Q3 2024: The Great Reset of Taxes, Tariffs and Deglobalisation

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%

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 9M	13%	10%

Overall Performance	Turnaround Portfolio	FTSE All Share TR
CAGR	**28.9%**	**5.3%**
2017-9M 24 Return	**615%**	**49%**

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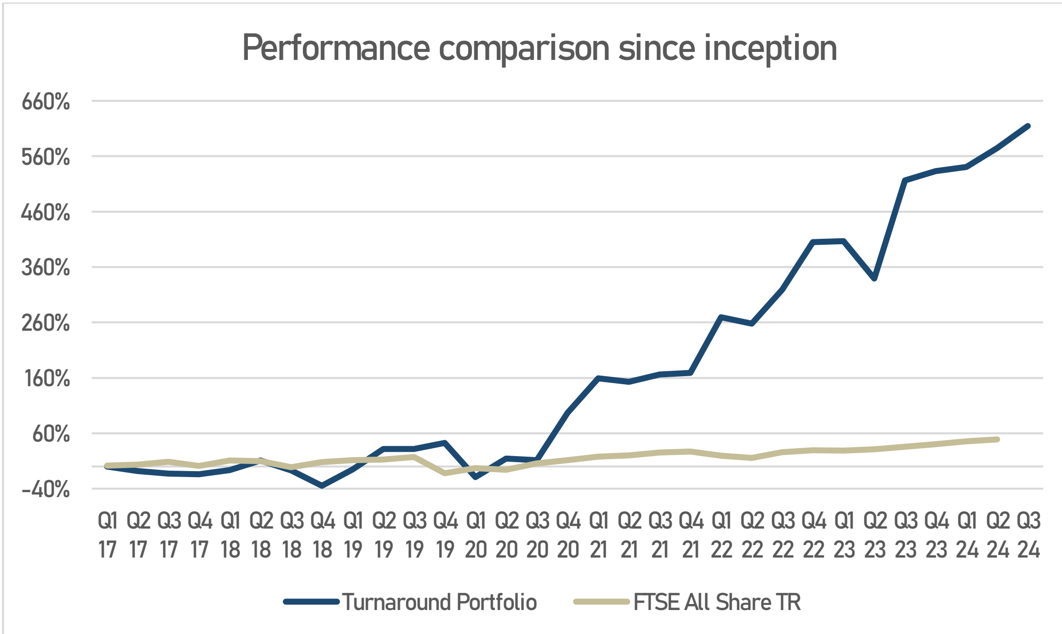

3rd October 2024

Dear fellow investor,

This quarter has been a mixed bag once again. The volatility event in August almost eliminated the entire 30% return on our holding in Oil States International. Despite beating the FTSE All Share TR, it felt like a quarter where performance was down due to the rapidly lost gains. Overall, I find it hard to form a convincing view at the moment. Nearly all companies that are reporting, are seeing subdued demand. Governments are trying to reduce their debt. Central banks remain concerned about an uptick in inflation. In combination with multiple ongoing wars, trade wars and an energy transition that is very uncertain, it provides a lot of potential downside across nearly every industry.

Before I lay out more details of these risks and review our performance, a brief operational update: Over the last few years, I have received indicative allocation quotes to my strategy from around 10 individuals amounting to ca. £3.5mio, which could make it viable to get started. I'm also in touch with a few family offices, with one being in their pipeline. Hence, I might be able to get started without having one of the 2-3 partners I had in mind that I wanted to bring onboard and work with. It would not be a listed company

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with £100mio+ AUM, which is my goal. But it would be a start under IB's SMA setup. Whilst I'm away in Japan next week, I'm seeking to get to at least £5-10mio indicative start AUM, which would make it viable even if say half of the potential investors pull out. To get there, I consider hiring a coach. A coach is something like a mentor, but with a professional focus on making you successful in your endeavours. The first trial session I had was quite interesting, because we explored the hidden fears and concerns. By identifying those and working on improving them, it should lead to a better outcome. In my case, my fears have to do with the high fixed costs of being regulated by the FCA and the limitations put on my own portfolio once managing external capital. That's why raising more capital than just to "break even" is so important.

