MARCH 2023

Systemic risks through denial of reality

EM VALUE

AvH Emerging Markets Fund
Quarterly Report I 2023

Content

Only for professional investors

The banking crisis is a crisis of the rich west

Dear investors and shareholders,

investors started the new stock market year in good spirits. Despite further rate hikes, the conviction prevailed that inflation was on the way out and that the central banks could soon loosen the reins again. In March, however, a banking crisis suddenly broke out. Several US institutes and the financial giant Credit Suisse found themselves in turmoil, apparently as a complete surprise, and panic spread among both customers and investors.

In the meantime, tempers have calmed down again. However, this was only possible because the states and central banks responded immediately with almost unlimited guarantees and liquidity commitments. In addition, Credit Suisse, one of the most important institutes in Europe, was forcibly merged with its competitor UBS in an unprecedented action with the exclusion of shareholder co-determination and without any balance sheet inventory. For politicians and the markets, however, it was only important that an obvious problem disappeared from the scene as quickly as possible.

It is telling what colossal reassurances once again had to be made to dispel doubts in the markets. The drama was also underlined by the fact that both Olaf Scholz and US President Joe Biden felt compelled to publicly declare that savers money was safe and that the banks were far more stable than in the times of the financial crisis. The latter had already been unequivocally refuted by the lightning-fast bank run.

Not the emerging countries are fragile!

But what is even more telling, is that it was once again the banking system of the wealthy western hemisphere that came under stress and not the banks from the supposedly fragile emerging markets. The ultra-aggressive low-interest policy of the western central banks has not only destroyed the traditional banking business there, in which the bankers paid 3% interest on money, could lend it to others at 6% and met on the golf course at 3 a.m. (“3-6- 3 rule"). In addition, it has obviously also produced drastic imbalances in the financial system, which can no longer be easily reversed. It is becoming increasingly clear that a return to normality is now only possible with considerable pain.

Even if the weather in rich countries is usually worse than in emerging markets, the banks in rich countries have become “fair-weather banks” that no longer anticipate crises and can no longer tolerate surprises. Interest rates were close to zero for a long time, so people thought they could calculate as if it would always be like this. This suggests that the assessment of all other risks (real estate, companies, etc.) was similar.

Where can you find crisis-proof banks?

The Western financial sector has suffered severe upheavals in recent decades. Nevertheless, people still behave there as if there was nothing that could shake the usual conditions. In the emerging markets it is exactly the opposite. The banks there are almost conditioned to crises. They are therefore extremely conservative when it comes to lending and avoid risk at almost any cost (even when it comes to mortgages, emerging market banks are usually extremely cautious).

Ultimately, however, this means that bank stocks in emerging countries are far safer investments for investors. The institutes there not only keep books that even ordinary investors can still understand, but they are also high-yield and crisis-resistant. That is why, during the financial crisis of 2008, there was almost no banking crisis in any emerging country, even though the Lehman bankruptcy shook the entire global financial system at the time.

West Africa's banks: an insider tip

Irrespective of this, shares in emerging market banks were also sold off again during the current crisis in March. However, we then use this to gain a new stake in some of these institutes or to expand our positions. Among others, we bought three West African bank stocks that currently have unbeatable fundamentals. Société Générale Banque Côte d'Ivoire, Bank of Africa Senegal and Bank of Africa Burkina Faso.

The P/E ratios of these bank stocks are all in the low single digits and the returns on equity are all over 20%. At the same time, the companies operate in the West African Economic and Monetary Union, whose currency is linked to the euro. Thus, these bank investments do not even have an exchange rate risk. The shares of these institutes are each weighted at around 1% in the AvH Emerging Markets fund.

