Hansa Investment Company

The power of investing differently.

Quarterly Report 30 June 2023

Economics, the Dismal Science.

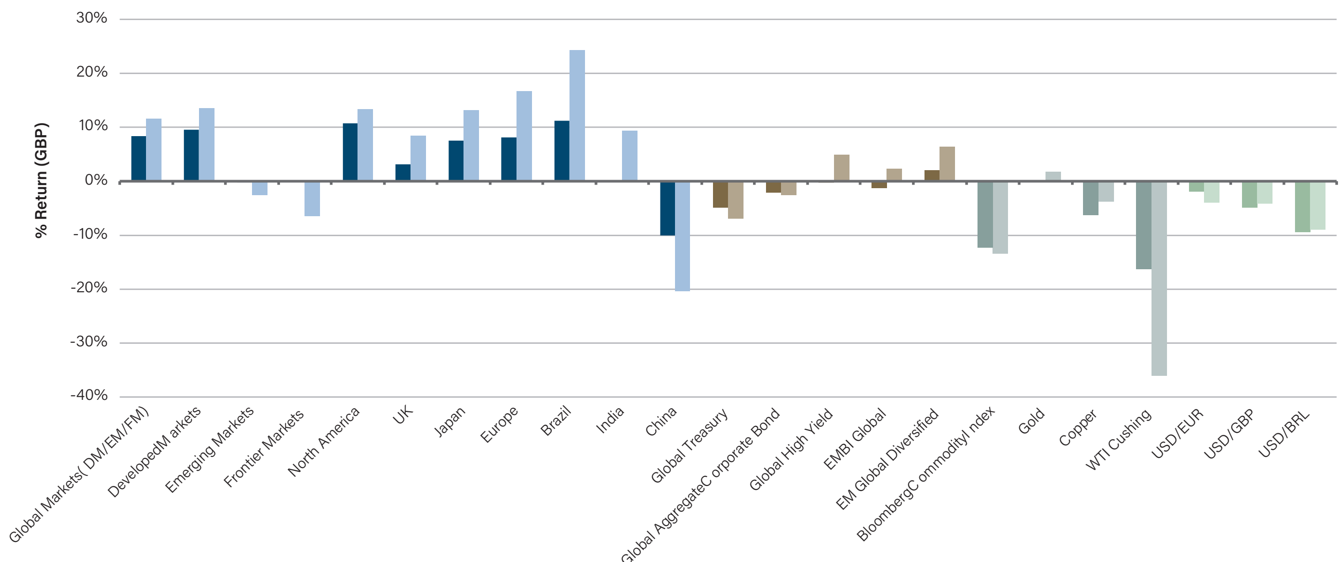
Market backdrop

Optically the strength of markets in the first half of 2023 is somewhat surprising. One only has to read the news to be bombarded by headlines of higher, and stickier, inflation, how central banks will need to be more forceful in raising rates if they are to be successful in their battle against inflation and the apparent inevitability of a deep, prolonged recession. Combined with further turmoil in Russia with what looked like an attempted coup by the warlord Yevgeny Prigozhin, this hardly seems the recipe for markets to rise by 8.4% in the first six months of the year, but this is exactly what they did.'

So why then did markets exhibit such strength in what appears to be such a challenging backdrop? Primarily it is a question of investors taking a view on the direction of travel rather than looking in the rear-view mirror. Markets are forward-looking pricing mechanisms and whilst the absolute level of inflation may still be extremely high by recent standards, we are now at a point where the rate of increase in prices, at least at the headline level, is diminishing. This has enabled investors to start looking to a point where interest rates peak and ultimately start falling again resulting in liquidity being reinjected back into markets, pushing asset prices up in the process.

Hence having seen the worst year in almost a century for the classic 60:40 Equity:Bond portfolio – which fell by some 14.9% in 2022 – markets have seen a widespread rebound in the year-to-date. As ever though the devil is in the detail. Whilst equities were mostly positive for the major markets, the US equity market has led the way. Powered by the rebound in big tech, US equities rose by 11.2% in H1 and indeed if the performance of the top seven technology companies were to be stripped out then the US market returns would only be just above 1%. Similarly, other global markets, where technology is typically a much smaller proportion of the indices, saw positive performance but of a much lower magnitude than that of the US. Europe rose 8.1% and the United Kingdom 3.2% while emerging markets fell 0.2%. Worth noting were the contrasting fortunes of China and Japan with the former falling by 10.1% and the latter up

Chart 1: Performance of countries, sectors, and asset classes.



Dark bars represent 3 month returns to 30 June 2023. Light bars represent 12 month returns to 30 June 2023.

Source: Bloomberg.

Inflation is a backwards looking indicator and the probability that inflation is more ingrained and will remain persistently higher is not insignificant.

by some 7.5%. More on this later.

Outside of equities, performance was more mixed. Within the bond markets US Treasuries and corporate bonds produced negative returns mainly due to the dollar weakening, falling by 4.8% and 2.0% respectively, while UK gilts were down by 3.5% reflecting the more persistent inflationary picture in the UK and the expectation that rates will need to move higher than many other markets if the battle against inflation is to be won.

