Hosking Partners®

Quarterly Commentary
Q2 2026

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The Hosking Partners strategy delivered another strong period of absolute returns, adding 11.7% (net) in the second quarter and taking year-to-date returns to 15.3% (net). After materially outperforming the MSCI ACWI benchmark in the first quarter, the strategy's double digit returns in the second quarter trailed the benchmark as a near-term return to animal spirits drove a nearly 15% rebound for the ACWI. Year-to-date, the strategy remains 4.0% ahead of the index after a volatile first half, marked by competing headlines of AI dominance, trillion-dollar IPOs and geopolitical turmoil.

Over the past year, much of the discussion in global markets has centred on shortages and bottlenecks across memory semiconductors, critical minerals, power, and defence. In each case, a surge of demand into an industry meets inelastic supply in the short run. This has surprised investors, who have spent the past decade investing predominantly in 'capital-light', intangible-heavy companies where inputs were largely flexible, and has prompted analysis of industry structures and lead times for new supply, to determine whether improvements in return on capital will be sustained or whether profits will mean-revert in short order. While the current market euphoria may feel once-in-a-lifetime, we believe we may be seeing a return to traditional capital-cycle investing.

As Michael Godfrey put it in his recent Hosking Post 'Normal' Service Resumes, "*The exuberance we see in markets today is an important part of investors re-learning fundamentals. Capital having a cost makes this lesson both inevitable and painful. While we will find our fair share of pain, we have reverted to a market much more conducive to the capital cycle: where capacity, competition and the cost of capital all bear on outcomes and where differences between businesses and management quality drive returns.*"

We are experiencing one of the biggest momentum markets in the modern history of equities. AI spending beneficiaries have produced 85% of the market's return this year. Based on analysts' expectations, they will generate nearly half the S&P 500's earnings growth this year, and four stocks – Nvidia, Micron, Broadcom, and Sandisk – will account for 40 percentage points of that.[1] In this environment, the strategy underperformed the ACWI benchmark by 3.2% as the ACWI surged 14.9% in a single quarter. While it is challenging for a truly differentiated strategy such as ours to outperform in the very short term when such a narrow group of stocks leads the supposedly diversified index, our 13.5% outperformance over the trailing 12 months highlights the benefits of a highly diversified and contrarian strategy in an uncertain environment.

[1] Empirical Research Partners. Portfolio Strategy June 2026 – The Anti-AI Plays: Ideas from the Other Side.

Performance Review

Information Technology was the biggest absolute return driver in the quarter, though it was a small relative detractor to performance in the quarter given the strategy is materially underweight the index's exposure to the sector. While the Hosking Partners IT weighting is less than a third of the MSCI ACWI's exposure to this top performing sector, our stock selection, and specifically our long-held position in memory semiconductors, drove an absolute strategy return in IT of ~100% compared with 39% for the index. We continued to take profits in our DRAM memory semiconductor basket as share prices made historic moves to new highs (Q2 performance in USD terms: **Micron** +242%, **SK Hynix** +225%, **Seagate** +147%, **Corning** +88%, **TSMC** +38%, **LAM Research** +103%, **Applied Materials** +112%, **BE Semiconductor** +60%). Year-to-date, the strategy has realised ~3% in profits from this long-held thesis. We cautiously maintain exposure in specific stocks, as the companies continue to benefit from their essential role in the AI arms race and their ability to add capacity to meet demand remains constrained in the short term. However, as capital cycle investors, we are acutely aware that in a demand-led super cycle, record profits will eventually incentivise new supply, with inevitable consequences for returns and ultimately for share prices, as Luke Bridgeman discussed in more detail in his recent Hosking Post Super Cycle or Capital Cycle.

The largest absolute and relative detractor in the quarter was the strategy's ~11% weight in energy, three times the benchmark's ~4%. A fragile ceasefire agreement, followed by the 14-point 'framework agreement' between the US and Iran, caused Brent oil prices to fall from ~$100 to $70. Although we tweaked our positions opportunistically in the period, our holdings in North American oil producers and offshore drillers remain largely unchanged as we continue to see a lack of a supply response to recurring geopolitical events, such as the conflict in Iran and Russia's invasion of Ukraine in 2022. The system has little excess capacity, as major producers are not responding to price spikes, assuming they will not last. With inventories depleted by the recent conflict, energy markets are likely to remain volatile, creating opportunities for a long-term investor focused on the supply side.

The second-largest detractor was the overweight to materials, largely driven by our 2.2% allocation to platinum group metal (PGM) companies in South Africa, which gave back some of the recent performance run up seen over the prior 12 months. The pullback in PGM basket prices gave us an opportunity to refocus our basket of miners, with increased investment into **Sibanye Stillwater**, funded by taking profits at its more highly rated peers. Sibanye has moved from a position of uncomfortable leverage 18 months ago to now having line-of-sight on a net cash balance sheet, the result of prodigious cash generation from the past year of high PGM prices. With new CEO Richard Stewart declaring a commitment to capital discipline, we expect shareholder returns to be prioritised and see the prospect of a material re-rating from the current c1x normalised EV/EBITDA valuation.

