OUR HEDGE FUND EXPERTS SPEAK THEIR MINDS:

WEEDS AMONG THE WHEAT

SILVERPEPPER COMMODITY STRATEGIES GLOBAL MACRO FUND

2Q 2023

Where's The Supercycle?

It's been difficult to see the Supercycle during the first six months of 2023. The Bloomberg Commodity Index (BCOM) is down 7.79% year-to-date, for the period ending June 30, 2023. And the SilverPepper Commodity Strategies Global Macro Fund (SPCIX) suffered even worse, falling 11.72% over the same period. Given the downdraft in commodity prices, people are asking: "Hey, where's my Supercycle?"

Supercycles, according to our research, last 15 to 20 years. We recognized the preconditions for a Supercycle back in 2020, and the market has affirmed our thesis, with the BCOM rallying 27% in 2021, and 16% in 2022. We are just three years into what we believe will be a long cycle of higher commodity prices. But the past 6 to 12 months have made clear that we shouldn't expect prices to trend upwards in one bold, straight line. Instead, commodities are reflecting Warren Buffet's observation of stock prices, that "in the short run, the market is a voting machine, but in the long run, it is a weighing machine."

So, don't get distracted by the short term, like many investors. Over the past 12 months since commodity prices have retrenched, we estimate about $29 billion has been pulled from commodity mutual funds and ETFs. Pulling the plug now on commodities reminds me of the great old story about Weeds Among the Wheat, where the fieldhands ask the farmer if they should go pull the weeds out of the wheat? "'No,' he answers, 'because while you are pulling the weeds, you may uproot the wheat with them. Let both grow together until the harvest. At that time, I will say: First collect the weeds and tie them in bundles to be burned; then gather the wheat and bring it into my barn.'" The past twelve months have been a period of weeds, and the harvest, I believe, is still in front of us. Let me explain.

The returns represent past performance. Past performance does not guarantee future results. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Call 855-554-5540 for current to most recent month-end performance.

SilverPepper

Where Did The Weeds Come From?

Several factors have combined to create downward pressure on commodity prices in the near term. They are:

Strong U.S. Dollar: Almost all commodities are traded in U.S. dollars (although this is becoming more tenuous every day). When the dollar is strong, it's more expensive for the rest of the world to purchase commodities. In the beginning of 2022, the USD Index was at 95. As the Federal Reserve Bank started raising rates in March of last year, and continued in earnest throughout the year, the dollar rose nearly 19%, to a high of around 113. As the dollar marched higher, we saw commodity prices peak, and then a more rapid commodities sell-off that began in June of last year, and continued through the first six months of this year. Only recently, as the banking crisis has unfolded, and the U.S. economy has started to show its vulnerability to recession, has the dollar sold off to about 102 today. I think the market is a bit bearish on the dollar, at the moment. But count me among the bears who think the dollar will fall in the long-term, particularly as the Fed nears the end of its hiking cycle.

Nagging inflation and rising interest rates: Inflation, as Milton Friedman said, "is always and everywhere a monetary phenomenon" — a problem of too much money chasing too few goods. During the Lockdowns, both the Trump and Biden Administrations, as well as many governments across the globe, used fiscal policy and monetary policy to stimulate their economies. These policies have created a persistent and nagging inflation. The abundance of money chasing too few goods, especially in the face of supply-chain disruptions and war, has allowed inflation to roar. Now, inflation traditionally causes commodity price increases, and it did that in the first half of 2022. But, with short-term cash now paying 5%, investors can choose to hold commodities, or instead, capture a sure 5% in short-term Treasury Bills. The cost, of holding physical assets versus paper assets, is one of the reasons investors have withdrawn capital from the commodity sector.

China's Unlocking: China, since the 1970s, has been the engine to which commodity demand has been tied. China's exit from its self-imposed Zero-Tolerance Virus Policy is taking longer than expected, humbling China's growth outlook for 2023, and putting near-term pressure on commodity prices. Inventories were built up in expectation of a quicker rebound, and it's taking longer than expected to deplete the buildup.

These factors, and others, are the weeds that are drawing attention from the fertile conditions we see, long term, for commodity prices.

Weigh The Underinvestment In Commodities

Just as Mr. Buffett "weighs" stocks, long-term commodity investors must weigh the impact of insufficient supply, relative to existing inventory, production capacity, and expected future demand. We believe the deciding factors in future commodity prices will be insufficient supply, and the concurrent lack of capital spending, and reinvestment, in more mines, wells and acreage. We believe we must weigh these dominant long-term factors in contemplating the existence and length of the Supercycle.