Similarly in the commodity markets, oil prices continued to flounder with Brent down by 15.3% in the first half, whereas gold rose by 0.1% reflecting its more defensive characteristics. Finally hedge funds were generally muted in the first half, pausing for breath having been robust in 2022 in contrast to the falls seen in many other asset classes.

Market outlook

Stock markets have an uncanny knack of being right. When the press is all doom and gloom (it makes for good reading) but markets are pushing ahead, nine times out of ten it is the market which is right. Given then the strong performance of markets in the first half should we assume that we are now past the worst, with the battle against inflation won, interest rates shortly to be reduced, and a deep recession avoided?

Well, maybe, but the backdrop is more nuanced than suggested by this goldilocks scenario. Typically when determining the outlook for markets there is a dominant, core view which will normally prevail and whilst there are inevitably other outlying possibilities, they are of a much lower probability and can almost be ignored when setting one's investment policy. Unfortunately this is not the case at present with the probabilities attached to the various outcomes similar in magnitude with the market outcomes very different and binary in many cases. With the scope for policy misstep also unusually high this makes for a very uncertain outcome.

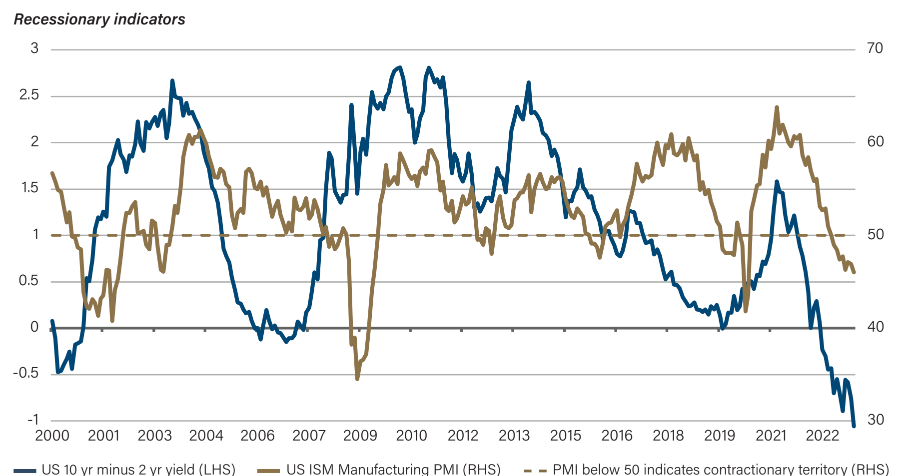
What we can say with some certainty is that inflation should continue to come down but what is much less clear is whether it falls to a rate which central bankers can live with. Looking at the component parts, excessive goods inflation has already largely worked its way through the system representing a post-COVID wave as supply was unable to meet the high demand. Service inflation is more mixed but important components such as shelter prices are diminishing which gives us growing confidence that this also represents a post-COVID wave, albeit a lagged one. The component that is looking most sticky is that of wage inflation driven by shortages in certain areas of the labour market. This combined with unemployment rates near historic lows (at 3.6% in the US and 4.0% in the UK) has meant that workers have had significant power to demand larger pay rises. Despite the stickiness of wage inflation, the decline of goods and service inflation indicates that we are past the peak of inflation. Hopefully, with inflation a lagging metric, this should enable central bankers to initially pause their rate rise programmes as they await confirmation that the war against inflation has been won leaving the door open for rate decreases in 2024. With economic growth continuing to be robust, much to the surprise of many economists, this raises the possibility of achieving the fabled soft-landing!

As ever though with the dismal science of economics, nothing is certain. As mentioned above, inflation is a backwards looking indicator and the probability that inflation is more ingrained and will remain persistently higher is not insignificant. This is highlighted by the fact that many notable economists and market commentators that we regard highly have polar opposite views to one another despite the fact that they are looking at exactly the same data. Unfortunately only time will tell as to who is correct!

A policy misstep is also a very real risk with policymakers potentially continuing to raise interest rates even if the inflationary threat has passed. Central bankers, having firmly been in the camp that inflation was transitory at the start of last year and that significant rate rises were not required, have now moved to the structurally stronger for longer camp, arguing that inflation must be killed off regardless of the cost to the broader economy. Partly this is a reflection of the experience of the central bankers leading the major institutions with Powell, Bailey and Lagarde all non-economists by training, but also the fact that predicting inflation is extremely hard. Historically most cyclical recessions were caused by over-zealous central bankers raising rates too far even when inflation was no longer a problem.

