

SEDONA

Continuing with our last commentary's desert theme, amidst this value-parched environment, we now figuratively travel six hours east from 29 Palms, California to Sedona, Arizona. Named after Sedona Arabella Miller Schnebly, the town is a famous tourist destination known for its beautiful, interesting sandstone formations. I'm told it's a wonderful place; sadly, I've never had a chance to go there. Therefore, this commentary was inspired, not by firsthand experience, but by a catchy little tune from a group named Houndmouth. It is a song about Sedona's early history as a movie town – more than sixty Hollywood pictures were shot there – and about how it subsequently became a casualty of Howard Hughes' staunch McCarthyism in the 1950s. As is a strangely persistent trait of mine, I hear distinctly alternative messages in song lyrics, usually pertaining to current investment-related topics. The song's chorus is a good place to start:

*"Hey, little Hollywood, you're gone but, you're not forgot
You've got the cash, but your credit's no good
You flipped the script, and you shot the plot
And I remember, I remember when the neon used to burn so bright and pink
Saturday night, kinda pink"*

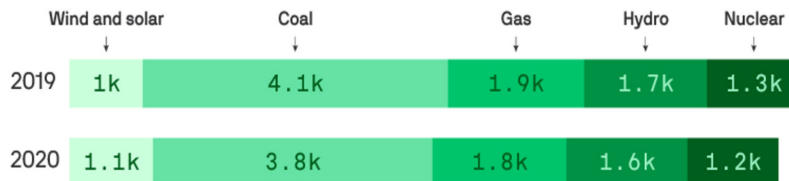
[-Sedona – Houndmouth](#)

"You've got the cash, but your credit's no good!" How can one not immediately think of central banks? "You flipped the script, and you shot the plot." Am I the only one who finds this an apt descriptor of modern-day economics? Academics? Government policy? And, yet again, central banks? It wasn't that long ago that a *script* calling for MMT (Modern Monetary Theory), UBI (Universal Basic Income), and QE (Quantitative Easing)-infinity would have been booted to the sci-fi department, who upon receipt would have debated whether or not it was too outlandish even for them. Certainly, the newly "flipped" contemporary script presents challenges and opportunities alike large enough to make Sedona's Bell Rock pale in size by comparison. Obviously, the investment implications are important and require equity portfolios to adhere to a carefully developed, well-thought-out plot.

With so many people seemingly reading from a faulty script, it is important that investors rein in their frustration and act on the exciting opportunities to profit from market inefficiencies. They appear wider than Arizona's sandstone gorges. Much of the new, avant-garde script bears examination. One must scratch one's head and wonder who has adapted the ESG (Environmental, Social, and Governance) script into something so skewed from logical intentions. For example, we are told, emphatically and simplistically, that EVs (electric vehicles) are good for the environment and that ICE (internal combustion engines) are bad. Period! That simple; that black and white. Now, I confess to being a fan of EVs. They are simpler, have fewer moving parts, need no service station stops. My wife owns an EV and our portfolios currently own one of the largest producers of them (Hyundai Motor Corp), so I'd be fine with the script if it seemed plausible. We're all fans of saving the earth and applaud the increases in fuel efficiency that have been realized over the past decades by ICE-powered cars. Alas, we're unable to pretend that EVs don't require the "high-carbon-footprint" mining of significant quantities of copper, cobalt, and, especially, nickel. It's hard to overlook the fact that they are powered by electricity, which in turn is primarily derived from hydrocarbons. Solar and wind make up a rapidly increasing, but still minuscule, portion of the pie. Other clean fuels like hydroelectric and nuclear are also worthy, but relatively small, contributors.

Global power generation in January to June

Terawatt hours of generation in 48 countries representing 83% of global power production



