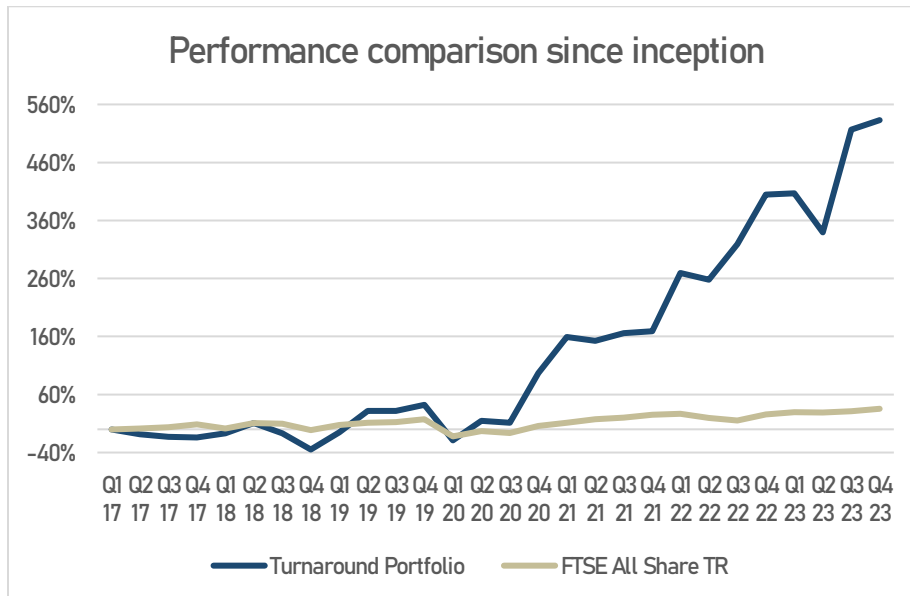


Q4 2023: Another Suez Canal Crisis?

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%

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	22%	5%

Overall Performance	Turnaround Portfolio	FTSE All Share TR
CAGR	30.2%	4.4%
2017-23 Return	533%	35%



7th February 2024

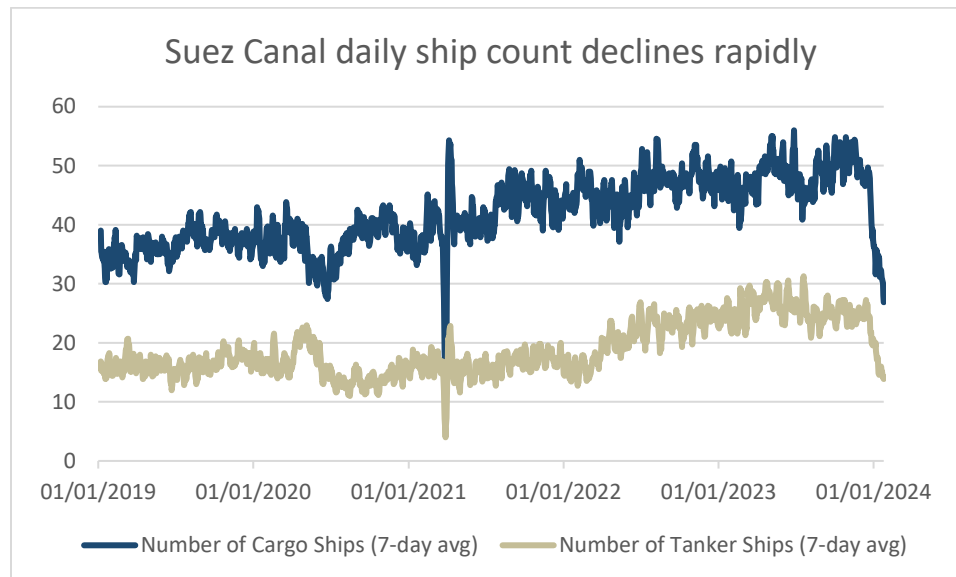
The initial impact of the Houthi attacks on shipping in the Red Sea

