



THE CALL OF THE WILD

“Deep in the forest a call was sounding, and as often as he heard this call, mysteriously thrilling and luring, he felt compelled to turn his back upon the fire and the beaten earth around it, and to plunge into the forest, and on and on, he knew not where or why; nor did he wonder where or why, the call sounding imperiously, deep in the forest.”

— Jack London, *The Call of the Wild*



What is it that calls mankind to throw caution to the wind? Why does a wild market appeal so much? Why do bargains seem so boring; inferior? What makes it so hard to resist the appeal of buying Tesla at \$900 per share when they could have bought it for less than \$300 a few weeks prior? What is the power of the siren song that leads a person to value a company at \$150 billion when it has never had a profitable year, and when said company resides in an industry where survival has been an outlier? What is the draw to join a party in the wee hours, after the NASDAQ has risen sevenfold? Mark the price of Amazon up to a value ONE HUNDRED BILLION DOLLARS higher than it was a minute earlier? Yes, Amazon is a great company, and yes, the earnings were good – but the reaction is a tad excessive; even insane. What makes people speculate on bonds which, if held until maturity, are guaranteed to generate an economic loss? *It seems to be something embedded deep in human DNA.*

“He was sounding the deeps of his nature, and of the parts of his nature that were deeper than he, going back into the womb of Time.”

— Jack London, *The Call of the Wild*

After a recent, particularly ridiculous day in the market, I took a quick break and watched *The Call of the Wild*, a Disneyfied version of the great Jack London novel, originally penned a hundred and twenty years ago. And, while Buck was a dog rather than a man, that seems irrelevant. Whether one is looking at a pack of wolves, a gaggle of geese, a troop of chimpanzees, a flock of sheep, or a group of people, one is witnessing herd behavior. While mankind prefers to use the term ‘social animal,’ and we call the group a crowd, or, in some cases, a mob, humans are definitely a herd-like species. Behavioral economists will talk of how thousands of years ago, people who strayed from the rest were picked off by predators; they were eliminated from the gene pool. A similar fate awaited those who didn’t run when they heard a rustling in the bushes. There is a reason mankind is a ‘social animal’; a reason that we get an adrenaline rush and follow when the crowd is euphoric or panicked. We humans aren’t that unlike Buck when it comes to the insatiable desire to run off into the wild to join the pack.



*"Wild thing, you make my heart sing
You make everything groovy, wild thing
Wild thing, I think I love you"*

– the Troggs

Here is where we could insert endless charts showing how wild the mob has gotten. Suffice it to say, on almost any metric, the stock market began 2020 as one of the three most expensive on record (1929 & 1999 provide tough competition). On most metrics, this is the most expensive in recorded history. Based upon enterprise-value to sales, this is far and away the most lavishly priced market ever. This suggests that the current, very high profit margins had better prove to be sustainable, rather than mostly the outcome of the prevalence of financial engineering. And, beyond excessive valuations, we have recently been witnessing the giddiness, FOMO (fear of missing out), and wild price swings that are often associated with market tops. The recent mood reminds one of the old traders' tale, relayed here by Seth Klarman:

"There is an old story about the market craze in sardine trading when the sardines disappeared from their traditional waters in Monterey, California. The commodity traders bid them up and the price of a can of sardines soared. One day a buyer decided to treat himself to an expensive meal and actually opened a can and started eating. He immediately became ill and told the seller the sardines were no good. The seller said, "You don't understand. These are not eating sardines, they are trading sardines."

On the last day of February, the NASDAQ rallied 2%, not on the day, but over the final ten minutes. Two of the first three days of March generated the two largest advances ever (dollars, not percentage) for the US stock market. Many stocks have been posting double-digit daily moves, on no news! As the longest stock bull market succumbs to exhaustion, the bond market's continuing bull run is making the stock market look absolutely sane, by comparison. Rates are at their lowest ever in the U.S., and dropping rapidly. As the policies to battle the coronavirus cause the government budget deficit to skyrocket, the bond market appears to believe that this is great news. Rates plunged to a level that is by far the lowest in the country's history. Pure mass psychosis. Rates are even lower in many other countries; negative in many. Negative rates on bonds make less sense than tulip bulbs did in that mania in seventh-century Holland. Every single part of the yield curve is yielding well below the government published rate of inflation (CPI = 2.5%), meaning a large expected economic loss on the bonds held until maturity. The much more believable ShadowStats organization estimates that inflation is closer to 10% annually. Bonds arguably long-ago stopped being investment securities and became exciting instruments of speculation, like pork-belly futures, etc. But, current valuations will certainly be gawked at by unbelieving students, studying the history books of posterity.

Before moving on, it's worthwhile adding a few more data points, as each passing day provides more support for the idea that the crowds have gone wild. The coronavirus, and peoples' reaction to it, has been a source of great bullishness and bearishness, depending on the day. Many of the biggest dollar moves in the history of the Dow Jones Industrial average have occurred over the past month. March 12th brought the biggest percentage drop since the 1987 crash. The next day, interestingly Friday the 13th, brought far and away the largest daily dollar increase ever; putting the old record to shame.

