OYAT ADVISORS – QUARTERLY COMMENTARY

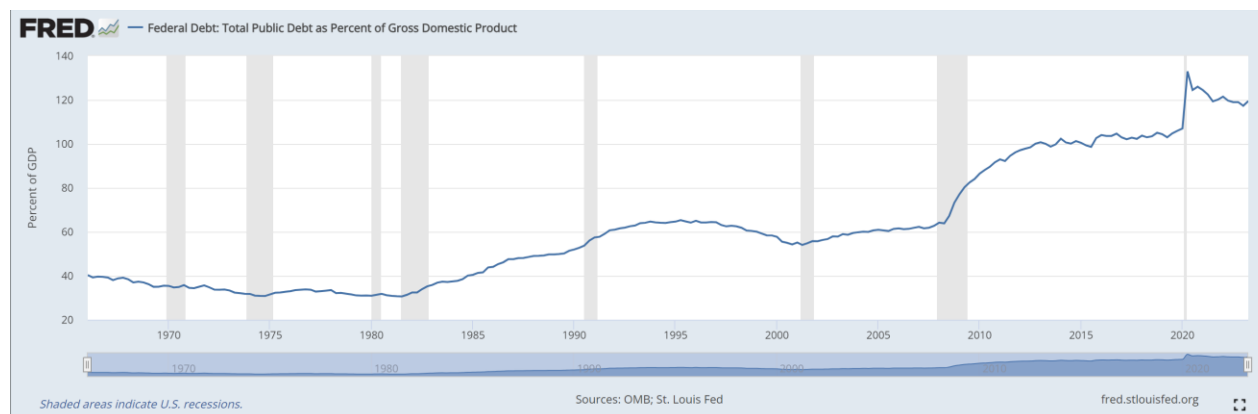
3Q 2023

Investment landscape

The third quarter of 2023 was a bit of a wake-up call for many investors after equity markets powered relentlessly upward in the first half of the year. Global stocks and bonds sank in the third quarter, raising fears of a correlated drop in both asset classes, as was seen in 2022. The reality is likely that markets could no longer ignore the looming risks created by escalating interest rates on top of ever more ominous levels of debt. Fiscal deficits in the U.S. near 8% of GDP clearly aren't helping, and raise the spectre of a government unable to carry the burden of higher interest rates that have been so rapidly increased by its central bank.

Equity markets, perhaps surprisingly, spent the beginning of the year benefitting from a moderation in inflation and the hope that lower interest rates were on the horizon. Inconveniently, inflation has not disappeared and in fact has even turned higher again in economies such as the U.S. It's a bold call to believe inflation will wither and die in the coming quarters considering the current backdrop. Oil prices are pushing ever higher on the back of geopolitical tensions. Wage inflation remains sticky and threatens to escalate with labor strikes across multiple industries. And mammoth fiscal deficits rarely seen outside of war time seem to necessitate a return to debt monetization. The third quarter reality check is likely the realization that interest rates will stay higher for longer and threaten to "break" parts of the economy or that a troubling recession is at the doorstep. Either way, it's unlikely equities will escape continued weakness going forward. Indeed, it's highly unusual to see equities hold up after rates have been ratcheted up in such aggressive fashion.

At the risk of sounding like a broken record, we want investors to seriously consider the peril of governments such as the U.S. being hopelessly in debt. In the U.S., public debt to GDP sits near 120%, essentially twice as high as it was in 2008.



And these debt statistics do not include entitlements such as Social Security, Medicare, and Medicaid, which make the situation look truly dire. As legendary investor Stanley Druckenmiller explains, *"The current $31 trillion US debt load doesn't account for future entitlement*

payments. Accounting for the present value of that burden, the debt load is more like $200 trillion." There simply isn't a painless way out of that kind of debt burden. In the meantime, fiscal irresponsibility continues with the deficit for 2023 potentially hitting $2 trillion. And things could get much worse should a recession emerge. As macroeconomist Luke Gromen points out, *"The U.S. Federal deficit is running at approximately 8% of GDP. The last 3 U.S. recessions saw deficits rise by 6%, 8% and 12% of GDP. So a U.S. recession could see 14-20% of GDP deficits."*

The excessive fiscal spending so far in 2023 is likely one reason we haven't seen more negative economic effects from central bank tightening. Perhaps the weak third quarter in financial markets reflects a gradual acceptance that unsustainable debt and spending, combined with higher interest rates, will eventually lead to recession or inflation, or perhaps both.

