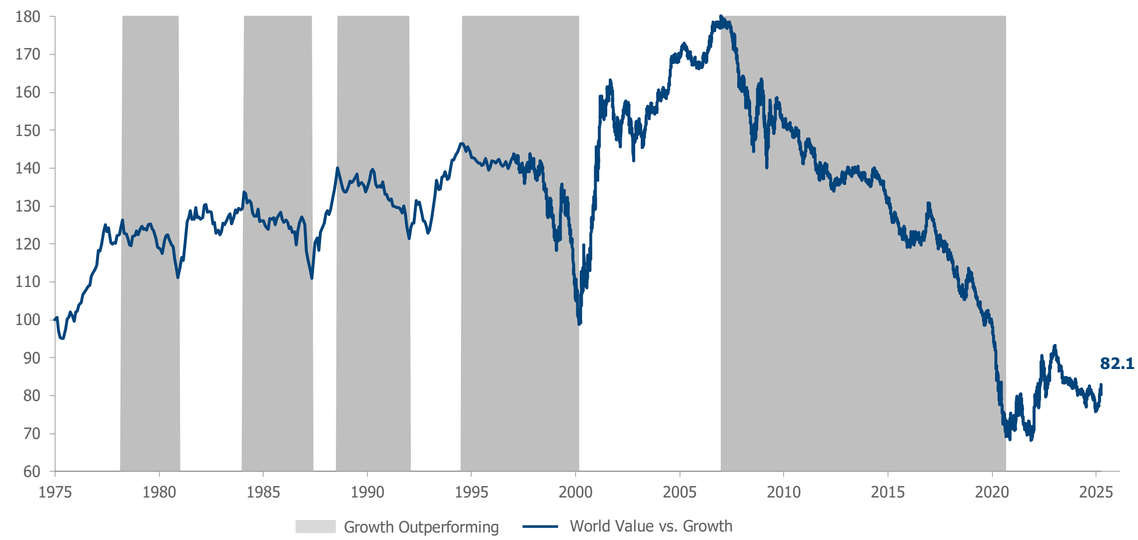
Holowesko Partners Ltd.
March 2025

Value investing – at a historic discount to growth.

After a long period of growth outperformance, we believe the landscape is shifting in favor of value strategies. Rising rates, decreasing liquidity and a shift in the long-term economic cycle provide an attractive backdrop for value to outperform. Increased volatility also creates opportunities for stock pickers to identify undervalued companies.

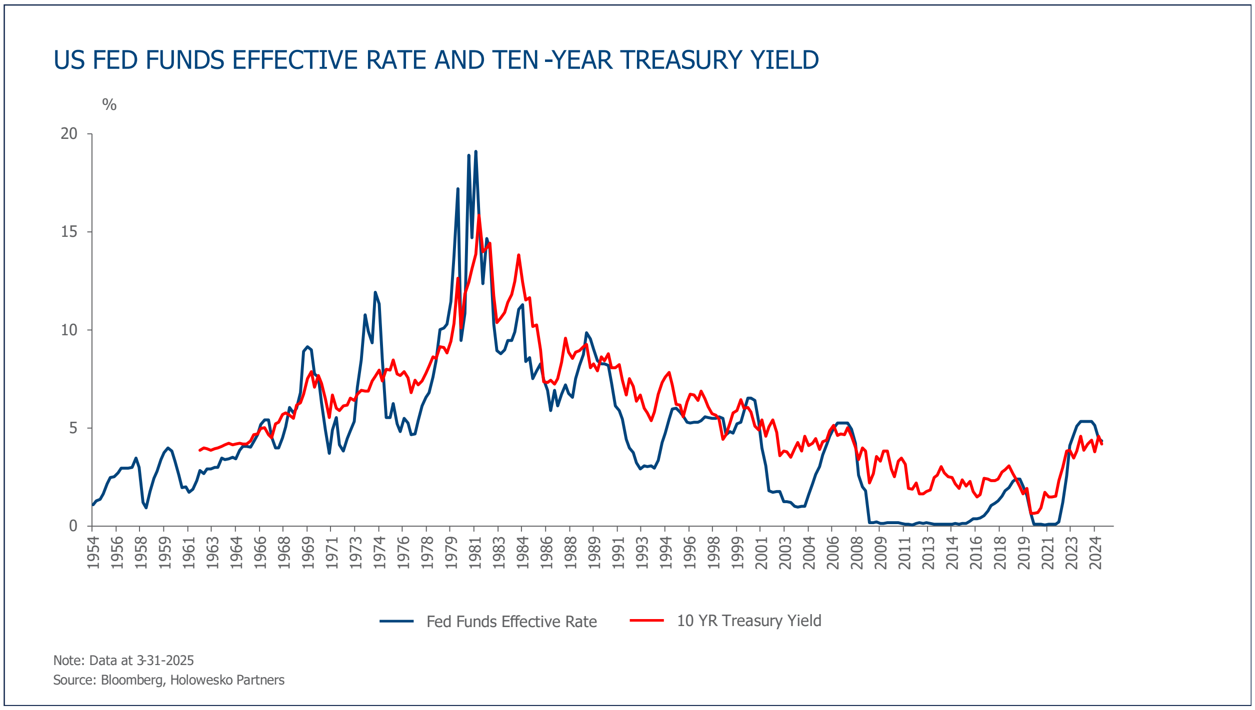
Value had a long history of outperforming growth from 1975, as shown in the graph below (line moving upwards), until the Global Financial Crisis (GFC), with periodic and sometimes strong outperformance of growth (bubble of 2000) temporarily breaking the trend. This reversed after the GFC, and significantly so in the 2016-2021 period. We believe that 2022 marked a low for value and we are now starting to see a turn, with good outperformance in the first quarter.

