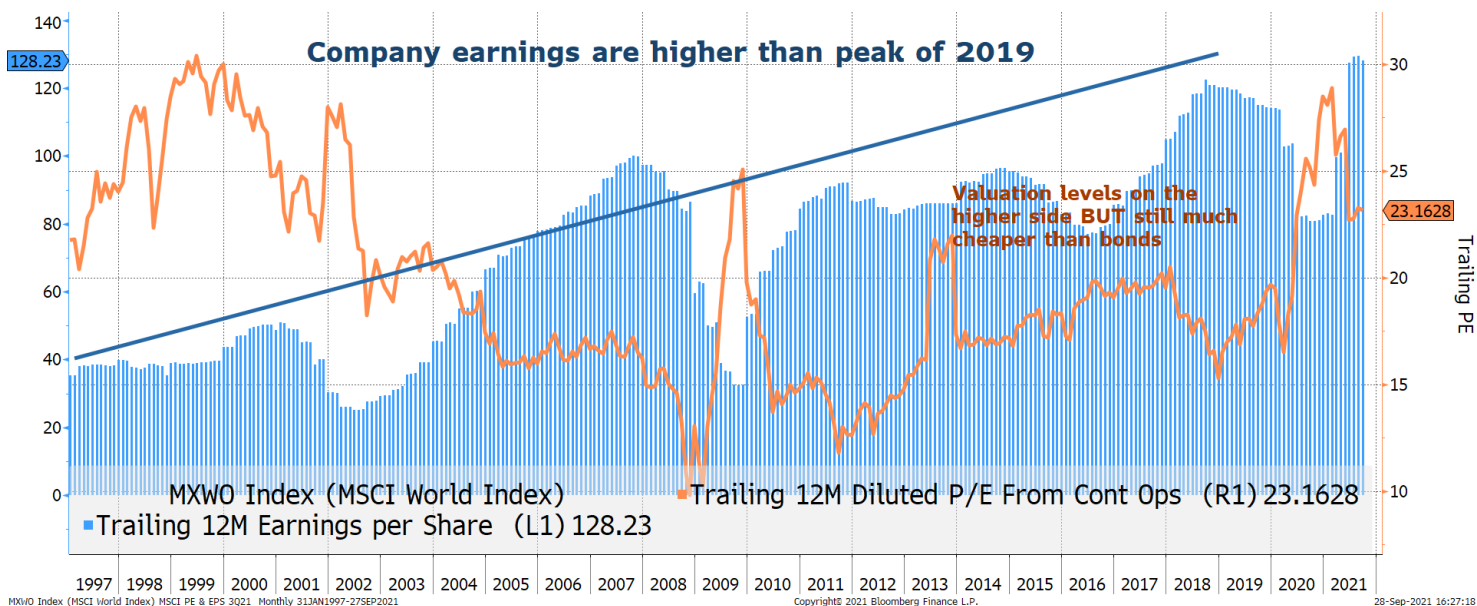


Jacques Berghmans

1. Economic and Market Environment

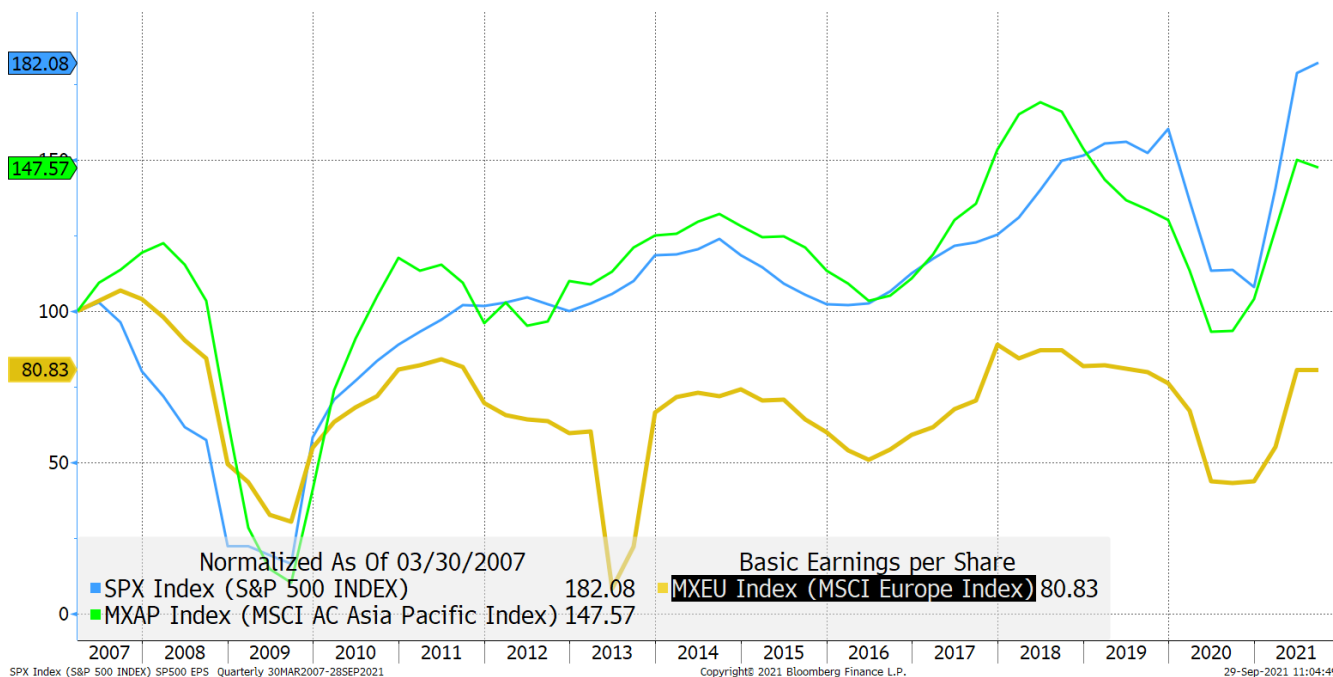
As I write this newsletter, I am happy to inform our clients that global equity markets are in excellent health. The MSCI All Countries World is more than 20% above its 2019 peak prior to the COVID-19 pandemic. While some of the strong performance was driven by valuation multiple expansion, global company earnings outperformed most expectations and aggregate company earnings are above their pre-pandemic levels. As we can see on the graph below, earnings per share (in blue) rebounded very strongly since the beginning of the year and the valuation multiple, trailing 12M diluted PE (in orange) is actually lower than six months ago. The global equity markets are not exactly cheap and valuation multiples remain above the average of the past ten years, but global price/earnings is lower than the peak in 2000. The investment world has also significantly changed since 2000, with global interest rates close to 0% and government debt close to or significantly above 100% of GDP for a number of countries (Italy, United States, Japan...). As a result, we think that central banks are likely to raise interest rates very cautiously, even if inflation picks-up, in order not to create refinancing issues for heavily indebted national governments. This unique situation makes us think that global stock markets could sustain relatively high valuation multiples for a long time¹.



If valuation multiples can hold up, the major driver for the global stock markets is earnings growth. We can't promise that earnings will continue to grow at the same historic rate, but we have good grounds to be positive over the **long term**.

