Whitepaper: Global Opportunities in a Deglobalising World

The benefits of contrarian investing

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1. Executive summary

Recent moves towards a retreat from globalisation do not demand a concomitant retreat from global equities. Setting aside any arguments about the broader geopolitical wisdom of greater isolationism, our objective view is that a comparative increase in market disintegration simply presents new and different opportunities for sophisticated investors.

We explain why this is so and aim to demonstrate how the investment philosophy we have championed in the past – one rooted in qualities such as imagination, creativity and rigour – should continue to deliver benefits in a world in which nationalist and protectionist policies have a more profound influence.

We do not presage a return to the full-blown tariff wars and consequent destruction of trade that accompanied the Great Depression of the 1930s. We do, though, acknowledge the emerging anti-globalisation sentiment shaping events in Europe, the US and elsewhere; and we make the case for confronting the challenges it brings with an investment approach defined by ingenuity and optimism rather than by inflexibility and fear.

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2. Introduction

Globalisation has been with us for some time, although quite how long is a matter of debate. Competing theories argue that the phenomenon began decades, centuries or even millennia ago.

Whatever its origins, the process has undoubtedly accelerated during the past half-century. We now have a genuinely worldwide nexus of trade, investment, migration and technological/financial integration. Exemplified by supranational organisations such as the IMF and the WTO, the so-called "death of distance" is all but complete.

Yet history shows only too clearly that globalisation can go backwards as well as forwards[1]. We do not have to gaze far into the past to find periods where openness has given way to insularity. The economic turmoil of the 1930s, characterised by tariffs and trade wars, is often cited as a classic illustration of deglobalisation in action.

Now a new phase of comparative isolationism could be in prospect. The outcome of the US presidential election and Britain's vote to leave the European Union are just two of the events that have suggested a shift back towards nationalism and, by extension, protectionist policies.

What does all of this mean for investors in global equities? In this white paper we look at the forces that have driven both globalisation and the current reaction to it; we examine lessons from history and their relevance to the situation today; and we outline some potential scenarios and how investors might best respond to them.

Using real-world examples from our own experience, we also analyse the significance of considerations such as market correlation, diversification and decoupling. Finally, extending some of the key themes from our earlier white paper, Daring to Be Different: the Benefits of Contrarian Investing, we discuss the importance of qualities such as imagination, creativity and rigour in shaping investment strategies for a world that, though in some ways seemingly in retreat, continues to offer investors in global equities a vast universe of value-led opportunities.

"History shows only too clearly that globalisation can go backwards as well as forwards."

[1] In our previous white paper, Daring to Be Different: the Benefits of Contrarian Investing, we spoke of "living in an age of unprecedented globalisation". In many ways the interconnectedness of our world will undoubtedly continue to intensify; in others, however, at least in the short-to-medium term, this interconnectedness may be set to diminish.

3. A brief guide to globalisation

3.1. Origins

Globalisation's origins have become a subject of fierce debate, not least in the academic literature. The problem, numerous scholars have claimed, is that we cannot accurately assess the effects of globalisation until we agree on when the process started; yet at the same time we cannot determine when the process started until we clarify what it actually entails.

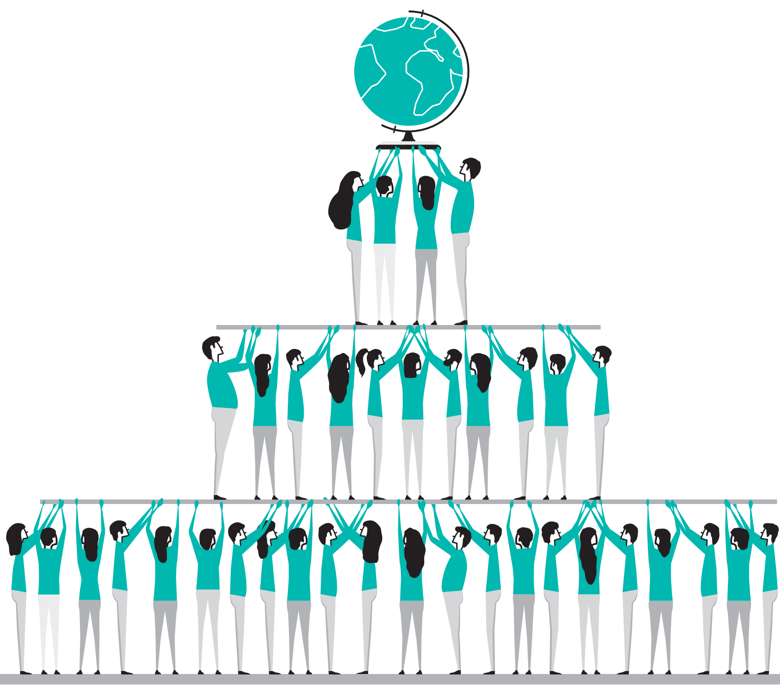
This sounds like a cross between Saint Thomas Aquinas and Aristotle – part "first cause", part "chicken and egg" – and we would perhaps be wise to avoid getting bogged down in paradoxes. Even so, a cursory review of some of the various schools of thought is worthwhile.

