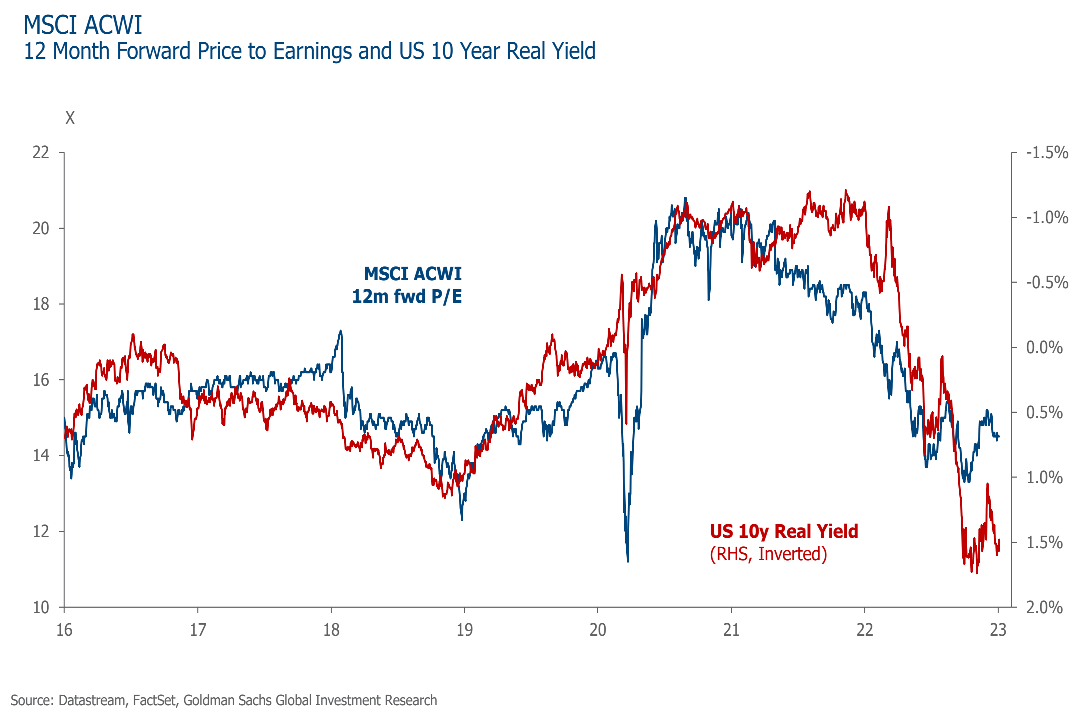
Holowesko Partners Ltd.
December 2022

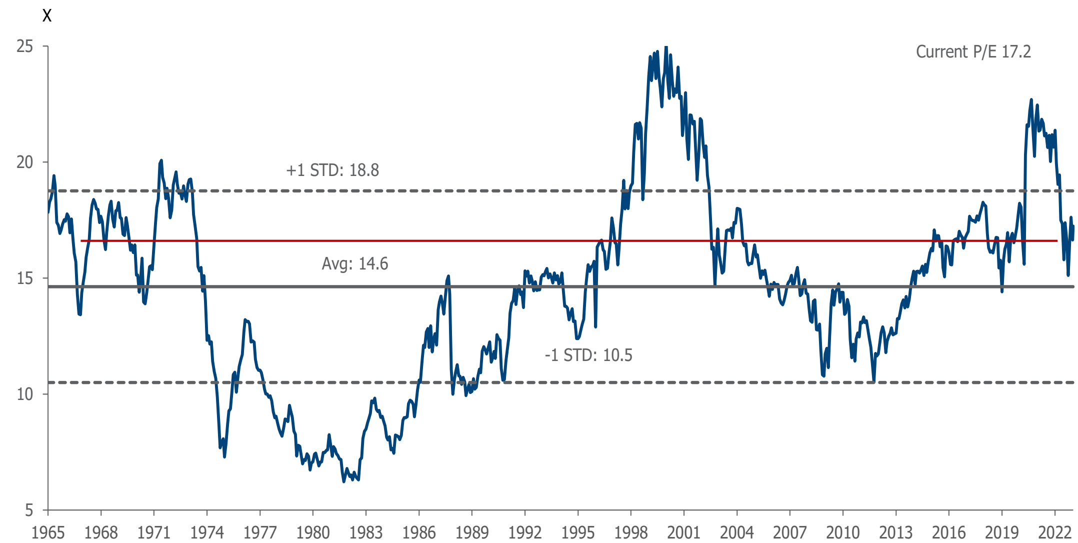
$33 trillion in global equity market value disappeared from the November 2021 highs as rising inflation and interest rates impacted markets. This reduced the MSCI ACWI forward price-to-earnings ratio (P/E) to attractive levels, primarily driven by lower multiples for non-US companies.



In the US, the S&P 500 was down -19% in 2022 while the NASDAQ fell -33%. Over $7 trillion in stock market value was erased from the NASDAQ-100 and $3.6 trillion from the popular FAAMG companies (Facebook (Meta), Apple, Amazon, Microsoft and Google). While the NASDAQ's drop of -41% in 2008 was larger than 2022, the index back then only lost $1 trillion in value due to its smaller size. The largest peak-to-trough decline in the S&P 500 during 2022 of -25% was 2x the median historical annual drawdown. The US market traded higher on only 43% of the days in 2022, the second worst year since WWII, yet the median gain on the higher days was the largest in postwar history.

Since 1940, the only years with larger declines in the S&P 500 than last year were 1974, 2002 and 2008. In the subsequent years the market rose, however in 1974 the P/E ratio of the market bottomed out at 6.8x, 17x in 2002 and 13x in 2008 versus 17x today. Although price levels are back to what appears to be a more normal valuation on next twelve months' earnings estimates, these earnings expectations are probably too high.

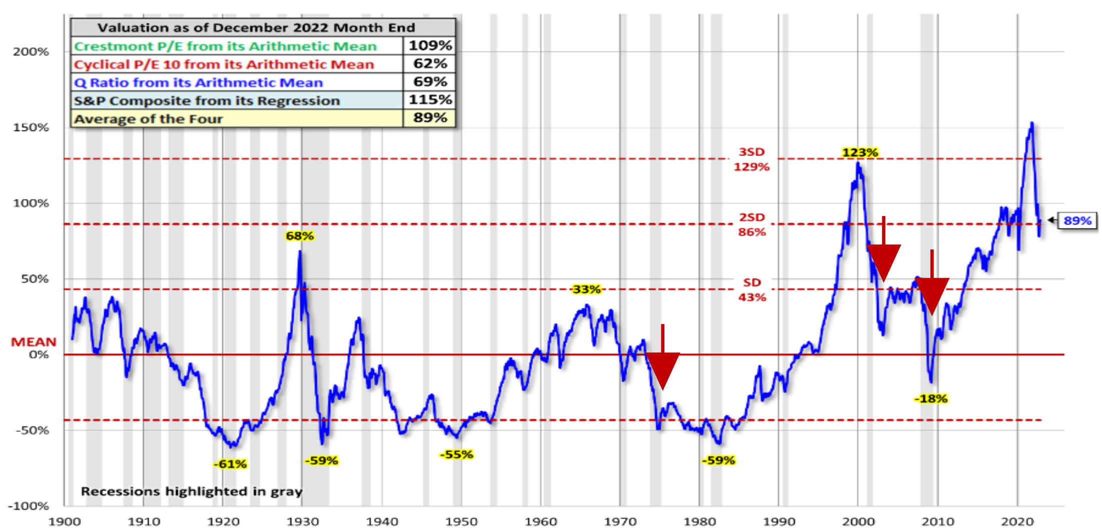
S&P 500
Next Twelve Months Price to Earnings



Source: Standard & Poor's, Refinitiv, FactSet, Credit Suisse

As the graph below indicates, a broader variety of valuation levels for the US market supported bottoms in those years. Not so much today. Equity valuations in the US are still quite stretched. The four-factor model below shows price levels remain above any historical period other than the 2000 stock market bubble.

