29 Palms

"29 Palms, I feel the heat of your desert heart, taking me back down the road that leads back to you."

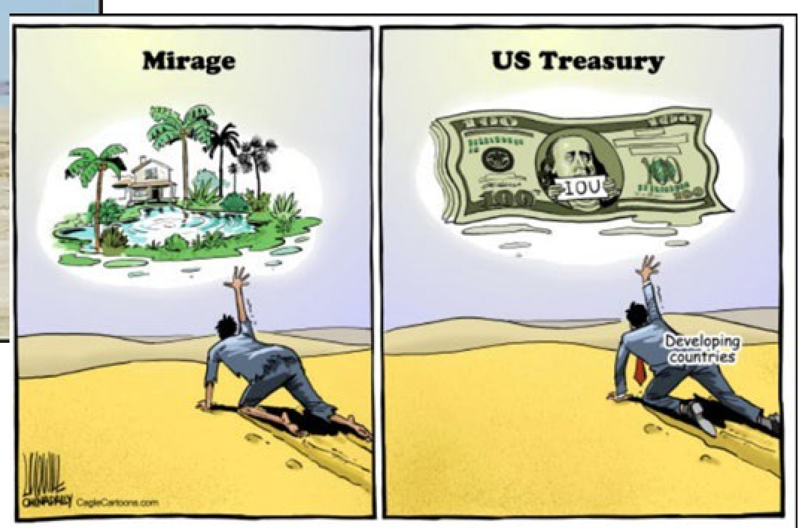
The words to this Robert Plant classic streamed through my mind as we traversed down the desert roads from Merzouga back to Marrakesh. The seeds of this commentary began to germinate during an excellent weekend trip to the outskirts of the Sahara Desert. I admit, a song about the heartbreak experienced by a rockstar on tour is an odd choice around which to build a narrative on inflation, the Cantillon effect, economics, and the merits of value investing. But it is equally a tale of palm groves, deserts, mirages, oases, scarcity, perception, and beauty. Interestingly enough, Plant found great inspiration on a 1972 holiday to Marrakesh. He said, "Berber music burrows into me, and why it does fascinates me. Can I try and do something with it that is part of me, part of the band, part of everything? So I did." Apparently, Plant was inspired to write "Kashmir" during a drive through the desolate desert area of southern Morocco. None of the Led Zeppelin band members had actually been to Kashmir.

While driving long distances through desert wastelands, the beauty and importance of water really crystallize in one's mind. Nothingness quickly gives rise to rich flora and fauna. Towns, teeming with life, invariably form nearby. The stark contrast was probably accentuated because we, at Kopernik, have increasingly been using water as an analogue for value, for cash flow, and for inflation. Certainly, when sighting an oasis, one needn't see the water to know that it is there. Clearly, in the desert: water = wealth.

An oasis in the deserts of Morocco. Photo by Dave Iben.

Suppose a government controlled an aquifer, the only aquifer for hundreds of miles, and sold all of the rights to the water, issuing shares to millions of people. People who needed more water could buy more shares from people who needed less. The system could be a pretty fair and equitable way to manage the water supply. On the other hand, to be equitable, the plan would need to limit the number of shares that could be concentrated, i.e., held by one person/group of persons. Governments have the power and ability to make things more equitable, but that is seldom how these things work. Sooner or later, it dawns on some person of power, well-meaning or otherwise, that they can issue a few more water rights than those for which there is actual water to pledge. Early on, it is probably easy to convince oneself that once a short-term problem is resolved, the extra claims can be pulled back out of circulation. In the real world, the future invariably provides reasons for further issuance and scant opportunities to actually rectify the problem. Over the years, claims on water continue to grow, as does the resultant problem.

