| Year | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | YTD |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2019 | | | 0.1% | 0.3% | 4.3% | -4.2% | 0.1% | -0.1% | 0.9% | -4.1% | 7.5% | 6.0% | 10.5% |
| 2020 | -6.2% | -2.0% | 2.5% | 12.4% | 3.6% | -6.6% | 19.6% | 12.1% | -3.0% | -7.1% | 2.1% | 11.9% | 41.6% |
| 2021 | 1.1% | 3.5% | -0.5% | 6.3% | 19.5% | -3.2% | 4.0% | -5.2% | 6.0% | 9.9% | -8.1% | -1.4% | 33.0% |
| 2022 | 1.5% | 10%* | | | | | | | | | | | 12%* |

Dear fellow investors,

We are sharing this note in light of Russia's invasion of Ukraine. We have no edge in geopolitics and so will leave the punditry to others; instead, we will just provide updates on our portfolio as well as any potential impact from the recent turn of events.

**Strong February Despite Risk-Off in Financial Markets**

The Cypress Fund will return approximately 10%* net of fees for the month of February and around 12% year-to-date. The gains are distributed across Clean Energy (3%), Shipping (2%), Nuclear (2%), Precious Metals (1%) and Oil & Gas (1%). Hedges also contributed 2% to the final figure.

February was a risk-off month across most assets classes – equities were weak in both developed and emerging markets while interest rates and credit markets continued their January decline. Interestingly, FX markets traded less in sync – the usual beneficiaries of risk-aversion like USD, JPY and CHF, were stronger but barely so. The outlier was commodities – the Bloomberg Commodity Index jumped 6.2% and continues to rally as I write this note.

| Asset Class Proxies | Year-To-Date (End Feb) |
|---|---|
| S&P 500 | -8.3% |
| MSCI Emerging Markets Index | -5.0% |
| Hield Yield ETF | -3.9% |
| Dollar | +1.1% |
| Bloomberg Commodity Index | +15.5% |

The conflict in Ukraine is undoubtedly a contributor to higher commodity prices. Since the invasion began, crude oil is up over 23%, European natural gas is up 100%, wheat is up over 40% and aluminium is up nearly 10%, just to give a few examples. Given that the Cypress Fund has substantial indirect exposures to commodities, we have been a beneficiary.

While our investments are primarily driven by longer-term supply-demand dynamics that favour owners of resources and other real assets, in the near term, we expect the war, resulting Russian sanctions and impact on logistics will determine price action.

In the following sections, we highlight Russia's dominance in exports across a large number of commodities. Then, we review the potential impact of the war on each of our investment themes in brief. We hope that this exercise, conducted in the "fog of war", will be helpful for you.

**Russia is World #1/#2/#3 Exporter in Many Commodities**

The first casualty of war is truth so we will focus just on facts. What we know is that Russia is the most resource rich country in the world and is a very substantial exporter in many commodity products. The following table (2019 figures) shows those where Russia ranks as a top three exporter.

| Product | Export Ranking | Value (US$ bn) | % Export Supply |
|---|---|---|---|
| Crude Oil | #2 | $ 123 | 13% |
| Refined Petroleum | #2 | $ 66 | 10% |
| Coal Briquettes | #3 | $ 17 | 14% |
| Natural Gas | #2 | $ 16 | 16% |
| Fertilizers | #1 | $ 9 | 13% |
| Wheat | #1 | $ 8 | 18% |
| Aluminium | #2 | $ 5 | 10% |
| Timber | #2 | $ 5 | 12% |
| Nickel | #1 | $ 4 | 28% |
| Seed Oils | #2 | $ 2 | 20% |
| Uranium Concentrate | #2 | $ 0.1 | 11% |

It is not an exaggeration to say that the potential implications on supply are considerable. Even for non-sanctioned Russian exports (eg energy), the willingness of traders to take on counterparty risk, banks to provide letter of credit financing, insurers to insure cargo, etc, mean that demand will be re-directed to non-Russian products. Unless sanctions are rapidly removed, prices will likely go much higher.

**VERY BULLISH (++) – Precious Metals • Shipping • Clean Energy • Oil & Gas**
**BULLISH (+) – Nuclear Energy • Basic Materials • Computing Power**
**NEUTRAL (=) – Financing • Farmland**

*Precious Metals ++++*

We have been invested in producers of precious metals for two reasons: i) as a protection against inflation and monetary debasement and ii) because it is under-owned by the official sector. The latter is now indisputably so. We will likely increase our exposure to this theme in the months to come.

Sanctions against Russia, including by freezing the foreign reserves of the central bank and cutting financial institutions from SWIFT, hammers home the reality that assets custodied by a third party are at risk of being frozen or even confiscated. Not surprisingly, countries like Russia and China have been ahead of the game in adjusting the mix of their foreign reserves in the past decade but even US-allies will likely increase their exposure to precious metals and away from fiat. In the short term, there could well be price volatility as Russia may need to liquidate gold reserves for funding needs and to defend the ruble but the longer-term price trend is clear.

*Shipping +++*

We like shipping, in particular tanker and LPG sectors, for their very favourable supply-demand dynamics. The average age of tanker and LPG fleets are old and hence poised for scrapping; this, combined with historically low new orders mean that supply is shrinking. Sanctions will further exacerbate supply disruption. Not surprisingly, charter rates are spiking in response.

The impact of sanctions are at least twofold. First, Russia-flagged vessels (1-8% of vessels depending on type) may no longer be acceptable, reducing vessel supply. Second, shorter Russia->Europe voyages may need to be substituted by longer Middle-East/US/Asia->Europe voyages, increasing ton-miles and hence also reducing supply. Away from Russia, lifting of sanctions on Iran will likely mean more oil to be transported (higher vessel demand), while global crude inventory drawdown means these will need to be restocked (higher vessel demand).

