# Wealthpin Pro

MAY 2023

Welcome to the May edition of Wealthpin Pro! Many happenings are afoot, and we have a lot to cover this month, so let's get right to it.

We'll start with the elephant in the room:

Inflation.

## STICKY OR NOT?

On May 10th, the latest Consumer Price Index data was released. Inflation fell to 4.9%. Expectations had it coming in at 5%, so this is a clear beat.

And it also continues a strong downward trend in the monthly prints. Take a look at this:

| Month | % |
|---|---|
| June | 9.06% |
| July | 8.52% |
| Aug | 8.26% |
| Sept | 8.20% |
| Oct | 7.75% |
| Nov | 7.11% |
| Dec | 6.45% |
| Jan | 6.41% |
| Feb | 6.04% |
| March | 4.98% |
| April | 4.93% |

The Fed started raising rates in March 2022. So, I guess the question is:

Is this drop in the CPI organic…or is it the result of the Fed raising rates? It might not seem like an important distinction, because hey, after all, if inflation is falling, But the reason why it's falling is important. Because if it is the Fed, well, that means that the central bankers actually made the right decisions.

So, not only can Jerome and crew pat themselves on the back, but their policy decisions can provide a framework for the next inflationary period.

If on the other hand the fall in inflation vis a vis Fed rate hike was just a happy coincidence, well, then that may turn into a big problem. Because the Fed raising rates IS having consequences on the economy (see the rash of bank failures, commercial real estate market, housing crash).

And if it was all for nothing, if the Fed has just been driving the economy off a cliff in the pursuit of a solution that would have naturally occurred anyways, well, that just sucks, plain and simple.

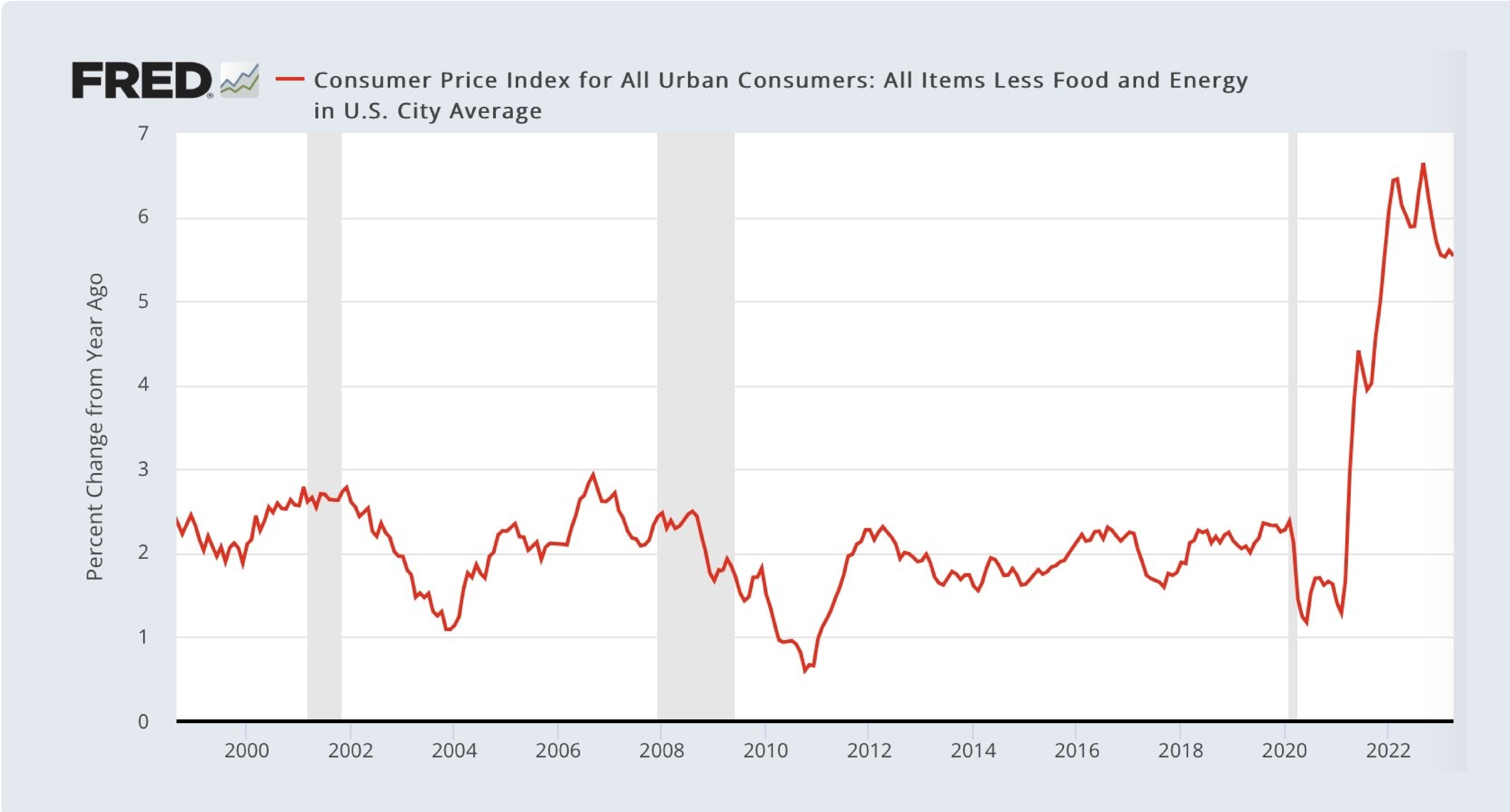
So, which is the right answer? I don't think anyone can truly say for sure, or will ever be able to say for sure. This period will probably be studied by economists for years as they try to pull apart the threads of causation.

