Kopernik Global Investors, LLC

Edited Transcript of the 3rd Quarter 2023
Conference Call with David Iben and Alissa Corcoran

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Mary Bracy: Good afternoon, everyone. Thank you for dialing in to the Kopernik Global Investors 3Q 2023 Conference Call. My name is Mary Bracy, Managing Editor of Investment Communications here at Kopernik, and it's my pleasure to welcome you to today's call. Before we get started, a reminder that today's call is being recorded and will be available on our website, kopernikglobal.com, at a later date. Also, we will have a Q&A session at the end of the call. If you have any questions, please type them in to the Q&A box, and we will get to as many of them as possible after Dave and Alissa's presentation. At this point, I'd like to turn the call over to Mr. Kassim Gaffar.

Kassim Gaffar: Thank you, Mary, and welcome, everyone. I'll provide a quick firm update. Clearly, it was a very busy quarter in the market. However, we are happy to report that our business continues to be steady and we've overall grown this year. From an asset standpoint, we entered the third quarter right around $5.95 billion under management. This is a slight increase from the beginning of the year when we were around $5.7 billion. Moving on to the personnel side, we're currently 42 employees strong and have continued to be stable with minimal turnover since the inception of the firm.

Please note, we also recently posted on our website, kopernikglobal.com, under the News & Media section, a great and highly informative podcast done by Dave, which was hosted by Stephanie Pomboy and Grant Williams [Super Terrific Happy Hour Ep. 19: How Do You Solve A Problem Like Inflation?]. With that, I conclude the business update and I'll pass it over to Dave and Alissa. Dave, please go ahead.

Dave Iben: All right, thanks, Kassim. Thanks, everybody, for joining us. The markets continue to get more and more interesting. To start off with my singing debut, I will not burden you with that, but we will burden you once again with more thoughts about how the last 40 years is probably not the best predictor of the market ahead of us. For that, we need to go to different periods of history in different places. With that, let's go with *Evita*.

Most of you probably know it's a play by Tim Rice and Andrew Lloyd Webber. It's about a young woman, poor family in the countryside who goes to the big city, hustles her way to top. At the top, she becomes first lady. Along with her husband, Juan Perón, they instituted Peronism or very populist policies. Lots of largess poured out on the population made them very, very popular. Whether it was good policy, intelligent people can disagree. With that, let's move on.

It was also later made into a motion picture with Madonna and Antonio Banderas. What brought this to our attention? We re-watched the movie last summer when a group of us went to Argentina to do some research. We highly recommend it. These pictures are just good things in Buenos Aires alone. There's much more to the country than that. The things are really cheap there now. If anybody wants a good vacation, consider that. We went there because every summer we've taken to doing research at different parts around the world. This was a good time to go there. One, because the currency was so cheap and things were affordable.

With resources being so interesting, they have a lot. We were able to go to a lithium conference with people [from] all around the world, visit some lithium mines, talk to companies in gold mining, copper mining, oil, agriculture, lots of great research that we think was a good time to be doing it. It wasn't all work, however. There was time to enjoy a good ribeye and a Malbec for less than $15. We're talking good steak, good wine. A good time and nice people. We can see the waiters and everything. Time to do a little dancing. Dancing-wise, I'm more like the guy on the left than the one on the right.

Argentina is a country that does have a lot of resources. There's so much to see, so much potential there. It was a good time to go there, but history, what's really interesting, many people might be surprised how much they have in common with the U.S. historically. They were the seventh richest. Some people say they were one of the richest or second richest in the world. I don't know about that but they were certainly a top 10 country and they were benefiting from the same thing as the U.S. was. Lots of people from Europe taking off to the new world, where they could take advantage of growth and great agricultural land and a wealth of minerals.

A very similar history, until the time of Evita. They made a lot of changes. You can see from right about that time that U.S. continued to grow and it's been more difficult for Argentina. How did that happen? Why did that happen? It's worth looking at. Let's start with the idea that Peronism did have a lot of attributes, a lot of good things. Created jobs, there were transfer payments, making a lot of people wealthy, free education (a good thing), hydroelectric power (a very good thing). The economy did very well. There was a reason they were so popular.

Of course, it had its failures, as we can see even nowadays, when governments pour massive amounts of money into the system very quickly, it doesn't always go where it's supposed to go. High levels of corruption. When you nationalize properties, that undermines people's faith in the system. A lot of things are trust-based. You have the idea that people in government, what they say and what they do is not always the same thing. And like we've seen with our own politicians recently, Eva Perón represented the poor people and yet lived like the rich people. She was well-known for her lavish lifestyle and keeping a lot of designers well up. Nothing comes free.

We were fortunate enough to be there at a really fascinating time. People, after all these years, after three quarters of a century, are seeming to say enough of Peronism. The election last weekend somewhat verified the election of a few months ago, where the Peronist party got 37% of the vote. The two other people were much more conservative. The other conservative one has endorsed Milei, who you can see here. Excellent chance that the Peronists lose the final election, so things might be changing.

Why might people be getting sick of populism? One is the aftermath. It has been a tough place to be in terms of devaluation. Johns Hopkins has them as one of the top seven in the world. They're number six behind Venezuela, Zimbabwe, Lebanon, Sudan, and Syria, good company. It's gotten so cheap that a 20-minute Uber ride is just about four bucks. Great for us, not so good for the Uber drivers. The steak we enjoy, not so good for the farmers. It's a tough time to be living there.

It got to be where if you wanted money, people would come and bring bags of money and you need a counter to count the money. Whereas 20-something years ago, $1 bought one peso. When we got there officially, it was 270 pesos. There's the blue market, which is what they call their black market, was 484. We were able to get 484 pesos for $1. That allowed things to be very cheap. If that sounds bad, two months later, the 484 is 714. A fascinating time. Since last summer, it's now gone to over a thousand. In 20-something years, $1 has gone from one peso to over a thousand pesos. Not a good time to be living and working there.

