Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2019			0.1%	0.3%	4.3%	-4.2%	0.1%	-0.1%	0.9%	-4.1%	7.5%	6.0%	10.5%
2020	-6.2%	-2.0%	2.5%	12.4%	3.6%	-6.6%	19.6%	12.1%	-3.0%	-7.1%	2.1%	11.9%	41.6%
2021	1.1%	3.5%	-0.5%	6.3%	19.5%	-3.2%	4.0%	-5.2%	6.0%				33.6%

- **The Cypress Fund returned -5.2% in August and 6.0% in September. Year-to-date returns are 33.6% net of fees.**
- **Energy prices increased substantially across the board in recent weeks. We share some preliminary observations; we suspect we will see spikes more often going forward.**
- **We discuss Sprott Physical Uranium Trust's ATM offering. This is a game changer and may be the catalyst for much higher uranium prices. We intend to increase exposures.**
- **We share why we invested in MBIA; we see ~100% upside from current prices given imminent resolution of Puerto Rico risk.**

Dear fellow investor,

The Cypress Fund returned -5.2% in August and 6.0% in September. Year-to-date, the fund generated net returns of 33.6%. Financial markets finally cracked in September, after months of deterioration under the surface. The headline reasons for this weakness include China and Evergrande risk, concerns about the US debt ceiling, higher inflation and rising interest rates. But as commented in our last letter, we think these are just triggers; the market's "immunity" has been weakening for a while making it more susceptible to declines. Our portfolio treaded water the last 2 months – losing money in August from our hedges and weaker metal prices; making gains in September from our energy names and index shorts. At this juncture, we still expect the market to chop around; we will update you when our view changes.

For the rest of this letter, we will share thoughts on the recent spikes in the energy complex, discuss Sprott's ATM offering and why it is bullish for uranium and share our thinking behind investing in MBIA.

Making Sense of Energy Spikes

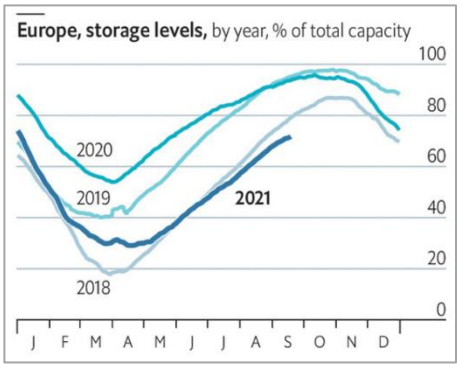
Energy prices have been making the news for all the wrong reasons over the past month. Natural gas prices in the UK and Europe surged to all-time highs on 5 October, exerting upward pressure on Asia-Pacific LNG (also hitting all-time highs) as buyers raised bids to attract cargo to Europe. Only US natural gas, which primarily feeds the domestic market, has stay somewhat insulated, merely achieving 7-year highs as opposed to all-time records. Crude oil also hit 7-year highs, breaking through the $80 barrier. Closer to home, coal shortages in China have led to price spikes and even resulted in power rationing. We are still trying to make sense of these developments; in the meantime, let us share a few observations.

Natural Gas Prices in Europe (White), UK (Blue), East Asia LNG (Purple), US (Yellow)

Coal Prices in Rotterdam (White), Australia (Blue), Indonesia (Purple), South Africa (Yellow)

I) Proximate vs Structural Causes; The Latter Suggest More Frequent Spikes to Come

The proximate causes of higher natural gas prices include lack of wind in the North Sea (Orsted reported the third worst quarter for wind out of 88 quarters on record), low European gas inventories (due to cold-than-average winter earlier this year) and Russian supply bottlenecks. Lack of wind drove increased demand for gas while supply struggled to meet the higher needs. Trader margin calls likely exacerbated the spikes, causing prices to shoot up 40% in a day in the UK, before closing lower on the day.



The structural reasons that underpinned the spikes in Europe include increasing reliance on renewables without building sufficient baseload power, depletion of gas in the Rough field (increasing UK dependence on European gas and LNG imports) as well as the liberalization of power markets which led to increased private sector participation and reduction in long-term contracting. You can find out more in this report by Dieter Helm.

Not being traders, we are less concerned about the proximate causes. After all, coal-burning power plants can be turned back on, Russia may increase their gas supply above agreed quotas and even wind conditions can change. On the other hand, structural drivers cannot be easily fixed and likely portend higher energy prices. In the short-term, price spikes can correct themselves but given structural issues, we would not be surprised if such price increases become more common in future.

