Kyklos Capital

What We Are Doing Now

"Take advantage of it now, while you are young, and suffer all you can, because these things don't last your whole life." **Gabriel García Márquez, "Love in the Time of Cholera"**

Muddy though the current outlook is, some facts are very clear. We can forget about portfolio bets on 2020's earnings growth, momentum, or valuation multiples. The ongoing shutdown will crush company earnings power worldwide for all sectors, for at least two quarters, and probably much longer. Similarly, macro predictions of country fiscal and current account balances and GDP growth are out the window for this year as governments and central banks react with massive emergency spending and interest rate cuts.

As a result, Kyklos is positioning the portfolio for the post-Covid economy that will probably emerge only in 2021. The earnings estimates and company strategy results that we base our decisions on will be longer-term, and the short-term risks and unknowns are larger. We continue to exit positions in some stocks with newly -impaired medium-term outlooks, business models hurt by durable changes in customer behavior, and low trading liquidity levels, all of which lead to permanent valuation discounts. We continue to add positions in stocks of companies that will likely benefit from an anticipated recovery, stimulus spending, and market-share gains due to the crisis, with low risk of deep losses in the meantime, and that offer meaningful potential gains 12 to 18 months from now. We think that the countries with the strongest rebound potential will feature high demographic growth, competitive manufacturing sectors, and big benefits from cheaper oil and raw materials. As a theme, China is no longer the primary source of global pressure on GDP, and is already becoming an early recovery candidate, with local production rebounding, hotel occupancy increasing sharply from extremely low levels, and massive stimulus programs, while Europe and the U.S. have yet to demonstrate any return to normal activity. Kyklos will continue taking advantage of the indiscriminate selling by trading out weaker companies with illiquid shares, when better, more liquid, and similarly undervalued comparable companies are available. Technical analysis has been useful in pulling the trigger on painful exit trades to avoid further losses, and on avoiding adding new positions too early, and has become more important in our decision timing.

Kyklos came into March with about 11% of the portfolio in cash, close to the long-term portfolio average. We targeted exits from companies with newly-impaired earnings recovery prospects and poor liquidity. After exiting several positions, the portfolio's cash weighting peaked at over

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30%, and was only reduced late in the month when we added positions after positive technical signals finally emerged. Those positions we sold all went down further, and we saved significant costs on our new positions by waiting for cheaper price levels. The portfolio's cash position is currently at about 13%, and we continue to add positions.

Kyklos has increased its weighting in Vietnam. GDP growth in 2020 will sharply decline from the recent trend of over 6% per year, as manufacturing and tourism plunge in the face of global lockdowns and consumer panic. Post-Covid, however, we see strong rebound potential. The long-term drivers of the boom remain intact, such as significantly lower production costs versus China and Developed markets, strong demographic growth with a very high labor participation rate, and high visibility on pro-development government policy following the Chinese model. Underlining the durability of its appeal was the recent announcement by Vietnam's top manufacturer, Samsung, that it intends to shift all its South Korean cellphone production to its Vietnam factories as a crisis measure. As we highlighted in our February letter, Vietnam's stocks are now somewhat less overvalued after a period of underperformance and diminished hopes of immediate re-classification as an Emerging economy.

Saigon Cargo Service (SCS) was added to Kyklos late last week. SCS is Vietnam's leading airfreight logistics company. SCS' share price has been almost cut in half since its 2019 peak as the immediate outlook for Vietnam's exports suffers from disrupted value chains and consumer stress worldwide. Longer-term, however, demand for electronics—a majority of total exports--will certainly grow, possibly even helped by the crisis, as connectivity, entertainment and communications are more vital than ever. Short-term, risks from the slowdown are somewhat hedged by Samsung's announcement mentioned above, as well as a switch to domestic shipment-by-air to replace trucking via roads. Exceptional for Vietnam, SCS offers meaningful earnings guidance to the market, and they have already delivered the obvious 2020 profit warning. Given SCS' structurally high operating margins and no debt, we think short-term risks of large losses are quite low. Longer term, long-planned airport expansions should add significant overall capacity and earnings power. Looking out to 2021 on a partial earnings recovery, we see one-year profit potential of about +50% in the stock. We also exited two positions in less attractive companies in the trade services sector, which partly funded our SCS purchase.

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