

HOROS

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MENT

QUARTERLY LETTER
TO OUR CO-INVESTORS

JANUARY 2023

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Dear co-investor,

The fourth quarter of the year was a relief for most markets, reducing part of the significant losses accumulated over the previous nine months. Our portfolios were not immune to this positive change. Horos Value Internacional fund gained 13.7% in the last three months of the year, bringing the 2022 return to 4.9%, compared to a 0.8% gain of its benchmark in the quarter and a decline of -13.0% over the calendar year. Horos Value Iberia, on the other hand, was up 12.1% over the quarter, for a return of -5.2% in 2022, compared to a gain of 11.9% in its benchmark over the quarter and a rise of 2.0% for the year.

As usual, I would like to take this opportunity to update our longer-term performance. Since the inception of Horos (May 21, 2018), Horos Value Internacional has returned 26.5%, below the 39.6% gain of its benchmark, while Horos Value Iberia has returned 4.5%, outperforming the 2.4% return of its index. Moreover, since 2012, the returns of this management team stand at 209% for the international strategy and 162% for the Iberian strategy, compared to 188% and 72% of their benchmark indices, respectively.¹

Despite the last quarter's bounce, many indices closed the year with sharp declines. Although many causes may be behind this setback, we are convinced that the tightening of central banks' monetary policies played a key role. In this letter, I would like to highlight the role that interest rates have played in the evolution of the markets, before and after their major shift to the upside. I will also update on the positive outlook of our portfolios.

As always, we thank you for your confidence and wish you all the best for this new year.

Yours sincerely,

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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.

Executive summary

All those factors that cause a bull market, they're not only stopping, they're reversing.

— Stanley Druckenmiller

We ended a very challenging year for most investors. A year in which virtually no asset was safe from the market downturn. Although many factors can explain it (Russia-Ukraine war, China, inflation, etc.), we firmly believe that the key market driver has been the increase in interest rates by central banks. As we have always argued, the expansionary monetary and fiscal policies of recent years explained the exuberance in the valuation of many assets, including fixed income. Now, the rise in interest rates has triggered the bursting of many of these blatantly overpriced assets. In addition, as a new year has just started, we also take the opportunity to review the positive outlook for our holdings over the next few years.

As usual, we will also discuss the most significant changes that we have made to our portfolios. Among others, we can highlight that at Horos Value Internacional we exited our position in the **Sprott Uranium Physical Trust** and **Teekay Corp**, as we found more attractive alternatives. We initiated new stakes in the payments platform **PayPal Holdings**, in the Chinese technology platform company **Baidu** and in the UK's car dealership group **Pendragon**, following the sharp decline in the stock price due to the withdrawal of the takeover bid by the Swedish group Anders Hedin. Horos Value Iberia has seen no new names or exits, but we increased our exposure to heavily penalized companies, such as **Atalaya Mining** and **Talgo**. In addition, the holding company **Sonaecom** received a takeover bid from its parent company **Sonae**, at a price that we believe is far from reasonable.

The *annus horribilis* that burst everything?

1992 is not a year on which I shall look back with undiluted pleasure. In the words of one of my more sympathetic correspondents, it has turned out to be an 'Annus Horribilis.'

— Queen Elizabeth II

Finally, after more than a decade of steadily rising stock prices in the world's main stock market index (except for a few setbacks), the **S&P500** suffered a major blow in 2022, falling nearly -20% in the period, posting its worst year since the Great Recession of 2008 and its third worst decline in several decades (the other largest recent drop was that of 2001, caused by the bursting of the dotcom bubble). The tech-heavy **Nasdaq** index was hit even harder, sliding by -33%. While the U.S. fared the worst among the major markets, virtually no index in the world was spared from the downturn. For instance, many of the Asian stock markets had declines that ranged from -15% for the Chinese indices to -33% in the case of Vietnam. Meanwhile, in Europe we saw the Austrian stock market fall by -19%, Switzerland by -17%, Sweden by -16%, Germany and Italy by around -13% and our **Ibex-35** by -5.5%. In contrast, it is very striking how some more "exotic" markets had extraordinary gains in this fateful 2022. Undoubtedly, the star stock market was the Venezuelan stock market, soaring by 255%, followed by the Turkish market (196%) and Argentina's Merval (142%). Coincidentally, these are stock indexes belonging to economies that have seen their currency destroyed (once again!) and, as a consequence, are suffering (among many other ills) hyperinflationary episodes which, in turn, demonstrate the **hedging qualities of equities against situations of collapsing purchasing power.**²

However, global equities are not the only asset class that experienced its particular *annus horribilis*. As we highlighted in our IV Annual Investors Conference (see [here](#)), global public fixed income (always used as a proxy for risk-free assets) posted its biggest annual loss in several decades and, in the case of the United States, it was actually the worst year ever.³ Moreover, major markets such as the United Kingdom and Japan experienced moments of severe financial stress, forcing their central banks to rethink their monetary policies overnight.⁴ In case anyone is

² Samson, A. and Yackley, A. J. (December 30, 2022). Turkish stocks soar as local investors seek refuge from blistering inflation. *Financial Times*.

³ Stanton, E. (December 31, 2022). Treasuries Post Biggest Annual Loss Ever as Inflation Takes Toll. *Bloomberg*; Cherry, L. (December 31, 2022). European Bond Markets Were Roiled This Year In Ways Few Imagined. *Bloomberg*.

⁴ Strubbington, T., Cumbo, J. and Flood, C. (September 28, 2022). How Kwasi Kwarteng's mini-Budget broke the UK bond market. *Financial Times*; Lewis, L. (December 30, 2022). Bank of Japan makes unscheduled bond purchases for third straight day. *Financial Times*.

wondering, **it is very unusual to have a year in which both equities and government bonds record negative nominal returns.** In fact, the number of times this has happened in the case of the U.S. market, since 1871, can be counted on the fingers of one hand.⁵ It is not difficult to imagine the pain that this extraordinary circumstance has created in the classic balanced portfolios that replicate the famous 60/40 investment strategy (60% in equities and 40% in fixed income).⁶

Likewise, real estate, which is also usually considered a low-risk asset, is also suffering severe downward pressure in countries where it seemed that it would never stop going up. Some examples, without being exhaustive, would be Australia or the United Kingdom, which had their worst year since 2008; Sweden, with declines not seen since the 1990s, or China, whose real estate collapse we highlighted a few quarters ago (see [here](#)).⁷ Of course, it seems only a matter of time before other housing markets that have boomed in recent years (such as the United States) end up joining this list.⁸

However, it is not only the more traditional assets that saw their prices tumble in 2022. Others, with a much more speculative component, such as those commonly known as cryptocurrencies, also experienced their own descent into hell. Following the success of **Bitcoin** (both as a concept and as an investment instrument) in recent years, an endless number of substitute assets began to flourish, as well as trading platforms to facilitate their purchase and sale. The extraordinary positive sentiment that surrounded this entire universe during 2020 and part of 2021 led to spectacular rises in assets with characteristics that (I am sure) very few buyers stopped to even try to understand. To give an example of the frenzy that was experienced for a time, a cryptocurrency called **Shiba Inu**, which began its journey in mid-2020, reached a market capitalization of more than \$41 billion (down to \$5.7 billion at present, without getting into whether it makes sense or not). Another very striking example is that of **Dodgecoin**, the cryptocurrency that was promoted and boosted by Elon Musk, the co-founder and "Technoking" of **Tesla** (it is not a fictitious position, you can look it up on its website) with his tweets, to reach a market value of over \$80 billion from the less than \$500 million it was valued at the end of 2020 (today its total value is about \$11 billion). And in the case of **Bitcoin**, its price went from \$10,000 in mid-2020 (\$175 billion capitalization) to

⁵ FT Reporters (December 31, 2022). Charts of the year: the big moments for gilts, crypto and the dollar. *Financial Times*.

