of Finance, warn of this same risk.⁶⁴ Finally, it is paradigmatic of this possible bubble that some of the largest ESG-labeled passive funds (ETFs) in the world hold, among their top positions, large U.S. tech companies.⁶⁵ I do not question the virtues of these companies, but perhaps one might expect to find other types of businesses more directly linked to the supposed theme of the fund that contains them.

*Sustainable Investing Bubbles Can Change the World—and Sink Your Portfolio.*⁶⁶

Although we have focused our analysis of renewable energies on the demand side, we cannot ignore some problems that the sector may face on the supply side. Firstly, the bottlenecks and cost inflation (commodities) suffered by all industries are also affecting wind turbine and solar farm manufacturers, narrowing their operating margins.⁶⁷ This will end up translating into higher selling prices or lower deployment of these facilities. Secondly, we cannot ignore the geopolitical risks affecting the production of so-called rare earths, which are necessary, among many other applications, to produce wind turbines, solar panels and electric vehicles. At present, the bulk of rare earth production takes place in China, which means that the whole world (unless there are regulatory changes that prioritize the production of these rare earths in other geographies over their environmental impact) is at the expense of the supply coming from the Asian giant.⁶⁸ This is certainly not a negligible risk.

⁶³ Bosley, C. (September 20, 2021). Green Investment Frenzy Runs Risk of Becoming a Bubble, BIS Says. *Bloomberg*.

⁶⁴ Lee, J. (October 28, 2021). Trillion-Dollar ESG Boom Rings Bubble-Trouble Alarm in New Study. *Bloomberg*.

⁶⁵ Ballentine, C. (April 14, 2021). BlackRock's Record-Breaking ESG Fund Looks Just Like a Big Tech ETF. *Bloomberg*.

⁶⁶ Mackintosh, J. (January 25, 2022). Sustainable Investing Bubbles Can Change the World—and Sink Your Portfolio. *The Wall Street Journal*.

⁶⁷ Milne, R. (January 26, 2022). Vestas warns of further turbulence for wind turbine makers. *Financial Times*.

⁶⁸ To learn more about the geology and industry of rare earths, I recommend Bustillo Revuelta, M. and Ruiz Sánchez-Porro, J. (2019). *Tierras raras: geología, producción, aplicaciones y reciclado*. Fueyo Editores.

Does this mean that the renewable energy sector is 'uninvestable' for Horos? Not at all. Quite simply, as with all other stock market sectors, we will only invest in companies that meet our investment criteria. In the case of renewable energy companies, we think that the market is generally being excessively complacent with their valuations, paying very high multiples for projects that are far away in time and, therefore, still to be developed. This is not the case of the Spanish company **Greenalia**, in which we have held a relatively stable stake since the beginnings of Horos. Nor is it the case of **Elecnor**, a company that gives us exposure to this theme through its subsidiary Enerfín (wind and photovoltaic power generation). On the other hand, companies such as the copper miner **Atalaya Mining** ("Atalaya") or the bodywork and chassis manufacturer **Gestamp**, to cite two examples, are very attractive ways to invest in this energy transition. The former, **Atalaya**, benefits from the strong current and future copper needs of renewable energies, while **Gestamp** is very well positioned for the expected growth of the electric vehicle fleet.

The great forgotten is back

Be careful what you wish for, lest it come true.

—Esopo

Before moving on to our main portfolio changes in the past quarter, I think it is very relevant to close the first section of this letter by highlighting how this energy transition, fueled by substantial monetary and fiscal stimulus, has triggered the highest inflation seen in decades in many economies. What was initially labeled as "transitory" is now labeled as "frustrating" and "persistent."⁶⁹ The fear of inflation becoming entrenched in the economy has led the U.S. Federal Reserve to end the longest period of monetary easing ever, beginning a tightening of monetary policy in 2022. Specifically, the market is discounting four interest rate hikes of 25 basis points each for this year, although some analysts do not rule out further increases.⁷⁰

In Europe, price inflation is not much more benign. For example, take the year-on-year increase (December 2021) in the industrial price index for Spain and Germany: 35.9% and 24.2%, respectively. Despite this, the European Central Bank has ruled out a rate hike in 2022 and is confident that inflation will correct itself as the

⁶⁹ Cox, J. (September 29, 2021). Fed Chair Powell calls inflation 'frustrating' and sees it running into next year. *CNBC*.