*I'm a real wild one
An' I like a wild fun
In a world gone crazy
Everything seems hazy
I'm a wild one
Ooh yeah I'm a wild one*

*-Iggy Pop
(written by Greenan, O'Keefe, & Owens)*



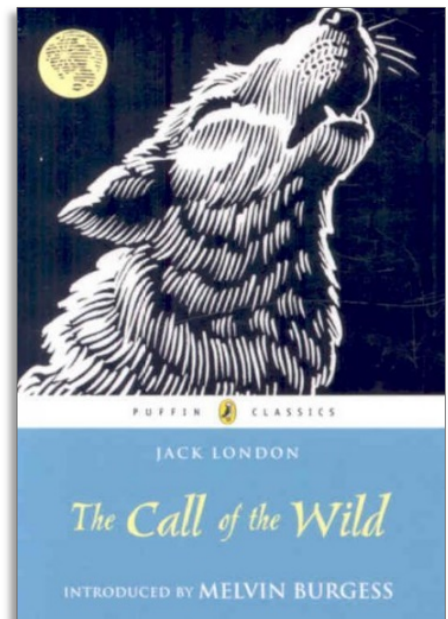
The Fed, which created \$0.8 trillion over its first 95 years of existence (1913 – 2008), and printed \$4 trillion more over the next decade, outdid itself, announcing a \$1.5 trillion injection of freshly conjured cash into the banking system over the next month. To repeat – next month. Not decade, not year, but one single month! On Thursday (March 12, 2020) the market rallied for a moment but then plunged by one of the largest amounts ever. Investors seemed to focus on the idea that the financial system must be broken to evoke this degree of panic from the Feds. And, it wasn't lost on folks that this sort of monetary policy is what got us into this predicament in the first place. But, the cat-like attention span of investors quickly shifted to the fact that profligate fiscal and monetary policy over the past dozen years had worked out well for the market, sending the NASDAQ composite up sevenfold. And, the Fed and the government are usually quick to remind investors that they have their backs. Up until mid-February, they always did, and they are attempting to prove that they still do. Only the future knows where investors will be focused mañana. In maybe one of the best examples ever of how quickly investor sentiment changes, well after the Fed's rescue package was announced late Thursday evening, Asian stocks were down, with the Japanese Nikkei index getting walloped for over ten percent. Nineteen hours later (March 13, 2020), the U.S. indices were up almost nine and a half percent. Almost twenty percent outperformance by the market that was open when sentiment changed. That outperformance would be impressive over a decade; we're talking less than a day! For Kopernik, and perhaps many other investors who still believe in bottom-up, fundamental analysis, the past several years have been painful. It certainly hasn't been our kind of market, and yet, *"It felt good feelin' like a stranger there"* as Graham Sharp (Steep Canyon Rangers) so poetically put it.

It's obviously no longer necessary to discuss how perilous the marketplace had recently become. The damage is availing itself for all to see. Certainly there was no dearth of warning signs. But, perhaps surprisingly, **this is meant to be a positive missive.**

Let's start by acknowledging that it is simultaneously a huge positive and a bitter fact of life that Disney isn't representative of the real world. The last commentary, Once Upon a Time, discussed how in the current era, even Tarantino contrived a happy ending to the Sharon Tate murders. In the movie version of Call of the Wild, most of the violence and carnage is absent. The Law of Club and Fang is given scant attention. The dogs and wolves are humanized animated characters; computer generated. All and all, though, it was still an enjoyable movie.

The book, of course, was also enjoyable, though very different. It was a classic. Take, for example, the beginning of chapter 2:

Buck's first day on the Dyea beach was like a nightmare. Every hour was filled with shock and surprise. He had been suddenly jerked from the heart of civilization and flung into the heart of things primordial. No lazy, sun-kissed life was this, with nothing to do but loaf and be bored. Here was neither peace, nor rest, nor a moment's safety. All was confusion and action, and every moment life and limb were in peril. There was imperative need to be constantly alert; for these dogs and men were not town dogs and men. They were savages, all of them, who knew no law but the law of club and fang.

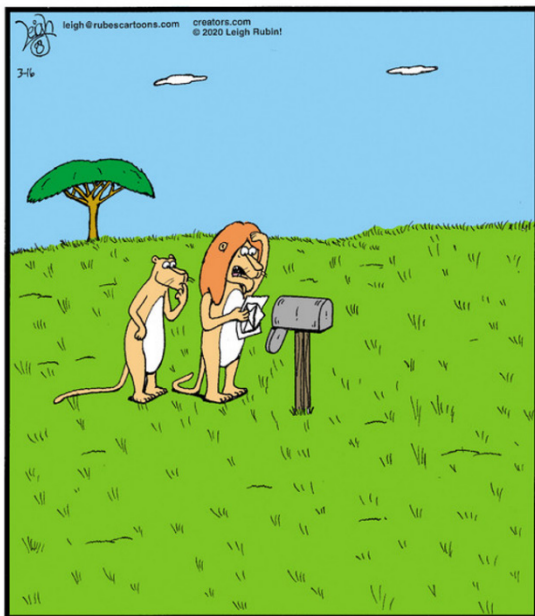


Similarly, following an eleven-year bull market, have investors been enticed into believing that the marketplace is no longer a cutthroat, caveat emptor beast? Had Club and Fang been usurped by (Country) Club and FANG (stocks)? Or FAMG now that Microsoft has replaced Netflix in the vaunted, must-own group of stocks? Have computers and algorithms tamed and humanized the markets or are they dangerous, momentum driven beasts, poised to figuratively rip the throats of credulous investors? Certainly, a lot of carnage has been inflicted since February 24th.



