Deuterium Global Dynamic Allocation

Quarterly Strategy Report Q3 2022

30 June 2022

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All data in this report are sourced from Deuterium Global Asset Allocation proprietary models.

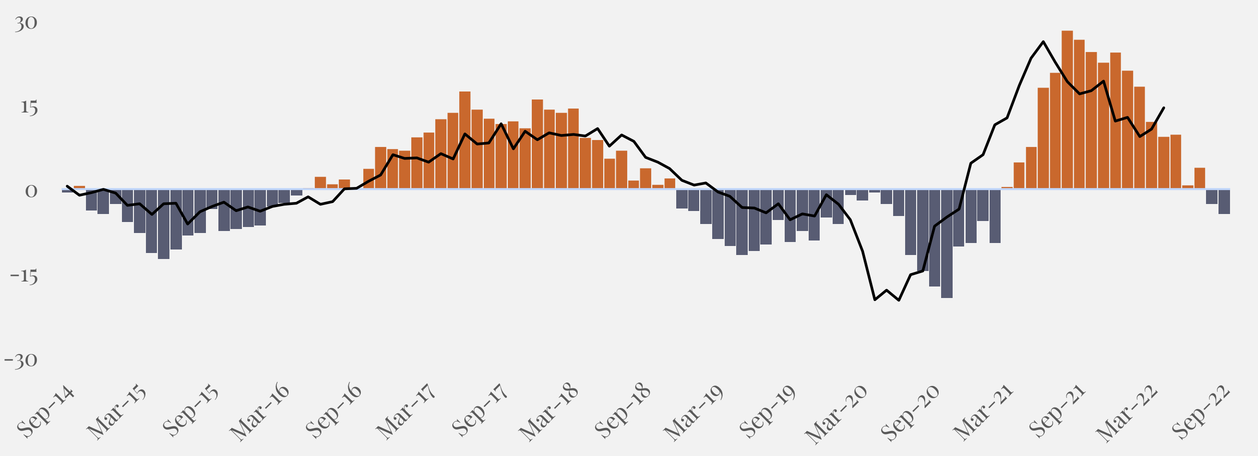
Deuterium Global Dynamic Allocation Outlook for Q3 2022

Risk asset performance likely will be positive to begin Q3 2022, when investors' current fears of yet higher prices, aggressive central bank tightening, and increasingly elevated recession risks will be lessened as inflation rates flatten over the next months. The investment outlook for risk assets will brighten at the start of the quarter when consumer and producer price inflation stop accelerating and economic growth remains positive, yet probably will darken again by quarter end when global output continues to slow and corporate earnings expectations fall significantly further. The worldwide instabilities following the Ukraine conflict that accelerated last year's global rise in energy and commodity prices likely will remain, even as upward pressure on US bond yields fades during the quarter. This year's high headline inflation has reduced real disposable income growth to weigh on consumption and retail sales growth across the major economies; and the ensuing drop in aggregate demand will bring global production close to contraction late in Q3 2022.

The central bank liquidity support mechanisms put in place during the March 2020 covid crisis continue to mitigate the negative financial system liquidity effects of international sanctions banning Russian institutions and blocking access to Russian sovereign reserves. Moreover, near record strength in the US housing market has provided additional buffers to US financial system reserves. A global liquidity crisis is unlikely in such a context. Poorer credit conditions in the wake of worldwide central banks hiking interest rates, in conjunction with lower personal income growth as wages trail prices, nonetheless will weaken global financial conditions, weakening world consumption and output.

Sector rotation will remain a major investment theme as US technology stocks, still overvalued despite their selloffs, likely will correct again, this time along with energy shares, when the global cycle slows markedly late in Q3 2022 and investors move to favour shares in interest-sensitive sectors such as healthcare.

Deuterium Global Asset Allocation projects world factory order growth falling in Q3 2022



World Factory Orders Annual Change (plain line) & DGDA projections (bars) 6 months ahead, Source: Deuterium

DGDA Market Projections for Q3 2022

DGDA projections for Q3 2022	At 30 June 2022	Market moves projected for end Q3 2022
USA		
3 Month yields	1.63%	🐻
10 Year yields	3.01%	
US Dollar Index	104.7	--
S&P 500 Index	3785	🐻
China		
3 Month yields	2.0%	
Chinese Yuan	0.149	+
MSCI China	74	+
Japan		
3 Month yields	-0.14%	
10 Year yields	0.23%	🐻
Japanese Yen	0.0074	--
Topix Share Index	1871	+
EMU		
3 Month yields	-0.47%	🐻
10 Year yields	1.34%	🐻
Euro	1.05	+
Euro Stoxx 50 Share Index	3455	--
UK		
3 Month yields	1.19%	🐻
10 Year yields	2.23%	--
British Pound	1.22	
FTSE 100 Share Index	7169	--
Commodity Markets		
All Commodities	117	🐻
Oil & Energy	49	--
Gold & Precious Metals	209	--

Source: Deuterium, Bloomberg

bearish	negative	neutral	positive	bullish
🐻	-		+	🐂

DGDA Global Investment Conclusions

1. Inflation will remain high but the rate of increase will flatten enough to have major central banks questioning how aggressively they will still need to raise directed interest rates. The global business cycle will be in a marked decelerating trend late in Q3 2022. This suggests that projections for lower inflation, improved financial conditions, and less upward pressures on bond yields will be positive for risk assets to begin the quarter, yet will be less so late in the quarter when the significant global cycle downturn brings negative corporate earnings revisions.

Market Projections			
	Major Equities	Negative	--
	Developing Equities	Negative	--
	Oil, Industrial Commodities	Negative	--
	Major Bonds	Neutral	
	Developing Bonds	Negative	--
	US Dollar	Negative	--
	Japanese Yen	Neutral	
	Euro	Positive	+
	British Pound	Neutral	

2. Investor anticipations of repeated, significant rate hikes over the next months from the US Federal Reserve, likely will dissipate quickly once the depth and breadth of the slowdown in US economic activity becomes evident late in Q3 2022. Major non-US monetary authorities currently aligned with those of the US in raising rates will have to question whether they can proceed with monetary tightening as projected, as most don't have the USA's full employment. All central banks will face conflicting policy pressures when output growth will slow rapidly.

Monetary Policy Projections		
	USA	Tightening
	China	Loose
	EMU	Tightening
	Japan	Loose
	UK	Tightening

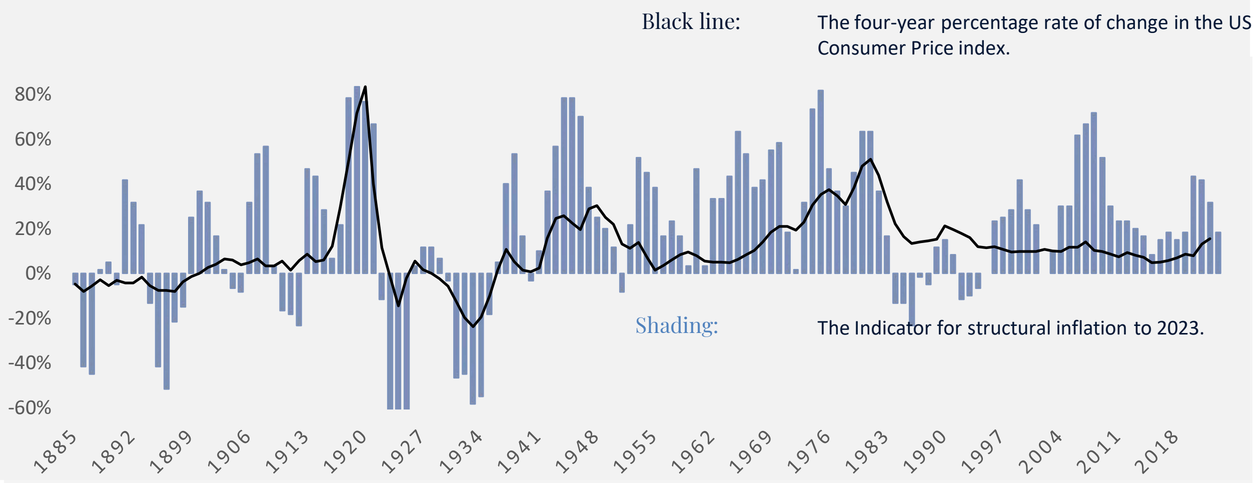
3. Late in Q3 2022 the US and European economies will show marked decelerations in aggregate demand and production, and industrial activity will continue to slow in Far-East economies with the exception of China's. Last year's monetary and fiscal interventions gave sufficient liquidity and income support to keep the global growth rate positive, but that support has gone as the central banks have shifted to global tightening.