*Clean Energy +++*

We are invested in clean energy transition via copper developers and explorers. Filo Mining, which we previously discussed in our [June 2021 investor letter], recently announced a private placement by BHP of CAD$ 100 million for a 5% stake in the company. This placement was done at CAD$ 15.95 per share, or a 12% premium to Filo's 20-day VWAP. BHP is the largest mining company in the world with a market capitalization over AUD$ 250 billion and currently operates the largest copper mine in the world (Escondida). BHP's investment further de-risks Filo and helps validate the potential for Filo to become one of the most substantial producers of copper in the years to come. We see 100% upside from here as being very likely.

At a macro level, Russia is only a small exporter of copper (0.4% of exported copper) but number two after Chile when it comes to refined copper exports. Copper prices have rallied in sympathy with other commodities and this should also provide a tailwind to our thesis.

*Oil & Gas ++*

We are invested in this theme via Canadian oil and gas producers as well as offshore rig owners. We expect non-Russian producers to benefit in the near-term. Over the medium-term, higher energy prices will drive increased exploration spend to the benefit of offshore rig owners. We are buyers on dips.

Russia is the number two exporter of crude oil, refined crude products as well as natural gas. In particular, it is also the largest exporter of natural gas to Europe. As highlighted above, even if energy products stay off the sanction lists, rational economic decision-making will drive down demand for Russian products and drive up demand for non-Russian alternatives. This is happening and is reflected in prices for WTI and Brent crude last seen in 2008 as well as unprecedented discounts for Russia's Urals blend.

In our [October 2021 investor letter], we highlighted that the spikes in gas prices then implied a per-barrel equivalent of $130-320 for crude oil. We are now touching the bottom end of the range. When markets are short something that is absolutely essential (eg food, energy, shelter), prices can skyrocket. This is not a market to be caught short in.

*Nuclear Energy +*

Longer term, the spike in energy prices reinforces the importance of diversifying energy sources and the the essential role played by nuclear power (clean, safe, cheap). Shorter term, while Russia itself is not a big producer, Russian-owned Uranium One is a substantial producer of uranium with mines in Kazakhstan, the United States and Tanzania. Russia's Tenex is also the largest enricher of uranium products. Since the start of hostilities, the price of uranium has rallied 16% to over US$ 50/lb.

There have been concerns that recent fighting at Ukraine's largest nuclear power plant could result in a meltdown and consequences similar to Fukushima (which resulted in a multi-year bear market for uranium). It appears that these worries have been grossly exaggerated, and in any case fighting there has ceased. We will continue to monitor this situation.

*Basic Materials +*

We have written about our investment in Adriatic Metals, a zinc + silver developer in our July 2020 investor letter. We do not expect the war to have any material impact on the company, although prices of zinc and silver have been strong (YTD: +13%/+10% respectively). From a fundamental perspective, Adriatic also recently completed a US$ 244.5 million construction financing package, including US$ 102 million in new equity at a price of AUD$ 2.80 (current price AUD$ 2.28). Like Filo, this substantially de-risks the project, limits our downside risk and increases our conviction level in the company.

Given that the company is going into development, there may not be noteworthy news headlines for a while. Price action could be sluggish in the short term given this, but it does not change our positive outlook for the company.

*Computing Power +*

We wrote about Alphamin Resources, a tin-producer, in our March 2021 investor letter. Like Adriatic, the war is unlikely to impact the company, although tin prices have also been very strong. Tin is up 20% year-to-date and over nearly 100% since our note. Alphamin is up a similar amount since we invested. In terms of fundamentals, the company announced increased tin production (+10%), increased tin sales (+13%), record EBITDA (+38%) as well as declared its first dividend (3% yield) in its 4Q21 earnings release. The company also continues exploration activity returning very promising assay results, increasing the likelihood that the resource will be expanded substantially.

*Financing / Farmland =*

*Financing*. Since we wrote about MBIA in our October 2021 investor letter, the restructuring of Puerto Rican exposures has been progressing as expected albeit with delays, with the plan of adjustment for GO and PBA bonds to be effective on March 15. Pricing for Puerto Rico exposures have already rallied in anticipation of their resolution. The company explained in their latest earnings call that they are analyzing a bid for the company. We see around 50% upside from here and the deal closing by the end of the year.

*Farmland*. Russia is the world's biggest exporter of nitrogenous fertilizers while Belarus (which seems to be joining the war) is the biggest exporter of potassic fertilizers, both of which have spiked in price. At the margin, this will reduce profitability of farmers going forward, although we note that crop prices (wheat and corn) are also making new highs. While we still think farmland is a good long-term investment, we have closed our positions in this theme for risk management reasons.

**Conclusion – Russia as Catalyst for Higher Commodity Prices**

Before the invasion, we had shared our view that the world is structurally short commodities. A decade of underinvestment in exploration and development in most commodity sectors mean that resources are being depleted even as demand grows, with the inevitable consequences that prices need to adjust substantially higher to incentivize replenishment.

Russia's invasion of Ukraine and the resulting sanctions on the world's biggest commodity exporter is driving home the reality that the world is short of "stuff". While supply-demand models were projecting deficits in the coming years, sanctions have fast-forwarded its recognition. We do not know how long the conflict will last nor how long sanctions will apply, but we can say with high certainty that resource nationalism, hoarding and the securing of supply chains will be something that more countries (not just the Chinese) will engage in to protect their own industries. The price of "stuff" will go higher, for longer.

As we wrote in our last letter: *Covid adds fuel to the fire with disruptions to supply chains; geopolitics is the final spark that can set off prices of real assets*. It is beginning.

Sincerely,

Yongchuan Pan
6 March 2022