HORROS ASSET MANAGEMENT

JANUARY 2024

Dear co-investor,

First of all, I would like to take this opportunity to wish you all the best for the new year. We concluded 2023 with two reasons for celebration. On the one hand, our investment funds closed the year at record highs. This means that, in the more than eleven years that Alejandro, Miguel and I have been part of the portfolio management team, we have delivered cumulative returns of 254% in the international strategy (11.5% annualized) and 203% in the Iberian strategy (10.3%), outperforming their benchmark indexes in both cases.[1] On the other hand, the Horos family of products continues to grow, with the launch of **Horos Internacional Empleo PPE** and, foreseeably in a short period of time, **Horos Internacional Autónomos PPES**, two pensions plans that will provide a long-term savings solution for employees and self-employed workers, respectively, replicating our successful international strategy.

Taking a shorter-term view, in 2023 our funds were up 14.3% for Horos Value Internacional (versus 18.1% of its benchmark) and 15.7% for Horos Value Iberia (versus 24.5%). Undoubtedly, as we will see throughout this document, this has been a very atypical year, in which various factors (some of them unsustainable) have dramatically pushed global financial assets higher. For our part, we continue to invest true to our philosophy, always trying to find and exploit those inefficiencies that arise in the market in the most advantageous way possible, in order to meet our goal of generating sustainable and satisfactory returns over the long term.

Thank you for your confidence.

Yours sincerely,

Javier Ruiz, CFA
Chief Investment Officer
Horos Asset Management

[1] The data includes the performance of the portfolio management team in its previous professional period working for another asset management firm (from May 31, 2012 for the international strategy and September 30 for the Iberian strategy, until May 22, 2018 in both cases, when they joined Horos AM). Past performance is not a guarantee of future performance.

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Executive summary

In most cases, value is its own catalyst.
— Mohnish Pabrai

2023 was a very atypical year in which, with everything going against them, equity markets performed exceptionally well. Although part of this outcome was driven by the extraordinary performance of the largest U.S. technology companies, the fact is that in the last two months of the year we saw a rally in most publicly listed assets. The main reason for this? A turnaround in expectations regarding the forthcoming evolution of interest rates set by central banks. 2023 was also a year that reminded us why making predictions of any kind is useless when it comes to investing. On the contrary, the essence of common sense investing, as we do at Horos, remains to look for market inefficiencies and try to exploit them as much as possible. On many occasions, these inefficiencies will be closed with the appearance of some catalyst, as many of our investments demonstrate. At other times, as investor Mohnish Pabrai argues, valuation will be the catalyst itself. We will expand on these ideas in this last quarterly letter of 2023.

As usual, we will also discuss the most significant changes that we have made to our portfolios. Among others, we can highlight that Horos Value Internacional fully divested our positions in the thermal coal company **Geo Energy Resources** and in the metallurgical coal producer **Ramaco Resources**. Meanwhile, we initiated a stake in the U.S. investment manager **AMG**. In Horos Value Iberia, we sold our entire position in **Inmobiliaria del Sur** and in the Portuguese paper company **The Navigator Company**, while we invested for the first time in the hotel company **NH Hotel Group** and reinvested in the glass container manufacturer **Vidrala**, just a few months after our exit.

From an *annus horribilis* to an *annus mirabilis*

More great than human now and more August, New deified she from her fires does rise.
— John Dryden ("*Annus Mirabilis*")

The verse that heads the beginning of this last quarterly letter of 2023 is part of the poem that John Dryden—English poet, playwright and literary critic of the 17th century—published in 1667 in honor of London, a city that year had suffered a terrible fire that destroyed everything, as well as an epidemic of bubonic plague that would kill more than a fifth of its population. Despite these misfortunes, Dryden wrote an optimistic poem, which he entitled *Annus Mirabilis: the Year of Wonders*.[2] This Latin expression, possibly popularized from that moment on, has been habitually used to refer to those miraculous moments in which something unforeseen and extraordinary happens. Fate would have it that, precisely in 1666, a young Isaac Newton fled from the plague that was also ravaging the city of Cambridge and secluded himself in Woolsthorpe, the village where his mother's house was located. In the 18 months he spent in retirement, Newton experienced an unprecedented creative explosion, in which he initiated infinitesimal and differential calculus, carried out an analysis of the spectrum of light and conceived his famous laws of universal gravitation. A unique year in the history of science, which would later be known as Newton's *annus mirabilis*.[3] More than two centuries would have to pass before physics underwent a similar revolution. Thus, in 1905, an unknown young man in his twenties, working as a civil servant at the Patent Office in Bern (Switzerland), wrote a series of revolutionary articles in which he formulated his theory of special relativity and laid the foundations (despite himself) for the subsequent revolution in quantum mechanics.[4] His name, of course, was Albert Einstein and that year would also be baptized, as it could not be otherwise, as his own *annus mirabilis*.

Indeed, if a year ago we described 2022 in financial markets as "the *annus horribilis* that burst everything" (see **here**), I find it hard not to think of 2023 as an *annus mirabilis*. Recall that, in 2022, the sharp rise in interest rates, orchestrated by most central banks to curb runaway inflation, triggered the bursting of the inflated valuations (bubbles?) of many publicly listed assets. In particular, cryptocurrencies (including some very notorious frauds), companies linked to the technology sector or even fixed income markets experienced dramatic downturns. Well, the beginning of 2023 did not seem to anticipate a very rosy outlook. As we highlighted in our 5th

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[2] Cronin, J. (June 11, 2014). John Dryden: 'Annus Mirabilis 1666'. *University of Cambridge*.
[3] Pimentel, J. (May 2, 2020). El annus mirabilis y la acción a distancia. *Madri+d*.
[4] Isaacson, W. (2007). *Einstein: His Life and Universe*. Simon & Schuster.

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Annual Investor Conference last October (see **here**), the current aggressive interest rate hike cycle (not seen in decades) had triggered the worst bear market in history for U.S. government bonds.[5]

Given that this particular financial asset is considered the quintessential risk-free asset, its terrible performance is no trivial matter: **if the pillar on which the financial markets stand wobbles, they can crack in their most fragile areas**. And what are the most fragile structures in the economic and financial systems? The most leveraged ones, i.e., those with the highest debt. Therefore, to use Nassim Taleb's terminology: **debt is a *fragilizer***.

> *You have to avoid debt because debt makes the system more fragile.*[6]

In the third quarter of 2022, we warned how the fall in U.K. government bonds had destabilized the portfolios of pension funds, which used this ("risk-free") asset as collateral for their financial leverage structures, leading the Bank of England to intervene (see **here**). This was a first warning sign of the potential risks of this monetary tightening, which would have its repercussions in the sector which, by its very nature, operates with the greatest leverage: banking. An industry whose business model becomes even more fragile by operating with a severe maturity mismatch, i.e., by taking on very short-term debt (current accounts and other types of financing) in order to invest in the very long term (loans and financial assets). As Howard Marks, one of the most important investors of the last decades, pointed out in his most recent memo:

> *Investors with liability maturities that match the duration of their assets make it across the river much more regularly.*[7]

Therefore, as we explained in our letter of the first quarter of 2023 (see **here**), the regional banking sector in the United States suffered a cascade of failures (such as those of **Silicon Valley Bank** or **Signature Bank**), which was replicated in Europe (with the historic collapse of the Swiss bank **Credit Suisse**) and whose contagion could only be stopped after the joint intervention of the Federal Reserve and the U.S. Treasury Department. An intense but short-lived financial earthquake that once again alerted the investment community to the inevitable **unsustainability** of the traditional banking model, as well as its persistent **moral hazard**:

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[5] Glover, G. (October 9, 2023). The rout in US Treasurys is now the worst bond bear market of all time. *Business Insider*.
[6] Horring, R. (April 13, 2011). Nassim Taleb on Living with Black Swans. *Knowledge at Wharton Podcast*.
[7] Marks, H. (January 9, 2024). Easy Money. *Oaktree Capital Management*.

