Setanta Global Equity Fund – Q3 2017

Setanta
ASSET MANAGEMENT

Fund Description

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

The Fund is a diversified, actively managed equity portfolio. As bottom-up fundamental value investors, our research process is designed to properly understand how each business functions and to consider risks pertinent to the business. Securities are chosen by a team of global sector specialists, targeting sensible diversification across industries, geographies and market capitalizations. We value each business, with the priority to pay a price that mitigates downside risk. We aim to make investments for the long-term, all the while considering the available opportunity set.

Fund Commentary

For the third quarter 2017, the Setanta Global Equity Fund posted a total return of 1.3%, which was broadly in line with the performance of the benchmark, the MSCI World Index Total Return 1.1%.

Regular readers of our material will know that, as long term investors in businesses, we tend not to focus a whole lot on short-term share price fluctuations. This is not because we are lazy or neglectful, it's because very often share prices move up or down in a period for almost random reasons only to reverse direction the following period. Many investment commentators look to rationalise these share price movements – "expectations are high for the new product release" or "the stronger dollar will hurt next quarter's profits", for example. This is not our approach. Besides, over-thinking the short-term can have the effect of taking one's eye off the all-important long-term. Are the barriers to entry for the business growing weaker or stronger? Are current profits a reasonable reflection of what can be sustainably earned? Is incremental capital invested in the business growing or reducing its value?

(Fund Commentary continued on Page 3)

Portfolio Managers

David Coyne & Sean Kenzie

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.

Irish Pensions AWARDS 2015 WINNER Equities Manager of the Year

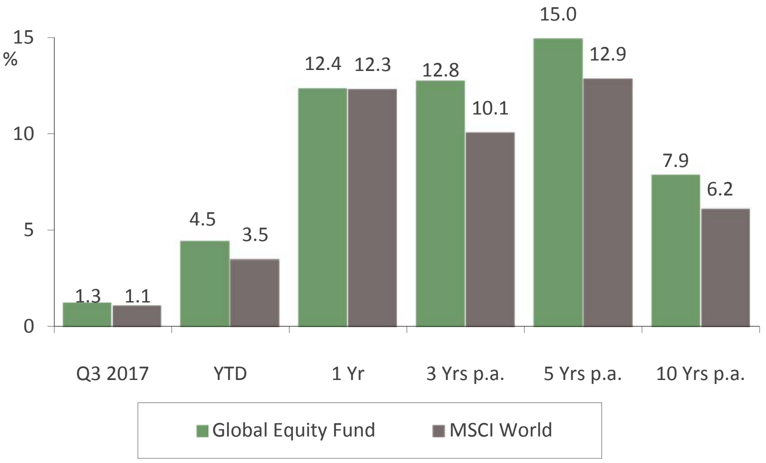
Irish Pensions AWARDS 2016 WINNER Equities Manager of the Year

Irish Pensions AWARDS 2014 WINNER Equities manager of the year

Irish Pensions AWARDS 2013 WINNER Equities Manager of the Year

Irish Pensions AWARDS 2012 WINNER Equities Manager of the Year

FUND PERFORMANCE – 30.09.17



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

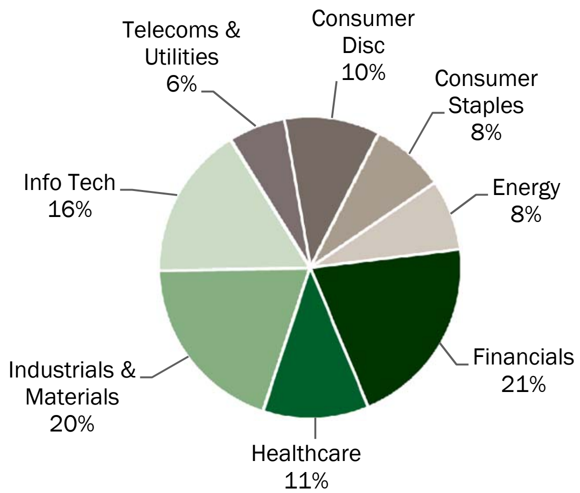
TOP 10 HOLDINGS

COMPANY	SECTOR	% OF FUND
OWENS-ILLINOIS	INDUSTRIALS & MATERIALS	3.7%
BERKSHIRE HATHAWAY	FINANCIALS	3.1%
CRH	INDUSTRIALS & MATERIALS	3.0%
DCC	INDUSTRIALS & MATERIALS	3.0%
OSHKOSH	INDUSTRIALS & MATERIALS	2.9%
LEUCADIA NATIONAL	FINANCIALS	2.6%
JOHNSON CONTROLS	INDUSTRIALS & MATERIALS	2.3%
FAIRFAX FINANCIAL	FINANCIALS	2.3%
MICROSOFT	INFORMATION TECHNOLOGY	2.2%
FEDERATED INVESTORS	FINANCIALS	2.2%

