

Narrowing down the big picture

Some markets have experienced one of the worst year-to-date performances ever. The Shenzhen Stock Exchange Component Index (SZSE) has lost 30%, the NASDAQ 19%, the DAX and EURO STOXX 50 are down 13%. At the same time, we experienced the biggest bond sell-off in history with the S&P 500 Bond Index down over 11% year-to-date. Unless you had money invested in energy, most investors are down double digits year-to-date. Most astoundingly, the current cycle and economic events match those of the 1918-1920 Influenza and the resulting Forgotten Depression precisely on the month, if you were to lay the start of Covid in 2020 on top of the start of Influenza in 1918. April 1920 was a major risk-off month led by the default of a Japanese bank. It was also the start of the 1920 Kiev Offensive, part of the Polish-Soviet War¹ and the beginning of a shifting consumer cycle. This could all be one hell of a coincidence, but the parallels are so striking, it almost begs the question whether it is artificially induced... Let's begin by updating a familiar table, which compares the events that led to the Forgotten Depression of 1920 to Today...

A timeline of the 1920 Forgotten Depression vs. Today

Influenza vs. Covid-19 waves

Influenza	Covid-19
1 st wave: Early 1918	1 st wave: Early 2020
2 nd wave: Late 1918	2 nd wave: Late 2020 (Alpha)
3 rd wave: Early to mid-1919	3 rd wave: Early & mid 2021 (Delta)
4 th wave: Spring 1920	4 th wave: Winter 2021/22 (Omicron)

1918-20s vs. 2020-22s timeline

1918-1920 and beyond	2020-2022
<u>1918</u> : Lockdowns were introduced to curb the virus	<u>2020</u> : Lockdowns were introduced to curb the virus
<u>1919</u> : 1 in 5 American was striking to achieve higher wages	<u>2021</u> : Record number of people left their jobs, resulting in labour shortages
<u>1919/early 1920</u> : Inflationary boom with commodity prices reaching all-time highs	<u>2021</u> : Inflationary boom with commodity prices reaching all-time highs
<u>November 1919</u> : Stock market peak, just as the Federal Reserve hiked rates from 4% to 4.75% to fight inflation and speculators, stocks slumped 12.8%	<u>November 2021</u> : Fed announced tapering. Central banks around the world turn hawkish. Stock market peaked in the US

¹ [https://en.wikipedia.org/wiki/Kiev_Offensive_\(1920\)](https://en.wikipedia.org/wiki/Kiev_Offensive_(1920))

<u>January 1920</u> : Fed raises rates to 6%, stock market didn't react	<u>January 2022</u> : Fed speeds up tapering and market priced in 50bps rate hikes for March 22
<u>1920</u> : Consumers changed to non-inflationary living, buying used clothes	
<u>April 1920</u> : A Tokyo bank defaulted, prices of rice, cotton and silk dropped quickly, GM shares dropped 8%	<u>April 2022</u> : China locks down important hubs such as Shanghai amidst Covid outbreaks leading to a stock market sell-off
<u>April 1920</u> : Steel Corporation had luxury of 10.4mio tons of unfilled orders. This backlog dwindled to 5.8mio tons from April 1920 to March 1921	<u>April 2022</u> : Orderbooks remain strong
<u>April 1920</u> : Weather was cold, wet and caused wheat and other agricultural goods to spike in price, farmers started borrowing more, but then were facing huge losses in 1921	<u>March/April 2022</u> : Russia's invasion of Ukraine has caused wheat prices and other commodities to spike
<u>Spring 1920</u> : Consumers stopped buying cars, strong demand disappeared. GM sold 52,000 vehicles a month in early summer, 13,000 in November and only 6,150 in January 1921	<u>Spring 2022</u> : There are signs that car purchases are starting to decline in late April
<u>June 1920</u> : Fed raises rates to 7%	
<u>April 1922</u> : Accumulated inventories were sold off for extremely low prices	