⁶ Otani, A. and Langley, K. (November 13, 2022). The Classic 60-40 Investment Strategy Falls Apart. 'There's No Place to Hide.' *The Wall Street Journal*.

⁷ Pandey, S. (January 2, 2023). Australia House Prices Tumble Most Since 2008. *BNN Bloomberg*; Romei, V. (December 30, 2022). UK house prices fall for longest period since financial crisis. *Financial Times*; Wilen, A. (January 2, 2023). Swedish Housing Market Rout Continues as Drop Extends to 17%. *Bloomberg*.

⁸ Burns, D. (December 27, 2022). Double-digit U.S. home price growth streak skids to an end. *Reuters*.

over \$65,000 at the end of 2021 (\$1.2 trillion) and then fell to around \$16,000 at the end of 2022.

Of course, as always happens, **when this type of bubble bursts** (I find it hard to describe it in any other way), **the fragility of the system surfaces in the form of bankruptcies and the uncovering of frauds.** Remember the cases of **Enron**, **Worldcom** or **Tyco**? They emerged after the dotcom crash.⁹ And the Madoff case? Indeed, after the bursting of the global real estate bubble at the beginning of this century.¹⁰ Well, the aftermath of the cryptocurrency crash has been no exception to this rule. In 2022 we saw the fall of so-called stablecoins such as **Terra/Luna**, the bankruptcy of trading platforms such as **Celsius** (some after freezing clients' withdrawals), as well as the collapse of the cryptocurrency hedge fund **Three Arrows Capital** or, much more resoundingly and recently, the **FTX** platform (and the hedge fund **Alameda Research**, closely related to this platform and its founder, Sam Bankman-Fried), whose bankruptcy may have uncovered one of the biggest financial frauds in the history of the United States.¹¹ Of course, it is very significant that the person in charge of supervising the **FTX** bankruptcy process, who is curiously enough the same person who supervised the **Enron** bankruptcy process, states that nothing similar has ever been found before:

Never in my career have I seen such a complete failure of corporate controls and such a complete absence of trustworthy financial information as occurred here.¹²

But why such a generalized meltdown in assets that appear to be so different? Although attributing all the credit to a single variable makes no sense when we are talking about complex adaptive systems such as financial markets, we can safely say that the tightening of monetary policy by the major global central banks and, in particular, the U.S. Federal Reserve, has been the main trigger for this global downturn.

⁹ (July 1, 2002). WorldCom, Tyco, Enron--R.I.P. *Forbes*.

¹⁰ Honan, E. and Wilchins, D. (December 12, 2008). Bernard Madoff arrested over alleged \$50 billion fraud. *Reuters*.

¹¹ Palma, E., Chaffin, J., Oliver, J. and Shubber, K. (December 13, 2022). Sam Bankman-Fried charged in one of 'biggest financial frauds' in US history. *Financial Times*; Nicolle, E., Kharif, O. and Ishmael, S-M. (December 22, 2022). All The Ways That Crypto Broke in 2022. *Bloomberg*.

¹² Smith, G. (November 17, 2022). FTX mess is worse than Enron, says the man overseeing its bankruptcy. *Yahoo Finance*.

The (great) monetary tipping point

When interest rates go up, asset prices go down.

— Ray Dalio

Howard Marks, co-founder and co-chairman of **Oaktree Capital Management**, as well as one of the most important investors of the last decades, publishes a series of memos every year in which he usually expresses his views on the markets and the economy. These reflections, full of lucidity and common sense, are followed by the entire investment community. In fact, Warren Buffett has even said that when he receives Marks' memo in the mail, he stops everything he is doing and immediately starts reading it (what better compliment can an investor receive?):

When I see memos from Howard Marks in my mail, they're the first thing I open and read. I always learn something.¹³

His latest writing in 2022 is arguably one of the most relevant he has published. In the memo, entitled *Sea Change*, Marks explains why he believes this is the third tidal or paradigm shift he has experienced in his long investment career.¹⁴ The first of these he identifies at the end of the 1970s, when the proliferation of new asset classes and, in particular, the development of the fixed-income market, awakened a change of mentality among investors who, from then on, began to manage their portfolios on the basis of the risk-return tradeoff (previously there was not such a clear conception of this relationship). The second occurred in the 1980s, when the then chairman of the Federal Reserve, Paul Volcker, managed to contain the skyrocketing inflation of that period with an aggressive hike in interest rates, creating a very favorable environment for a gradual reduction in interest rates that has lasted for more than four decades. **The combination of these two sea changes would explain the evolution and development of the financial markets that we have seen up to the beginning of 2022.** As Marks reminds us in the memo, in that period the S&P500 has shown an extraordinary performance, reaping an annualized return of 10.3%.

Once again, several factors explain the great outperformance of the US stock market over the period, such as economic growth, technological innovation and the good performance of its businesses. However, as Marks emphasizes, it is impossible to ignore the impact of interest rates on this performance:

¹³ Howard Marks: Luck, Risk and Avoiding Losers [The Knowledge Project Ep. #53]. *Farnam Street*.

¹⁴ Marks, H. (December 13, 2022). *Sea Change*. *Oaktree Capital Management*.

It seems to me that a significant portion of all the money investors made over this period resulted from the tailwind generated by the massive drop in interest rates. I consider it nearly impossible to overstate the influence of declining rates over the last four decades.¹⁵

Why? On the one hand, lower interest rates encourage borrowing, fostering an increase in consumption and investment, which has an impact on economic growth and corporate profits.¹⁶ On the other hand, these lower interest rates increase the valuation of assets by reducing their discount rate (remember that the value of an asset is equivalent to the sum of its future free cash flows discounted to the present):

*In The Theory of Investment Value, written over 50 years ago, John Burr Williams set forth the equation for value, which we condense here: **The value of any stock, bond or business today is determined by the cash inflows and outflows - discounted at an appropriate interest rate - that can be expected to occur during the remaining life of the asset.**¹⁷*

These dynamics have most likely been exacerbated, or at least maintained over a longer period of time than might have been expected, by the extraordinarily expansionary monetary and fiscal policies of the past fifteen years, something we have already discussed (see [here](#)). Therefore, on this occasion, I would like to focus on **the perverse dynamics that this environment has caused in the behavior of the executives of publicly traded companies and their investors** in recent years and how the turnaround in central banks' monetary policies has put an end to it.

The price of time

Without interest it becomes impossible to value investments.

