INSIDER

www.insider.com May 8, 2022

PREMIUM - HOME - MARKETS

A portfolio manager at a $31 billion firm shares his 7 top picks for international equities — and explains how 'home bias' could be keeping investors from realizing tremendous opportunities for gains

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- **Krishna Mohanraj says that "home bias" keeps investors from tremendous opportunities outside the US.**
- **US stocks have performed well lately, but Mohanraj says every market and currency is cyclical.**
- **He broke down seven of his top international stock picks to buy, including spirits producer Diageo.**

DIAMOND HILL CAPITAL MANAGEMENT

Krishna Mohanraj is a portfolio manager of international equities at Diamond Hill Capital Management.

Over the last few months, the war between Russia and Ukraine has strengthened the dollar's dominance as investors continue their flight to quality, "safe-haven" assets.

Krishna Mohanraj, an international equities portfolio manager at Diamond Hill, an investment firm that manages $31 billion in assets, acknowledges that the dollar has done very well lately. Even so, he believes that investors with a "home bias" – those that solely consider domestic investments – are missing out on massive opportunities for potential gains in the long run.

In a recent interview with Insider, Mohanraj explained that there are two reasons why investors should consider holding international equities. The first reason is simple: it gives investors a wider variety of choices.

"The number of opportunities when you look outside the US is tremendous compared to focusing just on the US. To the extent you can actually go outside your home country, it just allows us that much more opportunity to find mispricing," he said.

Mohanraj referenced research estimates that while US stocks represent between 40% and 50% of total global market capitalization, US securities only represent 20% of the total pool of individual securities available for investment.

Secondly, Mohanraj explained that all markets and currencies follow a cycle, and diversifying beyond US borders can help investors capture gains and prevent losses as cycles shift. He specifically contrasted the US's recent outperformance thanks to soaring growth stocks with Japan's recent losses.

And while Mohanraj called Brazil "out-of-favor" with investors last year, he said that it looked attractive now because of the commodity boom.

"There's always volatility in some markets, right? So, that means there›s always opportunity in some markets," he said. "By being patient and working through what's going on in the market and understanding these businesses, we are in a position to take advantage of opportunities when they show up."

Investing strategies for international stocks

As part of his investing philosophy, Mohanraj and his team focus less on macroeconomic factors like surging inflation, and more on an individual company's long-term fundamental story. Mohanraj closely examines a business's competitive position, the quality of its management, and both its potential growth and cash flow – the stock must either already be generating or have a strong likelihood of generating future cash flow – then buys while he believes the name is undervalued.

"We want to bet on our businesses based on their quality rather than make any macroeconomic predictions," said Mohanraj. He invests in both developed and emerging markets, with each receiving a respective 78.4% and 18.3% allocation. Mohanraj believes that exposure to emerging markets is especially important for growth.

"Despite all the volatility, despite all the noise, a lot of growth has been coming from China for a while, but outside China, India and Latin America are really where the demographics provide an opportunity over the very long run. In the short term, we go by valuations and look to see in which markets the ideas come from," he explained. Due to the more risky nature of investing in emerging markets, Mohanraj requires a cheaper price for those assets.

Mohanraj's investing process doesn't change due to geopolitical factors like the Russia-Ukraine crisis, although he does consider the potential long-term repercussions for stocks.

For instance, Mohanraj called the largest bank in Russia, Sberbank, a well-run business and attractive investment. However, he's avoided buying the name because banks are so tied into their local economies and regulations. On the other hand, he also said that the crisis has created opportunities in certain pockets of the world like Brazil.

"In Europe in particular, we've been looking at opportunities where we feel stocks have been unduly punished simply for being in Europe. Especially in late February, early March, there's been opportunities for us to increase some holdings," Mohanraj said.

With a 49.3% exposure, Europe remains the largest regional allocation in Mohanraj's portfolio as of March 31. Exposure to the United Kingdom and Switzerland make up 24.2% and 11.3%, respectively, of the total portfolio.

