Sunspur Global Fund

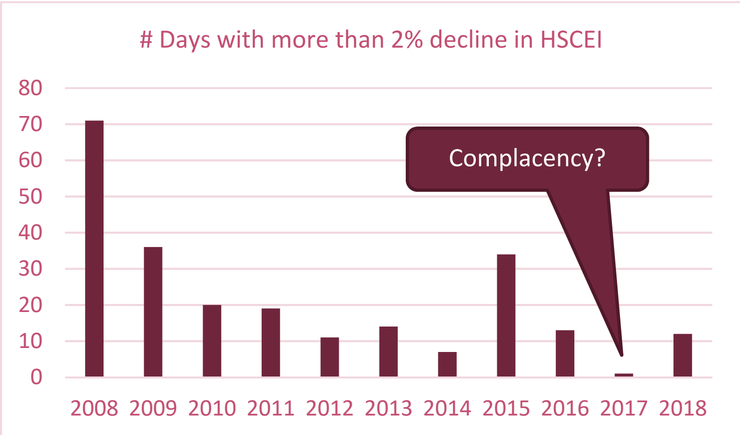
12 November 2018

Commentary on Recent Performance

Dear investor,

As you are probably aware, October 2018 was an unusual month in terms of large, synchronised downward moves across global equities. We will not be focusing on 'why the market moved' or 'where is it going from here' – there are plenty of opinions on those topics, but we hope to put these moves in context, with respect to our investment strategy.

1. These moves are unusual, but should not be unexpected



Source: Bloomberg, as of October 2018.

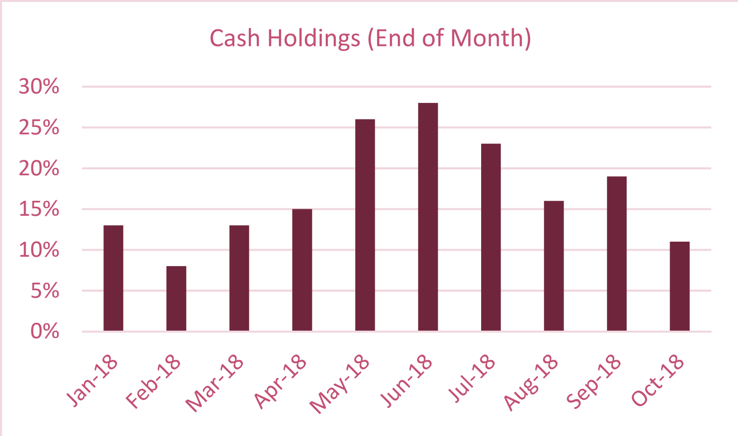
Looking at the small number of 'large down days' in 2017, we can conclude that a certain degree of complacency crept into markets, with investors (including many new entrants) projecting price stability, leading to many participants being caught off-guard by the 'surprise' moves in October.

It has been and continues to be our view that there will be the occasional large downward price move. In fact, there could well be moves in the future that exceed October or exceed anything we have ever seen before. The key is, we ***expect*** these things to occur.

2. We have prepared for these moves, but have never known when they will come

As long as we can find attractive long-term investments, we will continue to keep the vast majority of the portfolio invested. However, as part of our philosophy to always build in a ***"margin of safety"***, we have always held a healthy amount of cash reserves to take advantage of short term moves in markets. The level of our cash holdings is informed by general market valuations, relative to interest rates, an assessment of investor optimism/pessimism, an assessment of the current position in the economic cycle as well as government and monetary authority actions.

The above framework doesn't tell us **when** markets will decline, it simply gives us a sense of the odds of the market giving us acceptable returns over the long term. We assume that if markets are too excessively valued, it will get corrected at some point. We don't know when that point is, but having cash gives us the ability to ***act decisively*** when opportunities come our way.



Source: Sunspur Global Fund fact sheets.

As noted in our annual letter we have kept cash levels quite elevated during the year, and as you can see from the chart above the fund has held record levels of cash going into May/June. This has positioned us well to take advantage of market declines over the last 3 months.