— Edward Chancellor

Let us begin by succinctly explaining how lower interest rates have led to a change in the behavior of company executives. First, lower financing costs encourage entrepreneurs to increase their debt and initiate investment projects that would otherwise be unattractive. Moreover, low interest rates (remember that they have been negative for a long time) led the market to be willing to value projects that

¹⁵ *Idem*. Bold added for emphasis.

¹⁶ We already explained the formation of economic cycles in our quarterly letter published in January 2021 (see [here](#)).

¹⁷ Buffett, W. (1992). Warren Buffett's Letters to Berkshire Shareholders. *Berkshire Hathaway*. Bold added for emphasis.

were no more than mere promises very highly, given their uncertain success and distance in time. Consider the pernicious process uncovered by what we have just discussed. On the one hand, a company's management team would not carry out this type of project under more normal circumstances, since it would not be able to obtain financing to carry it out and the market would likely penalize this type of initiative by valuing the entity it manages at a lower multiple. On the other hand, entrepreneurs end up losing all discipline, finding themselves in an environment in which any idea is positively valued by the investment community, regardless of the (certain) losses that are occurring today, and as a consequence, contributing to an unsustainable competitive environment that is costly for the industry as a whole.

Let us think about the automotive industry. It is historically a very boring and competitive industry, with few changes in terms of manufacturers. However, in the last decade, several revolutions led to the emergence of new players that have put traditional manufacturers in check. In particular, the advent of electric vehicles and the development of autonomous driving technology are changing the industry's *status quo*. The "unlimited" access to capital enjoyed by the newcomers has allowed many of these new companies to reach valuations that would have been unthinkable in a different monetary context. Consider the specific case of electric vehicles, where manufacturers such as **Tesla** and **NIO** saw their stock market value rise dramatically. Thus, **Tesla** went from a market cap of around \$75 billion at the beginning of 2020 to reaching \$1.23 trillion at the end of 2021 (a 1,600% return in less than two years for a company that was already valued at \$75 billion!). For its part, **NIO** saw its market cap grow from a mere \$3 billion in 2020 to nearly \$100 billion at the beginning of 2021. In both cases their share prices have crashed from the highs, by around -75% in the case of **Tesla** and more than -85% for **NIO**. Did the performance and prospects of their businesses justify such a large and rapid increase in value? What future market share and what value did the market come to pay for the technologies/products beyond the manufacture of electric cars? How much did this low-rate environment benefit these companies that were offering promises to the market, allowing them to finance large investment projects that were unfeasible for their competitors, when the latter were the ones with a much more solid balance sheet and strong *current* cash generation power?¹⁸

As a reflection, Jim Chanos, arguably the best short seller (an investor who makes money if the stock price goes down) of all time, wryly commented this about **Tesla** a few months ago:

¹⁸ (January 4, 2023). Investors conclude that Tesla is a carmaker, not a tech firm. *The Economist*.

It's an energy company, it's a battery company, it's a robotics company, it's an autonomous driving company—take your pick. On top of that, it's going to grow its automotive revenue by 40 or 50 percent for the next 10 years. It's got everything and it's run by the smartest man in the universe. It is a hopes-and-dreams stock.¹⁹

Another clear example can be found in the sector of large technology platforms, where the market was willing to value these companies at ever-higher multiples, encouraging their management teams to increase all types of spending and investment in the hope of higher future earnings and returns. However, 2022 has put an end to this blatant lack of discipline, as evidenced by the big drawdowns of these companies, forcing them to initiate massive layoffs and take measures to improve profitability. Thus, **Amazon**, **Meta Platforms** (formerly Facebook), **Lyft**, **Hewlett-Packard**, **Salesforce**, **Snap**, **PayPal Holdings** ("PayPal") or **Alphabet**, to name a few, have announced significant staff reductions for the coming months and measures to increase the operating margins of their businesses.²⁰ The same dynamic is underway in China, where companies such as **Tencent Holdings** ("Tencent"), **Alibaba Group** ("Alibaba") or **Baidu** have started to implement optimization plans to cut costs in projects that are now less of a priority and of low returns.²¹ In other words, **the market has grown tired of paying for promises and demands certainty.**

But, as we mentioned above, it is not only the management teams of companies that have been influenced, in one way or another, by the loose monetary policies of these years. Indeed, many market participants also lost their discipline in an environment that was not favorable to investors based on fundamental analysis or, as we like to say at Horos, common sense. We have already highlighted in our annual conferences and in previous letters how the actions of central banks and expansionary fiscal policy during these years created a context that was not conducive to value investing, so I will not repeat that part of what has happened here. However, I would like to highlight the dangers of another narrative that for years seemed to justify any valuation in a certain company profile: investment in so-called *compounders*.

Roughly speaking, *compounders* are those companies that have a high-quality business, capable of generating high returns on capital employed (ROCE, in

¹⁹ Simplify Asset Management. (October 26, 2022). *Entering the Fall '22 - Fireside Chat with James Chanos*. Youtube. <https://www.youtube.com/watch?v=TPpRbZPFE5w>

²⁰ Mattioli, D. and Toonkel, J. (January 4, 2023). Amazon Layoffs to Hit Over 18,000 Workers, the Most in Recent Tech Wave. *The Wall Street Journal*.

²¹ Deng, I. and Cao, A. (December 23, 2022). Tencent's Pony Ma says cost-cutting will continue in 2023 and pins hope on short video as major growth driver. *South China Morning Post*.

financial jargon) and that, in addition, can reinvest earnings in their own business at these high rates of return in a sustainable manner over time. The latter part is very important, since there are companies that can generate high returns, but cannot reinvest the earnings every year as profitably, so they do not compound value in the same way. Obviously, **the ideal company for an investor is one that falls into the *compounder* category and is also trading at a sufficiently attractive price.** However, this is the crux of the matter, as many investors have ignored this second condition for too long, neglecting the maxim that *price is what you pay and value is what you get.*

It's not what you buy, it's what you pay. And success in investing doesn't come from buying good things, but from buying things well. And if you don't know the difference, you're in the wrong business.²²

This phenomenon was generally concentrated in those technology platforms called to revolutionize an industry. In some cases, the approach had its merits, given that **every extreme narrative needs its share of truth to be sustained over time.** However, in many other cases, these companies looked like startups, where their future cash generation was uncertain, to say the least. A clear example of this dynamic is **Carvana**, the online second-hand vehicle sales company that was going to put an end to the traditional *modus operandi* of physical sales at car dealerships (by the way, we have been invested in this space through companies such as **Vertu Motors** and **Pendragon** for years). This company went from a market capitalization of about \$8 billion at the beginning of 2020 to more than \$62 billion a little more than a year later (a 675% increase in value). Its current market cap is just over \$1.3 billion and beset by rumors of bankruptcy.²³ A second illustrative example is **Peloton Interactive**, the company that was going to break the mold in the fitness industry. Well, the company went from being worth about \$7.5 billion at the beginning of 2020 to more than \$45 billion a few months later (500% increase). Its current market cap is around \$4 billion. Once again, Jim Chanos, as we saw earlier with **Tesla**, made a very telling argument about what happened with **Carvana**:

If you're not growing anymore and you're not making any money, the valuation cliff from being an unprofitable TAM 20 times revenue story or whatever, ten times gross profit story to a used car dealer with an online presence that loses money... That's a big step down.²⁴

²² Koch, K. (June 1, 2022). Talks at GS. Howard Marks. *Goldman Sachs*.

