INVESTING IN STOCK MARKETS OF COMMODITY- AND COPPER-EXPORTING COUNTRIES

EXECUTIVE SUMMARY

In this report, we will focus on translating global economic trends into a major investment theme in our firm's portfolios: investing in single-country equity Exchange Traded Funds (ETFs) of commodity-exporting, and specifically, copper-exporting countries. We will explain why copper is one of our favorite commodities and talk about countries that are likely to benefit from increases, or even expected increases, in the price of copper. Readers of the report will virtually travel with us around the world: from the copper mines of Chile and Peru to the copper smelters and warehouses in China, Arizona, and Utah. We will also visit the final consumers of the copper and other commodities in the United States, China and all the way along railroads, roads, ports and other infrastructure projects that are being built within the Chinese-led *One Belt One Road* initiative throughout Africa and Asia. We will also consider risks to the global economic growth emanating from US monetary and fiscal policies as well as from the battlefields of the Syrian multi-party civil war and from the tense standoff on the Korean peninsula.

- The first part of the report focuses on forecasts of the accelerating economic growth in the largest countries around the world. The report discusses the US corporate tax cut as a major catalyst for the acceleration of the economic growth in the US and around the world. It talks about the "reshoring" trend that has already seen many US companies move production and other operations back to the US from abroad. We think that this trend will accelerate as companies move back to take advantage of the lowered US corporate taxes.

- The second part of the report focuses on the drivers of investment in commodities and Exchange Traded Funds (ETFs) of commodity-exporting countries as demand for commodities is likely to increase due to the corporations' move back to the US after the passage of the corporate tax. However, we will explain our belief that aging factories in the US are not appropriate for the production of modern products. In our opinion, these factories will have to be totally retrofitted or new factories will have to be built. These "corporate infrastructure" projects will increase demand for commodities, especially, industrial metals such as copper. Valuations of commodities, which currently range from low to reasonable, will increase as these projects are built. Prices of ETFs of commodity-exporting countries are likely to benefit from higher commodity prices.

- The third part of the report focuses on potential catalysts for the increases in prices of single-country ETFs of copper-exporting countries, which represent some of our largest current investments at Beyond Borders Investment Strategies. Some of these catalysts include a potentially higher price of copper due to upcoming negotiations in 2018 between owners of copper mines responsible for 40% of the world's copper ore production and trade unions in Chile and Peru, two largest copper-exporting countries. It also talks about the impact of the increased environmental regulations on refined copper production and curbs restrictions on scrap copper exports to China, the world's largest consumer of copper, on the price of copper. We think that these new regulations would exert an upward pressure on the price.

- The fourth part of the report focuses on risks to the global economic expansion and our investment scenarios that are dependent on this expansion. These risks include the US Federal Reserve Bank raising rates too fast or too high in its fight against accelerating inflation, the US dollar strengthening against other currencies, potential US tariffs on steel and aluminum, the multi-party civil war in Syria, and the tense standoff on the Korean peninsula.

BOSTON, MA – 02/28/18 – The year of 2017 was an excellent one for stock markets around the world. Out of 49 markets that we cover around the world, stock markets of only two countries had negative total returns. [1] However, as Andrew Grove, one of the founders and the CEO of Intel Corporation, who helped to transform the company into the world's largest manufacturer of semiconductors, said in his famous book *Only Paranoid Survives*, "Business success contains the seeds of its own destruction." As a result of stock market surge during 2017, valuations of many stock markets moved from cheap to expensive. At Beyond Borders Investment Strategies (BBIS), we do not expect stock markets to generate the same returns in 2018 as they posted in 2017. In our opinion, stock markets of countries around the world will demonstrate a more "normal" pattern with mixed returns.

Below is our discussion of most important economic trends that helped us determine country asset allocation in BBIS investment portfolios for 2018.

1. SYNCHRONIZED WIDE-SPREAD ECONOMIC GROWTH AROUND THE WORLD

In the October edition of the World Economic Outlook database, the International Monetary Fund forecast that in 2018, markets of the overwhelming majority of countries, 186 out of 192 covered, would have positive returns. [2] The only six countries that were forecast to have negative growth could be characterized as too small to impede the global economic growth and have clear country-specific reasons that make economic growth difficult, such as political strife, civil war, the aftermath of hurricane devastation, or low participation in labor force due to medical epidemics. [3] In the 2019 forecast, the number of countries with negative growth dropped to five. [4] The 2018 and 2019 forecasts look like an extrapolation of the 2017 economic growth when only 13 countries, none of them large in terms of their contributions to the global economic growth, were forecast to have negative economic growth. [5]

Four Engines of Economic Growth: As we wrote previously, we believe that only four countries/blocs responsible for more than 5% of global GDP can spark global economic growth. These four engines of the global growth are US (24.7% of the world's GDP), Euro Area (15.8%), China (14.9%), and Japan (6.5%) *(see Chart 1 for the largest components of the global economy).*

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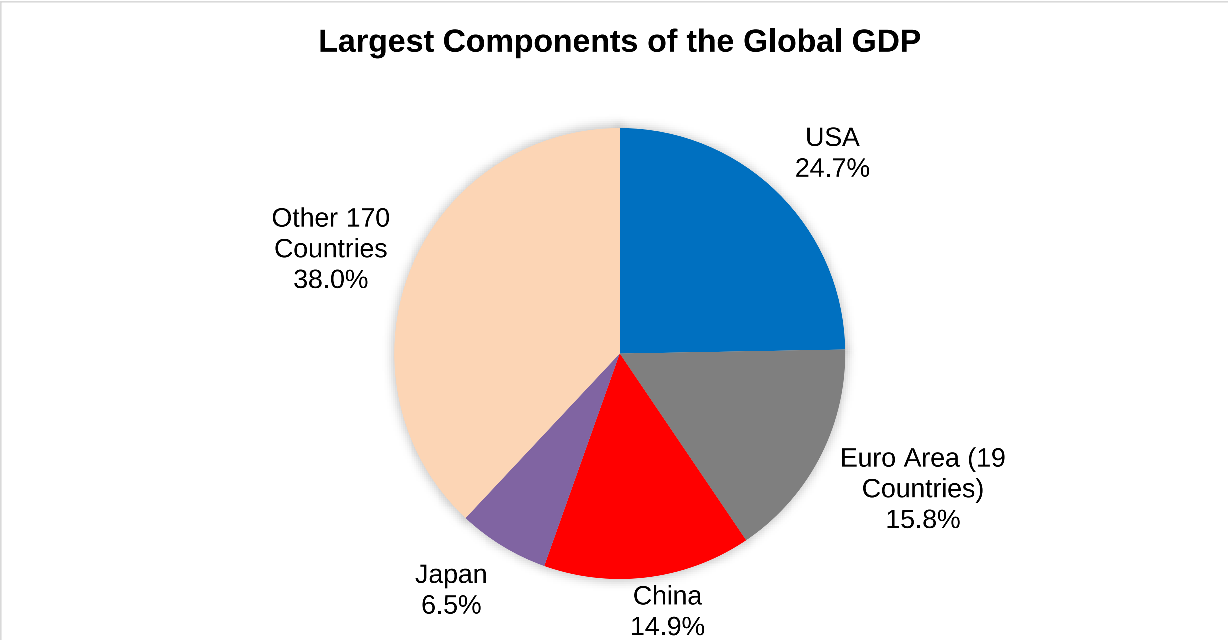
[1] These countries were Qatar and Pakistan. Performance was measured for the country-specific MSCI indices.
[2] The International Monetary Fund, World Economic Outlook Database, October 2017.
[3] Ibid. These countries include from best to worth: Swaziland, Puerto Rico, South Sudan, Nauru, Venezuela and Equatorial Guinea.
[4] Ibid. These countries include Libya, Republic of Congo, Puerto Rico, Venezuela and Equatorial Guinea.
[5] These countries included Oman, Iraq, Azerbaijan, Suriname, Brunei Darussalam, Yemen, Kuwait, Puerto Rico, Trinidad and Tobago, Republic of Congo, South Sudan, Equatorial Guinea and Venezuela.

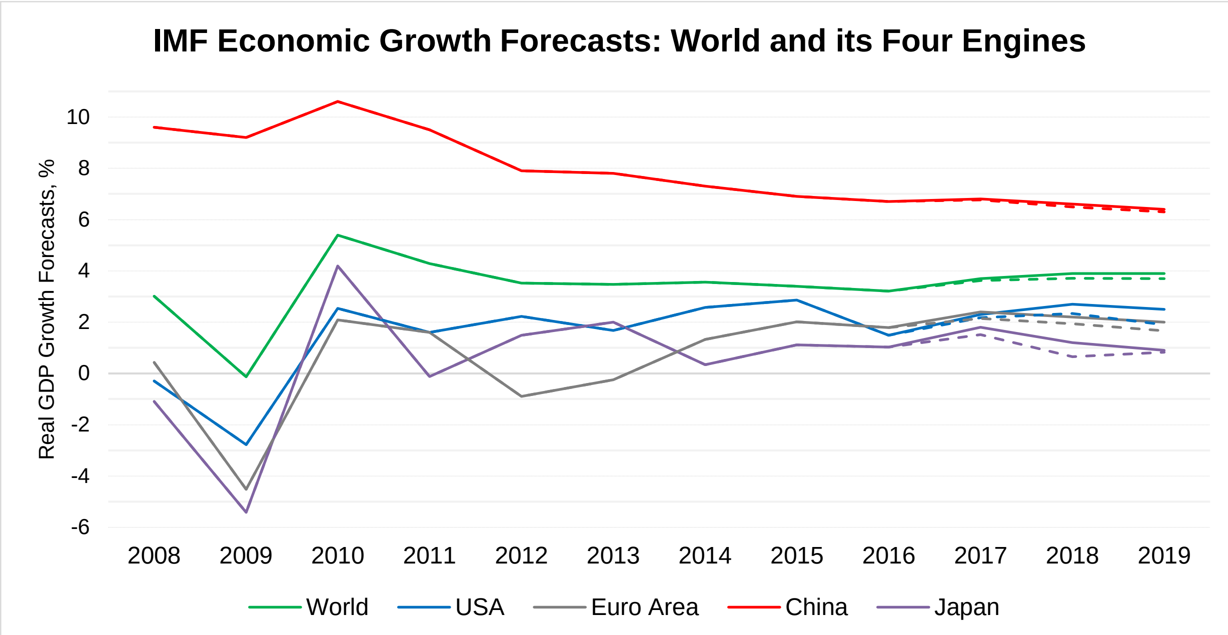
Chart 1. Largest Components of the Global Economy



Source: International Monetary Fund, World Economic Outlook Database, October 2017. All values are calculated as GDP ratios measured in the current US Dollar values as of the end of 2016, the last year with actual (not forecast) GDP values.

