

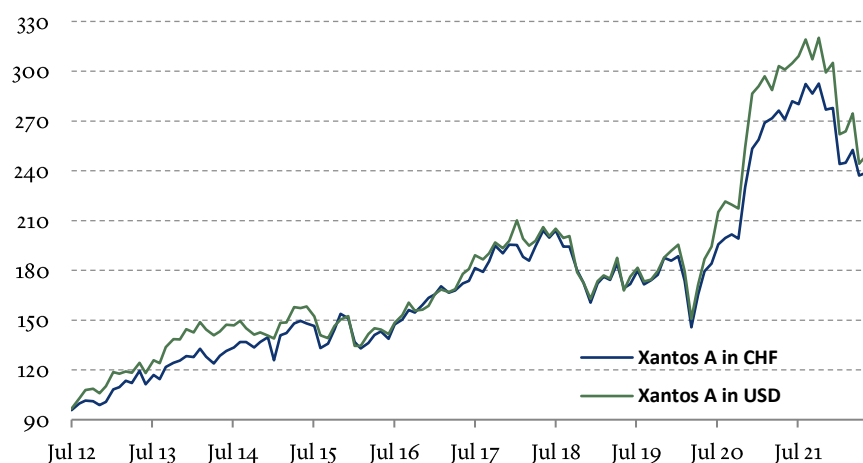


The first half of 2022 was deeply sobering for the stock market. The majority of global stock markets had their worst first half-year in 50 years, with a remarkably large-scale sell-off. All sectors apart from energy have been in decline this year. However, it was not only stocks that underwent sharp adjustments; practically all asset classes were affected.

At the start of the year, rising inflation and anticipated interest rate turnarounds were among the most pressing factors. Russia's invasion of Ukraine in late February rocked the entire world. In the financial markets, this led to panic selling on some fronts, while prices for commodities such as oil, gas and wheat rose to record levels. This in turn ratcheted up already high inflation and led to rapidly increasing interest rates. Central banks signalled their desire to rein in inflation with some initial substantial interest rate hikes and aggressive rhetoric. In the last two months, fears of a recession became increasingly widespread, dragging the already stricken markets down even further.

Even Xantos has been unable to resist the general downward trend. Following a very good performance in previous years, Xantos lost -23.8% in CHF (share class A) in the first half of 2022.

Performance Xantos A



Past performance is not indicative of future results.

Merger Luxembourg Selection Funds Xantos with W&P Selection Funds SICAV Xantos as of June 10 2021.

A difficult start

The year looked set to be challenging right from the outset. A correction on the stock markets was overdue after the strong profitability of the preceding years and had a particularly heavy impact on smaller companies as well as corporations in the technology and healthcare sectors, some of which had profited from the pandemic. Fears of inflation and higher interest rates have a toxic effect on stock market prices, and this



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has not been particularly helped by a cash ratio of over 10%. At the beginning of the year, energy and commodity stocks could still expect attractive price increases, which reflected the rising prices of oil and commodities such as metals and food.

Thanks to our selection of energy and commodity stocks, and also stocks in the alternative energy and defence sectors, the portfolio managed to remain relatively stable in February.

War brings added pressure

The recovery in March was short-lived, as was the one in May. The war in Ukraine has hit financial markets during a sensitive phase of adjustment to higher interest rates. Existing pressures such as inflation and shortages of raw materials have intensified further and decisions made by central banks have not simplified matters. While central banks around the world played down the threat of inflation for a long time, they have since been forced into action and have begun rapidly raising interest rates. The US Federal Reserve, for example, implemented its highest base rate increase in almost 30 years to combat inflation in June, having abandoned its zero-interest policy in March.

Panic towards the end of the half-year

In March and April, the central banks introduced their first significant interest rate hikes and attempted – in some cases by means of aggressive rhetoric – to stymie the threat of anticipated inflation. The massive interest rate increases that were announced increasingly gave rise to concerns that the economy would not be able to withstand such a rapid rise in interest.

