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Oldfield Partners

# Emerging Markets - Composite

## Patient, unconstrained, contrarian value investing

Quarterly Newsletter | Q3 2024

### Composite particulars

| | |
|---|---|
| Manager(s) | Tom Taylor<br>Charles Sunnucks |
| Launch date | 01 January 2001 |
| Comp. assets | US$187.5m |
| Structure | Composite |
| Base currency | USD |
| Benchmark | MSCI Emerging Markets |

*"A concentrated portfolio concentrates the mind..."*

**About Oldfield Partners**

Oldfield Partners LLP is an owner-managed boutique fund management firm which manages equity portfolios for a global client base that includes endowments funds, pension funds, charities, family offices and individuals.

Oldfield Partners began operations in March, 2005 and is majority owned by the executive partners.

We are value investors with a distinctive approach: a limited number of holdings, long-only, no leverage, diversified, index-agnostic and suspicious of short-termism.

All data as at 30 September 2024.
Source: Oldfield Partners.

## Composite performance (%)

| | | | | | Annualised | | |
|---|---|---|---|---|---|---|---|
| | 1 month | QTD | YTD | 1 year | 3 years | 5 years | Launch |
| Fund | +7.1 | +9.9 | +13.3 | +28.0 | +3.7 | +4.8 | +10.9 |
| MSCI Emerging Markets | +6.7 | +8.7 | +16.9 | +26.1 | +0.4 | +5.7 | +8.0 |

| Preceding five calendar years performance | 2023 | 2022 | 2021 | 2020 | 2019 |
|---|---|---|---|---|---|
| Fund | +20.8 | -20.9 | +11.6 | -3.7 | +7.8 |
| MSCI Emerging Markets | +9.8 | -20.1 | -2.5 | +18.3 | +18.4 |

Performance is calculated net of all fees and expenses and on a total return basis, inclusive of all distributions to unit holders.

Source: Rawlinson & Hunter, Alta Advisers Ltd, Oldfield Partners.

**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 a guide to future performance.**

## Portfolio breakdown

### Top 10 holdings (%)

| | Weight | MTD* | QTD* |
|---|---|---|---|
| Alibaba | 8.0 | +35.5 | +57.2 |
| Embraer | 6.9 | +6.4 | +36.9 |
| Samsung Electronics | 6.1 | -15.8 | -20.6 |
| SK Telecom | 6.1 | +3.0 | +15.2 |
| SK Square | 5.7 | +4.7 | -15.3 |
| Indofood | 5.1 | +5.4 | +29.6 |
| Thai Beverage | 4.9 | +2.7 | +25.6 |
| Infosys | 4.7 | -4.3 | +21.4 |
| ASE Technology | 4.6 | -0.7 | -5.9 |
| Petrobras | 4.5 | -5.5 | -1.0 |

*Total return in USD, reflects ownership period.

### Country breakdown (%)

| | |
|---|---|
| China/Hong Kong | 27.0 |
| Brazil | 19.1 |
| South Korea | 17.9 |
| Indonesia | 9.1 |
| Mexico | 6.4 |
| Thailand | 4.9 |
| India | 4.7 |
| Taiwan | 4.6 |
| Peru | 3.8 |
| Cash | 2.3 |

### Characteristics

| | Fund | Benchmark |
|---|---|---|
| P/E ratio (fwd) | 8.5 | 12.6 |
| P/B ratio (hist) | 1.2 | 1.9 |
| Gross div. yield (fwd) | 4.1 | 2.5 |
| Active share (%)** | 92.2 | |

**Active share is calculated using the sum of the absolute value of the differences of the weight of each holding in the manager's portfolio versus the weight of each holding in the MSCI Emerging Markets index, divided by two.

### Sector breakdown (%)

| | |
|---|---|
| Consumer Staples | 20.3 |
| Consumer Discretionary | 16.8 |
| Information Technology | 15.5 |
| Communication Services | 14.3 |
| Industrials | 12.7 |
| Materials | 10.3 |
| Energy | 4.5 |
| Health Care | 3.3 |
| Cash | 2.3 |


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## Fund manager commentary

The shape of the third quarter's EM equity headline performance was largely consistent with the prior two quarters – a strong India and China, a weak Mexico and Korea. Brazil, an equity market that had been performing miserably, enjoyed a modest rebound, and Taiwan, a market that had enjoyed strong performance, pulled back. Overall, at the benchmark level emerging market equity rose +8.7%, and the strategy returned +9.9%.

