



International Markets That Should be on Investors' Radar Screens

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After the strong rally in asset prices for almost all US-listed investments, many investors are trying to determine where to go next. While the full benefit of the US economy reopening is yet to be felt, it has started to feel like the markets have already priced in a fair amount of return-to-normalcy given valuation levels in many sectors are at all-time highs. While there are plenty potential drivers of growth outside of reopening dynamics, those drivers do come attached with risks as they are yet to be defined and occur.

Given the global unevenness of the post-pandemic recovery, international markets could still represent attractive areas for continued asset appreciation. These markets, particularly emerging and frontier markets, often come with an additional kicker of positive long-term secular growth dynamics such as growing middle classes, improving economic/political systems, and favorable demographic trends. For long-term oriented investors, finding the right investments in these markets could be a great way to allocate savings with the objective of long-term compounding.

We ask three of internationally focused managers for their thoughts on the markets they know best:

Sunil Asnani, First Principles Funds

First Principles Funds invests in exceptional Indian companies with long-term growth prospects, strong competitive position, attractive economic profile, and able and honest managers. The fund has a concentrated portfolio of 15 to 20 public companies with a focus on underfollowed small and mid-caps. Investment decisions are based on rigorous bottom-up evaluation with a business owner mindset. The strategy targets attractive absolute long-term returns, an asymmetric risk reward, and low risk of capital loss in each investment.

What are some of the wrong reasons to invest in Indian public markets?

Diversification from United States

The truth is that in the short run, India is quite correlated to developed markets such as United States. Also, during volatile times, India doesn't provide a safe haven either. India's volatility during

Share to



Covid times is understandable, but if you look at the tech-bubble burst in 2000 or the Great Financial Crisis in 2008, India declined much more than US, despite no fundamental reason other than foreign outflows. One should invest in India for the sake of India, not because one is running away from other markets.

Favorable Macroeconomics

India's macro has always been mixed, be it the political stability, inflation, currency, or deficits. Even if it becomes favorable, it might change pretty quickly without giving any time for investors to react. One should invest in India for its micro and not its macro.

Ability to time India

If history is any guide, there is a high chance that in the next 12 months, one might either lose money or make extraordinary returns. That's how polarized India investing is. However, if one holds India for five plus years, the chances of losing money declines to single digits in rupee terms. One should invest in India for the long term and long term only. Timing India, and for that matter any market, is extremely tricky.

Gosh, what are the right reasons to invest in India?

Imperfect but improving economy

India has embarked on economic reforms for the last three decades and continues to do so, even if at uneven pace. It's slowly strengthening its social and physical infrastructure, such as roads, ports, health care, education and improving the ease of doing business. India's low economic base and constant productivity improvements would ensure a sustainable growth path for its domiciled businesses.

Access to growth through stock market

Unlike many other economies, India's public markets provide a fair access to its growth for foreign investors. It has the oldest stock exchange in Asia with about 5,000 listings, more than any other Asian economy. Its stock exchange closely maps the underlying economy, with the private sector driving about 80% of businesses in the index and a similar proportion of the GDP.

Stable fundamentals amid volatile markets

India's economy is highly consumption-centric and is relatively immune to the global volatility. The listed companies also enjoy a high return on equity and sustainable earnings growth, on an average. If one can embrace the market volatility, it can provide good entry and exit points for public market investors.

High quality entrepreneurship

Indian entrepreneurs are adept at dealing with complex ecosystems, and with improving economy and simplifying rules, they can only do better. While there are a number of entrepreneurs with questionable standards, India also boasts some of the best ones.

India is right only for the right investor!

Stephen Rahl, Eschaton Opportunities Fund Management

With stocks and bonds in developed markets trading at all-time high valuations, the case for looking further afield is clear. However, it pays to be discriminating in such markets. Broad-based indices in Emerging Markets and Frontier Markets tend to be heavily weighted toward unprofitable state-owned enterprises where management incentives are poorly aligned with the goals of minority shareholders.

At the same time, those same Emerging Markets and Frontier Markets often host a number of extraordinarily profitable, well-managed franchises trading at reasonable valuations. Successfully differentiating between these two kinds of businesses can unlock enormous value.

One such market where it pays to be discriminating is Vietnam. Like many other emerging and frontier markets, a large fraction of the Vietnamese economy remains under the control of legacy state-owned enterprises. Meanwhile, the parallel privately run economy is flourishing, with many players boasting world class managements and corporate governance.

For example, FPT Group (FPT) is a Vietnamese tech company founded in 1990. Since its founding, FPT has generated extraordinary growth and returns for its shareholders over a period of decades. Today FPT operates Vietnam's leading software outsourcing business, its largest private IT university, its largest streaming service, a leading cloud business, and one of the country's three broadband businesses. FPT has relentlessly built on its own success by attracting Vietnam's top engineering talent and then leveraging that talent into the global marketplace.

FPT is not only globally competitive in terms of service and pricing, but also generate exceptional returns on capital while boasting strong corporate governance. FPT, and a number of its peers, have a decades-long growth fairway in front of them and can be bought today for a mid-teens multiple to earnings. A business with similar characteristics in the United States today might trade at 3-5x the same valuation.