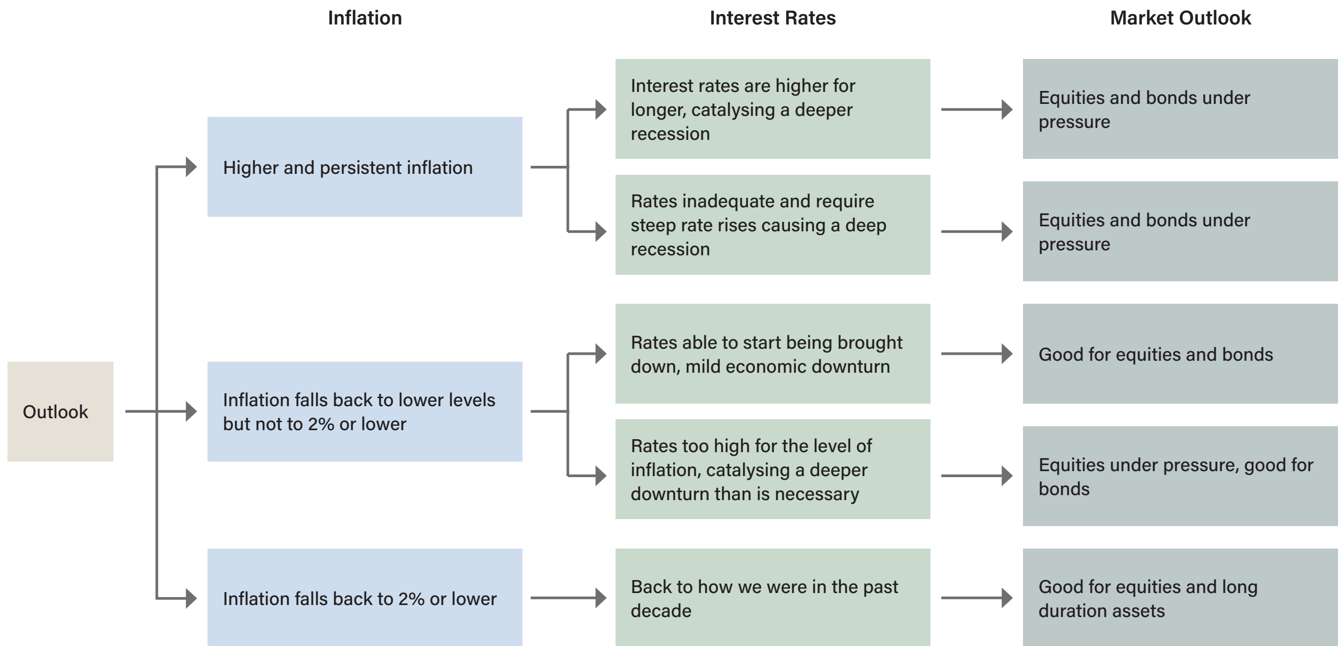
The last part of the jigsaw puzzle, growth, is also uncertain. As mentioned, growth has continued to surprise on the upside. Despite the apparently contradictory indicators suggesting that growth is set to fall, to-date growth has been surprisingly robust and certainly not indicative of the much-vaunted recession. Notably the key PMI lead indicator has been in contractionary territory for some time now and the yield curve is inverted which has historically been a reliable indicator of excessive rates and impending economic collapse. Again, economists cannot agree on what the current data are telling us. Some are of the view that the speed of the increase and the level of rates has already gone too far and a deep recession is therefore inevitable

Chart 2: PMIs are in contractionary territory and the yield curve is inverted.



Source: Bloomberg.

Chart 3: The path forward is far from clear given the inflation uncertainty.



whereas others believe that central bankers face a no-win situation and will be forced to keep pushing rates even higher if they have to induce a recession to eliminate inflation from the system.

Pulling all this together leaves us with a complex decision tree of potential outcomes, all of which are viable alternatives, and with comparable probabilities attached to the different scenarios. Hence, whilst not surprised by the positive returns generated by markets over the past few months given the improving backdrop on last year, we are perhaps surprised by the magnitude of these returns in view of the uncertainties that still abound.

Positioning

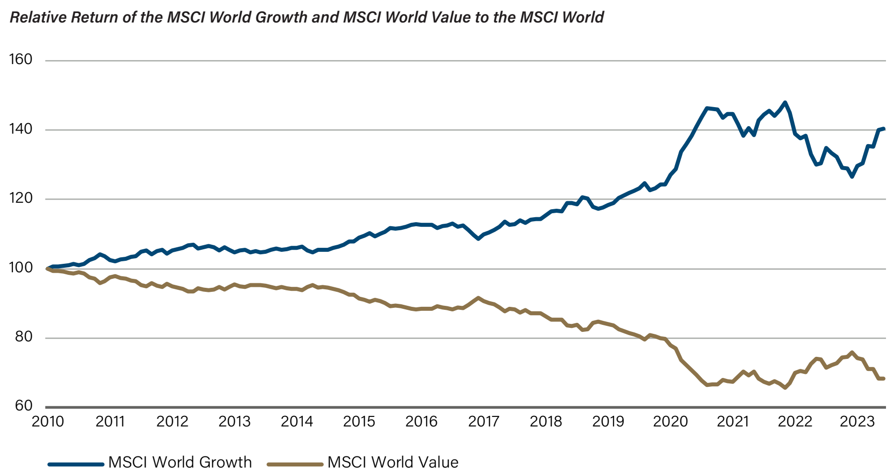
Positioning for this smorgasbord of potential outcomes is unsurprisingly challenging. Our first action has been to introduce more balance and diversification within portfolios. The dash to zero rates resulted in long duration investments performing well and a very US-centric portfolio given its dominance in sectors such as technology and biotechnology. In light of our view that we are not about to re-enter a zero-rate world any time soon, this suggests that portfolios should now be more diversified by asset type, style and country.