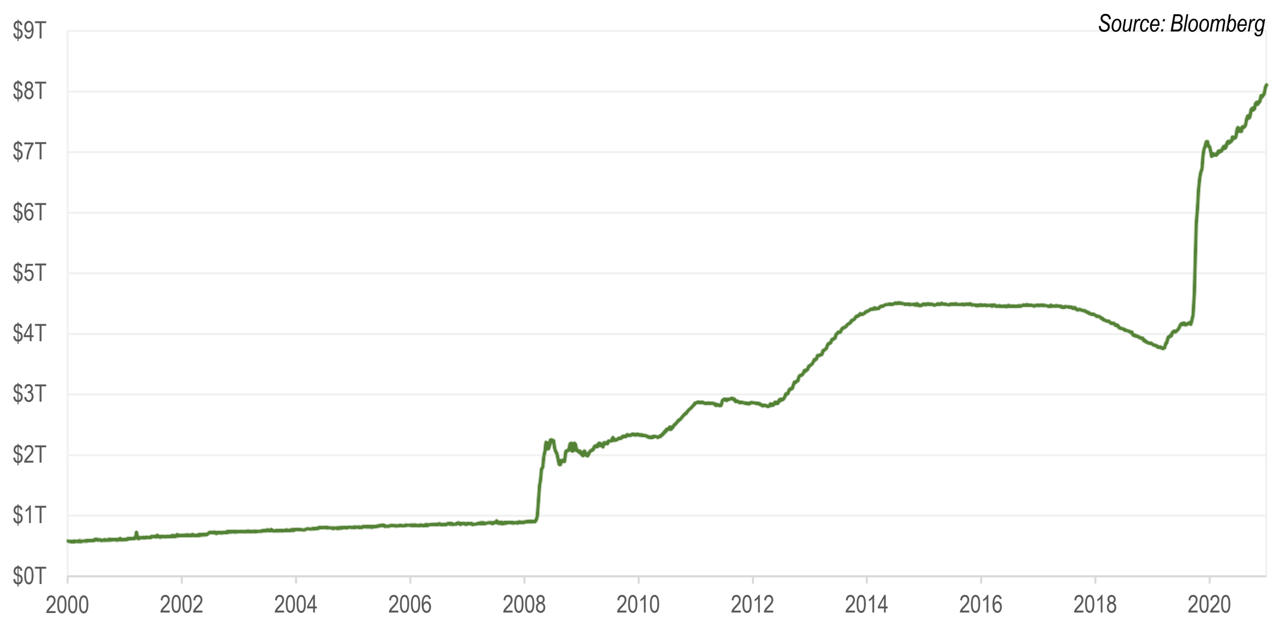
If/when the claims on water grow to twice the size of the actual water available, it should be clear to all that each claim on a liter of water is no longer worth a liter of water. It is, in fact, worth only 1/2 a liter of water (half of the claims will default). But, since very few are aware of the existence of excessive claims, they continue to trade near original value. Twice as many claims at full price mean that the claims on the water are now valued by the public at twice the value of the actual water supporting that value. People feel rich, well-endowed with a supply of water. The water could be viewed as an oasis, but the water claims can only be viewed as a beautiful, alluring mirage. **The point should be clear – printing more claims on water did NOT create more water; equally true, printing $4 trillion more U.S. dollars over the past year and a half has NOT created any more real wealth. The true value of the hypothetical water claim and the real U.S. dollar have both fallen in half.**



The Fed's attempt to make it appear like rain in the desert is detailed below. Rain, or a mirage?

"For now I smell the rain, And with it pain, And it's headed my way"
- Ramble On, Led Zeppelin

U.S. Condition of All Federal Reserve Banks Total Assets
FARBAST Index
2000-2021



A touch of desperation, from where I stood
The Fed turned my head around, round and round – taking liberties with *29 Palms*

While the debasement of the dollar is the key point, in 2021 there are many relevant things to consider. The gross mispricing that results from these devaluations portends opportunity and mischief. We are excited by the chance to capitalize on the gross mispricing, taking to heart Ben Graham's famous dictum, "In the short-term the market is like a voting machine – tallying up which firms are popular and unpopular, but in the long-run it is like a weighing machine, assessing the substance of a company." In the short-term, mirage; in the long-term, desert or oasis. Yet things are never simple. Economics is not like physical science – people's actions change outcomes. Too much currency leads to changed behavior, as things like reflexivity, blitz-scaling, corruption, and societal changes come into play. The doubling of the supply of dollars has resulted in the halving of the value of each dollar, **meaning that the NOMINAL value of everything has doubled – IN AGGREGATE**. Importantly, not everything is equal: fundamentals dictate that some goods and services will more than double in price, while others lag or even fall in price; some things appreciate rapidly, while others require a lot of time and effort to pass on costs; some are well-positioned to take advantage of the easy money to improve their lot while others find the spoils hopelessly out of reach. At this point, it probably makes sense to give a quick introduction to Richard Cantillon.

Per Wikipedia, "***Richard Cantillon*** *(1680s – May 1734) was an Irish-French economist and author of* *Essai sur la Nature du Commerce en Général (Essay on the Nature of Trade in General)*, *a book considered by* William Stanley Jevons *to be the 'cradle of* political economy*'. Although little information exists on Cantillon's life, it is known that he became a successful banker and merchant at an early age."*

He was a contemporary of John Law and made a fortune speculating in Law's infamous Mississippi Scheme. For those who would like to know more about John Law, the Mississippi Scheme, or our current quantitative easing (QE) infinity for that matter, please read, *Millionaire: The Philanderer, Gambler, and Duelist Who Invented Modern Finance*, by Janet Gleeson. It is highly informative and entertaining.

