



Oldfield Partners

## Overstone UCITS Global Smaller Companies Fund

### 2022 Investment Manager's Report

The Overstone UCITS Global Smaller Companies Fund (A shares) fell -16.6% in US dollar terms (total return inclusive of dividends and net of all fees) in 2022 compared to a fall of -18.9% in the MSCI World Small & Mid Cap Index (index used for illustrative purposes only). I shares returned -16.4%.

Large amounts of government spending during the pandemic coupled with continued supply chain disruption meant that inflation was probable in 2022 as lockdowns ended. However, inflationary pressures were worsened by Putin's decision to invade Ukraine pushing up energy and food prices. Pressure on companies to increase wages grew and central banks were forced to raise interest rates or risk inflation spiralling out of control. High inflation, rising interest rates and a worsening economic outlook led to weak equity markets. It was a year where energy companies outperformed and expensive companies underperformed. Not surprisingly, the top three performers in this strategy in the year were energy companies: Hallador Energy, NOV and Oceaneering.

The strategy's large exposure to energy as well as the relatively low valuations meant it was less impacted than the overall market, but exposure to cyclicals and consumer discretionary stocks hurt performance. The two largest positions, JD Wetherspoon and IWG, more than halved in the year and half the portfolio was down by more than 20% in USD.

The extreme underperformance of JD Wetherspoon was particularly surprising given the company tends to do relatively well in recessionary environments. From the end of 2007 to 2009, when inflation was high and unemployment doubled, Wetherspoon managed to increase sales, cashflow and profits as customers looked for value. Wetherspoon is in a stronger position today than it was then with the pricing differential between its local peers at an all time high. The market cap of Wetherspoon is now just £600m, the same as it was in 2002 when it had less than £400m of freehold property, £300m of debt and sales of about £600m. Today the company owns £1.5bn in freehold property, has £0.8bn in debt and sales of £2bn. We expect free cash flow to return to over £100m (as it was pre-pandemic) implying it trades on just six times free cash flow.

As with 2020, the volatility in 2022 provided an opportunity to add to companies that had fallen considerably further than our view of their earnings potential, resulting in the strategy's look through earnings growing faster than the earnings of the underlying companies. On a look through basis, next year's earnings are now expected to be 76% higher (in GBP) than they were in 2019. The P/E of the portfolio has fallen to just 9x and the upside to our target prices is over 100%.

**Oldfield Partners LLP**

**April 2023**

**The value of all investments and the income from them can go down as well as up; this may be due, in part, to exchange rate fluctuations. Past performance is not necessarily a guide to future performance**

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