The idea that globalisation can trace its roots back thousands of years was most notably expounded by economic historian and sociologist Andre Gunder Frank, a German-American who promoted development theory – the notion that a "world system" tends to revolve around the flow of resources from poor to wealthy states. According to Frank, the growth of trade and market integration between the Sumer and Indus civilisations of the third millennium BC was where it all began.

Adam Smith appeared to suggest a more recent genesis in his magnum opus, The Wealth of Nations. While never employing the word "globalisation" – the term did not enter common usage until the 1960s – Smith described the discovery of the Americas by Christopher Columbus in 1492 and Vasco da Gama's arrival in the East Indies six years later as "the two greatest and most important events recorded in the history of mankind".

Kevin O'Rourke, now the Chichele Professor of Economic History at the University of Oxford, and Jeffrey Williamson, a Professor of Economics at Harvard University, famously argued otherwise in a much-cited 2002 paper entitled simply When Did Globalisation Begin?. Uniquely, they explicitly distinguished between trade expansion driven by supply/demand and trade expansion driven by market integration. They concluded that an abrupt reduction in transport costs during the 1820s allowed the prices of commodities in Europe and Asia to converge and that this, as a result, should be regarded as globalisation's "big bang" period. "In that sense," they wrote, "it is a very modern phenomenon."

These are just a few of the competing hypotheses, which may explain why the Oxford English Dictionary defines globalisation[2] as "the process by which businesses or other organisations develop international influence or start operating on an international scale". Such a diplomatic delineation neatly encompasses the theories of Frank, Smith, O'Rourke/Williamson and several others in one fell and fuzzy swoop.



2 We perhaps should note that the Oxford English Dictionary favours "globalization" over "globalisation". Like other words with an "-ize" suffix, the former has all but vanished from mainstream publishing in the UK and is now widely thought of as an Americanism; yet it remains almost universally used in academia and is still preferred by the OED.

Applying this standard, Inspector Morse was able to solve a murder by deducing that an apparent suicide note could not have been written by Sir Julius Hanbury, once a candidate to become Master of an Oxford college, because it contained the phrase "I apologise". Such a usage, Morse somewhat pompously declared, was "illiterate". We can only hope he doesn't read this.

3.2. Impact

Particularly in recent decades, with the process faster and farther-reaching than ever before, globalisation has delivered tangible and very real benefits. Arguably the most significant of all from a purely economic perspective has been the spread of international trade.

The resulting evolution of open markets has served investors well. First and foremost, it has massively expanded the investment universe. In tandem with the rise of the internet and other technological advances facilitating the near-effortless sharing of information, it has produced an investment world virtually devoid of borders.

More widely, globalisation has brought a bigger and cheaper range of goods and services. It has driven a general rise in living standards and accelerated economic growth. In a speech in December 2016 the governor of the Bank of England, Mark Carney, credited it with lifting more than a billion people worldwide out of poverty.

Yet in the very same address Carney reiterated many of the common criticisms of globalisation. These include greater inequity, imbalances in economic power and social exclusion. For many people, Carney warned, globalisation is associated with "low wages, insecure employment, stateless corporations and striking inequalities".

At this stage we should stress that this is in no way a sociopolitical paper. We are not here to judge or moralise. It is nigh on impossible, though, to discuss the impact of globalisation without acknowledging the broader concerns that Carney and many others have highlighted and which populist politicians are increasingly tapping into by way of embracing – or even exploiting – a burgeoning anti-globalisation zeitgeist.

"In tandem with the rise of the internet and other technological advances facilitating near-effortless information-sharing, globalisation has produced an investment world virtually devoid of borders."

It is this latter trend, after all, that now looks set to play a substantial role in shaping an era in which globalisation could find itself in retreat. Thus, ironically, one of the key consequences of globalisation is likely to be a resurgence of its diametric opposite.

Globalisation: a pillar of prosperity?

In 2008 the International Monetary Fund published Globalisation: A Brief Overview. The following points were among those highlighted as evidence of globalisation's impact during the second half of the 20th century and the early years of the 21st:

- The value of trade (goods and services) as a percentage of world GDP rose from 42.1% in 1980 to 62.1% in 2007.
- Foreign direct investment increased from 6.5% of world GDP in 1980 to 31.8% in 2006.
- The stock of international claims (primarily bank loans) as a percentage of world GDP grew from roughly 10% in 1980 to 48% in 2006.
- The number of foreign workers stood at 191 million (3% of the world population) in 2005 – up from 78 million (2.4% of the world population) in 1965.

The report's authors described integration within the global economy as one of the "basic principles that seem to underpin greater prosperity", adding: "The biggest threat to continuing to raise living standards throughout the world is not that globalisation will succeed but that it will fail."

4.1. When globalisation stalls

Deglobalisation is not a new phenomenon. Irrespective of the conflicting theories outlined in section 3.1, there is ample evidence of the cause of globalisation having faltered in the past.

Although consensus among economic historians remains typically elusive, it has been argued that some form of major market disintegration occurred during periods as diverse as the Dark Ages, when the Roman Empire crumbled, and the 17th century, when the rampant mercantilism so despised by Adam Smith led to monopolies, high tariffs and a good number of wars. Doubtless even the traders of Sumer and Indus had their occasional ups and downs.

