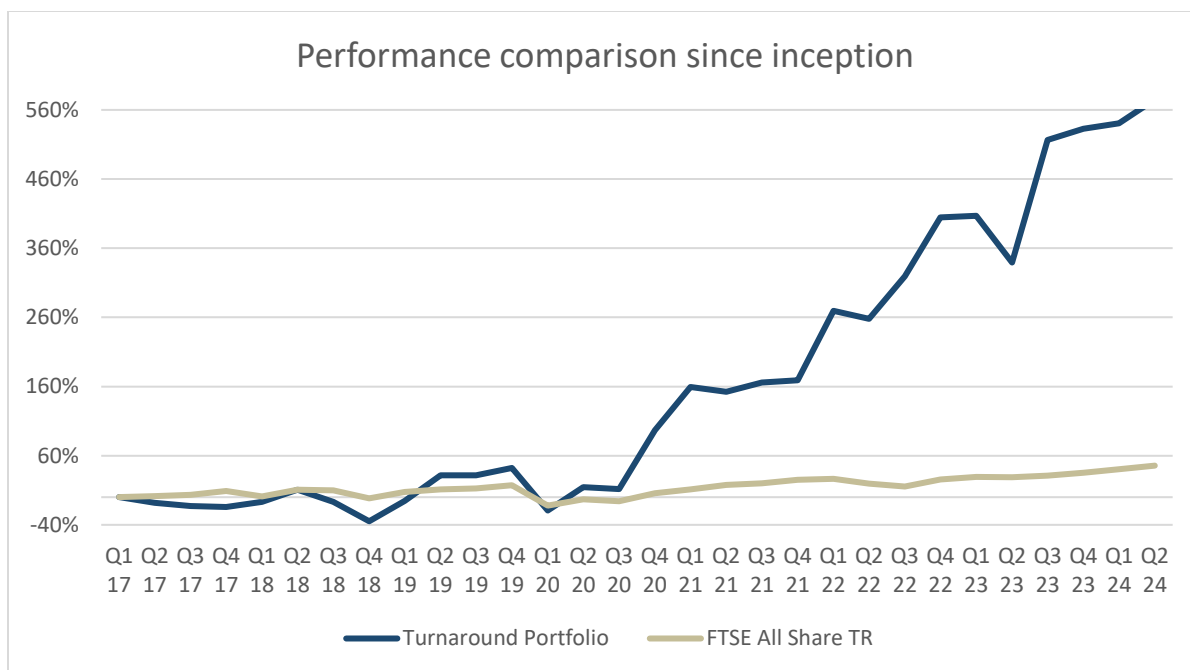


## Q2 2024: Maneuvering in a mine field

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%

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 H1	7%	8%

Overall Performance	Turnaround Portfolio	FTSE All Share TR
CAGR	29.0%	5.1%
2017-H1 24 Return	575%	46%



13<sup>th</sup> July 2024

Dear investor,

This quarter has again been a mixed bag. While achieving a 5% return, I have missed out on many big opportunities. In this rare case, I would have performed better being diversified than concentrated. Nevertheless, my SIPP (pension portfolio), which is excluded from this performance has doubled over the last year since I began managing it myself, mostly driven by positions in Nexxen, Direct Line Insurance, Synthomer and Future Plc. I'm considering including this portfolio in the performance going forward.

Over the last 4 months, I have met a total of 61 companies (partly via events organized by Cavendish, Peel Hunt and Zeus). What became clear was that many companies don't see much growth and often seek to grow via M&A. This is a typical late cycle phenomenon. Many macro factors point towards the same late cycle economy. While I don't like to sound like a doom-sayer, the mixture of global conflicts, high government debt, higher upcoming taxes, tariffs and trade wars, mass illegal migration, the energy transition, de-globalisation and political extremes, it all appears very similar to the 1920s and the run-up to the 1929 Global Depression. Studying the Smoot-Hawley Act has been very important ([here](#)), especially, the reasons of why US tariffs caused retaliation and a collapse in trade back then, but not 7 years prior after the implementation of the 1922 Fordney-McCumber Tariff, which also caused some other nations

to ramp up tariffs, but not specifically targeted the US and did not lead to a slowdown in global trade. The most convincing reason why the 1922 tariffs were more successful than the 1929 tariffs is that the global economy was doing quite well in 1922 exiting the 1920-21 depression, but not so well in 1929 after the stock market began crashing.<sup>1</sup> 1922 was an early cycle economy vs. 1929 was a late cycle economy. With Trump potentially becoming President and his goal of implementing new tariffs, it will be key to determine whether this is a “1922 tariff economy” or a “1929/30 tariff economy”. This quarterly letter will again first focus on macro matters with a focus on taxes, tariffs, the energy transition and the yield curve, before diving into the performance.

### **The coming wave of tax hikes**

The UK tax burden is currently at 35% of GDP and is expected to reach 37.7% by 2027/28, which would be the highest since the 2<sup>nd</sup> World War according to the OBR.<sup>2</sup> The main reasons for this high level are two-fold:

1. Government debt is reaching post WW II highs
2. Demographics result in an aging population

While Labour is potentially raising capital gains taxes this autumn (Rachel Reeves talked about this in 2018, although saying now she changed her mind)<sup>3</sup>, the Global Minimum Tax and expiration of the Trump income tax cuts in the US are also coming into play over this and next year. When Warren Buffett explained his reasoning for exiting some of his Apple holdings during this year’s AGM, he said, amongst other things, that potential tax changes have played a role in his decision. Apple, like many other Big Tech companies, uses subsidiaries in Ireland and Singapore to reduce their tax rate, while receiving R&D tax credits in the US. Trump’s Tax Act and Jobs Act has moved the corporate tax from a tiered 15-39% to a fixed 21% in 2018, which, different to the income tax changes that expire by the end of 2025, are permanent. Apple’s tax rate has been 13.7% in 2023<sup>4</sup> compared to 18.3% in 2018 (after the new US corporate tax) and 24.6% in 2017.<sup>5</sup> The race to the bottom in terms of taxes has meant that the OECD