Stylistically, a higher rate and inflationary world means that sectors such as value, which were largely ignored for the last ten years, become a viable investment again. With value companies still at historically low valuations relative to growth areas of the market this opportunity remains compelling. That's not to say we have become anti-growth, far from it. As has been demonstrated by the surge in all things AI over the last few months, we still believe that we are in the infancy of many technology advances. Indeed, one of major challenges faced by an ever-aging world is the need for improved productivity, and technology is likely to form part of the solution to this problem as labour costs become more expensive.

Similarly at the country level, despite our love of the US stock market and its capitalist model, other countries that have largely been ignored for the past decade are looking increasingly attractive. In particular we would highlight the emerging markets. Standing on some 13x earnings versus 21x that of the US, many of these markets are looking relatively very cheap having suffered from years of investor apathy. Through necessity they have been forced to run more prudent, conventional economic policies compared to that of the West, and with the West benefiting from years of zero interest rates, this has inevitably encouraged excess and bad behaviours in many developed markets. Now, with many of the emerging markets starting to cut interest rates having tackled inflation much earlier, this opens the window to a positive liquidity cycle.

Chart 4: Growth has significantly outperformed value since 2010.

Relative Return of the MSCI World Growth and MSCI World Value to the MSCI World



Source: Bloomberg.

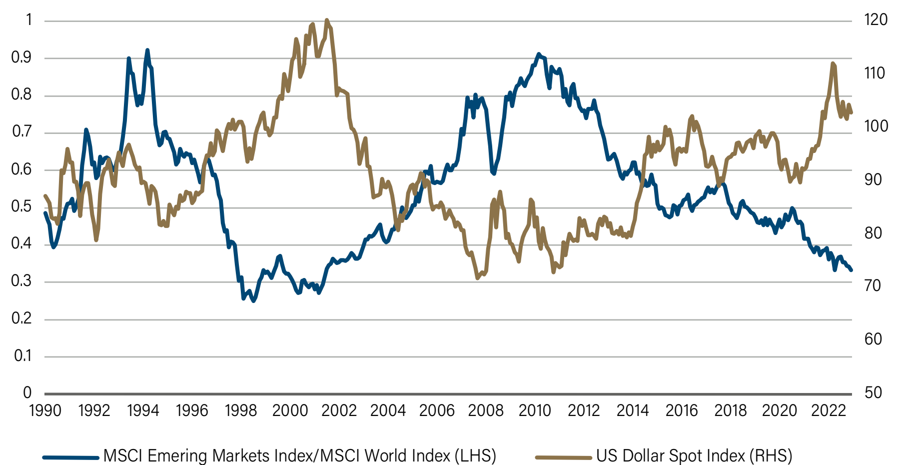
The final part of the jigsaw would be dollar weakness which historically has been key to the emerging markets outperforming the US.

The situation in Asia is looking particularly interesting at present. China continues to be viewed as toxic by much of the market. Having suffered from the self-inflicted pain of a prolonged zero-COVID policy (ZCP) and with the West increasingly viewing China as an enemy state, China has been one of the few stock markets to fall in the past six months. Whilst there are undoubtedly many challenges faced by China, not least the faltering nature of its exit from its ZCP, we do not view China as being uninvestable. Ultimately China may potentially become the largest economic power at some point in the future and like most investments everything has a price. Hence, as with all emerging markets, we do not view China as a buy and hold forever investment and a larger risk premia needs to be attached, but there will be points when one does want to lean into China with valuations more than capturing any risks involved.

More positively, the changes in Japan appear to be gaining traction. Japan has been undergoing a period of change ever since Prime Minister Abe launched his Three Arrows programme in 2012. Whilst very much a two steps forward, one step back process, there is a growing recognition that Japan must change if it is to reenergise its economy in light of a rapidly aging population, persistent disinflation and a zombie-like corporate sector. Having waxed and waned in recent years the process appears to be undergoing a new lease of life with the current government enacting a number of initiatives including the threat of throwing out those companies who trade on sub-1x book value from the key exchanges and a growing acceptance of activism in the corporate sector, something which it has historically resisted. With the overall market trading on just 1.5x book value and an improving picture of returns, this bodes well for the future and we remain overweight.

The other big debate is the outlook for bonds. For years they simply made no sense to us as an investment. Standing with near zero or even negative yields, you effectively received no returns as an investor combined with an asymmetric risk profile should inflation ever pick up again which of course it did. As a result of the subsequent rapid reset in yields to much higher, more attractive levels, this poses the question as to whether or not we should be re-entering bonds as an asset class having mostly avoided investing in them for the past ten years? The short answer is yes albeit given the uncertain economic outlook it is not without risk. If inflation remains high and interest rates are forced even higher it will likely weigh on returns. Similarly within the corporate bond market default rates remain extremely low by historic standards and if higher rates ultimately catalyse a recession, defaults will almost certainly increase. Nonetheless, investment is all about ensuring a margin of safety and with yields now looking the most attractive they have been for many years and with inflation and rates now probably nearing their highs, we view the risk reward as increasingly attractive. It is a question of being selective and whilst we believe that shorter duration, higher quality credit is now more attractive given that the issuing companies tend to be of a high quality and well capitalised, we would avoid the riskier end of the high yield market which is more vulnerable to economic stresses. Overall, bonds are likely to be area that we will be increasing exposure to in the coming months, not least because they typically charge much lower fees and are more liquid than most hedge funds which have been our default defensive investment in recent years.

