FSSA Investment Managers

Quarterly Manager Views

FSSA Global Emerging Markets Equities Focus

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Navigating uncertainty

The American economist Frank Knight once observed that uncertainty, unlike risk, cannot be quantified or predicted. This distinction feels particularly relevant today, as we navigate an unprecedented series of global challenges – from escalating geopolitical tensions and evolving trade relationships to technological disruptions that are reshaping entire industries.

While the headlines focus on the cross-currents – whether it's the implications of artificial intelligence or the ripple effects of trade barriers – we believe the fundamental question for long-term investors remains unchanged: how do we identify companies that can not only survive, but actively thrive amid such uncertainty?

Our experience suggests that the answer lies not in attempting to predict the unpredictable, but in identifying businesses with proven abilities to adapt and evolve. The companies in our portfolio have demonstrated this resilience through multiple cycles, which we believe has been upheld by two crucial pillars: strong franchises and exceptional stewardship.

While a strong franchise forms the foundation of sustainable value creation, exceptional management is equally critical in navigating uncertainty. We assess management quality through the lens of each company's business model and the competitive landscape it finds itself in. The best management teams don't just understand their industry – they build cultures precisely calibrated to its challenges.

As the saying goes, "Culture eats strategy for breakfast", but in our experience, it is more often a confluence of the two. A distinct culture that has been primed for the company's competitive advantage – that is often the sweet spot. When the two work together in lockstep, the result has proven to be more durable and difficult for others to replicate. Charlie Munger, former vice chairman of Berkshire Hathaway, might describe the intersection of the two as having a lollapalooza effect.

Consider the contrasting demands placed on management teams across different sectors. A retail business operating in a fast-moving competitive market requires leaders who can foster innovation, embrace rapid change and maintain organisational agility. In such environments, we look for management teams that have built cultures that encourage creative thinking and quick decision-making, while maintaining operational discipline. Our Latin-American e-commerce holding MercadoLibre exemplifies this balance, evident in the way it rapidly developed and scaled its in-house logistics platform Mercado Envios – building its own fulfilment network and last-mile delivery capabilities meant that it could cut delivery times in its key markets by around 75% and reduce its dependence on third-party shipping companies. Envios now handles more than 90% of the items sold on its marketplace, from a standing start three years ago. This rapid transformation, requiring both technological innovation and organisational adaptation, has led to superior customer delivery experiences and greater control over its costs.[1]

[1] Source: All company data herein retrieved from company annual reports or other such investor reports. As at 7th February 2025 or otherwise noted.

In contrast, banking and insurance businesses require a fundamentally different cultural orientation. Here, we seek management teams that have embedded strong risk awareness throughout their organisations. Our holding Bank Central Asia (BCA) in Indonesia demonstrates this approach well — its leadership has fostered a culture where prudent risk management is paramount, as reflected in its conservative lending practices and robust credit assessment processes. This manifests in the detailed transaction monitoring systems that flag unusual patterns, a comprehensive multi-layer credit approval process and its systematic branch-level risk management training programs. Its conservative culture is also evident in the way it maintained strict lending standards during Indonesia's property boom, when competitors were aggressively expanding their mortgage books. This disciplined approach has consistently resulted in lower non-performing loan ratios compared to peers through various economic cycles. The bank understands that its primary duty is protecting depositors' money; therefore, it has built a culture where careful risk evaluation becomes second nature, and growth is pursued sustainably rather than aggressively. BCA's leaders recognise that in financial services, the risks you choose not to take are often as important as the ones you accept.

Manufacturing businesses present yet another distinct challenge. Our Chinese medical device holding Shenzhen Mindray represents the ideal balance in this sector, with a culture that pairs rigorous quality control with continuous investment into research and development (R&D). Its systematic approach to product development maintains parallel tracks: improving its current products while advancing next-generation technologies. A comprehensive supplier management system, and testing protocols that exceed regulatory requirements, underscore its quality focus. This approach has enabled its expansion into premium market segments traditionally dominated by multinationals, while maintaining industry-leading margins through efficient manufacturing and strategic R&D. The result: Shenzhen Mindray has transformed from a local manufacturer into a global medical device powerhouse, competing effectively with international peers while preserving its cost advantages.

Despite these nuances, we believe the best management teams share certain fundamental characteristics irrespective of its sector. They think and act like owners and maintain high standards of capital allocation and corporate governance. They demonstrate strategic patience – willing to sacrifice short-term profits for long-term value creation when appropriate. And they are always aware of the risks — maintaining a strong balance sheet at all times and keeping a pulse of the market cycle. Most importantly, they build succession depth, ensuring their organisations' culture and values persist beyond their own tenure.

Trip notes from Poland and Taiwan

During recent trips to Poland and Taiwan, we were once again reminded of these critical management traits in our meetings with Taiwan Semiconductor Manufacturing (TSMC) and Dino Polska (which has subsequently become a holding). The two companies share many of the same quality features we look for in companies; and there are similarities between the countries too, despite their optical differences. Though geographically distant, both countries have emerged from complex historical circumstances to become prime exemplars of economic transformation, sharing remarkable parallels in their development trajectories, competitive advantages and resilience to geopolitical challenges.