MSCI WORLD GROWTH INDEX VERSUS WORLD VALUE INDEX

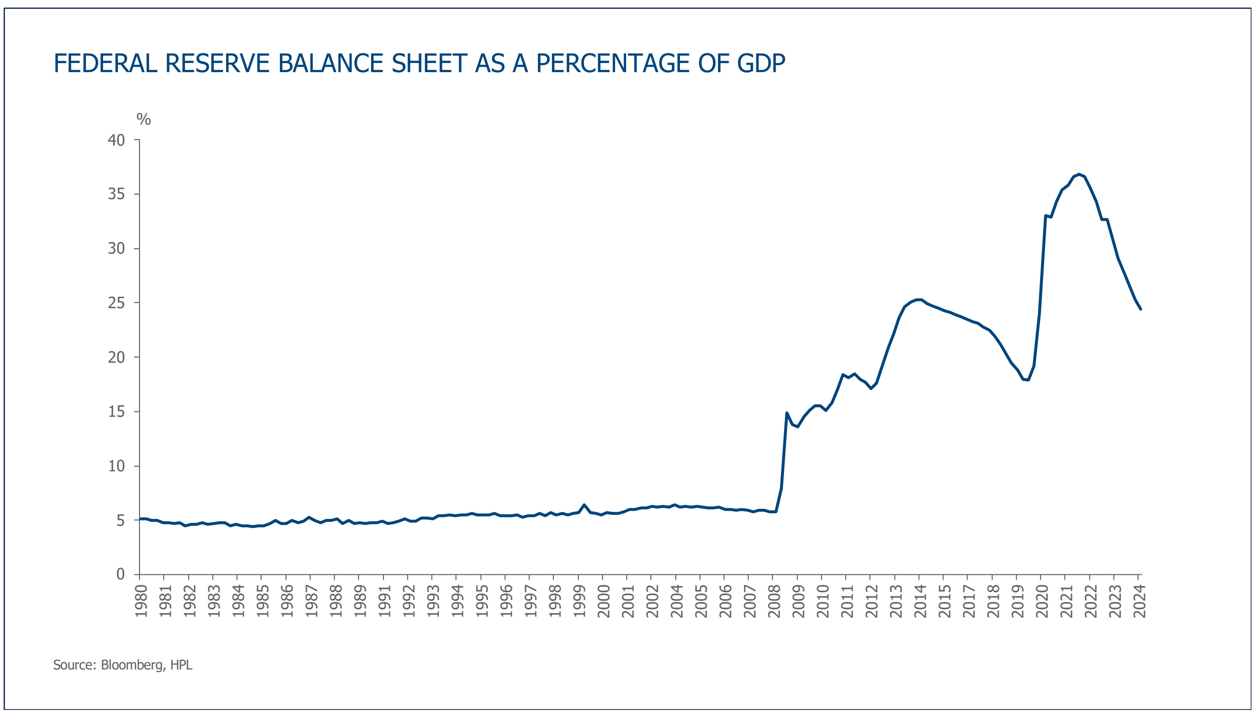


Note: Data at 3-31-2025
Source: Datastream, Goldman Sachs Global Investment Research

Growth's outperformance post the GFC was supported by a period of abnormally low rates, which began in 2008 and reappeared during Covid. While consensus expects current interest rates will decline substantially based on what was experienced in the 2008-2020 period, we don't think that's consistent with history, especially with elevated levels of inflation keeping rates higher than expected.

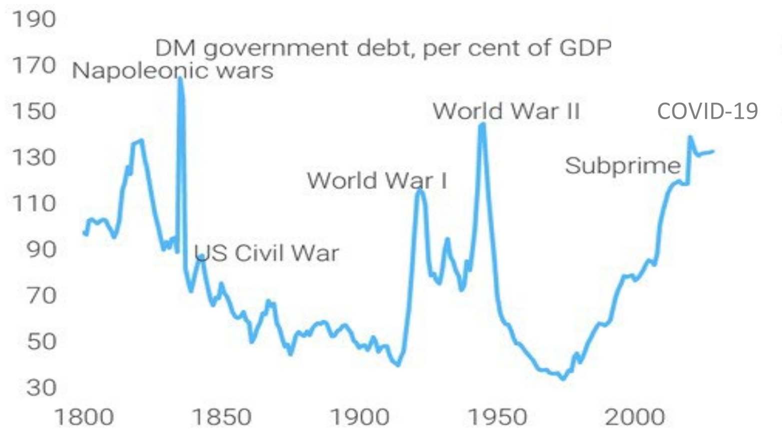


In addition to abnormally low interest rates during Covid, the US Federal Reserve and other central banks pumped an enormous amount of liquidity into the system. The graph below shows how significant the increase was but also shows it's starting to turn the other way, and quite significantly.



The enormous build up in liquidity was supported by rapidly rising debt at the government level. As a percentage of GDP, debt across developed countries is similar to where it was in World War II and the Napoleonic Wars.

DM GOVERNMENT DEBT AS A PERCENT OF GDP



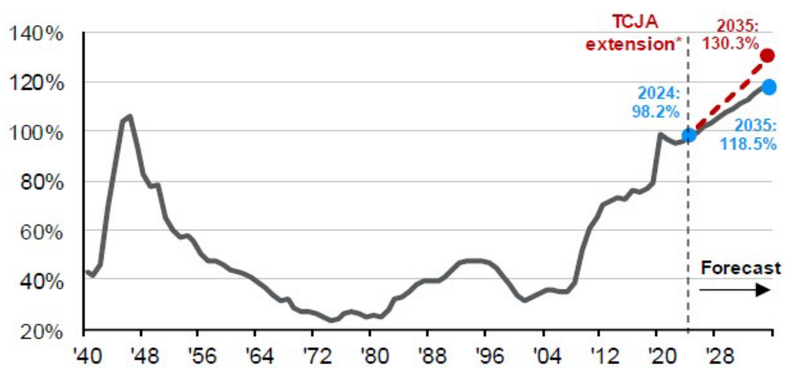
Source: MacroHistory, TS Lombard, Daily Shot

These debt levels are the result of massive deficit spending, which is unusual given the recent level of economic growth and low unemployment. While the new Trump administration is focused on ways to reduce debt in the US, you can see how high it's climbed relative to GDP, and where it's forecasted to go.

US FEDERAL NET DEBT

Percentage of GDP, CBO Baseline Forecast, End of Fiscal Year

1940-2034



Note: Estimates are from the Congressional Budget Office (CBO) January 2025 An Update to the Budget Outlook: 2025 to 2035. "Other" spending includes, but is not limited to, health insurance, subsidies, income security and federal civilian and military retirement. Years shown are fiscal years. *Adjusted by JPMAM to include estimates from the CBO March 2025 report "Projections of Deficits and Debt Under Alternative Scenarios for the Budget and Interest Rates" on the extension TCJA provisions. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated.

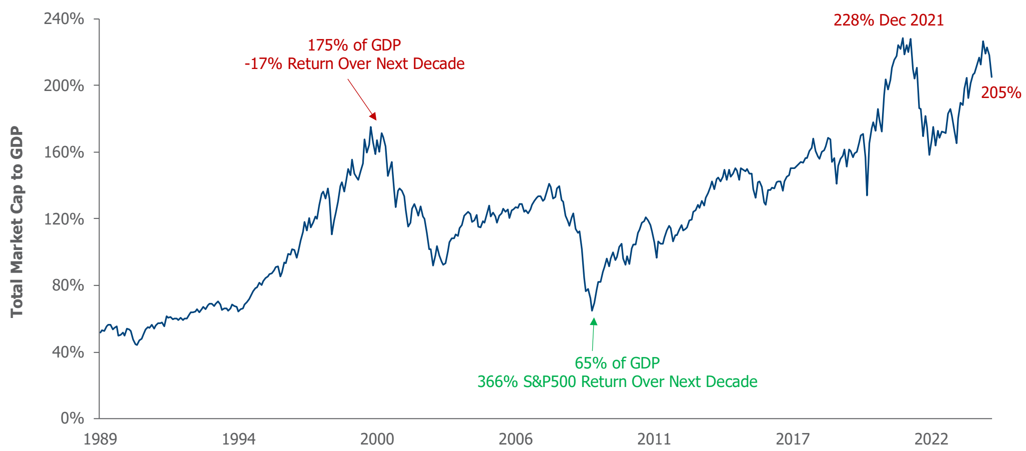
Guide to the Markets – U.S. Data are as of March 31, 2025.

Source: CBO, BEA, Treasury Department, J.P. Morgan Asset Management.

US equity market - at historically high valuations levels and extremely concentrated.

One way to look at the valuation of the US market is through the famous Warren Buffett valuation metric, which compares the value of the market to GDP. It's interesting that the individual this metric is named after is now carrying the largest cash position he's ever had in his portfolio. We've only been close to the current level once before, back in December 2021, and we're much higher than we were during the dot-com bubble in 2000.

