Overstone Global Equity Income Fund

Patient, unconstrained, contrarian value investing

Oldfield Partners

Quarterly Newsletter | Q1 2024

Investment objective

The Fund's objective is to achieve income and capital growth, (net of fees) over the longer term (i.e. 5 years or more). The Fund seeks to achieve this objective through investment in a global portfolio. The approach is classic contrarian value, based on bottom-up fundamental research of individual companies.

Fund particulars

Manager(s)	Jacob Laursen Samuel Ziff
Launch date	06 December 2011
Domicile	United Kingdom
Structure	UCITS
Base currency	GBP
Dealing	Daily
Min. investment	£10,000
IA sector	Global Equity Income
Benchmarks	MSCI World High Dividend Yield MSCI World
Fund size	£23.4m
Strategy size	£23.4m

"A concentrated portfolio concentrates the mind..."

About Oldfield Partners

Oldfield Partners LLP is an owner-managed boutique fund management firm which manages equity portfolios for a global client base that includes endowments funds, pension funds, charities, family offices and individuals.

Oldfield Partners began operations in March, 2005 and is majority owned by the executive partners.

We are value investors with a distinctive approach: a limited number of holdings, long-only, no leverage, diversified, index-agnostic and suspicious of short-termism.

All data as at 29 March 2024.
Source: Oldfield Partners.

Fund performance (GBP, %)

					Annualised		
	1 month	QTD	YTD	1 year	3 years	5 years	Launch
Fund (I shares)	+3.0	+3.0	+3.0	+11.4	+3.7	+5.1	+8.6
MSCI World High Dividend Yield	+4.1	+6.7	+6.7	+10.8	+9.4	+7.9	+9.8
MSCI World	+3.2	+10.1	+10.1	+22.4	+11.9	+12.7	+12.9
IA Sector Ranking	3	4	4	4	4	4	4

Preceding five calendar years performance	2023	2022	2021	2020	2019
Fund (I shares)	+20.3	-13.4	+15.9	-5.6	+20.5
MSCI World High Dividend Yield	+3.4	+6.6	+16.8	-2.9	+18.4
MSCI World	+17.3	-8.4	+22.9	+12.6	+22.7

Performance is calculated net of all fees and expenses and on a total return basis, inclusive of all distributions to unit holders. Charges and expenses for the I Acc GBP share class are deducted from Capital. MSCI World index is for comparison purposes only.
Source: Oldfield Partners.

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 a guide to future performance.

Portfolio breakdown

Top 10 holdings (%)

	Weight	MTD*	QTD*
J D Wetherspoon	9.2	-3.0	-9.3
Fairfax	7.7	+0.9	+19.7
Pason	6.5	+14.4	-3.7
KT&G	6.0	-0.2	+3.9
Arrow Electronics	5.8	+10.1	+17.2
Chubb	4.6	+3.3	+16.3
Brembo	4.6	+3.8	+5.5
Winpak	4.6	+0.9	-2.2
Ally Financial	4.4	+9.7	+18.5
Heineken	4.3	+4.7	-3.7

*Total return in GBP, reflects ownership period.

Country breakdown (%)

United States	28.3
Canada	22.1
United Kingdom	20.7
South Korea	8.6
Netherlands	7.8
Italy	4.6
Sweden	3.6
China/Hong Kong	3.1
Cash	1.2

Characteristics

	Fund	MSCI World
P/E ratio (fwd)	10.3	13.8
P/B ratio (hist)	1.4	2.6
Gross div. yield (fwd)	2.7	3.6
Active share (%)**	99.5	

**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 MSCI World High Dividend Yield index, divided by two.

Sector breakdown (%)

Consumer Staples	21.9
Consumer Discretionary	16.9
Energy	14.7
Insurance	12.3
Financial Services	7.9
Industrials	7.8
Information Technology	5.8
Banks	5.2
Materials	4.6
Communication Services	1.6
Cash	1.2

Fund manager commentary

The fund rose 3.1% in the first quarter of 2024 while the MSCI World High Dividend Yield Index rose 6.7%. The largest negative contributors to performance were, in order of impact, JD Wetherspoon (-9.3% total return in local currency), Reckitt Benckiser (-22.0% from the point of purchase to the point of sale), and Allegiant (-8.3%). The largest positive contributors to performance were, in order of impact, Fairfax (+21.4%), WK Kellogg (+44.6%), and Arrow Electronics (+16.2% from the point of purchase).