More recent episodes have a familiar ring to them. In 1914, for example, the outbreak of World War I signalled the end of around four decades of rising trade and migration – trends that many blamed for greater inequality and which ultimately stoked a resentment that propelled the disenfranchised towards firebrand politicians preaching nationalist policies.

By definition, such policies have almost always featured protectionism as a central plank. Protectionism is the very essence of an inward-looking philosophy – not just in strictly economic terms but in its basic appeal to the sentiments of those who believe, rightly or wrongly, that they need "saving" from the forces of globalisation.

We must again emphasise that this is not a political treatise; yet it seems reasonable to suggest that protectionism serves as a reliable and powerful expedient in recognising – and maybe even channelling – popular discontent. History certainly indicates as much, and so do the events of the present. Donald Trump was by no means alone among the US presidential candidates in questioning the merits of free trade and promising to safeguard American jobs.

Perhaps the most infamous instance of deglobalisation, at least in terms of its repercussions, is the breakdown of worldwide trade that accompanied the Great Depression of the 1930s. Maybe more than any other, this unhappy story illustrates both the damage that deglobalisation can wreak and the lasting nature of its effects. So let us briefly consider the roots of the turmoil, how it unfolded and whether there are any lessons we might usefully learn in anticipation of a new era of relative isolationism.

4.2. Lessons from history

By now it may come as no great surprise to discover that economic historians are divided on the issue of precisely what triggered the severe outbreak of protectionism that characterised the Great Depression[3]. Mercifully, they have more or less managed to restrict the candidates to just two.

Some blame the introduction in 1930 of the Smoot-Hawley tariff, which the US devised to protect its farmers and factory workers. Others cite the tariffs levied a year later by the likes of Germany, France and Canada in response to the UK's decision to abandon the Gold Standard – a move that saw the pound devalued and prompted those countries still within the currency regime to impose heavy duties on goods imported from Britain.

Regardless of exactly which tariff proved to be the tipping point, the result was a global trade war. The consequences of America's inward turn were especially seismic, with the US's share of worldwide economic trade plunging to a low of 10% in 1933 – down from 30% in 1914. The movement of money from one nation to another amounted to barely a trickle throughout the 1930s and into the 1940s. "Beggar thy neighbour" was the prevailing and devastatingly internecine credo. As Mahatma Gandhi once said: "An eye for an eye makes the whole world blind."

In tandem, sociopolitical forces were at work. As in the run-up to World War I, populism flourished. The mavericks may have remained confined to the sidelines in the US, but elsewhere – most notably in parts of Europe and Asia – they metamorphosed into the bellicose autocracies that started World War II.

It was only after the war that attempts to reassemble the building blocks of free trade commenced in earnest. Although these endeavours were successful, the sombre truth is that the global level of trade seen in 1914 was not witnessed again until the 1970s; moreover, capital flows did not fully recover until the 1990s.

This underscores two crucial lessons about the potential pitfalls of deglobalisation. The first is that market disintegration can be mutually destructive, with tit-for-tat recrimination over high tariffs eventually denying all concerned the benefits of comparative advantage. The second is that the corollaries may be anything but short-lived: the cycle of deglobalisation, like that of globalisation, is one liable to be gauged in decades rather than in years.

What might deglobalisation look like?

The International Futures Model (IFs) was first developed by researchers at the University of Denver's Josef Korbel School of International Studies almost 40 years ago. It aims to represent hundreds of relationships within and among more than 180 countries.

These relationships are based on theoretical and empirical specifications derived from the academic literature on international studies. They focus on factors such as trade, economic growth, income distribution, industrial structure, demographic change, the environment, social stability and war.

IFs has been used for long-range global forecasting by a number of institutions, including the United Nations. In 2010 researchers at the University of Kentucky used the model to predict the likely effects of four decades of globalisation/deglobalisation, beginning in 2006 and ending in 2035, on the US and the European Union.

US	Globalisation	Deglobalisation	% difference
GDP	$24,287bn	$19,794bn	-18.5
GDP per capita	$66,150	$60,290	-8.9
Population	367.2m	328.3m	-10.6
Gini coefficient[4]	0.402	0.397	
Share of wage bill going to unskilled workers	62.5%	63.6%	

EU	Globalisation	Deglobalisation	% difference
GDP	$15,455bn	$11,747bn	-24.0
GDP per capita	$31,270	$24,600	-21.3
Population	494.2m	477.5m	-3.4
Gini coefficient[4]	0.338	0.337	
Share of wage bill going to unskilled workers	63.1%	63.9%	

Source: Hillebrand, E: Deglobalisation Scenarios: Who Wins? Who Loses?, 2010

The paper concluded: "If globalisation halts or recedes the results will be profoundly negative for most countries and most income groups. While a retreat into protectionism may improve income inequality in some countries, it will reduce incomes of both the poor and the rich... and poverty headcounts will be increased. In addition, political instability will rise in a majority of countries."

"The sombre truth is that the global level of trade seen in 1914 was not witnessed again until the 1970s; moreover, capital flows did not fully recover until the 1990s."

[3] As Scientific American correspondent John Horgan noted in The End of Science, his sweeping appraisal of the limits of knowledge, scholars like to disagree with each other, because otherwise they would have nothing to talk about.