We are now well over three months into the Gaza War and the Houthi attacks on international shipping continue despite retaliatory attacks by the US and UK. So far, we have seen a decline of 50% in container ships and tankers that select the Suez Canal, with a near offsetting number of increase around the Cape of Good Hope. Insurers priced the “probability of getting hit & destroyed” by Houthis in the Red Sea at around 0.7% at its initial peak by mid-January (equivalent to \$800k in insurance costs per trip for a vessel with a total insurable value of \$120mio), compared to 0.05% prior to the Israel-Hamas war¹. Since then, the situation has further escalated, and insurance rates have climbed to around 1% of its value as of end of January 2024². Meanwhile, container freight rates have moved to levels last seen during the Covid lockdowns, and we have yet to see the 2nd round effects of a shortage of container boxes, which would lead to port congestion. Container freight levels could test the heights of the pandemic, as a 10-day detour

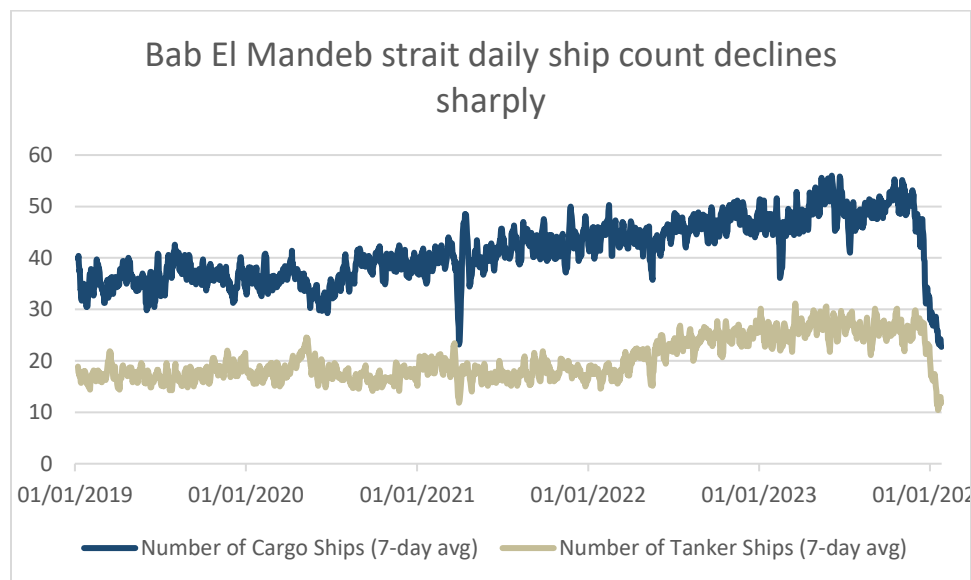
¹ <https://www.insurancebusinessmag.com/us/news/marine/red-sea-attacks--whats-the-war-insurance-impact-473010.aspx>

² <https://www.insurancebusinessmag.com/uk/business-news/houthi-hit-on-russian-fuel-has-traders-recalculating-risks-474725.aspx>

around the Cape of Good Hope doubles to 20-days on a return journey, which is equivalent to the delays we have had at the Port of LA and Long Beach during the pandemic³.

