AozoraStep

Q1 2025: Promises made, promises kept

Quarterly Performance	Turnaround Portfolio	FTSE All Share TR
Q1 17	0%	0%
Q2 17	-8%	1%
Q3 17	-5%	2%
Q4 17	-1%	5%
Q1 18	9%	-7%
Q2 18	19%	9%
Q3 18	-16%	-1%
Q4 18	-30%	-10%
Q1 19	45%	9%
Q2 19	39%	3%
Q3 19	0%	1%
Q4 19	8%	4%
Q1 20	-43%	-25%
Q2 20	42%	10%
Q3 20	-3%	-3%
Q4 20	76%	13%
Q1 21	32%	5%
Q2 21	-3%	6%
Q3 21	5%	2%
Q4 21	1%	4%
Q1 22	37%	1%
Q2 22	-3%	-6%
Q3 22	17%	-3%
Q4 22	20%	9%
Q1 23	0%	3%
Q2 23	-13%	0%
Q3 23	40%	2%
Q4 23	3%	3%
Q1 24	1%	4%
Q2 24	5%	4%
Q3 24	6%	2%
Q4 24	-14%	0%
Q1 25	-7%	5%

Annual Performance	Turnaround Portfolio	FTSE All Share TR
2017	-9%	9%
2018	-31%	-9%
2019	113%	19%
2020	52%	-10%
2021	37%	18%
2022	99%	0%
2023	26%	8%
2024	-1%	10%
Q1 2025	-7%	5%

Overall Performance	Turnaround Portfolio	FTSE All Share TR
CAGR	**23.6%**	**5.5%**
2017-Q1 25 Return	**474%**	**55%**

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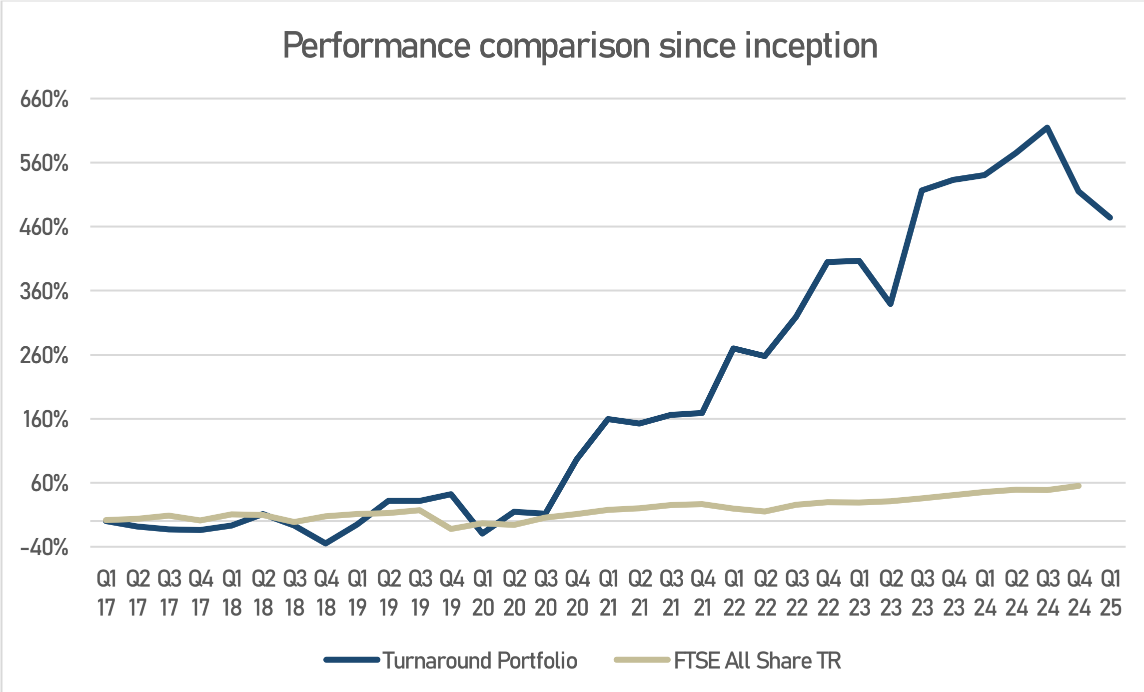

15th April 2025

Dear Reader,

This was a very tough quarter for me (-6.66%, I hope that's not a bad omen!). Nearly everything I looked at and took a position in, quickly had a surprise event attached to it that led me to exit the position, at times only a day after I entered. It was also a difficult quarter, because I spent a lot of time on business development and fund raising, including all the meetings and follow ups with allocators from iConnections at Miami Global Alts. At the same time, I've also finalized the onboarding with Vittoria & Partners, which means once I have a firm allocation, I can get the FCA badge with them within 48 hours or at max in a couple days' time. Next to iConnections, I have recently joined Coherra, a platform that connects family offices to managers, and had my first interview last Friday (here or here). The interview was not the easiest, as I was sick all week and still had a temperature. I'm not sure what flu strain is going around, but this has hit me much harder than any other flu strain in the past and I'm on antibiotics now! Finally, I'm working with two, three very experienced people to join AozoraStep as advisors and potentially board members

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or equity holders. Each of them has valuable experience and could really make a difference in the trajectory of the business. A few more things are in the pipeline, but perhaps too early to mention here. This quarterly note will, as usual, first focus on some macro themes before zooming in on the performance and the portfolio.