While it is doubtful that Law believed in his own policies, it is clear that Cantillon understood the difference between a mirage and the real thing. Returning to Wikipedia, "*Cantillon distinguishes between wealth and money, considering wealth in itself 'nothing but the food, conveniences, and pleasures of life.' While Cantillon advocated an 'intrinsic' theory of value, based on the input of land and labour (cost of production), he is considered to have touched upon a subjective theory of value. Cantillon held that market prices are* ***not immediately*** *decided by intrinsic value, but are derived from supply and demand. He considered market prices to be derived by comparing supply, the quantity of a particular good in a particular market, to demand, the quantity of money brought to be exchanged. Believing market prices to tend towards the intrinsic value of a good, Cantillon may have also originated the uniformity-of-profit principle—changes in the market price of a good may lead to changes in supply, reflecting a rise or fall in profit."*

This foreshadows Ben Graham's "voting machine" concept, follows on Mikolaj Kopernik's the quantity theory of money, and is completely in line with Kopernik Global's understanding of the world. Of Cantillon's many contributions to economic thought, the most important has come to be known as the Cantillon Effect. In his words, "*doubling the quantity of money in a state, the prices of products and merchandise are not always doubled. The river, which runs and winds about in its bed, will not flow with double the speed when the amount of water is doubled*."

This picture helps illuminate the idea that, with water as with currency, it is clearly better to be upstream than downstream, especially as summer saunters on.
Source: DesktopNexus

For those who want to know more about the Cantillon Effect, Duck Duck Go it (or Google if you must) and you will find an abundance of articles of varying degrees of sophistication, slant, and readability. Matt Stoller's article, "The Cantillon Effect: Why Wall Street Gets a Bailout and You Don't," is well written and easy to follow. A few paragraphs are excerpted here.

"(Cantillon's) basic theory was that who benefits when the state prints a bunch of money is based on the institutional setup of that state. In the 18th century, this meant that the closer you were to the king and the wealthy, the more you benefitted, and the further away you were, the more you were harmed. Money, in other words, is not neutral. This general observation, that money printing has distributional consequences that operate through the price system, is known as the 'Cantillon Effect.'

In Cantillon's day, the basis of money was gold, so he wrote about what happened when a nation-state discovered a gold mine in its territory. Increasing the amount of gold in the realm would not just increase price levels, he observed, but would change who had wealth and who didn't. As he put it, "doubling the quantity of money in a state, the prices of products and merchandise are not always doubled. The river, which runs and winds about in its bed, will not flow with double the speed when the amount of water is doubled."

Cantillon went on to discuss how money would flow, basically noting that rich people near the mine would spend it on 18th century luxuries like servants and meat pies, prompting a general rise in prices. Eventually the money would get out to the populace, but until it did, working people would have to pay higher prices without access to the new money that mine owners had. So, there would be inflation, with uneven distribution of purchasing power."

We believe that there are some very important takeaways from this in the age of QE-Infinity. The amount of dollars in existence has doubled over less than a year and a half (up nine-fold since 2008). As a result, aggregate prices can be expectedto double as well. Unknowable is the speed and distribution of this change. As a result, investors can: 1) assume that the money printing has no effect on supply and demand of currency, and thus, on price; or 2) acknowledge that it does affect priceand incorporate changes into their models of intrinsic value.