Source: Data: Ember; Chart: Danielle Alberti/Axios

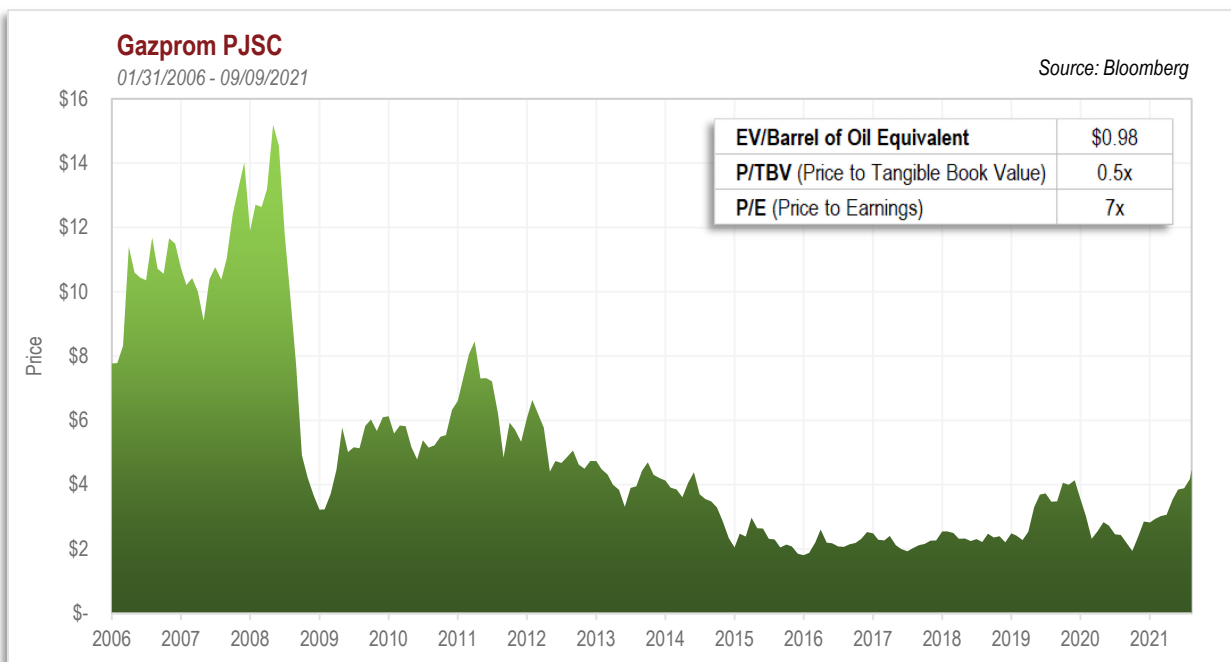
The continuing, rapid switch from coal to natural gas is believed to have been a more important contributor to CO2 reduction than has the build out of wind and solar. We are proponents of much of the progress being made on the energy front but believe that the flipped script that investors are acting on has led to gross mispricing. Stocks of purported good guys are selling at hard-to-support valuations. Members of the ESG-blacklists languish at attractive prices, despite the fact that many of these are on the blacklists for erroneous reasons. Often these unfortunate victims are actually an important element of the solution. We happily own shares of producers of clean hydro and nuclear energy, and relatively clean natural gas. We leave the ownership of a car company selling at *thirty times book value* and *eighteen times sales* to the sci-fi fans: a valuation 'altitude' of almost \$3/4 Trillion!!



