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A UK focused Turnaround Value Investment Partnership

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# 2023 MACRO OUTLOOK

1. Inflation or deflation - US
2. European energy crisis – End in sight?
3. 2023 Outlook

# 1. INFLATION OR DEFLATION – US

# US CPI – INFLATION IS SET TO DECLINE IN NOV/DEC

## +0.4% September 2022 CPI Print

### Biggest drivers:

- 1.1% used cars (4.0% weight)
- +0.7% new vehicles (4.05% weight)
- +2.5% car and truck rental (0.15% weight)

- 1.0% lodging away (0.97% weight)
- +0.8% airline fares (0.62% weight)
- +0.8% rent of shelter (32.1% weight)
- +1.9% transportation services (5.9% wgt)
- 0.3% apparel (2.43% weight)
- 2.1% energy (8.24% weight)

+0.8% Food (13.63% weight)

+1.0% Medical care services (6.89% wgt)

## +0.4% October 2022 CPI Print

### Biggest drivers:

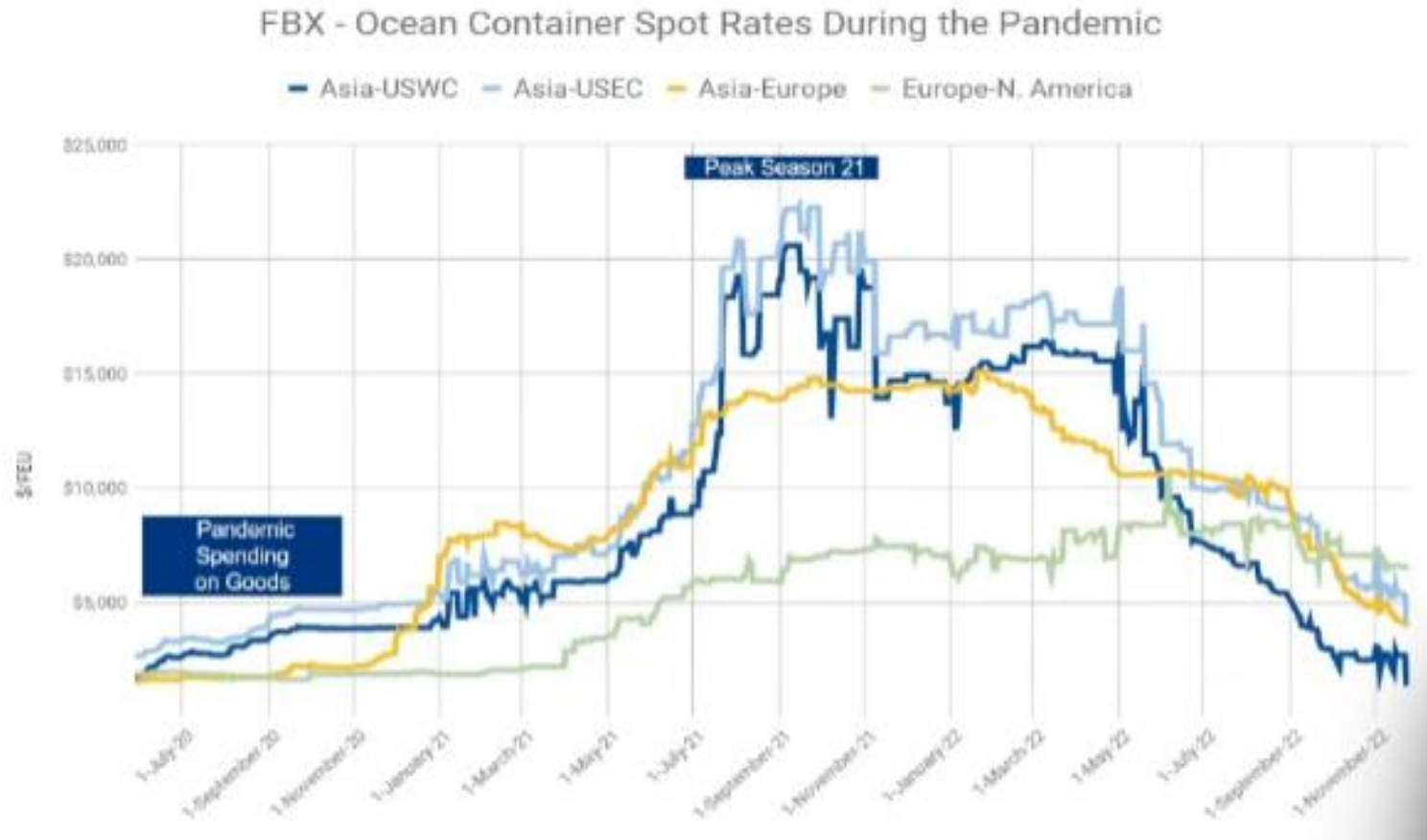
- 2.4% used cars (3.8% weight)
- +0.4% new vehicles (4.05% weight)
- 0.5% car and truck rental (0.14% weight)

- +4.9% lodging away (0.93% weight)
- 1.1% airline fares (0.62% weight)
- +0.8% rent of shelter (32.6% weight)
- +0.8% transportation services (5.9% wgt)
- 0.7% apparel (2.48% weight)
- +1.8% energy (8% weight)

+0.6% Food (13.7% weight)

