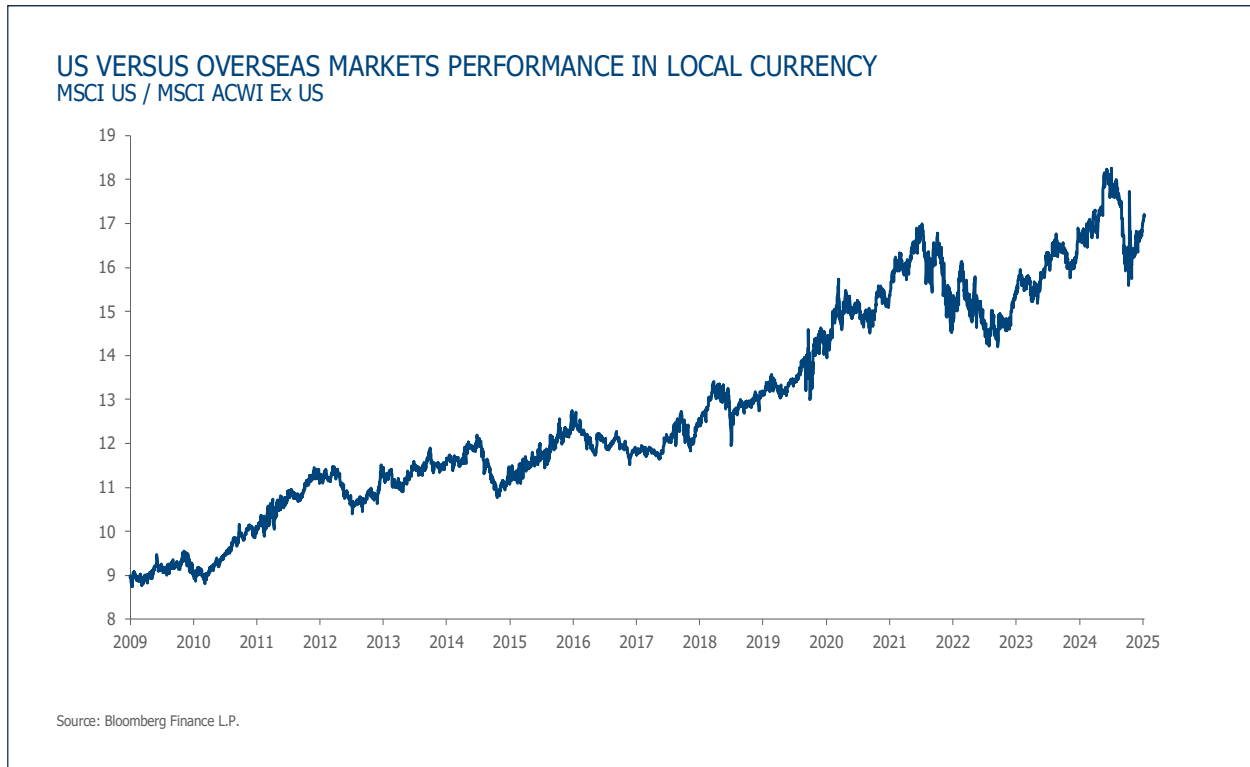


## Holowesko Partners Ltd.

### June 2025

From a peak at the end of 2024, the US market underperformed non-US markets by 15% in local currency terms through April, the largest relative underperformance in the past 15 years outside the 16% relative decline in 2022.



Unlike in 2022, however, when the US dollar rallied, the current period has been accompanied by the weakest YTD performance of the dollar in 30 years. That's meant that in USD terms, the underperformance of the US versus overseas equities at its April low amounted to 18%, the largest relative underperformance since the GFC.

## US VERSUS OVERSEAS MARKETS PERFORMANCE IN US DOLLARS

### MSCI US / MSCI ACWI Ex US



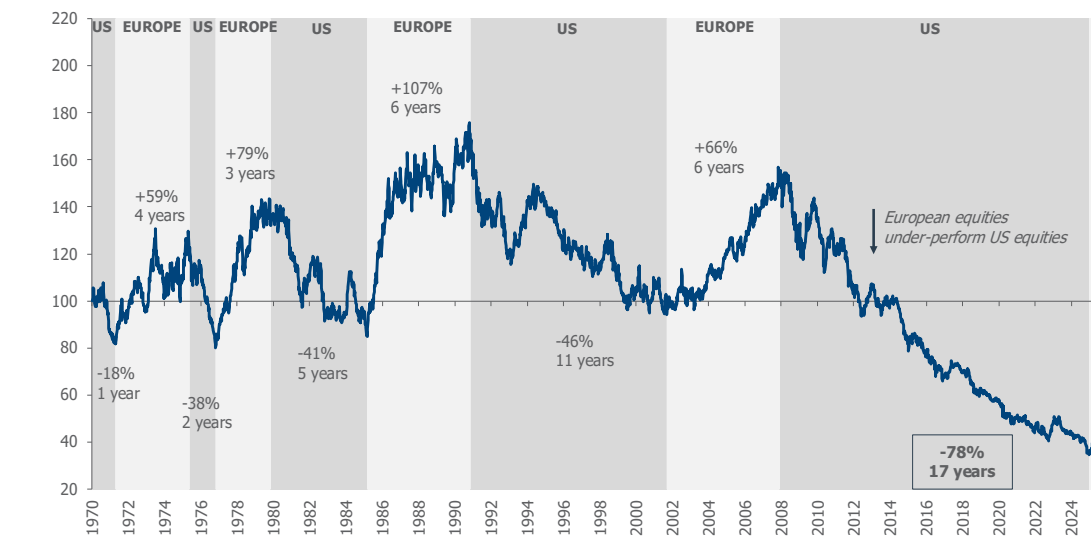
Source: Bloomberg Finance L.P.

Despite the dramatic recovery in US equities from their April bottom, the dollar has continued to weaken and foreign stocks have outperformed year-to-date. Might global investors adoration of US assets forsaking all others finally be waning?

It's worth recounting the depth of this love affair. The recent outperformance barely registers in the context of US market dominance since the global financial crisis. The chart below showing the US versus Europe demonstrates just how dramatic this outperformance has been. In both duration and magnitude, the US has outpaced even the extraordinary run in the 1990s that culminated in the dot-com bubble.

## US VERSUS EUROPE

### MSCI US versus MSCI EU

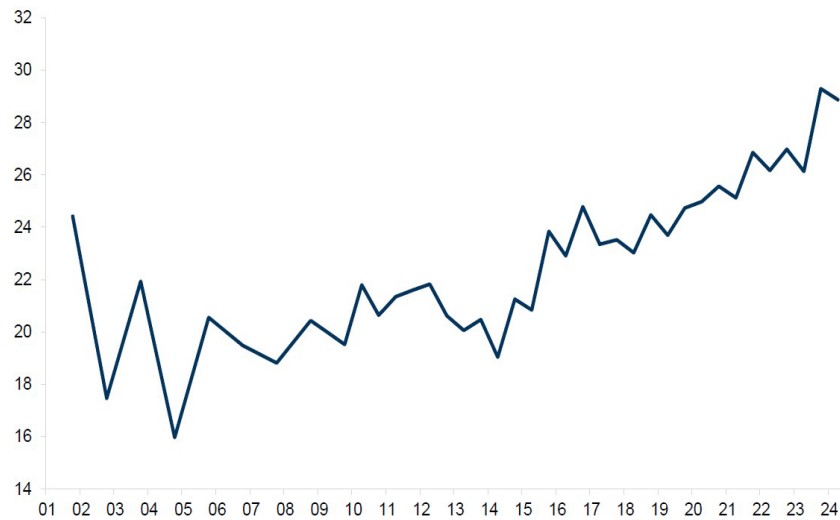


Source: Kepler Cheuvreux

Non-US investors have a far bigger commitment to US assets today than back then. They now own nearly a fifth of the US equity market, the most ever.

