KP7

November 1, 2021
Letter #2

Dear Friends and Investors:

KP7's composite was up 8.7% in October after all fees and expenses compared with a total return of +7.0% for the S&P 500. We are now up 3.4% since our inception on July 1 compared with a gain of 7.6% for the S&P 500 over the same period.

A Chinese battery manufacturer acquired one of our holdings, Neo Lithium, in October at a 118% premium to our cost base. We suspected Neo Lithium was undervalued based on our view of the lithium market; we were surprised to realize so much value so quickly. Other winners of note for the month were Ford (+20% in the month; +25% versus our cost base) and Impinj (+22% in the month; +28% versus our cost base).

Our portfolio at the moment consists of twenty-three investments exposed to seven global long-term themes. We cluster our investments around five to ten favorable long-term themes for the simple reason that, if we are right about the themes, our investments begin life subject to tailwinds that could persist for years.

Our themes typically target areas of change. We have found over the years that the market has a difficult time with change. Consensus-driven equity analysts do just fine extrapolating existing trends, but fail to adequately assess changes to the trend. Their tendency to extrapolate existing trends makes segments of the global economy undergoing rapid change fertile ground for undiscovered investment opportunities.

No industry is changing quite like today's energy industry. We are in the midst of a global and synchronized effort to reduce carbon emissions. Whatever your view on global warming, the world is moving to cleaner fuels. Two of our seven themes are invested to benefit.

The first is the all but forgotten industries that supply fossil fuels. The intellectual elite for some reason believe they can snap their fingers and the world will no longer need fossil fuels. Their actions are putting a crimp on the supply of fossil fuels. The world, meanwhile, still very much burns fossil fuels and will likely need them for not just years, but decades as we transition to cleaner fuels. Consumers in our view will do what they can to reduce emissions, but they will still travel. They will still heat their homes. They will still use electricity. They will enjoy life and prosper. That means, at least for the time being, there is a role for fossil fuels in the mix of global energy consumption. Trashing the suppliers of fossil fuels while at the same time needing their product has created some investment opportunities in the traditional industries that supply fossil fuels. We have about 12% of the portfolio invested in our Forgotten-But-Still-Very-Important Commodity Theme.

Our Clean Energy Theme is positioned to benefit from the other side of the shift to cleaner fuels. The shift to cleaner fuels will jolt the supply and demand balance for certain materials needed in a lower emissions world. Certain commodities that once relied on GDP growth for incremental demand will in the coming years see stepwise growth of one, two, or even three hundred percent as cars become more electric and electricity generation shifts to cleaner fuels. That's the type of change we like.

Lithium is one of a handful of green energy commodities we like. The supply schedule for lithium will steepen in the coming years. That is, the marginal unit that sets the price will become more costly to develop and produce. Lithium producers on the low-cost end of the supply schedule will benefit as the costs of supplying the marginal unit increases. That was our investment thesis on Neo Lithium. Based on our assessment of the future supply schedule of lithium, we believed Neo Lithium and the low cost lithium mine it is developing were dramatically undervalued. The Chinese battery manufacturer that took them out apparently had the same thesis. We sold our position at close to the takeout price.

We reinvested part of the proceeds of the sale into another green commodity we like. We currently have about 15% of the portfolio invested in our Clean Energy Theme, which we believe will benefit as the world moves to reduce its carbon footprint.

All the best to you and your families,