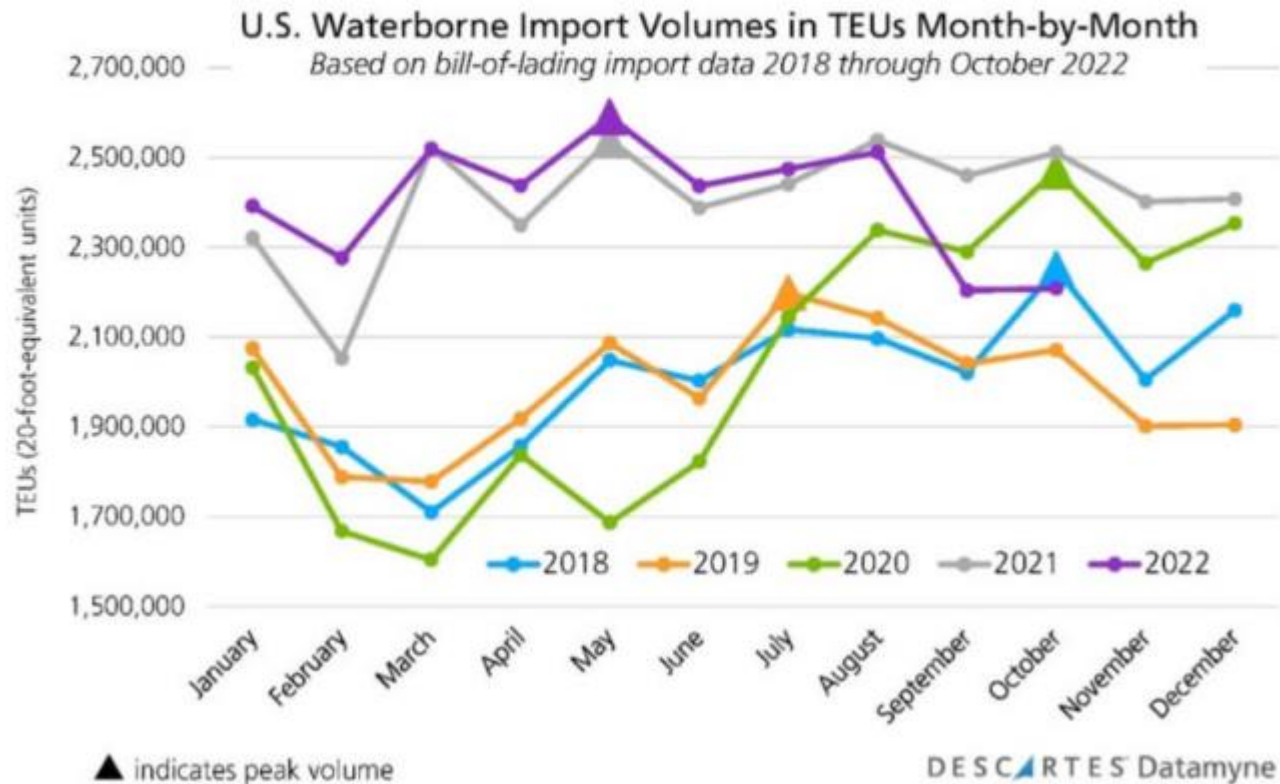
-0.6% Medical care services (6.9% wgt)

# US CPI – OCEAN CONTAINER RATES BACK TO PRE-COVID



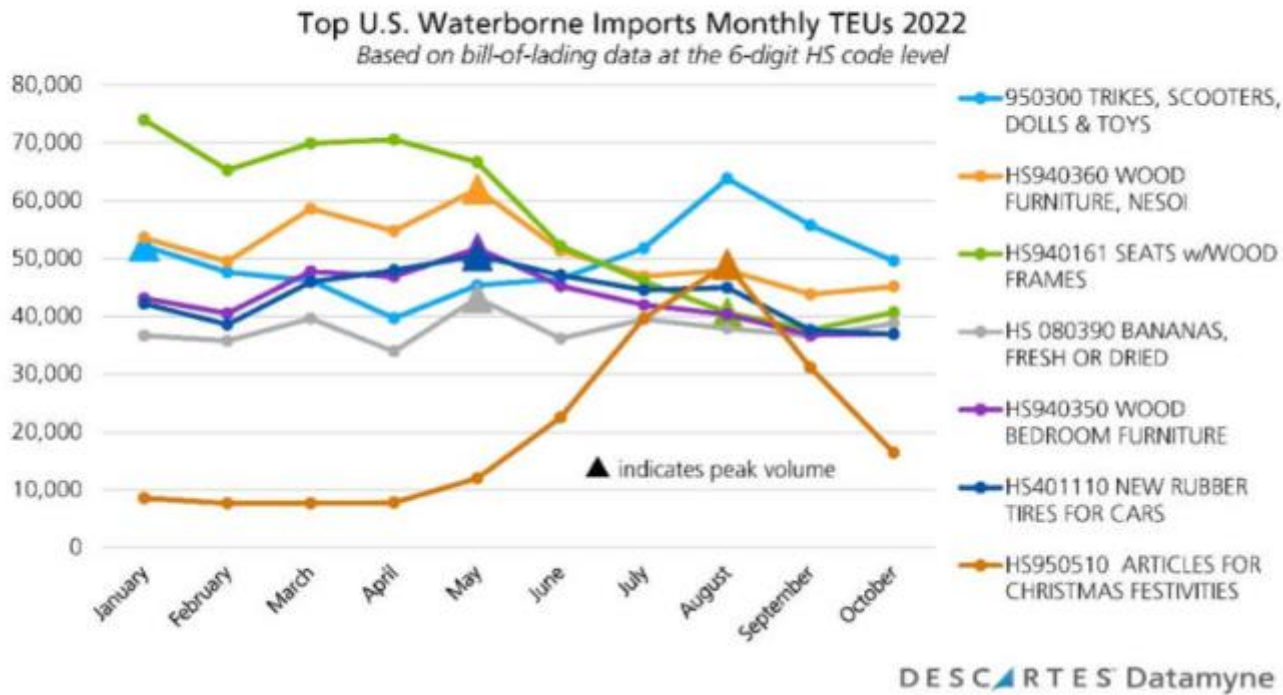
# US CPI – VOLUMES ARE FALLING BACK TO PRE-COVID

Figure 1: U.S. Container Import Volume Year-over-Year Comparison



# US CPI – FURNITURE AND TOYS ARE COMING BACK DOWN

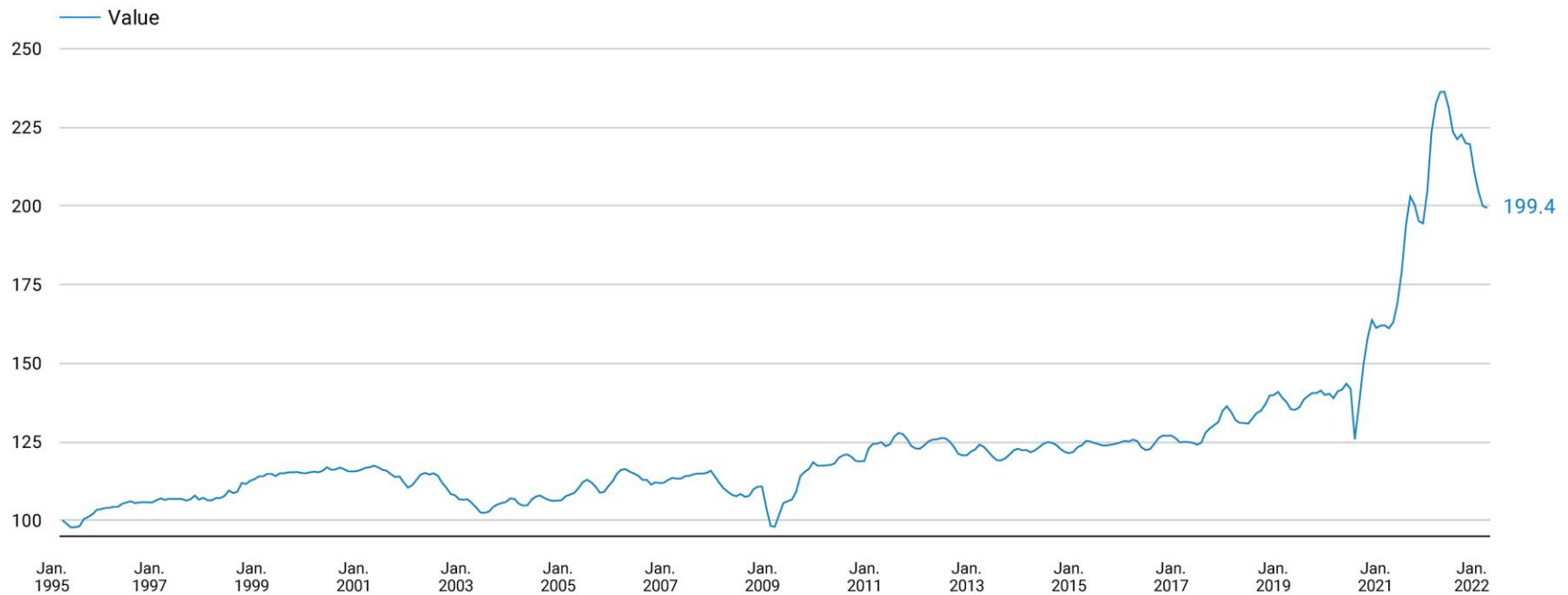
Figure 4: Import surges associated with year-end holiday demand