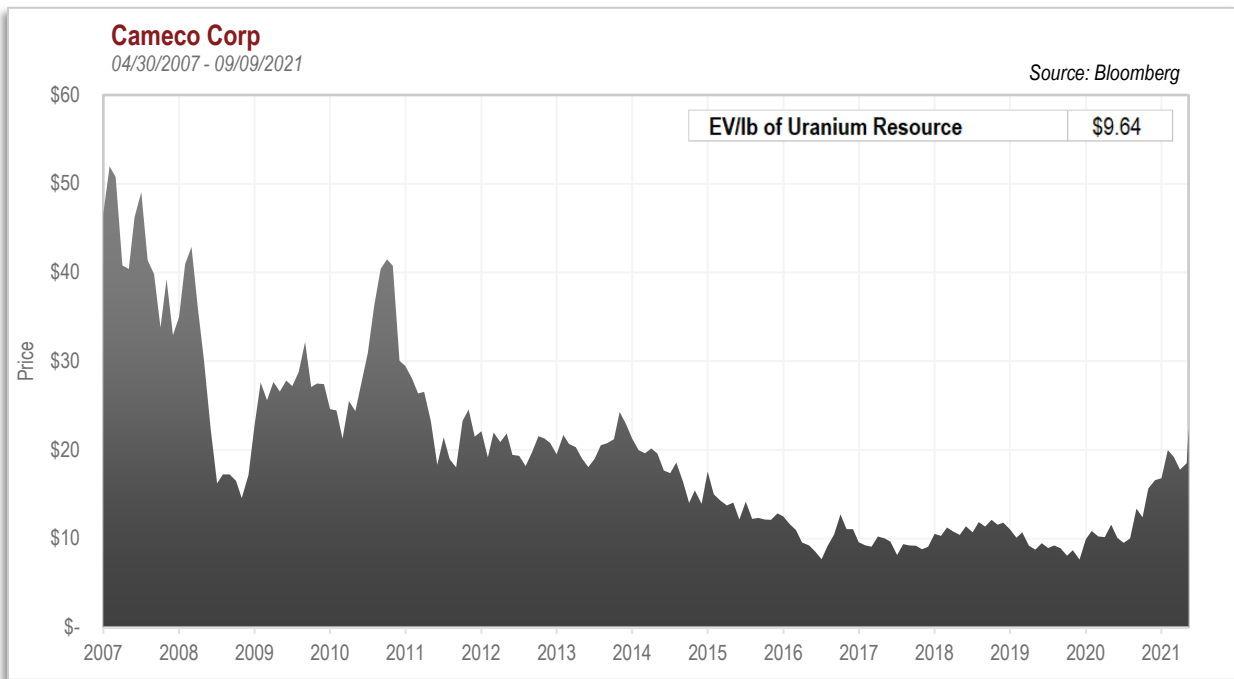
Bell Rock, Sedona, AZ



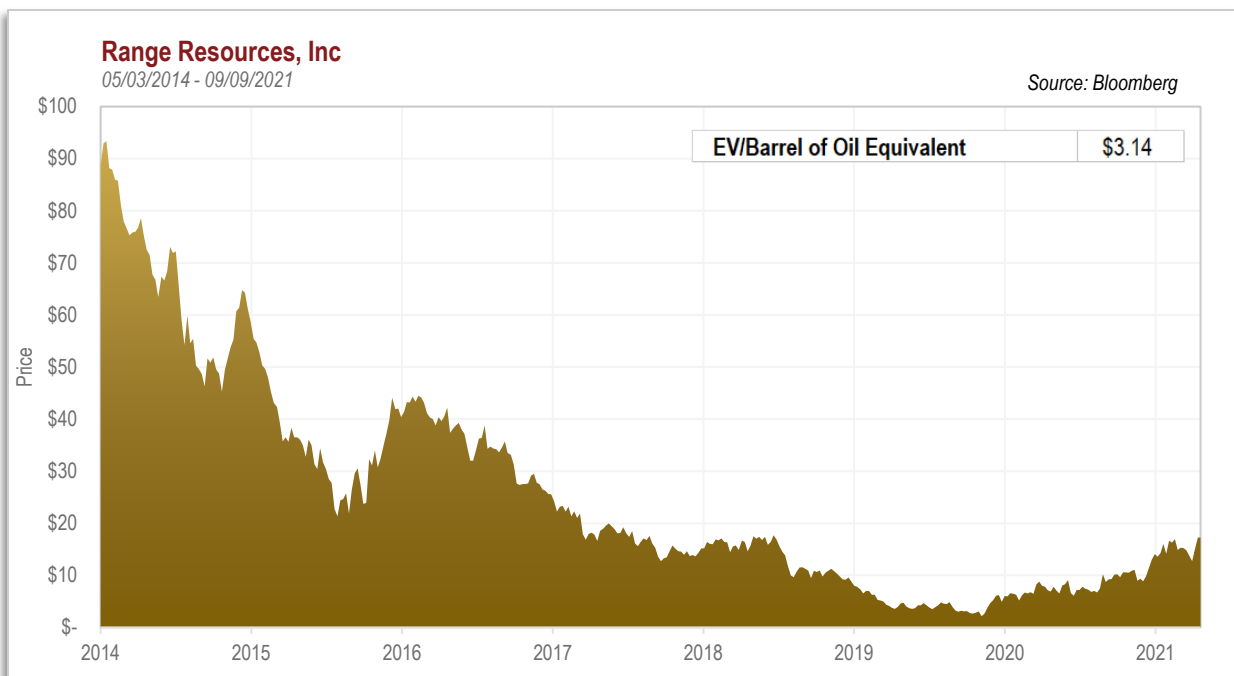
Tesla, Inc. designs, manufactures, and sells high-performance electric vehicles and electric vehicle powertrain components.



