

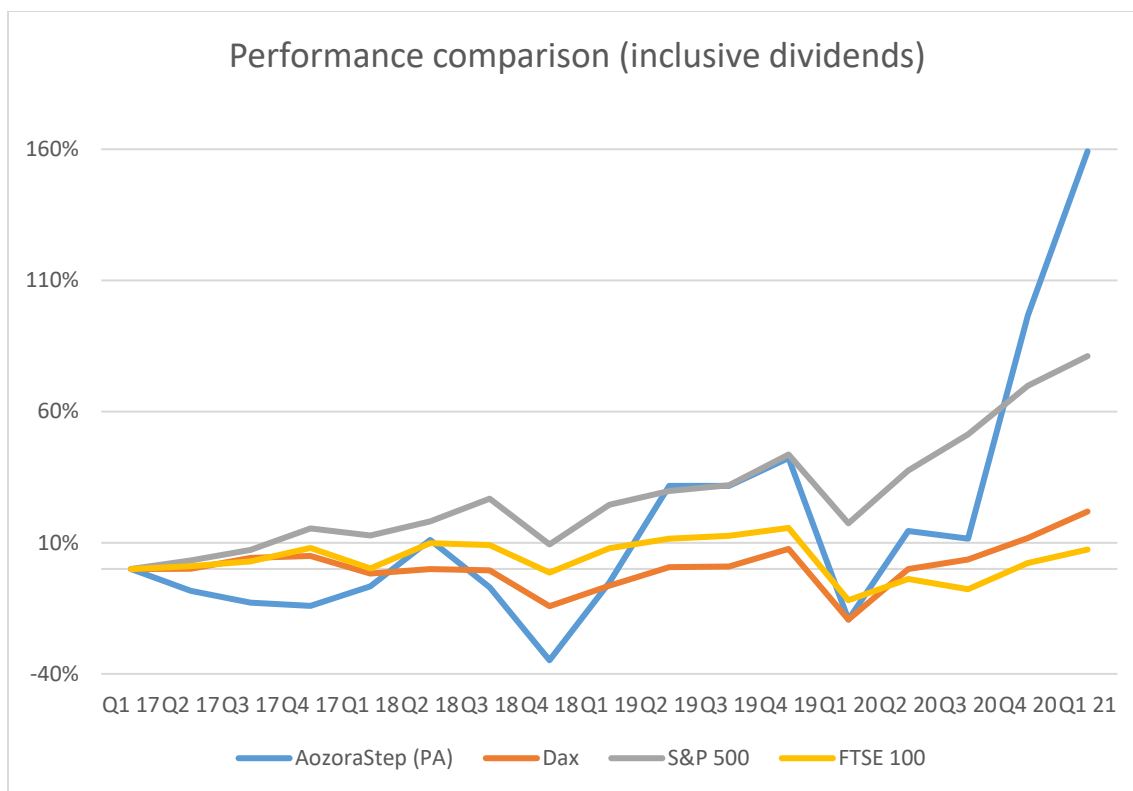


Quarterly Performance vs. S&P 500, FTSE 100 & DAX

Quarterly Performance	Our Performance	S&P 500	FTSE 100	Dax
Q1 17	0%	0%	0%	0%
Q2 17	-8%	3%	1%	0%
Q3 17	-5%	4%	2%	4%
Q4 17	-1%	8%	5%	1%
Q1 18	9%	-2%	-7%	-6%
Q2 18	19%	5%	10%	2%
Q3 18	-16%	7%	-1%	0%
Q4 18	-30%	-14%	-10%	-14%
Q1 19	45%	14%	9%	9%
Q2 19	39%	4%	3%	8%
Q3 19	0%	2%	1%	0%
Q4 19	8%	9%	3%	7%
Q1 20	-43%	-18%	-24%	-25%
Q2 20	42%	17%	9%	24%
Q3 20	-3%	10%	-4%	4%
Q4 20	76%	12%	11%	8%
Q1 21	32%	7%	5%	9%