²³ Olinga, L. (December 8, 2022). Carvana Defiant in Face of Alarms About Possible Bankruptcy. *The Street*.

²⁴ Moses, D., Adami, G. and Nathan, D. (April 2022). Excuse Me, I Need to do Some Hedging Trades with Jim Chanos. Also, an interview with iConnections co-founder and CEO, Ron Biscardi. *On The Tape*.

But as I said a moment ago, in other cases the multiple expansion experienced by many *compounders* had its fundamental explanation. Businesses of unquestionably high quality, with relevant competitive advantages, also performed extremely well during the period, reaching levels that are difficult to justify. Some of these companies have been on our radar for all these years (in fact, we owned them in our previous professional stage), in which we have been patiently waiting for the best moment to become shareholders again, in a context in which our holdings have always traded with a very high margin of safety and upside potential. Finally, as we will explain in more detail in the portfolio changes section, this opportunity has begun to materialize. Thus, over the last year, **the rise in interest rates put an end to this market exuberance, bringing these large businesses at much more reasonable and even very attractive market prices.** For this reason, in recent months we significantly increased our exposure to the sector, upping our stake in the South African holding **Naspers** (exposure to **Tencent** at a discount) and adding names such as **Alphabet**, **PayPal** and **Baidu**, after sharp corrections (of more than -75% in some cases) in this disastrous period for the technology platform industry.²⁵

In short, the great monetary turnaround we have experienced in 2022 allowed us to invest again, years later, in high-quality businesses at very attractive prices. We took advantage of this opportunity and increased our exposure to this industry to 13% of our international portfolio. In addition, it has served as a good reminder that **it is just as important to get what you invest in right as what you *do not* invest in, in order to generate solid and sustainable returns over time.** In the words of Jean-Marie Eveillard, one of the best value investors of all time:

I was more helped by what I did not own than what I did own. I owned nothing in Japan in the late '80s, owned nothing in the technology media and telecom stocks in the late '90s, I owned nothing in the financial stocks at the beginning of this century.²⁶

What to expect from our portfolios in 20xx?

A prediction about the direction of the stock market tells you nothing about where stocks are headed, but a whole lot about the person doing the predicting.

— Warren Buffett

²⁵ Miao, H. (January 1, 2023). The Year Big Tech Stocks Fell From Glory. *The Wall Street Journal*.

²⁶ (August 18, 2021). Learning From Jean-Marie Eveillard: Quotations and References. *MOI Global*.

It is very common at this time of year for a financial journalist or friend to ask us about our expectations for the market during the year. Obviously, we do not know and it's not something we care about, so we never give a "satisfactory" answer to such questions. Our view is that the market is there to help us as investors, by offering us different investment opportunities at each moment, which we try to take advantage of with greater or lesser success. Nor can we know how our portfolio is going to perform. It is not something that is in our hands. That said, we do always have a fairly clear picture of the merits of the holdings that make up our funds. For this reason, as we start a new year, I think it is interesting to review the major investment themes present in our Horos Value Internacional fund (Horos Value Iberia, being an Iberian equity fund, does not have major themes that allow this type of exercise) and why we are optimistic about its future performance.

ASIA (22.5% of the portfolio)

The bulk of our Asian exposure is through companies listed in Hong Kong, as well as the technology platforms **Naspers** and **Baidu** (which returns to our portfolio this quarter), whose businesses, in general, are closely linked to the performance of the Chinese economy. Obviously, its weak performance over the last two years has had a very negative impact on these companies and, even more so, on their share prices, all of which fell sharply over the period. As we have highlighted over the last few quarters, three factors have been behind this economic slowdown: the regulatory impact on China's technology sector, the real estate crisis and the "zero COVID" policy pursued by Xi Jinping's government. However, the events of the last few weeks encourage us to be cautiously optimistic about these three areas.

Let us start with the technology sector, where two fronts have wreaked havoc in this industry in recent times. On the one hand, the massive growth of big technology companies, as well as the rapid accumulation of wealth and power of their founders, possibly began to make the Chinese Communist Party and its leader Xi Jinping uncomfortable. This became more evident after the punishment received by Jack Ma (founder of Alibaba), following his famous speech criticizing the Chinese banking sector, and the subsequent regulatory measures aimed at penalizing and gaining greater control over the country's technology sector (see [here](#)). On the other hand, the formal threat by the U.S. Securities and Exchange Commission (SEC) to exclude Chinese companies listed there from its market, if they did not begin to provide sufficient access to information for their auditors, contributed to the negative sentiment already accompanying this sector. These fronts, together with the performance of the Chinese economy, explain the stock

market collapse of companies such as **Alibaba**, **Tencent**, **Baidu**, **Meituan**, **Pinduoduo** and **JD.com**, to name but a few of the most prominent.

However, it seems that an important turning point is underway on both fronts. In January, the Chinese government announced, through Guo Shuqing (Secretary of the Chinese Communist Party), that *future supervision of the sector will be normalized and that platforms will be supported to play a greater role in job creation and global competition*.²⁷ Moreover, China finally allowed a satisfactory audit by the U.S. regulator, completed in mid-December, which should significantly reduce the risk of its companies being delisted from the U.S. stock market.²⁸ These positive developments partly explain the recent outperformance of our investments in **Naspers** and **Baidu**, whose combined weighting in our portfolio is around 8.5%.

In the real estate sector, the "common prosperity" policy and, in particular, the implementation of the three red lines to limit the growth and leverage of the country's developers, have led the industry to experience a liquidity and solvency crisis that is difficult to contain. After the collapse of **Evergrande Group** and other major players in the sector, as well as the continuous debt defaults and widespread paralysis, the government seems to have had enough and has taken a series of increasingly decisive and forceful measures to try to alleviate the situation. Specifically, in mid-November it announced the implementation of a sixteen-point guide to be adopted by the financial sector to support real estate companies, in addition to encouraging the raising of capital through new debt issues, capital raises or the sale of subsidiaries.²⁹ Subsequently, in January, Beijing announced the draft of a new twenty-one-point plan, aimed at helping the "highest quality" developers, as well as lowering the requirements of the three red lines for some of these players.³⁰

We are not naïve enough to think that the sector is going to experience a V-shaped recovery, but we do seem to be entering a more constructive phase that may put an end to the unstoppable domino effect that had been unleashed. Although still with great uncertainties, we believe that this change in policy (and sentiment) will contribute to improving the prospects of **Asia Standard International** (exposure to various real estate assets in Hong Kong, China and Canada, as well as debt investments in Chinese real estate developers), where just over 1.5% of the fund is

²⁷ Ran, L. and Wei, H. (January 9, 2023). China wraps up two-year tech crackdown, top official says. *NIKKEI Asia*.

²⁸ Shidong, Z. (December 16, 2022). Chinese regulator welcomes positive PCAOB report, vows 'audit oversight cooperation with our US counterparts in years to come'. *South China Morning Post*.

²⁹ Liu, P. (December 22, 2022). China's State Council calls for implementation of property market rescue measures to boost economic growth. *South China Morning Post*.