THE BUFFETT VALUATION METRIC: TOTAL MARKET CAP TO GDP



Note: Data from 4-30-1989 to 3-31-2025.
Source: Kailash Capital Research, LLC

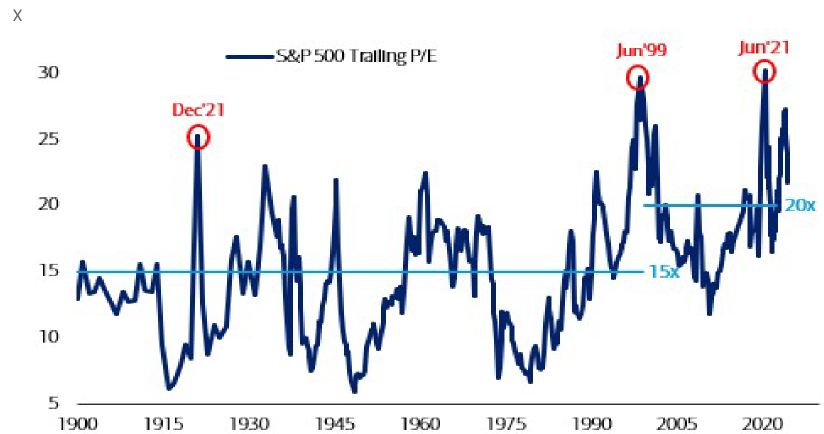
The US market looks similarly expensive when looking at it both on a price-to-sales basis, and on trailing price-to-earnings.

S&P 500 PRICE-TO-SALES INDEX

Data at: 3-31-2025
Source: Bloomberg, HPL

It's more conservative to look at trailing price-to-earnings ratios, as forecasts tend to be optimistic. On this basis, going back to the 1900s, there have only been three other periods higher than today. Those weren't necessarily good periods for the US stock market going forward.

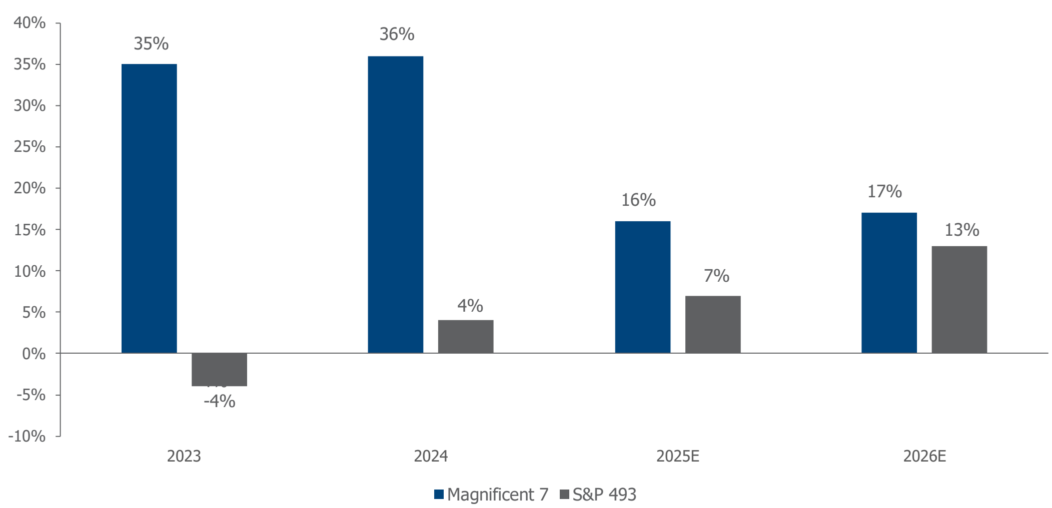
S&P 500 TRAILING PRICE-TO-EARNINGS
4th Highest S&P 500 Trailing Price-to-Earnings in 124 Years



Note: Trailing 4Q PE (GAAP until 1960, Pro-forma thereafter).
Source: BofA Global Investment Strategy, Bloomberg.

The Magnificent 7 (Mag-7), referring to seven dominant US tech companies – Apple, Microsoft, Amazon, Alphabet, Meta, Nvidia and Tesla – representing approximately 30% of the S&P 500, are partly to blame for the high valuation of the overall US market. While the Mag-7, to a certain extent, deserve premium valuations, as they have been growing earnings more than 30% over the past two years, it's striking to see that the other 493 companies in the index experienced overall earnings declines in 2023 and grew earnings just 4% in 2024. This fits with recent comments by Treasury Secretary Scott Bessent that the private economy, excluding the government, looks to be in a recession.

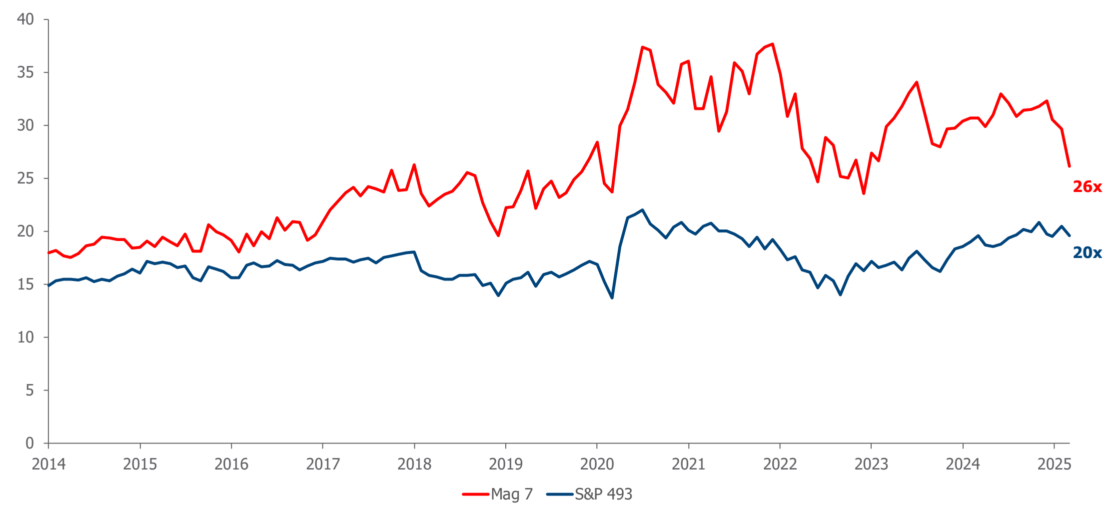
MAGNIFICENT 7 & S&P 493
Annual Earnings Growth



Source: Goldman Sachs

With the 493 non-Mag-7 companies experiencing effectively flat earnings over the last two years and forward earnings increasingly at risk with tariffs, reduced government spending and increased uncertainty, it begs the question of why you should be paying 20 times earnings for these 493 companies.