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One lesson of the events of last March is that, despite 15 years of reform efforts, we still have a system that privatizes gains while socializing losses.[8]

I would like to take this opportunity to remind you that **the so-called shadow banking, although often overlooked, contains the same seeds of destruction as traditional banking** (high debt and maturity mismatch). Despite its mysterious name, this term refers only to financial intermediation activities carried out by entities operating outside the commercial banking environment with which we are all familiar. Its practice is very common and, in fact, was largely at the root of the collapse of investment banks **Bear Stearns** and **Lehman Brothers** in the Great Recession of 2007/2008.[9] I mention this because the bankruptcy of the financial entity **Zhongzhi Enterprise**, one of the most important players in the Chinese shadow banking industry, was confirmed at the beginning of this new year:[10]

*(...) the recovery value of the group's assets, consisting mainly of **long-dated investments**, would be low due to poor liquidity, and therefore there was a shortfall in resources available to meet **near-term obligations**.*[11]

China was precisely the other major source of economic and financial uncertainty in 2023. Although the end of the "zero COVID" policy has contributed to a relative return to normality for its population, the reality is that the real estate crisis that has plagued the country since the fall of **Evergrande Group** in the second half of 2021 (see **here**) is proving to be very difficult to overcome. In fact, the collapse of **Zhongzhi Enterprise** is directly linked to this crisis, since the bulk of its assets were loans granted to real estate developers in the country. Hence, many voices are warning of a potential second phase of this real estate downturn, in which there will be a contagion in the country's financial sector, with significant repercussions at domestic and international levels:

If the $3tn Chinese shadow banking industry would begin to fail, the ripple effects would be felt globally. Since a lot of Chinese consumers invest in the shadow banking industry due to its attractive rates, a collapse in the sector will affect millions. (...) In addition, while it is hard to assess where the Chinese

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[8] McKernan, J. (January 5, 2024). Remarks by Jonathan McKernan, Director, FDIC Board of Directors, at the Session on Financial Regulation at the Annual Meeting of the Association of American Law Schools. *Federal Deposit Insurance Corporation*.
[9] Pozsar, Z. (2008) The Rise and Fall of the Shadow Banking System. Regional Financial Review, 44, 1-13.
[10] Ao, Y., Ren, D. and Xie, Y. (January 5, 2024). Beijing court accepts shadow bank Zhongzhi's bankruptcy application. *South China Morning Post*.
[11] Ren, D. (November 23, 2023). Troubled Chinese shadow bank Zhongzhi warns it is 'severely insolvent' after asset shortfall, failed bailouts. *South China Morning Post*. Bold added.

shadow banks invested or borrowed across the globe, the defaults in the sector will have implications on global lenders and institutions.[12]

In short, throughout 2023, we saw how the downturn in government bonds continued, how this roiled U.S. regional banks and how China sent clear signals of an economic slowdown that could last for several quarters. All this, ignoring the local war conflicts with the risk of turning into something much worse, such as the Ukraine-Russia and Israel-Gaza wars. It certainly does not look like the best environment for a soaring stock market. And yet that is precisely what happened during the year. This extraordinary performance demonstrates two things. On the one hand, **it is not worth wasting time trying to predict what equities will do**. It has always been impossible. On the other hand, **every year we find apparent reasons not to invest in the stock market.** There is no point in ever trying to guess the best time to do so. That said, what is behind this *annus mirabilis* of equities? We will devote the next section to try to answer this question.

The expectations game

The most important item over time and in valuation is obviously interest rates.
— Warren Buffett

There are possibly two factors behind this excellent performance of the stock markets and, more particularly, of the main U.S. indexes. First, as we also noted in our second quarterly letter of 2023 (see **here**), the recovery in the business performance of the large U.S. technology companies (via higher sales and cost cutting) and the massive deployment (often much ado about nothing) of artificial intelligence, triggered by the launch of **OpenAI**'s ChatGPT, sent these companies' stock prices soaring in 2023. Thus, the world's leading technology index, the **Nasdaq-100**, ended last year with impressive gains of 55%. The main contributors to this performance were the so-called *Magnificent Seven*, with outstanding gains that ranged from 240% for Nvidia to 50% for **Apple**.[13] This had a major impact on the world's main stock market index, the **S&P 500**. At the end of 2023, the top ten positions in this index (including the *Magnificent Seven*) accounted for 32% of its value.[14] A concentration not seen in decades and which led to only seven companies being responsible for more than 85% of the 24% return obtained by the **S&P 500**

[12] (December 3, 2023). The failure of Zhongzhi and its imminent impact on the troubled Chinese property sector. *Bocconi Students Investment Club*.
[13] Specifically, these seven companies performed as follows: Nvidia (+239%), Meta Platforms (+194%), Tesla (+102%), Amazon (+81%), Alphabet (+58%), Microsoft (+58%) and Apple (+49%).
[14] (January 2024). Guide to the Markets. US 1Q24. *JP Morgan Asset Management*.

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last year. We have already detailed on other occasions why we think this situation is not sustainable, so I will not repeat it here.

Second, another important development occurred in mid-October, when the **U.S. 10-year Treasury bond**, after a period of more than three years of steady losses and just when its yield was threatening to exceed 5%, stabilized and then began a strong recovery to a yield, at the time of writing, of around 4%. But what is behind this dramatic reversal? Quite simply, a turnaround in market expectations. The investment community, in the light of U.S. economic data and based on the (sometimes ambiguous) statements of the Federal Reserve's main officials, has inferred that the end of the interest rate hike cycle is near and is even starting to anticipate several cuts for this year.

This likely peak or, more particularly, the potential start of a cutting cycle, fuelled significant (historic, in some cases) gains in all financial assets. To give an example: U.S. government bonds saw their biggest bi-monthly rally since 1982.[15] A rise which, incidentally, helped to avoid what was on track to be the third consecutive year of losses for investors.[16] Likewise, most stock market indexes experienced double-digit gains in little more than a month, turning, in many cases, a dull year into one of strong returns (see the cases of the French **CAC 40** and the German **DAX**). Curiously, since this sort of turning point in interest rate expectations, the major technology companies have not outperformed the rest of the market.[17]

Now, if expectations play such a determining role in the evolution of financial assets, can we infer what they are discounting today? And, more importantly, are these expectations priced in by the market realistic? It is certainly not unreasonable to think that we may have reached a peak in interest rates. However, it is less clear what the path of interest rates will be in the coming quarters or years. Howard Marks, in the memorandum referred to in the previous section, noted that he does not like to make predictions of any kind, but he feels that **the market is discounting the best of all worlds**: an easy return to the inflation rate of recent years, rapid interest rate cuts and persistent economic expansion.[18]

What is our opinion? Like Marks, we do not attempt to make market predictions of any kind because they are unhelpful and even detrimental to our interests as

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[15] Bilello, C. [@charliebilello] (December 30, 2023). *The 8.5% gain for the US bond market in November-December was the best 2 months we've seen since September-October 1982*. Twitter. https://twitter.com/charliebilello/status/1741105606600069562
[16] Bilello, C. [@charliebilello] (December 30, 2023). *After losing 1.5% in 2021 and suffering their worst year in history in 2022 (-13%), US Bonds moved back into positive territory with a gain of 5.5% in 2023*. Twitter. https://twitter.com/charliebilello/status/1741096809077023173
[17] (January 3, 2024). Outperformance of Magnificent Seven Has Slowed. *Strategas Securities*.
[18] Marks, H. (January 9, 2024). *Ídem*.

investors. The good news, as we often point out, is that we do not need to make them in order to meet our goal of generating sustainable and satisfactory returns over the long term. **Our job, after all, is to find market inefficiencies and try to exploit them as much as possible**. However, to identify and take advantage of them, understanding why they are formed is essential.

