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Oldfield Partners

Panel Discussion

4th July 2016

Oldfield Partners (OP): *Claus Anthon (CA), Jamie Carter (JC), Harry Fraser (HF), Richard Garstang (RG), Richard Oldfield (RO), Tom Taylor (TT), Robert White (RW), Sam Ziff (SZ)*

JC: Good afternoon everyone, welcome to The Goring. Thank you for coming today. For those that don't know, I'm Jamie Carter, I'll be chairing the discussion today. First, I'd like to introduce the panel. Nearest to me we have Tom Taylor who runs the Emerging Markets portfolios, then we have Richard Garstang who co-manages the Global Equity Income Fund, Harry Fraser who manages Smaller Companies, Claus Anthon who manages the European Fund and lastly Robert White who manages the Japan Fund.

Today's format is that I will start with some questions, some of which have been kindly submitted in advance by you, the audience, and we'll try to progress things but if you have a question or if you want one of the panellists to expand on a particular topic or answer that's been given do put your hand up and I'll try to bring you in. I want to make this as interactive as possible. I'm going to try not to dwell on any particular topic for too long and that means not dwelling on THE topic for too long. We'll have a tea break no later than 5pm, so that those of you that need to leave can do so. After the tea break we'll continue for as long as anybody wants to with further questions.

Lastly, as most of you know we are value investors, we are contrarian in our approach, we use bottom up fundamental research to dig out what we think are attractive long term investment opportunities. We manage very concentrated portfolios and that means that they can look and behave very differently to a benchmark index. That's something that people need to be aware of. To give you an example, the Emerging Market strategy which holds around 20 stocks had actually performed pretty similarly to the benchmark in recent years until this year and then in a six month period it's outperformed by 20%. It means that the approach requires patience both on our part and then obviously from you as investors and we view the kind of uncertainty and volatility that we can get in markets as an opportunity - the market is offering us valuations which we think we can take advantage of.

I think that feeds in well to the first topic of the day. For those of you that were here last year you'll remember that we started the debate with a discussion of the possibility of Grexit. How many of you would have bet on us being in the position one year on where we'd actually be contemplating the aftermath of a decision to Brexit?

I'd like to start with Richard Oldfield. Could you just comment on Brexit and what it means to us as investors?

RO: I'm only going to say a very brief word about it, because none of us know, and all of us have heard far too much about Brexit already. I think Mark Carney's description in the paper this morning of Brexit as an economic post-traumatic stress syndrome is a very good description. In other words something which is quite serious but treatable and possibly temporary. Somebody was telling me that there are signs on the M4 which say "Thanks goodness we're leaving. Praise the Lord" and maybe we'll be thinking praise the Lord before very long about Brexit, but it doesn't feel quite like that at the moment. I think that the immediate effects as widely discussed have got to be bad in the UK economically, they don't need to be bad in every way and they don't have to be bad permanently, but they do have to be bad in the immediate future for, for example, foreign direct investment which is a tiny percentage of GDP, it's only 1.5% of GDP so it's almost irrelevant. They do have to be bad for capital investment in general, which is a bigger percentage of GDP, 17%. And then there is the consumer and nobody quite knows if there is a real impact on the consumer of potentially higher costs from the weaker sterling, but then much more important is the question of confidence. And confidence is a very fickle thing which at the moment is maybe feeling a little battered but it could revive. I think we're not in a position as we were after coming out of the Exchange Rate Mechanism in '92 because then we were immediately in a new regime and we knew exactly what that regime was. Now, we're in a sort of never-never land, we don't quite know what regime we are in and we may not know for some time. So I think if you are Brompton Bikes you're pretty pleased with life because your sales abroad are going to shoot up, if you're Deutsche Bahn who have had a value of €10 billion placed on their UK railway franchise, which has just been reduced to €8.5 billion, then you're not so pleased. But there will be mixed effects and in the short term at least I don't think they will be very good effects. Then there is Europe where there is obviously the danger of contagion and all sorts of opportunities for things to go very badly wrong. But I won't belabour all that. The thing that I just wanted to say before beginning is that one thing about which people are certain is that there is uncertainty and if everybody is certain about something, if there is unanimity, then that should be discounted in markets. It doesn't mean the worst outcome is discounted in markets but the uncertainty itself is discounted in markets and uncertainty brings volatility but, as Jamie said, it also brings opportunity. So our focus in the last week and on is to look for opportunities in valuations which in many cases are lower than they were.

JC: Thank you Richard. Why don't we start with a few specifics, thinking about Smaller Companies and Europe. If we start with you Harry, why don't you tell us what kind of action you have or haven't taken in the aftermath of the events of ten days ago?