MAGNIFICENT 7 & S&P 493
Forward Price-to-Earnings



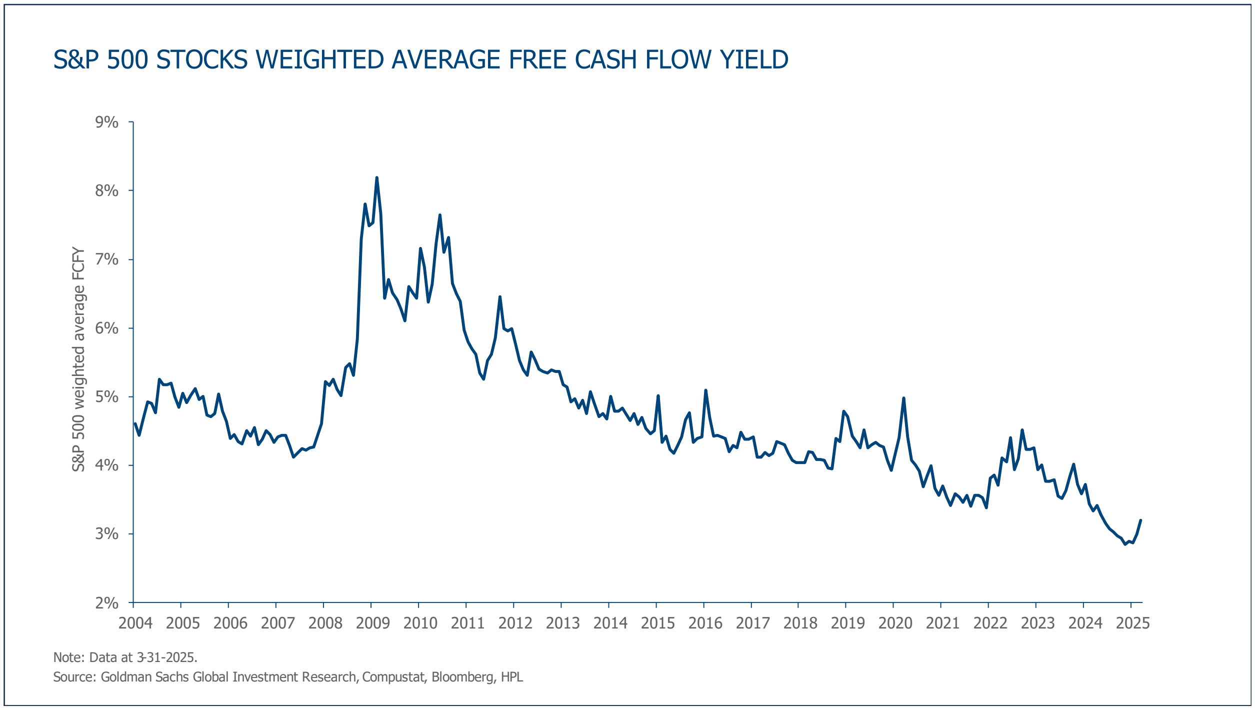
Note: Data at 3-31-2025.
Source: Goldman Sachs

If you look at the US market relative to 10-year average earnings (CAPE) and compare it to historical growth back to the 1800s, the US market is in rarified territory in terms of valuations.

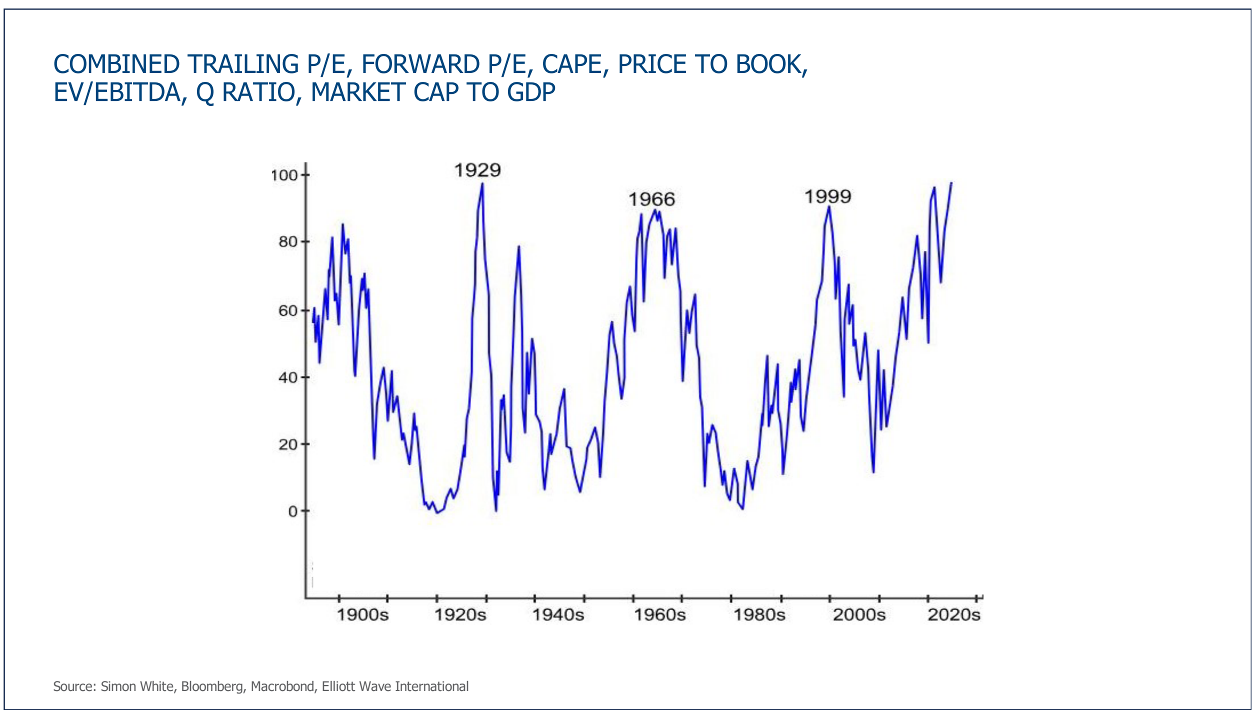
S&P 500 SHILLER CAPE RATIO

Note: Cyclically adjusted price-to-earnings (CAPE) ratio is a valuation metric that compares a stock price to the average earnigs over the past 10 years. Data at 4-1-2025.
Source: gurufocus.com

Average free cash flow yields for the S&P 500 are also in decline, and now at one of the lowest levels in many years.



If you add up different valuation criteria, as shown below, we're now at the highest point ever in US stock market history. This is for a market that represents 63% of the MSCI ACWI. We find it incredibly risky to have even 40-50% of a global equity portfolio in a market that you know is expensive just because it represents 63% of an index.



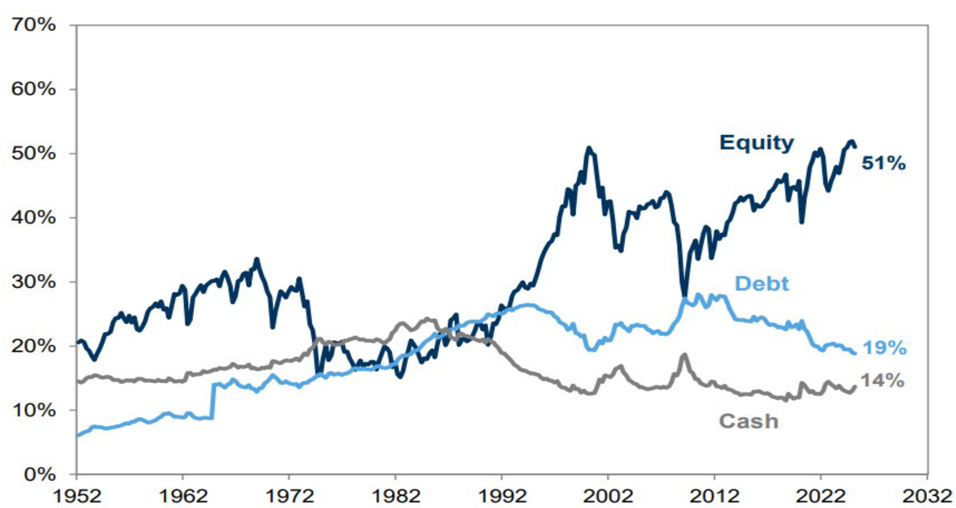
A similar situation occurred in Japan in the late 1980s. At its peak, Japan represented around 40% of the MSCI EAFE index. As seen below, it can take a long time to earn your money back after a bubble bursts.