In search of the lost alpha

Perhaps the biggest source of market inefficiency remains the human being.
— Andrew Feldstein

As we explained in our previous quarterly letter, describing the formation of markets' bullish and bearish patterns (see here), they are far from efficient. However, this evidence proves just that, that **market behavior is inefficient**. Therefore, we have yet to understand why it is so. Although there is a lot of literature in this regard, I have always felt a predilection for a particular report, entitled *Who is on the other side?*, published in 2019 by Michael Mauboussin, one of the analysts we most admire.[19] In this paper, Mauboussin identifies four sources of potential market inefficiencies: those dependent on the psychology of investors, those linked to their analytical skills and decisions, those related to their access to and use of information and, finally, those arising from technical and operational issues that influence their decisions.

Let us start with the first of these sources of inefficiency: **psychology**. These arise when the way investors act significantly separates the price of an asset from its intrinsic value. Specifically, three fundamental causes may be behind it. First, **excessive extrapolation** (also called *availability bias*). In general, investors tend to think that what has happened recently will continue the same in the near future. Therefore, they tend to invest more in those financial assets that have performed better lately, and vice versa. This may be one of the reasons that have led investors to concentrate their portfolios today in technology companies, with outstanding returns in recent quarters, and to ignore companies listed in markets with a depressing performance over the last few years, as is the case of the Hong Kong Stock Exchange, where we have had a significant exposure for some time.

Sentiment of the investment community is the second source of psychological inefficiency. For example, we can infer that negative sentiment plagues a market when there is a significant contraction in its trading volume, its valuation is

[19] Mauboussin, M. (February 12, 2019). Who is on the other side? *Blue Mountain Capital Management*.

extremely attractive and the number and value of companies that decide to go public (IPOs) is low. Indeed, the Spanish stock market and especially the Hong Kong stock market are very clear cases of extreme negative sentiment at the present time. For example, Hong Kong's **Hang Seng** index is trading at 0.8x book value or, to put it another way, the companies that make up this index are, on average, worth more dead than alive.

We have yet to mention **herd behavior**. This effect occurs when the bulk of investors act in the same way and heterogeneity in the market is lost. This inefficiency explains very well the formation of unsustainable stock market patterns (such as bubbles) and is responsible for the latent lack of liquidity that emerges when the pattern reaches its inflection point (the bubble bursts and there are no buyers because most investors overweight the same companies). Undoubtedly, the already high concentration of investors in the *Magnificent Seven* may be evidence of herd behavior today.

The second source of inefficiencies is investors' **research** capabilities and decisions. This inefficiency appears when there are investors who can analyze and make better use of the same information that is in the hands of the rest of investors. Think, for example, of all those studies that show that the vast majority of professional fund managers fail to beat the market.[20] In many cases, this performance is not caused by a lack of skill, but by deficiencies in implementing their capabilities.

A classic case is the **weighting** that managers give to the companies that make up their portfolios. It may happen that two investors reach the same conclusions about an investment thesis, but one gives a lower weighting in his portfolio to that company for fear of the consequences of tracking error (it is warmer inside the herd ~~there is safety in numbers~~) or, directly, because of the impositions of his fund's prospectus or the guidelines of a committee. The same applies to the concept of **time horizon**. A portfolio manager may be restricted by his organization, clients or product when establishing the best time horizon for an investment, which prevents him from optimizing his process and contributes to generate inefficiencies to be exploited by other investors without this type of time restriction. For all these reasons, at Horos we always keep in mind the following words attributed to the legendary investor John Templeton:

> *If you want to have a better performance than the crowd, you must do things differently from the crowd.*

[20] Wigglesworth, R. (March 8, 2023). Yeah, about that active comeback… *Financial Times*.

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Likewise, we cannot underestimate the role that **narratives** play in creating these kinds of analytical inefficiencies. I still remember how, a few years ago, many analysts in the commodities sector came to completely opposite conclusions to ours, even though their supply and demand work showed even more favorable scenarios than ours. In other words, they saw the same future bottlenecks in the sector as we did, but ignored the implications for commodity prices.

The third block of inefficiencies derives from the access to and use of **information**. Fundamentally, these occur when one investor gains an advantage over another by taking better advantage of information available to the entire market. One option to try to exploit this inefficiency would be to try to be the **fastest** to take advantage of new information, as is the aim of high-frequency trading (HFT) using algorithms. These mathematical tools usually operate on the basis of their interpretation of new data released by economic institutions and companies, asset price levels, news, etc. The fight to be the fastest in operating based on this information has led to an extraordinary investment and deployment of infrastructure in recent years, but also, ironically, has been a source of inefficiencies. Thus, this type of tools has even caused occasional market *flash crashes* (a collapse in stock prices in a short time because all the algorithms order the same asset to be sold at the same time), as was the case with the famous Flash Crash of May 6, 2010.[21] On that day of absolute madness, the U.S. indexes plummeted by 10% and large-cap companies, such as the consumer giant **Procter & Gamble**, saw their share price fall by around 40% in just a few minutes.[22]

However, it is more interesting when algorithms are behind nonsensical movements in the stock prices of some companies, generally of small capitalization, due to an erroneous interpretation of the newly released public information. For example, a few days ago, the management team of a company we hold shares in shared a suspicion with us. They believed that their stock price had plummeted on the day they released their earnings report because some investors' algorithms failed to recognize that the figures for the period were not comparable to those of the previous year, given that they had sold half of their business two quarters earlier.

Of course, in other cases the information is available and widely known to all, but integrating it into an analysis is more **complex** and laborious. A typical case is that of holding companies (vehicles with different businesses and investments), where assessing their structure requires analyzing several entities (sometimes belonging to different sectors) and the effect of the new information is not so relevant at

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[21] Kirilenko, Andrei A., Kyle, Albert (Pete) S., Samadi, Mehrdad and Tuzun, Tugkan, The Flash Crash: High-Frequency Trading in an Electronic Market (January 6, 2017). Journal of Finance, Forthcoming, Available at SSRN: https://ssrn.com/abstract=1686004 or http://dx.doi.org/10.2139/ssrn.1686004
[22] (May 6, 2010). Stock Selloff May Have Been Triggered by a Trader Error. *CNBC.com and Reuters*.

first sight. It is not surprising that we usually own several investments of this type in our portfolios. Perhaps the following comment by investor David Einhorn on his investment thesis on **Vodafone**, from several years ago, best captures what I am trying to explain:

> *Vodafone does not consolidate Verizon Wireless and, as a result, sell-side analysts seem to ignore its significant value.*[23]

Finally, there are inefficiencies due to **technical and operational problems** experienced by investors. In this case, the inefficiency arises because investors have to buy or sell an asset for reasons unrelated to its fundamental value. A paradigmatic case is that of **forced buyers and sellers** and, in particular, of fund managers tied to an index who have to adjust their portfolio on the basis of the companies that make up that benchmark. Periodically, companies move in and out of the indexes, forcing these funds to buy or sell these entities in order to keep track as closely as possible to the index they seek to replicate. Some of our investments in smaller companies are impacted by this circumstance relatively frequently, triggering "inexplicable" movements in their share price during some days.