⁷⁰ Abraham, T. (January 24, 2022). US Fed may raise rates more than 4 times this year due to inflation: Goldman Sachs. *CNBC TV18*.

bottlenecks that many industries are suffering in the wake of the pandemic normalize.⁷¹ However, renowned economists, such as the German Hans-Werner Sinn, argue that the ECB will end up capitulating and raising interest rates, as current inflation levels may last much longer than expected.⁷² The reasons? On the one hand, Sinn warns that the prices paid by the intermediate stages of the production chain will end up impacting, in some way, the prices paid by the consumer for the final products. On the other hand, the lower purchasing power of the public will lead them to demand wage increases to compensate for this inflation, which could unleash the much-feared wage-price spiral that is so difficult for a central bank to contain. In addition, Sinn warns of the higher prices that may be caused by the energy transition, replacing (cheap) fossil fuels with a less efficient mix, as we are currently seeing and as we have explained above. In fact, some members of the ECB itself are already warning that green inflation ("greenflation") is very real and will not be transitory.⁷³ In short, and given that the ECB's only legal mandate is to contain inflation (as opposed to the Federal Reserve's dual mandate), we cannot rule out an interest rate hike in Europe much sooner than the ECB would like.

It requires little imagination to see how Europe could end up back in a 1970s.⁷⁴

What will happen after central banks tighten monetary policy? It is impossible to know. However, if government bonds in countries such as the United States—the quintessential risk-free asset—begin to show higher yields, the outflows from these assets in recent years chasing yield into other more attractive assets (such as quality stocks) could be reversed. Finally, the impact on the public perception of renewables (and fossil fuels) remains to be seen if electricity prices continue to rise and remain volatile, as many of us fear. In the face of all this, we will try to protect ourselves by positioning our portfolios to benefit (or at least not be harmed) from these inflationary dynamics that we can expect in the coming years.

Main changes to our portfolios

Investors do not require the help of glamour stocks or bull markets to attain their investment goals.

— John Neff

⁷¹ Coniam, M. (January 22, 2022). ECB's Makhoul Sees Inflation Slowing, No Rate Hike in 2022. *Bloomberg*.

⁷² Sinn, H-W. (November 29, 2021). The End of Free Money. *Project Syndicate*.

⁷³ Blas, J. (January 10, 2022). Greenflation Is Very Real and, Sorry, It's Not Transitory. *Bloomberg*.

⁷⁴ Sinn, H-W. (November 29, 2021). *Idem*.

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

HOROS VALUE INTERNACIONAL

Stake decreases & exits:

COMMODITIES (26.5%)

Holdings discussed: Teekay LNG (exited) and Yellow Cake (exited)

This quarter we sold our entire stakes in **Teekay LNG** and **Yellow Cake**. Regarding the former, we already mentioned in our previous letter that we had taken advantage of the takeover bid launched by Stonepeak to sell our position. As for **Yellow Cake**, the only reason was to replace this holding with a greater allocation to **Sprott Physical Uranium Trust**, the other uranium vehicle in our portfolio. Why? Because on equal upside potential, we favor the greater liquidity of the **Sprott** vehicle. In addition, we think **Sprott's** capital raising model for buying uranium (At-The-Market) is much more suitable for value creation (or non-destruction) than the one used by **Yellow Cake**, so we will require a higher discount for the latter to reinvest in it.