Chart 5: EMs outperform during periods of dollar weakness.



Source: Bloomberg.

Case study: The insurance sector

Whilst much of our investment process focuses on identifying the best asset classes and countries within this, we also, more opportunistically, attempt to identify attractive themes within our thematic silo. One such theme that we have been leaning into over recent months is the insurance sector. It is a sector that we know well having owned a Lloyds insurance syndicate in the past and tends to be prone to extreme cycles as capital is sucked in and then out again. Recent years have been characterised by numerous false dawns with improving pricing being offset by historically severe catastrophes. The situation reached a crisis point at the end of the year when many investors threw in the towel and, despite the attractive returns on offer, were simply unwilling to commit more capital. As a result of this capitulation the recent pricing rounds saw prices jump in the region of 20% and it was at this point that we committed further capital to the sector.

Often one of the challenges of fund

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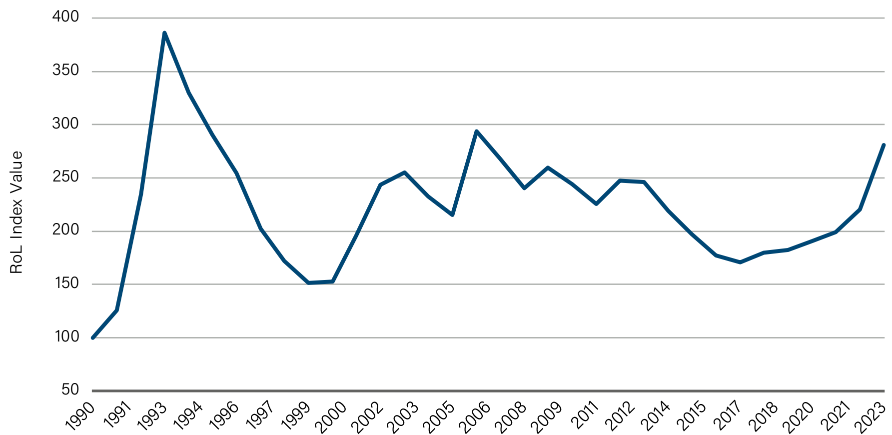
management is how to reflect a view or an idea within a portfolio. Unusually for this theme we have implemented it in three different ways where the portfolios' mandates allow. To capture the beta of the improved outlook we invested in the highly regarded Polar Global Insurance fund and more directly through investments in the insurance companies Arch and GCO. Polar Global Insurance has a long history of creating value through investing in a portfolio of high-quality insurance companies with most of their exposure in mid-cap property casualty and non-life insurers.

Our decision to engage in a direct investment in Arch is based on their exceptional underwriting capabilities and the competence of their management team in strategically allocating capital to maximize returns, dependant on the prevailing conditions in the insurance cycle. This is evidenced by Arch's remarkable 20-year track record of compounding book value per share at a rate of 14%, resulting in a thirteen-fold increase. Arch also happens to be the largest investment in Polar Global Insurance. GCO operates in the credit and traditional insurance sectors yet shares a similar conservative culture and long-term perspective as Arch. Over the past two decades, GCO has also achieved an annual growth rate of 14% in book value.

The third investment is in a specialist insurance fund called Nephila. Nephila is an extremely well regarded alternative manager in the insurance sector, founded by two fund managers based in Nashville, Tennessee, and backed by the US financial giant Markel. They invest in a wide range of insurance instruments ranging from catastrophe reinsurance to insurance-linked securities to pure insurance. We spent considerable time understanding their business model and in particular how a severe catastrophe, such as a very large hurricane hitting Florida, might affect their business model. This involved significant due diligence with peers in the insurance industry and utilising our wide network and speaking to other managers that we know in the space. Ultimately, we felt confident on both the risks and returns and viewed them as an excellent diversifying investment within our defensive silo with them, importantly, benefiting from a different cycle from that of broader economies which drives the majority of our equity-based investments.

Chart 6: Insurance pricing surges.

Global Property Catastrophe Rate-On-Line Index



Source: Guy Carpenter

Conclusion

Turning points in cycles are notoriously hard to pinpoint accurately with the current backdrop feeling particularly challenging. Indeed, anyone who professes to know

Chart 7: Nephila invests in a range of insurance instruments giving a less correlated return.

Market segments:	**Insurance**	**Non-syndicated reinsurance**	**Syndicated reinsurance**	**Cat bond**	**ILW**	**Retro**
Annual notional:	**$5.3 trillion**	**$50 billion**	**$400 billion**	**$28 billion**	**$3.5 billion**	**$32 billion**
Barriers to entry:	**HIGH**					**LOW**
Typical strategy:	Long	Long	Long/Short	Long	Long/Short	Long/Short
Investor benefit:	Higher returns from vertical integration and disintermediation	Higher returns in exchange for scale, longevity, and superior credit quality	Better allocations due to scale and credit quality	Increase expected returns via relative value trading across segments		
	Nephila platform focuses on high value, high barrier to entry trades where we have higher control over data quality, transparency, and pricing power					

Source: Nephila Capital Ltd.