Of course, investment fund subscription and redemption **flows** are also very relevant. When a large fund suffers a significant inflow or outflow of capital, the adjustments to its portfolio can have a major impact on the market. The most recent (and mediatic) example was that of British fund manager Crispin Odey who, after receiving countless complaints from former and current female employees of his asset management company, saw millions of pounds leaving his funds, forcing him to sell his holdings at *any* price and, ultimately, to close the iconic firm.[24] One of these investments was **Pendragon**, the car dealership company in which we were shareholders until the takeover bid process a few months ago, which saw its share price under pressure in June last year by this situation—totally unrelated to its business performance.[25]

In short, markets are far from being efficient for some of the reasons we have discussed in this section. Identifying the sources of inefficiency can help us to know how to take advantage of them when they occur. However, what guarantee is there that this inefficiency we have found will be closed and that we will obtain the expected return? None. Nevertheless, we are left with the (great) consolation of

[23] Einhorn, D. (January 19, 2010). *Greenlight Capital.*
[24] Cundy, A., Marriage, M. and Hickey, S. (October 31, 2023). Odey Asset Management to close after sexual assault allegations against founder. *Financial Times.*
[25] Evans, I. (June 15, 2023). Under-fire asset manager offloads £11m Pendragon stake. *TheBusinessDesk.com*

knowing that there is usually a spark that can help us achieve the desired outcome: the **catalyst**.

The right spark

Everything burns if you give it the right spark.
— Héroes del Silencio (Spanish rock band)

Last November, Charlie Munger passed away when he was about to turn 100 years old. Warren Buffett's partner and friend was certainly one of the main factors behind the success of the **Berkshire Hathaway** investment holding company. However, the investment community will always remember him for his approach to general knowledge through **mental models**: tools or concepts originating in different academic disciplines that can be used to improve our understanding of the world, including the field of investment.[26] Precisely, the concept of **catalyst** is a mental model that belongs to the fields of physics and chemistry. Think, for example, of the nuclear fission chain reaction or the autocatalytic chemical reaction. In both cases, a catalyst initiates (and sometimes sustains) that reaction. In the social world, i.e., in all areas where people interact, catalysts also play a decisive role, as shown by major revolutions and military conflicts. If we apply this idea to the world of investment, the catalyst will be that which induces a change that leads to closing the inefficiency that we have identified in the market. Therefore, they can play a key role in our future as investors.

In our opinion, the catalysts that contribute to uncovering the value of an investment can be of two types, depending on where they originate: external and internal. **External** catalysts are those factors that do not depend directly on the companies in which we are invested. They therefore come from the outside. An example could be monetary policy decisions by central banks, since the levels of interest rates or expansions (and contractions) of their balance sheets have a more direct impact on certain sectors and, in particular, on financial businesses. Consider the case of the insurance sector. These entities invest the premium income collected from policyholders mainly in fixed-income securities, historically generating a not negligible investment income in the process. However, for many years, the policy of "zero rates" and the expansion of the balance sheet followed by central banks meant that the yield on these assets was extremely low, greatly depressing the investment income of the insurance companies.

[26] Mental Models: The Best Way to Make Intelligent Decisions (~100 Models Explained). *Farnam Street.*

Now, the recent rise in interest rates has made fixed income attractive again, which is expected to have a very positive impact on this part of their business. Of course, this is reflected in the relative performance of the broad insurance sector over the last two years, except for those entities more dependent on the automobile business, where inflation has been wreaking havoc. We have been shareholders of the Spanish insurer **GCO** (Grupo Catalana Occidente) for many years. Although in our investment thesis we do not consider—to be conservative—a big upside in its financial results to be achieved in the coming years, the reality is that this factor could further make the company's market valuation cheaper by boosting its earnings. While I would love to be able to say that **GCO**'s share price is starting to reflect this potential upside, the investment community continues to ignore this well-managed company. This leads us to the conclusion that the **intensity** of the catalyst can also influence the closure of an inefficiency.

The intensity of the catalyst is precisely a very relevant factor in another example of an external catalyst: M&A. Specifically, in those situations in which there is a takeover bid for some of a company's businesses or assets or, directly, for the entire company. A case of the former would be the sale of the **Burger King** franchises by **Ibersol**, the Portuguese restaurant company, to **Restaurant Brands Iberia**, following the various offers negotiated throughout fiscal year 2022. As we explained at our 4th Annual Investor Conference (see here), this move helped to unlock a lot of value by pricing these assets and highlighting the huge attractiveness of the rest of **Ibersol**. On this occasion, the catalyst did have an effect and the company's share price, including dividends, has increased by up to 60% since the first negotiations were made public. On the other hand, a clear case of the latter would be the successive purchase offers that **Pendragon** received throughout the third quarter of 2023, which uncovered all the upside potential that we saw for this company in just a few days.

However, waiting for an external catalyst to appear can take a long time, raising the opportunity cost of an investment. Therefore, it is important to try to be shareholders of those companies where **internal** catalysts are most likely to emerge. In general, we refer to those that depend on the actions of a company's management team and, more specifically, those related to capital allocation. I am not going to elaborate on this point, as we devoted a quarterly letter in 2022 (see here) to stressing their relevance, so I will just give a couple of very enlightening recent examples. The first is the catalyst derived from an internally originated corporate deal. Contrary to what was mentioned in the cases of **Ibersol** and **Pendragon**, sometimes it is the senior management itself that tries to unlock the value of some of the company's assets, as shown by what happened with the Spanish company **Elecnor** in 2023 (see here). Its Board of Directors announced in

2022 the search for a minority partner (later, in early 2023, it would extend its search to a majority partner) for its renewable energy subsidiary Enerfín. Since the announcement of this process (already executed) until today, its share price, which had been languishing for several years, has rallied by around 80%, proving once again that the market can be very inefficient and that a company's management team plays a key role in the process.

The second case is even more blatant, as it is an atypical situation in which external catalysts (not so obvious) are combined with internal catalysts. Indeed, I am referring to **AerCap**, the world leader in the aircraft leasing business, whose investment thesis we have discussed several times. Now, for some time, we have been benefiting as shareholders from two dynamics that the market does not fully recognize. On the one hand, the aircraft leasing sector is experiencing favorable asset inflation, as a result of a sustained bottleneck in production by the two largest manufacturers, **Airbus** and **Boeing**. The reasons? A production capacity unable to recover after the shutdowns during the pandemic, in addition to all the problems **Boeing** is suffering with the design of its 737 MAX model. This restricted supply, together with a demand that has almost recovered from the impact of COVID-19, is leading to a steady increase in the value of the aircraft that are currently in operation. This means greater pricing power (lease rates) by the leasing companies and a higher value of their fleet.[27]

This second impact is the most relevant in our investment thesis, as the market is not realizing this higher asset value in **AerCap**'s share price, generating a significant inefficiency. Therefore, the external catalyst is not having an effect and an internal catalyst is needed. This is where the company's management team comes in, helping to take advantage of this inefficiency and uncover value. Specifically, the team led by CEO Gus Kelly is selling aircraft that do not fit into the company's long-term strategy at market prices (inflated by bottlenecks), realizing significant capital gains on these sales. Not only that, instead of distributing a dividend or buying more aircraft with the cash generated, the company is taking advantage of the fact that its share price does not reflect the value of its fleet to buy back its own shares (which is equivalent to buying the company's aircraft at a discount) in a very aggressive manner. Specifically, over the course of 2023, **AerCap** repurchased nearly 20% of its outstanding shares, increasing shareholder value and contributing to its strong stock performance.

