

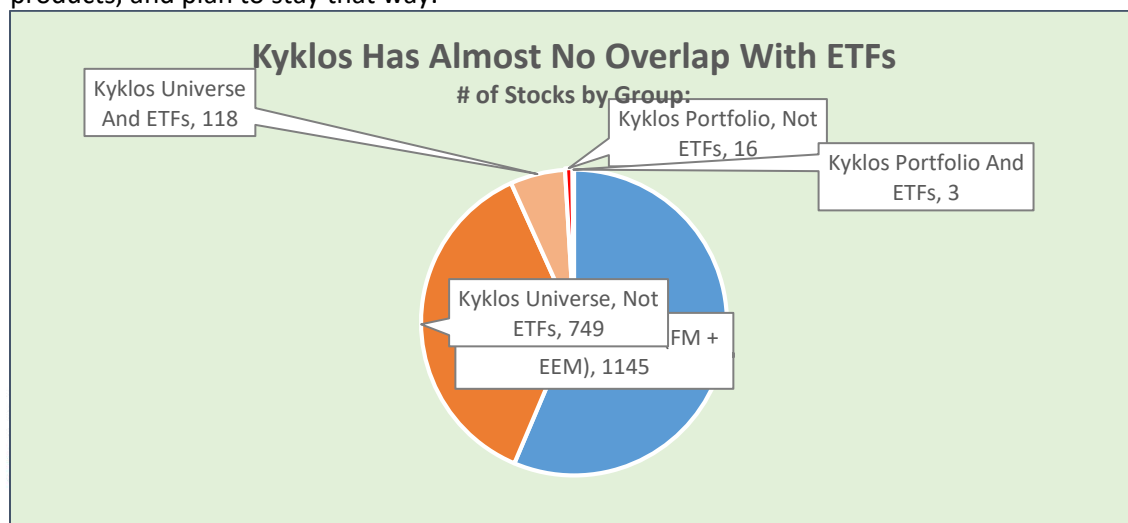
Kyklos Capital

Outlook: Active Management Means No Index Stocks for Kyklos. Passive Pakistan Smackdown.

"Passivity is fatal to us. Our goal is to make the enemy passive." Mao Zedong

Kyklos's active investment process has little in common with passive ETFs and indexes from MSCI, FTSE or other providers. We focus on absolute returns and are not benchmarked to any index. Our process involves searching through stocks in small Emerging and Frontier equity markets, which have sufficient trading liquidity for a fund of below \$500m, which is well above our size. We look for companies with high and sustainable profits and strong managements, which we expect to be positively re-valued by investors in a specific timeframe. MSCI or FTSE are mainly relevant to us when they trigger price changes by driving investment flows into or out of our stocks, which is rare. Because index ETFs mainly focus on the largest listed companies in the largest markets, which are already widely owned, their stocks are more likely to be correctly valued by the market and offer less profit opportunity. Many of Kyklos's positions offer better quality characteristics-- operating margins, balance sheet cash, etc.-- at lower valuations, than the much bigger companies included in the big stock indexes.

An investor in Kyklos, therefore, will share almost no positions with the largest ETFs in our space, the iShares MSCI Emerging Markets ETF (EEM), and the iShares MSCI Frontier and Select EM ETF (FM). About 900 stocks make up Kyklos's current universe of stocks, while the ETFs together hold about 1,300 different positions. Of those, only about 120 stocks, or less than 10% of the ETF names, appear on Kyklos's potential shopping list, and only three stocks in our portfolio are also held by either ETF (below). We are a very different animal versus these passive products, and plan to stay that way.



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For an example of the pitfalls of passive index-chasing, **Pakistan offers a cautionary tale**. In September, MSCI confirmed that they will remove Pakistan from their Emerging Markets Index (MXEF) as of November, returning it to Frontier. A passive MSCI Emerging Markets Index (MXEF) investor needs to sell his Pakistan holdings, now a piddly 0.02% of his portfolio, while an MSCI Frontier Markets Index (MXFM) investor will need to invest 1.9% of the portfolio into the proper Pakistan stocks at that time. In hard dollars, that represents a move of some \$150m out of Pakistan, which has largely already been anticipated by active investors. Since 2017 when MSCI reclassified the country to Emerging from Frontier, the passive Emerging investor has lost over 50% on their Pakistan positions. Not for nothin', Kyklos's Pakistan positions returned a positive +27% in the same timeframe. Not terrific-- just better.

Charlie Gushee
October 1, 2021

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t: 646.738.8078
cgushee@kykloscapital.com