All of these four countries and blocs were forecast to have positive growth in 2018 and 2019 by the International Monetary Fund in its October 2017 World Economic Outlook database. What is very important growth rates for 2018 and 2019 for all of these regions and the world were increased in the January 2018 World Economic Outlook Update *(see Chart 2 where October 2017 forecasts for 2017-2019 represented by punctured lines and January 2018 forecasts by solid lines).*

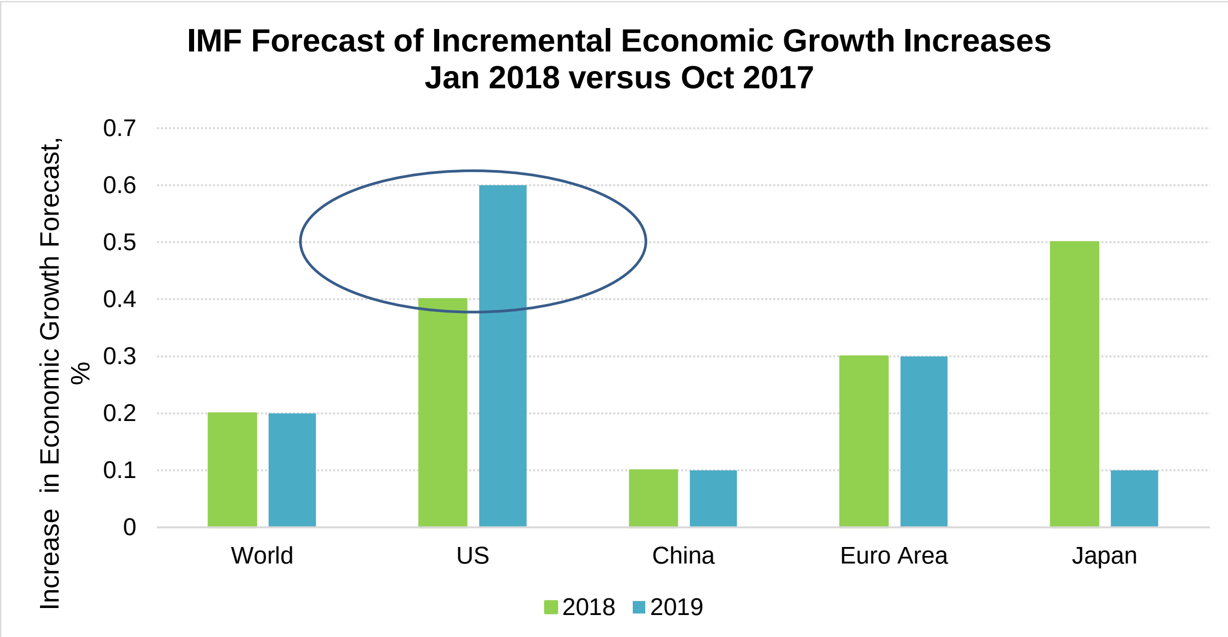
Chart 2. IMF Economic Growth Forecasts: World and Four Engines



Sources: The International Monetary Fund, World Economic Outlook Database, Gross Domestic Product, Constant Prices Series, October 2017. The International Monetary Fund, World Economic Outlook Update, Gross Domestic Product, Constant Prices Series, January 2018.

Chart 3 demonstrates that the US forecasts in the January 2018 World Economic Outlook Update were increased for 2018 and 2019 more than forecasts for the other regions. In our opinion, the US tax reform is the reason for the highest increase in the GDP growth as it increases competitiveness of the US companies.

Chart 3. Increases in IMF Forecasts of Economic Growth in January 2018 vs. October 2017



Sources: For October 2017 Forecasts - The International Monetary Fund, World Economic Outlook Database, Gross Domestic Product, Constant Prices Series, October 2017. For January 2018 - The International Monetary Fund, World Economic Outlook Update, January 22, 2018.

US TAX REFORM AS A CATALYST OF THE GLOBAL ECONOMIC GROWTH

Large and Medium Business Optimism: In our opinion, the US tax reform is the largest catalyst for the increased forecast of the economic growth in the US, and through the international trade links, in other areas around the world. The tax reform is likely to significantly increase competitiveness of US companies by cutting corporate taxes from some of the highest levels in the world to much more competitive levels. Before the tax reform, the US had the fourth highest corporate tax rate out of 202 countries around the world. [6] The US statutory corporate tax rate of 38.91% was surpassed only by tax rates of the United Arab Emirates (55%), Comoros (50%), and Puerto Rico (39%). The US had by far the highest corporate tax rate among the 35 members of the Organization for the Economic Cooperation and Development (OECD), an organization focused on promoting "policies that will improve the economic and social well-being of people around the world." [7] (*see Chart 4 for corporate tax rates in OECD member countries)*. Under the old tax regime, the US statutory corporate tax rate of 38.91% was more than 15% higher than tax average tax rate of 23.75% in the other 34 OECD countries. In percentage terms, the US taxes were almost 64% higher than those in the other OECD countries. It was not surprising that for decades US and foreign companies chose to have manufacturing facilities, offices, call centers, and other operations in countries with lower taxes.

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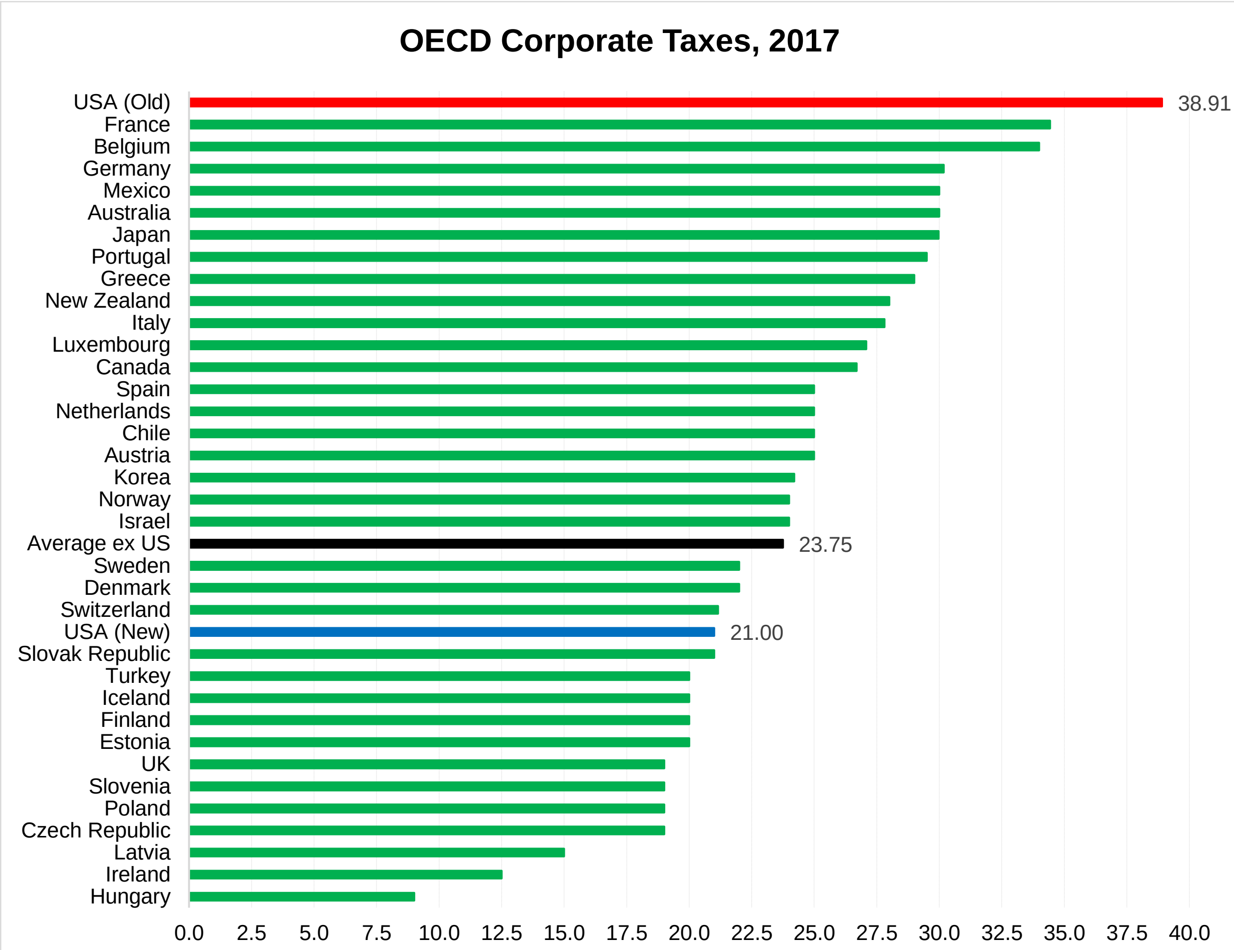
[6] Kari Jahnsen and Kyle Pomerleau, Tax Foundation, "Corporate Income Tax Rates around the World, 2017," September 2017.
[7] Mission of OECD. Downloaded on January 31, 2018.

Chart 4. Corporate Tax Rates for OECD Member Countries



Source: Organization for Economic Co-Operation and Development (OECD), OECD Tax Database. Downloaded on February 4, 2018. Added the new USA tax rate adopted at the end of December 2017. Highlighted USA old and new taxes.