¹ No guarantee of result or performance

Looking at the three major regions in the world for stock investors, Asia, the United States and Europe, we can see that earnings have rebounded everywhere, though some markets are doing better. Earnings of the S&P500 companies (in blue) rebounded strongly and are above their peak in 2019. Earnings of the MSCI Asia (in green) were in a downward trend prior to the pandemic and have rebounded above their pre-pandemic level but are still lower than their peak in 2018. Earnings in Europe (in yellow) rebounded later than other markets and while the short-term trend is good, aggregate earnings for the MSCI Europe are still 20% lower than their peak in 2007. Over the last 15 years, global corporate earnings have grown but this has mostly been an American phenomena and other regions of the world have lagged. A faster catch-up of earnings growth in Asia and Europe could form the next leg of earnings growth and drive global earnings growth further¹.



Evolution of Basic Earnings per share in Europe, the United States & Asia – Source: Bloomberg

The American equity markets remain the most important constituent of global equity market, with the region making up between 50% and 60% of the global stock market. Looking at Bloomberg consensus, analysts estimate that earnings of the S&P500 will grow a significant 23% year on year in the next twelve months before slowing down to mid-single digits. Given the high base effect, the earnings of American companies are unlikely to grow exponentially, but stable growth combined with a further recovery in Asia, as well as Europe, could drive global earnings, as well the stock market, higher¹.