HF: The Smaller Companies Fund had just over a third in domestic UK stocks before the vote. We concluded that we didn't know what the outcome of Brexit would be but in the long run all these companies were not likely to be majorly impacted, so valuations being low we decided not to make any changes before Brexit. Following the vote all the UK stocks fell heavily, much more heavily than we had expected. Some as much as 30%- companies like Bovis Homes, Sports Direct, so that was clearly pretty painful. More positively we had 4% in cash and we put all of that back into those UK stocks. Almost all our UK stocks were trading on single digit price to earnings ratios. The value within the portfolio has improved dramatically, with underlying book value of the portfolio increasing 10% in dollars in the first half of this year and 20% in sterling. We've been able to buy companies much cheaper than they were at the beginning of the year. For the first time since I started managing this fund in January 2012, the whole portfolio is trading at less than book value. So it's provided a great opportunity to buy things extremely cheaply but at the same time it's been quite a painful week.

JC: And Claus, how about from a European perspective?

CA: We also took advantage of the weakness in the markets and decided to increase our exposure to the UK. We increased our holdings in Bovis, Lloyds and JD Wetherspoon. At the same time we also saw some price discrepancy in the energy sector. For instance, one company we hold is Lukoil and it did extremely well over those two days and is now up nearly 80% year to date so we decided to cut our holding down to 5% and used the proceeds to increase PGS (Petroleum Geo-Services) in Norway which is also an energy stock but which has not performed well.

JC: The question that follows is, as many people are saying, there are obviously going to be question marks about referendums in other countries. There is likely to be uncertainty and potentially instability over the coming years, so what do you think that means for a stock picker like yourself?

CA: I think it is too early to say what is going to happen but Europe has been through instability over the last 5 years and we managed to find interesting stocks to invest in. If you go back to 2012 when we had the first crisis in Greece we bought into a company called Coca-Cola Hellenic and that did very well for us. Last year when we had the second crisis in Greece, which was even more serious, we found a stock called Jumbo, a toy retailer, which had halved in value over a three/four month period. We felt the stock was oversold as they had already been through capital control issues beforehand in Cyprus and managed the situation well. Again we made a nice return on this investment.

This time the uncertainty is in the UK. We have taken advantage of this and I hope the same will happen here. I think this shows we will take action as and when opportunities present themselves.

JC: Yes. Investors do tend to react very sharply as we saw last week - so you expect that to happen again in the next couple of years?

CA: Although Brexit has now happened I am not sure we will see other countries following although there are rumours Denmark will be the next one. If that happened I am not certain we will see the same sharp market reaction. The UK was unique in that everyone thought we would remain and even at 10pm on the day of voting the pound rose to $1.50. It was the surprise that the leave campaign had won that caused the massive selloff in the market. At one stage Bovis was down 56% and you ask yourself is a company worth 56% less within 8 hours? I accept the company will have issues but not to that extent.

JC: Richard, for the Income Fund, does that short term volatility offer opportunities given your need for income?

RG: Absolutely. It is worth reiterating that the Global Equity Income Fund is primarily a value focused fund, but you are paid the dividend whilst you wait for this value to be realised. And we regard volatility, as with the other strategies, as a source of opportunity to buy interesting companies at good valuations. We did exactly the same as Claus and Harry over the last week or so, adding to our positions in Lloyds, Bovis and Stagecoach - all UK companies that had fallen over 30%, all now trading below book value, and all offering dividend yields over 4%. We also increased two of our holdings in Japan - MUFG, the Japanese bank, and Toyota - after they both fell significantly. MUFG is now trading at a price to book of 0.4 times and Toyota, once you strip out the excess cash, is now trading on a price to earnings multiple of just six times. Both offer dividend yields over 4% that are well covered.

JC: I am very intrigued by that fall in Japan after the referendum Robert, what did you think was going on? The market was down 8 or 9% on that Friday morning, what do you put that down to?

RW: Predominantly the currency. I think people regard for whatever reason the yen as a safe haven and in times of uncertainty the yen has been going up in spite of the fact the ten year Government bond is now trading at -0.25%, and also concerns about world trade and the financial system. So the financials in Japan were particularly badly hit, some of the exporters and stocks with at least on the surface a large exposure to the UK, such as Hitachi with its nuclear and railway exposure.

JC: Are there any further questions about Brexit before we move on?

Q: You mentioned you topped up in JD Wetherspoon, for me that feels a bit of a value trap - the costs are rising, the competition gets sharper and sharper, the margins are falling, they're already selling as many rashers of bacon at breakfast as they can – where is the value in that company?