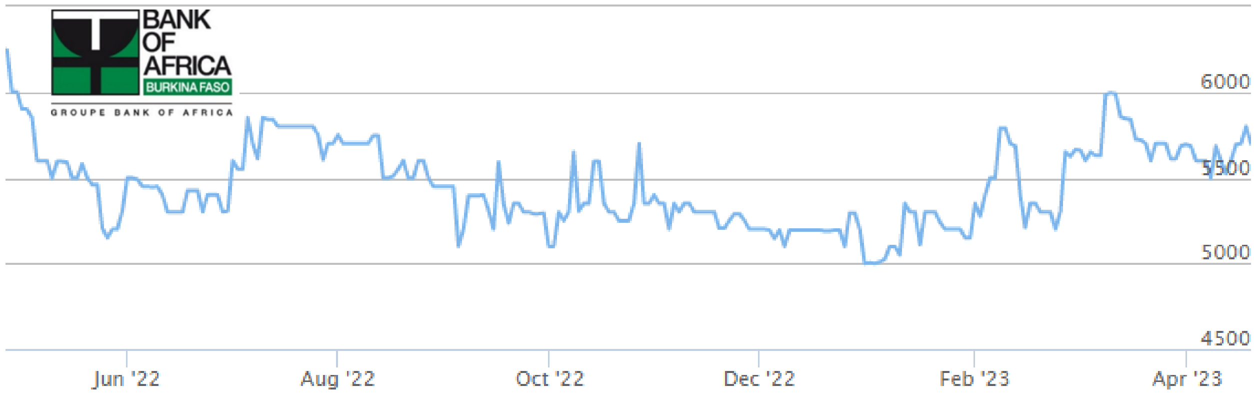
Societe Generale Cote D'ivoire in CFA | 1 Year

Source: Reuters

Bank of Africa Senegal in CFA | 1 Year

Source: Africanxchanges

Bank of Africa Burkina Faso in CFA | 1 Year



Source: Africanxchanges

Quality from Kazakhstan

We also re-invested in Halyk Savings Bank, where we had been invested for some time. The company is Kazakhstan's largest bank and enjoys a particularly good reputation there. Its shares have now been listed on the London Stock Exchange for over 15 years. The financial group increased its net profit by almost 20% even in the difficult year 2022. Still, the P/E ratio there is now below 3 and the stock also has a dividend yield of over 8%.

Halyk Savings Bank in KZT | 1 Year

Source: Reuters

New discoveries in the Philippines

However, we did not just focus on bank stocks in the first quarter. I also took a trip to Southeast Asia and checked out quite a few companies that were overdue to visit. In some cases, we have invested in their shares for the fund immediately afterwards. I continue to believe that before making an investment decision, there is nothing better than looking at the relevant companies on site. Paper is patient. But if you make the effort to exchange ideas with employees and managers on the spot, you quickly get a feeling for what the company is about and also what spirit prevails there.

One date was particularly important to me on my trip, namely the visit to the holding company Cosco Capital in the Philippines. Among other things, I wanted to make sure that I understood the company correctly. The financial positions and ownership structure I had previously researched seemed almost too good to be true. After the meeting, however, we went straight to action and built up a position in Cosco Capital that now comprises around 2% of the fund volume.

Cosco Capital in PHP | 1 Year

Source: Reuters

Balance sheet with incredible assets

Cosco Capital holds shares in various Philippine companies from the consumer sector, some of which are also listed. The most important holdings are a 49% stake in the retail group Puregold, which operates more than 500 supermarkets of all sizes. In addition, Cosco owns 78% of the shares in Keepers, the largest spirits importer in the country, which is also highly profitable. There are also a number of retail properties.

Cosco Capital's revenues and profits have grown steadily in recent years. Nevertheless, the stock is currently only valued at a P/E ratio of around 4. It also trades at a discount of almost 70% to book value and its net cash alone of approximately $800 million is almost 50% above its market cap. All of this makes the stock a value stock, which is only available so cheaply because apparently hardly anyone in Manila is interested in these holding companies.

Gas bottles - too boring?

Another exciting company from the Philippines is Prye Corp. The company primarily supplies households with gas cylinders, a business model that many investors are probably too bored with. Pryce Corp is pretty successful in this. The company's market share is growing continuously, which is also reflected in the figures. Revenue has grown significantly over the past decade from $140m to $350m and profit has even jumped from $2m to $29m. Therefore, Pryce Corp. essentially is a growth company.

The gas price plays no part in the development of profits. All this makes Pryce Corp a company that is as stable as it is promising. Nevertheless, this share is also only traded with a P/E ratio of around 6. The stock is also trading below book value and the dividend yield is over 5%.

