Q2 2020 MANAGER COMMENTARY

"In the short run the market is a voting machine, but in the long run it is a weighing machine"
Benjamin Graham, Economist & Author

16 July 2020

Dear fellow MMIT shareholder,

In 1940, McGraw-Hill published a second edition of Security Analysis, Benjamin Graham and David Dodd's seminal work on the challenges of stock market investing. The update included an enlightening section on the authors' views regarding the fluctuations in General Electric's valuation between 1937-38.

"*It was little short of nonsense for the stock market to say in 1937 that General Electric Company was worth $1.87bn and almost precisely a year later that it was worth only $784mln. Certainly nothing had happened within twelve months' time to destroy more than half of the value of this powerful enterprise, nor did investors even pretend to claim that the falling off in earnings from 1937 to 1938 had any permanent significance for the future of the company. GE sold at $64 because the public was in an optimistic frame of mind and at $27 because the same people were pessimistic. To speak of the prices as representing "investment values" or the 'appraisal of investors' is to do violence either to the English language or to common sense, or both.*"[1]

Undoubtably, market dynamics continue to evolve, however certain rules and observations appear to remain constant. In 2020, emerging and frontier markets have shifted dramatically in response to arguably three different phases of public sentiment, from initial optimism, to widespread pessimism and back again!

In our Q1 2020 Manager Commentary, we argued that when analysing emerging and frontier markets, investors "*tend to overreact to external shocks and are therefore far less efficient in pricing in risk than their developed counterparts. In particular, it was worth observing the 2008 drawdown in the EM small and mid-cap space and the subsequent recoveries in 2009.*" At the time of writing that, the JP Morgan EM FX Index had dropped 13.1% (*see graphs and table below*) while the MSCI EM Mid Cap Index was down 26.1% and more than $52bn had been pulled out of emerging market equity funds.[2] Subsequently, despite the MSCI EM Mid Cap Index rebounding by 24.8% in Q2[3], there have been further outflows across emerging market equities over 20 consecutive weeks; the 3rd longest outflow streak since 2000[4]. Accordingly, emerging markets look significantly under owned, with c$130bn of stock to buy to address the flow gap vs rest of the world.[5]

Top Five Best Performing EM/FM Currencies (Jan- March 2020)[6]:

Currency	Q1 2020 Change
Hong Kong Dollar	0.5%
Philippine Peso	(0.1%)
Taiwanese Dollar	(0.7%)
Bulgarian Lev	(1.7%)
Chinese Renminbi	(1.7%)

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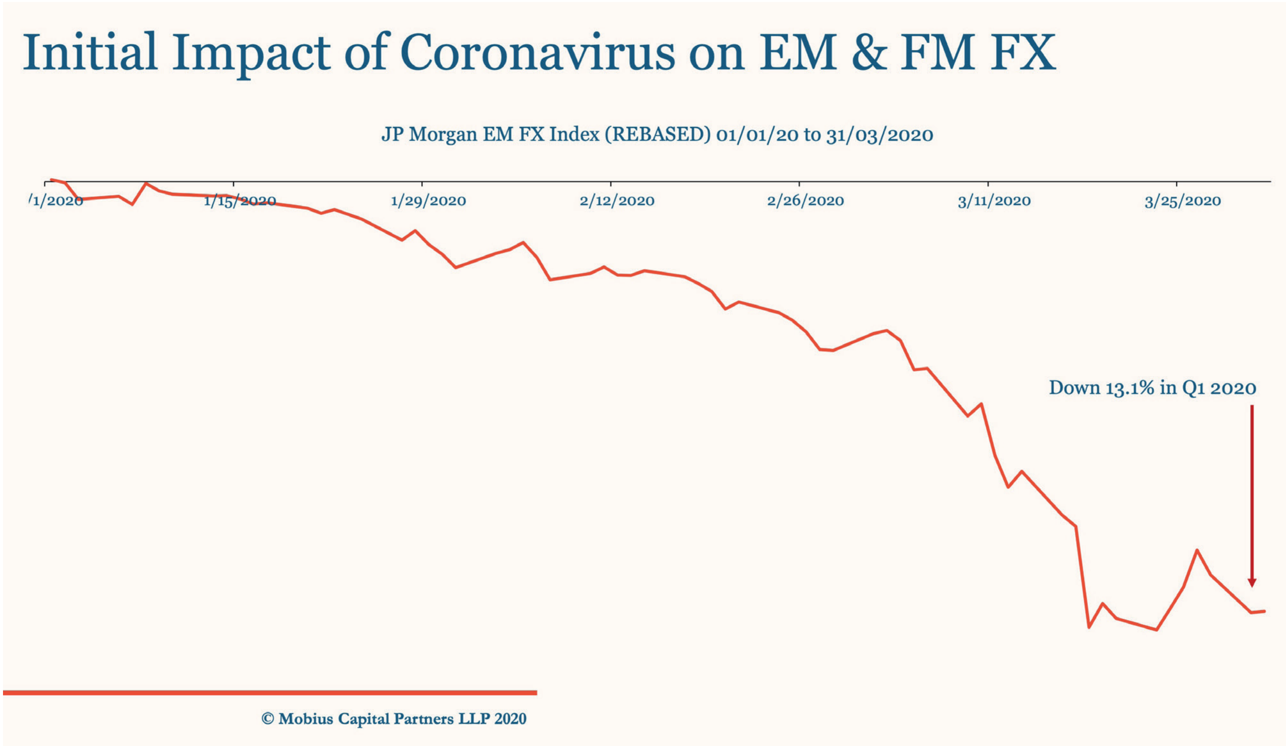
Five Worst Performing EM/FM Currencies (Jan- March 2020)[7]:

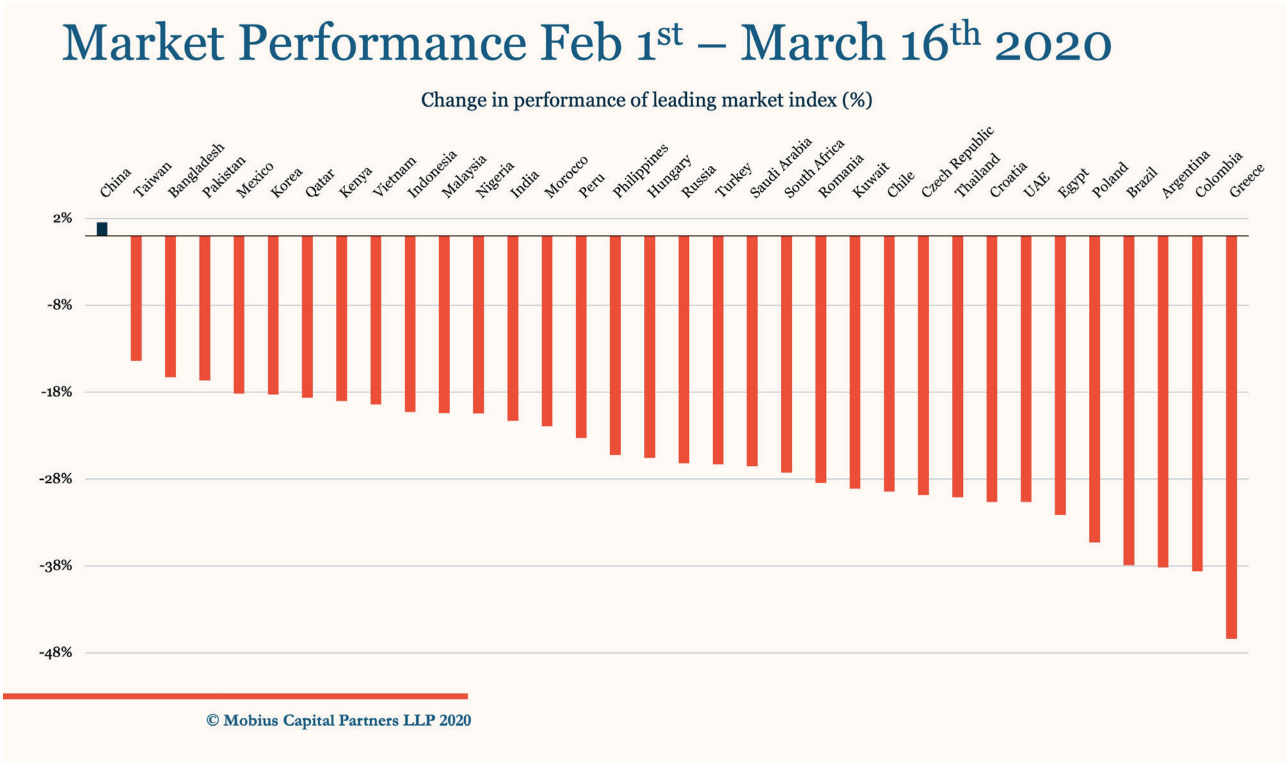
Currency	Q1 2020 Change
Colombian Peso	(19.2%)
Mexican Peso	(20.0%)
Russian Ruble	(21.0%)
South African Rand	(21.5%)
Brazilian Real	(22.6%)