Similarities between the two time periods

1918-20s	2020-22s
High inequality, with top 1% owning 12-19% of the total share of income	High inequality, with top 1% owning 30% of all household wealth
Combustion engine replaces horses	Electric vehicles set to replace combustion engine
High speculation with businesses borrowing excessively and individuals borrowing to buy stocks	High speculation with individuals investing in "no return" cryptocurrencies
Large backlogs	Large backlogs
Income tax and other taxes were set to be introduced	Global corporation tax is set to be introduced, taxes are increasing
World was in globalization mode, but faced headwinds with WW I	Globalization continues, but faces headwinds with China desiring to become a world power
World leader had excessive debt/GDP of over 150% (England)	World leader had excessive debt/GDP of over 130% (USA)
<i>"On the way up, inventory accumulation had contributed to the panicky sense that the world was running out of everything. On the way down, inventory destocking helped to enflame the fear that the world was oversupplied with everything"</i>	High inventory accumulation now, and while inventory/sales ratio are extremely low (automobile industry), industries have stocked up in expectation of high Christmas sales & due to supply chain issues, but got disappointed

Source: The Forgotten Depression by James Grant

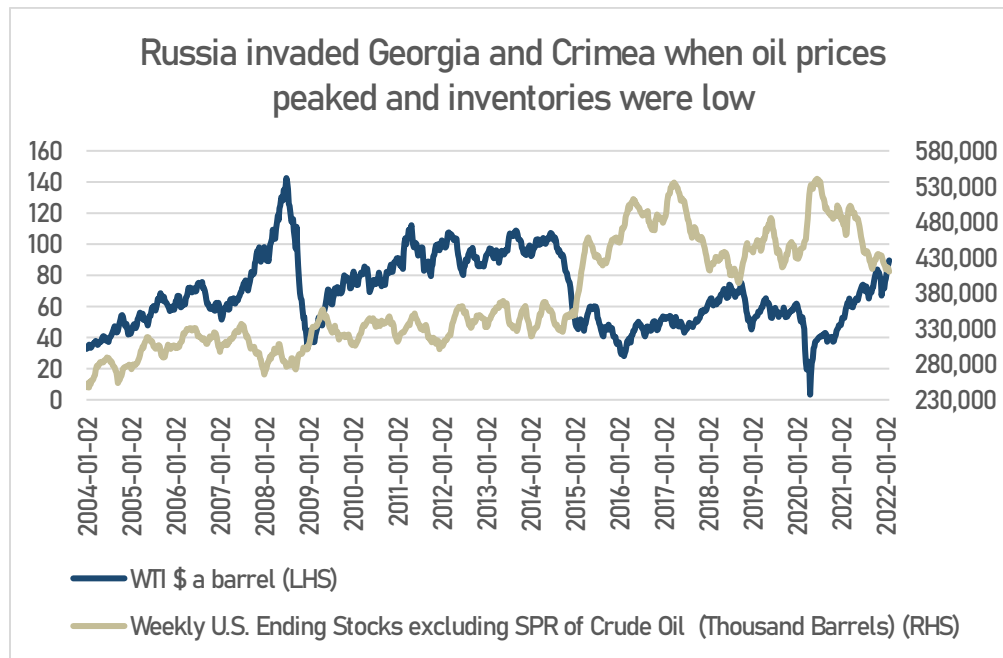
Kiev Offensive 1920 vs. 2022

In 1919 the Soviet Union was engulfed in a Civil War and an actual war with Poland. The Polish Army took most of Lithuania and Belarus and by 1920 took over Kiev, yet not eastern Ukraine. The Ukrainians saw Poland as the aggressor and the Soviet Union as the creator of Ukraine, as before Stalin began to rule from 1922 the Soviet Union actually provided liberal policies to Ukraine, creating a Ukrainian language and Ukrainian culture. While there are no exact parallels to today, the year 1920 vs. 2022 matches again with Ukraine being invaded – this time by Russia. The war in Ukraine and the resulting sanctions against Russia have led to shortages across a range of commodities. These shortages have led to higher prices. Importantly, however, each time Russia invaded another country (Georgia in August 2008 and Crimea in February 2014), oil was above \$100 a barrel and subsequently sold off (below \$60 a barrel by November 2008 and below \$80 a barrel by November 2014). But this time the problem is gas... And with Russia turning down the valves to Poland and Bulgaria there is another parallel to 1920 – a different kind of war.