[4] The Gini coefficient is a widely used measure of income inequality.

5.1. A lesson learned?

As warnings from economic history go, the events of the 1930s – not to mention their lingering effects – represent a sobering tale. This being so, we ought to reassure ourselves that they also constitute a worst-case scenario – one whose magnitude we are unlikely to encounter again.

There are several reasons for this guarded optimism, chief among them the encouraging fact that humanity has very occasionally been known to learn from the lessons of the past. The prospect of another all-out trade war flies in the face of everything from expert opinion to common sense, and it is hard to believe that any remotely civilised government or population would willingly court a return to such unmitigated havoc.

We might also derive some comfort, however perverse, from politicians' inherent disinclination to transform rhetoric into reality. The stridency that traditionally accompanies promises of nationalist and protectionist policies often surrenders to a less vociferous stance once a vote has been won and the probable ramifications of resolute insularity start to sink in.

Nonetheless, if only for the sake of argument, let us imagine a slide back into something akin to the 1930s. What might the implications for investors be in such circumstances?

The impact on individual companies would almost inevitably be dramatic. On balance, there would be more losers than winners. Any organisation with a global supply chain would incur rising costs. Some firms would no longer face authentic competition, possibly diminishing their incentive to innovate. Share prices would fluctuate in light of each new tariff and subsequent act of retaliation.

We believe active fund management at its most flexible would be essential in such a fast-moving and tumultuous environment, as would an investment philosophy that seeks to limit volatility. With a modicum of short-term pain practically unavoidable, firmness of conviction and longer-term thinking would also be helpful. We will come back to all of these qualities later.

5.2. Deglobalisation by stealth

The academic literature habitually refers to a "big bang" phase of globalisation, but the world did not become interconnected overnight – less still in a matter of Plancks, the measure employed to chronicle the earliest moments of the universe. The integration of markets takes time; so, too, at least in the absence of a full-blown trade war, does their drifting apart.

Accordingly, should it come, deglobalisation is likely to be piecemeal rather than spectacularly conspicuous. Politicians could gradually – even quietly – abandon policies geared towards the further liberalisation of trade and so ratchet up protectionism by degrees. Tub-thumping need not be obligatory.

Indeed, it is well worth remembering that high tariffs are not the exclusive preserve of nationalist demagogues. It was none other than Barack Obama who oversaw the US's raising of import duties on Chinese tyres from 4% to 39% between 2009 and 2011 – a ploy that one study later blamed for a net loss of around 2,500 American jobs.

We can use this ill-fated flirtation with autarky as the basis for another salutary lesson about the investment expertise that protectionism demands. Shares in US tyre manufacturers leapt in expectation of improved profit margins, but the 30% decrease in Chinese imports that occurred during those two years did not equate to a 30% increase in the production of American tyres: instead, as US International Trade Commission figures later revealed, it was companies in Canada, Indonesia, Japan, South Korea and Thailand that took up the slack.

Such are the perils of home-country bias; and we hardly need add that these dangers apply to investors as well. This harks back to a point we made in our earlier white paper, Daring to Be Different: the Benefits of Contrarian Investing, in which we referenced a 2013 MSCI study that found greater global diversification over the course of the preceding two decades would have led to a double-digit reduction in risk.

"Politicians could gradually – even quietly – abandon policies geared towards the further liberalisation of trade and so ratchet up protectionism by degrees."

What is perhaps manifest above all else is that deglobalisation, even if it should occur by stealth, requires investors to keep a close and ever-watchful eye on the bigger picture. And this brings us to the enduring attractions of a successful global equities strategy – because the global picture, as we have remarked in the past, is the biggest picture of all.

6.1. Winners and losers in a deglobalising world: Q&A with Professor Richard Kneller

Professor Richard Kneller, Globalisation and Economic Policy Centre (GEP), School of Economics, University of Nottingham

Richard Kneller is a Professor of Economics and a leading researcher in the field of globalisation. His main interests are the causes and consequences of technological change, including the effects on productivity at firm level and on international trade; the determinants and consequences of exporting; and the effects of fiscal policy. He has advised policymaking organisations including UKTI, the UK's exports promotion agency, and has co-authored a number of influential reports, including a major study into the economic corollaries of offshoring – the practice of sending jobs abroad.

Why are we facing the prospect of deglobalisation?
Globalisation has brought tremendous economic gains, with every successful economy since World War II exploiting the opportunities afforded by greater international trade. But all trade models result in winners and losers, and globalisation is no exception.

It's widely acknowledged that the people who lose out from globalisation are usually lower-skilled workers in more labour-intensive industries, particularly industries in which other countries pay lower wages. It's also widely acknowledged that these industries naturally agglomerate regionally, as a consequence of which the disadvantages that can arise from free trade tend to be concentrated among certain groups in certain locations.