We expect that under the new corporate tax regime, the US reshoring trend will accelerate. As a reminder, "reshoring" is the process of transferring a business operation that was moved overseas back to the country from which it was originally relocated. A number of large US companies have already started moving cash back to the US that they previously held abroad in order to avoid paying the 35% corporate tax, in addition to varying state and local taxes. Moreover, under the new tax law, companies that make a one-time repatriation of cash from abroad will be taxed at a rate of 15.5% on cash holdings and 8 percent on non-liquid assets, which is lower than the new 21% corporate rate. [8] These large companies are planning to use a large portion of this cash for expanding their operations in the United States. Furthermore, we think that a significant number of large, medium, and small US companies will build new facilities and expand their domestic workforce. Below are

[8] Daisuke Wakabayashi and Brian X. Chen, The New York Times, "Apple, Capitalizing on New Tax Law, Plans to Bring Billions in Cash Back to U.S.," January 17, 2018.

several examples of these companies from diverse industries such as Technology, Auto Making, Biotechnology, and Energy.

- **Apple Inc.** unveiled plans to bring back the vast majority of the $252 billion that it held in cash abroad and to make sizable investments in the US. Apple announced that it would put a portion of the funds toward 20,000 new jobs, a new domestic campus, and other in-country spending. [9] These 20,000 new jobs would represent a 24% increase in Apple's US jobs. It currently has about 84,000 domestic employees. [10] The company also added that it would spend more than $30 billion on capital expenditures in the United States over the next five years. [11]

- **Fiat Chrysler Automobiles N.V.,** citing the new tax law, is planning to invest more than $1 billion to modernize the company's Warren Truck Plant in Metro Detroit, adding 2,500 jobs and moving production of its Ram Heavy Duty trucks from Mexico. [12] Importantly, according to a recent report by MAPI Foundation, which conducts research on the economic impact of manufacturing, for every dollar of domestic manufacturing, another $3.60 of value-added is generated elsewhere. Expressing the multiplier in terms of jobs, for each full-time equivalent job in manufacturing dedicated to producing value for final demand, there are 3.4 full-time jobs created in non-manufacturing. [13] These jobs are created in areas such as manufacturing and transportation of inputs (e.g. steel, wires, auto parts, gas, and electricity), as well as in transportation, sales rentals, warehousing, and maintenance of the manufacturing companies' final products. Applying the investment and job multipliers to Fiat Chrysler, its investment is equivalent to $4.6 billion and 11,000 jobs in terms of total economic impact and jobs.

- **Amgen Inc.,** the world's largest independent biotechnology firm headquartered in California, announced in January 2018 that it would build a new plant in the United States after the passage of the corporate tax cut. The company is planning to invest up to $300 million and hire up to 300 workers for the new facility. [14]

- **Exxon Mobil Corporation** announced $35 billion in new US investments over the next five years, attributing the decision to the US corporate tax cut. According to the announcement made by the company in February 2018, it is planning to invest $50 billion in the United States overall, $15 billion of which had been announced earlier. [15]

The investments are not limited only to US companies. Some major foreign manufacturers announced their plans to invest in the US in a major way.

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[9] Ibid.
[10] Ibid.
[11] Ibid.
[12] Eric D. Lawrence, USA Today, "Fiat Chrysler moving some production back from Mexico," January 11, 2018.
[13] Daniel J. Meckstroth, MAPI Foundation, "The Manufacturing Value Chain is Much Bigger than You Think," February 2016.
[14] Eric Palmer, Fierce Pharma, "Part of Amgen's tax savings to go into $300M U.S. biologics plant, 300 new jobs," February 6, 2018.
[15] Reuters, "Exxon plans major U.S. investments due to tax reform: CEO," January 29, 2018.

- **Volkswagen Group**, a German automaker, announced in January 2018 that it was planning to invest $1.2 billion in the United States to restore relevance of its brand that was significantly damaged by the diesel-emissions scandal in 2015. [16]

- **Electrolux AB**, a Swedish multinational home appliance manufacturer, announced in January 2018 that it would be investing $500 million in the U.S. product innovation and manufacturing. [17]

- **Aisin Drivetrain, Inc**., a Japanese manufacturer of automotive and heavy equipment parts, announced in February 2018 that it would invest more than $16 million and create 47 new jobs in its production facility in Indiana by the end of 2018. [18] The manufacturer will produce parts for Toyota and Lexus cars.

Small Business Optimism: The optimism is not limited to large US and international businesses. According to the January 2018 Small Business Economic Trends report by the National Federation of Independent Business (NFIB), *The Small Business Optimism Index* jumped to one of the highest levels in January 2018 and set a record in one of its ten components with the number of small business owners saying *Now Is a Good Time to Expand*. [19] Thirty two percent of the survey participants stated that *Now Is a Good Time to Expand*, the highest level in the 45-year history of the NFIB survey (*see Chart 5 for Now is a Good Time to Expand levels*). [20] Business expansions usually include hiring people and capital expenditures on equipment and facilities. The sentiment of small business managers is important because small businesses, or businesses with fewer than 500 employees, are responsible for 48% of private sector employees in the US. [21]

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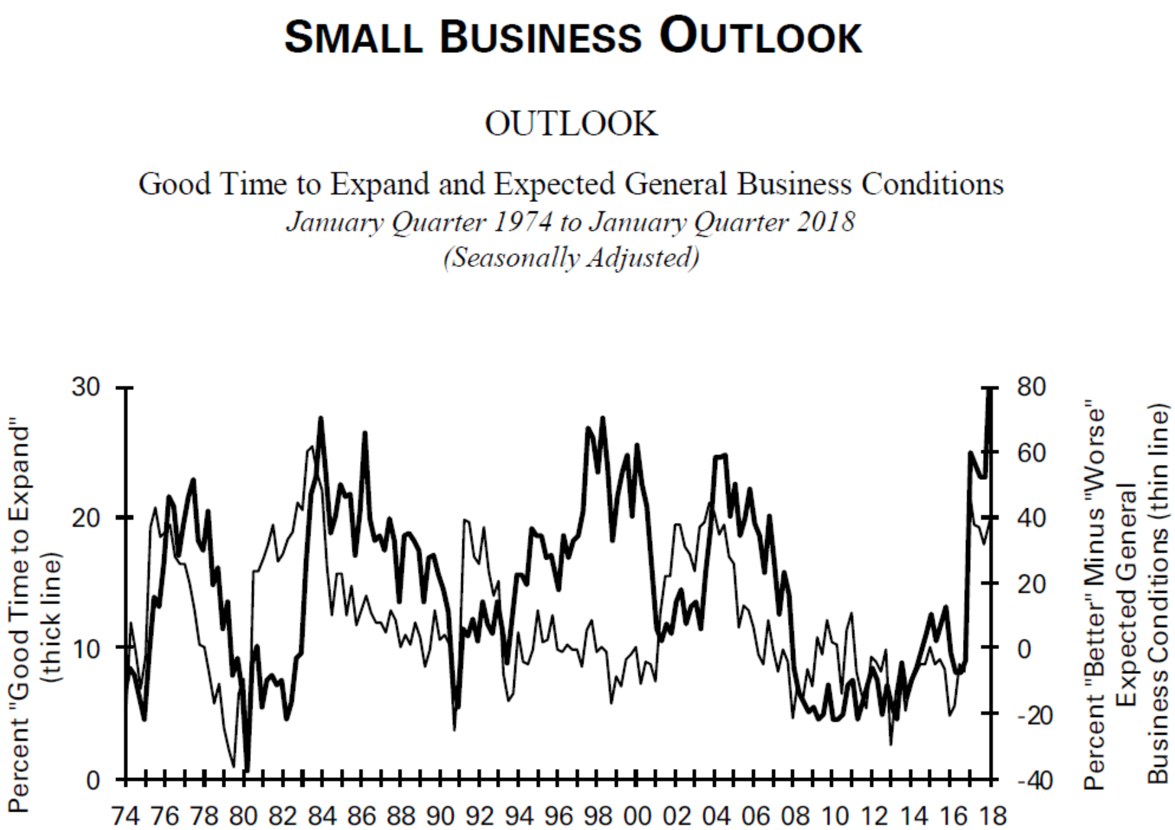
[16] Elizabeth Behrmann, Bloomberg, "VW Brand to Invest $1.2 Billion in Quest for US Relevance," January 14, 2015.
[17] Investors Hub, "Electrolux Investing $500 Million in U.S. Product Innovation and Manufacturing, Also Consolidating Production," January 30, 2018.
[18] Area Development, "Japan-Based Aisin Drivetrain Expands Operations in Crothersville, Indiana," February 8, 2018.
[19] William C. Dunkelberg and Holly Wade, NFIB Small Business Economic Trends, January 2018.
[20] Ibid.
[21] US Small Business Administration, Office of Advocacy, "Frequently Asked Questions," June 2016.

Chart 5. NFIB Small Business Outlook: Good Time to Expand and Expected General Business Conditions



Source: William C. Dunkelberg and Holly Wade, NFIB Small Business Economic Trends, January 2018.

American Worker Bonuses: In addition to businesses, individuals are also benefitting from the corporate tax cuts, and we are not even talking about personal tax cuts that were a part of the tax reform package. According to a tally compiled by Americans for Tax Reform group, more than four million American workers will or have received special bonuses in the wake of the tax reform. The group compiled a list that had 401 US employers that announced tax reform bonuses, raises, or 401(k) hikes after the passage of the corporate tax rate that cut corporate taxes from 35% to 21%. [22] These extra bonuses are likely to further increase consumption, economic growth, and investments needed to produce extra goods in the US and global economies.

[22] List of Tax Reform Good News, Americans for Tax Reform, https://www.atr.org/list. List downloaded on February 24, 2018.

