Re-Thinking International Diversification

Over the past eight years, this publication has urged readers to avoid international stock investments. Natural geopolitical advantages positioned U.S. stocks to systemically outperform international stocks.

Our conviction intensified in 2017 with Trump as President. Lower corporate tax rates and higher import tariffs raised income and corporate profits. The U.S. stock market soared.

As time passed, we found more reasons to avoid international markets. We anticipated hostilities with Russia, China, and Iran. Wars cause economic dislocation and destroy wealth… better to avoid that risk altogether. Also, China's debt bubble had surpassed all previous bubbles of the modern era. A debt crisis would eventually require economic reorganization, especially in the real estate and banking sectors. Subsequently, debt-liquidation pressures have deflated China's real estate bubble, dragging the broad stock market down.

On a couple of occasions, Vigilante Portfolio made modest allocations to Mexico, Argentina, and India. These countries benefit from U.S. trade policies and were not at risk for war-related dislocations. However, Vigilante Investor has concentrated investment allocations in the U.S.

The U.S. investment concentration strategy has paid off. Figure 1 of benchmark index performance shows that U.S. stocks have consistently outperformed Japan, Germany, and China.

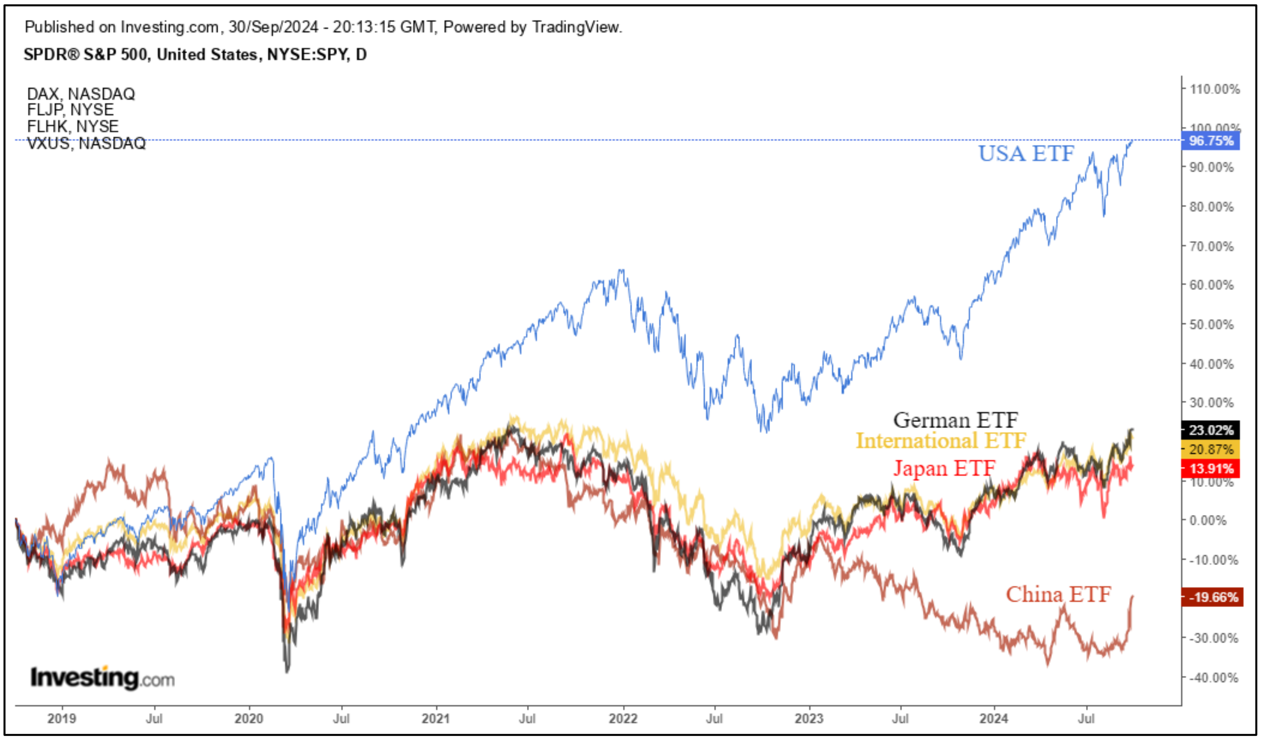
Figure 1: U.S. Stock Market Performance vs. International Indices

The benchmark index returns shown in Figure 1 understates the full benefit of concentrating in the U.S. Benchmark returns do not incorporate the impact of currency gains and losses.