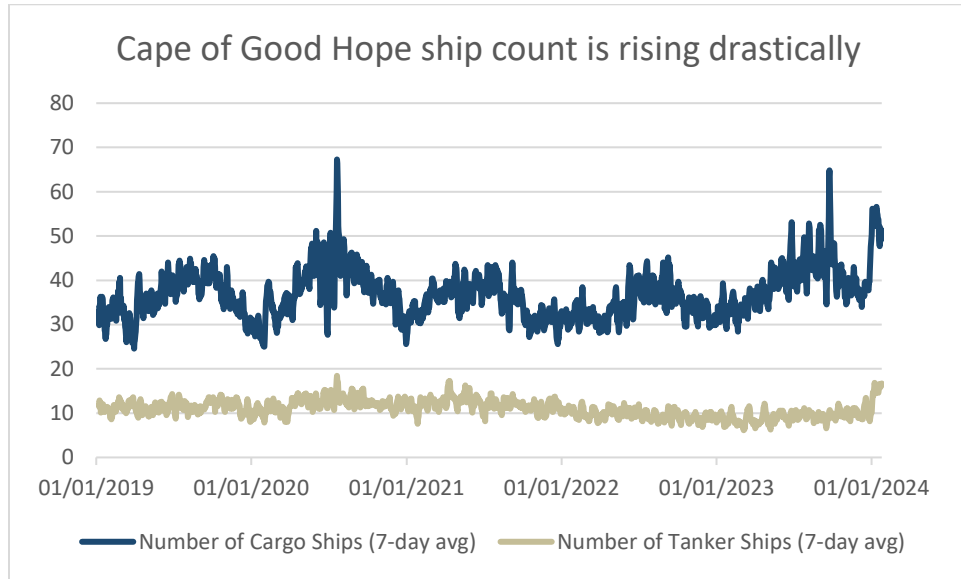


Source: IMF Portwatch

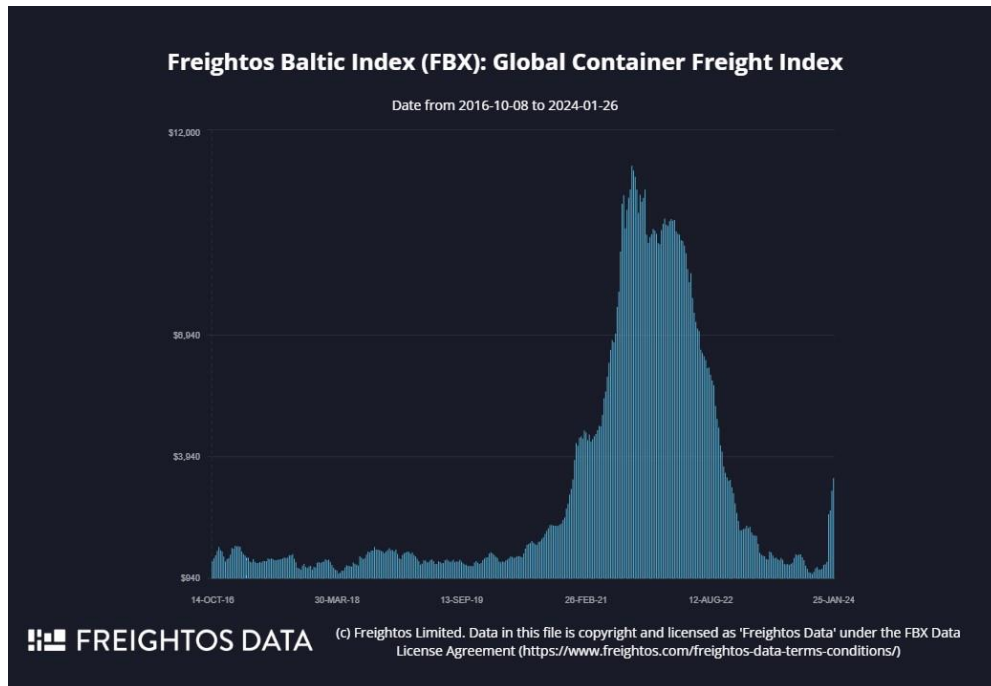


Source: IMF Portwatch

³ <https://www.wsj.com/articles/container-ship-backup-at-southern-california-ports-is-receding-11644523945>



Source: IMF Portwatch



Source: Freightos.com

Why the Houthi attacks don't necessarily disrupt oil flows

Then there is the big question of how the rerouting of oil could impact oil inventories and prices? The daily tanker count in the charts above showed that while tanker count at the Bab El Mandeb strait declined by well over 50%, the decline was less severe for the Suez Canal. The reason for the divergence is the East-West Pipeline in Saudi Arabia. The East-West Pipeline in Saudi Arabia has a capacity of 5mio b/d (was sought to be expanded to 7mio b/d in case Iran would ever shut the Strait of Hormuz⁴), but has only been used for around 1-1.5mio b/d in recent years. In fact, Saudi Arabia's East-West Pipeline could feed the entire demand of oil that needs to flow northwards through the Suez Canal, and Saudi Arabia has doubled its exports in the month of January 2024 according to Aramco port shipping data⁵. However, we have seen a number of tankers rerouting around the Cape of Good Hope nevertheless⁶, as not all European oil imports come from Saudi Arabia and certain refined fuel types can't be transferred through the pipeline. On the other hand, 4mio out of the 5mio b/d southbound volumes are originated in Russia⁷, and hence are somewhat less of a subject of disruption – although the Trafigura incident⁸ could change this. Overall, I would expect to see some larger oil inventory draws, especially in Europe & especially due to the 300k b/d of distillates that India refines from Russian oil to ship to Europe⁹, which should be supportive for oil prices.