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<sup>1</sup> Peddling Protectionism p.170 chapter 3 by Douglas A. Irwin

<sup>2</sup> <https://obr.uk/box/the-uks-tax-burden-in-historical-and-international-context/>

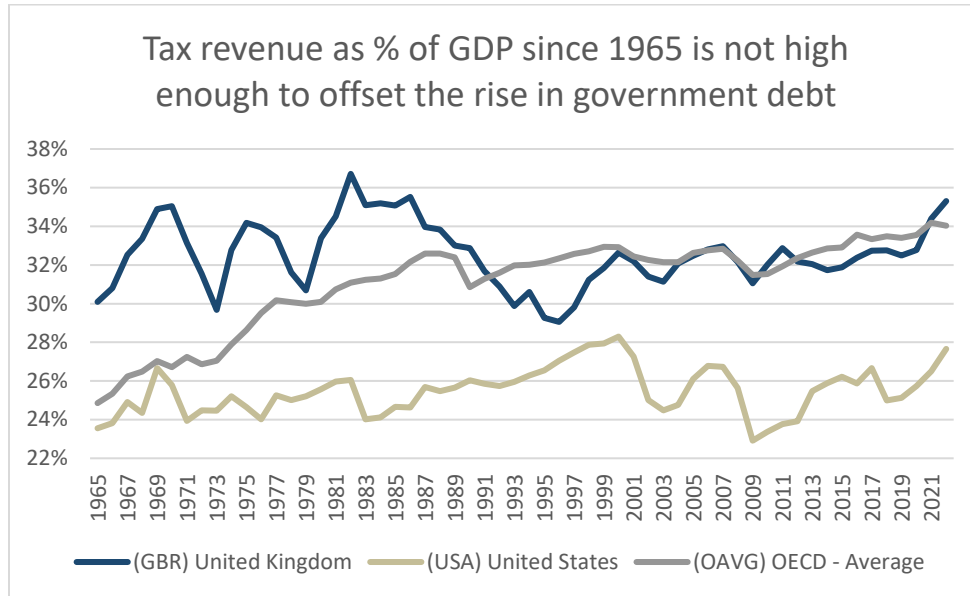
<sup>3</sup>

<https://www.aozorastep.com/The%20UK%20in%20crisis%20and%20what%20could%20be%20done%20to%20avert%20it.pdf> p. 14

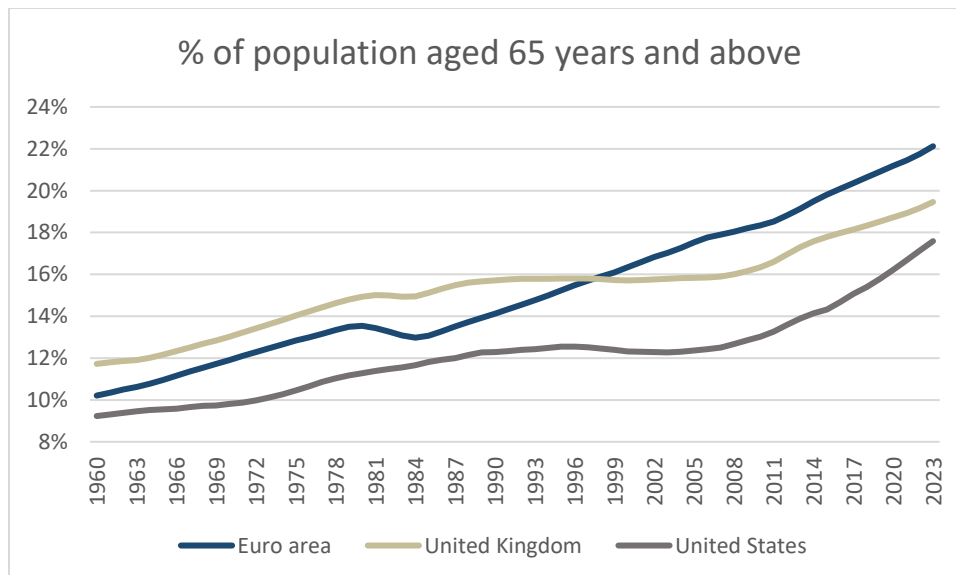
<sup>4</sup> [https://s2.q4cdn.com/470004039/files/doc\\_earnings/2023/q4/filing/\\_10-K-Q4-2023-As-Filed.pdf](https://s2.q4cdn.com/470004039/files/doc_earnings/2023/q4/filing/_10-K-Q4-2023-As-Filed.pdf)

<sup>5</sup> <https://www.sec.gov/Archives/edgar/data/320193/000032019317000070/a10-k20179302017.htm>

statutory corporate tax average was 23.37% in 2022, compared to 40.11% in 1980.<sup>6</sup> As we are beginning to de-globalise from certain countries and with the introduction of the Global Minimum Tax rate, this trend towards the bottom is now starting to reverse, and it could impact corporate earnings.