Over the past 6 years, the dollar appreciated vs. most major currencies. Dollar appreciation translates in foreign currency depreciation.

Exchange Traded Fund (ETFs) returns incorporate the impact of foreign currency gains and losses. Figure 2 shows an ETF return of each major international market… in comparison to the S&P 500 SPDR ETF.

Figure 2: U.S. vs. Germany, Japan, China, and International Aggregate ETF



Over the past 6 years, the U.S. ETF outperformed the German ETF by 73%, the International Aggregate index by 76%, the Japan ETF by 82%, and the China ETF by 115%.

If you followed our advice, you avoided international diversification, and you saved money.

Now - A Good Time to Diversify

As discussed in the previous issue, America has reached a political impasse. Both sides believe the opponent is a threat to democracy. Neither side is willing to concede a close election. Unless one side… either side… wins decisively, half the nation will consider the government to be "illegitimate." At best, this will lead to political disorder, civil disobedience, and economic fragility… at worst, revolution.

It seems like a suitable time to reduce risk by investing in cheap international markets.

International Markets Poised to do Better Anyway

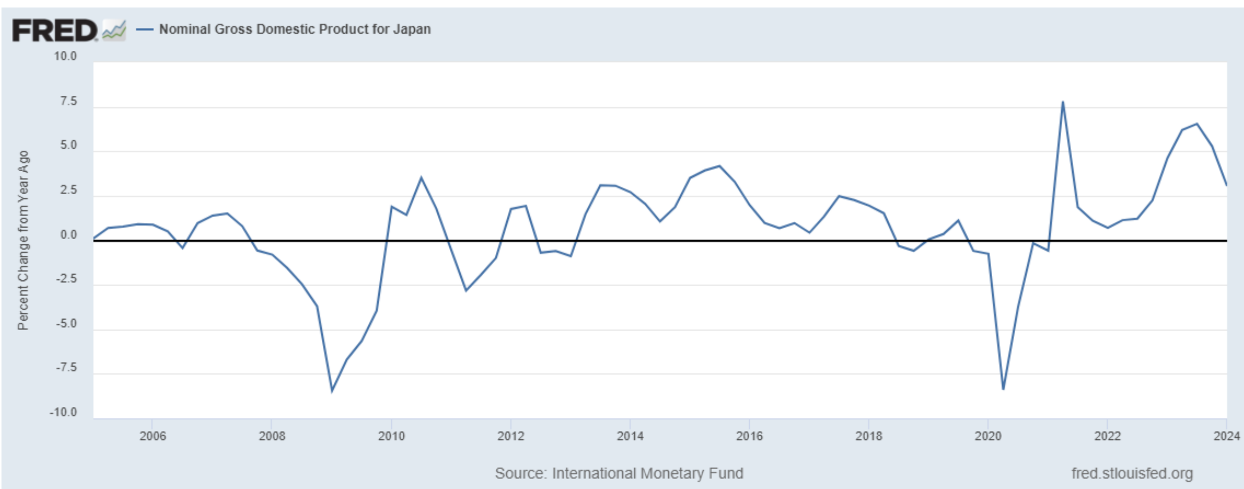
After severely lagging U.S. markets over the past decade, international markets are due for a "catch up."

German stocks have performed poorly in recent years, reflecting the destruction caused by Ukraine war. The loss of abundant, cheap gas supplies (from Russia) has forced German industry to hunker down. As a result, German stocks are unusually cheap.

