Hosking Partners®

Quarterly Commentary
Q4 2023

www.hoskingpartners.com | info@hoskingpartners.com | +44 (0) 20 7004 7850 | 11 Charles II Street, London, SW1Y 4QU

“Eya, nobis annus est”[1]

The Hosking Partners portfolio enjoyed a strong second half of the year after relative underperformance in the first two quarters of 2023. The year-end rally, whilst impressive, was not quite enough to produce benchmark beating performance by the portfolio for the year as a whole. The robust 11% advance in the benchmark in Q4 was a synchronized affair, albeit led by the US as investors upgraded dramatically the probability of a soft landing, previously an outcome regarded as ridiculously impossible given the vigour with which central banks had been pushing up interest rates over the previous 18 months.

The quarter saw negative contributions from regional allocation (namely the underweight to the US and the overweights to Japan, UK and Emerging Markets) largely offset by positive stock selection. Given the positive shift in investor expectations regarding the economic prognosis, a much better showing by value stocks was unsurprising. For much of the last two years their valuations have been repeatedly hit hard by recession fears. Initially this was because of the Covid economic downturn, later the result of relentless increases in interest rates in all major economies bar Japan. As such a “hard” landing is all but discounted in prices and a better outcome, such as that which began to emerge in Q4, would produce positive valuation improvement. Growth stocks also did well, emboldened by the perception that interest rate increases (from here) are less likely given the moderation in the inflation rate.

Of course, these quarterly fluctuations are of questionable relevance given the long-term nature of the investment horizon. The headline conclusions for the quarter were equally valid for the calendar year as a whole. Regional allocation was a negative and was largely offset by strong stock selection. The great exception to this overall summary was in the US where growth stocks in general, particularly the “Magnificent Seven”, led the market. So the strange conclusion for the quarter and twelve-months, is that growth investors had the better returns in the US, but a value approach more than held its own elsewhere.

[1] Benedicamus Domino (an anonymous 15th century Latin poem)

In the quarter just ended it was encouraging to note that the financial sector overweight benefited relative performance. The underweights to defensive sectors like healthcare and consumer staples also proved beneficial. On the other side of the ledger, the long standing underweight to IT was a drag on performance as "growth" segments enjoyed investor optimism concerning the more benign interest rate outlook. The longer standing overweights to energy and materials, which together amount to 27% of the portfolio, underperformed on a relative basis. In the case of materials there were continuing concerns about the effect of economic slowdown on commodity prices. The energy sector, where there is a three-times benchmark exposure, took a breather in line with oil prices. The longer-term capital cycle dynamics remain positive, in our view, and the sector contributed handsomely to the year's performance.

It is also appropriate in this report to draw attention to portfolio turnover. This was c. 20% on the year, low by industry standards but up on what Hosking Partners generally reports. This reflects the move to three multi-counsellors. The transition which has taken place has reduced the number of holdings in the portfolio, but at the same time has increased the intensity of the active investment bets made by the firm. For example, the overweight to Japan is increased as is the energy sector overweight. Active share has increased to c. 86%, average market capitalization has declined, and non-benchmark securities are now around 37% of portfolio exposure. Overall, the effect of this transition has been to increase the value attributes of the overall portfolio, which we hope will pay off in the years ahead.

This continues a trend over the past several years during which the portfolio has progressively increased its value bias. This is the result of a more systematic adherence to the traditional Capital Cycle investment model across the team as well as a reaction to the last few years' increasing divergence in relative valuations between so-called growth and value styles. The swing of the portfolio's pendulum towards value accelerated somewhat during the recent Covid pandemic when low interest rates, digital workstyles and working from home all spoke in favour of a major spike in technology-related company valuations. During 2023, the "errors of omission" i.e., underweights to the mega-growth trend continued to hurt the portfolio. That this did not materially affect relative return is testament to signs of life in unloved and undervalued sectors of the market. But it also reflects the valuation headwind problem which affects the most loved stocks in the global benchmark. Take Apple (not owned in the portfolio) for example, a firm with an enterprise value (EV) of $2.8 trillion with an annual sales figure of $380 billion. This EV multiple of seven times is a useful way to understand this. For Apple to be worthy of its benchmark weighting, investors expect the enterprise value to rise by, say, 10% and $280 billion. At the current valuation of seven times this implies sales growth of $38 billion in just 12 months. This is a tall order for any firm, let alone for one with a mature product line as the iPhone 15 product label inadvertently signals. For context, Tesla (not owned), itself a miracle firm, took 20 years to build annual sales to $80 billion. If Apple fails this hurdle, investors require the share valuation to stretch further to justify its portfolio inclusion.