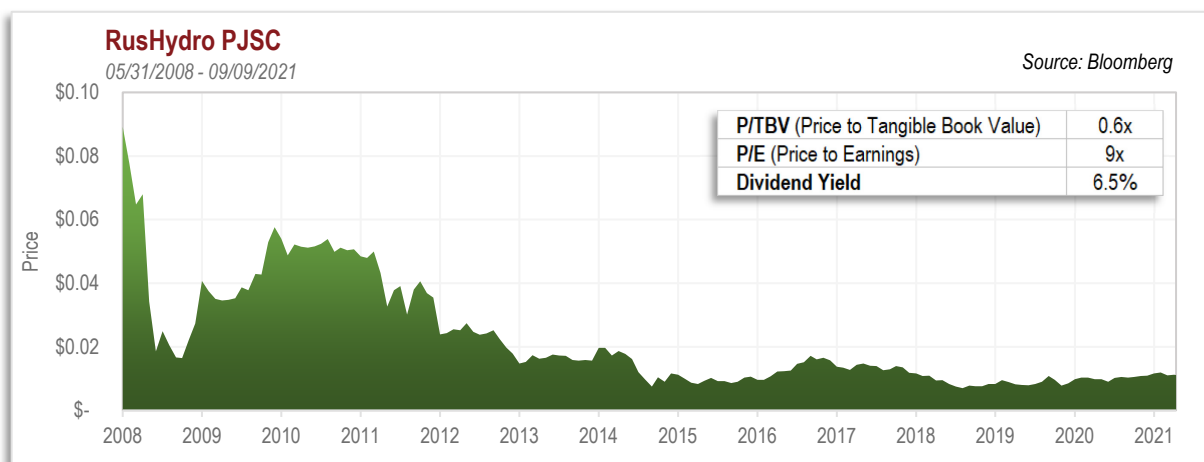
Gazprom PJSC operates gas pipeline systems, produces and explores gas, and transports high-pressure gas in the Russian Federation and European countries.



Cameco Corporation explores, develops, mines, refines, converts, and fabricates uranium.



Range Resources Corporation is an independent oil and gas company that explores, develops, and acquires oil and gas properties.



RusHydro PJSC owns and operates hydroelectric generation plants.

Analysis suggests that the “clean” energy stocks featured above are attractive. Following a long descent down the cliff and continuing journey along the bottom, purveyors of efficient, effective sources of energy – nuclear, hydro, natural gas – are still just getting started on their current ascent up the far face of the canyon. Kopernik valuation models dictate doubles from current prices.

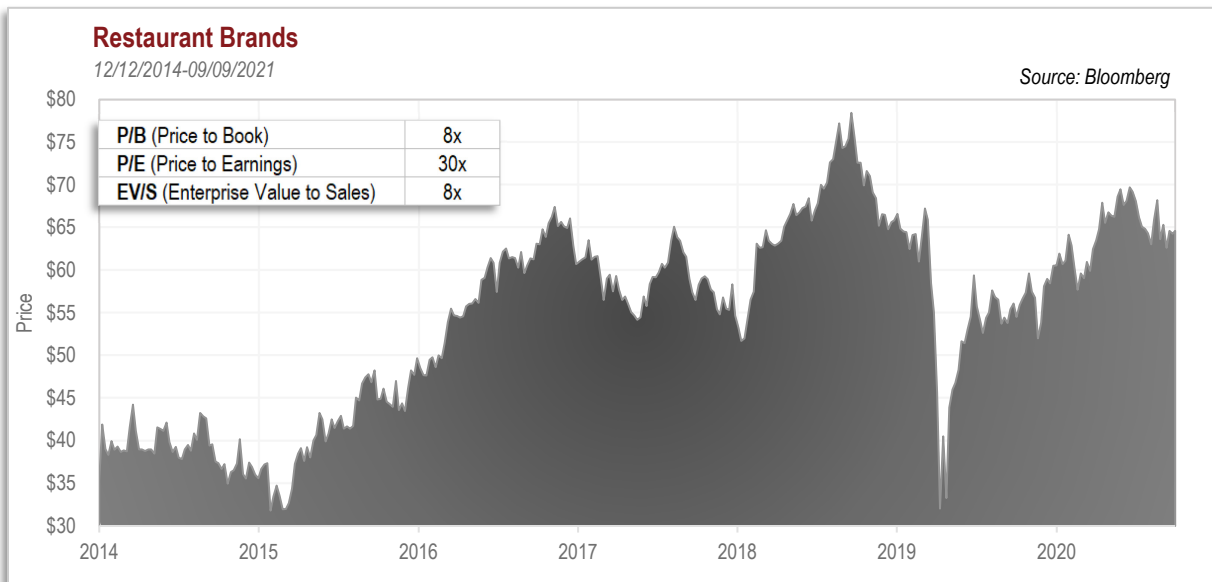
Sticking with ESG-related issues, we reiterate that we are supporters, when approached logically. We all want to live in a better environment and are happy to work toward that end. ESG, thoughtlessly and illogically applied is a meaningful and increasing problem, in our view. Fortunately, at the same time, it has created significant opportunities for research-based investors.