What's Wealthpin's humble opinion? As I often do on such complicated matters, I'm going to take the middle road. To understand why, allow me to take your hand, and guide you deeper into the nuances of the CPI data.

When we talk about inflation, most of us are talking about headline inflation. This is an aggregate price of all consumer goods, commodities and services. So, the 4.9% CPI reading is a *headline* inflation number.

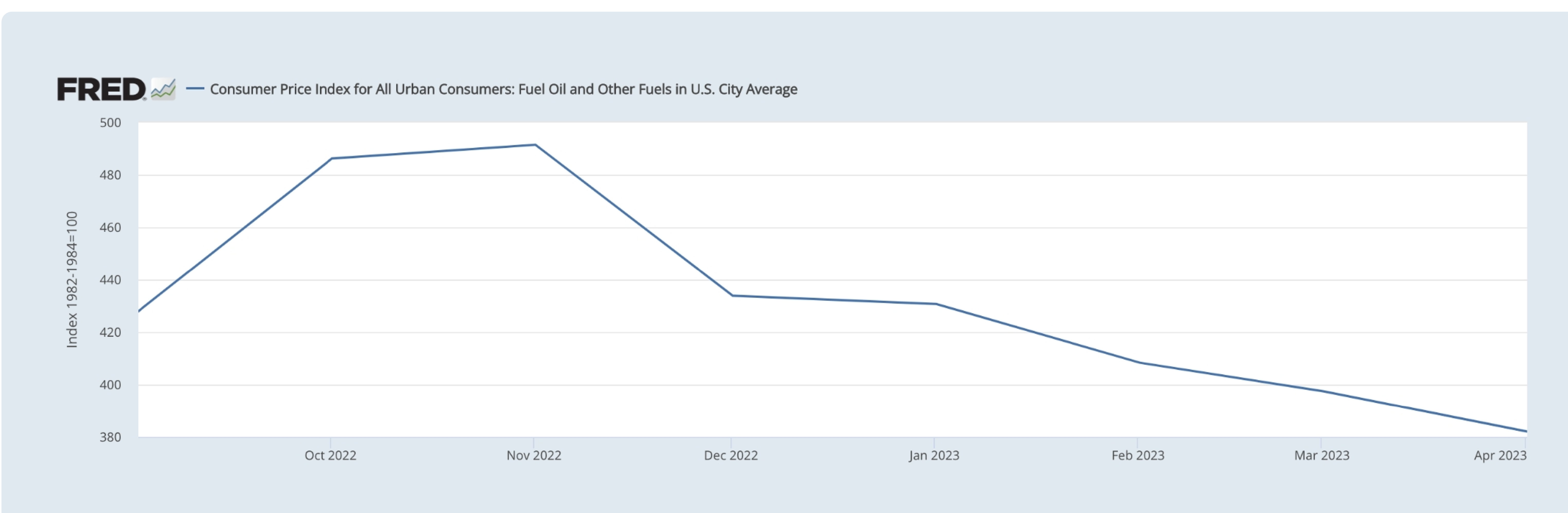
But there's another type of inflation measurement called ***core inflation***. Core inflation is all of the goods, commodities, and services that are included in headline inflation, minus fuel and food prices.