Source: Bloomberg

The steep sell-off across markets in March 2020 (*see performance of individual markets below*), and the subsequent recovery presented us with an excellent opportunity to showcase the advantages of a concentrated and high conviction-based investment strategy.

Time and again, we have witnessed resourceful and innovative companies repositioning or adjusting their business models to adapt to the crisis, or simply benefitting from it. Common examples of pivoting existing business models includes eMemory, which has been in the process of developing a unique and unclonable silicon "fingerprint" for a wide range of security purposes, including encryption, identification and authentication. This type of security key generation is currently in high demand due to the global move towards "home offices". Other examples include restaurant chains (such as Yum China) which have increased capacity for delivery services to try and mitigate lost revenues. Simultaneously, we have seen some companies go further in using their resources and skills to contribute to a national effort while others have used it as a moment to improve their sustainability practices (Mail.Ru recently published its inaugural ESG Report).



Source: Based on data from Capital IQ, Trading Economics

Due to our rigorous due diligence process, Mobius Capital Partner's investment strategy is specifically designed to scour emerging and frontier markets to discover these resourceful and long-term orientated management teams; characteristics which contribute to what we describe as "*Quality Companies*". These are stocks that offer a superior return on invested capital, have low levels of debt compared to peers, and competitive strengths built up by management over time. To support Graham and Dodd's argument, we believe that this what represents true "investment value".