3. We have already structured your investments to be agnostic to macro issues

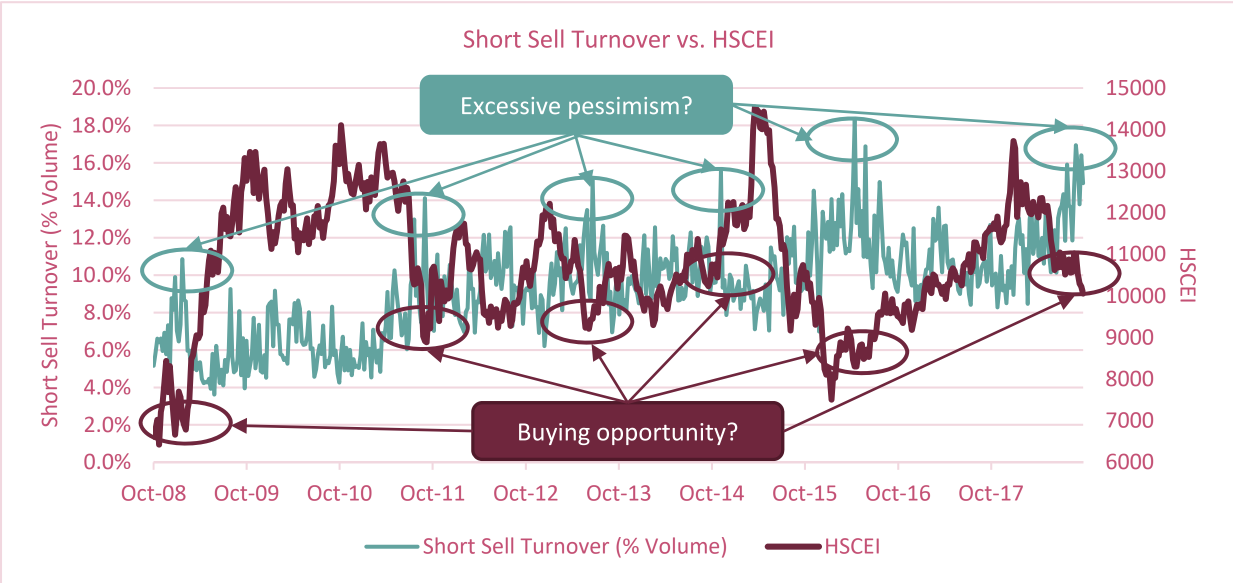
In line with our views on broader global macro, we have consciously been buying businesses which should perform well (in terms of earnings) despite uncertainties in the macro environment. We will briefly run through our top 5 holdings and their primary economic characteristics:

- *#1 West China Cement*[1]. Trading at ~30% FCF Yield (or 3-4x P/E), the business is mainly a beneficiary of supply discipline in an oligopolistic region – macro concerns are unlikely to impact the business, since price and volume are controlled under most demand scenarios. In fact, in an adverse macro environment, the stock could be a beneficiary as infrastructure spending is ramped up to counter a broad economic slowdown.
- *#2 Wells Fargo*. One of the best-run U.S. banks, currently trading at 10-11x P/E, with a dividend + buyback equating to an almost 10% yield. The bank is exposed to U.S. macro, but we think the current valuation on temporarily depressed earnings will more than offset any macro weakness **over time**.
- *#3 Goodbaby International*. China's largest baby durables manufacturer and a large baby goods retailer, currently trading at 8-9x P/E. The business has wonderful brands and a strong franchise – importantly, we doubt parents will underspend on their babies and young children even in adverse economic scenarios, so we expect little macro impact.
- *#4 HKBN*. One of Hong Kong's duopoly providers of fixed broadband services. Whilst 'expensive' on current multiples (about 20x FCF), we expect continued strong growth as they have just begun monetising their market share investments of the last few years. This business has little to no correlation to the macro environment.
- *#5 Liberty Global plc*. One of Europe's largest providers of cable video and broadband services. It is in the process of selling a substantial part of its European operations (at high valuations) and investing for high growth at high returns in the UK (its biggest market). As a cable business, its earnings have little correlation to the macro environment.