This quarterly economic/macro outlook is very similar to the one from Q2 2024. I've kept it a bit shorter, as the many macro and geopolitical topics discussed over the last year still prevail. Here you can also find my current market view as of beginning of September, which haven't really changed. I believe we might be at a turning point, where corporate taxes are climbing, trade tariffs are put in place and with it, deglobalization begins. This process would take decades, as it happened during the 1920s/30s/40s. I don't think this view changes with a Harris or Trump presidency, but a Trump presidency could accelerate it.

How US corporate tax changes could impact foreign direct investment outside the US

In 2017, the US passed the Tax Cuts and Jobs Act (TCJA)[1], which lowered individual income taxes and corporate taxes in the US. Whilst the individual income tax reductions have an end of 2025 end date, the corporate taxes are permanent. The corporate tax was lowered to 21% compared to 15-39% corporate tax previously. At the same time, the tax system was changed from a worldwide[2] to a territorial tax system[3]. This meant that when a corporation pays 15% tax in Ireland and would want to repatriate their profits back to their home jurisdiction, the US, it would not need to pay the difference between the 15% tax in Ireland and the now 21% tax in the US any longer. In exchange for this new offer, the TCJA required US companies to pay taxes on all foreign earnings held overseas which were not repatriated to the US yet

[1] https://taxfoundation.org/taxedu/glossary/tax-cuts-and-jobs-act/
[2] https://taxfoundation.org/taxedu/glossary/worldwide-taxation/
[3] https://taxfoundation.org/taxedu/glossary/territorial-taxation/

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from 1987 to 2017[4]. To incentivize companies from future tax avoidance at home and more so to ensure US companies keep their IP at home and not abroad, Foreign-Derived Intangible Income (FDII), i.e. the sale of products related to intellectual property, is taxed at only 13.125%[5]. After 2025, this tax rate is raised to 16.4%. Together with two other separate taxes[6], the goal of the Tax Cuts and Jobs Act is about bringing investment back home to the US by making it unattractive from a tax perspective to invest elsewhere. Trump is now campaigning to set a fixed 15% corporate tax rate, which would be in line with the 15% Global Minimum Tax. Similar to the 21% corporate tax rate reduction, I can imagine the 15% corporate tax has some strings attached, too. Most likely, it could prove a way around the Global Minimum Tax Pillar 2, which places a 15% minimum tax on all jurisdictions. The US and China haven't signed up for Pillar 2, as the R&D tax credits given by the US and China can sometimes lower the effective tax rate to below 15%, which would trigger tax transfers from the US and China to other countries. If the US corporate tax would be decreased to 15%, while the FDDI and R&D tax credits be eliminated and forcing US companies to keep all their IP and R&D in the US, the actual tax revenues from the magnificent 7 would be almost identical to the current 21% tax rate including FDDI and R&D tax credits. The agenda is clear: More investment will go to the US, less to Europe and elsewhere.

US corporate tax rate at 15% possible when FDDI and R&D tax credit are eliminated (US$ bn)

in $bn	2023	2022	2021
Magnificent 7 R&D tax credits	8,338	5,956	5,606
Magnificent 7 FDDI	13,501	12,432	8,591
Magnificent 7 corporate tax expense (21%)	**87,683**	**66,136**	**78,280**
Magnificent 7 corporate tax expense (15%)	62,631	47,240	55,914
Magnificent 7 corporate tax expense (15%) without FDDI & R&D tax credits	**84,470**	**65,628**	**70,112**

Source: Individual annual reports of Apple, Microsoft, Alphabet, Amazon, Meta, Nvidia and Tesla

4 https://bipartisanpolicy.org/explainer/the-2025-tax-debate-mandatory-repatriation-and-the-dividends-received-deduction-under-the-tax-cuts-and-jobs-act/
5 https://taxfoundation.org/taxedu/glossary/foreign-derived-intangible-income-fdii/
6 https://bipartisanpolicy.org/explainer/the-2025-tax-debate-gilti-fdii-and-beat-under-the-tax-cuts-and-jobs-act/

