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Oldfield Partners

Newsletter Q3 2017

Oldfield Partners has about $4.8 billion under management for families, individuals, charities, trusts, endowment funds and pension funds, through separate portfolios and pooled funds. The executive partners are Claus Anthon, Jamie Carter, Chris Driver, Richard Garstang, Andrew Goodwin, David Jones, Juliet Marber, John McEwing, Richard Oldfield, Tom Taylor, Edward Troughton, Nigel Waller, and Robert White.

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, a global equity income fund, a European equity fund, a global smaller companies equity fund, a Japanese equity fund, and a fund of funds.

Marking the 30th anniversary this month of the 1987 crash, the *Financial Times* quoted among others Art Cashin (a nice example of nominative determinism) of UBS who remarked on the similarities between then and now. On the eve of the 1987 crash the BBC weather forecaster Michael Fish told viewers that a lady from Hampshire had rung to ask whether there was a hurricane on the way to Britain: he could reassure her that there was not.

But there was. It was what has subsequently become known as a black swan event. The crash was also what we now know to be a Minsky Moment: a dramatic reversal made inevitable, and all the more dramatic, by the sense of complacency that preceded it. The governor of the Central Bank of China has been warning about the possibility of a Minsky Moment because of the build-up of credit in China. It is not just China. Debt is high in all the major economies, which themselves have been growing comfortably, maybe too comfortably. The back pages of *The Economist* which list 42 economies show only two in which there has been a fall in GDP over the last year. Stock markets have climbed remorselessly. Richard Thaler, the new Nobel laureate, and the leading exponent of behavioural economics which is another development of the last 30 years, suggests that 'we are living in the riskiest moment of our lives, and yet the stock market seems to be napping.'

This is debatable. Richard Thaler is 72. Another anniversary this month, the 55th, is of the Bay of Pigs episode, when Robert McNamara, Defense Secretary in JFK's administration, observing one glorious early autumnal Saturday evening in Washington, wondered if he would ever see another. There are certainly risks aplenty. But this anniversary is a reminder that there have been worse times. Indeed, since 1962 there have been huge advances in technology and productivity, economic advances with corresponding advances in the human condition: in infant mortality, in poverty, in medicine, in liberty.

Nonetheless there do seem to be an unusual number of risks. The geopolitical ones hardly need enumerating. The principal financial risk in the medium term is that interest rates, having gone down for 35 years, cannot go down any further, and need to go up to levels at which they are higher than the rate of inflation, with a reversal of quantitative easing; and the principal financial risk in the shorter term is just that things have been a little too good and investors have got a little too confident.

In markets generally there are no wild excesses. Jeremy Grantham, a thoroughly wise and experienced observer especially sensitive to overvaluations, says 'I don't think the market carries the

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typical traits of a bubble, which is euphoria.' Some investors have never quite recovered their sangfroid after the damage done in 2008 and many families have ample cash. There are, however, pockets of complacency after too much of a good thing.

Howard Marks, in his most recent memo, quotes from the 1997 Annual Report of Amazon: 'we established long-term relationships with many important strategic partners, including America Online, Yahoo!, Excite, Netscape, GeoCities, AltaVista, @Home, and Prodigy.' He points out that these relationships turned out to be not so long-term since the number of these important strategic partners which still exist is zero (apart from Yahoo! in another form).

His message is mainly that the future is unpredictable; it might also be that it is dangerous to extrapolate. The FAANGs – Facebook, Apple, Amazon, Netflix, Google – and their like have dominated stock markets in the last few years. There are a few straws in the wind that caution is called for. Politicians and press are beginning to question whether the power of companies like this needs to be curbed. *Barrons* had a recent banner headline which read 'Should Amazon be broken up?' *The Economist* has wondered whether governments should regulate the mega-tech companies as utilities. Uber has lost its licence (probably temporarily) in London, has withdrawn from Denmark, and has been banned in some parts of Australia. Books by Jonathan Taplin (*Move fast and break things*) and Franklin Foer (*World without mind: the existential threat of big tech*) attack the mega-tech companies for their monopolistic tendencies, negligence, creation of digital addiction, the encouragement of extreme partisan politics with facilitation of fake news and the 'echo chamber effect'. The research firm 13D concludes that 'the era of blind-faith in tech-giant utopianism must end' and Chris Wood of *Greed & Fear* says that 'the original libertarian ethos of the internet has long since degenerated into abetting and enabling a surveillance state.' A long time ago Rupert Murdoch observed that George Orwell had been wrong in positing in *1984* (written in 1948) that technology would result in a Big Brother sort of world of constant monitoring and invasion of privacy; Murdoch may have been right for a while, but no longer.

