fund profile

Steyn Capital's Global EM fund shines in tough market conditions

Launched in 2022, the fund's forensic accounting approach to identify long/short opportunities has proved successful and it has returned 22% since inception

More than a decade of intensive research preceded the launch of the Steyn Capital Global Emerging Markets Hedge Fund in February 2022, according to portfolio manager James Corkin.

"My colleague Bernard Griesel, who manages our Frontier Fund, was looking into a company which owned bonds of a now infamous Chinese property developer," he notes. "Naturally, he looked into the bond holdings too. This was years before China Evergrande was on the front page of the *Financial Times*. He looked at it and saw fraud. We asked ourselves: 'How could such a luminous fraud exist and no one is taking advantage of it?'"

"We realised then that we would have a big advantage on the short side, simply because not enough people were doing the work. There is a huge opportunity for those who bother to open the financial statements with a critical eye," says Corkin.

James Corkin

Steyn Capital Management's value-oriented long/short fund, focusing on emerging markets, aims to achieve high rates of return over the long term through exploiting inefficiencies in global markets.

The Cape Town-based boutique asset manager has been investing in global frontier and emerging markets (including across Africa) since 2018, with an initial focus on frontier and smaller emerging markets, venturing into broader EM three years later.

It has a 15-year track record, starting in 2009 when founder André Steyn moved back to South Africa from London.

Beginning with a South African long/short strategy, the team now also offers South African long-only products, an Africa-focused strategy and Frontier funds.

It has total assets under management of R14.5 billion and a staff complement of 15, with nine on the investment team.

"As a team, we have been investing long and short in emerging markets for many years, building on André's experience of applying forensic accounting skills to emerging and frontier markets," says Corkin.

A CA(SA) and a CFA charterholder, Steyn started his investment management career in 2002 as a dedicated short selling analyst at Ziff Brothers Investments, a multi-billion dollar hedge fund, where he employed forensic accounting analysis to identify short sale candidates in markets outside the US.

He then joined Temujin Fund Management UK, as CEO and partner, where he was responsible for all non-US investments, managing more than $1 billion.

Corkin is a qualified CA(SA) and joined Steyn Capital in 2016. He is the lead SA analyst and PM of the global EM hedge strategy, responsible for detailed research on long and short ideas in SA and emerging markets. He worked previously as an investment banking analyst at Bravura Capital and audit manager at KPMG, where he was also a manager in the KPMG Financial Engineering Group, focused on financial instrument and derivative valuation, as well as advisory work on hedge accounting and treasury risk management.

Since inception in February 2022 to the end of August, the Steyn Capital Global Emerging Markets Hedge Fund has returned 22.1% in dollars, while the MSCI Emerging Markets Index has been down 2% over the period.

"It was not easy timing for the fund launch," says Corkin. "EM went straight down for six months. There was the Russian invasion of Ukraine; property deleveraging in China. In the fund's first nine months, broader EM was down around 30% and our strategy had lost just 5%. It demonstrates the power of hedge. The markets have been highly volatile, yet we have had the ability to generate alpha on both sides."

After dipping 4.2% in its first year versus broad emerging markets which were down 18.6%, the fund went on to return a net 16.74% in 2023, and is 9.2% higher year to date.

Corkin notes that being able to efficiently identify investment ideas is core to the team's process. With over 40,000 companies in global EM and frontier, they needed to whittle the universe down in a sensible way.

"Our road to launch was an 11-year process. We divided those 40,000 companies across the team and spent 11 years going through every single one, examining their business models to sift the high-quality businesses from the low-quality ones. All the

FUND FACTS

Steyn Capital Global Emerging Markets Hedge Fund

Strategy: Global emerging markets long/short
Inception date: February 2022
Portfolio manager: James Corkin
CIO: André Steyn
Domicile: Cayman Islands
Administrator: Apex Fund Services
Prime broker: Morgan Stanley

high-quality names went into our screen, while the others, the low-quality, marginal businesses or businesses in structural decline, were kicked into Siberia, which is where short ideas are screened."

The result is a high-quality proprietary universe of 4,300 companies, which forms the starting point of its daily internal screens.

"Our internally developed software screens for the most promising opportunities, based on academic research, value and quality metrics, and sends those out to the team for further research. It's a big world out there, and our proprietary universe and screen give us the licence to manage global portfolios from South Africa. We have a unique edge in uncovering high-quality, often overlooked, and cheap businesses that are able to either reinvest their own capital at high rates of return, or return it to shareholders via dividends and buybacks."

Most frontier markets – where Steyn's long-only strategy has invested since 2018 – do not allow shorting. The global EM space is, however, a lot more liquid.

The diverse hedge fund portfolio invests in a range of different companies, in countries that include Turkey, Brazil, Indonesia, Thailand, Poland and Korea, the Philippines and Argentina.

