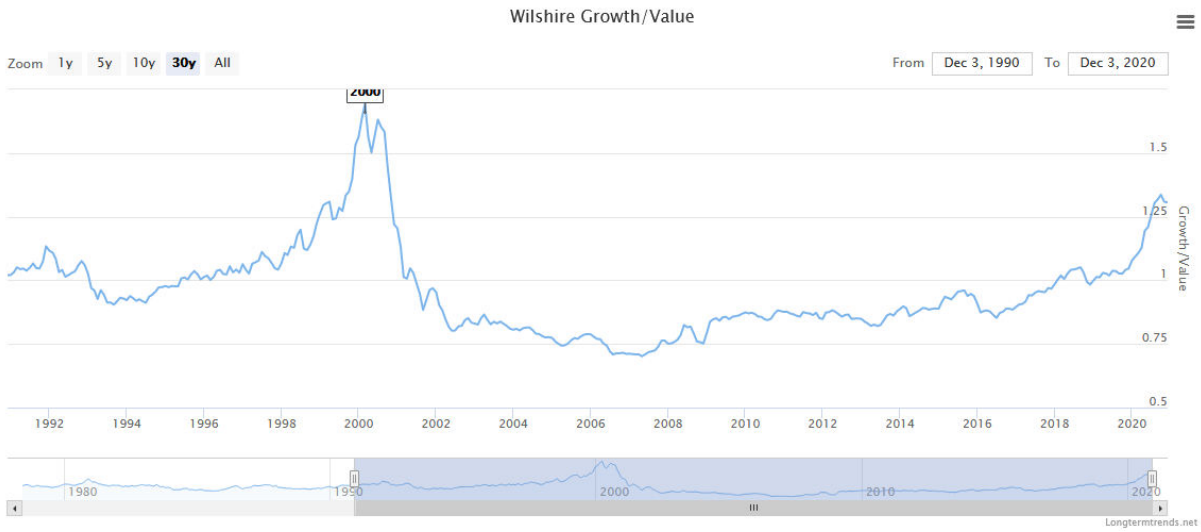
PVI – The Global Investment Newsletter

09th of December 2020

Value stocks make a comeback

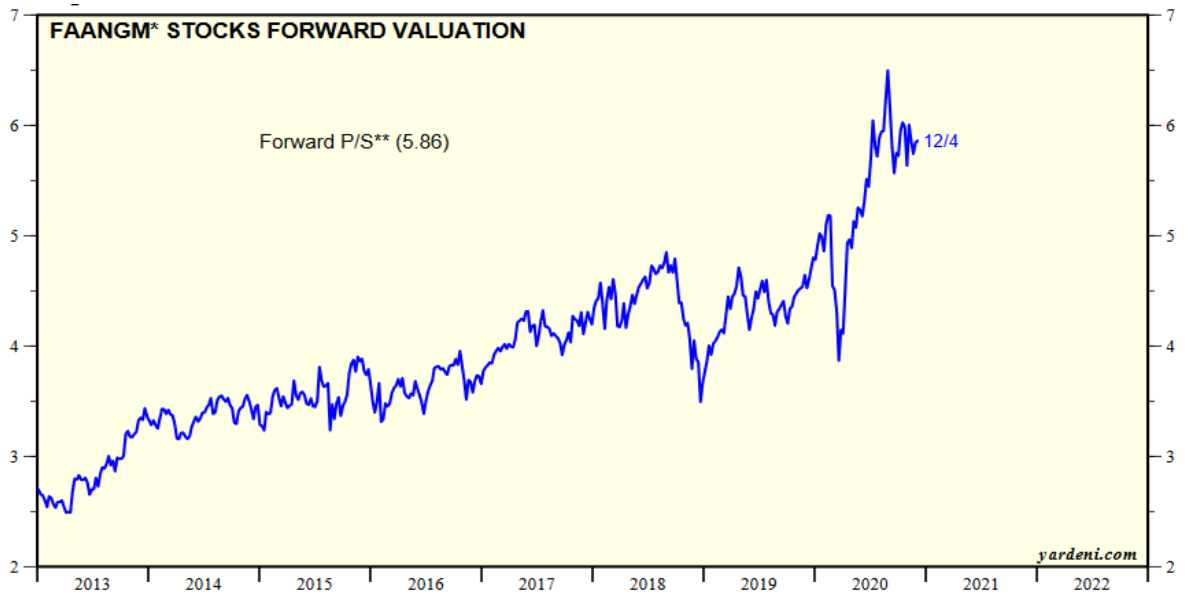
After almost 10 years of relative underperformance, value stocks are enjoying a reversing of trends. This is due to the significant undervaluation of these stocks on the one hand, but also to the prospect of a strong economic upswing in 2021/22 on the other. Cyclical, statistically low-valued stocks are favored in this phase, the very highly valued tech stocks should underperform. The following chart shows the ratio of growth stocks to value stocks. It was only higher than it is today during the Internet bubble in 1999. This was followed by a multiyear-long boom for value stocks.