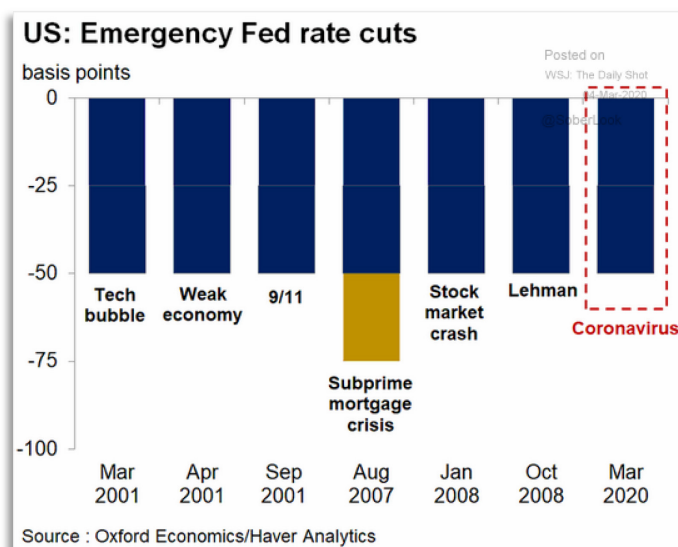
“He was a killer, a thing that preyed, living on the things that lived, unaided, alone, by virtue of his own strength and prowess, surviving triumphantly in a hostile environment where only the strong survive.”

— Jack London, *The Call of the Wild*



“Oh, my gawd, have you seen our credit card interest rate?! And they say *our* predatory practices are brutal and heartless!”

Whether or not the world’s central banks will succeed yet again, in their attempt to “rescue” investors, remains to be seen. Can a group of people turn **limited** resources into **unlimited** wealth, prosperity, and bull markets? The marketplace was hopeful, as Friday the 13th’s rally was far and away the biggest dollar advance on record. The next week dashed what remained of the bull’s hopes. The following chart shows that past “emergency” rate cuts proved to be poor entry points:



(On Sunday the 15th, the Fed went all in, cutting rates to zero; 150 basis points in less than two weeks.)



INVESTMENT STRATEGY AT AN IMPORTANT GENERATIONAL INFLECTION POINT

"A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty."

-Winston Churchill

But, as we suggested earlier, **our message is positive**; very much so. Investors, operating in panic mode, have been buying and selling the wrong things. As the federal budget swells like never before, government bonds have never been less alluring, and yet the yield one receives for loaning money to this spendthrift government has never been so miniscule. On the other side of the coin, **following a dozen years of post-Global Financial Crisis policy designed to transfer wealth from financial assets to real assets, investors are currently selling the wrong stocks.** While financial assets seemingly can't get more expensive than negative interest rates, can real, tangible, necessary assets get much cheaper? We are likely entering a generational shift in the market. The stocks of companies that are endowed with these assets have been dumped, by panicky investors and their momentum-programed algorithms, to mouth-wateringly attractive levels. Using dates violates every rule of prognostication, but not being forecasters, we nominate March 23rd as the inflection point in the investment markets; the day that the FED announced Unlimited QE. We're not making this up – potentially inflation without bounds.

"There is an ecstasy that marks the summit of life, and beyond which life cannot rise. And such is the paradox of living, this ecstasy comes when one is most alive, and it comes as a complete forgetfulness that one is alive. This ecstasy, this forgetfulness of living, comes to the artist, caught up and out of himself in a sheet of flame."

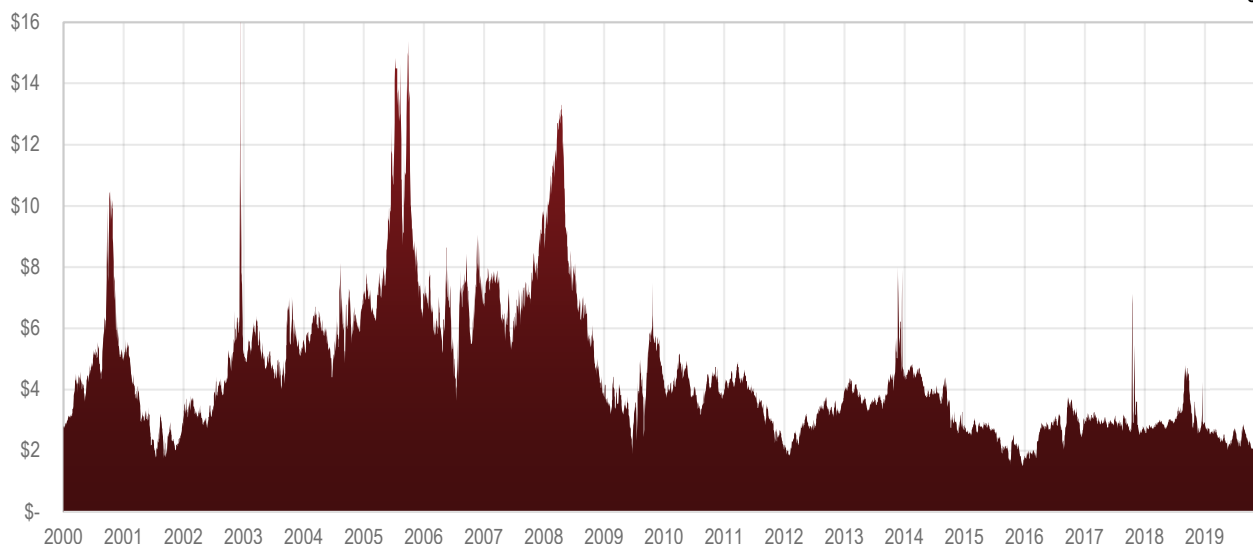
— Jack London, The Call of the Wild

Buck, certainly a **value investor at heart** 😊, shows perseverance and patience to ultimately end up on top. Hard times are the investors' friend, as they sow the seeds for future harvests. Certainly, too much money, as it's wont to do, caused a lot of mal-investment over the past decade. Perhaps nowhere was this more the case than in the energy space.