³⁰ Liu, P. (January 13, 2023). China property crisis: Beijing drafts 21-point plan to aid developers with financing, debt extensions, state media says. *South China Morning Post*.

invested, as well as reactivating the business of our property services companies **Kaisa Prosperity** and **Aoyuan Healthy Life**, whose combined weighting accounts for 2.2% of Horos Value Internacional. I also want to point out that nearly 30% of the shares of **Aoyuan Healthy Life** are in the process of being able to be sold by its parent company, the developer **Aoyuan Group**.³¹ This is a very common move in the sector in recent times and, *a priori*, should be good news for its shareholders (it would avoid the risk of covert financing operations to the parent company and could speed up ending the suspension of its listing, which has been in force for months due to the failure to complete the audit of its results).

Finally, there is the last major driver behind China's recent economic debacle. Indeed, the Chinese government's strict "zero COVID" policy, without assessing its validity as a measure to contain the pandemic in the country, has reduced aggregate consumption and investment, negatively impacting the performance of most businesses. However, when everything seemed to indicate that this policy would be maintained in 2023, the government has made a 180-degree turn and has decided to greatly relax the measures to combat the coronavirus. Possibly, the great public discontent with rolling lockdowns (with citizens suffering great problems to access food) and, additionally, the high infection rate of the current strain, made Xi Jinping finally give his rigid arm to twist. As expected, this greater openness, together with the large accumulation of precautionary savings by families in recent months, will facilitate the recovery of many industries, such as finance, catering and leisure.³² All this should benefit companies in which we are invested, such as **Sun Hung Kai & Co** (consumer finance and investments), **NagaCorp** (casino in Cambodia), **Tang Palace (China) Holdings** (restaurant chain), **Tai Cheung Holdings** (luxury real estate and the Sheraton hotel in Hong Kong), **Ajisen China Holdings** (restaurant chain) and **Time Watch Investments** (manufacture and sale of watches). In addition to the positive outlook we expect for their businesses, these companies are trading at ridiculously low multiples and pay an average dividend yield of close to 10%. Together, if we include **Keck Seng Investments** (with residential assets in Macau, a hotel in Vietnam and other hotel assets in the United States, Canada and Japan), these investments account for more than 10% of our fund.

³¹ Ao, Y. (December 6, 2022). Developer China Aoyuan posts note saying it is in talks to sell stake in property services unit as liquidity crisis rumbles on. *South China Morning Post*.

³² Kawate, I. (January 12, 2023). Chinese bank deposits exceed loans by \$6.5tn as caution prevails. *NIKKEI Asia*.

COMMODITIES (19% of the portfolio)

In contrast to China, this theme has been the largest positive contributor to our portfolio over the past year and a half. Obviously, this outperformance has led us to gradually reduce our exposure and change the composition of the names we hold. Although it may seem otherwise, not all commodities move in unison (each has its own demand and supply dynamics), nor are they always at the same point in the capital cycle of their industry, so we try to be active when positioning our portfolio, always looking for investments that offer us the best risk-return trade-off. Hence, at present, the bulk of our exposure is to companies across the oil and gas value chain, where we believe the supply and demand outlook is favorable in the medium term and, just as importantly, where we continue to find attractive investment opportunities. For this reason, **Mistras Group** (asset protection solutions for the oil and gas industry), **Spartan Delta** (oil and natural gas production), **Cool Company** (liquefied natural gas transportation), **TGS** (geophysical data generation and analysis services) and **Shelf Drilling** (offshore drilling rigs) account for just over 12% of Horos Value Internacional. The other 7% is split among **Aperam** (stainless steel), **Atalaya Mining** (copper), **Geo Energy Resources** (thermal coal) and **Ramaco Resources** (metallurgical coal). All of them are trading at very attractive levels after their share price declines due to recession fears.

FINANCIALS/HOLDINGS EX CHINA (30% of the portfolio)

This is the most relevant theme of the fund, as we include both pure financial companies and holding companies that own or invest in other entities. However, given its heterogeneity, I have preferred to keep it at the end of this section, since we cannot draw general conclusions that affect all of these companies.

In the purely financials segment, companies in which we have invested for years stand out, such as **AerCap** (aircraft leasing), **Catalana Occidente** (traditional and credit insurance) and **S&U** (financing for the purchase of second-hand vehicles and bridge financing for homebuyers). All three companies have top-level management teams, fully aligned with shareholders, with a constant focus on operational efficiency and a conservative approach to balance sheet management. In terms of capital allocation, we believe **AerCap** is a step above the other two (perhaps more conditioned by its historical culture), always seeking to maximize shareholder value and taking advantage of aggressive share buybacks when the circumstances are most suitable. Apart from this, all three companies trade at very attractive valuations, which certainly do not reflect the future earnings prospects and

sustainable returns of their businesses. The investments that make up this "pure financials" group account for around 17% of our portfolio.

Our holding companies also include historical investments of our team, as varied as **Fairfax India**, **Semapa** and **CIR**. Specifically, I would like to write a couple of lines on the first of these. **Fairfax India** is the holding company controlled and managed by the reinsurer **Fairfax Financial Holdings**, the famous vehicle led by Prem Watsa (an Indian-Canadian businessman considered for many years to be the "Canadian Warren Buffett"). It is an entity that gives us exposure to unique assets in India (listed and unlisted), with a team whose investment philosophy is very similar to ours. Despite the positive results they are achieving (they have almost doubled their NAV per share in six years), the market has come to value **Fairfax India** 50% below its book value. Some investors attribute this to the generous fee structure that the management team collects (linked to vehicle size and NAV performance, rather than share price, for example). While we share the dissatisfaction with the fee structure at the current valuation, it is not something we as shareholders were unaware of and, arguably, is not a conversation that would be taking place if the vehicle were trading at or even above book value. On the other hand, although we would like them to be more aggressive, the management team is making value-enhancing share buybacks at this steep discount and also continues to rotate the asset portfolio, demonstrating in the exit valuations that the published NAV is not only true, but possibly quite conservative. Obviously, the big catalyst for the share price could be the IPO of Bangalore airport, **Fairfax India**'s main asset and whose valuation, according to the latest news, could be well above the book value recorded in the company's NAV.³³ In short, the company is trading at a discount that seems inexplicable to us, which is why it is one of our fund's top positions. Combined, holding companies account for 13% of Horos Value Internacional.

Main changes to our portfolios

By ignoring the crowd, we find opportunities in stocks that people are running away from.

— Bruce Berkowitz

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

³³ Kalesh, B. (November 17, 2022). Fairfax Weighing Bangalore Airport IPO at \$3.7 Billion Value, Sources Say. *Bloomberg*.

HOROS VALUE INTERNACIONAL

Stake decreases & exits:

COMMODITIES (19%)

Holdings discussed: Teekay Corp. (exited) and Sprott Physical Uranium Trust (exited)

Two companies in which we have been invested for several years exited our portfolio during the quarter: **Teekay Corp.** and **Sprott Physical Uranium Trust**. Although both continue to offer some upside, each investment alternative competes with the rest of our portfolio. In this case, we believe we have other options with more attractive risk-adjusted return potential.