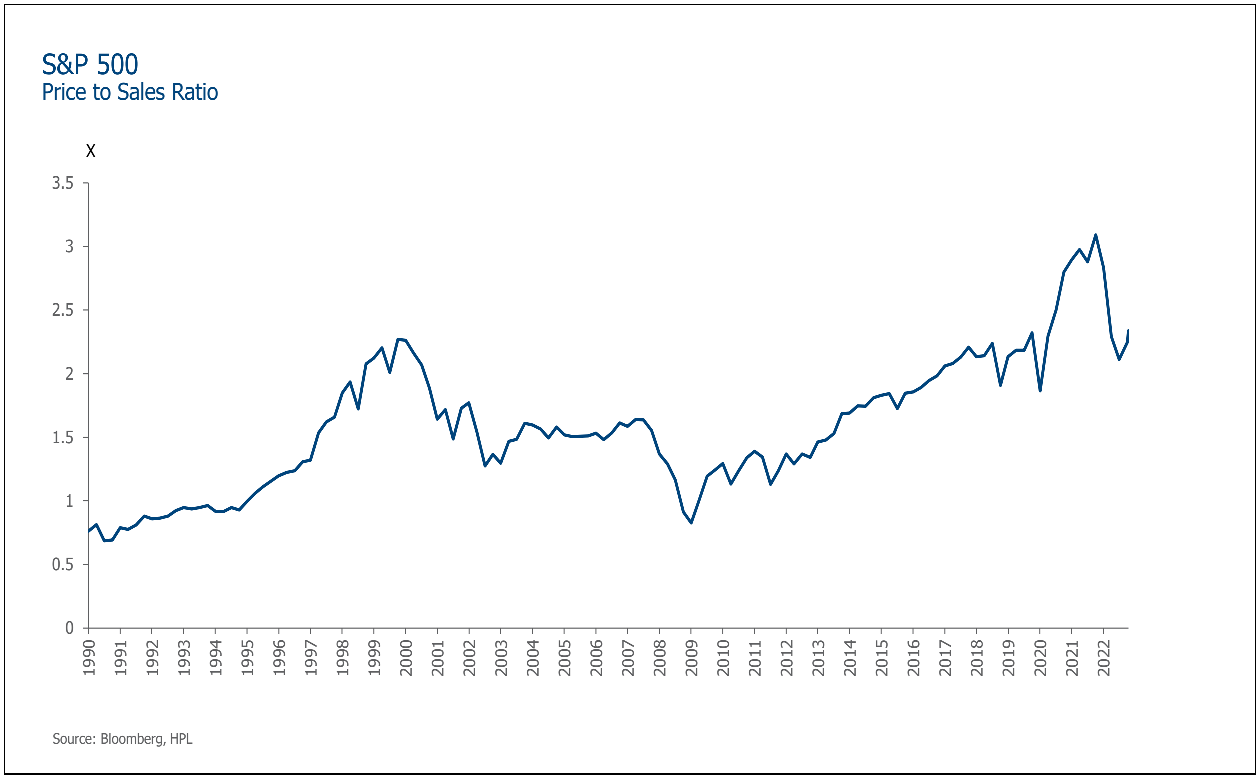
S&P 500 INDEX
Average of the Four Valuation Indicators



Note: Chart gives a simplified summary of valuations by plotting the average of the four arithmetic series along with the standard deviations above and below the mean.

Source: advisorperspectives.com

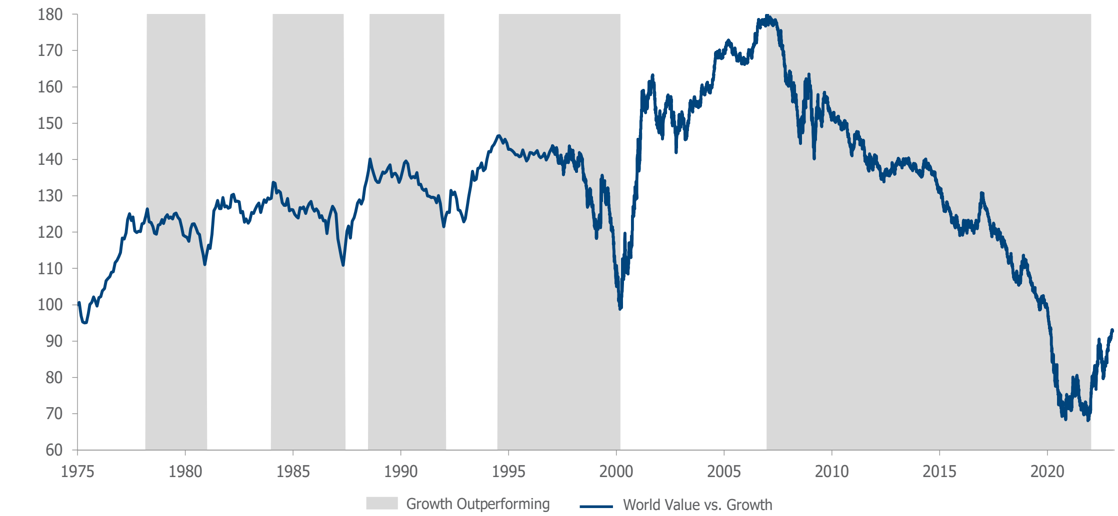
Relative to sales (P/S), the US market is at the highest level in history except for the years immediately following Covid when liquidity from monetary and fiscal stimulus drove valuations. If the market fell to where it bottomed in 2002 and 2008 on a P/S basis, it would need to decline more than -40%.



2022 was also only the third time since 1926 that both US stocks and bonds lost money, a staggering $17 trillion in 2022 based on October lows. Traditional investment advice to allocate 60% to stocks and 40% to bonds turned out to be a big losing strategy this year, with returns from this allocation in the US the worst since 1932 when the US was in the midst of the Great Depression. The -16% return on the US 10-year treasury note last year was the worst annual return in history. The 30-year US Treasury also fell -35%, the worst performance in a century. Bond prices dropped as US inflation rose from 7% in January to 9% by June and finished the year at 6%, prompting the Federal Reserve to raise the Fed Funds rate from 0.1% to 4.4%, the largest annual move since the 1970s.

Since the 2008 Global Financial Crisis dramatic outperformance of growth versus value worldwide helped to erase 30 years of overall outperformance of value, as shown on the graph below (with the exception of the 3 years leading up to the tech bubble). The trend finally reversed in 2022. As interest rates return to more normal levels and the rising cost of capital impacts the valuation of all assets globally, this is providing a dramatic, and we believe, sustainable shift away from high growth towards value, especially interest rate sensitive companies, commodities and non-US investments.