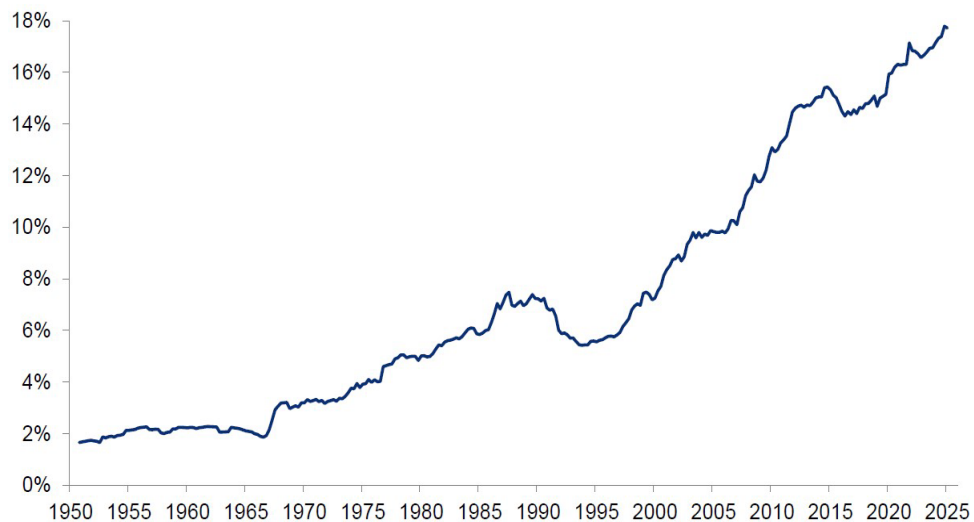
### CROSS BORDER INVESTMENTS IN US ASSETS

Debt + Equity, as a Percentage of the Global Portfolio



Note: Includes equity and investment fund shares, and total debt securities (long-term plus short-term debt securities).  
Source: International Monetary Fund, Haver Analytics, Goldman Sachs Global Investment Research

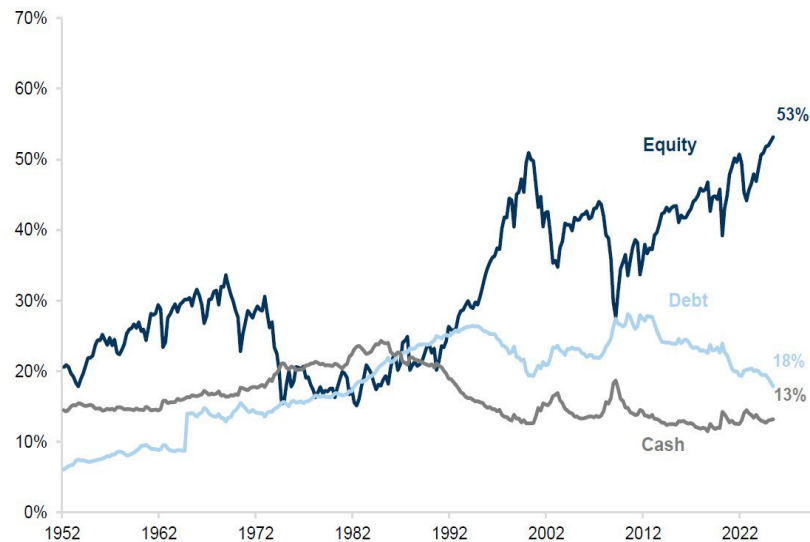
### US CORPORATE EQUITIES HELD BY FOREIGN INVESTORS



Source: FRB, Haver Analytics, Deutsche Bank

US investors are equally enamored with domestic stocks. The portion of assets invested in equities by American households is the highest on record.

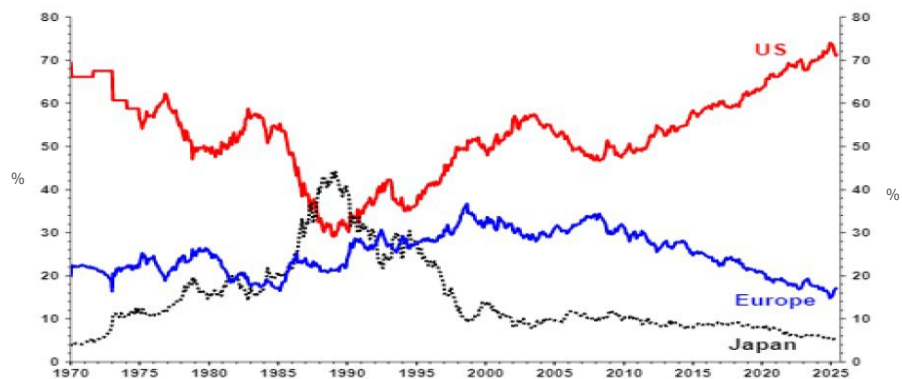
#### AGGREGATE FINANCIAL ASSET ALLOCATION ACROSS US HOUSEHOLDS, MUTUAL FUNDS, PENSION FUNDS, AND FOREIGN INVESTORS



Source: EPFR, Goldman Sachs Global Investment Research

Never has there been more concentration in a single stock market than there is today.

#### MSCI WORLD INDEX Regional Weightings



Source: Datastream, Societe Generale

Within the US market, never have investors been so concentrated in just a handful of companies.

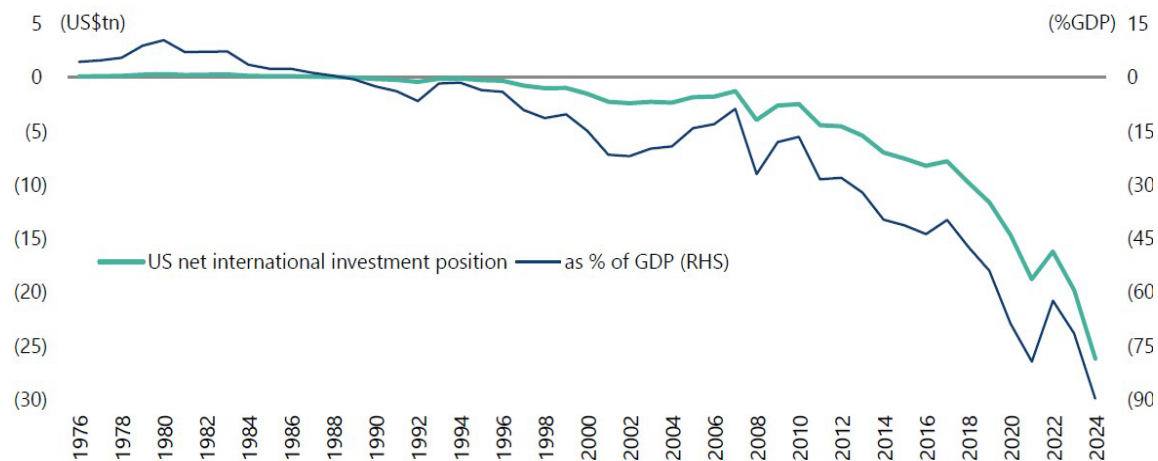
### 10 LARGEST COMPANIES AS A SHARE OF S&P 500



Source: FactSet, Goldman Sachs Global Investment Research

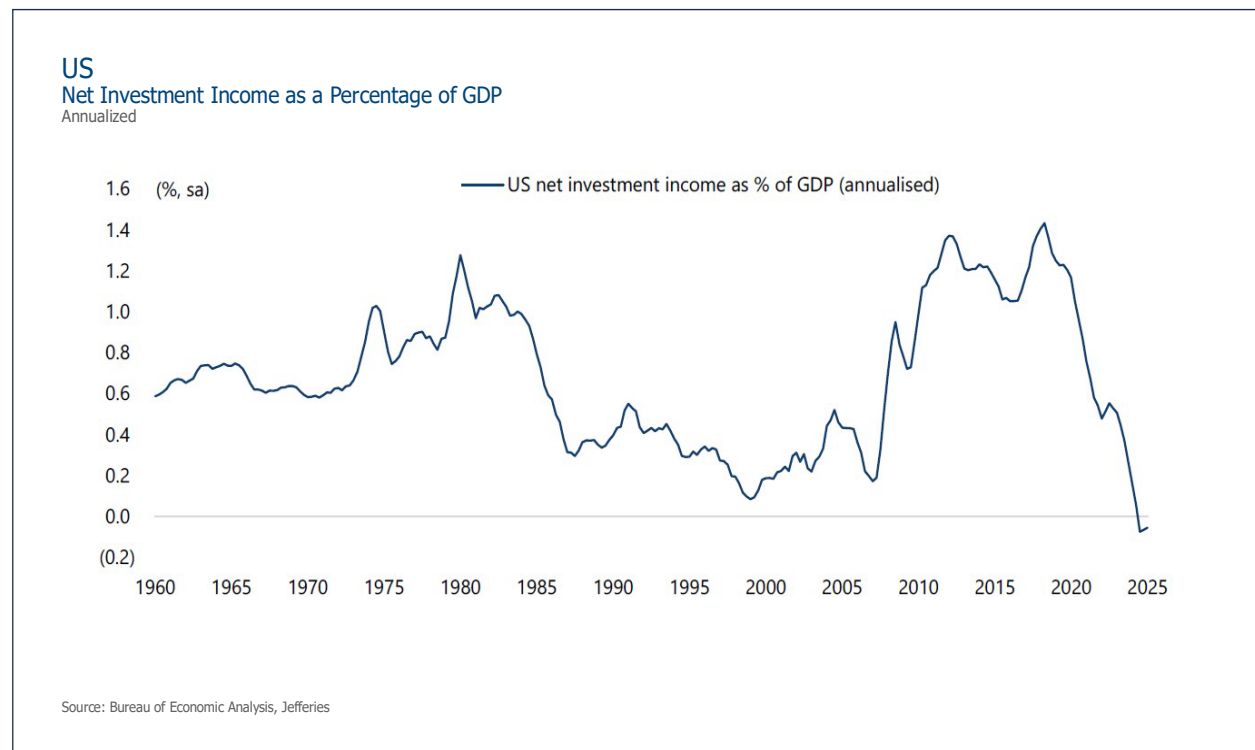
The net international investment position of the US shown below reflects the degree to which investment by foreigners in America exceeds American investment abroad. It gives a sense of how much overseas capital has now accumulated in the US. Note how dramatically the deficit increase has been since the GFC.