The Trump tariffs

As this is a very fluid situation, I won't go too much into the details here. Below is a table of some of the tariffs announced or in place with pharmaceutical and chips tariffs still to come. I would expect the chips and pharmaceutical tariffs to be quite high, as both sectors are much more about national security than simply a trade deficit. Therefore, Trump needs to come up with a rate or a deal that make companies shift their production back to the U.S. as soon as possible. Whilst China and India make up nearly 60% of pharmaceutical imports by volumes, they make up just around 9% in terms of value. These pharmaceuticals are generally those where patents are expired and it boils down to the cheapest source of production. Hence, the tariffs on the Chinese and Indian pharmaceuticals will likely be higher than those from other countries where patents are not expired yet, and prices are a lot higher. My opinion on tariffs remains that tariffs are deflationary, as the chart from Ray Dalio and the Smoot-Hawley Act demonstrates due to a collapse in trade and the resulting increase in unemployment and economic downturn far exceeding any inflationary pressure (oil and natural gas are already down by 10-20%). Back in 1929-31, the Fed also did not have unemployment as a mandate and was not allowed to engage in QE until 1932. Therefore, I entered the TG73 (UKTi 2073 linker) again to benefit from such a scenario, especially as the UK is unlikely to retaliate and might even open up for more imports from China to reduce inflation further.

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Tariffs on Top 25 Trading Nations of U.S. (10% for 90 days except for China)

Country	Trade balance in $m	Tariffs charged to U.S.	Reciprocal tariff	Fentanyl tariff	Steel/Aluminum, autos/auto parts tariff	Pharmaceutical, Chips tariffs
China	-278,716	67% (125%)	125%	20%	25%	?
Mexico	-161,382	-	-	25%	25%	?
Canada	-72,329	-	-	25%	25%	?
EU	-201,645	39%	20%		25%	?
Vietnam	-104,598	90%	46%		25%	?
Taiwan	-47,328	64%	32%		25%	?
Japan	-71,878	46%	24%		25%	?
India	-43,233	52%	26%		25%	?
South Korea	-50,996	50%	25%		25%	?
Thailand	-45,600	72%	36%		25%	?
Switzerland	-24,241	61%	31%		25%	?
Indonesia	-17,900	64%	32%		25%	?
Malaysia	-26,920	47%	24%		25%	?
Cambodia	-12,300	97%	49%		25%	?
UK	11,800	10%	10%		25%	?
South Africa	-8,800	60%	30%		25%	?
Brazil	5,284	10%	10%		25%	?
Bangladesh	-6,200	74%	37%		25%	?
Singapore	1,576	10%	10%		25%	?
Israel	-6,200	33%	17%		25%	?
Philippines	-4,900	34%	17%		25%	?
Chile	1,700	10%	10%		25%	?
Australia	17,569	10%	10%		25%	?
Pakistan	-3,000	58%	29%		25%	?

Source: Truth Social, White House

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Top Ten U.S. Sources for Pharmaceutical Imports by Weight 2023			
#	Source	Imports 2023 (kg)	Share of Total Imports (%)
1	China	217,224,446	31.50%
2	India	179,910,580	26.10%
3	Germany	38,899,115	5.60%
4	Italy	26,304,262	3.80%
5	Spain	24,169,277	3.50%
6	Switzerland	24,062,952	3.50%
7	France	19,853,500	2.90%
8	Ireland	19,780,522	2.90%
9	United Kingdom	13,690,196	2.00%
10	Israel	12,455,212	1.80%
	World Total	690,456,126	100.00%

Source: https://prosperousamerica.org/surge-in-pharmaceutical-imports-threatens-u-s-national-security-as-india-china-dominance-grows/

Top Ten U.S. Sources for Pharmaceutical Imports by Value 2023			
#	Source	Import Value in $m 2023	Share of Total Imports (%)
1	Ireland	51,503	24.70%
2	Germany	20,059	9.60%
3	Switzerland	15,786	7.60%
4	India	11,265	5.40%
5	Netherlands	10,799	5.20%
6	Italy	8,794	4.20%
7	China	7,796	3.70%
8	United Kingdom	7,709	3.70%
9	Canada	6,251	3.00%
10	Denmark	5,833	2.80%
	World Total	208,547	100.00%

Source: https://prosperousamerica.org/surge-in-pharmaceutical-imports-threatens-u-s-national-security-as-india-china-dominance-grows/