Many areas of the market neglected in the recent years appear to have their prospects looking much improved.

with certainty should be treated with some caution! Nonetheless we feel confident that we are nearing the end game and, as longer-term investors who do not seek to obsess about predicting short-term market movements, we are becoming increasingly upbeat on the opportunities presented by the current backdrop. Whilst recognising that there are still a number of hurdles to overcome, many areas that have been neglected by investors in recent years are now looking far more attractive. We view this as a fruitful hunting ground for longer term investors who are prepared to scratch beneath the surface and do the hard work to fully diligence more complex themes and investments.

Importantly however we do not expect markets to return to the model that has prevailed over recent years, viewing the period of zero inflation and interest rates as an aberration rather than the norm. This has important implications for how we structure portfolios and the rather one-dimensional approach that has prevailed over the last cycle is no longer appropriate. Instead, we believe that diversification and balance is required at both the country, asset class and style level. Specifically, bonds are increasingly becoming a viable asset class again and the approach that has prevailed whereby There Is No Alternative (TINA) to equities is no longer the case. Similarly at the country level, other countries to the US are increasingly attractive both being cheaper in valuation, through years of neglect, and improving investment stories in many instances. Finally, stylistically, value investing is again becoming attractive having suffered years of underperformance as a low duration asset class. Hence whilst this new backdrop might generate returns that are somewhat lower than the supernormal returns generated by stock markets over the past ten years, we would still view them as being attractive and the opportunity set arguably more abundant.

Portfolio Review and Activity

During the first quarter of the financial year the NAV total return of your Company was 3.0%, in line with the 3.1% rise of the MSCI ACWI NR Index (GBP) and significantly ahead of the 5.4% decline of the FTSE UK Gilts All Stocks TR Index. Global equity markets continued to rise during the quarter, as investors appeared to put their concerns about the March mini banking crisis behind them, and instead took comfort from signs that inflation was beginning to fall and that the peak in the interest rate cycle might be coming nearer. Large cap technology stocks drove market gains, supported by advances in artificial intelligence (AI), which are expected to increase demand for chips. As a result, the US market was the strongest performer, while European and UK markets were flat to slightly down. Over the last twelve months the NAV total return was 5.9%, while the MSCI ACWI NR Index gained 11.6%, UK CPI is up 8.0% and the FTSE UK Gilts All Stocks TR Index has fallen 14.5%. Over both the quarter and the last year the performance has compared very favourably with the classic 60:40 equity/bond balanced portfolio which fell 0.4% in the quarter and is up just 0.5% over the year.

The position in Ocean Wilsons Holdings made a strong gain over the quarter, up 13.8%, and is up 8.4% for the year. We believe its investment portfolio offers very useful diversification benefits, with significant exposure to private equity including venture capital. The Brazilian market has performed more strongly recently, helped by improving sentiment towards the country, which should be supportive of its Wilson Sons position. Increasing global trade and more activity in the offshore energy sector are helping to drive improved operational results for the company.

The Company's net asset value per share rose from 305.8 pence at the end of March 2023 to 314.3 pence at the end of June 2023, with 0.8 pence per share being paid out as a dividend during the quarter. The net asset value has increased from 299.9 pence at the end of June 2022, while 3.2 pence per share has been paid out in dividends in that time.

Core and Thematic Funds

The Core Regional silo made a gain of 1.2% during the quarter while the Thematic silo was down 1.4%. For the last twelve months, the two silos' returns were 7.2% and 1.1%, respectively.

The North American holdings led performance once again, although the narrowness of the market, with a few large cap technology names driving returns, made it hard for active managers to keep up with the index. **Findlay Park American** returned 5.2%, taking it to be up 12.0% over the past year. The fund has an approximate weight of 10% in the big technology names including Microsoft (its largest position), NVIDIA and Alphabet. This is underweight the index which has 26% in the eight biggest technology companies but has helped drive its performance this quarter. Microsoft particularly benefited from the interest in AI since it is a major investor in OpenAI, the creator of ChatGPT. The passive holding in **iShares S&P 500 ETF** returned 6.0% over the quarter, while **Pershing Square Holdings** and **BA Beutel Goodman US Value** made very muted gains of 0.7% and 0.6%, respectively.

BlackRock Strategic Equity enjoyed a strong quarter, gaining 3.9%, taking its performance over the last year to 8.6%. Microsoft is a large investment for this fund and so was a significant contributor in the quarter. Other strong performers included ASML, the major Dutch producer of semiconductor manufacturing equipment, that benefited from the increased interest in AI. The increased desire from Western governments to onshore semiconductor production is another factor that is likely to significantly benefit the company.