About now you're wondering, "Isn't this an investment call? We didn't tune in for a travelogue or a movie review or a history lesson," but history is worth paying attention to. As they say, history doesn't repeat, it rhymes. If it rhymes, how did Argentina get into this mess in the first place? It seems it was because their politicians made a whole lot of promises they couldn't afford to keep. This led to lots of debt creation. Debt creation leads to money printing. Might sound familiar to people.

Is it going to work any better for us? It's amazing that this headline here is from satire, but it's pretty close to reality. Since they raised the debt ceiling here, the debt went up by, what, another half trillion pretty quickly, something like that. We're talking $2 trillion deficit in the year just ended. That's without a recession, without a major war. These are big numbers that are being thrown around. In the U.S. Japan, China, Europe are not far behind. How did this stuff work for Argentina and all their neighbors with similar policies in Latin America? This chart shows the defaults over the last couple of centuries. The one for Argentina doesn't even include the most recent one from two, three years ago. While this is happening, you can see how their GDP per capita has lagged that of the U.S. Good times to start, and prices to pay later.

Now, admittedly, the massive spending did produce results early on. The U.S. did very well after World War II. This shows Argentina did even better. These are stock market returns off to the left. Even more than a decade later, Argentina remained one of the stronger countries in the world. This money poured in the system that early on turned out well, and they coasted to re-election, the Perons. Everything seemed good.

Just like in the post-COVID policy, we've seen in the modern world the same thing. They printed in the U.S. $4 trillion out of thin air. Other countries were doing similarly, and you can see stock markets around the world have done pretty well. This shows in the U.S. 10x increase in the money supply led to a 10x increase in the NASDAQ. Good times. Until recently, you've seen similar in the real estate indexes and we've all seen in the last 10 years what's happening to the art market and alternatives markets and Bitcoin here. It's been a very good time for people that are well positioned to benefit from the money printing. It seems pretty easy if you're on the beneficiaries of the money. Life is good.

It's been a good time to be in the healthcare business, to be in the defense business. Fortunately, it's been a good time to be in the businesses that most of us are in. That's been good. But, as the song says, maybe these things are not the solutions they promised to be. Maybe it's time to pay the piper. We mentioned before the deficits of the lower right, the well-known saying, if a thing can't go on forever, it will eventually stop. $33.5 trillion, that's a big number.

Recently, it's been said that the average debt in the U.S. is going up by $1.4 billion per hour. Pretty staggering sum. If it can't go on forever, is it getting close to time to pay the piper? If so, when? More importantly, how? I do want to point out that we're not talking about just the U.S. here. We're talking U.S., Europe, Japan, China, you name it. That's point one, we're all facing it. Secondly, it won't be outright defaults. History would suggest it would be money printing.

Also, I want to make it clear, we're not talking about any particular party or Republicans or Democrats or any parties overseas. We're not aware of any major party in any major country right now that is campaigning on austerity. People don't get elected by saying, "We want to cut your benefits and raise your taxes." We think the sort of things we're talking about, at least for now, are endemic to the system. If so, this debt will once again be monetized. I think it's one of the few places where we're in the consensus. I think most everybody, including us, believes it's not if but when the Fed and other central banks return to printing money. Time will tell.

As we await that, what does all this populist stuff mean, really? It's really been a circus, as you watch both parties campaigning for who gets the most pork. These things are all going to require money. The money itself is inherently inflationary. Then there's big government in general. There's a lot of good things about government and good things they can provide, but when governments become big and intrusive, things like taxes, and tariffs, and trade barriers, and lots of regulation, and sanctions, these are things that historically have proven to be inflationary. Inflation is probably not over.

For people saying it's over, it'll point up. My lifetime, there's not been a single year of the CPI [Consumer Price Index] dropping year-over-year. That's a pretty amazing thing. Not a single year. People confuse a CPI that's rising slower than it used to be as inflation done with. No, inflation's here. In the early parts of inflation, as we'll talk about, it goes into markets and people are happy. Central bankers like Evita are high-flying adored. Maybe we're getting to the point where they shouldn't look down because it's a long, long way to fall.

That's the backdrop. Fortunately, that's the end of all the negatives, because as Argentina and the U.S. and others show, these do create big opportunities for making money too. To talk about the positive story, let's hand things off to Alissa.

Alissa Corcoran: Thanks, Dave. As investment professionals, we are observers and we can't control what the high-flying central bankers do, the governments do, but we can control our portfolio and how it's positioned. We would say after four decades of dropping interest rates and low inflation, many investment professionals are not prepared for what we think is going to be the coming decade. We look back to the '70s, we look back to Argentina and other countries that have experienced inflation, and we can learn some lessons. That's what we will be talking about over the next couple of slides, are some of the observations and lessons we've learned and use history as our guide to create lemonade when we are given lemons.

Lesson number one is that you want to own intrinsically valuable things. The rise in price relative to depreciating currency, which comes about from, as Milton Friedman pointed out, printing money. Then three centuries earlier, though, Richard Cantillon observed that when you print money, it's not neutral. Things rise at different times. They rise at different rates. The key is to identify the winners and losers and buy the winners before they have fully reflected all that money printing. The winners during other inflationary times have been commodities. As the middle chart shows, you wanted to own oil and copper and commodities which outperformed in real terms. What you did not want to own are the expensive growth stocks, which is very similar to what we're facing today. We have very expensive tech and health care in U.S., and discretionary stocks that are not pricing in the potential for inflation and higher interest rates.