SILVERPEPPER COMMODITY STRATEGIES GLOBAL MACRO FUND INSTITUTIONAL MONTHLY RETURNS (%)

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YEAR
2013											0.10	0.00	0.10
2014	-0.30	0.00	0.50	0.00	0.10	0.70	- 0.69	0.00	- 1.59	- 0.61	- 1.43	- 3.41	- 6.59
2015	-0.43	-1.72	-1.42	1.11	-0.11	0.33	-2.52	-0.67	-1.13	-0.23	-0.57	0.00	- 7.17
2016	-0.46	-0.23	1.51	0.69	-1.48	3.00	-0.22	-1.57	1.17	0.45	0.78	1.11	5.30
2017	0.33	-1.31	-1.66	-1.69	-2.06	-0.70	1.99	0.81	0.80	1.25	-0.67	0.86	-2.12
2018	2.35	-3.29	-1.13	1.72	2.25	-3.74	-1.83	-1.28	0.35	-1.65	2.03	-4.11	-8.30
2019	5.41	0.98	-0.85	-1.59	-1.61	1.39	-0.99	-2.38	0.90	1.53	-2.13	3.94	4.34
2020	-6.79	-2.91	-5.46	-0.72	2.03	0.71	6.22	6.13	-4.27	-1.18	6.76	4.60	3.95
2021	1.07	5.52	-4.68	9.46	3.20	0.93	1.84	-0.20	4.23	2.42	-3.87	1.32	22.50
2022	8.30	3.89	8.98	2.16	0.86	-10.48	1.38	1.89	-8.44	-2.36	4.38	-5.41	3.13
2023	-1.63	-4.98	-0.63	-1.92	-5.70	2.76							-11.72

One-Year Return as of 06/30/2023	-19.52
Five-Year Annualized Return as of 06/30/2023	2.51
Total Annualized Return Since Inception, (11/1/2013)	-0.08

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Beginning in about 2010, we saw declines in capital expenditures, which are a marker for future production. This reduction, at the time, was understandable, as the economic recession spurred by the financial crisis of 2008 slowed demand. Prices began falling for many commodities — some below the marginal cost of production. So, with such low prices, investing in more capacity was a money losing business. Higher prices, however, are usually the most potent cure for undersupply. However, price signals are being muted by government policy preference, permitting and pipeline refusals, and economic sanctions on Russia and other countries. For example, environmental, social, and governance (ESG)-style policies in many countries are hampering investment in fossil fuel exploration and production. Keep in mind, 196 countries signed the Paris Agreement, all of whom are committed (on paper at least) to reducing carbon emissions. This affects the prices of both crude oil and natural gas. From the looks of it, capital expenditures for oil peaked in about 2014, at nearly $650 billion. Since then, they've averaged about $410 billion per year. That's a big decline.

Compare what is actually being spent with the amount the International Energy Forum asserts will be needed: "a cumulative $4.9 trillion… between 2023 and 2030 to meet market needs." That's about $700 billion per year. And it's not just for exploration, but for the other essential ingredients — pipelines and refineries will also require investment capital. But, getting an allocation of capital of that size will be hard. Drillers don't want to invest in long-term projects, which have long payback periods, if states, like California, are going to outlaw combustion engine cars by 2035. And, if you study some of these energy transition plans floating around, you'll see, to get to net zero by 2050, oil and gas usage must be reduced by 50% to 100%. Allocating capital with that kind of demand forecast is feasible, but it will require much higher prices to offset the risk. Indeed, even though I am a long-term bear on the dirtier fossil fuels like oil and coal, energy demand is increasing globally. During the next five to 10 years, supply and demand imbalances will cause price spikes and create enormous opportunities for commodity investors. As one astute investor has observed, "one person's required return is another person's cost of capital."

On the other hand, there is plenty of capital available to flow into green energy projects.

The Biden Administration's "Inflation Reduction Act" delivers about $400 billion in federal funding to clean energy initiatives, in the hopes of lowering carbon emissions. This means increased funding for mining (copper, lithium, nickel, cobalt, aluminum) to make electric cars and wind turbines. And more acreage for biofuels production.

