Corrections and Opportunities

[Author's Note]

As Loudspring we have been working on a wider article over the past month which indicated our position on the status of the global economy, along with how we fit in. While the full article is still under development, given the events of the past 72 hours we have decided to release the first section of the article today. See below, and stay tuned on more to follow.

Best,

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INTRODUCTION

Howard Marks of Oaktree Capital Management recently communicated a warning where he issued a "Yellow Flag" on the current state of the economy. Given that his previous warnings came in early 2000 with "Bubble.com" and again in 2005 with "Here They Go Again" it is important to pay attention when Howard issues such warnings. His third warning is the very aptly named "Here They Go Again … Again"

Two guys meet in the street. Joe tells Bob about the hamster he has for sale: pedigreed and highly intelligent. Bob says he'd like to buy a hamster for his kid: "How much is it?" Joe answers, "half a million," and Bob tells him he's crazy.

They meet again the next day. "How'd you do with that hamster?" Bob asks. "Sold it," says Joe. "Did you get $500,000?" Bob asks. "Sure," says Joe. "Cash?" "No," Joe answers, "I took two $250,000 canaries."

LOUDSPRING

When put to good use, investment capital can transform industries, and as a result our perception of what is possible or indeed normal. At Loudspring, this is what we are trying to do; put capital (*and expertise*) to use in those industries where we see the opportunity to create a positive impact.

For those of you who do not know us, our strength has been a result of our focus on growing capital-light, highly-scalable and high impact businesses. Another strength has been our ability to take a broad perspective on the market, evolving with flexibility. A key differentiator between Loudspring and other company groups is that traditional industrial companies typically consume more natural resources as they grow, whereas Loudspring saves natural resources as our combined companies increase revenues. The very nature of our NASDAQ listed organization requires there to be profit at the end of the tunnel.

In reality, having a "profit requirement" is as much a drain on potential impact as a backup parachute is on a skydiver. It forces us to look for those opportunities and investments that remain viable throughout geopolitical or economic cycles.

It is only natural that as officers of this endeavor we would keep a watchful eye on those trends and events that shape, create, and end cycles. This is something that we have done, and will continue to do as will be covered in this memo.

In publishing this document, I hope to show to our stakeholders the thought and consideration that we take at Loudspring towards planning for the future. I would also like to elaborate on my confidence in our portfolio while explaining why I believe that the Loudspring stock is not only well shielded, but poised to thrive in the inevitable bearish economy that is soon to come.

Long term thinking means moving when an investment makes sense and there is an acceptable risk to return matrix in play. This occurs when an investor has the confidence to operate in, versus react to the market. Generally, these plays tend to go against the current flow of capital, as underpriced assets are a direct result of lack of investor interest (*until investors notice*).

FORGETTING LONG TERM

In the vast majority of asset classes, prospective returns are the lowest they've ever been. Asset prices are high across the board. Almost nothing can be bought below its intrinsic value, and there are few bargains. In general, the best we can do is look for things that are less over-priced than others. Pro-risk behavior is commonplace, as the majority of investors embrace increased risk as the route to the returns they want or need. Argentina and Greece have taken advantage of this investor demand to issue bonds.

Let's take into account the following situation brought up in the memo;

- Argentina has recently brought online 2.75 BN worth of century bonds at 8%.
- In the last 200 years Argentina has defaulted no less than 8 times on government bonds.

Given the current economic environment where 'nothing can go wrong', Argentina had no issue selling the bonds as long qualified investors and advisors pushed bonds as a good short-term investment trade. Isn't it inevitable that eventually someone trading the short term will draw the short end of the stick?

BULLISH MARKETS: OVERCONFIDENCE

In "Here We Go Again … Again" there are nine factors listed as setting the foundation of a bull market and eventual bubble. Below I have curated a paraphrased selection. As you read through them ask yourself how many of them (*if any*) can be used to explain an investment you have made in the recent past.

- **A benign environment** – good results lull investors into complacency. Gains in the recent past encourage the heated pursuit of further gains in the future, rather than suggest that past gains might have borrowed from future gains. **I**

- **Early success** – the gains enjoyed by the "wise man in the beginning" tends to attract "the fool in the end" who jumps in too late. **I**

- **Rejection of valuation norms** – all we hear is, "the asset is so great: there's no price too high." Buying into a fad regardless of price is the absolute hallmark of a bubble.

- **The pursuit of the new** – old timers fare worst in a boom, with the gains going disproportionately to those who are untrammeled by knowledge of the past and thus able to buy into an entirely new future. **I**

- **The virtuous circle** – no one can see any end to the potential of the underlying truth or how high it can push the prices of related assets. Certainly no one can picture things taking a turn for the worse. **I**

- **Fear of missing out** – when all the above becomes widespread, optimism prevails and no one can imagine a glitch. That causes most people to conclude that the greatest potential error lies in failing to participate in the current market darling.

In the United States, the market has been *(apart from a few blips)* sustainably bullish, and as a result has fallen victim to the points listed above (*one of which is lulling investors into a sense of security*). Built into bullish trends is an admirably human inability to spot the tipping point. As Howard Marks puts it;

"*most people can't think of what might cause trouble anytime soon. But it's precisely when people can't see what it is that could make things turn down that risk is highest, since they tend not to price in risks they can't see*".