These rather political remarks might be taken as market-irrelevant rantings were it not for the fact that they may reflect the changing sentiment of those in a position to damage these mega-tech companies: legislators, regulators, tax authorities, and ultimately investors. Investors have been willing to provide apparently unlimited finance in equity and debt to companies determined on a land grab. If that were to change, the stock market perception, and valuation, of these companies might be very different. If a Minsky Moment, or even a mini-Minsky Moment, lies ahead it will not in itself affect our portfolios which do not contain very highly valued companies, however wonderful they may be. There might even be some benefit. If there were an inflection point for the FAANGs, and a realisation that not everything traditional is disrupted unconditionally, there might also be an inflection point in some old-fashioned places. We are intrigued especially by traditional retailers. Could there be a point at which what we used to be told about shopping in the 1980s and 1990s, that it is a leisure activity, becomes noticed again; and a point at which traditional retailers make a comeback, both because people like shopping and because some of the retail companies have themselves become strong in online sales? If so, in companies with still strong free cash flow and with single-figure price-earnings ratios, there might be great opportunities.

As for potential excesses, Bitcoin stands out. The *Financial Times* recently carried two headlines, 'Wall Street finds it harder to dismiss bitcoin' and 'Bitcoin gets official blessing [in Japan]…' which might serve as a harbinger of trouble: why do sensible people who regarded Bitcoin as a craze a few months ago now suggest that it is a 'valid asset class' at twice the price? In stock markets there is nothing quite so extreme, but the US market has a Shiller price-earnings ratio which is among the highest in its history and does not portend good returns for US indices over the next ten years. In the short term volatility in the US is unduly low, usually not a sustainable state of affairs – as measured by VIX it has

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not been lower since Bill Clinton became president in 1993; and the Investors Intelligence Survey of Advisory Sentiment, an excellent short-term inverse indicator, is in danger territory.

Our approach is to have faith in equities for the long term. We believe investors should have a cushion of comfort in cash or something else other than equities to protect in the phases in which equities are in trouble; and that above all valuation should be the guide. If markets are indeed overextended in the short term, the 'value' area of markets should be reasonably well protected.

Performance Summary as at 30th September 2017

			Since inception		2017 to date	
Strategy	**Inception**	**Currency**	**OP**	**Index**	**OP**	**Index**
Emerging Markets Equity	01-Jan-01	USD	+820.9%	+385.4%	+20.2%	+27.8%
European Equity	01-Oct-05	EUR	+97.6%	+76.9%	+7.4%	+9.7%
Global Equity	01-Jan-00	USD	+231.8%	+96.1%	+12.8%	+16.0%
Global ex US Equity	01-Jun-06	USD	+74.9%	+48.2%	+9.3%	+20.0%
Global Equity Income	01-Jan-12	GBP	+95.3%	+96.0%	+7.6%	+5.2%
Global Smaller Companies	01-Apr-05	USD	+129.8%	+162.4%	+16.9%	+16.6%
Japanese Equity	01-Oct-07	USD	+10.5%	+29.7%	+12.5%	+16.5%
Manager of Managers	01-Nov-05	USD	+85.0%	+114.2%	+9.4%	+16.0%

Source: Oldfield Partners, Bloomberg, MSCI ©. 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 as at 30th September 2017

	No. of stocks	Market cap. focus	Active share	2017 turnover
Emerging Markets Equity	18	>US$0.5bn	94%	14%
European Equity	23	>US$1bn	94%	11%
Global Equity	21	>US$10bn	98%	15%
Global ex US Equity	23	>US$1bn	98%	32%
Global Equity Income	28	>US$1bn	92%	14%
Global Smaller Companies	23	<US$5bn	100%	18%
Japanese Equity	23	>US$1bn	86%	9%

Source: OP, 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.

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