Consequently, fears of a recession dominated the stock market in June and are leading to renewed selling pressure. Indicators of market sentiment sank to levels not seen since the financial crisis or after the bursting of the dot-com bubble. Sectors sensitive to economic fluctuation such as energy and commodities, as well as semiconductor stocks, reacted with hefty levies, while defensive sectors such as the consumer sector remained stable and the healthcare sector was in demand.

Wide-ranging losses

The leading indices were down 17% (Stoxx Europe 600 and SMI) and 30% (Nasdaq) in local currency in the first half of the year. The losses of the S&P 500 (-21%) and the Russell 2000 (-24%) fall between these two figures. However, the variation in half-year performance between different industries is much greater. Within the S&P 500, the 500 largest American companies, oil and gas were up by over 20%. The "Movie &



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Entertainment" and "Health Care Supply" industry groups, on the other hand, were down 50%. There was a similarly wide range in Europe, where tobacco increased by around 20% while steel and industrial products dropped by over 40%. The variation is even greater at the level of individual securities. In particular, growth companies – which do not yet yield a profit – lost a large part of their market capitalisation. Crueller still were the drops in share prices for companies which have a product or technology but are not yet generating sales. The price declines, and therefore the valuation adjustments in response to the new interest and economic situation, are well advanced. Opinions as to whether they are sufficient are also subject to a great deal of variation.

Inflation is driven by supply

Inflation was triggered by a supply shock. Global supply was reduced by a combination of simultaneous factors such as supply chain problems, ongoing lockdowns in China or capacity reductions during the COVID-19 pandemic. Much has been written on the topic of supply chains, but the fact that the output of many industries was drastically reduced during the coronavirus period is often overlooked. Due to lack of staff and resources, rebuilding capacity takes time. In the case of energy and some commodities, the war in Ukraine and sanctions against Russia are naturally having an important impact. Pressure on prices is likely to remain high. It may take some time for the energy situation in Europe to reach a new equilibrium.

From China-centric to economic globalisation

Much has been said about the globalisation of the economy over the last few years. Yet the mask debacle in the early stages of COVID-19 made it clear for the first time that production is not globally structured, but rather that China is often the only source of supply. The current supply chain problems largely confirm the theory that globalisation in recent years has mostly involved relocating large parts of production to China. Companies have already started rethinking and overhauling their supply chains. This does not mean that production is being brought back to within domestic borders. Reorganising supply chains could also be an opportunity for a broader form of globalisation from which more countries could benefit.

Structural upheavals

The world economy is currently undergoing various structural upheavals in both a geopolitical and an economic sense.

A new conflict between East and West is emerging. It is highly likely that we are heading towards two economic spheres – one Chinese and



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one Western. The disassociation off Russia from the West is an important factor with regard to energy and commodities. The economic relationship with China is likely to be far more complex in future. On the one hand, the West does not want to lose access to China's huge market. On the other hand, it – and Europe in particular – does not want to get drawn into deeper dependence.

The stock market boom of the last ten years was driven by the growth of a small number of dominant technology companies (“FANG” or “the big five”, namely Facebook, Amazon, Netflix, Google and Microsoft). The growth rates of Netflix and Facebook are already pushing their limits. Yet other dominant companies may also emerge in the foreseeable future, and the leading technology enterprises may come up against increasing competition. There is a theory that smaller and local IT service providers could adapt technologies and applications, and put themselves in an increasingly strong position to offer local or national alternatives to global solutions. Competition authorities are also becoming more suspicious towards the acquisition of rival solutions being used as a means of cementing of market power.

One dominant driver of the stock market over the last ten years has been the subject of the “cloud”. This has brought structural growth to numerous industries: the expansion and equipment of data centres has worked to the advantage of the semiconductor industry, as well as the leading providers of data centres such as Amazon, Microsoft and Google, in addition to various software companies in the field of security, networking and IT infrastructure. The cloud infrastructure is sure to grow further still, though not at the high growth rates seen in the past. The return expectations of the companies involved are therefore likely to return to normal too.

