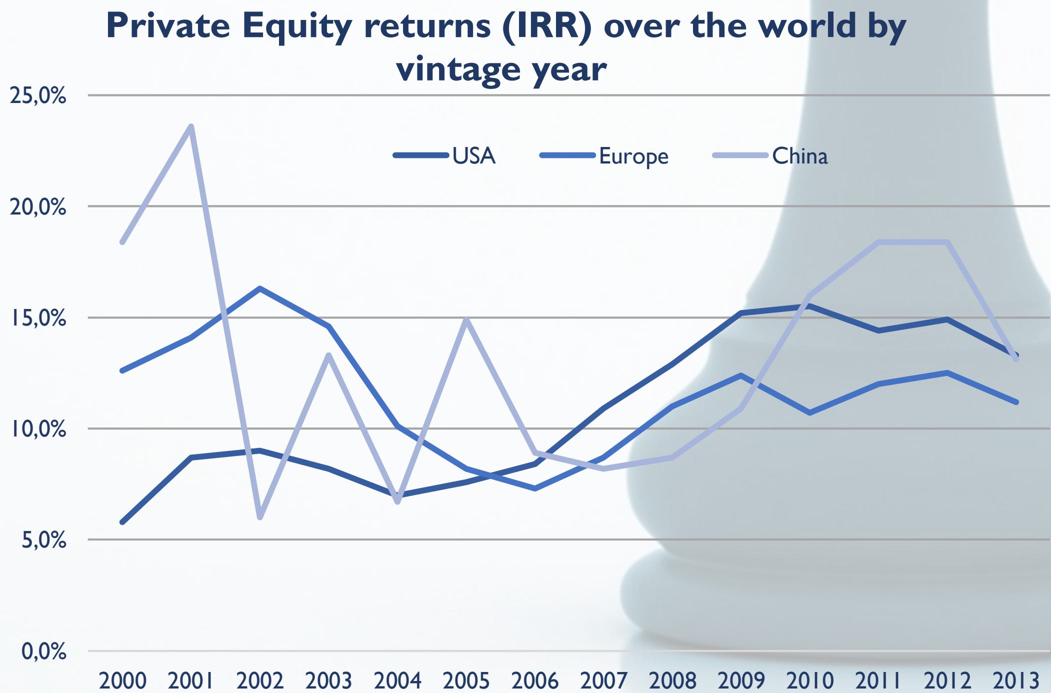
The danger of a single (investment) story

Nigerian writer, Chimamanda Adichie, once gave a TED talk on the dangers of the single story. She argues that despite our lives being composed by a multitude of stories, in certain moments, we have a tendency to simplify reality, especially regarding subjects that are distant to us. In her case, she mentions being criticized by a professor for writing a fiction story in which her Nigerian characters weren't suffering from extreme poverty; instead, she wrote about simple middle class people who drove cars and watched TV. According to her, the story failed to comply with the single story her professor expected to read given that it was plotted in Nigeria.

Our perception is that we also suffer from the single story paradigm in the investment world. Ever since Jim O'Neil coined the BRICs term, Brazil, China and other emerging market countries have been expected to be places of high growth with an emerging middle class. Thus, by simply investing in sectors that catered to this growing consumption, one was in theory assured of positive returns.

However, over a decade has passed and the single story did not hold.

China has grown according to expectations, its middle class emerged, but returns have lagged. Average 10-year Private Equity returns for China have not been substantially better than the US or Europe.



*Preqin Private Equity Spotlight. Database September 2016.

Reasons for this seemingly underperformance abound. However, our preferred explanation is that once every market player shares the same vision, prices adjust and any overperformance is lost. Claudia Zeisberger, an INSEAD professor, shines light on recent healthcare deals in China priced at staggering 30x EBITDA. China grows, healthcare grows even more; thus, a healthcare deal in China would represent guaranteed growth. The buyer is not the only one to perceive this and, consequently, the seller adjusts his price to this perceived scenario. The extremely high prices of Chinese companies have all but eroded any over performance one could expect to achieve by allocating their resources to this high growth region.

At the same time, a story very few were paying attention to 10 years ago has been responsible for a disproportionate percentage of the return in that part of the planet. The emergence of the VC eco-system in China with its ever increasing number of unicorns was not something widely discussed back then and, at the same time, has produced outstanding returns for the investors who ventured there - outside of the single story.

China today has 1 in 3 new unicorns created in the last 3 years. Its unicorns are increasingly competing with the ones created in the US, exemplified by the Didi x Uber fight. The outsized returns that VC investments in China produced are partly what made private returns there worthwhile. However, back then, when the BRIC term was coined, it was not because of new tech companies that foreigners began pouring money into China.

Moving to Latin America, the region, on average, failed to deliver its expected returns. Its middle class did not grow, nor did its consumption. Investors who believed in the single story for Latin America have, on average, lost money.

*Preqin Private Equity in Latin America. Database November 2015.

Moreover, given the overall expectation of little to moderate growth in Latin America for the next cycle, many investors have decided to stay away from the region, once again following the tale of the single story.