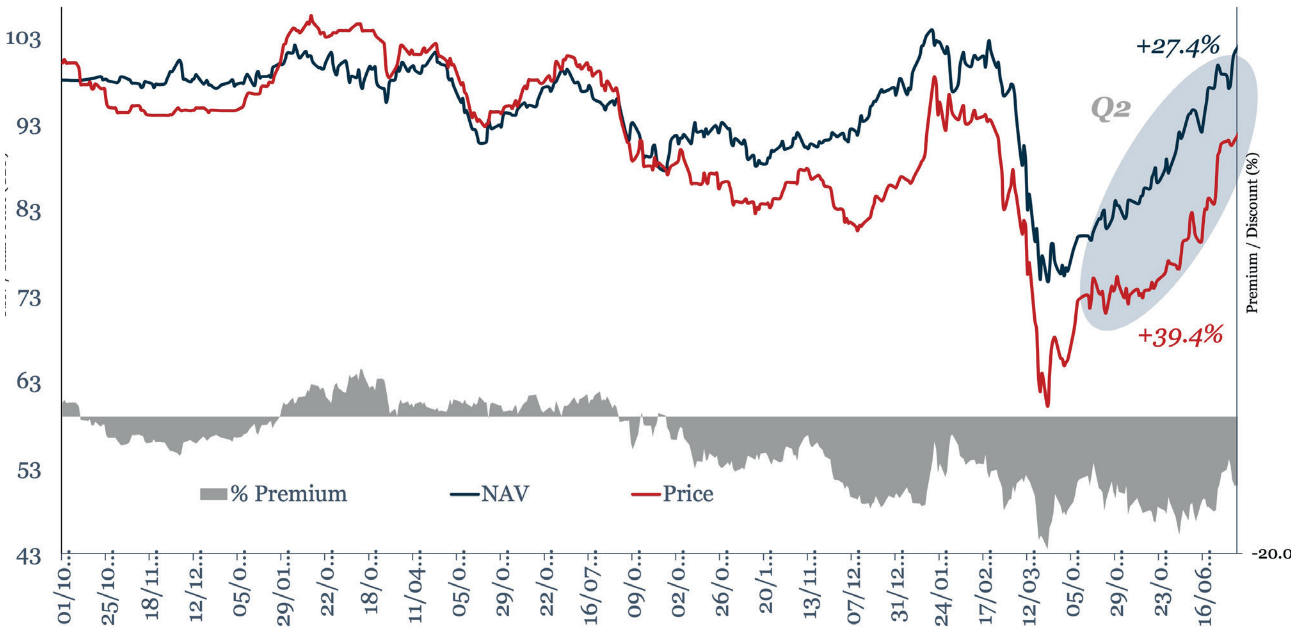
Performance

The Net Asset Value (NAV) of MMIT increased by 27.4% over Q2 2020, reaching a high of 99.7p on 24 June 2020 before closing at 97.0p on 30 June 2020. MMIT's share price increased to 91.0p in Q2 2020 (up 39.4%), trading at an average discount to NAV of 12.3%. This decreased to 6.2% at close on 30 June 2020. Both MMIT NAV and share price outperformed the wider peer group[8] in Q2 (on average 19.6% and 18.9% respectively).

Over the period, the top three largest contributors to performance were eMemory Technology (+5.6%), AK Medical (+3.1%) and LEENO Industrials (+1.9%). IMAX China (-0.2%), Clicks Group (-0.2%) and Magma Fincorp (-0.05%) detracted the most from performance.

MMIT's 14.3% cash position in January 2020 allowed us to react swiftly when opportunities presented themselves, allowing us to add to a range of existing holdings as well as building new positions in stocks that had reached compelling entry level valuations, in particular in Brazil and Africa.

MMIT – Monthly Performance



Source: Bloomberg

Investment Update

As of 30 June 2020, MMIT had invested 93.5% of capital, with 29 holdings across 12 countries. MMIT's top ten holdings are shown below:

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Top 10 Holdings (%):	Country	(%) of MMIT portfolio
eMemory Technology Inc	Taiwan	8.4%
Yum China Holdings Inc	China	6.4%
Fleury SA	Brazil	5.8%
APL Apollo Tubes Ltd	India	5.4%
AK Medical Holdings	China	5.0%
Persistent Systems Ltd	India	4.9%
Safaricom Ltd	Kenya	4.8%
Polycab India	India	4.5%
LEENO Industrial	South Korea	4.4%
Hugel Inc.	South Korea	4.3%
Total		53.9%

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During Q2 we acquired six new holdings, three of which have now reached target weight so we can provide some further details:

Clicks Group owns and manages a chain of retail stores and pharmacies across South Africa. It operates in a large and structurally growing end market, and we are excited about opportunities to further expand into Namibia, Swaziland & Botswana. Clicks' established brand, differentiated offering and supply chain efficiency all act as natural moats against new entrants.

TOTVS is a Brazilian technology company that specialises in software and consulting, with a focus on integrating the core processes of a firm (e.g. finance, procurement, sales etc) into a single platform. The company is one of the leading providers for small and medium businesses in Brazil and also has operations in the rest of Latin America and the US. We started building our position with the share price down 45% from its peak in February, which we felt was an attractive entry point given the structural growth profile of the business.

With a similar profile to existing portfolio company Cogna/Kroton (see MMIT Q2 2019 Manager Commentary), YDUQS operates in the Brazilian educational sector with a focus on higher education. The company is in the process of consolidating the fastest growing and the most profitable segment of the market – medical schools.

With all three businesses, we have identified some specific areas where our engagement can enable further success. We have started a constructive dialogue with management teams.

Why Will Good Corporate Governance Protect You During Covid-19?

One of the most exciting aspects of being a global emerging market investor is the ability to follow companies, news flow, and trends throughout all continents. Since the start of the current pandemic, we have spoken to companies across sectors and geographies; be it in China, Vietnam, Korea, Egypt, South Africa, Poland or Brazil. It has been a fascinating experience to observe how corporates and countries have prepared, rapidly adapted and in some cases, are beginning to see green shoots of recovery.

Whilst much has been written about the ESG implications of Covid-19, there has been little focus on how adhering to good corporate governance during the crisis impacts companies in the emerging and frontier universe. We believe the pandemic presents governance challenges and opportunities. We know from previous studies that companies with stronger governance benefit from a lower cost of capital and better operational performance.[9] We argue that companies which demonstrate strong governance will weather this crisis more effectively, whilst the companies which fail to adapt and show robust leadership, may struggle to survive.