Over the last decade, the most important value creation in the stock market has been the massive growth of internet services everywhere in the world². While there are a huge number of people who use these services, there are only a few businesses, most of them Chinese or American, that capture most customers. The pandemic has turbocharged this trend and as of June 2021, five companies (Apple, Facebook, Amazon, Microsoft and Google/Alphabet) made up 20% of the total market capitalization of the S&P500³. In China also, Tencent and Alibaba capture a significant share of internet services and have been extremely successful investments over the last decade. While we recognize the quality of these companies, we are somewhat worried about paying top valuation multiples for stocks which are likely to have reached peak margins and revenue growth. Given the heavy reliance of indexes on these tech names, we decided at TreeTop, at the end of last year to launch a new value-focused-strategy called the ‘Dogs of the Dow’, which will progressively make up a portion of our investment solution offered to clients. It is an indexed strategy which consists of buying an equal position in the ten companies with the highest dividend yield from the Dow Jones Industrial

² MSCI World Information Technology Index (USD), Cumulative Index Performance: <https://www.msci.com/documents/10199/69aaf9fd-d91d-4505-a877-4b1ad70ee855>

³ <https://www.marketwatch.com/story/the-s-p-500-now-is-top-heavy-in-5-big-tech-stocks-but-that-alone-wont-end-this-bull-market-11623187957>

index and holding them for 12 months until the next review. The strategy has an excellent long-term track-record⁴, generating an annual total return of 9.5% since 2000, which compares to 8.4% for the Dow Jones, and we think it continues to have good prospects given the current characteristics of global equity markets. It has the added benefit that, by buying high yielding stocks, it avoids highly valued tech stocks.

As I am sure you are aware, there are new daily headlines about the alarming rise of gas prices, supply bottlenecks and other various price increases which could lead to an important pick-up in inflation. In our last newsletter, we spoke extensively about the causes of inflation, the possibility of inflation being temporary and the ability of the stock market to provide some protection against rapidly increasing prices. Not wanting to bore our readers, I'll not speak about the subject extensively again. I would just summarize that stocks provide much better inflation protection than bonds and that companies earnings tend to be inflation protected over the long term.

In conclusion, we remain convinced that TreeTop's approach focused on **global equity** markets combining a **low cost index fund** with a few **actively managed portfolios** managed by **experienced managers** with an excellent track-record, should continue to be rewarding for clients. As the world is finally re-opening after two years of partial or total lockdown, we would be delighted to welcome you into our offices to present our strategy in more detail.

2. Our convictions

Our investment strategy has had a good year so far, driven by the excellent performance of **CHINASOFT**, **ASSTEAD**, **UNITED RENTALS**, **BANK NORWEGIAN** (formerly known as **NORWEGIAN FINANCE**) and **ZOOPLUS**. The only significant detractor to our performance was **VIPSHOP HOLDING**, with most positions contributing positively to our performance or only generating small losses. Interestingly, one of our best performing investments is a Chinese stock, while the overall Chinese market suffered significantly from aggressive government regulation in the new economy, and concerns about a potential real estate bubble burst in China. Our investment in **CHINASOFT** shows that as long as you buy a good business, which has little interference with the communist party, you can make excellent returns in the country. We are trading carefully though, as China is going through both an important political transition, as President Xi Jinping might or might not stay in power in the next two years, and an economic transition, as its economy moves from investments (real estate, infrastructure) to consumption & services.

CHINASOFT started as an outsourcer for the Chinese technology giant Huawei, and progressively became an IT supplier for other major companies, like HSBC, and local government agencies. We invested in the stock following one of our last trips in China, after a meeting with the management. The stock had recently de-rated as outsourcing work from Huawei had slowed down, and the Company was building new business lines to achieve its next level of growth. We found the Company attractive as its stock traded on reasonable valuation multiples, unlike most software stocks, and still had the potential to grow significantly. We are delighted that our investment thesis worked out beyond our expectations, with the Company winning a number of new clients & projects and nearly doubling its revenue and net profit between 2017 and 2021. While more expensive than a few years ago, the stock still trades on a reasonable 20x forward price earnings multiple with the potential to continue to grow earnings double digits¹.