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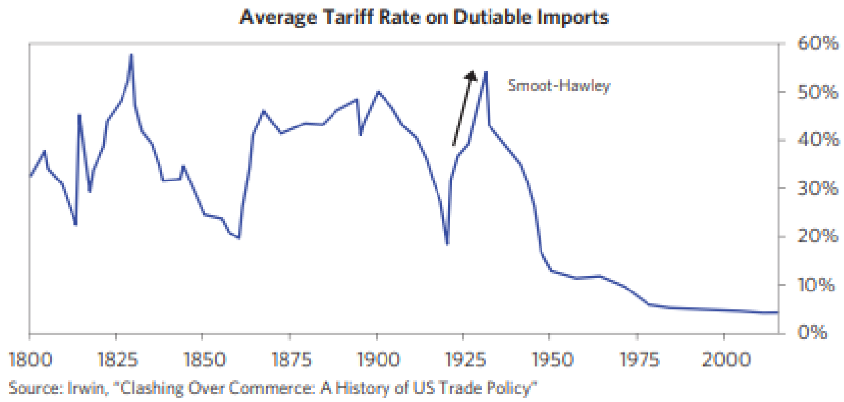
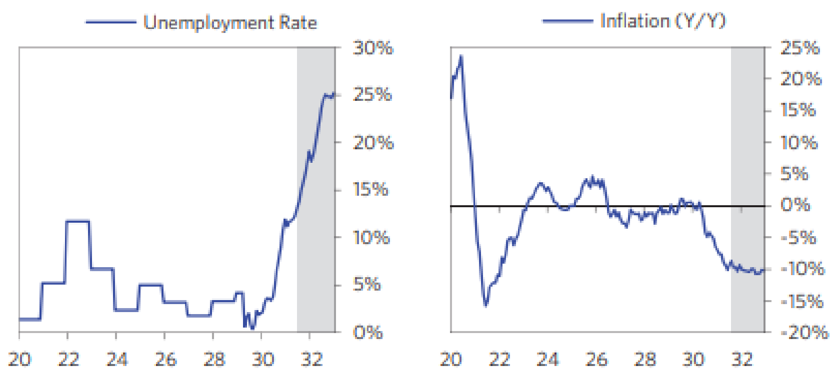
The 1929-33 analogy





Source: https://www.bridgewater.com/big-debt-crises/principles-for-navigating-big-debt-crises-by-ray-dalio.pdf

Could inflation expectations become unanchored?

After having spent so much time on tariffs and historic analogies (here and here), it was a little frustrating that my conclusion of lower yields in the UK did not come to fruition for the long end. Sometimes economic history can be a very accurate guide, other times it can be less accurate. In this case, we did see higher 10yr UST yields in 1931, but this was only after the UK abandoned the Gold Standard and devalued the Sterling by over 25%. This in turn led to turmoil in currency and bond markets in 1931, as investors were unsure whether other countries might follow the UK and devalue their currencies. Today, there is fear whether tariffs will raise inflation again and might lead to central banks stepping in again. The University of Michigan 1yr and 5yr inflation expectations saw their largest increases since multiple decades to 6.7% and 4.4% respectively[1]. However, the inflation expectations from surveys are not

[1] https://data.sca.isr.umich.edu/fetchdoc.php?docid=78393

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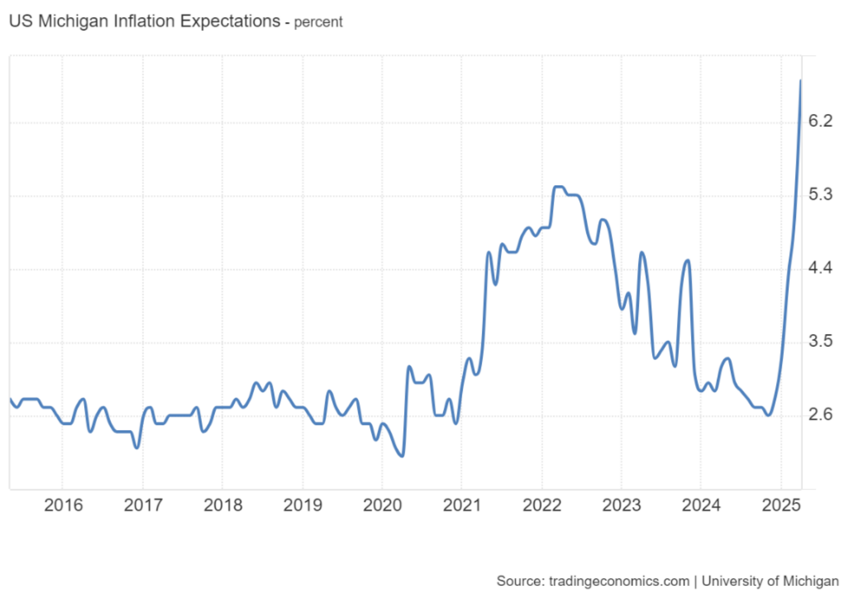
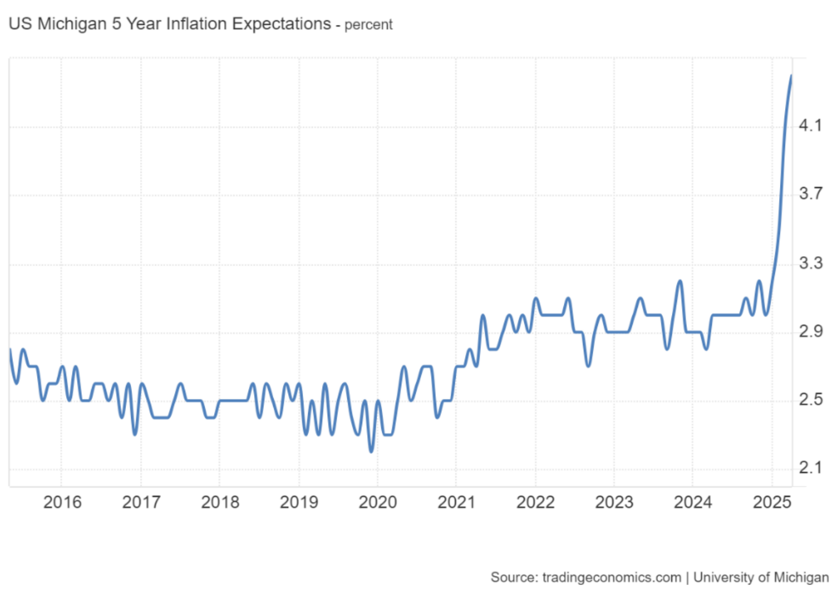
reflected in inflation expectations set by financial markets to the same degree, with U.S. 5yr-5yr inflation expectations falling to their lowest level since before the Ukraine invasion[2]. Therefore, I expect the University of Michigan inflation expectations to turn out to be wrong.

