Annual Letter 2023

KUYLENSTIERNA & SKOG S.A.
ASSETMANAGEMENT

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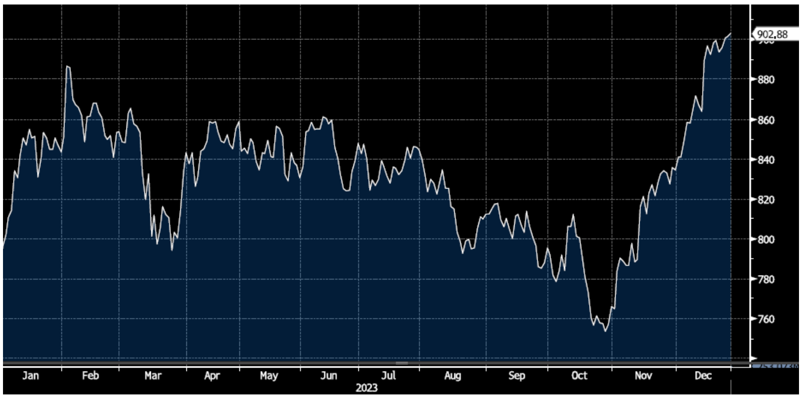
In 2023, we once again witnessed significant movements in the global financial markets. Investors closely monitored central bank actions, weighing their words to determine whether the economic conditions would remain favourable or if we were headed into a recession as household and business expenses increased due to rising interest rates and other costs. The hopes for lower inflation and interest rates specifically contributed to a strong finish for stock markets.

Geopolitical tensions also influenced financial markets, causing human suffering as several conflicts escalated.

The development around AI gained considerable attention and the "fantastic 7" had a notable impact on the US stock markets.

Market Development

The year began with a sharp rise in stock markets, driven by expectations of lower inflation and a resilient economy. Spring statistics revealed a weaker economy while inflation continued to rise more than expected, particularly in the service sector and within shelter. Despite a significant drop in commodity prices and changing consumption patterns, certain sectors like travel and hotels remained stable.

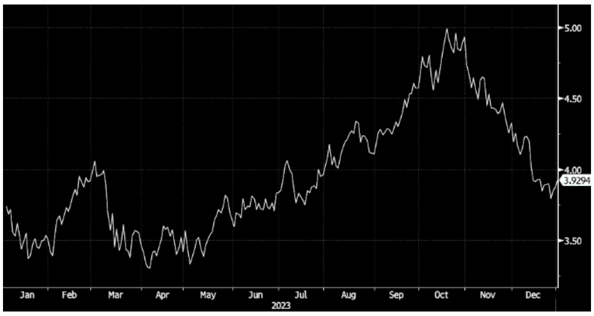


Central banks implemented frequent interest rate hikes in spring, impacting smaller US banks and leading to the rescue of Credit Suisse by UBS. Rising costs for households, including increased electricity bills, food prices, and mortgage expenses, accompanied the challenging situation in the banking system. High-leverage real estate companies and smaller businesses with financing needs also faced pressure, contributing to substantial stock market declines in March.

As summer approached, data indicated a decrease in the inflation rate. However, weaker economic figures emerged, prompting the Federal Reserve (FED) to hold off on further interest rate hikes, anticipating a mild recession towards the year-end. Sweden experienced declines in both GDP and the Swedish krona. The negative news raised hopes for more accommodative central banks, resulting in rising stock prices.

Market sentiment reversed again after summer, primarily due to more hawkish central banks coupled with stronger economic outlooks, increasing the likelihood of new interest rate hikes. The FED, however, maintained its interest rates unchanged, while the

Swedish Riksbank and the ECB implemented new hikes. Unemployment continued to rise in Sweden.



By the end of October, stock markets bottomed out, with the Stockholm Stock Exchange down around 4% for the year, while the US 10-year Treasury bond peaked at around 5%. Poor employment figures, declining inflation, and lower interest rates fuelled the markets in the last months of the year. The FED, the Riksbank, and the ECB all kept their interest rates unchanged while adopting softer tones in their comments.

About…

Real Estate

The Swedish real estate sector faced challenges due to a higher interest rate environment, impacting the cost of financing for many companies. Housing construction declined, and a potential future shortage, combined with lower interest rates, could evolve into an attractive environment for those navigating the tougher times.

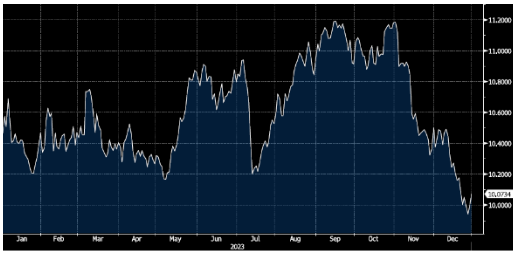
Sweden, often portrayed as highly leveraged and interest-rate-sensitive, has a property ownership culture, with most Swedes owning the properties they reside in. Outside Sweden, concerns arose about office properties in the US and the real estate crisis in China.

Central Banks

Central banks walked a thin line, attempting to reduce inflation without plunging into a deep recession with increased unemployment as a result. The effects of interest rate hikes have a significant delay on the real economy and could be compared to manoeuvring a fully fuelled super tanker. Central banks were also faced with incorporating behavioural changes related to the pandemic into their models.

Currencies

The Swedish krona weakened against both the euro and the dollar in the first half of the year. The Riksbank faced a challenging situation where a weak krona led to imported inflation. The relationship between raising the policy rate to strengthen the krona was questioned, as foreign investors believed it could excessively cool the Swedish economy. In the second half of the year, the krona strengthened, ending the year almost unchanged against the euro and stronger against the dollar.



Geopolitical Situation

Geopolitical tensions increased during the year with ongoing wars and conflicts in Ukraine, Israel and Hamas, China, Taiwan, and the USA to mention some. Combined with disruptions in logistic chains due to the pandemic, this led to increased protectionism and a desire to secure access to military, technology, and other critical system resources.

Company reports

Expectations for companies were relatively high throughout the year. Global industrial companies experienced strong demand, while other sectors, such as consumer discretionary, faced more challenges. Swedish major banks showed good profitability with low credit losses.

Tech, AI and Semiconductors

The seven major tech companies (magnificent seven) in the USA were the drivers of the positive stock market development. The evolution of AI was a major catalyst during the year. The full effects of AI are, of course, hard to predict, but we are confident that it will play a central role for companies and individuals going forward – "AI will not take your job, someone using AI will."

China

Chinese markets faced significant declines during the year, influenced by ongoing repercussions from the pandemic, concerns about the real estate and banking sectors, high youth unemployment, strained relations with the USA, and political unpredictability.

2024 Outlook:

The market expects low inflation, reduced interest rates, low unemployment, and a strong economy in 2024. While the first two are considered likely, there is a perceived risk with the latter two.

Smaller companies may become an interesting theme for the year, but caution will be taken, avoiding companies with high financing needs and the risk of rights issues. 2024 is an election year, with half of the world's population heading to the polls, including the US.

Expectations include the continuation of megatrends such as electrification, the significant shift away from fossil fuels, automation, and energy efficiency. Significant investments in the defence and security industry, both physical and digital, are anticipated.

Lastly, our belief is that AI will continue to play a significant role in 2024, with its development seemingly limitless and potentially contributing to increased efficiency and productivity.