NIKKEI 225 INDEX

Note: Data at 3-31-2025.
Source: Bloomberg, HPL

If you look at asset allocation across households, mutual funds, pension funds and foreign investors, you can see that people are all in, in terms of their exposure to US equities.

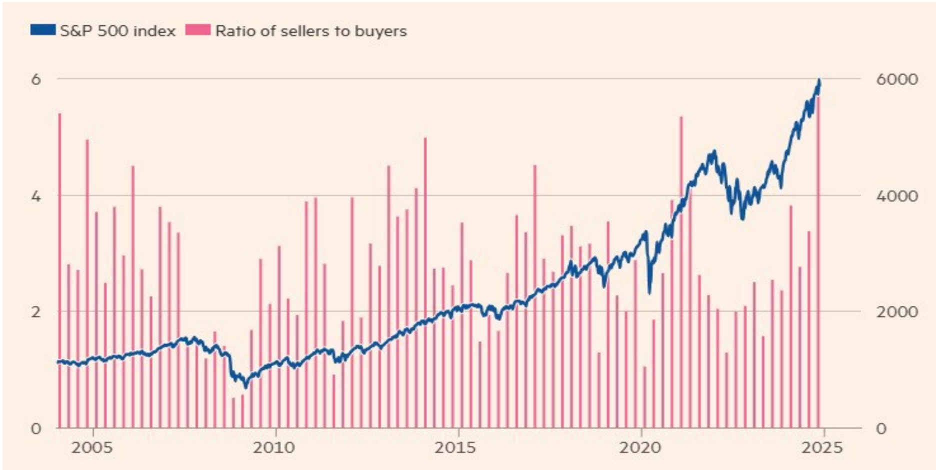
AGGREGATE FINANCIAL ASSET ALLOCATION ACROSS HOUSEHOLDS, MUTUAL FUNDS, PENSION FUNDS, AND FOREIGN INVESTORS



Source: Goldman Sachs Global Investment Research, EPFR. Data at 328-2025.

While these investors are holding historically high equity exposure, corporate insiders are selling.

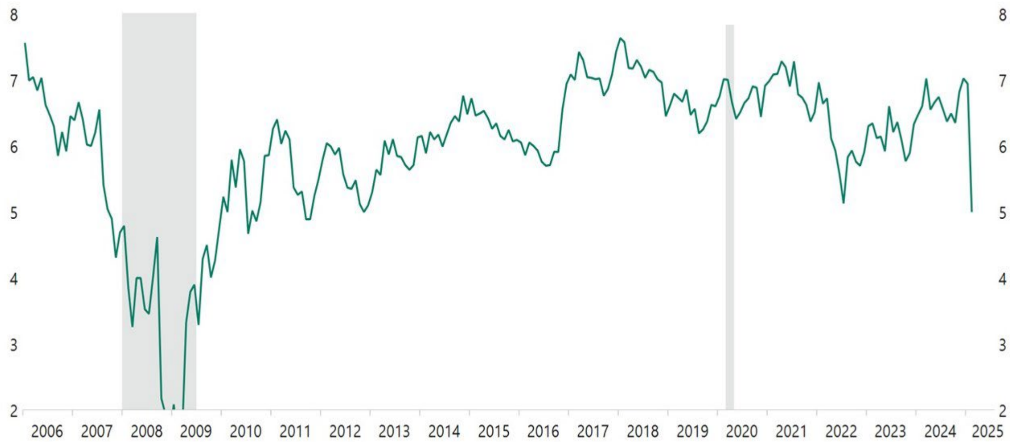
CORPORATE EXECUTIVE STOCK SALES REACH ALL-TIME HIGH



Source: VerityData, LSEG via markets.ft.com

CEO confidence in the economy has declined in recent months, and they are voting on valuations by selling.

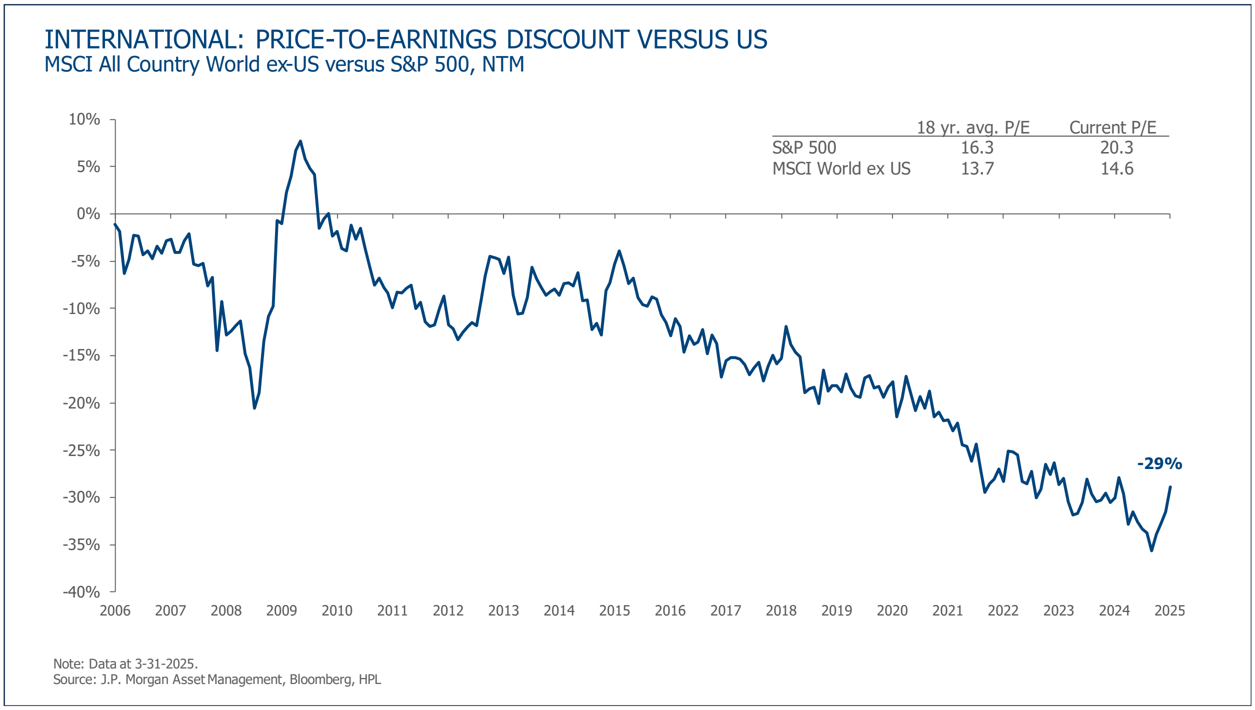
CEO CONFIDENCE INDEX
Confidence in the Economy 1 Year from Now