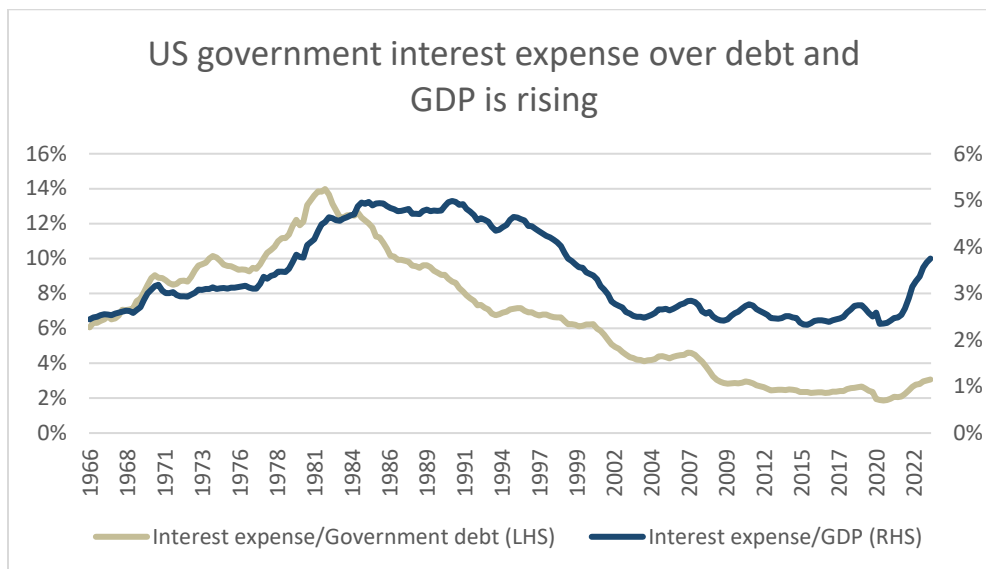


Source: OECD

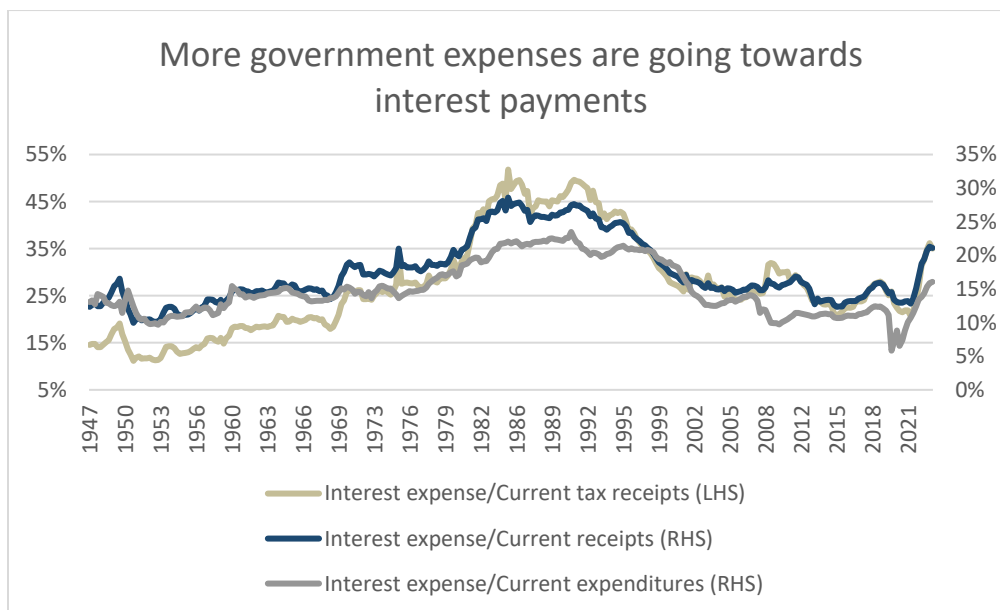


Source: World Bank

<sup>6</sup> <https://www.fdiintelligence.com/content/feature/the-15-global-corporate-minimum-tax-gamble-83232>



Source: FRED St. Louis



Source: FRED St. Louis

## The Global Minimum Tax

The Global Minimum Tax (GMT) consists of 2 pillars:

Pillar 1: Only affects companies with at least EUR 20bn revenues and 10% profit margins (impacting roughly \$200bn in annual profits) and redistributes 25% of profits to regions where they have sales/consumers.<sup>7</sup>

Pillar 2: Only affects companies with at least EUR 750mio revenues (estimated tax revenues of \$220bn, with some estimates start at \$155bn) and places a 15% minimum tax on all jurisdictions. If the tax paid is lower than that in one jurisdiction, additional taxes would be owed to the company's home jurisdiction.<sup>8</sup>

While this sounds relatively simple, it can get very, very complex quickly. Pillar 1 is expected to cost (not gain) the US tax dollars, as it is estimated to impact US companies to a large 70% of the total potential global profits. Pillar 1 has also missed a 30<sup>th</sup> June 2024 deadline for implementation, and it seems unlikely to be passed.<sup>9</sup> Pillar 2 has been passed in a number of countries, but the US and China continue to object it. The US Republicans block the passage of Pillar 2, because of concerns how R&D tax credits are treated.<sup>10</sup> These R&D tax credits are generally quite large. For example, Nvidia has not paid any taxes in FY 2023, and only paid an effective tax rate of 12% in FY 2024.<sup>11</sup> One estimate suggests potential US tax losses of \$122bn with the implementation of Pillar 2.<sup>12</sup> In short, while this is an initiative proposed by the Biden administration, it appeared to have completely backfired. The legislation would also be highly problematic for China due to their massive subsidies to Chinese businesses, which impacts the tax rate. For example, if a business makes \$100bn in revenues and pays \$24bn in tax, but then received \$20bn in subsidies, the effective tax rate could be either 20% when subsidies are added to revenue (\$24bn tax of \$100bn + \$20bn = 20%) or 4% when subsidies are deducted from the tax directly (\$24bn - \$20bn = 4% of \$100bn).<sup>13</sup> The difference of 15% Global Minimum Tax and a 4% tax rate under the latter scenario would then be transferred to another country.<sup>14</sup> Worryingly, the countries that stand to join will automatically benefit from the countries that decide not to join. Many European and smaller countries are already