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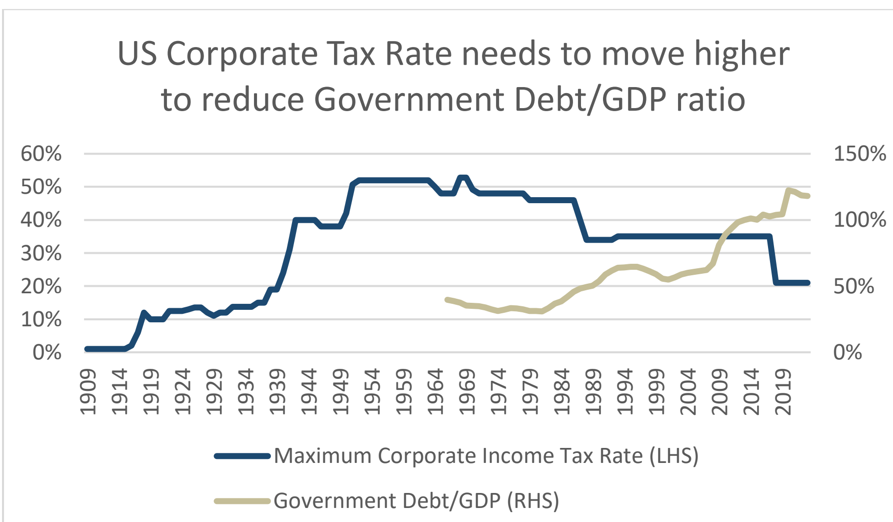
Can the US afford a 15% corporate tax rate?

While the calculation above could make sense for the US to implement, overall corporate taxes are following a different trend elsewhere, which is up. France is considering a temporary 8.5% corporate tax hike to 33.5%[7]. The UK could (I believe should) raise corporate taxes by (say) 2% in the autumn budget, as it could bring in £10bn additional revenue, which would reduce the pressure to hike capital gains taxes and inheritance taxes excessively. If the US were to go against the trend of higher corporate taxes and instead implement higher tariffs to make up for it, it would once again resemble the period of the 1920s, where Europe economically struggled while the US outperformed. But we all know how the story ended, as towards the end of 1920s additional tariffs would not bring the desired results anymore. Therefore, a delay in corporate tax hikes would only lead to more drastic corporate tax hikes later on. Overall, there are only a few ways to reduce government debt, which is via lower interest rates, tariffs and higher taxes, with corporate taxes being the most lucrative at this stage. The complexity of corporate taxes is very much related to globalization. This means, once you need to hike corporate taxes and increase tariffs, it would ultimately lead to deglobalization – a dangerous spiral that could end up being similar to the 1930s/40s.



Source: https://taxfoundation.org/data/all/federal/historical-corporate-tax-rates-brackets/ , FRED St. Louis

7 https://www.reuters.com/world/europe/france-considers-tax-increase-big-companies-le-monde-reports-2024-09-29/