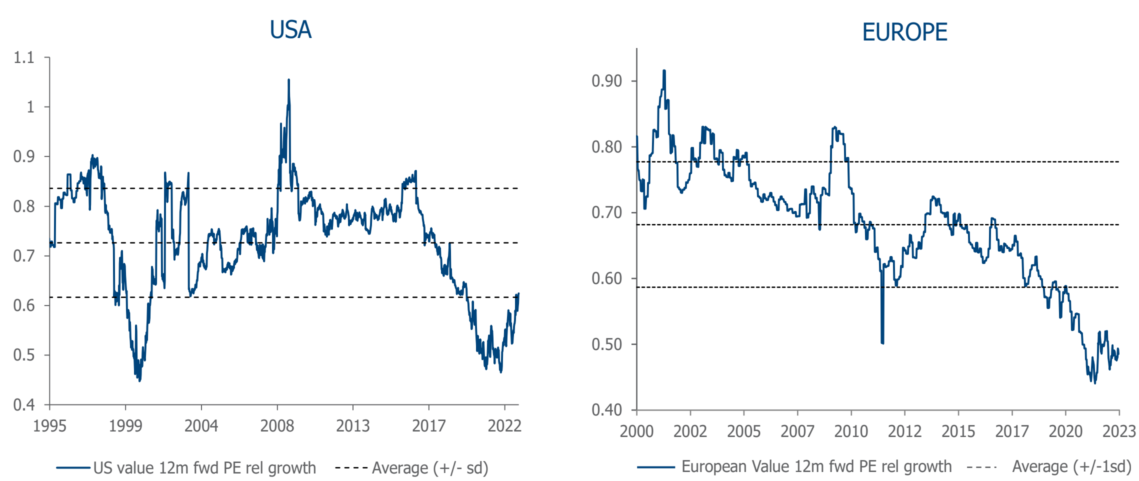
VALUE VERSUS GROWTH
Relative Price Performance, Global



Note: Monthly Frequency until 1996. Daily Frequency from 1997 onwards.
Source: Datastream, Goldman Sachs Global Investment Research

Despite the recent outperformance of value, the P/E discount to growth is still substantial as many value company earnings have recently held up well. It wouldn't be a surprise if value now outperforms for a while similar to the period after the bursting of the technology bubble in 2000. While the US value discount is wide, the European discount is greater.

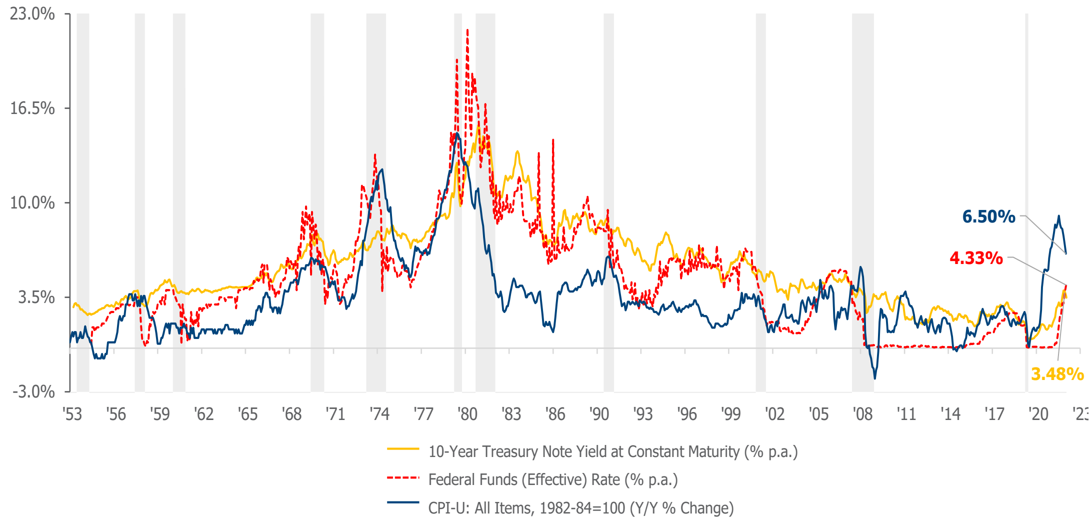
US AND EUROPEAN VALUE 12M FORWARD PRICE TO EARNINGS RELATIVE TO GROWTH



Source: Refinitiv, Credit Suisse Research

In an attempt to shore-up economies post the GFC and Covid, central banks unleashed the greatest amount of liquidity ever experienced. In the US, immediately following the GFC and Covid, the effective funds rate was pushed down to the lowest in history. Many bond yields dropped, and at one point there was US$18 trillion worth of negative yielding bonds.

US CPI, FED FUNDS RATE, TEN-YEAR TREASURY YIELD AND MONEY STOCK

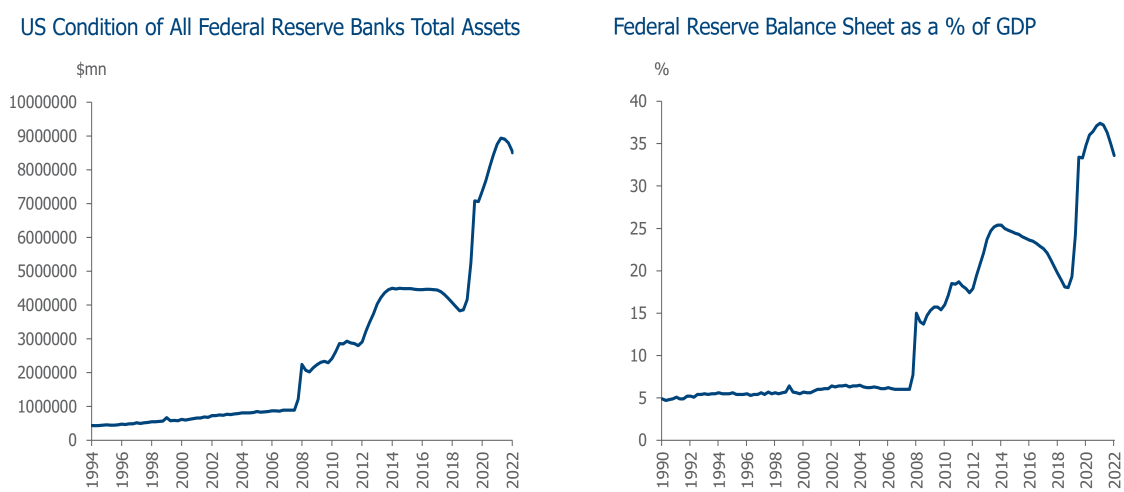


- Real 10-year US yield = -6.1% (was -5.6% when slide was prepared 1 month ago)
- Real FF [effective] rate = -7.5% (versus -8.3% 1 month ago)

Note: Data at 31/12/2022
Source: Strategas Research Partners

Low interest rates and rising liquidity were supported by exploding central bank balance sheets and government spending. In the US, the Federal Reserve's balance sheet increased to over $9 trillion dollars, the largest amount ever relative to the GDP, climbing from less than 5% prior to the GFC to over 30%.

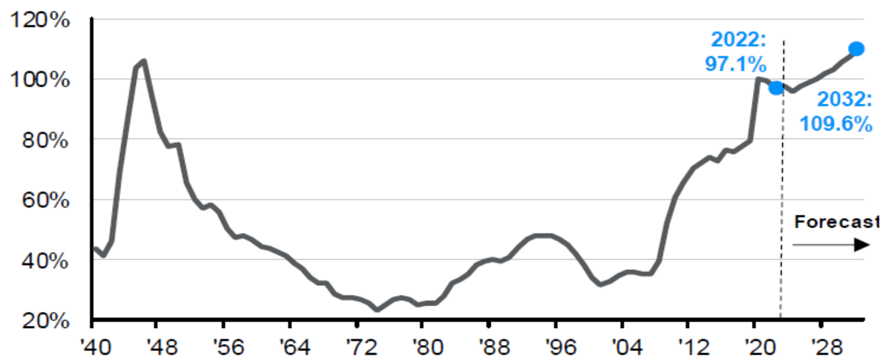
FEDERAL RESERVE BALANCE SHEET



Source: Bloomberg, HPL

The US federal government also added to the liquidity. Spurred on by political necessity and a seemingly zero cost of debt, they aggressively spent and borrowed, driving debt, as a percentage of GDP, to levels beyond the previous peak of WWII.