What was the latest core inflation number? 5.5%. Not too far off of the headline reading, except here's the thing: Unlike the headline inflation number, core inflation doesn't seem to be falling.




In fact, it's been stubbornly persistent right around the 5-6% mark throughout all of 2023. This is an interesting economic signal. Because headline inflation is so heavily dependent on oil, some critics argue that it's not very indicative of Fed policy results.

After all, OPEC+ — not the Federal Reserve — are largely responsible for oil prices. And since October, fuel costs have dropped by 20%.




And since the price of fuel and the price of food is so heavily interconnected, falling oil prices usually lead to cheaper food. But here's where it gets sketchy:

Is oil the real cause for lowered headline inflation numbers? Rather than the Fed? After all, the chart above does seem eerily similar to the chart of headline inflation. And if that's the case, then if OPEC+ decides to cut oil production — which they did last month — will it send inflation soaring once again?

These are questions we all need to be thinking about. For what it's worth, I do believe that the Fed has had some success in tamping down inflation. We can see that in the tech layoffs, bank failures, venture capital drought, etc. Low-interest rates led to a lot of market *inefficiencies* shall we say…companies, industries, and economic actions that shouldn't and couldn't have existed outside of basically a "free-money" regime. Powell and the Fed are shaking some of these poorly-run ventures out, which is like clearing the deadwood out of the forest. It might hurt, but it's ultimately a good thing.

At the same time, I also think that the Fed blunt hammer is unable to accurately fix all of the problems that are leading to inflation. Demographics, a tightening labor pool, and a secular commodity uptrend (which we'll talk about in the next section), combined with shifting geopolitics are combining to increase structural inflation.


The Fed has absolutely no power over any of these things, which means if inflation rise or falls is largely up to the way these macro trends break. How's that for an answer?

I don't mean to play both sides of the fence, but I'm not here to be the smartest man in the room. I'm here to look at all the available information, and try to translate that info for you, here, in a way that allows you to make up your own mind.

And one of the biggest shift I see on the horizon, a shift that is intimately connected with inflation, is a new commodity supercycle.

# THE COMMODITY SUPERCYCLE

A commodity supercycle is a prolonged period of rising commodity prices that can last for several years or even decades. During these cycles, demand for commodities exceeds supply, driving prices higher. Conversely, during commodity downturns, supply exceeds demand, leading to falling prices.

Commodity supercycles have occurred throughout history, and they have been associated with significant economic and social changes. Let's dive a little deeper.

## DRIVERS OF COMMODITY SUPERCYCLES

Commodity supercycles are driven by a combination of factors, including demographic, geopolitical, and technological trends. Demographic factors, such as population growth and urbanization, can increase demand for commodities such as food, energy, and metals.

Geopolitical events, such as wars and sanctions, can disrupt supply chains and drive up prices. Technological innovations can increase efficiency in production and transportation, but they can also create new demand for commodities, as new applications are discovered.