This is not the end of information technology, but it does raise the question of which technologies and solutions will emerge and prevail in the coming years.

Energy transition and security

It should be clear, at least since war broke out in Ukraine, how dependent Europe, Japan and other countries are on energy and commodity imports. Up to now, the energy transition has been primarily part of a climate debate. Now the high level of energy independence being striven for could serve as a catalyst. Investments in renewable energies and storage technologies will increase significantly. The idea of investing in renewable energies is certainly no longer an insider tip and far more investors are already venturing into this segment.

Arms and security companies have also been greatly buoyed by the war in Ukraine. In Europe, the conflict has first and foremost led to a re-think. The fact that Europe needs to invest more in its own security is

not up for debate. But there also many Asian countries, such as Japan and South Korea, that want to bolster their own security and defence. In addition to classic defence, security is increasingly expanding into new areas such as cybersecurity, information manipulation, destabilisation and disruption. The concept of security now encompasses a growing number of technology and software organisations as well as traditional arms companies. Unlike the case with renewable energies, many investors are shying away from security.



Performance drivers

The largest negative performance contribution came from the information technology sector. This area suffered disproportionately from the contraction in valuations which occurred in the first half of the year due to increased interest rates. The financial sector made a slightly negative contribution, while the healthcare, industry, commodities and consumer sectors made cyclical contributions. The energy and consumer sectors, as well as increased cash holdings, had a stable, positive effect on returns in the first half of the year.

In terms of individual companies, Inmode (a leading global provider of innovative medical technology for minimally invasive treatment in the beauty industry) made the largest negative contribution to returns. After a sensational performance over the last two years, the security has suffered from profit-taking. The valuation has dropped back down significantly and is now at a P/E 22E of 10.7x. QT Group (software) has also seen a huge valuation adjustment following an exceptionally strong performance since its entry in February 2019. The semiconductor companies (Nordic Semiconductor, SiTime, VAT Group, BE Semiconductor and Lattice Semiconductor) were also obliged to record disproportionate setbacks. In addition to reduced valuations, burgeoning fears of a recession exerted particular pressure on the performance of this economically sensitive field of industry. Investments in both the semiconductor and software sectors have been gradually reducing since as early as last autumn for valuation-related reasons. In the long term, however, these companies will benefit from various structural trends.

The arms companies Rheinmetall and SAAB AB both produced positive performance contributions as direct beneficiaries of the war in Ukraine. The energy firms Patterson-UTI Energy, Helmerich & Payne and Kosmos Energy have profited from the increase in energy prices. Rising salmon prices have worked to the advantage of salmon producers (Norway Royal Salmon, Salmar). Salmar has also made a takeover bid for Norway Royal Salmon, demonstrating further consolidation within the farmed salmon market. In May, Biohaven Pharmaceuticals received a takeover bid in cash from Pfizer. The takeover premium is 47%.

Portfolio structure and adjustments



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As of late June, Xantos' investments were slightly focused on technology (28%), industry (15%) and health (12%). During the pandemic, the technology and healthcare sectors made up almost 70% of the fund. From as early as last autumn, we started to reduce the value of very high-value investments and companies which had not yet generated a profit or sell them in their entirety. This process has continued into this year too. To counteract the effects of this, we have invested in energy and commodity stocks, as well as North American financial stocks/digital financial service providers. With the omicron wave subsiding and a general backlog of travel demand having built up, we have also developed a "travel basket", the purpose of which is to take into account the anticipated shift in consumer spending from goods back to services. In terms of the sectors represented, the portfolio was much broader-based than in previous years.

