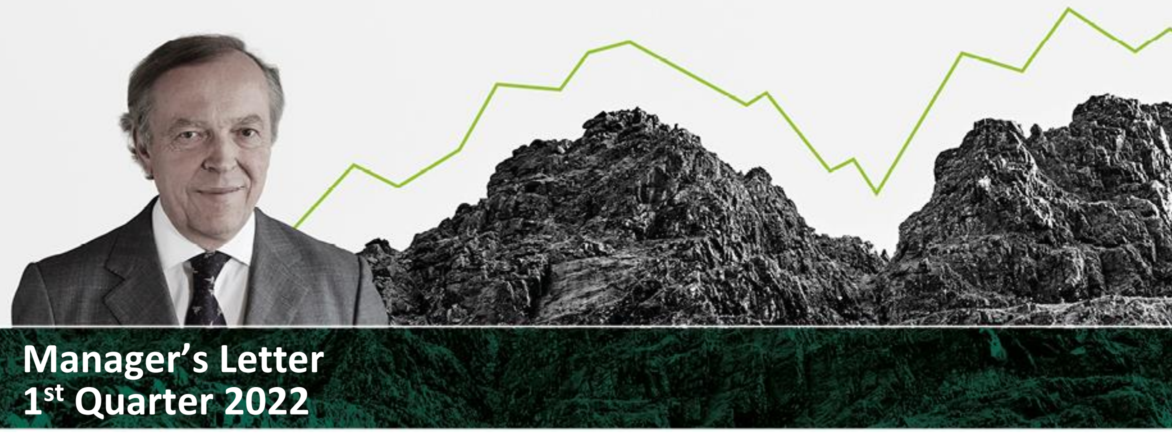

Manager's Letter
1st Quarter 2022

Jacques Berghmans

1. Economic and Market Environment

After an excellent 2021 for global equity investors, the first few months of 2022 have been more difficult with most global indexes down high single digit percentages. Most investors started the year somewhat nervous about increasing inflation across the Western world and started to sell aggressively at the start of the Ukraine crisis. We are all following the situation closely and hope this tragedy can soon end peacefully. We don't want to make any geopolitical comments though given our lack of expertise in the field.

Looking at the situation through an economic and financial lense, we can see that Russia, while a very big country, is a relatively small economy and an even smaller financial market. According to Morningstar, European assets exposure to Russian equity is only 0.27%[1] and Russian financial assets are only a rounding error on a global level. Now, as most of you will have observed at the fuel station, the Ukrainian crisis has triggered the beginning of an energy crisis. Though even there, the crisis has to be put into perspective. Oil prices are still below their peak in 2007 (especially adjusted for inflation in light green) and while gas prices are very high in Europe, they are close to a 10-year low in the United States.