In conclusion, however, it is important to always keep in mind that **context** is essential to the more immediate impact of a catalyst, whatever type it may be.

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[27] Pfeifer, S. and Georgiadis, P. (October 23, 2023). Aircraft rental costs soar as industry struggles with manufacturing delays. *Financial Times*.

Whether we like it or not, the performance of a stock or a market depends on the money flows of the investment community. Therefore, as I mentioned in the previous section, sentiment plays a key role in this equation. Consider the case of the Spanish stock market: how can we expect a rapid reaction in the **Grupo Catalana Occidente**'s share price to improved financial results, when negative sentiment about the Spanish market remains extreme? For instance, **Bank of America** highlighted in its well-known survey of European managers carried out in January that Spain was the second most unattractive market in Europe (our consolation is that in October it was the first).[28] Or the situation of the Hong Kong Stock Exchange, a market that has accumulated four consecutive years of declines and has started 2024 sliding more than -10%, reaching levels not seen for almost 20 years.[29] The reasons? Although the latest down move may be explained by the "snowball" effects in market exposures with leveraged structures through financial derivatives, at least in the case of Chinese indexes, the reality is that negative sentiment is flooding this market as rarely seen at any other time.[30] As the Chief China Equity Strategist at Bank of America Securities recently commented:

> *Almost every day this year, people have asked 'why is China down again?'* [31]

Therefore, these are situations in which, unless it is of high intensity and magnitude, the catalyst will have a more residual role in the short term to uncover the value in some of our investments. However, we cannot lose sight of the fact that, even in such extreme contexts, the market will eventually reflect their value and patience will eventually pay off, as illustrated in this 1955 conversation between Benjamin Graham (founder of value investing) and Senator Fulbright:

> ***Fulbright****: When you find a special situation and you decide, just for illustration, that you can buy for 10 and it is worth 30, and you take a position, and then you cannot realize it until a lot of other people decide it is worth 30, how is that process brought about – advertising, or what happens?*
>
> ***Graham****: That is one of the mysteries of our business, and it is a mystery to me as well as to everybody else. We know from experience that eventually the market catches up with value. It realizes it in one way or another.*[32]

[28] Carvajal, A. (January 20, 2024). La encuesta de Bank of America infrapondera a España y la sitúa como segundo peor destino de inversión tras Italia (Bank of America survey underweights Spain as second worst investment destination after Italy). *Vozpópuli*.
[29] (January 22, 2024). China Stock Selloff Worsens as Hong Kong Index Nears 19-Year Low. *Bloomberg News*.
[30] Shidong, Z. (January 19, 2024). China stocks rout exposes risk from US$30 billion of little-known leveraged 'snowball' derivatives. *South China Morning Post*.
[31] Li, J. (January 19, 2024). 'Why is China down again?' Bewildered Hong Kong-based funds ask BofA Securities to explain stock losses. *South China Morning Post*.
[32] (13 de enero de 2016). Graham: The Mysteries of the Stock Market. *Novel Investor*.

Main changes to our portfolios

Whatever you do in your investments, look for a margin of safety.
— Prem Watsa

The following is a summary of the most significant changes to our funds' portfolios:

HOROS VALUE INTERNACIONAL
Stake decreases & exits:

COMMODITIES (19%)
Holdings discussed: Geo Energy Resources (exited) and Ramaco Resources A (exited)

This quarter we exited the two companies that gave us exposure to the coal market: **Geo Energy Resources** ("Geo") and **Ramaco Resources A** ("Ramaco"). In the first case, the sale followed the company's announcement of a $200 million investment in the Indonesian mining group **PT Golden Eagle Energy** and the acquisition of a minority stake in **Marga Bara Jaya**. Two transformational moves for **Geo**, which completely change the profile of its asset base, as well as its financial structure. All this, together with disappointing results published in recent quarters (lower production and higher than expected costs) and a lower attractiveness compared to other alternatives in the portfolio, led us to sell our stake in this Asian thermal coal producer.

We also sold the A shares of **Ramaco** (we had already divested the B shares last quarter, as we explained in our previous quarterly letter) following their excellent stock market performance and their poor risk-return potential, given our (conservative) assumptions for the future price of metallurgical coal.

FINANCIALS (17%)
Holdings discussed: AerCap Holdings (3.6%)

Additionally, we trimmed our stake in **AerCap Holdings** ("AerCap"), the world's leading aircraft leasing company. As we have highlighted in this same document, **AerCap** aggressively repurchased shares in 2023, taking advantage of the various placements made by **General Electric** (with no stake today, after controlling more than 40% of the shares just a year ago). Specifically, the company acquired nearly 20% of the outstanding shares in the last twelve months, always at a significant discount to their intrinsic value. A move that has generated even more value for its shareholders, as it has been financed, in large part, through the sale of non-strategic aircraft for **AerCap** in the secondary market, yielding significant capital gains as the sales were made at a premium to their book value. In addition, the company reported that it has begun to recover a high percentage of some of the claims made to insurance companies, following the confiscation in 2022 of the aircraft that **AerCap** had leased to Russian airlines. As a result, **AerCap**'s share price has risen by more than 20% in the last three months.

OTHER:
Holdings discussed: Pendragon (exited)

As we mentioned in our last quarterly letter, in October we proceeded to sell our entire position in the British auto dealer **Pendragon**, following the bidding battle for the company, which contributed to realize its full upside potential.

Stake increases & new stakes:

COMMODITIES (19%)
Holdings discussed: TGS (2.6%) and Spartan Delta (2.5%)

Within our commodity exposure, we took advantage of the general weakness in the oil and gas sector to increase our stakes in **TGS** and **Spartan Delta**.

TGS, a company that primarily provides geophysical data collection and analysis services for the oil and gas industry, has performed poorly in recent months, mainly due to the oil price weakness, which could lead to a delay in the recovery of capital investments by its clients. However, we believe that the current stock price discount an excessively negative scenario for the company, in addition to not giving any value to the recent acquisition of **PGS**, where we see an interesting strategic fit and, especially, significant operational and financial synergies.

As for **Spartan Delta**, a Canadian producer of natural gas, natural gas liquids and oil, its share price has been under severe pressure. This has been due to the continued fall in the price of natural gas in Canada and the United States, because of the current oversupply in this domestic market. However, we believe that this situation of depressed prices is not sustainable and we expect some convergence towards international prices over the course of 2025, when the new liquefied natural gas (LNG) export facilities in North America begin to operate, which will satisfy the demand from Europe and Asia. In the meantime, **Spartan Delta**'s management team is focused on implementing three strategic pillars to generate value for its shareholders. First, optimizing their current operating assets in the Deep Basin, where they have achieved capital efficiencies of 20%. Second, by trying to be an active player in the consolidation of this area. Third, by investing in the New Duvernay area, where they have acquired underutilized oil assets at very attractive prices.