**Demographic Factors**

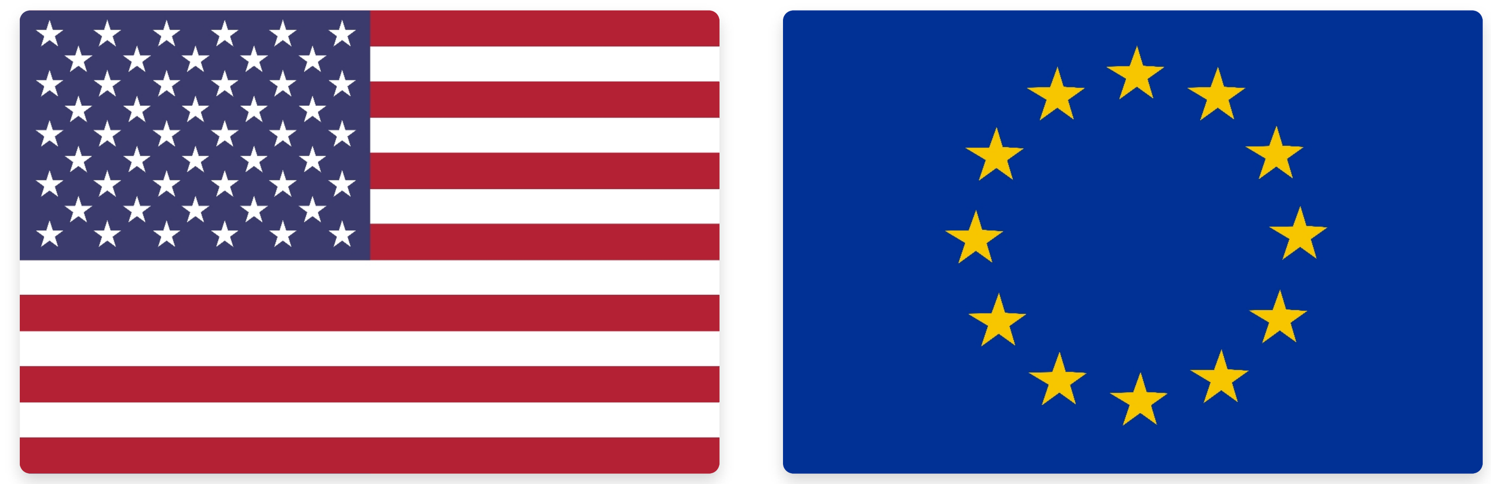
**Geopolitical Events**

**Technological Innovations**

## HISTORICAL EXAMPLES OF COMMODITY SUPERCYCLES

One of the most significant commodity supercycles in history occurred in the late 19th and early 20th centuries. This cycle was driven by the industrialization of the United States and Europe, which created unprecedented demand for raw materials such as iron, coal, and oil. The cycle ended with the Great Depression, which led to a prolonged period of commodity price weakness.

*Late 19th and Early 20th Centuries*

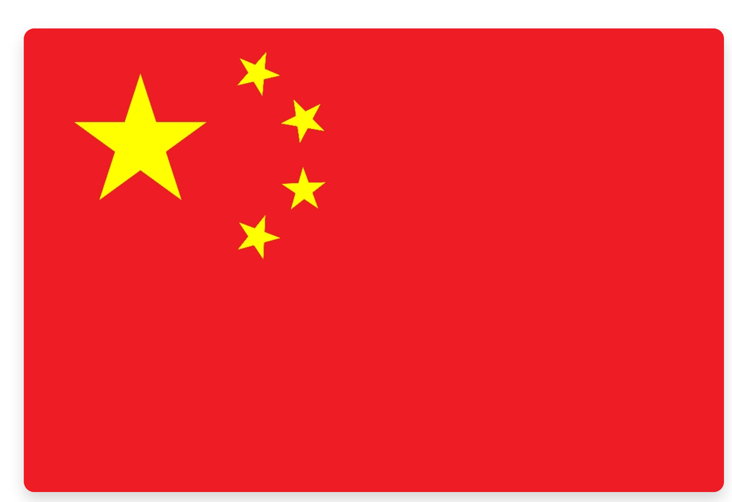


*1970s*

Another significant commodity supercycle occurred in the 1970s, when oil prices skyrocketed following the Arab oil embargo. This led to a prolonged period of high inflation and economic stagnation in many countries, as businesses and consumers struggled to cope with the rising cost of energy.

