



Setanta Focus 15 Fund – Q2 2011

Fund Description

The **Focus 15 Fund** ('the Fund') is managed by Setanta Asset Management Limited ("Setanta") and is a representative account of the Focus 15 strategy.

The Fund is an actively managed, concentrated Global Equity fund that invests in circa 15 stocks. As a fundamental value investor our research is designed to properly understand how each business functions and to consider pertinent risks to the business. We attempt to value each business, incorporating relevant upside and downside scenarios.

As such the fund attempts to invest in the most attractive stocks using a risk-return framework. Investments are made for the long-term and are based on investment merit rather than with reference to benchmark. This fund is mandated to be fully invested in equities. Due to the concentrated-nature of the fund, performance may be volatile and it is therefore suitable for those investors with experience of the stock market.

Investment Philosophy

We in Setanta do not believe the market is efficient. Our aim is to purchase and own assets at a price below a reasonable assessment of their worth. This is where we focus our resources. Our process is akin to assessing a part ownership of a business rather than trading a security. This assessment of value must always encompass a thorough understanding of where this value is derived. We have a long term investment horizon and risk management is always central. We regard risk as the potential for permanent impairment of value. Integrity is a key tenet of our professional DNA and we embrace a culture of continued learning.

Portfolio Managers

Rowan Smith & David Coyne



Investment Principles

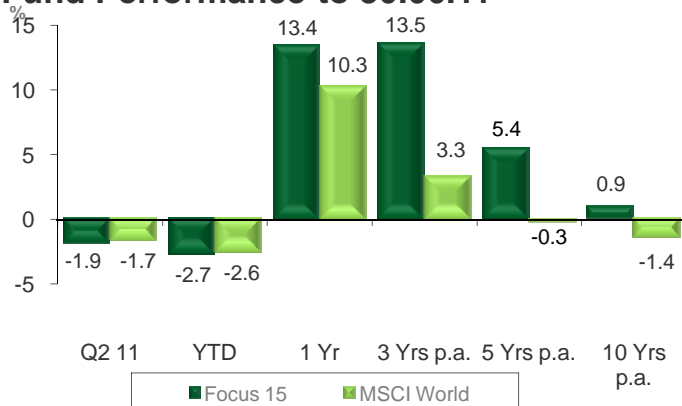
- We do not believe the market is efficient.
- We aim to make investments at a price below our assessment of intrinsic value.
- We make an investment in a business rather than trade securities.
- We believe risk is the possibility of permanent impairment of value.
- We make investments for the long term.
- We invest where we see value and are not afraid to be contrarian and swim against the tide.
- We don't make forecasts, we consider scenarios.
- We demand financial strength from the companies we invest in.
- We will act with integrity and communicate with our clients in a manner representative of our investment style.
- We have the humility to know we make mistakes and embrace the need to continue learning through both experience and study.

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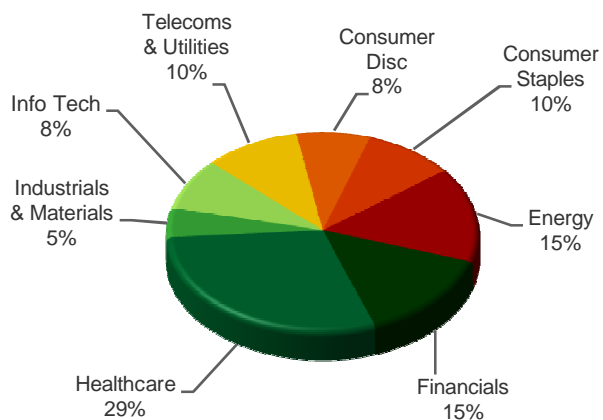
Fund Performance to 30.06.11



The investment objective of the Fund is to outperform the MSCI World index over periods of three years or more.

Performance Source: Setanta Asset Management Limited. Benchmark: MSCI World. The Fund returns stated are based on the movements in the unit prices of a representative account, based on mid to mid prices, and are gross of management fees. The performance will be reduced by the impact of management fees paid, the amount of which varies. **Fund Statistics Source:** Bloomberg (Valuation) Median ex Financials

Sector Distribution



Yearly Performance

Year	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Fund	-19.7	-35.6	3.9	7.6	27.3	17.0	-2.7	-35.2	44.0	28.2
Benchmark	-12.2	-32.1	11.3	6.5	26.2	7.4	-1.7	-37.6	25.9	19.5

Fund Statistics

PRICE/BOOK	1.8
PRICE/EARNINGS RATIO (FY 1)	13.7
FREE CASH FLOW/EV %	6.3
DIVIDEND YIELD %	3.3
AVERAGE MARKET CAP (€BN)	43
NO. OF HOLDINGS	15