OTROS

Holdings discussed: MBIA (exited), Kaisa Prosperity (3.4%) and Power REIT (2.3%)

We completely sold our stake in **MBIA** after its good performance during the period. Although we still see upside and we believe that an eventual corporate transaction will come (the management team itself wants it to), time is working against its shareholders, so we are demanding a greater margin of safety in this investment. Furthermore, we trimmed our stake in **Kaisa Prosperity** and **Power REIT**. In the case of the former, although we took advantage of the sharp decline in its share price to increase our position, its poorer relative performance meant that our allocation to the company was reduced. In addition, we took advantage of the downturn in China's real estate services sector to diversify our exposure, as we will see later, through the company **Aoyuan Healthy Life Group**. Regarding **Power REIT**, we slightly trimmed our position following the strong performance of the company, which owns greenhouses for cannabis cultivation.

Stake increases & new stakes:

COMMODITIES (26.5%)

Holdings discussed: Sprott Physical Uranium Trust (5.4%), Ramaco Resources (2.5%), Geo Energy Resources (1.8%) and Spartan Delta (1.8%)

Horos Value Internacional has two new names in the commodities theme. We initiated a position in **Geo Energy Resources** ("Geo Energy"). I have already summarized the dynamics of thermal coal above, so here I will only outline the company-specific aspects of the investment thesis. **Geo Energy** is listed and headquartered in Singapore, operating three open pit thermal coal mines in Indonesia. In addition, the company has one undeveloped project. One of **Geo Energy's** strengths lies in having founders and a Board that are fully aligned with the rest of the shareholders, controlling c. 44% of the shares. This has resulted in a capital allocation strategy that has created significant value for its shareholders over the last two years, taking advantage of the financial distress in the sector to repurchase its debt at a deep discount.

At the operating level, **Geo Energy** produces mainly low-sulfur coal, which makes it very attractive for its main market (China). The company also stands out as a low-cost producer, with part of its costs indexed to the price of coal, which has allowed **Geo Energy** to protect its margins in a low-price market environment. Therefore, despite assuming normalized selling prices well below current levels and the risks inherent in a jurisdiction such as Indonesia (for example, with restrictions on exports and the imposition of maximum domestic selling prices), we believe that **Geo Energy** is an excellent way to gain exposure to the thermal coal sector.

The other new name in our portfolio is **Spartan Delta**. As with **Geo Energy**, we will focus the commentary on the most salient features of the company, as we have already explained in depth the current situation of the oil and gas market (before continuing, I take this opportunity to thank José Ruiz de Alda, portfolio manager of CIMA Capital, for introducing us to this idea).⁷⁵ **Spartan Delta** was formed at the end of 2019, following the restructuring that brought the current management team into the company, who now control 10% of the shares. This team, led by Richard McHardy and Fotis Kalantzis, has extensive experience in operations within the oil and gas sector and has generated strong returns for its shareholders through the acquisition of assets, on very attractive terms, for their subsequent

⁷⁵ Highly recommended the summary of his investment thesis on the company for MOI Global: CIMA Capital (January 13, 2022). CIMA Capital Tesis de inversión en Spartan. YouTube. <https://www.youtube.com/watch?v=CUYJQB-ON4s>

sale (see the three previous cases of Spartan Exploration, Spartan Oil and Spartan Energy).

In this fourth venture of the management team, the formula remains the same. Hence, throughout 2020 and 2021, **Spartan Delta** has made several transformational acquisitions and taken over oil and natural gas assets—in several cases from forced sellers—located in the Alberta Deep Basin and Montney formations (Canada), areas of expertise of the "Spartan team." Following these moves, the company expects to produce 84,000 barrels of oil equivalent per day in 2024, up from only 225 in 2019, which shows the profound transformation undergone by the company. All in all, being conservative with our estimates for the future price of oil and natural gas, we think the company has attractive upside potential, with possible positive surprises in the future due to going hand in hand with McHardy and Kalantzis.

