Active Insights Podcast – Altinsic Global Advisors: "The next 10 years are going to be very, very different than the last 10 years."

Diane Merritt:

Welcome to North Square Investments Active Insights podcast. North Square Investments is dedicated to bringing differentiated active investment strategies to financial advisors and investors through our multi-boutique asset management platform.

Today, Mark Goodwin, Chief Executive Officer of North Square Investments, will discuss international equities and building high-conviction equity portfolios with John Hock, Chief Investment Officer with Altrinsic Global Advisors. Altrinsic is a partner firm in the North Square platform, and subadvisor to North Square Altrinsic International Equity Fund.

Mark and John, we look forward to your discussion.

Mark Goodwin:

Thanks. As you mentioned, at North Square, we seek out best-in-class active managers for our platform, and our partners at Altrinsic have a history of success with their fundamental approach to equity investing across global markets.[1]

John, first, welcome. Altrinsic has managed equity portfolios for over 20 years, primarily for institutional clients. Your investment approach is very research intensive, with a focus on stock selection. Can you talk about what characteristics are most important to you as you evaluate a stock to ultimately become a position in your equity portfolio?

John Hock:

Sure. Thanks for having me, Mark.

The core ingredients are really two things, quality of business and price paid, or valuation. So as we focus on quality, what does that mean? Means different things to people. For us empirically, it means focusing on companies with sustainable returns on capital or returns on invested capital and/or companies with improving returns on invested capital. So to discover that or to evaluate that, what we'll do is focus first and foremost on a company's competitive advantage, the durability of that competitive advantage. Focus on the management team, really asking three key questions. Do these people do what they say they do? Is their success or failure in the past because of what they've done or in spite of what they've done? But really, what's their strategy and execution plan going forward over the long term?

Then, another key ingredient of quality has to do with {the} balance sheet. Are they prudent balance sheet managers, which is vital over the very long-term. How do these various factors come together to impact profitability, returns on capital, and ultimately the per share value of the business. And then secondly, the valuation that I mentioned upfront. For us, the focus is really looking at the intersection of at least three different valuation measures, all focused on the very long-term. What's the company's valuation now relative to its long-term normal, sustainable-earnings power? What is the valuation in the context of a discounted cash flow?[2] Again, looking beyond the current earnings, but what are those earnings and cash flow measurements going to be looking out for you four and five years? What's the risk associated with those? Then lastly, valuation, the context of a private market transaction, what deal activity is being done out there, and how are those metrics comparing? So essentially, just quality of business and price paid.

Mark Goodwin:

John, as you're constructing the portfolio, how do you balance your return goals with a consideration for risk management given that you're investing across sectors, and across regions, and have different currency exposures and local economic exposures? Give us some sense there.

John Hock:

Yes, Mark, I like that you use the word balance because a lot of people when they talk about risk, they look at it as a statistic or as a single isolated thing, but it really has to be evaluated in the context of the opportunity. So for us, it really begins at the company-specific level where we're looking for an asymmetric skew, whereby if we're right in our analysis, we can make our clients a lot of money. And if we're wrong, we have protection to a degree in terms of the margin of safety of the business. We're really at the company-specific level focusing on that asymmetric skew, as demonstrated by our analysis.

How do we do that? Again, that's that focus in our base case scenarios on what are the long-term normal sustainable earnings power in the business? We have deep engagement in the capital structures of our business. A common mistake of a lot of value investors is they don't put proper attention on the capital structure or the debt side of the balance sheet. Consideration of macro. Then ultimately, we apply conservative assumptions to our cost of capital. Ultimately, in our process, additionally, as we think of risk, Mark, where we have a peer review where all eyes go on all ideas, so there's a number of checks and balances. And then ultimately, the portfolios are constructed at the portfolio-construction level, with a prudent respect for concentrations with some broad parameters that are really intended to ensure that which we think we're good at and different at the company's specific level is what's driving performance as opposed to unintended systematic factors or other things.