We added a further 1% to our significant overweight in Japan, bringing the strategy weighting to 13%. This included adding to our largest Japanese holding, **Hikari Tsushin**, which is owned by all five multi-counsellors and whose shares have derated back to levels seen at the time of our initial purchase in late 2022. Hikari has operated under the radar in Japan, with a unique culture laser-focused on capital efficiency, resulting in book value compounding at 17% over the last 15 years. Omar Malik discussed our investment case for Hikari Tsushin in more detail recently at the MOI Global Asian Investing Summit. We also increased our positions in other deep-value opportunities that we believe will benefit from the corporate reform underway in Japan, such as **Tokyo Steel**, **Iwatani**, **Asahi Group**, **Ezaki Glico**, and **Tosei**. At the same time, we took profits in longer held positions, such as **Kyocera** and **Mitsubishi**, which have performed strongly.

We meaningfully increased the strategy's more recent position in New York real estate investment trusts (REITs) **SL Green** and **Vornado**, reflecting a growing scarcity of prime office space, which is exerting upward pressure on rents following a decade-plus build cycle that halted with COVID.

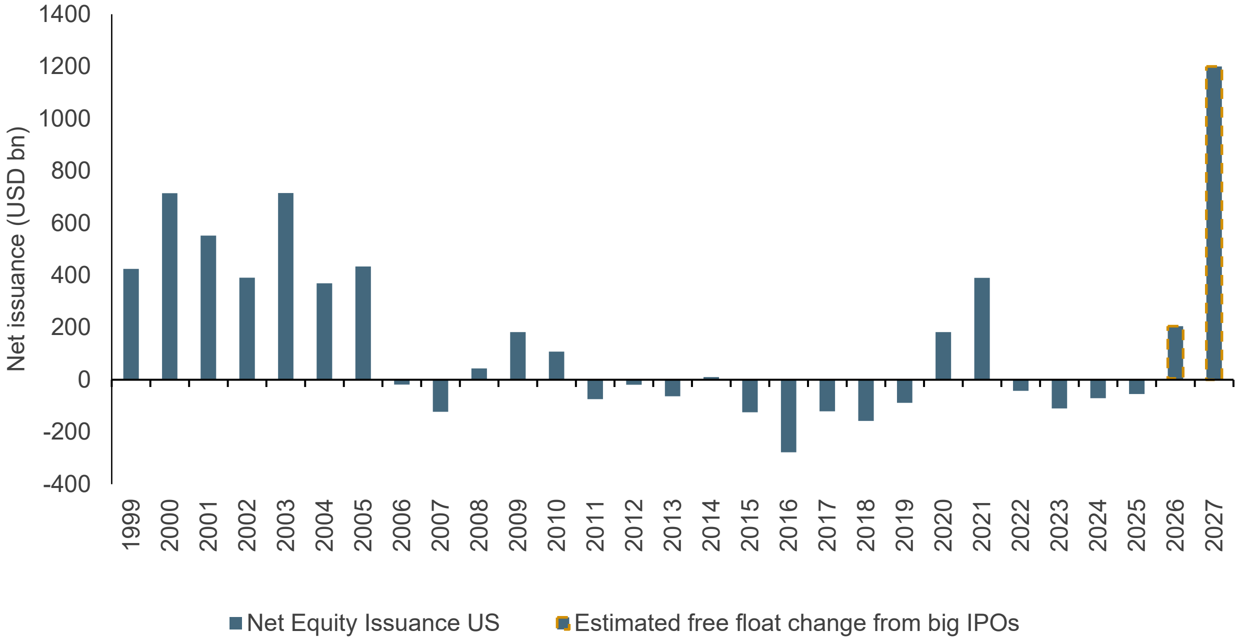
Outlook

"When we apply capital cycle analysis to the anomalies of behavioural finance suddenly an 'economic' explanation suggests itself: value stocks attract less competition, growth stocks attract more; IPOs and secondary offerings (right issues) appear in sectors which are 'hot', where investment and competition are increasing; high rates of earnings retention and capital expenditure by companies leads to excess capacity, causing future returns on capital (and stock prices) to decline. Growth companies fail to maintain their historic rates of earnings growth because they attract competition" – Edward Chancellor, introduction to Capital Account.

The parallels to what is described in *Capital Account* are now evident today. We are seeing the largest industry sector, information technology, issue vast amounts of equity over the next 12 months. This is an indicator that valuations are high and competition will rise, which is typically a sign of poor future returns on capital for this sector.

Since the global financial crisis, US companies have been reducing the number of shares outstanding through buybacks, aided by cheap debt. This reduction of supply has been a powerful tailwind for returns and valuations. This phenomenon seems to be approaching its end, as the scale of AI building has consumed all the hyperscalers' free cash flow, leaving no room to continue buybacks.

In a reversal, Alphabet and Meta have recently conducted secondary offerings to ensure they do not fall behind in the spending race. SpaceX raised $75bn in its recent IPO, more than double the previous record holder, Saudi Aramco, which raised $29bn in 2019. This will be followed by mega IPOs from the large model players OpenAI and Anthropic. As is the case in every cycle, investment bankers will encourage a whole host of private companies to follow, lest the window of opportunity closes and leaves them stuck with mere paper gains. As shown in the chart below, JP Morgan estimates that net US equity issuance could reach $1.2tn in 2027, the largest increase in supply since 1999. This supply will need to be absorbed at a time when US households already have their highest-ever allocation to equities.



Source: JP Morgan. Data from 31/12/99 to 31/12/27. 2026, 2027 estimates.

While this may not inspire confidence in the future returns of the increasingly concentrated index, our strategy by contrast is well-positioned given our significant underweight to sectors with record capital spending that are increasingly issuing equity, and overweight to industries with disciplined capital spending, rising free cash flow, and, in many cases, a falling share count.

OMAR MALIK

Portfolio Manager

Note: Weights as at 30 June 2026.