FEDERAL NET DEBT (ACCUMULATED DEFICITS)
Percentage of GDP, 1940-2032, CBO Baseline Forecast, End of Fiscal Year



Source: CBO, J.P. Morgan Asset Management; (Top and bottom right) BEA, Treasury Department. Estimates are based on the Congressional Budget Office (CBO) July 2021 Update to the Budget and Economic Outlook, except for 2021 estimates of the federal deficit and net debt levels. These estimates and the details on the breakdown of spending, excluding net interest, are J.P. Morgan Asset Management estimates. Other spending includes, but is not limited to, health insurance subsidies, income security and federal civilian and military retirement. Note: Years shown are fiscal years. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated.

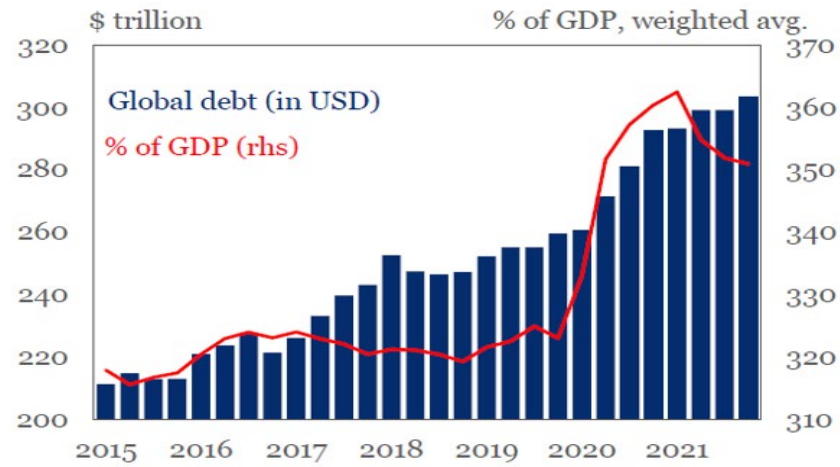
Guide to the Markets – U.S. Data are as of December 31, 2022.

Markets are now going through a profound period of change, with massive stimulus being removed. The period of low, or no cost of capital, is coming to an end (bad for companies that grow quickly with little prospects for profitability). A rising cost of capital (higher interest rates) will have significant impact on all asset prices going forward, especially in the vulnerable bond market. But this "quantitative tightening" (QT) is only beginning, and it's happening after almost all assets globally are coming off excessive valuations.

Systematic risk is now evident in most government bond markets, especially in the US. Federal debt in the US now stands at $31.3 trillion, and at 121% of nominal GDP compares to 35% in the 1980s when Paul Volcker was fighting inflation. 50% of all US government debt is set to mature in 3 years with the current average coupon on all debt at 1.7%, versus the federal funds rate of 4.5%, estimated to increase further at the next Federal Reserve meeting. In 2021, the interest expense for the US government was roughly 9% of total tax receipts. At the current federal funds rate, the US government would have to spend 29% of 2022 tax revenue on interest. This is obviously unrealistic and shows the perilous position the US is in with Central Bank support of the government debt market probably a necessity to keep interest rates from skyrocketing. The US Federal Reserve is now in a tricky spot. They need to raise rates to take on inflation, while being mindful of the constant rising cost of servicing the growing levels of government debt. The Federal Reserve also appears to be raising interest rates as the US economy goes into a much anticipated recession, something unique in US economic history.

Over the last 5 years, total global debt has risen from less than $240 trillion to slightly over $300 trillion. At 6%, CLSA estimates that the interest cost alone would be about the same size as China's GDP. The world's debt markets are extremely vulnerable, and a risk to investors in all asset classes is a problem or liquidity event related to government debt.

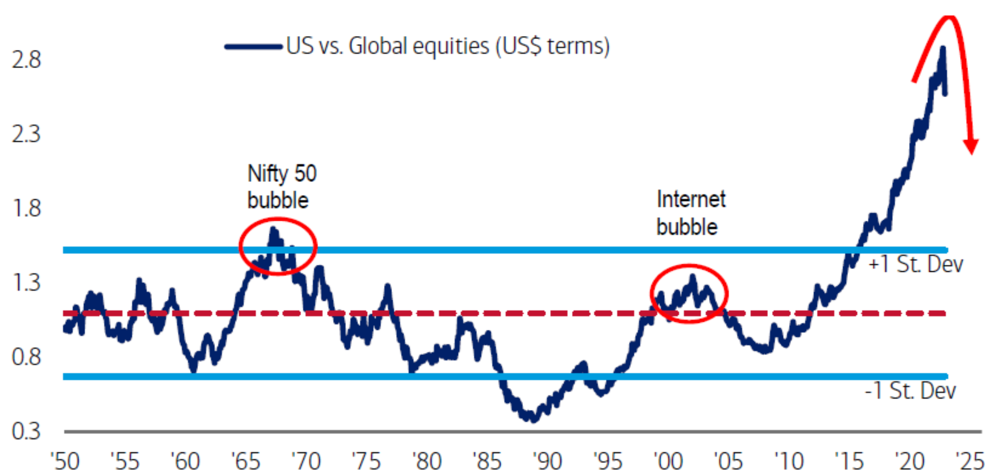
TOTAL GLOBAL DEBT SURPASSED $300 TRILLION IN 2021



Source: IIF, BIS, National Sources, Haver, CLSA

It has been easier to find investments outside the US for the Fund after the dramatic outperformance in the US since 2008, and substantially easier to find things to short in the US.

US VERSUS GLOBAL EQUITIES PRICE RELATIVE (US DOLLAR-TERMS)



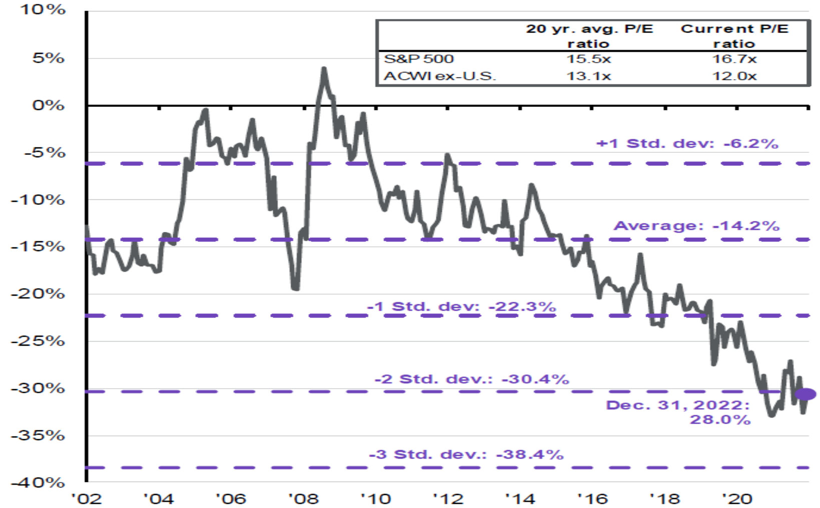
Source: BofA Global Investment Strategy, Bloomberg, MSCI USA. Index: MSCI Developed Markets excluding USA

As a result of substantial outperformance by US companies, the P/E ratio of non-US companies is now at one of the largest discounts in history relative to the US.

