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The way to get through the global crisis – invest in leaders who grow stronger in times of chaos

Executive Summary

- The Ukraine-Russia conflict is just one manifestation of various tsunami forces and ongoing crises which have been unfolding in the last few years in the world. These forces will eventually push the world into chaos.
- A truly tragic failure of western diplomacy has come at the time when the worst possible scenario is unfolding in the financial markets.
- You must reboot your vision completely and break the paradigm, as traditional asset allocation in the investment portfolio will result in capital losses in coming years. There will be no "safe havens" and no places to hide. All our experience gained prior to 2022 will not necessarily help us get through the chaos which is coming.
- Instead of investing in asset classes, the successful investment strategy will be to invest in leaders who will grow stronger during the crisis and in such times of chaos.

Pressure has been building in the world in all aspects of human life, leading to the erosion of social cohesion, livelihood crises, and the deterioration of mental health.

Climate crisis

The world has been heating up with the acceleration of carbon dioxide emissions since the mid-20th century. **An unfolding climate crisis could trigger economic shocks and supply-chain disruptions with unimaginable consequences**. Global warming and food shortages are just initial signs.

Energy crisis

As a consequence of the political attack on fossil fuels in the last few years, **there is a structural lack of supply, as Oil and Gas industry investments have dropped by 50% since 2014 and oil and gas discoveries have plunged to their lowest level in 75 years**.

At the same time, the populist political choice made in favor of renewable energy has led to a continued rise in electricity prices and blackouts as the existing energy stock fails to satisfy demand.

Food crisis

In March 2022, the UN warned that the global food prices rise could trigger a global food crisis of historic proportions. The COVID-19 pandemic has led to a steep rise in hunger in countries already struggling with conflict, climate change, and economic turbulence. An energy crisis added fire to the food crisis, pushing prices of agriculture commodities higher. As a result, food prices have hit a new record high, according to the Food and Agriculture Organization's (FAO) latest food price index, which records the price movements of main food crops. The climate crisis has contributed to food insecurity through changing weather patterns such as rainfall and increased climatic shocks (floods, droughts) which all have an impact on harvests.

Geopolitical crisis

A truly tragic failure of western diplomacy came at the worst possible time for the global economy and financial markets. Arrogance is the mother of all failures. How much would it have cost 1) To say "NATO doesn't need Ukraine" 2) To listen politely to Russian security concerns, which Russia communicated to the United States and NATO at the end of 2021 and find some compromise solution? This would have been within the capabilities of even the most mediocre diplomacy.

Back in February of 1997, George Kennan, the architect of Cold War containment of the USSR, implored America not to seize its triumphal moment and move NATO into Eastern Europe: "Expanding NATO would be the most fateful error of American policy in the entire post-Cold War era." But the US and NATO did exactly the opposite, which provoked and alienated Russia by treating it as an incorrigible and permanent enemy by pushing NATO onto its front porch.

At the same time, U.S.-China relations are transitioning into intense rivalry across nearly every dimension, including trade, technology, ideology, defense issues, and more. **The U.S. will do whatever it takes to prevent China from becoming the largest global economy**. As former Secretary of State Madeleine Albright explained: "If we have to use force, it is because we are America; we are the indispensable nation. We stand tall and we see further than other countries into the future."

The geopolitical fragmentation will continue to rise. **Tensions between the U.S./NATO and Russia and between the U.S. and China will intensify, deglobalization will accelerate, and inequality will widen both within and between countries**.

Social crisis

According to the Global Risk Report 2022, published by the World Economic Forum, respondents again signal societal risks as among the most concerning. They see those risks specifically as "social cohesion erosion", "livelihood crises", and "mental health deterioration"— as those are the risks that have worsened the most since the pandemic began. The issue of inequality becomes worse every year. The pandemic has exacerbated divergences both between and within countries. Many developing countries will be badly damaged as they have weak healthcare infrastructure, limited institutional capacity, poor governance, and little policy space to maneuver. The pandemic has erased decades of progress in the fight against poverty and the building of middle-class households.

Excessive regulation crisis

Increased regulation across the board limits competition and productivity. It also diverts the energy and time of management teams, from successful execution to dealing with bureaucrats and regulators.