University of Michigan 1yr and 5yr inflation expectations see large jumps





[2] https://fred.stlouisfed.org/series/T5YIFR

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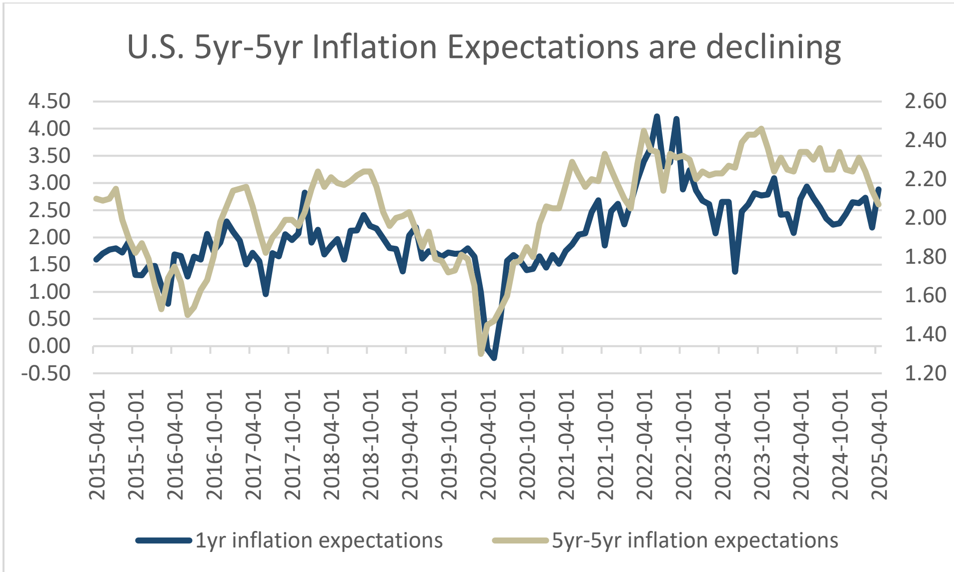
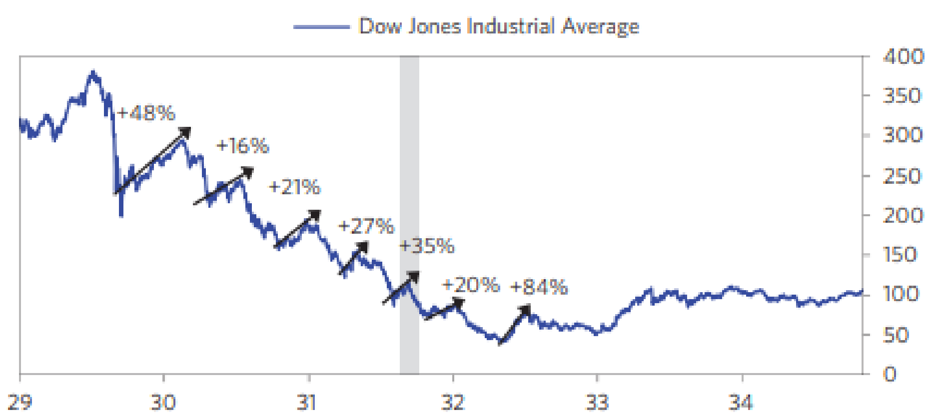


Source: FRED St. Louis

The 1929-33 analogy



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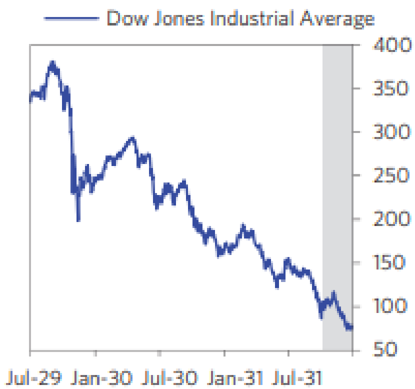

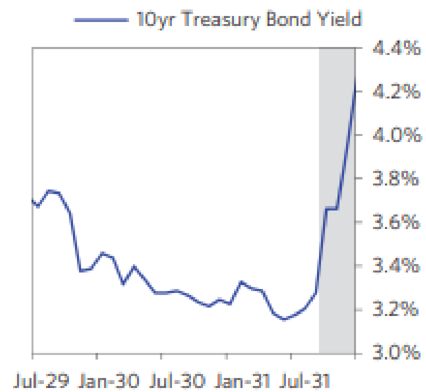

Source: https://www.bridgewater.com/big-debt-crises/principles-for-navigating-big-debt-crises-by-ray-dalio.pdf

Trump, the "Messiah" & political instability that will eventually come to haunt us