⁴ <https://www.argusmedia.com/en/news/1952657-saudi-aramco-fasttracks-eastwest-pipeline-expansion>

⁵ https://www.rigzone.com/news/saudis_continue_sending_oil_via_tense_red_sea-26-jan-2024-175520-article/

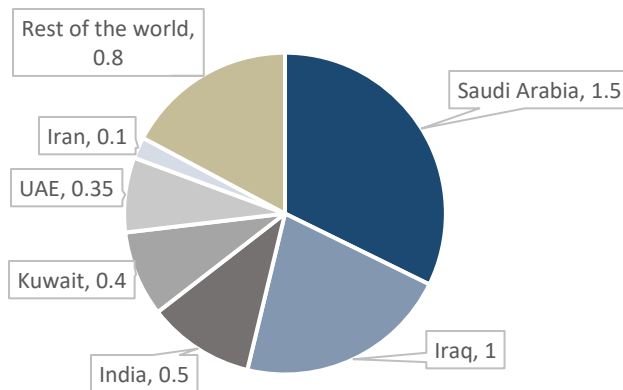
⁶ <https://www.vortexa.com/insights/products/the-global-oil-demand-slowdown-east-versus-west/>

⁷ <https://www.eia.gov/todayinenergy/detail.php?id=61025>

⁸ <https://www.bnnbloomberg.ca/oil-tanker-hit-by-missile-was-carrying-russian-fuel-trafigura-says-1.2027229>

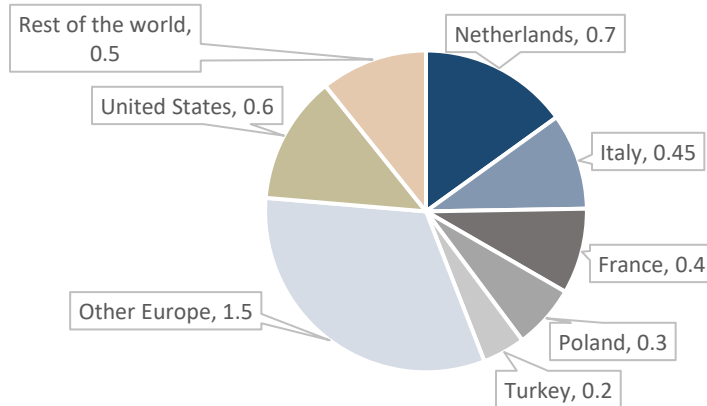
⁹ <https://www.bloomberg.com/news/articles/2023-11-27/europe-is-guzzling-diesel-from-india-a-key-buyer-of-russian-oil>

4.65mio bopd Northbound crude oil and petroleum product volumes transiting Suez Canal and SUMED pipeline in mio barrels per day by country of origin



Source: US EIA, Vortexa tanker tracking

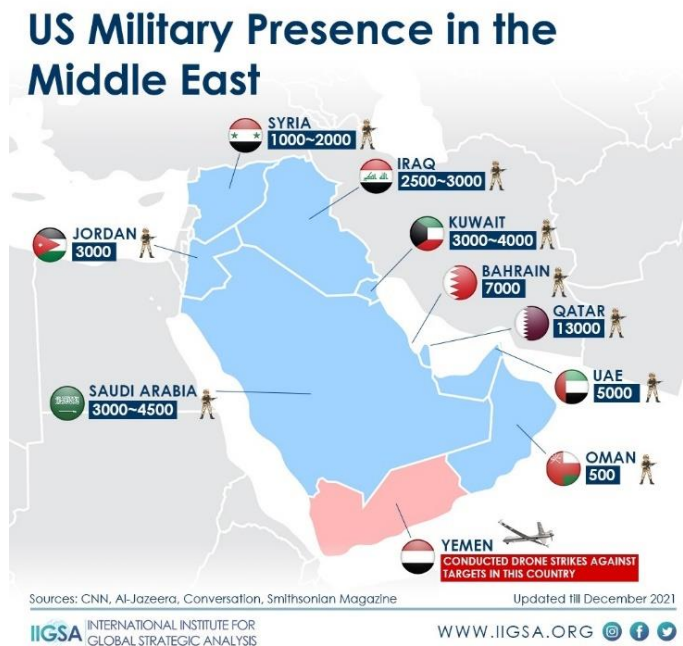
4.65mio bopd Northbound crude oil and petroleum product volumes transiting Suez Canal and SUMED pipeline in mio barrels per day by country of destination



