LHV Portfolio Management

Monthly Investment Report

June 2021

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Assets exposed to rising inflation were very popular on the stock exchanges for a while, and in June the weaker hands on the stock markets were wiped out of this segment. We believe that such fluctuations provide a good opportunity to buy these assets.

Stock market opportunities in inflationary assets

During June, we saw a decline in assets exposed to inflation on stock exchanges, which also had a somewhat negative effect on our portfolios. Selling pressures on inflationary assets were brought about by the US Federal Reserve's comment that there were plans to reduce financial asset purchase programmes in the coming years.

We assume from the US Federal Reserve's earlier communication that, in fact, the central bank's steps in normalising monetary policy will be slower than generally expected. The focus of central banks is mainly on the recovery of the labour market, where there is still a long way to go. Assets exposed to rising inflation were very popular on the stock exchanges for a while, and in June the weaker hands on the stock markets were wiped out of this segment. We believe that such fluctuations provide a good opportunity to buy these assets.

We have been positive about commodities since the beginning of the COVID-19 pandemic, and our vision has become stronger over time. While this was initially reflected primarily in investments in the gold and copper sectors, in recent quarters we have developed a strong belief that the commodities sector more broadly is on the rise. As a rule, commodities move up as a whole basket.

Market index movements	1 month	2021
Eurozone bond index	0.4%	–2.3%
World stock markets	4.5%	15.9%
North America	5.8%	18.6%
Europe	1.7%	15.4%
Emerging markets	3.3%	10.9%

** Total return of MSCI indices, in euros*

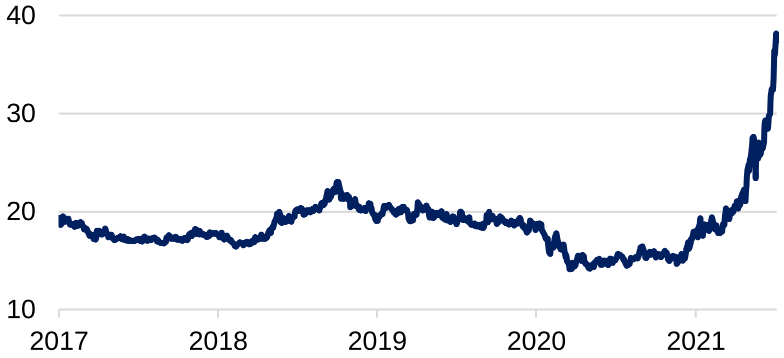
Rising energy and food prices

We see the greatest impact on people's daily lives through energy prices, where we expect a sharp and large rise in the coming years. Old companies producing cheap but high CO_2 fossil fuels are under pressure to stop investing in new production. Rather, it is almost impossible to make new investments in the fossil fuel business. Activist investors are increasingly taking seats on corporate boards, putting pressure on companies to change course.

However, this will quickly lead us to a situation where the supply of fossil fuels will fall significantly faster than its potential demand, and we believe that we are now sowing the seeds of the next energy crisis. Energy transformation will be much more expensive than expected.

As the prices of different types of energy are strongly interdependent, the decline in the supply side in traditional energy sources will affect the prices of all types of energy. For example, Europe is significantly increasing its consumption of Russian gas as an energy source after the closure of nuclear and coal-fired power plants, and this is directly reaching input prices. European natural gas prices for December 2021, according to which Estonian natural gas prices are also shaped, have risen close to historical peaks. These prices will not affect consumers until December, but we already anticipate that the effect will be significant.

European natural gas price, EUR/MWh



Source: Bloomberg (Dutch December 2021 futures price)

Energy prices are the lifeblood of the economy. When they rise, we usually see a broad-based rise in inflation, as energy is an important input almost everywhere.

Another important segment of the commodities sector, where we see a major impact on inflation and people's wallets, is food prices and agricultural products more broadly. The aforementioned trends in the energy sector are significantly raising the cost base of agricultural products, as the heavy machinery used in agriculture makes fuel one of the most important inputs.

Another important input for rising agricultural prices is fertilisers. The production of fertilisers is indirectly linked to energy prices, as the production of nitrogen-based fertilisers uses a lot of natural gas as an input.

Nitrogen must be applied to the fields every year to restore the level of minerals in the soil that the previous crop has used up. Without fertilisers, all agriculture would be deeply unprofitable. Phosphorus must be applied to the soil every few years. An important component in the production of phosphorus-based fertilisers is sulphur, the price of which is directly linked to the price of oil, as sulphur is a residual product of oil refineries that is resold to fertiliser producers.

As a third trend, agriculture is affected by the popularity of plant-based diets and a broader growth in the demand for agricultural products. Thus, as strange and distant as this connection may seem, restricting oil production will significantly increase the prices of plant-based food. We have been monitoring fertiliser and energy producers for some time and are seeking a good position in our portfolios to benefit from these trends.

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Looking at commodity market trends more broadly, we believe that input price inflation will be the most important issue in the coming years. This change means that investors who are not directly exposed to the commodities sector through the very first link in the value chain will be under pressure in terms of maintaining purchasing power in their portfolios. All in all, our projection has not changed. Rather, we are increasingly convinced that we are at the beginning of a rise in input prices in the form of commodity prices. We see many attractive investment opportunities in this trend, which will help grow the portfolio and protect it from inflation.

Best regards,
Kaius Kiivramees and Mikk Taras