In 2011, Charlie Munger mentioned two words regarding why he wouldn't want Donald Trump as a President: Vainglory & puffery. I think Charlie hit the nail on the coffin with these two words and that's likely the reason why Trump is so unpopular, especially in Europe. However, I think it also wouldn't be crazy if a religious person views Trump as a sort of "Jesus" or "Messiah": The way he survived the assassination attempt in Butler, how he won or survived the endless lawfare that has put so many other leaders worldwide out of the race over the last 12 months, and how at age 78 Trump has eliminated illegal immigration, worked on a peace deal in Ukraine, in Israel, put on tariffs across all nations, working on deals to bring the Panama Canal back into U.S.'s hands, ensuring nuclear security is guaranteed over Greenland, eliminated the "woke virus", raised issues in South Africa, and is holding daily news conferences. This man has achieved more in 100 days than other Presidents in two entire terms, whether you like him or not, this is an unbelievable success story. And while China, Russia, North Korea and Iran (Supreme Leader) basically have a single leader for life, it is worrying that Western democracies are taking out the leading opposition party leaders mostly via lawfare, one after the other (table below). The idea of democracy is under attack and a lot of people seem to be completely fine with it, because the person who is taken out is against their political ideas. In the end, this is all about migration and the data behind illegal and excessive one-way migration is not positive (page 17/18 here), which makes an eventual outright majority shift towards the political right inevitable, in my opinion.

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Democratic leaders being taken out mostly by law over the last year (except Trump, who won)

Political leader	Country	% of votes/ polls	Reason for barring	Additional info
Jair Bolsonaro	Brazil	48%	Attempt to stage a coup	Some polls put him first in 2024 pre-campaign polling for 2026 election
Marine Le Pen	France	36%	EU fund embezzlement	Leading candidate in the 2027 Presidential polls
Calin Georgescu	Romania	23%	Alleged Russian interference	Won first round of voting in 2024
Yoon Suk Yeol	South Korea	36%	Attempt to implement martial law	Became more popular during the court proceedings
Ekrem Imamoglu	Turkey	48%	Alleged corruption for obtaining Istanbul University degree	He is the frontrunner of the opposition party for the 2028 Presidential elections
Donald Trump	USA	50%	Multiple, mainly 6th January 14th Amendment	Won the election

Source: Multiple news sources and polls

How illegal and excessive legal migration is the single largest threat

The cost of an illegal migrant in the UK is massively underestimated, but can be summarized as follows:

- >£50k per migrant per year for hotel stays (currently £3bn a year[3])
- Next, they will require social/affordable homes (£11.4bn a year[4], a £1.5bn jump yoy)
- They will receive universal credit (£51.2bn a year[5], a £10bn jump yoy and forecasted to climb by £7.38bn per year for 5 years to £88.1bn a year in 2028/29)
- Free childcare (£85% of childcare cost, or £1,031.88 per month for one child, £1,768.94 per month for 2 or more children)[6]
- Free education (£8,210 per pupil per year[7])
- Free health care (£2,700 per person per year[8])

This is better than winning the lottery when you come from one of the least developed countries. And the moment you raise your concerns about these numbers, you will be branded a far-right Nazi. I'm a German migrant, have lived and worked on 5 continents in multiple countries, have a wife from Japan and we gave

[3] https://www.gov.uk/government/news/100th-asylum-hotel-set-to-close-next-week
[4] https://www.axxco.co.uk/post/how-much-does-the-uk-government-spend-on-social-housing
[5] https://obr.uk/forecasts-in-depth/tax-by-tax-spend-by-spend/welfare-spending-universal-credit/
[6] https://www.gov.uk/help-with-childcare-costs/universal-credit
[7] https://explore-education-statistics.service.gov.uk/find-statistics/school-funding-statistics/2024-25
[8] https://www.myhsn.co.uk/top-tip/how-much-does-the-nhs-cost-per-person-in-the-uk/

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our daughter a Muslim name. I'm very far away from being far-right, but excessive legal and illegal migration will eventually bankrupt the UK due to adverse selection, because the combination of high taxes on high earners & asset owners and excessively high social benefits on low/no earners & debtors will make rich people disappear (11,300 millionaires have left London in the last 12 months[9]) and low-skilled, poor people from the least developed nations flood the country (~1% population growth per annum from migration in 2023). It's a disaster in the making and the longer it takes to cut down on this problem, (which would mean to shut the borders or cut benefits) the worse the outcome could be (the danger is that the UK could turn into Israel/Palestine or South Africa). The rise in income thresholds for legal migration is a step in the right direction[10], but illegal migration still requires serious adjustment. Charts and figures can be found here on page 17/18.

Performance

As indicated, the performance this quarter was very disappointing, as I was unable to make a solid investment case for 3-6 months. Instead of going into each individual investment, I have created a table below, which summarizes the position changes. I'm embarrassed about it and can only point out that I should have sat in cash for a while when the opportunity set was unfavourable and the rapid changes from the Trump Presidency meant more caution was needed. Because I exited the position quite rapidly, the positions were oftentimes still small, hence the impact was less negative as it appears. I also entered a position in Serica Energy on 1st April, but quickly exited the position roughly flat after the Trump tariff announcement.

[9] https://www.standard.co.uk/news/london/london-millionaire-exodus-moscow-b1221474.html
[10] https://www.nhsemployers.org/articles/impacts-changes-uk-immigration-policy .