# US CPI – USED CAR PRICES DOWN -14.5% Y-O-Y IN NOV

## MANHEIM USED VEHICLE VALUE INDEX *November 2022*

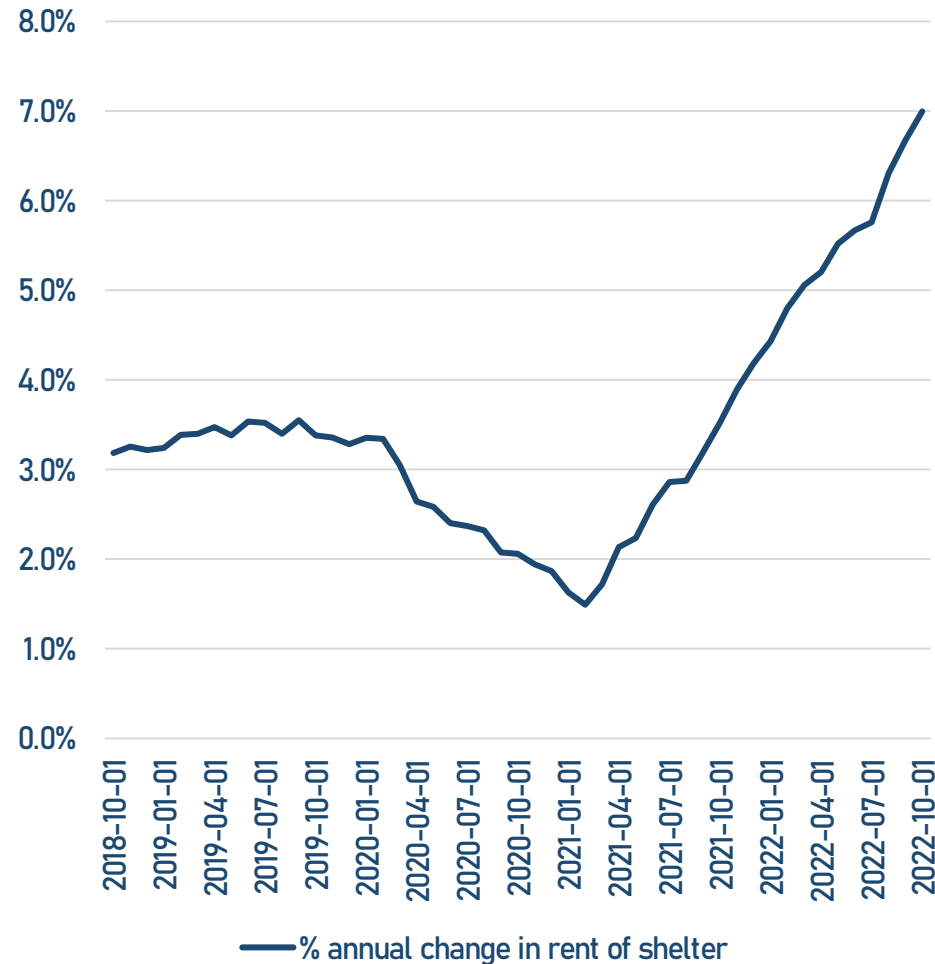


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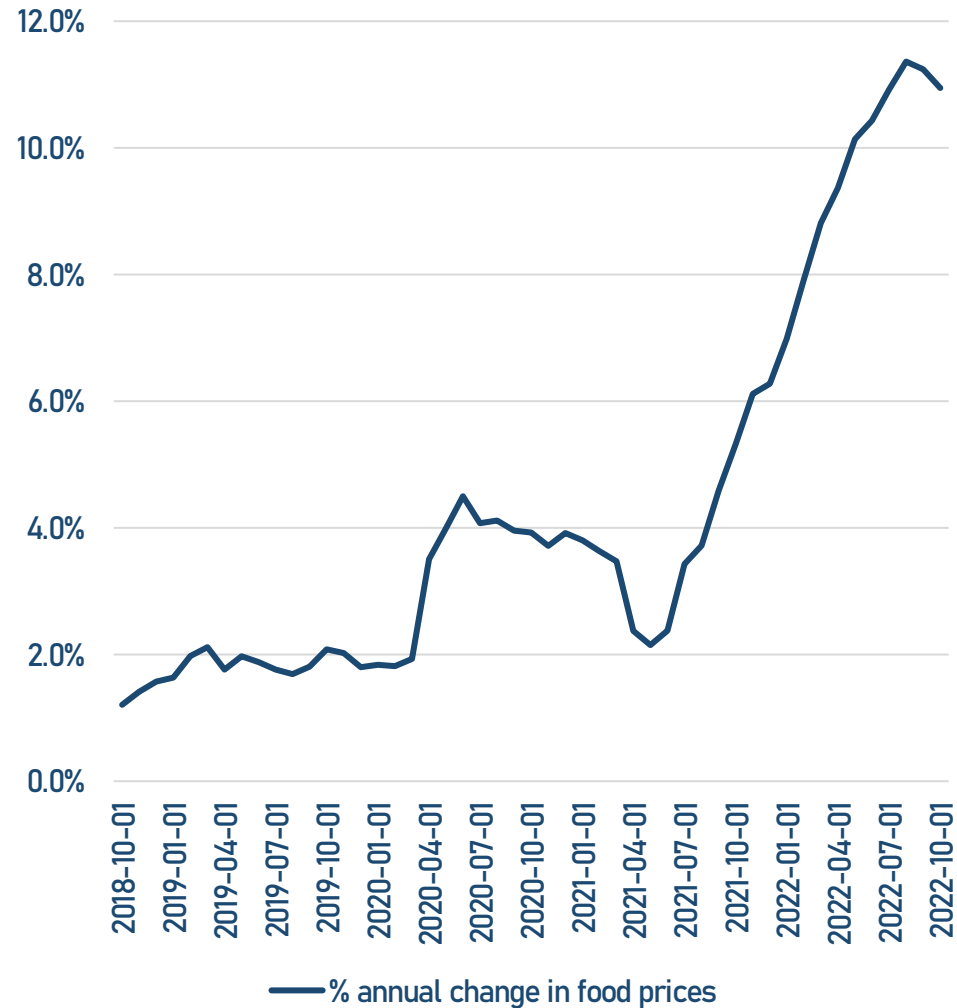