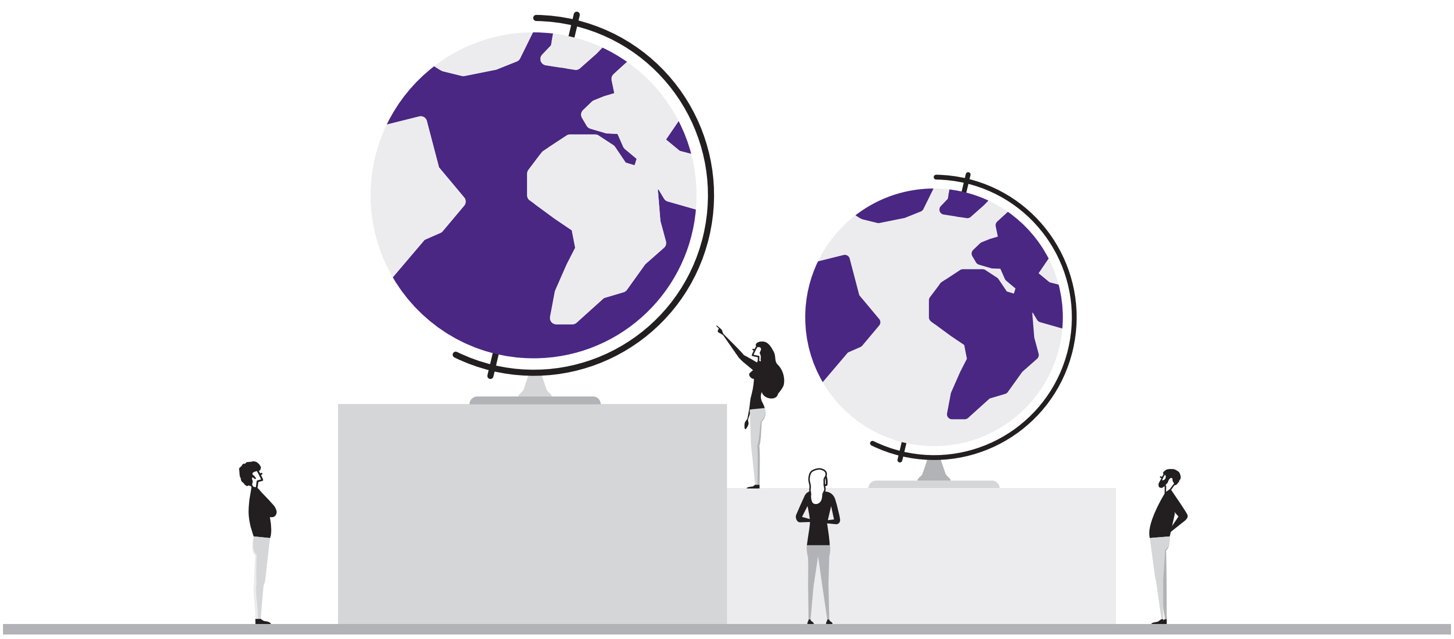
Given the existence of winners and losers, a necessary condition for continued globalisation is that there should be a net positive gain. For this to happen the winners need to compensate the losers, whether through education and training, through support schemes for those who lose their jobs or through other policies. A fundamental goal from a policymaking perspective should be to ensure that everyone feels this great economic project is of benefit to them or at least that it will benefit them at some point.

Events such as Brexit and Donald Trump's election suggest efforts in this direction aren't as effective as they might have been previously. There's certainly evidence that the scale of policy adjustment that occurred after China's entry into the World Trade Organisation in 2001 was insufficient, and the problem has undoubtedly been exacerbated by the austerity that followed the global financial crisis. So we seem to have reached the point where those who lose out from globalisation feel those who win aren't compensating them enough.

That sort of scenario has had disastrous repercussions in the past. What are the chances of a return to, say, the chaos of the 1930s?
The prospect of full-blown trade wars is much harder to imagine today, when we have supranational organisations that were in large part established to prevent precisely that kind of thing from happening again.

Imagine, for example, that country A were to impose a sizeable tariff on a certain good from country B. Country B would almost inevitably appeal to the WTO. Unless there were evidence of wrongdoing on country B's part – dumping goods on country A, for instance – country A would be obliged to reduce the tariff.

Of course, what we perhaps don't know at the moment – and what we might just find out under a Trump presidency – is what would happen if country A were to flat out reject the WTO's judgment.



How likely is it that certain countries might pursue wide-ranging, overtly protectionist policies?

In previous periods of globalisation the number of countries any nation could trade with was smaller. Maybe now, with so many more trading partners to choose from, some countries might feel they can afford to be more selective.

This leads to an interesting question, which is whether such an approach would prove systematic or symbolic. Trump, for instance, may well be determined to make a point with the likes of China and Mexico but might not do anything comparable otherwise.

We saw something similar under the Obama presidency, when higher tariffs were imposed on Chinese tyres. That was a largely symbolic act – one couched in the usual rhetoric about protecting domestic jobs, even though a subsequent study claimed the net effect was nothing of the sort.

There might also be an element of sabre-rattling. It could be politically expedient in the short term to threaten the likes of Ford or GM and have them commit to an "America first" philosophy, but these companies are very likely to take a longer-term view and leave themselves well positioned to quietly row back from a Trump-appeasing approach in four years' time. In short, it wouldn't be altogether surprising if the political economy turns out to be different to the economic reality.