Position changes Q1 2025

Date	Buy/ Sell	Company	Profit/ Loss	Comment
06 January 2025	Buy	Vistry	-	Increased existing position at a lower price
06 January 2025	Buy	JD Sports Fashion	-	
14 January 2025	Sell	JD Sports Fashion	-12%	Disappointing trading result
21 January 2025	Sell	Vistry	-6%	(up double digits on the quarter, as original position was entered Q4)
05 February 2025	Buy	IG Design Group	-	
07 February 2025	Buy	Sabre Insurance Plc	-	Added more to this position over multiple days when the share price was under pressure
11 February 2025	Sell	IG Design Group	-6%	Follow up call with management confirmed the danger of tariffs and how bankrupt Joann was a strong profit center for them
13 February 2025	Buy	Synthomer plc	-	
17 February 2025	Sell	Synthomer plc	-2%	Made a mistake on their guided numbers
19 February 2025	Buy	TT Electronics	-	
04 March 2025	Sell	TT Electronics	-9%	Trade war and delayed results made this position riskier
12 March 2025	Buy	Diversified Energy	-	
26 March 2025	Sell	Diversified Energy	4%	Could have made a higher return, but sold the position in between due to results uncertainty. Bond issuance came as a surprise to me

Current Holdings

Company	Average Purchase Price	Current Market Price	% change
Sabre Insurance	1.3126	1.292	-1.57%
Cash			

As of 31st March 2025

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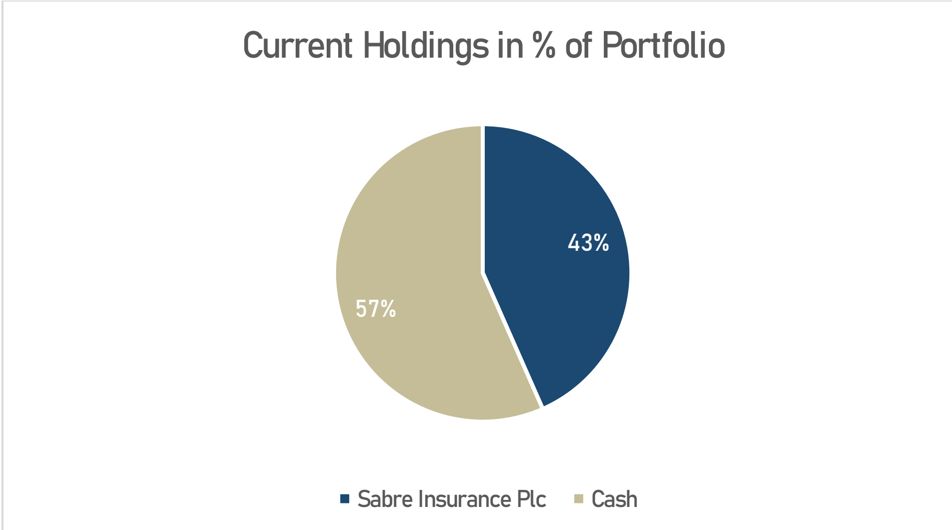

As of 31st March 2025

Entry UKTi 2073

After Trump announced the tariffs on Wednesday, I sold the entire equity portfolio on the Thursday after. Due to the settlement cycle, I could only invest in the 50yr UK inflation-linked government bond a day later, on Friday. I was extremely content heading into the weekend on Friday 4th April, having averted the market selloff and being up in Q2. What a horrific mistake this was! This position became one of the toughest positions I've held in recent history. Despite a nearly 20% drop in oil and gas prices, long-end government bonds in the US and the UK suddenly sold off by 25bps on Monday 7th April and another 25bps on Wednesday 9th April. At some point, the mark-to-market losses on Wednesday were larger than most equity mark-to-market losses at that time. While yields on the UK long-end have come down again, they remain above Friday's level. The worst of all, apart from flows through steepeners, I could not identify a reason for the selloff, as UK inflation should clearly drop as a result of the decline in commodity prices and the economic slowdown from tariffs on US imports. If there were credit concerns, French and Italian 30yr yields should have behaved similarly to the US and UK, which didn't happen. The negative correlation between long-end yields and equity valuations is a very dangerous, unprecedented development, and the market might continue to test this lose/lose correlation until the Fed/BoE steps in. Tomorrow's UK CPI figures might move the needle in the next direction. I can't describe my frustration, after all the time I've spent analysing this exact tariff scenario. And yet, the market is telling me I'm wrong. At the same time,

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the UK equities I have on my watchlist are either doing quite well or are becoming a bit too cheap to ignore…

Outlook

U.S. merchandise imports only accounted for 4.5% of GDP in 1930. Today, this figure is 14%, hence the inflationary impact from tariffs might be higher than in the 1930s. At the same time, trade makes up 38% of China’s GDP and accounts for 27% of U.S. GDP compared to 25% globally. These figures are important, as global trade as % of GDP declined from 11% in 1929 to 5% in 1935. Today, such a decline in trade would have a much deeper impact on economic activity. Inspecs, an eyewear (mostly lenses) designer with a manufacturing hub in Vietnam, recently stated in their results that “tariffs are based on the landed value of the products, which will not materially affect the price to the end consumer and therefore is not expected to impact current consumer demand”[11]. In other words, the price of lenses or sunglasses that pass the border is significantly lower than the price of that product being retailed in shops. Although this might have a different impact on high-value goods like cars, Trump has backpaddled on most of these high-value goods (delayed some of the car tariffs and exempted Apple products from the 145% China tariff). Together with the 15-20% decline in commodity prices and the -10% deflation experienced due to the Smoot-Hawley tariffs in 1930, I cannot come to any other conclusion than a deflationary scenario and I’m baffled how central bankers come to different conclusions. Let’s be very clear: This is an economic war against China. And China cannot win this economic war due to the worst demographics of any country in the entire human history (which affects housing (1/3 of China’s GDP)) and an economic model that is entirely focused on exporting products to the US either directly or through other countries.