20 YEARS OF NATURAL GAS

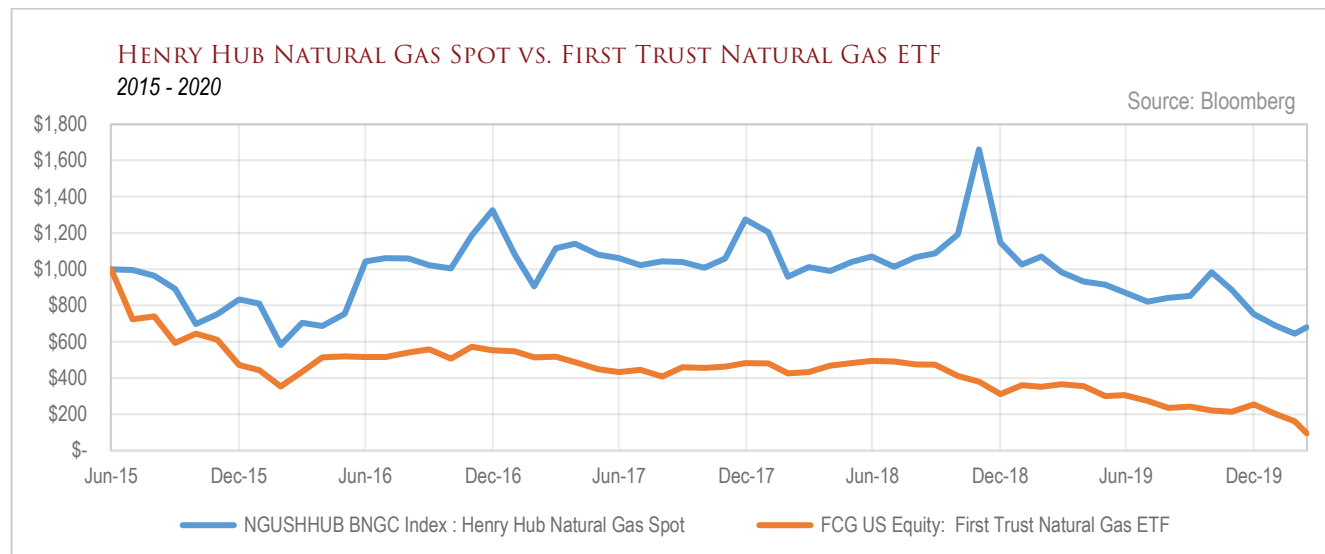
NGUSHHUB BNGC Index : Henry Hub Natural Gas Spot
2000 - 2020

Source: Bloomberg



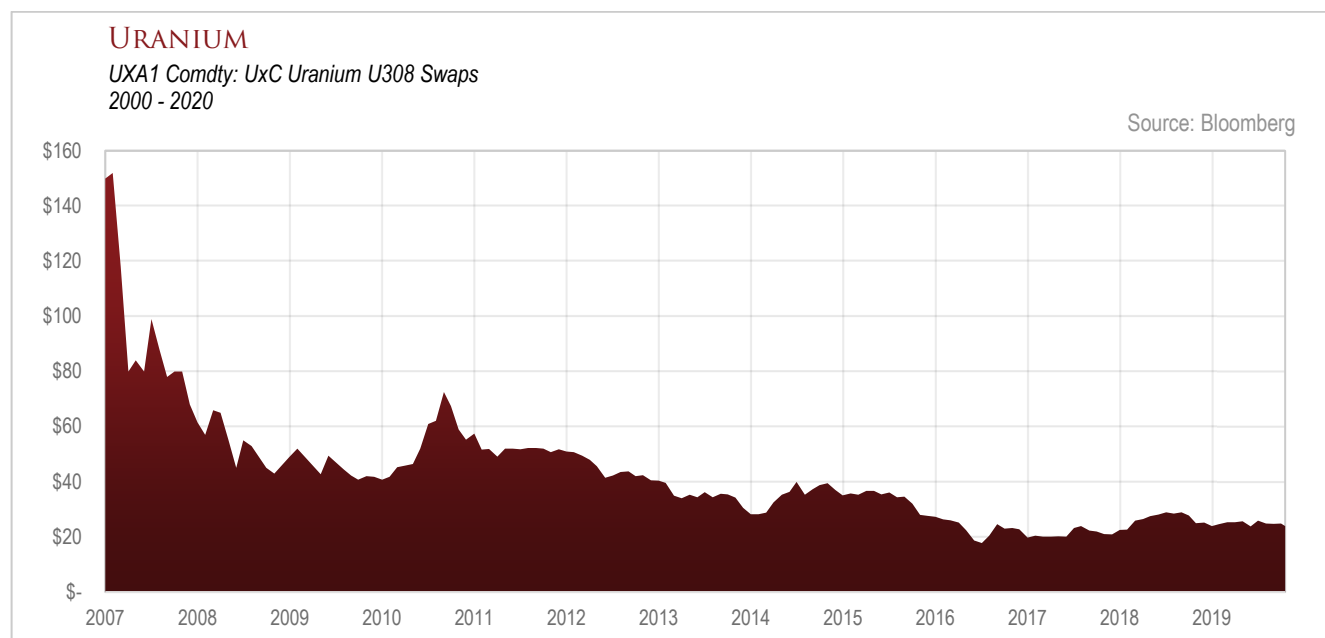


The price of natural gas in North America has bounced around between \$1.5 and \$14 over the past half-century. Last week's rout took prices back near the 50-year low. But, while the price of gas at the Henry Hub is low, the very same chemical compound held, in-situ, by public companies can now be purchased for a song. The chart below highlights the disconnect between gas at Henry Hub and gas on Wall Street. We'll take Wall Street.