### US Net International Investment Position

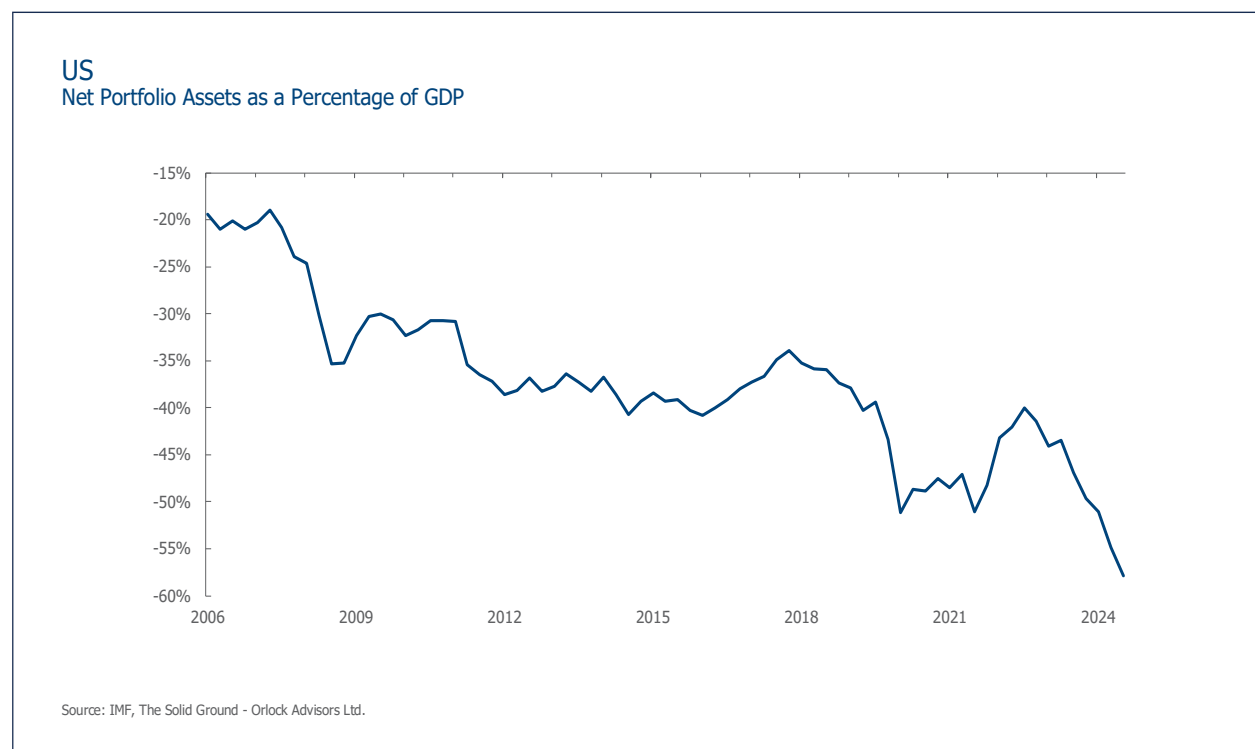


Source: Bureau of Economic Analysis, Jefferies

Even though much smaller in size, America's overseas assets historically generated higher returns than foreigner holdings in the US. As Jefferies note, that too has shifted into a deficit position for the first time on record.



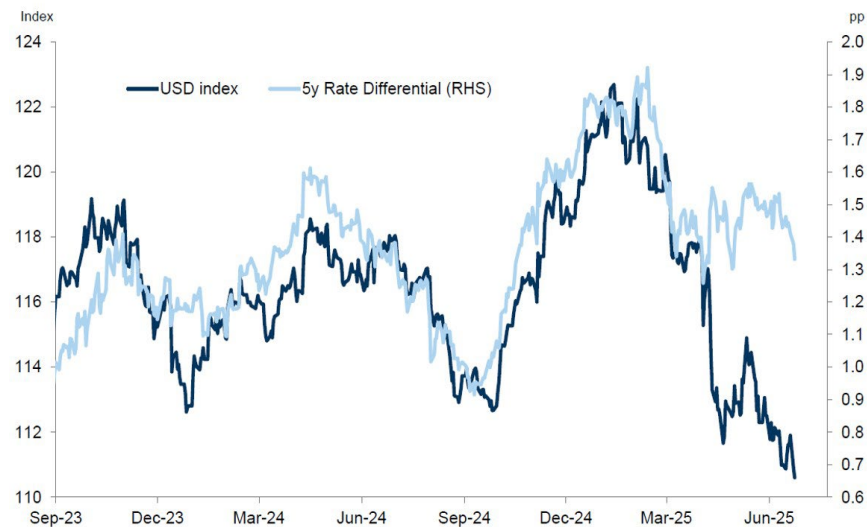
Foreigners now own \$62tn worth of US assets equal to over 200% of GDP, just over half of which is highly liquid portfolio investment that can easily be shifted elsewhere. US asset prices depend not only on retaining this investment, but adding \$2tn more each year to offset America's current account deficit and capital outflow. Financial historian Russell Napier notes that America is the most reliant on foreign portfolio capital since at least 1914.



So what might now be causing this seemingly unflappable conviction in US equities over all others to teeter? The outflow from the US dollar this year even in the face of supportive interest rate differentials is an indication something has changed.

## US DOLLAR VERSUS RATE DIFFERENTIALS

USD Index and Weighted Average of USD versus the Majors 5 Year Rate

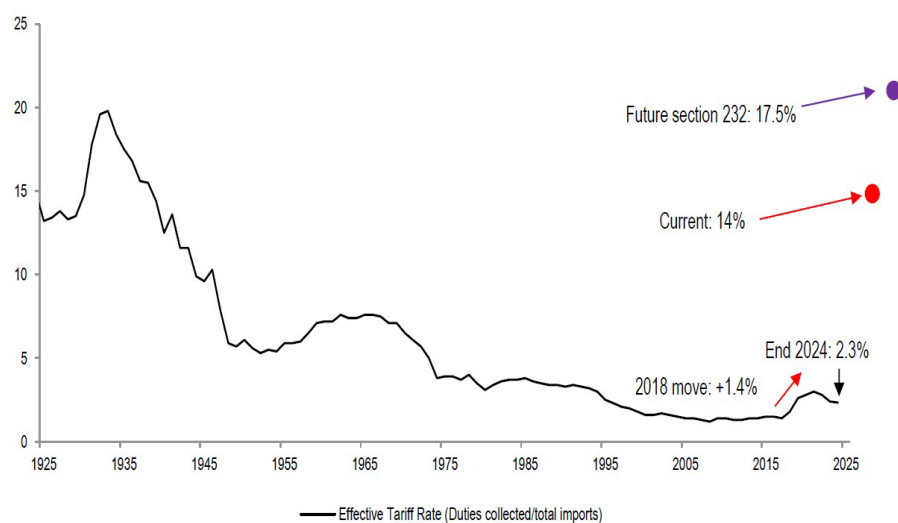


Source: Bloomberg, Goldman Sachs Investment Research

The proximate cause of this dislocation was "Liberation Day" and the introduction of across-the-board tariffs at the beginning of April. While the more punitive levels were deferred, the 7pp increase implemented to date leaves the current effective overall tariff rate near 14%, the highest since the 1930s. This could well move higher depending on the progress toward trade deals ahead of the new August 1<sup>st</sup> deadline.

## US

Effective Tariff Rate Over the Last 100 Years



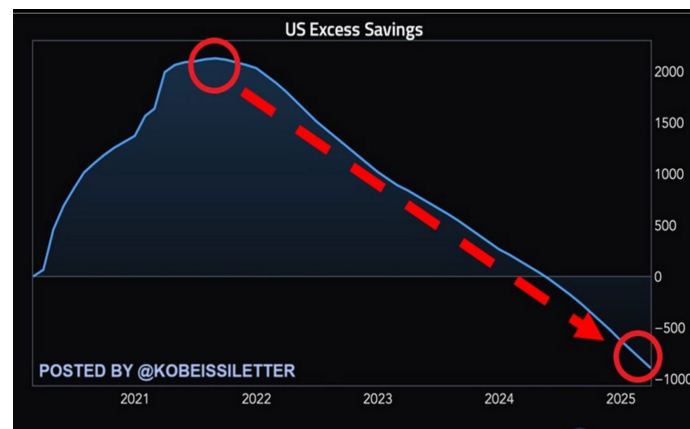
Source: JPMorgan Economics Research

In addition to trade fears, foreign investors faced the specter of punitive measures targeting their US financial investments. One proposal was Section 899 of the One Big Beautiful Bill Act, the so called "revenge tax." This would have empowered the Treasury to identify countries imposing "unfair" taxes on US businesses and penalize them with additional taxes on US generated income including dividends, interest and subsidiary profits. Another idea floated was a Mar-a-Lago Accord whereby foreign treasury bond holdings would be swapped into longer dated zero coupon bonds possibly in exchange for US defense guarantees. While neither proposal has been implemented, just the threat of a less welcoming environment for overseas investment has led foreigners to question the level of concentration they have in US assets.