Meanwhile, as you can see on the left, you don't even really need inflation for these commodities to do well versus financial assets. They're very under-owned. Then on the right side, you can see the scale of these commodity price increases in the 1970s. It's truly staggering. Back to Cantillon. We won't let you get off so easily. As they point out, many believe that inflation is declining, and therefore, we have slain the inflation dragon. Rates are going to go down. We were in Germany, and I can't tell you how many meetings we heard management teams thinking, "Well, rates are definitely going down." We believe that inflation is not dead, that it's instead migrating through the system, which is the observations of Richard Cantillon. Even in the '70s, you had times where inflation was high and then it would come back down before it started breaching again.

Inflation comes in waves. If you were to pour water at the mouth of the river, you buy bonds with that, so those go up, which then drives stocks up and then drives real estate up. Then with real estate going up, then people are building houses, which then drives lumber up and the cost of buildings, which pays carpenters and electricians, who then go spend their money at the local stores, which then pass along those higher profits to wages of their workers. That's tends to be how inflation does migrate through the system. The key is to go where that inflation hasn't yet reached. Since our prices don't rise in unison, it's not neutral, not everything rises at the same time, it does pay to shop around. We saw this in Argentina. As Dave pointed out, the currency dropped 50% in two months. Some stores were very quick to reflect that depreciation, some reflected at 20%, some didn't reflect it at all. Those are where you would want to be shopping. Similar in the stock market, it also pays to shop around. It pays to be an active investor in times like now. Emerging markets are a great opportunity. No, they are not a niche. They are 76% of the land, almost 90% of the population, 40% of the globe's purchasing power.

The pushback we get, alright, aren't EMs [Emerging Markets] risky? Certainly, we do worry about the rule of law and property rights. We worry about corruption, poor infrastructure, education, but the best opportunities are not where things look good and where things are comfortable. John Templeton takes up a lot of space in our minds as well as our walls. His quotes are all over our walls in our office. One of our favorite quotes is, "Where is the outlook most miserable?" That is where you want to be shopping. That is where the negatives are more than priced in.

Argentina, as Dave showed, has been a basket case for a very long time. The time to buy it was in 2020 when things were looking most miserable. This is in U.S. dollar terms. If you had bought in 2020, you made three times your money. If you had bought in YPF, their big oil company, you made seven times your money in U.S. dollar terms, despite all the inflation.

While emerging markets are more risky in some areas, when you look at debt, emerging markets are much less risky. If you take China out of the equation, emerging markets have half of the level of public debt and less than half of the amount of private debt. From that standpoint, not so miserable. The U.S. markets are not considering any inflation, not considering the debt, which is future inflation. They are priced to - the markets have to stick a perfect landing. Many investors are now thinking, "No landing." That's very hard to do. Meanwhile, the emerging markets are the mirror image, and investors just have to start seeing some of the positives that are there. You have the growth, you have the resources, you have the purchasing power. They were seeing these in 2007, right now they're only focused on the risks. This just shows exactly what I was mentioning with the positives. If you look at the green line, which is the BRICS 11, they have more population than the G7, they have more purchasing power, and they produce more resources.

We particularly like when we get to take advantage of EM prices in a country that is not very EM at all. In fact, when you compare it to the United States, it looks downright developed. In many cases, South Korea is better than the United States. In terms of education, life expectancy, health spending, internet access, it looks very good. FTSE actually considers it developed, MSCI still classifies it as Emerging Markets. One of the biggest reasons they do this is that market access is difficult for foreign investors.

September 29th issue of *Grant's* was like free marketing for Kopernik because two of their articles, one was talking about how cheap gold mining companies were, and the other was talking about the improvements that South Korea is making. Hopefully, some of these improvements will lead to easier access from foreigners and maybe a reclassification to become a developed market. *Grant's* also points out some of the bullet points on the right that it's the 13th largest economy, the fifth easiest country in which to do business and the sixth largest exporter.

What kinds of discounts are we getting, you might ask. Let's look at telecom. KT Corp is a large holding that we have had for a very long time. It's a triopoly very similar to Verizon and AT&T. They have very good technology. They've spent a lot of CapEx, and so they are the equivalent of AT&T and Verizon. On earnings, we're paying very similar amounts. Dividend yields aren't that much different. However, if you look at book value, AT&T and Verizon have negative tangible book value, while KT's is positive and it's trading for very cheaply. Plus, there's a lot more potential with KT, because if margins were to normalize to a global telecom average, KT could triple.

The other ways that it could go up are just that the market could start pricing in, paying a more normal price for the earnings they do generate. Even if nothing goes right, we're still just pocketing a 6% dividend. We think that margins should revert. However, we like it when the downside is very limited because it is cheap on all these other metrics.

Other examples. We like Cameco, but we like Kazatomprom better, which is much cheaper per pound. We like Exxon, but we like Petrobras [Petroleo Brasileiro] better. We like DuPont, but Lotte Chemical, we get for a fourth of the price. On railroads, we can buy Japanese railroads, Chinese railroads for much, much cheaper than Union Pacific. We prefer Samsung to Apple. It's one-third of the price. Utilities, if you like cheap, carbon-free, pollution-free power, we can buy CGM Power for much less than Constellation. By the way, CGM's nuclear power plants are much newer.

The third and concluding lesson is that volatility and optionality are our friend. Volatility is not risk, it is our friend. The fact that people believe that volatility is risk creates a lot of opportunities for us. Also, time is also our friend, especially when you're dealing with real assets. We could spend a lot of time on this slide. We could spend hours, but I will point you to the recent podcast that Dave did with Grant Williams and Stephanie Pomboy. It was excellent. He went into great detail of the math behind this. I encourage you to either get ahold of us or listen to that podcast, and we're happy to spend some more time on this.