Annual Performance	Our Performance	S&P 500	FTSE 100	Dax
2017	-9%	15%	8%	5%
2018	-31%	-5%	-9%	-18%
2019	113%	31%	17%	25%
2020	52%	18%	-12%	4%
Q1 21	32%	7%	5%	9%

Overall Performance	Our Performance	S&P 500	FTSE 100	Dax
CAGR	25.1%	15.0%	1.7%	4.8%
2017-21 Return	159%	81%	7%	22%



2nd April, 2021

Dear Investor,

First of all, this is my last quarterly report while being employed with Bluecrest Capital Management and working for AozoraStep at the same time. As of mid-June, I'll be solely focusing on AozoraStep, forming a partnership, producing more research and working together with potential investors. Taking this step was not light-hearted, but as my income from investing has topped my post-tax income from Bluecrest Capital Management, it felt like the right decision. In addition, I see tremendous opportunities in the UK equity market and the pandemic has brought a lot of volatility on which need to be acted fast. By taking this step, I am also hoping to improve returns potentially during market turbulence by shifting parts of the portfolio temporarily from stocks into bonds, as I have more flexibility due to the lack of compliance related to minimal holding periods. Overall, I will be able to offer a better service to you, have deeper insight and more time to focus on shifts in the economy and act quickly, while maintaining the same fundamental equity buy and hold investment style.

Moving on and before drilling into our portfolio, as per usual, I will introduce the current macro-economic environment. Specifically, as the economic Supercycle has become the main theme in markets, I'd like to start this quarterly report by taking a look at similar economic cycles in the history to single out any potential risks in current markets that could lead to a pull back:

1. Dot-com crash vs. current environment
2. 1921 forgotten depression
3. Archegos Capital Management blowup

1. Dot-com crash vs. current environment

Understanding where we are in the current economic cycle can help us planning our investments better. Below is a table that compares the events that led to the Dot-com crash with the current environment we are in (✓ similarities, X dissimilarities)

<u>2000 Dot-com Crash</u>	<u>Current environment</u>
10 th January 2000: AOL merged with Time Warner in the largest merger to date (\$182bn) that had analysts questioned valuations	✓ X Yes and no. The largest merger in the 2020s has been S&P Global buying IHS Markit for \$44bn. There are however similarities when considering the mega SPAC deals
30 th January 2000: Internet companies advertising at Superbowl make up nearly 20%	X Looking at WPP's (largest advertising company) 2020 annual results, advertising revenue was down 10% y-o-y. There are some questionable advertisements from unprofitable firms like Just Eat (Snoop Dogg) and Uber Eats \$5.5mio Superbowl ad
10 th March 2000: Often unprofitable, low revenue companies are hitting crazy valuations with Nasdaq peaking at 200 Price/Earnings	✓ Tesla is probably a good example with a Price/Earnings ratio of 1,038, although overall valuations don't seem at such lofty levels as in 2000
13 th March 2000: Japan entered recession	X Economies are emerging from the Covid 19 crisis and hence grow in high single digits
15 th March 2000: Large Internet stocks end merger talks (Yahoo & Ebay) – moderate decline in Nasdaq of 2.4%	X Mergers have been relatively small and mostly centered energy firms to cope with the changes in future energy demand, no cancellations of mergers
20 th March 2000: Article warning on internet companies running out of cash. First accounting scandal (MicroStrategy – falls 62%). Later on in 2001/02 more accounting scandals followed with Enron, WorldCom and Adelphia	✓ There was the Wirecard collapse in 2020 and the Greensill collapse in 2021, but no warnings about any impact on other companies apart from troubles at Gupta's Liberty Steel
21 st March 2000: Yield curve inverted amid hiking rate cycle (interest rates got raised), stocks rallied temporarily	X Interest rates are bottom low and yield curve steep in the 5yr+ region
3 rd April 2000: Microsoft found guilty of monopolization (Microsoft – 15% decline) – 8% decline in Nasdaq	✓ There are some similarities as internet giants in Australia need to pay newspapers for linking searches to their articles. In addition, we have tax hikes and countries around the world are looking at how to tax large tech companies more
14 th April 2000: Stock selling into tax date after record year (Nasdaq declines 9%, ending the week 25% down)	X Many states in the US have moved the Tax Date to June, but this is something to watch out for given the retail investment activities in 2020
June 2000: Internet companies began rethinking their advertising spending. Superbowl in January 2001 only had 3 dot.com firms advertising	X None of that happening now. The only major rethinking is happening in the energy sector
9 th November 2000: Pets.com (backed by Amazon) went bankrupt after 75% decline in stock price	X No large bankruptcy other than related to accounting scandals