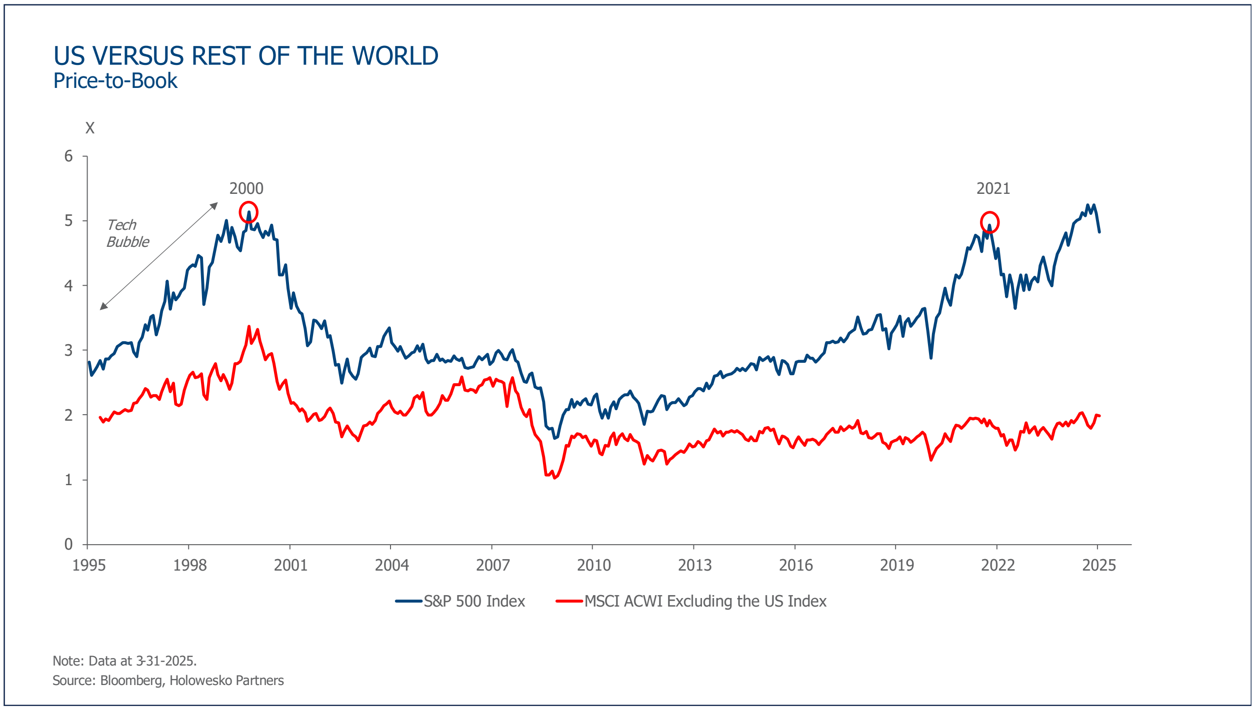
Source: Chief Executive Magazine, Bloomberg, Macrobond, Apollo Chief Economist

Non-US equity markets - at a substantial discount to the US

While US valuations are high, international markets sell at a 29% discount to the US on a price-to-earnings basis.

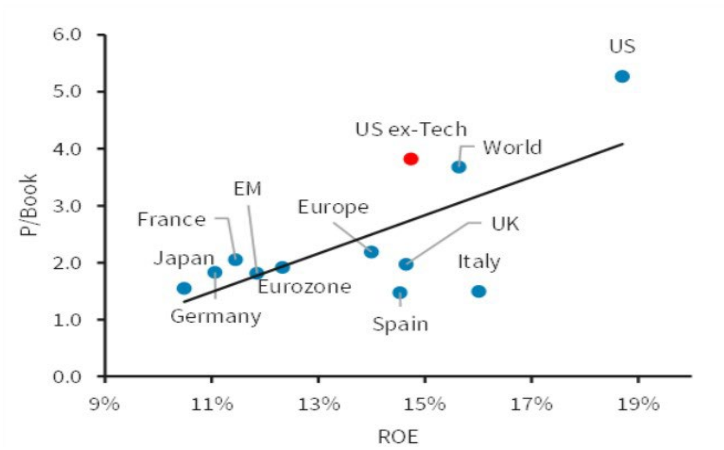


It's a similar picture on a price-to-book basis. While the spread between the multiple in the US and ex-US blew out during the dot-com bubble, today that spread is even wider. Although the US is growing much faster than the rest of the world, American exceptionalism is starting to be questioned.



If you look at price-to-book relative to returns on equity and exclude technology companies, the UK is half the valuation of the US, but it's just as profitable. Europe is similar. Compared with non-US technology businesses, most overseas companies are much cheaper, with similar levels of profitability, better free cash flow yields, higher dividend yields and, in most cases, much better balance sheets.

REGIONAL RETURN ON EQUITY VERSUS PRICE-TO-BOOK

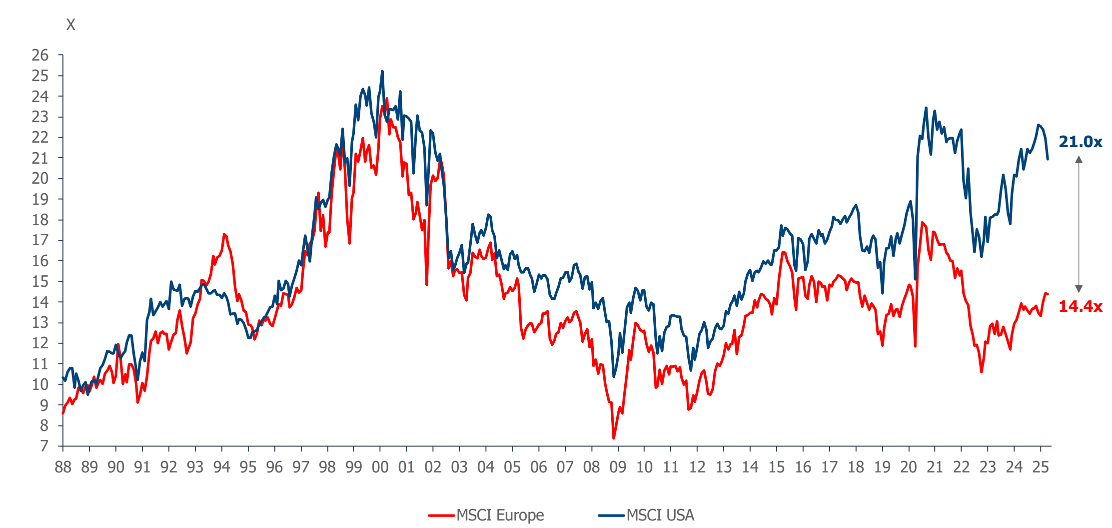


Source: IBES, LSEG Data & Analytics, Barclays Research. Data as at 331-2025.

The spread in valuations of European equities compared to US equities is at the widest it's ever been on a forward price-to-earnings basis.