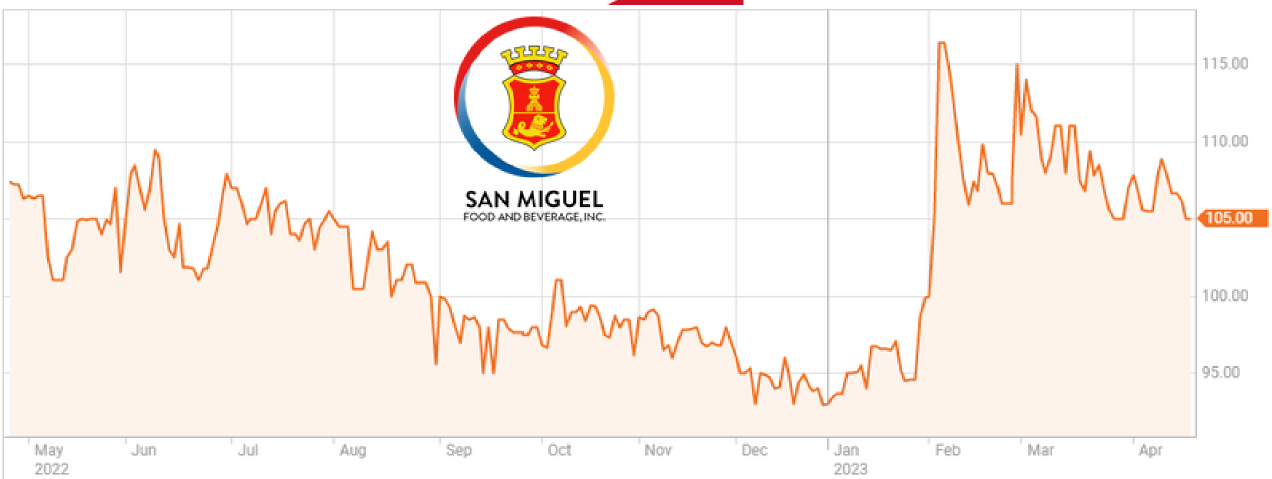
Pryce Corp in PHP | 3 Years

Source: Reuters

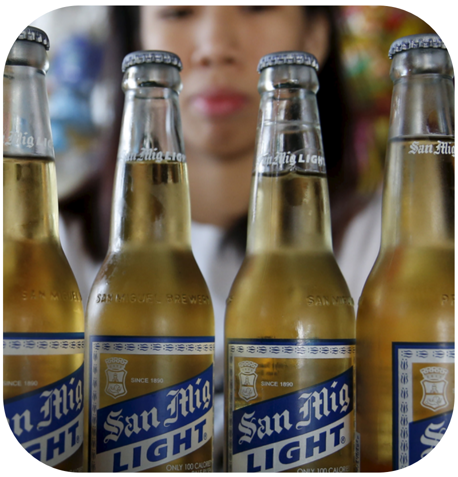
The consumption giant

We did not get quite as good a deal on the Filipino food giant San Miguel Food & Beverage. The stock is currently valued at around 13 times its expected earnings for the current year. On the other hand, the group has almost the beer monopoly in the island state with its more than 100 million inhabitants. The company generates the remaining third of its sales from meat, poultry products and ready meals of all kinds. San Miguel is a major beneficiary of growing domestic demand in the fast-growing country. At around 1.2% of the fund volume, the position is still relatively small. In the event of price setbacks, however, we would still buy here.

San Miguel Corp in PHP | 1 Year



Source: Reuters



Southeast Asia – exceptionally attractive!

The Philippines is a large country that is currently developing quite well. However, they cannot yet keep up with Indonesia, where enormous ambition and strong growth momentum have unfolded in recent years. The island kingdom remains economically still under its possibilities. On the other hand, the valuations there are more attractive, which is especially true for stocks from the back rows.

Malaysia and the Sultanate of Brunei, which I also visited on my trip, still seem pretty sleepy compared to the rest of Southeast Asia. Singapore, on the other hand, remains a fascinating metropolis where the urge for success and innovation is as palpable as ever.

However, the city-state has long had a highly developed financial sector, so finding undiscovered and undervalued stocks there is no longer easy. Ultimately, however, Southeast Asia remains a healthy and dynamic region that many investors have unfairly lost sight of recently.