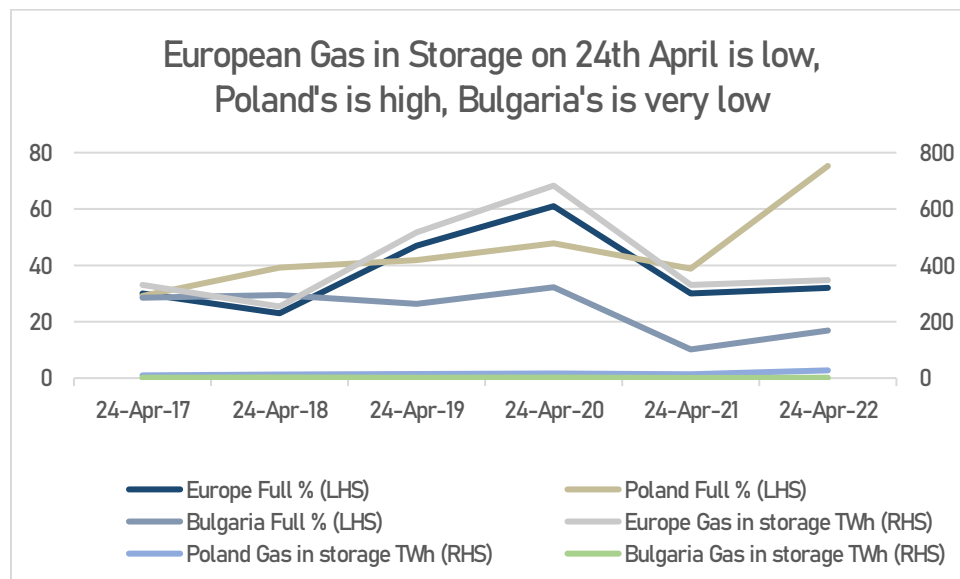
Share of world commodity supply by Russia/Belarus/Ukraine

Commodity	Russia/Ukraine/Belarus of world supply
Aluminium	6%
Barley	27%
Coal	5%
Corn	20%
Diamonds	30%
Enriched uranium	35%
Fertilizers	22%
Maize	18%
Natural gas	18%
Nickel	7%
Nickel (High quality)	17%
Oil	11%
Palladium	30%
Platinum	15%
Seafarers	15%
Semi-conductor gases	50%
Steel	10%
Sunflower	24%
Sunflower oil	73%
Uranium	6%
Wheat	34%