II) The Butterfly Effect: High Energy Prices Affect Food Supplies, Computer Chips, Solar Panels, Etc

Energy touches every aspect of our lives, sometimes in unexpected ways. In September, Ocado Group in the UK stopped supplying frozen food to customers and the meat industry warned that business could grind to a halt due to a shortage of carbon dioxide. CO2 is used to make dry ice and to stun animals hence the shortage jeopardized UK's food supply. This shortage was a direct consequence of high natural gas prices forcing 2 fertilizer plants to shut – they provide 60% of the UK's food-grade CO2 as a by-product of fertilizer production. In the end, the UK government had to bail out the company, CF Industries, in order to avert a potential food crisis.

Silicon, essential in the manufacturing of semiconductor chips and solar panels, have also shot up in price because of energy's surge. The silicon market is facing a supply crunch as Yunnan province, a top producer, ordered production cuts of the metal amid a power crunch in China caused by high prices of coal. Coal prices skyrocketed because production has lagged demand growth this year as Xi Jinping's decarbonization agenda led to production caps on mines. Domestic production grew by only 6% while consumption surged 14% in the first 8 months of this year. To add fuel to fire, recent heavy downpours in Shanxi, the top coal-producing province, has forced 60 mines to shut temporarily. All this is happening even as high natural gas prices prompt US utilities to switch back to burning coal.

Silicon Prices in Shanghai, China

III) No Price Too High When Supply is Short

The headline spikes in energy prices were stunning – both UK and European gas were up 80% in September and hit 4.5x their previous all-time highs in October. While natural gas and crude oil are not directly substitutable, it is interesting to think about what the recent extreme natural gas prices imply for crude prices. In short, should supply/demand woes hit the crude market, do not be surprised if prices go much, much higher.

Simplistically, we can compare natural gas and crude oil on an energy-equivalent basis – gas is priced in million British Thermal Units (mmBTUs) while crude oil is priced per barrel; each barrel of oil contains the energy equivalent of 5.8 mmBTUs of gas. Thus, we apply 5.8 as a multiplier on the price of gas to estimate the per barrel crude equivalent, although crude oil almost always trades a ratio greater than that because it is more useful than natural gas. Finally, I also looked at the price of crude by extrapolating its 2008 peak (assuming 2% inflation) and as a ratio to the price of gold to see the extremes that are possible.

	Peak Price	Crude Per Barrel Equivalent
UK Gas	£41/mmBTU	$320
European Gas	€45/mmBTU	$305
US Gas (Feb Henry Hub Peak)	$23/mmBTU	$133
2008 Oil Peak (2% inflation)	$148/barrel	$191
Gold / Crude Oil Ratio	7x	$257

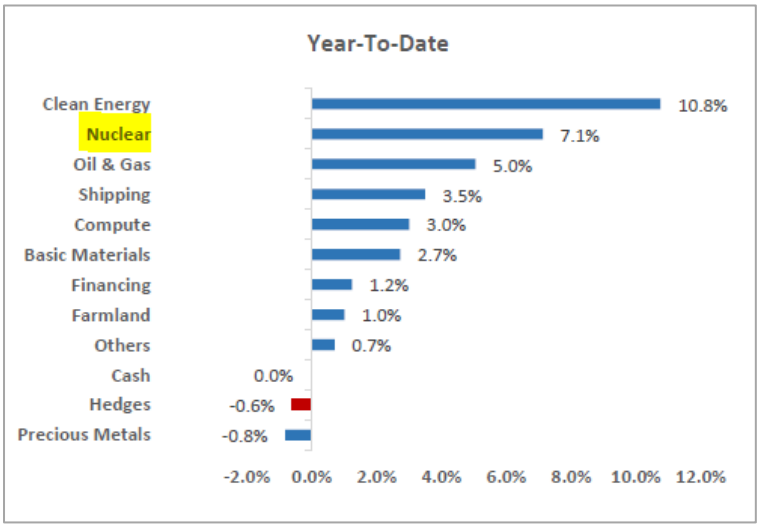
These numbers are not predictions for where crude oil will trade. Instead, we are pointing out that when markets are short something that is absolutely essential (eg food, energy, shelter), prices can hit hard-to-imagine levels. The energy market is not one that I would want to short.