But Germany's dire situation will pass. The war in Ukraine will end. If Trump wins the U.S. Presidency, he will end the war. If Harris wins, the war will grind on until either a) Ukraine runs out of solders or b) NATO's bombing of Russia intensifies to levels that trigger a nuclear war. In the former case, cheap Nord Stream supplies will resume, and German industry will recover. In the latter case, no one needs to worry about investing any longer.

Japan has finally freed itself from the deflationary spiral. Thanks to surging inflation, nominal growth has finally risen to levels that allowed the Bank of Japan (BOJ) to end negative interest rates.

Figure 3: Japan Nominal GDP



The BOJ will continue to raise interest rates. This will boost the profits of long-suffering banks and insurance companies. Additionally, rising interest rates could incentivize Japanese investors to repatriate dollar-denominated investments, raising the value of the Yen. Yen currency gains augment (dollar-denominated) returns of Japanese stock investments.

Many stocks in China have fallen so far that they now bear limited downside risk. China's government is cutting interest rates and stimulating the housing sector. Some recovery seems probable.

When conditions change - from unbelievably bad to less bad- stock prices tend to recover. This is the case right now.

Table 1: *Vigilante Investor* Target ADRs For International Diversification

Company	Ticker	Price	EPS	Fwd EPS	Fwd PE	Exp 5-YR Growth	Debt/ Equity
BASF ADR	BASFY	$13.19	-$0.01	$1.18	11.21	NA	0.69
Deutsche Telekom ADR	DTEGY	$29.39	$1.12	$2.52	11.59	11.9	1.59
Mitsubishi UFJ	MUFG	$10.18	$0.88	$0.93	10.95	11.4	NA
JD.com Inc ADR	JD	$40.00	$2.83	$3.98	10.04	25.0	0.39
Alibaba ADR	BABA	$106.12	$3.98	$9.50	11.17	8.9	0.22

Sources: Yahoo Finance and Finviz.com

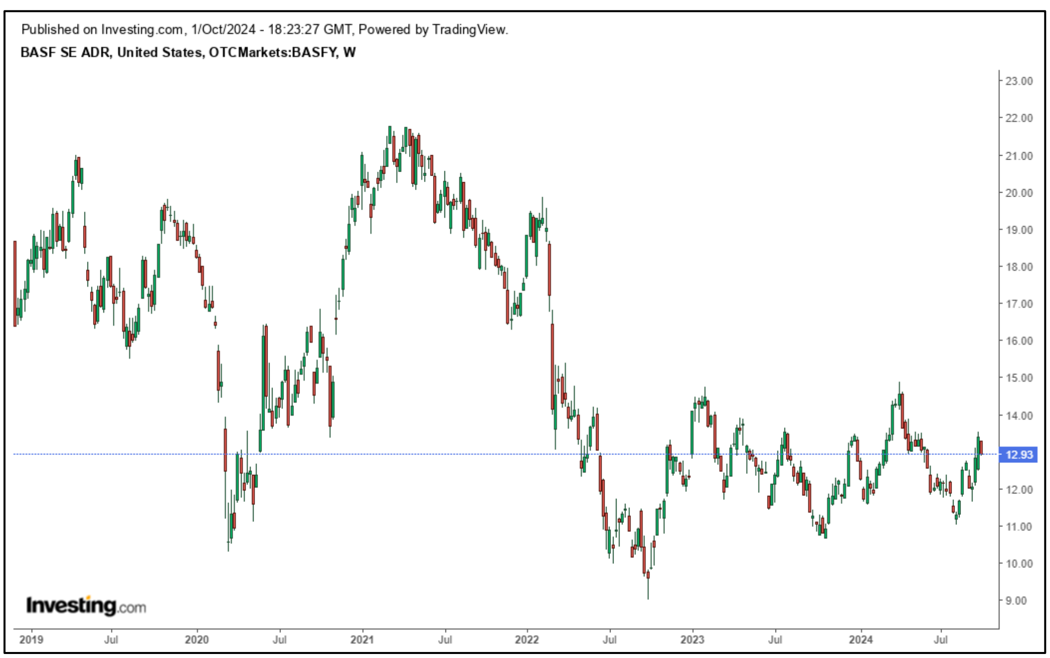
BASF ADR (BASFY)

Headquartered in Germany, BASF operates one of the world's largest chemical manufacturers. Product applications include resins, electronics, automotive, plastics, paints, coatings, pharmaceuticals, cosmetics, detergents, and agricultural products.