A more recent example of a commodity supercycle occurred in the 2000s, when surging demand from China and other emerging markets led to rapid price increases for many commodities, including oil, metals, and food. This cycle ended abruptly in 2008 with the global financial crisis, which caused a sharp decline in demand and prices for many commodities.

*2000s*



## ENTERING A NEW COMMODITY SUPERCYCLE

We are now entering a new commodity supercycle, driven by a combination of factors. First, the global population continues to grow, increasing demand for food, energy, and other commodities.

**Second,** governments around the world are committing to ambitious infrastructure spending programs, which will boost demand for industrial metals such as copper and steel.

**Third,** the global shift to renewable energy sources, such as wind and solar power, will require significant investment in commodities such as lithium and cobalt.

Finally, the COVID-19 pandemic disrupted global supply chains, which led to shortages of many commodities, from semiconductors to lumber.

## WHY INVESTORS SHOULD PAY ATTENTION

Commodity supercycles can have significant implications for investors. During periods of rising commodity prices, companies that produce or transport commodities can see their profits increase substantially. This can lead to higher stock prices and dividends for investors in these companies.


Finally, investors should be aware of the potential for commodity supercycles to drive inflation. When commodity prices rise, businesses may pass on the higher costs to consumers in the form of higher prices for goods and services.

This can lead to higher inflation, which can erode the purchasing power of money. Investors may want to consider investing in assets that can help protect against inflation, such as inflation-linked bonds, real estate, or commodities.

Moreover, commodity supercycles can also have important geopolitical implications, as countries that are rich in natural resources may see their economies grow rapidly, while countries that are heavily reliant on imports of commodities may struggle.

So, in a commodity supercycle, there are potentially two paths to investing. One, you can invest in emerging markets, specifically with countries that have a wealth of natural resources. Or, you can invest in the commodities themselves, and the industries adjacent to said commodities.

Our trade idea this month is one such company.

# TRADE IDEA:
# INTERNATIONAL SEAWAYS INC (NYSE: INSW)

**PRICE AT PUBLICATION: $40.35**

**MARKET CAP AT PUBLICATION: $1.99 BILLION**

**52-WEEK RANGE: $17.89 - $53.25**

## ELEVATOR PITCH

International Seaways Inc. (INSW) operates as an independent tanker company in the maritime industry. The company's business model revolves around the transportation of energy commodities, primarily crude oil and petroleum products.

INSW owns and operates a diverse fleet of vessels, including large crude carriers and smaller product tankers. The company generates revenue by chartering its vessels to clients, which can be major oil companies, energy traders, or other shipping companies. There are a few things that I believe make INSW a strong choice for current market conditions:

## 1 UNIQUE MARKET POSITION:

INSW boasts a robust fleet of vessels, strategically positioned to capitalize on the increasing demand for energy transportation. With a diversified fleet and long-standing industry relationships, INSW stands out among its peers, enabling it to secure profitable charters and capture market opportunities.

## 2 BENEFICIARY OF COMMODITY UPSWING:

During a commodity supercycle, prices soar, resulting in greater demand for energy commodities. This translates to higher shipping volumes, increased charter rates, and improved revenue potential for INSW. As the global economy rebounds, INSW stands to benefit from this favorable market environment.

## 3 EXPERIENCED MANAGEMENT TEAM:

INSW is led by a seasoned management team with deep industry knowledge and a proven track record. Their expertise in fleet optimization, chartering strategies, and risk management positions the company for sustained growth and effective capital allocation.

## 4 DIVIDEND POTENTIAL:

INSW has a history of returning value to its shareholders through regular dividend payments. As the company's profitability grows alongside the commodity supercycle, investors can potentially enjoy attractive dividend yields, further enhancing their total returns.

# THE BUSINESS MODEL

As an independent tanker company, International Seaways owns and operates a diverse fleet of vessels. These vessels, ranging from large crude carriers to smaller product tankers, serve as the backbone of the company's operations.

