

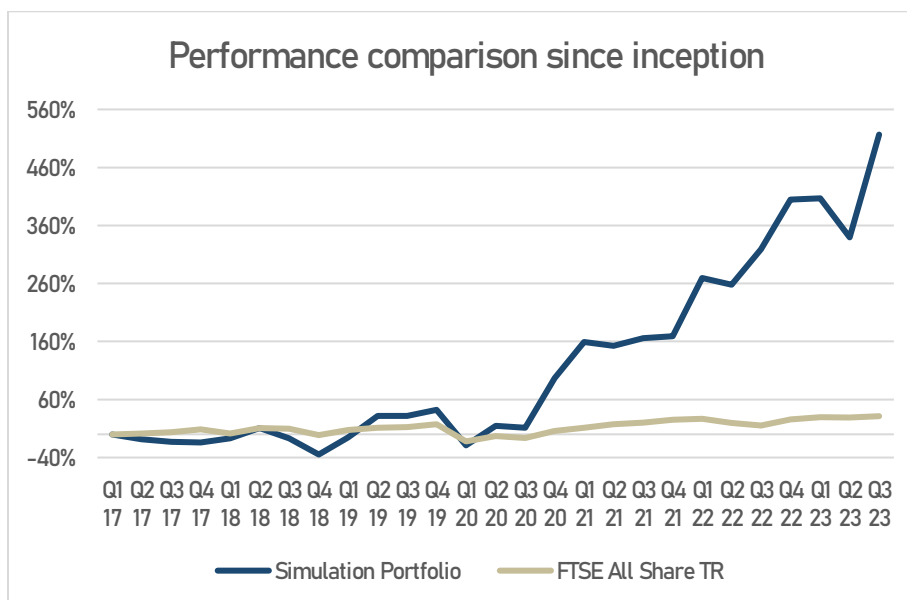
Q3 2023:

OPEC vs. Federal Reserve: Fight!

Quarterly Performance	Personal Account	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%

Annual Performance	Personal Account	FTSE All Share TR
2017	-9%	9%
2018	-31%	-9%
2019	113%	19%
2020	52%	-10%
2021	37%	18%
2022	99%	0%
9M 2023	22%	5%

Overall Performance	Personal Account	FTSE All Share TR
CAGR	30.9%	4.1%
2017-23 Return	517%	31%



4th October 2023

Dear fellow investor,

“Doing too little could allow above-target inflation to become entrenched and ultimately require monetary policy to wring more persistent inflation from the economy at a high cost to employment,” he said. “Doing too much could also do unnecessary harm to the economy.” These were Fed’s Powell’s comments on inflation during the August 2023 Jackson Hole meeting. Since then, Brent crude oil prices have surged from \$83/bbl to over \$95/bbl in just one month. Subsequently, we saw a jump in long-end interest rates and a steepening of the curve. I have been scratching my head to find historic analogies to find out what could happen in the future. One thing is clear to me, unless oil prices are kept stable or are falling, the Fed will continue its hiking path in an unconstrained manner. Hence, we are facing a fight of OPEC vs. Federal Reserve... who will win?

OPEC cuts generally lead to higher oil prices

When we look at all historic OPEC cuts and supply increases, it becomes clear that OPEC has strong pricing power and generally prices will follow whatever OPEC decides to do. Over the last 20 years, OPEC has been successful in cutting supply and building a bottom for oil prices. 2023 has been the first time in this time period that OPEC really had to cut twice, first in October 2022, then again in April 2023, and even then it took time for oil prices to rise. Supply rises have generally led to a rapid decline in oil prices, such as in June 2011 or July 2008.

