J O Hambro
Capital Management Group

News

A View from Asia

Samir Mehta shares his views on the outlook for Asia

Samir Mehta

07 Mar 2022

MOAT – (Mightiest Of All Time - with apologies to Roger Federer) or ordinarily a deep, wide ditch surrounding a castle, fort, or town, typically filled with water and intended as a defence against attack.

Power politics. Many astute and knowledgeable analysts have opined on the current state of geopolitical tensions and potential outcomes. I have nothing to offer on that front. Life and investing were already challenging; they got even more so.

The current state of affairs, the reactions and counteractions of various countries and institutions did get me thinking on one critical aspect for the companies and stocks we own. What is a firm's genuine competitive advantage?

Before I get there, allow me to digress just a bit and wade into geopolitics.
Sanctions are not new - on Iran, Cuba, North Korea we witness extreme versions. Other countries have had milder ones to deal with. After Russia annexed Crimea in 2014, they endured a sanctions regime. Those sanctions hurt but did not cripple Russia's economy. Those sanctions were much weaker than this current round.

Back then, Russia endured. They "learnt" from what the West did and embarked on a national economic strategy. Seemingly, they did everything they could to minimise or cushion their state of discomfort for when the next round of sanctions might hit them in future. Russia modernised their armed forces. They forced import substitution in several areas to reduce imports and build resilience. They took advantage of solid energy prices to build hard currency reserves. Other prominent steps were - diversify away from the US dollar in their reserve holdings; hold gold and minimise holdings in US Treasuries; set up swaps with 'friendlier' central banks to exchange dollars for other currencies. To no avail. The Russian authorities might have thought they had a 'moat' to protect their competitive advantage. Were they wrong!

What does this have to do with stocks and companies we own? In a sense, similar to countries, every company thinks of their natural advantages and their moats. Take the 2018 trade sanctions against China. What that episode did was to push companies outside China to think of "China +1" strategies. Companies operating in China looked for alternative supply-lines or to increase focus on in-house technologies. Hitherto, just in time logistics and scalable supplier relationships in China were the de facto norm. Today, dispersion, building slack and carrying more inventory is paramount.

Globally, companies were already retooling their businesses to deal with technology disruption when COVID accelerated their plans. Many have pivoted and adapted to the new ways of doing business. Yet, in their technology stack, there is a high probability that they have dependencies on US or European software, hardware, cloud computing power, data centres, data pipes and the like. And then, what about operating systems, mail servers, credit cards, social media advertising platforms, financial leverage and GPS systems?

If you then think about the physical stuff – grains, energy, shipping, aeroplanes and more – and where do you draw the line on vulnerabilities to sanctions? How do you build a genuine moat?

I do not have definitive answers, just more points for due diligence when trying to understand real competitive advantages. One thing is clear – the years of seamless globalisation are behind us. Disparate systems with built-in redundancies mean higher costs of doing business going forward. The risk of geopolitically induced sanctions on countries is difficult to price. What is prudent is to assume much lower profit margins and much lower returns on capital for most businesses. There are exceptions which present opportunities even in gloomy situations but most importantly, we might need to reassess what we pay for businesses once thought secure due to their moats.

An overview of the fund can be found here.

Related Articles

A View from Asia

Samir Mehta shares his views on the outlook for Asia

Read More

09 February 2022

A View from Asia

A look ahead: a short note from Samir Mehta, manager of the JOHCM Asia ex Japan fund.

Read More

28 January 2022