Economic Projections		
	USA	Slowing Expansion
	China	Expansion
	EMU	Slowing Expansion
	Japan	Expansion
	UK	Slowing Expansion

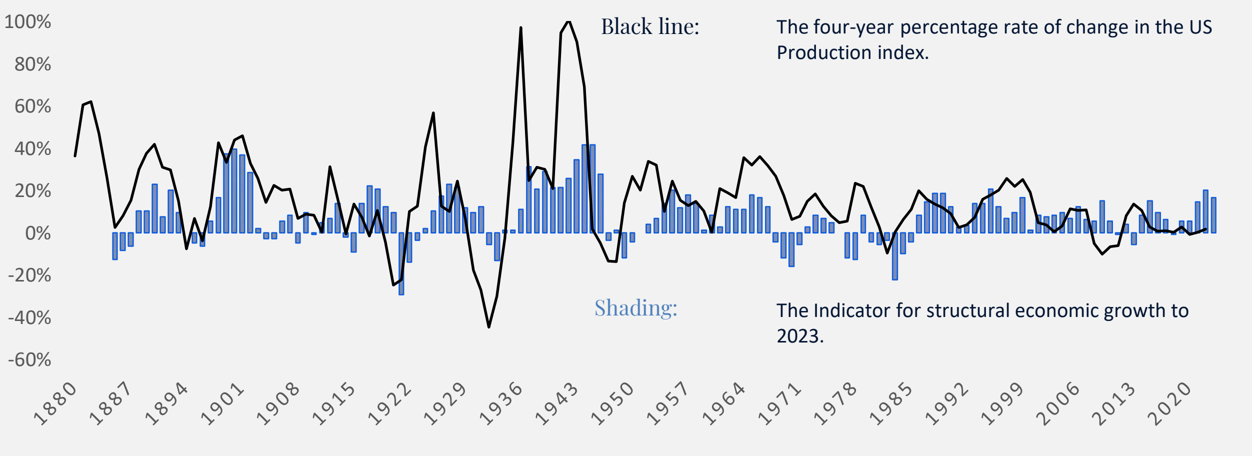
Deuterium Global Dynamic Allocation Outlook for Q3 2022

Our Q3 2022 projections for inflation to remain high and industrial activity growth to remain positive but to decelerate during the quarter are aligned with our structural projections for US CPI and Production through end 2023, based on our 150-year historical analysis (published separately).
The charts below show our predictive Indicators for US Structural Inflation & Growth from 1885 to 2023.

This chart shows the percent change over four years of US inflation & our four-year inflation indicator.



This chart shows the percent change over four years of US industrial production & our four-year production indicator.



Sources: Deuterium, Bureau of Labor Statistics, U.S. Department of Labor, Board of Governors of the Federal Reserve System (US), Quarterly Journal of Economics (1700-1919)

The key measures that underpinned the historical evolution of prices and industrial activity were money supply, commodity prices, interest rates, fiscal policy, and output. These therefore lay behind the booms and bust in the equity, precious metals, and bond markets. Our quarterly projections for a cyclical upswing align well currently with our historical projections, available on our website.

Global Economic signals shifting to significantly negative by end Q3 2022

DGDA projections for production, orders, and exports show that industrial activity growth will decelerate rapidly across nearly all regions, with signals negative by end Q3 2022,

Global Production Monitors (+/- 1)

Production Monitor	Production	Orders	Exports	Direction	Average
USA					-0.29
Europe					-0.26
Japan					-0.36
UK					-0.20
Canada					-0.54
France					-0.28
Switzerland					-0.11
Germany					-0.34
Australia					-0.49
Netherland					-0.25
Spain					-0.33
Sweden					-0.25
Italy					-0.41
China					0.22
South_Korea					-0.14
Taiwan					-0.06
Hong_Kong					-0.35
Singapore					-0.13
Indonesia					-0.05
Thailand					-0.07
India					0.00
Brazil					-0.32
Russia					-0.11
Mexico					-0.17
South_Africa					-0.06

Best   Worst

Source: Deuterium

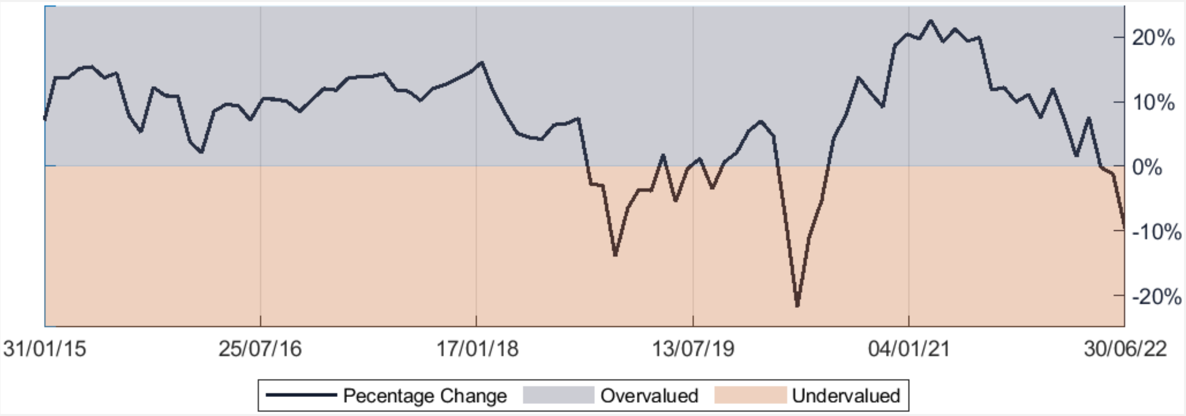
Our indicators for industrial activity are more negative yet for Q3 2022, signaling decelerations in all regions other than in China. These widespread, poor projections for production, factory orders, and durable goods suggest a deepening global slowdown by quarter end. Higher energy prices, deteriorating trade relationships, and worsening financial conditions were headwinds to worldwide demand even before central banks made rate hikes and quantitative tightening their priority.

Lessening US disposable income and weaker housing market support for consumption and production growth will have a negative impact, while the ECB and BoE will be tightening into slowing growth for their economies at less than full employment.

Non-US Equity Markets are at extremely attractive valuations

Equity market levels have declined significantly over the past months while growth in corporate earnings, cash flows, and dividends has remained steady, leaving most major markets far below fair value with even US shares now in line with historical averages.

World equity index percent change from its historical valuation



Source: Deuterium

US equities now show as fairly valued, with most major markets materially below fair value at present. Chinese, UK, EMU, Far-East, and Emerging market equities all show very attractive valuations.

COUNTRY	Current Price	Target Price	Price Move required to get to target price
World	2537	2783	9.7%
EAFE	1851	2333	26.1%
United States	3760	3851	2.4%
EMU	3465	4377	26.3%
Japan	26150	27873	6.6%
United Kingdom	7089	8666	22.2%
Canada	19004	20532	8.0%
France	5917	7457	26.0%
Switzerland	10528	13653	29.7%
Germany	13144	17645	34.2%
Australia	6509	8368	28.6%
Netherlands	642	784	22.2%
Spain	8145	9906	21.6%
Sweden	1896	1939	2.3%
Italy	21789	30348	39.3%
Asia Ex Japan	585	749	27.9%
China	71	95	33.3%
South Korea	2343	2773	18.4%

COUNTRY	Current Price	Target Price	Price Move required to get to target price
Taiwan	15348	19903	29.7%
Hong Kong	21008	27201	29.5%
Singapore	3093	3687	19.2%
Indonesia	6984	9477	35.7%
Malaysia	1431	1795	25.4%
Thailand	1560	1671	7.1%
Philippines	6168	6787	10.0%
Emerging	994	1323	33.1%
India	51823	63623	22.8%
Brazil	99522	149283	50.0%
Russia	2374	3439	44.9%
Mexico	47144	59242	25.7%
Turkey	2574	2687	4.4%
Resource	320	473	47.8%
South Africa	65713	95303	45.0%
Colombia	453	607	33.8%
Chile	5056	7585	50.0%
Argentina	85662	97408	13.7%

Source: Deuterium, Bloomberg

Negative Positive

US equities are fairly valued and major non-US markets are very undervalued

› US equity markets now show in line with historical averages for standard measures, with shares in most US sectors close to five-year averages for prices compared to earnings, sales, book value, cash flow, and dividends. In terms of their valuation metrics, shares in financial and energy sectors remain substantially below their levels for fair value, while large capitalization sectors such as information technology and consumer discretionary, despite their selloffs, still are markedly above their five-year averages. With US shares no longer keeping world equities overvalued, all of the 34 equity markets under review show attractive valuations at present.

› To start Q3 2022, Flattening inflation rates and attractive equity valuations likely will boost risk asset performance early in Q3 2022, as the upward pressures on short-term interest rates from central banks worldwide may appear somewhat to subside. These conditions eventually will not provide sufficient support to counter the negative effects of growth slowing late in the quarter, with fundamental support for shares deteriorating.

› Central bank policy tightening will remain in effect across the major regions, even as consumption, industrial production, and export growth will show significant decelerations. In this context large US sectors such as technology and consumer discretionary may again underperform, and shares in the energy sector may do poorly as well.