Furthermore, we expect Vietnam to be among the largest beneficiaries of continued geopolitical friction between China and the West, as manufacturers seeking low costs, reliable infrastructure and global markets will continue to relocate operations from China to Vietnam. The resulting influx of investment and talent will continue to power Vietnam's compelling domestic fundamentals.

Eschaton is highly selective and holds a strict discipline for investments that meet our standards for quality, value and risk/reward profile. Eschaton owns several investments in Vietnam and other Emerging and Frontier Markets which are growing earnings at a mid-to-high-teens rate, while we wait for their eventual upward re-evaluation.

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Kevin Durkin, Ballina Capital

Ballina Capital is a traditional long only manager, solely focused on publicly traded equities with a bias towards a value style. We have a repeatable process where we screen for companies, and then we research the fundamentals of these companies intensively. We construct active, concentrated portfolios of our best ideas from the bottom up, with a goal to limit downside volatility. We accept resulting sector and country biases. One of the companies we've been invested in since our founding is an Italian bank named Banca IFIS. It represents the unique and overlooked kind of idea that we can find.

Banca IFIS ("IF") – 692mm EUR market cap. Price – 12.96 EUR/share. Our target 21.1 EUR/share.

Investors do not want to own Italian banks because they are sensitive to Italian govt bond yields, and have dim profit outlooks. Italian banks hold Italian public securities equal to 11% of their assets. For IF, it is less than 6%. And the percentage would be zero for IF if the TLTRO program was not still going. This ECB program provides very attractive funding for Italian banks, including IF, so IF avails of that, and uses the excess to buy some Italian Govt bonds in a sort of carry trade. When and if this program expires, or isn't kind of found money, they will not own Italian Govt bonds.

Dim profits: Most mid and smaller Italian banks suffer due to their corporate lending exposures, and high expenses. There are large Non Performing Loans ("NPL's") in the system that have been

and high expenses. There are large Non Performing Loans (NPLs) in the system that have been reduced, but they are still very large. IF is not a traditional bank. It is more of a specialty lender. For example, IF is a large participant in factoring, especially to small and mid-sized businesses. The key here is that the exposures are short term, 3-6 months. These should not turn into a large source of bad loans. Factoring should be a source of growth. They serve 9,000 customers in factoring, but they count SME's that they can target of 35,000.

I mentioned NPL's before as a reason to avoid Italian Banks. In IF's case, half of their profits come from a very unique NPL segment. IF buys unsecured claims against individuals, small ticket exposures, that are being sold by other financial institutions. They profit from the creation of NPL's in Italy. IF understands what claims to buy at what prices, for example, those of pensioners, and their lawyers know how to work the court process. They'll typically buy a claim for 10,000 euro for 500 euros, and eventually recover 1,000 euros. If Italy was a flawless economy, this business wouldn't exist. Instead, they have a very profitable business. So you can think of this as bringing a high floor to IF business.

And IF do not have branches. Their cost to income ratio is less than 50%, when many Italian banks are 10-20 % points higher.

But IF has upside too in the case that Italy gets better. The corporate businesses such as factoring and leasing, will be a source of upside in the form of loan growth if the economy reopens and does well. So we think of IF as resilient with upside. It trades for 0.45x tangible book value. They've paid dividends in every year since 2001. They provisioned for dividends in respect of 2019 and 2020, and will presumably pay those as soon as they are allowed by the ECB. We value IF at 0.72x Tangible Book Value, a level that is well supported by comparables, as well as IF own trading history.

About

Sunil Asnani, Founder and Managing Partner

Prior to First Principles Funds, Sunil was with the Matthews India Fund (2008-2019), where he was the lead manager since April 2014. Earlier, he was a management consultant with McKinsey in New York (2006-2008) and an officer in the Indian Police Service (1999-2004). Sunil holds an M.B.A. from Wharton Business School (2006) and a B.S. from the Indian Institute of Technology (IIT), Delhi (1997).

Stephen Rahl, Co-Portfolio Manager

Stephen Rahl is the Co-Portfolio Manager at Eschaton Opportunities Fund Management, a global long/short opportunistic value investment vehicle. Prior to joining Eschaton, Steve worked as an associate at Capital Market Risk Advisors from 2011 through 2013, building expertise in the valuation of derivatives and structured products. Prior to Capital Market Risk Advisors, Steve worked as an analyst at Equinox Partners from 2005 through 2010 working side by side with William Strong, the Co-Portfolio Manager for Eschaton. At Equinox, Steve primarily covered the banking and insurance sectors. Prior to and during the financial crisis, Steve was responsible for researching Equinox's US housing short, with Equinox ultimately taking short positions in US banks, brokers, mortgage finance companies, and mortgage insurers. On the long side, he covered financials in both emerging and developed markets. Additionally, he covered oil & gas exploration companies.

Steve graduated from Williams College cum laude in 2005. In 2015 he received his MBA from Columbia Business School, where he earned Dean's Highest Honors (denoting top 5% of the class).

Kevin Durkin, Founder and Portfolio Manager

Kevin was a founding member of Causeway Capital Management in 2001. He served as Portfolio Manager from 2006-2015. During this period, was responsible for 20-30% of the firm's investments. Kevin went on to start Ballina Capital in 2017.

He earned his B.S. from Boston College, M.B.A. from University of Chicago.

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