The third quarter was progressing as unremarkable after all the political excitement earlier in the year (including elections in India, Russia, Indonesia, Mexico). That changed in the final week of the quarter, when mainland China policymakers let rip a bazooka of stimulative measures. This was largely focused on monetary easing, including a lowered policy rate, lowered reserve requirement, lowered second home down payment ratio requirement, and lowered mortgage rates. There was also an effort to directly stimulate the equity market, including an announced equity market swap facility and the review of a stock market stabilisation fund.

China's announcement blitz was notably out of character for a system that emphasises cautious change – "Crossing the river by feeling stones" to quote former leader Mao Zedong. While these announcements are well received, and all help at the margin, the practical medium-term influence may be more muted. China's challenge as we see it is not tight liquidity, and further loosening the liquidity taps at this point could prove to be pushing on a piece of string. There are plenty of lessons-learned from Japan in this respect – for those interested, Richard Khoo's book on "Balance Sheet Recessions" is an excellent read. As for the equity market support measures, the practical effect of such brute state programmes is relatively negligible in the context of China's vast capital markets. While these changes may provide a sugar hit for market confidence and indeed this may spread into the real economy, we remain cautious about a meaningful medium-term recovery. Change in China is likely going to be more of a marathon than a sprint. We still however have strong confidence in the valuation case for the fund's four holdings there, where we believe the risk still skews heavily to the upside.

Beyond China, across the North Pacific Ocean, in Mexico there has also been a slow boil of activity over the quarter. Earlier in June, Mexico had their elections, voting in Claudi Sheinbaum as the country's first female president. Despite this, the September period presented former President Amlo with a window where he overlapped with the new Congress, thus allowing him a final 'hurrah' to push through his legislative agenda. This created market uncertainty, as some of the 18 institutional reforms he had proposed earlier in the year cut right through to the country's long-term economic stability.

The most meaningful Amlo reform was judicial reform. All federal and local judges will be elected by public vote with half of the judges to be elected in June 2025 and the other half in 2027. This reform also creates a new judiciary body with great power in disciplining and removing judges without legal recourses, and lowers the threshold for those who can become judges. The change is at the margin negative for the local equity market in our view, due to the risk of system dysfunction, potential for political influence in the judiciary, and added uncertainty. The practical impact it has on the fund's two Mexican holdings – Ternium and Orbia – are relatively limited however, as while both operate out of Mexico, they are both primarily exporters. Trading at a cyclically adjusted price to earnings ratio (Graham Dodd PE) of approximately six times, valuations for these two positions remain highly attractive on a through-the-cycle basis, be it compared with peers or history.

**Performance**

During the quarter, the strategy returned +9.9%, just ahead of its MSCI EM benchmark return of +8.7%. Key contributors to fund performance were Alibaba, Embraer, and Indofood; meanwhile the key detractors were Samsung, SK Square, and Buenaventura.

**Alibaba** is a Chinese firm specialising in online commerce, but also with a leading cloud, media and fintech business. Established in 1999 by Jack Ma, the firm was listed in 2014 and enjoyed an exceptional period of share price performance into the end of the decade. The stock price then collapsed in 2021 due to a combination of factors, but primarily due to building concerns on competitive intensity and an incrementally more challenging policy environment. The fund then initiated a position in the firm, determining that while the backdrop had indeed worsened, the underlying operating business remained robust, and there was the opportunity for a meaningful shareholder return program – both features which the market valuation severely under-priced. As it stands, despite the rally this quarter due to the Chinese stimulus program, the valuation remains heavily depressed.

**Embraer** is a Brazilian aircraft manufacturer, producing narrow body commercial airplanes, private jets and defence aircraft. The firm's share price has primarily benefited from recovery in its core divisions post COVID, entry into new international markets, and the successful launch of the C-390 - a military transport aircraft similar in size to the Lockheed C-130 Hercules. Embraer is also the majority owner in US-listed EVE, a firm developing an eVTOL (electric vertical take-off and landing) aircraft, a market that could scale quickly in size over the coming decade. The position was trimmed during the quarter due to strong share price performance, although it continues to deliver ahead of expectations and valuation upside remains.

The key detractor from performance was **Samsung.** The firm is a Korean-domiciled electronics multinational, best known for its handsets, but with around half of its through-cycle profitability generated by the production of semiconductors – namely, memory chips but now also logic chips. There have been market concerns that the firm is now in the foothills of a new memory chip pricing downcycle. Our view is that while the data does suggest weakness in conventional memory pricing, fears of a severe downcycle are overstated given the capacity shift from conventional memory to high band-width memory (HBM) – a dynamic that will tighten conventional supply over the coming quarters. Moreover, the valuation for Samsung has dropped to book value and twelve times its cyclically adjusted price to earnings ratio (Graham & Dodd PE), a level that has historically been consistent with substantial subsequent upside returns.