Deuterium Global Asset Allocation Conclusions for Q3 2022

Projections for corporate earnings will fade significantly by end Q3 2022. The fiscal and monetary policies that boosted incomes and output last year will be less and less in effect, and the global cycle expansion will show signs of an imminent slowdown. Sustained consumer inflation will not have come down enough to reverse upward pressure on short term interest rates, while lower commodity price inflation will be more a sign of global recessionary pressures reducing aggregate demand than of newly efficient supply chains.

To start the coming quarter, the global context will be one where flattening inflation will have investors anticipating that central banks will tighten less aggressively, thereby mitigating the risk of policy errors that would drastically affect corporate earnings growth to the downside. The headwinds to global growth nonetheless will become more substantial throughout Q3 2022, so that by quarter end the global context will not be supportive of risk asset valuations, despite very attractive levels for nearly all equity markets.

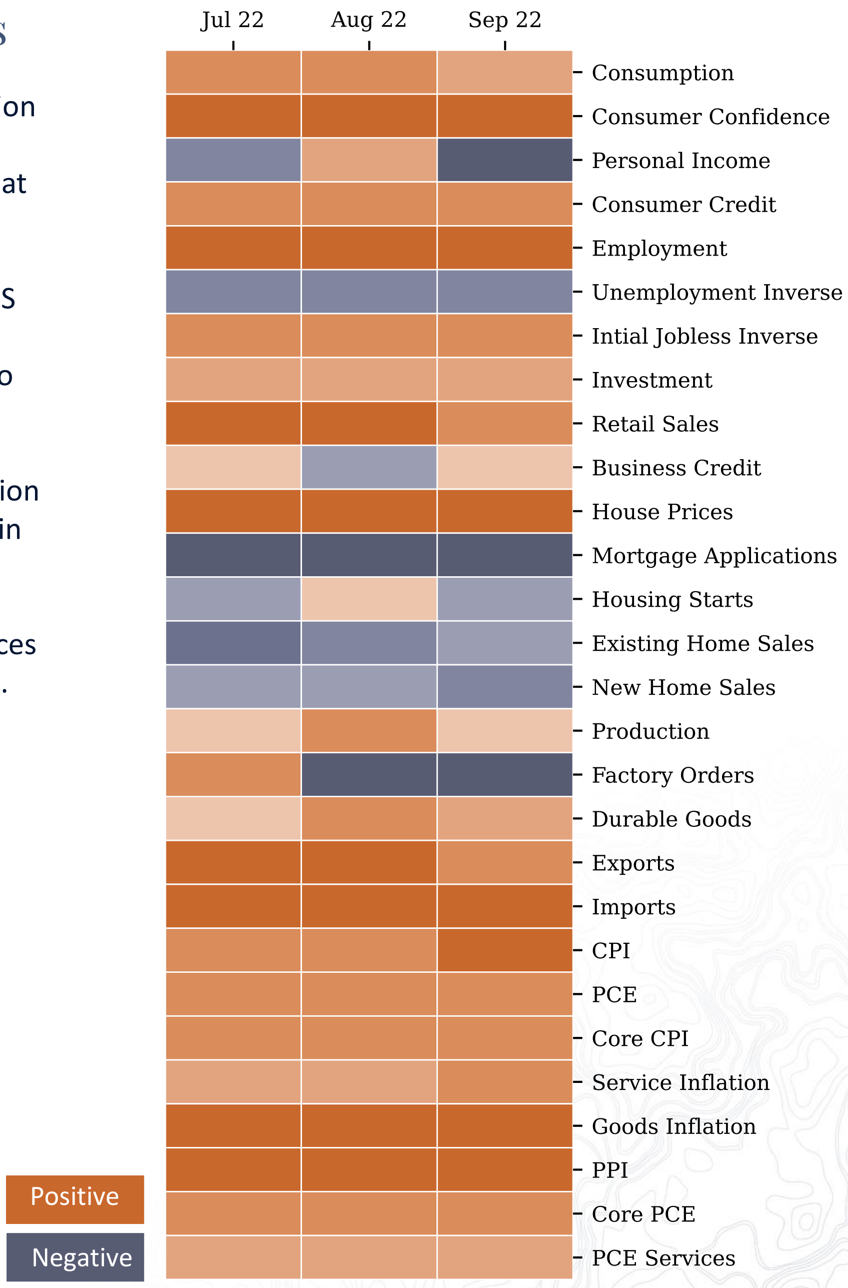
Investors may do well to hold allocations to risk assets to start Q3 2022 in order to benefit from slowing inflation in a period when nearly all equity markets are deeply undervalued. They likely also will do well to reduce those allocations by quarter end as fading economic growth worldwide will lower corporate revenue and earnings projections. Further decelerations in US consumption and retail sales growth, as well as in US production and export growth, will have technology and consumer discretionary shares again underperforming, with energy shares also out of favour. Short-term interest rates likely will stay high as central banks look to prevent inflation rates shifting further above target, yet slower global output growth may well cap bond yields by quarter end.

USA Regional Investment Conclusions Q3 2022:

DGDA Economic Projection Surfaces

Economic Projections

Deuterium Global Asset Allocation models project that US consumption will be expanding at a slower rate this quarter, with personal income and factory orders down from a year ago. US housing starts, sales, and mortgage applications all look to be contracting year on year as well, even as house prices stay high. During Q3 2022, US inflation will be sustained, and will remain the principal problem for US authorities even as goods inflation, PCE, and producer prices will stop accelerating from here.



USA Annual Change Projections in Q3 2022

Source: Deuterium, Refinitiv

Market Valuations

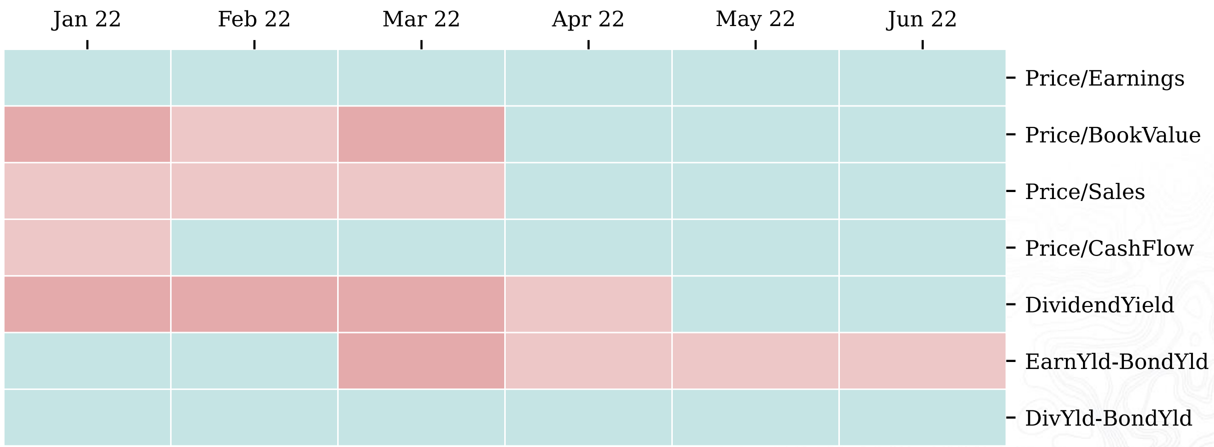
Outlook Summary

USA	Equities	Three Month Bills
		

Market Valuations

Equity valuation metrics show that US shares are undervalued for the first time in nearly two years, joining attractively valued equity markets worldwide. Comparisons of nearly all US equity metrics such as trailing earnings and dividend yields against US bond yields now are within historical bounds.

The Federal Reserve’s policy interventions and high reported US inflation have brought US bond yields up to the point that US bond valuations now are in line with their long-term averages. The US Dollar is undervalued on inflation and external account differentials.



USA Equity Valuation Surface Q2 2022

Over valued | Under valued

Source: Deuterium, Refinitiv

DGDA models show US equities to be undervalued on metrics such as price/sales, dividend yields, and price/cash flow compared to historical averages