The Japanese holdings declined over the quarter, with **Indus Japan Long Only** being down 2.1% and **Goodhart: Hanjo Fund** being down 2.9%. However, over twelve months these funds are up 7.4% and 4.5%, respectively. For the Indus fund, Renesas, a manufacturer of semiconductors, has been a strong contributor in recent months as it upgraded its profit and free cash flow forecasts giving more certainty that its share buybacks will continue. Detractors over the quarter included Food & Life, a large sushi restaurant chain, and Nippon Shinyaku, a pharmaceutical manufacturer, which fell back as a US competitor received approval for a gene therapy drug.

There were some negative performances within the emerging market holdings, as both the emerging and frontier market indices fell during the quarter, although some holdings delivered gains, among them **NTAsian Discovery** that was up 0.3%. **Schroder Asian Total Return** fell 1.7%, to leave it up 5.5% over twelve months, and **KLS Corinium Emerging Markets** was down 4.5%, to leave it down 9.0% over the year. The Schroder Asian fund has a significant weighting (34%) to information technology companies, several of which contributed positively to performance over the quarter, but not to the same extent as the sector did in the US. Some of the fund's detractors included AIA Group and DBS Group, Hong Kong and Singapore listed financial services firms which fell

back in the quarter. Bucking the trend was **BlackRock Frontiers Investment Trust**, which delivered a 5.3% return in the quarter despite the MSCI Frontier Markets falling 0.8%, and the trust is up an impressive 18.3% over twelve months. This return has come from NAV growth as the discount to NAV has stayed about the same at -9% over the year. Strong contributors came from a number of areas including Eastern Europe where lower gas prices boosted hopes of a stronger economic recovery. The Polish bank PKO and the Kazakh bank Halyk were both strong performers following good earnings results. The manager has taken profits in some holdings such as the Saudi grocery operator Al Othaim which had a very strong quarter following a bonus stock dividend.

The thematic holdings had a more difficult quarter, despite a 3.7% gain for **GAM Star Disruptive Growth**. This, however, lagged the wider technology index given its focus on smaller cap companies and significant underweight position in the mega-cap names such as Microsoft, Apple and NVIDIA that have driven the sector's performance. There were gains by **RA Capital International Healthcare** and **Worldwide Healthcare Trust** (up 2.9% and 2.2%, respectively), but **BB Biotech** had a difficult quarter as it went from trading on a 20% premium to a 5% discount, resulting in a 22.3% decline, and a 27.1% fall over the year. The **Polar Capital Global Insurance Fund** was about flat on the quarter (-0.1%) but has risen 8.3% over the year.

Following the recent decision to add an element of private equity exposure to the portfolio, a commitment was made during the quarter to **Triton Fund 6, LP**, which held its first close shortly after the quarter end. Triton is a European-based and focused investment firm, and Fund 6 is the next fund in their mid-market flagship strategy, with a sector focus on business services, industrial tech, consumer and healthcare. The strategy's regional focus remains the DACH and Nordic regions as well as Benelux and the UK. Triton's approach is to invest in more complex deals such as those involving corporate carve-outs, debt restructuring and distressed companies. This constitutes a differentiated strategy versus other core European private equity funds and has delivered a good track record of performance.

Diversifying Funds

The diversifying holdings provide an alternative source of returns whilst dampening volatility and displaying low beta to the equity market. They delivered a small decline of 0.8% in the quarter but a gain of 1.1% in the last twelve months, which compares very well to the steep losses in the bond markets, where the UK gilt index is down 14.5% over the year.

During the quarter we made an investment in the **Nephila Iron Catastrophe Fund**, which is a specialist strategy investing in catastrophe bonds and related securities that can provide investors with returns that are uncorrelated to both traditional and alternative markets. Nephila is one of the world's leading institutional investors in insurance-linked securities, having launched its first strategy in 1998. In recent years the fund's returns have been muted owing to a higher than usual number of major events such as Hurricanes Harvey, Ida and Ian, but this has led to extremely attractive pricing in the space, which we believe should provide good returns going forward and help protect against losses from future events. The fund is up 0.7% in the short period since we bought it.

There were positive returns in the quarter from some of the holdings in the fixed income space, with **Selwood Liquid Credit Strategy** rising 4.0%, **Apollo Total Return** up 1.3% and **Lazard Convertible Global** up 1.1%. These funds are now up 15.7%, 2.6% and 5.1%, respectively, over twelve months. The passive position in **Vanguard US Government Bond Index Fund** fell 1.6% this quarter, while **BioPharma Credit** was down more steeply, on -7.2%. BioPharma's share price declined in May as LumiraDx, to which it has lent $150m, reported a sharp drop in revenue as a result of a company restructuring and it announced an equity raise, which BioPharma has said it is actively monitoring. However, over the last year BioPharma remains up 4.1%.

The two trend-following CTA funds have been among the more volatile holdings in the last year, with both struggling in the latter part of 2022 and again in March 2023 when markets were so changeable. The **Schroder GAIA BlueTrend** has recovered well this quarter, being up 5.0% to leave it down 8.1% over the year. **GAM Systematic Core Macro** delivered a negative return of -2.3% this quarter, although it did pick up significantly at the end of the period. Over the last year the GAM fund is down 5.3%.