While the portfolio construction is bottom-up in nature, Steyn Capital's macro analyst Jason Horn contributes macro views to the stock selection process.

At any given time, the portfolio comprises 20-25 long positions and 25-50 single-stock short positions. The short book is more diverse than the long-only portfolio, with a focus on bigger companies and higher turnover.

"What is different about us is that we only do single-stock shorts; in that regard we are quite different from our peers," says Corkin. "The short book is an alpha generator – we don't use index shorts."

Corkin notes that in its first year, the fund was short three companies that effectively "went to zero".

Brazilian retailer Americanas, the largest corporate fraud in Brazilian history, which filed for bankruptcy protection in January 2023, was thrown into crisis by the disclosure of accounting inconsistencies.

"The 100-year-old retailer had been understating debt by over $8 billion," says Corkin. "The financial statements contained red flags. There are always indicators of stress before fraud. We shorted the stock in October 2022 and in January 2023 the company went into bankruptcy."

In a similar vein, Bangkok-listed renewables firm Energy Absolute, described as "Thailand's Enron", went from a market capitalisation of $5 billion to $500 million after allegations of fraud, including made-up earnings, related party transactions and other aggressive accounting practices.

> **"The investment proposition now for emerging markets is extraordinary. Their totally unloved nature relative to developed markets is extreme, and there are very interesting potential catalysts coming. Increasingly, there is interest in these markets. The way we invest resonates with investors. We are bullish EM; it is a great time to be investing."**
> *James Corkin*

And while China Evergrande had played out before the fund launch, Sunac China was also overlevered, understating debt and inflating sales, including a series of related party transactions, providing an effective short for the fund.

Having launched with $2 million in 2022, the fund now has assets of $31 million in an offshore Caymans structure. Besides the hedge strategy, the team also runs a risk-adjusted carve-out of the long book as a UCITS fund.

Corkin notes that concentrated emerging market indices tend to focus on certain themes, meaning that "lots of wonderful businesses are overlooked".

"EM investors tend to be thematic – for example, they target Asian consumers – which means they can cluster in certain names. That can get you into trouble, as we saw with the Vietnamese banks, which faced unrealised property losses in late 2022. We like to avoid landmines. Our investment philosophy is to focus on high-quality names that are not being recognised by the market."

Portfolio companies have a median market capitalisation of around $5 billion, including some smaller opportunities in the mid-cap space. Long positions tend to start at 3% of the portfolio, and can reach 8%, while the average short position is much smaller at 1% of the book.

The short book considers risk control, liquidity and borrow costs, focusing on bigger names with different holding periods to the long book. Holding periods on the long side are typically 12-36 months, and on the short side at six to 12 months.

The fund is typically 100% long and 30-40% short, with average beta-adjusted net exposure of 30-50%.

Steyn's rigorous process relies on exhaustive accounting, research and due diligence rather than having a geographic presence where it invests.

"That is how we invest and generate ideas," says Corkin. "We don't travel to visit companies and kick the tyres. It is hard to articulate how you could feasibly run a global strategy that way. We don't believe being a 'visiting expert' can give an edge in every market. We do our research and we work from there; it is the same process that has worked affectively across all our strategies."

Corkin notes that for 14 years, emerging markets have underperformed versus the S&P 500, making them the cheapest they have been since the inception of the MSCI Emerging Markets Index in 1998.

At present, the fund's quality/value bucket trades at a weighted average Ev/EBIT multiple of only six times, with a return on invested capital of 26%.

Having recently returned from the Morgan Stanley NextGen 25 conference in New York, where he was the only South African manager represented, Corkin is excited to see growing interest in the EM space, and an appreciation for his team's approach.

"The investment proposition now for emerging markets is extraordinary," he says. "Their totally unloved nature relative to developed markets is extreme, and there are very interesting potential catalysts coming. Increasingly, there is interest in these markets. The way we invest resonates with investors. We are bullish EM; it is a great time to be investing."

"We have managed to generate alpha in markets that have been down since we launched, and that for me is exciting," he adds. "A big EM tailwind over the next few years will be very beneficial for our strategy."

Corkin notes that a strong US dollar has historically had an inverse correlation to the performance of emerging markets. A weaker US dollar will be a catalyst for change in EM, and political rhetoric out of the US suggests the greenback may well weaken, amid concerns about the fiscal position of the world's biggest economy and a long-awaited rate-cutting cycle.

Corkin believes the strategy can comfortably reach $1 billion, given that it is active in many different markets with significant capacity.

"History shows that when emerging markets do begin to outperform, this outperformance can be substantial and multi-year. Our contention is that this period of emerging market outperformance may be sooner than many investors are positioned for. We continue to find exceptional opportunities to deploy capital."