This capital has already made an impact on our energy mix. For example, consider the input changes in Texas' energy grid. In just the last year, wind and solar have grown from 8% to 30% of the energy mix, while natural gas has increased from 30% to 55%, and dirty coal has fallen from 30% to 13%. Unfortunately, green-energy ambitions are also meeting up with market realities. Copper, for example, is a significant input to electrification. Electric cars require four to six times more copper than gas powered cars. But two countries, Peru and Chile, currently mine about 40% of the world's copper. And, in Peru, production has plateaued, as political instability, government permitting problems, and protests have increased. And, Chile is preparing a new constitution that is expected to increase the role of government, resulting in more regulations, higher tax payments, and increased royalty payments. Therefore, despite willing capital, can these obstacles be overcome? And if so, how long will it take to get these essential commodities to market? I am bullish on the commodities that will drive the green-energy transition (including natural gas), but over the next five to 10-years there will be short-term price drops as production ramps up ahead of the actual transition. Investment opportunities will be plentiful.

Yes, I am very supportive of the energy transition. Yet, I realize this tug of war between fossil fuels, which are extant and reasonably affordable, versus green energy sources, which are more expensive and will take more than a decade to fully build out, will create a fascinating and dynamic period for commodities markets. This environment will create plenty of investment opportunities, and fortunately, it will play to our strengths of astute supply and demand analysis and rigorous risk management. Oil and gas must remain operational to support current consumption. Green energy investment capital will be a tailwind for metals and biofuels, until a balance is found. Despite the challenges on both sides, the best signal for capital allocation and innovation will be rising prices. This is what we will be watching.

How We Are Set Up In A Bid To Profit

We believe that this is a perfect environment for us, as it plays to our strengths: 1) active management; 2) using our "Fingernails-in-the-Dirt" research to understand the supply and demand fundamentals of each individual commodity; and 3) proactive risk management, that allows us to use options and short positions, in an attempt to reduce risk, and potentially profit from the volatility in the market, or the downward move of some commodities.

Our portfolio constantly differs from the Index, because of our research. We actively go out into the corn, coffee, or oil fields to conduct research. And that fingernails-in-the-dirt research directly impacts how we structure the portfolio. We structure the portfolio by favoring, or overweighting, those specific commodities that we believe offer us the best risk and reward tradeoff. Second, we think long term, and our long-term vision has historically paid off. Since our Fund's inception more than nine years ago, we have delivered better returns than our Index, with less risk. Better returns with less risk is an attractive outcome.

Structured To Harvest Gains

As a result of our longer-term viewpoint, the portfolio continues to be positioned to benefit from a rise in most, but not all, commodities. At the end of the second quarter, we had 114% gross exposure to investments. 92% of our exposure was long commodities, ranging from aluminum to zinc. We took short positions in Brent Crude, as well as a small short position in a Canadian natural-resources company, for a total short position of about 6% of assets. And, as is fairly typical, our largest commodity-related position was currencies, where we had about 15% of gross assets invested in a short U.S. dollar position, versus other commodity and trade-related currencies. As we said, we believe the dollar is facing a long-term decline, which will support long-term global demand for commodities.

From a technical perspective, the BCOM, which is a broad-based index representing 24 underlying commodities, has been trading in a range of 98 to 102, after hitting a Ukraine War high of 140. Our price analysis model classifies this range as extreme undervaluation. We expect the asset class may grind up to a new multi-year high, with a price target of 150 to 175 over the next couple of years. The correction we are seeing right now is reminiscent of the 2020 capitulation, where investors threw in the towel. We think this recent low makes for a good place to add exposure, with a five to 10-year horizon.

Flame Out In Natural Gas

Natural gas has been a stalwart position of the Fund during past years, contributing nicely to returns. However, in the first half of 2023, it has been a bruiser to the Fund's returns. In fact, our position, which was about 10% of assets, accounted for about 60% of the Fund's total losses during the year-to-date period, as natural gas fell from about $4.44 Bcf (British cubic feet) at the start of the year, to $2.27, as of June 30.

In retrospect, I got two things wrong. First, the entire world stocked up on natural gas, in 2022, preparing for a cold winter, buying everything in sight, and shoving it in storage. This hoarding of natural gas, particularly in Europe, was planned to offset vulnerability to Russia's potentially withholding natural gas deliveries, and in response to the mysterious sabotage and destruction of the Nordstream pipeline. In actuality, winter ended up being mild. And in Europe, conservation efforts ended up being robust, as thermostats were reset, and streetlamps turned off. Instead of tight supplies, Europe came out of winter with abundant supply.