EUROPE IS NOW TRADING CLOSE TO A RECORD 30% DISCOUNT TO THE US

12-Month Forward Price-to-Earnings

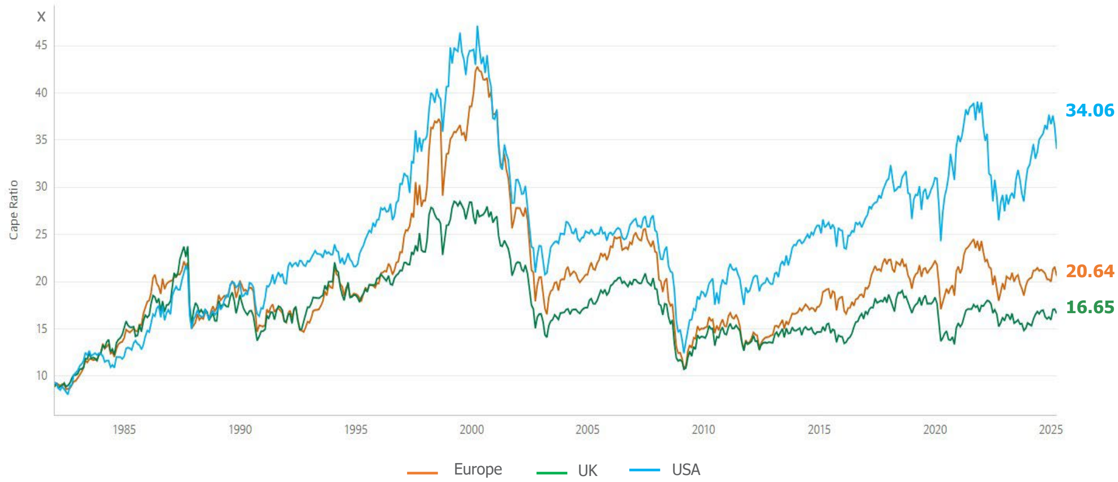


Note: Data at 3-31-2025

Source: Datastream, Kepler Cheuvreux

If you compare the price you're paying relative to 10 years' worth of average earnings (CAPE ratio), you see a similar pattern. During the dot-com bubble, Europe and the US were close to the same valuation levels relative to 10 years' worth of average earnings. That's no longer the case today. Most notably, the UK looks incredibly cheap relative to both Europe and the US, and also compared to its own history.

EUROPE EQUITY VALUATION
Cyclically Adjusted Price-to-Earnings Ratio



Note: Data at 3-31-2025.
Source: Barclays.
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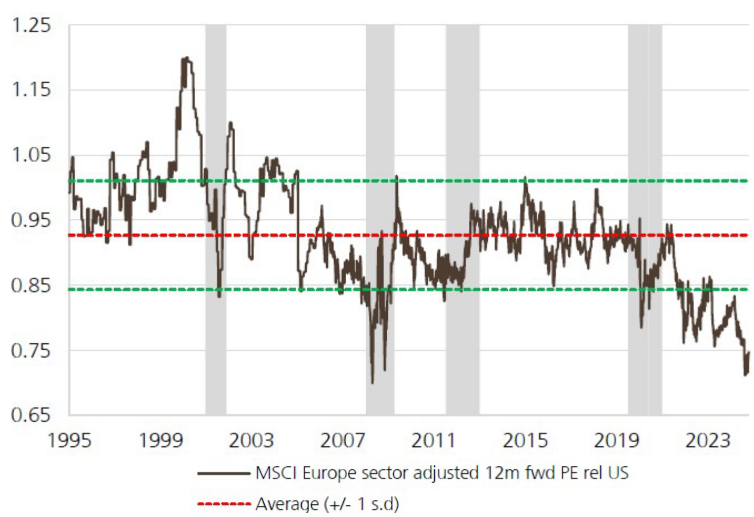
EUROPE
MSCI Europe Sector Adjusted Forward Price-to-Earnings Relative US

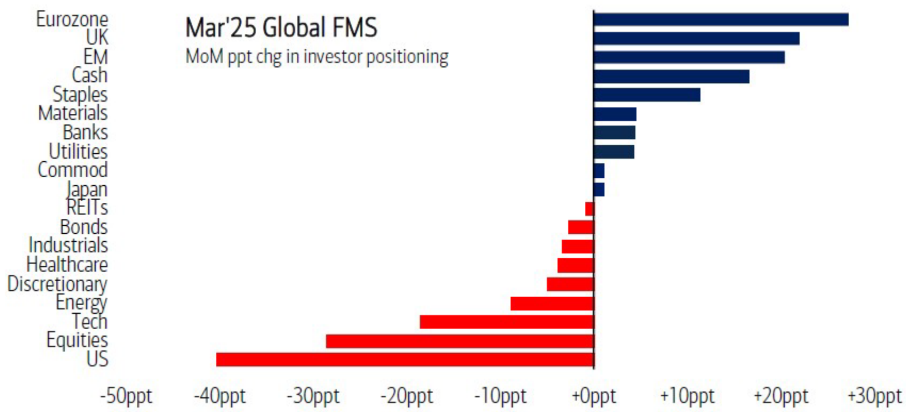


Source: Refinitiv Datastream, UBS

Europe appears to be having a resurgence with both stock performance and investor interest in European equities on the rise. Fund flows in Europe have turned positive for the first time in many years and the America First policy seems to have awakened Europe to the realization that they cannot rely on the US to defend them going forward, setting off a wave of spending. After 15 years of austerity, Germany has amended its debt cap to allow greater defense spending with an additional €500bn infrastructure fund (12% of German GDP). This adds on to the EU's ReArm plan, which entails €800bn of defense spending. Increased fiscal expenditure across Europe could have significant impacts on earnings and valuations of European companies, potentially marking a change after many years of US equity markets outperforming their European counterparts.

MARCH FMS SHOWS BIGGEST DROP IN US EQUITY ALLOCATION ON RECORD

Monthly Change in FMS Investor Positioning



Source: BofA Global Fund Manager Survey

It's interesting to note that despite all the issues Europe has faced (Ukraine war, high power prices, low PMIs and now tariffs), and the lack of a domestic growth story (notably few tech companies), big-cap EU companies have actually kept pace with the S&P 493 (ex-Mag 7). Now with Germany's fiscal package, which is equivalent to the Marshall Plan and Reunification spend combined, the structural investment case for Europe has materially changed. Add this to potentially lower gas prices from a ceasefire, and lower base rates transmitted through a bank lending driven economy, and for the first time since the GFC we have the set up for a domestic driven earnings story in Europe.

Tariff Uncertainty

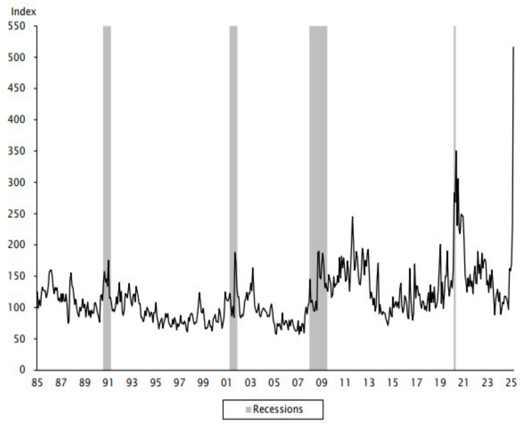
The outlook for stocks remains uncertain with President Trump's tariffs hanging over the global economy and dampening business and consumer sentiment.