By way of an illustration, look at what happened when China was accused of dumping steel on world markets in 2016. In that instance the UK, for one, wasn't especially keen to seek anti-dumping measures. The government was obviously concerned about the bigger picture, aware that China would almost certainly respond by imposing restrictions of its own. The reality is that nobody could expect to impose protectionism of that kind without creating a world with more trade friction and tariff barriers, less genuine competition and less incentive to innovate or reduce costs.

Who are the winners and losers likely to be if deglobalisation occurs, even to a limited extent?

It's important to make clear from the outset that we can't be sure, at least not empirically, because we don't have these episodes very often and certainly not in modern society. It's also worth remembering the sheer interconnectedness of the world today: it would be all but impossible to somehow tear all of that up.

It doesn't even necessarily follow that deglobalisation will be the inverse of globalisation. It may be that it results in just a small increase in the friction of trade, in which case we would see an impact but maybe not too much. We might see a different kind of globalisation – one in which the world becomes more fragmented as a whole but more integrated and agglomerated regionally – but for there to be a genuinely major impact a country would essentially have to take a significant step towards autarky, which isn't going to happen. That said, all the evidence suggests that misinformed policy creates more losers than winners.

Why is that?

Firstly, tariffs and barriers are imposed to allow domestic firms to increase profitability and productivity, but what frequently happens is that firms enjoy the greater profit margins but don't make any investment – often because they no longer have an incentive to innovate.

Another potential problem with supposedly saving domestic jobs is that workers might remain in struggling industries rather than finding new employment in sectors in which their country is strong. An important point that's consistently overlooked is that over the longer term the number of people in employment is determined by the deeper characteristics of a country's labour market rather than by trade, although trade may have some short-run effects. GEP's own research shows that in the UK alone around 50,000 jobs are lost and around 50,000 are created every week, with sending jobs abroad accounting for only a tiny percentage of that figure. So the idea that protectionism saves jobs is at best misleading and at worst wrong.

In the end protectionism may be of some short-term benefit to the groups we mentioned earlier – lower-skilled workers in labour-intensive industries and others who tend to lose out from free trade – but everybody else has to pay with higher costs, higher taxes and less innovation. So if every country were to become a little less globalised then all the evidence suggests the ultimate loser would be the consumer.

There would be winners and losers in the markets, too, of course, because of the implications at firm level. Companies with global supply chains would inevitably face some pressing decisions, which is why I think there could be greater regional agglomeration.

And what about investors?

The fact is that anything that disrupts markets offers opportunities. New policies, new innovations, new freedoms, new frictions – they all lead to situations in which some firms in some markets do better than others. Regardless of whether markets are converging, diverging or even decoupling, from an investment perspective, as ever, success or failure boils down to the ability to identify and exploit those opportunities. It's a question of recognising which businesses are likely to adapt, survive and flourish.

"The fact is that anything that disrupts markets offers opportunities. New policies, new innovations, new freedoms, new frictions – they all lead to situations in which some firms in some markets do better than others."

6.2. Case study: Trump, Mexico and the search for "triple-word-score investments"

We have argued that deglobalisation requires investors to keep a close and ever-watchful eye on the bigger picture. We have also seen that success or failure is likely to be determined by an ability to spot the opportunities to which deglobalisation, like any source of market friction, is liable to give rise.

We can illustrate the application of these considerations in a global equities setting by relating a recent fact-finding trip undertaken by one of the co-authors. In light of Donald Trump's promise to renegotiate the North America Free Trade Agreement (NAFTA) and threats to build a wall between the US and Mexico, Stephen Anness recently met with managers from a range of companies and industries to identify potential investment opportunities arising from America's moves towards protectionism.

He did not travel to the US. He travelled to Mexico. In the following Q&A he explains why, reveals what he learned and discusses how the exercise reflects a contrarian investment philosophy.

The Mexican stock exchange plunged in the wake of Trump's isolationist rhetoric. The peso hit a record low against the US dollar. Could markets have sent any stronger signal that Mexico is a high-risk, damaged economy to be avoided – a victim of deglobalisation trends if ever there was one?

There's certainly a degree of uncertainty about Mexico. The market has pulled back some way – not hugely in peso terms but in dollar terms – and the currency has reacted negatively to Trump's campaign rhetoric. But markets tend to overreact and can bounce back strongly.

We saw this last year in Brazil, which before its recovery offered the opportunity to get the stock, the market and the currency right – the triple-word-score of investing. Currency is notoriously hard to call, but you have even more high-scoring letters to play with if you can find valuation anomalies in a currency that looks extremely cheap.

Aren't you underplaying the threat to Mexico from Trump? After all, he still says he wants to build a wall between the two countries.

Does he mean it literally? Many people might see it as a metaphorical wall that has more to do with protectionism and tariffs. Either way, his rhetoric seems to have softened a little since he came to power.

The US may well cast Mexico adrift, but it's worth noting that there's a lot of interdependency between the two. It strikes us as odd that the incoming administration would want to do something that would inevitably lead to higher prices. If you renegotiate NAFTA and include oil imports and put a massive border-adjustment tax on everything coming into the country then all you're going to do is push up consumer pricing.

How much leverage does Mexico have over the US?

More than many people might imagine. Mexican exports to the US are important – they account for nearly 80% of all Mexico's exports – but Mexico is also the second-largest export destination for US goods; in fact, the US sells more to Mexico than it does to all 28 countries in the European Union combined.