HF: Wetherspoon, we think, is one of the most misunderstood companies. Over the last 15 years it's had something like 12 to 20 analysts covering it throughout the whole period and over half of them have been negative on the stock. Margins have consistently been falling, which many analysts focus on, despite Tim Martin saying he is more interested in absolute profits per pub rather than margins. Over that period it's outperformed all the other pub groups, compounding at 17% per annum - it's done fantastically well. Tim Martin, the founder, read a book by Sam Walton called *Made in America* and he decided to copy the business model in an industry that is fundamentally uncompetitive and poorly run. Much of the competition was hundreds of years old, they either had loads of debt with large interest payments or, they were tied to a brewer and had to pay huge rents and had no choice of beer which was bought expensively. Tim Martin saw an opportunity to come in and buy disused buildings like old cinemas or old churches and convert them - the cost per square foot is much, much lower, you're not tied to anyone at any brewer and you have much lower rent. He then followed the discount model of Walmart, where he charged prices that were 20-30% lower than everyone else, driving sales. Over time sales have gone up year after year and their sales per pub are now four times that of an average town pub. No-one can compete, they can't even get close on competing on the price per pint. This meant leveraging the fixed cost base. We expect next year margins will continue to fall but profits will go up. At the moment it's on more than 11% free cash flow yield and it's continuing to grow. The company is extremely excited about its prospects which is shown by the fact it's doing large buy-backs - just two days ago it did a £7 million buy-back. It has halved its share count over the last ten years. It's the company I'm most excited about in the portfolio so I hope it's not a value trap!

JC: Harry just to that point, there are a number of things you said about that particular company, are there certain traits that you look for in most of the companies that are in the portfolio?

HF: Yes, we look for founder managers, sustainable profits where the product is not likely to be innovated away. We're looking for relatively misunderstood companies and companies that have decent returns on invested capital, have good cash flow generating ability and have relatively strong balance sheets. Obviously some of the portfolio companies do not have all of these characteristics and there are some companies that are trading at exceedingly low valuations compared to their assets or earnings.

Q: Is there any real rational underlying data or fact for assuming that the world is going to go into a recession just because we've had this political shock?

CA: It is mainly about foreign investment where we could have some problems for instance car producers delaying investment in the UK ahead of new trade agreements - this could lead to a slowdown in the economy.

Q: But European stock markets went down a lot more didn't they?

CA: Yes initially. It also depends which UK index you look at. For instance the FTSE 100 was down only 3% on the first day as it includes a substantial number of large international companies and therefore did less badly compared to the FTSE 250 which is mainly a domestic index and was down 7%. In Europe the markets were also weak, especially the financials.

HF: In euro terms the FTSE 250 was down 16% because the currency moved so much as well.

Q: You mentioned the banks but the one big effect that did happen two Fridays ago and since then is bonds have gone even higher. I think in Switzerland now the entire yield curve is negative. Basically, yields have come down and that has an impact on banks. So in the UK and Japan what effect does that have on Lloyds and MUFG or other banks that you're looking at because that is an important factor for the banks.

RG: Yes, and you've seen that with the share price reactions across the world. The first impact may be on the net interest margin, with lower rates eventually feeding through into lower net interest margins. A second impact may be higher provision levels caused by a weaker economic environment. In the case of Lloyds, we've modelled how these factors may impact earnings. If you cut the net interest margin by 50bps, which would be in line with comments that the Bank of England may cut rates to zero, and increase provisions to around 40-50bps of average loans, which is a more normalised level across a cycle, then we believe that earnings per share could still be in the 5p range which means you're getting a bank trading at 10 times earnings, even assuming these negative outcomes. It is now trading below book value, despite earning a return on equity of about 9 or 10% allowing for these negative outcomes. And we would regard this scenario as pretty extreme because it assumes Lloyds does nothing on the deposit side - you'd expect them to reduce the amount of interest they pay on deposits, which at the moment averages around 1%. Time deposits are over 1%, so they can cut that. This would mean the net interest margin compression won't be anywhere near 50 bps. So under what we regard as a pretty bearish scenario you're still getting a bank trading at 10 times earnings and under book value. And in the case of Lloyds, it has leading market shares in many of its businesses, it is well provisioned and the loan to value in its mortgage book on average is below 50%.