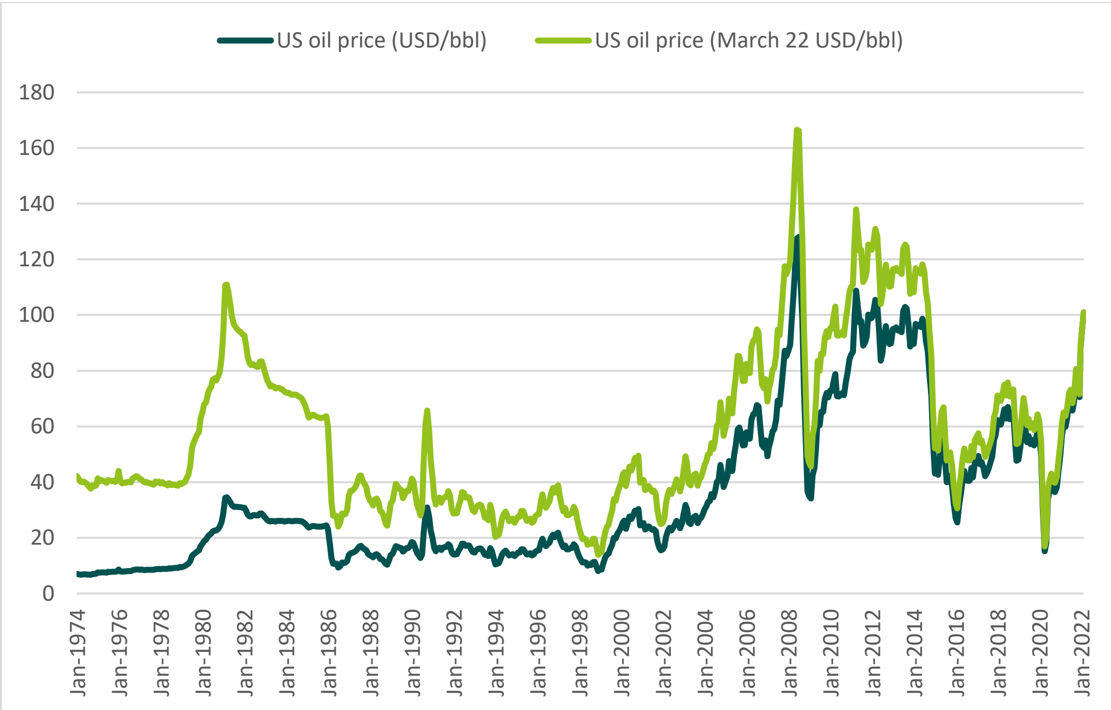

Figure 1 Source: Bloomberg, https://www.eia.gov/, TreeTop AM

[1] *https://www.morningstar.co.uk/uk/news/219189/how-exposed-are-european-funds-to-russia.aspx*

This crisis reminds us of the importance of taking a **global approach when investing in equities.** A crisis can quickly derail a region or a sub-sector, but very rarely negatively affects every company in the world. Even a global crisis like the COVID-19 pandemic creates opportunities. It significantly boosted immunization & RNA research, potentially leading to new discoveries in the future. It led to a boom for e-commerce companies and to widespread adoption of work from home policies. It also showed that **selling in panic is rarely a good idea** and that better times always emerge at the end.

Looking purely at financial fundamentals, the picture starts to be a lot more positive. Company earnings (in blue) are at all time high, and the global stock market has de-rated over the last six months and now trades in line with long term valuation multiples (in orange).

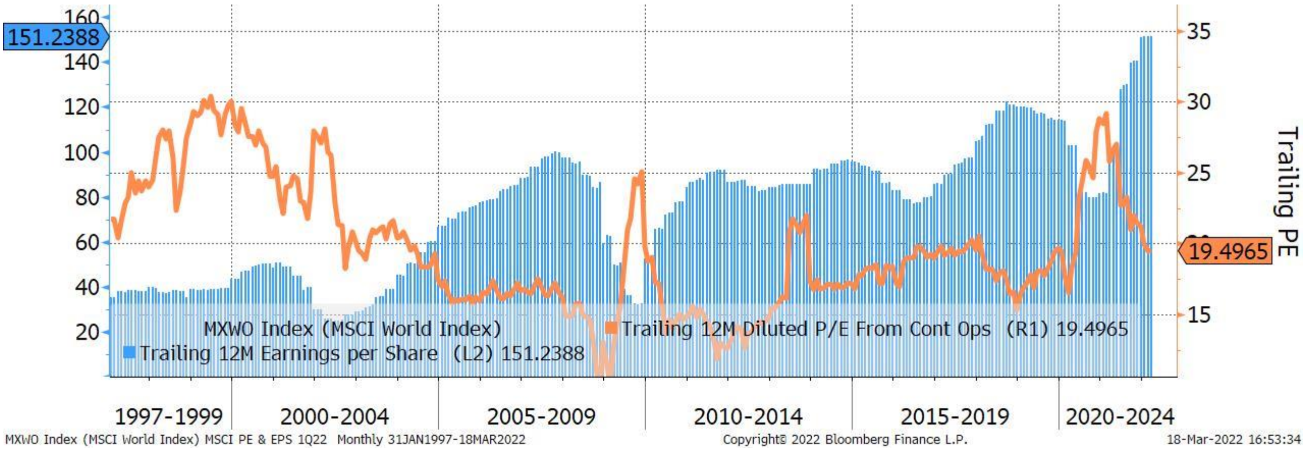

Figure 2 Source Bloomberg

As we can see on the chart below, the recent earnings recovery for global markets appears to be mostly a long overdue catch-up. Global earnings growth was below trend since 2015 and the recent earnings recovery post pandemic caused global earnings per share (global prospective EPS) to come back closer to its long term trendline. We are very far from the 'excessive earnings' period in the mid two-thousands where global earnings significantly overshot their long term trendline until the global financial crisis in 2009 caused earnings to crash.