And ultimately, what does that mean for the end client or investor in the North Square Altrinsic International Fund? It means a behavioral characteristic where when markets are high and there's a lot of risk in market, you may find well below market risk embedded in our portfolio[2]. At the same time, stealing from Sir John Templeton's quote, you want to “be greedy when others are fearful.” When there's a lot of fear in markets is typically when you'll see a greater degree of risk in the portfolio as we're buying into that fear in perhaps more cyclical businesses.

Mark Goodwin:

Thanks, John. To distill it down further, what do you see as the key driver or, as I like to say, secret sauce of your portfolio performance over time?

John Hock:

Well, it's the combination of two things. It's that focusing on the company specific. And really, when we look at a company, Mark, our beginning starting point is what do we see differently than everybody else? And as a long-term investor, we buy that business outright with our own capital, so it begins at the company-specific level. And empirically now for over 23 years, and I think what any investor should expect over the very long-term is that the company-specific and the idiosyncratic elements should be the drivers. In other words, we're not making macro calls on countries or regions and styles and the sort, but it's really that company-specific work, which is essentially a function of our team and our investment process.

And secondly, it's that approach to risk that I briefly alluded to at the portfolio level, where we have an obsession for risk, but not in the context of the way it is popularly perceived in our industry. But it's really a tireless pursuit of what are the unintended risk factors that are out there in the marketplace, but also in the portfolio that could disrupt what we are focusing on that we think is different at the company-specific level.

Mark Goodwin:

That's very helpful. John, the Fed has aggressively raised interest rates for much of 2022 and into the current year, and other developed markets have followed. Globally, inflation has been very high and economic growth has slowed. We have also seen significant geopolitical tensions that have added to the volatility as well. How have these various global challenges impacted international economies as well as their equity markets?

John Hock:

Well, every economy in the world has been impacted by this, and clearly we're entering a new era, so to speak. So I mean there's a lot in your question we can unpack, but as it pertains to interest rates, I should preface this, Mark, by saying we are not macro investors. We respect macro from the perspective of risk, but we certainly have opinions. So in terms of interest rates, which everyone seems to be focused on right now, yes, we're probably closer to the end of the rates hike cycle, and that's what markets seem to be focused on globally, but they're probably not fully appreciating the extent that these reversal of policies have significant lagged effects. So at some point, markets and economies should begin to reflect some of these efforts that have been made in the last 6, 12, 18 months, and those are dampening effects.

More specific to your question in terms of how this affects the global economy, well, it's interesting. First, we've got to remember that stocks are leading indicators. So typically, a great economy may or may not be a great investment. Sometimes, economies, when there's a lot of negative headlines, present the best underlying company-specific investments. Using Europe as an example. Last year, Europe had a lot of headlines around it because the assault on its front doorsteps in the Ukraine, concerns about gas prices, et cetera. Well, this year, Europe is one of the best-performing markets in the world. Natural gas prices have collapsed. The point is that markets adapt. Rarely do things play out the way they're perceived on the front page. And oftentimes, the more murky the front page, the more compelling the bottom up specific opportunity that exists.

So in Europe's framework, yes, there's a lot of issues in Europe surrounding Ukraine, a lot of that is discounted in the marketplace. There's always a low probability, high consequence adverse outcome, but that exists in all markets, including the United States. We can unpack this later when we get into the portfolio, but we see a lot of opportunity in Europe. Up until recently, that value has been more among your companies domiciled in Europe, but those that operate on a global scale, the global consumer and healthcare franchises.

Move over to Japan. Japan's been dealing with a lot of the deflationary pressures the world encountered for a couple of decades. So this burst of inflation is potentially a good thing, as long as it doesn't get out of control. There's tremendous value to be unlocked in Japan. There's a lot of change taking place, albeit at a Japanese pace, which is kind of slow. But like many things in the world, some of the most important and powerful things happen very slowly and then real fast, that's how we see Japan today.

Interesting to see Warren Buffett the other day getting a lot of airtime on his recent trip to Japan, visiting a lot of the holding companies. So you're seeing more of that. You're seeing more private equity activity. So regardless of the economy, there's opportunities there. China, slow to open, but it's opening with a roar. Every company which we owned that is either directly in China or has business in China has seen robust increase in its growth rates coming out of China. And then lastly, I comment on emerging markets more broadly. Typically, if there was a landmine in the world, emerging market central banks would step on it. They've learned a lot of lessons, more so than developed markets. A lot of emerging market economies, emerging market policymakers have been a bit ahead of the curve in addressing inflation and rising interest rates.