Finally, with regard to the most significant stake increases, we have already commented on the replacement of **Yellow Cake** with a greater allocation to **Sprott's** uranium vehicle. We also took advantage of the stock price decline in **Ramaco Resources**, following its previous strong performance, to increase our exposure to this U.S. metallurgical coal producer. This is a clear example of how we can improve our funds' returns by rebalancing our positions (depending on their performance and thus their relative potential compared with the rest of the portfolio). **Ramaco Resources** stock rose several-fold since our initial investment, so we gradually sold shares as its upside declined until we exited the position completely. Subsequently, during the last quarter, we did the opposite, taking advantage of its weaker performance to reinvest in the company.

OTHER

Holdings discussed: Millenium Investment and Acquisition (1.9%) and Aoyuan Healthy Life Group (1.6%)

The third addition to the fund's portfolio, as was mentioned above, is **Aoyuan Healthy Life Group** ("Aoyuan Healthy"). This is a Chinese company, listed in Hong Kong, which provides real estate services to residential and non-residential clients, as well as operational services to shopping centers. Specifically, **Aoyuan Healthy** has four segments: property management services, intelligent engineering services, general health and wellness services and commercial operational services. As is the case with **Kaisa Prosperity** (of which we are also shareholders) and with most players in the sector, **Aoyuan Healthy** went public recently (2019) and since then has made continuous acquisitions to increase its scale, gain exposure to businesses

where they see greater future potential and reduce dependence on its parent company (property developer **Aoyuan Group**). Also, like the rest of the sector, the company has been through a major stock market bust in recent months, caused by the massive flight of investors from anything related to the real estate sector in China, which has left **Aoyuan Healthy**, **Kaisa Prosperity** and other companies trading at what appear to be absurdly low valuations.

That said, it should be noted that, at least in the medium term, we can rule out a strong recovery in the business growth of these service companies, given the fragile situation of the development sector and, consequently, of their parent companies. Likewise, it is more than likely that these service companies will be used to improve the liquidity and solvency of their parent companies, so they will seek to sell them (at prices that may not be attractive) or even try to squeeze them for cash (related-party transactions, working capital strain, etc.). Nevertheless, assuming the impact of these more negative scenarios, we find the valuation too attractive to ignore and therefore decided to add **Aoyuan Healthy** to our portfolio.

In the case of **Millenium Investment and Acquisition**, we continued to build our position in the company, which was initiated at the end of the third quarter of 2021.

HOROS VALUE IBERIA

Stake decreases & exits:

OTHER

Holdings discussed: **Sonae** (4.9%) and **Renta Corporación** (3.9%)

We trimmed our position in **Sonae** solely because of its strong performance. The solid progress of its distribution business **Sonae MC**, as well as the corporate transactions and other operational decisions made by the team led by **Claudia Azevedo**, are helping to uncover the value of this holding, gradually reducing its upside potential.

As for **Renta Corporación**, the weight of our position has been trimmed due to its poorer relative performance, which was caused by weaker forecasts for the company's business. Although we have consequently reduced its valuation, we believe that the margin of safety of this investment is still very high, which is why we maintain a significant stake in the company.

Stake increases & new stakes:

OTHER

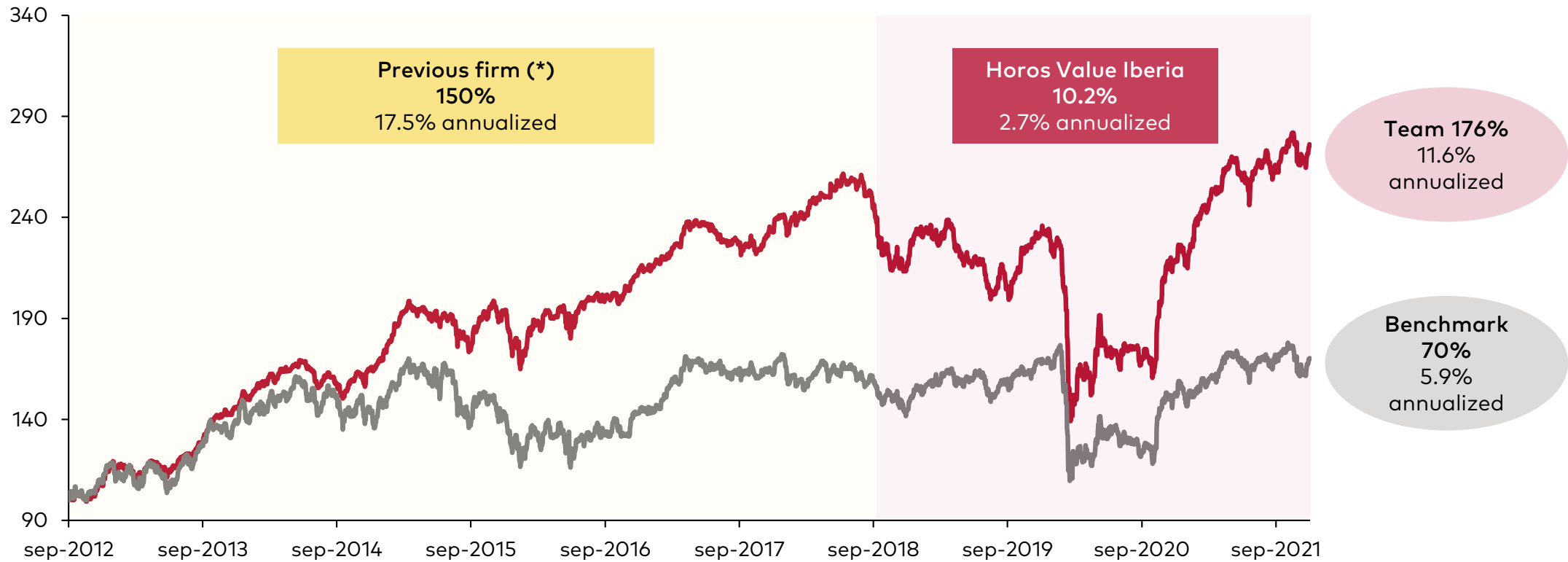
Holdings discussed: Atalaya Mining (4.8%), Aperam (3.2%) and The Navigator Company (2.0%)

Atalaya Mining has been a solid outperformer in our portfolio, which is why our exposure to this company has increased. This reflects the company's excellent operating performance and persistently high copper prices, leading us to raise its valuation. It is worth highlighting the mining company's recent announcement to invest 12 million euros in the first phase of development of its new industrial plant in Riotinto, where they will test the E-LIX technology (developed by Lain Technologies) to produce high value-added metals from mixed concentrates of primary copper and zinc sulfides.

As for **Aperam** and **The Navigator Company**, we took advantage of moments of weakness in their share price to increase our allocation to two companies that are experiencing a period of outstanding profitability and cash generation, which has contributed to raising our valuation in both companies.