So, how does International Seaways generate revenue? Let's take a closer look. The company leverages its fleet by chartering its vessels to clients, which could be major oil companies, energy traders, or other shipping companies. These charters can take various forms, such as time charters or spot charters.

Under a time charter, International Seaways essentially leases its vessels to clients for an agreed-upon period, typically several months to a few years. During this time, the charterer pays a fixed rate to International Seaways, ensuring a predictable stream of income for the company.

On the other hand, spot charters involve shorter-term contracts, often spanning weeks or even days. These charters are typically utilized when there's a sudden surge in demand for tanker transportation or when market conditions favor spot charter rates. While spot charters offer more flexibility, the rates can fluctuate depending on market dynamics.

# WHERE THE INDUSTRY IS HEADING

Despite some uncertainty in the past year, I believe that the tanker market is going to do well over the next five years. The tanker market, like any other component in a market economy, is heavily influenced by the interplay between supply and demand. Recent analysis from BIMCO provides valuable insights into the dynamics of the tanker market:

> *According to BIMCO's forecast for FY2023 and FY2024, demand is projected to outpace supply in both years. The study predicts a 4.5-6.5% increase in crude tanker demand for FY2024, accompanied by a 0.6% decrease in supply. Similarly, product tanker demand is expected to grow by 6-8%, with a 0.7% decline in supply. This creates a shift in the equilibrium equation, with the demand curve moving rightward while the supply curve moves leftward.*

The anticipated increase in demand and decrease in supply are likely to drive gains in freight rates, time charter rates, and second-ship values throughout 2023 and 2024. Factors contributing to this growth include renewed economic expansion in China, increased demand for jet fuel following the reopening of travel, and the EU's ban on Russian oil leading to longer sailing distances.

Furthermore, limited fleet growth due to small order books, combined with the decarbonization regulations leading to reduced sailing speeds, will contribute to a decrease in overall supply. While there are potential downside risks to this positive outlook, such as global GDP growth uncertainty and falling oil prices, it is important to note that lower oil prices do not necessarily pose a risk factor for tanker companies.

> *Euronav's analysis suggests that there is a price band between $35 and $70 where oil demand remains stimulated. Freight rates have shown resilience despite a decline in Brent crude oil prices, further highlighting the complex relationship between oil prices and tanker demand.*

Although a potential recession may impact tanker demand, emerging markets like China, India, and Russia are expected to sustain a substantial need for tankers in the coming years. Given the difficulties in the supply side, characterized by the lack of new vessels, the demand side is poised to drive up freight rates and improve the valuation of tanker companies' assets, which are currently undervalued.