However, as we explain below, we have decided to take on slightly more macro exposure recently.

[1] We have written extensively on West China Cement, please refer to our 2017 Annual Letter for more information.

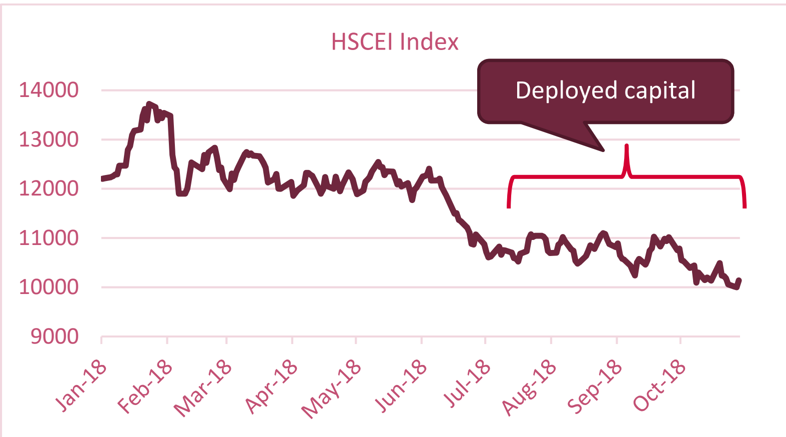
4. We have deployed your cash as markets have declined



Source: Bloomberg, as of October 2018.

One of the key tenets of our investment philosophy is our willingness to ***"be contrarian at market extremes"***. This means that when we judge share prices to have gone 'too far' in either direction, we are willing to swim in a completely different direction to the market.

A key indicator of pessimism is short sell turnover in the market. As you can see from the chart above, there have been many times over the course of the last 10 years where 'investor pessimism' has spiked due to macroeconomic concerns and buying during these periods has been fruitful for investors. In fact, recent short sell turnover has hit near decade highs, suggesting an excessive level of pessimism in the market. Perhaps this is an opportune time to invest?



Source: Bloomberg, as of October 2018.

Over the last 3 months, and more so in October, we have deployed a substantial amount of cash into existing investments and some new investments which have cropped up. Our deployment has been extensively focused on Chinese equities. It is our judgment that market valuations in *'old, industrial China'* have become quite attractive, relative to any other large market or sector, considering the significant structural change[2] that has occurred across the Chinese economy.

[2] Covering the extent of the structural changes will require more space than is reasonably available, but they broadly involve supply-side reform, environmental protection, SOE reform and debt restructurings.

Although individual stock positions may not be visible in our fact sheets, I would like to make it clear to our investors that the tail of the portfolio now contains a diversified basket of Chinese, H-share listed, primarily state-owned companies with strong competitive positions, trading at attractive valuations, where management is beginning to receive stock grants, in sectors such as property, travel, hospitality, healthcare, culture, environment and financials.

This approach may lead to some degree of underperformance in the short term should markets continue to decline, but we believe it will work out favourably in the long term.

5. The above strategies only work with a long-term investment horizon

In general, it has been profitable to invest in markets of a strong, resilient economy[3] during times of macroeconomic stress. We have seen this cycle many times – e.g. the Global Financial Crisis, the European debt crisis, SARS, the dot-com boom, the Asian Financial Crisis, the various oil shocks and World War 2 through to the Great Depression. Eventually macro concerns fade away.

However, the results can take years to become evident, and in the interim, markets can exhibit significant volatility. The main risk here isn't that markets are volatile, it is that market volatility keeps investors on the side-lines, and fear of further declines prevent people from investing (or even worse, selling) precisely when markets are attractive.

We try hard to guard ourselves against this damaging psychology, and we are appreciative of your patience, which allows us to go against the grain during times of heightened uncertainty.

Thank you.

If you have any queries, please do not hesitate to contact me at:
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Regards,

Loke Wen Wei
Portfolio Manager
Sunspur Global Fund

[3] These are economies where there is an abundance of hard working, educated, industrious people, and an economically responsible government which provides for infrastructure and a market-oriented system so that people can achieve their potential. Not all economies would meet this definition.