One of the benefits of being local is that it allows you to understand the subtleties that outsiders, in general, do not see. As we analyze the outcomes of the most recent investment cycle in Latin America, Spectra was able to perceive the multitude of stories that compose Latam's investment space and thus we invested accordingly.

Let us give just a few examples of investment themes beyond the single story that stem from our portfolio.

1. Latin America is a land of commodities. Everyone knows that. Both our farms are increasingly producing food crops that supply to the rest of the planet, but also our mines and oil reserves are used to feed growth elsewhere. Investor's profitability in such a theme has nothing to do with local growth but global consumption.

2. The same technology that is disrupting corporate life in the US and is changing the face of China is also present in Latam. It's true that the local market is growing at a different pace, but at the same time it's much less capital intensive and less competitive. Again, the potential returns from this space have less to do with local middle class growth and more to do with technology adoption rate.

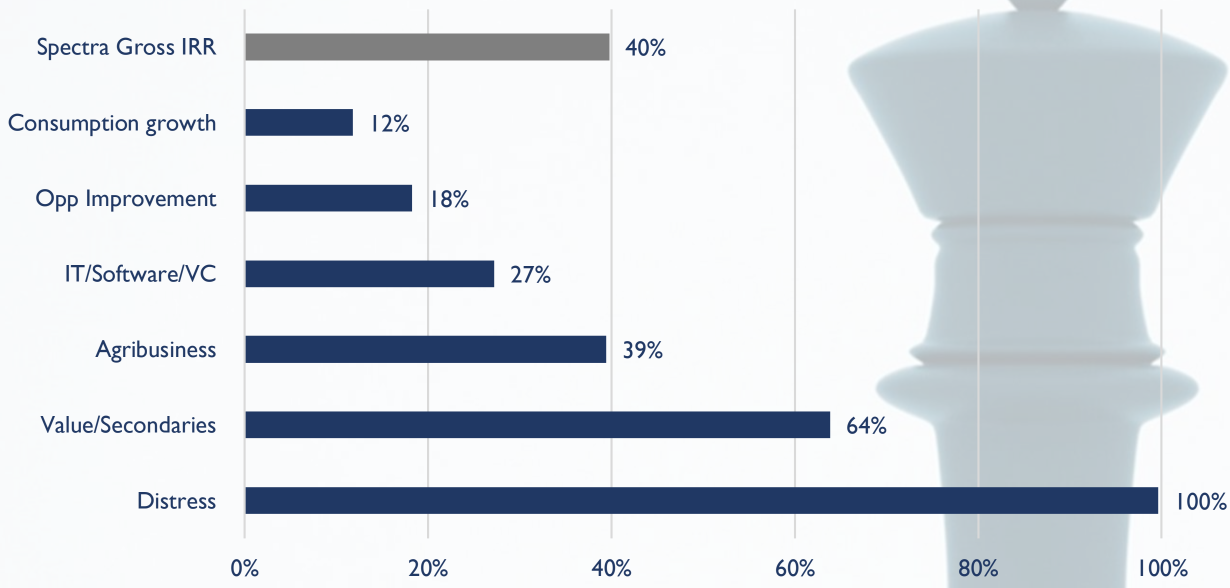
3. Recent recession has led to the emergence of distress investing as an asset class in the region. With 1863 companies filling for **"chapter 11"** in Brazil in 2016, it has become an interesting space to shop and, once more, it's not dependent on growth (quite the contrary) for it to be profitable.

4. The lack of attention from global players towards Latam has permitted investors to acquire solid assets at very attractive prices, in what we call Value Investing. Returns come more from the yield or price arbitrage when selling the asset than for an outstanding growth it might have.

5. Lastly, the Brazilian firm 3G Capital has become widely renowned for buying global mature companies budgeting low or no growth in their business plans, focusing instead on massive operational improvements to drive up margins. Operational improvement opportunities on family owned companies abound in the region. This margin improvement from better management practices is decoupled from GDP growth.

This list is far from an attempt to be exhaustive. A number of other stories and sub-stories exist. I am stopping at these for simplicity sake only.

Turning to Spectra's portfolios, if we aggregate our underlying investments into each of the above stories, it becomes clear how each of them has very different return dynamics than the simple growth of the middle class story:



* Spectra I, II & III Consolidate gross return. As of September, 30, 2017

Many first time LPs that flocked to the region post the global financial crisis armed with sound macro-economic research looking for the next El Dorado of growth have now left and cut Latin America from their asset allocation matrix.

Were we to have invested in the single story of Latin America, we'd most likely be out of business by now. However, a recognition that in equities and, most probably, any asset class, there are a multitude of value drivers has saved our performance in this past cycle.

Single stories lose not only by missing out the whole picture, but also because they tend to concentrate investors along them and, thus, move prices in order to reflect the view of the majority. An understanding of the multitude of driving forces around an asset, helps the investor to see the details that an outsider usually cannot.

Going forward, we see a few single stories on people's minds. They include: the risk of technology disruption, China slowdown/blow-up, interest rate increase and, adding a local one, Brazilian 2018 presidential elections. All of these worry us. However, they are, individually, single stories and, thankfully, the world is much more complex than that.

SPECTRA INVESTMENTS

Thank You

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