Two major contributors to performance this year, **BANK NORWEGIAN** and **ZOOPLUS**, have been acquisition targets of banks and private equity funds. **ZOOPLUS**, a leading online pet food retailer, has been a volatile ride but an excellent investment nonetheless, with the stock first going down due to a slowdown in growth, and then rebounding very strongly from the start of the pandemic. Our investment thesis at the time was that **ZOOPLUS**, being a specialized e-commerce company, could offer better value and convenience than e-commerce generalists like Amazon and brick & mortar retailers. The pandemic significantly accelerated the growth for **ZOOPLUS**, as people bought more pets and traditional stores closed. A number of private equity funds have now recognized this trend and have launched a bidding war to buy the Company. The case of **BANK NORWEGIAN**, a leading online consumer lender in the Nordics didn't work

⁴ <https://www.investopedia.com/terms/d/dogsofthedow.asp>

as well, as the pandemic created some credit risks for some households and at the same time reduced credit demand for other households. Given these exceptional circumstances, the Company actually delivered decent numbers, a testimony to the Company's agility. Unfortunately for public shareholders, another bank NORDAX saw the low stock price as an opportunity to buy an excellent business at a discount. We publicly protested that the offer price was far too low, especially compared to loss-making fintech companies elsewhere in the world. The CEO of **BANK NORWEGIAN** also resigned, not agreeing with the acquisition price & strategy for the firm, but we could only get a slightly better offer and no other bidder joined the acquisition process. A small consolation is the stock was an excellent performer this year and it frees up capital for new ideas.

VIPSHOP HOLDING, a leading Chinese online apparel retailer, ended up as one of our worst performing stocks this year after a stellar start of the year. The Company actually released a decent set of financial results, but was first affected by the closure of Archegos Capital, a big holder of the stock, and then the deterioration of sentiment towards Chinese e-commerce companies. The Company also decided to invest more in growth, which will have an impact on short-term margins and was not really appreciated by investors in this difficult environment. While the stock performance is very disappointing, the financial fundamentals remain sound, and we continue to hold a small position. We wait for the situation to stabilize and will potentially increase the position size when momentum picks up.

Our two investments in equipment rental companies in the United States, **UNITED RENTALS** and **ASHTEAD**, continued their strong recovery since the bottom of the pandemic and are reaching all-time highs. We have owned these businesses for several years now, through a few economic cycles, and have been impressed by their resilience through downturns. These companies are great examples of what we are looking for when we invest in a stock. Both companies have excellent business models with high returns on capital over long periods of time. A combination of network & scale effects, large and growing addressable markets and great execution have allowed both companies to successfully re-invest capital organically and through acquisitions to grow earnings. Between 2012 and 2021, **UNITED RENTALS** grew earnings per share more than 7x and **ASHTEAD** nearly 10x! The last ingredient for a truly successful investment is a misunderstanding by the market of how good the business is and a progressive change of perception. Both **UNITED RENTALS** and **ASHTEAD** were for a long time considered as highly cyclical businesses and therefore traded on low valuation multiples. While true to an extent, the overall market didn't totally grasp the counter-cyclical nature of cashflows, as well as the increasing pricing power of both companies. The issue with truly cyclical businesses like traditional car OEM's or airlines, is that they burn significant amounts of cash when there is an economic crisis creating all kind of issues. Over the years, both **UNITED RENTALS** and **ASHTEAD** have fine-tuned their business models to significantly reduce capex at the first sight of a crisis. A more consolidated industry and a move to specialty rental also allowed both companies to have a much better control on pricing - protecting cashflows and earnings in a downturn. All these elements combined resulted in much more stable earnings and a progressive re-rating of the stocks.

In conclusion, we are delighted for our clients that both the market and our strategy have delivered excellent results⁵ so far this year. While there are some economic clouds on the horizon, there has never been a perfectly clear sky over my forty-year career. It is key to remember that eventually every storm passes and that one should not succumb to fear (panic-selling in stock market terms) or euphoria (leverage investing) when investing in the stock market.

Happy investing and please feel free to contact us for any eventual questions

⁵ Past market behaviours do not prejudice future behaviours, no guarantee of results or performance

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Data & Information as of 30th September 2021

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