LHV Portfolio Management

Monthly Investment Report

July 2023

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Investments in the commodities sector have been sold off and a recession has already been priced in.

The absence of a recession should lift these investments going forward.

Positive summer month

In July, our equity investments related to commodities made an increase in the portfolios. Against the backdrop of higher interest rates, the macro environment remained stable, the wider economic recession feared by the general public did not occur in the summer and commodity prices started to recover from the recent lows.

In the portfolios, Freeport McMoran, Pan American Silver and UPM-Kymmene shares contributed the most to the gains by rising 10-14%. Among other investments, Alphabet shares rose 9% after strong quarterly results. Bond investments, which we have increased in our portfolios this year, also contributed to the gains but to a lesser extent.

Market index movements	**1 month**	**2023**
Eurozone bond index	0.2%	2.4%
World stock markets	2.6%	14.3%
North America	2.3%	16.5%
Europe	2.0%	13.3%
Emerging markets	5.1%	7.9%

** The performance of MSCI indices, in euros*

The macro environment remains stable

The general public has been negative about the outlook for the world economy this year. Economic recession was already expected in the spring due to higher interest rates, then in the summer and now in the fall. So far, the opposite has happened. In the US, consumption remains high and unemployment low. The US government continues to add fuel to the fire. At full employment, the government runs a budget deficit of 6% of GDP. As long as the US government spends so aggressively on borrowed money, it will be difficult for the world's largest economy to enter a recession.

China's economic recovery from the corona crisis is disappointing. But nothing drastic has happened in China. China's economy has not simply recovered from the pandemic in the usual way with public construction projects. But domestic consumption in China is doing fine. This helps explain why European luxury goods stocks are doing well. Much of the consumption of luxury goods comes from China. China is also taking advantage of major changes in the automotive industry. With the advent of electric cars, China has taken over a large part of the automotive supply chain. The country has become the world's second largest exporter of cars.

So, in the grand scheme of things, no major crises has happened in the economy after the rise in interest rates. It is very possible that this will not happen in the next year also as no one wants to reduce public spending in the US before the presidential elections. But the risks are increasing every day. Higher interest rates quietly increase costs for many countries, businesses and households behind the scenes.

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Upside in commodities

The interest rate shock has created the illusion that the world economy is declining and that there is enough supply of natural resources. In reality the opposite is true. The economy has not fallen into a hole and the demand for commodities has not disappeared. Rather, higher interest rates and fears of recession are delaying capital investment in the sector. This will further increase the deficit of undersupplied commodities in the long run.

Structural underinvestment in the sector means that at some point commodity prices will rise, and sharply. Underinvestment reaches higher prices just as water freezes in the cold. If the water temperature drops from 20C degrees to 10, nothing happens. If the temperature drops from 10C degrees to 5, nothing happens. But at some point, when the water reaches zero degrees, the game changes. We saw this in commodity markets in the aftermath of the pandemic when demand for commodities spiked.

In the equity markets, companies related to the commodity sector are cheap relative to earnings and have good upside potential if commodity prices rise. From the energy sector, our largest position is in shares of Yellow Cake, which mirrors the price of uranium. We are seeing rapid growth in CO_2-free nuclear power in Asia and a comeback in Europe, where several countries such as Sweden are restarting old nuclear plants.

Among industrial metals, our largest position is the copper mining company Freeport-McMoran. Copper is a critical industrial metal for electrification where we see structural undersupply.

Limited options for diversification

The largest equity position in the portfolios is the share of the US gold miner Barrick Gold, which moves up and down with the price of gold. The major market shocks of recent years, from the pandemic to the war in Ukraine, have shown that gold is a critical defensive investment in portfolios at such moments. A bull market can create the illusion that more defensive investments are not needed in the portfolio. In reality, however, these are the most important positions after major high tides.

In addition to commodity related positions, we have also diversified the portfolio with other investments. In the technology sector, this year we bought shares of Alphabet, which has risen well on the back of the artificial intelligence boom. Among the Nordic single stocks, the shares of the fast-growing logistics company DSV have performed well.

Unfortunately, there are few options to diversify positions at reasonable price levels. We believe that this year's rise in tech giants' stock prices is driven more by the inertia of investors from the previous market cycle. With few exceptions, the sector is expensive for our taste.

In order to get a more stable income, this year we have channeled cash into corporate bonds, where we earn 5-10% yield. When autumn arrives, we expect new bond issues where we can make additional investments.

Best wishes
Mikk Taras and Kaius Kiivramee

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