BASF is *the* dominant chemical producer in Europe. Prior to Ukraine war, BASF expanded market share and earnings by utilizing cheap supplies of natural gas from Russia. Natural gas is the primary feedstock and energy source for chemical production.

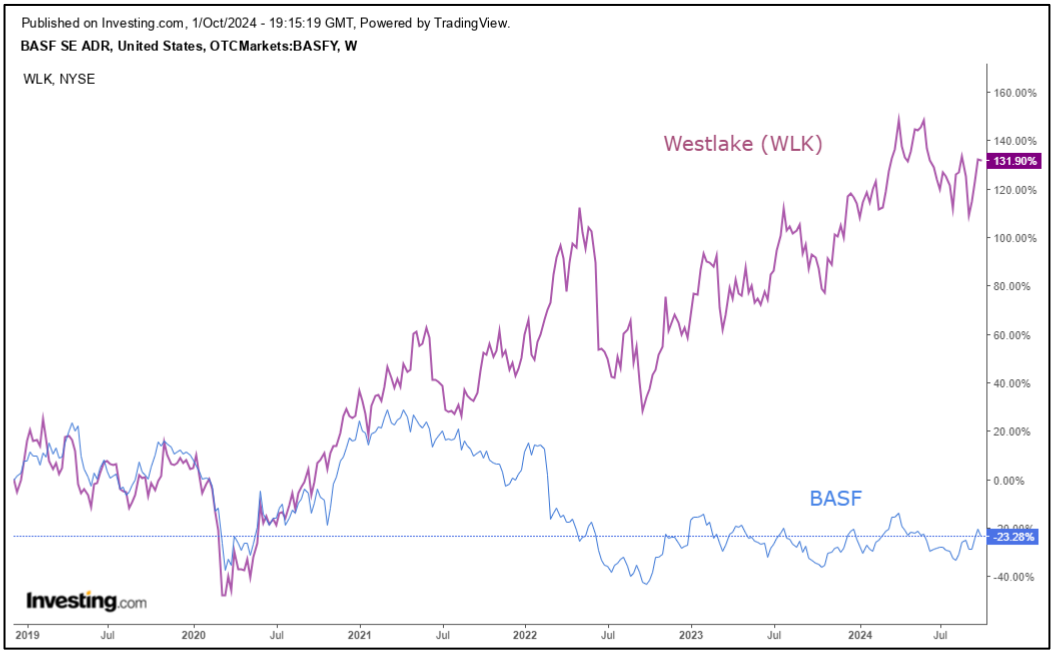
Ukraine war and subsequent sabotage of the Nord Stream pipeline severed BASF's access to Russian gas supplies. Ever since, BASF has paid up for gas, often paying a 10x multiple of American competitors for limited European supplies. In the wake of the war, BASF's energy costs soared by 3.2 billion Euros. Sales volume declined 7%.

Figure 4: BASF ADR – Weekly Chart - Oct 1, 2024



American producers, who benefit from cheap domestic gas supplies, ramped up production to fill the void. Figure 4 compares the stock returns of American producer Westlake Chemical with BASF. Since the start of the Russia-Ukraine war, BASF stock has lost value, but Westlake shares soared more than 100%.

Figure 5: BASF S vs. Westlake Chemical (WLK)



BASF may never fully recover from the effects of Ukraine war. But it will do better when peace returns to Europe. Nord Stream will repair the pipeline. Cheap Russian gas supplies will again feed BASF operations. Doubts will linger about the reliability of Russian gas supplies. But at the very least, BASF will compete again. BASF stock value will catch up, at least partially, to the global competition.

Recommended Strategy: Buy a full position of BASF at current prices. Use limit orders to accumulate your position due to the sometimes-spotty liquidity of ADR trading. Use a 25% stop-loss to manage your risk.