It was previously noted that the title song is actually about McCarthyism:

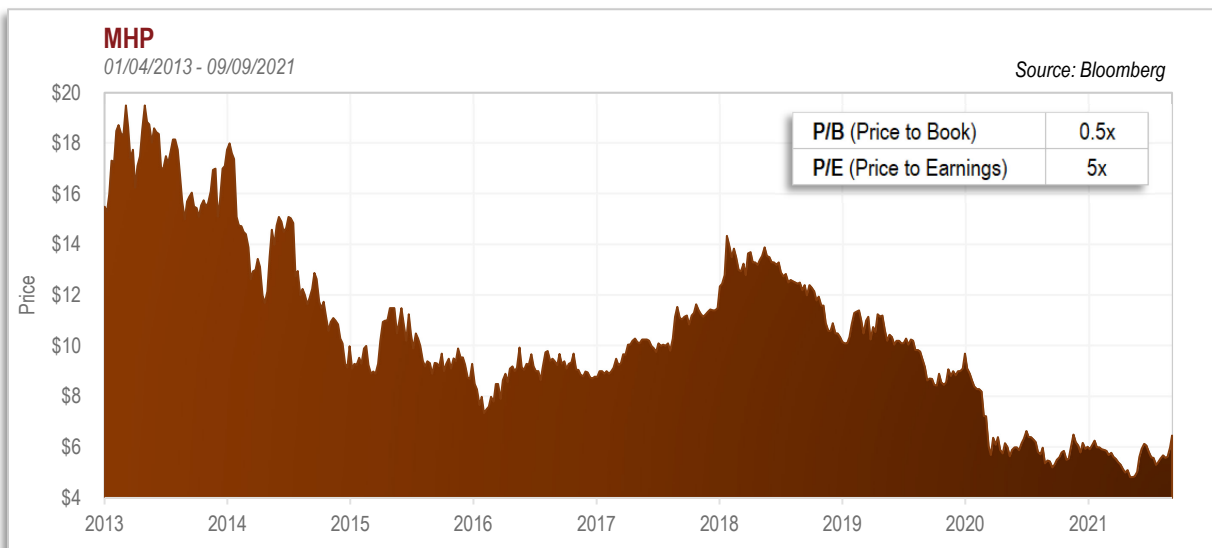
*“The blacklist and its hosts
Came down so swift and it drove ‘em to the coast”*

I grew up staunchly anti-communist and continue to view it as a logically and empirically flawed philosophy. All the same, we are no fans of blacklists or mob psychology turned ugly. One must feel sorry for the individuals whose careers were shattered after they were **falsely** accused of communist leanings. Stocks, of course, aren't people, and as the above energy example highlights, **we are fans of buying bargains off of an errant blacklist**. Investing often is about taking advantage of mob-psychology-induced mispricing. Certainly, independent thought has become a relatively scarce commodity.

Moving on to another example - when it comes to health, it is widely accepted that obesity is a major problem (particularly in America). Evidence suggests that it is a very important contributor to the leading causes of death, such as diabetes, heart disease, cancer, and the flu. It is also generally accepted that whole foods are healthy, while processed foods have increasingly found themselves on the hot seat due to their clear ties to obesity. Now, I'm not preaching, I could stand to lose a few pounds and my diet is far down the spectrum from wholistic. The point is that the main architects of the ESG script have made little effort to incorporate healthiness into their narrative. The result is that purveyors of unhealthy food often find their stocks are prominently featured in the scripts of portfolio managers, while the stocks of healthy food producers lie on the cutting room floor. The result is a delicious bifurcation of valuations. We believe that attractive valuations are important to portfolio health.



Restaurant Brands International Inc. operates fast food and quick-service restaurants.



MHP focuses on the production of poultry meat and grains.

MHP, a leading Ukrainian chicken producer, sells at half of book value and less than five times earnings. Restaurant Brands is an owner of fast-food restaurants that slap chicken (and beef) onto a bleached bun, lather it with mayonnaise and salt, and sell it with a side of fries and full-sugar soda. While I confess to liking Burger King, I find the valuations hard to swallow. It trades at eight times book value and almost eight times sales. Elsewhere, I choke on the value of Chipotle, a good restaurant with seeming carcinogenic valuations: 101 times earnings, 25 times book, and 8 times sales. Our lack of risk-tolerance aside, whole foods vs. processed foods is yet another great example of how whimsically applied ESG standards have created canyon-sized bifurcations in the market. Health benefits should accrue to the independent-minded investor.



Another example of how misperceptions of the mob have led to bargains is the stocks of global phone companies. The darlings of the 1999 - TMT stock mania have had a tough couple of decades in the markets despite massive growth in the usage of their services. With the exception of Verizon (which is slightly above its 1999 level), almost every major global player is well off of its previous peak levels.