# US CPI – Y-O-Y INFLATION IS STARTING TO DROP

US rent of shelter in cities continues to move higher

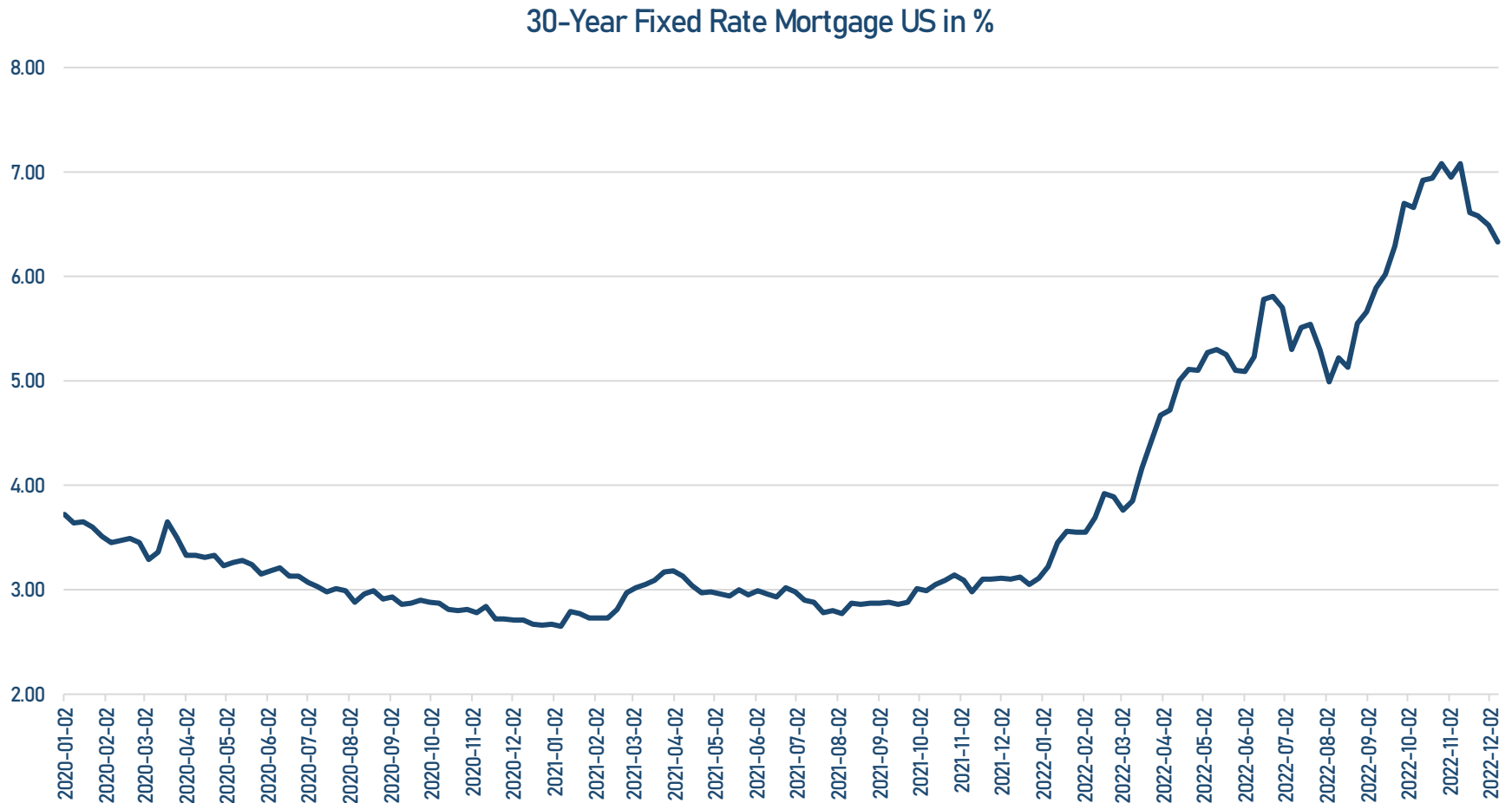


US food inflation appears to have peaked



# US CPI – MORTGAGE RATES ARE DECLINING

- Lower mortgage rates makes buying more attractive vs. renting



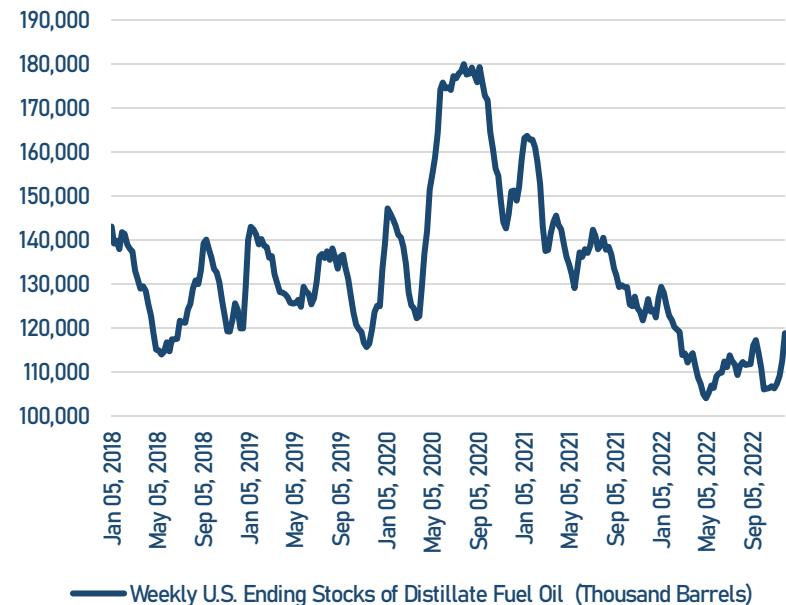
# US CPI – OIL PRICES HAVE COME WAY DOWN