Markets often do have a curious way of pricing in risks and opportunities in the short-term, but there are ways for investors to achieve satisfactory results despite all of the challenges. Long-term thinking and a process to follow through the volatility are critical. On a practical level in equity markets, current circumstances call for an insistence on strong balance sheets and attractive and sustainable cash flows. Resilient businesses researched from the bottom up that aren't reliant on cheap debt and a strong cyclical environment can provide a "hedge" to the tricky economic backdrop. Of course, attractive valuations, perhaps for companies already unloved and punished by the market, also provide a degree of downside protection. Diversifying assets such as gold may help to insulate investors from currency debasement (through inflation for example) as well as financial or geopolitical stress, while providing a potential source of liquidity to pounce on truly attractive investment opportunities as they arise.

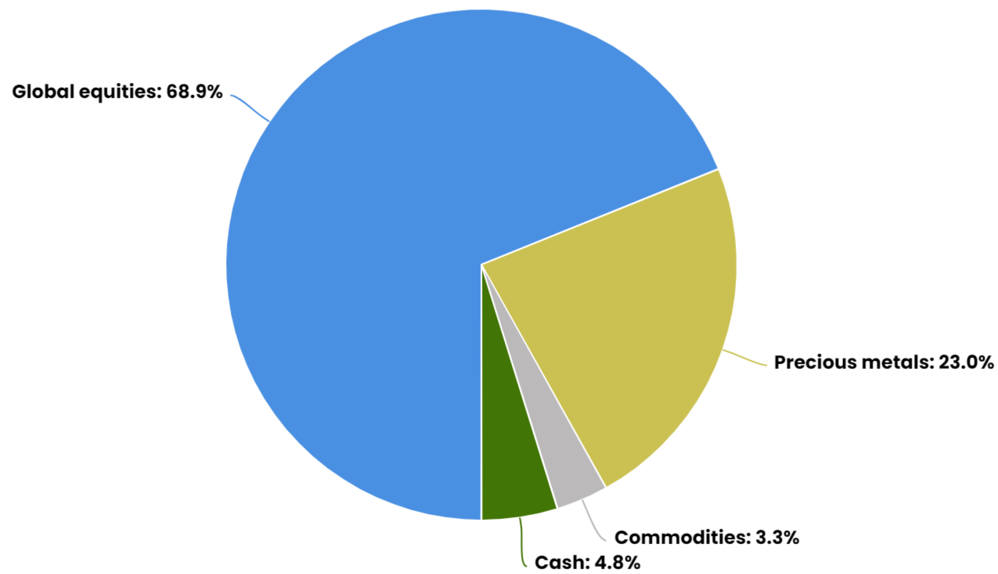
We are convinced that investors with a structured process and the appropriate discipline can find attractive idiosyncratic investment opportunities, as well as benefit from overall market volatility. Our investment process enables us to deploy capital in what we believe to be the best possible way to navigate the current investment environment - by focusing on owning scarce and productive assets, often in the form of high-quality companies, as well as maintaining a significant level of optionality by holding liquid reserves such as physical gold.

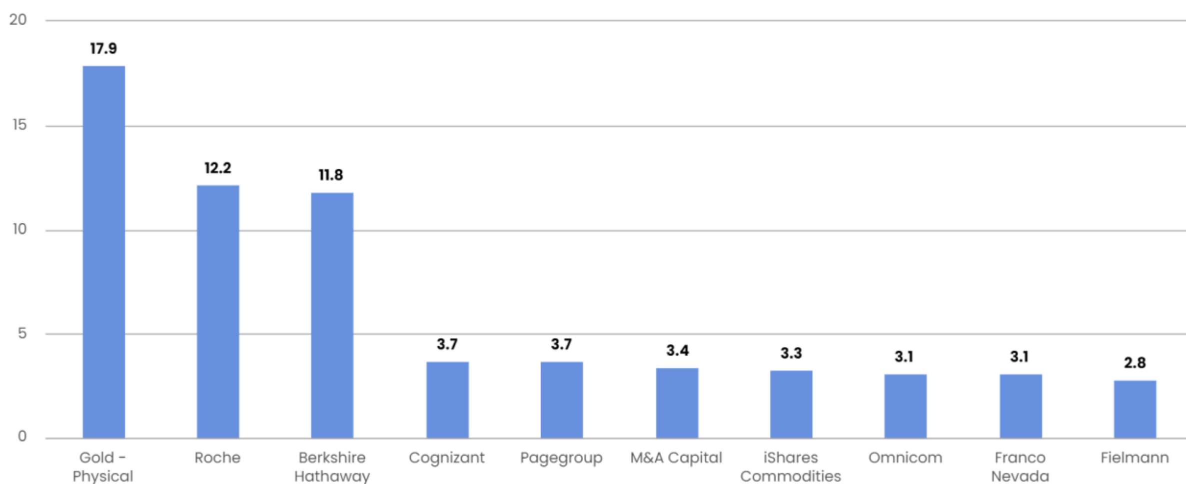
"You make most of your money in a bear market, you just don't realise it at the time".