RW: MUFG got hit, as Richard said it is very cheap now, 0.4 of book. I think the really interesting thing that's happening with Japanese banks is that there is restructuring going on, they are being forced to change, they're doing much less trading on their prop book, they're reducing their cross shareholdings, and I think that will continue. Somebody was suggesting to me the other day that the next move by the Government after the election, which takes place this weekend, is to possibly create a fund to buy all of the cross shareholdings from the banks, and that the banks will be allowed to take the profits tax free and that this will offset any problems they're having with negative interest rate policy. One should never invest in Japan solely on the basis that Japan is going to change, that's the golden rule, but if that were to happen I think that would completely change the landscape but it's happening – change is taking place already. I've just come from a Mitsubishi conference and there were some really very interesting things being said about how the group is changing. In the short term one has to be a little bit cautious but in the medium term I think the bank and the financials are changing generally.

JC: Is there anything else on this topic – possibly on the European banks?

CA: I'm not worried about the investment banks in Europe as such; I don't really know what's in their balance sheets and therefore avoid them. However, I'm sure that at some stage there will be a time to buy them but for now why take the risk when I can make good returns for investors in some of the domestic retail banks?

JC: What about the Italian banks?

CA: You don't know what's going to happen now, if the banks will be allowed to be bailed out by the Italian Government. At present Merkel is fighting it so we will have to wait and see.

RG: Different regions have dealt with the financial crisis in different ways. The US probably led by example and recapitalised all their banks, very large amounts very early on, but Europe has dragged its heels. The UK being out of that Eurozone has made it easier for UK banks. If you think about risk in terms of the ratio of total assets compared to its equity roughly speaking US banks are about 10 to 12 times, the UK banks are nearer to 18-20 times, whereas a bank like Deutsche Bank is closer to 40 times. Now it is partly because there are trading assets and liabilities, there are derivatives, there are different accounting methodologies - it's not straightforward - but as a guide that just shows you where the risk lies.

Q: Long before Brexit I read something about the fact that the European QE policy would fail because it was infinitely not ambitious enough and that the banks would go again. I was just wondering do you think there might be some sort of sea change in attitude?

RG: Yes, I mean this is the point around the Italian referendum and the Prime Minster trying to push through reforms. I think there are €350 billion of non-performing loans in Italy, that's an incredible number and they're looking for a €40 billion bail-out. That tells you where some of the problems lie within the Eurozone and then you add in the Brexit equation and the potential for contagion and you can see why the European banks fell as much as other banks that you would think are more directly affected. How you solve Italy is a big question mark, but I suspect the ECB and the Eurozone will have to be more accommodating.

Q: And can they do it? I read somewhere that it was going to cost the Germans 4% of their GDP, I don't know what that means in numbers, but the trouble was would all the other countries accept the conditions that would be attached to the Germans having to give up 4% of the GDP? I know this is speculation but in terms of why one would invest in the banks other than the fact that they're cheaper than they were.

RG: That is your ultimate risk. You're balancing the will of the Eurozone to hold it together and the will of the German people to make sure it holds together - otherwise you may have contagion and worries in peripheral banks and you wouldn't want to invest in all of them. All banks can fail because they are leveraged. Even if you've got 10 times leverage in the US, it doesn't take a lot to wipe out the equity and as a shareholder that's what you're worried about. Tom, for example, takes the view that you should not invest in emerging markets banks, the risks are just too high. You can get very high quality banks, I'm sure Mr Buffett will tell you he's very happy with Wells Fargo and his holding in Bank of America, but there are also plenty of banks that are bad and it's about trying to identify which ones are which and what valuations you pay.

SZ: Adding to that point, the issue we've had with Italy is that the NPLs are very high and to move a NPL off the balance sheet in the UK it usually takes about 18 months in order to get your hands on the collateral if it was non-performing. In Italy it can take up to 8 years in the North and as much as 12 years in the South. Any investor who wants to buy those loans from a bank knows it's going to take 12 years to get their hands on the collateral. This is one of the biggest issues that Renzi is trying to deal with - he can't get the reforms through Parliament in Italy. It becomes as much a political problem as an economic problem and I think we do have to treat each region within the Eurozone differently as a result.

RG: And of course €350 billion of non-performing loans doesn't necessarily mean €350 billion of losses.

JC: Perhaps we ought to draw this part to a close, we can come back to it at the end. Robert, you said a couple of things I'd like to pick up on. Anyone that knows us knows that we think the Japanese market is cheap, you also said about not investing in Japan solely in hope of change. Japan has been cheap for a long time, but what is going to change that?