Overseas governments have been reacting to this threat for some time now, following the weaponization of the dollar after the invasion of Ukraine in 2022 which led to the US freezing Russia's foreign exchange reserves. This unprecedented step prompted central banks globally to shift out of US bonds and into gold, increasing their bullion purchases five-fold and setting off a 75% rise in the gold price. Now they see the US using tariffs not only to improve its trade position, but also to achieve political aims. India has been threatened with an additional 10% tariff if it continues to join with BRIC countries in pursuing an alternative to the dollar. Spain was threatened with higher duties for not increasing its defense spending enough. Brazil now faces a 50% tariff tied to the US administration's dissatisfaction over the treatment of former President Bolsonaro who is currently on trial. "The weapon of US economic power is being wielded more aggressively perhaps than any other time in peacetime," according to Napier. The risk to foreign investment of being caught on the wrong side of these policy shifts has rarely been higher.

One explicit aim of raising tariff barriers is to bring manufacturing back to America. Doing so will likely come at a cost to consumers. Half of tariff increases are typically absorbed by the end purchaser, according to the Fed. Thus far there have been only small signs of any inflationary impact. Companies are working down pre-tariff inventories (typically 1-2 months' worth) and awaiting greater clarity before adjusting prices, meaning hikes will likely show up in the coming quarter. Higher prices from tariffs puts more pressure on households who have already begun to retrench. Consumer spending in 1Q 2025 rose just 0.5%, the weakest since 2Q 2020 in the midst of Covid, with buying slowing further in April and declining in May. This weakness is not surprising given excess savings post-Covid have disappeared and higher financing costs are eating into the average household's income.

## US Excess Savings

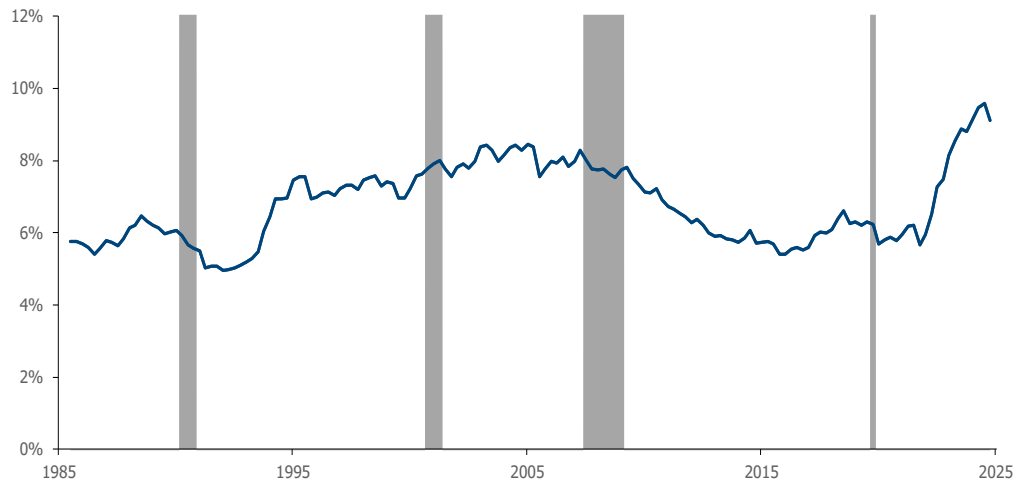


Source: The Kobeissi Letter



## US HOUSEHOLD FINANCING COSTS

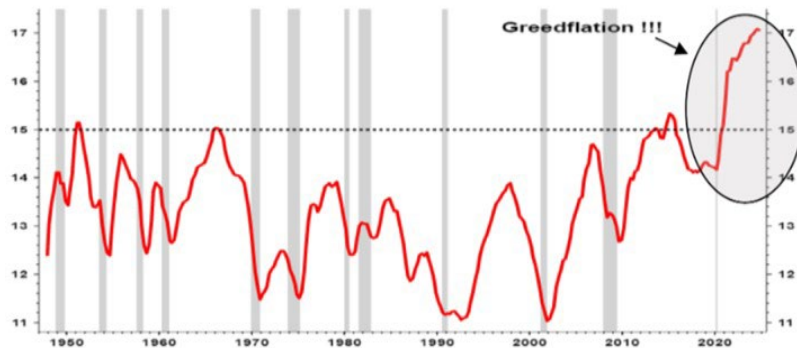
Credit Card and Auto Loan Interest as a Percentage of Disposable Income



Source: Federal Reserve, Bloomberg as of 12/31/24, Strategas

Lower spending impacts US corporate profit growth, as does higher input costs. The question is to what degree business will choose to absorb the hit themselves versus passing along higher costs to consumers via higher prices. The Fed estimate importers may take as much as 40% of the hit to margins. US corporate margins are already near all-time highs which many attribute to managements taking advantage of the post-Covid largess to hike prices well ahead of costs. Raising prices further to compensate for tariffs may draw the ire of the administration with President Trump already criticizing Walmart for suggesting it would do just that.

## US Profit Margins



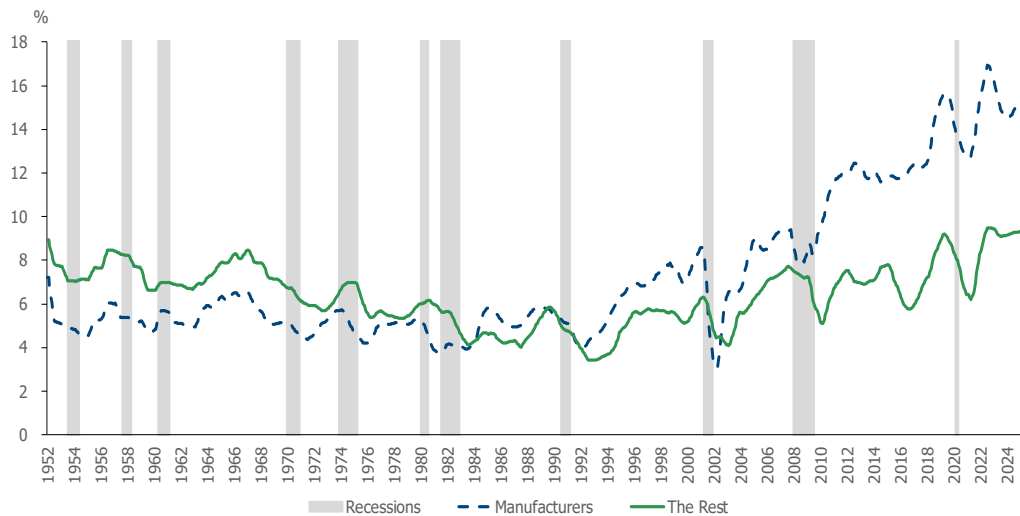
Source: Societe General, Datastream

Beyond the near-term impact of tariffs, there is the broader implication of a retrenchment away from globalization that has benefited US companies since 2000. The chart below from Empirical shows how much manufacturing margins have expanded over that period and how significant the contribution has been from globalization.

## S&P 500 MANUFACTURERS AND ALL OTHERS

### Net Profit Margins\*

1952 Through Early April 2025

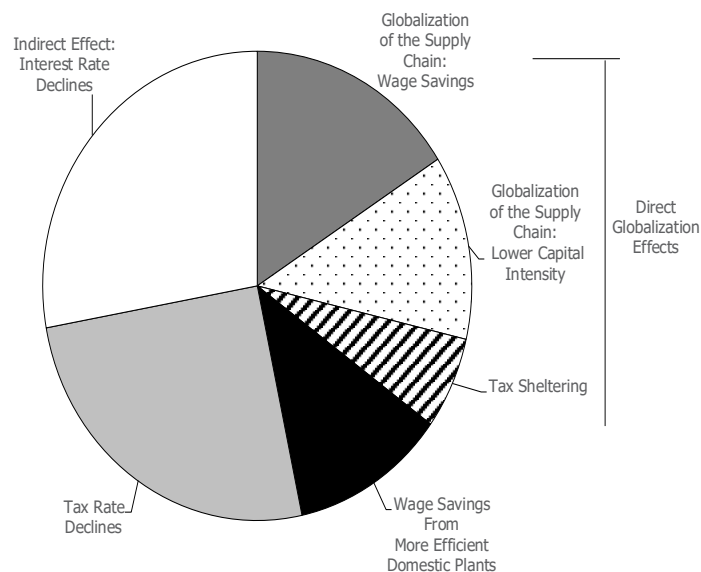


Note: \*Excludes financials, REITs and utilities; based on trailing-four quarter aggregate data smoothed on a trailing six-month basis. Prior to 1977, the large-cap stock universe is used.  
Source: National Bureau of Economic Research, Corporate Reports, Empirical Research Partners Analysis and Estimates.

## S&P 500 MANUFACTURERS

### Margin Expansion Dynamics

2024 Versus 2000



Source: U.S. Census Bureau, U.S. Bureau of Labor Statistics, Corporate Reports, Empirical Research Partners Analysis and Estimates.

According to Societe Generale, cost of goods sold (COGS) relative to sales for S&P companies (ex. Financials) has dropped 700bps over this period. Virtually all of the margin gain occurred in the technology sector. S&P 500 operating margins ex-technology increased marginally from 11.4% to 12.6% in the 20 years following 2004, according to Bloomberg Intelligence, but the tech sector skyrocketed from 13.4% to 32.1%. Part of the increase was due to a growing share of higher-margin software firms, as hardware firms fell from 44% of the sector's market cap in 2000 to 27% today. But tech companies were also large beneficiaries of lower cost overseas inputs which make up 78% of COGS for the sector compared to 43% for the market overall. A reversal in this trend structurally challenges corporate margins on top of the cyclical headwinds from tariffs. Growth expectations of S&P 500 earnings for 2025 at 7% are now half what they were when Trump took office.