Deutsche Telekom ADR (DTEGY)

Deutsche Telekom, headquartered in Germany, provides broadband, mobile, internet, and cloud services in Europe and the U.S.

As detailed in Table 1, the forward PE ratio trades below expected long-term growth. As such, this stock has exceptional value and limited downside risk.

As the European Central Bank (ECB) cuts rates, European growth will accelerate. This will lead to much higher demand and profitability for Europe's dominant telecommunication company.

Figure 6: Deutsche Telekom ADR (DTEGY) Oct 1, 2024

Recommended Strategy: Buy half of a position of DTEGY at current prices. Buy another half position if the stock price dips below $27. Use limit orders to accumulate your position due to the uneven liquidity of ADR trading. Use a 25% stop-loss on your average cost to manage risk.

Mitsubishi UFJ ADR (MUFG)

Mitsubishi UFJ is the largest bank holding company in Japan . It provides a broad range of financial services, including Commercial Banking, Investment Banking, Trust Banking, Asset Management, Pension Administration, Credit Cards, and various digital financial services.

In 2008, Mitsubishi took advantage of the distressed American stock market to buy a 21% stake in Morgan Stanley for $9 billion. Morgan Stanley provided much needed profit growth throughout the (2016-2023) negative-interest-rate experiment in Japan. Negative rates hampered the bank's ability to profit from traditional lending and investment activities.

Currently, the Bank of Japan is raising interest rates. Mitsubishi UFJ can anticipate higher net-interest-margins on loans. Investment securities will once again earn a positive return. Profits will rise significantly.

MUFG's forward PE is trading below the company's long-term expected growth rate, indicating solid value.

Figure 7: Mitsubishi UFJ (MUFG) Oct 1, 2024

<u>Recommended Strategy:</u> Buy a full position of MUFG at current prices. Use a 25% stop-loss to manage your risk.

<u>JD.com Inc ADR (JD)</u>

JD.com operates a supply-chain based logistics business, providing a host of low-tech, high tech, household, e-commerce, and digital products and services in China.

JD makes money through retail sales, marketplace services, logistics and fulfillment services, and advertising.

The company continually innovates. Delivery technologies incorporate AI, drones, autonomous vehicles, and robots.

JD's strategic investors include some of the most important companies in China, including Walmart and Tencent. JD collaborates with these companies on system development, providing the company a substantial edge over competitors.

The stock is trading at amazingly cheap levels. Its forward PE ratio is less than half the expected long-term growth rate. If this company continues to execute as it has in the past, it could triple within the next three years.

Figure 8: JD.com (JD) Oct 1, 2024

Recommended Strategy: Buy a full position of JD at current prices. Use a 30% stop-loss to manage your risk.

Alibaba ADR (BABA)

Alibaba provides technology infrastructure, marketing, digital retail and wholesale marketing services, cloud computing, data and storage services, online video, and entertainment services to Chinese customers. Many people think of Alibaba at the Amazon of China.

The stock has almost doubled since David Tepper started accumulating shares. This stock still represents fair value, but it no longer trades at crazy-cheap levels. For this reason, I suggest buying shares on a dip.

Recommended Strategy: Scale into a position of BABA if prices fall into the range of $90-$100. Use a 25% stop-loss to manage your risk.

Figure 9: Alibaba (BABA) Oct 1, 2024

Restructuring the Portfolio

To fund purchases of international stocks, we need to sell U.S. stocks. Vigilante Investor suggests strategically selling to reduce exposure to vulnerable industries and companies.

Crude Oil Exposure

The crude oil market is heading for a glut. On October 2, Saudi oil minister Prince Abdulaziz bin Salman said that oil prices could drop to $50 if the OPEC-Plus cheaters don't stick to their agreed-upon production limits.

Iraq exceeds its limit by 400,000 barrels per day. Iran has raised production about 400,000 barrels per day since last year. Venezuela and Nigeria have each raised production more than 100,000 barrels per day. Kazakhstan is preparing to bring a massive field online, which will raise global production even more.