RW: Those of us who've done Japan for decades, we say never invest in Japan on the hope that things will change, but actually we think things are changing in terms of corporate governance, in terms of capital efficiency, I mentioned cross-shareholding unwinding, dividends are rising, you've got a 2.3% dividend on TOPIX which is the highest level I've seen for quite a long time, particularly given the fact that JGBs have negative yields, but the managements are changing, boards are becoming more focussed, the number of independent directors is rising and we are seeing other changes - there have been a number of instances of senior management being thrown out of their positions because the rest of the board has voted against them. The independent directors and the executive directors are actually starting to realise that not only do they need to do something but they can do something. So I think that's extremely encouraging. I said I had just come from a conference, at that conference I saw Mitsubishi Estate (which we don't own), Japan's biggest real estate company. We've known them for years and I was absolutely staggered today – the Mitsubishi Group is very conservative – when the person I was talking to said that they were introducing a system of incentives for senior management which linked them much more closely to the performance of the share price, a quarter of their remuneration from this year will be linked to the share price performance of the stock and this has been brought in in the last couple of months by some regulatory reform. It's the first time I've actually seen anybody responding to it. So change is happening. I think we can invest.

JC: Perhaps you could give an example of something that's in the portfolio?

RW: We've talked before about Hitachi, so I won't talk about Hitachi. We invested in NTT in 2012 and in 2012 a new president came in, the stock had been performing un-interestingly I think is probably the best way of putting it, and the new president put in place targets for the stock for earnings and for performance and other performance measures. The key measure that he articulated to investors was that the earnings per share would increase – his target was to increase it between March 2012 and March 2016 by 60% and that would happen through a rise in earnings but also through share buy backs. And just to cut a long story short in those four years they have bought back approximately 20% of the outstanding shares and earnings were up 68% over the period and restructuring is still going on and the group president has worked with the mobile phone company, NTT DoCoMo, to get efficiencies through there too and the companies are reforming their real estate business, they have 7,400 pieces of real estate in the telephone companies, and that is not including those pieces of real estate that are held by NTT Urban which was set up at the time of privatisation. We bought NTT for change, there were those who were sceptical, but it's come through and it's delivered very, very good performance.

JC: Richard in the Income fund, I don't know whether you hold NTT but if you can just say whether you do and also I think it's interesting the idea of yield, change, valuation, how do you put those three things together?

RG: We do own NTT for all the reasons that Robert outlined in terms of value, in terms of change and it has a good yield of 3.5%. In the Income fund, it's not purely about income as you might think of it, this is a value focussed Income Fund. We are looking for companies which combine a number of things - where we believe there is a big gap between value and price, where you are paid a reasonable dividend yield while you wait for this value to be realised, and where the dividend is sustainable and hopefully growing. We also look for companies that are unloved, out of fashion and where there could be change. We found this combination in NTT which we bought three/four years ago - that unloved dinosaur of Japan has come through with the goods. At the moment a couple of areas that we have in the Income Fund that you probably wouldn't expect in what you might call a traditional Income Fund, is exposure to mining, oil and the banks. Those areas are really unloved but we are still getting those dividends of 3-4% whilst we wait for the value to be realised.

Q: I'm impressed by your hunt for the restructuring story in Japan because I think from the outside many of us probably see the economy as quite stagnant, reluctant to change. The ageing population, high cost, can't compete in the world, slightly lost its mojo but do you actually think there are companies which have just been undermanaged which can be kicked into shape and generate value for you?

RW: I think there's lots of opportunity and the encouraging thing is that it actually is the attitude of managements, it's not all managements but the attitude of a lot of the company managements we see are becoming much more open to change, much more accepting of it, the need for it, the understanding of it. For many years they paid lip service to the fact that they needed to raise their ROE but they didn't really understand what was going on and I think the really encouraging thing is that there are a lot of people in senior management positions in Japan who were sent abroad in the 80s as juniors, as trainees, and who came back and have now found themselves in very senior positions, whether it's the president of MUFG or the president of Hitachi, understand this better so I think there is a lot of opportunity. As far as the ageing population is concerned one of the great things about having an ageing demographic in a country where people are paid on the basis of their seniority is that as the older employees retire wage costs come down. So you can raise the wages of younger people but because the older people are retiring, your overall wage bill doesn't increase. NTT has a fabulous chart, which we won't show now, but it demonstrates that phenomenon clearly.

Q: Could you reflect on the balance sheets of Japanese companies in general?