OPEC Supply Cuts			
Year of cut	Month of announcement	Month of cut	Amount in mio bopd
2023	April	May	1.66
2022	October	November	2
2020	April	May	9.7
2018	December	January	1.2
2016	November	January	1.2
2008	December	2009	multiple
2006	October	November	1.2
2004	September	November	1

Source: OPEC

OPEC Supply Increases			
Year of raise	Month of announcement	Month of cut	Amount in mio bopd
2021	April	gradually	0.4 a month (5.8mio)
2011	June	July	1.5
2008	July	August	2.2
2005	June	July	0.5

Source: OPEC

Largest weekly oil price declines generally had a solid reason

Over the last 15 years, there were only 20 weeks when oil prices declined by more than 10% in a week. What is striking with this current week's -12.5% decline is that there is no specific reason for the decline. At the same time, this is the first time we face a straight 10% or more decline in a week from its top. On October 4th, we have seen oil prices decline by 5.5% in a single day. Since 2005, there have only been 83 days (1.3%) when oil prices declined by more than 5% in a single day. In almost all cases when we have seen more than 5% declines in oil in a single day, this was generally when oil prices were already in a sort of bear market, not so close to the top. This makes this week's decline so hard to understand.

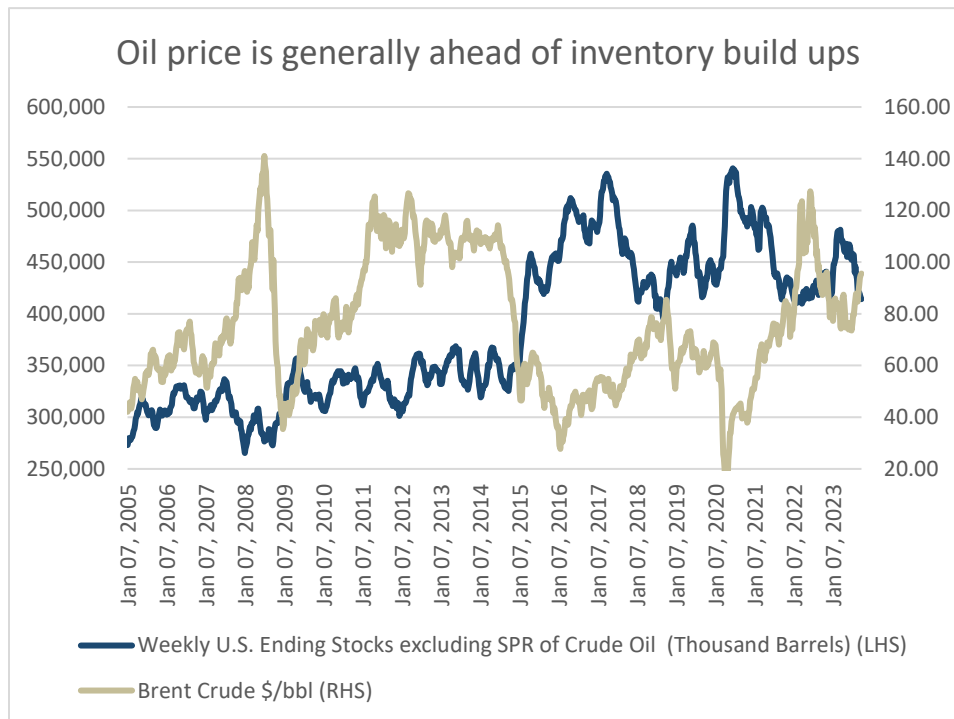
Largest single day crude oil price declines

Date	Change in commercial crude oil inventories	Brent Crude \$/bbl	Weekly Crude oil price change	Reason for decline
Oct 10, 2008	5,611	80.98	-11.9%	GFC
Oct 17, 2008	3,182	69.28	-14.4%	GFC
Nov 14, 2008	1,599	53.27	-10.4%	GFC
Nov 21, 2008	7,280	47.79	-10.3%	GFC
Dec 05, 2008	352	43.70	-10.0%	GFC
Dec 26, 2008	549	35.38	-15.2%	GFC
Feb 20, 2009	717	40.91	-10.3%	GFC
Jul 10, 2009	-2,813	60.39	-11.2%	Aftermath of GFC
Jan 09, 2015	5,389	49.47	-11.7%	Oversupply, OPEC continues market share fight
Aug 07, 2015	-1,404	48.59	-10.2%	Iran deal
Jan 15, 2016	3,979	29.10	-14.9%	Rising inventories, OPEC supply increase talk
Mar 13, 2020	1,954	33.72	-33.5%	Pandemic related
Mar 20, 2020	1,623	25.65	-23.9%	Pandemic related
Apr 03, 2020	15,177	18.72	-21.9%	Pandemic related
Apr 17, 2020	15,022	20.00	-11.3%	Pandemic related
Apr 24, 2020	8,991	14.24	-28.8%	Pandemic related
Dec 03, 2021	-241	71.00	-11.5%	WHO labels Omicron as variant of concern
Mar 18, 2022	-2,508	109.59	-10.4%	Russia related
Apr 01, 2022	2,421	111.26	-10.0%	Russia related
Oct 06, 2023	?	83.70	-12.5%	Iraq-Turkey Pipeline restart