Over the past year, Saudi Arabia has voluntarily cut production about 1 million barrels per day to support the oil price. Nevertheless, supplies expanded, and oil prices fell to $70. When Saudi Arabia raises production to its quota, prices will collapse. The oil minister is signaling that Saudi Arabia will do that. Oil will trade down to $50.

Vigilante is cutting exposure to oilfield service companies.

One our oilfield service holdings, ProPetro can ride out the coming storm. ProPetro can afford to idle its equipment and wait for a cyclical recovery because of minimal debt burdens. We will continue to hold this stock.

On the other hand, Nine Energy has significant debt, and KLX has moderate debt.

Recommended Strategy: Sell positions in Nine Energy (NINE) and KLX Energy Services (KLXE) at current prices.

Insurance Exposure

In April 2021, *Vigilante Investor* added a basket of property-casualty insurance stocks. We anticipated soaring inflation and interest rates. We also correctly anticipated that rising interest rates would juice the insurance company earnings, providing a tailwind for these companies. Consequently, these stocks sailed through the rough 2022 bear market without a worry.

Now, the Fed is cutting interest rates. The tailwind is turning into a headwind.

Recommended Strategy: Sell positions in Chubb (CB) and WR Berkley (WRB) at current prices. Hold AIG to maintain modest exposure to this sector.

The Economy

At face value, it looks like growth and inflation are accelerating.

Table 2: Vigilante Investor Scorecard of Economic Conditions October 4, 2024

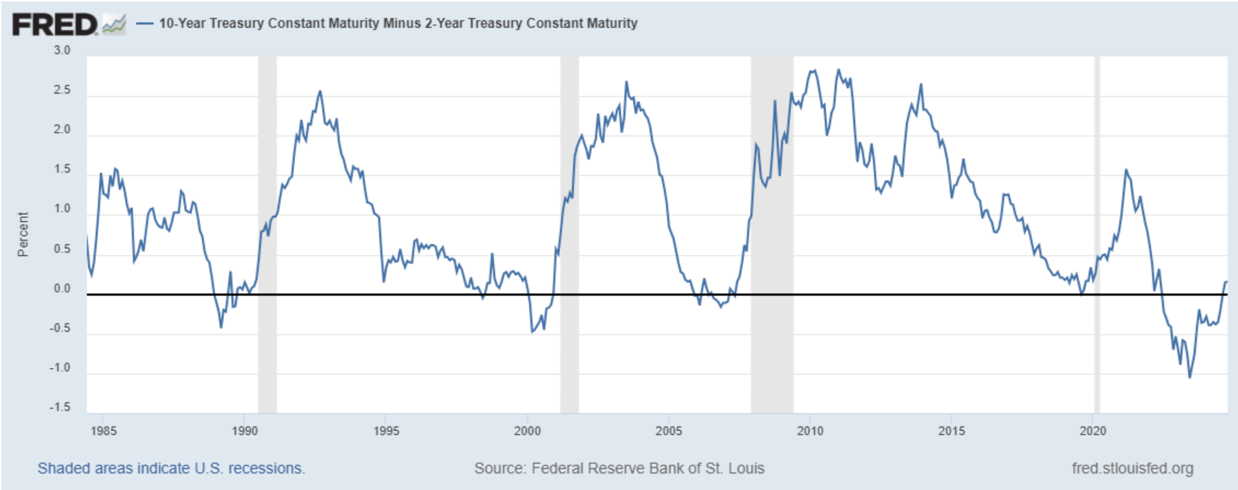
Score	Positive	Neutral	Negative
Growth 4 Contraction 1	US Real GDP +3.0%YOY US Productivity +3.0%YOY Global Comp PMI 52.8 US Non-Manf PMI 54.9	Fed Signal +0.55%	US 2-10 Spread +0.07%
Inflation 4 Deflation 1	CPI +2.5% YOY US Wages +4.0% YOY Gold +32.4% YOY Gold / Euro +28.4% YOY	US Dollar -3.1% YOY	Crude Oil -15.3% YOY
Positive $ 2 Negative $ 0	US-Ger2YR Spread +1.71% US-Ger10YR Spread+1.78%		

Sources: Tradingeconomics.com, St. Louis Fed, and Investing.com

Enormous government deficit spending drives both trends.