By contrast, in the unloved value parts of the global equity markets, tailwinds are gathering strength. For instance, Japan represents, with a few exceptions, a stock market synonymous with undervaluation, but now with a tailwind of government diktat that shareholder performance must improve. Orthodox monetary policy (positive rather than negative real interest rates) underpins a market rotation toward valuation, as does persistent underinvestment in sectors such as banking, energy, shipping and mining which points to return on capital movements in these sectors' favour. A re-assessment of the ESG agenda, which we believe has thus far approached a complex problem with a blunt set of tools, will also help the value factor whilst mitigating against the fantasy-appeal of some growth investments. As Alice memorably remarks in 'Through the Looking Glass', "One can't believe in impossible things", whether that is a $38 billion annual increment in Apple revenues or a global economy entirely dependent on solar and wind-produced electricity generation. A more balanced assessment of the investment merits of various sectors is long overdue. Finally, more pre-conditions for this have been established.

Investing with a value bias, as our capital cycle approach has directed us for the vast majority of the team's 40-year history, requires a degree of stoicism. One of our favorite practitioners is Admiral Stockdale, the highest-ranking officer held (for eight years) in a Vietnamese prisoner of war camp. The 'Stockdale Paradox' is a model of persistence that comes from confronting the brutal facts of reality whilst retaining unwavering faith that one will prevail. The team at Hosking Partners have been living a geared version of this – the realities of the situation (to wit the 460bps of missed performance from the "Magnificent Seven") compound our faith that the next decade will look different to the last. And we finish it with an idiomatic translation (thank you resident classicist Luke Bridgeman) of the quote we started with – Eya, this is our time!

Legal & Regulatory Notice

Hosking Partners LLP (“Hosking”) is authorised and regulated by the Financial Conduct Authority and is also registered as an Investment Adviser with the Securities and Exchange Commission. 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 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 in Australia. Hosking accordingly does not hold an Australian financial services licence. Hosking is authorised under United Kingdom laws, which differ from Australian laws.

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 Partners LLP 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 also “wholesale clients” as defined in the Corporations Act of Australia (“Wholesale Clients”) and this document is intended for Professional Clients and, where applicable, Wholesale Clients only.

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.

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

Opinions expressed are current as of the date appearing in this document only. This document is produced for information purposes only and does not constitute advice, a recommendation, an offer or a solicitation to purchase or sell any securities (including shares or units of any pooled fund managed or advised by Hosking) or any other financial instrument or to invest with Hosking or appoint Hosking to provide any financial services, nor shall it form the basis of or be relied upon in connection with any contract or commitment whatsoever. In addition, this document does not constitute legal, regulatory, tax, accounting, investment or other advice.

Opinions included in this material constitute the judgment of the author at the time specified and may be subject to change without notice. Hosking is not obliged to update or alter the information or opinions contained within this material. 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 the author’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.

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 nor are they intended as investment advice. Such examples will not necessarily be sold, purchased or recommended for portfolios managed by Hosking. Nor do they represent all of the investments sold, purchased or recommended for portfolios managed by Hosking within the last twelve months; a complete list of such investments is available on request. Partners, officers, employees or clients of Hosking may have positions in the securities or investments mentioned in this document.

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.

Please note that different types of investments, if contained within this material, involve varying degrees of risk and there can be no assurance that any specific investment may either be suitable, appropriate or profitable for a client or prospective client’s investment portfolio.

This document may include statistical data and other information received or derived from third party sources, and Hosking makes no representation or warranty as to the accuracy of that third party data or information.