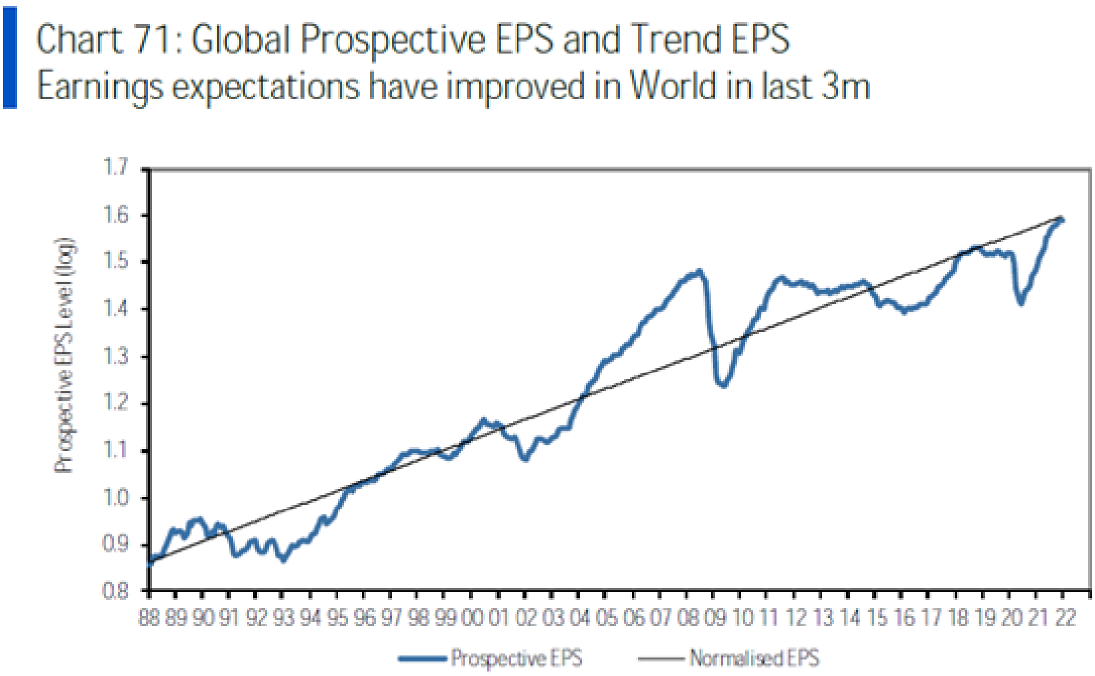

Figure 3 Source BofA Global Quantitative Strategy, MSCI, IBES

Breaking down the recent performance per region, the US stock market (S&P500 in yellow) has clearly outperformed all its peers. The European market (MSCI Europe in purple) is slightly below its peak pre-COVID and the MSCI Asia (in green) is the laggard.