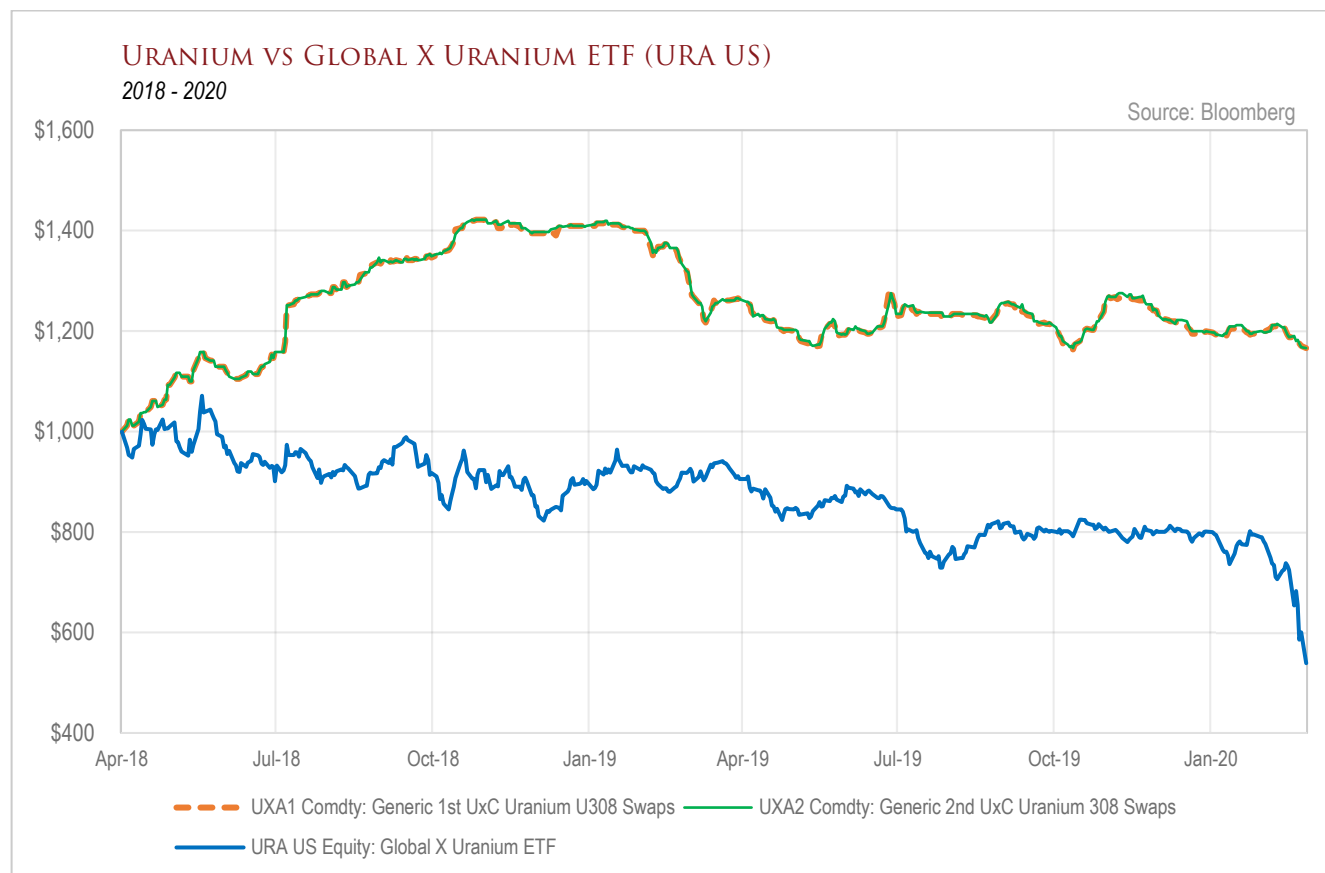
We estimate some gas stocks could be worth up to twenty-fold the current price, although adjusted for a prudent margin of safety, five to ten times upside is a more reasonable expectation. That kind of potential merits patience.

Elsewhere, the bulk of the mal-investment in the uranium space began a little earlier. The price shot from the teens twenty years ago, to \$150 by 2007, as investors clamored to secure clean, cheap, greenhouse-gas-free power sources to meet the insatiable demand of the emerging markets.





It is often said that the cure for high prices is – high prices. Prices above \$100 per pound did the trick. Kazakhstan alone increased production 10-fold. Inventories ballooned, and then Fukushima happened. Inventories really ballooned. Prices fell for the next decade. Note that they bottomed out several years ago, bouncing from \$18 to \$24, where they reside today. The stock market, giddily chasing dreams and unicorns, has failed to take notice. Notice the disconnect over the past two years:



The price of uranium above the ground is up 18%, in-situ, down 40%. Once again, we'll buy on Wall Street (Actually Bay Street). This looks like the bargain of a lifetime. Low prices are driving supply out (production cuts by the two largest producers, plus the U.S. and Russian governments choosing not to sell here), and driving demand up (Japanese restarts, Chinese starts with many more in the pipeline, and investment vehicles). There will be a lot of very expensive generators sitting idle unless the price of uranium moves up substantially and quickly. It takes a long time to build a mine.

