Material events which requires a deeper analysis on after effects

- Germany, a major gas importer with 60% of import dependance from Russia has moved to build first LNG Terminal *(expected completion by 2024)*. Should Russia decide to cut/halt natural gas supplies, it could get **cold** unless sufficient supplies of LNG are sourced & stored. Problem is there aren't LNG terminals in Germany for freighters to feed their cargo into national pipeline system.
- Aramco revives talks to set up $10 billion oil refinery in China. Saudi Arabia is China's biggest crude oil supplier and former is considering to accept yuan for oil sales. *(Largest oil refinery in US is owned by Aramco & the Kingdom has historically been top 20 holder of US Treasuries, though a net seller in recent years).*
- India PLI scheme – Introduced to boost domestic manufacturing, improving cost competitiveness of local goods & focusing on reducing import bills the scheme provides cash incentives. The scheme is likely to boost India's manufacturing output by **$520 bn** +1 cr jobs in 5 years.
- European leaders are pushing for a faster switch to renewables as part of the strategy to end dependence on Russian gas with a target of tripling clean energy capacity by 2030.
- Germany commits €100 bn to defense spending, mark an extraordinary and unexpected shift in defense policy sharply increase its defense spending to > 2% of its economic output. In 2020, spending was capped at an estimated €51.4 bn.

What is the common link between all the above events? Everybody is providing information via their actions, non-actions, body language etc. Every economy is signaling changing patterns followed erstwhile and one common way to cater to these changing patterns is ***Industrialization*** i.e., investment into capex to rebuild their capacities, which in essence is commodity intensive .

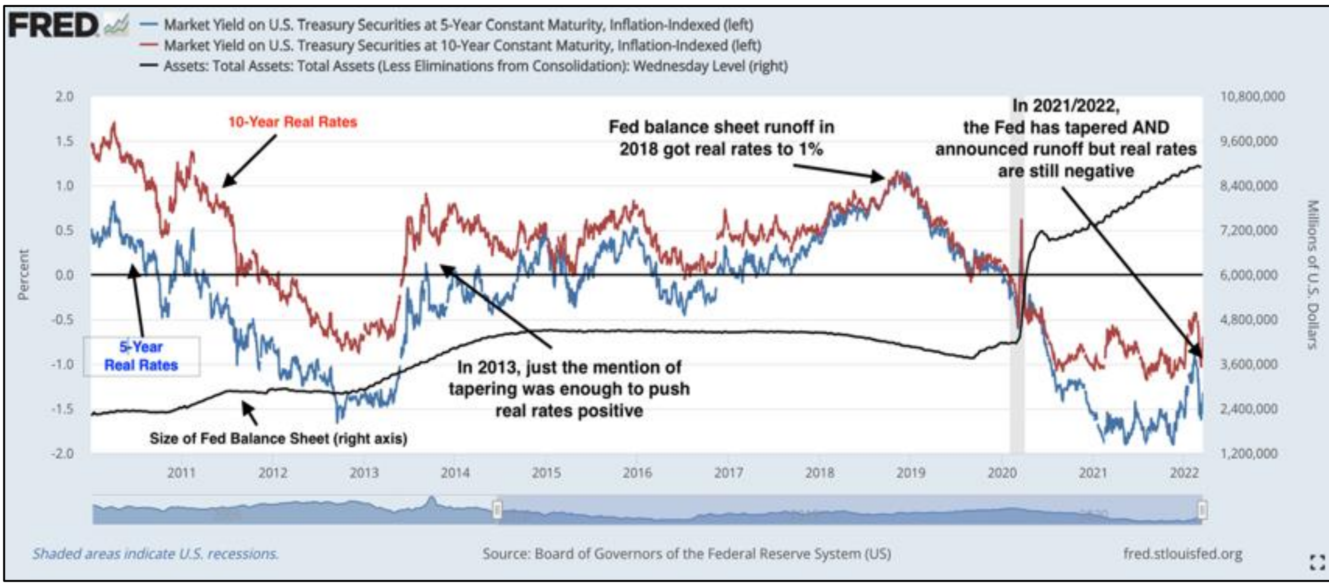
Additionally, food & energy *(again commodities)* could easily double as % of GDP which could potentially shrink rest of economy, unless this is followed by monetary expansion. In such a scenario, will countries use reserves to establish self sufficiency before investing outside their economies?