Source: US EIA, Vortexa tanker tracking

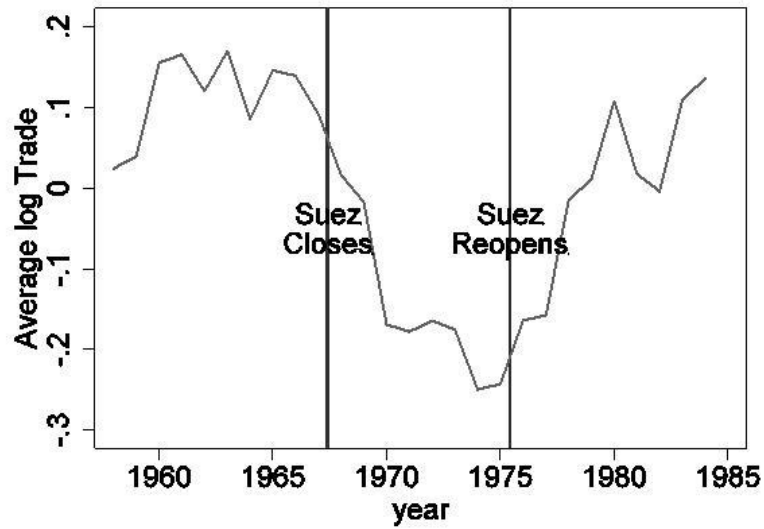
Are we going to war against Iran?

The Middle East is pretty much conquered by the US. There are military bases in almost all countries apart from Iran, Yemen, Lebanon and Palestine. And in exactly these countries, as well as in Iraq and Syria, Iran is a major power by supplying militants with weapons. The strategic location of these countries is key for the transport of oil. Iran could block the Strait of Hormuz, Yemen could block the Bab El Mandeb strait, Palestine and Lebanon/Hezbollah are surrounding Israel and had historic significance with oil pipelines passing through, and Iraq and Syria are connecting Iran to the Mediterranean Ocean, have a pipeline network (partly legacy) and also high reserves of oil and gas. When the Suez Canal closed between 1967-1975, there was a significant decline in global trade. This occurred gradually over multiple years¹⁰, and could once again occur today with Yemen in control of the Bab El Madeb strait. At one point, however, either the US needs to negotiate with Iran or the US needs to fight Iran directly in order to bring the region under control yet again.