STOCK MARKET RISK: FAANGS

When a market turns Bullish, the market tends to be spearheaded by a track of leader stocks that consistently outperform the market and create benchmarks for valuations that continue to drive the market. However, as we will explore now, much of the merit of these stocks' performance lies less with the company operations versus market mechanics.

FAANGS refer to Facebook, Amazon, Apple, Netflix, and Google (Alphabet). These stocks tend to be generally trading at about 30 years plus earning. While there are clear reasons to be excited by their potential growth, can we truly take for granted that these behemoths will be around in 30 years, let alone trade them based on those earnings.

Below is an excerpt taken from a 1997 letter to shareholders:

"We established long-term relationships with many important strategic partners, including America Online, Yahoo!, Excite, Netscape, GeoCities, AltaVista, @Home, and Prodigy."

Howard Marks points out:

"The powerful multiple expansion that makes a small number of stocks the leaders in a bull market is often reversed in the correction that follows, saddling them with the biggest losses. But when the mood is positive and things are going well, the likelihood of such a development is easily overlooked."

He goes on to say that "given human nature, the best will always come eventually to be overpriced, even for their stellar fundamentals."

SO, WHERE DO WE GO FROM HERE?

Howard Marks may have set the stage for what is to come, but he is not the only asset manager that is weary of the next couple of years. Larry Fink of Blackrock has also issued a widely-shared opinion piece talking openly to CEO's.

In it Fink addresses the same investor sentiments that Marks alluded to in his memo; among those are investor unease for the profits that have been realized, paired with an uncertainty of what is to come.

"We are seeing a paradox of high returns and high anxiety. Since the financial crisis, those with capital have reaped enormous benefits. At the same time, many individuals across the world are facing a combination of low rates, low wage growth, and inadequate retirement systems."

Fink talks about a responsibility that is being shifted to the private sector.

"Society increasingly is turning to the private sector and asking that companies respond to broader societal challenges. Indeed, the public expectations of your company have never been greater."

The solution is to mitigate this by shifting focus into a long term mentality, and to focus on the fundamentals that will drive growth for decades to come - very Buffett.

"Without a sense of purpose, no company, either public or private, can achieve its full potential. It will ultimately lose the license to operate from key stakeholders. It will succumb to short-term pressures to distribute earnings, and, in the process, sacrifice investments in employee development, innovation, and capital expenditures that are necessary for long-term growth."

The piece is openly asking CEO's to avert short term profits in exchange for longer term goals. Fink's memo is not revolutionary in its content, but the fact that it comes from Blackrock suggests that its implications will resonate globally.

However, this is nothing that has not been said before. What is changing is the level of expectation that consumers have in the extent of societal benefit that corporations are creating.

Recession Proof [Term]: *A term used to describe an asset, company, industry or other entity that is believed to be economically resistant to the outcomes of a recession.*

There are new modes of operating and a shift towards more environmentally-friendly solutions on the markets where Loudspring companies operate and are experiencing strong growth. During the last five years, the cost of more environmentally-friendly alternatives to traditional solutions have radically dropped and we clearly see through the growth of companies such as ResQ Club, Swap.com, and Plugsurfing that willingness to adopt these solutions has increased steadily.

Fortunately, there are sections of the impact economy that have been gaining traction as consumers and investors have started to shift their perspective. Looking at the energy sector we can see the following:

- In the U.S., natural gas, wind and solar already meet 40% of the country's power needs, up from 22% a decade ago.

- South Korea, having shifted toward renewables, is planning to increase its solar capacity eight-fold and its wind capacity fourteen-fold by 2030.

- Denmark is planning on reducing its renewable energy subsidies, because the industry no longer needs them to compete with conventional energy.

The cost of renewables continues to decline; the cost of solar panels fell over 17% in the past year alone. At the same time, over 50% of nuclear power plants are unprofitable. Evidence points towards an economic shift from monolithic project to modular components that can fit the specific requirements of geographic areas. The result is that in certain parts of the world, renewables are no longer an alternative to traditional energy, but the default. This trend is something that we cannot limit to the energy sector, and is being perpetuated in retail, food, water, among others.

If we take a pragmatic approach to the movement of capital, it is only logical that as traditional industries fail to sustain the current market momentum, there will be a dramatic shift in the way that capital is deployed.

All things point towards a transitional change that is happening across several markets as has been highlighted through this piece. This transition opens-up opportunities to disrupt legacy industries with capital-light, innovative solutions, as well as a distinct shift in what investors are allocating their resources to.

How then can we create businesses with long term vision that still meet the return criteria?

No single geographic location can tackle our global challenges in isolation.

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Loudspring in brief

Loudspring is a company group focused on saving natural resources, with offices in the Nordics and California. TheLoudspring companies are active on global markets in five sectors: energy, real estate, fashion, food and manufacturing. Loudspring management consists of company builders combining positive environmental impact with business for over a decade.

The company group is listed on First North Finland under the ticker LOUD and on First North Stockholm under the ticker LOUDS.

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