2. DRIVERS FOR INVESTING IN COMMODITIES & COMMODITY-EXPORTING COUNTRIES

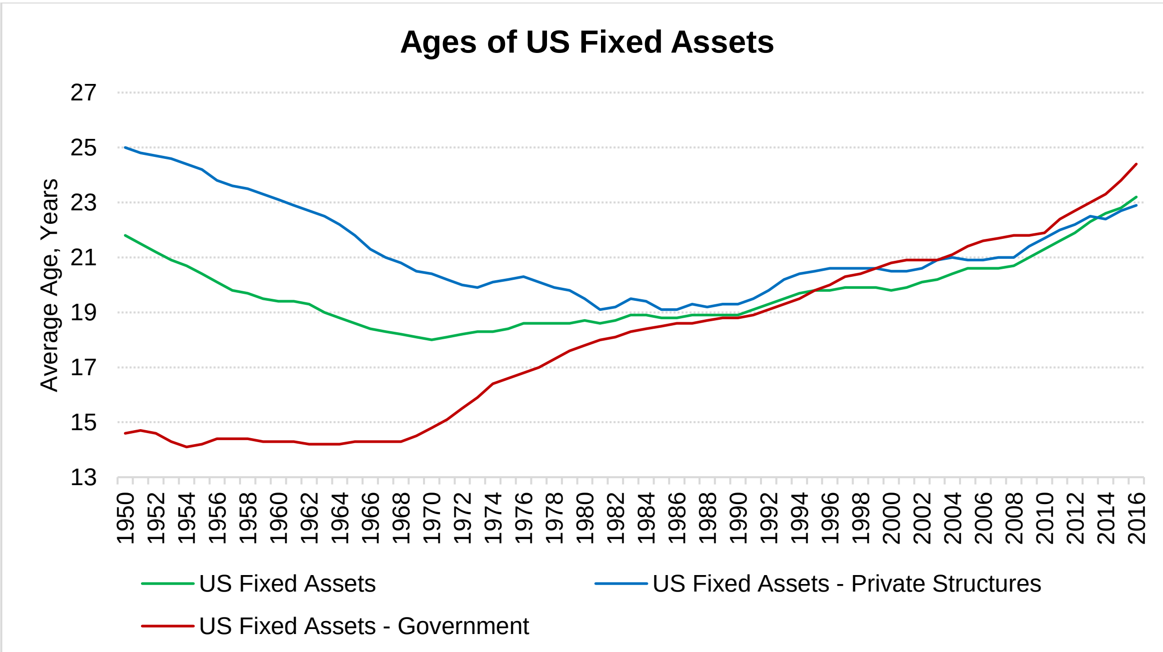
Below are seven reasons that make investing in commodities and by extension in equity Exchange Traded Funds (ETF) of commodity-exporting countries attractive in 2018.

1. **Accelerating Economic Growth Mainly Due to the US Corporate Tax Cut:** We believe that due to the corporate tax cuts, increased production and consumption, the US real GDP may grow in 2018 in line or even faster than 3.1% and 3.2% it posted during the second and third quarters of 2017, and definitely faster than 2.6% that it posted during the fourth quarter of 2017. [23] In our opinion, the lower real growth during the last quarter of 2017 reflected lower investments and consumption by businesses and individuals due to serious concerns about the chances of the corporate and personal tax reform package's approval by the Congress.

2. **Aging US Fixed Production Assets:** While the reshoring has started in earnest, US fixed production assets are old in absolute and relative terms. As a reminder, according to the US Bureau of Economic Analysis (BEA), "fixed assets are production assets that are used repeatedly, or continuously, in the processes of production for more than one year. BEA's estimates of fixed assets cover structures, equipment, and intellectual property products that belong to the private sector and government." [24] According to the BEA, the age of private structures, which are fixed assets with the longest life that include manufacturing plants and factories, power plants, mining structures, and transportation and health care facilities, is high (22.9 years as of 2016) in the absolute terms and is the highest in relative terms over the last 57 years since 1961 *(see Chart 6 for ages of the US fixed production assets and private structures).* [25] Since the mid-1980s, when US corporations moved production offshore, investment in domestic production facilities slowed and their age started to creep up. The age of all US fixed assets, both private and government-owned, is even higher than that of private structures and is the highest since the BEA started measuring it in 1950. The age of government fixed assets, which include infrastructure, defense, and other assets is also the highest since 1950. We will return to the discussion of the age of government assets in the section on the *US Infrastructure Initiative* below.

[23] Bureau of Economic Analysis, US Department of Commerce, "National Income and Product Accounts Gross Domestic Product: Fourth Quarter and Annual 2017 (Advance Estimate)," January 26, 2018.
[24] Bureau of Economic Analysis, US Department of Commerce, "NIPA Handbook: Concepts and Methods of the U.S. National Income and Product Accounts," November 2017, Chapter 2, page 2-3.
[25] Bureau of Economic Analysis, US Department of Commerce, "Relation of Private Fixed Investment in Structures (by type) in the Fixed Assets Accounts," August 9, 2017.

Chart 6. Ages of US Fixed Production Assets, Private Structures, and Government Fixed Assets



Sources: US Bureau of Economic Analysis. Data downloaded via Thomson Reuters on January 31, 2018.

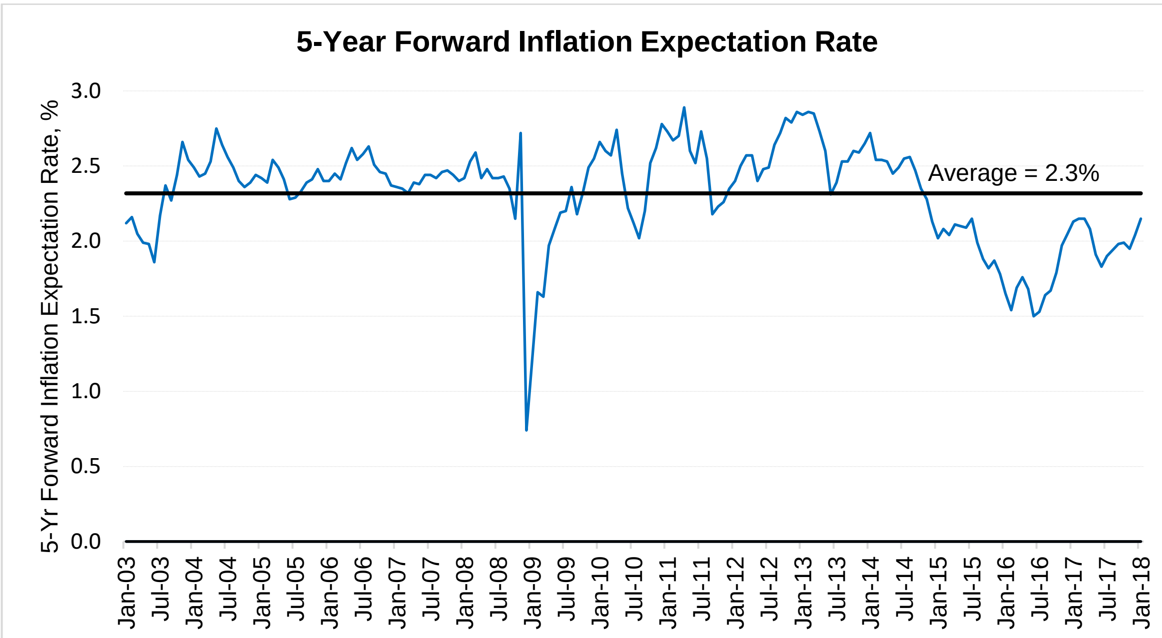
This brings us to one of the most important investment conclusions in this report. The US and foreign corporations that are planning to increase their US production would not be able to produce modern goods in old plants and factories without totally retrofitting them or building new ones. At most, the corporations would be able to use the exteriors of the old structures, while totally replacing equipment and re-wiring the facilities. These efforts would require various industrial metals for construction and energy commodities for fueling production in these new facilities. We think that the price of copper, which is ubiquitously used in wiring for both buildings and industrial equipment, is likely to experience upward pressure from the accelerated economic growth during 2018.

3. **Commodities as Protection against Inflation:** Investing in commodities, and equities of commodity producing firms and countries, also makes sense because commodities serve as hedges against inflation as their prices usually increase as inflation in large economies increases. In other words, commodities, or real assets, serve as a protection against the loss of purchasing power of such liquid investment asset classes as currencies and fixed income investments. The increasing economic growth, low unemployment, shrinking output gap are all likely contributing factors to the increasing inflation in the United States. As the 5-year breakeven forward inflation rate forecast demonstrates, investors expect inflation to increase to 2.15% over the next five years. [26] The expected inflation is a touch above the Fed's target

[26] A breakeven inflation is calculated as the difference between the yield of a nominal bond and an inflation-indexed bond of the same maturity. In this case, the breakeven inflation rate represents a measure of expected

rate of 2% and slightly lower than the average expected rate of 2.3% for the 15-year period from January 2003 to January 2018 *(see Chart 7 for the breakeven 5-year forward inflation expectation rate*).

Chart 7. Breakeven 5-Year Forward Inflation Expectation Rate, %



Source: Federal Reserve Bank of St. Louis, FRED Graph Observations, Federal Reserve Economic Data. Downloaded via Thomson Reuters on January 15, 2018.

4. **Commodities as Late Cycle Stars:** Commodities, commodity-related stocks and single-country Exchange Traded Funds (ETFs) of commodity-exporting countries often outperform at the end of economic cycles. At these times, business people, confident in economic expansion, have already hired new employees and are willing to spend capital with a long-term investment horizon on acquiring fixed assets, such as buildings and equipment. We believe that the global economy is in the late cycle expansion for the following reasons. As *Chart 2* demonstrates, the global and US economies have been expanding since 2010, making it one of the longest economic recoveries on record. The average length of the economic expansion in the US during 11 business cycles since 1945 was 58.4 months, or a little bit less than 5 years. [27] According to the National Bureau of Economic Research's monthly data, that is more granular than the annual data in *Chart 2*, the latest expansion of the US economy started in June 2009. [28] As of the end of January 2018, the current expansion

inflation derived from 5-Year Treasury Constant Maturity Securities and 5-Year Treasury Inflation-Indexed Constant Maturity Securities.

[27] The National Bureau of Economic Research, US Business Cycles Expansions and Contractions, http://www.nber.org/cycles.html. Downloaded on January 31, 2018. In Chart 2, which is based on the annual data, the expansion started in 2010.