*"The second spring of their quest, they come across a shallow stream in a valley, which is **loaded with gold**. This is not the mine they are seeking, but it fills the desire to find enough gold to sustain them for a long time and they decide to make a permanent camp there. The three men work the find every day, loading moose-hide bags with gold nuggets and gold dust. The dogs are free to roam, unless they are needed to haul meat on the sled."*

– Jack London, *The Call of the Wild*

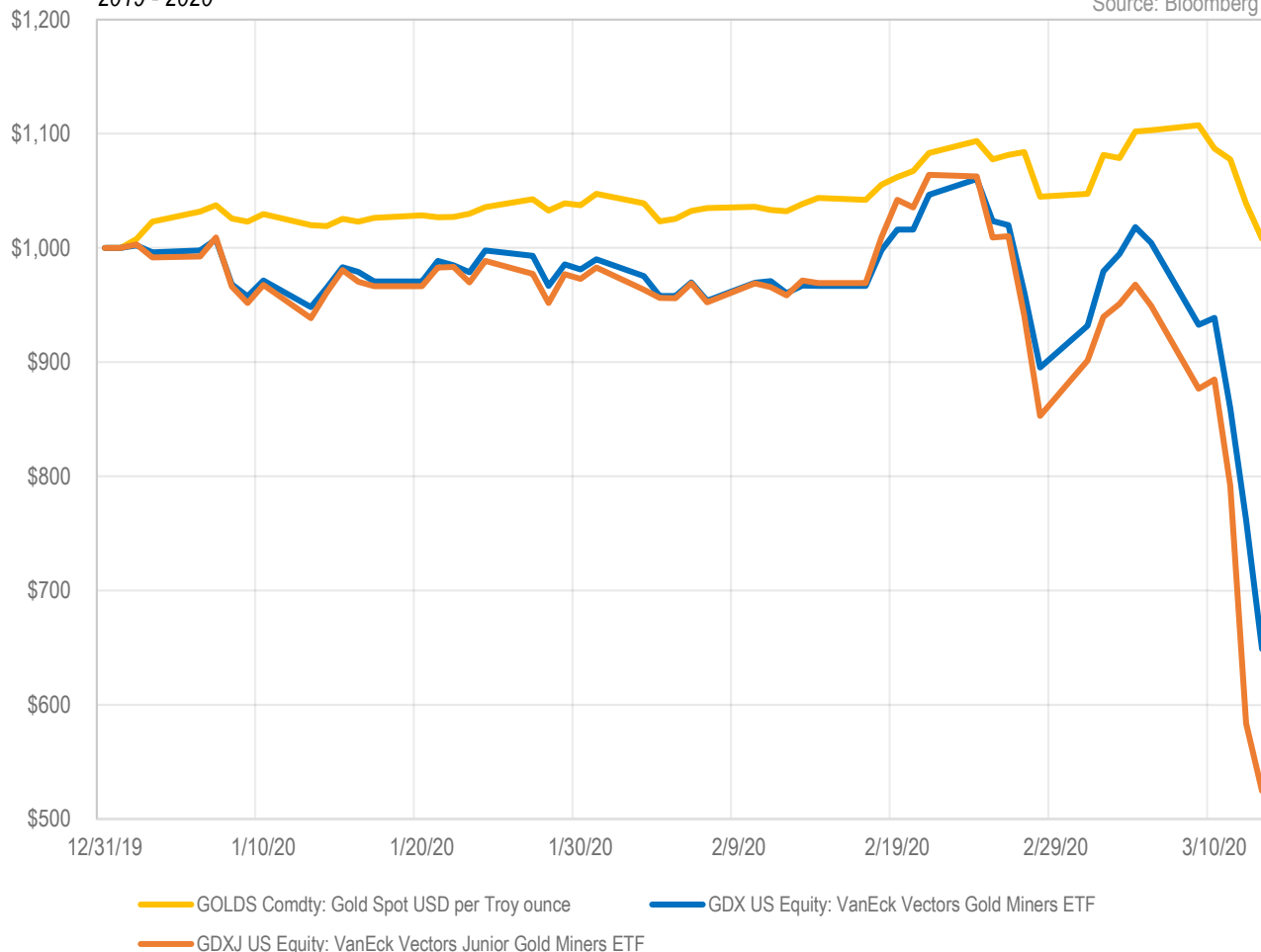
Top-down economists would put forth that Fed easing is bullish for gold. Certainly, gold is about the only thing, outside of bonds (the direct objects of Fed largesse), that is up in price this year. From our bottom-up perspective, gold is trading at around a twenty-five percent discount to its cost of incremental production. It's hard not to be bullish. Yet, here again, the more exciting story is the disconnect between the spot market with Wall Street/Bay Street's emotion-driven appraisal.



GOLD VS GOLD MINERS & JUNIOR GOLD MINERS

2019 - 2020

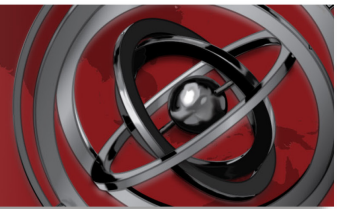
Source: Bloomberg



The price of gold above the ground is flat; below the ground it is down 35%. The price of gold owned by the smaller gold companies is down 48%. That is right, thus far in 2020, the price of gold held by smaller companies is almost half-price despite the fact that the price of the gold they own is not down! Given the Fed's folly, up 50% would have been a reasonable guess as to how mining stocks might respond to recent, ultra-bullish events. As an interesting side note, JNUG, a 3x levered gold ETF is down 96%. We'll leave the levered ETFs to others, but this may be one of the better times ever to invest in quality gold-mining franchises. We prefer those with large resources; if one doesn't already own it, gold is very hard to find.