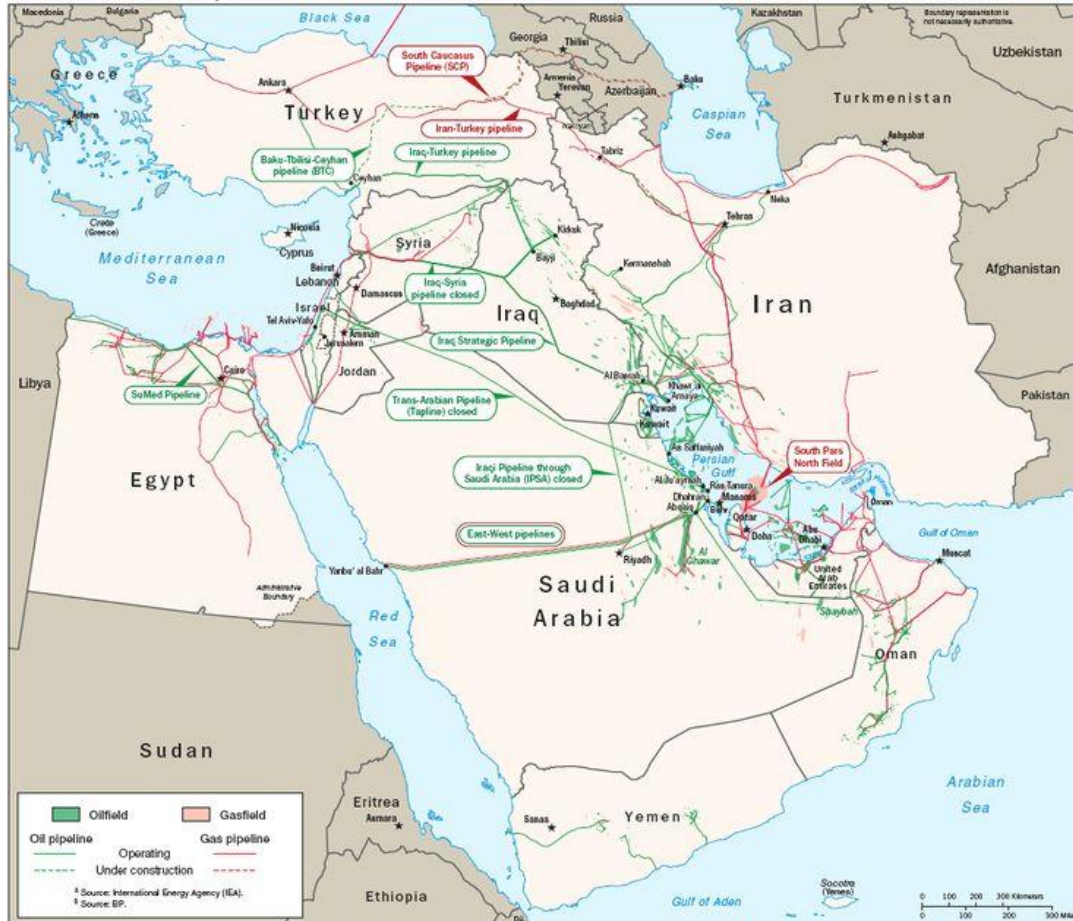
¹⁰ <https://cepr.org/voxeu/columns/1967-75-suez-canal-closure-lessons-trade-and-trade-income-link#:~:text=The%20aggregate%20effect%20on%20trade,roughly%2030%25%20during%20the%20closure.>

The fall in trade caused by closing Suez



Source: IMF direction of trade database, James Feyrer, Vox EU (note: average bilateral trade residuals for country pairs with distance increases over 50%. Residuals from a regression with country pair and year dummies)

Selected Oil and Gas Pipeline Infrastructure in the Middle East



Source: Researchgate.net

Historic yield curve inversions predict recessions, but asset prices direction is unclear

Another risk we face is the yield curve inversion, which is now counting over 62 weeks for the 10yr UST vs. Fed Funds (as of end of January 2024). History, unfortunately, doesn't teach us a clear lesson as to how equity valuations and oil prices move, as results differ across several time periods. The length of the inversion and strong equity performance throughout the yield curve inversion with over 20.6% return is most similar to the 19.2% return and 81-week inversion during 2006-08. However, oil prices declined by -10% during the current inversion amidst Strategic Petroleum Reserve (SPR) releases compared to a near 19% climb during 2006-08, as the US was building up their SPR. The US is now also refilling their SPR, and combined with the geopolitical risks and China stimulus, and if the US were to cut interest rates first and faster than elsewhere, this could lead to a US\$ depreciation and a higher US\$ oil price.

Historic yield curve inversions and oil and equity prices

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 (end January 2024)	62	-10.0%	?	20.6%	?