Source: Mixture of news articles (CNN, San Francisco Chronicle, Barron's, Bloomberg, MSNBC – all from Wikipedia)

2. 1921 forgotten depression

Covid 19 has had many looking for answers in the past. The “Spanish Flu” from 1918-1920 has quickly become the posterchild of comparative historic periods. And indeed, there are many similarities between the current period and the 1918-1920s. What many businesses are quick to point out are the roaring 20s when stock markets hit new highs and consumer spending reached highest on record back then. However, there was also a depression that often got forgotten to mention: The 1921 forgotten depression.

Similar to the comparison between the Dotcom crash and now, I will list below a comparison between the 1921 forgotten depression and the current environment.

<u>1918-1920 Pandemic</u>	<u>Current environment</u>
In the run up to the pandemic (1914-18) business was booming, the democrats founded the Federal Reserve Central Bank, the wealth gap between rich and poor hit historic highs, income taxes for more than \$1mio were introduced at 68% and real wages declined amid high inflation. The government nationalized railways and protected labour unions	X ✓ Prior Covid 19 business was booming as well and the wealth gap between rich and poor widened. However, taxes were rather lowered and inflation rates were not extraordinary high. While the Federal Reserve is still there, the Modern monetary theory of fiscal + monetary stimulus is new
The Spanish flu began in March 1918 and had around 4 global waves, 1 st in March 1918, 2 nd in late 1918, 3 rd at beginning of 1919 to mid-1919 and the 4 th in spring 1920	✓ The Covid 19 pandemic had a very similar timeline thus far: 1 st wave in March 2020, 2 nd in autumn 2020, 3 rd in late 2020, beginning 2021
In 1919 at some point every 4 th British worker was on strike. There was general discontent, as prices rose faster than wages	✓ In the UK there have been multiple strikes on a weekly basis, from teachers to bus drivers, to train drivers, airport staff, Centrica’s engineers and many more – even NHS staff considered strikes at the height of the pandemic
In November 1919 the Federal Reserve chairman tried to deter speculators by raising interest rates 50bps. The Federal Reserve felt the market has gone way ahead of fundamentals	X While market valuations in certain regions such as the US seem elevated, the Federal Reserve has so far kept interest rates low and projects to keep them low for the next few years
Back in 1919, the stock market reached its high on 3 rd November 1919 and started declining first slowly the quickly in the spring of 1920. In April/May 1920 cotton prices began declining quickly	X This has clearly not happened yet. But since the waves have been so similar, one should watch out for a market correct in winter 2021 and beginning of 2022, especially if interest rates change/clamp down on speculators
Between 1920-21 the US GDP declined by 23.9%, commodities sold off sharply and rapid deflation set in. Producer prices fell by 40.8%, industrial production by 31.6%, stock prices by 46.6% and corporate profits by 92%. After the sell-off new taxes were introduced, among others a capital gain tax of 12.5%	X ✓ Some sort of adjustment might come, but before that the supercycle needs to advance first. We did see major GDP declines, but currently GDP is rising. Commodity prices climbed very fast, but haven’t declined yet. We are going to have a rise in corporate taxes though and possibly more to come there