The summary is that when time is on your side, like it is when you're owning a mine, you want the longest mine life possible, an option model makes more sense to us (versus a DCF model). As you can see, the difference between the orange line and the blue line is enormous, hence the opportunity. This concept is on full display here. Gold has gone nowhere, and yet gold miners, which everyone says are too volatile, are down 51%. The gold mining juniors are down, which have the most optionality, look the worst on DCF, hence people don't like them, are down 71%. We think that these offer some very good opportunities, even if gold doesn't go anywhere. You do have to be patient. These have certainly tested our patience, but when you're dealing with upsides that are even much larger than 150%, you can be patient and still make very positive returns. As the comic before suggested, perhaps we've served our time. Just like the gold miners, volatility creates opportunity in emerging markets. The best time to buy emerging markets is when everybody hates them, not when everybody's focused on all the positives, like they were in 2007.

As you can see from these charts of the Chinese index, Petrobras, investors loved these countries and these companies. Now the Chinese index is lower than it was in 2007, and yet the country has grown significantly, and the companies have grown significantly, and they have some very world-class companies there. Eletrobras [Centrais Eletricas Brasileiras] is still our top contributor to our funds since inception. The market absolutely hated it in 2016. The company went up seven times in a matter of months when Rousseff was impeached. These are the types of opportunities that we find and we like to put them in a diversified portfolio.

The volatility, we use it to our advantage. Every quarter, we trim the things that have gone up, like many of these Japanese companies. We buy more of the things that have gone down and initiate some new names. We initiated in China Shenhua [Energy], which is one of the largest and high-quality coal companies in China. We added more to Lotte Chemical, which is exposed and people are worried about the Chinese economy. We added more to Impala as people believe that EVs [Electronic Vehicles] are the future. We also trimmed uranium, which it's been wonderful to see how quickly sentiment can change, from absolutely hating uranium to now we're trimming pretty significantly.

As active investors, we are always looking for companies trading at a discount and we've created a portfolio that is now trading very, very cheaply, well below book value, cheap on cashflow, cheap on earnings. We feel very good about how we have positioned ourselves. Same with international. While we have a portfolio of deep value prices, I would like to remind everyone that these are not deep value companies. These are world leading companies in many of their respective industries. We think that with investors solely focused on one country and pretty much one sector, there are lots of great companies that have been left behind, which we are taking advantage of.

Concluding thoughts are that we are in territory that we have not seen for many, many decades. It behooves investors to look at Latin America in the 1940s. It behooves investors to look at the 1970s, which can be a tour guide. If inflation is here to stay, as it's hard not to believe with all the amount of money printing, you should own inflation beneficiaries. You should shop for bargains, demand optionality, and diversify across countries assets, geographies, and currencies. This is a great time for active management.

Also, it's nice when the macro and the bottom-up are both blowing in the same direction because we are bottom-up. Even if inflation isn't here to stay, the real assets are so cheap, but we get that optionality for free. With that, I will open it up for questions.

Mary Bracy: Thank you, Alissa and Dave. It was a great presentation today. Again, if you have a question, please type it into the Q&A box and we will do our best to get to it. We currently have only about three questions. We'll go ahead and get started, and please, keep them coming if anything comes up as we go along. Our first question is from Gar Wei. I apologize if I pronounced that wrong. It's a question about China. We'll start there. "How do you view China with regards to EVs, solar, and rare earth minerals, their dominance in those areas?"

Dave Iben: We've been on the road getting lots and lots of questions on China. That seems to be top of everybody's mind. As Alissa showed, 2007, people loved China. Now since then, the economy's up many times and the stock market's a lot cheaper. Stocks in general there are much more interesting. Point one is, there are good companies in China that we are looking at.

As to rare earths, other minerals, solar, there it's more mixed. Their economy, that's in hyperdrive for 20 years, has slowed down a lot. They're one of the biggest buyers of many of those things, but they're also a big supplier of many of those things. There we can't give you a concrete answer. On the resource side, we focus more on the things where demand can't be there or is unlikely to be there. The things that nobody spent any time developing. Our case is stronger for copper, and nickel, and gold, and platinum, and uranium, where nobody's really investing. There's some investment in copper. Rare earths, it's hard for us to know what they are not producing and what they are or not demanding, or that other people will do that. Solar panels, same thing. They produce a lot. Knowing how much capacity they have and what demand is and what future subsidies will be, it's certainly an exciting field, but it's not something that we feel like we have a competitive advantage in. We are more inclined to probably put small amounts of additional capital in China, but probably not in those areas.

Also, it's not part of your question, but banks and real estate have become very cheap in China, but we're unlikely to be rushing in there, either because it's hard to really know what you have there with massive debts. We feel like it's much easier to understand a railroad there or a utility there that's low cost, low pollution. It's easier to understand big drug distribution companies or dominant elevator companies. Things like that are more interesting to us. To your question, it's exciting. We just don't have a competitive advantage that we know of.

Alissa Corcoran: I will add that we have been buying Impala [Platinum Holdings]. They produce platinum and palladium, which many have described as the anti-ESG metals, anti-EV metals, because they are not demanded in this EV world. Wherever there's a ton of hype and there's an extreme belief that EVs are going to take over IC engines, we let others-- when they're at the extreme, we think that even if palladium demand went away, some of these platinum and gold that come with the platinum mines will do very well. We also think that there's a lot of issues to EVs. There's a lot of costs, there's a lot of infrastructure issues. Where is the supply of the copper and the lithium and the cobalt going to come to develop these batteries? We think that it's an exciting field. We think it's going to grow, but maybe people have gotten a little bit ahead of themselves in terms of the expectations for EV penetration.