The Fuse is Lit for Higher Uranium Prices

We have written about nuclear power and uranium in previous notes; you can read them in our July 2020, April 2020 and Year End 2019 letters. In short, even though nuclear power generates 11% of the world's power needs and uranium is undersupplied, the uranium's spot price trades well below its marginal cost of production; this is not sustainable and prices have to go much higher. In this section, we wanted to share about developments with the Sprott Physical Uranium Trust (SPUT, TSX: U-UN) and why we think it will catalyze higher prices for uranium.

Sprott is creating the uranium equivalent of GLD ETF for the gold market, giving investors an easy way to get exposure to the uranium market. If successful, the Sprott vehicle itself may add nearly 20% in annual demand for uranium oxide – that's how small the market is. This creates a positive feedback loop, where SPUT's demand catalyzes higher uranium prices, inducing more demand as other financial players enter, pushing up prices further. Higher prices increase the urgency of utilities to secure feedstock, fueling even higher prices, which then draws in even more capital to the space. Against a potential tidal wave of new demand in the short term for a market that only trades US$ 7bn of product a year, there is going to be virtually no supply response since mines take years to find, permit and build.

Specifically, SPUT launched an at-the-market (ATM) equity program in August, which allows the closed-end trust to raise additional monies to buy uranium. In the 2 months since, Sprott has had to upsize the ATM offering from US$ 300m to US$ 1.3bn, bought over 12 million pounds of uranium (8% of annual production), and drove prices up over 25% to US$ 37/pound. If SPUT continues to raise money at this rate, they will exhaust the ATM (US$ 800m remaining) in 2 months and purchase another 20 million pounds or 14% of annual uranium production.



Year-To-Date Performance Attribution

We have been a beneficiary of this development but we think there is more to go; this is the time to press our advantage rather than take our foot off the pedal. What Sprott is doing with SPUT is a game-changer, and if successful will spur copycats and draw much more capital into this space. This is on top of the macro tailwinds in the energy markets (higher prices across the board) and nuclear specifically (part of the solution to reduce carbon emissions). We like the asymmetric risk-reward in this sector, we think SPUT can be the catalyst for a re-rate and going forward will likely add to our portfolio allocation.

MBIA – Puerto Rico Resolution a Catalyst for Higher Share Price

In this section, we wanted to discuss another company we own, MBIA Inc (NYSE: MBI), with near-term catalysts for a re-rate. It is categorized in our "Financing" bucket and is a more esoteric investment but offers many of the characteristics we look for in the companies we like (substantial upside optionality, near-term catalyst, limited downside). MBIA has a market cap of under US$ 700m, book value of over US$ 1.6bn and around US$ 1bn in excess capital that may be returned to shareholders. We started investing in the company earlier in the year at prices just below $10; today it trades around $12-13 and we see upside in the mid-20s.

MBIA is an insurance company known as a monoline insurer. Within the insurance market, monolines provide a very specific type of insurance – they insure the timely payment of interest and principal on bonds issued by municipalities and structured finance vehicles. This helps the bond issuer reduce its cost of financing because insured bonds benefit from an improved credit rating. After all, investors in these

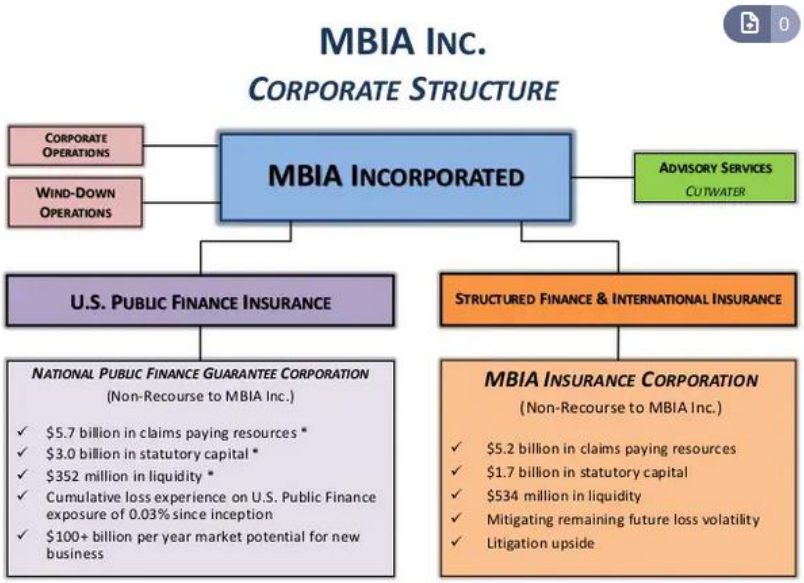
bonds now have two parties on the hook for principal and interest payments – first from the issuers themselves, failing which from the monoline.