In short, we believe that the recent market weakness of both companies created an excellent opportunity to increase our stakes in two very well-managed entities with the capacity to generate cash in any environment.

HOLDINGS AND ASSET MANAGEMENT (20%)

Holdings discussed: Affiliated Managers Group (1.9%)

Affiliated Managers Group ("AMG") is a company founded in 1993 and specialized in acquiring stakes in independent investment management companies at a global level, supporting them in their long-term growth plans. One of **AMG**'s distinguishing features is that it does not interfere in the management of the entities in which it invests, supporting them, through its distribution channels, with asset raising and even advising and facilitating the succession plans of the management teams. Some of its most emblematic investees include Tweedy Browne, Third Avenue Management, Yacktman Asset Management, Artemis and AQR.

The assets under management of all the group's companies total around $675 billion and are distributed among four strategies: alternatives (36.5%), global equities (27.5%), U.S. equities (21%) and multi-asset (15%). **AMG** generates revenues based on sales or profits earned by these firms.

The company has seen its assets under management struggle in recent years due to the relative underperformance of active equity mutual funds, which has weighed on its stock performance. However, we think the share price reflects a very negative scenario for the coming years as, at the time of our investment, **AMG** was trading at less than 5x its 2026 free cash flow. Not only that, but the management team is also taking advantage of this undervaluation to buy back shares very aggressively, which further elevates the attractiveness we see in this investment.

HOROS VALUE IBERIA
Stake decreases & exits:

REAL ESTATE/REAL ASSETS (11%):
Holdings discussed: Merlin Properties SOCIMI (3.8%) and Inmobiliaria del Sur (exited)

Whereas last quarter we highlighted the divestment of a historical position in our Iberian portfolio (**Corporación Financiera Alba**), this quarter it is the case with **Inmobiliaria del Sur**. The property and development company, which has a portfolio of assets of reasonable quality, mainly distributed between Andalusia and Madrid, continues to trade at a very high discount to the underlying net asset value. Despite this, we decided to sell our stake, given the lack of determination on the part of the management team to try to close this large discount. This is particularly relevant as this is an entity that has to bear a relatively high cost structure, which increases the opportunity cost of this investment that we have held in our Iberian portfolio for several years.

Furthermore, the excellent performance of **Merlin Properties** in the last three months of the year, with gains of close to 30%, led us to cut our position, recycling this capital in other more attractive investment ideas at the present time.

INDUSTRIALS (31%):
Holdings discussed: Elecnor (4.2%) and The Navigator Company (exited)

We also trimmed our stake in **Elecnor** following its share price rally due to the sale of its renewable energy subsidiary Enerfín to the Nordic company Statkraft for €1.8 billion (€1.4 billion in cash and €400 million in debt). It remains to be seen what the management team will do with the cash generated by this sale. For now, they have announced the award of new power transmission lines in Brazil for their subsidiary Celeo and confirmed the distribution of an extraordinary dividend at the last General Shareholders' Meeting held on January 24, although the amount has not been disclosed. In our view, the distribution of a high dividend would contribute to unlocking even more value for shareholders.

The Navigator Company's lower relative upside compared to other companies led us to sell our position, although we maintain a high exposure through the **Semapa** holding company, which owns around 70% of the Portuguese paper company.

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Stake increases & new stakes:

REAL ESTATE/REAL ASSETS (11%):
Holdings discussed: NH Hotel Group (2.1%)

One of the major changes this quarter is the addition of **NH Hotel Group** ("NH") to Horos Value Iberia. This investment could be classified as a "special situation," as its appeal lies in the potential corporate deal that could occur in the short term. To understand this, it is interesting to take a quick look at the changes that have taken place in the ownership structure of the Spanish company in recent years. Thus, in the first half of 2018, the Thai hotel group **Minor International** ("Minor") acquired, among others, the share packages controlled by the Chinese **HNA Group** and the **Oceanwood** fund, to establish itself as the largest owner of **NH**, with 46.25% of the shares. Shortly afterwards, in September of the same year, **Minor** launched a takeover bid for the remaining shares at €6.3 per share, achieving an acceptance rate of close to 89% and, as a result, gaining control of more than 94% of the shares. Subsequently, at the beginning of 2020, the **NH** board approved the launch of a delisting takeover bid for the remaining shares at €7.3 per share. However, the coronavirus pandemic paralyzed this deal.

The move was frozen until the first half of 2022, when **Minor** expressed to the **NH** board its willingness to launch a delisting offer again. This time, they requested an independent valuation that put **NH**'s value at between €4.81 and €5.68 per share. The CNMV (the Spanish securities market commission) rejected this valuation and the delisting offer could not be completed. Nevertheless, **Minor** announced that it would carry out market purchase transactions with a limit of €4.5 per share (lower than the range rejected by the CNMV). As this was a move equivalent to a takeover bid, the Spanish regulator suspended **NH**'s share price in response and forced **Minor** to terminate this transaction. In the meantime, **Minor** has continued to increase its stake to 95.87% of the shares through market purchases.

Since then, there have been several resignations and changes in **NH**'s board, in favor of a delisting takeover bid at a price approved by the CNMV. We are of the opinion that the most likely scenario is the latter, so we initiated a position in the Spanish company. Importantly, we are investing at a sufficiently attractive valuation to be able to hedge against a scenario in which this likely corporate deal does not take place.

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INDUSTRIALS (31%):
Holdings discussed: Vidrala (2.1%)

The second entry of the quarter is an "old acquaintance" of our Iberian portfolio: **Vidrala**. A few quarters ago we invested in the glass container producer, taking advantage of the sector downturn due to soaring energy costs. The upside of the investment was realized very quickly and we exited this excellent company with significant capital gains. Now, the opportunity arose during the last quarter of 2023, after companies in the sector, including **Vidrala**, noted the weakness in demand due to lower consumption and the previous accumulation of inventories by their customers. The correction seemed excessive to us, so we decided to reinvest in the company. In addition, at the beginning of December, **Vidrala**'s management team once again demonstrated its capital allocation skills by announcing the acquisition of the approximately 70% it did not control of the Brazilian company **Vidroporto**. A key purchase for **Vidrala** which, in addition to being made at a very attractive valuation, allows it to enter Brazil, a market of high growth and relevance for the glass industry.

FINANCIALS (12%):
Holdings discussed: Alantra Partners (6.0%)

Finally, we significantly increased our stake in **Alantra Partners** ("Alantra"). The (foreseeable) poor performance of the results of the different segments of this financial company—especially those of the investment banking division—is affecting its stock market performance. Thus, over the course of 2023, **Alantra**'s share price fell nearly 35%, which, in our opinion, created a great investment opportunity. As a reminder, **Alantra** has an extraordinarily comfortable financial position (cash and cash equivalents account for 50% of its market capitalization) and in a normalized environment should generate free cash flow of more than €40 million, which compares with a current market value of just over €330 million. This does not include the value of the group's subsidiaries, which could be worth around €150 million. Add to this the track record of value creation by **Alantra**'s team and its high alignment of interests with shareholders, and it is understandable that we made the company one of the fund's top positions.