Meanwhile, the recession indicator has lit up. After a yield-curve inversion the past 2 years, the yield curve is now trading with a normal, positive slope. This occurred four times in the past 40 years, and each time, a recession followed.

Figure 10: Yield Curve Inversion and Recession



Investment Strategy and Portfolio Review

ETF Portfolio: We are restructuring the ETF Model Portfolio to accommodate international diversification. We recommend a 20% position in the Vanguard International Stock ETF (VXUS). We are raising cash to pay for these purchases by selling the Vanguard Financial ETF (VFH) in entirety. We are also selling part of iShares US Insurance ETF (IAK) and First Reserve Natural Gas ETF (FCG).

Table 3: The Vigilante Model ETF Portfolio as of 10/04/2024

All ETF Portfolio	%	Selections	Symbol	Initial Price	Price Oct 4
Broad Market	14%	VG Mid-Cap Value ETF	VOE	$137.05	$167.13
	4%	VG Large-Cap Value ETF	VTV	$121.81	$174.62
Financials	0%	VG Financials	VFH	$88.21	$110.74
	4%	iShares U.S. Insurance	IAK	$84.25	$130.87
Energy	18%	First Trust Revere Nat Gas	FCG	$19.01	$25.40
Defense	10%	Invesco Aerospace & Defense	PPA	$91.40	$116.38
International	20%	Vang International Stock ETF	VXUS	$64.61	$64.61
Precious Matals	5%	VanEck Vectors Gold Miners	GDX	$32.75	$39.55
	5%	Global X Silver Miners	SIL	$39.51	$35.77
Intermediate Bonds	*10%*	VG Intermed Corp Bond ETF	VCIT	$80.70	$82.80
Short Term Bonds	*10%*	VG ST Corporate Bond ETF	VCSH	$74.95	$78.78
Cash	0%	Broker MoneyFund			

Vigilante Portfolio: The portfolio remains 20% invested in fixed income assets. It holds another 10% precious metals, and 20% international. As such, exposure to the U.S. stock market has dropped to 50%.

Table 4: The Vigilante Model Portfolio as of 10/04/2024

Sector	%	Selections	Symbol	Initial Price	Price Oct 4
Broad Market	4%	Vanguard Midcap Value ETF	VOE	$158.02	$167.13
Defense/Aerospace	14%	Rtx Corporation	RTX	$85.17	$124.91
		Lockheed Martin	LMT	$428.00	$605.13
		Textron	TXT	$93.31	$86.74
		Boeing	BA	$169.84	$155.00
Financials	6%	Chubb	CB	$165.98	$290.59
		AIG	AIG	$47.54	$76.05
		WR Berkley	WRB	$35.72	$58.51
		Bank OZK	OZK	$34.86	$42.25
Energy	18%	ProPetro	PUMP	$8.25	$8.44
		Nine Energy	NINE	$1.90	$1.22
		Coterra (Formerly Cabot)	CTRA	$18.69	$24.87
		Expand Energy (Formerly SWN)	EXE	$46.81	$85.63
		Antero Resources Corporation	AR	$32.67	$29.99
		KLX Energy Services	KLXE	$9.94	$5.71
Agriculture	4%	Mosaic Co	MOS	$28.67	$26.93
Industrial	4%	Genuine Parts Company	GPC	$153.50	$136.70
International	20%	BASF ADR	BASFY	$13.94	$13.24
		Deutsche Telecom ADR	DTEG	$28.92	$28.92
		Mitsubishi UFJ ADR	MUFG	$10.37	$10.37
		JD.com ADR	JD	$46.97	$46.97
		Alibaba ADR	BABA	<$100	
Precious Metals	10%	Junior Gold Miners ETF	GDXJ	$46.02	$48.64
		Gold Miners Index	GDX	$29.30	$39.55
		Pan American Silver	PAAS	$21.13	$21.51
		Silver Miners ETF	SIL	$42.00	$35.77
		Newmont Mining	NEM	$53.32	$53.34
Intermediate Bonds	10%	VG Intermed Corp Bond ETF	VCIT	$80.70	$82.80
Short Terrm Bonds	10%	VG ST Corporate Bond ETF	VCSH	$74.95	$78.78
Cash	0%	Broker Money Fund			