OTHER

Holdings discussed: AerCap (4.0%) and Verallia (2.5%)

AerCap and **Verallia** were the positions we trimmed the most. In both cases, their share prices have performed very well in recent months, thanks to quarterly results that exceeded market expectations. We continue to see high upside in both companies, which is why, despite the partial sale, we hold them with a medium/high weighting within Horos Value Internacional.

Stake increases & new stakes:

TECHNOLOGY PLATFORMS (12.7%)

Holdings discussed: PayPal Holdings (2.0%) and Baidu (2.0%)

As I mentioned at the beginning of this quarterly letter, we took advantage of the meltdown in technology platforms to initiate new positions in companies in which we had already been shareholders in the past and whose valuation did not, until now, provide a sufficiently high margin of safety. Such is the case of **PayPal** and **Baidu**.

PayPal is one of the world's largest online payment companies and the leader (ex-China) among digital wallets. The company operates on both sides of a transaction, offering services that facilitate buying for its users and selling for merchants, acting as a payment gateway. In recent years, **PayPal** has expanded its ecosystem, organically and inorganically, into other financial services (business and consumer lending, remittances, fraud prevention, dataphones, card payments, etc.) and marketing (discounts, targeted campaigns, etc.). Its most successful current

products are probably Venmo (an app with services like **PayPal**, but with a social network component, which successfully attracts a younger audience), Braintree (payment gateway) and its interest-free consumer finance service (Buy Now, Pay Later).

This rich ecosystem has allowed **PayPal** to continue its high growth in recent years, reaching 432 million active accounts (of which some 35 million correspond to merchants) by the end of the third quarter of 2022, as well as increasing the attractiveness for its customers, as evidenced by the record number of transactions per account recorded in the latest earnings release. In addition to this, **PayPal** has achieved a historic milestone, reaching an agreement with **Amazon** that will allow its customers to buy products with Venmo's payment service. However, not all has been good news for **PayPal** in recent years. The reality is that this growth has not been accompanied by the operating leverage that was expected, which contributed to the negative sentiment towards the company in 2022, already elevated due to the burst in the tech sector valuations and the recessionary environment in many economies where **PayPal** operates. However, the management team has taken action and is starting a series of initiatives to expand margins significantly over the next few years. This turnaround, coupled with a (now) very attractive valuation, led us to reinvest in the company.

In the case of **Baidu**, as many will know, it is known as the "Chinese Google". The company has been the leading Internet search engine in the Asian country for years, which has given it a historically privileged position to monetize, through online advertising, a huge user base. However, the rise of two types of applications has called into question the sustainability of its business model. On the one hand, mobile social apps, such as **ByteDance**'s well-known TikTok, have emerged as a new model of online consumption, generating a new platform through which to monetize Internet users. On the other hand, even more disruptive in the long term, is the emergence of the so-called super apps: a sort of virtual Swiss Army knives that allow users to access many products and services without having to leave their interface at any time, making **Baidu**'s traditional search engine less attractive. In this field, **Tencent** (with its super app Weixin/WeChat), **Alibaba** (Alipay) and **Meituan** certainly stand out. These two factors have caused **Baidu**'s online advertising market share to drop from 17% in 2017 to less than 7% estimated for 2022.³⁴ To this deterioration, we should add the collapse in market value of its stake in **iQiyi** (video platform controlled by **Baidu**) and its equity holdings such as **Trip.com** (hotel and flight platform).

³⁴ Yao, A. (February 2022). Baidu deep dive. *JP Morgan*.

Why, then, did we decide to reinvest in the company given the issues mentioned above? First of all, because the management team has not stood idly by in the face of these threats and has managed to reinvent itself by launching its own super app. Baidu App now has 634 million monthly active users and, very importantly, nearly 85% of them use it every day. In addition, they have been able to refocus the search engine business through their Baidu Feed portal (personalized content recommendation, especially short videos, for each user) and their managed pages product, where companies pay **Baidu** to provide them with their artificial intelligence solutions for their marketing and user traffic acquisition activities. Notably, managed pages already account for more than 50% of **Baidu's** advertising revenue. Precisely, artificial intelligence is a field in which the company clearly stands out and, in particular, for its virtual assistant DuerOS and for its autonomous driving technology. Specifically, **Baidu** has autonomous cab services (Apollo Go) that already compete, in some cities, on a level playing field with traditional cabs and have recently obtained the important approval of Beijing to offer this service without human assistance. In addition, it has formed a joint venture with **Geely Automobile Holdings** to manufacture autonomous electric vehicles.

On the other hand, like the rest of the world's technology platforms, **Baidu** is taking steps to expand the profitability of the business, prioritizing those initiatives that are most important (and profitable) for the company. A common industry example is cloud services and products, where all Chinese companies, without exception, have put the brakes on their expansion in a major way. In addition, at current prices, its stake in **iQiyi** and its equity investments in companies such as **Trip.com** probably have significant upside potential. All this, together with the expected recovery of the Chinese economy, a very solid balance sheet (at the time of our investment, cash and financial investments accounted for more than half of the company's market capitalization), a greater appetite (although still timid) of the management team for share buybacks and, in particular, a very attractive valuation for a business that still has significant competitive advantages, led us to become shareholders again.

OTHER

Holdings discussed: ALD Automotive (4.7%) and Pendragon (0.9%)

We took advantage of the market apathy towards **ALD Automotive** ("ALD") during part of the quarter to substantially increase our stake in the French vehicle leasing company. The quarter coincided with the release of extraordinarily positive results, in addition to having executed the already announced capital raise to

formalize the acquisition of its great competitor, **LeasePlan**. We continue to believe that the market is not properly valuing a company that should generate normalized returns on tangible equity close to 20%, thanks to its significant advantages of scale within its competitive sector.

Finally, the reentry into the car dealership company **Pendragon** is noteworthy. We exited our position last quarter, following the takeover bid launched by the Swedish group Anders Hedin (led by the former CEO of **Pendragon**), which already held 27% of the shares. However, in early December they announced that they were withdrawing the takeover bid due to the uncertainty at the time, which triggered a significant correction in **Pendragon** shares. We think it is possible that, in fact, the reason has more to do with the tightening of the financing conditions of the transaction, so we do not rule out a new attempt in the future. All this, together with the current attractive price at which the company is trading, encouraged us to invest again in this company.

HOROS VALUE IBERIA

Stake decreases & exits:

OTHER

Holdings discussed: Semapa (7.0%) and Catalana Occidente (6.9%)

Both **Semapa** and **Catalana Occidente** remain as the top holdings of our Iberian fund. However, during quarter we rebalanced the weightings of some positions, based on their relative upside potential.

Stake increases & new stakes:

OTHER

Holdings discussed: Talgo (4.6%), Atalaya Mining (3.2%) and Sonaecom (2.6%)

The two companies in which we increased our exposure the most were **Talgo** and **Atalaya Mining**. In the case of **Talgo** (a company specializing in the design, manufacture, technological development and maintenance of rolling stock), the earnings weakness through 2022 was a major drag on its share price. However, we believe that only the maintenance business alone would be worth around the current valuation, so the margin of safety is very high. **Atalaya Mining** also suffered a significant correction, induced by the copper price drop, which in turn was due to fears about the Chinese economic situation. However, the expected recovery of the

Asian country in 2023 and, in particular, the favorable supply and demand dynamics for the metal in the medium and long term, mean that the company is trading at a very attractive valuation, which led us to increase our stake.