Mary Bracy: We've got a couple more questions on China, so since we're on that topic, we'll keep going. We have two very similar questions on the geopolitical risk in China. The first is, how do you manage the risk of a lockup like in Russia if China was to do something like invade Taiwan? The second question is similar, how do you handicap the political risks of China? The government can choose to disadvantage foreign investors or something along those lines.

Dave Iben: As our presentation talked about, when you have populist policies all around the world, things get dicier, there's winners, there's losers. Because of the massive debt load around the world, volatility will probably stay high and history would suggest maybe skirmishes and geopolitical conflict are something that would not go away tomorrow. Your question is very good, how do we handicap this? It's hard to know which year people are going to dislike China more than Russia or Russia more than China, or how much they'll fear Africa or how much they'll fear Latin America.

It's interesting, five years ago, it seemed crazy that we were investing in copper and Africa when we could invest in Chile, which is so safe. Now everybody seems to be prospering in the DRC [Democratic Republic of the Congo]. It's been one of our better investments and people are scared to death about Chile, which makes it a little more interesting now. We believe because of this, people should pay way too little for things. They should only buy bargains and then they should diversify because you never know which countries, who could have guessed a month ago that maybe Israel will be a place that people would have to worry about the skirmishes. It was fully understood 40 years ago that it was seeming very safe and now it's unfortunate to see what's happening. Rather than focus on any one particular country, skirmishes are probably going to be more prevalent everywhere as the world becomes a poorer place because of the overspending by every government. When you look at Russia and China, we talk about volatility. China was very cheap in 2003. Everybody said, "Do not invest there. They had SARS," the first SARS. It was not that long after Tiananmen Square and they were talking about child labor and people said do not invest there and look at a chart from what that market did from 2003 to 2007.

It was monster run and then as Alissa pointed out, it's cheaper now than it was in 2007. You wanted to buy in '03 and head for the hills when people liked it. Now people don't like it. Russia, people liked it in 2010 or whatever. It was one of the BRICS that was going to prosper. You must own it. Then they hated it in 2015. It was the best market in the world the next five years, way better than the S&P. It was not as good as the NASDAQ, but that was the time to buy that. China got very cheap last fall and then bounced big, but now it's gotten very cheap again. People shouldn't say “should I own China or not China?” They should be, "How much do I discount China for the risk?"

We think 50% plus is something that should be mandatory. You should demand things sell at least 50% too cheap and that's kept us out of China for the most part the last 15 years with opportunities here and there. Now you can buy things a lot more than 50% too cheap. I'm around long enough to very well remember the Japanese bubble when people said that when Japan was taking over the world, how could we compete with them? They had the best technology, the best companies, the best work ethic, and the best saving. A lot of it was true. What was really happening was a bubble, and it went into a 25-year bear market. But if you owned the housing and banks, you did poorly. If you own Mitsui, Mitsubishi and Shimano, and good companies, you did very well. China certainly seems like a bubble is popping. The debt levels there are just crazy and it's coming unwound, but I suspect that if you own really good companies there, it quite likely will do very well in the future. Not for sure and we only have a few percent of the portfolio, 4% or 5% of the portfolio in China, but whether it's China or Korea or Indonesia or Mexico or Brazil, buy the good companies. Buy them way too cheaply. Diversify across the world. That's our approach to China. Guessing better than the next guy on if and when there's going to be conflict. That's not a game that too many people are good at.

Mary Bracy: One more question that we currently have on China, and this is a little more specific and digs down into sort of what you were just talking about of a cheaper company in China as opposed to in a developed market, although they're both cheap. Guangshen [Railway] versus East Japan Railway. If you could talk a little bit more about our specific investment case for those.

Dave Iben: Yes, 20 years ago, we had a lot of investment in most of the railroads in the U.S. because people were saying that quite correctly the U.S. rails hadn't earned their cost of capital in 80 years, but they were looking at the wrong thing because the world was changing. Regulation was getting better, length of haul was getting better, there was consolidation, technology was getting better.

Turns out they earned their cost of capital a lot more so and it went up big and we sold and since then it's gone up big again, but it's no longer cheap. Then when Fukushima happened that was tragic and it did about $400 million worth of damage to the JR East [East Japan Railway] I think, and the stock dropped by a couple billion or something like that. We were fortunate or not to be there when that all happened. We were visiting the railroads and were able to buy lots of JR East and JR West [West Japan Railway] at bargain prices because people took bad news, and they priced it in three or four times over and so that worked out well. We made a lot of money since then it's gone up and down the volatility. We've been able to buy and sell that and even more so JR West, but at current prices, JR East seems a lot more attractive than the Union Pacific to us. Guangshen, try having a railroad when the government shuts down and won't let people go outside it was very bad, and so they lost a lot of money and that was a great buying opportunity. The stock went up a lot the last couple months, I was just looking actually it's given back 60% of its gains so very interesting again. We figure between Hong Kong and Shenzhen there's lots and lots of people there. If you own a railroad – a passenger railroad – that's what you want, a very dense population it's very competitive compared to cars. We like it a lot it's a quasi-monopoly with a good route and should make lots of money in the future.

Mary Bracy: All right let's continue then with a few-- I think we're done with our China questions unless something else comes in but we do have quite a few sort of regional-specific questions so let's keep going with EMs. With a question on basically South America, Argentina in general what opportunities are we are we seeing there?

Alissa Corcoran: I think we're looking, most of the opportunities we're still seeing in Asia really those are some of the newer opportunities that the analysts are finding and just a reminder of our process is analysts are sector-specific and so they can look across the globe. They are finding the best companies that are trading at the biggest discounts so still South Korea seems to be one of the best but we have been looking in Argentina. We've been looking at an agriculture company that actually also owns real estate in Argentina. That's looking pretty good. As Dave mentioned, copper in the DRC worked really well and now maybe copper in Chile is looking pretty good. Those are some of the things that we're looking at and always thinking about.