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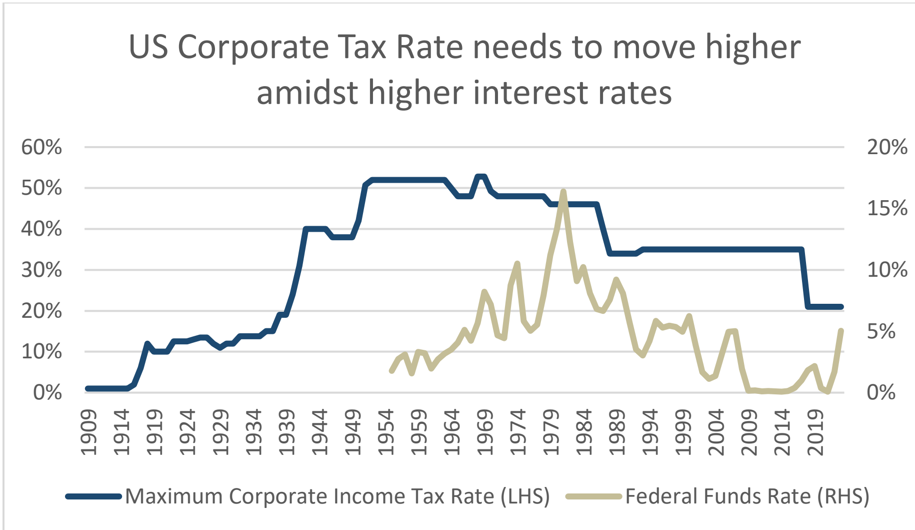
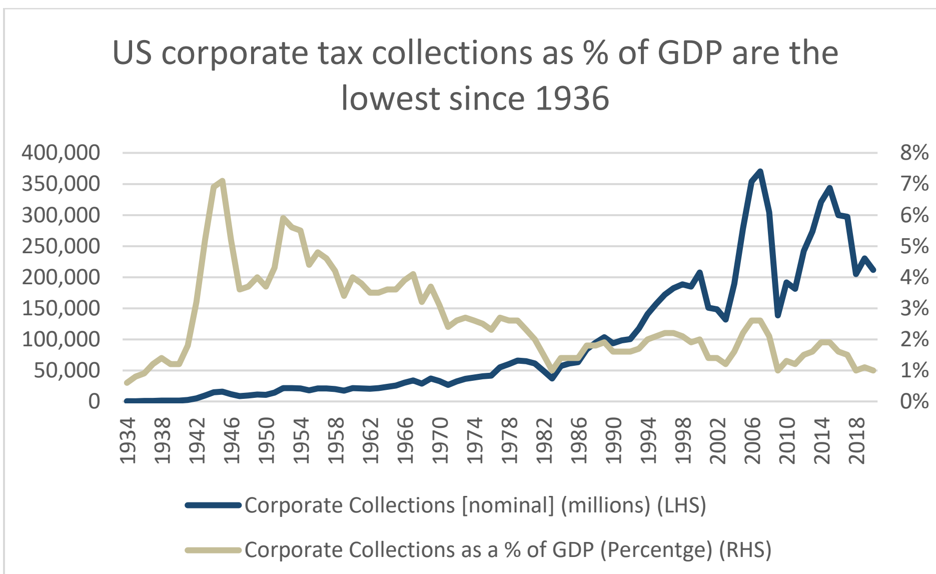


Source: https://taxfoundation.org/data/all/federal/historical-corporate-tax-rates-brackets/ , FRED St. Louis



Source: https://taxfoundation.org/data/all/federal/historical-corporate-tax-rates-brackets/

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China stimulus in context with history

With China being the world's manufacturer, any changes in monetary and fiscal policy can have large impacts on the global economy. Last week's monetary and fiscal stimulus from China was around half in size of the Global Financial Crisis and the Covid-19 Pandemic stimulus. In most historic instances, UST 30yr yields would move down for one month after the China stimulus and then up, while oil prices showed very mixed movements during the initial first months after the stimulus. In the past, China also always put stimulus in place either in May or November. After President Xi came to power in 2013, this pattern stopped. China had to stimulate the economy more often and during different times of the year. Whilst there are no clear patterns for commodities and interest rates after China stimulus in recent years, I would tend to believe that we could see 30yr UST yields go down with oil prices for a month, into the US elections and then move higher – similar to China stimulus cases from the early 2000s.

Historic economic stimulus in China & changes in 30yr UST yields and oil prices

Event	Year	Month	Stimulus size	30yr UST yield change	Oil price change
Asian Financial Crisis stimulus	1998	November	1trn Yuan ($120bn)	Down 1 month, then up	Down 1 month, then up
SARS Epidemic stimulus	2003	May	100bn Yuan ($12bn)	Down 1 month, then up	Up
Global Financial Crisis stimulus	2008	November	4trn Yuan ($586bn)	Down 1.5 months, then up	Down 1.5 months, then up
Economic Slowdown	2012	May	1trn Yuan ($158bn)	Down 1 month, then up	Down 1 month, then slightly up
Monetary Stimulus	2014-15	November	500bn Yuan ($82bn)	Down until April 2015, then up	Down until April, then up
Supply-side reforms and fiscal stimulus	2016	January	1.5trn Yuan ($230bn)	Down 1 month, then slightly up	Down 1 month, then up
Trade War stimulus	2018	July	2trn Yuan ($304bn)	Stable, then up later on as Fed continued hiking	Stable, then down as Fed continued hiking
Monetary stimulus	2019	January	900bn Yuan ($135bn)	Up a touch, 4 months later down	Up
Covid-19 Pandemic stimulus	2020	May	3.6trn Yuan ($500bn)	Up	Up
Economic Slowdown stimulus	2022-23	August	1trn Yuan ($146bn)	Up	Down
Economic Slowdown stimulus	2024	September	2trn Yuan ($284bn)	Up and down so far	Up so far