With US monetary policy still restrictive, demand should slow with additional tariffs. Consumers will likely balk at higher prices, at a time when consumer sentiment is already decreasing. The sudden drop in immigration and a lack of incremental fiscal spending were already showing up in the data before tariffs were announced. US consumer confidence fell in March to the lowest level in four years on concerns of higher prices and fears around the economic outlook amid escalating tariffs.

US

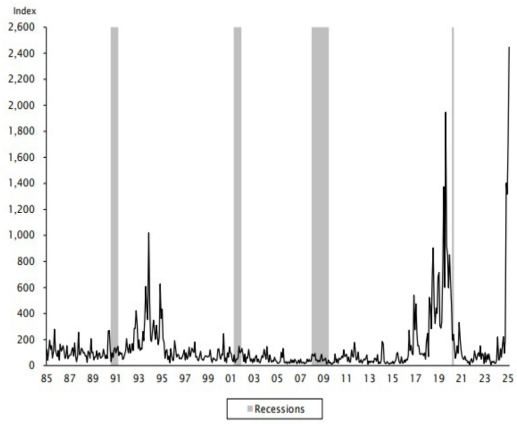
Economic Policy Uncertainty Index

1985 Through March 2025E



Trade Policy Uncertainty Index

1985 Through February 2025



Note: The March 2025 estimate is based on the daily economic policy uncertainty series.

Source: PolicyUncertainty.com; National Bureau of Economic Research

At the time of writing this report, the Trump Administration introduced both a baseline tariff of 10% and reciprocal tariffs on certain countries' goods entering the US. Higher reciprocal tariff rates were based on a rough estimation of each country's trade deficit. The introduction of tariffs was well-telegraphed, but the magnitude was unexpected.

Exemptions so far include steel/aluminum articles and auto/auto parts already subject to section 232 tariffs, as well as copper, semiconductors, lumber articles, bullion, energy and other materials not available in the US.

For Canada and Mexico, USMCA compliant goods have a 0% reciprocal tariff, non-USMCA compliant goods will be at 25%, with non-USMCA compliant energy and potash at 10%. Baseline tariffs started April 5th and reciprocal tariffs on April 9th.

Treasury Secretary Scott Bessent has described Trump's use of tariffs falling into three buckets – a tool to gain leverage in negotiations, a revenue generating measure to offset the cost of extending the 2017 tax cuts, and as a way to re-balance trade in the US's favor. The US is shifting towards fiscal austerity and trade wars at a time of peak market valuations. Reductions in government jobs and lower consumer benefits could essentially act as a tax on many households, impacting those in lower and middle income brackets who rely on these forms of support. Over the past 12 months, hiring by the government has contributed ~20% to non-farm payrolls. This number rises to ~70% if you include education and healthcare jobs, according to Exane. US consumers receive benefits roughly worth 18.3% of annual income. A reduction to even pre-Covid norms is akin to a tax hike. Increased uncertainty is starting to see consumers pullback on spending via increasing savings rates. Nearly 50% of consumer spending is carried out by the top 10% of wage earners, so decreases in equity prices will be impactful.

These tariffs add to the downside risk for companies globally both in terms of profitability but also market valuations. In the US, consumer and corporate confidence have deteriorated sharply and the equity market value declined by $6 trillion. Hardest hit are obviously foreign companies selling into the US, but also American companies that produce large quantities of products overseas, including those in the electronics, furniture, and apparel sectors.

Uncertainty has an almost self-fulfilling impact on the economy with a sharp reversal in US corporate CAPEX spending plans in recent weeks, as well as slowing loan issuance. This also tends to impact IPO and M&A activity. Many economists estimate that a 25% tariff would reduce US GDP by 1-1.5% with a similar estimated increase in inflation.

JP Morgan has raised their estimates of the odds of a recession to 60% with their chief economist noting that that this year's tariff increases amounts to the largest tax hike since 1968 with the effect likely to be magnified through retaliation, a slide in business sentiment and supply chain disruptions. The IMF estimates that a 20% tariff hike as well as retaliation from China and Europe could reduce US GDP by 2 percentage points and global GDP by 1 point.

Historically the average earnings revision during a recession is -20% but was as high as -45% during the GFC.

While legal and political challenges are initiated, there will be signs of both escalation, de-escalation and retaliation. Already we have seen tariffs on US goods being removed, retaliation by China, and a willingness by some countries hit hard by tariffs (Vietnam) to negotiate.

This action is a major turning point for global trade, as well as geopolitics. Americans have become tired of uneven tariffs and non-tariff restrictions on US goods. The list is long, but examples include restrictions on American beef in Europe and Australia, large tariffs on American dairy products, massive tariffs on American rice in Asia (over 700% in some countries) and uneven rates on cars entering Europe. Combined with outsourcing, the Trump Administration would argue that these tariffs on US goods have hollowed out America's manufacturing base and put a large dent in the wealth of the US middle and lower wage earners.

Because of the size of some of the reciprocal tariffs and the disruption caused, it is hard to believe the tariffs will stay in their current form for very long. This initial "shot across the bow" will most likely be used to negotiate down the reciprocal tariffs, with the baseline of 10% is more likely to remain. It would be surprising to see most reciprocal tariffs in place at these levels by year-end.

The impact of past tariffs has normally been absorbed by a devaluation in a country's currency, a decline in corporate profits, and an increase in prices to consumers. Although it will vary by goods and country, it is possible/probable this will be felt equally among these three types of historical adjustments.

In our view, the Trump administration is focused on changing the world order for trade and manufacturing and is willing to suffer the short-term consequences for longer-term gains. The large decline in the equity market will certainly have an impact on spending, especially for high priced goods and travel. For Americans in the bottom half of the wealth and income range, the Administration's view is that higher pricing on some goods will be more than offset by lowering interest rates (lower mortgages and credit card payments), lowering energy prices (lower gasoline and energy/electricity prices) lowering food costs and growing employment and wages by bringing manufacturing slowly back to the US. This last item will take time and is quite difficult in certain industries. American auto workers, for example, earn roughly $26/hr compared to less than $3/hr in Mexico. In Vietnam, it's possible to manufacture an athletic shoe for roughly $10/pair that can be sold in the US for 5-10 times that amount. There are also long and cheap supply chains for raw materials in many foreign countries that do not exist in the US, which will either take time or be impossible to replicate. Eventually robotics replacing cheap labor will even out the playing field for some sectors.

We are constantly evaluating the downside risk in all our investments. We are also looking to take advantage of declines in equity valuations in this period that appear overdone relative to the impact on underlying company profitability. Our view is to look out 6-18 months when most of these reciprocal tariffs will be negotiated to lower levels, although in the interim period we factor in declines in GDP and profitability. In some cases, the potential impact of tariffs has already been factored into equity prices. In many cases it has not, and the overall downside risk in the US equity market is still apparent. We are also using options to take advantage of higher volatility to earn income on positions we are happy to add to at lower prices.

We are working tirelessly to maintain our historical record of doing well through downdrafts in equity markets and are confident in our work and current investments in the portfolio.

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