Dave Iben: Lithium is something that the stocks are down big over the last year but still up big over the last five years. I mentioned we went and toured some places, met a lot of companies, went to a conference. May or may not be buying that in the future but we're putting a lot of time into that and Chile has the best resources there. Argentina's are good but Chile's are the best. People mistakenly think the government's taking it all. The government's taking all future fines. The people that got grandfathered in years ago, they still own it. So that's a possibility.

Also, Alissa mentioned our single best performer in the last 10 years has been Eletrobras which is Brazilian. There's been times in the past where we've had a lot of others. More recently this year, Petrobras has done very well for us but we like it a lot less at this price than we did six months ago. Argentina's got good prices, lots of resources, lots of volatility. It was like we say, it's a good thing, not a bad thing. Good question.

Mary Bracy: Then Japan. Are we finding opportunities there? Basically, what are we doing in that area?

Dave Iben: I can start and then you [Alissa] can go to the healthcare but we, in 1989, it was so expensive. Who thought we would ever own it? 11 years ago, we had 25% of the portfolio into Japan. That's how cheap it had become. That bounced big when Abe won the election years ago and we sold a lot of that. Since then, we've taken advantage of volatility and it's been fairly meaningful part of the portfolio and we like it. However, it is up a lot over the last four or five years. Nobody liked it five years ago. Lots of people like it now. Mitsubishi and Mitsui used to be two of the biggest positions in the entire portfolio. They're still not much above book value. They're still arguably cheap, but no longer dirt cheap. We own a lot less of those than we used to own. We used to be able to buy some tech companies there at a third of the cash in the bank. Those opportunities don't exist anymore. We talked about the railroads, which are still interesting. We have energy that's run up a lot, but still interesting. Then there still are various areas that look pretty interesting. Alissa can talk about those.

Alissa Corcoran: Yes, on the slide that shows our trends, you'll see, particularly in September, a lot of trends in Japan. As Dave mentioned, it's done quite well, but there's still some opportunities. We have some healthcare companies. They distribute drugs there. We own Medipal, Toho, and Suzuken. They're top one, two, and number four drug distributor in Japan. They're cheap on book and they're cheap on sales, and they are making money. Those are the opportunities that we like. A couple of years ago, they were in a price war, and so everybody hated them. They are under-earning a lot of other drug distributors. That's really what we are looking for is companies that have great franchises that we see a lot of potential, just like we saw in KT, where there's potential for margins to do much better, but even if they don't, we still make some very good money. That's some of the stuff we're seeing in healthcare. We have a drug manufacturer there as well that has some leading drugs. In addition, we own the railroad company, like Dave mentioned. We still own Mitsubishi and Mitsui, but much smaller positions.

Mary Bracy: All right, we're going to shift gears completely and move to the U.S. And Howard Eisenman has a question. In the U.S. market, are valuations in smaller companies worth considering? Where are we finding value in the U.S.? Might be a bigger way, different way of asking that question.

Dave Iben: Certainly worth considering. Small stocks have done so much worse than big stocks. Things like the regional banks we don't own, but they're very cheap and we're spending time trying to figure out which ones have neither credit exposure or duration exposure that we're uncomfortable with. That's a possibility. At one point, Range and Southwestern were small cap. They've gotten a lot bigger. They're still like them, but a lot less. There's a lot of niche markets across lots of industries that we now are looking at that we can't find. It's getting interesting. Then large caps in the U.S. are still, in our opinion, far from attractive.

Alissa Corcoran: Yes, I would just add that some of the small caps are down significantly. Speaking from what I see, at least in the healthcare sector, some of the debt that they've taken on is quite significant. That is something that we pay a lot of attention to. We're not just looking at how much that they have, but what are the terms of their debt, and how exposed are they to rising interest rates? Also, some of the corporate governance can be worrisome, but definitely, these are all things that we consider for every company that we're investing in.

Dave Iben: Yes, the debt's interesting. We talked repeatedly about how the last 40 years might not be the thing to look at. Companies have been rewarded for too much debt for 40 straight years. Maybe they'll start being punished for too much debt. That's one reason why we look at multiple metrics, different ways to value companies, because you're starting to see, and probably will continue to see, margin pressure on companies that have to keep rolling their debt at higher and higher interest rates.

Mary Bracy: All right, so we have quite a few questions still remaining, so we'll continue on. I want to sort of lump together and just sort of go through rapid-fire several portfolio-specific questions, not company-specific or sector-specific, but actual portfolio-specific. The first from Robert Borchardt, who asks if there are any capital gains this year.

Dave Iben: There are. We've offset what we could. We're continuing to try to offset because energy stocks had such a good year earlier and uranium later. Those were a lot of gains that we've harvested. We've tried to offset a lot. It's nowhere near as big as it was last year. I think, I don't know, on our website, did we update that? It should be on our website, so that could give you a more accurate number that we're keeping up-to-date.

Mary Bracy: Next in the similar sort of type of question about current cash levels both in GAC and International.

Dave Iben: One more thing on the last question. We have a put option, as most of you know and that gets priced as if we'd sold it even if we haven't on the capital gains. If the market keeps falling, that will add to the capital gains. That's worth noting, but our website will keep you posted up on that.

Cash to repeat is residual to our process. Never ever is the cash based on our opinion of the market. We are always trimming things that go up. We are always adding to things that drop. Anytime a market has a major move, we get more trims done than adds because we're pretty price-disciplined. Cash balances go up. 2019, 2021, cash balances were as high as they've been in my career because the market was the most expensive it's been in my career. A couple months ago, we were sort of in that same league or one month ago even. Cash balances are higher than what we would think they would be over time. But, it's not just the markets, it's sectors. Certain sectors have been falling. The market's finally getting back in a mood where it punishes companies for disappointments. Things are falling into range. Now in the last week or two the overall market's starting to fall. We are getting more ads done than we are trims lately. The cash balances are starting to go down. In Global All-Cap, it's just above 10% and International, it's 20% -21%, and coming down.

