STABIHO
INVESTMENT PARTNERS

# Newsletter #1

*In this publication, we want to make a brief reminder of our organization and share some thoughts on markets and investments.*

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Our small company was created in November 2022. Through its creation, we wish to reconnect with artisanal and unconstrained way of running a portfolio, and a company.

For us, artisanal rhymes with the prioritization of common sense, in-depth reflection based on the search for quality but also with a certain ambition to anticipate future market developments. This approach opposes the current trends of wanting to “industrialize” portfolio management, trends intended to make it possible to run increasingly large assets at low cost. The so-called “industrialization” may possibly work in calm and linear markets but is certainly not adapted to the volatile environments that we have been experiencing for the past two or three years. The market regime is at a potential historical crossing point while “industrial algorithms” are based on what has worked in the past.

**Stabiho Investment Partners (SIP)** also aims to be unconstrained, which means that we give ourselves complete freedom when generating investment ideas. Our priority is the search for the best long-term opportunities without regard to the benchmark index or other fashionable restrictions that an artisan manager should not really worry about. However, because some of these restrictions may represent a risk to a company's operations, we take them into account when analyzing a potential investment.

SIP's main objective is to generate solid performance in the long term and our only ambition is to ultimately be considered (very) respectable and respected specialists in emerging markets.

We indeed operate on the stock markets of emerging economies whose growth we wish to capture through a concentrated portfolio of companies, while keeping the protection of capital as our primary objective. A focus on defensive and quality companies, on reasonable valuations and on stable or improving macroeconomic environments are the main elements that will allow us to protect ourselves against market shocks.

In this context, we have just launched a French SICAV, **Stabiho Emerging Markets (SEM).** This is the only product we want to manage at SIP. SEM is available in five classes, all in euros and all capitalizing at this stage. We intend to enrich our range of classes later in order to make the investment in SEM as comfortable as possible for all our future customers.

Without going into the pricing details of our offer, we would just like to mention that for our first customers we have reserved very attractive price conditions.

And perhaps, now is not a bad time to take another look at emerging stock markets. Indeed, we note with some surprise the low exposure of investors to emerging countries. Only 6% of global assets are invested there, compared with 12% at the top of last cycle, in 2011. The MSCI ACWI index contains 11% of emerging assets at the moment, almost twice as much as an average investor.

This low weighting in emerging assets is surprising for several reasons. Let's think "by elimination" first. Why, for example, favor the S&P500 whose valuation levels are once again reaching historic highs? With a weighting of 59% in MSCI ACWI today, can we reasonably expect that the weighting of the American market will increase significantly in the future? Isn't the dollar rather expensive after a decade of appreciation? So what does the investor in American stocks hope for? We do not understand…

What about the European market? Certainly, valuations are more attractive there and European stock markets lag behind the S&P500. But what should we think of the heavily indebted European economies embroiled in a serious conflict at their borders depriving them of reasonably priced energy? Can we really consider that the conditions are ripe for European businesses to flourish in the years to come?

By elimination, our attention goes to other destinations and Asia naturally comes to mind. It is a huge area and it is rather difficult to aggregate it. We'll talk about China in a moment. Asia excluding China is doing well and, honestly, deserves better than being chosen "by elimination". Growth there is solid and debt rates, half as high as in developed countries on average, leave room for policies to deal with stressful situations.

Japan is in a different situation and far from us is the desire to explain what is happening in this highly complex country. But the very good performance of the Japanese market, a rather unexpected one, means that investors are looking for new destinations, where companies with reasonable valuations and the potential to improve their profitability reside. South East Asia, and emerging markets more generally, are also full of companies of this type, after more than a decade of disappointing performance.

Critics will say that, of course, there have been more than ten years of cleaning up of the emerging machine, but that fundamental reforms allowing improvement in productivity have not taken place. And probably the critics are not entirely wrong even if the good macroeconomic health of South East Asia in particular suggests otherwise. We will still allow ourselves to draw your attention to some changes which could give an advantage to the productivity of emerging countries and therefore widen the growth gap with developed countries in the years to come.

A **bull market in commodities** is likely ahead of us. Even if the demand from China is no longer the same, the "underinvestment" of the last decade in (fossil) energy and basic products has been considerable and suggests that the supply is not going to be sufficient. Too much money has been wasted on technology sectors, on a poorly organized energy transition or even on COVID.