And I don't want to paint an overly rosy picture. In fact, we think there should be a lot of challenges going forward at the broad economic level, but there's going to be a lot of innovation. Companies will adapt, there will be growth, just not going to be as much growth as there was in the past.

Mark Goodwin:

John, staying in Asia for a minute, looking at the strains between China and the US, are you seeing potential shifts in the global supply chain towards other countries? And if so, what countries do you expect to benefit from these shifts? Or are there particular industries that are or will drive these changes?

John Hock:

Yes, huge shifts underway. The big shift being one of efficiency to one of resiliency, and these are seismic shifts that are going to take place over a very long term. However, that pace is going to be a lot slower than people think. A lot slower than the media presents it to being. You can't just change your supply chain overnight if you're a multinational institution. So we're already seeing meaningful benefits of this coming out of the ASEAN, the Southeast Asian countries, Indonesia, to a lesser extent Taiwan in certain cases, Vietnam you're seeing being a beneficiary of this.

In Latin America, Mexico, Brazil, but throughout the whole Latin America region. And even here in our backyard in middle America, you're seeing the seeds being planted, but these are going to be very, very, very, very long term. So essentially, what are the implications? I think the opportunity on this market is more at the company-specific level, and in terms of technology and innovation, there's a lot of attention always focused on the primary layer of that innovation, the tech companies. And because of that, they've created very high valuation. But a lot of the opportunities and the structural sources of opportunity are traditional industrial businesses that are embracing technology, going through digitizing their businesses, and are playing a role in that nearshoring, onshoring, and helping their customers become more efficient in their ways. So a long-winded answer of saying yes, it's huge. It's going to take longer than people think, but the beneficiaries go far beyond the countries that are often presented in the media.

Mark Goodwin:

Yes, thank you, John. Kind of a two-part question. In terms of your longer-term view, maybe 12, 18 months out, with respect to recession or no recession, soft landing. Where equity markets around the globe might offer the best opportunities for investors with this medium to longer-term horizon?

John Hock:

So as you said, we have no crystal ball in that, but we're pretty deeply engaged. I get most of our perspective from the companies in which we're investing and in our time spent traveling around the world. So I think what is a pretty safe bet is that the next 10 years are going to be very, very different than the last 10 years. That's “table stakes.” Now, that doesn't mean there's not going to be growth, there's going to be innovation. It's just going to be perhaps slower growth than it was in the past. We dial that down to more the short-term, the intermediate-term. One of the areas that we're probably more concerned than most on is earnings in many more cyclical areas, in many countries, there's a lot of trend extrapolation. Meaning, a lot of very aggressive earnings that's out there in the marketplace that could be a source of meaningful disappointment, so perhaps an earnings recession in certain popular areas. So we're very mindful of that as one of the key risks out there.

But more broadly, I think the risk of a major disruption in markets out there is quite low. Areas that we are very closely dialed in on, that could be commercial real estate here in the United States, and that could be more than a US phenomena. So you could see a circular cycle involving commercial real estate and US regional banks becoming very, very ugly. It's not a super-high probability, but it's a reasonable-probability outcome. So as value investors, we're always very mindful of the things that can go wrong, of which there's plenty. But I think one's base case should be, hey, we're just working our way out of this broad transition. The most important thing though from an investment perspective is that there's a major regime change underway, and that comes back to that first point I mentioned earlier about the next 10 years being very different than the past 10 years.

First, we won't have that tailwind of stable, benign inflation and falling interest rates. We're not going to have that tailwind of lower tax rates in the world. We're not going to have that tailwind of decreased regulation. In fact, many of those things that were... If you decompose these at the company-specific level, these things were very additive to return on equity per share. So that's why one can't just look at the quality of the business, you have to look at the valuation and price paid, much more so than in the previous 10 years. So I'm rambling a bit there on you, but the world's a big place, those are some points to share. So maybe I should frame this out in terms of where we see the opportunity for the North Square Altrinsic International {Fund} and where we've been investing, or would you like to discuss more macro issues, Mark?