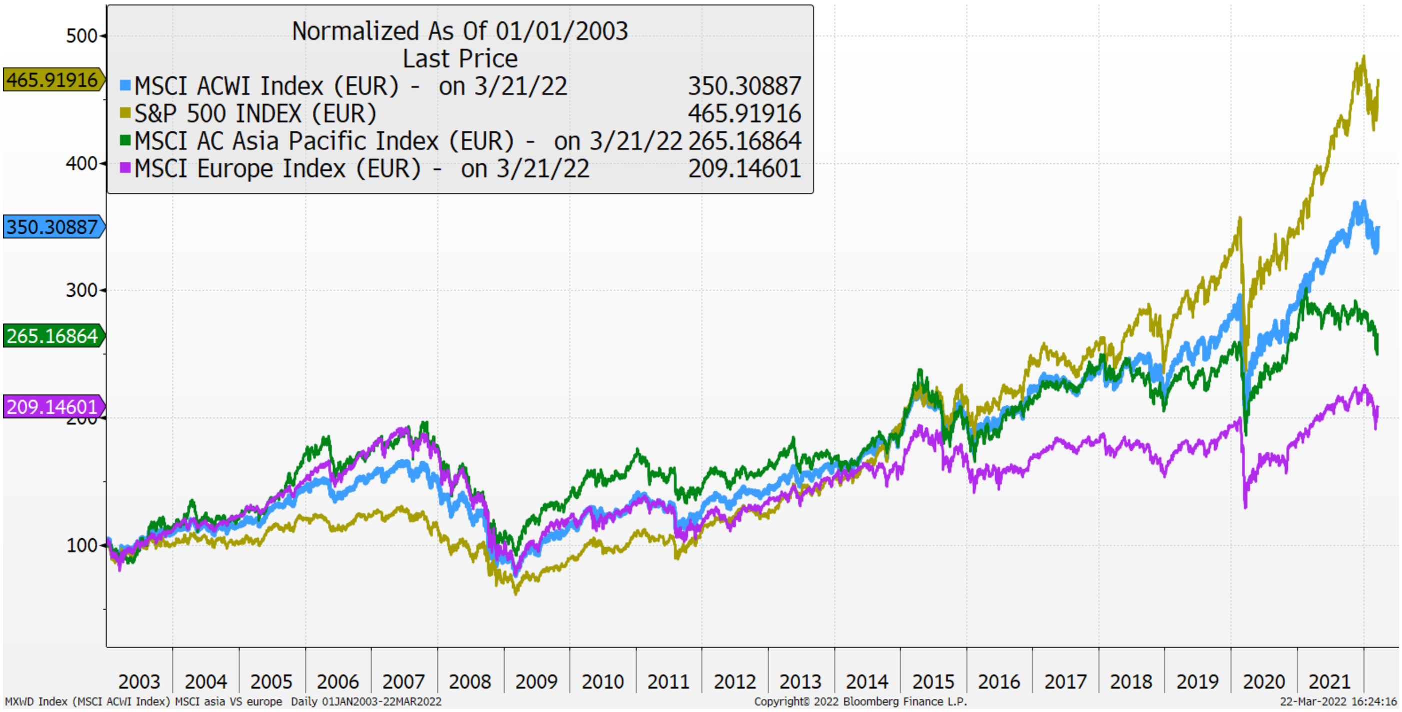

Figure 4 Source Bloomberg

The difference in market recovery across markets appears to be mostly fundamentally driven as earnings recovery in the US (in yellow) has been much stronger than in any other region in the world. European companies' earnings (in purple) were heavily affected by the pandemic. They did recover strongly in recent months but the recent energy crisis in Europe is likely to dampen this recovery. Asian companies (in green), while they delivered much better earnings during the pandemic than European businesses, have lagged the general market in recent months. Looking at the long-term picture, the US massively outperformed all the other major markets and pulled the whole market higher.

