Oldfield Partners - Quarterly Firm Newsletter

30 September 2020

OP
Oldfield Partners

Patient, unconstrained, contrarian value investing

Oldfield Partners has about $3.2 billion under management for families, individuals, charities, trusts, endowment funds and pension funds, through separate portfolios and pooled funds. The executive partners are Chris Driver, Harry Fraser, Richard Garstang, Andrew Goodwin, David Jones, Juliet Marber, John McEwing, Richard Oldfield, Tom Taylor, Edward Troughton, Nigel Waller and Samuel Ziff.

This quarterly newsletter is the companion to our monthly reports on the pooled funds which we manage. If you do not currently receive a monthly report for any of these but want to in the future, please email info@oldfieldpartners.com.

Our approach in the management of all portfolios is long-only, no leverage, value-focused, index-ignorant, highly concentrated, and anti-short-term. The focus is on investing in individually attractive companies rather than on considering the respective attractions of different countries or sectors. With rare exceptions the country and sector weightings are the result of stock selection.

We manage global equity portfolios, emerging market equity portfolios, an EAFE equity fund, a global equity income fund and a global smaller companies equity fund.

Commentary

A *Financial Times* columnist wrote recently: "if Berkshire Hathaway [Warren Buffett's company] is ever to beat the market again, it will have to make some much bigger changes than it did in the second quarter." "Ever"! That is a bold claim. Even if Berkshire Hathaway were indeed now a beaten up old has-been, the likelihood that its current portfolio, unchanged, will never – in, say, any quarter or any year – outperform again is extremely slim: every dog has its day. But we doubt whether Berkshire Hathaway is such a superannuated dog.

Similar loss of confidence in Warren Buffett has been expressed from time to time in the last 50 years; it usually happens at what turns out to have been close to a turning point. Eugene Fama was awarded the Nobel Prize for his and Kenneth French's efficient market hypothesis, propounded in the late 1960s. This theory has now been modified by behavioural finance, a smart way of saying that people behave emotionally and extremely. Markets now are showing more FOMO than Fama. The massive interest in day trading in the most exciting sectors is a worrying manifestation of this FOMO.

OP is still struggling in terms of performance. In our Global funds the only really good year in performance in the last ten was 2016, our best ever. Otherwise, the past decade has been grim in relative performance. We do not usually mention other investment firms, but this time we will: we take our hat off to those who have captured the wave, with prescience and boldness, such as Baillie Gifford; and to firms like Ruffer which stuck to its cautious guns for several years and this year consolidated an excellent long-term record by imaginative positioning pre-and post- the outbreak of Covid.

For our own part, we make the claim that we have a particular investment style which is a constant, and that this constancy, even if underperforming in short periods, in the long term wins out. This has been a very long short period. Another way of looking at it is to say, as the highly successful manager of Scottish Mortgage Investment Trust has said, that Warren Buffett's success "has sanctified a freezing of the investment narrative." It is hard to disentangle what might be sensible constancy from stubbornness and from the misunderstanding or underestimating of fundamental changes. But whichever it has been, or in whatever proportions, we are convinced that the gap between value and growth, which people are naturally tired of hearing about, is at super-stretched levels and that the elastic will snap back so that we do well for our clients again; and we carry on trying to invest in companies with low valuations and businesses we think essentially sound – doggedly.

The market hallmarks are similar to those of 1999, just before a major change in markets. At this stage, in the areas which have been most exciting there is no longer talk of growth at the right price, but simply of growth, with all issues of valuation being lost in the ether. Our experience is that this tends to be a tail-end stage and suggests that we are drawing very close to the time when once more valuation matters. Between 2010 and 2017 the price to forward earnings ratios of the MSCI World Value Index and the MSCI World Growth Index were very much in line; since 2017 they have parted company, with the value index now at about 17 times forward earnings and the growth index at over 30 times.

Belonging to a generation which regards Warren Buffett as an investment super-hero, we are always interested in what Berkshire Hathaway is doing. So we are interested to see the recent purchases of Barrick Gold, especially since Mr Buffett has often been rude about gold. We continue to believe that gold shares play a useful part in our portfolios.