INTERNATIONAL PRICE TO EARNINGS DISCOUNT VERSUS US

MSCI AC World Ex-US Versus S&P 500 Indices

Next 12 Months

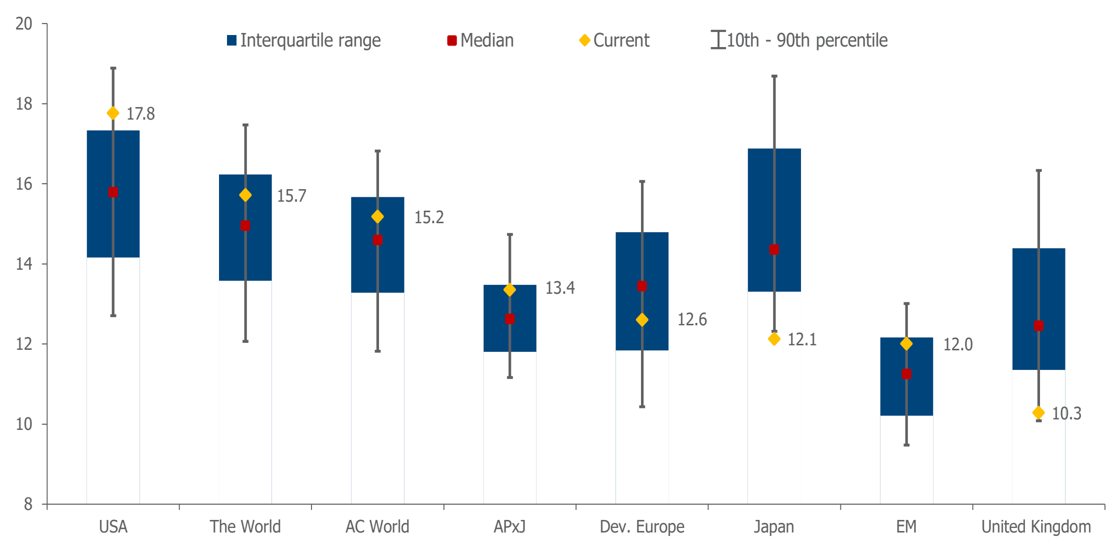


Source: Factset, MSCI, Standard & Poor's, J.P. Morgan Asset Management, *Guide to the Markets – U.S.* Data are as of December 31, 2022

Relative to the last 20 years, valuations in Japan, Europe and the UK are much lower than normal, giving us ample opportunity to find investments in these markets.

VALUATION RANGES (MSCI REGIONS) OVER A 20-YEAR TIMELINE

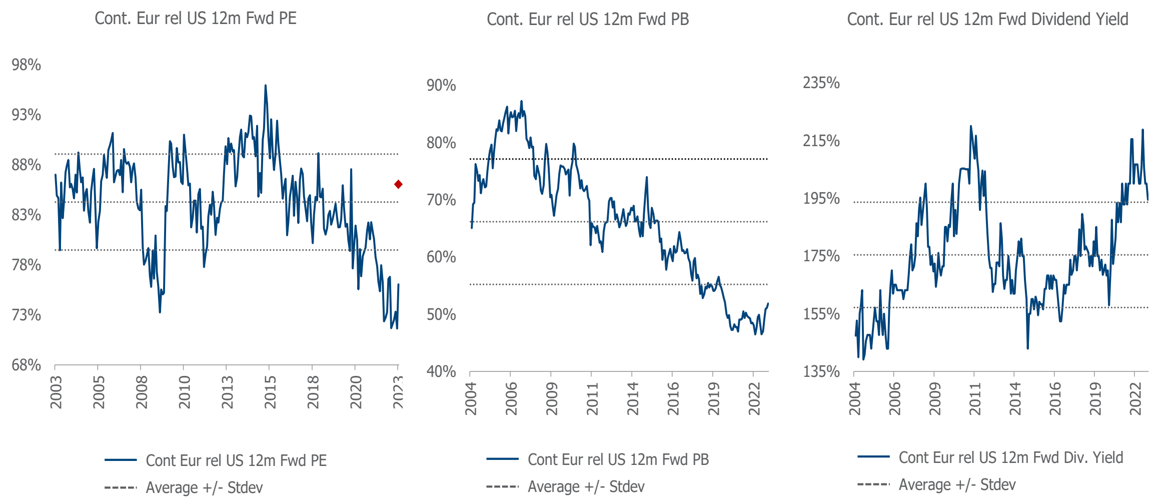
12 Month Forward Price to Earnings Multiples



Source: Factset, Goldman Sachs Global Investment Research

Many European companies appear cheap and trade at large discounts to the US. Europe also benefits from sectors with many companies generating well above average free cash flow yields, specifically autos and energy. According to Credit Suisse, Europe is 3x more exposed than the US to value stocks, which currently trade at recession lows, and only cheaper 3% of the time over the last 20 years.

EUROPE VERSUS US



Source: Bloomberg, Credit Suisse

Dividends have played an important role in shareholder returns for European companies. According to Credit Suisse, dividends have provided 83% of the total return for stocks since 1900 and 66% since 1995.

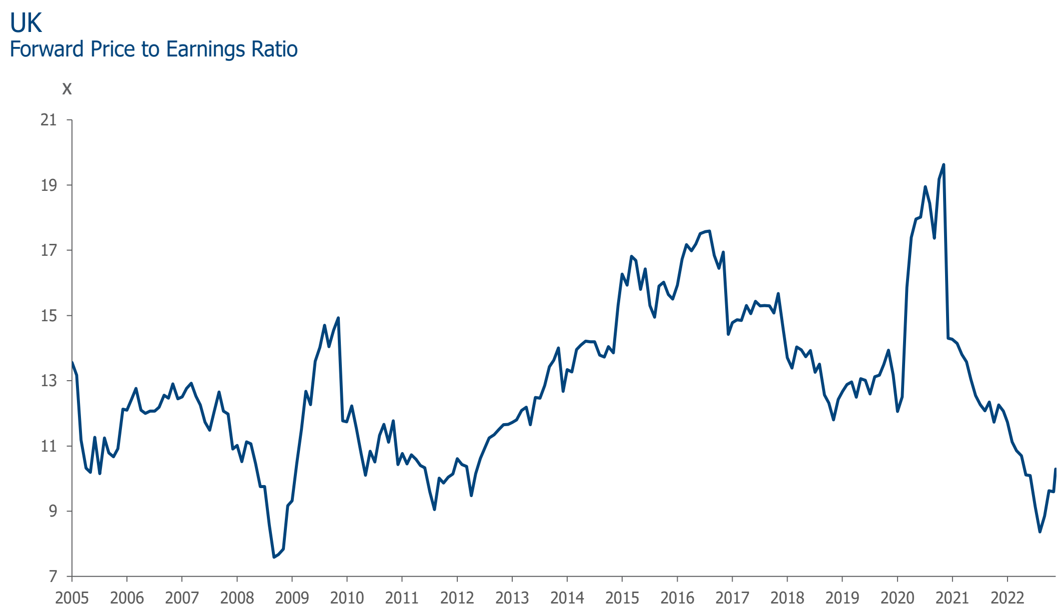
US AND EUROPE
Returns since 1995

Since 1995	US	Europe
Total Return	1385%	655%
Price Return	780%	224%
% from dividends	43.7%	65.7%
% from price	56.3%	34.3%