One of the consequences of the conflict in Ukraine, the **de-dollarization** of part of the world is a boon for certain emerging countries whose local currencies will probably suffer less downward pressure. Emerging currencies, which have served as the main adjustment variable during the clean-up over the past decade,  are otherwise rather inexpensive.

**The relocation** of production outside China will favor a number of emerging economies such as Mexico, Vietnam, or South East Asia more generally.

Less pressure linked to climate change in the emerging world and the formation of a BRICS block mean easier access to **cheap energy**, which would improve the competitiveness of emerging companies, especially compared to their European equivalents. Ultimately, the economy is transformed energy, isn't it?

So many factors that can change the current balance in favor of the emerging world.

Let's talk about China for a moment, because it's a pretty darn important part of the emerging hemisphere.

First, it seems to us that China has changed, following American agitations. Growth at all costs is no longer relevant. It is stability that is now prioritized in order to avoid destabilizing the machine, destabilization which could be used by the adversary. We can therefore no longer count on China to fuel global growth. Instead, we should expect occasional stimulus aimed primarily at appeasing dissatisfied parts of the population and/or plugging a breach in the system.

Second, there is a lot of talk about relocating production outside of China. Certainly, this is an ongoing phenomenon. However, it seems to us to be lacking in common sense to think that anyone can replace China as the factory of the world. No one has the scale or logistics to do it and we must salute the phenomenal work done by China over the last forty years to make the world dependent on its productive apparatus (the Americans who facilitated this movement now feel that they made a strategic error dictated by the short-term greed). Anyone who has traveled to India, the only country large enough to compete with China, quickly understands that despite all the will in the world, India will not be able to replicate the Chinese model. Vietnam, Indonesia, Mexico are not only too small but above all lack the qualified workforce and financial means to develop the necessary infrastructure (roads, airports, ports, warehouses, etc.) to become the factory of the world. However, these countries can certainly accommodate marginal production units and serve as an industrial base for their respective regions. Their economies will therefore benefit from it.

Third, we must keep in mind that China also has 1.3 billion consumers whose purchasing power continues to increase. No one can ignore this market and many companies depend on it.

Let's imagine what would become some of the world's largest companies like Apple, Amazon, LVMH or VW if we closed their access to Chinese consumers or local subcontractors. There would be many disgruntled and even ruined shareholders and managers. And since the decision-makers today are precisely the principals or the owners of very large companies, it is unlikely that in terms of sanctions, China will suffer the same fate than Russia, even if the military faction of the American establishment would probably have liked it. We must not forget that presidential campaigns have become very expensive today, especially in the United States, and therefore that the men in power are indebted to their rich sponsors.

All this to say that we do believe that China will escape Russian economic restrictions, although relations between the United States and China will certainly remain tense. And in the end, if geopolitics were to triumph over economics and a military conflict were to engulf China, there wouldn't be many places to hide anyway. We therefore consider China to be **investable** and the moment seems opportune to

unearth some nuggets at reasonable valuations, while keeping in mind that the country must resolve some real problems, the consequence of unbridled past growth (real estate sector, debt of regions).

Some brief comments on other emerging countries. **India** is very coveted at the moment as is often the case when China is unloved by investors. The market is therefore strongly overvalued and we do not intend to dwell on it at the moment. The other beneficiaries of the Sino-American confrontation are Mexico and Indonesia. Given that these two countries have already attracted a lot of interest, illustrated for example by the very good performance of the Mexican peso, opportunities are becoming rarer for the contrarians like us.

**Brazil** has its share of political and economic challenges while the potential for lower interest rates is already partially understood by the market. In the medium and long term, it seems to us that the country should benefit from its quasi-geopolitical neutrality as well as the wealth of its subsoil in raw materials. Brazil is home to many quality companies and we monitor this market very carefully.

Two countries that are much less looked at by investors, given their small size, **Chile and Peru**, seem very interesting to us. Their respective economic and monetary cycles and their exposure to the raw materials necessary for the energy transition (copper, lithium, rare metals) are two factors that will favor these two small economies on the South American continent.

**South Africa**, on the other hand, is accumulating problems, between power cuts, record unemployment, political instability, the depreciation of the rand, it is indeed difficult to see a light at the end of the tunnel. We observe this place with great attention as some companies operating there have become inexpensive despite the long history of quality of their business models.

Overall, economic growth in the emerging world is estimated at 3.8% in 2023 and 3.6% in 2024. This should be put into perspective of very weak and weakening growth in the developed world. The growth gap between the two blocs should therefore gradually shift in favor of the emerging world. The profits of emerging companies have already been widely revised and will fall by around 6% in 2023. A rebound of 18% is expected to follow in 2024, but this certainly remains a little optimistic. The market is trading at around 12x next 12 months' earnings, which is roughly in line with the historical average.