The Chinese phone companies are an interesting study of regulation gone awry. Last winter, the U.S. government decided that certain Chinese stocks should be divested from U.S. portfolios. Selling cheap stocks of profitable companies that are in no need of raising capital harms the portfolios of U.S. investors, while in no way harming the divestee companies. Be that as it may, the decision was made to force divestiture. Subsequently, it was decided that the publicly traded Chinese phone companies, being subsidiaries, were exempt from the ruling. During his last week in office, the previous president of the U.S. decided that they would not be exempted. The ensuing mass exodus created bargains for **non-U.S.** investors across the globe. The stocks subsequently bounced between 25% and 50%. The new president decided he would make up his own mind, but in the meantime, it was okay for investors to buy these stocks. Later, he decided that they should be sanctioned after all; this ruling took effect in early August. I wish I were making this "stuff" up. As a result of this foolhardy intervention, investors outside of the U.S. can buy these stocks at a small fraction of what must be paid for Verizon or AT&T stocks.

Granted, this is only one contributing factor to the valuation chasm; phone stocks are quite cheap in Korea, and a few other places. Investors dwell on what's popular, on what might be on somebody's unpopular list, and on what current margins are. We believe that they would be better served to focus on which are good companies and are at valuations that portend good future outcomes. Secondly, rather than harping on whether KT Corp and China Telecom will ever be allowed to earn more than current margins, a noteworthy 60%-80% discounts to those of Verizon, they should enjoy the fact that they are collecting nice dividends (>4%), garnering nice earned-yields, and not having to worry about whether regulators will continue allowing Verizon to grab 22% operating margins into perpetuity, even as the "risk-free" rate languishes at 0%. Verizon stock seems like a decent value but with prospective downside-risk, whereas many of the shunned Asian telecom stocks represent great value, along with significant upside potential.

"You got the cash but your credit's no good"

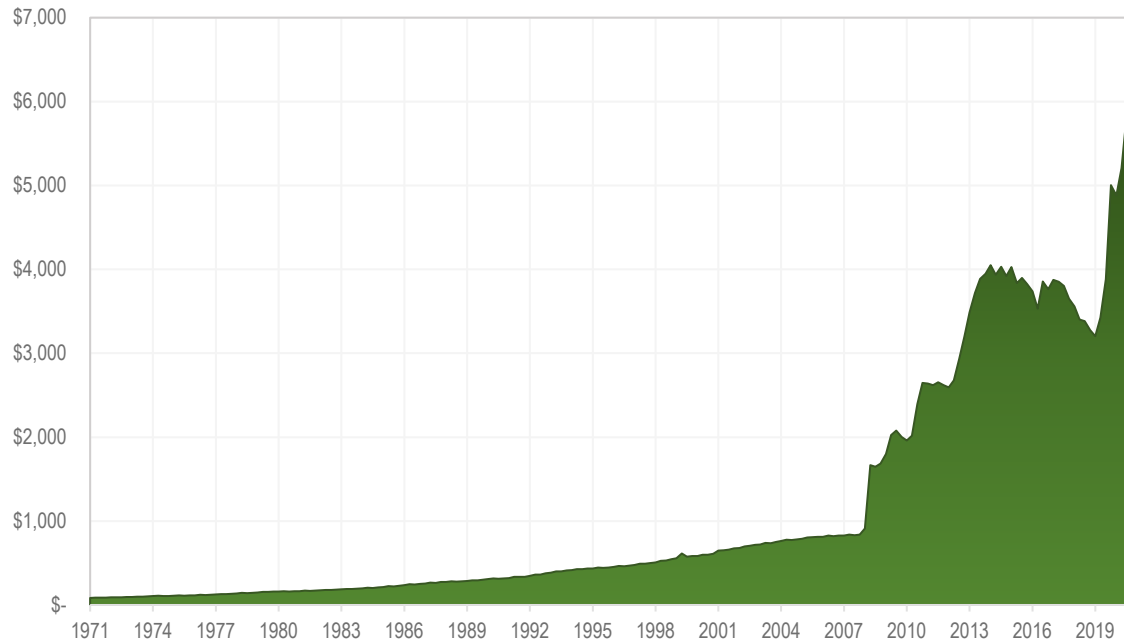
Segueing to our next topic, we live in a world where even as 100% bottom-up investors, we would be remiss if we didn't factor into our models the fact that the **Federal Reserve has conjured into existence almost nine times more dollars over the past fourteen years than they did during the previous ninety-five years!** And, predictably, as their cash goes up, their credit goes down in lockstep. I suppose it is worth reminding people **that federal reserve notes (dollars) are what the name implies – credit instruments rather than money.** Per Investopedia: "A Federal Reserve note is a term to describe the paper demand liabilities of the Federal Reserve, commonly referred to as "dollar bills," which circulate in the U.S. as legal tender." They go on to mention that since 1971 the notes haven't been backed by hard assets and are now backed solely by the government's declaration that such paper money was legal tender in the United States. These notes are still commonly referred to as "dollars," which was previously a legally defined quantity of gold or silver but is now simply the official unit of account for U.S. legal tender.