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<sup>7</sup> <https://taxfoundation.org/blog/global-tax-agreement/>

<sup>8</sup> <https://taxfoundation.org/blog/global-tax-agreement/>

<sup>9</sup> <https://taxfoundation.org/blog/global-tax-agreement/#timeline>

<sup>10</sup> <https://www.reuters.com/world/us/yellen-us-negotiating-rd-tax-credit-part-global-tax-deal-2024-04-30/>

<sup>11</sup> <https://d18rn0p25nwr6d.cloudfront.net/CIK-0001045810/1cbe8fe7-e08a-46e3-8dcc-b429fc06c1a4.pdf>

<sup>12</sup> [https://www.finance.senate.gov/imo/media/doc/118-0228b\\_june\\_2023.pdf](https://www.finance.senate.gov/imo/media/doc/118-0228b_june_2023.pdf) p. 10

<sup>13</sup> <https://taxfoundation.org/blog/pillar-two-flaw/>

<sup>14</sup> [https://www.europarl.europa.eu/RegData/etudes/ATAG/2023/749793/EPRS\\_ATAG\(2023\)749793\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/ATAG/2023/749793/EPRS_ATAG(2023)749793_EN.pdf)

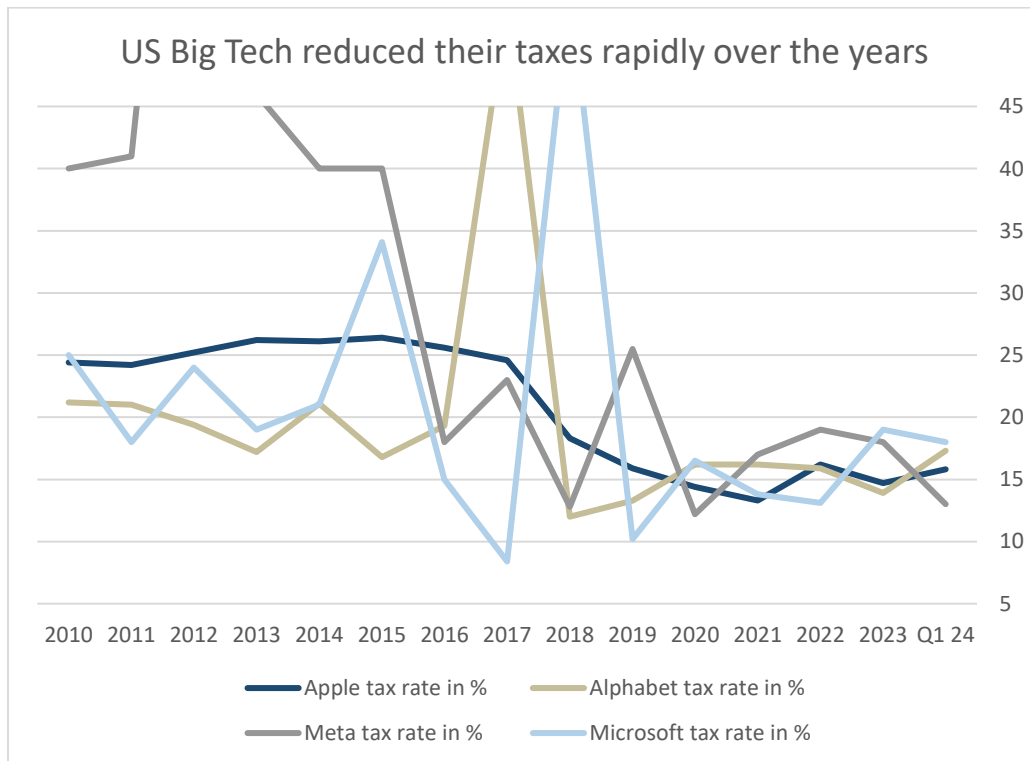
implementing Pillar 2, which I believe will result in massive future conflicts due to cheating and potentially very volatile tax revenues. It will also be complex and expensive for companies to account for it.

### FY Federal Tax Receipt Revenue Effects for Various Scenarios of the Enactment of Pillar Two

Scenarios	2023-2028 \$bn	2023-2033 \$bn
1. Rest of the world enacts Pillar 2 in 2025; United States does not enact.	-\$39.2	-\$122
2. Rest of the world enacts Pillar 2 in 2025; United States also enacts Pillar 2 in 2025.	-\$6.8	-\$56.5
3. Rest of the world does not enact Pillar 2; United States does not either.	-	-
4. Rest of the world does not enact Pillar 2; U.S. enacts Pillar 2 in 2025, but no U.S. UTPR.	\$36	\$102.6
5. Rest of the world does not enact Pillar 2; United States enacts Pillar 2 in 2025.	\$98.2	\$236.5

Source: [https://www.finance.senate.gov/imo/media/doc/118-0228b\\_june\\_2023.pdf](https://www.finance.senate.gov/imo/media/doc/118-0228b_june_2023.pdf)