Holdings

COMPANY	SECTOR	% OF FUND
Sysco	Consumer Staples	9.3
Tidewater	Energy	8.3
Wincor Nixdorf	Information Technology	8.1
Johnson & Johnson	Healthcare	7.7
Everest Re Group	Financials	7.1
MI Developments	Financials	7.1
Steris	Healthcare	7.1
Astellas Pharmaceutical	Healthcare	7.0
Pfizer	Healthcare	6.7
Total	Energy	6.5
NTT Docomo	Telecoms & Utilities	6.2
Toyota Motor	Consumer Discretionary	6.0
Komori	Industrials & Materials	4.5
Belgacom	Telecoms & Utilities	3.7
OPAP	Consumer Discretionary	1.6
Cash		3.1

We are often our own harshest critics. Even when fund performance is good, we continually think about our 'mistakes'. This process of self-flagellation is actually an important part of our learning process – by studying where we went wrong in the past, we hope to avoid making similar mistakes in the future. We hope this process will improve our investment capabilities and future fund performance.

It's important to properly define what, in the investment world, is a mistake. Some might view investment mistakes as those which decline in value relative to their purchase price or those which underperform their relative benchmark. This is much too simplistic in our view. In fact, it's wrong. It ignores the bad and good luck events that charter a path for companies and their share prices. Of course, luck evens out over the long run but in the context of self-examination, many individual losing investments do not contain any lessons at all.

To illustrate, imagine you are offered the chance to play a coin tossing game (50-50 odds) that pays off 5-to-1 if you correctly 'predict' its outcome. The payoff structure of this game is clearly very favourable; if such an investment ever becomes available to us you can expect us to fill our boots! The skill of this game is not being able to correctly 'call' the coin, but to realise the payoff structure of the game is exceptionally favourable. Of course each time we play the game we only have a 50-50 chance of being right. In any individual game we could call the coin wrong and lose our stake, but over the long run this game is a 'gimme' (and no amount of soul searching will change that fact).

In the real world 'gimmies' rarely present themselves. The range of possible outcomes is never so confined and the probability of such outcomes is never known. And think again if you believe such information is available in annual reports or research reports. So how can anyone determine the merits of such unknowable investments? This is precisely what makes investing so difficult.

Our approach to investing starts just there – an acknowledgement that identifying mispriced investments is *extremely hard*. We compete with many, many global investors. When we invest, we clearly think we are buying on the cheap. What makes us think we are right and the seller is wrong? We try to figure out our 'edge'. In many cases our edge is that we are patient, valuing the business on the basis of our judgement of its long term prospects. That might not sound much, but think about this: the average holding period for stocks quoted on the New York Stock Exchange (NYSE) is now just six months (for reference between the mid-1930s and the late-1970s it was between 4 and 10 years). In other words, the average 'investor' is trading stock prices based on the short term ebb and flow of good and bad news, with no reference to the company's assets, brands, market share, balance sheet strength, long term growth potential and other fundamental factors.

So how do we go about correctly assessing a company's long term prospects? Most importantly, we aim to invest in businesses that we think we understand. We try to imagine how they may be positioned in years to come, say in 10 years, and what events could derail their business model. Looking at investment candidates in this way naturally draws us to established businesses and industries, where the last 10 years is as good a guide to the next 10 years as you're likely to see. As perverse as it sounds, we don't really like our companies to be innovative. Not only does innovation cost money, but it increases the risk of a sea-change in industry dynamics, where previous leaders can be dethroned by hungry new kids on the block.

And entwined in all of this is the price we are willing to pay for these business attributes. Paying a high price for business safety is a sure way of generating sub-par investment performance. At times, for a sufficiently low price, we may be willing to compromise on a slightly hazier vision of the future.

With all that in mind, we bought a new stock for Focus 15 in March 2008. The company had highly attractive attributes. For instance, it had a high market share of 25-30%, a wide margin over its nearest competitors, which would likely give it self-sustaining economies of scale advantages. The company had also seen off many of its competitors over the previous five years, giving us confidence in the strength of their products and brand. Newer competitors had emerged in their place and while they could threaten the position of our company, we believed it had a sufficient lead that would protect us for years to come. To cap it off, the company had a net cash position and was adding to this pile at a good pace from on-going profits, in addition to paying a reasonable dividend. At the time the stock was attractively priced, trading at a low double-digit price-to-earnings ratio. While the company was facing some squeeze on profits, we believed these to be cyclical pressures related to a tight-fisted consumer. Does all this sound good? Well the stock was Nokia and unfortunately for the fund this investment was definitely a mistake.