After we added Rheinmetall to the portfolio in January due its valuation, this investment has been developed further against the backdrop of the war in Ukraine and bolstered with the addition of arms companies SAAB AB and AeroVironment. It is safe to assume that there will be a rethink of security policy in Europe and that a greater portion of public spending will be channelled into defence budgets. We are keen to take advantage of this.

Due to the high prices of energy and commodities, we were already handling cyclical consumer goods stocks with caution at the beginning of the year, as high inflation has a negative impact on consumer spending. The focus is on companies with the pricing power to bear the brunt of rising inflation. Alongside the traditional fields of food, energy and commodities, the technology, software, semiconductors and medtech sectors are also well-placed to sidestep the pressure of inflation.

The war in Ukraine has once again shown how dependent we are on certain countries in terms of the supply of energy and commodities. There will be a rethink in Europe with a view to reducing energy dependency. This may push up demand for renewable and alternative energy solutions. One of the areas we have established investments in is uranium (Cameco and Uranium Energy) and we have also expanded our scope within the alternative energy sector (SolarEdge Technologies, Canadian Solar, SunPower and TPI Composites).

Over the first half of the year, the cash ratio gradually rose from 10% at the outset to over 15%. In geographical terms, the USA and Europe (excluding Switzerland and the UK) each currently account for around 37% of Xantos' investments. At the beginning of the year, the investment ratio was 40% for the USA and 30% for Europe.

Outlook

Technology and digitalisation still point the way

Technology and digitalisation will still point the way in the future. There may, however, be a shift away from technology providers to technology users. Signs of this phenomenon first began to emerge back in the aftermath of the dot-com bubble bursting in 2000. Many traditional industries are speeding up their use of new technologies. In the last few years, technology leaders have been very much in favour with investors and their valuations have often hit stratospheric heights. There are good reasons for believing that the coming years will belong to users. The use of new technologies could enable many traditional businesses and industries to increase productivity and efficiency and therefore boost their profitability too. Our goal is to add more “users” of technology to our portfolio.

Inflation remains high, but should ease off

An economic slowdown or even a recession may ease inflationary pressure. As mentioned above, inflation has been driven by supply constraints. Due to a lack of resources, staff and necessary investment, it will take some time for supply to right itself. A temporary decline in demand could have a more rapid effect in this respect. Of course, other driving forces behind inflation still remain, especially wage negotiations, and these may push inflation up further. In the past, many supply contracts gave suppliers the option to pass on their own price increases. In upcoming contract renegotiations producers of end products such as cars, washing machines or furniture may put these automatic adjustment processes up for discussion.

Downward spiral

The markets are still currently in a downward spiral. Economists, analysts and strategists seem set on outdoing one another’s negative forecasts. This pessimism in the media and the ongoing fear-mongering naturally run the risk of creating a self-fulfilling prophecy. To date, the global economy has remained remarkably solid in spite of all the difficulties it has faced. The labour market in western countries has dried up to a degree not seen in decades. Whether the fears of a recession currently dominating the financial world will manifest in the real economy remains to be seen.



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When will the markets be attractive?

All sentiment indicators are at their lowest levels. In terms of real returns, the current correction now already counts among the largest negative fluctuations since 1900. The stock markets have factored in interest rate hikes of around 2.5% to 3%. This corresponds to a US base rate (Fed Funds) of 3%.

The markets are currently reacting to a potential recession and falling profits. It is difficult to estimate how turnover and profits will develop, as not only is the threat of a recession leading to a fall in demand, but also everybody is already trying to increase their prices. Even if demand is weakening slightly in some sectors, there are still many sectors of the economy that are a long way away from a recession.

As in all economic situations, there are winners and losers. Faced with the end of the big tech boom, stockpicking may become even more important in the months ahead.

Jamie Dimon, CEO of JPMorgan Chase, has predicted an economic hurricane. On the stock markets, the storm already appears to be brewing. The trick is to keep a cool head and not to let yourself get swept up by every whirlwind. Every crisis is a hotbed for new solutions and opportunities.



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