Source: Credit Suisse Research

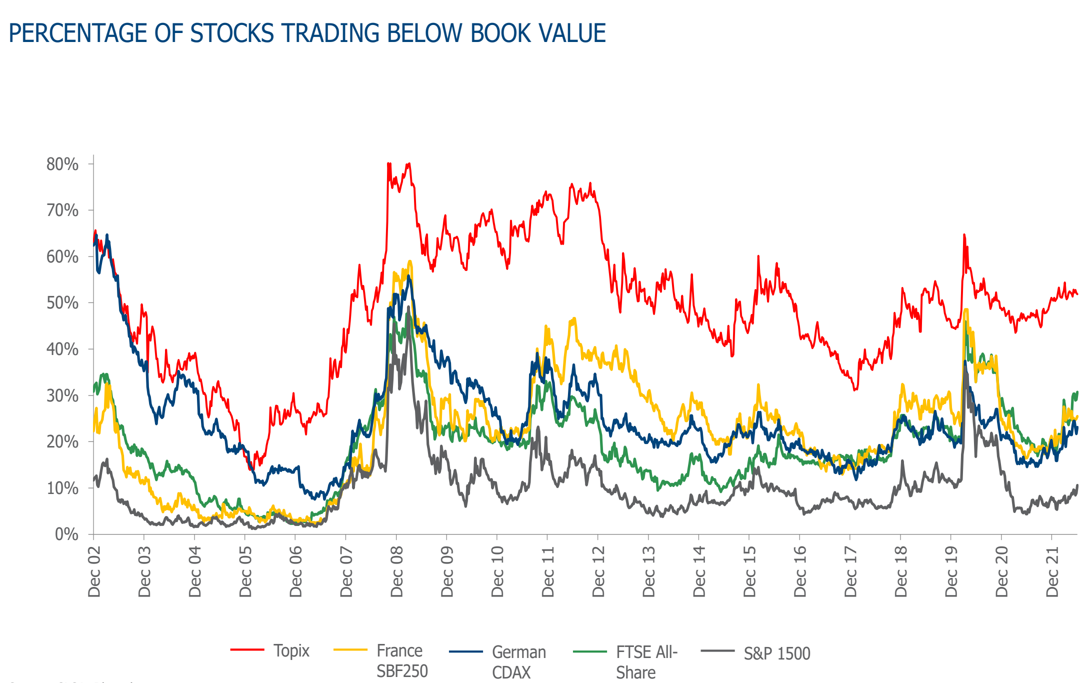
Although Europe as a whole lacks the broad number of growth companies found in the US, it does have world class companies in the growth sector that became cheap enough to be investment opportunities.

Within Europe, the UK is particularly cheap versus history. The UK is suffering from a series of problems including Brexit strains, energy shortages and labor market issues. Much of this seems to be reflected in stock prices giving us a chance to buy world-class companies at reasonable valuations.



Source: Bloomberg Finance LP, HPL

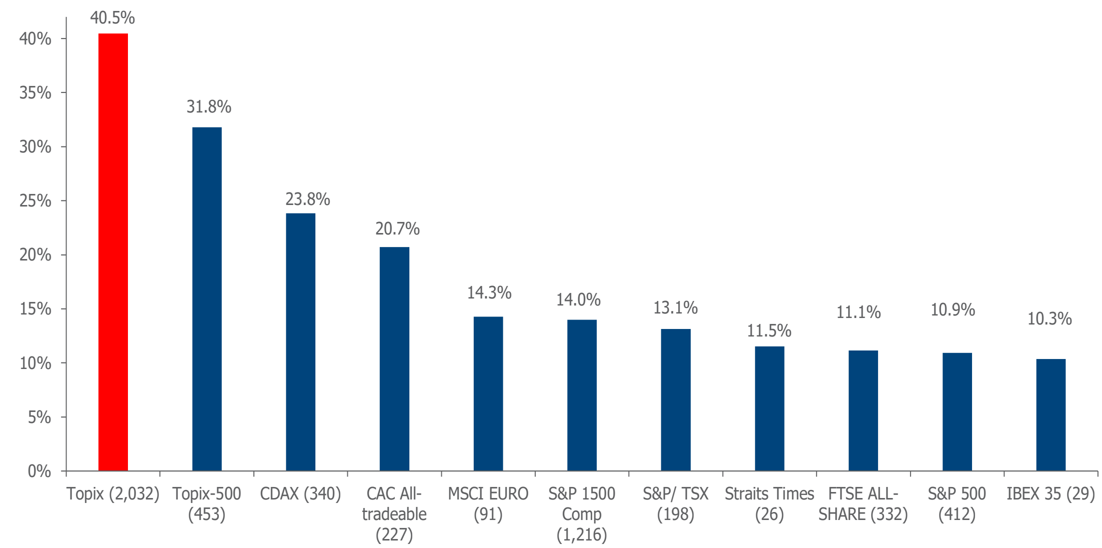
Japan's economy has attractive growth potential at a time when other economies are slowing. Our ability to find investments in Japan is also supported by a market that is substantially cheaper than most developed markets. For example, Japan has the highest percentage of stocks trading below book value.



Source: CLSA, Bloomberg

Japan also has the largest number of companies with net cash over 20% of equity. Crossholdings in other companies' shares are also worth 19% of the market capitalization for the Topix-500 non financials.

PERCENTAGE OF NON-FINANCIALS WITH NET CASH OF OVER 20% OF EQUITY



Source: CLSA, Bloomberg

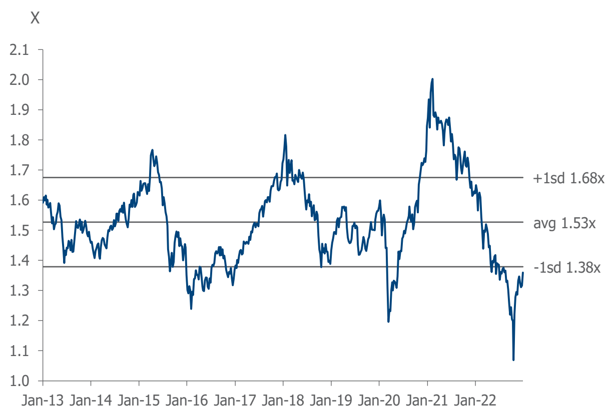
Japan benefits from a very cheap currency, which helps its large export sector. The last time the Yen was as cheap as it got in the fourth quarter of 2022 was in 1998, when Japan's economy was in a meltdown and continental Asia was in the midst of the "Asian Financial Crisis".