Returns

Historical returns of the management team in the Iberian Strategy



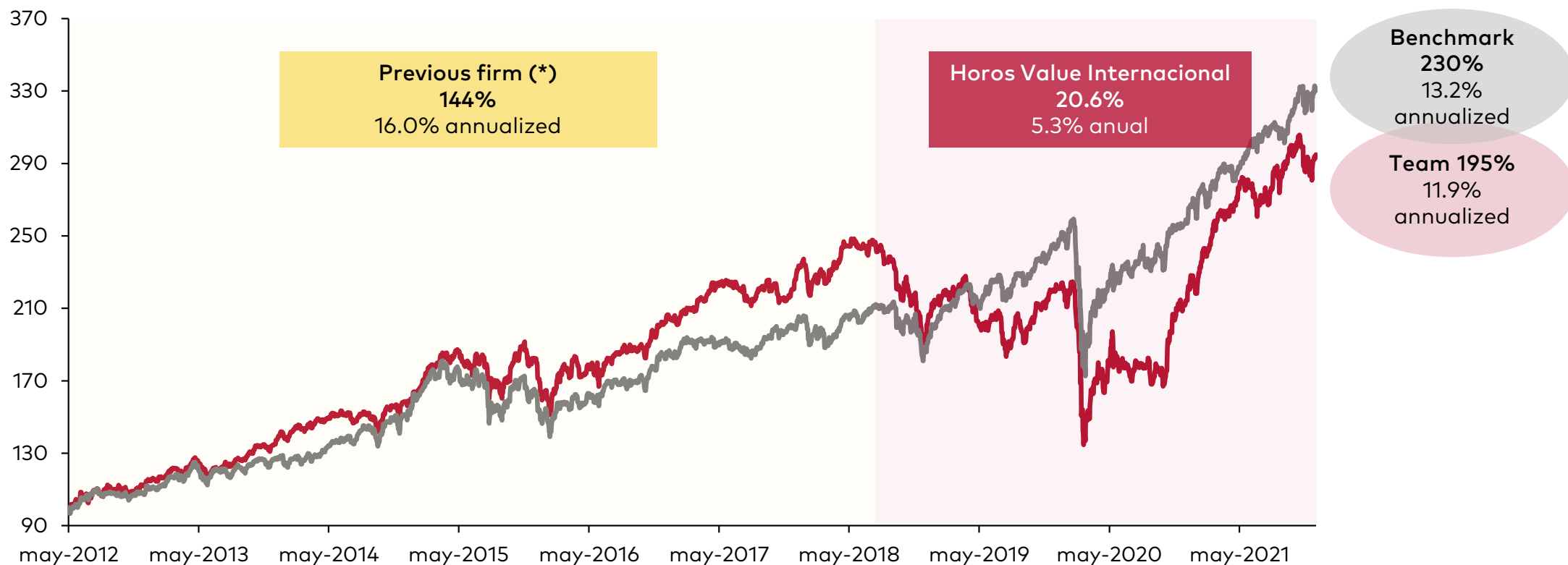
Data cover the period between the 30th September 2012 and 31st December 2021.

*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 December 2021.

*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 May 2012 and 22nd May 2018.

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Top 10 Holdings
Horos Value Iberia

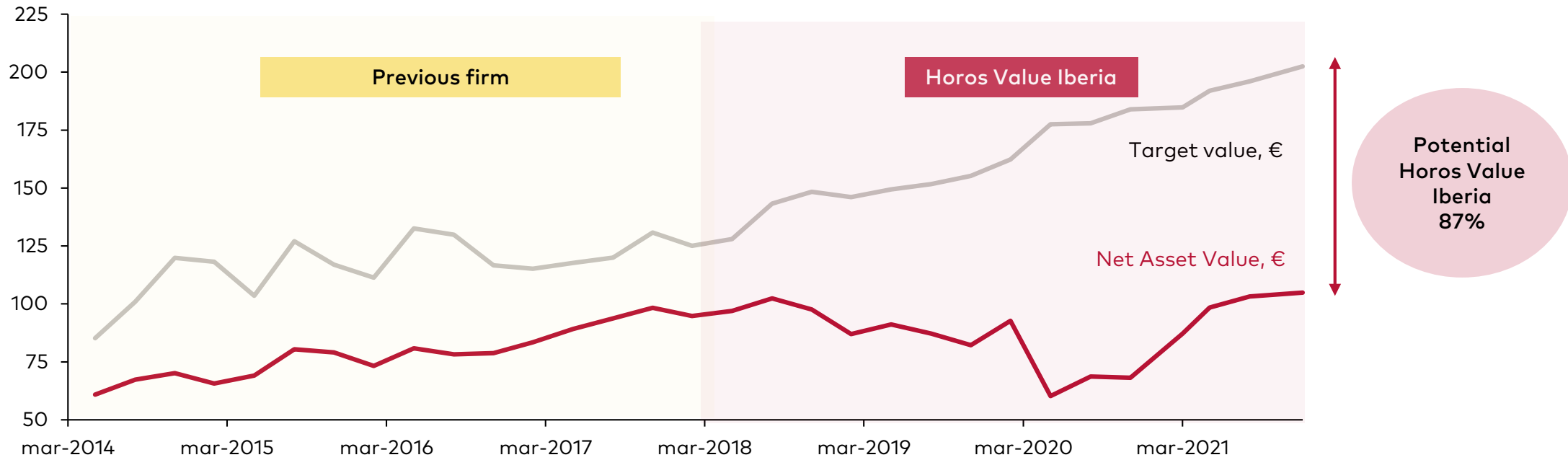
 Holding 	 % 	 Theme
Semapa	7.0%	Financial
Horos Value Internacional	6.6%	Financial
Merlin Properties	6.3%	Real estate and construction
Catalana Occidente	5.1%	Financial
Sonae SGPS	4.9%	Distribution
Gestamp	4.8%	Industrial
Atalaya Mining	4.8%	Commodities
Iberpapel	4.4%	Industrial
Elecnor	4.4%	Engineering
Talgo	4.1%	Engineering