It has also been estimated that between five million and seven million jobs in the US are dependent on trade with Mexico, so it's not a one-way street in any regard. Mexico plays a big part in keeping down US prices, and trying to break all that apart would be tough and couldn't be done quickly. It has been suggested that something like a trillion dollars of investment would be needed to get even a portion of Mexican manufacturing capacity into the US, and on top of that you would have to factor in wage differentials – it probably costs five times more to employ a car worker in the US than in Mexico.

What else might be in Mexico's favour?

Mexico exports high-quality products. It has been growing consistently in terms of auto manufacturing. It's one of the biggest exporters of silver and of avocados. It's the world's biggest exporter of flat-screen TVs – which, bearing in mind that most people would expect an Asian nation to hold that distinction, shows that Mexico is a very competitive country.

And the irony, of course, is that it has become even more competitive since its currency weakened. It's more competitive than China on a labour-force basis. The working-age population is expected to grow by 11% a year up to 2035, whereas in China it's expected to fall. So if you were planning to build a factory right now, for all sorts of reasons, Mexico would be the place to build it.

There are other attractions. Mexico has some high-quality manufacturing facilities and good demographics. The proximity to the US is a positive. It's still a developing country and not without risk, but its industry structures are good and quite consolidated.

So it's by no means a purely negative picture – far from it. Right now Mexico has more pricing power and is less prone to super-competitive dynamics than many other markets might be, and the moats around its businesses are greater because of the industry structure there.

"We go the other way. We ask what negative impacts Trump has had and whether these create any valuation anomalies. We're not afraid to follow the path of uncertainty."

What sort of companies did you visit and what impression did you get?
We visited a range of companies – food producers, auto component manufacturers, bottling plants, businesses specialising in convenience stores, infrastructure, real estate – and the overall impression we got was that people are well aware of the concerns and issues but aren't unduly panicked by them. In short, managers are less concerned about Mexico than the rest of the world might be.

Now, this might simply reflect home bias and a degree of naivety. On the other hand, it may just be realistic. It could well be that these people see the positives in their own economy, which is continuing to perform pretty well, with consumer spending up.

Naturally, we don't think many of them will be going out and doing massive M&A deals anytime soon. Yet the business specialising in convenience stores is continuing to roll out at the same rate; the infrastructure business is continuing to deploy capital but doing it in a very sensible way, using long-term fixed-rate deals that are a little more expensive rather than going for floating-rate arrangements.

On the whole, we think people are being realistic about the threats and the opportunities. If the US imports less from Mexico, for instance, then they feel confident that they can export that capacity to other parts of the world, because they have decent road and port infrastructure and can get their products out.

What does this example tell us about your investment approach?
It highlights the value of contrarianism. Most people would reason that Trump is going to spend more on defence, that there's going to be an inflationary backdrop and that the natural course of action would be to follow that trend. We go the other way. We ask what negative impacts Trump has had and whether these create any valuation anomalies.

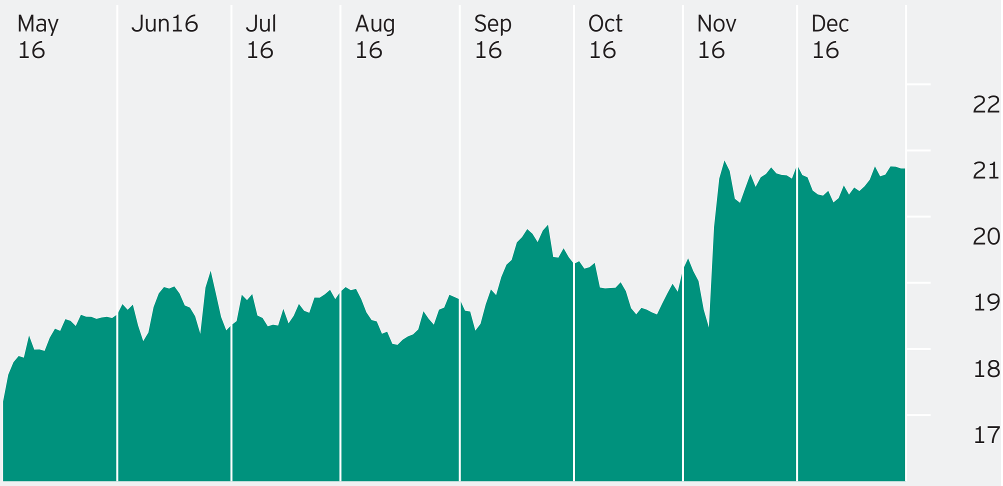
We know, after all, that uncertainty does create valuation anomalies. People don't quite know how to price things, so they often end up pricing them unrealistically. So by visiting Mexico and looking for opportunities we show we're not afraid to follow the path of uncertainty. And at the same time, of course, we don't rush into things – we did a lot of research before we went and have done a lot more since.

It also highlights our focus on valuation-driven investing and the time-arbitrage nature of what we do – our long-term view of investing. In the long term we feel quite comfortable about what we learned from this trip, which is that many companies are well managed, allocate capital sensibly and have good balance sheets in a country with solid demographics, a strengthening domestic market and a burgeoning middle class.