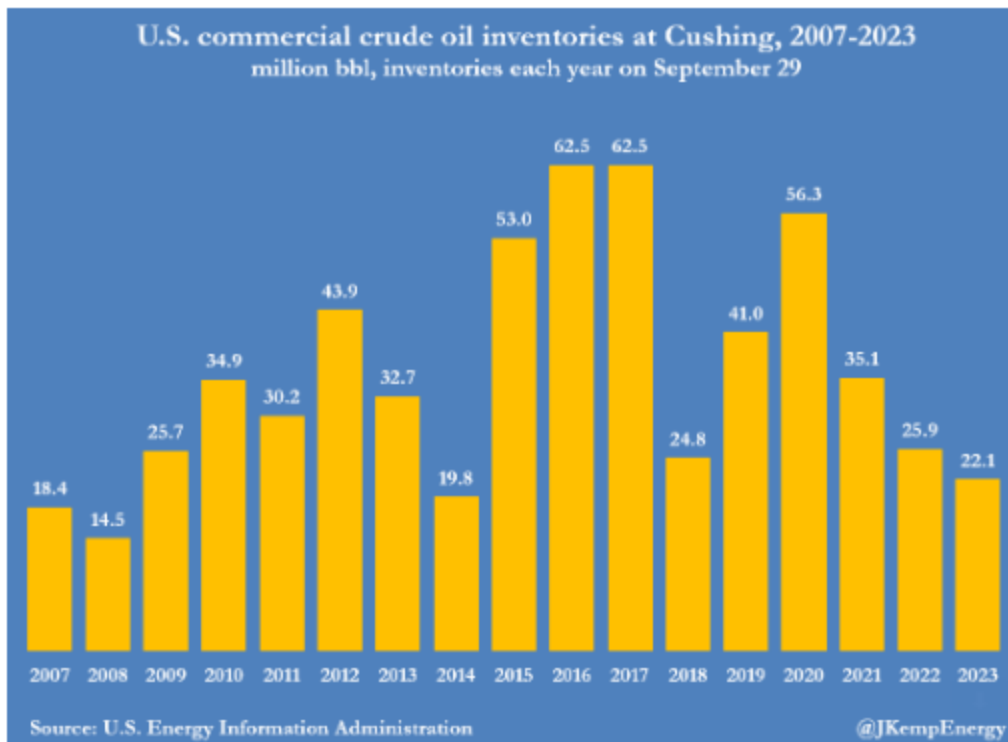
Source: FRED St. Louis

What about these low inventories?

