

Q1 2024 - International Small Cap Value Quarterly Update

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Hi, my name is Matthew Ring, and I'm a portfolio manager for the International Small Cap Focus Value strategy at Pzena Investment Management. Markets in the quarter were modestly up, and really two themes emerged in this quarter. First, first was the market starting to digest less aggressive interest rate cuts. This drove our holdings in bank stocks to perform well, as well as things that we don't own, such as real estate, which our lack of exposure there was also a positive contributor in the quarter. The second thing in the quarter was this quarter, and this year is turning out to be really a year of efficiency for many corporates. This is in line with our investment in companies that are experiencing some temporary pain and need to recover. And so, companies that are starting to cut costs or put through pricing were a benefit to our portfolio holdings, such as Hankook Tire or U, who were able to offset inflationary cost pressures and recover their earnings more quickly than expected.

In terms of individual contributors and detractors, our largest contributors were Beeper and Unika, both European banks who benefited from a higher expectation of interest rates for longer, as well as Saber Insurance, a UK motor insurer who's able to pass through pricing and recover volume as more of the non-standard market comes back to them, which is in line with our thesis. All these financial stocks are also well capitalized and have expectations that they could have higher capital returns in the future.

On the detractor side, AMS Osram was our largest detractor. The stock was weak as they ended their partnership with Apple for micro-LED for the Apple Watch display. While this was disappointing for the ultimate upside of the stock, we underwrote AMS Osram on really strong earnings power from their core AMS sensor business, as well as their strong position in Osram in automotive headlights. This represents an over 25% free cash flow yield on the current market cap, and we used the opportunity of weakness to add to the position.

More generally, and looking forward, we see quite a variety of opportunities. In this quarter alone, we added three new opportunities from very diverse sectors. We added Elders, an Australian AG retailer; we added Hay Specialist, an IT and STEM recruiter; and we added Saai, a generic pharmaceutical manufacturer in Japan, which is going through seismic change and we recently highlighted in our Pzena Best Ideas podcast.

Backing up to the more general, this quarter represented another quarter of underperformance of small versus large, exacerbating the significant discount that you can now buy small-cap stocks for versus large caps in the non-U.S. markets. This is creating a really interesting opportunity at a macro level, but also at the company-specific level, where we can continue to buy really great franchises on sale.

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