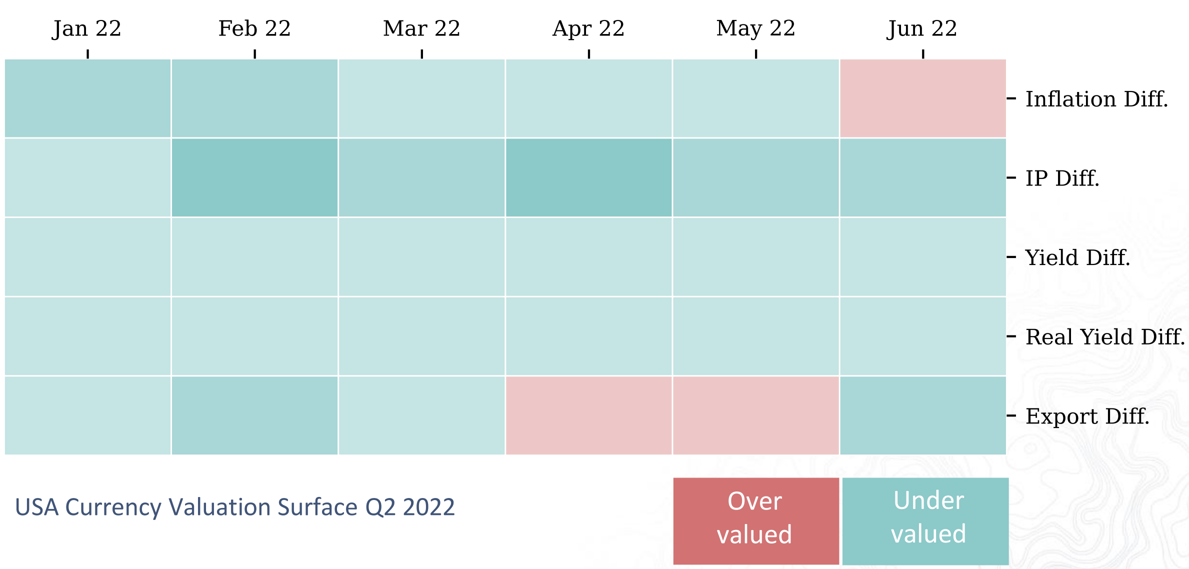
Monetary Policy and Transmission

Outlook Summary

USA	USD	Ten Year Bonds

Monetary Policy and Transmission

DGDA models suggest that US inflation rates will stay high but stop accelerating over the course of Q3 2022, so that the Federal Reserve's sustained shift towards keeping upward pressure on US short-term interest rates will appear to be having an dampening effect on prices, even as signs of significant slowdowns in US consumption and production growth materialize during the quarter.



USA Currency Valuation Surface Q2 2022

Source: Deuterium, Refinitiv

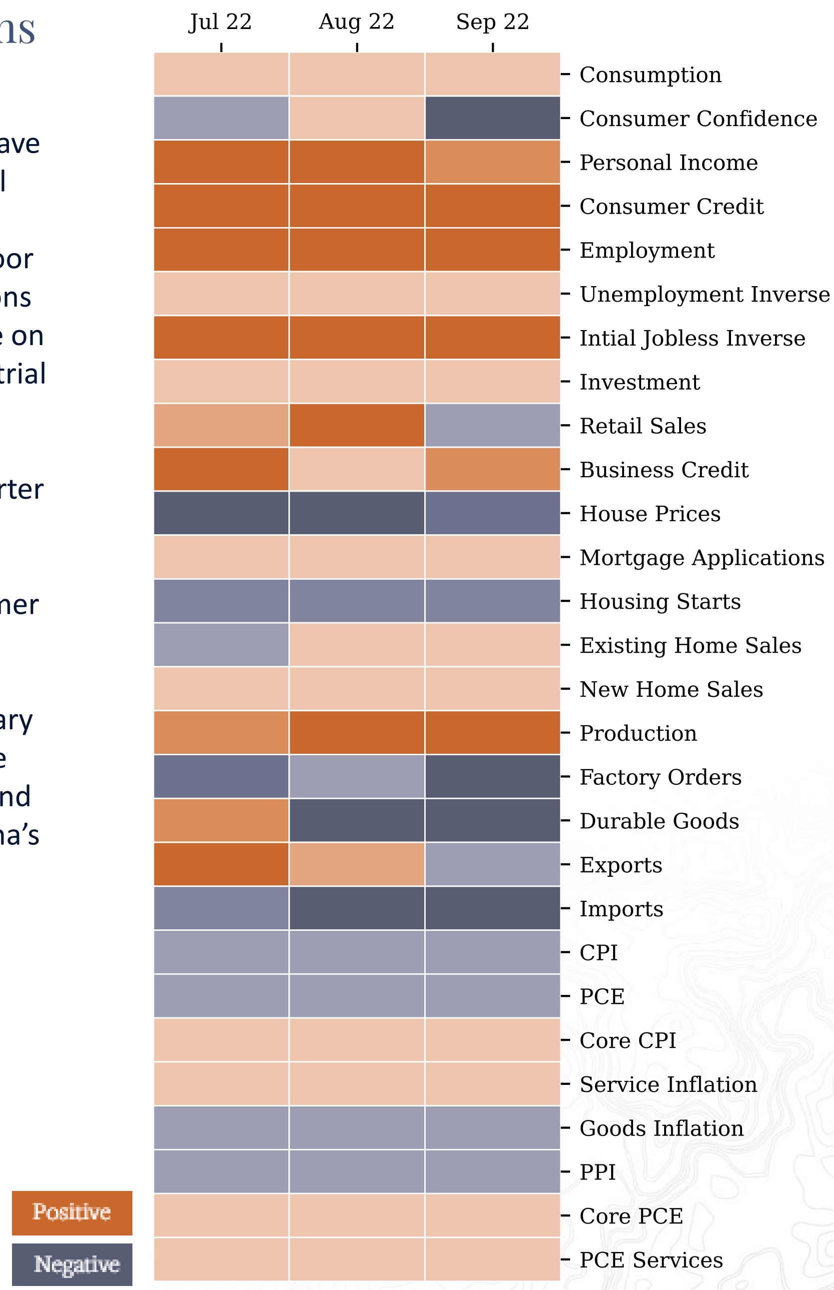
DGDA models show the USD to be undervalued on relative output trends, international real yield comparisons, and external account measures

China Regional Investment Conclusions Q3 2022:

DGDA Economic Projection Surfaces

Economic Projections

DGDA models show that real output growth in China will have headwinds from weaker retail sales, lower consumer confidence, and continued poor housing conditions. Expansions in personal income look to be on track over the quarter. Industrial activity appears mixed, with positive production growth countered by severe late quarter drag from contracting factory orders, durable goods, and exports. Decelerating consumer and producer prices will have Chinese authorities shifting further toward looser monetary policy in order to alleviate the stresses that property price and credit issues have put on China's financial system.



China Annual Change Projections in Q3 2022

Source: Deuterium, Refinitiv

Market Valuations

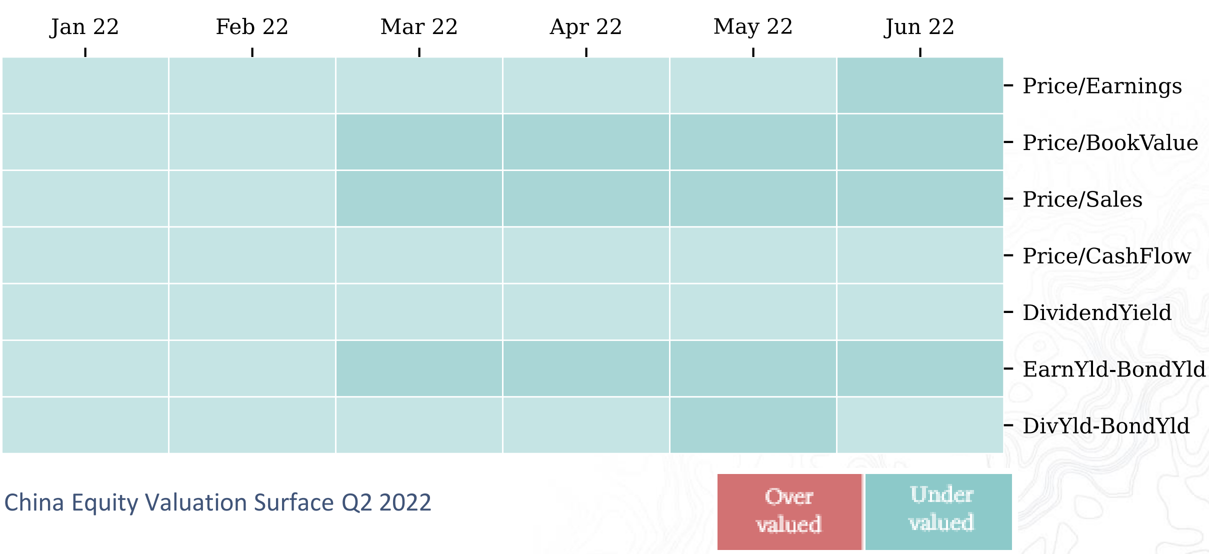
Outlook Summary

China	Equities	Three Month Bills
	+	

Market Valuations

Valuation tools suggest that Chinese shares in mainland indices have moved to significantly undervalued levels compared to long-term measures for trailing cash flow and earnings yields, while Hong Kong equities also are at very inexpensive valuations compared to fundamentals.

Chinese bond market valuations are attractive, while the Yuan remains fair value on international comparisons.