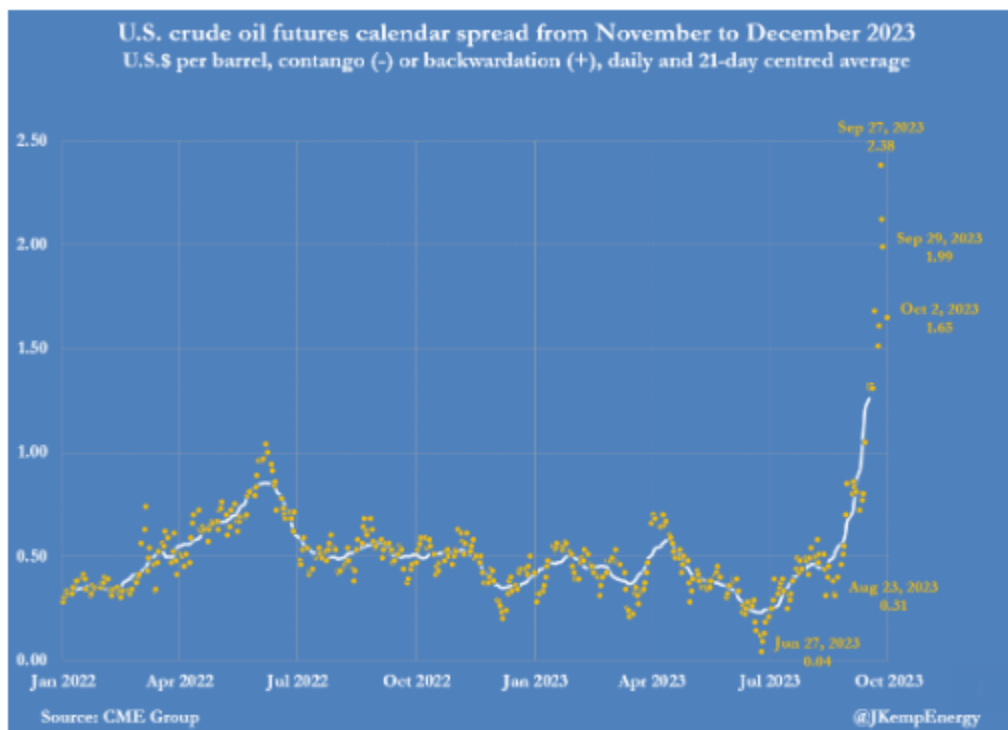
While low oil inventories generally lead to higher oil prices, a rise in oil inventories is generally only visible after oil prices have already declined. Against common sense, when inventories are near historic lows, very often we actually see a decline in oil prices and subsequent rise in inventories, as oil supply increases in light of higher prices and demand faces some obstacles in the way. Cushing oil inventories are especially sensitive. The key is that whenever we have seen cushing inventories decline to below 25mio barrels, there has been a major slump in oil prices, such as in 2008, 2014 and 2018. Therefore, declining inventories are positive for oil prices, but when inventories reach critical lows, there is a risk of a reversal, as it is the case right now. The same is true for backwardation of the curve.



Source: EIA, FRED St. Louis



Source: JKempEnergy



Source: JKempEnergy

2023: Where is the balance

While OPEC has been cutting production pro-actively, there are fears of additional supplies from countries like Iran, Venezuela and Nigeria. Nigeria is currently 500k bopd below its quota and hence has room to increase supply. The Iraq-Turkey pipeline could also come back online with 450k bopd. Hence, there are real supply risks. At the same time, a return of the Iraq-Turkey pipeline could increase Iraq oil production above its quota by around 265k bopd¹. If Saudi Arabia is not continuing its 1mio bopd voluntary cut after December, we could face an oversupplied market very quickly.

Iran oil production



Source: TradeEconomics.com

¹ <https://www.reuters.com/markets/commodities/iraq-produced-well-below-its-opec-quota-may-source-says-2023-06-13/>