Mark Goodwin:

No, I think that would be a good pivot. And just to recap for folks, you sub-advise the North Square Altrinsic International Equity Fund, the ticker NSIVX. So maybe, if you could comment broadly. As the markets have shifted over the past 12 to 18 months, how did the Fund's investment portfolio change, and what's the current positioning for the NSIVX portfolio?

John Hock:

Sure. There's been huge volatility and variability in markets during that timeframe, which you mentioned. So looking back in the last 12 to 18 months in 2022. So opportunities, value begin to emerge in a few key areas. One, in some of those industrial-related businesses that I had mentioned, so we bought into a number of those are added positions to existing positions. Secondly, in a number of our emerging-market related businesses. We have positions ranging from Korean banks to an Indian Bank, HDFC, we bought into Brazilian institutions. So emerging markets after underperforming for a number of years, began to offer a lot of value at a time when they're making tremendous initiatives to improve the financial productivity of the underlying core businesses. And the third class would be pretty much a wide variety of businesses across industries, that had a bit more of a cyclical tilt to them.

As we entered the fourth quarter, that opportunity set transition, there wasn't a tremendous amount of activity in the portfolio. And as we come into this year and as you look at the portfolio today, right now we have about 65 positions in the portfolio. Each one, we'd be perfectly comfortable owning outright with our own capital if we are a private equity buyer without an underlying business. Second point would be that the embedded risk in the portfolio, Mark, is well below out of the market.[3] That's not targeted. That's just a byproduct of the types of companies where we found value and that approach to risk that we mentioned earlier. Now, we will not always be below market risk, and if the portfolio increases, it's oftentimes the result of opportunities emerging in a more cyclical or volatile area.

Regionally, well-diversified, certain notable differences versus broad markets would be first that increase in emerging market exposure, which is currently around 14 or 15%. So that is up materially, and that we think is a very favorable asymmetric skew upside considering the downside. The second area would be in Japan. Our Japanese exposure is down to 11, 12% because we've sold a few positions as they approach our intrinsic value, but we have a very healthy pipeline of ideas there. We like a lot of the change that we're seeing, so we're technically underweight, but a good pipeline of new ideas surfacing there and good idea flow.

Largest exposure's in Europe. I alluded to earlier in Europe, the bulk of our positions are companies that are headquartered there, but they really operate at a global scale. Many of these could be leading consumer franchises, Heineken for example, or Diageo, or it could be leading healthcare franchises. Now, as I framed out the last 12 to 18 months, more value began to emerge in certain industrial-related businesses. So we redeployed capital to new and existing positions in that area. We actually bought our first bank in quite some time in a developed market late last year, and that was BBVA, and I'll expand upon that for one second. The true economic value of the driver of the business is its Mexican franchise. And it has other tidbits around the world, so lots of value to be unleashed there.

So anyway, that gives you a bit of a framework for the positioning, but if I were to sum it up, very different from the benchmark, below market risk, heavy concentration and high-quality compounders, heavy non-bank financial related businesses. We see a lot of opportunity in financials, just less so in developed market banks, with a few new exceptions, a la BBVA. Then lastly, just a range of those more idiosyncratic stock-specific situations in both developed in emerging markets.

Mark Goodwin:

That's a great summary. A final question for you, US investors are typically under invested in international securities. How do you see an actively-managed high-conviction international strategy like the Altrinsic NSIVX Fund being best positioned in the diversified portfolio of an investor, and what are the key benefits to them?

John Hock:

Well, the key benefits are just the scope of the long-term absolute returns. You look at, again, the quality defined as returns and equity of the asset class, not to mention those that we own, and map that out against the valuation. It's a very compelling proposition, certainly versus other public equities. I know private equity and alternatives have been quite popular, but by any measure, the opportunity set that you see in public markets right now is far more compelling according to us than what you can see in private markets. So the absolute return story is legitimate and it's compelling.

And then secondly, just the diversification benefits. Now, if you have a client who thinks the next 10 years will be similar to the last 10 years, no, then you should not go anywhere near this stuff or have just a little bit. But any other scenario, which there's a wide range of outcomes, diversification benefits alone will be quite meaningful. In terms of the role and the positioning, I'll defer to the professional advisor who knows our client's risk tolerance and other issues, so I'll defer to them on that.