Source: FRED St. Louis, ChatGPT

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Performance

As mentioned, Q3 2024 has been somewhat disappointing due to the largely lost gains in Oil States International during the quarter, only giving us a positive 5.87% return (exit note here). China's weak economy, the potential decoupling of the US from China and the energy transition has ultimately outweighed the attractive valuation and potential positive outlook for oil in light of lower interest rates and stimulus. Companies in the oil & gas sector have even gotten cheaper since, which could make a potential entry into other companies in the sector still possible in Q4. I have also exited Jupiter Fund Management after receiving the attractive dividend and gaining a small 2% capital return. Jupiter Fund Management remains undervalued, but potential capital gains tax changes in the UK could lead to accelerated outflows (exit note here). I have recently observed large shareholders selling their shares in a variety of different businesses[8]. I have also trimmed down our new holding in Conduit when it became clear that hurricane Helene was exceeding all damage expectations. I'm considering to now add back to the position at a lower price. Trading positions so actively is generally not positive, and I prefer not to do so. However, when I do so, it generally turns out to be the right thing to do. I also bought a position in UKTi 2073, a 50yr UK inflation linked government bond.

Current Holdings

Company	Average Purchase Price	Current Market Price	% change
Conduit Holdings	5.27	5.20	-1%
UKTi 2073	0.85	0.82	-4%

As of 30th September 2024

[8] https://x.com/AozoraStep/status/1833819903570088362

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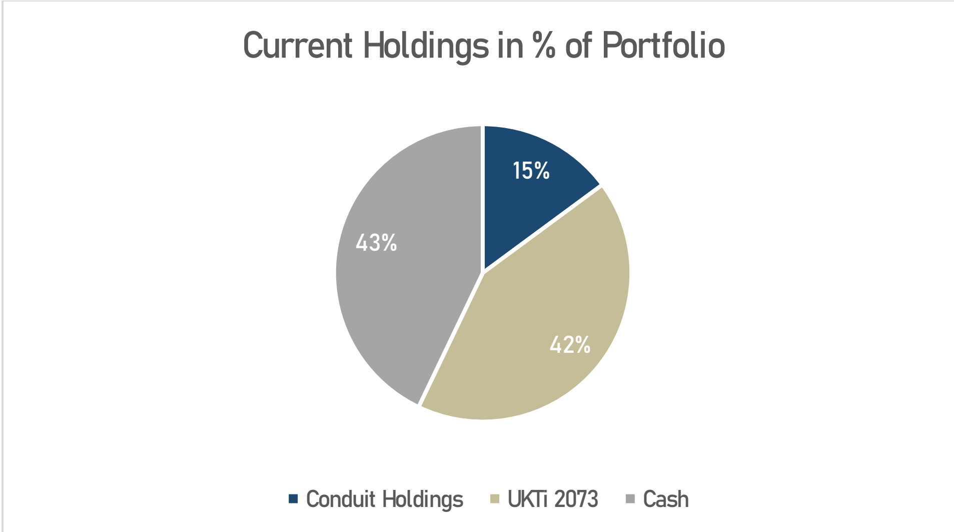

Entry Conduit Holdings

Conduit Holdings is both, positioned in an attractive industry where positive demand/supply dynamics reign (reinsurance), and also valued relatively attractive compared to its peers. Whilst hurricane Helene caused higher insured damage than initially estimated, and now estimated at around $6.4bn according to KCC[9], I estimate the total loss from the year-to-date hurricane season for Conduit at around $25mio. I arrived at this figure by comparing the losses to the $40mio loss Conduit incurred from hurricane Ian. As the maximum insured losses are less than 1/3, but Conduit's revenue nearly doubled, the $25mio loss from four major hurricanes this 2024 season feels appropriate. It would still give Conduit over $200mio in net income for the year compared to a $1.05bn valuation. Key will be whether there is another hurricane formation in the Gulf of Mexico over the next two weeks, which is currently estimated at below 40% chance of developing[10] & how hurricane Helene's losses could still develop higher[11]. Entry note [here](), hurricane update note [here]().