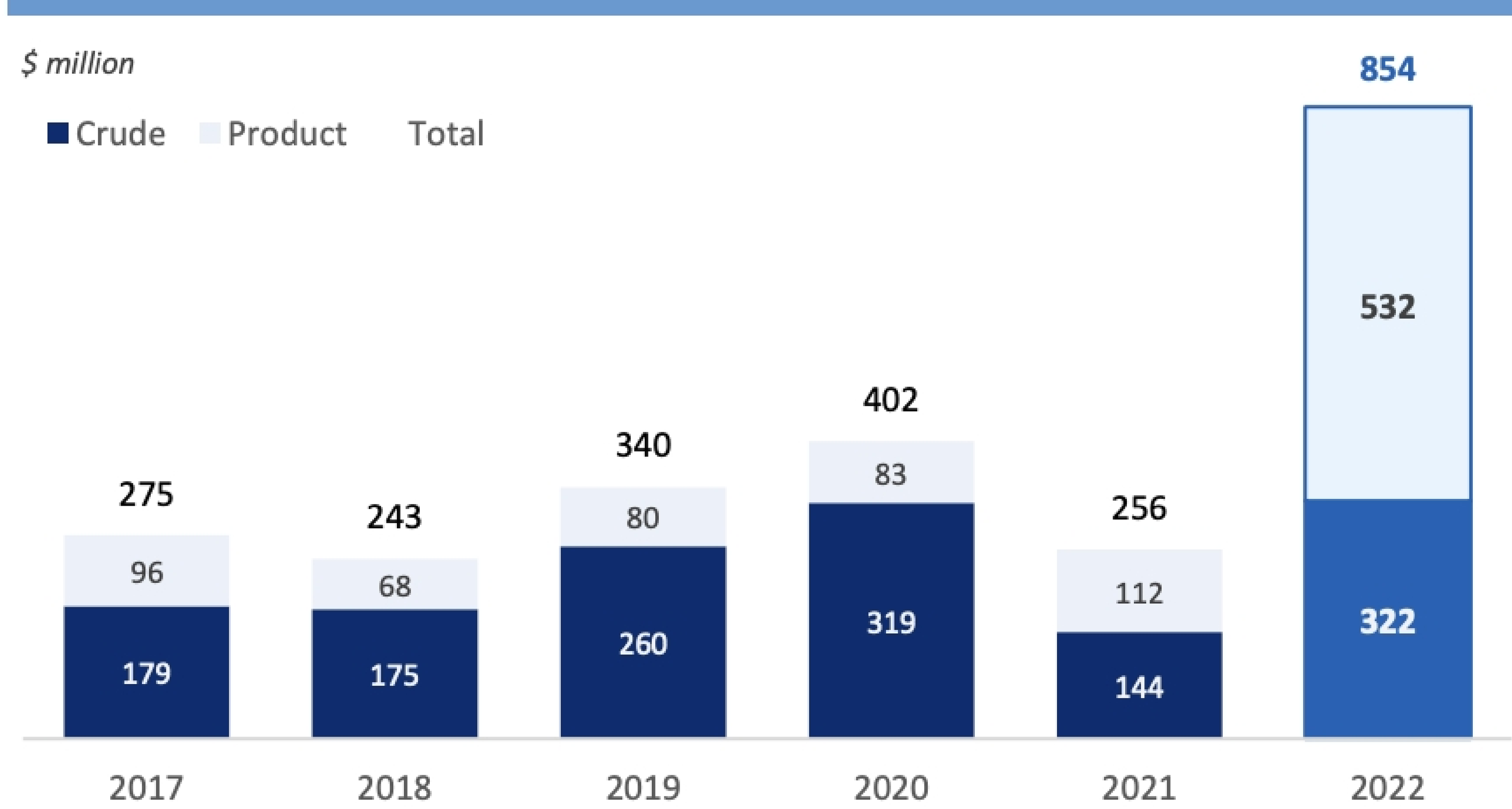
Overall, the tanker market presents an opportunity for investment, considering the projected increase in demand, limited fleet growth, and the potential for improved market conditions and asset valuations in the coming years.

# THE FINANCIALS

First let's take a look at the 2022 results that were released back in April.

Total revenues for 2022 reached a record-high of $854 million, a remarkable year-on-year increase of 234%. Revenues from product tankers accounted for 62%, while crude tankers represented approximately 38%. Notably, revenues from crude tankers grew by 124%, while revenues from product tankers more than tripled, showing a 375% increase. This revenue surge was primarily driven by higher day rates across all vessel categories throughout 2022, with spot rates reaching exceptionally high levels in Q4 2022.

**TCE Revenues[1]**




*$ per day*

| Spot Earnings[2] | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|
| VLCC | $24,900 | $18,900 | $31,700 | $46,900 | $13,600 | $29,400 |
| Suezmax | $17,900 | $19,000 | $29,800 | $32,500 | $12,600 | $32,600 |
| Aframax | $13,400 | $12,800 | $20,000 | $20,500 | $10,800 | $36,500 |
| LR1 | $12,900 | $14,900 | $21,500 | $25,700 | $14,800 | $38,700 |
| MR | $11,000 | $10,100 | $12,600 | $16,400 | $10,500 | $30,300 |

On the cost side, total operating expenses were 10% higher than the previous year, amounting to $422 million compared to $384 million. However, effective cost control measures enabled the company to mitigate the impact. The most significant increases were seen in vessel expenses (31% increase, reaching $240 million) and depreciation and amortization (28% increase, reaching $110 million). The absence of $50 million in merger integration costs, which weighed on the 2021 accounts, partially offset these cost increases.