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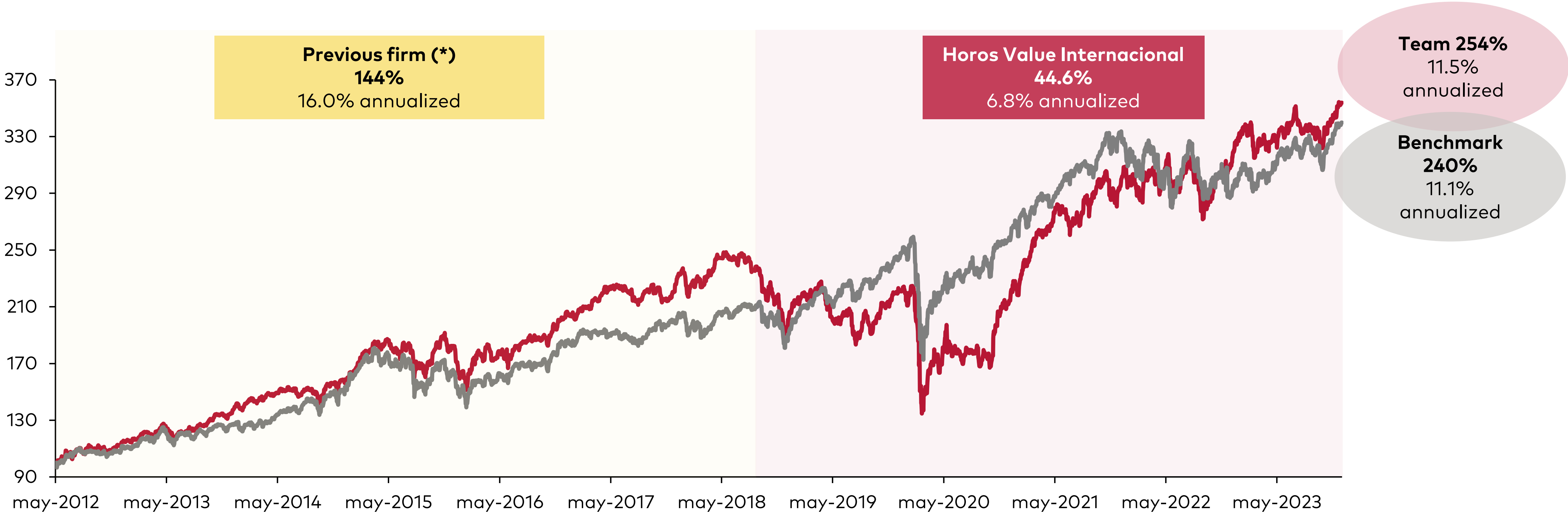
Returns

Historical returns of the management team in the International Strategy



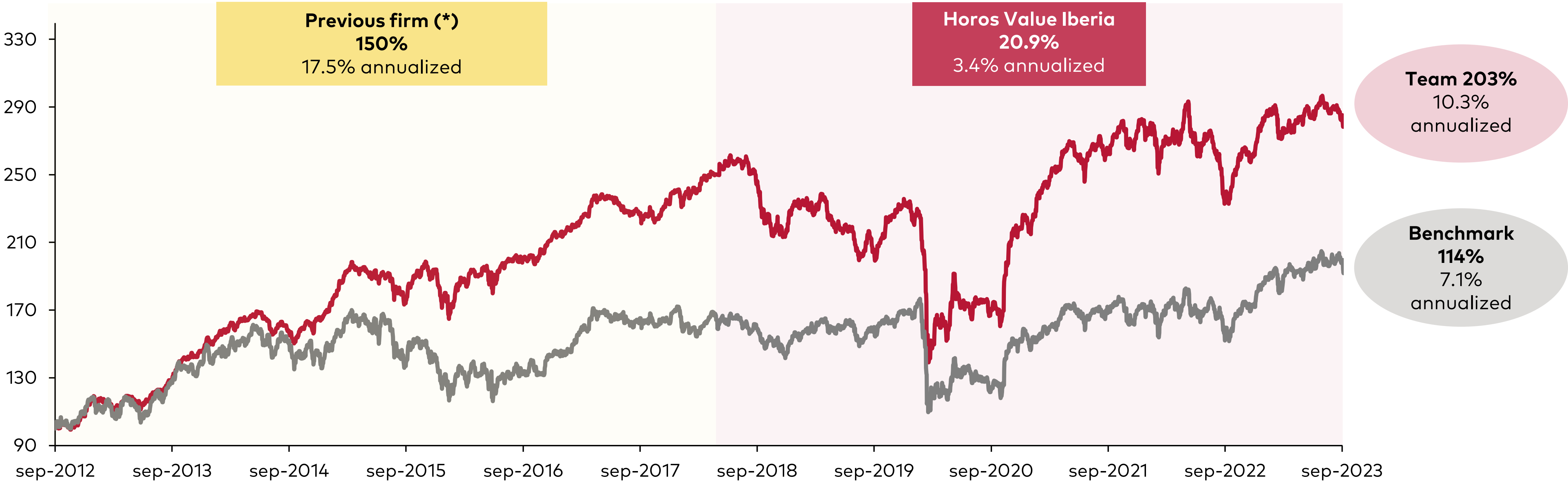
Data cover the period between the 30th May 2012 and 31st December 2023.

*Previous firm returns correspond to the management team performance achieved in their previous profesional stage, where they worked for a different asset management firm. This "previous stage" corresponds to the period between the 30th May 2012 and 22nd May 2018. It references the MSCI ACWI NET TR EUR, the most representative index of stock exchanges worldwide. This index takes into account net dividends.

Past performance is no guarantee of future performance. The Fund's investments are subject to market fluctuations and other risks inherent to investing in securities, so the acquisition of the Fund and the returns obtained may vary both upwards and downwards and an investor may not recoup the amount initially invested. Decisions to invest or divest in the Fund must be made by the investor in accordance with the legal documents at all times, and in particular on the basis of the Regulations and the Fundamental Data for the Investor (DFI) of each Fund, accompanied, where appropriate, by the Annual Report and the last quarterly Report. All this information, and any others, will be available to you at the headquarters of the Manager and through the website: www.horosam.com

Returns

Historical returns of the management team in the Iberian Strategy



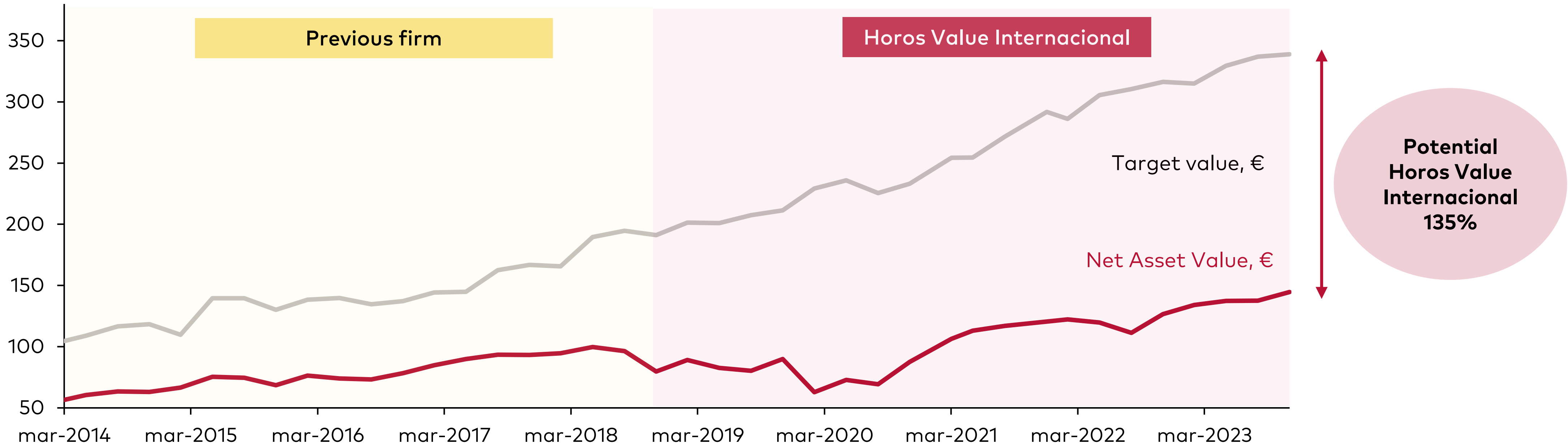
Data cover the period between the 30th September 2012 and 31st December 2023.