JAPANESE YEN

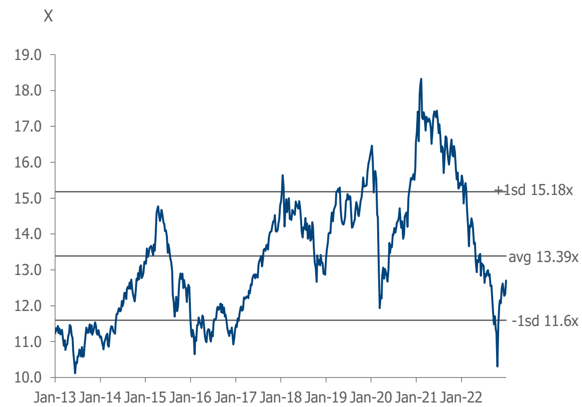
Source: Bloomberg, CLSA

ASIA EX-JAPAN

Price to Book Ratio



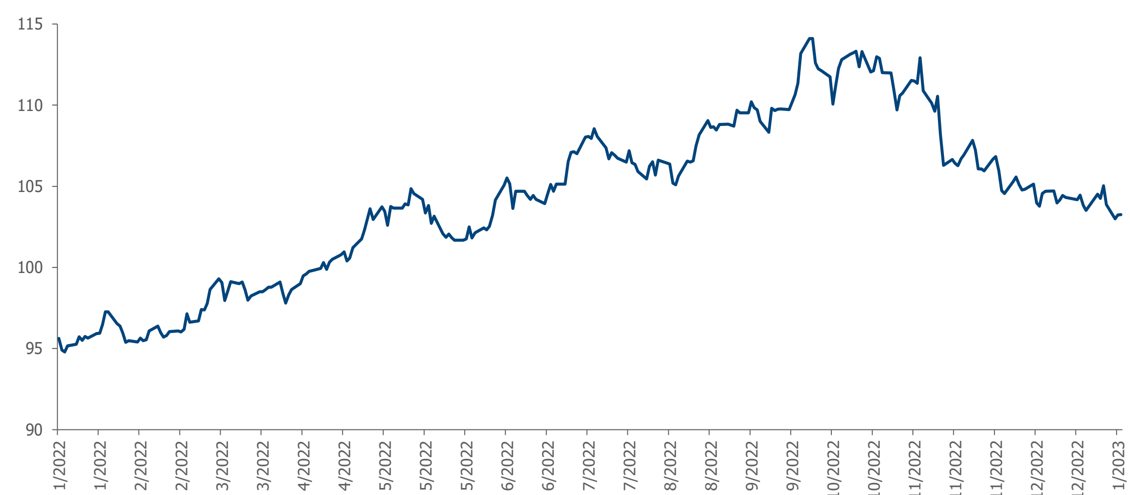
Price to Core Earnings Ratio



Source: CLSA

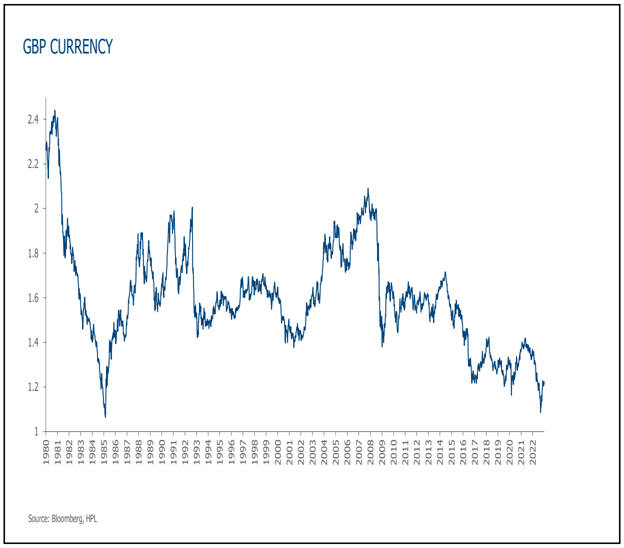
For the first three quarters of 2022, currency was a drag for any US dollar-based investor investing in non-dollar assets. The US Dollar Index, which reflects the average exchange rates between the US dollar and major world currencies, rose in 2022 until the end of September. Prospects for higher US interest rates versus other countries drove the majority of this move. As other countries started raising rates and a perception grew that the US may have to slow or reverse their rate increases, the US dollar came under some pressure.

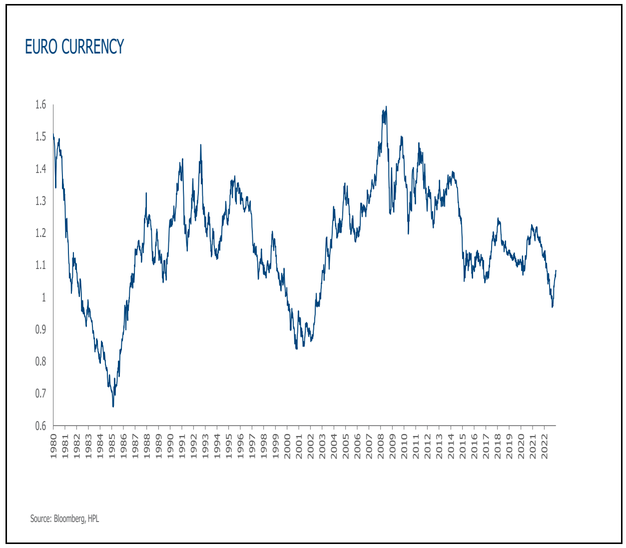
DXY DOLLAR INDEX



Source: Bloomberg, HPL

The strength of the US dollar now adds to the appeal of some non-US assets. Consider the current levels of the Pound and the Euro versus levels in 2005-2009. With 78% of UK sales generated overseas (half from the US), the weak Pound and cheap valuations make the UK equity market interesting.





In my view, the biggest contribution to performance in 2022 was the collective analytical work by our research team. Holowesko Partners is a global equity asset management firm that uses rigorous fundamental research to drive the allocation of capital. Today we stand out in a category that is increasingly shrinking – intrinsic value based, global equity management firms with tenure. We have a strong, dedicated group of experienced professionals who understand the discipline, conviction and prudent management and evaluation of risk and returns needed, as they apply our intrinsic value approach to analyzing investments. On average we have over 28 years of research experience, and 37 years of successfully managing risk as portfolio managers. Very few people investing client assets today have experienced and managed the challenges we have encountered since taking over the management of the Templeton Funds from Sir John Templeton in 1987.

DIFFERENTIATING FACTORS – 37 YEARS OF SUCCESSFULLY MANAGING RISK

'87	'86–'91	'90–'91	'90–'91	'92	'94	'97	'98	'95–'00	'01	'03–'11	'08	'12	'20	'20–'22	'22
Black Monday	Japan Bubble	Gulf War	US Recession	Soros £ break	Mexico Devaluation	Asian Financial Crisis	Russia/LTCM	TMT Bubble	September 11th	Iraq War	Global Financial Crisis	Euro Debt Crisis	Brexit	Covid Pandemic	Russia Ukraine

Experienced

- Portfolio Managers have been investing globally for over 30 years
- Seasoned investment team in place since inception 22 years ago
- 198 years of combined experience

Disciplined

- Detailed analytical approach combined with catalyst driven decision making
- Conviction derived from internal fundamental research reinforces patience, which is key to investing success
- Plan and invest for the long-term

Prudent

- Manage risk by quantifying problems and calculating company specific risk
- History of outperformance in down markets
- Leverage almost entirely limited to short positions

Global

- Portfolios constructed without consideration of index weightings but diversified by company and sector
- Investments directed by opportunities not benchmarks
- View the world from outside the confines of Wall Street

Aligned

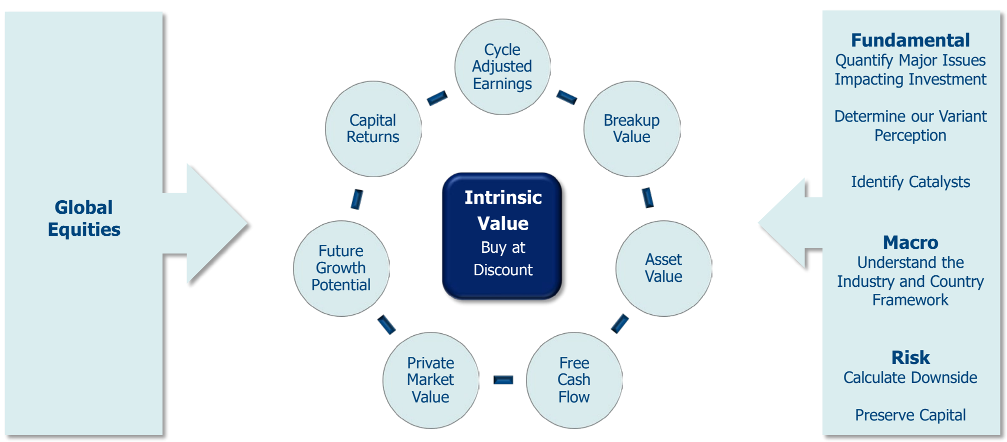
- Majority of firm principals' net worth invested alongside client capital
- Focus on performance rather than asset gathering

This tenure helps foster a patient, focused, vigilant, and opportunistic approach, which served us well in 2022 while managing investments in a turbulent market environment. Time in markets helps you realize that maximizing returns can't be achieved without being different from the crowd, being measured in assessing risk, and limiting losses while you are patiently and temporarily wrong. You not only need more success in stock picking than failure, but to limit losses when wrong. Our intrinsic value approach helps to limit losses. Every investment made has both an upside price target driven by our fundamental research, as well as a downside risk estimate if our thesis proves wrong.