- \$60 Russian price cap irrelevant, as Urals already trade in \$ mid-50
- End of SPR releases has come at a time when Diesel inventories began rising against seasonal norm

OECD commercial inventories of crude oil and other liquids



US distillate fuel oil inventories are rising in November – against seasonal norm



# US CPI – OIL PRICES HAVE COME WAY DOWN

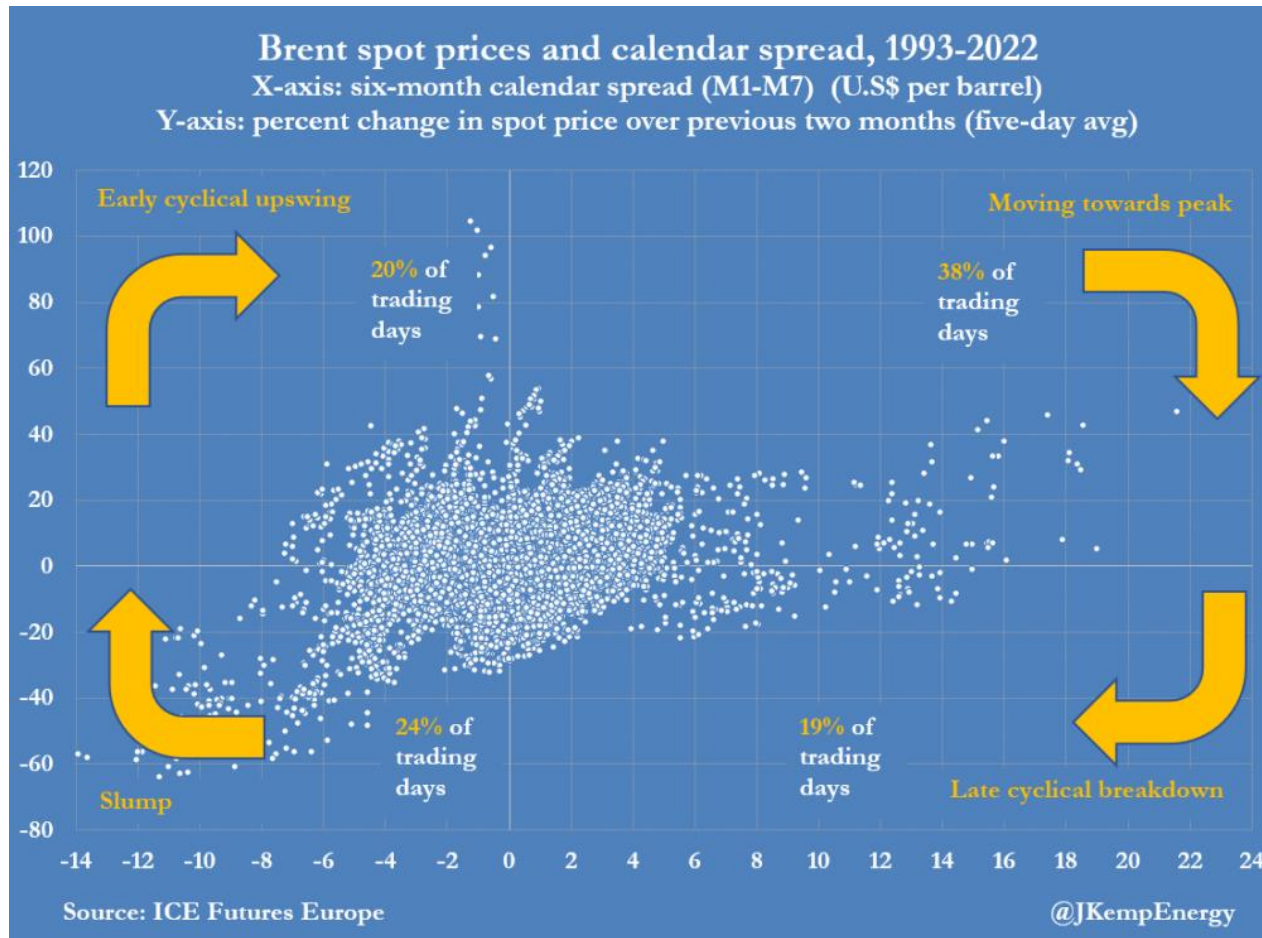
- Oil prices not in equilibrium yet

A dovish Fed could stabilise oil



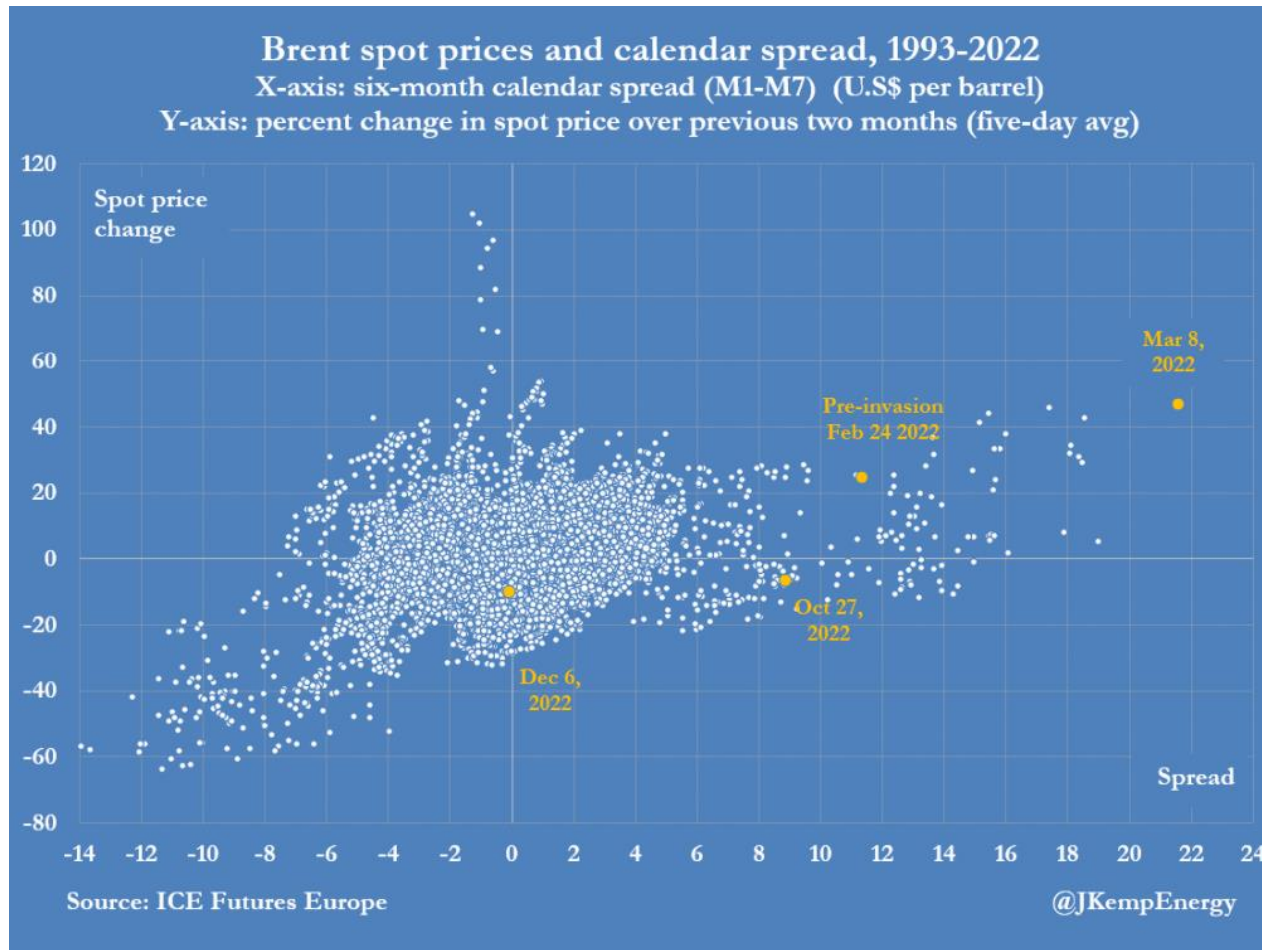
# US CPI – OIL PRICES HAVE COME WAY DOWN