Top stock picks

While Mohanraj's team chooses to pick individual stocks rather than follow a particular theme or sector, he said his portfolio had a large weighting in healthcare stocks due to both an aging global population and because the sector has recently fallen out of favor with investors. He also has a lot of exposure to both the consumer staples and consumer discretionary sectors."We are a strong believer in the emerging consumer for the long run," he said.

With price inflation a given nowadays, Mohanraj focuses on finding the firms with the highest pricing power, meaning they can pass on elevated prices to consumers without losing too much volume. For example, he said that business-to-business (B2B) companies like **Compass Group** (CMPGY), which supplies products to Walmart, are able to pass on prices to their clients, as can high-end brands like **Louis Vuitton** (LVMUY).

"The Louis Vuittons of the world are passing on prices quite easily because their consumer is less stretched," explained Mohanraj. Within consumer discretionaries he also likes **Richemont** (CFRUY) and other watch and jewelry makers.

Within consumer staples, Mohanraj likes **Nestlé** (NSRGY) and **Unilever** (UL), both large corporations that have the means to manage increasing input costs. As another top consumer staples pick, Mohanraj selected **Diageo** (DEO), one of the largest spirits producers in the world.

Mohanraj said that Diageo is a high-quality name because it owns brands that are very difficult to replicate, such as scotch label Johnny Walker. Scotch in particular is an industry with very high barriers to entry, he said.

Mohanraj also complimented the company's management team for raising tequila's profile in the US and for building a strong position in tequila from strategic acquisitions like the Don Julio brand and George Clooney's premium Casamigos label. Under Diageo's leadership, Mohanraj said that Casamigos has grown into one of the fastest selling tequilas in the US.

"Not only do you have a company with like 200 years of history in these scotch brands, they are able to see what's coming and jump in and take advantage of the new things in the market," said Mohanraj. "In the US, tequila over the last 10 years has gone from being one of those spring break-type, low-quality drinks to a now premium proposition in the market – huge amounts of value created by Diageo in just a short period."

Mohanraj also likes Diageo because it has exposure to both developed and emerging markets like India.

"It's very hard for us to see how a business like Diageo could be destroyed by a pandemic or a crisis because they've survived for 200 years and they seem to be doing all the right things," Mohanraj continued. "That's an example of a super attractive business that if it sells off because of Russia, why would we not add to a position in that?"

As his final top stock pick, Mohanraj named **Exor** (EXXRF), a holding company that manages the Fiat founders' family fortune. The company invests in a collection of assets including Fiat Chrysler, Ferrari, Stellantis, and even has stakes in "The Economist" and the Juventus Football Club.

"Of course, it was selling off in the crisis because it's Italian, it sits in Europe, and it has exposure to autos," said Mohanraj, who values Exor using a sum-of-the-parts method due to its diversified stakes. "It's super attractive, super cheap, a set of high-quality assets, and very well-managed. We just looked for an opportunity to buy in, and in February or March we finally got that opportunity."

Besides the seven names mentioned above, Mohanraj also shared his portfolio's top 10 holdings as of March 31 with Insider. **Fairfax Financial Holdings** (FRFHF) leads the pack at 4% of net assets, followed by **Check Point** (CHKP), **Diageo** (DEO), **Novartis** (NVS), **BR Group** (BTGOF), **Unilever** (UL), **Samsung** (SSNLF), **Nintendo** (NTDOY), **Spotify** (SPOT). The top 10 holdings are rounded out by **Roche** (RHHBY), which makes up 2.5% of net assets.

As of 30 April 2022, Diamond Hill owned shares of BT Group PLC, Check Point Software Technologies Ltd., Compass Group PLC, Diageo PLC, Exor N.V., Fairfax Financial Holdings Ltd., LVMH Moet Hennessy Louis Vuitton SE, Nestlé SA, Nintendo Co. Ltd., Novartis AG, Compagnie Financiere Richemont SA, Roche Holdings AG, Samsung Electronics Co. Ltd., Spotify Technology SA and Unilever PLC.

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