Svelland Capital

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Four experts after a year of war and extreme markets: - Many investors do not understand how serious it still is

The war in Ukraine has changed the world economy and financial markets forever, say manager Tor Svelland and Pareto partner Nadia Wiggen. They have no doubts about where they should be invested now.

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- I didn't think the war would last so long and change the world so much, says hedge fund manager Tor Svelland. (Photo: Elin Høyland)

Martin Kvaernes and Mikael Holter

One year has passed since Russia brutally invaded Ukraine, an action that sent shockwaves through the energy and commodity markets.

Only half a year earlier, hedge fund manager Tor Svelland had warned that the world was heading full speed into an energy crisis. But even he was surprised by how big the consequences of the war were for the world economy and markets.

- I did not think the war would last so long and change the world so much. Now protectionism in many countries has increased, with individual nations thinking more about their own security of supply than being a stable supplier of raw materials to other countries, says Svelland.

Many have pointed out that globalization is being reversed in several areas. The sanctions against Russia are well known. On the raw materials and energy front, Svelland also points out that Mexico will limit the export of oil products, while Indonesia is considering limiting coal exports. Peru and Chile's exports of copper are now also at risk.

- It can put the entire electrification under pressure. Going forward, it is quite clear that you must be invested in everything related to raw materials. One must nevertheless be prepared for the fact that we may have periods of large fluctuations and falling markets.

Bigger and more dominant

Last year was characterized by extreme fluctuations in oil and gas prices, where the latter in particular went off the hinges. However, since the gas price peaked last summer, it has fallen to the lowest level in a year and a half.

Svelland warns against thinking that it is due to balance in the commodity market.

- The gas market was already tight before the war broke out. To say otherwise is just nonsense. When Germany lowers the temperature in all buildings and you shut down parts of the industry, it is clear that the price will go down. The world has also been lucky with the weather and that the reopening in China has been slow. The world was simply lucky, says Svelland.

Svelland points to the reopening in China as the single most important factor for oil and gas prices going forward.

- The reopening will take time. It is a total misunderstanding to think that a country of 1.4 billion people can just press a button and the wheels will be in motion already on the first Monday after the New Year. We will know more about this in the next four to eight weeks.

The oil price is now around 80 dollars, lower than before the war. Svelland points to so-called CTA funds - algorithm-managed funds that trade based on trends - as one of the main reasons why oil prices are not higher. In addition, there are heavily leveraged funds that are forced to sell off.

- These players are getting bigger and more dominant, and it becomes clearer with each passing day how much influence these funds have on the market. They force large movements that almost no one understands, not even big and well-known investors. The market has been partially destroyed and has not followed the fundamental conditions, and that is the core of the market right now, says Svelland.

Håkon Haugnes, partner and CFO of the commodity-oriented investment company Andurand Capital, believes that part of the explanation for lower oil prices is that there are fewer oil specialists trading in the market now than before, so that too much emphasis is placed on cross-term variables and macroeconomic noise.

- Something is not right in the oil market. If you look at it from above, there is a reopening in China, maximum oil production in almost all countries, and an end to the supply of oil from strategic storages in the USA. Important variables for the oil price are not observable at the moment and will probably come to light during the next quarter, says Haugnes.

Andurand Capital is founded by the well-known hedge fund manager Pierre Andurand, who recently spoke out in the Financial Times and said that Vladimir Putin has lost the energy war. Haugnes and Andurand do not believe that Russia will return as a stable supplier of raw materials to Europe, but they also do not believe that Russia will be a big loss, as long as Europe remains focused.

- We have to be very careful about continuing to build the gas stocks so that we have enough for next winter. The energy transition must continue, and this will have major repercussions in the raw materials sector. That means higher carbon prices, fluctuations in the oil price and the repricing of a wide range of assets, says Haugnes.

Over 100 dollars

Russia's oil production has long been at full capacity after the country succeeded in redirecting the oil to countries such as India and China, but recently Russia launched a production cut of 500,000 barrels per day as a response to the West's price ceiling on Russian oil and Russian oil products. Before that, Russia still exported over eight million barrels per day, over four times as much as Norway.

Nadia Wiggen, analyst and partner at brokerage Pareto Securities, foresees Russian oil production falling sharply, but that is a few years ahead. Much depends on the American oil services company Schlumberger, one of the few Western companies that still has not pulled out of the country.

- Our main scenario is that production will fall by several million barrels within six years. It takes resources to maintain old fields, and to develop new fields you need good technology. The market has not taken enough account of that.

Wiggen points to China as the main reason why Western Europe has fared better than expected, as the Chinese shutdown made more liquefied natural gas (LNG) available to Europe. On top of this, many industry players found alternatives to gas.

- It is not that the war did not have an effect on Europe, but it was less than feared. Our expectation is a strong reopening in China in the second half of the year. China still buys relatively little crude oil, but once they start buying, the oil price will probably be pulled higher than USD 100 again, says Wiggen.

In the long term, Wiggen is very concerned that China may come to support Russia more actively. The countries are important trading partners, but China has not yet taken a clear position on the war in Ukraine.

- The geopolitical situation in the world is very precarious, and how this relationship develops will have great significance for the world economy, she says.

Svelland agrees.

- It is very worrying. I really hope China takes a neutral position. Anything else will be negative for world trade. It's just another example of why you have to be active and not invest in indices, he believes.

Last year ended with a return of 46.6 per cent for Svelland Capital, which has around NOK 2.4 billion under management. So far this year, the fund has a return of around eight percent. Svelland believes an important reason for the success is that the raw material and shipping markets are under-analysed and misunderstood.

- There are many people who do not understand the physical market. Many investors do not understand how serious it still is, as long as the market still has a normal demand. We may receive a message this afternoon that Russia will further cut oil production. A mild recession will not be enough to destroy raw materials, says Svelland.

He also believes the metal market will do very well.

- We have been through a weak period, but it will tighten up in the future. Oil, metals and shipping must be owned, because there has been underinvestment over many years. There is also no capital in the market available to build many new ships or start new mining operations.

Prolonged inflation?

When the war broke out, the general view among analysts and investors was that the main effect of the war on the broad stock market would be increased inflationary pressures, which could exacerbate an inflationary problem that at the time was only growing bigger and bigger in almost the entire world.

- It is not that the war created inflation, but it has made the inflation problem even more complicated. It was a problem, then it became a bigger problem. Today, only four percent of the world's countries have inflation below two percent, and that is certainly a long way down for many, says Pål Ringholm, investment director at PKH.

Ringholm fears that inflation will seriously take hold in wages and create a long-term inflation problem, as was experienced in the 70s. In any case, he believes that it will be difficult to get inflation down to the long-term target of two percent without the world economy suffering major damage.

- Seen over several hundred years, there has never been greater trade in the world, but something has happened. What happens in geopolitics going forward will affect trade. Things can happen that we don't even want to think about, and then we can get the biggest results in the markets.