RW: If we invest in companies which are operationally geared, we don't like combining that with balance sheet leverage because if you get the cycle wrong you may be in trouble. From a portfolio holding point of view there is not a lot of leverage in the portfolio, with one or two stocks where we see change coming through and balance sheets improving, we have some debt but not that much. Why Japan is interesting now is that after the bursting of the bubble in 1989 the country spent ten years re-building its financial system and then they started to sort out the companies themselves, so the financial stocks were restructured then you get the corporates restructuring because they had very extended balance sheets and then we had 2008 so nobody spent any money for ages because they were too worried. Now we're in a position where the cash sitting on the balance sheets of a lot of companies is available either for M&A, or for capital expenditure but there is still a lot for the shareholders, so I think there are some really positive stories, some positive technological stories in Japan which we won't go into now but there are some positive corporate restructuring stories.

JC: I'd like to pick up on a couple of things that were left hanging by you Richard: one is to turn to Tom who has been very quiet and I think we do need to know why you don't invest in emerging market banks?

TT: As Richard pointed out, developed market banks and emerging market banks are somewhat different. Crises in emerging markets can be much quicker and harsher and banks can easily get wiped out. There doesn't tend to be anyone there to rescue them either, so on the whole when we buy cyclical companies we like stocks that have strong balance sheets and/or a really good asset behind them - be that a gold mine or an oilfield, something like that. Currently the portfolio is very much skewed to those sort of quality cyclicals and banks just don't offer that sort of downside protection.

JC: So can you give us an example of something that you feel does, with their oil reserves or gold mine or similar?

TT: We have a lot of very strong balance sheets in the portfolio, the net debt to equity ratio of the portfolio is 11% which is half of the index, but in terms of asset protection a stock like Lukoil has fantastic assets in Russia and a very strong balance sheet.

JC: Richard you said that you have oil and mining stocks in the Income Fund which is perhaps contrarian, can you talk about that?

RG: We've got Lukoil for the exact reasons that Tom just talked about, and it pays a good dividend. We've also got ENI and BP. In the case of BP we are getting a 6.5% yield and we expect 25-30% total return over the next two years. That's using a $60 oil price. We value it on a sum of the parts basis, valuing the exploration and production business, the downstream business, allowing for the ownership of Rosneft, adjusting for the net debt and the remaining Macondo oil spill liabilities, and we still get this upside. This is an example where it's not your steady Nestle, P&G or your Unilever, this is a company where we felt the valuation was very, very attractive. It's still trading below book value and you do get your 6.5% yield whilst we wait for that value to be realised.

JC: That's an unloved sector and for those of you that read our newsletters you'll know there are a number of sectors that we're not necessarily big fans of in the long term, autos being one, airlines another, but we have had investments in both of those areas. Robert / Claus would you like to talk about some of the auto investments, the opportunities that you've seen there over the years?

CA: In the European fund we have exposure to three car manufacturers, which are Volkswagen, Ferrari and Fiat Chrysler. However, we do not have direct exposure to these companies as we hold them through holding companies at a substantial discount to the underlying value. If you look at Volkswagen, we bought that through Porsche Holdings. Porsche Holdings main asset is its 51% ownership of Volkswagen but it's trading on a 40% discount. For me that meant more safety when purchasing the stock. We bought into the stock in November last year after the emission scandal as we felt the shares had been oversold due to the potential litigation. We have since reduced our holding into the recovery.

The other stock is Exor, which we have held for a long time. The company is controlled by the Agnelli family and run by John Elkann. It is trading at 30% discount to the current market value of its holdings. These include Fiat Chrysler, Ferrari, CNH and the recent acquisition Partners Re, one of the highest quality US reinsurance businesses. For us it is interesting to gain exposure to Fiat Chrysler, a company trading on 4x forward earnings at a 30% discount to the current value. Based on our view of fair value there should be an 80% upside in Exor.

RW: Richard's already mentioned Toyota and the fact there's a lot of value there and it's got a high dividend, we own that. We also own DENSO which is an electronic components company. DENSO has two main things going for it, it's the main autonomous driving and software company for Toyota but it also is the world's largest manufacturer of car air conditioners. When you turn on your car air conditioning, your fuel consumption efficiency goes way down, it's one of the reasons why official figures and actual figures for car petrol consumption is so different. DENSO without any question is the leader in efficient air conditioners for cars. There was an article very recently, I think it was in the FT, talking about the fact that more and more global car companies are buying from DENSO in order to get the level of their fleet fuel consumption down significantly and DENSO itself is on an attractive multiple, so that's one of the reasons we own it.

JC: There are still a number of questions we haven't been quite able to get to but we'll take one or two more questions from the audience and then have a break.

Q: Can you update on gold, I know you've had positions in gold over the years.

JC: Can we start with Tom who has a gold miner (Buenaventura) in the EM fund.