Financial crisis 2022: The worst possible macro set-up for the financial markets

After manipulating the business cycle for many years to prevent an economic downturn at any costs, Western central banks face the dilemma today of deciding between massive rate hikes (with a risk of a deep recession) and Weimar style hyperinflation.

Increasing interest rates, quantitative tightening, inflation getting out of control, continued deterioration of liquidity, and a major geopolitical conflict between NATO and Russia all happening in one year, in 2022 – this is the worst possible scenario for equity markets. The unfolding energy crisis is negatively influencing economic growth and corporate earnings. Continued supply chain disruptions, labor market gaps, repeated massive lockdowns in China, and protectionism are increasing the pressure on the world economy.

High valuations, extreme leverage, and broad deterioration in market technicals are all signaling a multi-year bear market in equities. Corporate profits will be revised significantly (!) downwards in the coming months and the currently high allocation in equities will be reduced.

Despite the severe recession warning by leading investment banks, the major Western central banks are behaving as if they have all the time in the world – but they don't! The Fed moved its 2022 inflation forecast up significantly from 2.6% to 4.3%. The latest March print for the US Consumer Price Index (CPI) was 8.5% on an annualized basis. Investors and major investment banks are forecasting 5.0 – 5.5% for 2022, while corporates see it at 7.0%, as price trends are the strongest ever by a very wide margin. If there is any more reassurance from Jerome Powell or Christine Lagarde, who has set a whole new standard for incompetence, we will start to raise cash more aggressively in our portfolios.

The world will have to go through a transformational self-cleaning stage. This is a condition to move to the next stage of evolution.

The crisis which is unfolding slowly is not just an ordinary recession, which happens at the end of each business cycle. We have entered a crisis of our civilization, which is 6000 – 7000 years old.

The existing society model, based on consumption, does not work and will be gone. And no one knows what is ahead of us.

Now is the time for a new creative vision. You must wake up and reboot your vision completely. Break the paradigm. Previous experience gained before 2022 will not necessarily help to get through the chaos – we live in a world no one ever lived in before. How long will the politicians and Western central bankers still try to solve all the problems by printing money and issuing new debt? How much time do we have before global warming will redefine the world order? Where and when will the next military conflict happen? When will the population of the developed world learn the true meaning of the word "hunger"? How long will the coming recession, which may be the worst in many decades, last?

Invest in new leaders

Instead of investing in traditional asset classes, corporate entities, or financial instruments, invest in leaders who will grow stronger during the crisis and in such times of chaos. And consider which asset classes are represented by these leaders: stocks, bonds, VC/private equity deals, real estate, new asset classes, etc. There will be new leaders – the winners in each asset class, who will demonstrate their best skills at the toughest time. And these leaders will find a way to solve problems and create value even in a time of chaos. Such leaders have enabled humankind to survive for millions of years.

The game plan to get through the time of chaos

- An old, fixed, rigid, outdated vision will result in failure in the new world order.
- Create a new strategy, new competitive advantage, new competencies, new tactics, new technology, new products, and new approaches. Build new relationships.
- Stop blaming others: government, other countries, other people, past events, dark forces, etc. Each one of us is responsible for what is happening in the world today and what the future will look like. The world will go through transformational change accordingly.

- Let go, do not try to hold on to something which will disappear or will be destroyed: outdated business models, capital losses, non-performing assets, difficult relationships, poorly performing managers, and anything and anybody that wastes time and energy, etc.
- Get rid of excess baggage and anything which is not essential. My definition of excess baggage: non-performing assets or assets with performance below expectation, anything which is destructive, complicated, or wastes time and energy.
- Accumulate capital. Stay liquid. Sell all the assets where you have low confidence and poor vision. Staying liquid is more important than trying to make an extra penny on assets with poor visibility. Remember: major market crashes happened because of problems with liquidity, not because of economic problems. Also, there will be once-in-a-century investment opportunities ahead.
- Make sure that your teams are balanced with "cold blood" veterans who have "grey hair experience" for making strong decisions and taking responsibility, and young people who think fast, have a new vision and look at the world with fresh eyes. In the next few years important skills will be pragmatic risk management and the ability to cut losses, hedge, and restructure, but also the ability to spot new ideas and new developments and act fast.
- "Expect the unexpected" is the new normal.