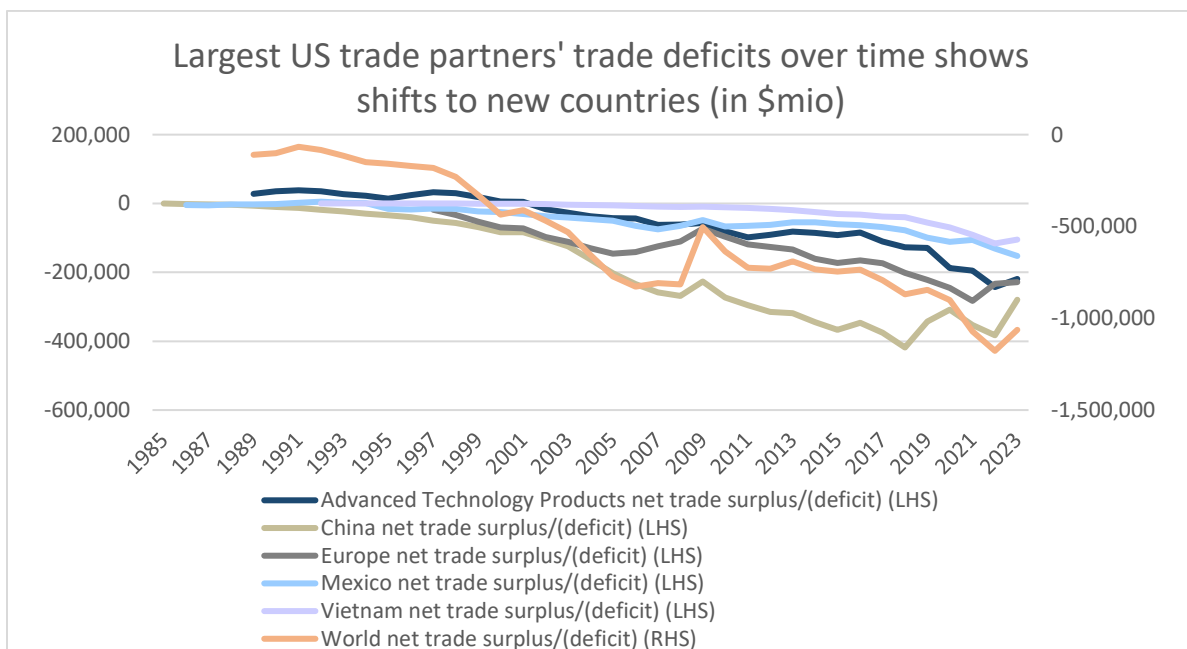
UTPR = Undertaxed profits rule, which means taxing subsidiaries whose parent entity are in low tax jurisdictions, i.e. in the case of the US, if R&D tax credits & subsidies reduce the effective tax rate below 15%



Source: Annual reports of individual companies. Excessive moves are related to tax changes and jurisdiction changes

## The alternative: Tariffs

While the Biden administration has begun implementing tariffs against China<sup>15</sup>, Trump has vowed to increase tariffs on all Chinese imports to 60% and a 10% tariff on all imports from the rest of the world.<sup>16</sup> Although it can be expected that Trump uses tariffs as a threat to negotiate a better deal, a general 10% tariff on global imports appears to be non-negotiable as it doesn't target a specific nation. The problem with tariffs is that they can be circumvented by, for example, exporting through another country like Mexico to the US, which has a free trade agreement with the USA. The Biden administration recently passed a new 25% tariff on steel imports from Mexico, unless the steel is documented to have been melted and poured in Mexico, the US or Canada.<sup>17</sup> Like the Global Minimum Tax, tariffs are making global trade increasingly complex, and it will be hard to fix every loophole. The key will be whether the combination of the Global Minimum Tax and tariffs could lead to dramatic shifts in government revenues that could put some countries at a sudden disadvantage, which ultimately would lead to a surge in far-right political support and conflict.



Source: US Bureau of Economic Analysis

<sup>15</sup> <https://www.whitehouse.gov/briefing-room/statements-releases/2024/05/14/fact-sheet-president-biden-takes-action-to-protect-american-workers-and-businesses-from-chinas-unfair-trade-practices/>

<sup>16</sup> <https://www.piie.com/blogs/realtime-economics/2024/trumps-proposed-blanket-tariffs-would-risk-global-trade-war>

<sup>17</sup> <https://www.reuters.com/markets/commodities/us-mexico-move-thwart-china-circumvention-us-steel-aluminum-tariffs-2024-07-10/>



## The Energy transition is going in the wrong direction

While globalization and the resulting economic changes are starting to become a challenge, on top of that we are incurring self-inflicted challenges such as excessive & illegal migration, wars that could in part be avoided and the energy transition that is tackled from a very risky angle. If we are really 100% certain that CO2 is causing climate change, to electrify our economies by seeking to eliminate oil and gas before eliminating coal, which makes up ¼ of global energy use<sup>18</sup>, is going in the completely wrong direction. This is a very simple equation, as the build out of renewables would not be fast enough to replace higher electricity demand from EVs, potentially leading to a higher usage of coal. Hence, as long as you have coal in the energy mix, the shift away from ICE to EVs makes absolute zero sense, because coal emits double the amount of CO2 compared to gas and 30% more than oil. Reducing CO2 emissions via biofuels and taxes on CO2 emissions will be costly. For example, Lufthansa is now seeking to charge EUR 1-72 emission surcharge per flight per passenger due to the more expensive sustainable aviation fuel (SAF).<sup>19</sup> Denmark is charging farmers EUR 100 per year per cow due to CO2.<sup>20</sup> And the UK is looking to charge up to £15k per non-EV sold, which prompted Stellantis to put Vauxhall's production future in the UK in doubt.<sup>21</sup> People were quick to criticize Trump for abandoning the Paris Climate Accord. However, the costs of achieving these climate goals will be so immense that economies could suffer from the implementation, which in turn would make voters again shift to extremes, likely far-right parties. Consumers have zero interest in paying more for an invisible green product that is otherwise the same as a non-green product.