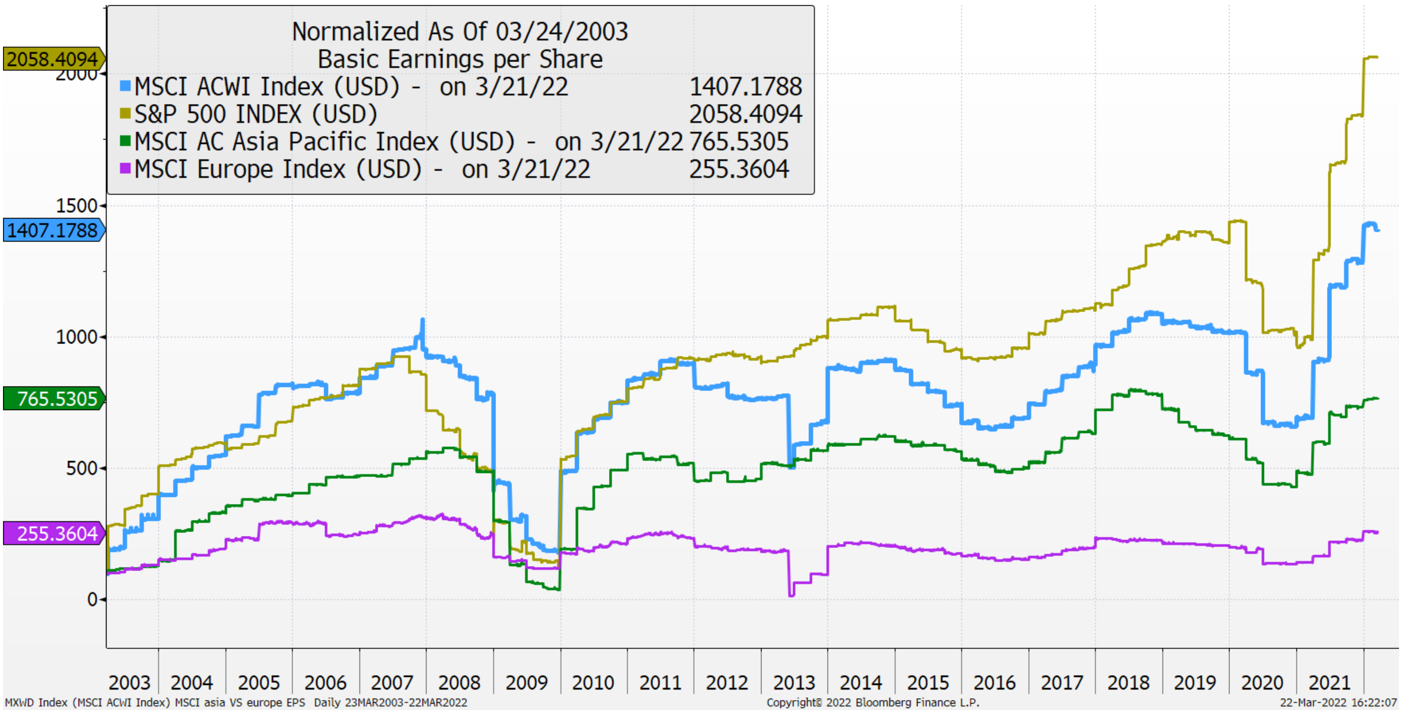

Figure 5 Source Bloomberg

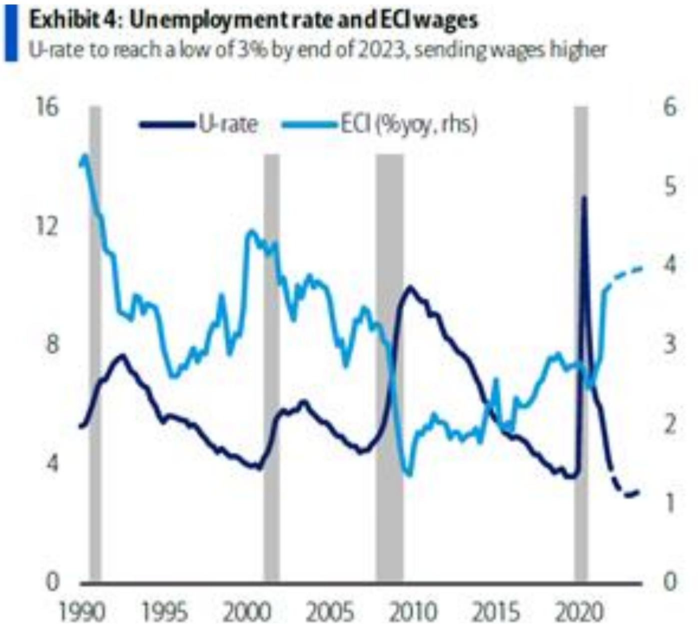

Figure 6 Source BofA Global Research, Bureau of Labor Statistics

The recent earnings recovery in the US appears to be sustainable in the medium term as it is based on a strong domestic economy. Inflation is a worry, but unlike in Europe where inflation is mostly derived from an energy shock, increasing prices in the US is mostly derived from very strong aggregate demand and increasing wages. This is a much better problem to have as it allows more wriggle room for US policy makers to take the appropriate measures to combat inflation without damaging the long-term prospects of the US economy. Jerome Powell, the chairman of the Federal Reserve in the US, has a number of tools (such as raising interest rates) to combat inflation while European policy makers don't have much control over gas prices in the short term. As we can see on the graph on the left, unemployment in the US (dark blue line) quickly receded after the acute phase of the pandemic. Low unemployment is now causing an acceleration in wages growth (light blue), which should fuel an economic US recovery.

Analysing the US stock market drivers in more details, we can see that 9 out 10 of the largest performance detractors were large American tech companies (such as Facebook and Microsoft; on the right side of the table below). Positive contributors were oil companies (Chevron, Exxon and Occidental Petroleum), pharmaceutical businesses (Abbvie), defence companies (Lockheed Martin) and the good old Berkshire Hathaway, which shows that even at 95, Warren Buffett continues to make waves in the investment world.

Ticker	End Prc	Net Chg	Points	%Idx Mv↓	Ticker	End Prc	Net Chg	Points	%Idx Mv↑
1. CVX UN	159.48	+43.35	+9.913	+2.82%	1. FB UW	211.19	-125.16	-34.981	-9.95%
2. BRK/B UN	342.77	+43.77	+9.462	+2.69%	2. MSFT UW	296.29	-39.34	-34.959	-9.94%
3. XOM UN	78.30	+17.78	+8.997	+2.56%	3. AAPL UW	161.29	-16.05	-29.552	-8.40%
4. ABBV UN	157.63	+23.62	+4.930	+1.40%	4. TSLA UW	896.53	-160.25	-15.398	-4.38%