Source: AozoraStep Capital Market Views Episode 11

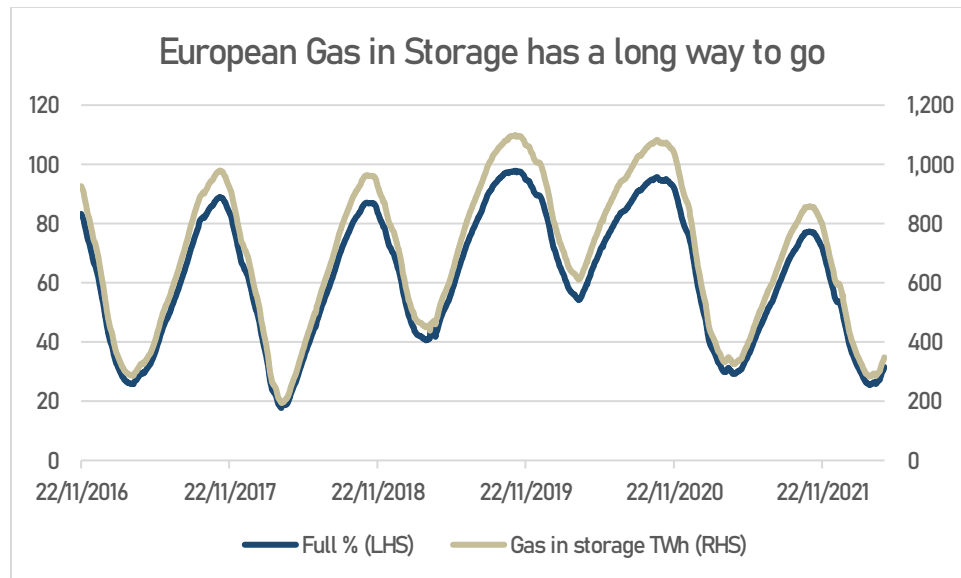


Source: FRED St. Louis, EIA



Source: AGSI

While European gas storage is relatively low at this point in time, Poland's gas in storage is comparatively high at over 75%. Bulgaria, on the other hand is facing problems with only 17% of storage full...



Source: AGSI

Russia has significant influence over the world

In two recent notes, [The New Battleground: NATO vs. SCO](#) and [The Re-Entry into a bipolar World](#) I have laid out the changes in the geopolitical landscape with the UN vote about asking Russia to withdraw troops from Ukraine perfectly displaying this change. Russia has been extremely smart by either supplying countries with weapons and security or commodities, be it energy or food. In Europe, Russia achieved this by luring ex-European politicians to lucrative and well-paid jobs on company boards. In less well-off countries, Russia either provided security and weapons or cheap, likely subsidized food, such as wheat. In that way, these countries became dependent on Russia and this in turn helps Russia to gain support in the UN. Developments in Egypt will be key, as a closure of the Suez Canal, as it happened between 1967 and 1975 in light of the 6-day war with Israel, could be another weapon against Europe. One might ask, was the blockage in 2021 of the Ever Given perhaps sabotage? Then there are continuous attacks by the Houthis (Iran) on Saudi Arabian oil infrastructure. This region is vulnerable and could be used to restrict oil and gas supplies to Europe.

Most vulnerable countries to wheat imports from Ukraine/Russia

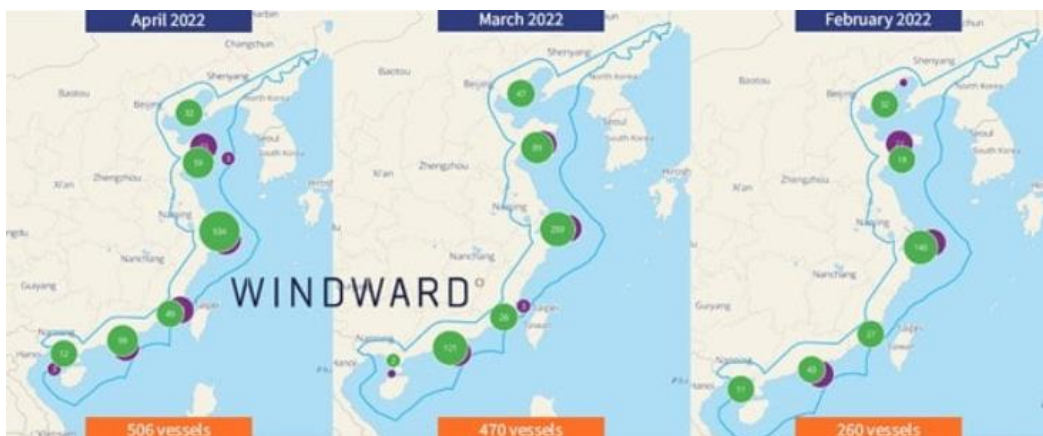
Country	Wheat import share from Ukraine	Wheat import share from Russia
Somalia	68%	32%
Benin	0%	100%
Laos	23%	71%
Egypt	21%	61%
Sudan	5%	70%
DR Congo	14%	55%
Senegal	16%	50%
Tanzania	2%	62%

Source: UNCTAD, Statista

ESG makes supply in oil and gas difficult, but a recession could lower prices: China comes into play

With oil and gas supply still below demand levels, how could commodity prices fall this time? Following the 1920 Forgotten Depression playbook, it will be central banks that hike aggressively, slowing down the economy. This, for now, however, has not happened and central banks remain careful in inducing a recession with rate hikes. The alternative would be stagflation, and this in turn could be achieved by China's renewed Covid lockdowns, which will likely lead to a worsening of the supply chain once again. According to Windward Intelligence, the Chinese port congestion last year took around 5-6 months to recover from restrictions². Windward also notes that congestion outside China's ports doubled from 260 vessels in February 2022 to 506 vessels in April 2022, representing 27.7% of all container vessels waiting outside ports worldwide. In comparison, this figure was only 14.8% in February.

