



Hosking Partners[®]

Quarterly Commentary Q4 2022

Hosking Partners is authorised and regulated by the Financial Conduct Authority and is registered with the Securities and Exchange Commission as an Investment Adviser. Hosking Partners LLP (ARBN 613 188 471) is a limited liability partnership formed in the United Kingdom and the liability of its members is limited. Hosking Partners is an authorised financial services provider with the Financial Sector Conduct Authority of South Africa in terms of the Financial Advisory and Intermediary Services Act, 37 of 2002. FSP no. 45612.

www.hoskingpartners.com | info@hoskingpartners.com | +44 (0) 20 7004 7850 | 2 St James's Market, London, SW1Y 4AH



The final quarter of 2022 delivered positive market returns in stark contrast to investors' loss-making experience in the first nine months, but overall this was a year that many market participants would rather forget. The portfolio's strong quarter on both a relative and absolute basis helped recover almost all of the underperformance that resulted from the writedown of its Russian exposure in February following Putin's invasion and the consequent international sanctions.

At the end of a year in which headlines were dominated by the war in Ukraine, China's seemingly never-ending Covid clampdown, and almost daily inflation updates accompanied by false reports of a Fed pivot while the pace of interest rates hikes barely slowed (the Fed overnight rate rising by 4.25% during the year), the fourth quarter was characterised by a glass-half-full response by markets. The prospect of an eventual China reopening and the positive effect of rising interest rates on the earnings of financials outweighed concerns about the credit impact of higher rates (in contrast to the previous quarter) and the scaling back of valuation multiples for growth stocks.

Breaking down performance by sector, the greatest contribution was from Materials, with copper a key exposure. Financials benefitted from both Insurance and Banks generally. IT and Consumer Discretionary stood out among the winners thanks to absence of exposure to large index constituents. On the other side of the ledger, underweights towards Biotech and Pharmaceuticals were detractors. In regional terms, the US was the stand-out performer thanks to the aforementioned Big Tech underweights, along with the UK owing to a number of the global miners being listed in London.

Activity saw continuing additions to Japan in the form of midcaps at cheap valuations (some even with negative enterprise values) and often with an activist already on the share register. Additions were also made to the basket of offshore drillers.



As we step over the year's threshold into 2023 and consider what future might lie before us, there is much talk of regime change, paradigm shifts and inflection points, and discussion of all these makes for good editorial copy. As with all forecasts, the timing and extent of any outcomes are uncertain. A forthcoming US recession has been described as the most heralded in history, yet this is yet to be reflected in earnings estimates. Inflation is called out by many as having peaked, yet the Fed appears adamant that interest rates will not fall in the coming year. The war in Ukraine certainly holds lessons for China and its attitude towards Taiwan, yet it is not clear which ones.

As ever, the Hosking Partners portfolio is not positioned for any particular outcome in mind, nor to generate editorial copy. The number of stocks in the portfolio remains over 400, and this diversified collection of ideas, based in each case on a bottom-up, supply-side approach is definitely not attempting to express a macro-themed investment thesis where the chances of being right may not be that different than 50:50. We prefer to look for easier, stock-specific wins. At the same time, the portfolio contains a number of ideas which are enjoying a powerful boost from the elastic of mean reversion which had become increasingly stretched: our capital cycle approach reinforces contra-cyclical behaviour, so as growth stocks were chased higher the portfolio actually increased its value tilt. Likewise, we added to energy and materials against the background of "capital-lite" being the *sine qua non*, and we picked up off-benchmark names which had been ostracised for not being listed in the index.

If the era of narrow stock market dominance by a small cohort of US Megacap tech names really is coming to an end, the Hosking Partners portfolio will benefit. The so-called FAANGM stocks peaked as a percentage of the S&P500 market cap at 26.2% back in September 2020 and now stands at 18.5%. Meanwhile, the passive-driven momentum phenomenon, which saw the big get bigger at the expense of almost everything else, may have peaked too - the size of S&P500 index ETFs hit \$1.1 trillion in January 2022 and have since declined to \$939 billion. Against this backdrop, the portfolio's value tilt remains pronounced, evidenced by a forward p/e of less than 10x.