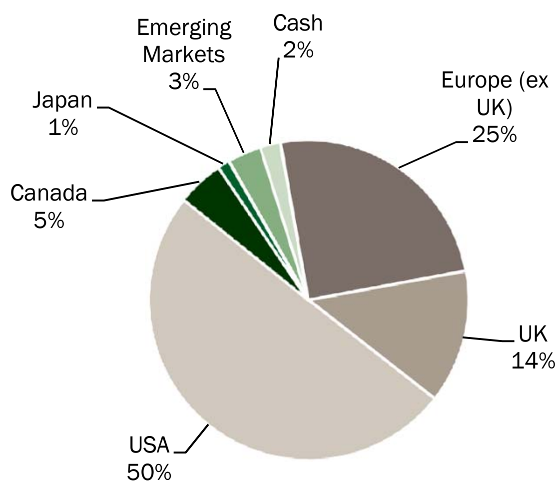
FUND STATISTICS

PRICE/BOOK	2.1
PRICE/EARNINGS RATIO (FY 1)	17.5
DIVIDEND YIELD %	1.9
AVERAGE MARKET CAP €BN	51.1
NO. OF HOLDINGS	90
ACTIVE SHARE %	89.0
DEBT/EQUITY %	55.3

SECTOR DISTRIBUTION



GEOGRAPHIC DISTRIBUTION



YEARLY PERFORMANCE

Year %	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Fund	-29.1	16.3	10.9	27.7	13.0	-1.0	-36.6	32.2	16.2	0.9	14.1	24.5	20.6	9.0	16.2
Benchmark	-32.1	10.7	6.5	26.2	7.4	-1.7	-37.6	25.9	19.5	-2.4	14.1	21.2	19.5	10.4	10.7

To give you an insight into how we think long-term in a short-term world, we would like to share with you our thoughts on three portfolio holdings with notable share price changes during the quarter just passed.

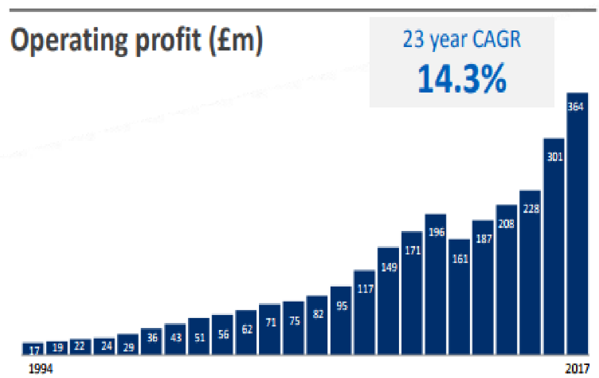
First up is Melrose Industries plc (-12% Q3:17), the somewhat unique UK company that acquires underperforming industrial businesses, improves their operational performance over a 3-5 year period and then sells them in a tax efficient manner. Over a 10 year period Melrose has delivered an IRR of 30%, just over three times the return on the market.

During the quarter Melrose announced its half-year results, which disappointed investors who have become used to the company consistently exceeding expectations on profit and margin development. The share price fell 20% peak-to-trough intra quarter. Investors' disappointment stemmed from an acute deterioration in the turbo generator market, with the consequence of materially lowering the operating result at Brush, one of Melrose's businesses. After speaking with management we are confident they will either take material action on the cost front or positon themselves for a longer-term recovery in combination with larger industry players.

The combination of a potentially extended timeframe over which Melrose might sell Brush and the lack of a new large acquisition announcement prompted those shareholders more interested in near term results to head for the exits. We used this share price weakness to add to our shareholding in Melrose, with the rationale that the weaker near term prospects for Brush were more than compensated by the low valuation, as well as the option value of the next deal.

Many of our holdings have option value, whose payoff is uncertain both in timing and amount. Melrose is very likely to do another value-creating deal and is actively looking at candidates. If we assume such a deal is completed and apply some conservative assumptions framed by Melrose's track record around price paid, equity/debt funding and margin improvement, then a £3bn deal may be worth around one-third of the current market value of the company. Of course this value is not certain, but either way it's not currently being priced into the stock.

We see a similar dynamic with core holding **DCC plc**, where opportunistic M&A has contributed to the majority of profit growth over the long term. DCC sees large scope for market share expansion via their disciplined M&A process, but the amount and timing of these acquisitions are uncertain. For the longer term shareholder who values long term economics over short term profits, this upside optionality will play out over a period of years, not quarters.



