LHV Portfolio Management

Monthly Investment Report

October 2022

Monthly Report
October 2022

We are seeing the first signs of a change in China's zero-tolerance policy on COVID-19. This should have a significant impact on our positions in mineral resources.

October in the markets

October was a positive month for the markets. Global stock markets rose 5.1% measured in euros, reducing the 2022 loss in stock indices to −9%. Bond markets stabilized, bringing this year's loss to −16.1%.

The month was also positive for portfolio management. Energy sector investments made the biggest contribution to the positive performance of our portfolios: Antero Resources (+18%), Range Resources (+10%) and Yellow Cake (+8%). As another key sector, investments related to energy metals rose significantly in the portfolios: Freeport McMoran (+14%) and Metso Outotec (+13%). In addition, our recent investment in European banks (BNKE) rose by +9%. On the downside, precious metals weakened, and so did our positions in Barrick Gold (−5%) and ZKB Gold (−4%).

The most significant events, however, occurred in early November as we are writing this report. The US Federal Reserve, which completely slept through the dawn of inflation, is now trying to curb inflation by raising interest rates and appears confident in continuing doing so.

Market index movements	1 month	2022
Eurozone bond index	0.1%	−16.1%
World stock markets	5.1%	−9.3%
North America	6.9%	−6.7%
Europe	6.2%	−12.2%
Emerging markets	−4.0%	−18.8%

** The performance of MSCI indices, in euros*

At the same time, the expected change in China's zero-tolerance policy for COVID-19 is playing an important role for our investments. China has had a radical approach to controlling COVID-19. Their zero-tolerance policy means that if a case of COVID-19 is detected, the area will be locked down and the movement of people will be significantly restricted. If, for example, a case of COVID-19 is detected in a shopping mall, the people inside the mall will be locked in the mall for an extended period of time. To put it simply, China has lived in a work-home-work regime for almost three years.

We are seeing the first signs that there might be a step-by-step alleviation of this policy. This will have a significant impact on the global economy and, among other things, on an increase in the consumer price index. We remember the economic activity brought about by the opening of economies after the ease of COVID-19 restrictions in Europe and the US. China's economy has not been operating at full capacity for three years, and even a slight economic opening would lead to a significant rise in the commodities that are important to our investments – oil, gas, energy metals, and precious metals. The increase in the price of mineral resources would then significantly increase the prices of all the most important inputs again.

We witnessed that last Friday, when our positions in mineral resources rose by 5% to 10% after the first signs of an alleviation in China's zero-tolerance policy, and the dollar fell by more than 2% against the euro.

Monthly Report
October 2022

Should China’s economy gradually open up, both the US Federal Reserve (FED) and the European Central Bank (ECB) will find it considerably more difficult to fight inflation.

For our portfolio, we believe that the lifting of COVID-19 restrictions in China is a more important event than interest rate decisions from the US Federal Reserve. Expectations of a tighter monetary policy are already reflected in prices, while the opening of China is not.

As China opens, the demand for commodities will go up like a balloon. Since a large part of our portfolio investments are in assets protecting against inflation, mostly from the mineral resources sector, we expect significant sensitivity to the news from China in the coming months. China will certainly not be locked down forever, and the opening of its economy will have a positive impact on our investments.

China’s opening also has another effect. While Western central banks hope to curb inflation by raising interest rates, the world’s second-largest economy, China, has instead exported price falls for the rest of the economy, as their zero-tolerance policy on COVID-19 has suppressed demand in China in recent years. Even Europe has been able to replenish its winter LNG gas reserves, because China has resold some of its LNG gas to Europe due to low demand.

Should China’s economy gradually open up, both the US Federal Reserve (FED) and the European Central Bank (ECB) will find it considerably more difficult to fight inflation.

China’s weak demand in recent years has also had an impact on the prices of mineral resources, which have been lower than normal. The oil market is an example. Midterm elections were held in the US this month.

To put the Democrats in a better position, President Joe Biden has sold to the oil market 1 million barrels per day (mbpd) of the US strategic oil reserve during the past six months (for comparison, global demand is about 100 mbpd). During the last two weeks before the election, the selling pace went up to 2 mbpd of oil reserves. By doing this, President Biden has reduced the US oil reserves to their lowest level in 40 years. While oil supply was increased by the sale of reserves, in China, the zero-COVID-19 policy has reduced consumption by an estimated 1 to 1.5 mbpd. From the week after the elections, the sale of US oil reserves will end, and the gradual opening of China’s economy will boost demand in the oil market.

All this is likely to sharply raise the prices of liquid fuels, giving new impetus to the wheel of inflation. This leaves both the FED and the ECB in a bystander role with their inflation management policies. And investors, who are eagerly waiting for a pause in central bank interest rate rises, will be disappointed.

All these changes will bring many interesting investment opportunities both in the energy sector and in mineral resources in general. We believe we are in the golden age of active investing, and there will be a number of opportunities for investors who adapt quickly, like 2022 as a whole has shown so far. It is important to maintain liquidity in portfolios at such moments to take advantage of emerging opportunities.

Best regards,
Kaius Kiivramees and Mikk Taras