Vigilante Investor Performance

Six years ago, at the end of the third quarter of 2018, I began managing a separate investment account, utilizing Vigilante Model Portfolio recommendations for asset strategy and selection. My client and I agreed to benchmark the account performance using the CRSP Large Cap Value Index, which reflects the value-oriented strategy of *Vigilante Investor*. Table 5 provides a statistical summary of the account's lifetime performance.

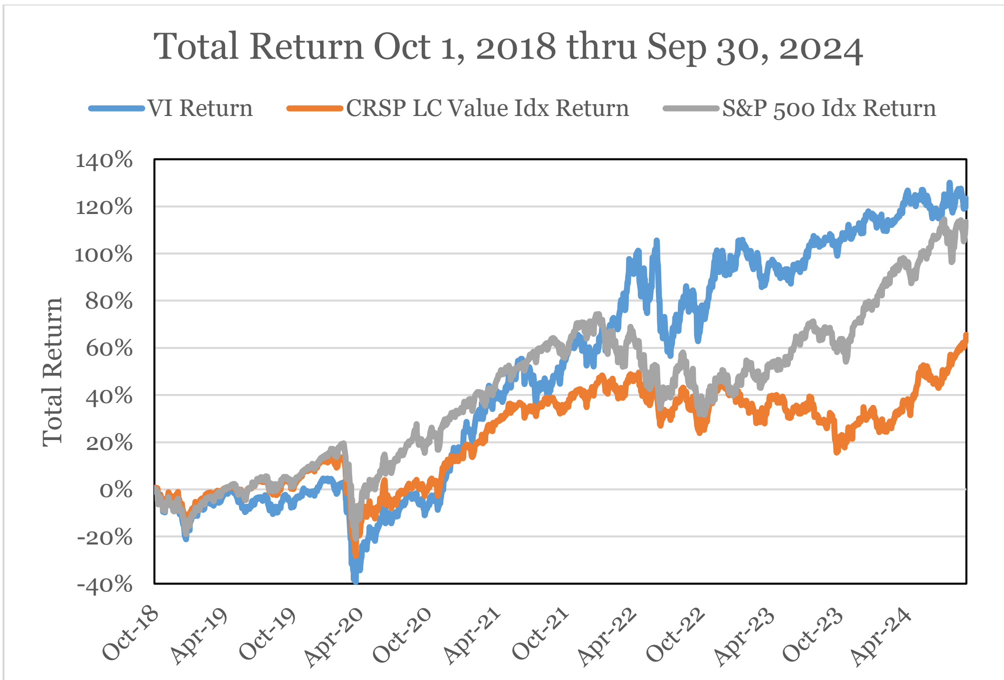
Table 5: Vigilante Portfolio Statistical Summary

Regression Analysis Oct 1, 2018 - Sep 30, 2024		
VI Daily Returns	CRSP LC Value Index	vs. S&P 500 Index
Alpha	0.025%	0.011%
Beta	93%	91%
Correlation	79%	78%

The Statistical summary shows alpha of 2.5 bps per day vs. the value index and of 1.1 bps per day vs the S&P 500. The Vigilante strategy delivered a low correlation (less than 80%) and a low index beta (about 92%).

Figure 11 is a graphic illustration of Vigilante performance vs. both the CRSP Index and the S&P 500.

Figure 11: Vigilante Portfolio Performance



To summarize performance… higher returns with less volatility compared to the benchmark indices.

May peace be with you!

Steve Koomar

October 6, 2024

Disclosures: Publisher Steve Koomar has either already invested or will invest in the securities recommended by this publication.

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