The other key detractor was **SK Square** which is exposed to very much the same semi-cycle dynamic. Spun out of SK Telecom in 2021, the firm is a holding company primarily for the SK Group's ownership of SK Hynix, but the entity also has stakes in a range of other private investments. Holding company discounts are not uncommon in public markets; however, the extent of the SK Square discount makes this business a relative outlier. This is especially true when the underlying NAV is largely market- derived, rather than a private market estimate, and the firm has been actively making efforts to realise value, including focusing capital on a share buyback program rather than new investments. The investment case for the holding is largely premised on the expectation that the level of discount will narrow, although given the recent fall in its core holding SK Hynix, there is also now a robust argument for material NAV uplift.

**Outlook**

We remain confident that there is considerable value across the portfolio, overlooked by the market. Over the past decade, emerging markets have performed poorly compared to developed markets, and this has bifurcated valuations, creating compelling opportunities for bottom-up investors.

In terms of 'what could go wrong', at the company level, each holding has its own idiosyncratic risks, although these risks vary in form and degree. At the 'macro' level, key areas that we continue to monitor include economic activity within the key end-markets of portfolio holdings, the possibility of new conflict arising or spreading, and the changing demand outlook for developed markets. The US election will also likely have a significant effect on overall market confidence. The world may be becoming increasingly multipolar, but the US is still the single largest cog when it comes to global economic activity.

Beyond the high-level figures, there is a complex melting pot of opportunity and risk. It is an exciting time to be an active value investor, and importantly, based on our valuation analysis there remains significant investment upside to the Fund's holdings. We remain long-term patient investors, and shy away from grand annual predictions. What we can note however, is that valuations are at a level that have been historically indicative of subsequent strong positive returns.

**Russian holdings**

Please note that on 3rd March 2022 the Fund's investment in Lukoil ADR listed on the London Stock Exchange (LSE) was suspended from trading. Our Valuation Committee considered it was in the Fund's best interests that the holding of Lukoil ADR be fair value priced (FVP) at zero. In June 2022, we elected for the holding to be converted into local shares (Lukoil PJSC).

**Commentary - continued**

Given the current international sanctions on Russian securities and cash balances, we believe that if lifted and the Fund was able to access the local market, the holding in Lukoil PJSC (with a current FVP of zero) would represent 11% of the Fund and cash dividend of 2.8%. On 22nd August 2023 a Reuters article suggested that Lukoil was planning to repurchase 25% of its shares from foreign shareholders. The repurchase price would be at least a 50% discount from the quoted price.  We continue to monitor the situation closely.

**Transition in Management**

We are pleased to announce that Charles Sunnucks has been promoted to sole manager of the Emerging Markets & Emerging Markets Ex China strategies, with effect from 1st January 2025. Charles has contributed to the strategies since joining OP in January 2023 and prior to this co-managed the Jupiter Emerging & Frontier Income Trust.

At the firm level, Richard Garstang has been appointed Managing Partner. Richard Oldfield has returned to the firm in a part-time role on the investment team, providing support and perspective, and has resumed his role as Chair of the Board. This leadership transition is the result of careful, long-term succession planning, and we are confident that it positions the firm for sustained success and innovation.

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The Emerging Markets Equity Composite includes global emerging markets equity portfolios run with the following style: value focussed, concentrated, index agnostic and anti-short term. The benchmark for this composite is the MSCI Emerging Markets Index with net dividends reinvested. A complete listing and description of all composites is available on request. The composite was created in January 2001. Net of fees performance is presented net of actual investment management fees. Fees vary between accounts contained within the composite, in particular between segregated accounts and pooled vehicles. The highest fee Oldfield Partners LLP charges on any account within this composite is 1.25% per annum. Oldfield Partners LLP is authorised and regulated by the Financial Conduct Authority. Oldfield Partners LLP has approved and issued this communication for use by the Client. It should not be provided to third parties without the consent of Oldfield Partners LLP. Information contained in this communication must not be construed as giving investment advice within or outside the United Kingdom. This document is not a solicitation or offer of investment services. Any reference to stocks is only for illustrative purposes and opinions expressed herein may be changed without notice at any time. Oldfield Partners LLP does not warrant the accuracy, adequacy or completeness of the information and data contained herein and expressly disclaims liability for errors or omissions in this information and data. No warranty of any kind, implied, expressed or statutory, is given in conjunction with the information and data. 