With America increasingly looking inward and making access to its consumers more costly, other regions are forced to take steps to support their domestic economies. Nowhere has change been more dramatic than in Germany recently. After years of fiscal rectitude, growing domestic political discontent and increased uncertainty surrounding the US's military umbrella has led the new Chancellor to introduce a massive government spending plan. In addition to doubling defense outlays over the coming four years, Germany intends to invest E500bn in infrastructure projects over the coming twelve years. The net result is a roughly 3.7% deficit for Europe's largest economy (a quarter of Europe's GDP), a sea change from the budget surplus of 2013 to 2019. With the lowest debt to GDP in the G7 at 65%, nearly half that of the US, Germany has substantial capacity to stimulate regional growth. Partly due to improved confidence on the back of this announcement, German industrial production turned positive in May for the first time in two years.

One area of focus is energy resilience, not surprising given the crushing electricity prices resulting from Russia's curtailing of natural gas exports. 20% of Germany's infrastructure investment is targeted toward electricity including improvement in its grid infrastructure.

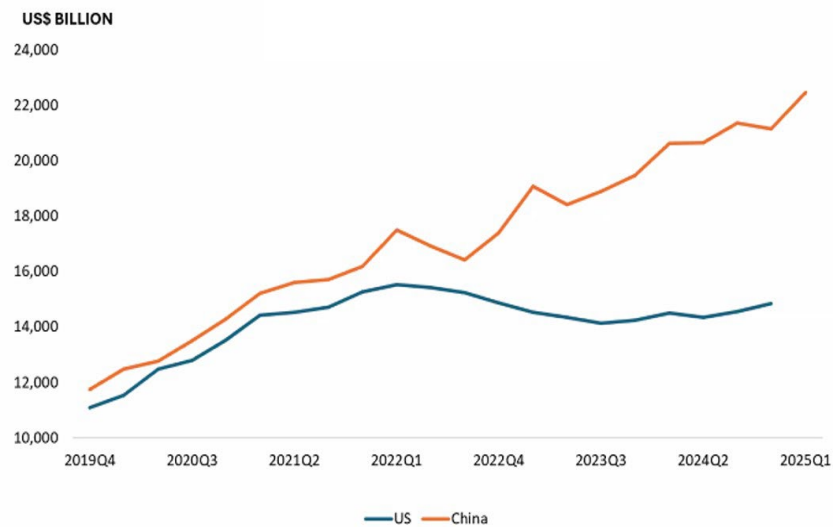
Another country reacting to America's moves to recapture manufacturing is China. The issues facing the PRC's economy are well known. The recovery of consumer confidence in the wake of the pandemic was crushed by a downturn in the property market. Housing prices dropped 25% from their peak four years ago, reversing what had been a major driver of economic growth (a quarter of GDP expansion before 2020) and undermining consumer confidence. Home values at their peak accounted for as much as 80% of Chinese wealth compared to the 50% they represented in the US at the peak of the housing market in 2008. Real GDP growth has slowed from an average near 10% annually in the decade following entry into the WTO to half that level today (and in truth probably even lower). Nominal growth is even weaker as deflation now weighs on both consumer prices (-0.1% in May) and producer prices (-3.3%). Nominal numbers are what people see and feel, making the slowdown even more pronounced and especially pernicious for an economy that has taken on tremendous debt over the past decade. China's private and government debt combined amount to 300% of GDP, among of the highest in the world, having doubled since the global financial crisis. Most of this debt is funded internally on the back of high savings, which has prevented a more severe crisis. But the burden contributes to a slower economic outlook, which is compounded by rising trade barriers which threaten exports, China's main growth engine last year accounting for 30% of GDP.

There are indications that China is increasingly looking inward to escape this malaise. The first signs came with a shift in the leadership's attitude towards the private sector, following a four-year campaign ostensibly aimed at reducing growing inequality and corruption. Having reigned in the country's major tech firms and entrepreneurs, China's leader held a rare, high-profile meeting in February with leading private sector CEOs urging them to "show their talent." Re-invigorating the private sector, which accounts for over 80% of employment, is a key first step to boosting investment and confidence.

In March, the National People's Congress (NPC) made increasing consumer spending its top priority for 2025. Similar pronouncements in the past have done little to boost Chinese consumers share of GDP, which at around 40% is far lower than the 70% in the US. But tentative signs that the housing decline may abate could help, following measures to improve mortgage affordability introduced last September. New home transactions fell 3% in the first 4 months of 2025 compared with a 17% decline in 2024, according to the Economist. Developer inventory in tier one cities has fallen from 20 months a year ago to 12 months today as transaction volumes have risen 15-20%. Rising turnover is typically a precursor to price improvements in the housing sector. While national prices were down 2% through the first quarter of 2025 (an improvement over last year's 6% decline), prices in Shanghai and Shenzhen have begun to rise modestly.

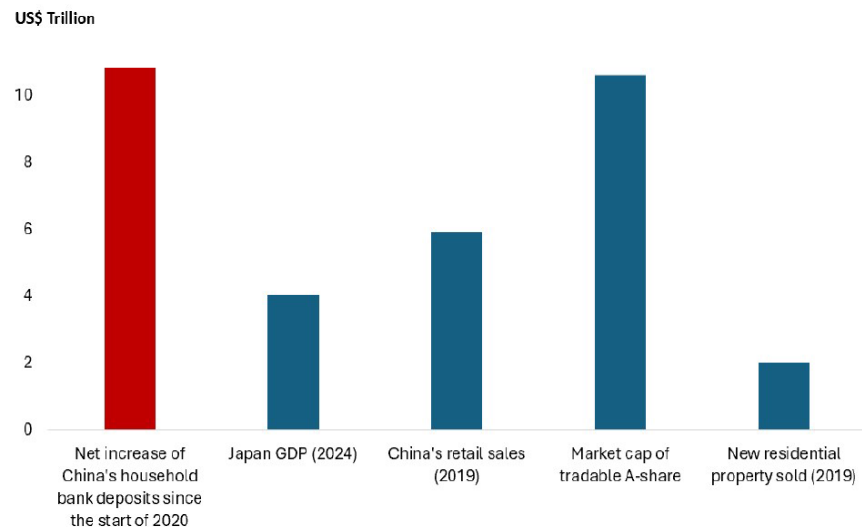
One swallow does not spring make, but the potential for a consumer recovery to improve China’s growth trajectory is meaningful. As the charts below from Andy Rothman shows, Chinese household deposits have nearly doubled to over \$11tn since the start of the pandemic and now dwarf those in the US. The size of this increase relative to pre-Covid retail sales show just how impactful an improvement in confidence could be.

CHINA HOUSEHOLD TOTAL SAVINGS



Source: CEIC, US Federal Reserve, Sinology LLC

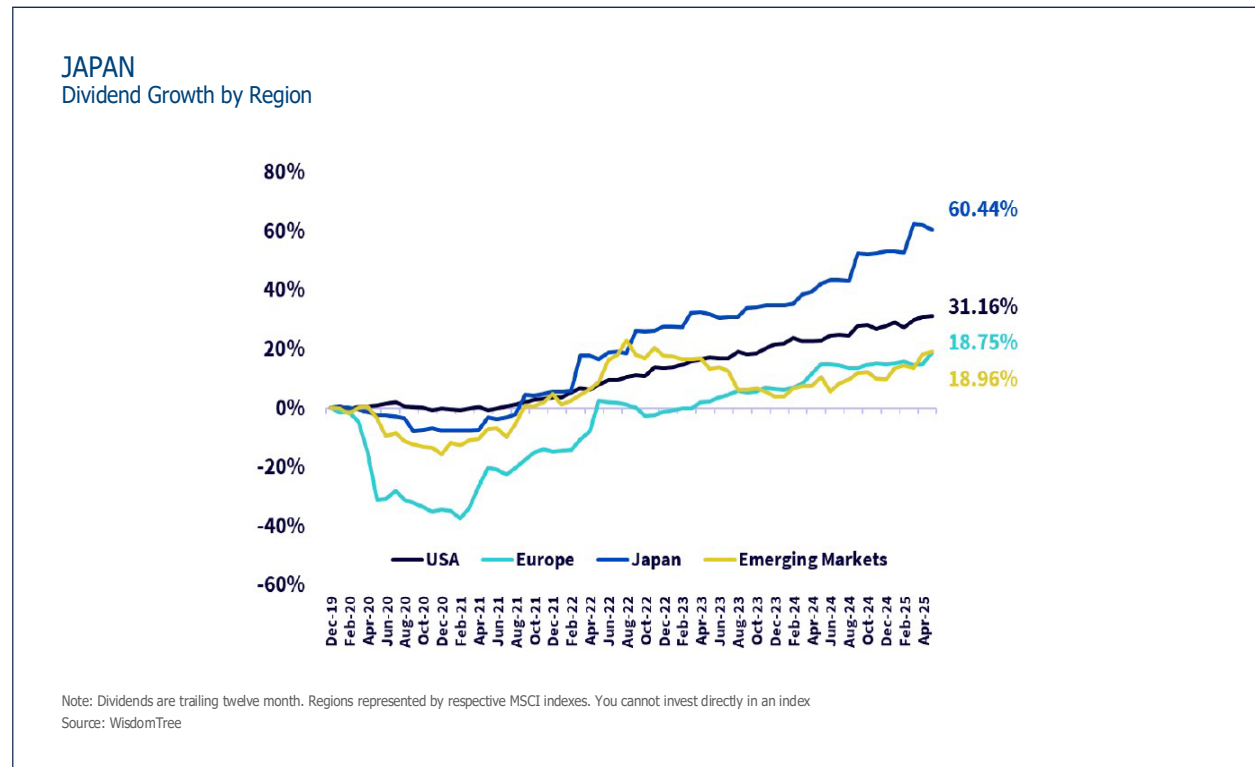
CHINA HOUSEHOLD EXCESS SAVINGS



Note: China's household bank deposits and A-share market cap are by March 2025.  
Source: CEIC, Sinology

Third on the list of countries having to react to America's turn inward is Japan, although its Damascene moment occurred about ten years ago. Japan finds itself in a precarious position facing a rising threat economically and militarily from its biggest trading partner, China. At the same time, its largest export market and security provider, the US, has become increasingly less reliable. Compounded by demographic decline, these challenges have led to a unified Japanese effort to improve the productivity of capital in order to drive national economic revitalization.