## How is the Stabiho Emerging Markets portfolio structured in this context?

As you can understand, we pay attention to the economic environment since businesses do not operate in a vacuum. In the emerging world in particular, the macroeconomic aspect weighs heavily on the activity of companies, even of the best ones. This desire to understand the context does not, however, distract us from the essential. Thus, our readings, analysis and research time is mainly dedicated to companies in order to identify those of solid quality and proven economic models.

Typically, we select around thirty stocks for our portfolio. The investment horizon is long. Even if our research can be influenced by "top down" factors (for example the unpopularity of a region or sector encourages us to take an interest in it), the geographic and sectoral breakdown of the fund is a consequence of the stock selection.

We have identified several companies which present the qualities sought (quality, aggregate return greater than 10%, reasonable valuation) and which other investors do not seem to appreciate.

**Samsung Fire and Marine** is the leading non-life insurance company in South Korea. The company excels in health, property and casualty, auto and industrial insurance products. Its brand and distribution network are its main competitive advantages. SF&M is also very well capitalized and generates a lot of excess cash. However, the company is no longer growing dynamically, as the penetration rate of insurance products in Korea is already high. The attractiveness of investment is therefore linked to the rise in interest rates: each 10 basis points of increase is equivalent to around 4% more of net profit. The rise in interest rates also frees up capital reserves, built up in the past to provision old guaranteed rate policies sold somewhat imprudently. The release of excess capital equates to more dividend knowing that the yield is already around 6%. Samsung F&M trades at 5x earnings, with its valuation depressed by years of low rates that have weighed on ROE.

**Yuexiu Transport Infrastructure** is a highway and bridge operator in the Guangdong region of China. The period of strong growth for the sector is behind us and many Chinese highway companies have diversified into real estate or stock market investment activities. Yuexiu is one of the few who has stayed the course and instead continues to seek investment opportunities in its area of expertise, either by expanding existing concessions or seeking new ones. Its earnings growth is expected to be around 6-7% per year while the dividend yield is 6%. The company is poorly valued because the Chinese government has blocked/reduced tolls for the Covid period. The situation has since returned to normal but not the valuation of the stock which trades at 7x profits for an aggregate yield (EPS growth + dividend yield) of around 12%.

**Minth** produces automobile parts and specializes mainly in aluminum profiles of different types, roof bars, door and window frames, plastic front grilles, plastic logos, seat frames etc. More recently, Minth has developed boxes to house the batteries of electric vehicles. The latter product, unsurprisingly, has shown tremendous growth in recent times. Minth has around 60 factories around the world and enjoys around 30% market share in its areas of expertise. Future growth is estimated at around 15% per year while the company is valued at just 11x earnings. China's unpopularity certainly has something to do with it.

**Fibra Macquarie** is a real estate company based in Mexico. It specializes in industrial buildings and is mainly present in northern Mexico, close to the United States. The portfolio of assets that Fibra Macquarie has historically accumulated is difficult to replicate and the company is now fully benefiting from the industrial onshoring movement which is gaining strength in Mexico. Often, real estate companies are poorly managed, overly indebted and overuse the accounting revaluations of their buildings or land to increase the net asset value (NAV). This is not the case for Fibra Macquarie. Debt is low, Fibra is very prudently managed, rents are in dollars and indexed to inflation, assets are reasonably valued which gives credibility to the Fibra's market discount to the NAV. At 10x profits we access an aggregate return of around 12-13%, more than half of which will come from dividends.

**Orion Corp** is a company based in South Korea but whose main activity is in Asia. More than 40% of operations are carried out in China, 30% in Vietnam and Russia, with Korea representing the balance. Orion produces and sells pastries, sweets, candies, aperitif snacks and drinks. The company had a very good idea to enter China 20 years ago and was able to establish its brand and its factories there. The same is true for Vietnam and Russia. Orion products enjoy very strong brand awareness and its chocolate pies with various tastes are highly acclaimed internationally. We very cautiously forecast net profit growth of around 10% per year. Orion deals at 13x profits.

We have not seen many emerging funds that hold the companies mentioned above even though they seem to us to present a very attractive return-valuation profile. Our contrarian approach, our independence and our artisanal organization allow us to look where others will not or cannot. We want to make it our franchise and progressively build on it the superiority of our performance.

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