[28] Ibid.

of the US economy was 8.67 years long, making it third longest expansion since 1945. [29] The longest expansion was a 10-year expansion that lasted from March 1991 to March 2001 and ended with the bursting of the Internet bubble. [30]

As demonstrated by *Chart 2*, China's economy has been expanding since even earlier. The Euro Area's economy has been expanding since 2014 as it has been recovering since after the European Sovereign Debt Crisis. Japan's economy has been expanding since 2012, the year when Prime Minister Shinzo Abe was elected and started implementing his pro-growth economic policies named *Abenomics* after him. [31]

5. **China's *One Belt One Road* Initiative:** China's ambitious program of connecting close to 70 countries in Asia Pacific, Europe and Africa via new infrastructure links continues to be a driver for prices of commodities, especially industrial metals. According to analyst assessments, the total cost of the initiative's infrastructure projects will reach from $4 to $8 trillion. [32] [33] According to the World Economic Forum as of June 2017, the *One Belt One Road* initiative already has $1 trillion worth of projects underway, including major infrastructure works in Africa and Central Asia. [34]

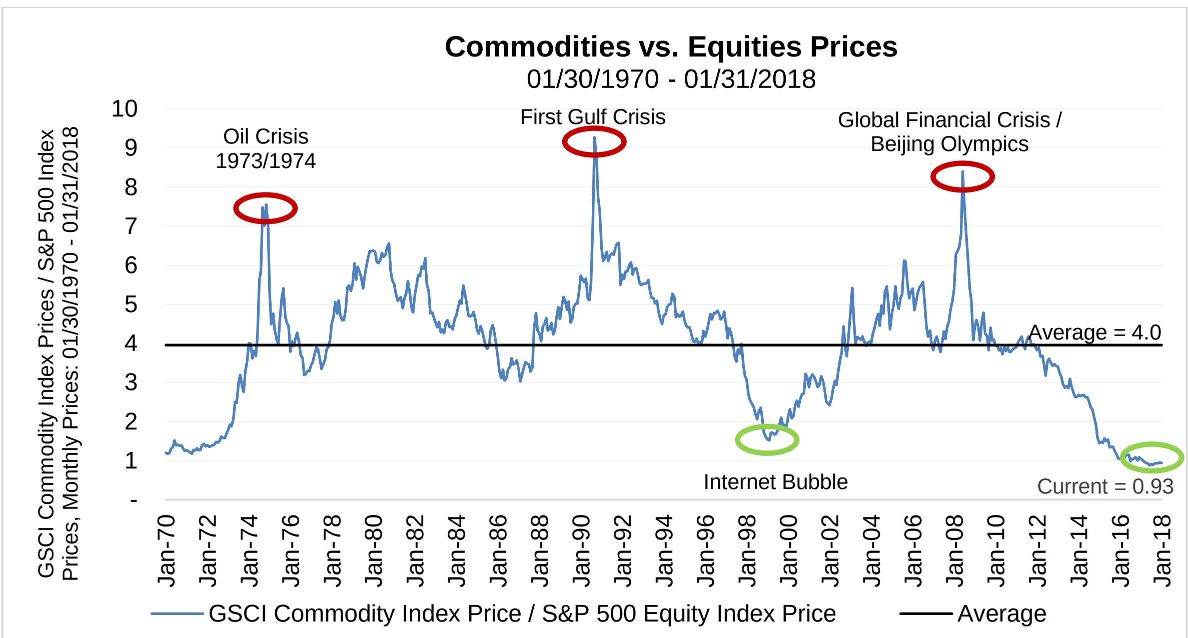
6. **US Infrastructure Initiative:** President Trump announced his goal of dedicating $200 billion in Federal funds to spur at least $1.5 trillion in infrastructure investments over the next 10 years with partners at the state, local, tribal, and private level. [35] There is a clear need in infrastructure improvement in the United States. In its 2017 America's Infrastructure Report Card, the American Society of Civil Engineers once again gave the US infrastructure a D+ grade, hardly a vote of confidence. [36] The age of the US government fixed assets, which includes infrastructure, has been increasing quickly and is the highest since the Bureau of Economic Analysis (BEA) started measuring this statistic in 1950 *(see Chart 6 for the age of the US government fixed assets).* Critics of the initiative have said that it would put a huge burden on local governments without providing enough federal funds. [37] If the legislation is approved by the Congress, it would result in higher commodity prices, especially those of industrial metals. Although Congressional approval of this project is far from certain, even speculation about the initiative puts an upward pressure on commodity prices.

7. **Low Commodity Prices versus Equity Prices:** Currently, commodities are trading at low prices relative to equities. Due to the detrimental impact of the Global Financial Crisis and lower Chinese demand for commodities as the country completed its program of infrastructure and building construction in the preparation for the Olympics in Beijing in 2008, the relative prices of commodities to equites dropped dramatically that year (*see Chart 8 for the historical*

[29] Ibid.
[30] Ibid.
[31] *Abenomics* is not responsible for the expansion of the Japanese economy in 2012 as Prime Minister Abe came to power only in December of that year.
[32] The Economist, "Our Bulldozers, Our Rules," July 2, 2016.
[33] Willy Lam Wo-lap, EJ Insight on The Pulse, "Getting Lost in "One Road, One Belt," April 12, 2016.
[34] World Economic Forum, "China's $900 Billion New Silk Road. What You Need to Know," June 26, 2017.
[35] The White House, "Building a Stronger America: President Donald J. Trump's American Infrastructure Initiative," February 12, 2018.
[36] American Society of Civil Engineers, 2017 Infrastructure Report Card. Downloaded on January 31, 2018.
[37] David Shepherdson, Reuters, "Trump Unveils Infrastructure Plan; Uphill Battle Awaits in Congress," February 12, 2018.

perspective on the relative strength of commodity prices compared to equity prices in the US). The relative prices dropped even further as the demand for commodities further softened during the European Sovereign Debt Crisis in 2009-2012. The demand for commodities in the US and Euro Area stayed low through 2016 due to the slow economic growth in both areas. In the US, for example, the annual real economic growth has not reached its long-term average of 3% since the Global Financial Crisis (*see Chart 2*). In the Euro Area, the annual real economic growth rate mostly stayed below 2% (*see Chart 2*). The valuations of equities, however, grew dramatically driven by the monetary stimulus programs in the US and Euro Area in the aftermath of the Global Financial Crisis. As a result of these diverging trends, the commodity prices are the lowest versus the equity prices since the data for both indices is available starting from January 1970. In our opinion, prices of commodities are likely to rebound to higher levels driven by higher demand from the US and Euro Area and lower supply that was caused by decreased capital expenditures in various areas of the commodity complex since the Global Financial Crisis.

Chart 8. Relative Strength: Commodities versus Equities



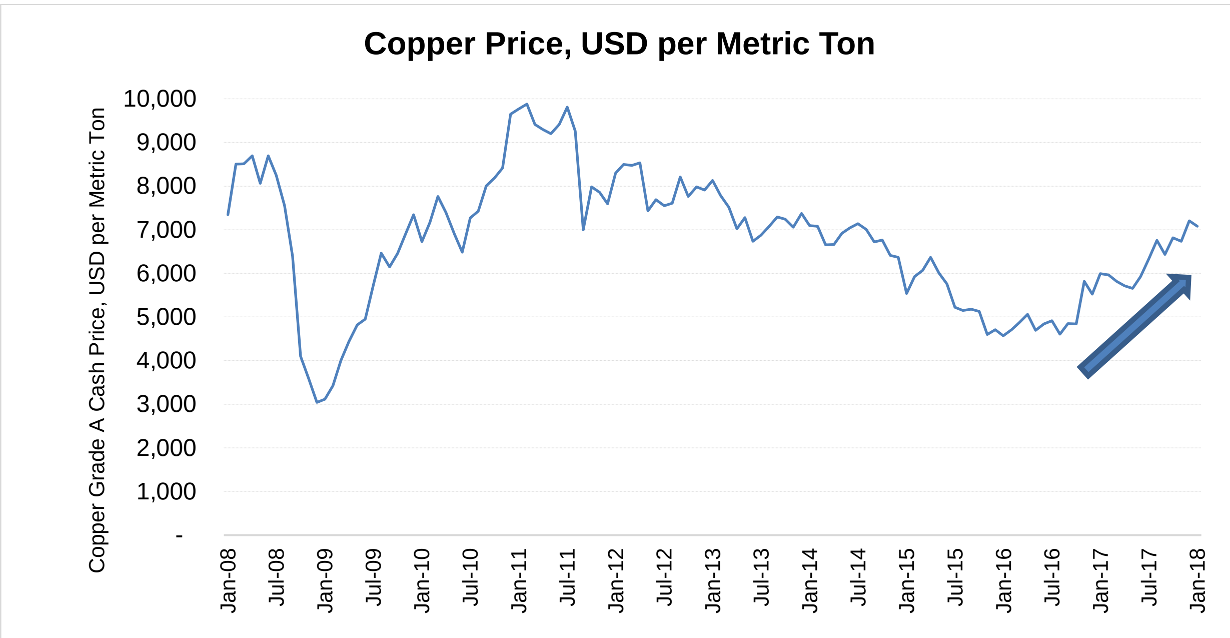
Source: Thomson Reuters for monthly prices for S&P GSCI Commodity Index and S&P 500 Index. Monthly series are for the period from January 30, 1970 to January 31, 2018. The idea for the chart came from the following report: Incrementum, Ronald-Peter Stoeferle, Peter Valek, "In Gold We Trust," June 1, 2017.

3. CASE FOR COPPER-EXPORTING COUNTRIES

At Beyond Borders Investment Strategies, we finished 2017 and entered 2018 with ETFs representing the world's two largest copper exporters, Chile and Peru, having the highest weights in our International Country Value Strategy. These ETFs are likely to do well if the price of copper increases or if there is a perception among markets that it is likely to increase. I wrote in a report on Chilean ETFs "Buy Chilean Equities: Impact of Copper Oversupply is Overblown," which was published in March 2014, that the correlation between the price of iShares MSCI Chile ETF (Ticker: ECH) and price of copper has been very high. For example, the three-year correlation between the prices ranged from 80% to 90% from October 2011 and January 2014. [38]

Below are six reasons that make us believe that the price of copper, which is not very low, will either increase or there will be a perception that it is likely to increase in 2018 (*see Chart 9 for the historical price of copper*).