- Oil business cycle is very cyclical



# US CPI – OIL PRICES HAVE COME WAY DOWN

- We are approaching “Slump” cycle....



# US CPI – SUMMARY THOUGHTS

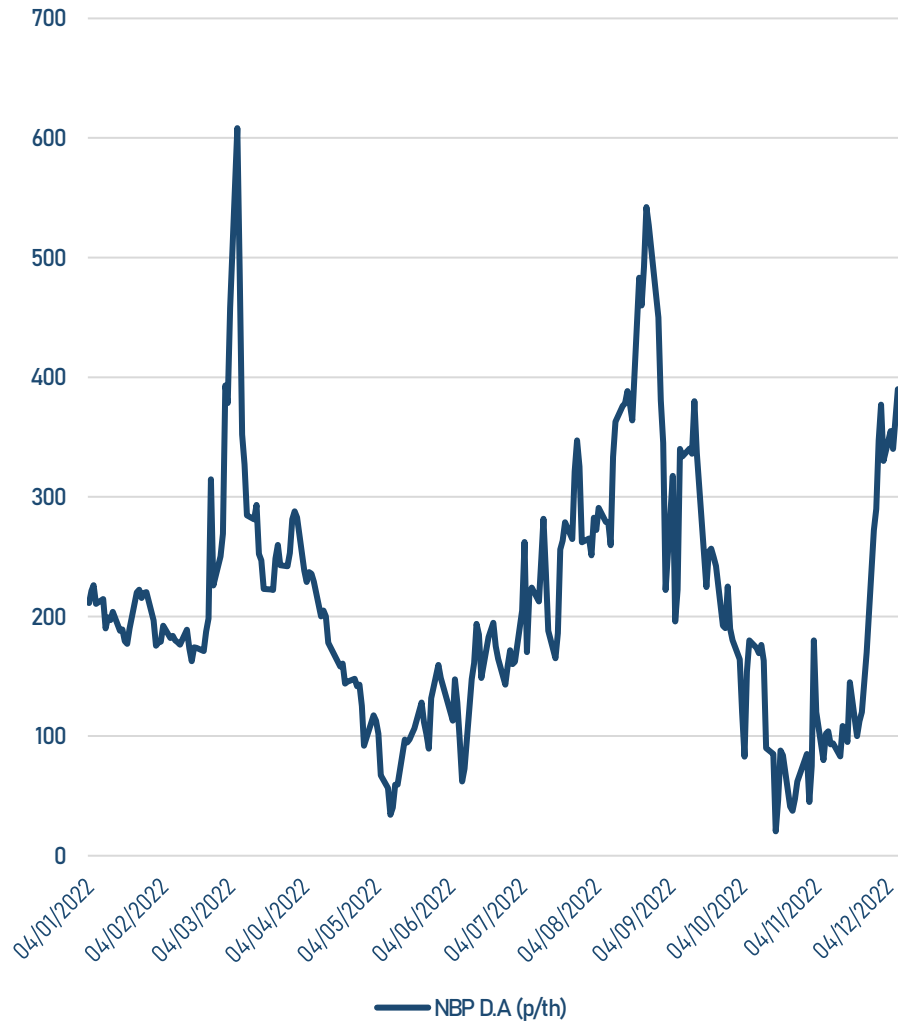
- US CPI has peaked
- Energy prices have come down and were a major trigger of inflation in other items such as food and ultimately labour costs
- Rent of shelter is the last remaining category to fall
- Rent of shelter in cities will likely start falling, as people are finalizing their move back to cities after moving out during the lockdowns
- Mortgage rates have come down, getting back to balance of affordability in renting vs. buying
- The cost-of-living crisis = Cost-of-lockdown crisis
- European inflation will depend on gas prices...