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<sup>18</sup> <https://ourworldindata.org/grapher/global-energy-substitution?tab=table>

<sup>19</sup> <https://newsroom.lufthansagroup.com/en/lufthansa-group-introduces--environmental-cost-surcharge>

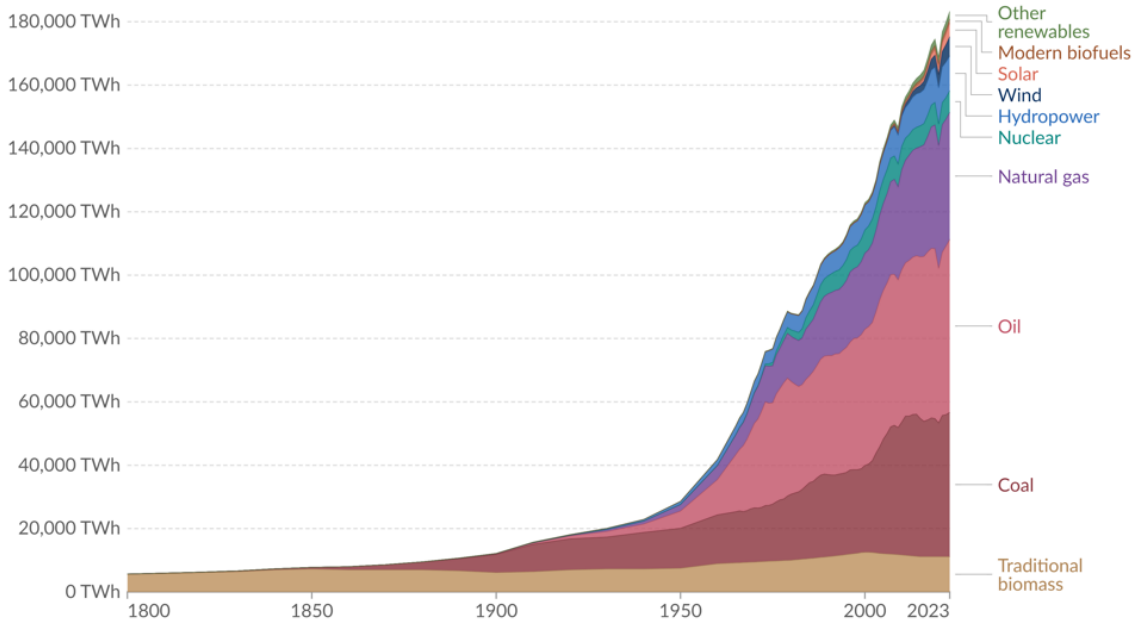
<sup>20</sup> <https://www.ft.com/content/c7a4eeaa-3a00-4132-bac3-82e1d0650c78>

<sup>21</sup> <https://www.reuters.com/business/autos-transportation/stellantis-mulls-halting-uk-production-amid-ev-demand-concerns-2024-06-25/>

## Global primary energy consumption by source

Primary energy<sup>1</sup> is based on the substitution method<sup>2</sup> and measured in terawatt-hours<sup>3</sup>.

Our World  
in Data



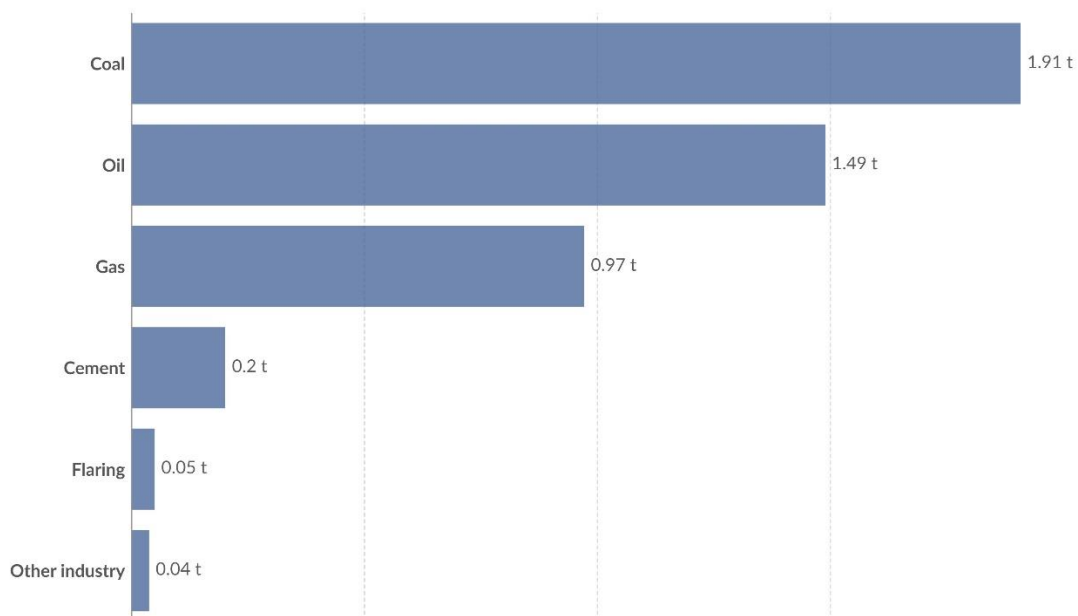
Data source: Energy Institute - Statistical Review of World Energy (2024); Smil (2017)

Note: In the absence of more recent data, traditional biomass is assumed constant since 2015.