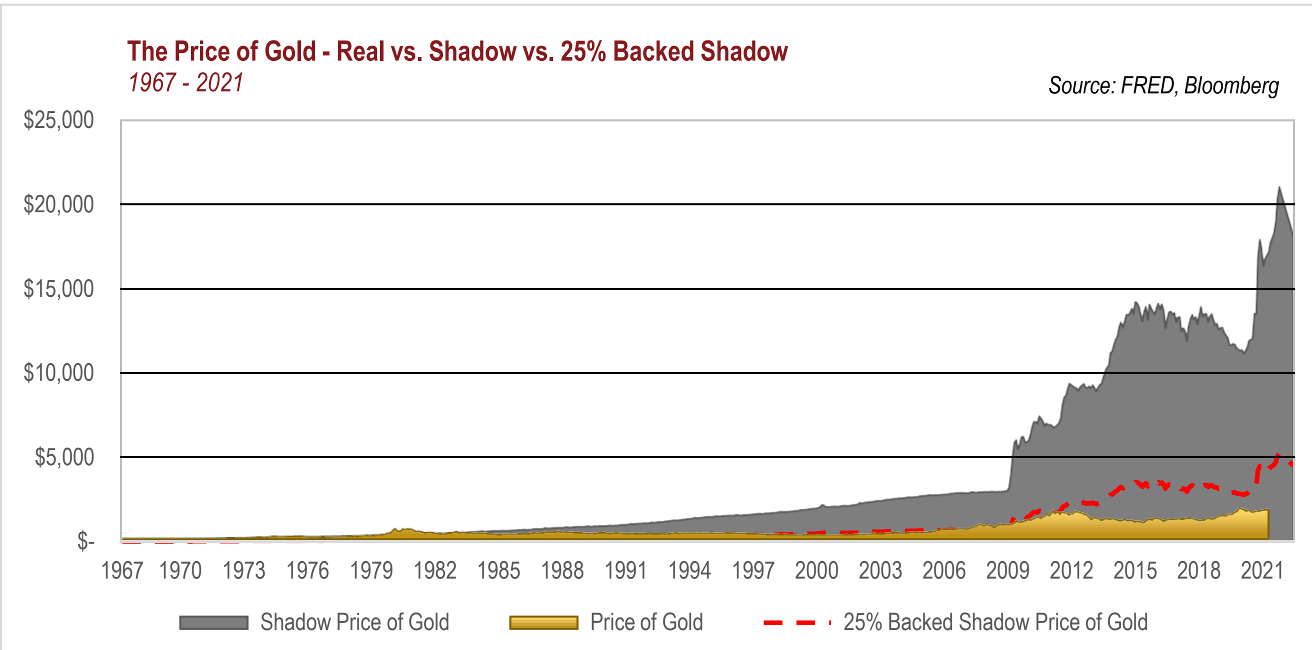
The largest increase in prices should be expected from assets that are valuable, scarce, meet important needs, and/or have early access to the newly minted money. On the latter front, many, *many* firms are benefitting via investment in companies/funds that have access to the deluge of newly printed dollars through insight, knowledge, luck, but also, of course, from government largesse, corruption, or "playing the game" well. In this arena, Kopernik is a fish out of water. We choose to leave that playing field to those more suited. Our current forte is investment in scarce, undervalued, useful assets. Fortunately, it is a surprisingly large opportunity set.

We do not view our approach as the only correct approach, by any stretch. Those in a position to gain early access to the newly conjured dollars are exercising their competitive advantage. There is a reason that many billionaires have emerged from among private equity and hedge fund players. Certainly, it has been entirely to the advantage of large technology and healthcare firms that they are often top-of-list when governments are deciding where to allocate expenditures. And the mirages created from central bank-generated illusions of wealth aren't entirely bad. Mirages create hope, which can be important. They prompt a drive to keep going. For good and bad, they have been used to fight wars. Elsewhere, many very useful benefits to mankind were made possible by mirages created by bubble-financed invention during the exciting manias of the 1920s, 1960s, and 1990s. It is certainly happening again now. In these environments great fortunes are made, and many of them are subsequently lost. On the less seemly side, enterprising individuals have learned that a beautiful mirage can be sold for *beaucoup* bucks. Foremost amongst them were Charles Ponzi, Bernie Madoff, and arguably more than a few of the current promoters of non-fungible tokens (NFTs) and special purpose acquisition companies (SPACs). Certainly, riches have been amassed in the realm of private equity and venture capital with a large assist from easy money.

In a world where nine times more dollars have been printed over the past thirteen years than were conjured over the prior century, having access to those government/central bank officials who are in a position to distribute the booty is arguably an insurmountable competitive advantage. And yet Kopernik, having no insider contacts nor interest in playing that game, continues with the "old-fashioned" process of fundamentally researching and analyzing businesses and buying them at a discount to their intrinsic value. Some may wonder if we have more than a snowball's chance in the desert heat of good investment returns in the 21st century. Perhaps surprisingly, we feel extremely good about our current prospects. First, it is said that it is hard to make good returns in a crowded place, and nothing could be more saturated than the currently popular stocks, be they theme stocks, meme stocks, growth stocks, index stocks, or ETFs. Second, from our vantage point, buying things for less than they are worth is a strategy that will never become passé, will never stop working. Third, and most importantly, even in an otherwise dangerously valued market, the size of the **discount** at which scarce, valuable, useful assets can be purchased is extreme and alluring. Finally, and not unimportantly, if/when inflation becomes increasingly hard to deny, these assets should prove to be much better investments than high multiple stocks.