Venezuela oil production



Source: TradeEconomics.com

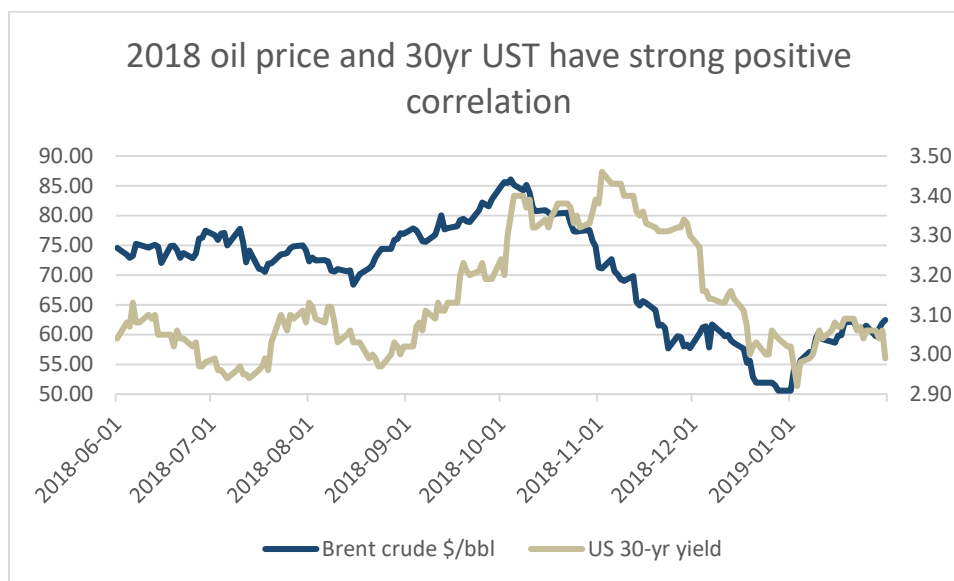
Nigeria oil production



Source: TradeEconomics.com

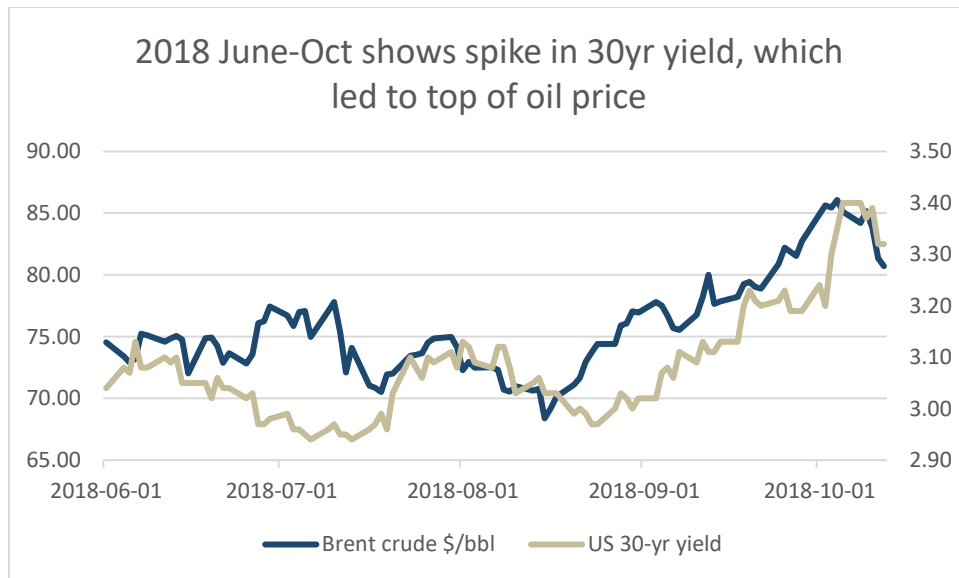
Are we facing a 2018 repeat?

Looking at all the data and historical comparisons, the 2018 episode feels like the closest comparison. Back then, same as now, we had the Fed tightening monetary conditions aggressively, which ultimately led to rates spiking higher and causing oil prices as well as equities in general to plummet. While companies report a challenging operating environment, wage hikes have really helped the consumer manage the higher inflation. The key difference to 2018 is that Saudi Arabia just hiked its oil prices to +\$7.2 for NW Europe and +\$7.45 for the US. This did not occur in H2 2018. However, same as now, back then there was talk about \$100/bbl and the desire for Saudi Arabia to have prices above \$80/bbl². In 2018, the economy as a whole was in a much better state, though, which raises the question how much the Fed can hike further. If the 1970/80s are a guide and you compare US interest expense over GDP, there seems to be little room for the Fed to hike more.