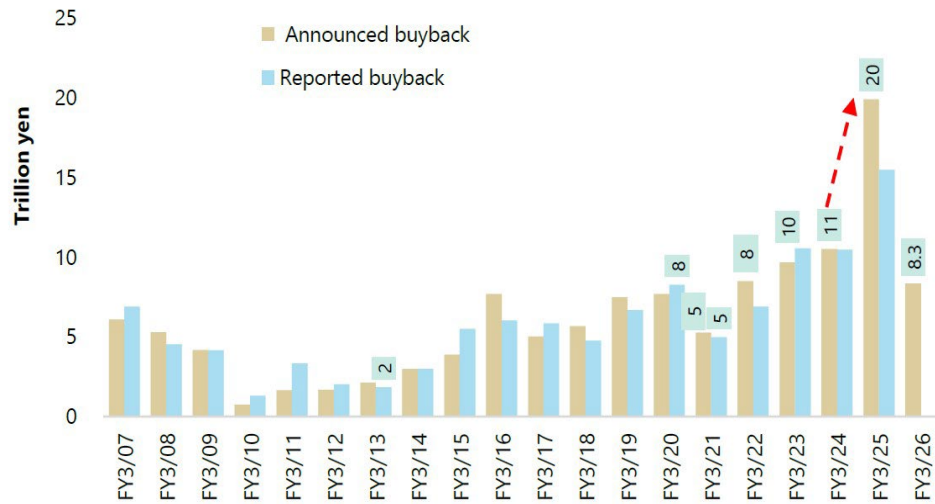
Part of this effort entails unlocking dormant resources and having them flow through the economy. The trauma of the post-bubble deflationary bust meant Japanese companies historically paid much lower dividends, hoarding cash on balance sheets instead. Thanks in part to the introduction of corporate governance reform and pressure from the Tokyo Stock Exchange, that mentality has changed dramatically. The dividend payout ratio for the Topix has increased by a fifth from 29% a decade ago to 35% today. As a result, dividend growth in Japan has been the fastest globally in the past five years.



Buybacks have exploded. Last year, share repurchases by Japanese companies hit a record ¥20trn, double the previous year according to Jefferies. Announcements for this year through May 2025 were 20% above 2024's record levels. Combined with anticipated dividend increases, Jefferies estimate Japan is on pace to achieve a combined shareholder yield of over 5%.

## JAPAN

### Announced Versus Reported Buybacks, Topix

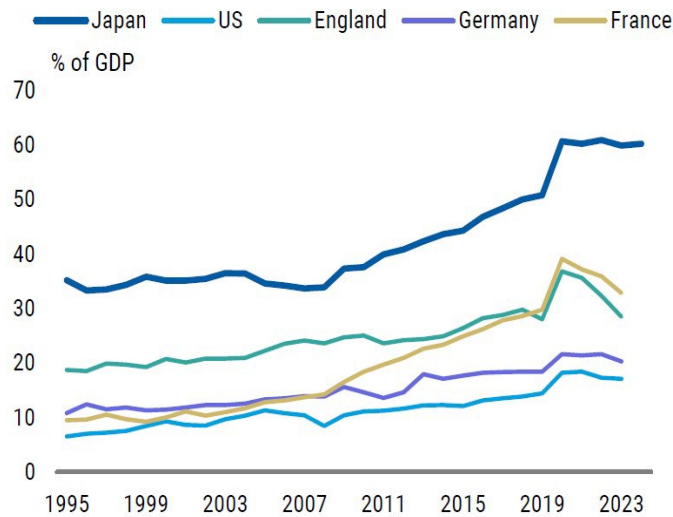


Note: As of May 16, 2025.  
Source: FactSet, Jefferies

If the first phase of boosting capital efficiency centered around unlocking underutilized funds, the latest step is increasing what has been referred to as Japan's corporate metabolism. In the past 3 years, M&A has increased dramatically with 2024 seeing 2,195 deals totaling \$167bn. That figure has already been surpassed in just the first six months of this year with deals totaling \$232bn. Hostile or unsolicited bids which were once unthinkable have become increasingly common and successful; 2024 saw 94 such attempts versus zero or low single digit levels in prior years. Regulatory changes have encouraged this acceleration. Japanese companies historically never revealed "bids without consent," until METI issued Guidelines on Corporate Takeovers in 2023 which promoted disclosure and independent review. Management buyouts were also up 44% last year, as corporate insiders took advantage of low market valuations. There is huge potential for this to continue. Even with higher payouts, Japanese companies remain cash rich as shown below.

## JAPAN

### Ratio of Cash and Deposits Held by Corporates

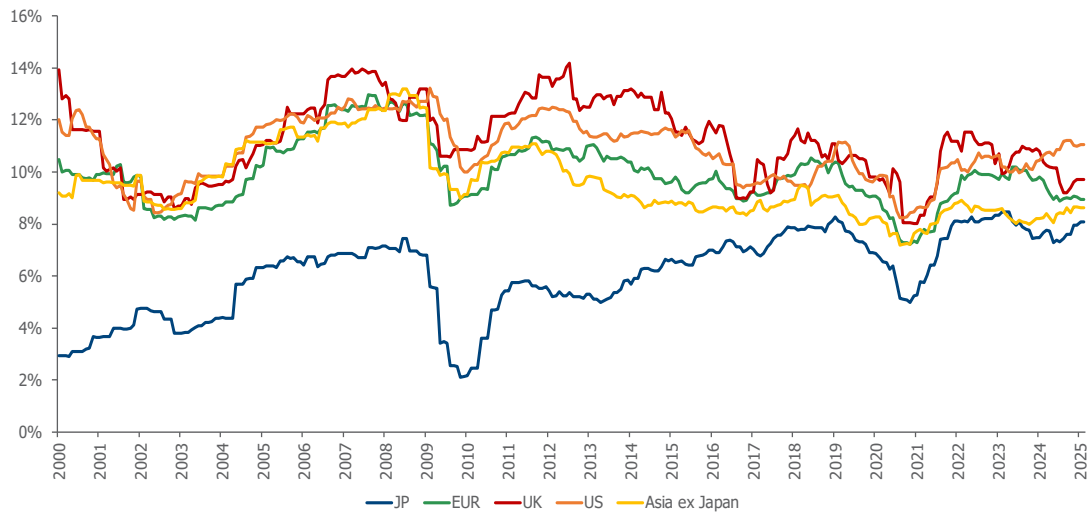


Note: The ratio of cash and deposit balances of non-financial corporations to the GDP (CY basis). For Japan, in 2024, the results were calculated by the value of the cash and deposits at the end of September divided by the nominal GDP (annualized, seasonally adjusted value) for the period ending July- September  
Source: Cabinet Office, MOF, BOJ, OECD, Morgan Stanley

They also remain plentiful. Japan has over 4,000 listed companies compared with around 2,500 in the US, despite the latter being 4.5x larger in terms of market capitalization. As Goldman point out, Japan's machinery sector alone has 256 listed companies compared to just 87 in the US and only 15% of these Japanese stocks trade more than \$5mn a day. This high degree of fragmentation has contributed to lower profitability and growing consolidation should provide another leg up in Japan's continuing improvement in return on invested capital.