OurWorldInData.org/energy | CC BY

## Per capita CO<sub>2</sub> emissions by fuel type, World, 2022

Our World  
in Data

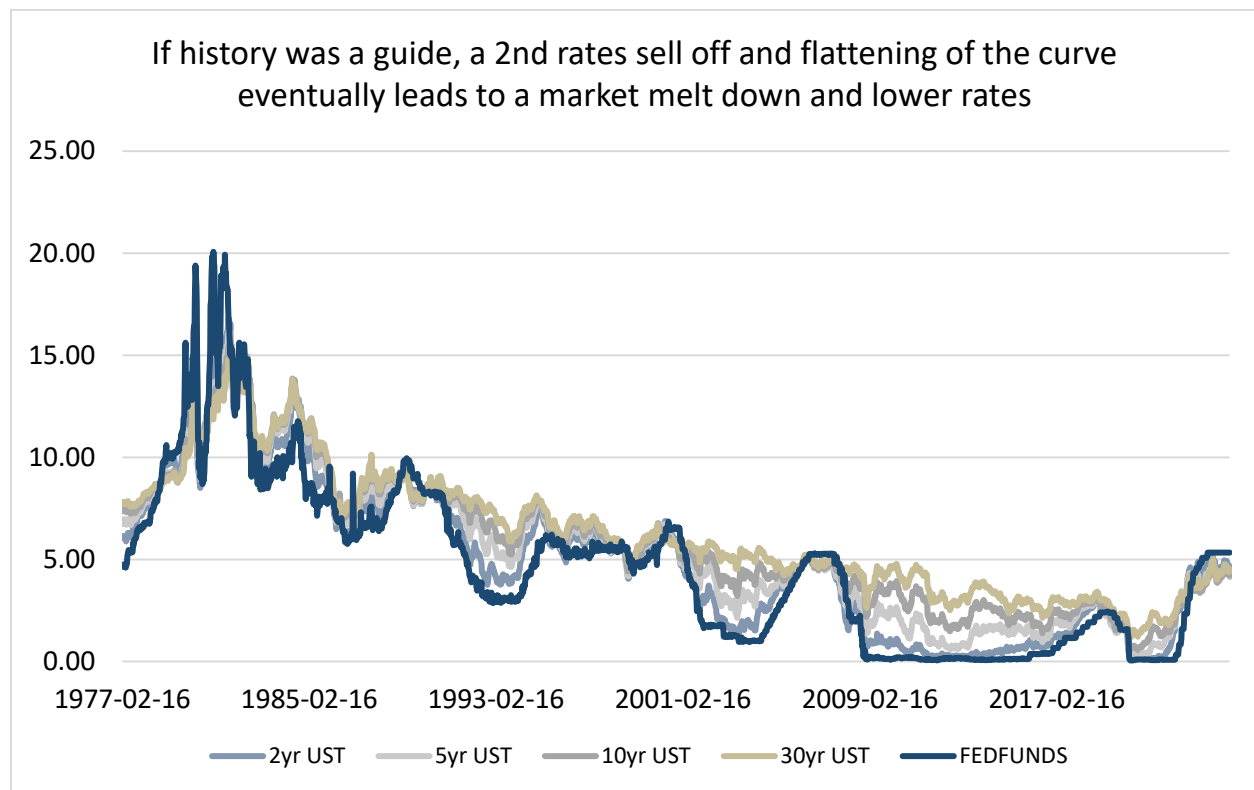


Data source: Global Carbon Budget (2023); Population based on various sources (2023)

OurWorldInData.org/co2-and-greenhouse-gas-emissions | CC BY

## The yield curve points to imminent cuts

The history of the yield curve suggests that we will have an equity market correction relatively soon. The UST 10yr/Fed Funds inversion is already exceeding the number of weeks during the 2006-08 period. We are only two months away from matching the number of weeks between the last hike and the (potentially) first cut of 58 weeks, which was also recorded during the 2006-08 period. If 2006-08 was a guide, we would first face a liquidity event with the Fed abstaining from cutting rates while the market expects the Fed to cut, which would then lead the Fed to cut rates by 50bps and provide liquidity support<sup>22</sup>. If 1929 was a guide, the Fed will be very slow in cutting rates and, while we would face a downturn, the Fed would hike rates again into the downturn, as happened in 1931 (although this was related to the US being on the gold standard and the loss of gold reserves).



<sup>22</sup>

<https://www.aozorastep.com/How%20the%20yield%20curve%20and%20interest%20rates%20compare%20in%20historical%20context.pdf> p. 2

### US weeks of yield curve inversions and rate hikes/cuts

Period	# of weeks UST 10yr - Fed Funds inversion	Weeks between last hike and first cut	Weeks between last hike and end of inversion
1973-74	99	1	26
1978-80	92	1	7
1982	17	1	16
1989	52	9	39
1998	29	12	16
2000-01	46	33	46
2006-09	81	58	77
2019	23	32	44
2020 Covid	4	-	-
Now	87 (so far)	50 (so far)	50 (so far)

Source: FRED St. Louis

Period	# of weeks UST 10yr - Fed Funds inversion	WTI \$/bbl change	WTI \$/bbl change 3 months after inversion	S&P 500 change	S&P 500 change 3 months after inversion
1973-75	99				
1978-80	92			6.7%	13.5%
1980-81	60			-3.9%	-10.4%
1982	17			-2.7%	18.0%
1989	52	21.0%	-22.0%	15.3%	1.5%
1998	29	-22.0%	27.0%	11.5%	5.6%
2000-01	46	-7.0%	-7.2%	-7.8%	-4.2%
2006-08	81	18.7%	23.6%	19.2%	-5.8%
2019	23	-13.0%	15.0%	11.4%	6.5%
2020 Covid	4	-10.0%	-20.0%	-22.0%	19.7%
Now	87	-1.0%	?	41.6%	?