Source: The Forgotten Depression by James Grant

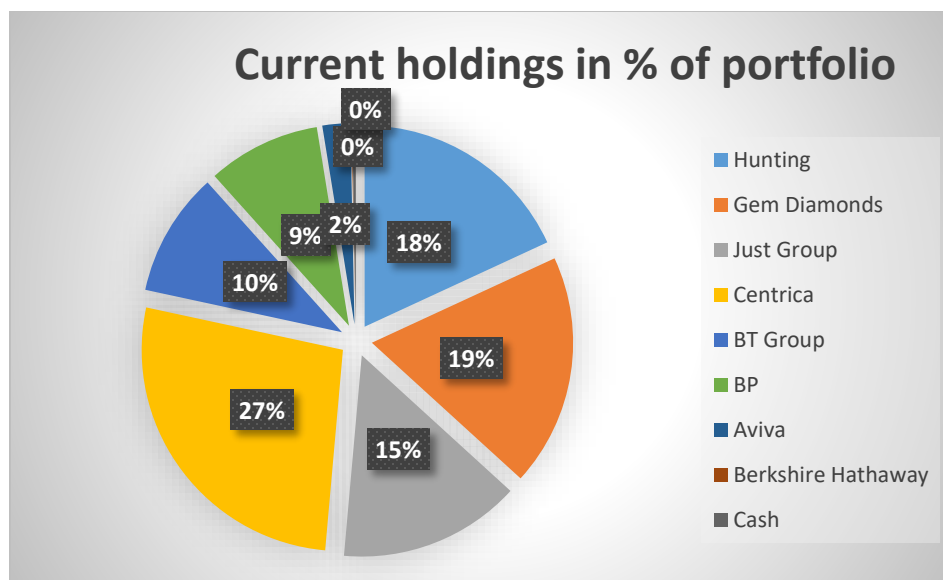
3. Archegos Capital Management blowup

Both the Dot-com crash and the 1921 forgotten depression were mostly driven by central banks increasing interest rates to reduce speculators from driving up prices far from fundamentals. Could Archegos Capital Management blowup potentially be the start of this cycle's drain of speculators? While the Federal Reserve and other developed nation's central banks kept promising low interest rates for the foreseeable future, banks might change their risk taking towards family offices like Archegos. The unwinding of positions has led to a major decline in those single stocks, e.g. Viacom declined by over 50%, however, importantly the market overall did not sell off. The Financial Times reports that \$16 trillion are currently managed by family offices. These family offices lack financial oversight and often manage large amount of leverage at multiples of their AUM. If we have another case like Archegos, the next time it could potentially have wider implications on markets. Although I think it is too early to speculate on any market implications from this single case, one might look at the Archegos blowup and compare it to the Bear Stearns of leveraged family offices. What follows next we all know too well...

Performance

After a 75% return in the 4th quarter, we could reap in another 32% in Q1 21 mostly amid the energy related rally. Into the commodity rally I sold Enquest (64% return) and Ferrexpo (60% return + dividends) as they reached my fair valuations. I have then bought diamond producer Gem Diamonds, added more to our Centrica position and bought the pension & lifetime insurer Just Group. With additional capital that arrived in Q1 I have created new positions in telecommunications group BT, oil major BP and a small position in insurer Aviva.

Company	Average Purchase Price	Current Market Price	Currency	% change
Hunting	1.88	2.56	GBP	36%
Gem Diamonds	0.49	0.67	GBP	37%
Just Group	0.84	1.01	GBP	20%
Centrica	0.46	0.54	GBP	19%
BT Group	1.37	1.55	GBP	13%
BP	3.18	2.95	GBP	-7%
Aviva	3.95	4.08	GBP	3%
Berkshire Hathaway	224.70	255.47	USD	14%
Cash	-	-	GBP	



Performance explanation

As you can see, this is the first time that we are invested in more than 5 companies at the same time. We are also the most diversified ever, by holding a variety of industries such as Energy, insurance, telecommunications and mining while in the last quarter we were mainly focused on energy. Part of this reason is that at the moment I had extra cash to invest, I found those new additions (BT, BP and Aviva) slightly more attractive than our existing holdings. Nonetheless, I want to stick to the rule of owning no more than 5 companies at a time at this stage and will likely consolidate our holdings over the coming weeks.

