KP7

April 29, 2024
Letter #13

Dear Investors:

KP7 was up 4.5% in the first quarter of 2024 after all fees and expenses. The S&P 500 was up 10.6%, including dividends.

We continue to take a cautious stance with respect to the U.S. economy. We see two specific and related risks.

First, we believe the U.S. government has dangerous and unsustainable levels of debt. Interest expense on U.S. federal debt will exceed 3% of U.S. GDP in calendar year 2024 and will likely exceed 4% of U.S. GDP in 2025 as deficit spending continues and interest rates edge up. Countries with interest expense exceeding 3% of GDP cannot simply grow their way out of their debt problem. They eventually rely on some form of default or restructuring. We believe the U.S. will be no exception. It is the lenders to the U.S. government that will determine the time and location of the restructuring.

Second, we believe the U.S. dollar will continue to devalue relative to goods and services. That is, we think our battle with inflation is far from over. The size of the U.S. Federal Reserve's balance sheet has increased 7-fold since the Global Financial Crisis, despite recent efforts to shrink it. Every dollar added to the Fed's balance sheet is a dollar of liquidity injected into the U.S. economy. We don't think a few months of single-digit inflation is the price we'll pay for the trillions of dollars of liquidity injected into the economy.

Those two risks are related because the easiest and most expedient way out of our debt problem is to repay our debt with devalued currency. Nobody intends to do that from the outset. It just sort of happens. We believe it will just sort of happen in the U.S.. Nearly every country that spends its way into a debt problem that also controls the supply of the currency that the debt is denominated in works its way out of the debt problem by issuing more currency. There are other scenarios that could play out to-be-sure, but paying our debt off with devalued currency is the most likely one, in our view. Make no mistake, paying debt off with devalued currency is a form of default.

Our portfolio consists of twenty to thirty publicly-traded equities clustered around a handful of favorable investment themes. Our biggest cluster in the portfolio today, by far, is a collection of stocks that will benefit from the effects of the increased central bank balance sheets just described. The Fed isn't the only central bank to expand its balance sheet. The central banks of most other major economies around the world have similarly expanded their balance sheets and injected liquidity into their economies. Most of the liquidity created since the Global Financial Crisis remains in those economies.

We have found that the hoarding of newly-created liquidity or the channeling of the liquidity into places like the stock market prevent it from creating a broad-based price inflation for everyday items like fuel, food, and housing. Only when the newly-created liquidity is spent does it affect the prices of everyday items. We believe we are in the early stages of people spending the new money. We have positioned a large portion of the portfolio to benefit.

In a world battling the effects of inflation, we like companies with built-in and automatic price increases with no lag or delay, exposure to rising prices but not rising costs, revenues in jurisdictions that are not debasing their currencies, or cost advantages relative to competition that increase with inflation. We have a large portion of the fund invested in companies with one or more of these characteristics. We also have a large portion of the fund invested in companies with exposure to precious metals, including royalties on gold and silver mines. We have very little exposure to the U.S. economy.

We exist because of your trust. We work every day to gain and keep that trust.

All the best to you and your families,