Some "out of the box ideas" in asset allocation

Cash

We have aggressive cash allocation (30% +) in our portfolios based on institutional standards. We think the biggest mistake investor can make in today's environment – is to be fully invested. We favor cash in emerging Asia currencies and Chinese renminbi. Our core assumption is that in coming years (2022-2024) we will be able to buy shares in the best companies at levels 20-30% lower than current levels (April 25, 2022 levels). And that we will be able to buy quality corporate bonds at levels 5-10% lower than current levels. So, as usual, cash will remain king in the upcoming crisis.

Equities (20%)

Some equity exposure ideas:

- Recession resistant disruptive innovators – the companies, where long-term earnings growth is based on innovative breakthrough technologies. These companies will perform regardless of what is happening in the economy or markets. Good examples of the sectors where such companies are based: biotechnology companies that save human life and improve quality of life by creating drugs to fight chronic diseases; Predictive Data Analytics using modern artificial intelligence (AI) algorithms are becoming a key source of competitive advantage for the leaders of the future; Disruptive Intelligent Automation (Based on AI, Robotics, and Cloud Digital Platforms) stand to benefit from unprecedented demand as a result of the digital transformation acceleration, and the importance of flexibility, scalability, and resiliency.
- Fossil energy (oil, gas, coal producers). As discussed above, Oil and Gas producers, Coal miners will be the biggest beneficiaries of a structural lack of supply in the next 3-5 years.
- Resources (copper miners and aluminium producers as a priority). We expect a deficit in the aluminium market already in 2022. And we expect a deficit in the copper market from 2025 onward. As the most cost-effective conductive material, copper sits at the heart of capturing, storing, and transporting new

sources of alternative energy. Without a surge in the use of copper and other key metals, the substitution of renewables for oil will not happen.

- Precious metals miners (especially silver miners). Gold mining companies have operational leverage of 2 – 2.5 times, meaning that the operating income grows 2 – 2.5 higher vs an increase in revenues (in line with gold price increase), as the costs remain unchanged. Today gold mining companies are enjoying record high margins, which will result in an increase of dividends.
- Pharma/healthcare (defensive). Healthcare stocks are considered a recession resistant, as the demand for drugs usually remains stable even during the worst recession.
- Biotech. Carefully selected biotech stocks perform regardless of what is happening in the economy or markets.
- Chinese real estate developers (some of them offer 10%+ dividend yield).
- Chinese technology and internet stocks are trading at USD 20-30 cents for USD 1.0 value.

Fixed income

Our core view is that the weight of the bond portfolio in an overall multi-asset portfolio should be kept to a minimum (10-15%). A multiyear bear market in government bonds has started. Spreads have started to widen in corporate bonds. We expect the Chinese renminbi to outperform the USD on a 3-year basis. Chinese local government bonds could therefore be a good idea as a new safe haven – a good place to hide during the coming bear market.

Alternatives (20-25%)

On top of traditional alternatives, **we like two asset classes in this segment**:

1. **Trade finance and shipping/freight funds**.

As a result of the Russia-Ukraine conflict, many traditional trade channels are being re-routed. The cost of trade finance is increasing. Trade finance funds are making good money. Shipping rates will increase. The price that the People's Bank of China (PBoC) will pay to lease ships to fill them with Russian commodities will rise significantly. The price that the EU will pay to lease ships to fill them with substitutes for Russian oil, gas, and coal will also rise considerably. Shipping/freight funds will be the main beneficiary of changing trade routes and supply channels.

2. **Private credit funds**. As the world enters a recession, mid-size and small-size borrowers will suffer. The interest rates for private loans will increase and private credit funds will benefit.

Precision metals (5%)

Both physical gold and silver and exposure via ETFs.

Hedging instruments (3%)

- Short-only equity funds
- Long volatility funds
- Option trading strategies (selling puts on high-quality stocks)

Cryptocurrencies (1%)

In coming years there will be no “safe havens” and no places to hide for investors. The way to get through the crisis and chaos is to stay active, and to stay in the front line. Take the responsibility, make strong decisions, and take firm actions. Help others, especially those who are weaker. It is the time to share, serve, love, and give.

Abilities to live in the present moment, be flexible, adapt quickly to changes, and be open to new ideas will be the key success factors.