1. Energy

Hunting

Hunting has been one of our holdings for over three quarters now. The oil drilling equipment company has nearly reached my fair valuation when it reported earnings this quarter, but then gave up most of its gains. While Hunting pays a modest dividend, the firm still has close to \$290mio in inventories and \$100mio in cash, but has a market cap of only \$590mio. At the same time operating cash flow was above \$50mio in 2020, which means given \$10mio lease liabilities and \$10mio of equipment investments, in any scenario, this company provides +\$30mio in cash under worst conditions. As oil prices have recovered to pre-pandemic levels, capital expenditures of the oil majors and shale drillers remain often lower by around 1/3 compared to pre-pandemic times in order to return cash to shareholders. The shale space has also focused on better wells with lower decline rates and many producers only plan to ramp up expenditures in 2022. Given the strong balance sheet, I have so far held off taking profits on our investment in Hunting. With the new Covid wave hitting European travel demand, it seems hard to argue for oil prices to climb much over the summer, despite OPEC being very supportive. Biden's crackdown on shale oil is also a key risk. One thing of note though, the US is nearly fully vaccinated and national travel demand is already very strong. In

addition, in January 2021, according to the FT methane emissions from shale activity rose to a level that is close to pre-pandemic times. Hunting still seems like a good investment to keep, as the wells will start to run dry and producers will be looking to start drilling again, potentially all at the same time.

BP

I have started a new position in oil producer BP. For similar reasons as given above for Hunting, BP slashed expenditures and is paying a 5% dividend quarterly. To benefit from a high oil price vs. low expenditures and at the same time to be long invested in an oil major that is shifting spending dramatically into wind offshore farms and EV charging partnerships, BP seems to be ideal. In addition, valuations are more attractive than Shell, Chevron or Exxon Mobil. Margins on oil and refinery activities have hit a 1 year high (back to pre-pandemic levels) and BP should have benefitted from the Texas freeze, as their refineries are outside of Texas (many oil refineries in Texas are still shut, at a time when air travel is bouncing back). This should move earnings back to \$10 cents per share per quarter and leave BP attractively priced at below 10 price/earnings.

Centrica

Similar to Hunting, we have held Centrica shares already for the 3rd quarter. Different to Hunting, I have added to our position this quarter again and might look to increase it further. The firm struggles with its working union accepting new contracts and management has been a little slow to act. However, the turnaround story is taking shape, Centrica benefitted from taking over customers of defaulting energy providers, started buying up struggling providers this quarter and the proceeds of the sale of North America business cover all their outstanding debt (although some of this cash will be used to reduce their pension liabilities). Furthermore, the regulator moved the price cap of variable contracts higher, giving Centrica a better profit margin. The company has free cash flow of <1/5th their market capitalization and benefits from an unusually cold winter. Natural gas prices have recovered to higher levels than pre-pandemic this quarter with storage facilities 60% below last year's range. There might also be a wild card come into play: Ukraine-Russia conflict. If the conflict between Ukraine and Russia flares up (troops build up at Russia & Belarus border), this could spike natural gas prices, as most of European gas is coming through Ukraine.

2. Insurance

Just Group

I have long shied away from insurance, as low interest rates and increasing regulation harmed the industry enormously over the last few years. Just Group made me change my mind. With a price/earnings of less than 5, I began looking into the company and found out three key reasons to invest:

1. Regulation (Solvency II) has reached its limits and Brexit provides a platform to reduce harmful regulation. While Just Group is behind other insurers on meeting its requirements (156% solvency II vs. others at 200%), it is on track to get to 160-180% Solvency II (target of most insurers) by 2022
2. Just Group is a major player in the Life Time Mortgage (LTM) market and while they reduced new business, their market value hinges on UK property prices – which increased throughout the pandemic due to higher demand amid household savings and tax incentives by the government

3. Many UK companies have large pension deficits and look to reduce their defined benefit liabilities. This market is highly attractive and Just Group is set to grow this part of the business

Aviva

Despite being a small investment, I expect Aviva to return around 20% in just a couple of months. The company has sold their Asian and European businesses to focus on UK, Ireland and Canada (65% of their earnings). The proceeds of the sales (£7.7bn) will partly be used to reduce debt and partly to return cash to shareholders. As most insurers, Aviva targets to return anything above 180% of solvency II cover ratio to shareholders (currently 202%), which provides a 20% return at stable market valuations in itself (although the returns are likely happening by end of year/2022 with the incoming proceeds of the sold business units in Europe).

