KP7

April 4, 2023
Letter #9

Dear Investors:

KP7 was up 9.2% after all fees and expenses in the first quarter of 2023. The S&P 500 was up 7.5% including dividends.

We managed to miss the debacle unfolding in the U.S. financial services industry. We had identified U.S. home mortgages as a potential hidden risk in the U.S. economy in October of last year (see, for instance, our blog posting: *Br'er Rabbit and the U.S. Mortgage Market*) and of course the degradation in the value of mortgage-backed securities is what wiped out 100% of Silicon Valley Bank's equity. We have opted to steer clear of the entire U.S. financial services sector. At some point, we will sift through the wreckage for good value, but not yet.

Our portfolio still has very little direct exposure to the U.S. economy. We believe the growing levels of debt in the economy in general and the large and growing pool of debt at the U.S. federal government specifically is unsustainable. Debt service burdens are heading higher due to the combination of rising interest rates and rising debt balances. We suspect debt service costs at the U.S. government will more than double from its fiscal 2022 to fiscal 2023 and will easily become the single largest expense item of government spending over time.

The U.S. Federal Reserve, meanwhile, continues to battle inflation. It will in all likelihood have to choose between two dismal alternatives: keep rates low and let inflation go or drive rates high and cause more pain for borrowers, including the U.S. government. We don't like the results of either choice. We'd prefer to watch the situation unfold from the sidelines.

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Our portfolio consists of twenty to thirty investments clustered around a handful of favorable long-term trends. Our largest cluster in the portfolio today by far consists of companies that will benefit from the deleterious effects of the expansion of central banks' balance sheets in the years since the Global Financial Crisis of 2008. That sounds almost like a contradiction in terms, but companies do exist that will benefit from what we think will be persistent global inflation. Our biggest winners so far this year have been in this cluster.

Alamos Gold (+21% for the quarter) is a low-cost gold producer with assets in safe mining-friendly jurisdictions and a long runway of high-return growth projects. It is now up 60%

from our cost basis and is currently the largest position in the portfolio by a wide margin. We like the long-term prospects of Alamos Gold through at least the balance of this decade. We'll hang on to it despite it being a large portion of the overall portfolio.

Osisko Gold Royalties (+31% in the quarter) owns royalties on gold mines. It has the dual benefits of being exposed to gold prices, but not to the costs of mining gold, which always escalate in gold bull markets. Osisko owns a 5% royalty on Agnico Eagle's Canadian Malartic Mine. We believe that royalty is the single most valuable gold royalty in the entire world. We suspect it will only get more valuable over time.

Osisko Mining (+36% for the quarter) was spun out of Osisko Gold Royalties several years ago and now operates as a standalone company. It owns and operates one of the largest and highest-grade undeveloped gold deposits in the world. The deposit is located in Canada, a safe and mining-friendly jurisdiction. The mine is currently under development. Once complete, it should be a large, low-cost operation with plenty of valuable reserves for future high-return growth.

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Our stock selection activities frequently uncover attractive investments not tied to a specific theme. We expect 15-20% of the portfolio overall to be invested in these non-theme-specific investments. Two of our biggest winners in the first quarter came from this portion of our portfolio.

Palantir (+33% in the quarter) provides software to help companies and governments integrate data from disparate sources to assist in faster and more real-time decision-making. Palantir software has applications in practically every business in every industry on the planet and also has value-adding military applications. We have heard from multiple publicly-available news accounts that Palantir software is a competitive advantage for the Ukraine in its war against Russia. One thing we like to see with software companies is validation of the utility of the software by someone with a vested interest in the outcome. In this case, we feel that Ukraine's experience with the software is one source of validation.

Evolution Gaming (+37% in the quarter) is another one-off investment not tied to a particular cluster. Evolution is a Swedish company that provides a platform that facilitates live online gambling. Evolution is a one-stop shop for online casino operators. Gambling is moving online at a rapid pace and Evolution makes it easy for online casino operators to offer unique and engaging games. Evolution is signing up both the exclusive on-line operators as well as the major bricks-and-mortar casino operators that want to move online. Evolution's book of customers is validation for the utility of its platform, which has awesome unit economics and is globally scalable.

What little direct exposure we have to the U.S. economy exists largely in these two one-off investments. Palantir has contracts with many U.S. government agencies. Evolution is rapidly expanding in the U.S. in order to capture the online gambling opportunity that exists there.

While we had no major offsets to the winners just described, the rest of our portfolio was essentially flat in the quarter, which led to the overall performance of +9.2% cited above.

We added materially to our position in Metals X in the quarter. Metals X owns a 50% interest in the second-largest tin mine in the world. The mine is in Australia, which again is a safe mining-friendly jurisdiction.

Tin, we believe, will be one of those pinch points we described in our last letter. Tin is used in electrical connections. The growth in tin demand is set to accelerate as the world becomes more electric. Tin supply, in our view, will struggle to keep up. Metals X should benefit.

We believe our investment in Metals X brings value to the portfolio well in excess of the price we paid. The company has significant free cash flow potential relative to its market capitalization, has cash on the balance sheet equal to 40% of its market capitalization, and has no debt. Metals X is now one of our top three positions.

As always, we appreciate the confidence you have in us. We work every day to gain and keep your trust. All the best to you and your families,