Warsaw today stands as a testament to successful economic transformation. Walking through its clean streets lined with modern buildings and efficient infrastructure, it's hard to imagine that just three decades or so ago, in the immediate aftermath of the Iron Curtain's fall, Poland's gross domestic product (GDP) per capita stood at a mere 8% of the Western European average. Today, the International Monetary Fund (IMF) projects that Poland will surpass Greece in GDP per capita within the next five years, while steadily closing the gap with Portugal, Spain and Italy.[2]

What sets Poland apart is its unique combination of Northern European efficiency with a distinctly entrepreneurial spirit. Unlike Germany, which doubled down on its industrial giants after 1990, Poland has developed a more balanced economy dominated by small and medium-sized businesses. This entrepreneurial drive was evident in our meetings with companies across various sectors, where we encountered management teams who combined pragmatic operational discipline with innovative thinking and global ambitions.

The Polish business culture reflects the nation's history and geography. Positioned between Germany and Russia, Poland has developed a resilient, adaptable mindset while maintaining high standards of execution. This combination has made Poland a preferred destination for European companies seeking to combine operational excellence with cost efficiency — a competitive advantage that continues to drive economic growth.

One notable highlight from our visit to Poland was our meeting with Dino Polska, a company whose corporate culture closely mirrors those of Europe's most successful retail dynasties. Like the families behind Aldi, Lidl and IKEA, Dino's founder Tomasz Biernacki maintains a characteristically low profile while fostering a culture of operational excellence, low costs and long-term value creation. This approach, which prioritises business sustainability over short-term market considerations, has been fundamental to building one of the continent's most successful business models.

[2] Source: IMF Datamapper, GDP per capita, current prices (US dollars per capita) in 1990, Poland vs. Western Europe; and GDP per capita, current prices (US dollars per capita) in 2029 (forecasted), Poland vs. Portugal, Italy, Greece, Spain. Retrieved 7th Feb 2025.

Dino operates a proximity supermarket chain throughout Poland, serving millions of customers through its network of over 4,000 stores. With approximately 4% market share in a competitive market dominated by Biedronka (27%) and Lidl (11%), Dino has carved out a distinct niche through its proximity-focused model. The company's competitive edge stems from what we consider one of the most efficient retail models in emerging markets, combining carefully selected store locations in areas with as few as 3,000-4,000 inhabitants, a curated assortment of fresh and branded products, and vertical integration in meat production. The company's culture is extremely cost conscious which helps to improve this efficiency further. Impressively, it has never had to close any of the stores it has built. The meticulous focus on getting things right in the first instance, and avoiding costly errors, is a stark contrast to most other retailers we analyse.

The business model's efficiency is evident in its operational metrics. Dino's standardised store format, typically featuring just two checkouts, is optimised for its primarily rural customer base, where 50% of transactions are still made in cash. This lean operational approach, combined with its strategy of owning rather than leasing locations, has created a scalable expansion platform that delivers consistent returns. A network of nine distribution centres provides the infrastructure to support its planned low-teens store growth rate, as the company continues to see significant expansion opportunities across Poland.

What particularly impresses us is how this cultural focus on operational excellence and long-term thinking translates into execution. While Biernacki maintains his distance from investors and media, preferring to influence through his role on the supervisory board, we understand and respect this approach. Like the families behind Aldi and Lidl, he believes frequent investor interactions can be a distraction from building a multi-generational business. His focus is clearly on the sustainability of the business rather than pleasing the market in the short run – an alignment we appreciate. The company's disciplined approach to growth and efficiency bears his clear imprint and is manifested throughout the business, from its methodical store rollout strategy to its vertical integration initiatives.

While historically we have been cautious about its valuation, particularly as the company's strong performance during Covid was more than reflected in its share price, recent challenging quarters have created an attractive opportunity to buy a quality business at a bargain price. With significant whitespace remaining across Poland's regions (high network density achieved in only two out of 16 regions), potential for international expansion in the medium term and a proven model of consistent execution, we believe this presents an opportunity to partner with an exceptional business at compelling valuations. The combination of a focused founder, clear competitive advantages and substantial growth runway makes Dino well positioned to continue compounding value for years to come.

Taiwan's evolution

An equally pleasant trip was our recent visit to Taiwan. The country's transformation has been remarkable and in sharp contrast to just a few decades ago, when many businesses were highly commoditised, and positioned in the lower parts of the value chain with limited intellectual property (IP). Back then, companies were exposed to short product cycles and often struggled to cover their cost of capital over the cycle. Today it is quite a different story. Technology's share of the global economy has tripled to 15% over the past couple of decades,[3] and Taiwanese companies have captured an outsized portion of this expanding profit pool. Barriers to entry in the tech industry continue to rise due to increasing complexity which not only benefits the largest companies in the country, but also an entire subset of smaller companies in the ecosystem, from design houses to testing companies.