Shelby Cullom Davis, an experienced value investor

Asset allocation

The graphs below display the Oyat Investment Fund's allocation of capital across asset classes, as well as the Fund's top-10 positions:





Performance

Quarterly returns as of September 30, 2023, in CHF

	3Q23	YTD	1 Year	3 Year	5 Year	Since Inception*
Oyat Investment Fund	-2.48%	0.13%				-2.29%
MSCI World	-1.25%	10.41%				4.84%

Total returns presented for periods greater than one year are annualized.

**Inception Date: November 10, 2022*

In the third quarter of 2023, the Oyat Investment Fund returned -2.48% in CHF, versus -1.25% for the MSCI World Index. Since inception, the Fund's total return stands at -2.29% vs. 4.84% for the aforementioned reference index.

The Fund's lackluster performance in the past quarter was impacted by weakness in the large Roche position. Roche is out of favor currently as revenues related to COVID diagnostics continue to decline, denting the company's short-term growth profile. We prefer to focus on the continuing value of Roche's R&D machine and the company's ability to consistently produce impressive returns on invested capital. Roche now trades toward the bottom end of its historical valuation range, while providing defensive exposure largely detached from the economic cycle. Roche also provides an attractive dividend yield. While the company did not favorably impact performance in the quarter, we used the opportunity to again increase our holding, fully expecting to claw back performance when the market once again appreciates the value of Roche's market position.

Also of note was the continued weak performance from athletic footwear retailer Foot Locker. As mentioned in our previous quarterly commentary, Foot Locker was struggling to implement its turnaround plan while facing weakness in consumer spending. Unfortunately, the company's struggles continued in the third quarter. The company's inability to return to value creation, combined with increasing balance sheet stress, led us to exit the position entirely in the period. Fortunately, we had previously added peer Hibbett to the portfolio to diversify our exposure in the area. Hibbett's superior omnichannel platform, strong relationship with key supplier Nike and commendable execution led to exceptional performance in the quarter which largely offset the negative impact from Foot Locker. Hibbett remains significantly undervalued in our opinion.

Also on the positive side of performance were Berkshire Hathaway and Novo Nordisk. Berkshire remains a diversified company with an exemplary track record of capital allocation and plenty of option value in the form of ample cash reserves. Interest rate hikes have gradually increased the return on Berkshire's cash reserves while the company has made investments in the energy space. Improved insurance business results along with meaningful share repurchases and impressive operating earnings have certainly helped the share price. Berkshire remains one of the largest positions in the fund.

We reluctantly exited our Novo Nordisk position in the third quarter after exceptional performance. Novo Nordisk, with its core diabetes business and rapidly growing weight loss products such as Wegovy, is a stellar company producing exemplary return on invested capital while investing in growth and maintaining a strong balance sheet. It's exactly the type of company we want to have in the portfolio, but everything has its price. Novo Nordisk's stock has appreciated nearly 400% in the past 5 years, driving its P/E multiple into the mid-30s and pushing its Price to Sales ratio above 10x. We were willing to hold such a high-quality company even at a rich valuation, but we had to model far too much growth to legitimize the valuation than we were comfortable doing, and we ultimately sold the position.

In general, during the quarter, we became increasingly concerned about the macro backdrop and geopolitical frictions. We decided to implement several trades to focus the portfolio on companies with acceptable geopolitical risk, strong balance sheets and attractive valuations, including some smaller companies which have already seen their stock prices pulled down by economic concerns. The trades were also a reflection of our investment process and the risks discussed in the investment landscape section of this commentary. In addition to the trades already mentioned, we trimmed several positions and exited others. The cash created was largely reinvested in our most attractive current holdings as well as several new positions. The trades are described below.

Trims included timely reductions in Thor Industries and IPG Photonics in order to recycle the cash into positions with more upside potential such as recruiting company Pagegroup, Gilead Sciences and Hargreaves Lansdown. These trades ultimately optimized the upside potential of the portfolio.