Generally speaking, insurance was a sector that mostly benefitted from the pandemic, as lockdowns reduced the number of claims.

3. Telecommunications

BT

BT is UK's largest telecommunications provider with leading positions in fibre broadband and mobile network. The company struggled due to their large pension deficit and higher capital expenditures amid the 5G rollout. This has led the market value to erode over the last 5 years by over 60%. While the tri-annual pension re-evaluation will be a risk, there have been a few positive elements over the last few weeks, namely that Ofcom (the UK regulator) removed price caps to give telecommunication companies more incentives to expand their full-fibre broadband rollout across the country and to more rural areas. If pension fund deficit payments of over £900mio annually will be removed and the pension deficit goes to zero, the market valuation should double of what it currently is.

4. Mining

Gem Diamonds

I have long been a fan of diamonds myself, but it has never been an attractive investment... until now. The pandemic and lockdowns have left consumers with little options to employ their savings and more have flocked to luxury goods such as diamonds. Gem Diamonds owns the world's largest diamond producing mine of the world in Lesotho and together with the closure of Australia's Argyle mine (which produced 90% of the world's pink diamond supply) and emergence of synthetic diamonds, which can only be produced in small size and often bad quality, the large diamonds Gem Diamonds is famous for, could finally be a good investment. Despite having had to shut down the mine for a full month in 2020, Gem Diamonds slashed costs/waste stripping and ended 2020 with a net cash position of \$35mio (market cap \$130mio). For the first time in 5 years the company will pay a dividend and adjusts its dividend policy to pay additional dividends when large diamonds are sold. On top of that, the firm invests in technology to reduce waste stripping further and find large stones more easily.

Learning points

As mentioned in the beginning, I ended up diversifying the portfolio quite a bit and increasing the number of investments above my comfortable level of 5. I strongly believe that diversification is the wrong path to market outperformance, as I will naturally know the details of 7 companies less than of 5. I have also began investing more in larger companies such as BP, Aviva and BT (all FTSE 100), which are subject to stamp duty. Both points I prefer to at least partially improve over this coming quarter by reducing the number of firms and consolidating into those companies that are further away from my fair valuation. Selling Enquest and Ferrexpo was correct, but I could have waited slightly longer. The reason I sold Enquest was mostly due to its volatility and reaching my fair value. However, when I sold (before end of February Opec meeting), there was strong momentum in oil/energy shares; hence I could have sold a little later and gained another 50%. Similarly for Ferrexpo, as I sold due to concerns of supply ramp up of Brazilian producer Vale, there were also good reasons to hold on to Ferrexpo and wait for their annual results, as they ended up paying a massive dividend of nearly 10%. At the same time, I used the proceeds to buy Gem Diamonds, which already yielded a 37% return so far. My weakness of selling a little too early still needs improvement.

Outlook

In terms of market outlook, I discussed most of it in the introduction. The pent-up demand caused due to the lockdowns should lead to a consumer boom once this recent Covid 19 wave has subsided. But beware of central banks trying to slow down speculation, which is high, especially among retail investors (Reddit crowd). Over the next few months, I will continuously recap the 1921 forgotten depression and other market downturns such as the dotcom crash or even the Lehman shock. I have been looking at some consumer related companies, but most of their valuations were unattractive. Mulberry was the only one that looked a bit interesting and it is something I will closely follow in the coming quarter.

By spending my full time on AozoraStep, returns should in theory also improve. Changes, however, can have negatives as well, and living without salary could be a drag mentally when the market moves lower. I have set aside some money to cover fixed costs over the first year in order to reduce this risk.

Sincerely,

David Herrmann