| | | | |
|---|---|---|---|
| **Operating Expenses:** | | | |
| Voyage expenses | 10,955 | 16,686 | 19,643 |
| Vessel expenses | 240,674 | 183,057 | 128,373 |
| Charter hire expenses | 32,132 | 23,934 | 30,114 |
| Depreciation and amortization | 110,388 | 86,674 | 74,343 |
| General and administrative | 46,351 | 33,235 | 28,976 |
| Third-party debt modification fees | 1,158 | 110 | 232 |
| Merger and integration related costs | — | 50,740 | — |
| (Gain)/loss on disposal of vessels and other assets, net of impairments | (19,647) | (9,753) | 100,087 |
| Total operating expenses | 422,011 | 384,683 | 381,768 |
| Income/(loss) from vessel operations | 442,654 | (112,137) | 39,880 |
| Equity in income of affiliated companies | 714 | 21,838 | 4,119 |
| Operating income/(loss) | 443,368 | (90,299) | 43,999 |
| Other income/(expense) | 2,332 | (5,947) | (12,817) |
| Income/(loss) before interest expense and income taxes | 445,700 | (96,246) | 31,182 |
| Interest expense | (57,721) | (36,796) | (36,712) |
| Income/(loss) before income taxes | 387,979 | (133,042) | (5,530) |
| Income tax provision | (88) | (1,618) | (1) |
| Net income/(loss) | 387,891 | (134,660) | (5,531) |
| Less: Net loss attributable to noncontrolling interest | — | (1,168) | — |
| **Net income/(loss) attributable to the Company** | $ 387,891 | $ (133,492) | $ (5,531) |

Net income for 2022 was positive at $387 million, a substantial improvement compared to the net loss of -$133 million in the previous year. Cash flow from operations stood at $287 million, while cash flow from investing activities amounted to $43 million. Investments in vessels and vessel improvements accounted for a significant portion of the outflow, along with investments in short-term deposits.

| | | | |
|---|---|---|---|
| Net cash used in by financing activities | (185,789) | (173,840) | (183,074) |
| Net (decrease)/increase in cash, cash equivalents and restricted cash | 144,811 | (116,744) | 65,434 |
| Cash, cash equivalents and restricted cash at beginning of year | 98,933 | 215,677 | 150,243 |
| Cash, cash equivalents and restricted cash at end of year | $ 243,744 | $ 98,933 | $ 215,677 |

Cash flow from financing was negative at -$185 million, primarily driven by debt restructuring initiatives, which involved $640 million of new debt drawdown and $800 million debt repayment.

As of December 31, 2022, the net debt amounted to $537 million, equivalent to 26% of the current market capitalization. Furthermore, International Seaways declared a combined dividend of $2 per share, totaling $90 million in cash returns to shareholders over the course of 2022.

# THE DIVIDEND

INSW pays an annual dividend yield of 1.18%, or $0.12 quarterly per share.

It's not the greatest, but I'm really looking at INSW as a growth play, rather than an income play, so this doesn't bother me that much.

# CONCLUSION

The market outlook for oil and product tankers in 2023 remains highly positive, with several factors expected to sustain high tanker day rates and ensure profitability and strong free cash flow generation. Oil demand is projected to grow by 2% in 2023, driven in part by a demand of 0.7 million barrels per day from China. The ongoing Ukrainian/Russian conflict continues to disrupt oil and product routes, with the EU reducing purchases from Russia, resulting in longer voyages to facilitate sales to other countries.

Considering the increasing demand for oil tankers and the limited supply, with the tanker order book remaining at a low level (5% of the current fleet) and the net fleet only increasing by 2.8% since January 2022, the stage is set for sustaining high tanker day rates in the coming months and years.

And I think International Seaways is perfectly positioned to capture that growth. Which is why we're adding it to the model portfolio with a price target of $59.50.

To your wealth,
**Alex Reid**
Founder, Wealthpin Pro

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