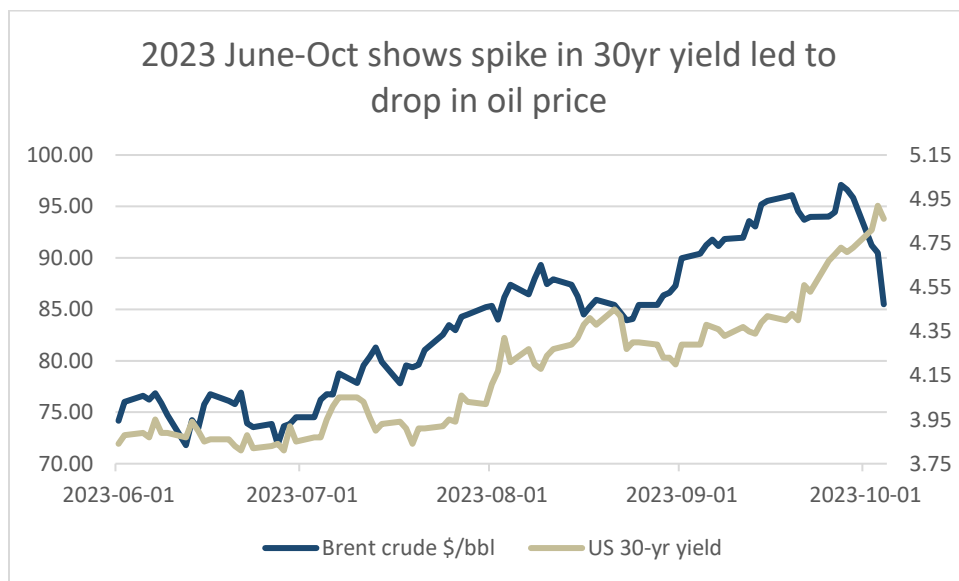


Source: FRED St. Louis, EIA

² <https://www.cnbc.com/2018/04/20/forget-100-oil-75-is-probably-the-ceiling-this-year-says-omans-oil-minister.html>