Source: FRED St. Louis

Performance

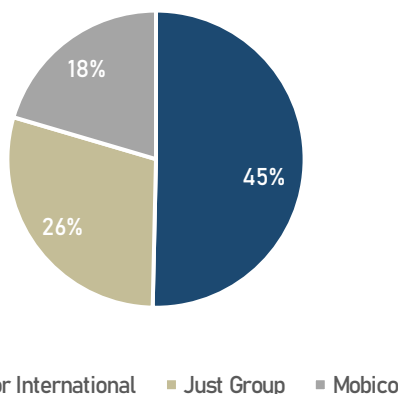
2023 has been a volatile year in terms of performance. If I hadn't been regulated, I'd been a lot more flexible in managing the portfolio, and on two occasions would have increased a position that yielded high returns. Overall, the performance was satisfactory. At the time of writing, I have exited the position in Tremor International (now Nexxen) and focused the portfolio on Mobico and Just Group.

Current Holdings

Company	Average Purchase Price	Current Market Price	% change
Tremor International	1.52	2.04	34%
Just Group	0.84	0.86	2%
Mobico	0.76	0.85	11%

As of 31st December 2023

Current Holdings in % of Portfolio

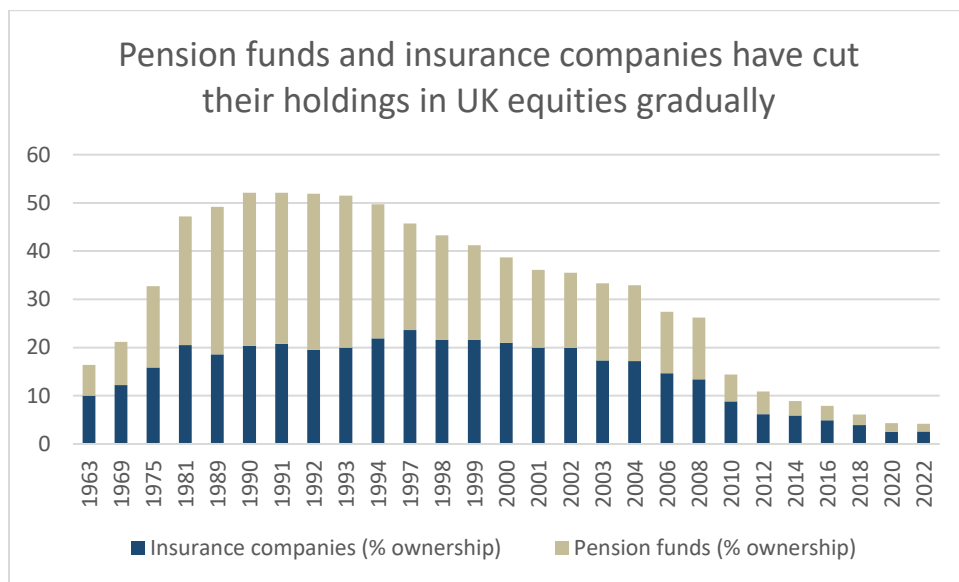


Outlook

Details on Mobico and Just Group can be found by clicking on the links: [Mobico](#) & [Just Group](#). The outlook for the UK is somewhat mixed. The key is that the UK has the highest share of inflation linked government bonds worldwide at 25% of total outstanding. To reduce inflation is therefore extremely important for the country, which is being done by the Bank of England with higher interest rates to reduce demand, and by multiple regulators to increase supply. Last year, the UK regulators announced a number of reforms, all of which have the goal of reducing inflation or compensating customers (full list [here](#)):

1. FCA is looking at firms that are not paying customers for interest on their cash balances ([here](#))
2. FCA introduced the Consumer Duty, which particularly hit insurance companies, as they need to charge their existing clients the same premiums as their new clients ([here](#))
3. FCA is undertaking work to reduce interest rates that customers pay for their motor finances ([here](#))
4. OFCOM proposes ban on broadband and mobile inflation-linked mid-contract price rises ([here](#))
5. The Office for Rail and Road (ORR) is looking at ways to increase competition in railway station catering ([here](#))
6. OFGEM is looking at ways to reduce debt-related costs for customers ([here](#))
7. OFWAT continues its fight against the UK's water companies to reduce its sewage discharges into the environment ([here](#))