INVESTMENT PHILOSOPHY & APPROACH – DISCIPLINE, PATIENCE & JUDGEMENT

A global fundamentally-driven, value-based investment approach emphasizing catalysts and downside risk mitigation.

Mispriced securities are an outcome of different market environments. Where and how we uncover opportunities evolves and changes in various market conditions.



Holowesko Global Funds

The upside/downside ratio for each individual investment is critical to our success and a good indicator of risk. If you can find securities with +40% upside potential and only -10% downside, you only have to be right less than half the time to make money. The more the ratio deteriorates, the more successful you have to be in picking winners.

This "margin of safety" approach worked in 2022 and allowed many of our long positions to hold up in a severe market correction. This isn't to say that we avoid all risk. Prudent risk taking, that which is covered by analytical work, is the safest way to achieve returns.

It's also helpful, and hopefully reassuring, that our interests are aligned with our clients. Our capacity to manage capital is primarily driven by the number of clients rather than size of assets, and we are grateful and humbled by the long relationships we have established.

Our global value-based investment approach relies on the discipline of calculating the value and risk of every security, the patience to look long-term towards the catalysts that will narrow the discount to our value, and the judgement to overlay macro issues that are important to our thesis.

At the beginning of 2022 our commentary addressed the largest macro issues facing us as bottom-up stock pickers, specifically inflation, rising interest rates and excessive valuations.

In that year-end letter we wrote, "Inflation probably isn't transitory when you consider: the large amount of money thrown at the system by central banks; the surge in demand from consumers flush with cash and strong personal balance sheets; the rise in energy and labor costs worldwide that are making their way into the cost of producing products and services; supply chain bottlenecks; the need for governments to inflate away their massive debts, which are impossible to service without doing so; the slow reversal of globalization bringing production from low cost to politically practical locations; the environmental, social and governance (ESG) revolution that is adding costs in numerous ways; and the possible growing surge in bank lending. If inflation isn't transitory then investing in bonds will be a very poor choice. Bond yields do not reflect current inflation or the prospects of future high and sustained inflation, and these yields are starting from abnormally depressed levels."

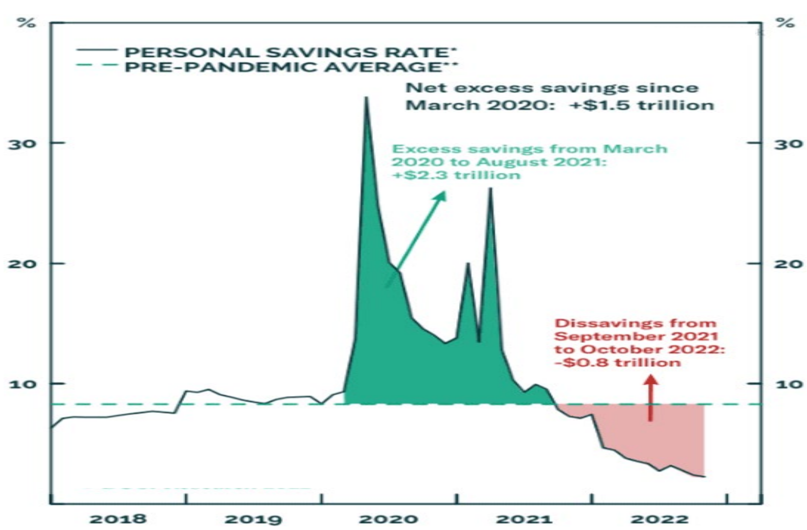
As mentioned previously in this note, bond returns in 2022 were among the worst ever. Although central banks are raising rates in the US, they are slow to reduce the Fed's balance sheet, which is being offset somewhat by government spending. Labor costs and many of the issues noted above still persist. Bonds were a lousy investment in 2022, yet the risks remain. We believe much of the inflationary pressure is "sticky", especially in wage growth, and we anticipate the era of abnormally low rates is over.

We also wrote, "US stock indices are at historically high valuations just as the US Federal Reserve has begun to reverse course on rates and stimulus. Dramatic declines in equity prices are difficult or impossible to predict, but the risk of loss at this point on "low-cost index funds" must be greater than the likelihood of return. Why is that? Well to begin with, the market has never been more expensive on almost any valuation parameter."

The US market now "appears" to be more favorably priced after its fall. Some parts of the market have even become cheap, especially a few large technology companies. But earnings now appear to be more vulnerable. Although a possible US recession is discussed often and appears highly anticipated by many, it is not yet reflected in many estimates. On Bloomberg, actual earnings per share for the S&P 500 are $206, with $227 expected for year 1 and $248 for year 2. This puts the S&P 500 at 18x actual, 17x and 15x, respectively. However, the average decline in S&P 500 EPS during all post WWII recessions is -19%. Certainly, this is not being reflected in the current S&P 500 EPS estimates despite constant commentary of a possible recession.

A recession in the US may occur as the US consumer runs through all the accumulated savings from the pandemic. The US consumer typically supports two-thirds of the US economy. The excess savings of $2.3 trillion accumulated during the pandemic has been reduced by roughly half and is contributing to consumers spending 10% more than they were before the pandemic, according to JP Morgan's Jamie Dimon. Recent credit card data +16% YoY also shows the magnitude of spending.

PANDEMIC SAVINGS



Note: *Shown as a percent of disposable income. **Average savings rate from the beginning of 2018 until the start of the pandemic.
The calculation of excess savings assumes a pre-pandemic baseline with 4% disposable income growth and 8.3% savings rate.
Source: The Daily Shot

As this excess disappears, spending should slow down rapidly as the personal savings rate hit the lowest level on record in 2022 (consumers not rebuilding savings).

Other signs of an impending recession in the US are the inversion of the yield curve (which typically leads a recession by 10 months), weak corporate spending surveys, and a CEO business confidence survey which is consistent with recessions.

Not only do earnings fall in a recession, but the multiple on earnings also declines. The information below shows the trough P/E multiple over the last 4 recessions at an average of 16x. This isn't too far from the current market valuations, implying changes in earnings will probably be the main driver of performance over the next year, something normally good for stock pickers.

S&P 500
Peak to Trough Changes

Peak to Trough Changes, S&P 500

	PE	Price	Fwd EPS	Trough PE
1990 recession	-20.0%	-19.9%	-7.9%	13.8x
2000 recession	-23.1%	-29.7%	-17.8%	15.4x
2008 recession	-39.3%	-54.8%	-38.9%	14.0x
COVID recession	-21.2%	-32.8%	-21.3%	21.8x
Average	-25.9%	-34.4%	-21.5%	16.3x

Source: Refinitiv, Credit Suisse research

Many of these issues, and those we will encounter this year and in following years, lead us to constantly re-examine, question and justify the assumptions we are using when we calculate the intrinsic value of a company. But paramount to the allocation of capital for our clients is the ultimate valuation we apply to specific companies and the ratio of upside return to potential downside risk that we calculate. Although 2022 was a year of greater macro influence than normal, I believe this year will be more about company specific earnings and valuations. This should be helpful for stock pickers.

Intrinsic value for stock pickers comes in a variety of forms. We will continue to focus on our bottom-up stock picking, being mindful of the macro risks in an increasingly complex world.