## JAPAN

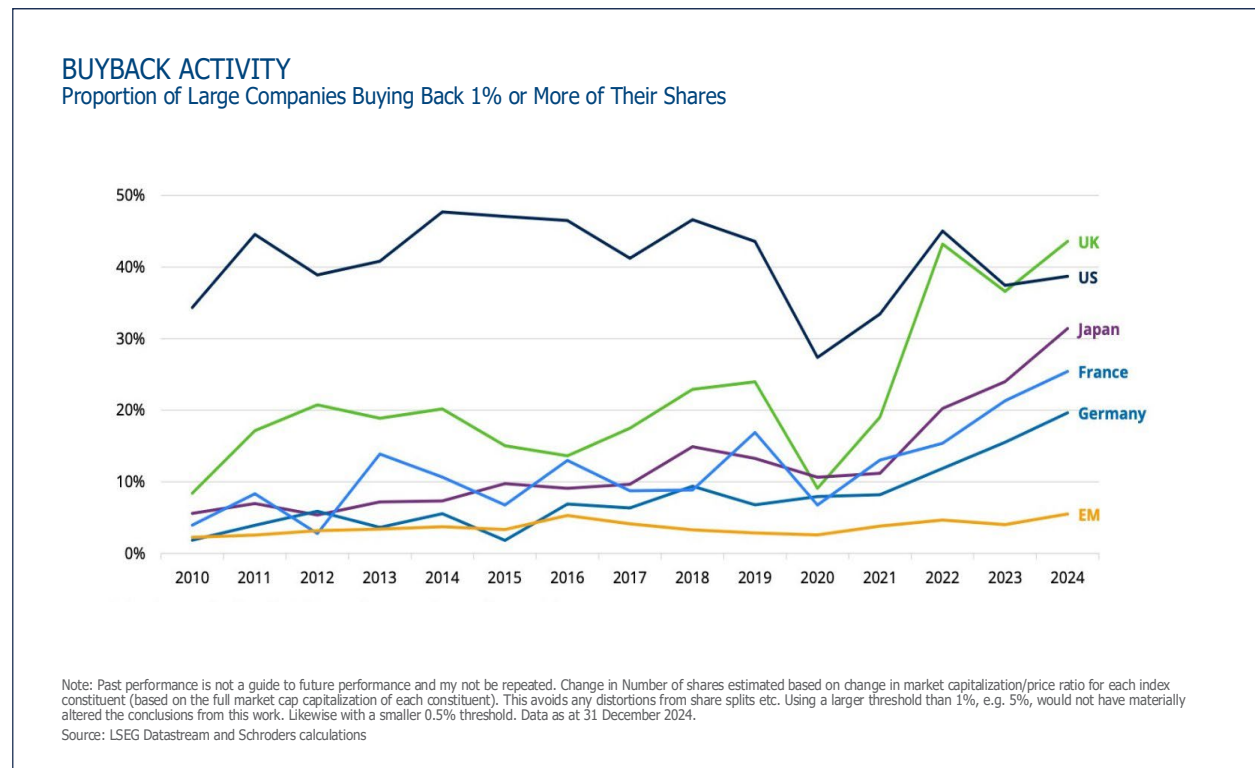
### Return on Invested Capital versus Developed Markets



Note: Data through February 2025. ROIC is ex-financials.  
Source: IBES, MSCI, FactSet, Bernstein analysis

Growing activist involvement is also a driving force behind improving returns. The number of activist campaigns in Japan has doubled since 2021 making it the second largest market for engagement after the US and 4.5x larger than the UK, the next biggest market. CLSA estimate that one in every six listed companies in Japan now has an activist shareholder.

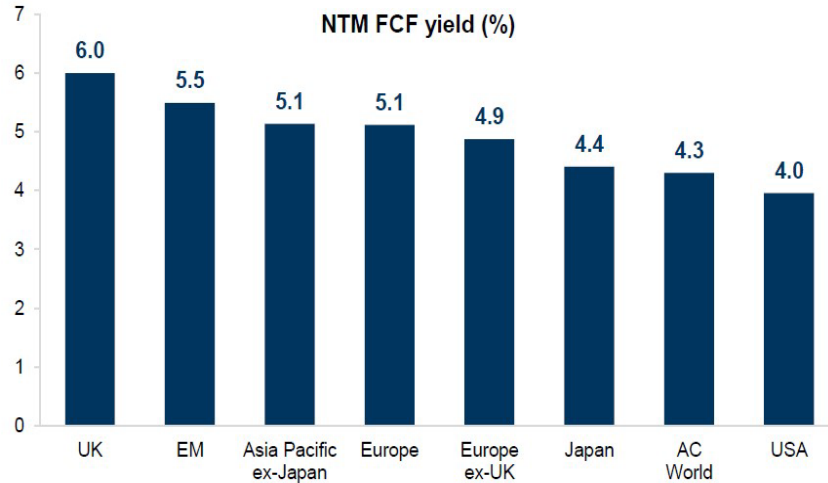
The other market where we see similar bootstrapping is the UK. Dividends have historically been a prominent feature of the British market growing a steady 3-4% a year. What's changed recently is a step up in share buybacks. FTSE 100 companies repurchased £57bn worth of stock last year, the third year in a row above the £50bn mark and more than double the historic run rate prior to 2021. The UK now has the highest proportion of companies undertaking buybacks of any market globally.



It's not surprising that British managers find their own shares so attractive. The market overall sells on just 12x earnings, 15% cheaper than European peers and 45% less than US equities. UK stocks have the highest free cash flow yields globally.



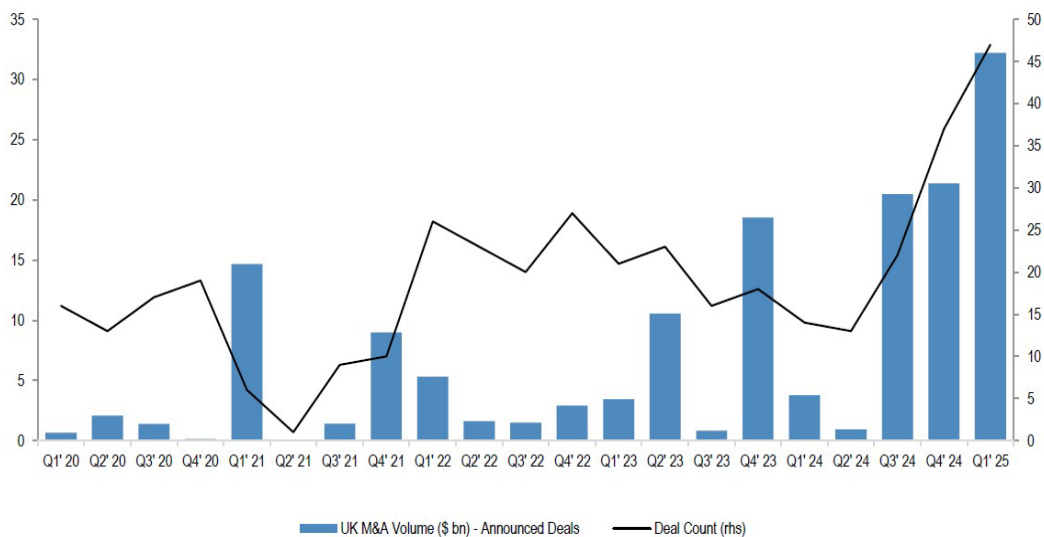
## UK 12m Forward Free Cash Flow Yield, MSCI Indices



Source: Factset, Goldman Sachs Global Investment Research

It's not just management that is taking notice. Outside corporate buyer interest is also growing rapidly. The value of M&A last year rose by 160% with the number of deals accelerating over the past three quarters. Interestingly, Peel Hunt note that 70% of buyers this year have been corporates as opposed to financial institutions.

## UK M&A VOLUME AND DEAL COUNT – ANNOUNCED DEALS



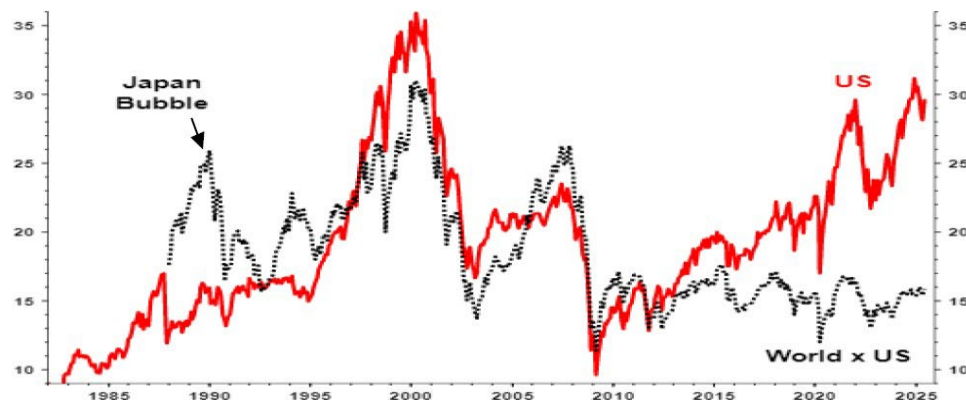
Source: Bloomberg Finance L.P.

UK companies in aggregate now have the highest combined dividend and buyback yield in the world at 6%, essentially returning their free cash flow to investors. Buybacks alone are now larger in the UK and Japan as a percentage of market cap than in the US, a recent reversal. Beyond just the quantitative increase, there is also a qualitative difference worth considering. Not all buybacks are created equal. Take a company whose intrinsic value is around \$100mn with \$50mn in net cash and 100mn shares outstanding (so \$1 per share in intrinsic value). Assume the stock trades at \$2 per share. If management use all the cash to repurchase stock, the intrinsic value drops by \$50 (the cash spent) and the number of shares falls by 25mn (\$50mn divided by \$2 per share) to 75mn. That leaves the intrinsic value per share for the remaining shareholder at \$50mn divided by 75mn or \$0.67 per share, a drop of 33% from the original \$1! As Warren Buffett said, "If you buy a dollar bill for 90 cents, you're doing your shareholders a favor. And if you buy it for \$1.10, you are doing them no favor at all."