The combined impact of the three largest detractors was -3.3% which largely explains the relative underperformance in the quarter. JD Wetherspoon reported strong results during the quarter, and we therefore took the opportunity to add to the holding. The second largest detractor, Reckitt, was both a new purchase and sale during the quarter. As the facts changed for Reckitt shortly after our purchase, we decided to sell the stock. We will discuss our investment thesis and rationale for selling Reckitt in more detail.

The positive contributors included Fairfax which continues to benefit from a 'hard' insurance market and higher investment yield on its bond portfolio.

In terms of activity during the quarter, we sold Sanofi and IWG. The proceeds from Sanofi and IWG were used to fund a new position in Arrow Electronics and Reckitt. As we subsequently sold our position in Reckitt, we added to our holdings in Brembo, Pason, and Winpak.

The weighted average upside of the portfolio is currently 60% which is well above the long run average. We are even more excited on a relative basis. The broader market is trading on a price-to-earnings multiple of twenty times; this is a nearly 100% premium to the portfolio. Despite the significant valuation discount of the portfolio, the growth outlook (based on consensus), leverage, and returns on capital – metrics that broadly define business quality and prospects – are all in line with the broader market. The fund offers market-type quality at nearly half the price.

JD Wetherspoon (JDW)

The share price of the UK pub-operator appreciated more than 80% in 2023 which made it one of the fund's best performers last year.

During the quarter, JDW reported results for half-year ending January 2024. Sales on a comparable-pub basis were +10% compared to prior year and +15% compared to pre-COVID levels. Whilst sales have more than recovered compared to pre-COVID levels, operating margins of 6.8% are still below pre-COVID levels of c. 8%, reflecting higher staff and energy costs. JDW is slowly recovering these through a combination of price increases that are slower than competitors and increased volumes. From all the evidence that we see, JDW's price discount on a pint of beer is at a near-record 50% compared to neighbouring pubs. We believe this low-cost model will help continued volume growth in the years ahead.

In addition to strong operating performance, JDW's net debt of £690 million is below pre-COVID net debt of c. £800 million. The debt is backed by a significant freehold property portfolio. Reflecting the strong balance sheet, JDW started repurchasing shares in December 2023 and bought back a total of £34 million until the end of January. We believe buybacks are very accretive for shareholders as the shares are being repurchased significantly below our estimate of fair value.

In terms of valuation, we see a path to JDW generating net income of £90-100 million from its existing pubs in the near term. This puts the shares on 9-10x earnings at the current market capitalisation. We believe this is far too low for a business with a good balance sheet, sustainable competitive advantages, a track-record of growing at attractive returns on capital, and which is being run by a proven owner-operator.

Reckitt Benckiser (RB)

RB is a diversified consumer staples business with brands across health, hygiene and nutrition. Its brands in the hygiene business include Harpic, Vanish and Cillit Bang; health includes Nurofen, Strepsils and Dettol; whilst the nutrition business is dominated by baby formula brand Enfamil.

The company has been built around acquisitions, with Reckitt Benckiser itself formed in 1999 following a merger between Reckitt & Colman and Benckiser. Prior to 2016 the company's largest acquisition was around $3 billion. In February 2017 they purchased infant formula maker Mead Johnson for $16.7 billion. This proved to be a bad transaction with low single digit returns on the investment and excess leverage which the company spent the last 7 years reducing.

RB has best in class margins that helped protect it from the worst of the inflation in recent years and announced they were buying back shares. At a decade low valuation, the shares looked attractively priced for what was meant to be a relatively low risk investment.

As part of our pre-mortem analysis there were three key areas we thought could derail our investment. One such area related to poor organic sales growth; while this may not be a disaster for the investment, it would likely result in disappointing returns. A large (and poor) acquisition, in the mould of Mead Johnson, would be a major disappointment. Finally, a large product liability issue had the potential to derail the investment.

The company had faced various fines and issues with products over the years. Given RB's healthcare-related product exposure, we did not consider any of these out of the ordinary. However, following a court ruling in the middle of March, the company now faces a major liability relating to necrotising enterocolitis (NEC) with its Enfamil baby formula in the USA.

Despite convincing arguments in favour of RB, the jury ruled in favour of the plaintiff Ms Watson. She was awarded a headline sum of $60 million. RB's reaction to the verdict was one of 'surprise' and 'disappointment'. RB will now appeal the ruling. RB are facing c.400 other cases across the US.

It is likely that it will take a couple of years before we know the actual conclusion of the US legal cases. Determining the liability is a near impossible task, analysts assume anywhere between zero and $10 billion. What we know is that we do not know what the outcome will be. Furthermore, as a result, the investment case changed from being a view on operational delivery (and the return of cash through dividends and buybacks) to a view on litigation (which would impair the cash return prospects) and we therefore sold the shares.