We are also interested in Berkshire Hathaway's recent $6 billion purchase of holdings in Japan's five biggest trading houses, which looks like a simple diversified expression of confidence in Japan and the valuations available. A year ago Berkshire Hathaway raised $4 billion in yen denominated bonds with an annual cost of less than 1%. The departure of Mr Abe as Prime Minister is not the end of Abenomics, and the most effective strand of Abenomics has been the change in corporate practices with a stewardship code, internationalisation of boards, reduction in cross shareholdings, sorting out of subsidiaries, and more efficient use of balance sheets with increased buying back activity financed by cash flow and cash piles. We expect these trends to continue under Mr Suga as Prime Minister. The Japanese stock market trades at 19 times forward earnings – not cheap, but this is a Covid year of depressed earnings. It is half the valuation of the US Standard & Poor's index. An added comfort is that before Covid struck, 14% of companies in the S&P had net cash (rather than debt) whereas in Japan the comparable figure was 53%.

Governments and central banks are going to be reluctant to take their foot off the accelerator, given the fragility of the world economy in the midst of Covid. The consensus is that interest rates will remain low for some time to come. That may well be the case; nonetheless after 40 years of more or less uninterrupted declines in interest rates we feel that we are in a multi-year period in which they will bottom out and begin to rise, accompanying a rise in inflation. The former president of the Bundesbank, Karl Otto Pohl, said that "inflation is like toothpaste. Once it gets out you can hardly get it back in the tube." If inflation is due to rise, we think it unlikely that central banks will fine-tune efficiently enough to stop it going further than they intend.

As Ruffer have pointed out, since 2007 the MSCI World Index excluding the US returned 0.8% per annum, while the MSCI US Index returned 8% per annum, the same as US Treasury long bonds. But corporate profits in the US have been flat since 2011. Earnings per share have risen because of share buybacks – not financed, as in Japan, from cash but from debt. This has led to the US having a higher Shiller price earnings ratio (today's share prices divided by the average of the last 10 years earnings) than at any time other than 1929 and 1999. Most of the recent years rise in the US market has therefore been due to a rerating – ever higher valuations – benefiting from zero interest rates and quantitative easing. We may enter soon a new phase in which valuation matters.

Strategy performance summary

			Since launch (%)		Year to date (%)	
	Launch date	**Currency**	**Strategy**	**Index**	**Strategy**	**Index**
EAFE Equity	01/01/2019	USD	-10.6	+13.4	-23.6	-7.1
Emerging Markets Equity	01/01/2001	USD	+668.2	+421.4	-22.8	-1.2
Global Equity	01/01/2000	USD	+190.7	+145.3	-21.5	+1.7
Global Equity Income	01/01/2012	GBP	+86.3	+114.5	-19.6	-8.0
Global Smaller Companies	01/04/2005	USD	+126.7	+190.4	-19.0	-4.4

Source: Oldfield Partners. Performance shown is the composite performance for each respective strategy. Performance is calculated net of investment management fees and expenses and on a total return basis.

Strategy snapshot

	Number of holdings	Market cap. focus	Active share	Year to date turnover
EAFE Equity	24	>US$10.0bn	95%	12%
Emerging Markets Equity	16	>US$0.5bn	94%	7%
Global Equity	27	>US$10.0bn	97%	23%
Global Equity Income	25	>US$1.0bn	93%	19%
Global Smaller Companies	25	<US$5.0bn	100%	35%

Source: Oldfield Partners, Bloomberg. Strategy representative portfolios used. Active share is calculated using the sum of the absolute value of the differences of the weight of each holding in the manager's portfolio versus the weight of each holding in the benchmark index, divided by two. Turnover is calculated by dividing the lesser of purchases and sales by the average market value.

The value of all investments and the income from them can go down as well as up; this may be due, in part, to exchange rate fluctuations. Past performance is not necessarily a guide to future performance.

Oldfield Partners

11 Grosvenor Place
London, SW1X 7HH
United Kingdom

Telephone: +44 (0)20 7259 1000
Email: info@oldfieldpartners.com
www.oldfieldpartners.com