Chart 9. Copper Grade A Cash Price, US Dollars per Metric Ton



Source: London Metal Exchange. Downloaded via Thomson Reuters on February 2, 2018.

1. **Increasing Demand for Copper due to the Passage of the US Corporate Tax Cut:** We believe that the price of copper on the global markets will further increase in line with a trend started in November 2016 with the election of a business-friendly President Trump in the United States. In 2018, construction of plants and facilities in the United States due to the passage of the corporate tax reform is likely to be the largest incremental catalyst for the price of copper. The process of shifting copper inventory to the US has already started. According to the International Copper Study Group, stocks of copper increased by dramatic 137% in the US warehouses owned by the New York-based Commodity Exchange (COMEX), while they dropped in the warehouses owned by the London Metals Exchange by

[38] Vitaly Veksler, Beyond Borders Investment Strategies, "Buy Chilean Equities: Impact of Copper Oversupply is Overblown," pages 3-4, March 10, 2014.

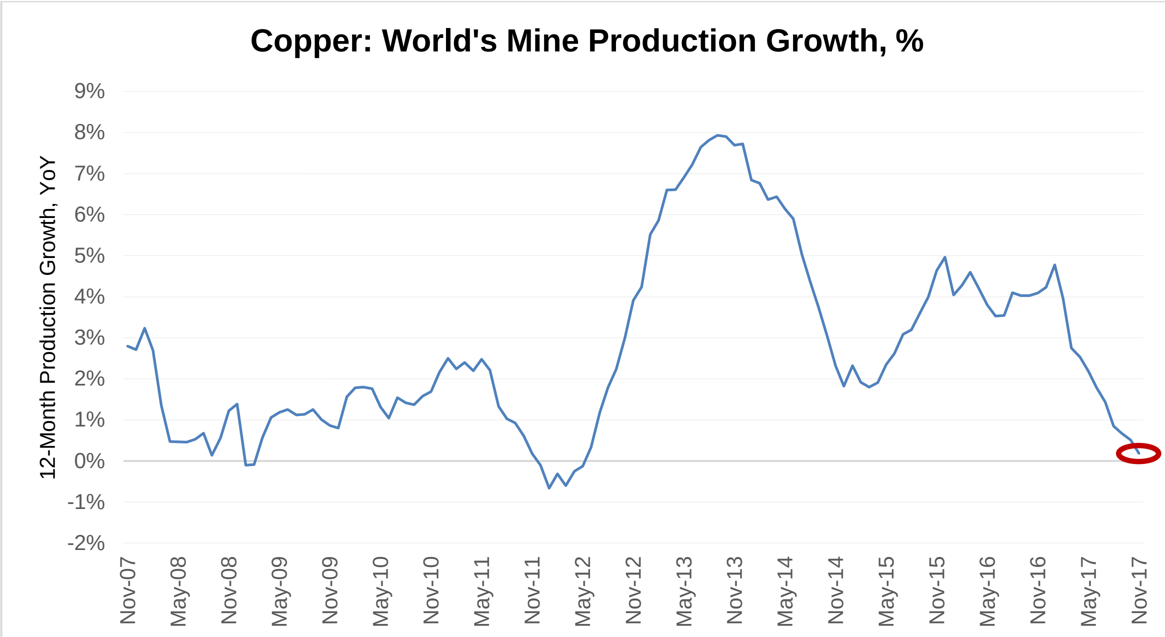
significant 36% during the first 10 months of 2017 compared to the December 2016 levels. [39] The copper inventories increased modestly by 3% in the warehouses owned by the Shanghai Futures Exchange. [40]

2. **Potential Bottlenecks Due to Copper Production Disruptions in Chile and Peru Slowing Copper Ore Production Further:** As Sergio Hernandez, Vice President of Chile's State Copper Comission (Cochilco), the largest copper producer in world, put it there is a "perception of vulnerability" in the copper supply in 2018. [41] Growth of production of copper ore from mines has already slowed to almost zero by the end of November 2017 (*see Chart 10*). It may stay relatively low in 2018. Just in Chile, the world's largest exporter of copper, there are 20 to 25 contract negotiations between companies and trade unions scheduled for 2018. [42] Overall, more than 30 labor contracts, mostly in Chile and Peru, are due to be renegotiated this year. [43] The number of the labor contracts to be negotiated is the highest since 2010. It means that nearly 40% of the global production, or more than 7 million tons, could be subject to disruption. [44] In our opinion, even without the disruption, it is possible and likely that these contract negotiations will lead to higher wages for the miners and, consequently, to more expensive copper.

   Furthermore, if one or several of these negotiations are not successful, strikes will lead to the decreased supply of copper to the global markets. This could further increase the copper deficit and increase the price of copper even more compared to the scenario without the strikes. An article from the Financial Times, *Chile Miners' Strike Turns Cost of Copper Red Hot*, tells a story about a strike in the Collahuasi mine in 2010 and its impact on the global price of copper. [45] The article provides a quote from the president of Collahuasi trade union that describes challenging environment that some copper producing companies may be faced with in 2018. "The company may be able to keep this up 10 or 15 days, but we're going to hold out until we reach our objectives. We're waiting for them to call us. We're not calling them," said Manuel Muñoz, president of the Collahuasi union in 2010. Even in a fortunate but unlikely case that all of the 2018 negotiations go smoothly, the uncertainty associated with them and the opportunity of a strike are likely to keep an upward pressure on the price of copper.

[39] The International Copper Study Group (ICSG), ICSG Press Release, "Copper: Preliminary Data for October 2017," January 22, 2018.
[40] Ibid.
[41] Fabiano Cambero, Reuters, "Supply Disruptions Could Boost Copper Prices," January 17, 2018.
[42] Ibid.
[43] Danielle Assalve, Metal Bulletin, 2018 Preview: Wave of Labor Negotiations Puts Global Copper Supply at Risk, January 5, 2018.
[44] Ibid.
[45] Jude Webber and Jack Farchy, The Financial Times, "Chile Miners' Strike Turns Cost of Copper Red Hot," November 9, 2010.

Chart 10. World's Copper Mine Production Growth



Source: The International Copper Study Group. Downloaded via Thomson Reuters on February 15, 2017.

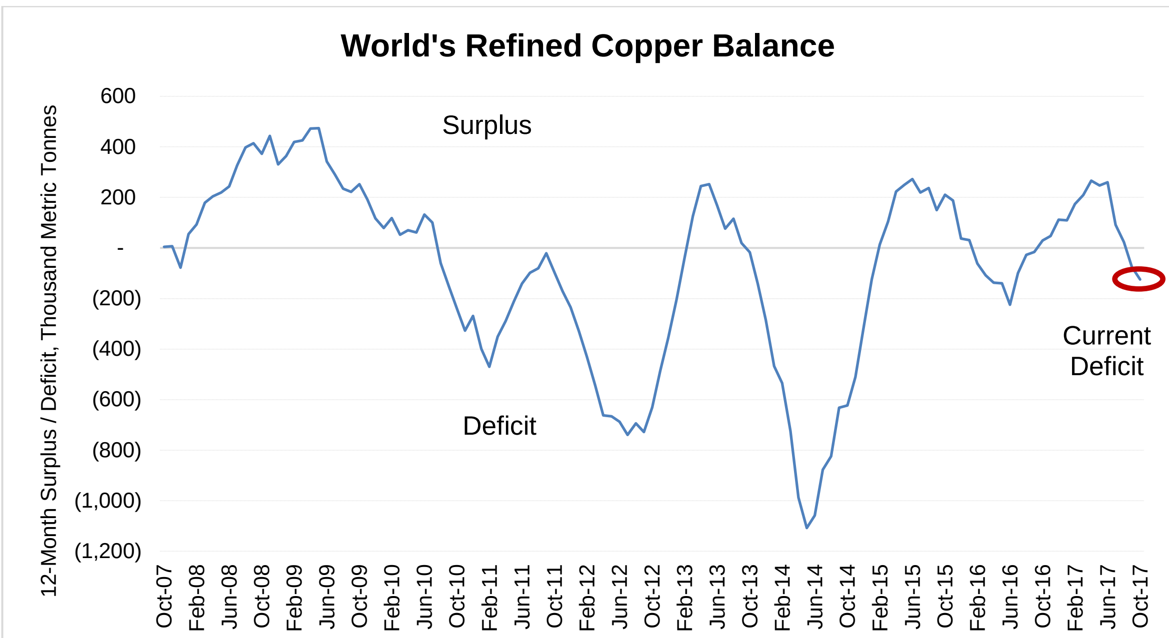
3. **Refined Copper Deficit on Global Markets:** According to the International Copper Study Group, there was a deficit of refined copper on the global market over the last 12 months as of the end of October 2017 (*see Chart 11 below*). The deficit is likely to keep the upward pressure on the copper price. The slow growth of copper ore production became one of the reasons for the refined copper deficit. As a reminder, refinded copper is copper that contains at least 97.5% of copper and 2.5% or less of impurities. [46] In the future, the balance of copper on the markets is likely to be impacted by factors such as the increased demand from the US and potential disruptions to the copper supply due to the labor renegotiations in Chile and Peru (described above), as well as new environmental regulations on smelters that produce refined copper in China and wider adoption of electric cars worldwide (described below). In our opinion, if there was a deficit of refined copper during the first 10 months of 2017, when the copper mine capacity and copper refinery utilization rates were relatively low, 81% and 84%, respectively, the refined copper surplus can be achieved with higher operating costs as capacity utilization moves to higher levels.[47] These higher operating costs are also likely to exert an upward pressure on the price of copper, counterbalancing the potential downward pressure that the potential copper surplus may exert on the price of copper.