Do you know - The annual production capacity of cement for 2021 for Ultratech Cement (95.3 mn metric tons) was higher than the capacity of all companies in USA (92 mn metric tons)

Real yields – Important factor to determine direction of Liquidity

The 1921-1923 hyperinflation in Germany and Austria was blamed on the 1918 Spanish Flu. The 202X stagflation will be blamed on Covid-19?

Despite, Fed tapering bond purchases & likely announcement of reduction of its balance sheet, *Real rates* are still in negative territory. Ways to fix this is (a) convince markets that Inflation will come down quickly *(ref our brief on material events to infer this)* or (b) to get nominal rates higher, sooner.



US Inflation soared 7.9% in the past year, a fresh 40-year high. Last time US Fed rate was 13% when CPI touched 7.9% in 1980. At that time, every 1% increase in interest rates increased US government interest expense *(as a % of tax receipts)* by 1.7%; today, that percentage is 7.5% per 1% rate increase, assuming that US tax receipts *(which are likely much more interest rate-sensitive after 40 years of financialization of the US economy)* would not fall as rates rose

<u>This means that the Fed not only *cannot raise rates sharply* like it did in 1980 to fight inflation, but more importantly, it means even modest rate hikes will likely send US Interest Expense *(incl all promised entitlements)* even further above tax receipts, likely necessitating *additional USD liquidity injections from the Fed* or the US banking system.</u>

Will foreigner investors still oblige Fed by buying additional treasury issuances or will Treasury issuances crowd out private markets? In that case will the markets demand higher nominal rates?

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Case for Bretton Woods system III

Recent developments have accelerated the already emerging change in world economic order & regime change from disinflationary globalization of last 4 decades to beginning of inflationary era of 2020s with effectively east *(Russia, China, Iran, Saudi, Syria & allies)* facing west *(US, Europe & allies).*

From Russia Swift sanctions - removal of Russian energy from the west - global corporates moving back to onshoring and restocking 'just in case' inventories - fear of state freezing or confiscation of bank account *(supporters of Canada truck drivers)* all point out at a regime change.

Asper Zoltan Pozsar from Credit Suisse, these will eventually translate into the birth of Bretton Woods III – a new world (monetary) order centered around *commodity-based currencies* in the East that will likely weaken the Eurodollar system and also contribute *to inflationary forces in the West*.

Will we see broader central bank diversification away from US$ assets to hard assets, commodity based currencies, real assets and renminbi/alternate currencies for global trade? (P.S –India which imports 80% of its oil requirements is considering importing discounted oil from Russia in Rupee) <u>(We believe we are in the early stages of this decade long theme</u>

XME (Metals and Miners ETF) has broken a long term trend which if real could be the start of biggest rotation trade of the decade.

PINETREE MACRO

Reallocation of Capital to Hard/Real Assets

Real assets or Hard assets, have historically acted as good inflation hedges because they are real and tangible. If the construction cost of apartment communities goes up, then the value of existing properties increases as well.

Being asset heavy has gone from a bad thing to a good thing in this inflationary environment. 2010-2020 was all above asset light + growth model and cheap money from low interest rates attracted high valuation stocks. Tech is asset light and needs low inflation and rates to flourish.

We believe next decade is all about asset heavy companies i.e., essentially industries which are capex intensive and see operating leverage kick in as volume increases. As for the fundamentals – energy's free cash flow yield is more than double that of tech and inflation makes all of its assets all the more worthwhile.

We've the lowest interest rates in history with the highest debt levels in history, and simultaneously undergoing a change in world order which has affected the most important part of the global stability equation –Commodities.