Second, we predicted a hotter than normal summer, according to our weather and geologic analysis. Our prediction proved accurate — we are seeing increased demand for natural gas shift from winter months to summer months, simply because summers are getting hotter. Although the hot summer weather has increased demand, it wasn't enough to keep prices from falling all the way to $1.94 Bcf in March, before rising 30%, to today's current prices of $2.60 Bcf. Despite the hot weather, prices stayed under pressure, as electric-grid operators drew down natural gas supplies from storage, and the supply of alternative energy sources coming into the grid, primarily solar and wind, and some nuclear, muted a price response in natural gas prices.

In light of all these events, we reduced our natural gas exposure during the first half of the year by nearly 50%, but we were still overweight. The reason the overweight remains, is because I calculate fair value at $5.0 Bcf. I think it's cheap at current levels. Production costs for natural gas are up. Just like other products and services, natural gas producers are experiencing higher input costs, ranging from financing costs, to labor and equipment costs. In fact, although I believe fair value to be about $5.0 per Bcf, my long-run demand models may support prices up to $7.0 Bcf. I must admit, in the near term, our positioning has proven to be a bit of a value trap. But we do expect prices to work their way higher. The majority of our position is held in the winter- and summer-month futures contracts for the next two years, in contrast to the near-term, and more volatile front-month contract. It might take a bit of time to hit our expected price levels, since there is still a storage overhang. Right now, storage is estimated at 2.8 Tcf (trillion cubic feet), which exceeds the 5-year average of 2.5 Tcf. So, we are backing off of our future price target from $7 to $10 Bcf, but holding firm for now on $5 Bcf. So, at the current level of $2.60 Bcf, we see modest risk and the potential to move from $2.60 Bcf per contract to $5 Bcf.

Range Bound Crude

Crude oil provides gasoline, diesel, heating oil, and airplane fuel, not to mention byproducts like asphalt. Right now, we view crude oil as range-bound, between $65 to $85 per barrel, with the capacity to hit $90, later this year. If you look at inventory levels outside of the Strategic Petroleum Reserve (SPR), they are in line with 5-year averages. To address falling prices, OPEC+ has been reducing production. They cut 1.0 million barrels a day back in October of 2022, and another 1.6 million in April. They recently backed another 1.0 million reduction at their June 5th meeting. But, with concerns about recession in the U.S. and Europe, and with China's economy sputtering, the supply reductions haven't done much to lift prices, which have declined from $80 per barrel for WTI Crude at the beginning of the year, to about $70, as of June 30.

Given our range-bound expectations, we expect to trade the range and look for relative value trades in the oil market. Since the WTI/Brent spread has narrowed from $5.0 to $3.95 per barrel, we see more value in WTI crude. Therefore, we ended the month with a 16% long position in WTI Crude (which is about twice that of the Index) and had a 4% short position in Brent Crude, which overall, was a bit underweight the total crude exposure of the Index.

Grains Satisfy The Hungry Heart

At the end of June, we were overweight almost all agricultural commodities, with the exception of corn. There are about 270 million acres of land for row crops in the U.S. At the end of May, the USDA released "planter intentions," which indicated farmers would plant 92 million acres of corn, 87 million acres of soybeans, 50 million acres of wheat, and a few more million in barley, rice, and other crops. Now, with the very dry weather across the Midwest, in early spring, and continuing until the beginning of June, there were concerns that planter intentions might exceed actual plantings. That's because American farmers have the option to enter "Prevent Plant," a government plan that pays the farmers if they can't get a crop planted on time. However, farmers love to plant corn. So, we were underweighting corn.

That proved to be prescient, as actual plantings of 94 million acres exceeded expectations, by 2 million acres. With this outlook, corn prices have declined from about $6.60 per bushel, to about $5.50 per bushel. However, it's important to keep in mind that the size of the crop is a function of both acreage, and yield. It's not until 55 to 60 days after silking, that corn is fully developed. So, our general take on corn prices is bearish, as inventory could swell to over 2 billion bushels this season, depending on the actual harvest. Another thing that could also hurt prices is the expected reduction of exports. China, in order to reduce its dependence on U.S. agricultural exports, has been busy buying from South American farmers, especially the Brazilians. So, we are positioned with outright long futures positions. And we also have bought put options to help hedge against the downside, as well as purchased some long call exposure, to give us additional exposure, if the rugged weather imperils the harvest.