If the Megacap momentum trade is over, it should come as little surprise that the portfolio's exposure to the US was around 45% at the end of 2022, a c.16% underweight relative to its MSCI ACWI yardstick. In other respects, too, the portfolio has a very different feel from its benchmark, not least in off-benchmark names amounting to 31% of the portfolio. As the baton of market leadership passes from the FAANGMs, it is noteworthy that names with market caps of less than \$15 billion represent c. 42% of the portfolio, compared with just 13% for the benchmark. Indeed, of the ten stocks which delivered the greatest contribution to the model portfolio's performance in absolute US dollar terms in the course of 2022, six had a market cap of less than \$5 billion (measured at the end of the year).

Two themes in the portfolio are worth mentioning at this point. The first, energy, is one we have written about extensively already, in particular the gap between the amount of energy the world's economy needs in order to grow and the limited increase in energy that is being delivered at current investment levels. Despite the humbling of Tesla during 2022, not to mention ARKK, Bitcoin and the S&P500, all have performed better than the energy sector (XLE) since 2015, suggesting the runway is long. Viewing the world from an energy perspective is helpful for providing a differentiated view on familiar questions, for example the risk that high energy prices may trigger a commodity-led recession, or geopolitical instability arising from energy and food shortages. These are lessons we are keen to pay attention to in light of the losses inflicted on the portfolio following Putin's invasion of Ukraine earlier in the year.

The second theme to mention is Japan with our capital cycle lens resulting in recent additions offering some combination of deep value, a supply-side angle (capital discipline being unsurprisingly stronger in Japan than in more frothy markets) and activist involvement to provide a catalyst. The market is under-owned, and cheap. Foreign investors sold a net cumulative \$242 billion of Japanese equities from 2014 up to 2021, since when just \$20 billion of purchases have been made. The market p/e is 11.6x, more than one standard deviation below its long-term average. The country is a Covid-reopening laggard, but as activity does recover it appears the dragon of deflation may finally have



been slain. The recent policy changes by the Bank of Japan anticipate those which would have been introduced anyway when the governor changes later this year, providing further catalyst for some of the deep discounts to intrinsic value in our Japanese stocks to be closed.

We leave 2022 relieved to have finished the year strongly, but disappointed that relative performance was not significantly greater, given how in so many cases the market came round to agreeing with our investment ideas. We have already invoked the Ukraine invasion as one of the major factors holding back performance. The other we have identified is that the portfolio's rotation into energy was more gradual and less dramatic than would have been justified by hindsight. We draw comfort from the thought that if past transitions from growth to value phases of the market are anything to go by, value has a multi-year ascendancy ahead of it. Meanwhile, the prospect of so-called 'non-linear events' arising from geopolitical tension makes us glad of the valuation margin of safety in many of our positions. Guests at the recently-ended Megacap Growth party may look across at the more sedate Value-themed session which has just got started, asking themselves whether it is worth joining or is it too late, but what they do not realise is that the punchbowl at the Growth party was spiked with the over-proof spirit of QE, and their hangover has only begun to kick in.



Legal & Regulatory Notice

Hosking Partners LLP ("Hosking") is authorised and regulated by the Financial Conduct Authority and is registered as an Investment Adviser with the US Securities and Exchange Commission (the "SEC") under the Investment Advisers Act of 1940. Hosking Partners LLP ("Hosking") is an authorised financial services provider with the Financial Sector Conduct Authority of South Africa in terms of the Financial Advisory and Intermediary Services Act, 37 of 2002. FSP no. 45612.

Hosking Partners LLP (ARBN 613 188 471) ("Hosking") is a limited liability partnership formed in the United Kingdom and the liability of its members is limited. Hosking is authorised and regulated by the FCA under United Kingdom laws, which differ from Australian laws. Hosking is exempt from the requirement to hold an Australian financial services licence under the Corporations Act 2001 (Commonwealth of Australia) ("Corporations Act") in respect of the financial services it provides to "wholesale clients" as defined in the Corporations Act ("Wholesale Clients") in Australia. Hosking accordingly does not hold an Australian financial services licence.