Mark Goodwin:

John, thank you for joining me today. This has been a great discussion.

John Hock:

Thank you, Mark. I'm always available to chat.

Diane Merritt:

Thank you for tuning in to our North Square Active Insights podcast.

[1]The determination of "best-in-class" is solely the opinion of the Fund's Adviser, and such opinion is subject to change. Those companies that hold leading market share positions, strong growth potential, historically good probability, and management teams known or integrity and good corporate governance are generally considered to be "best-in-class."

Principal Risks of Investing, Altrinsic International Equity Fund: Risk is inherent in all investing, including an investment in the Fund. An investment in the Fund involves risk, including the following principal risks, among others: Credit and Subordination Risk, Preferred Securities Risk, Hybrid Security Risk, Additional Tier 1 Securities Risk, Optionality Risk, Foreign Investments Risk, Rule 144A and Regulation S Securities Risk, Currency Risk, Emerging Markets Risk, Derivatives and Hedging Transactions Risk, and LIBOR Risk. Summary descriptions of these and other principal risks of investing in the Fund are set forth in the Fund's prospectus. Before you decide whether to invest in the Fund, carefully consider these risk factors and special considerations associated with investing in the Fund, which may cause investors to lose money. There can be no assurance that the Fund will achieve its investment objective. An investment in the Fund is not a deposit of the bank and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Please see the Fund's prospectus for additional risk disclosures.

[2]**Cash flow**: the term cash flow refers to the net amount of cash and cash equivalents being transferred in and out of a company. Cash received by the company represents inflows, while money spent represents outflows.

[3]Market risk can be measured by Beta. Beta is a measure of the volatility, or systematic risk, of a security or portfolio when compared to the market as a whole. A beta of 1 implies that you can expect the movement of a manager's return series to match that of the benchmark used to measure beta. This statement means that Altrinsic Global Advisors have demonstrated below market Beta, or lower exposure to market risk than the MSCI EAFE Index, an equity index which captures large and mid-cap representation across 21 Developed Markets countries around the world, excluding the US and Canada.

North Square Altrinsic International Equity Fund Sector and Region Weights as of March 31, 2023

SECTOR WEIGHTS (%)

	Altrinsic International	MSCI EAFE
Financials	30.54%	17.88%
Consumer Staples	13.85%	10.20%
Health Care	12.91%	13.11%
Industrials	9.80%	16.20%
Information Technology	6.25%	8.05%
Cash	5.74%	0.00%
Materials	5.45%	7.64%
Energy	4.31%	4.48%
Consumer Discretionary	3.97%	11.83%
Real Estate	3.73%	2.28%
Communication Services	3.46%	4.92%
Utilities	0.00%	3.42%

REGION WEIGHTS (%)

	Altrinsic International	MSCI EAFE
Europe Ex-UK	49.06%	51.32%
Other	14.40%	4.69%
UK	13.93%	14.80%
Japan	11.90%	21.51%
Cash	5.74%	0.00%
Americas	4.98%	0.00%

The Portfolio is actively managed and current holdings and characteristics may be different. The holdings listed should not be considered recommendations to buy or sell any particular security listed. The holdings identified do not represent all of the securities purchased or sold. Actual portfolio investments may vary when actually invested. A complete list of holdings is available upon request.

TOP TEN HOLDINGS (%)

Chubb Ltd.	3.40%
Heineken NV	3.33%
Sanofi	3.19%
Willis Towers Watson plc	3.12%
Everest Re Group Ltd.	2.93%
Total Energies SE	2.61%
Zurich Insurance Group AG	2.41%
Medtronic plc	2.40%
Akzo Nobel NV	2.31%
Check Point Software Tech	2.29%

As of March 31, 2023, the following securities mentioned in this podcast represented the following percentage of the Altrinsic International Equity Fund's portfolio:

Name of Security	Percent of Fund Net Assets
Heineken NV	3.33%
Diageo	2.21%
Banco Bilbao Vizcaya	0.99%
HDFC Bank LTD – ADR	1.84%