A few examples may be useful. We'd rather own an aquifer than downstream water that may or may not run dry, be diverted, or get polluted. We'd rather own downstream water than a piece of paper suggesting a tenuous claim on water. And we would be highly skeptical of peoples' claims to have created "new" water. In the same vein, we'd rather own gold than certificates that are supposedly backed by gold. We'd rather own certificates backed by gold than own fiat currency, those abundant, redundant, proliferating pieces of paper that are backed by absolutely nothing. And we remain skeptical that many of the plethoras of new-fangled cryptocurrencies will still be with us in the future. This is not to say that governments won't issue cryptos in the future (they undoubtedly will), only that we doubt the practicality and staying power of all of the different options.

Cantillon's theory would suggest that the ninefold increase in dollars will lead to a ninefold increase (plus or minus) in the price of gold, too; it's just a matter of when. Thus far, it has only tripled. Might another triple be on the way? And this math doesn't even factor in the likelihood that more currency printing is on the way or the distinct possibility that gold was undervalued before it tripled over the past thirteen years. Better yet, gold in the ground, as represented by the VanEck Vectors Gold Miners ETF (GDX), has a long way to go on the road to a ninefold increase – it hasn't appreciated at all since the pre-QE1 days of so long ago. Whereas nine times may prove a bit much, our models portend significant upside, even sans further inflation. This powerful chart highlights the amount of gold relative to the amount of dollars conjured by the Fed over time.

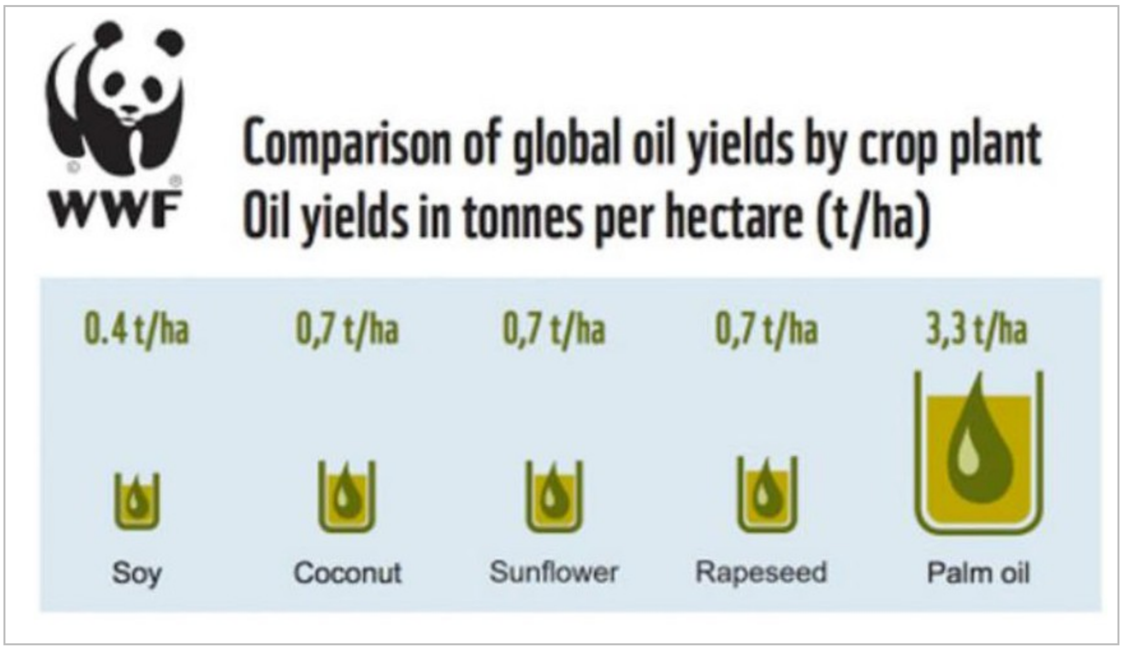


Whether one is analyzing gold, copper, nickel, real estate, food, businesses, or services, logic suggests that the devaluation of the dollar (and most other currencies) will sooner or later be reflected in their prices. Indeed, the price of iron, copper, lumber, and the NASDAQ have all more than doubled, to already fully reflect the recent doubling of the money supply. In our increasingly volatile world, fraught with monetary and fiscal experimentation, Kopernik believes that it behooves investors to incorporate scenario analysis and optionality into their valuation models. They should ask: what if prices return to their lows; reach a level that will equalize long-term supply and demand; partially reflect the debasement of the dollar; quickly reflect the bulk of the debasement? All these scenarios **must** be given proper reflection, in our opinion. It certainly garners an important share of our attention. We gravitate toward investments where we detect little, if any, downside based upon the bearish assumptions, but offer substantial upside optionality if prices move as economics dictates.