Upside Optionality	1. Potential special dividend that exceeds market cap of MBIA (150% of MC) 2. Potential acquisition by Assured Guaranty (150-200% of MC) 3. Potential reinsurance by Assured Guaranty
Near-Term Catalyst	1. Exposure to Puerto Rico close to resolution
Limited Downside	1. Shares are trading at ~40% of book value 2. Company executing large share buybacks

The opportunity to invest in MBIA is many years in the making. Before the 2008 GFC, monolines were highly sought after by investors. They reinvested their insurance premiums into higher yielding instruments and consistently compounded their book value 10-15% each year. As a result, investors rewarded them by paying 10 to 20% premiums on top of book value for the equity.

The first strike against MBIA occurred when the ABS, CDOs and CLOs they insured imploded during the 2008 GFC. They had provided financial guarantees on these complex structured products that were ultimately exposed as junk, leaving the company on the hook for billions in bond payments. MBIA was effectively insolvent and its stock plummeted over 95% from its highs.

Because MBIA was also a big insurer of US municipal bonds, their structured product losses directly affected their ability to fulfil their obligations in the muni bonds they wrapped. This could potentially set off systemic risk issues if munis were downgraded and investors forced to sell. Long story short, this was not politically acceptable, and the company was restructured in 2009 into a GoodCo and BadCo and put into runoff mode. Their structured finance holdings were parked in the BadCo – allowing the holding company and the public finance subsidiary (National Public Finance Guarantee Corporation) to continue business as usual without the liability of the structured finance business.



MBIA stock staged a recovery, climbing from $2 in 2009 to $16 in 2013. Unfortunately, the second strike hit in 2014 when Puerto Rico, whose bonds MBIA insured, was downgraded and subsequently defaulted. This meant MBIA's public finance subsidiary was on the hook for over US$ 5bn of Puerto Rican exposures; once again investors deserted the company.

Yet despite the Puerto Rican fiasco, MBIA has been able to return over US$ 2bn to investors since 2014, including buying back over 70% of its shares. This was possible because MBIA's insured portfolio has been amortizing so fast (they are not writing new business) that their capital far exceeded the minimum statutory capital and claims-paying resources their regulator needed them to maintain. The company has consistently returned US$ 200-400m a year in dividends and buybacks from 2014 to 2020 while improving its leverage ratio (in blue below), even with the Puerto Rican situation on its hands. If not for Puerto Rico, we expect MBIA would be able to operate with a leverage ratio in the 30s and even more capital would have been returned.

	2013	2014	2015	2016	2017	2018	2019	2020
Statutory Capital	3,258	3,266	3,388	3,476	2,760	2,520	2,376	1,971
YoY	-	*0.2%*	*3.7%*	*2.6%*	*-20.6%*	*-8.7%*	*-5.7%*	*-17.0%*
Insured Portfolio	276,846	222,293	161,017	110,367	71,928	57,865	48,920	41,856
YoY	-	*-19.7%*	*-27.6%*	*-31.5%*	*-34.8%*	*-19.6%*	*-15.5%*	*-14.4%*
Distributions	214	254	417	224	443	156	235	279
Leverage Ratio	85	68	48	32	26	23	21	21

Leverage Ratio = Insured Portfolio / Statutory Capital

The good news and near-term catalyst is that Puerto Rico bonds are very close to getting restructured. When that happens, which will likely be in November this year for some of the bonds, uncertainty surrounding their Puerto Rican risk will go away and the company can apply to their regulator to release some of their excess capital to the parent. We estimate the excess capital to be at least US$ 800m and up to US$ 1.2bn. Puerto Rico's resolution also substantially increases the likelihood that Assured Guaranty, another monoline, considers acquiring MBIA at a premium to current prices, or even re-insuring the MBIA book, which should lead to a re-rate in its stock.