*Previous firm returns correspond to the management team performance achieved in their previous professional stage, where they worked for a different asset management firm. This "previous stage" corresponds to the period between the 30th September 2012 and 22nd May 2018. It references 80% of the ITGBM and 20% the PSI TR, which are the most representative indexes of the Spanish and Portuguese stock market. Both indexes take into account the reinvestment of dividends.

Past performance is no guarantee of future performance. The Fund's investments are subject to market fluctuations and other risks inherent to investing in securities, so the acquisition of the Fund and the returns obtained may vary both upwards and downwards and an investor may not recoup the amount initially invested. Decisions to invest or divest in the Fund must be made by the investor in accordance with the legal documents at all times, and in particular on the basis of the Regulations and the Fundamental Data for the Investor (DFI) of each Fund, accompanied, where appropriate, by the Annual Report and the last quarterly Report. All this information, and any others, will be available to you at the headquarters of the Manager and through the website: www.horosam.com

Upside Potential

Target value vs. Net Asset Value of the Management Team



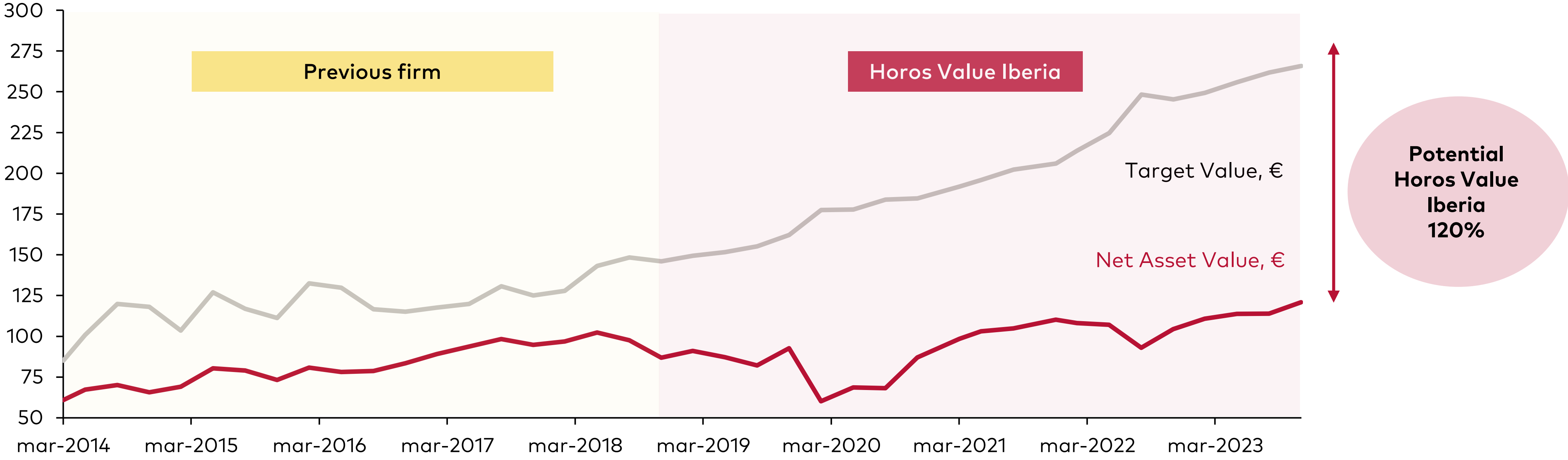
Data cover the period between the 31st March 2014 and the 31st December 2023.

Previous firm data correspond to the period when the management team worked for a different asset management firm. For the NAV calculation, this previous firm performance has been used, and as a base for retrieving the simulated NAV within this period, the NAV of Horos Value Internacional at 23rd May 2018, the day when the management team joins the project.

For the target value calculation, we perform an individual assessment of each Investment included in the portfolio. Specifically, we make a three-year estimate of the value of each company in which we invest. To do this we calculate, in a conservative way, the future cash flows we think the business will generate over the next three years in order to estimate the company future value (understood as market capitalization adjusted for net financial position). Subsequently, with this data we estimate the EV/FCF multiple (future value of the company divided by its normalised free cash flow, adjusting the latter for extraordinary items) at which each company would be priced. Finally, as a result of the qualitative analysis we do on each company, we assign an exit multiple to each investment (how much we think each business is worth trading at) and compare it with the previous figure to estimate the potential or attractiveness of the investment. Occasionally, given the nature of the investments, other generally accepted valuation methods would be used such as sum of parts, discounted cash flow or price to book value multiples.

Upside Potential

Target value vs. Net Asset Value of the Management Team



Data cover the period between the 31st March 2014 and the 31st December 2023.

Previous firm data correspond to the period when the management team worked for a different asset management firm. For the NAV calculation, this previous firm performance has been used, and as a base for retrieving the simulated NAV within this period, the NAV of Horos Value Iberia at 23rd May 2018, the day when the management team joins the project.

For the target value calculation, we perform an individual assessment of each Investment included in the portfolio. Specifically, we make a three-year estimate of the value of each company in which we invest. To do this we calculate, in a conservative way, the future cash flows we think the business will generate over the next three years in order to estimate the company future value (understood as market capitalization adjusted for net financial position). Subsequently, with this data we estimate the EV/FCF multiple (future value of the company divided by its normalised free cash flow, adjusting the latter for extraordinary items) at which each company would be priced. Finally, as a result of the qualitative analysis we do on each company, we assign an exit multiple to each investment (how much we think each business is worth trading at) and compare it with the previous figure to estimate the potential or attractiveness of the investment. Occasionally, given the nature of the investments, other generally accepted valuation methods would be used such as sum of parts, discounted cash flow or price to book value multiples.

Top 10 Holdings
Horos Value Internacional

Holding	%	Theme
Mistras Group	4.7%	Commodities
Catalana Occidente	4.0%	Financial
Talgo	3.9%	Industrial
Fairfax India	3.7%	Holding
ALD Automotive	3.7%	Financial
Aercap Holdings	3.6%	Financial
Semapa	3.6%	Holding
Naspers	3.6%	TMT
Aperam	3.1%	Commodities
Atalaya Mining	3.1%	Commodities

Top 10 Holdings
Horos Value Iberia

Holding	%	Theme
Catalana Occidente	6.0%	Financial
Semapa	5.8%	Holding
Alantra Partners	5.7%	Financial
Horos Value Internacional	5.5%	Others
Iberpapel	5.4%	Industrial
Talgo	4.8%	Engineering
Aperam	4.4%	Commodities
Gestamp Automocion	4.3%	Industrial
Elecnor	4.0%	Industrial
Atalaya Mining	3.7%	Commodities