Global Equities

The portfolio fell 1.0% over the past quarter, with the biggest contributors being **Bergman & Beving**, **ViaSat** and **Arch Capital**. The biggest detractors were **Grupo Catalana**, **Dollar General** and **Orion**.

The past quarter has presented us with a fascinating dichotomy—an equity market that continues to be driven by highly rated tech stocks, reminiscent of a similar scenario three years ago, while simultaneously offering compelling bargains for value-oriented investors.

While highly rated tech stocks with AI exposure may dominate the headlines, the wider equity market offers numerous underappreciated companies with strong fundamentals and compelling growth prospects. These oft overlooked businesses possess solid balance sheets, sustainable competitive advantages, and robust cash flow generation capabilities.

We are increasingly finding more of these businesses outside of the US, where the market is beginning to look expensive versus Europe. US equity valuations are now in the top 20% of their ten-year range whilst Europe has only been cheaper 9% of the time. The dispersion in valuations is also stark: in the US there are twice as many stocks trading above 30x PE as there are stocks trading below10x PE. In Europe, however, there are more than three times as many cheap stocks trading below 10x PE as there are expensive stocks trading above 30x PE. It is no surprise then that our weighting to Europe has increased recently,

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Investing in undervalued companies requires patience and conviction. Short-term market fluctuations and sentiment-driven price swings can cause temporary divergence from intrinsic value, and we may not see the true fruits of our investment until money flows out of the popular stocks.

and it is now just over 50% of the portfolio, up from 30% three years ago. We continued this trend towards Europe after quarter end and initiated a new position in a UK listed business that we will discuss next quarter. Our European holdings trade on a 12% free cash flow yield despite the fact they have grown free cash flow at over 10% a year for the past five years.

A good example is **GCO** (formerly Grupo Catalana Occidente) which we initially purchased three years ago. It was then trading on 9.5x P/E and 0.8x book value, a wide discount to its history (1.8x) and peers (1.2x). Today it trades on 6x P/E and 0.7x book. We continue to wait for its rerating, but in the meantime the shares have returned over 50% as earnings in 2023 will be double those of 2020 and the business has continued to pay out a healthy dividend.

It is important to recognize that investing in undervalued companies requires patience and conviction. Short-term market fluctuations and sentiment-driven price swings can cause temporary divergence from intrinsic value, and we may not see the true fruits of our investment until money flows out of the popular stocks. In the meantime, we expect our European holdings will continue compounding their intrinsic value (like GCO) whilst paying us a 3.3% average dividend yield.

During the quarter we added to our positions in **Bergman & Beving**, **Subsea 7**, **Interactive Brokers** and **ViaSat**, we reduced our position in **Arch Capital** and sold our remaining shares of **CVS Health** to fund our purchases.

Ocean Wilsons Holdings

As the largest integrated provider of port and maritime logistics in Brazil, we believe the Ocean Wilsons' subsidiary, Wilson Sons, is well-placed to perform in the coming years. The business has a strong competitive position, being the leading provider of towage services in Brazil with the largest and most modern fleet, as well as operating major container terminals in the north and south of the country: Rio Grande and Salvador. In recent times the company has seen several challenges, including political upheaval in Brazil and the disruption stemming from covid that significantly impacted global trade and hurt the energy sector that is an important part of the company's demand. However, there are now signs that these factors are improving, which should be positive for the company going forwards.

There has been more evidence of improving results recently, with the first quarter results showing stronger revenues thanks to good performance in the towage division, with higher volumes and an increase in average revenue per manoeuvre. These results build on strong earnings growth in 2022, thanks partly to a recovery in global trade and increased activity in the energy sector. Operational data for the first six months of the year were positive, with total volumes in the container terminals division being 7.1% higher than last year and the number of vessel turnarounds in the offshore support bases being nearly 70% higher than the previous period, thanks to markedly higher demand for the company's offshore energy-linked services. In the second quarter Wilson Sons' shipyard delivered WS Rosalvo, the third of a series of six tugboats which will add over 90 tonnes of bollard pull to the fleet by 2024. The vessel is already operational in the port of Açu.

The investment portfolio shares many characteristics with the portfolio held directly within Hansa Investment Company, with a preference for funds with clearly-defined strategies run by managers with skin in the game. During 2022 the portfolio declined but its return was significantly ahead of the global equity and bond indices. The most recent valuation for the investment portfolio was $298.1m as at end March 2023, which represents an increase of 1.5% from December 2022, and a decline of 8.2% from March 2022. Performance has been helped by thematic exposures to energy and commodities, as well as the private market investments which have demonstrated resilience. Some of the largest private equity positions include venture capital funds of funds managed by Stepstone, US buyout funds managed by KKR and a financials-focused fund managed by Reverence Capital. During 2022 dividends of $5m, in two equal tranches, were paid out from the portfolio in May and July.

On 12 July 2023, the Board of Ocean Wilsons Holdings made an announcement in which they confirmed the company is undertaking a strategic review involving the Company's investment in Wilson Sons. The review, which will consider all potential strategic options, is currently at an early stage and there can be no certainty as to its outcome. We will report further on any developments as they are made known.

Alec Letchfield
Chief Investment Officer
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