This is a convoluted invesment and not likely one that gets picked up by the Reddit / Wall Street Bets crowd. While there are still risks to this investment (eg. Puerto Rico restructuring falling through, future defaults by muni issuers), MBIA's cheap valuation, the likely and imminent resolution as well as the multiple ways money can be returned to shareholders make this a compelling investment for us.

Conclusion

In our March investor letter this year, we wrote:

> *…the market is structurally short commodities. Commodities had been the darling of investors in the 2000s and a key component of strategic asset allocation, in part driven by the Chinese-led boom in commodity demand. Over-investment in the go-go years and the GFC resulted in a collapse in commodity prices and an exodus of investor capital from the space. The energy sector's weighting in the S&P 500 has fallen from over 16% in 2008 to under 3% today. No doubt,*

this is due in part to climate change concerns and the push to diversify from fossil fuels. That said, this is unmoored from the reality that energy transitions take a long time and we will likely still be using fossil fuels for decades to come. The historically low capital allocation by investors to energy and commodities mean that should narratives change, there could be a rush by investors to re-allocate to this space, with potentially explosive impact on prices.

After the rally in industrial metals earlier this year and the recent surge in the energy complex, investors seem to be waking up to the realization that the market is structurally short commodities. Covid has accelerated this acknowledgement, both on the supply side via reduced and delayed production as well as on the demand side from government fiscal stimulus. Given that much of the world still has some Covid restrictions in place and air travel is less than half the peak levels in 2019, energy needs will only continue to rise in the coming 6 to 12 months as countries re-open. More imminently, the coming winter in the Northern Hemisphere will likely put the availability of energy supplies to the test.

The Cypress Fund's "Real Assets" strategy has benefitted from this shift in narrative, although we believe we are in the very early innings. For those of you who are more aggressive, we encourage you to consider increasing your exposure to the commodity sector – the upside from here is easily 3x or more as capital shifts into this space. After all, people need food to eat, energy to use, clothes to wear and homes to live in and Covid is forcing all of us to confront the reality of shortages in raw materials, energy and other essentials. After a decade of capital chasing high growth, asset-light tech companies, we believe the tide is finally shifting.

Once again, thank you for your support. We welcome your questions and feedback and we look forward to connecting again soon.

Sincerely,

Yongchuan Pan
12 October 2021

Theme	Thesis	Upside	Risks
Nuclear/Uranium	• Growing acceptance of nuclear as source of carbon-free energy • Growing demand and falling supply for uranium • Priced below marginal cost of production	100-500%	• Larger amounts of secondary inventory than expected • Another Fukushima
Shipping	• Extremely favourable supply dynamics for tankers and LPG vessels (old fleet, few new build orders) • Stocks trade at discounts to NAVs with large dividends (>10%)	100-200%	• OPEC+ production cuts • Recession
Basic Materials	• Adriatic Metals trading at substantial discount to NPV • Heavy insider ownership with likely takeout by current shareholder • Leverage to silver price without paying for it	50-300%	• Country risk • Construction risk • Lassonde curve
Computing Power	• Surging chip and tin consumption due to increasing demand for compute – automobiles, IoT, defence • Demand not priced in at all at current multiples; huge exploration upside for free	50-200%	• Recession • Idiosyncratic company risks
Precious Metals	• Protection against inflation and fiat debasement • Under-owned by official sector/central banks • Potential alternative to bonds – producers trade at high and growing free cashflow yields	100-300%	• Strong economy with low inflation • Regulatory risk • Challenge from crypto
Clean Energy Transition	• Climate change is driving energy transition; this shift to cleaner energy will rely heavily on electrification • Own highest quality copper producers levered to higher prices with exploration upside	100-500%	• Recession • Idiosyncratic company risks
Oil & Gas	• Energy transition will take longer than expected; fossil fuel use will remain for decades to come • Own producers and offshore service providers pricing in much lower crude oil and natural gas prices than in the market	50-200%	• Recession • Regulatory risk
Farmland	• Growing demand for food and improving productivity driving higher yield for farmland and hence valuations • Overlooked asset class, 20-30% discounts to fair value, dividend-paying	50-150%	• Recession • Poor harvests / climate anomalies
Financing	• Own equity in structured financing vehicles • Substantial upside with very limited risk	50-100%	• Opaque and hard to analyze • Narrative too complicated for most investors