Sonaecom's weighting increased during the period following the takeover bid received on December 21 by the Portuguese holding company **Sonae**, of which we are also shareholders, and which already controlled 89.97% of this subsidiary. The price offered was €2.5 per share, payable in cash, which represents a premium of approximately 25% over the previous day's price and more than 30% over the average of previous days. As we have pointed out on other occasions, takeover bids are usually good news for the shareholders of the target company, as they help to realize the potential return on the investment more quickly and allow the money to be reinvested in other more attractive alternatives. However, this is not the case. The price offered by **Sonae** is well below any fair value for **Sonaecom**, which, in our case, we estimate to be approximately 55% above the €2.50 per share. For this reason, we are assessing what actions we can take to try to get a fairer price for the interests of minority shareholders who are clearly being harmed.

Highlights:

OTHER

Holdings discussed: Iberpapel (4.8%), Ibersol (3.4%) and Applus (3.3%)

In addition to these portfolio changes, I would like to highlight some key milestones of several of our holdings. In particular, I would like to write a few lines about **Iberpapel**, **Ibersol** and **Applus**, although we could extend this commentary to many other of our investments, underscoring the work that their management teams are doing to generate value for their shareholders.

On the one hand, the **Iberpapel** paper group recently announced that it would initiate a share buyback program of up to 5% of the company's capital, something we applaud in a company historically very reluctant to implement this type of action due to its reduced free float (shares traded on the stock exchange). In addition, **Iberpapel** granted an option to sell its Uruguayan forestry land for around €50 million, which, if executed, would contribute to financing the pending part of the Hernani Project.

Meanwhile, **Ibersol** (a Portuguese multi-brand restaurant company that operates restaurants and franchises in Portugal, Spain and Angola) announced in mid-2022 the sale of its **Burker King** restaurants to **Restaurant Brands Iberia** for around

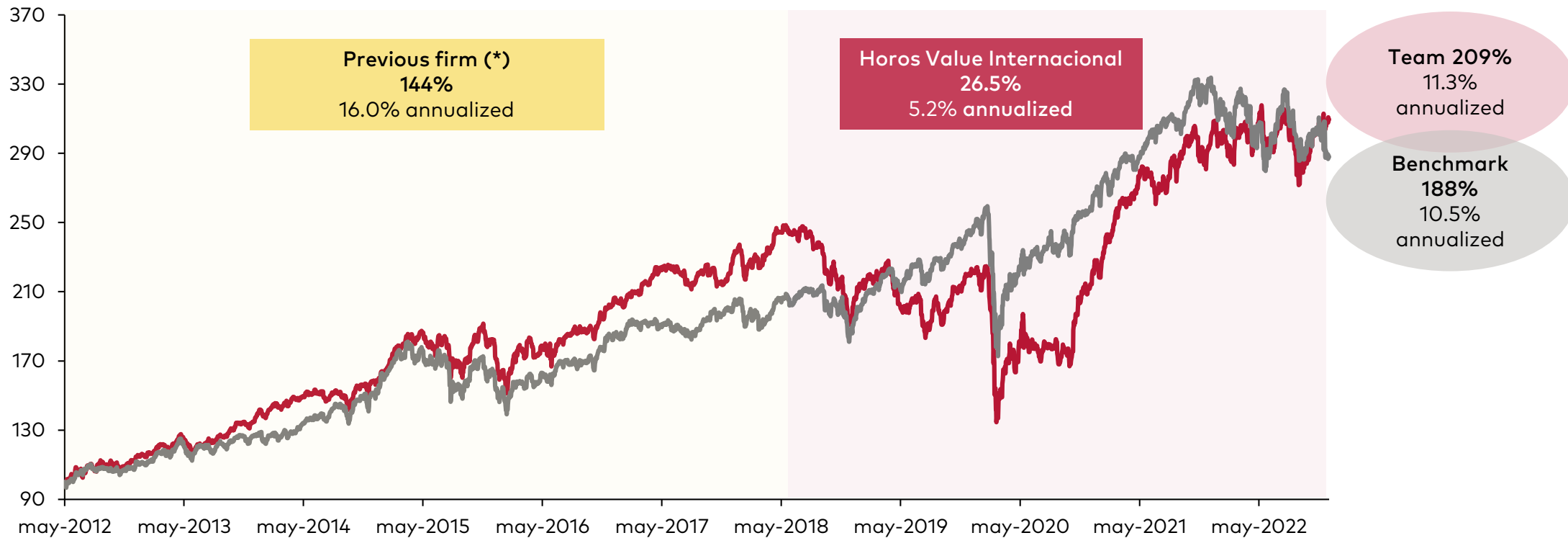
€260 million. The transaction helped uncover value for shareholders, with the remainder of **Ibersol** valued at around 2x EBITDA, which makes no sense for a business like this. The big question is, of course, what the management will do with so much cash: will they reinvest in their existing franchises? Will they make any acquisitions? Will they pay out a special dividend or perhaps buy back their own shares? For now, albeit very timidly, they have done some share buybacks this past December.

Finally, **Applus** (an inspection, testing and certification company) is another example of a company that is taking advantage of its current valuation to generate value for its shareholders by repurchasing its own shares, as evidenced by the plan to buy back 5% of the capital approved last November, once the previous buyback program was completed.

In short, our companies listed on the Iberian market, in addition to being valued at very attractive levels, have, as these three examples demonstrate, top-level management teams that strive to generate value for their shareholders.

Returns

Historical returns of the management team in the **International Strategy**



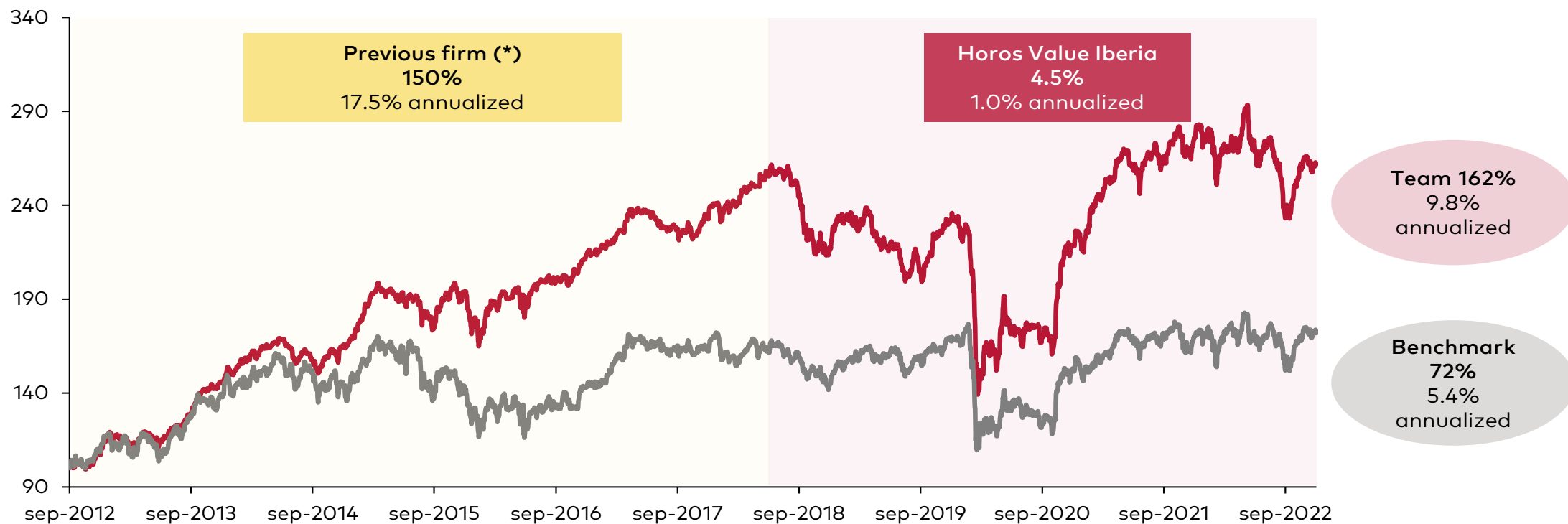
Data cover the period between the 30th May 2012 and 31st December 2022.