Container vessels off the coast of China doubled since February 2022

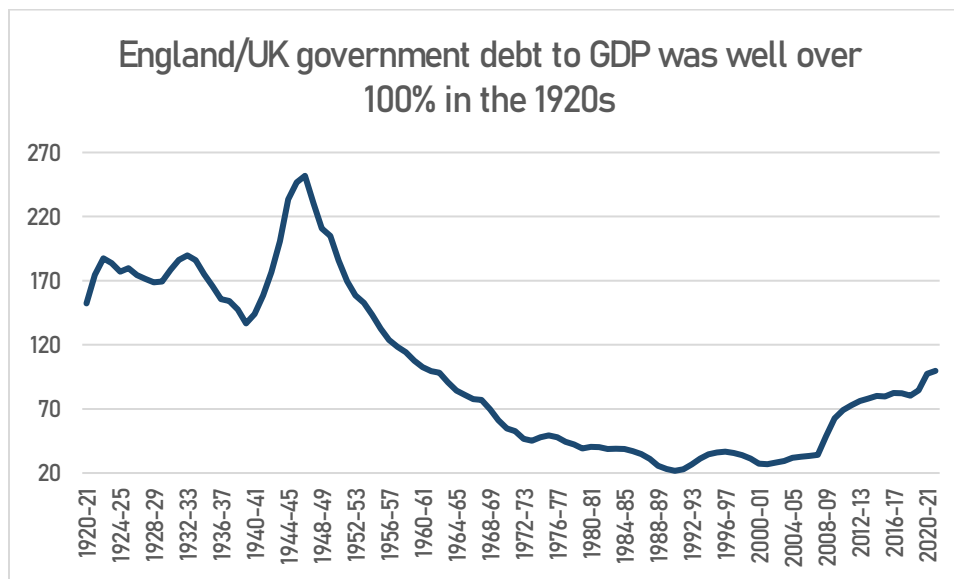


Source: Windward

² <https://windward.ai/blog/chinese-port-congestion-stalls-container-vessels-worldwide/>

Is China trying to repeat history?

Whether friend or foe, China's lockdowns could exacerbate supply chain problems once again and the resulting stagflation could lead to a recession. Some data suggests that volume handled at Chinese ports is even lower than during February 2020³. In light of Russia's invasion of Ukraine, a recession could be positive by lowering oil and gas prices and hence hindering chances of Russia winning/gaining from the war. On the other hand, China's goal could be to try and repeat history as the 1920s were a major contributor of a shift in world power from highly indebted England to the emerging USA, which perhaps China is trying to achieve by pushing the indebted US government over the brink by inducing a supply chain chaos, which increases inflation even further and will need to be followed up with more aggressive monetary tightening. England's government debt/GDP was over 150% in 1920, just as the US government debt/GDP is around 130% today.