The information contained in this document is strictly confidential and is intended only for use by the person to whom Hosking has provided the material. No part of this report may be divulged to any other person, distributed, and/or reproduced without the prior written permission of Hosking.

The investment products and services of Hosking are only available to persons who are Professional Clients for the purpose of the Financial Conduct Authority's rules and, in relation to Australia, who are Wholesale Clients. To the extent that this message concerns such products and services, then this message is communicated only to and/or directed only at persons who are Professional Clients and, where applicable, Wholesale Clients and the information in this message about such products and services should not be relied on by any other person.

This document is for general information purposes only and does not constitute an offer to buy or sell shares in any pooled funds managed or advised by Hosking. Investment in a Hosking pooled fund is subject to the terms of the offering documents of the relevant fund and distribution of fund offering documents restricted to persons who are "Professional Clients" for the purpose of the Financial Conduct Authority's rules and, for US investors, "Qualified Purchasers" or, for Australian investors, Wholesale Clients and whom Hosking have selected to receive such offering documents after completion of due diligence verification.

This document is not intended for distribution to, or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation. Distribution in the United States, or for the account of a "US persons", is restricted to persons who are "accredited investors", as defined in the Securities Act 1933, as amended, and "qualified purchasers", as defined in the Investment Company Act 1940, as amended.

Investors are also reminded that past performance is not a guide to future performance and that their capital will be at risk and they may therefore lose some or all of the amount that they choose to allocate to the management of Hosking. Nothing in these materials should be construed as a personal recommendation to invest with Hosking or as a suitable investment for any investor or as legal, regulatory, tax, accounting, investment or other advice. Potential investors should seek their own independent financial advice. In making a decision to invest with Hosking, prospective investors may not rely on the information in this document. Such information is preliminary and subject to change and is also incomplete and does not constitute all the information necessary to adequately evaluate the consequences of investing with Hosking. The information regarding specific stock selections and stock views contained herein represents both profitable and unprofitable transactions and does not represent all of the investments sold, purchased or recommended for portfolios managed by Hosking within the last twelve months. Please contact us for information regarding the methodology used for including specific investments herein and for a complete list of investments in portfolios managed by Hosking. Information regarding Investment Performance is based on a sample account but the actual performance experienced by a client of Hosking is subject to a number of variables, including timing of funding, fees and ability to recover withholding tax and accordingly may vary from the performance of this sample account.

Any issuers or securities noted in this document are provided as illustrations or examples only for the limited purpose of analysing general market or economic conditions and may not form the basis for an investment decision or are they intended as investment advice. Partners, officers, employees or clients may have positions in the securities or investments mentioned in this document. Any information and statistical data which is derived from third party sources are believed to be reliable but Hosking does not represent that they are accurate and they should not be relied upon or form the basis for an investment decision.

Information regarding investments contained in portfolios managed by Hosking is subject to change and is strictly confidential.

Certain information contained in this material may constitute forward-looking statements, which can be identified by the use of forward-looking terminology such as "may," "will," "should," "expect," "anticipate," "target," "project," "projections," "estimate," "intend," "continue," or "believe," or the negatives thereof or other variations thereon or comparable terminology. Such statements are not guarantees of future performance or activities. Due to various risks and uncertainties, actual events or results or the actual performance may differ materially from those reflected or contemplated in such forward-looking statements. Hosking has taken all reasonable care to ensure that the information contained in this document is accurate at the time of publication; however it does not make any guarantee as to the accuracy of the information provided. While many of the thoughts expressed in this document are presented in a factual manner, the discussion reflects only Hosking's beliefs and opinions about the financial markets in which it invests portfolio assets following its investment strategy, and these beliefs and opinions are subject to change at any time.

"Hosking Partners" is the registered trademark of Hosking Partners LLP in the UK and on the Supplemental Register in the U.S.