We explain these issues by assessing and sharing our experiences on the following topics in emerging and frontier market companies: (1) long-term strategic horizons, and (2) the duty of the board of directors.

1) **Long-term strategic horizons:** Many listed companies in emerging and frontier markets have some form of family ownership. In India, over 56% of the largest companies by revenue are family-controlled businesses. In 90% of these family businesses in India, there is managerial involvement by family members.[10] One may ask why this is relevant. In a recent article in the Harvard Business Review, the authors stated, "through exercising their rights, family owners have the ability to position the company for long-term success or doom it to failure."[11]

In a crisis like now, long-term thinking must not be underestimated; a privilege which many family businesses are poised to benefit from. Difficult decisions will have to be made from scaling down the workforce, reallocating capital to new priorities, and suspending dividend payments. Whilst some companies may be forced to take short-term measures to focus on the next quarter, we believe companies with an engaged and a long-term focused shareholder base (such as families) are better equipped to weather the crisis. Families are often focused on the next generation and not the next quarter. Many of these companies have weathered multiple crises before and their seasoned family members are able to share their retained learnings.

"In a crisis like now, long-term thinking must not be underestimated."

In the Middle East, we spoke to one company where the Founder and Chairman has been in his position since 1993. He has sailed through multiple crises, including revolutions, terrorist attacks, and currency devaluations. The company rapidly provided an update to investors providing a detailed outline of how the company has adapted during Covid-19. With an outstanding management team, a strong balance sheet, and clear and transparent communication with shareholders, the company is well-positioned in the current crisis. The conservative approach taken by the controlling family for decades has also resulted in no workforce layoffs. Indeed, the Covid-19 crisis is unique, but a steady hand is an important strength, and in many cases should be viewed as an asset.

2) **The duty of the board of directors:** Boards have been unable to convene like they have in previous crises and have had reduced interaction with management. Whilst management teams must be supported and should not be overburdened at this difficult time, letting accountability sweep under the carpet would be a negative outcome for all stakeholders. One of the dangers of leading through a crisis is the long-standing issue of conformity. Whilst family-controlled businesses in emerging markets offer many advantages, it is important that board members and in particular, independent directors are not afraid to challenge management during this crisis. The psychologist Irving Janis has argued that individuals are more susceptible to group thinking during a crisis in order to reach an agreement.

Even outside of businesses where there is family involvement, many emerging market companies suffer from a lower percentage of independent directors compared to their developed market peers. Whilst there is evidence to suggest that board independence in many emerging markets has improved since the global financial crisis, let us not be fooled by the statistics. The various definitions of "independence" have almost become an orthodoxy globally. Yet they do not necessarily prevent board members from turning up (for the foreseeable future on Zoom) to board meetings having rigorously read the board materials, nor do they consider that "independent" directors do not always adequately challenge management.

The risk of groupthink is a heightened risk during this crisis. We believe this could be mitigated by following the actions below:

1. **The role of the chairman:** This is a time when the true leadership and capability of a chairman becomes evident. A chairman will find the right balance to work with the management team to see where the future of the company should be. Both the chairman and the CEO must agree on the future vision of the company. It is crucial that if the chairman position is not held by the CEO, management are sufficiently challenged and are pushed on strategic planning post-COVID-19. In the absence of an independent chairman, it is the duty of independent directors to ensure this occurs.

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2. **Utilizing expertise:** The board must contribute to the debate on the future of the company by providing experience from the past, in addition to their deep industry knowledge. It often takes a crisis to show if directors are the right fit for board and have a thorough understanding of the business and the industry of the company. A lack of debate across the board and acquiescence to what the CEO or the chairman say does not show true competence

3. **Data:** data analytics are more useful today than ever before: management must present frequent updates to the board about the performance of the business, not only in financial terms but also by demonstrating how the company is managing relationships with its customers and suppliers. The board can only develop a clear vision of the future by understanding where the stakeholders of the company are moving towards.

4. **Learning from peers:** The board has a duty to challenge management and to assess peers in the industry on a global scale within their industry and niche: if management do not benchmark themselves to best in class industry practices, they should be challenged.