TT: Yes, it's a large position in the EM fund, it's a stock that I've held on and off since the early 2000s and each time it's been a fantastic investment. Last year this stock got down to 0.3 times book value and it was the lowest valuation I'd ever seen. Sentiment towards gold and gold miners was so low that it was very easy to have such a significant positon in this gold miner. Forecasting the gold price is particularly difficult so you want to have really good assets and you want those assets to be growing as well. That gives you the confidence that you'll have something even if the gold price starts to fluctuate. Also having assets way down on the cost curve is important. Buenaventura is in the bottom third of the overall gold industry cash curve. The reason it got so cheap last year was that it was effectively mining rock rather than the mineral, but management flagged that so it does help to have a good relationship with the management team, they flagged that this was happening in the industry and the market as a whole decided to somewhat ignore that and not trust them partly because they have very short reserve lives. It did mean that cash costs went up to about $1000 an ounce at a time when the gold price itself was getting down to that sort of level. They did get through that and back on to the mineral, cash costs halved and coupled with the rising gold price that gave a very nice return, I think it's up about 180% this year.

JC: And did you want us to comment specifically on Barrick? I'm sure Richard's itching to!

RO: Barrick too has very, very high quality assets, it has the lowest cost of production of all the majors and it's still making progress in reducing the cost, the all in sustainable cost of production per ounce most recently has been in the low $700s and it's pushing that lower still. They have been concentrating on getting their balance sheet in shape, it's done that. The management which has been in place for the last three years has been totally focussed on getting a return to the shareholders. So as a company it's right on the mark, it's been everything we could possibly want and then there's the gold price which as Tom said is a very unpredictable thing. Given the behaviour of central banks over the last eight years there is a significant risk of dislocation of one sort or another and gold looks after that risk very nicely.

Q: We've been hearing quite a bit to do with macro, if we were to just ignore that at the moment - tell us what's really crashed down in price and how does that value compare to 2009 say. Has anyone got some interesting areas?

HF: Certainly if you look at some of the UK stocks that we hold, like Stagecoach for example, it is trading on similar cash flow yields and earnings yields as 2009, earnings yields are about 12%. And it's got a dividend yield of 6% which is much higher than it did in 2009.

Bovis is not quite down at that level but it's trading at slightly below book value and normally it trades on about 1.5 times. It makes returns on equity of about 15%.

Sports Direct has now got the strongest balance sheet it's ever had since listing but is on 7 times last year's earnings – the first time since 2009.

We own a seismic imaging company called PGS which is trading below where it was in 2009. Clearly the oil industry has had a damaging period but the valuation is exceptionally low at 0.4 times book value, and the book value has been written down. There may be more to write down but you've just got a lot of protection in the value. When things turn in this industry, they can turn fast and as utilisation rises, earnings grow rapidly. PGS at its peak was trading on many multiples of book value.

JC: On that point Harry, are you just talking about one or two cheap companies? For smaller companies generally the valuations are pretty high around the world so what does the portfolio look like from a valuation perspective?

HF: The portfolio couldn't look more different to our benchmark. Our benchmark has around 60% in the US and the US is trading on 25 times earnings, two and a bit times book value. This compares to the portfolio, which for the first time is on less than book value and on a forward P/E of 10 times. In terms of opportunities - because the dislocation between Europe and the US is so extreme we're finding things that are cheap despite average valuations being high.

JC: A question for Claus then, how does Europe catch up to the US? There is this big difference in valuation but why should that change?

CA: I feel Europe is still undervalued compared to other regions. Firstly if you look back to the 1970s the relative performance between the European and US markets has always mean reverted. Over this time the outperformance of one region over the other has never been more than 20%. However, since 2007 it's been a one way bet only for the US market, and at the moment you're talking about an outperformance of 75%. I do not think this is going to continue forever and at some point Europe will catch up.

Another way you can see the cheapness of Europe is looking at the operating margins of the different regions. Back in 2009/10 the operating margin in the US and Europe were both 11% whereas in Japan it was about 3.5% and then if you look at today the margins in the US is still 11% but in Europe they have collapsed to 8% whereas in Japan they have moved up to 7%. The reason Japan has seen this improvement is due to the weakness of the yen and restructuring. I feel the same will happen for Europe, we have now been through about 20 months of euro weakness and companies are going through restructuring. For me it is only a matter of time before European operating margins will start to recover. I'm quite confident that unless the whole of Europe breaks up, sooner or later we will start to see profits improving which should help valuation levels.

Q: I think this is a really interesting point because the reason we've all been talking about macro was that macro so dominates anything over and above stock picking at the moment in terms of currencies, in terms of geo political, wars, elections, QE, negative interest rates. Can you foresee or anticipate a time where markets will revert?