You have to offset all of this against the prevailing concerns, just as you have to weigh up the pros and cons of any investment. We're being given an opportunity in markets that look attractively valued, in stocks that look attractively valued and in a currency that looks attractively valued – all for obvious reasons – and we know that markets can often overreact. This, in our view, makes Mexico a good hunting ground.

Populism, protectionism and the plummeting peso
The Mexican peso hit record lows against the US dollar in the wake of Donald Trump's election in November 2016 (see chart). Ford's subsequent announcement that it would not press ahead with plans to build a $1.6 billion plant in San Luis Potisi – an about-turn that followed public criticism from the new president – prompted a further plunge.

USD vs Mexican peso



Source: Bloomberg, as of 31 December 2016.

7. Conclusion

Earlier in this white paper, in assessing the impact of globalisation, we discussed the emergence and advantages of an investment world without borders. Fuelled by the spread of international trade, the evolution of open markets has undoubtedly served investors extremely well during the past half-century and more.

Having historically benefited from openness, some investors may now fear they could suffer in the face of greater insularity. If globalisation has generally had a positive influence on corporate profits, the argument might go, then surely deglobalisation is likely to have the opposite effect.

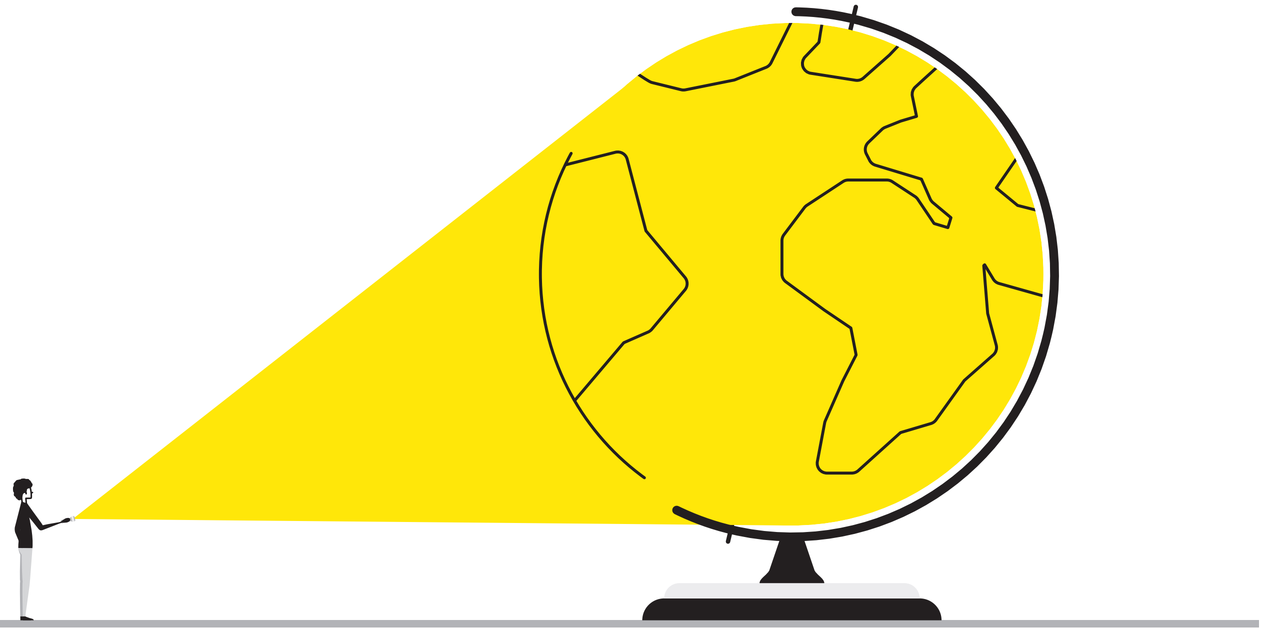
We do not see why this should be the case where global equities are concerned. The kind of opportunities we look for existed before Donald Trump's presidency and the vote for Brexit, and they will continue to exist after and in spite of these and similar events. Come what may, with or without borders, potentially attractive investments will always be "out there": it is just a matter of finding them.

The fact that they may become more difficult to uncover should only prove advantageous to those who are willing to approach the task with imagination, discipline, rigour and firmness of conviction. By contrast, those who are content merely to continue relying on conformity and convention might struggle as markets gradually drift apart.

Accordingly, we believe our own modus operandi is not threatened by a renaissance of nationalism and protectionism. If anything, its merits might even be reinforced. We remarked in our previous white paper that the ability to think independently constitutes one of humanity's most basic engines of progress and change, and we stand by that assertion. As illustrated by the example of our fact-finding trip to Mexico, there is still much to be said for abandoning the herd.

The cause of globalisation may well rise and fall, wax and wane, prosper and flounder. History tells us as much, irrespective of whether we think converging commodity prices, Christopher Columbus or commercially savvy tribes initiated the "big bang". But the investment universe is still fabulously vast, at least if properly searched and researched; and this thought alone should provide reassurance in potentially challenging times.

"Come what may, with or without borders, potentially attractive investments will always be 'out there': it is just a matter of finding them."



8. Appendix

8.1. References and suggested reading

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