Boards are ultimately responsible for the strategy of the business and more specifically, ought to be asking the following questions:

- Are employees healthy and safe? How have management teams assessed this?
- Have board members received a complete risk assessment of the implications of Covid-19 across all aspects of the business? Have they been able to confirm the resiliency of the business model they follow?
- Have P&L stress tests taken place which considers extreme scenarios?
- Does a separate board committee need to be established to address business continuity and contingency planning?
- Does the company have the liquidity it needs to weather the crisis?
- Is it prudent to pay a dividend or engage in buybacks?
- Should the company be re-investing in the business to prepare for the recovery? Where should capital be (re)allocated?
- Are managers clearly communicating with all employees? Are they leading by example and reducing their own compensation?
- How is the company thinking about the communities it is operating in?

We have found the majority of companies in our portfolio to be rising to the challenge and taking robust action. Boards have performed their supervisory function diligently and management teams have taken the necessary measures to secure the survival of the company. Despite boasting a solid balance sheet, in China, a QSR chain has reacted with caution and has suspended its dividend and buyback programme for the next two quarters.

"Boards have performed their supervisory function diligently and management teams have taken measures to secure the survival of the company.."

The board and management also went further and cut their compensation, whilst extending health insurance for employees' family members and their parents aged over 75. In India, the Managing Director of an industrial conglomerate has foregone his entire salary until the company's earnings are back to their pre-outbreak level. Board members and other senior leaders for this company will also see a 30-50% cut in their compensation.

Conclusion

The primary goal of corporate governance is to ensure that management and directors make good business decisions. Given the circumstances, today, making good decisions is far from easy. We believe following the crisis, companies will broadly fall into one or more of the following three categories:

- Companies which have failed to adapt their business models and may face significant liquidity issues, with bankruptcy as a bear case;
- Companies which can show resilience in a highly uncertain and rapidly changing post-pandemic world and survive with some necessary adaptations;
- Companies that can grow faster than before, innovate, and create value for all stakeholders. These companies will not only have adapted but will have strategically thought about their business model and will have started to design and implement changes that will allow them to be future leaders in their sector(s).

Whilst boards and management teams have never been in such a situation before, now is the time to show leadership and rise to the challenges. Companies which had previously been prudent and are fortunate to sit on a healthy balance sheet and an engaged and long-term focused shareholder base, should come out stronger. Yet this alone will not suffice; robust, transparent, and exemplary governance from all senior leaders is important today, more so than ever before. Ultimately, strong governance is a prerequisite for emerging as a leader in the post-pandemic world. The winners of tomorrow will be the companies which show leadership today: the companies which look after their employees, who adapt where necessary, who (re)allocate capital to focus on the long-term, and the companies who communicate with all stakeholders more powerfully than they have ever done so before.

If you would be interested in speaking with any of the Mobius Capital Partners' investment team, this can be arranged by emailing: harry@mobiuscapitalpartners.com.

Thank you for your continued support.

The Mobius Capital Partners Team

Footnotes:

1. Security Analysis, by Benjamin Graham and David l. Dodd, 1940
2. Chinese equities had outflows of $12.3 billion while the rest of emerging market equities suffered a $40.1 billion outflows. Source: International Institute of Finance (IIF).
3. https://www.msci.com/documents/10199/87682efd-bb6f-4ede-ae40-372b41b5a1c9
4. Goldman Sachs: CEEMEA in the City - Asia/EM Flows- 11 July 2020
5. Goldman Sachs: CEEMEA in the City - Asia/EM Flows- 11 July 2020
6. Bloomberg (31/12/2019 to 31/03/2020)
7. Bloomberg (31/12/2019 to 31/03/2020)
8. Jupiter Emerging & Frontier Income Trust,JPMorgan Global Emerging Markets Income Trust, JPMorgan Emerging Markets Investment Trust, Templeton Emerging Markets Investment Trust, Genesis Emerging Markets Fund, BlackRock Frontiers Investment Trust, Utilico Emerging Markets Trust, Fundsmith Emerging Equities Trus
9. https://www.smithschool.ox.ac.uk/publications/reports/SSEE_Arabesque_Paper_16Sept14.pdf
10. https://www.bcg.com/publications/2016/what-makes-family-businesses-in-emerging-markets-sodifferent.aspx
11. https://hbr.org/2020/04/a-crisis-playbook-for-family-businesses

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