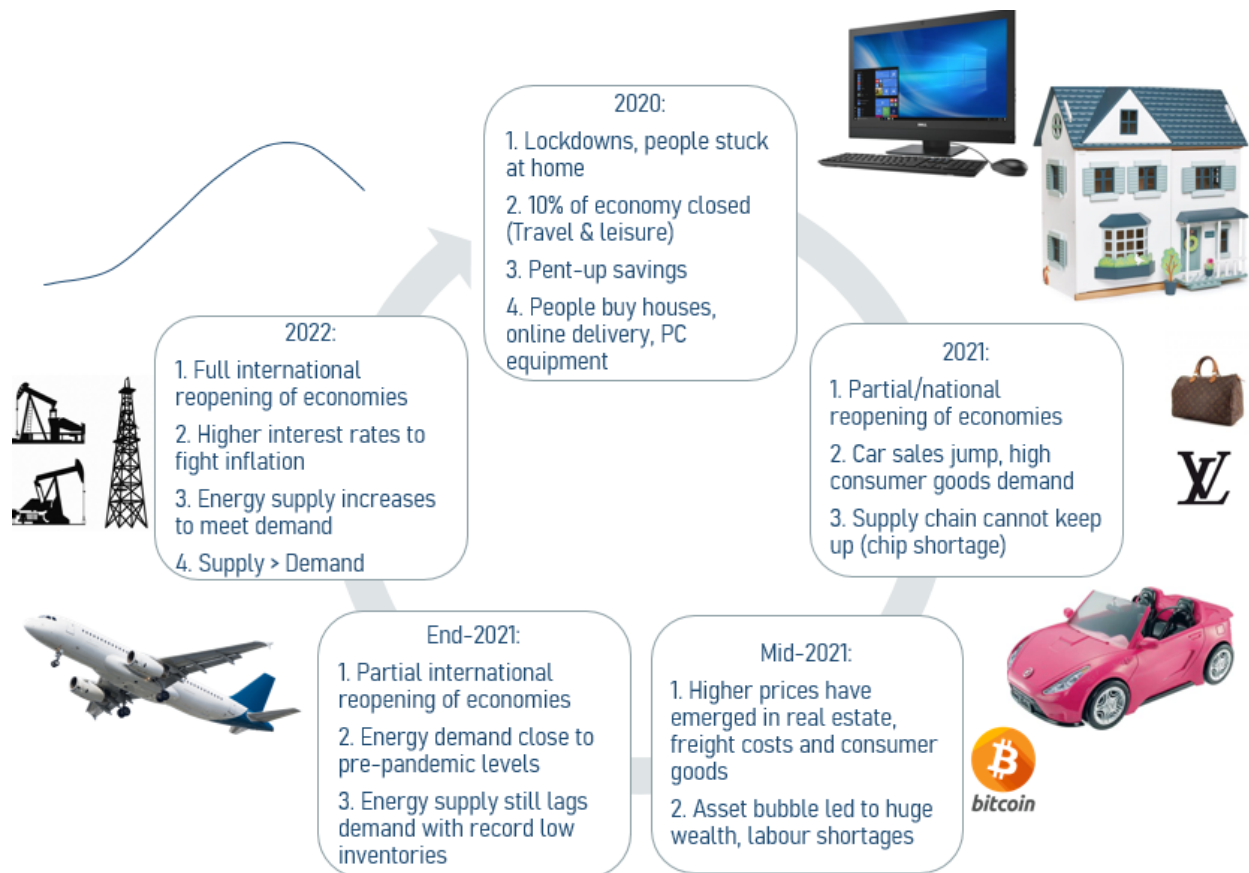
Source: Office for National Statistics

³ <https://twitter.com/FreightAlley/status/1519193097992822784>

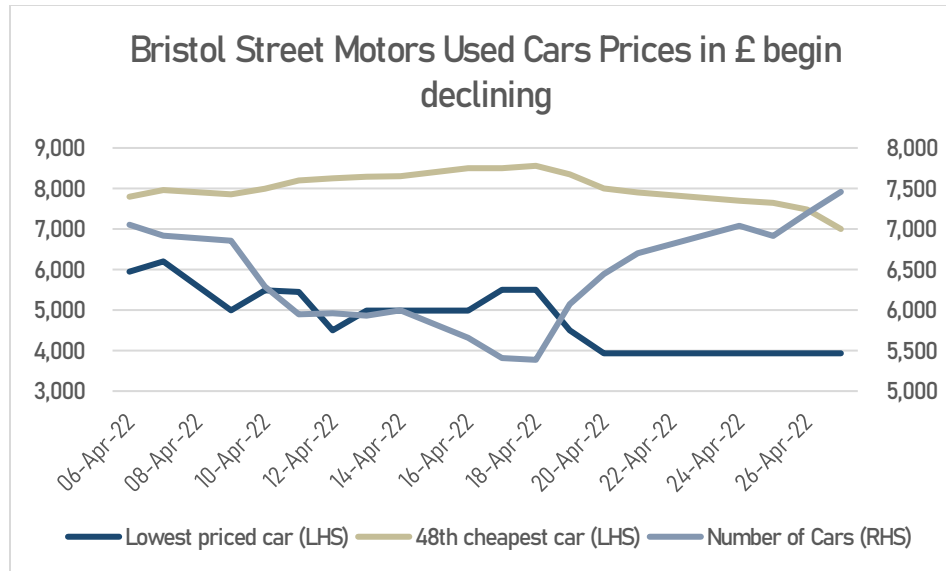
A Shift in Behavior

Ultimately, similar to the end of Influenza in 1920, the end of Covid in 2022 will shift people's behavior back to pre-pandemic levels. This means all the industries that benefitted from the pandemic (which were a lot!), will decline, while those that struggled, will rise. The most important change in behavior will be the lack of consumer interest in cars and the higher interest in public transport, such as buses and airplanes. And we are beginning to see this in lower priced vehicles sold by Bristol Street Motors in the UK, where the number of used cars inventories increased by 6% over the last three weeks, while the cheapest used car price declined by 34% and the 48th cheapest priced used car declined by 10%.

The Pandemic Consumer Cycle



Source: AozoraStep Capital Market Views Episode 10



Source: Bristol Street Motors

From global players to local beneficiaries

In light of the renewed Covid lockdown, I have sold my position in IG Design Group (Exit note [here](#)). I still own Centrica and Vertu Motors, but the latter position doesn't fit my macro view perfectly anymore and could turn out to be a value trap (Update notes to come). Over a 3-month horizon, the biggest momentum will likely lie in bus, rail and plane transportation, as well as in food on-the-go with attractive companies benefitting being Go-Ahead Group and Greencore Group. The new economic cycle will not be about global growth companies. We are now in an environment where investment horizons shrink with focus on domestic firms that are attractively valued.

A brief note on Germany

As I'm German myself and due to the pandemic having spent more time in the UK and less in Germany, I almost get a culture shock whenever I go back to Germany nowadays. The Germans express very strong opinions, but there are multiple events in the past where they shifted their stance dramatically in a very short period of time. Back in the 1920s amid hyperinflation the shift was from the political left to the far right. But there are many more recent examples that are similar. Amidst the Tsunami in Japan in March 2011 and the resulting nuclear meltdown, the important German state Baden Wuerttemberg suddenly