[9] https://www.reinsurancene.ws/kcc-pegs-privately-insured-loss-from-hurricane-helene-at-close-to-6-4bn/
[10] https://tropical.colostate.edu/Forecast/2024-1001.pdf
[11] https://www.artemis.bm/news/some-nerves-evident-as-helenes-florida-claims-outpace-idalia-state-farms-outpace-ian-on-nfip/

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Estimated insured losses from 2024 hurricane season as of 3rd October 2024

Hurricane	Low loss $bn estimate	High loss $bn estimate
Beryl	2.5	4.5
Debby	1	2
Francine	1	3
Helene	5	9

Source: Artemis.bm

Estimated loss from 2024 hurricane season compared to 2022 hurricane Ian

H2	Conduit H2 Revenue in $mio	Minimum hurricane loss in $bn	Maximum hurricane loss in $bn	Conduit loss incurred in $mio (H2 24 estimated)
H2 24	440	10	20	25
H2 Hurricane Ian	220	50	65	40

Source: own estimates

Entering UKTi 2073

I have bought UKTi 2073 a few times in the past with a view of seeing negative real interest rates again. This never quite worked out. This time, I expect the market to get uncomfortable with the risk of a UK budget that spurs tax hikes and the US election. The other main idea is that the UK government is not repeating the 2022 “Mini Budget”. However, as the graph below suggests, the ultra-long bonds (50yr) are trading at a premium compared to the long bonds (30yr) at the moment. 50yr inflation expectations, on the other hand, have recently hit new cycle lows, which generally makes it an attractive entry point. If oil prices were to spike again, the ultra-long end will of course suffer – less so the inflation-linked ultra-long end though.

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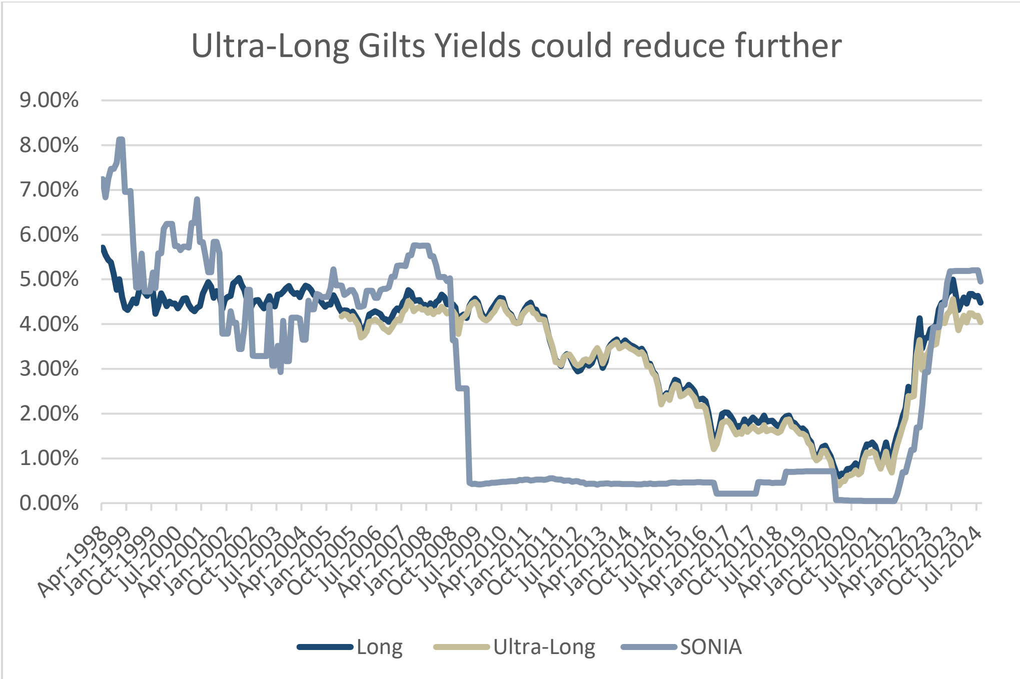

Outlook

The US Presidential election and the UK Budget will be the key events driving markets and I expect that there will be profit taking into these events. This could provide attractive entry points to pick up bargains. If markets remain stable heading into these events, I will position myself to wait for the outcome and then depending on changes in valuation buy into cheaper companies.

Sincerely,

David Herrmann

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