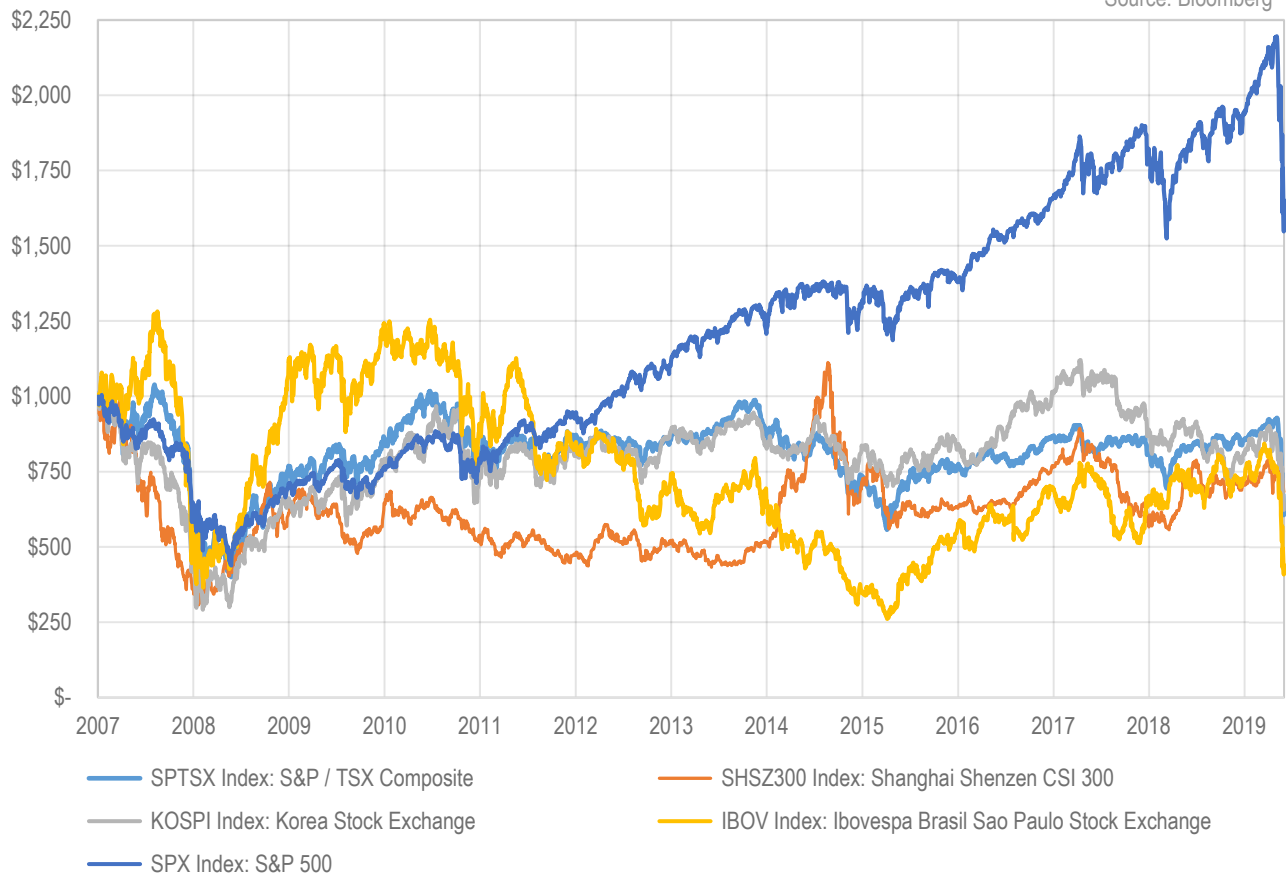
Before leaving resources, it must be pointed out that there has been a dramatic cheapening of the prices of copper and other base-metals, of platinum, palladium, silver and other precious metals, and in valuable assets like farmland, ocean-going vessels, and others. It's a great time to be bargain hunting.

Outside of resources, emerging markets are being thrown to the wolves as well. Since the previous market top in October of 2007, the S&P 500 is up 54% (yes, even after five weeks of meltdown), while China, Russia, Brazil, Canada (not even an emerging market), and Korea are down between 30% and 60% each. That is a large drop, happening over more than a dozen years; a dozen years during which there was aggressive use of inflationary monetary policy. At a propitious point in the movie, Buck knew exactly when to get off the beaten path. Fortunately, he did so posthaste.



2007 - 2020

Source: Bloomberg



*"Like a true nature's child
We were born, born to be wild
We can climb so high
I never wanna die
Born to be wild"*