Source: FRED St. Louis

## Performance

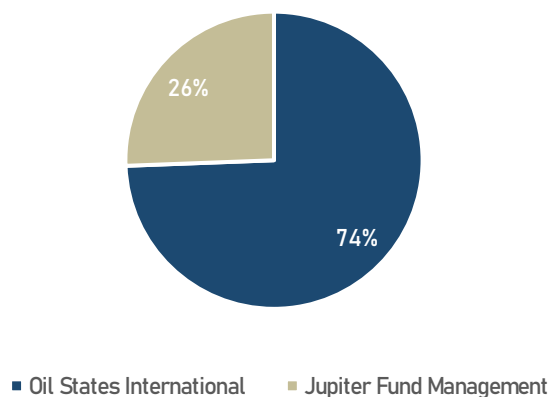
Q2 2024 has been a quarter full of missed opportunities. It could have been a high double digit % return amidst strong rerating from companies like Direct Line Insurance, Future Plc, Synthomer and Reach. Apart from Reach, I had a position in all the other companies, but partly only in a separate portfolio I manage (my SIPP, which I might include going forward). I have also faced a few liquidity constraints (already!), where it took me a week to exit a position and then I had to pay up to enter a new position. Overall, I'm relatively content with the performance, as I generally made the right decision to exit certain positions like Mobico, Direct Line Insurance or Nexxen at or close to the Q1 and Q2 high point valuation.

### Current Holdings

Company	Average Purchase Price	Current Market Price	% change
Oil States International	4.36	4.43	2%
Jupiter Fund Management	0.82	0.77	-6%

As of 28<sup>th</sup> June 2024

### Current Holdings in % of Portfolio



### **Exit Nexxen & Direct Line Insurance**

Last quarter, we had an 82% concentration in Nexxen, which was a record high concentration. To me the valuation appeared too low and in light of the strong performance of its competitors, I felt it was justified. In the end, it was the right decision, but I exited Nexxen, because of a potential war with Lebanon and the divestment of Israeli companies by pension funds in protest of the war in Gaza. The Q1 earnings also showed that Q2 could have a less favourable working capital position. Programmatic advertising is extremely volatile, and Nexxen is not the most liquid stock. Hence, I sold the position, as my target valuation of \$500mio was also getting very close. ([here](#))

I have also exited Direct Line Insurance, not because the thesis of falling used car prices & hence higher motor insurance margins changed, but rather due to new competition entering the market, potential regulatory scrutiny and profitability in motor insurance, which is not expected before Q3. In addition, I just generally saw higher returns elsewhere and wanted to reallocate the capital. ([here](#))

### **Entering Jupiter Fund Management**

Jupiter Fund Management is trading at extremely low multiples of 5x Free Cash Flow. In addition, the company has by now probably close to £200mio excess capital that could partly be distributed. While the valuation is very attractive, the fund management industry as a whole is not seeing a turnaround, although outflows have reduced. The share buyback programme that was approved at the AGM, has not started yet, which let me wonder whether they expect the valuation to drop further once their star-manager Ben Whitmore is leaving. Ben's leaving date was also delayed to 7<sup>th</sup> October. While I've held on to the position, it became less attractive due to the yield curve indicating problems ahead and competitors losing market value. ([here](#))

Entered Jupiter just before Liontrust Asset Management rallied, but recently corrected (as of 12<sup>th</sup> July)



Source: TradingView, blue = Jupiter Asset Management, orange = Liontrust Asset Management (YTD performance)

## Entering Oil States International

I have come to know Oil States International through our past holding in Hunting. Oil States International is a competitor of Hunting and the two companies have generally traded in line with each other. Recently, however, Hunting has scored large orders in their OCTG business, which has resulted in a diversion of the two companies' valuations. Oil States International is now valued at an enterprise to net current asset

valuation that matches the Covid lows. This doesn't make a lot of sense to me. The last time this happened was in September 2022, and while I was considering taking a position back then, I objected because it was not UK listed. This time around I didn't want to make the same mistake again (although the opportunity now is not as attractive as in 2022). While the US oil and gas shale industry is not in great shape at the moment, the company still expects \$40mio free cash flow (7x) and the likelihood is high that they are repurchasing shares and their convertible bond at this valuation. ([here](#))

### Oil States International vs. competitors YTD stock performance



Source: TradingView, blue = Oil States International, yellow = DMC Global, turquoise = Core Laboratories, orange = Hunting



## Outlook

Given the rather negative macro-outlook, I'm considering taking a position in the 50yr UK Inflation linker again. At the same time, I believe that the conflict between Israel and Hezbollah could escalate further, which in turn could lead to higher oil prices. Biden, on the other hand, is laser focused to keep oil prices within the current range ahead of the election. The great thing is that Biden would not welcome a collapse in oil prices and would likely increase SPR purchases below \$80/bbl. With potential rate cuts and hurricanes disrupting the Gulf of Mexico, I believe the position in Oil States International is not facing any further medium-term downside. Blackrock and Goldman Sachs have shifted their views on UK equities to positive after the Labour election win. Although I remain skeptical about a major positive development in the UK due to the potential of higher capital gains taxes, the narrative and recent UK GDP prints are helping our position in Jupiter Fund Management. Other companies like Reach could benefit further from a Labour government. I have felt this directly when the Mirror (part of Reach), a Labour supportive tabloid newspaper, had an exclusive interview with the Labour Transport Secretary about UK car insurance<sup>23</sup>, which completely missed my radar, but had a large impact on the valuation of Direct Line Insurance. Overall, I feel like walking through a mine field when investing at the moment due to the vast number of risks simmering on the horizon. The opportunities, on the other hand, mostly lie in valuations, which remain highly attractive if earnings at least stay stable.

Sincerely,

A handwritten signature in black ink, appearing to read "Herrmann".

David Herrmann



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<sup>23</sup> <https://www.mirror.co.uk/news/politics/labour-promises-crack-down-unfair-32952223>

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