Top 10 Holdings
Horos Value Internacional

 Holding 	 % 	 Theme
Sprott Physical Uranium Trust	5.4%	Commodities
Aercap Holdings	5.2%	Financial
Semapa	4.2%	Financial
Sonae SGPS	3.7%	Distribution
Fairfax India	3.7%	Financial
Teekay Corp.	3.6%	Oil & Gas
Catalana Occidente	3.4%	Financial
Kaisa Prosperity Holdings	3.4%	Real estate and construction
Sun Hung Kai And Co	3.3%	Financial
BMW	3.0%	Consumer cyclicals

Upside Potential

Target value vs. Net Asset Value of the Management Team



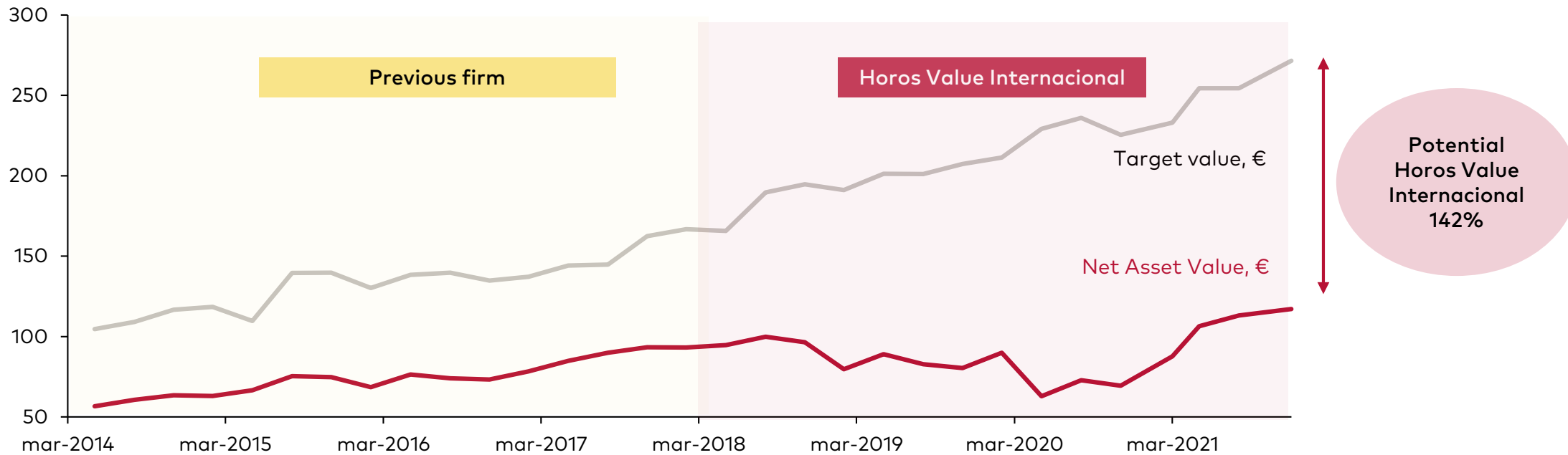
Data cover the period between the 31st March 2014 and the 31st December 2021.

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 December 2021.

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.