5. COP UN	98.92	+27.10	+4.237	+1.20%	5. NFLX UW	375.98	-226.46	-11.846	-3.37%
6. OXY UN	56.95	+28.03	+2.943	+0.84%	6. PYPL UW	113.57	-75.01	-10.409	-2.96%
7. LMT UN	431.22	+78.24	+2.274	+0.65%	7. NVDA UW	260.62	-33.44	-9.882	-2.81%
8. BMY UN	70.08	+8.27	+2.168	+0.62%	8. AMZN UW	3143.00	-191.34	-9.860	-2.80%
9. DE UN	407.83	+64.94	+2.163	+0.62%	9. HD UN	334.87	-77.65	-9.753	-2.77%
10. RTX UN	97.76	+12.18	+2.160	+0.61%	10. GOOGL UW	2676.87	-220.17	-7.823	-2.22%

Figure 7 Source Bloomberg

It appears that unlike the previous boom in the US equity market between 2015 and 2021 which was mostly driven by the US tech sector, this time the earnings recovery is much broader based. In a recent article '*Companies Exploit Inflation to pad bottom Lines'*, the Bloomberg columnist Nir Kaissar explains that most sectors in recent months have been able to raise their prices beyond their input cost increase leading to expanding margins. As we can see on the table below, most sectors with the exception of financials are expected to grow margins between 2021 and 2022[2].

[2] *No guarantee of performance or result*

Spread the Wealth

Ebit margins are higher across S&P 500 sectors

	2020	2021	2022E
Communication Services	16%	22%	24%
Consumer Discretionary	6	10	11
Consumer Staples	9	10	10
Energy	-20	9	15
Financials	18	31	21
Health Care	8	11	14
Industrials	6	12	14
Information Technology	22	26	31
Materials	9	16	18
Real Estate	20	23	25
Utilities	19	16	23

Source: Bloomberg
Note: Ebit margins for 2022 are analysts' consensus estimate.

BloombergOpinion

Fortunately, TreeTop, with the help of Aubrey Capital, re-balanced its general investment strategy towards the US a few years ago. Our global indexed strategy which is heavily exposed to American markets also helped to deliver good results to clients in recent years and we hope we can continue to do so in the future. In conclusion, the recent market correction is unfortunate but not unusual and we think it should be quickly forgotten by the long-term investor.