voted with over 25% for the Greens to phase out nuclear power instantly. In other states polling suggested that voters for the Greens trebled (This was to some degree helping Russia to make Germany dependent on their energy). During the 2014-15 migration crisis due to Syria, Germany again made a bold move in opening up its borders to millions of refugees from Syrian origin – even though they might be coming from safe countries like Turkey (This was to some degree a trigger of Brexit). In another more recent event, when Merkel announced a lockdown in March 2020, the Germans were very quick in adapting their lives leaving infections in the first wave at amongst the lowest levels worldwide (This was positive at first, but the latest restrictions have been negative, also affecting net exports adversely). Then this year, we have seen a late, but equally dramatic shift in Germany's stance to Russia, first avoiding to send weapons to Ukraine, and now sending tanks and other big equipment while increasing their military spending to at least 2% of GDP. Germany is making big decisions abruptly and often very controversial ones. The country is now in a very difficult situation of being energy poor, very dependent on global supply chains, having a weak defense and having increased their labour force through migration, which could exacerbate unemployment during a recession and de-globalisation (although higher defense spending and higher migration/labour force are overall positive for the economy). And last, but not least, while ESG is extremely popular, it will redraw the world's map, as there will be a need for more resources, such as lithium and copper. The countries that have access to these resources will benefit – Germany, as a big proponent of ESG and an important automotive industry, is fast in adopting EVs, but will be highly dependent on the resources of other countries. For now, Germany drives EVs with coal and I see no change in the medium term.



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