Mary Bracy: Additionally, great to talk about uranium as Alissa sort of alluded to. This has been a very interesting time to watch our thesis play out a little bit. The question John Seitzer asked, what percentage of our portfolio is uranium now? Give or take.

Alissa Corcoran: We are about 7% in uranium and that is inclusive of the physical. That just shows how much we have been trimming because Cameco was one of our largest positions. It's now only 25 basis points. NextGen had a larger position, it's now much smaller too. We still see a lot of upside in Kazatomprom as our presentation noted. We also still see a lot of upside in the actual physical.

Dave Iben: With us, it's always important to look beneath the surface, which you guys are doing. Materials could be high, but one year it can be more copper and another year it can be more gold. With energy, it can be high. Most years it's had no oil in it but a few years there was plenty of oil and gas got very cheap. In other years it's been mostly uranium and that's one point. Even within the uranium, you've heard us talk a lot about optionality. We owned uranium when uranium got very very cheap. A few years back is when we owned a lot of high optionality. Our opinion was "If uranium doubles, we'll double our money in the holding companies, but we'll make four times our money and the big miners and we'll make 6, 7, 8 times our money in the high optionality." That's Alissa was talking about, that's exactly what happened. Uranium doubled, actually tripled when it was all said and done. Those companies went up three times; the holding companies. The mining companies, Cameco was up sevenfold something like that. We like it a lot less than we did before. It went up sevenfold and we don't own much anymore. The high optionalities, the Denisons and the NextGens, they went up 10x from the bottom to the top. We basically don't own much of those anymore, but we still have good solid positions in the holding companies because they'll go step for step with uranium, which arguably should go higher. We still have the Kazatomprom that Alissa mentioned. Why it has gone up quite a bit and we have trimmed it. It's a cash flow machine even at these prices.

Mary Bracy: Let's talk about a couple of big-picture questions. I want to circle back around to a big theme that we've talked a lot about in this particular call, which is inflation. Before we get back to-- This is also sort of about inflation. The question is, how long does the Cantillon Effect last? Do you think that the increase in M2 velocity since 2020 is a secular trend?

Dave Iben: Well, there's a lot there. One, should people use M2 or M1 or M0, we tend to want to use M0. M2 may be a better predictor of whether it's making its way into the economy, but our view is not that we can know when are the lags, six months or six years. More importantly, as I understand that not counting the recent drawbacks, the money is migrating through the system. As Alissa mentioned, we want to own valuable things, stores of value. As the money surges, we don't necessarily know whether it's one year or four or five or six years. We could be fairly certain that the money will find its way into things that are needed and scarce. It's less likely to find its places into things that aren't needed or aren't scarce. That should be the focus. We always show you that chart we showed you earlier. That if it's going to find its way into something that's needed and scarce and that's going to double in price, then we hope it happens in one year. If it happens in three years, we're making 26% a year and if it happens in seven years, we're making double-digit annual returns. We wish we knew the answer to your question, but we try to focus on what we do know. We are going to focus more on where the Cantillon effect is going to take effect as opposed to when it's going to take effect.

Mary Bracy: Another big-picture question comes from Chuck Ballou. This is a hypothetical thought exercise question. Have you considered or discussed if the world were to lose confidence in central banks and fiat money/the banking system, what would our financial world look like? Understanding that no one alive has ever seen such a world.

Dave Iben: I love questions like that. I would say people have seen such a world. We talk about the 1970s and people do not have faith in central banks. They absolutely did not. People given a choice of 22% money market funds and I lived through this or gold that yields zero. They said, "We want to own gold at $800 up from $35." When they should have been taking their 22% or better yet, they should have been locking their money up in long bonds, but they didn't. We can assure you people do not have faith in the Central Bank of Argentina. A lot of this presentation is trying to answer that very question. We can imagine a world where people lose faith in central [banks].

We like to read Jim Grant a lot too. He talks about the gold standard versus the Ph.D. standard. How much faith should we have from people that have a Ph.D. that they can control economic forces? It generally doesn't work out. It's a matter of when not if people lose their faith in the central banks, they might be in the process of doing that now. Why we love intellectual thought. Let's reiterate - as Alissa said, our portfolio is at three-quarters of book value and a few times cash flow. We're happy if there's no inflation, but if people lose faith in central banks, it's probably a world where you want to own a portfolio like this one.

Mary Bracy: We'll do some industry-specific questions to wrap up. Our first industry-specific question from John Seitzer is on regional banks. Are you able to really dig into the financials of regional banks? Is there sufficient data to know unrealized losses on their health and maturity bonds and default risk? A little bit more about that particular process.

Alissa Corcoran: We've been looking at a couple and it is difficult. We do our best to mark down what they refuse to mark down themselves. You have a lot of risk. One of the questions we were discussing as a group is, what happens when they're going to have to reprice their deposits to keep their deposits? Some of the regional banks are saying, "Well, we'll cross that bridge at a later time, and we're thinking by that time you're going to have lost all of your deposits." These are things that these regional banks, some real issues that they're going to have to figure out. We are looking into the duration of their portfolio, the credit risk of their portfolio, and asking management a lot of questions. We view banks as doing basically what we do, which is manage portfolios of loans. We are extremely picky when we're buying a company that's leveraged like a bank is.