Please feel free to contact the TreeTop team for any questions you might have about this newsletter or investing in general.

2. Our convictions

Our strategy, while slightly down year to date, has done better than the overall market thanks to a combination of exposure to the **DOGS of the DOW** and investments in 'value stocks' all across the world. As explained in our last newsletter, we decided last year to invest part of our strategy using the **DOGS of the DOW** methodology with the aim to increase exposure to large profitable American businesses trading on relatively low valuation multiples. Another rational was to better balance the risks in our strategy, which is heavily exposed to growing mid-sized businesses in Asia.

We are delighted to observe that this strategic move has delivered good performance so far this year with a number of companies, mainly **CHEVRON,** a leading oil & gas producer, **DOW INC,** a large international petrochemical business, **AMGEN** and **MERCK,** two large pharmaceutical companies, all contributing positively to performance this quarter.

Other major contributors to our strategy's performance this quarter were **FUFENG GROUP, JAZZ PHARMACEUTICALS** and **UPLL. FUFENG GROUP,** a long-held position of ours has finally started to generate some results in a very difficult Chinese equity market. The Company is the leading MSG (an important food additive in Asian cuisine) producer in the world and has consolidated its market thanks to its low-cost production base. The stock hadn't really worked in previous years as the Company struggled to completely control its margins. Nonetheless, we kept an important investment in **FUFENG GROUP** given the very low stock valuation and the Company's strong financials. We think there is significant upside potential if the Company successfully finalizes the consolidation of its sector. If not, the downside appears limited as the existing business is strongly cash generative and the stock is cheap. **JAZZ PHARMACEUTICALS** is a growing pharmaceutical US Company with a few important treatments for sleep disorders and a growing business in medicinal cannabis used in the treatment of neurological disorders. In recent years, the Company has done an excellent job at maintaining its cashflows thanks to good sales of its sleep disorder treatments. It used the cash proceeds to buy a UK biotechnology firm GW Pharmaceuticals, a leader in the science, development and commercialization of cannabinoid-based prescription medicines. The acquisition was initially not well appreciated by the market and the stock dropped significantly. In recent months, **JAZZ PHARMACEUTICALS** has started to recover as the Company delivered good financials in its core sleep franchise business as well as in cannabinoid-based prescription medicines.

The three major performance detractors so far this year were **INDIABULLS HOUSING FINANCE,** a leading mortgage provider in India, **CHINASOFT INTERNATIONAL,** a large Chinese IT outsourcing company and **MAN WAH HOLDINGS,** an upscale sofa brand and manufacturer in China. **INDIABULLS HOUSING FINANCE** delivered reasonably good results and an exciting business plan for the next few years but the stock, as with most Indian financial institutions, suffered from a more difficult macro-economic environment. **MAN WAH HOLDING** continued to deliver good results but its export business to the US suffered from increasing freight raises and there are concerns about potentially slower demand in China. Finally, investors started to discount the risk of raising wages for IT employees and potentially lower margins for **CHINASOFT INTERNATIONAL.** We have taken some profit on some of these three stocks in the past we have maintained investments as these three businesses have good management teams with growth track records. These three companies still have large addressable markets in the case of **MAN WAH** and **CHINASOFT** and 'enormous' growth potential[2] in the case of **INDIABULLS HOUSING FINANCE.** All these three stocks also trade at a discount to the overall market despite what we believe are much better growth potential.

As we mentioned earlier, every crisis creates some winning businesses who are generally part of the solution to the crisis. Over the last twenty years, the promotor of **UPLL** transformed a domestic, family agri-business into a global leader in generic pesticides and herbicides, with a major presence in Brazil, the United States, Europe and Asia. This global presence has paid off in recent months as **UPLL** managed to take market share from competitors suffering from logistics logjams. The Ukraine-Russia crisis has also boosted global food prices and will require new suppliers of food from stable countries, boosting **UPLL's** prospects.

Data & Information as of 31st March 2022

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