U.S. Monetary Base (in billions USD)

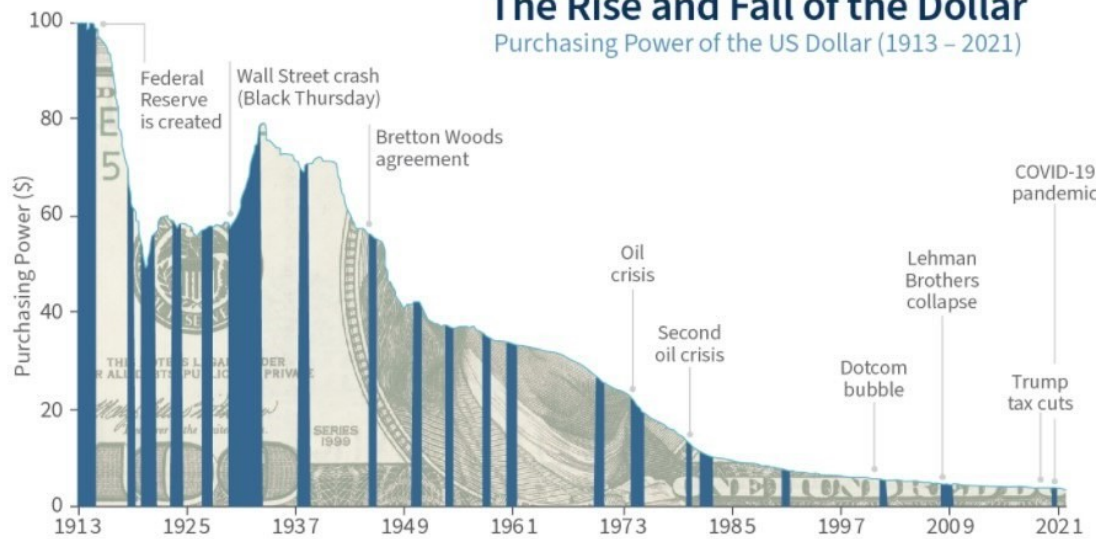
ARDIMONY Index
09/30/1971 - 07/31/2021

Source: Bloomberg



The Rise and Fall of the Dollar

Purchasing Power of the US Dollar (1913 - 2021)



Source: FactSet

US Recession Periods

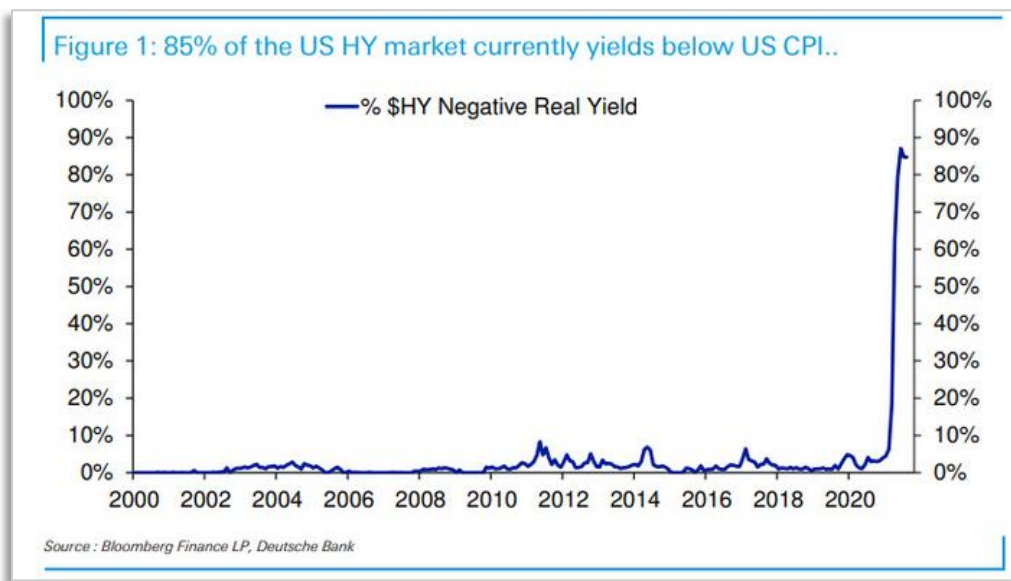
So there you have it, more dollars, less value per dollar. According to the Fed's website, during my lifetime, the monetary base has gone up more than 120 times. That is *not* a typo, but it is a devaluation of 99.8%. Even the horribly manipulated CPI (consumer price index) confesses to a 96% loss of purchasing power over that timeframe. History substantiates economic theory demonstrating that there is a lag between when money is printed and when prices increase noticeably. Since most of the current stock of "money" has been printed over the past year and a half, much of the increase in prices will become starkly apparent in the future.