It goes without saying that we are very disappointed by the outcome of and our short holding period in Reckitt. We have a substantial portion of our own savings invested in the fund alongside our investors so we share the pain. That said, we believe there are two important points to keep in mind. First, the importance of distinguishing process and outcome. We are the first to admit when mistakes are made - and we have made plenty. One of the key mistakes has been holding onto 'leaky boats' we believe this would have been the case here. We believe that recognising and learning from mistakes is critical because it is how we improve as investors. That said, good processes sometimes lead to bad outcomes. The initial investment case was sound, but the facts changed and we quickly took action and sold the shares. Second, by quickly taking action we limited our loss to c.1% which, for purposes of illustration, was similar to our gain in WK Kellogg during the quarter. Hence, whilst the loss is disappointing, it was manageable.

Fairfax

The Canadian insurer was once again one of the largest contributors. Ironically, this was despite a short report being released during the quarter, alleging that Fairfax has "consistently manipulated asset values and income by engaging in often value destructive transactions to produce accounting gains". The shares were down 12% on the day the report was released but have since more than recovered and, as of the end of March, are up 18% from the day the short report was released. In our view, the short report was grossly misleading and cherry-picking facts that suited the short-seller.

We reported at year-end how Fairfax's three earnings engines – insurance underwriting, investment income, and non-insurance – are firing on all cylinders. Fairfax released its 2023 results during the quarter, and we are pleased to say that all three earnings engines continue to fire on all cylinders with 2023 being the best year in the history of the company. Despite the share price being up more than 350% since the bottom in 2020, the shares still trade at less than 12x our view of normalised earnings. We remain excited about the prospects for Fairfax, but we have been reducing the position somewhat as it has been approaching our view of fair value.

WK Kellogg

We purchased WK Kellogg five months ago, in October 2023. Back then, WK Kellogg had been spun out of Kellanova just one month earlier and the shares were down more than 40% from the price at spin-off due to a combination of forced selling and concerns over GLP-1. What a difference just five months can make; the share price of WK Kellogg is now up more than 80% since we bought it.

Commentary - continued

Whilst the company has reported two good sets of quarterly results since we bought the shares, we believe almost perfect execution is now being discounted. We have therefore taken the opportunity to significantly reduce our position during the quarter. At quarter end, WK Kellogg was less than 2% weight in the portfolio. We will likely be exiting the position completely in the near term as we do not consider the risk/reward to be particularly attractive from here.

Arrow Electronics

Arrow was a new purchase during the quarter. Arrow is a US-based distributor of electronic products, mostly semiconductors. It is essentially a middleman between 700+ suppliers (such as Texas Instruments, Samsung, NetApp, Renesas, Infineon, NXP) and 210,000+ customers across a range of end- markets (industrial, automotive, aerospace, defence, healthcare, consumer electronics).

As you would expect from all distributors, Arrow moves products from suppliers to customers. However, it also adds value through helping suppliers with supply chain management and customers with design & engineering.

Suppliers need distributors like Arrow because they are not able to serve hundreds of thousands of customers themselves; customers need distributors to get access to all the suppliers. Due to this network effect, scale is an important factor for distributors and the market is therefore dominated by two players – Arrow and Avnet – who together have c. 60% market share in North America and Europe.

Not unlike many other distributors, Arrow has low margins but generates attractive returns on tangible capital (15-year average ROTE exceeding 30%). Additionally, it benefits from increasing demand for semiconductor products as industries ranging from automotive to industrials to defence continue to digitalise. Total revenue growth (including acquisitions) has been c. 6% annualised over the last 15 years. We expect Arrow will continue to benefit from increasing demand for semiconductor products.

Not surprisingly, Arrow was a beneficiary of the semiconductor shortages in recent years, leading to revenue growth of 20% in 2021 and 8% in 2022. This ended abruptly in 2023 where revenues declined 11%. It was this slowdown in demand that created the opportunity to purchase the shares at an attractive valuation.

A key feature of Arrow's business model is its counter-cyclical cash flows. During industry downturns, as the one we are currently experiencing, Arrow generates substantial free cash flow. This is because Arrow builds inventory when demand is strong and releases inventory when demand is weak. In 2021-22, when revenues were up 30%, Arrow generated free cash flow of c. $200 million. In 2019-20, when revenues declined 3%, Arrow generated free cash flow of nearly $2 billion. Arrow used the free cash flow in 2019-20 to pay off debt and repurchase shares. We believe the counter-cyclical cash flows is an important feature of Arrow's business model and is underestimated by the market.