CA: These trends can last a long time as we saw with the tech bubble which lasted two to three years.

HF: If you look at Google and Facebook for example, they've now got a combined market cap of $800 billion, they've been doing well. $800 billion is 6 times the global digital advertising market. The digital advertising market is now 30% of the overall advertising market and it's becoming mature. Advertising may grow at the rate of GDP may be plus a bit but not much. Google and Facebook can't gain much market share because they already have very dominant positions. Their valuation is 6 times the entire market. Advertising will fall in a recession and when it does I think there's no protection from a valuation perspective.

Q: But does that relate to the macro environment if people just feel safe in Google and Facebook, does that mean that they look at valuations?

HF: They've continued to grow and have consistently beaten expectations, which provided comfort to investors. When things go wrong, you've got no protection in the valuation.

Q: Have we seen any big falls in emerging market shares that you keep an eye on to buy or have they all been too solid?

TT: For the Brexit two day event the EM portfolio outperformed by 1.5%, the index itself was fairly solid as well, so this is thankfully a crisis that EM has basically sat out. We have only added 0.2% to one stock.

JC: I have one last question for the panel which is to ask each of you which stock in the portfolio you're most excited about and why? I'm giving each of you theoretically £1000, which of your stocks in the portfolio do you put it into?

TT: I'd rather invest it in the portfolio itself but if I have to pick a stock it would be Samsung Electronics which is the largest holding, it's unreasonably cheap at a P/E of 9 times with one third of its market cap in net cash, trading a little bit above book value, improving its corporate governance and shareholder returns and hence the dividend is rising.

RG: There are many excellent opportunities to choose from - Bovis and Lloyds spring to mind - but I think MUFG in particular stands out. The valuation is extreme at just 0.4 times book value and 8 times earnings - that is almost as cheap as it got to in the financial crisis. It pays you a 4% yield, it is reducing costs, selling its cross-holdings and it has a strong capital position. I think it's very interesting and we've got nearly 100% upside in that one.

HF: Well I think I've already answered this, Wetherspoon.

CA: I think I've answered that with Exor but I think I have one more, I would say Maersk which is the largest container ship operator in the world. The company is the lowest cost operator with margins 5% above its peer group, it has a very strong balance sheet, shareholder friendly management, and it continues to gain market share and is being restructured.

RW: Our largest position is Seven and I Holdings. Seven and I is the largest retail company in Japan, it's far away the largest convenience store company in the world, it has over 20,000 outlets in Japan, it has 8,000 in the US and the free cash flow that's thrown off by the convenience store operations is huge. The problem has been its general merchandise stores and supermarket operations which have either been loss-making or have been at best unexciting. We talked about change earlier, the Seven & I board threw out the former president recently and has replaced him, that's the Holdings company president, with the former head of the convenience store operations. He has said that he will come up with a plan to completely reform the supermarkets and general merchandise store businesses within his first 100 days, well it doesn't really matter whether it's 100 days or 150 days, this is what we need. If we get it, that stock could double.

Q: I'm surprised nobody's talked about China, is there a reason?

TT: Well that may be a crisis to come. I think the focus today has been on the immediate crisis. It's in a very difficult position, there is an awful lot of debt hanging around there, so certainly I would not be investing in China's banks for a start. On top of the amount of debt you've obviously got a severely slowing economy so even though the headline might be 6.5% GDP growth it's really not anywhere close to that, which you can see through various indicators. So the only part that's really growing and it's basically where we are indirectly exposed to, is the consumer - so that's the bit you want to be in. Now China is in effect a closed financial system, so that debt and we've seen this over the last 20 years is continuing to grow which is the worrying bit, but, as it does pop up in various places the government can move it around. So there are state banks, and the main problem is in the state SOEs - there's an amount of net off there. So baseline is I think China can probably muddle through for now, but over time it's very clear what they're trying to do, and they have the mini stimulus in place at the moment, the amount of debt is just rising to worrying levels. So currently the exposure in the portfolio is only 6% through one stock, Lee and Man Paper, which is a containerboard manufacturer. Effectively you're getting a cyclical valuation on the stock but 70% of its end market is consumers. That's basically through cardboard boxes, so if you think every time you get an Amazon package exactly the same thing is happening in China through Alibaba and that's where the growth is but you pay a much cheaper cyclical valuation.

JC: Just to be clear, Tom said he wasn't investing in Chinese banks, no-one at OP is.

I think that brings us to a close. Thanks very much for coming, we'll see you soon.