It should be clear to all that **central bankers can print currency but they can't print wealth**. It is said that years ago when Janet Yellen proposed to the Reserve Board that they should target a 2% annual debasement, she made the case that the vast majority of people would foolishly prefer a 3% raise in a 5% inflationary environment than no raise in a deflationary environment. Apparently the board members condescendingly chuckled with the exception of one person. He suggested that people had been asked the wrong question; how might they have responded if queried as to their preference between losing 86% of the worth or 95%, over the next century. That is the difference between the Fed's stated goal of 2% inflation versus their new willingness to overshoot at little, at 3%. At 5% inflation, 37% of the dollar's value erodes in one decade. Imagine being told by your investment manager that their aim was to lose a third of your net worth over the next decade. How are central bankers getting away with it?



"I don't know what kind of game you're playing, pal, but perhaps I didn't make myself clear. When I said your money's no good here, I meant it literally ... here or anywhere else, for that matter."

I have said before that bonds are essentially un-investable, and with current yields trailing the CPI as the chart below shows, it is clear why.





Listening to Houndmouth singing, “*I remember, I remember when your neon used to burn so bright and pink, so bright and pink*” while perusing the above evidence of the destruction of the dollar’s purchasing power, a slightly altered chorus runs top of mind: “*I remember, I remember when **money** couldn’t burn, and used to shine so bright and golden.*” But, alas, as stated on page one of this missive, “it is important that investors rein in their frustration and act on the exciting opportunities to profit from market inefficiencies.”

Investment Strategy

Value investors, so accustomed to having the figurative “macro” winds in their faces now find themselves fortuitously with a galeforce wind at their backs. The most undervalued stocks – sans inflation – are often the very same stocks that should perform best if/when the investing crowd gets a whiff of inflationary symptoms. This is important because the past 13 years demonstrate the central bankers’ seriousness about their consistent pledge to debase their currencies. Understanding the “Cantillon Effect,” i.e. the effects of debasing currencies flowing unevenly through the economy, is perhaps the preeminent task for investors in the current environment.

Kopernik concludes that investors are well served to:

- 1) Shun fixed-income investments that yield less than the promised rate of debasement
- 2) Shun defacto fixed-income investments that don’t yield incrementally more than the promised rate of debasement
- 3) Factor the non-neutrality of money into the analytical process
 - a. When money supply doubles, then doubling of prices is neither instantaneous nor uniform
 - b. Asset prices tend to move first (witness stocks, bonds, real estate, even quasi-assets)
 - c. Services and intermediate goods take longer to move
 - d. Beware of assets with pricing difficulty. Buyers of inflating assets are especially troubled (if pass-through is difficult)
 - e. Creditors are disadvantaged
- 4) While factoring the effects of debasement into models is error-prone, assuming that money printing doesn’t have an effect on pricing is abject folly

In addition to shunning fixed-income, we believe that investors should seek large margins of error for price takers. Now is the time to own intrinsically valuable franchises. Investors understand this to the extent that they are buying great companies like the FAANMGs¹. Due to strained valuations of those, we’ll leave investing in these companies to others. What investors are missing are the great companies that are far more attractively valued either because they aren’t prominently featured on a list (popular index or exchange traded fund) or because they are prominently featured on a list (someone’s blacklists based upon erroneous ESG-assumptions, unpopular regional/country domiciles, bad technicals, etc).

¹ FAANMG is an acronym that refers to the stocks of six prominent U.S. technology companies - Facebook (FB), Amazon (AMZN), Apple (AAPL), Netflix (NFLX), Microsoft (MSFT), Google (GOOG).

*"The devil's in their rush
And this duct tape makes you hush
Hey there Sedona, let me cut you a deal"*

We believe **there is current value, plus meaningful 'free' optionality in a handful of areas**: emerging markets, infrastructure, agriculture, precious metals, other metals (especially uranium), natural gas, and occasionally other hydrocarbons. We re-emphasize that value doesn't come from estimates of future cash flows. The converse is true, **future cash flow is the likely outcome of possessing intrinsic value**. As the central bankers strive to strip currency of intrinsic value, it is more important than ever to keep this in mind.

We wish you all much health and happiness during these historic times. We continue to strive to protect and grow the intrinsic value of your portfolio in the face of ongoing monetary debasement. We like the current prospects.

Cheers,

David B Iben, CFA
Chief Investment Officer
September 2021

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