   Often there are serious reasons explaining why companies choose some of the facilities (i.e. mines, smelters) to operate most of the time and why some other facilities they operate only when they have to, usually, during "peak" demand periods. It is more expensive to use "peak" mines and smelters, or facilities that are used mostly during the peak demand times, because

[46] The International Copper Study Group, Definitions. Downloaded on February 15, 2018.
[47] Ibid.

often they are not the easiest or cheapest to use, or have lower productivity. For example, due to the remote locations of some of the "peak" facilities, the cost of production there may be higher because of higher wages needed to attract workers there and higher transportation costs to and from these facilities for labor and copper. These facilities may also have higher energy costs. Some of the facilities are more difficult to operate from the technological or environmental perspectives, which results in higher operating costs. There are also costs involved in starting and testing facilities that were not used for a while. To summarize, any disruption to the refined copper supply, which is more likely when the industry relies on the "peak" facilities, would move the industry to a higher copper deficit. Regardless of the disruptions, higher costs of operating the "peak" facilities are likely to lead to higher prices of copper.

Chart 11. The World's Refined Copper Balance



Source: The International Copper Study Group. For each month, the surplus and deficits values are calculated for 12-month periods. Data for October 2007 - October 2017 downloaded via Thomson Reuters on February 26, 2018.

4. **Lower Copper Imports to China Due to Increased Environmental Regulations:** New Chinese environmental regulations on smelters and restrictions on scrap copper imports aimed at countering pollution are also likely to exert an upward pressure on the copper price by decreasing supply of the refined copper to Chinese copper consumers. [48] China is the world's largest consumer of coper, responsible for 50% of the world's demand. [49] Chinese

[48] Fabiano Cambero, Reuters, "Supply Disruptions Could Boost Copper Prices," January 17, 2018.
[49] Australian Department of Industry, Innovation and Science, "Resources and Energy Quarterly," page 91, December 2017. According to the report, the world's copper consumption was 24,000 Million Tons in 2017 with China's responsible for 50% of the world's consumption.

copper smelters have had to halt production for some time periods during the winter of 2017-2018 on orders of authorities fighting pollution. For example, China's second-largest copper smelter, Tongling Nonferrous Metals Group Co, had to stop production temporarily in December 2017 at its main production hub after the local government ordered the restrictions as part of a national plan to ease pollution over the winter months. [50] The company was ordered to stop production in 20-30% of its annual smelting capacity of eight hundred thousand metric tons. Later in December 2017, Jiangxi Copper Co., China's largest producer responsible for one million metric tons of annual capacity, was ordered to stop production at least for a week. [51]

In line with Beijing's "clear skies" policy, the Ministry of Environmental Protection announced at the end of 2017 that only end-users and processors of copper scrap would be allowed import quotas in 2018. [52] This announcement meant that traders and merchants did not receive their licenses. The supply of copper scraps is likely to decrease. The second measure that is likely to reduce copper scrap supplies is that they should have only up to 1% of hazardous impurities, a quality threshold that only the purest copper scraps are likely to pass. [53] As a result, the number of new 2018 copper scrap import licenses collapsed. [54] According to a forecast by Jiangxi Copper, one of China's largest copper producers, China will import 500,000 metric tons fewer of copper scrap in 2018 compared to 2017. [55] It represents a 45% decline in the copper scrap imports, or a decrease of around 4% of China's total copper supply. [56] [57]

In an implicit acknowledgement of the tight copper supply, China Smelters Purchase Team (CSPT), a group of the country's ten largest smelting and refining companies, agreed to cut the minimum levels that the smelters would be charging in the first quarter of 2018 for treatment and refinement charges. [58] The rule of thumb is that the treatment and refining charges go up when supply is considered to be abundant and down when it is considered tight. [59] In the first quarter of 2018, the CSPT cut its fees from $95 per ton to $87 per ton and cut its refining charges from 9.5 cents per pound to 8.7 cents per pound compared the fourth quarter of 2017, or by significant 8.4%. [60]

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[50] Bloomberg News, "Chinese Copper Smelter Halts Capacity to Ease Winter Pollution," December 7, 2017.
[51] Bloomberg News, "China Top Copper Producer Halts Output After Pollution Order," December 26, 2017.
[52] Andy Home, Reuters, "Copper Faces Double Supply Disruption Threat in 2018," January 10, 2018.
[53] Ibid.
[54] Ibid.
[55] Brian Taylor, Recycling Today, "Chinese Copper Producer Foresees Major Scrap Shortfall," January 17, 2018.
[56] Metal Bulletin, "China's Copper Scrap Restrictions Could Remove 500 KT of Copper from Market – Jiangxi Copper," January 13, 2018.
[57] Australian Department of Industry, Innovation and Science, "Resources and Energy Quarterly," page 91, December 2017. According to the report, the world's copper consumption was 24,000 Million Tons in 2017 with China's responsible for 50% of the world's consumption. The amount of 500 K Tons is slightly more than 4% of China's consumption of 12,000 K Tons.
[58] Reuters, "China's Copper Smelters Cut Treatment, Refining Charges for First-Quarter 2018," December 29, 2017.
[59] Ibid.
[60] Ibid.

5. **High Industrial Transportation Costs in the US:** Along with higher demand in the United States, high transportation costs are a significant reason for the increase in copper inventories in the US warehouses close to copper production sites in Arizona and Utah. [61] Reasons for rising transport costs include the jump in oil prices, increasing demand for industrial transport due to the strong U.S. economic growth, and tighter restrictions on the numbers of hours that truck drivers in the U.S. can be on the road. [62]

   Current physical market transaction premiums over prices of futures, which are set on future exchanges such as COMEX and the London Metal Exchange, are not high enough to cover the transportation costs and profits of truckers to the US industrial destinations or ports for exports to China and other places around the world. These premiums, currently stand at around $130 per ton. [63] The costs of taking copper from a warehouse in Arizona, loading it into a container, then onto a truck, driving it to a seaport, unloading the container, then loading it onto a vessel are between $120 and $150 a ton. [64] These premiums may go up further pushing up the price of copper as demand for copper materializes, and businesses increase their capital expenditures.

6. **Electric Car Adoption Worldwide is Likely to Lead to Higher Copper Consumption:** Growing global demand for electric cars and renewable energy will lead to stronger growth in copper consumption over the next two years. Electric vehicles on average contain 85 kilograms of copper compared to 25 kilograms in regular vehicles. [65] It constitutes an increase of 240%. Increased global production of electric vehicles is expected to raise copper consumption by around 300,000 tons annually in 2018 and 2019, further exerting an upward pressure on the price of copper. [66]

4. RISKS TO OUR INVESTMENT THESIS

Five risks to the global or regional economic growth described below can also decrease attractiveness of commodity- and copper-related investments. Three of these risks come from the economic sphere, while two risks are of the geopolitical nature.

1. **The US Federal Reserve Bank Increases Interest Rates Too Fast in its Fight against Inflation:** As we mentioned earlier in the report, investors expect inflation to increase to 2.15% over the next five years *(see Chart 7)*. The US Federal Reserve Bank is likely to raise interest rates in order to control it. If the Fed increases rates too fast or too much, the US economy and the global economy can slow dramatically. We carefully follow statements from the US Federal Reserve and are willing to reduce riskiness of our portfolios, including selling ETFs and increasing cash positions, in the case that the Fed becomes extremely hawkish and decides to raise rates dramatically.

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[61] Pratima Desai, Reuters, "US Copper Stocks Sprint to Record High, Reflecting Transport Costs, Weak Demand," February 22, 2018.
[62] Ibid.
[63] Ibid.
[64] Ibid.
[65] Australian Department of Industry, Innovation and Science, "Resources and Energy Quarterly," page 91, December 2017.
[66] Ibid.

2. **US Dollar Strengthens Too Much:** Interest rate hikes in the United States can lead to strengthening of the US dollar versus currencies of other countries around the world. It is especially likely if central banks of these countries do not raise their interest rates or even cut them. In general, a strong dollar is usually bad for economies of commodity-exporting countries because of the following reasons:

   - Their revenues, measured in the US dollars, shrink as each unit of commodities is worth less in US dollars;
   - They spend a higher percentage of their GDP servicing their debts as the value of corporate and government loans, once again measured in the US dollars, increases;
   - These countries face capital outflows as foreign and domestic investors sell their investments in the countries in order to invest in the US; and
   - All reasons described above can cause a vicious cycle of local currency devaluation versus the US dollar. It is difficult for these countries to stop the currency devaluation cycle as they find it difficult to raise their interest rates thus slowing their economies as they are already suffering impact of currency devaluation.

   In our opinion, there are reasons that would not allow the US dollar to strengthen dramatically or maybe even weaken compared to other currencies in 2018.

   - High valuations of the US stock markets are likely to preclude them from massive inflows of cash that would lead to the US dollar appreciation;
   - US bond yields are low, especially compared to emerging market bonds. Foreign investors are more likely to avoid investing in the US bonds and choose investing in other asset classes, such as infrastructure, where they can earn more attractive "bond-like" returns. China, the largest holder of the US Treasuries, has started investing its foreign currency reserves in building infrastructure within its *One Belt One Road* and other initiatives;
   - US high government debt ratio as a percentage of GDP puts a ceiling on the potential US dollar appreciation. Also, this ratio makes the US Treasury bonds less attractive as the US credit rating can be downgraded by rating agencies;
   - As the Euro Area's economy stabilized after the Sovereign Debt Crisis and grew by over 2% in 2017 (*see Chart 2*), the European Central Bank may finish its massive €2.55 asset-purchasing stimulus program by September 2018 and start raising its interest rates in early 2019. [67] This would make Euro-denominated investments more attractive to global investors and preclude the US dollar from appreciating dramatically; and
   - Most emerging markets learned their lessons of building limitless debts during "good" times (i.e. when prices of commodities or manufactured goods produced by the countries were high) and not being able to service these debts when the "good" times were over. Currently, their lower debts as percentage of GDP, balanced budgets, and foreign currency reserves are likely to limit the US dollar appreciation versus their currencies. However, we stay vigilant and either avoid completely or limit the size of our investments

[67] Dhara Ranasinghe, Reuters, "Bond Markets Look Beyond Easy ECB Money to First Rate Rise," January 8, 2018.

in the *Fragile Five* or other economies with unbalanced budgets or high debt levels. [68] These countries are more likely to suffer the strongest negative consequences of the US dollar appreciation and of the global financial tightening in general.