Sincerely,

David Herrmann

[11] https://otp.tools.investis.com/clients/uk/inspecs_group_plc/rns/regulatory-story.aspx?cid=2662&newsid=1927636

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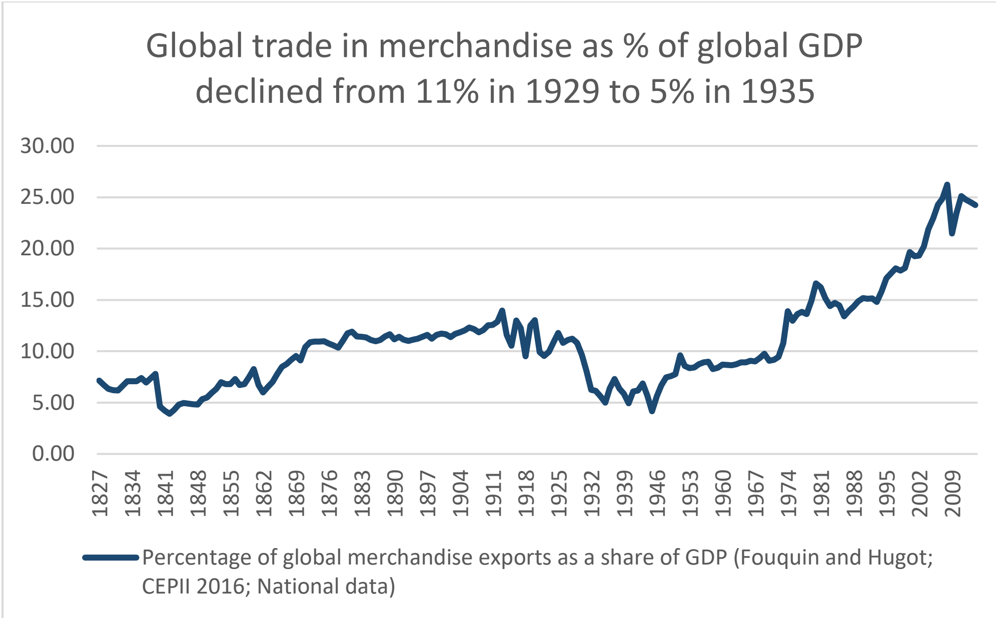
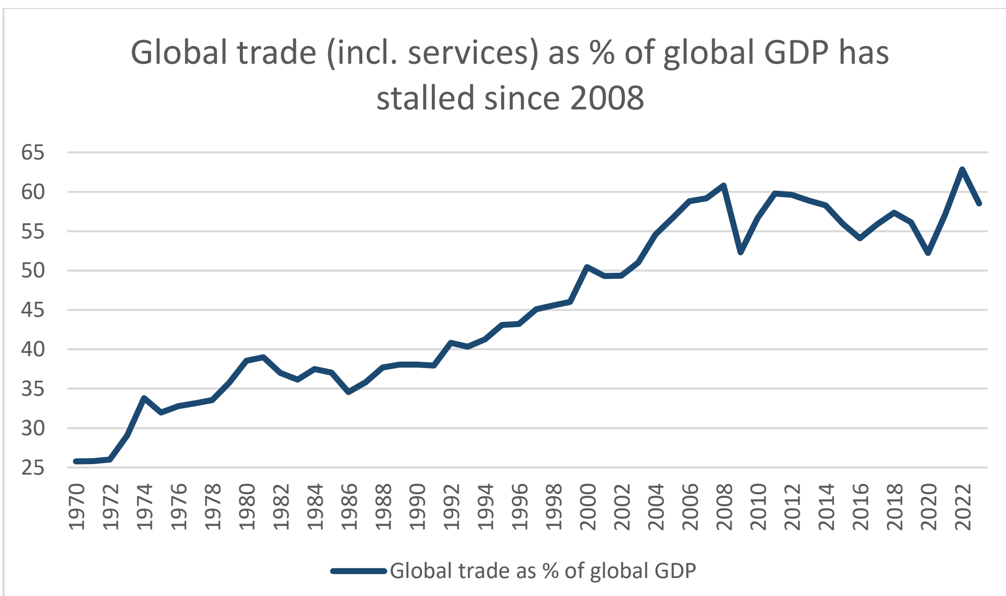