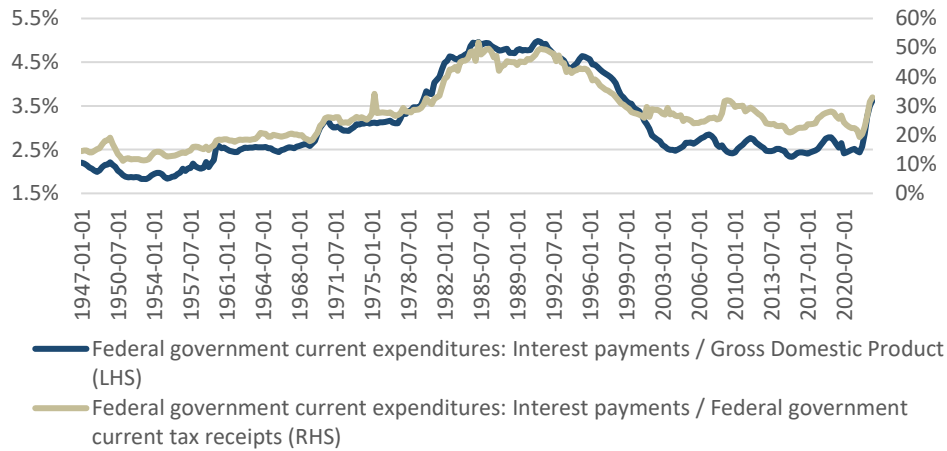


Source: FRED St. Louis, EIA



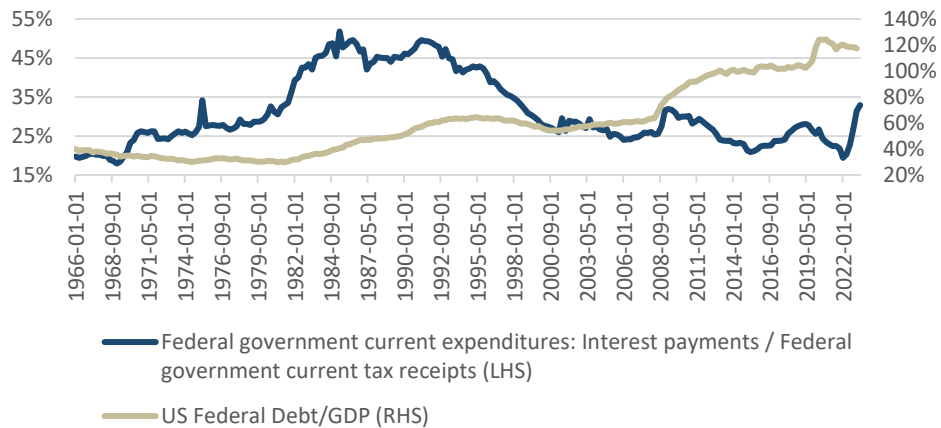
Source: FRED St. Louis, EIA

1/3 of US tax income is used to service interest payments vs. 50% in the 1980s/90s



Source: FRED St. Louis

US debt/GDP can double within 10 years when half of tax receipts go towards bondholders



Source: FRED St. Louis

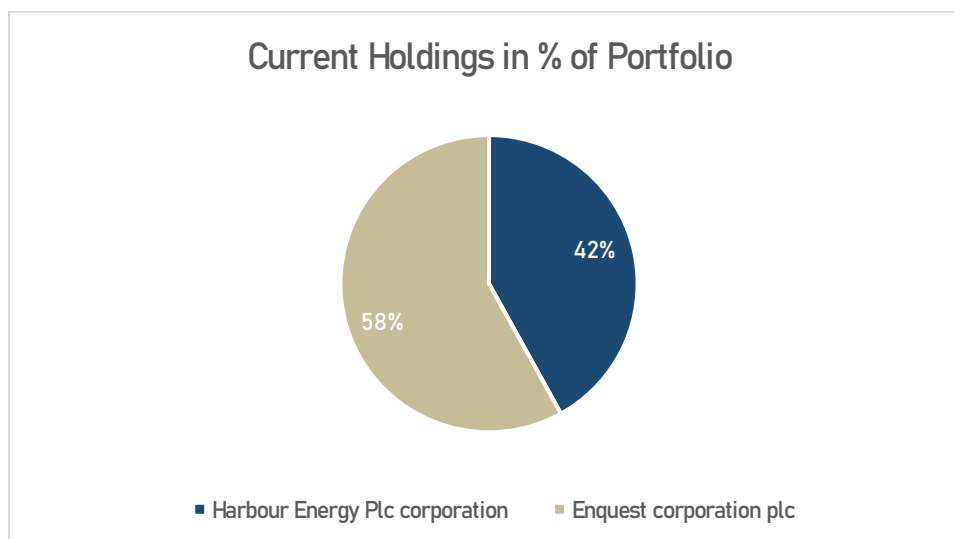
Performance

After the poor performance in Q2 2023, Q3 proved to be much more fruitful after our position in Hunting Plc finally turned around. I have exited National Express after a disappointing H1 result as well as exiting Secure Trust Bank to focus completely on geopolitics with positions in UK oil producers. However, despite having taken the position only shortly, the macro is not so clear to me (as discussed above), and given that a 2018 scenario appears more and more likely, I have already decided to exit the positions.

Current Holdings

Company	Average Purchase Price	Current Market Price	% change
Harbour Energy Plc	2.65	2.58	-3%
Enquest plc	0.15	0.15	1%

As of 30th September 2023



Outlook

While I continued to expect a spike in oil prices led by the end of rate hikes and a potential of rate declines, this might never play out if 2018 was a guide. Therefore, cash might really be the best option at rates of 5% or more. At the same time, we still have over \$1.3trn of cash in the reverse repo facility at the Fed. At the current run rate, it would take until February 2024 to hit zero. A very rapid pace. If the Fed decides to continue selling USTs at that point, the 2018 playbook could be used very well. Sometimes it pays to be patient. Hence, I'll seek quick turnarounds in the equity space, rather than the 3-6 month view, it should be something heavily mispriced that performs no matter what.

Sincerely,

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

David Herrmann



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