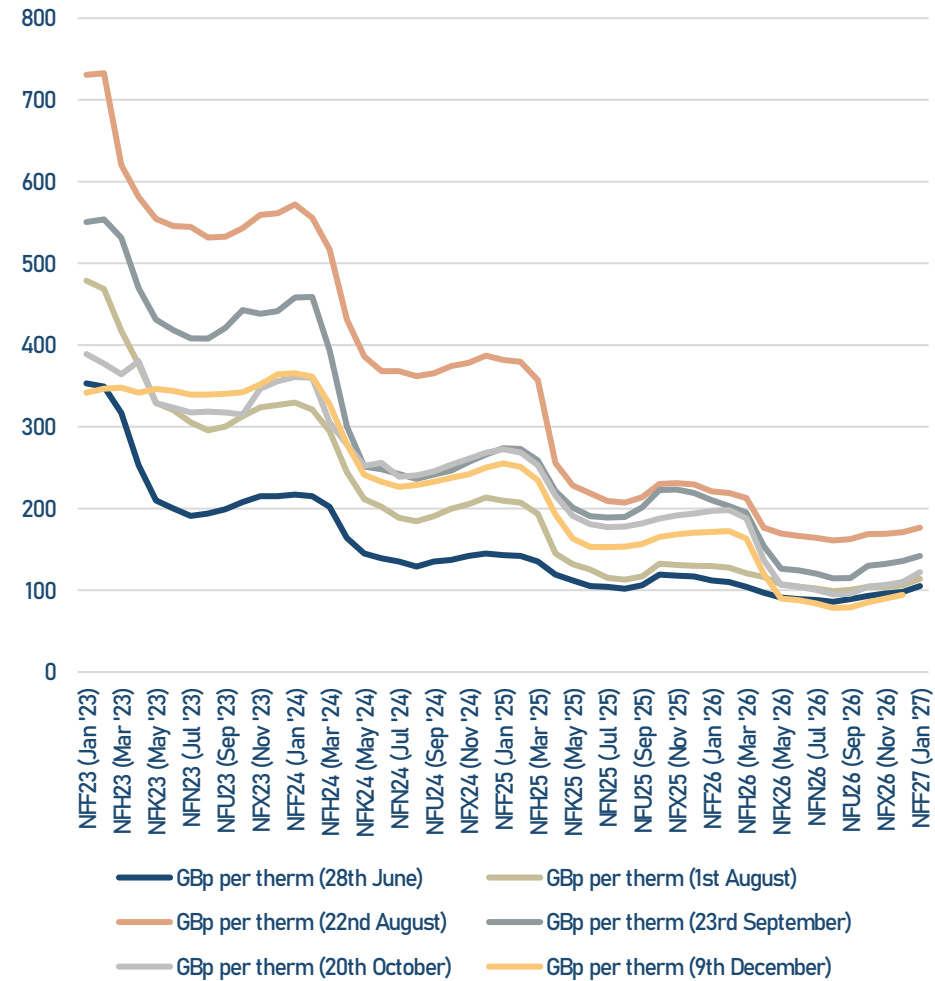
## 2. EUROPEAN ENERGY CRISIS – END IN SIGHT?

# FUTURES GAS PRICES REMAIN ELEVATED

UK day-ahead gas prices have surged again



UK future gas prices remain elevated, but near-term have come down from excessive levels



# GAS STORAGE WITHDRAWALS LOWER DESPITE FREEZE

18 <sup>th</sup> Nov	EU Gas Storage Full %
18/11/2017	85
18/11/2018	86
18/11/2019	96
18/11/2020	93
18/11/2021	73
18/11/2022	95

7th Dec	EU Gas Storage Full %
07/12/2016	75
07/12/2017	76
07/12/2018	79
07/12/2019	92
07/12/2020	84
07/12/2021	64
07/12/2022	90

Year	Dates	Withdrawal (GWh)	EU Gas Storage Full % Start	EU Gas Storage Full % End
2016	29th Nov - 7th Dec	65,598	80	75
2017	29th Nov - 7th Dec	59,923	81	76
2018	29th Nov - 7th Dec	33,408	81	79
2019	29th Nov - 7th Dec	30,018	94	92
2020	29th Nov - 7th Dec	60,402	89	84
2021	29th Nov - 7th Dec	58,122	68	64
2022	29th Nov - 7th Dec	41,912	93	90

# RUSSIAN GAS IMPORTS HAVE NEARLY ALL BEEN REPLACED

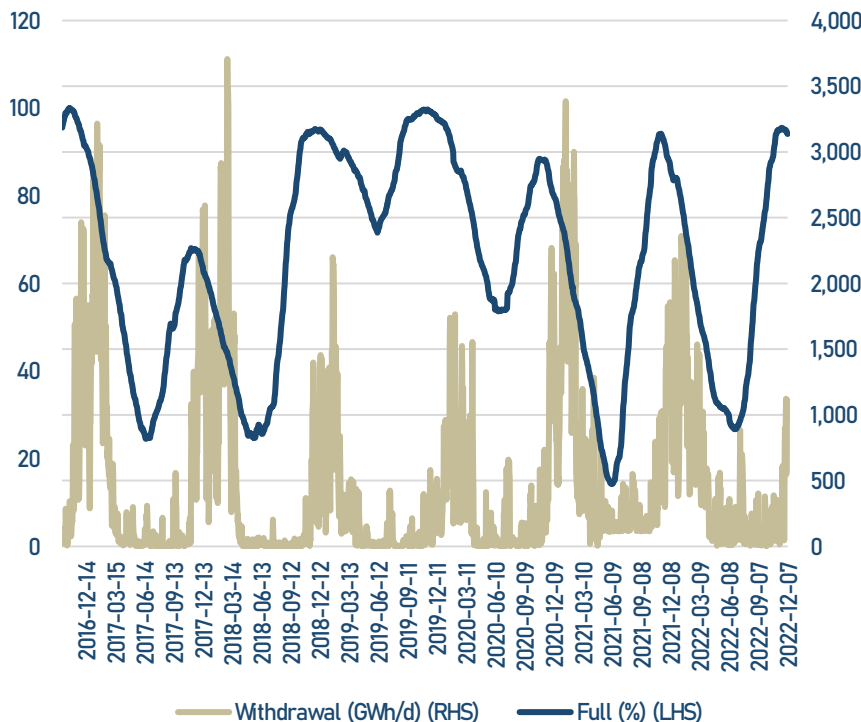
- Annual gas consumption of EU (excluding UK and Ukraine) is 3,776 TWh (AGSI)
- Net loss imports due to Russia ~150 TWh

Pipeline/LNG carrier	Europe imports 2019 (in TWh)	Current imports (annualised in TWh)	Pipeline/LNG carrier	Europe imports 2019 (in TWh)	Estimated current imports (annualised in TWh)
Russia Yamal Pipeline	358	0	Norway pipelines	1065	1200
Russia Nord Stream Pipeline	596	0	Norway LNG Carrier	59	59
Russia Ukraine Pipeline	433	87	Qatar LNG Carrier	293	293
Russia TurkStream Pipeline	347	347	Algeria Pipeline	205	300
Russia Blue Stream Pipeline	173	173	Algeria LNG Carrier	98	98
Russia LNG Carrier	228	250	Libya Pipeline	49	49
Total	2134	857	US LNG Carrier	166	992
Difference		-1278	Nigeria LNG carrier	127	127
			Trinidad and Tobago LNG carrier	59	59
			Other LNG carrier	49	100
			Total	2170	3277
			Difference		1107