China Equity Valuation Surface Q2 2022

Source: Deuterium, Refinitiv

DGDA models show Chinese equities as very undervalued
on historical price to earnings, price to book value, and price to sales measures

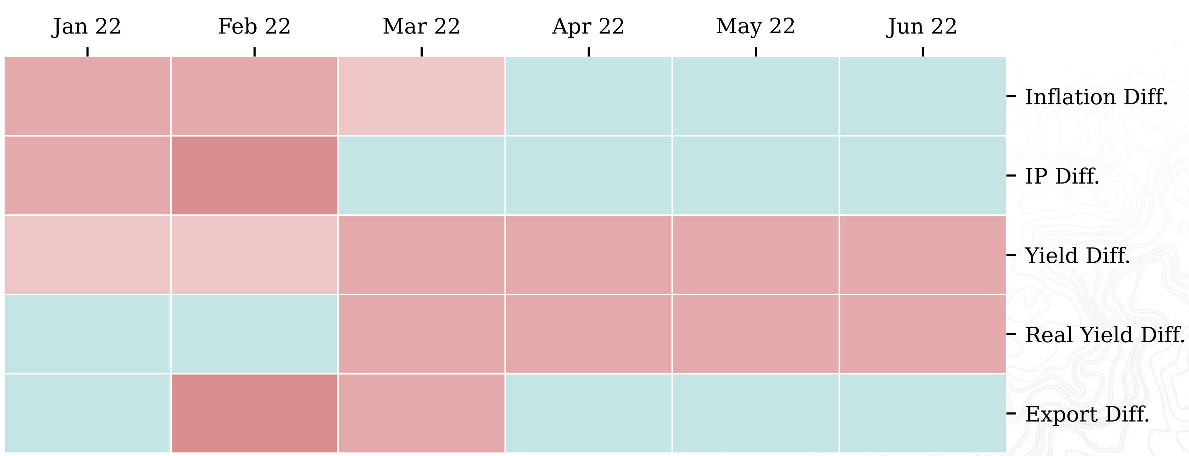
Monetary Policy and Transmission

Outlook Summary

China	CNY	Ten Year Bonds
		

Monetary Policy And Transmission

Chinese monetary authorities have reversed their prior steps to contain credit expansion, responding in part to low domestic inflation, and to financial system stress from negative conditions for Chinese property markets. China’s monetary channels now have begun to show positive transmission effects into the real economy, which should lead through positive effects on consumption and production to higher Chinese real GDP growth.



China Currency Valuation Surface Q2 2022

Over valued | Under valued

Source: Deuterium, Refinitiv

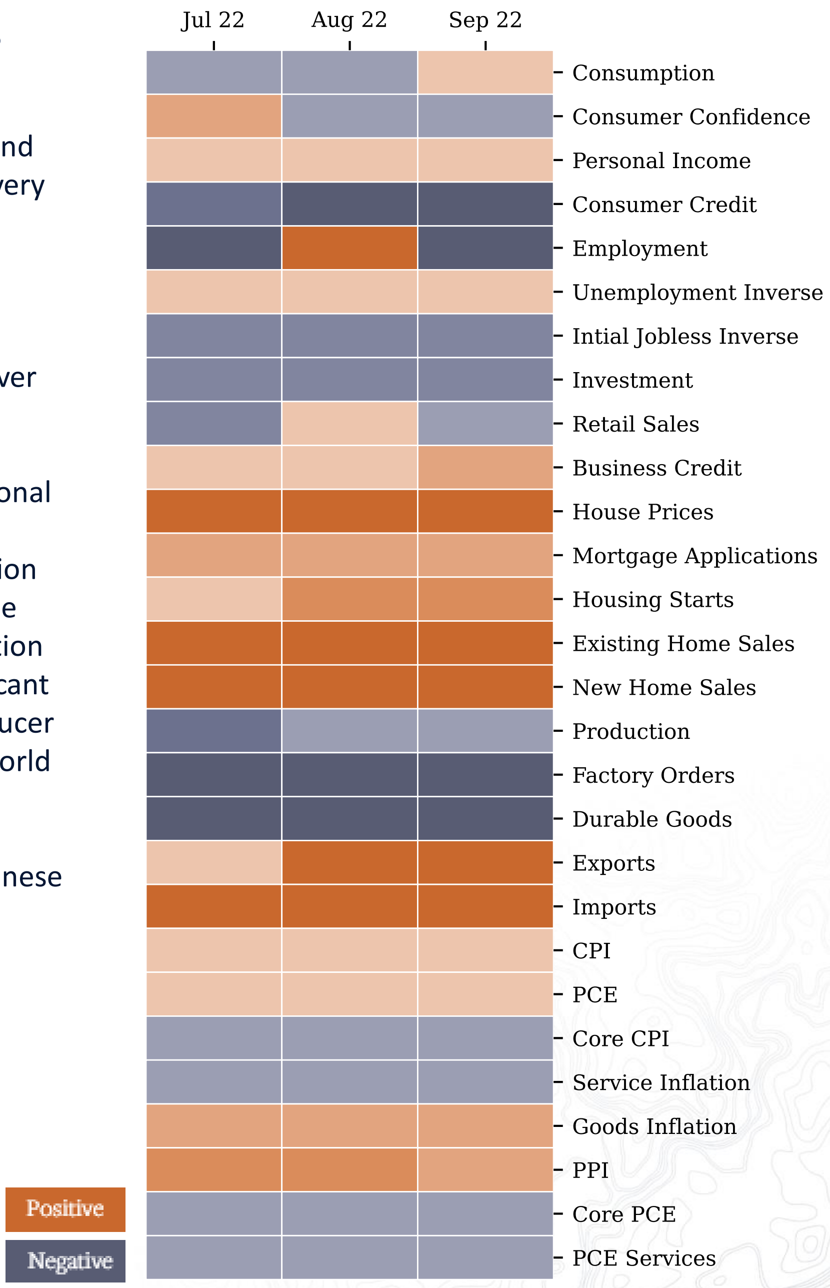
DGDA models show the CNY to be undervalued on inflation, real interest rate and domestic cycle comparisons

Japan Regional Investment Conclusions Q3 2022:

DGDA Economic Projection Surfaces

Economic Projections

DGDA models show significant accelerations in Japanese new and existing home sales with a recovery in housing starts contributing to Japanese investment growth. Production, factory order, and durable goods growth on the contrary will fade significantly over Q3 2022, likely reducing overall Japanese output growth for the quarter. Consumption and personal income expansions will remain relatively weak. Japanese inflation measures show positive headline consumer price and goods inflation rates, reflecting the Yen's significant devaluation, and Japanese producer prices will be high in line with world PPI measures. Core and service inflation measures nevertheless show the signs of historical Japanese deflation.



Japan Annual Change Projections in Q3 2022

Source: Deuterium, Refinitiv

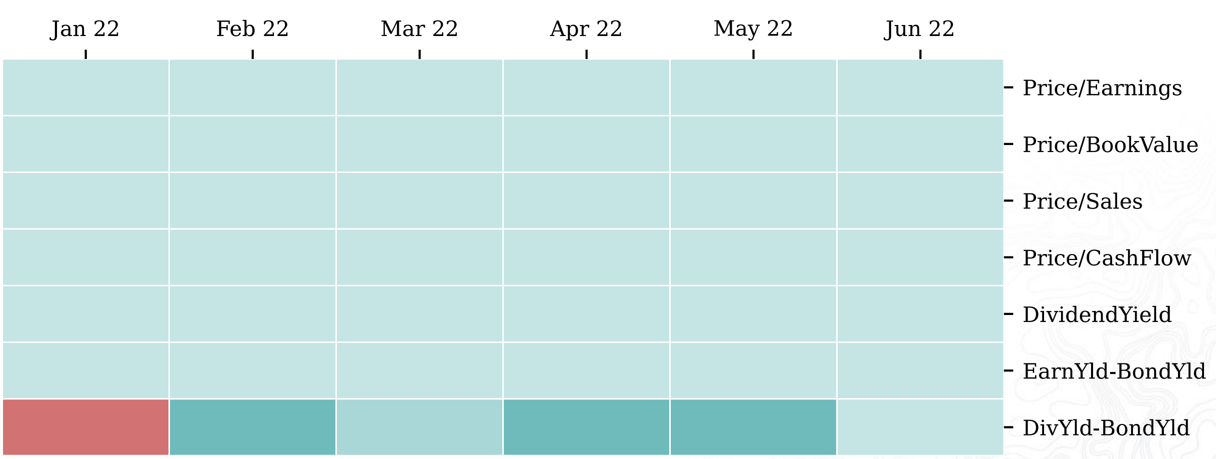
Market Valuations

Outlook Summary

Japan	Equities	Three Month Bills
	+	

Market Valuations

Japanese shares are undervalued, with several metrics including earnings yields and dividend yields compared to long-term bond yields moderately attractive when measured against their historical averages. The Yen looks to be overvalued despite its pronounced weakness this year.