In other words, you want to own companies buying back shares at below intrinsic value not above it. Determining intrinsic value with precision is challenging. But looking at a range of broad valuation measures, we would argue odds are that repurchases overseas are far more value accretive than those in the US. Look at the valuation of the US market compared with that of non-US equities relative to trend earnings. Never has the differential been wider. The only other time US valuations were more expensive was back at the peak of the dot-com bubble when overseas equities had joined the party. That's not the case today.

### PRICE TO TREND EARNINGS

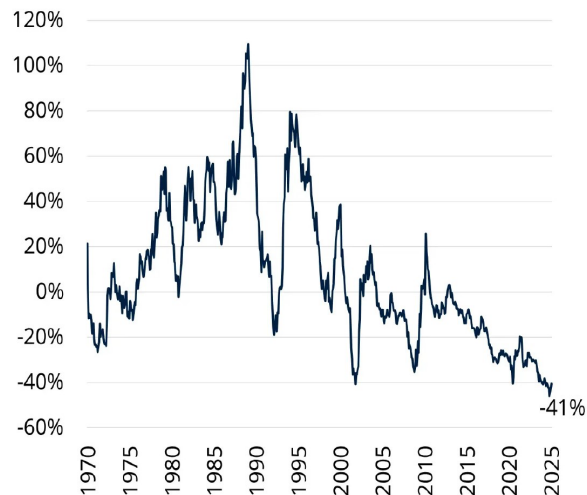
Similar to the Shiller P/E or Cyclically Adjusted P/E – AKA CAPE



Source: Datastream, Societe Generale

The same is true looking at prices relative to actual earnings expectations for the coming twelve months. Non-US stocks on this basis have never been cheaper relative to US stocks. The discount of non-US equities to US stocks is not simply a function of a lower technology sector weighting overseas; on a median basis, the non-US stocks trade on 20% lower price to earnings ratios than US companies.

### US PRICE TO EARNINGS VERSUS NON-US



Note: Data to 28 February 2025. Non-US stocks are MSCI World ex-US index, US is MSCI USA  
Source: LSEG Datastream, MSCI, S&P, and Schroders

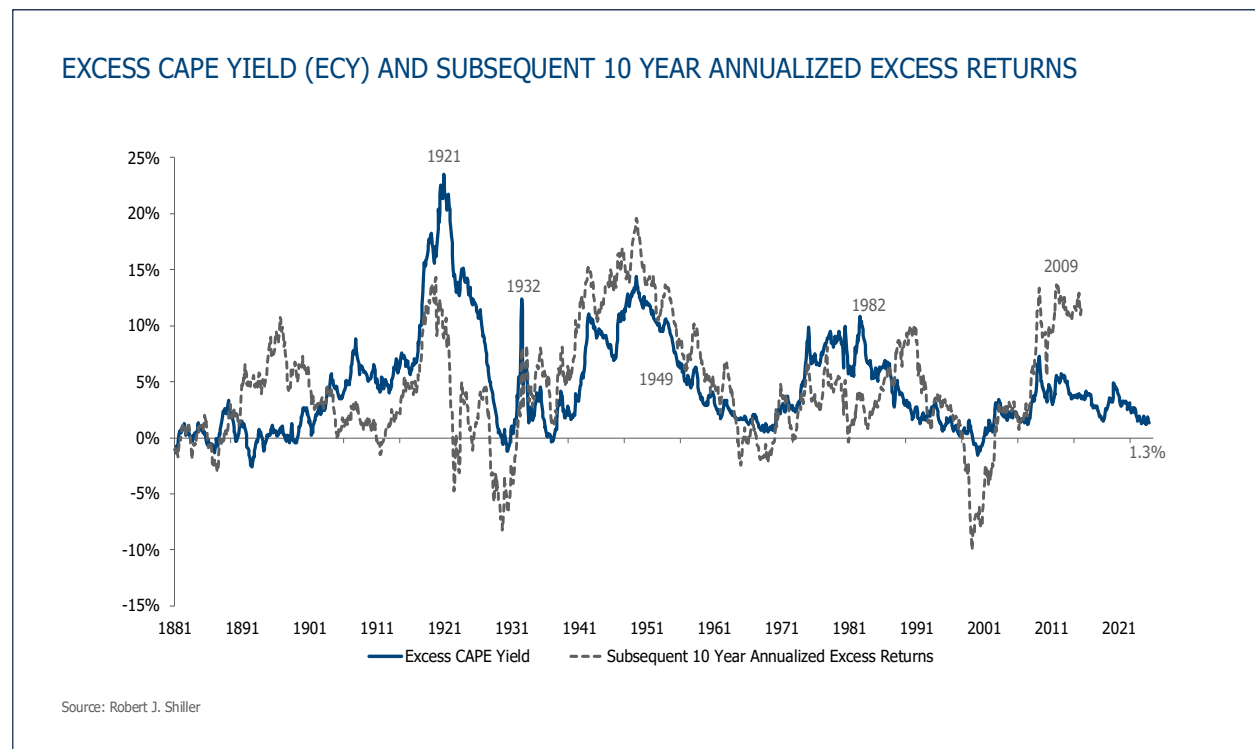
In absolute terms and relative to history, US valuations have again reached extremes following the rally off the April lows. The equity yield (inverse of the P/E) offered by US stocks is now less than the yield on 10-year government bonds, the lowest in roughly 25 years.

### S&P 500 EARNINGS YIELD LESS THE 10 YEAR BOND YIELD

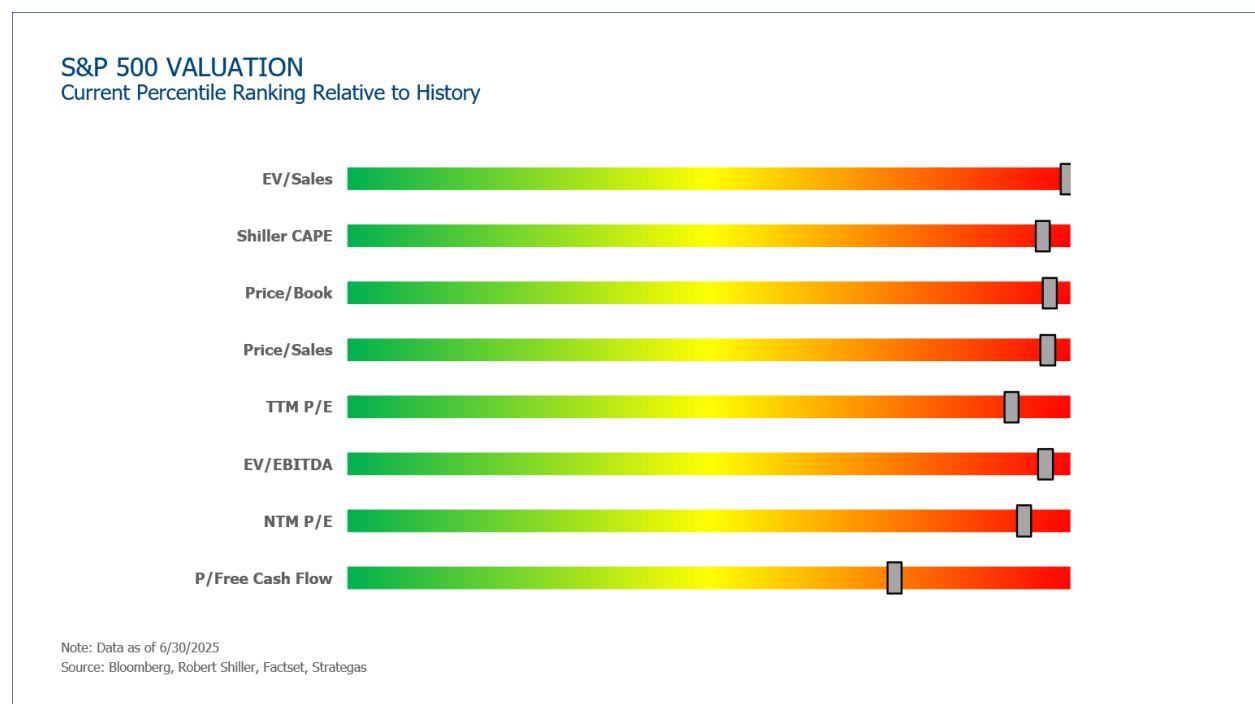


Source: Bloomberg Finance L.P.

Robert Shiller's longer-term study comparing the cyclically adjusted earnings yield of the US market with real interest rates which shows a similar picture. On this measure, American equities have only been more expensive roughly 14% of the time in the past 100 years. The subsequent 10-year real annual return following those periods averaged less than 1% and lagged bond returns by nearly 2 percentage points.



On virtually every measure we look at, US equities look expensive versus peers and versus history.



If the past few years have proven anything, it's that valuation alone is not enough to sway investor interest. But the extremes at which we sit today when combined with the implications of America's pivot inward may have started to put some of the exceptional values we see outside the US back onto investors' radar screens. It's also encouraging that the management of companies we own are increasingly taking value realization into their own hands. We believe the portfolio is well positioned to benefit from these trends.

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