Dave Iben: Yes. The two main points to your question, a few just heard, they are cheap. We are looking for the answers to those questions. We are trying to find out if we can understand them. Since they're cheap, don't be surprised if they end up in the portfolio. However, as Warren Buffett says, "You get unlimited pitches. You don't need to swing unless you want to." If we don't get the answers to that, don't be surprised if you don't see these banks in the portfolio.

Mary Bracy: Our next industry that we'll move to is utilities, particularly their vulnerability in an era of ongoing inflation. Given Kopernik's outlook for ongoing inflation, how vulnerable are utilities given leveraged balance sheets? Again, that's from Howard Eisenman.

Dave Iben: We talk a lot about Cantillon. We have Cantillon winners and Cantillon losers, and in our opinion, utilities are Cantillon losers. You won't see them in the portfolio unless they're very cheap. Beyond very, very cheap, what are you buying? If you have electricity that's cheap and clean and carbon free, it's probably in a better position to push costs through. It's in a way better position to not have costs go up on you a lot. If the price of oil doubles, then that kills the utilities that buy oil. It doesn't make the ones that use the flow of a river or uranium to generate their electricity. Those get hurt a lot less.

Also, uranium is a very small part of the cost of their utilities, where gas and oil are a huge percentage of the cost. You'll notice we don't have oil and gas generation for the most part. What we have is hydroelectric and we have nuclear, so they're less exposed.

Also, they tend to be in countries that have higher interest rates and things like that. If you're in Japan and the yen drops in half. That's a problem. You're going to be paying twice as much for LNG [liquified natural gas]. You're probably going to end up paying a lot more for interest rates. You're going to go to the regulators and say, "We want to pass this on." The regulators will say, "No, we're going to lose votes." That's a big Cantillon loser.
If you're in Brazil where interest rates are already high and you're using hydroelectric and the currency drops, yes, as a foreign investor, we get hurt by that. We want a big discount. They're not paying more for interest rates and they're not paying more for oil that they're not using there. They're much less exposed. We want a

fairly big discount for the utilities we own. We want a really big one for the ones we don't own, such as companies that are using hydrocarbons as their input and may see currency devaluation.

Mary Bracy: All right, let's move on to gold miners. Surprise, we have some questions on gold miners! I'm sure that surprises absolutely everyone. Let's talk about a company-specific one first. Talk a little bit about the Newcrest/Newmont acquisition.

Alissa Corcoran: It's been interesting to watch because we've seen some big deals in oil and we're just starting to see some deals in gold, which is a sign that things might be changing. Things are turning around. However, it's been interesting to see which kinds of deals are being done. From our standpoint, Newmont could have done much better if they had acquired ounces in these high-optionality companies where these junior miners are sitting on massive deposits, which are very scarce, very difficult to find. Yet they are starved for capital and they're starved for people who know how to build a mine, which Newmont has. It's a perfect marriage.

Yet, who did Newmont go after is Newcrest, who's also well capitalized, good operators and have producing mines. We think that, it's unfortunate from our standpoint because Newcrest had much more upside just as a standalone company. However, now the two are married and they still have a wonderful portfolio with lots of optionality. We will continue to own Newmont. We think that the types of deals, we're still not in the bull craze of the market where companies were paying billions for barely discovered ounces. That's really where you know that you're at the top of the market. It's been interesting to see. It is what it is, I guess.

Dave Iben: To our risk-adjusted estimates, Newmont was worth twice as much as Newcrest was worth four times as much. We voted against it. It happened, tip of the hat to Newmont. Now they're worth three times our estimate. They added value. That's why we're disappointed in the transaction, but happy to own Newmont stock afterwards.

Mary Bracy: Let's talk a little bit about your thoughts on the royalty companies versus the miners.

Alissa Corcoran: The royalty companies are much less risky than a mining company. A mining company as oil goes up or labor issues, whatever it is, they are exposed to that cost inflation, whereas the royalty companies, the straining companies are just skimming off the top. They are exposed to the increase in gold prices and precious metal prices and much less exposed to the cost increases, which makes them less risky, but also you don't have as much leverage to the gold price. We think that gold is undervalued from how much money has been printed. It's still not even at incentive prices.

We think that gold is going to go much higher from here. We think the companies with the most optionality to gold are way too discounted. People are over-discounting, in our opinion, that exposure to cost increases. We like the royalty companies. We own several of them, but the most upside we see is [not] in these companies. They're just sitting on deposits.

Mary Bracy: That segues really well into our last question, which comes from Scott Powell, who asks on a decile basis, how would you mark gold stocks in terms of their cheapness versus their potential?

Alissa Corcoran: Yes, I guess the first decile with the most potential are these high-octane optionality companies, the companies with the least potential in terms of upside are the royalty and streaming companies, and the producers are somewhat in between. It really plays into that chart that we were showing where an industry is obsessed with the DCF models and cash flow models. They prefer the companies that are producing cash and turning gold into cash as quickly as they can, which is interesting since as you mine, then you then you're just sitting on depreciating cash. We actually prefer the companies that have very long mine lives and won't be turning that gold into cash for 40 years.

Dave Iben: To add to that, we talked just earlier on uranium when the price was really depressed and we had the high optionality ones. When it went up, we sold that. Those of you that have been with us for a while, you'll notice in 2015, we bought a lot of the high-optionality ones. In '16, we sold a lot of them and went more into the royalty companies. Then in 2019, back into the high-optionality in 2020, we were able to sell some of the high-optionality and back into the royalty. More recently, been a lot of opportunities in the high optionality ones now.

Mary Bracy: All right. That does it for our questions. Dave, any last concluding thoughts?

Dave Iben: No, we appreciate everybody calling in. Market gets more exciting by the day, I guess. We're hopeful that the market's in the early stages of starting to recognize the value of stores of value and look forward to talking again soon.

Thank you.