Japan Equity Valuation Surface Q2 2022

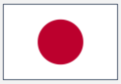
Over valued | Under valued

Source: Deuterium, Refinitiv

DGDA models show that Japanese equities are undervalued on most historical metrics

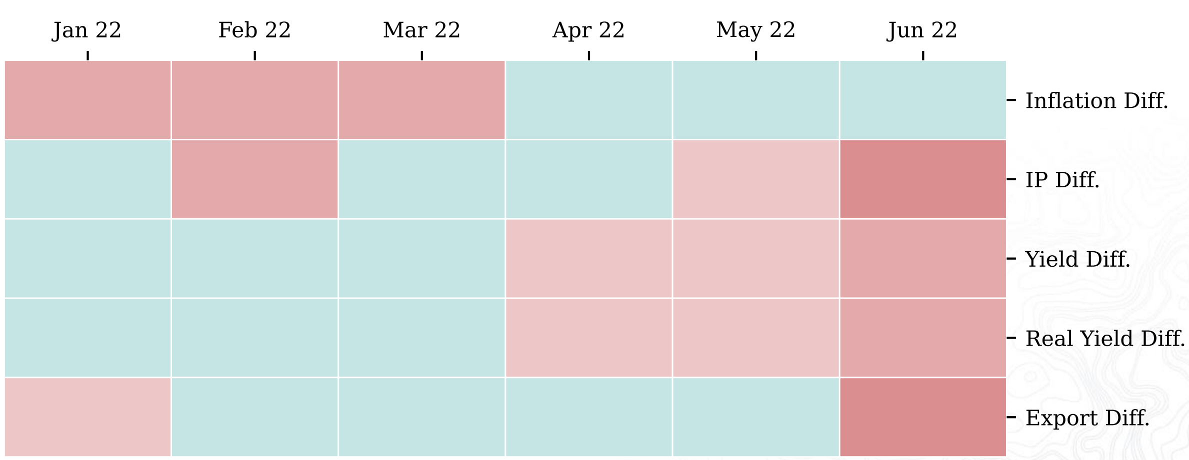
Monetary Policy and Transmission

Outlook Summary

Japan	JPY	Ten Year Bonds
		

Monetary Policy And Transmission

DGDA models indicate that Japanese monetary authorities will continue to be supportive of prices and real economy growth, in line with BoJ policies of the past decades. The BoJ has kept policy loose enough to have the implicit reflationary pressures that stem from a weakening Yen and rising world commodity prices put a floor under Japanese headline prices.



Japan Currency Valuation Surface Q2 2022

Over valued | Under valued

Source: Deuterium, Refinitiv

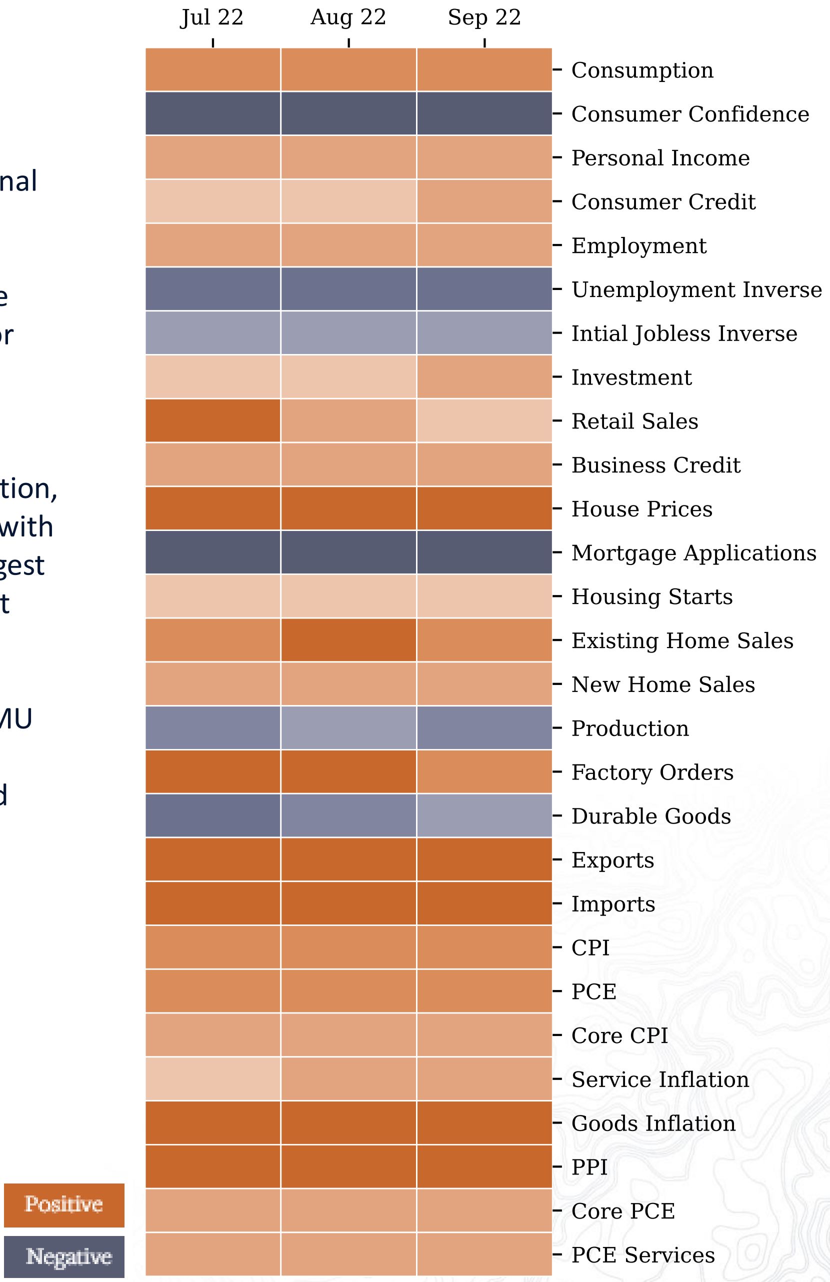
DGDA models show the JPY to be fairly valued on international fundamentals

Eurozone Regional Investment Conclusions Q3 2022:
DGDA Economic Projection Surfaces

Economic Projections

DGDA models show that economic growth in the Eurozone will reflect expansions in home sales and external trade during Q3 2022. The EMU consumption surface shows mixed readings, with consumer confidence low despite positive growth rates for consumption, personal income and employment.

Negative annual changes in production, and durable goods, in combination with decelerating factory orders will suggest that Eurozone industrial activity is at risk. Trade growth looks to remain elevated in the wake of the Euro's depreciation; and it appears that EMU inflation will stay high, with accelerations in producer prices and goods inflation.



Eurozone Annual Change Projections in Q3 2022

Source: Deuterium, Refinitiv

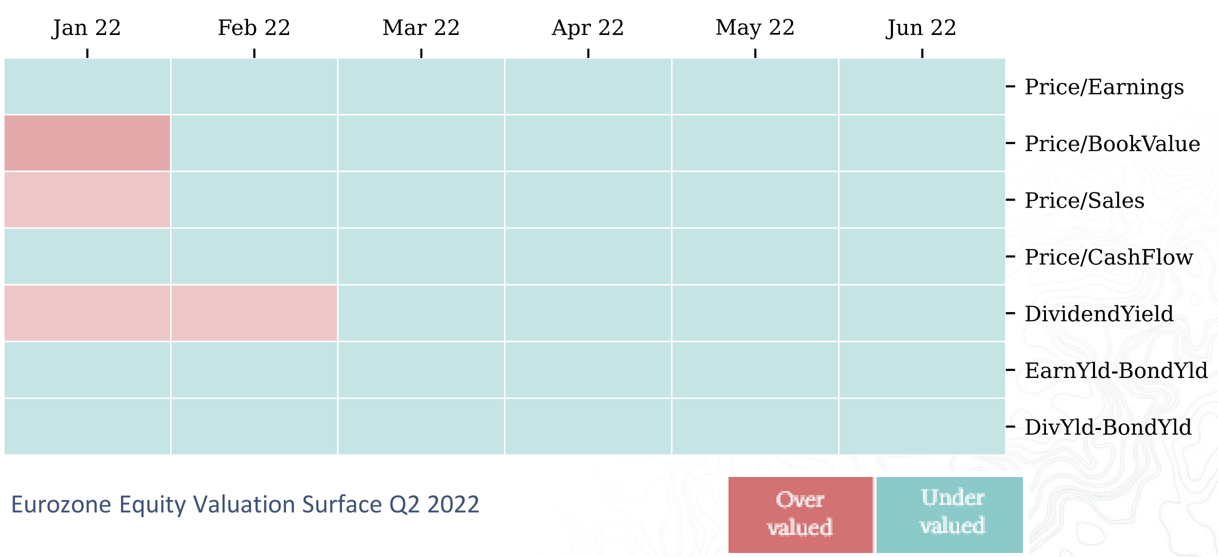
Market Valuations

Outlook Summary

Eurozone	Equities	Three Month Bills
		

Market Valuations

Eurozone equities are undervalued according to all measures, including comparisons of trailing earnings yields and dividend yields to long-maturity bond yields, and remain more attractive than US shares on most metrics. Eurozone bonds look to be overvalued at present given the Eurozone's likely higher inflation, while the Euro is attractive.