Nike Inc. (-15% Q3:17) will be known to all of you as the dominant global sportswear company. You will probably also be aware of the difficulties facing some physical retailers, especially in the US, due to disruptive forces from online retailing. Our sense is that Nike shoes are somewhat over supplied in the US, which causes a problem if the inventory of bankrupt retailers makes its way onto market places like Amazon at a discount (as has been happening). The company has admitted to making too many styles and is cutting their lowest 25% of styles representing 1% of sales. It is also looking to control more of its own distribution over time (internet as well as Nike-branded stores) in order to better control supply / pricing. An additional headwind facing Nike is its loss of market share to Adidas in the US, which is capitalising on the current 'retro' shoe trend. Both of these factors have dragged on investor sentiment and the share price has lagged the overall stock market this year.

Actually, looking at Nike's share price decline in the third quarter is a great example of why it is often nonsensical to look at short term share price moves. The Nike stock price rose 11% on the last day of June on a release of a stronger-than-expected quarterly report from them, only for the stock price to fall by roughly an equivalent amount in mid-August following weak results from Foot Locker, a key retailer of Nike products in the US. So you had two sharply conflicting data points in a seven week window. Which piece of information was correct? We don't know. Will either prove significant in 10 years' time? We doubt it. Longer-term we see the continuing trends of more casual fashion, Asian consumer demand and women increasingly bigger buyers of sportswear being supportive of sales growth and underpins the prospects for the shares over the coming years.

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The share price of Oshkosh Corporation (+16% Q3:17) rose robustly despite little in the way of 'news' in quarter. Our view was that the company was materially undervalued in Q1 2016 and we added significantly to our shareholding on the belief that the private market value of their four businesses in Defence, Access Equipment, Fire & Emergency and Commercial vehicles was not reflected in the prevailing market price.

That thesis is now playing out as a recovery in Access equipment demand brings into focus very strong prospects for 2018. Moreover the economics of their key US Department of Defense contract is better understood, as are the international prospects for the defence business as a whole. Fire & Emergency is progressing towards management's 10% operating margin objective. The company is in a very good place currently and while valuation is no longer cheap there is sufficient strategic and balance sheet optionality for us to remain constructive on the investment case.

Portfolio changes in the quarter:

During the quarter we made an investment in Ericsson, which is a fundamentally good business experiencing some difficulties that we think are fixable. Ericsson has a very strong position in the market for telecom equipment and ancillary software and services, used to operate wireless networks. Chinese competitors, Huawei and ZTE have made significant inroads over the past decade but Ericsson has been able to maintain market share and we feel the Chinese competitors will find it harder to gain market share from here, particularly given wariness in the US of potential national security issues. The data requirements of modern cities continue to rapidly increase, so demand for wireless network software and equipment should increase in the future. We are also intrigued by Ericsson's extensive patent portfolio, the largest in the industry, which we suspect is highly valuable. There is controversy around the stock. In recent years some clients outsourced service contracts and Ericsson was too aggressive in the bidding process, the result of which has been depressed group profitability. Alongside this Ericsson made numerous value destructive acquisitions in adjacent areas. The board has recognised the problems and appointed a new CEO to lead a turnaround. We believe these problems are fixable and see good value in the stock on that basis.

We also invested in a Japanese company which we will detail in our next report when we finish buying stock up to the desired level.

An ongoing reassessment of the risks inherent in the traditional media segment of Omnicom led us to question the sustainability of margins in their Media buying business. Media buying basically means the purchasing of media across print, internet and TV channels and the large media companies like Omnicom have been earning 20-30% margins in this space, with particularly high margins in TV. Furthermore, the large media players have taken advantage of volume buying rebates, which arguably should be for the end customer but which may have been retained at the agencies and is the subject of an ongoing investigation. At the same time, advertising services – basically ad campaigns charged on a 'billable hours' basis – have been subject to intense competitive pressure as tenders get recirculated every 2-3 years. Overall we concluded that with risks to the model increasing and industry disrupters taking more market share we were no longer being compensated in terms of prospective returns and so sold our remaining shareholding (0.4% of the fund at June 2017).

We also sold was our remaining ownership (0.2% of the fund at June 2017) of Intel, the maker of semi-conductor chips for the PC and Server markets. Intel was a long-held stock in the fund but one where we have been selling our holding down over the last year or so. While the headline valuation of the company does not look stretched, our view is that we are at a high point in the semi-conductor cycle so the cyclically adjusted Price-Earnings ratio is likely quite a bit higher. Also, the sale reflects portfolio management considerations. The fund holds two other semi-conductor businesses, Samsung and TSMC, and we think that over time some of their operations are likely to converge with Intel, so it made sense not to have too much exposure to the one type of business. The proceeds from Intel over the course of the last year were used to fund the purchases of Keysight and Ericsson.

Sean Kenzie – Portfolio Manager

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IMPORTANT INFORMATION