The Gift Of Finest Wheat

Wheat is also a crop that is garnering our attention. We hold positions in Chicago Wheat, Kansas City Wheat, and Midwest Wheat. Each futures contract represents a different kind of wheat, and each trades on different exchanges. Generally speaking, the different wheats — Soft Red Winter Wheat, Hard Red Winter Wheat, and Hard Red Spring Wheat — have differentiated planting and harvest periods. They have different levels of protein content. They have different commercial uses, ranging from baking bread or crackers, to producing starches, or even adhesives.

Wheat has been stuck in a sideways-pattern, as tight supply expectations in the U.S. markets are being offset, primarily by Russian plantings. Russia raised its production estimate by 3.5 million tons, to 85 million tons (all for winter wheat), because of ideal growing conditions. Nevertheless, the U.S. has a shortage of high-protein wheat, stemming from drought in the Southern Plains states. Finally, the outlook is clouded by the Russia/Ukraine War. In particular, uncertainty remains around Ukraine's ability to produce and distribute its wheat harvest, which was about 30 million tons in 2021. And, the outlook is increasingly complicated, with Russia recently reneging on the Black Sea Grain Initiative, which would have allowed Ukrainian grain to flow to Africa, Asia, and the Middle East. Right now, we are positioned for increased prices, with long futures positions in all of the wheat contracts. But we also have a hedge in place, with long put options on the more liquid Chicago Wheat Contracts, just in case we get more supply than expected.

We Will Gather The Wheat, And Bring It Into The Barn

For the past few months, at our Fund, there have been metaphorical weeds growing among wheat. But, if any of you are farmers, like me, or back-yard gardeners, you know, that as much as you try and try — there will always be weeds. Commodities are complicated and varied resources. Sometimes you simply must tolerate the weeds, knowing, that if you pull them too early, you uproot the valuable wheat. So, we are biding our time. And we will pull the weeds after the crop can be safely harvested. That's our plan.

More ➤

Thank you for being an investor. We hope you will continue to ride the Commodities Supercycle with us for many years to come.

Warm regards,

Renee Haugerud

Portfolio Manager

Performance as of 06.30.23 (Annualized Returns)

Inception Date: 10.31.13	YTD	1-Year	3-Year	5-Year	Since Inception
SilverPepper Commodity Strategies Global Macro Fund Inst	-11.72%	-19.52%	9.92%	2.51%	-0.08%
Bloomberg Commodity TR USD	-7.79%	-9.61%	17.82%	4.73%	-1.09%

Investors should carefully consider the Fund's investment objectives, risks, charges and expenses. Please see the prospectus for a complete discussion of the risks of investing in this Fund. To obtain a prospectus, please call 855-554-5540 or visit silverpepperfunds.com. The prospectus should be read carefully before investing. All investing involves risk including the possible loss of principal. There can be no assurance that the Fund will achieve its investment objective.

The Fund's specific risks include futures/commodities risk, derivatives risk, Subsidiary risk, high-fee risk, tax risk, foreign investment risk and non-diversification risk. Futures contracts may fluctuate significantly and unpredictably over short time periods and commodities are subject to disruptions and distortions, causing loss of principal. All these risks may increase costs, volatility and lower performance. See the prospectus for a complete discussion of investing in this Fund.

As of June 30, 2023, the notional exposure of futures and/or options consisted of Natural Gas, 10.07%; Currencies, 15.17%; Brent Crude Oil, -3.58%; WTI Crude Oil, 15.63%; Corn, 2.75%; Chicago Wheat, 3.36%; Kansas City Wheat, 2.12%; and Midwest Wheat, 0.11% of the SilverPepper Commodity Strategies Global Macro Fund's total net assets. Portfolio holdings are subject to change without notice and are not intended as a recommendation.

The Bloomberg Commodity TR Index: As of December 2022, this widely used Index is made up of 24 exchange traded futures contracts on physical commodities which are weighted within the Index to account for economic significance and market liquidity.

Definition: A basis point is equal to 1/100th of 1 percent, such that 100 basis points are equal to 1 percentage point.

Standard Deviation is a statistical measure of risk that measures the volatility of returns around a mean, or average return. In general, the higher the standard deviation, the greater the volatility of returns. If a portfolio had a mean (average return) of 10% and a standard deviation of 2%, you would expect the portfolio's return to fall within 6% and 14%, 95% of the time. The SilverPepper Commodity Strategies Global Macro Fund's standard deviation since inception is 10.92, or approximately 25% lower than the Bloomberg Commodity Index's standard deviation of 14.34.

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