Eurozone Equity Valuation Surface Q2 2022

Source: Deuterium, Refinitiv

DGDA models show EMU equities to be attractively valued on all measures including price to earnings, dividend yield, and earnings yield to bond yield comparisons

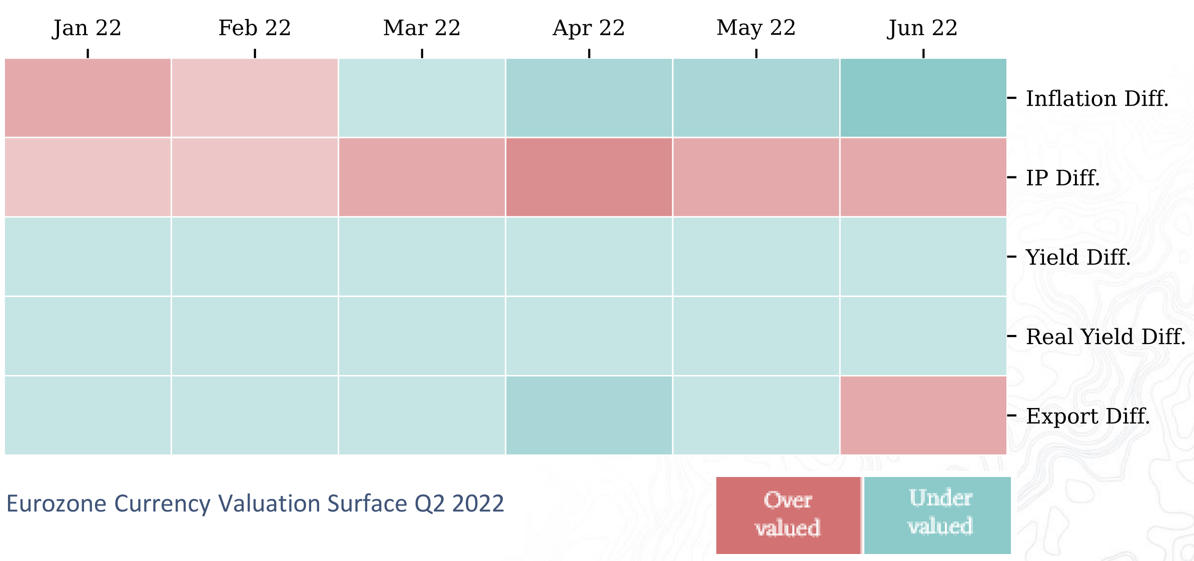
Monetary Policy and Transmission

Outlook Summary

Eurozone	EUR	Ten Year Bonds
		

Monetary Policy And Transmission

The ECB has declared its firm commitment to further tightening in order to counter Eurozone inflation, all the while stating that it will intervene to support sovereign fixed-income markets as needed across the zone. The ECB’s full alignment with the US Federal Reserve’s aggressive policy shift will keep upward pressure on EMU short-term interest rates, whatever the ongoing requirements for European financial institutions saddled with exposure to Russia.



Eurozone Currency Valuation Surface Q2 2022

Source: Deuterium, Refinitiv

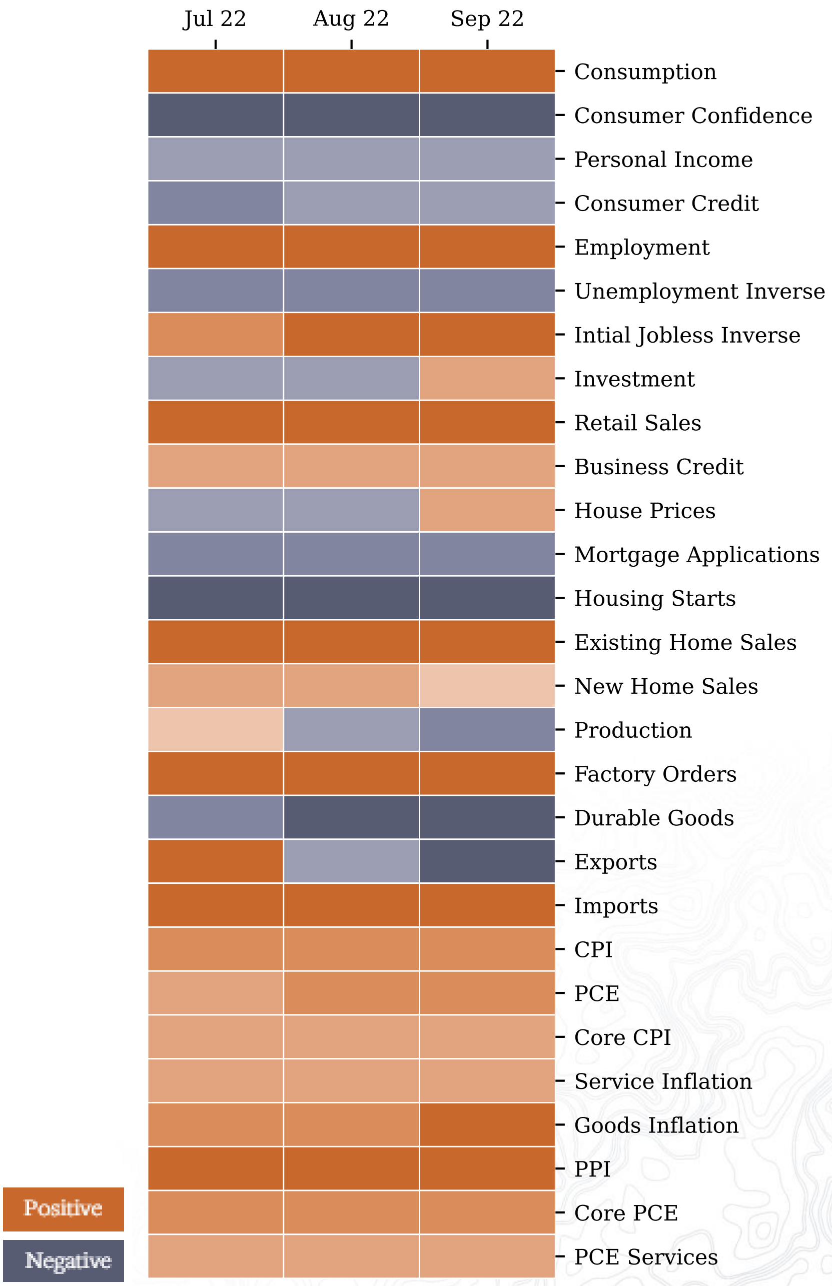
DGDA models show that the Euro looks to be attractively valued on historical comparisons

UK Regional Investment Conclusions Q3 2022:

DGDA Economic Projection Surfaces

Economic Projections

DGDA models show mixed output expansions in Britain during Q3 2022, with consumption constrained by weak confidence, lower personal income, and poor credit growth. UK production and durable goods growth all look to be slowing significantly in Q3 2022. External accounts will deteriorate materially when exports contract while imports remain high. Construction and the housing sector will be weaker with negative housing starts and mortgage application growth. UK inflation remains positive, with goods and producer price inflation moving up during the quarter.



UK Annual Change Projections in Q3 2022

Source: Deuterium, Refinitiv

Market Valuations

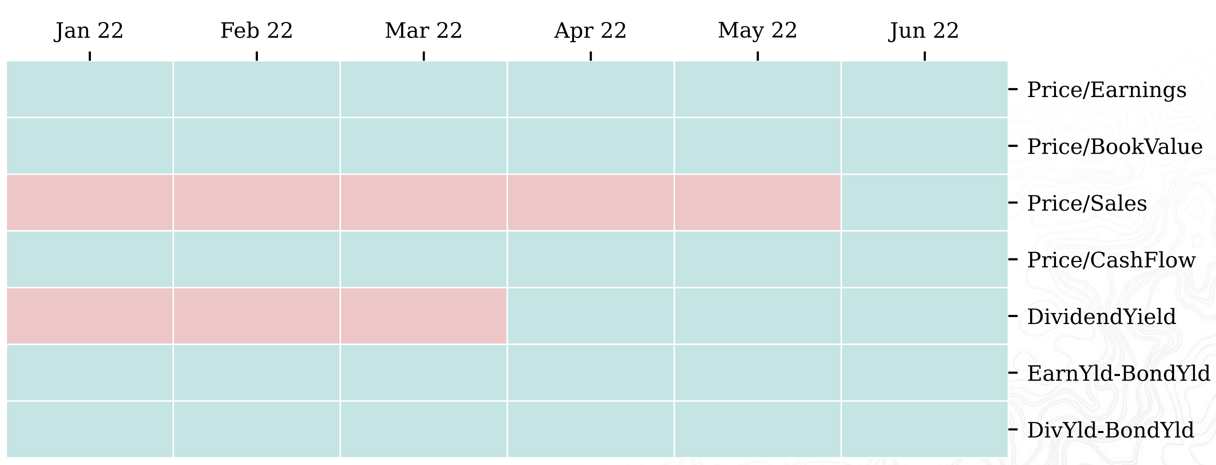
Outlook Summary

UK	Equities	Three Month Bills
	--	--

Market Valuations

UK shares valuations are attractive, comparable to those for most major non-US equity markets. The prior deep contractions in UK GDP, along with FTSE 100 companies often having global earnings tied to developing markets, have UK shares showing as undervalued across all metrics.

The Pound is fairly valued against the USD at its current exchange rate and may find better support if UK trade agreement negotiations eventually show progress. UK bonds look to have expensive valuations given their low yields in real terms.