*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 May 2012 and 22nd May 2018.

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



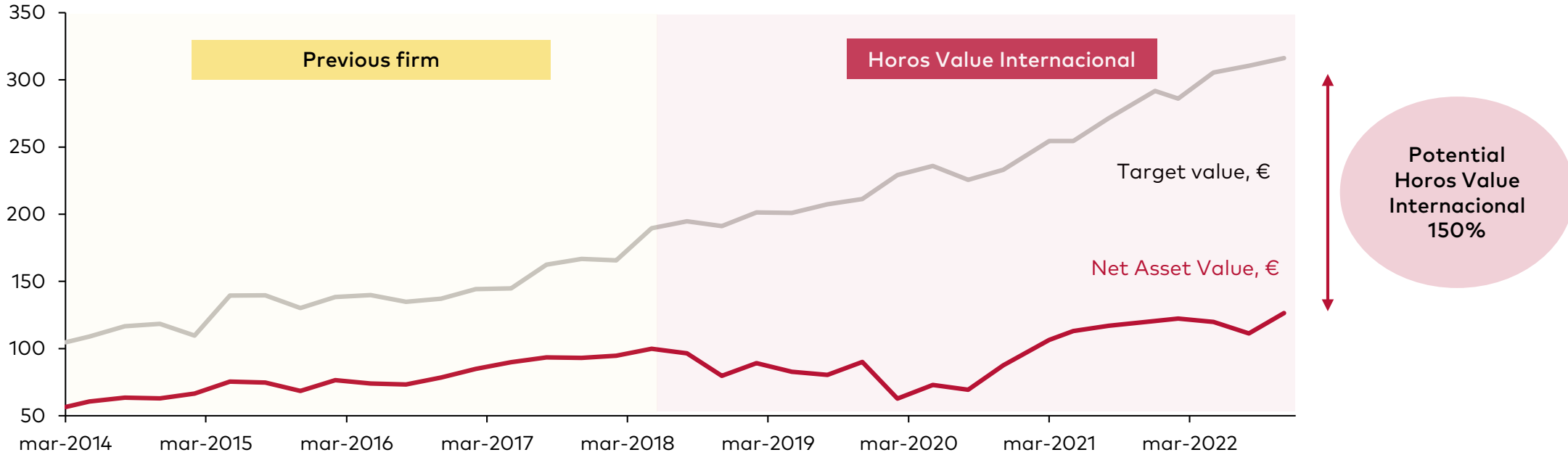
Data cover the period between the 30th September 2012 and 31st December 2022.

*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.

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Upside Potential

Target value vs. Net Asset Value of the Management Team



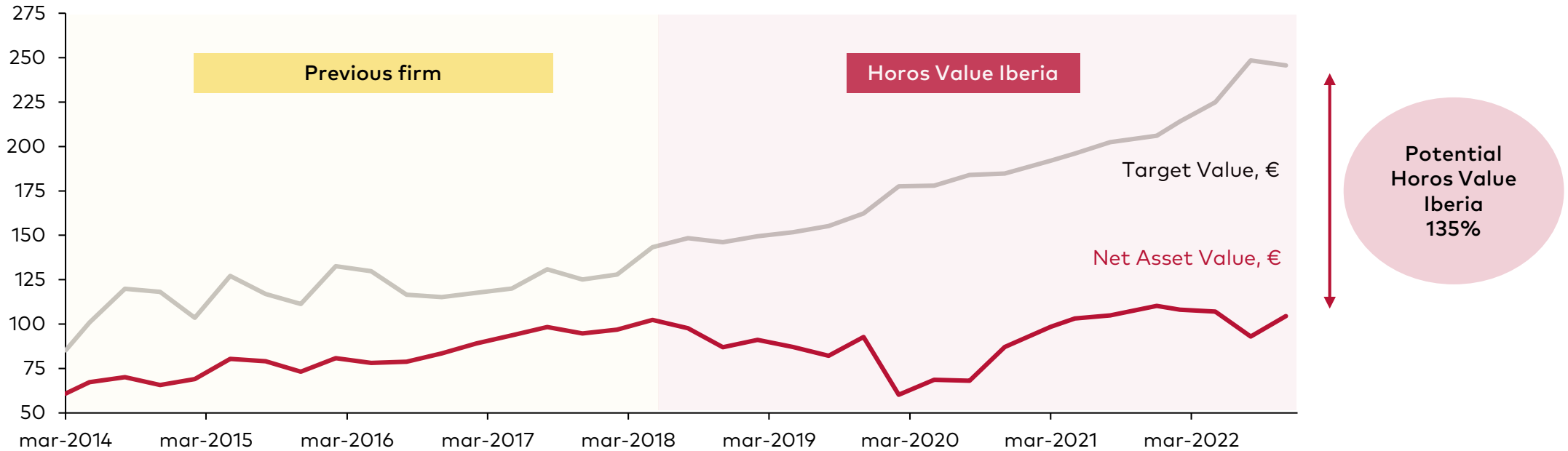
Data cover the period between the 31st March 2014 and the 31st December 2022.

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 2022.

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
Naspers	6.3%	TMT
ALD	4.6%	Financial
Aercap Holdings	4.0%	Financial
Catalana Occidente	3.9%	Financial
Fairfax India	3.8%	Financial
Semapa	3.3%	Financial
Mistras Group	3.3%	Industrial
Gestamp Automocion	3.0%	Industrial
CIR	2.9%	Financial
Talgo	2.9%	Engineering

Top 10 Holdings
Horos Value Iberia

Holding	%	Theme
Semapa	7.1%	Financial
Catalana Occidente	7.0%	Financial
Horos Value Internacional	6.3%	Financial
Gestamp	5.7%	Industrial
Merlin Properties	5.4%	Real estate and construction
Iberpapel	4.9%	Industrial
Aperam	4.7%	Commodities
Talgo	4.6%	Engineering
Elecnor	4.5%	Engineering
Global Dominion	3.6%	TMT