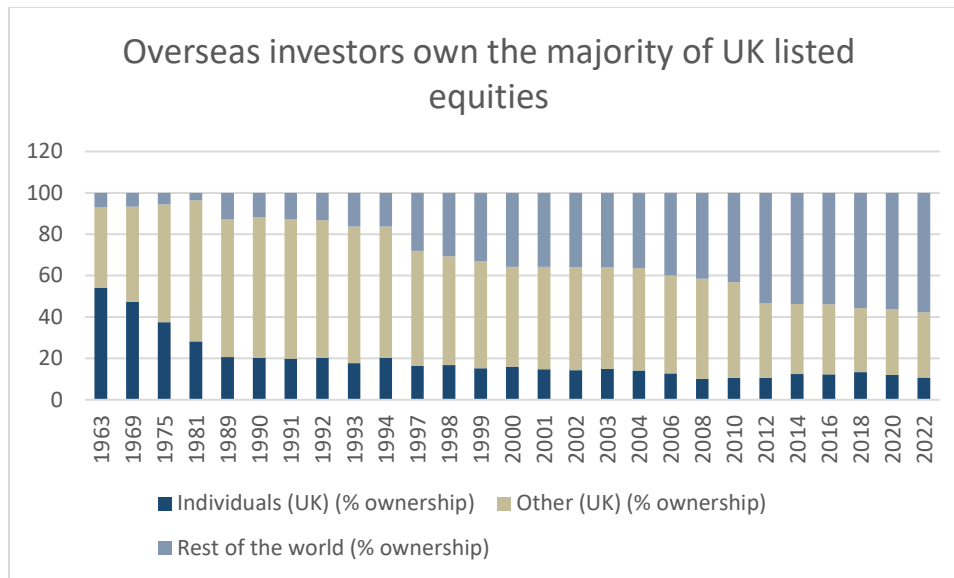
I remain highly skeptical of the high interest rates, as it also increases mortgage costs, vehicle financing and any other consumer financing rates, which will keep core inflation elevated. The harsh regulatory system in the UK also ultimately reduces investment, as companies become less profitable. The actions being taken by the regulators right now present a real danger to UK's corporate profitability. On top of the regulatory constraints, from April 2024 the national minimum wage will climb by nearly £1 to £11.44¹¹. Therefore, the outlook for UK equities varies considerably given the number of new regulatory reforms in progress. But it doesn't need to be this way. The UK has over £1.4trn in pension assets of defined benefit pension schemes alone¹², of which nearly half is invested abroad. Regulatory changes in the deployment of these funds, for instance by making it mandatory to invest in the UK, could result in an investment boom locally, especially in UK equities. This is a very strong hand the UK government could and probably will eventually play...



Source: Office for National Statistics

¹¹ <https://www.gov.uk/national-minimum-wage-rates>

¹² <https://www.ppf.co.uk/PPF-7800-index>



Source: Office for National Statistics

Sincerely,



David Herrmann



Legal Disclaimer

The contents of this publication have been prepared solely for the purpose of providing information about AozoraStep Capital LLP and the services and products it is intending to offer, which are targeted for professional investors only. The opinions and views expressed are those of AozoraStep Capital LLP, may change without notice and should not be construed as investment, tax, legal or other advice. AozoraStep Capital LLP does not guarantee the completeness and accuracy of the information provided and all content can become out of date. Products or services mentioned in this publication are subject to legal and regulatory requirements in applicable jurisdictions and may not be available in all jurisdictions. Accordingly, persons are required to inform themselves and observe any such restrictions. In respect to investments described in this document, past performance is not a guide to future performance. The value of investments and the income of any financial instruments mentioned in this document may fall as well as rise and may have tax consequences. The performance of the investment strategy that AozoraStep Capital LLP is planning to offer is based on a personal track record and approved by Sedulo for the time period Q1 2019 - Q1 2021 and by HiCloud Accounting for the time period 2020 - 2022, only with further examinations being done on an occasional basis. AozoraStep Capital LLP is currently not authorized and regulated by the FCA, and therefore, is not allowed to provide financial products and services. AozoraStep Capital LLP is registered in England and Wales with registered number OC436835. Registered Office: 21 Knightsbridge, London SW1X 7LY, United Kingdom. Reproduction or distribution of any materials obtained in this document or linking to this document without written permission is prohibited.