Nokia was what is known as a value trap – something that has the illusion of being cheap but in fact turns out to be anything but. The crux of our investment case was that the earnings were sustainable. At the time we bought in, Nokia was expected to generate earnings per share of around E1.70. Earnings for 2011 are expected to come in close to zero, with not much of a rebound expected for 2012. What went wrong?

Well, perhaps we were somewhat unlucky with Nokia – despite spending almost E18bn in research and development over the last 3 years (more than four times what Apple spent), the company could not manage to develop a range of competitive phones. You could also say that the iPhone was such a great product that Nokia was destined to lose. The reality is that both Nokia and Apple operate in a fast-changing and very innovative industry – just think how much mobile phones have changed since the introduction of the ‘brick’ phones in the 1980s. Every year, every month new technologies are being developed. In order to survive, mobile phone companies have to be at the cutting edge of *all* developing technologies – miss just one of these waves and they could be consigned to the heap of has-beens, like Siemens, Ericsson, Sony, Motorola, Alcatel or Sagem before them. We thought that Nokia had an entrenched position in the minds (and ears) of its customers. We also thought that while we might be wrong we were buying at a sufficiently low valuation, so that the payoff-downside opportunity set was in our favour. We placed too much store in Nokia’s business performance in the previous 5 years but the reality is that the mobile phone industry is still in its infancy. Our mistake was to think that the odds of Nokia *profitably* maintaining its dominance for years to come were relatively high. In retrospect they were quite low indeed (just as, in our opinion, they are low for Apple and HTC). This was a game with odds 5:1 *against!*

We finally sold out of Nokia during the quarter (after yet another ‘profit warning’). The investment case had changed. We feared that Nokia may continue to throw good money after bad in a desperate attempt to regain lost market share and margins. They may succeed, but the odds are against them. As bad investments go, this ranks up near the top – we lost over half our money in a stock where the company was profitable and had no financial leverage. *Nostra culpa*, our mistake. Next time we are offered the chance to invest in other early stage industries our guess is that we will pass.

Of course, it’s not all bad news. Despite our experience with Nokia over the last 3 years, the fund has increased in value by over 30% in that time, while global stock markets were more or less flat. We like to think that we are at least doing some things right.

Transactions during Quarter

As discussed above, we sold out of **Nokia** at the end of May. On a more positive note, we sold down around a quarter of the position in drug company Pfizer, which had increased in value by around 40% in US dollar terms since purchased just over a year ago. We still see good value in Pfizer, but the stock had grown to a very large weighting in the fund.

In May, we topped up **Wincor Nixdorf**, the maker of ATMs and cash deposit systems. Having increased its estimate of growth for the year in November last, in May the company downplayed expectations for growth in the year to September 2011. Such changes in a company’s short term fortunes, both positively and negatively, typically don’t bother us one way or the other, as it tells us little about the long term prospects for the company. We think that Wincor has many good years ahead of it and were only too happy to increase our position size as the market dumped the stock down by over 20% from its February high. Unlike Nokia, Wincor dominates its market along with two other global competitors; this has been the case for many years. We see lower innovation risk in this industry, lower risk from new upstart competitors.

The same is true of **Tidewater**. The company provides marine support vessels to the offshore oil and gas industry; we don’t think product substitution risk comes any lower than this. The stock had drifted down by around 15% since March 2011 for no particular reason. Tidewater operates in a highly cyclical industry, whose earnings are now depressed. It is buying up cheap vessels in the downturn, stealing a big advantage on its financially weak competitors. When good times eventually come again (and they will come), we are confident that Tidewater’s earnings and share price will benefit enormously.

Finally we completed our purchase of **Komori**, the Japanese manufacturer of printing machines, which we started buying in the days after the Japanese earthquake in March. The stock initially rallied above what we were willing to pay, but our patience was rewarded as it fell again towards the end of Q2. Of course only time will tell if our assessment of Komori's prospects was more or less realistic than the market's – and whether or not we will in time view Komori as a success or a mistake.

David Coyne.

IMPORTANT INFORMATION

The Fund is currently available in Ireland via a unit-linked offering of Canada Life Assurance (Ireland) Limited. For this life assurance product, investors should refer to the relevant policy conditions. The strategy is also available on a segregated basis. Investors should consider the investment objectives, risks, charges and expenses carefully before investing. See 'WARNING' and 'IMPORTANT INFORMATION' sections below.

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WARNING: Past performance is not a reliable indicator of future results. The price of units and the income from them may go down as well as up and investors may not get back the amount invested. The return may increase or decrease as a result of currency fluctuations. Forecasts are not a reliable indicator of future performance.