UK Equity Valuation Surface Q2 2022

Over valued | Under valued

Source: Deuterium, Refinitiv

DGDA models show UK equities to be attractively valued on all measures including price to earnings and price to cash flow comparisons

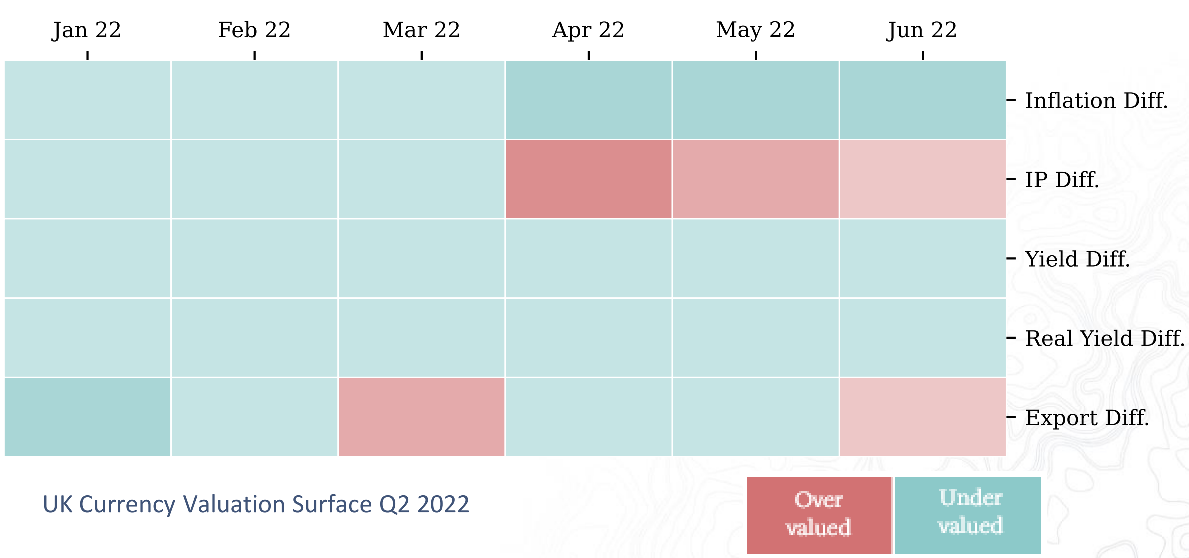
Monetary Policy and Transmission

Outlook Summary

UK	GBP	Ten Year Bonds
		

Monetary Policy And Transmission

The BOE was early in the worldwide central banks' pivot to rate hikes when faced with rapidly rising headline inflation, perhaps reflecting the UK authorities' difficulties in controlling domestic price changes during past cycles. A period of political stability has allowed the UK authorities to set monetary policies adapted to the UK's needs. These appear to be more flexible, now working through domestic transmission channels to promote expansions in Britain's nominal GDP as shifting global financial conditions may require.



UK Currency Valuation Surface Q2 2022

Source: Deuterium, Refinitiv

DGDA models show the Pound to be fairly valued on international inflation and business cycle comparisons

Emerging, Far East ex Japan, and Commodity Markets
Regional Investment Conclusions Q3 2022

Outlook Summary

Emerging Equities	Far East Equities	Commodities
--	--	

Economic Projections

Commodity prices likely will subside in the coming quarter as world factory orders contract year on year. Those developing market economies that rely upon commodity exports to accumulate international reserves will find themselves less able to adapt to worsening international financial conditions from major central bank rate hikes. Valuations for developing equity markets stayed low and very attractive even as world output rebounded over the past year, translating into one of the largest historical divergences between major and emerging market performances. This has meant that Brazilian and other developing resource equity markets remain at as much as 50% discounts to their long term valuations. Both producer and consumer prices will stay high in Q3 2022, and while elevated commodity prices will relieve pressure on such countries' external accounts, the negative effects of major central banks tightening will counter those effects strongly to the downside. The shift to lower in world consumption and export growth during Q3 2022 likely will be to the detriment of developing market equity valuations worldwide.

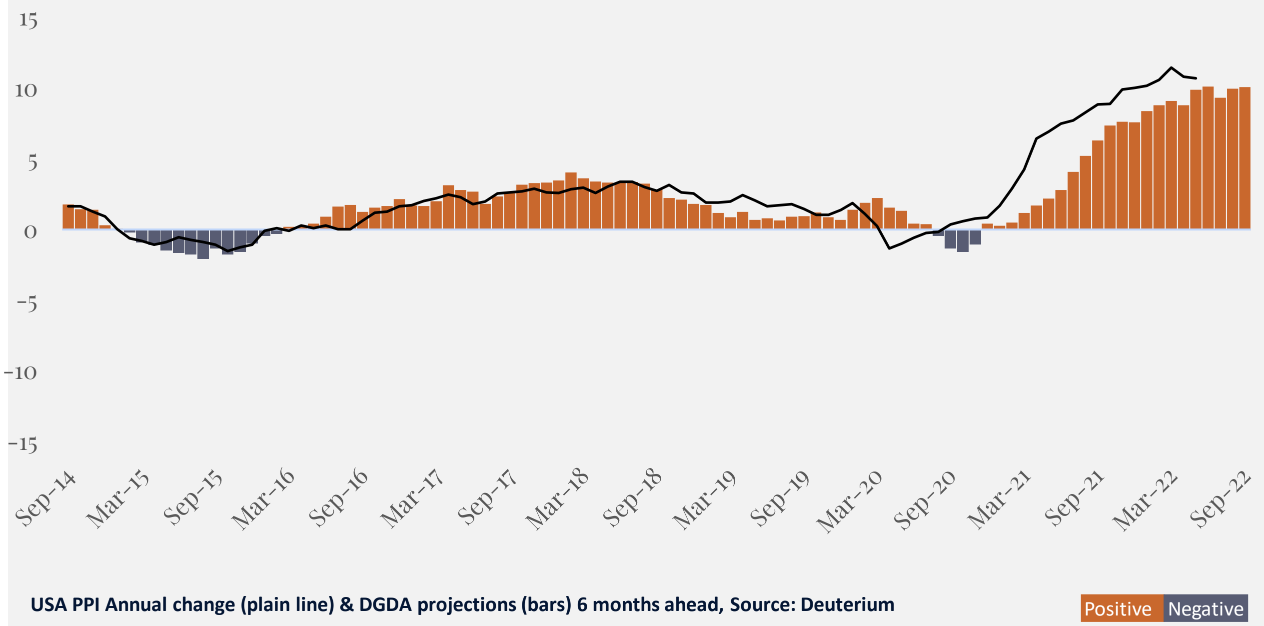
Monetary Policy And Transmission

Central banks around the world have their monetary policies set on rapid tightening, with the Federal Reserve expected to implement a rapid series of hikes worthy of monetary authorities who are concerned that they are already well behind the curve on inflation, even as they are about to begin an unprecedented program of QT. The BoE and ECB are well along their counter-inflationary path, with only China and Japan among the majors without rate hikes at present. Even if world producer price inflation flattens enough to put into question the pace at which major central banks will continue to raise rates, the rapid shift down in global output growth at quarter end likely will weigh heavily upon risk asset performance in the Far East and developing regions.

Market Valuation And Sentiment

Shares for Far East ex Japan countries such as South Korea and Taiwan are very undervalued compared to historical measures, while those of developing markets such as Mexico and Brazil also show as highly attractive compared to their long-term averages.

DGDA models show the USA producer price inflation rate flattening during Q3 2022



USA PPI Annual change (plain line) & DGDA projections (bars) 6 months ahead, Source: Deuterium

About the Author: John Ricciardi

Lead Manager of the Deuterium Global Dynamic Allocation Fund
Head of Global Asset Allocation, Deuterium Capital Management, LLC

Before joining Deuterium in January 2021, John was the Head of Global Asset Allocation at Merian Global Investors (MGI). John co-founded Kestrel Investment Partners LLP in 2011, whose global asset allocation business was acquired by MGI. Prior to Kestrel, John served as the Head of Asset Allocation at Iveagh Limited between 2006 and 2011, where he launched the Iveagh Wealth Fund.

Earlier in his career, John cofounded Cursitor Management. Cursitor was one of the first firms to offer top-down, global asset allocation solutions for institutions. Upon the sale of Cursitor to Alliance Capital in 1996, John became the Head of Global Asset Allocation for AllianceBernstein, where he served until 2003. With AllianceBernstein, John also cofounded Bullrun Financial in 2000, a pioneer of quantitative portfolio strategies for institutions and advisers. John chaired the business through to 2010 when it was sold to Quantal International Inc.

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Online

Download fund data and read investment updates from this fund manager at **deuterium.us**

Telephone

Speak to us at +44 2033 93 3133

London

Deuterium Investment Advisors Limited Cannon Green, 27 Bush Lane
London EC4R 0AA United Kingdom

Tampa Bay

Deuterium Capital Management, LLC 1006 N. Fort Harrison Avenue Clearwater, Florida, 33755
United States

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