We then exited several positions including 3M, Alibaba and Vtech. Alibaba and Vtech were both Hong Kong listed companies with substantial geopolitical risk associated with China. Alibaba is a Chinese multinational technology company specializing in e-commerce, retail, Internet, and technology which has come under increasing pressure from governmental reforms in the country. Vtech is a Hong Kong-based global supplier of electronic learning products selling largely into Europe and the Americas. Vtech's Chinese exposure is more indirect, but meaningful, nonetheless. Although both Alibaba and Vtech continue to show significant upside in our valuation models and although both companies have performed adequately since being added to the portfolio, we decided that the increasing geopolitical risk, and perhaps our inability to quantify or properly understand its possible impacts, meant exiting the positions was the most prudent course of action.

3M is a company we have followed for many years. The company has a history of innovation and regularly producing strong returns on invested capital. We owned the company under the premise that its valuation did not reflect 3M's continued ability to create value and achieve a reasonable level of growth. Unfortunately, we have become less convinced of the company's ability to maintain its historic status as an innovative value creator with commendable returns. The company has failed to convert research and development into growth in recent years, with revenue largely stagnant, while stock compensation has remained more than generous. The company also ran into multiple legal issues including concerns it contaminated drinking water with "forever chemicals" and that certain earplug products did not perform as intended. Ultimately, our conviction in 3M's investment case became relatively unattractive when considering our opportunity set.

Exiting various companies provided the capital to initiate several new positions in the most attractive investment opportunities emerging from our structured process, including holdings in M&A Capital Partners, GQG Partners and Société pour l'informatique industrielle (SII).

M&A Capital Partners is a Japanese company engaged in the brokerage business of mergers and acquisitions (M&A) for middle and small-sized enterprises. The M&A market in Japan is a structural growth market due to Japan's aging population and the demographic trend toward smaller families. Ultimately, Japanese small and mid-sized business owners are getting older and struggling to find successors, leading to an increase in mergers and acquisitions as a solution. M&A Capital Partners has stepped in to provide business owners the services they need and has built itself into the second largest independent M&A boutique in Japan. The company's operating metrics have been impressive with return on invested capital regularly above 20% while maintaining strong double-digit growth and attractive cash flow production. The balance sheet is more than pristine, with cash representing around 40% of the company's market capitalization. We also like the strategic ownership, with about 55% of the shares held by insiders and 44% by the Founder & CEO. There are some concerns about new market entrants, but it's clear that the company ticks essentially all the boxes on our investment checklist, including an attractive valuation.

GQG Partners is another smaller-cap company with substantial strategic ownership and high potential growth. GQG Partners is a global asset management firm focused on active equity portfolios, with USD 104 billion in assets under management (AuM) at the end of 1H23. The company was co-founded by Rajiv Jain (Executive Chairman and CIO) and Tim Carver (CEO) in June 2016. Rajiv Jain has a track record of managing both emerging and developed markets equities that extends over two decades, including previously investment strategies that had combined AuM of approximately US$45 billion during his 21-year tenure at Vontobel Asset Management. Tim Carver has extensive experience in establishing and growing investment boutiques with a differentiated proposition for clients, having served as CEO of ASX-listed Pacific Current Group, a multi-boutique asset manager. It's hard not to be impressed with what GQG Partners has achieved since its founding 7 short years ago. Starting from nothing, the company's rapid ramp in AuM ranks it as one of the fastest-growing asset managers of all time. Moreover, this has been achieved by "doing things right", which includes charging reasonable fees to clients, aligning interests as best as possible, and most importantly focusing on delivering superior performance. GQG Partners ticks all these boxes. Strong return on invested capital and a strong balance sheet round out the profile along with the mentioned strategic ownership as Rajiv Jain still owns nearly 70% of the company.

SII is yet another smaller-cap company trading at an attractive valuation and with strategic ownership. SII is a successful French technology consultant and a technology services company. The company has been in existence for 44 years, and it has achieved a strong market position in multiple sectors in many countries. SII is largely family owned and is a classic example of an owner operated company that effectively allocates capital for long-term success that is underappreciated by the market. SII's financial metrics are evidence of effective management with double-digit return on invested capital accompanied by rapid growth and a strong balance sheet. Such a company is a clear bargain near 10x earnings and a 5x EV/ EBITDA multiple. While the company's end markets are generally cyclical, its ability to navigate previous downturns combined with the attractive valuation mean risks are skewed to the upside with this exceptional investment opportunity.

Ultimately, we have shifted the portfolio away from geopolitical risk and toward underappreciated companies with strategic ownership and substantial upside potential while also optimizing the balance of quality, valuation, and financial strength in the portfolio. These high-quality companies complement the material gold position (which was largely stable in the quarter) as we seek to protect and grow client capital.

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