Share repurchases is a key part of Arrow's capital allocation. Over the last five years, Arrow has bought back shares worth $3.6 billion which is more than half of the current market capitalisation. An important part of the investment case is continued share repurchases which we consider to be very accretive at the current valuation.

At the time of purchase, Arrow had a market capitalisation of c. $6 billion. It generated net income of nearly $1 billion in 2023. The lowest net income over the last ten years is c. $600 million and the average c. $800 million. Consensus estimates net income for 2024 of c. $640 million which we expect to be the trough year. This would put Arrow on less than 10x trough earnings. We think this is very attractive valuation for a business with significant competitive advantages and organic growth at attractive returns on capital.

Russian holdings

Please note that on 3rd March 2022 the Fund's investment in Lukoil ADR listed on the London Stock Exchange (LSE) was suspended from trading. Our Valuation Committee considered it was in the Fund's best interests that the holding of Lukoil ADR be fair value priced (FVP) at zero. In June 2022, we elected for the holding to be converted into local shares (Lukoil PJSC).

Given the current international sanctions on Russian securities and cash balances, we believe that if lifted and the Fund was able to access the local market, the holding in Lukoil PJSC (with a current FVP of zero) would represent 14% of the Fund and cash dividend of 2.7%. On 22nd August 2023 a Reuters article suggested that Lukoil was planning to repurchase 25% of its shares from foreign shareholders. The repurchase price would be at least a 50% discount from the quoted price. We continue to monitor the situation closely.

Performance summary of all share classes

				Annualised	
GBP shares	**1 month**	**YTD**	**1 year**	**3 years**	**5 years**
I Inc GBP	+3.0	+3.0	+11.4	+3.7	+5.1
I Acc GBP	+3.0	+3.0	+11.4	+3.7	+5.1
J GBP	+3.0	+3.1	+11.5	+3.7	+5.1
J Acc GBP	+3.0	+3.0	+11.5	+3.7	+5.1
MSCI World High Dividend Yield	+4.1	+6.7	+10.8	+9.4	+7.9
MSCI World	+3.2	+10.1	+22.4	+11.9	+12.7

Annualised

				Annualised	
EUR shares	**1 month**	**YTD**	**1 year**	**3 years**	**5 years**
K Acc EUR	+3.2	+4.4	+14.7	+3.5	+5.3
MSCI World High Dividend Yield	+4.2	+8.2	+14.1	+9.3	+8.1
MSCI World	+3.4	+11.8	+26.2	+11.8	+13.0

				Annualised	
USD shares	**1 month**	**YTD**	**1 year**	**3 years**	**5 years**
L Acc USD	+3.0	+2.1	+14.1	+0.7	+4.5
L USD	+3.0	+2.0	+14.0	+0.7	-
MSCI World High Dividend Yield	+4.1	+5.5	+13.3	+6.2	+7.2
MSCI World	+3.2	+8.9	+25.1	+8.6	+12.1

Performance is calculated net of all fees and expenses and on a total return basis, inclusive of all distributions to unit holders. Charges and expenses are deducted from Capital for A, FI and I shares.
MSCI World index is for comparison purposes only.
Source: Oldfield Partners.

Share class details

Share class	Dividend type	Fees from	AMC*	OCF**	SEDOL	Bloomberg	ISIN	Price
I GBP	Distribution	Capital	0.65%	1.00%	B75LT54	TMOVSII	GB00B75LT544	£1.88
I GBP	Accumulation	Capital	0.65%	1.00%	B75K5L9	TMOVSIA	GB00B75K5L91	£2.78
J GBP	Distribution	Income	0.65%	1.00%	B75KB22	TMOVSJI	GB00B75KB221	£2.13
J GBP	Accumulation	Income	0.65%	1.00%	B75M355	TMOVSJA	GB00B75M3558	£2.77
K EUR	Accumulation	Income	0.65%	1.00%	B75LBN6	TMOVSKA	GB00B75LBN68	€2.79
L USD	Accumulation	Income	0.65%	1.00%	B3ZMR33	TMOVSLA	GB00B3ZMR334	US$2.19
L USD	Distribution	Income	0.65%	1.00%	B7B2V88	TMOVSLI	GB00B7B2V886	US$2.04

Where fees are deducted from capital rather than income, capital growth may be constrained.
*AMC - Annual management charge
**OCF - Ongoing charge figure

Copies of our latest KIIDs and Prospectus for the fund can be accessed via our website, Overstone Global Equity Income Fund – Resources, or for assistance please contact info@oldfieldpartners.com.

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