3. **US Imposes Tariffs on Steel and Aluminum Potentially Causing Retaliation against US Imports:** According to a number of press reports, President Trump intends to impose tariffs of 24% on imports of steel and tariffs of 10% on imports of aluminum to the United States in an effort to revive production of steel and aluminum in the United States. [69] According to an article from Bloomberg Politics, The Commerce Department outlined a range of actions that the president is entitled to take on tariffs. Some of these options as related to steel included:
   - **Option 1:** Impose a global tariff on all steel imports of at least 24 percent.
   - **Option 2:** Impose a tariff of at least 53 percent on steel imports from a select number of countries, including China, India and Brazil, while other countries would have their shipments capped at the amount they exported to the U.S. last year.
   - **Option 3:** Impose a quota on all steel products equal to 63 percent of each country's 2017 exports. [70]

   While both tariffs and quotas are protectionist measures that usually reduce international trade and have negative consequences for steel and aluminum producers abroad and domestic producers that use these commodities as inputs, we believe that **Option 1** favored by President Trump is the least damaging. Below are our comparisons of **Option 1** versus **Option 2** and **Option 3**.
   - **Option 1 vs. Option 2:** In our opinion, **Option 1** is less likely to lead to a trade war as it does not single out any commodity exporters at the expense of other. If the US were to impose tariffs on China, India and Brazil, and not impose them on our imports from other major exporting nations, who happened to be our allies (i.e. Canada, South Korea, Mexico and Germany), the countries in the first group would be more likely to retaliate.
   - **Option 1 vs. Option 3:** Tariffs (**Option 1**) are less damaging than quotas (**Option 3**) for two important reasons.
     - **Quotas Can Be Perceived as Treating Various Countries Unequally:** While equal tariffs imposed by the US on all countries make doing business with the US less lucrative, nevertheless, they impact all countries equally and, in our opinion, are not likely to lead to trade wars. However, quotas do not treat different importers as equals and create winners and losers. Countries that received lower import quotas are more likely to be "offended" and more likely to retaliate with trade wars. In general, quotas create more problems related to the perception of unequal treatment. For example, if steel imports from one country in 2017, the base year for calculating quotas, jumped up or down for any reason during the year, this country would benefit or suffer for a long time because of the short-term increase or decrease of imports to the US in 2017. If the US imported more steel from this country at the expense of

[68] Moritz Kraemer, S&P Global Ratings, "Sovereign Postcard: The New Fragile Five," November 6, 2017. According to the report, the New Fragile Five countries from the most to least fragile include Turkey, Argentina, Pakistan, Egypt and Qatar.
[69] Jennifer Jacobs, Bloomberg Politics, "Trump Favors Commerce's Harshest Steel and Aluminum Tariffs, Sources Say," February 24, 2018.
[70] Ibid.

other countries in 2017, these countries may have lower long-term import quotas that they may consider unfair. Also, a country can challenge the US about its decision to calculate quotas based on the 2017 level rather than the 5-year average as of 2017. Another country may be upset that its ally status was not translated into a higher quota. A country unhappy with its quota may accuse the US of corruption or giving preferential treatment to the other importers.

- **Total US Demand for Commodities May Not Be Satisfied:** With import quotas in place, some of the US demand for steel and commodities may not be satisfied at any price if the domestic and foreign suppliers do not meet the demand. It is especially relevant for situations when the US demand for commodities increases unexpectedly and domestic producers cannot increase their production fast enough. With the global tariffs, however, the US importers of commodities (i.e. producers of cars, equipment, or other goods) would still be able to buy the commodities at higher prices if there were an unexpected increase in demand for the manufactured goods.

At BBIS, we have investment positions in ETFs of countries that export steel and aluminum to the US, but the impact of potential tariffs would be softened by the diversified nature of these countries' economies and of the ETFs. This is an advantage of investing using ETFs rather than via individual stocks. For example, let's look at the South Korean economy, one of the major exporters of steel to the United States. An investor in a South Korean steel producer can be negatively impacted by the potential tariffs. At the same time, a negative impact on South Korean ETF would be significantly less pronounced as the weight of companies that belong to the Materials sector, which includes metal producers among others material companies, would be much smaller. The total weights of companies that belonged to the Materials sector were 8.71% for iShares MSCI South Korea ETF (Ticker: EWY) and 9.72% for Franklin Templeton Investments' Franklin FTSE South Korea ETF (Ticker: FLKR). [71] [72]

Also, we believe that copper and copper-producing countries are less likely to face tariffs in the US as steel and aluminum took the center stage in the government discussions on the topic. The tariffs on aluminum and steel may increase the price of copper via increased risk premiums on all commodities, which could be positive for ETFs of copper-exporting countries. Finally, the price of copper may benefit from the tariffs on steel and aluminum due to the substitution effect. For example, the tariffs make steel pipes more expensive, while the price of copper pipes stays the same. This is another potential positive for ETFs of copper-exporting countries.

4. **Geopolitical Risk in Syria:** The current situation in Syria represents an example of the geopolitical risk that we currently follow. The fact that a number of armies and groups (e.g. the Syrian army and its Iranian and Lebanese (Hezbollah) allies, Kurdish forces, US, Russia, Turkey, non-Jihadi rebels, Jihadi rebels, ISIS) fight in a relatively small area cannot be ignored. In our estimate, risk in the country was declining as the Syrian government and Kurdish forces, allied with the United States, were re-taking control of the country in 2017. However, two recent developments increased risks in and outside of the country:

[71] iShares by BlackRock, iShares MSCI South Korea Fact Sheet, December 31, 2017.
[72] Franklin Templeton Investments, Franklin FTSE South Korea Fact Sheet, January 31, 2018.

- **Tensions between NATO Allies:** Turkish offensive against Syria's Afrin district in their desire to uproot Kurdish fighters from the Y.P.G. group led to tensions with the United States. The US and Kurdish fighters fought together against ISIS. When Turkish President Erdogan had reportedly said that the Turkish operation against Afrin will be extended to Manbij, another Syrian district controlled by the Kurds where the US troops are currently stationed, the US responded that the US troops would not leave the area. [73] While not entering Afrin, the US is not leaving other Kurdish areas, such as Manbij, rejecting Turkish demands. A Turkish potential offensive against Manbij would potentially bring the US and Turkey, two NATO allies, into direct conflict on the opposite sides. President Trump "urged Turkey to exercise caution and to avoid any actions that might risk conflict between Turkish and American forces." [74] Germany, another powerful member of NATO, postponed its sale of new Leopard tanks to Turkey, accusing Turkey of an illegal military operation against Syria. [75]

- **Tensions between NATO and Russia:** There are high civilian casualties in Eastern Ghouta as the Syrian government, with the support of Russian aviation, fights to re-take this suburb of Damascus from the rebels, who shoot at the government troops from apartment buildings and other heavily populated positions. There is clear tension between the US and Russia in Syria as Russia supports the Syrian government troops' assault on Eastern Ghouta, while the US does not support it. A senior Western diplomat said that the Russians were trying to repeat in Eastern Ghouta tactics that helped the Syrian government to take control of Aleppo earlier during the civil war. Russia proposed to have five-hour daily ceasefires to create a humanitarian corridor that would allow civilians and wounded to leave the war zone, while allowing medical personal to bring medicines and aid into the conflict zone. [76] They want to evacuate civilians from the area and then kill "the terrorists even if it's not just Nusra." [77] Until July 2016, Al-Nusra Front was also known as Al Qaida in Syria or Al Qaida in the Levant. [78] A senior U.S. general accused Moscow of acting as "both arsonist and firefighter" referring to Russia's support of Syrian government troops' attacks on rebels in Eastern Ghouta for 19 hours every day and helping wounded and civilians during the five-hour daily ceasefire. [79]

We carefully observe developments in Syria as we realize that a potential military incident could have a direct negative impact on ETFs of Russia, Turkey, and other countries participating in the conflict. Also, the price of oil, which may jump based on the news of this potential incident, could be a conduit for the shock from the incident to other oil-exporting and oil-importing countries.

[73] BBC, "Syria war: Germany Suspends Upgrade to Turkey Tanks," January 28, 2018.
[74] Ibid.
[75] Ibid.
[76] Ibid.
[77] Ibid.
[78] Wikipedia, Al-Nusra Front. Downloaded on February 27, 2018.
[79] Reuters, "Syrian Government Ground Forces Attack Ghouta Despite Russian Truce Plan," February 28, 2018.

5. **Nuclear Risk on the Korean Peninsula:** The situation on the Korean peninsula remains tense despite both North Korea and the US expressing their willingness to negotiate under the right circumstances after the Olympics. We do not think that the probability of a military conflict is high: the sides have a lot to lose from the conflict. The government of North Korea probably realizes that their regime with its one or maybe several nuclear warheads is not likely to survive a nuclear war with South Korea and the US, as the US has more nuclear firepower aboard of one of its nuclear submarines than the North Korean regime. Moreover, the US Navy has 18 Ohio-class nuclear submarines with 24 missiles each, let alone all other nuclear installations on islands in the Pacific Ocean and on the mainland US. [80] However, South Korea's capital Seoul and its suburbs, where more than 25 million people live, are within the North's artillery range. [81] In addition to the impact on South Korea, the conflict can have impact on large neighbors, China and Russia, and via their and the US' trade and diplomatic relationships on countries all over the world. At BBIS, we carefully observe developments related to sanctions against and negotiations with North Korea, as we believe that these economic and diplomatic instruments rather than military means will be used to resolve the conflict on the peninsula.

Please let us know if you have questions about this report or Beyond Borders Investment Strategies. Thank you!

Best regards,

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[80] Wikipedia, Ohio-Class Submarine. Downloaded on January 31, 2018.
[81] World Population Review, Seoul Population 2018. Downloaded on February 21, 2018.