Interestingly, while geopolitical concerns about Taiwan often dominate media headlines overseas, the local business leaders and employees we met appeared largely undistracted. Perhaps most striking is how Taiwan's largest technology companies have become standard-bearers for corporate governance excellence. This stands in sharp contrast to our experience in Korea, where the chaebols have frequently been criticised for complex ownership structures and mistreatment of minority shareholders. In Taiwan, TSMC's legendary founder Morris Chang has influenced best practice standards – from transparent capital allocation to rigorous board oversight – which has created a virtuous cycle, with other Taiwanese technology companies actively emulating these practices. Needless to say, our meeting with TSMC's senior management at their headquarters in Hsinchu, along with sampling the local Taiwanese cuisine, was without a doubt the highlight of our visit.

TSMC's governance philosophy has been integral to its business strategy and success, and the company

[3] https://www.weforum.org/stories/2023/12/tech-diplomacy-harness-digital-economy/

continues to have one of the strongest competitive moats in the world, in our view. At its core, TSMC's success stems from its unwavering commitment to the pure-play foundry model — a strategic choice taken many years ago that makes them the natural partner of choice for the vast majority of the market. Unlike integrated players such as Samsung or Intel who compete with their potential customers, TSMC's pure-play model eliminates any conflicts of interest, allowing customers to share their most sensitive intellectual property without reservation. This trust-based foundation has proven increasingly valuable as semiconductor manufacturing becomes more complex and is the reason why even well-funded competitors have struggled to close the gap.

The other added benefit of the pure foundry model and TSMC's position within the industry is that it gives them exposure to the newest technological trends (which all require increasingly advanced semiconductors) while shielding them from product-specific risks. Since TSMC manufactures chips for others rather than designing its own products, it doesn't face the risk of its products becoming obsolete — it simply produces whatever cutting-edge chips its customers need. This strengthens both its economic resilience and its position within the ecosystem. Leading-edge nodes now contribute over 50% of revenue, reflecting the company's technological dominance.

Looking ahead, we see multiple growth drivers for TSMC. Over the medium term, AI will continue to represent a significant growth opportunity, with AI-related revenues expected to grow at a 40-50% compound annual rate over the next five years. This growth spans multiple applications: from training and deploying large language models in data centres, to enabling autonomous driving capabilities, powering advanced robotics systems and supporting AI agents embedded in consumer devices. The management view this as part of a broader transition toward ubiquitous computing, where devices will continuously collect, transmit and process data, driving sustained semiconductor demand growth. While cloud computing will be important, latency requirements mean many AI tasks will need to be handled locally on devices, further expanding semiconductor needs across both advanced and mature nodes.

However, what particularly impresses us is TSMC's measured approach to this opportunity. Rather than simply chasing growth, the company assesses each investment through strict return on invested capital requirements. While new facilities may initially show lower returns given high upfront costs, its systematic approach to scaling operations typically brings returns in line with legacy plants over a period of 3-4 years. This disciplined expansion strategy has proven to be successful historically, as demonstrated by its Shanghai facility, which now generates returns comparable to its Taiwan operations, despite the initial lower profitability during its ramp-up phase.

Despite TSMC's unparalleled competitive position and robust growth outlook, the shares continue to trade at what we believe are attractive valuations. With semiconductor content growing across industries and TSMC's position in advanced nodes strengthening, we see current valuations as an opportunity to invest in one of the world's most formidable franchises at a compelling price.

Portfolio outlook

2024 was a volatile year, with significant performance divergence within emerging markets. The China market staged a strong comeback in the second half, following the September announcement of two major economic support programs — one monetary and one fiscal. The latter is particularly important, as it is expected to set a floor under the current deflationary downward spiral that has wreaked havoc on China over the past few years.

With respect to the rest of emerging markets, while the asset class has clearly faced a number of headline challenges, we believe it is difficult to be optimistic about global markets while remaining pessimistic on emerging markets. The global economy is increasingly led by emerging markets — a trend we believe will accelerate in the coming years. US growth has been undeniably strong over the past 5-6 years compared to the rest of the world, but some of the cyclical factors that contributed to that growth are looking more uncertain on a forward-looking basis. This will, we believe, increasingly prompt investors to reconsider alternatives.

To reiterate, we continue to invest in businesses with proven management teams and competitive advantages that allow them to capitalise on long-term secular trends across emerging markets. Whether it is the expansion of branded economy hotel chains across China's lower-tier cities, the formalisation of the Indian economy, the continued financialisation of the South African population, or the growing adoption of enterprise resource planning tools by Brazilian small- to medium-sized enterprises (SMEs), we believe there are plenty of investment opportunities. Yet, these kinds of businesses are often underrepresented in broader indices, which is why we believe a bottom-up, active investment approach adds significant value.

As we enter 2025, we believe our holdings continue to offer long-term, attractive compounding opportunities. Our analysis suggests they can grow earnings at a mid- to high-teens compound annual growth rate (CAGR) on a weighted average basis over the medium term. For this kind of growth, the portfolio's aggregate valuations, at 4.8% free cash flow yield and 20x price-to-earnings, seem reasonable and sustainable to us.[4] This makes us optimistic from both an absolute and relative perspective.

[4] Source: Financial metrics and valuations are from FactSet and Bloomberg. As at 7th February 2025 or otherwise noted.