Source: www.longtermtrends.net

FAANG shares have benefited from the lockdown measures, but it is questionable whether growth rates can be sustained in the years to come, as further growth should be slower due to the sheer size of these companies alone. The valuations measured by the market capitalization / sales ratio (see chart below) and other valuation criteria are extremely high; combined with a slowdown in the growth of these companies in the years to come, this should result in far weaker share price performance in this basket.

Chart: Price-to-sales ratio of FAANGM shares:



* FAANGM stocks include Facebook, Amazon, Apple, Netflix, Google (Alphabet), and Microsoft. Both classes of Alphabet are included.
** Market cap divided by aggregate forward consensus expected revenues per share.
Source: I/B/E/S data by Refinitiv.

Source: www.yardeni.com

Precious Metals

The precious metals actually turned exactly at the end of November and could have an upswing phase in the coming months. We remain positive for gold and silver - for the reasons mentioned in the last stock market letter - and advise continuing to build up long-term positions in the event of price weaknesses.

Natural Gas Shares

Due to the previously warm winter in the USA, gas prices came under further pressure. The natural gas stocks held their own better. We hold on to our positions and emphasize again that the winter in La Nina years is generally rather cold and the cold spell could also set in in January or February. Furthermore, gas prices lower than USD 2.4 would result in fuel switching in the generation of electricity from coal to gas. We therefore recommend investors who trade futures or certificates to build positions at the current gas prices (approx. USD 2.45 in the March contract). Target price would be 3-4 USD in March / April.

Trading Recommendations:

Amplify Energy

In order to participate in the renaissance of value and energy stocks, we are including **Amplify Energy** (price: 1.33 USD, WKN: A2PP3L, ISIN: US03212B1035, market capitalization approx. 50 million USD, trading in New York) in the model portfolio.

While the stock is clearly classified as speculative, the signs for the turnaround are clearly positive here, the company has turned the corner already. Amplify Energy is one of the few companies with a 50-50 gas-oil production ratio.

Fundamental situation on the oil and gas market:

While the gas producers were still under significant pressure before the Corona crisis and the oil producers were in better shape, the relationship has now been reversed as a result of the lock-down. Since the demand for oil is currently around 93 million bbl per day and is now around 7 million bbl below the pre-crisis level, the oil frackers have reacted violently and dramatically shut down drilling activities. Since natural gas is often created as a by-product in oil fracking, natural gas production also fell significantly (approx. 30% of natural gas production is a by-product). Since the demand for natural gas is relatively stable in the US and the LNG trade (exports to Asia) is also moving back towards the pre-crisis level, the gas market is now in deficit. Of course, the short term depends on the weather and the temperatures during the winter heating season in the USA, but regardless of this, the supply of natural gas must increase in some quarters or the demand for natural gas must be reduced by rising gas prices.

The gas producers will only invest in new wells at a gas price of USD 3-3.5. Therefore, as shown in our previous stock market letters, we are assuming rising gas prices. This scenario could only be averted by resuming fracking activities by the oil producers. Due to the current global oversupply of crude oil, this should only be possible after the recovery in oil demand, i.e. from mid-2021. Furthermore, oil fracking activities would only be able to be expanded at oil prices above USD 50 (based on WTI oil).

Therefore, we see gas prices rise to well above USD 3.5 in 2021 and oil prices will only rise again to USD 55-60 (WTI) in 2022.

However, given the dynamics between oil and gas prices, it is very unlikely that both gas and oil prices will fall back to low levels at the same time. For this reason, an investment in Amplify Energy is highly recommended, as it will become clear to the market in the coming months that at least half of its assets must be upgraded.