We agree that arguably the NASDAQ, copper, lumber, etc. are all worth twice as many dollar bills as they were pre-QE Infinity. Whether they were over or undervalued a year and a half ago is up for serious debate. And, without a doubt, in a market full of stocks (and real estate), some will be undervalued, and some overvalued. Bottom-up, fundamental analysis is requisite. If visible inflation is a possibility, high multiple stocks are probably exceptionally vulnerable. And inflation is already visible to anyone who is looking, in stocks, medicine, housing, lumber, metals, food service, and more. Jared Dillian recently put it this way: "Shadowstats says that if we calculated inflation the same way we did in 1990, it could currently be 8%. If we calculated it the same way we did in 1980, it would be 13%. It's not a mirage." We have found Shadowstats well worth following for many years now.

Many asset-rich businesses are undoubtedly better positioned. It has been interesting to see copper morph from hated industrial metal into an environmental, social and corporate governance (ESG) friendly green metal for use in electric vehicles and electronics. It is possible that we are witnessing a similar evolution in the food oil business. *À la* copper, might the palm oil business be transitioning from deforesting purveyors of saturated fats to environmentally-aware, highly land-efficient, providers of quality nutrition serving the world's 7.5 billion consumers of plant-based food?

Despite being by far the most land-efficient way to produce food oil, palm plantations became hated due to deforestation and labor rights concerns. Having little choice, the industry decided to cease such practices; they are always under the watchful eye of the non-governmental organizations (NGOs) and regulators. Attention has begun to turn more to others, such as soy farmers, regarding similar environmental practices. This change should continue to improve their public image while making palm acreage increasingly scarce and valuable. Golden Agri-Resources Ltd. ("Golden Agri), a Singapore-based palm producer with plantations in Malaysia and Indonesia has dedicated several hundred people toward their ESG efforts.



Source: World Wild Life Fund For Nature

It was interesting to see how well palms flourished in the desert, yet a little research revealed that they are a very diverse plant, thriving in rainforests as well as in deserts. There are currently **2,600** known species. The tallest species, *Quindio wax*, in Columbia has reached 200 feet. Some can live for a century. Palm trees are usually associated with coconuts or dates, but there are many types of fruits. Many aren't especially edible. One type, the Sago palm, is poisonous.