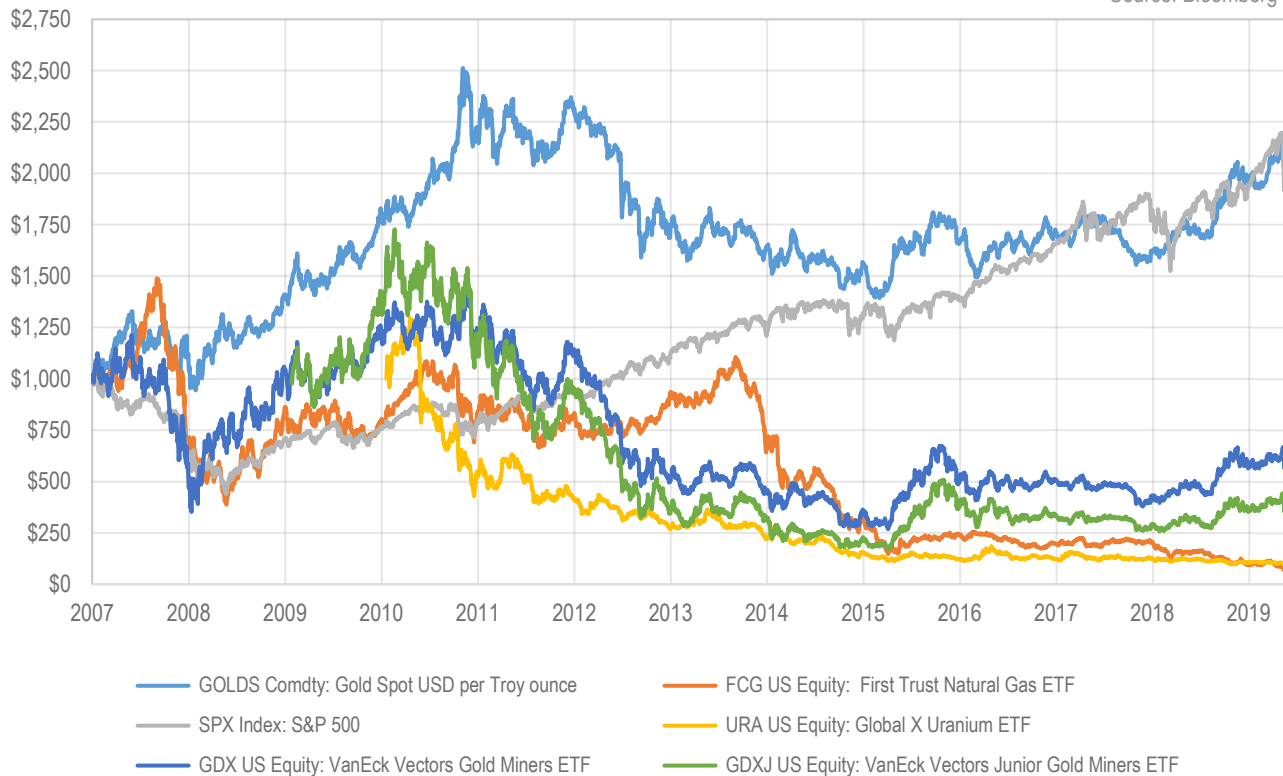
-Steppenwolf

Signing off, when discussing the wild and wolves, it would have been a crime to not use Steppenwolf's great song. Importantly, we are not against the wild. We love the wilderness. But history shows that when the crowd gets wild, head for the exit. Mr. London seems to fully approve of leaving a domesticated existence of centrality behind. No matter which way the crowd takes the popular stocks of the past few years, we'll stand clear. We'll search for stocks in the wilderness, far from the purview of the momentum crowd and their obsequious algos. Warren Buffett counsels to be greedy when others are fearful. We still don't see much fear in the overall marketplace. A notable exception, the resources space panicked and capitulated long ago. Baron Rothschild purportedly said that the time to buy is when there's blood in the streets. The treatment of resource stocks the past several years is the closest I've seen to a massacre, with the exception of high-yield bonds in 2008. The resource massacre came after, what was already, a decade of harsh times.



2007 - 2020

Source: Bloomberg



Investors in resource stocks are a long way from the mob. With the crowds stampeding in and out of the market, the safest place to be is the wilderness. At current levels, it should also prove the most lucrative. Let others decide what to do with stocks that are down 15% from all-times highs. We'll take down 90%, while the underlying fundamentals have improved. It's time for prospecting.

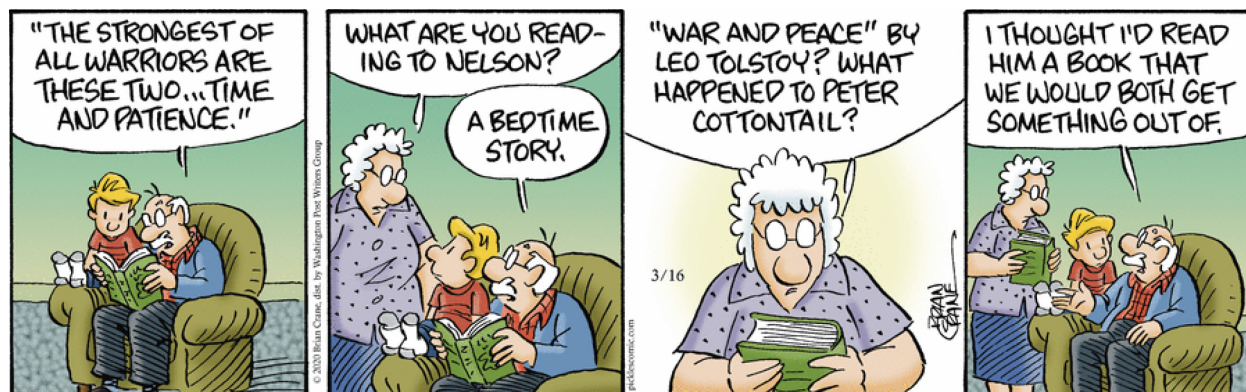
The following synopsis of the book can be found on the internet:

Throughout Call of the Wild, Buck shows his hard work and determination through a dominant trait of leadership, which he learned after struggling through the many hardships he faces. Buck transforms from a dog, living a simple life on a farm in California, to a dominating beast fighting for survival in the Alaskan wilderness. He was forced to gain these traits to help him attain leadership.

While admittedly a bit melodramatic, Buck's adventures sound all too familiar to value investors. Maybe the remaining, hardened, value investors have earned their return to leadership. With value stocks still suffering mightily, it is way too early to tell, but it is way overdue. The math is in our favor. We look forward the second quarter. We all wish the best of health to you and your family, during this challenging time. Nature occasionally reminds us that it can be tough out there.

All the best,

David B. Iben, CFA
Chief Investment Officer
March 2020



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