Chart: Amplify Energy

Source: www.bigcharts.com

As a result of the crash in oil and gas prices during the Corona crisis in the spring, Amplify Energy's bank credit lines were only extended on the condition that every cent of cash flow must be used to reduce debt. Thanks to the rapid recovery in oil and, above all, gas prices, the reduction could take place faster than planned. Therefore, in November it was even possible to relax the conditions and allow additional leeway for the credit lines.

This, combined with the fact that Amplify has already hedged around 70% of production for 2021 at good prices (around USD 45 oil and USD 2.4 gas), means that it is very certain that the debt of currently around USD 250 million will fall towards USD 200 million. The banks are currently granting Amplify credit leeway of up to USD 270 million. With these hedges one can be quite comfortable that the company has turned around and the stock market can concentrate on the enormous values of the oil and gas assets of Amplify: At the current prices, it should generate free cash flow of approx. 50 million in 2021 - with a current market cap of only USD 50 million! The important valuation figure for oil stocks - the discounted value (so-called "PV10") of the current production (excluding new wells) amounts to over USD 500 million at the current oil and gas prices, or approx. USD 5 per share (after deduction of debts). Just like Amplify's cash flow, this value reacts very sensitively to the oil and gas price, as this evaluation matrix shows:

		Oil Price (USD WTI)						
		30	**35**	**40**	**45**	**50**	**55**	
	2.00	-0.50	0.40	1.60	3.20	4.60	8.00	
	2.25	0.40	1.35	2.55	4.20	5.60	8.95	
	2.50	1.35	2.30	3.50	5.15	6.55	9.90	resulting
Gas price (USD,	**2.75**	2.30	3.30	4.50	6.10	7.50	10.85	net value per
Henry Hub)	**3.00**	3.25	4.20	5.30	7.05	8.50	11.80	share
	3.25	4.20	5.20	6.40	7.95	9.40	12.75	
	3.50	5.15	6.10	7.30	8.95	10.35	13.70	

Mind you, only the current production is included in this calculation, but not other values that could be raised by more drilling, provided that oil prices were above USD 55 and the gas prices above USD 3 (from then on it would make sense for Amplify to drill) . Due to these high values, it is hardly surprising that the banks granted Amplify credit lines of more than USD 500 million before the Corona crisis, as these appeared to be covered by the values of the future cash flows. We foresee that oil and gas prices will recover significantly in 2021/22 and that Amplify's share price will recover towards USD 5-10.

The price of Amplify is currently depressed by the fact that a large fund (Fir Tree Capital) is cleaning up its books and selling around 0.1 million shares on the market every day. The 20% stake in Amplify that Fir Tree still holds is only worth around USD 10 million - this hardly matters with the total capital of the large fund of USD 4 billion. Therefore, Fir Tree sells indiscriminately. Such cleaning of institutional books often offers very good buying opportunities.

In addition, the oil industry is on the sell or cleanup list for many funds due to its poor “ESG” (Ecological, Social, and Governance) rating. One can argue about the meaning or the reality of this classification, but this results in extremely low prices for oil and gas stocks - precisely at a time when supply is becoming scarcer and demand should pick up again after the economy opens up. Therefore, there are particularly good opportunities in this sector.

Buy: Amplify Energy (WKN: A2PP3L, ISIN: US03212B1035), current price: 1,33 USD,

target 5-10 USD, time frame: 12 – 24 months, Stop/Loss 0,5 USD

Current Model Portfolio: (starting value on 01/01/2020: 100.000 Euro)

YTD return: +22,40%*

25.000	**Euro Cash**
25.000	**Euro Amplify Energy (entry 12/09/2020: 1,33 USD)**
22.140	**Euro Peyto (entry 11/11/2020: 2,85 CAD, currently: 2,85 CAD)**
24.720	**Euro Centrica (entry 11/24/2020: 44,5 pence, currently: 44 pence)**
25.540	**Euro Barrick Gold (entry 11/24/2020: 23 USD, currently: 23,5 USD)**
122.400	**Euro Total Value as of 12/09/2020**

*the model portfolio assumes a flat tax rate of 25% on profits generated (tax is calculated after positions are sold)