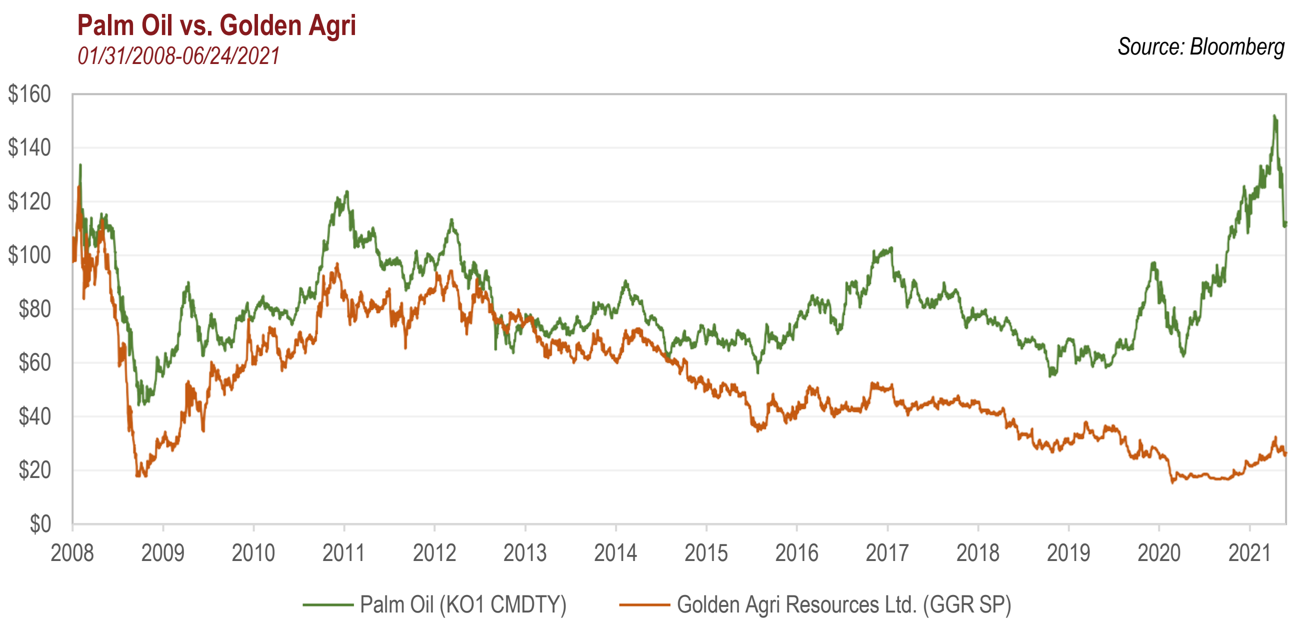
Source: Google

Palm oil generally comes from the fruit of the African Oil Palm. The WWF (World Wide Fund for Nature) has particularly helpful and balanced information. They suggest that while palm oil is produced in 42 countries, 85% of the supply comes from Indonesia and Malaysia. It is found in roughly half of all packaged products, including food, toothpaste, lipstick, shampoo, and much more. In their view, deforestation is a big problem, but a manageable one. The Roundtable of Sustainable Palm Oil (RSPO) was formed back in 2004. They have a list of which consumer products use sustainable oil, for those who are interested. The WWF believes that boycotting palm is not a good solution, saying "*Palm oil is an incredibly efficient crop, producing more oil per land area than any other equivalent vegetable oil crop. Globally, palm oil supplies 35% of the world's vegetable oil demand on just 10% of the land. To get the same amount of alternative oils like soybean or coconut oil you would need anything between 4 and 10 times more land, which would just shift the problem to other parts of the world and threaten other habitats and species. Furthermore, palm oil is an important crop for the GDP of emerging economies and there are millions of smallholder farmers who depend on producing palm oil for their livelihood. Boycotting palm oil is not always the answer, but demanding more action to tackle the issues and go further and faster, is*."

Below are several pictures taken by our analyst a few years ago, when members of our research team visited Golden Agri's properties.

Golden Agri employees harvest and prepare palm fruit for processing.

At any rate, companies with scarce, capacity-constrained properties, that produce goods that are needed by mankind, that are deeply undervalued, and are making positive efforts on ESG-related issues are exactly Kopernik's cup of tea. Like many commodities, CPO (crude palm oil) prices have struggled for years but have recently bounced back strongly, riding the QE tidal wave. And, like gold, gas, oil, and other commodities, the common stocks of the corporate owners of these increasingly valuable commodities have not come close to keeping pace. See the chart for Golden Agri-Resources below.

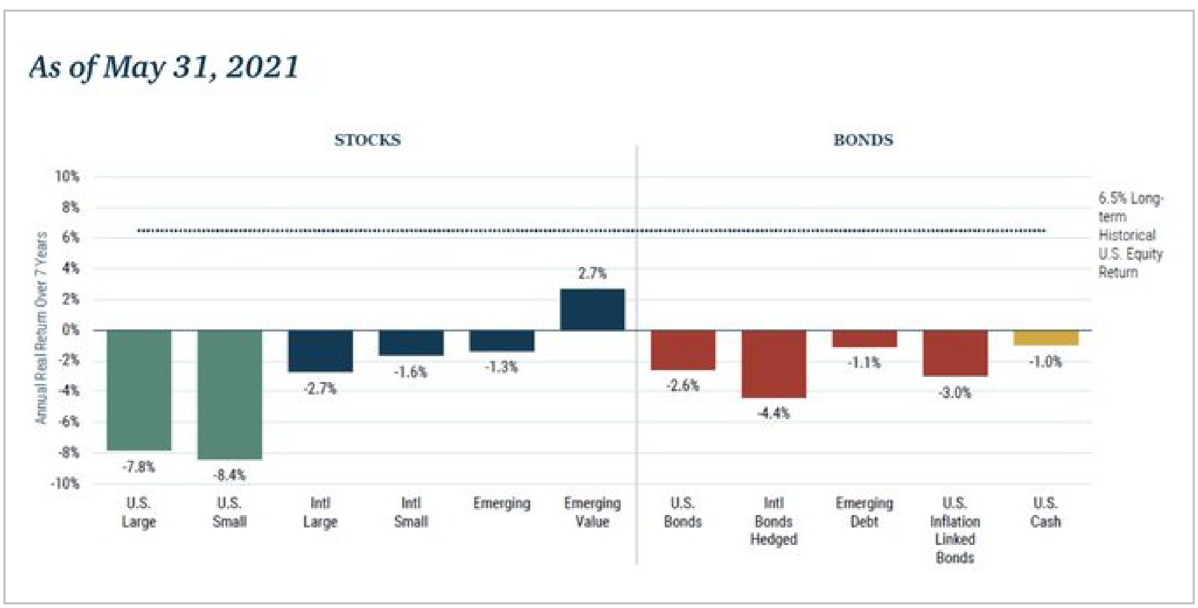


The price of CPO is back where it started; Golden Agri's stock is down by three-quarters!