Nigeria and Indonesia remain mainstays

The share value of the AvH Emerging Markets Fund fell slightly by 0.5% in the past quarter. It has developed roughly in line with the MSCI Emerging Markets Index, which, however, is only of limited use as a guide due to its completely different orientation. The AvH Emerging Markets Fund pursues an approach that is consistently geared towards substance and intrinsic value and thus prefers to operate on the stock exchanges of the up-and-coming frontier markets and in countries that are currently unpopular with international institutions for various reasons.

In the first quarter, the AvH Emerging Markets Fund remained by far most heavily invested in Nigeria. The proportion of investments in Africa's most populous country was just under 22% at the end of the quarter. The proportion of Indonesian equities also remained relatively constant at around 13% of the portfolio.

The positions from the Philippines, which accounted for almost 8% of the fund portfolio at the end of the quarter, which corresponds to the third-highest country weighting, were greatly expanded with our new acquisitions. We have not made any further investments in China, India, Taiwan and South Korea, which are particularly heavily weighted in traditional emerging market indices.

Portfolio with a P/E ratio of 3

AvH Key figures in comparison

	SP 500	MSCI Emerging Markets Index	AvH Emerging Markets Fund
P/E	22	12	3
Div. Yield	2 %	3 %	6 %

Source: Bloomberg

The strong value orientation of the AvH Emerging Markets fund can also be seen in the valuation figures. The stocks in the portfolio yielded an average dividend yield of 5.9% at the end of the quarter. The average price-to-book ratio was 0.7. However, we are particularly proud of the average price-earnings ratio, which has now fallen to a value of just 3.3.

The portfolio as such not only shows a considerable discount on the substance of the target companies, but they also convince with a high earning power, which has meanwhile increased again significantly. However, it should be noted that this intrinsic value could only be achieved over the years because ever since the fund was founded, we have almost always opposed current trend topics and other narratives of the markets.

From the point of view of most investors, the markets in which we are active are not necessarily obvious. After all, we find ourselves in an opaque and volatile market phase in which risk limitation is once again becoming increasingly important. However, we cannot emphasize enough that it is not the supposedly unsound emerging markets that we have to thank for the major financial upheavals of recent years.

The failure of the convenient solutions

At the heart of the current misery is and remains the behaviour of rich countries, which for many years have denied economic reality and have tried to brush aside their apparent problems with ever-increasing debt and easy money. The acute devaluation of money and the systemic fragility that we are currently experiencing are the logical consequence of this, which can no longer be eliminated with the previous, oh so convenient, methods.

The seriousness of the current dilemma seems to be slowly dawning on the decision-makers. Christine Lagarde recently emphasized again that the ECB is standing firm in the current crisis and that there is no contradiction between price stability and financial stability. However, at the end of a long series of mistakes and omissions, this is likely to be the last decisive error because the central banks will inevitably have to make a decision and if in doubt they will then sacrifice the fight against inflation to stabilize the system.

Invest when it "hurts"

For us as investors, this means that the markets can remain turbulent but that shouldn't tempt us to withdraw and just hoard cash. Instead, we should pull out all the stops to get cheap and solid material assets because only substance can offer long-term protection and value retention.

In any case, it is always surprising that stocks are often avoided precisely when the value of money is visibly disappearing for everyone. The reason for this reluctance is then mostly the general insecurity. However, experience teaches that it is best to invest when you are particularly resistant to it. Even the stock market old-timer Kostolany knew that price gains should be understood primarily as "compensation for pain".

Yours, Axel Krohne
Head of Portfolio Management
AvH Emerging Markets Funds UI

Risk warning

Historical performance does not allow conclusions to be drawn on a similar development in the future. This cannot be predicted. The price or market value development of financial products depends in particular on the development of the capital markets, which in turn is influenced by the general situation of the global economy as well as the economic and political framework conditions in the respective countries. Irrational factors such as moods, opinions and rumors can also affect the general course development, especially on a stock market. The value development of the fund is influenced in particular by developments on the international stock markets or commodity markets as well as by changes in yields or price developments on the bond markets, which create opportunities and risks.

Due to its composition and investment policy, the fund is subject to a not-tobe-excluded risk of increased volatility meaning that in short periods upwards or downwards strongly fluctuating share prices.

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