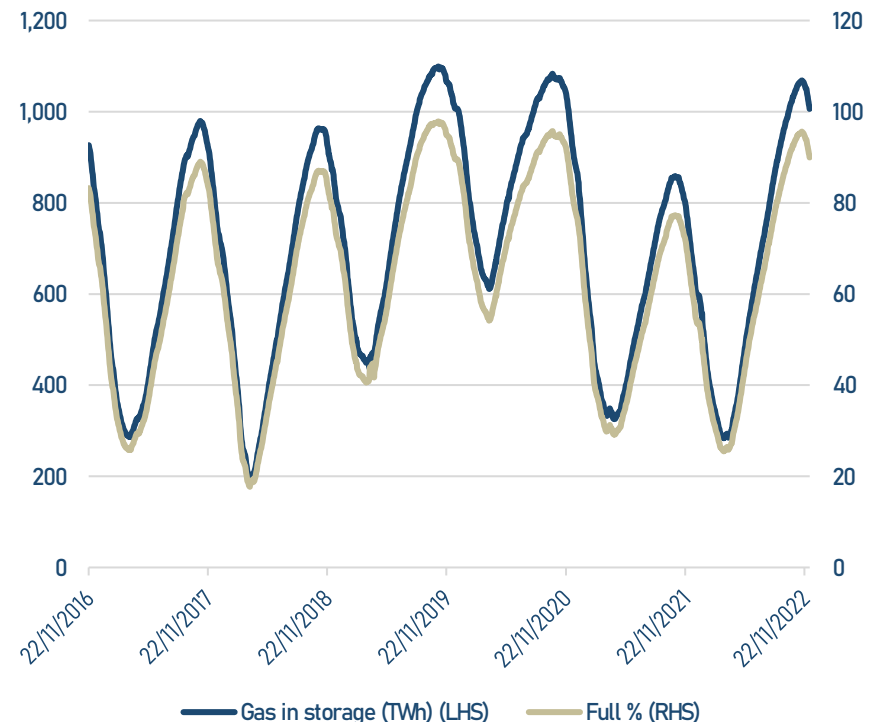
# DESPITE COLDER WEATHER, CONSUMPTION IS DOWN

- Europe is using 25% less gas than usual this winter (FT)
- Germany's target of 40% gas in storage by end of Feb 2023 will likely be exceeded

German gas in storage levels remain high



European gas in storage at comfortable levels

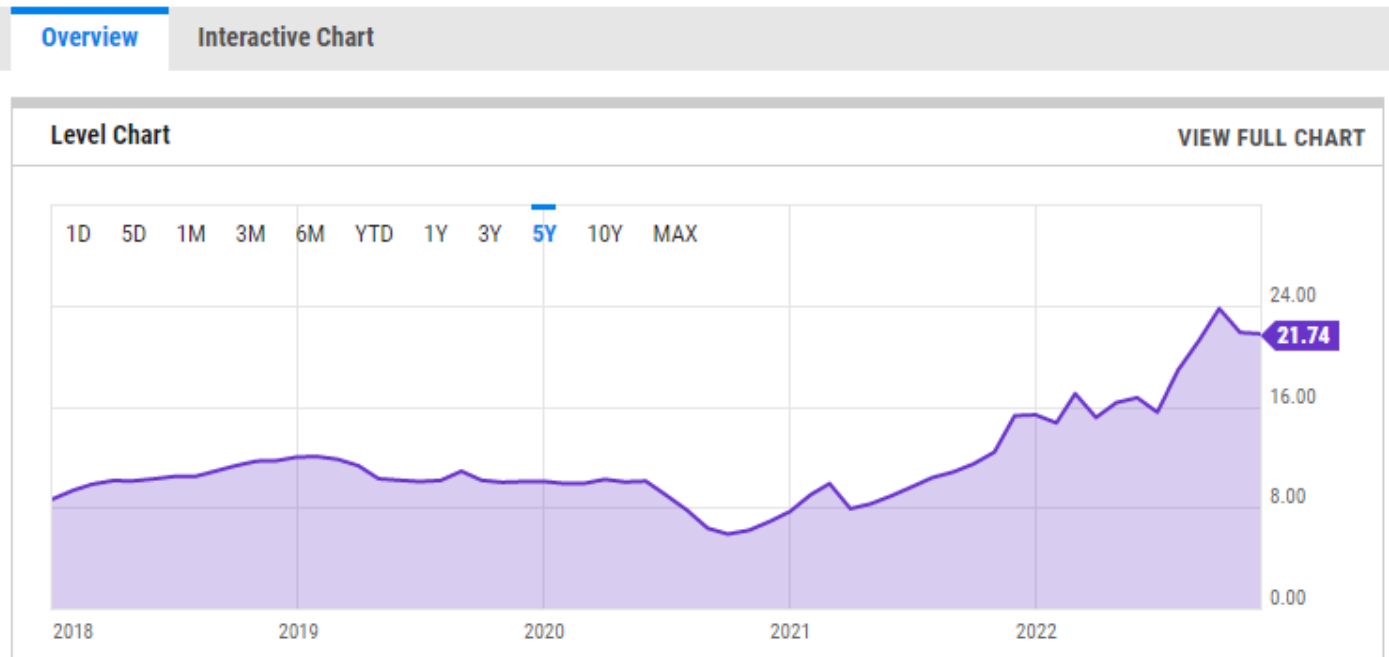


# EUROPE COMPETES WITH ASIA FOR LNG

- Japan LNG prices have been close to 100p/th pre-pandemic @1.2 GBPUSD
- Current prices are close to 200p/th

## Japan Liquefied Natural Gas Import Price

21.74 USD/MMBtu for Nov 2022



# EUROPEAN GAS PRICES – CONCLUSIONS

- Europe has record gas in storage despite cuts from Russia
- Europe was able to replace nearly all Russian gas
- Japan's gas prices are around 200p/therm currently (very stable) vs. 1-400p/th in the UK (very volatile)
- Europe needs to outbid Asia to get extra supplies, hence ~+100p/th minimum price
- However, multiple levers can be pulled:
  - Japan and France are restarting their nuclear plants
  - US Freeport export terminal will come back online soon
  - EU gas consumption is down -25%
- Valuations of UK listed energy producers are low due to taxes
- Nevertheless, valuations are very attractive at current gas prices
- Prices will follow the weather...

## 3. 2023 OUTLOOK



# 2023 OUTLOOK

- Deflation seems to be the most logic scenario with energy prices finally moving lower
- This will help governments balancing their books as energy subsidies subside
- While energy company valuations in Europe look attractive, which is down to windfall taxes, natural gas prices would need to come down to historical levels for taxes to be removed. Removal of windfall taxes on oil still possible
- UK retail is not recovering yet, as anticipated last month. More bankruptcies could follow, but this sector could become a strong outperformer as long as January/February inventories won't be excessive
- Similar to companies exposed to high interest rates, the turnaround won't come fast, as interest rates would need to be cut first
- While inflation could come down fast as multiple indicators suggest, central banks will likely only cut rates when there is more trouble brewing up... such as bankruptcies