In the sand dunes of the Sahara, just outside of Merzouga, we stumbled onto this little guy. The attached video hints that he is willing to dig deep, searching in obscure parts of the globe. We can't imagine him buying AMC or Tesla here! 😉😉

Photo and video by Isabel Satra

Certainly, in the current, wildly bifurcated marketplace, we believe that staying off of the beaten path is more important than ever. The chart by GMO below suggests that they believe it is the only place investors are likely to receive positive returns.



Source: GMO

We are firmly committed to digging deeply for value, wherever it might reside. In the scarce, hard-asset space, we believe we've unearthed an oasis of values.

It comes kinda hard
When I hear 'false memes' on the radio
'but leading things back down the road that leads back to 'val-ue'
-taking liberties with 29 Palms, by Robert Plant

David B. Iben, CFA
Chief Investment Officer
July 2021

Important Information and Disclosures

The information presented herein is confidential and proprietary to Kopernik Global Investors, LLC. This material is not to be reproduced in whole or in part or used for any purpose except as authorized by Kopernik Global Investors, LLC. This material is for informational purposes only and should not be regarded as a recommendation or an offer to buy or sell any product or service to which this information may relate.

This letter may contain forward-looking statements. Use of words such as "believe", "intend", "expect", anticipate", "project", "estimate", "predict", "is confident", "has confidence" and similar expressions are intended to identify forward-looking statements. Forward-looking statements are not historical facts and are based on current observations, beliefs, assumptions, expectations, estimates, and projections. Forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control and are difficult to predict. As a result, actual results could differ materially from those expressed, implied or forecasted in the forward-looking statements.

Please consider all risks carefully before investing. Investments in a Kopernik strategy are subject to certain risks such as market, investment style, interest rate, deflation, and liquidity risk. Investments in small and mid-capitalization companies also involve greater risk and portfolio price volatility than investments in larger capitalization stocks. Investing in non-U.S. markets, including emerging and frontier markets, involves certain additional risks, including potential currency fluctuations and controls, restrictions on foreign investments, less governmental supervision and regulation, less liquidity, less disclosure, and the potential for market volatility, expropriation, confiscatory taxation, and social, economic and political instability. Investments in energy and natural resources companies are especially affected by developments in the commodities markets, the supply of and demand for specific resources, raw materials, products and services, the price of oil and gas, exploration and production spending, government regulation, economic conditions, international political developments, energy conservation efforts and the success of exploration projects.

Investing involves risk, including possible loss of principal. There can be no assurance that a fund will achieve its stated objectives. Equity funds are subject generally to market, market sector, market liquidity, issuer, and investment style risks, among other factors, to varying degrees, all of which are more fully described in the fund’s prospectus. Investments in foreign securities may underperform and may be more volatile than comparable U.S. securities because of the risks involving foreign economies and markets, foreign political systems, foreign regulatory standards, foreign currencies and taxes. Investments in foreign and emerging markets present additional risks, such as increased volatility and lower trading volume.

The holdings discussed in this piece should not be considered recommendations to purchase or sell a particular security. It should not be assumed that securities bought or sold in the future will be profitable or will equal the performance of the securities in this portfolio. Current and future portfolio holdings are subject to risk.

Many countries worldwide have experienced outbreaks of infectious illnesses and may be subject to other public health threats, infectious illnesses, diseases or similar issues in the future. Any spread of an infectious illness, public health threat or similar issue could reduce consumer demand or economic output, result in market closures, travel restrictions or quarantines, and generally have a significant impact on the economies of the affected country and other countries with which it does business, which in turn could adversely affect investments in that country and other affected countries.

To determine if a Fund is an appropriate investment for you, carefully consider the Fund’s investment objectives, risk factors, charges and expenses before investing. This and other information can be found in the Fund offering materials, which may be obtained by contacting your investment professional or calling Kopernik Fund at 1-855-887-4KGI (4544). Read the offering materials carefully before investing or sending money. Check with your investment professional to determine if a Fund is available for sale within their firm. Not all funds are available for sale at all firms.