Source: OurWorldInData.org



Source: World Bank Group

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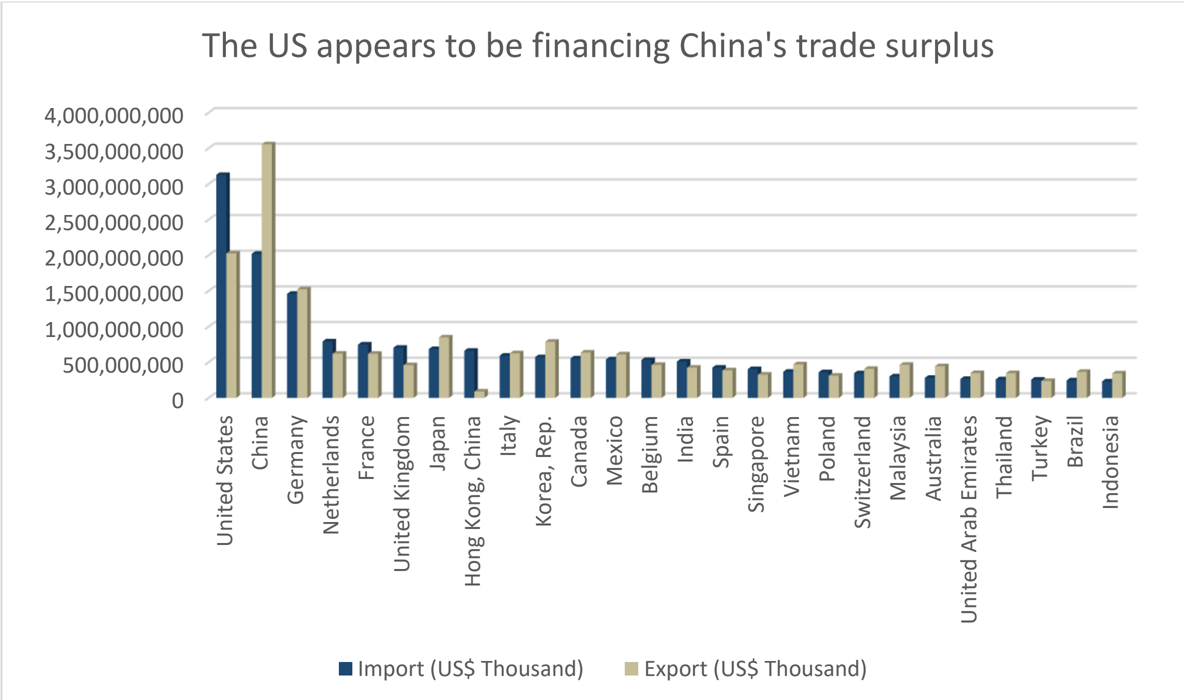

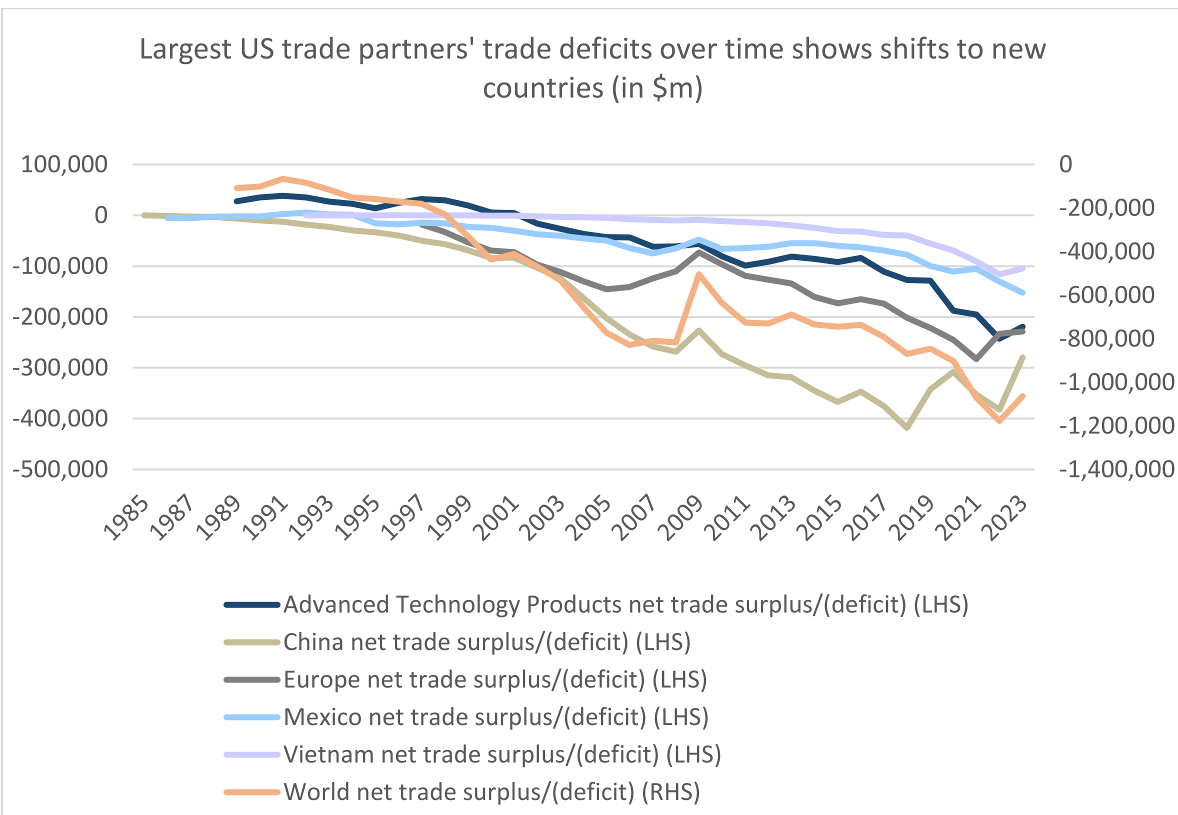

Source: World Integrated Trade Solution, US Bureau of Economic Analysis

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