Setanta Managed Fund
Q4 2018

Fund Description

The **Managed Fund** ("the Fund"), managed by Setanta Asset Management Limited ("Setanta"), is a unit-linked offering of Irish Life Assurance Limited.

The Managed Fund is an actively managed multi-asset portfolio, which holds a combination of equities, fixed income, property, commodities, cash and absolute value. The Fund holds between 50-80% of its assets in equities, reflecting the breadth of the market and Setanta's expertise in the area. The portfolio is managed in accordance with the Setanta investment philosophy. That is, the managers seek to own good assets for the long-term at prices below what they think they're worth, carefully considering each investment's risk profile.

The investment objective of the Fund is to outperform the median of competitor Managed Fund offerings over the long term.

Fund Commentary

The Setanta Managed fund was down -7.9% over the quarter, bringing the year to date figure to -2.7%.

Global equities markets were very weak over the period (-10.8%), ending the year returning -4.1%.

Within global equities, the Energy and Consumer Discretionary sector were the main laggards, while Telecom & Utilities and Healthcare, though negative were the outperformers.

(Fund Commentary continued on Page 3)

Portfolio Managers

Kieran Dempsey & David Ryan CFA, CAIA, FRM

Our Investment Principles

We do not believe markets are efficient

We invest below our estimate of intrinsic value

We invest in businesses rather than buying stocks

Preservation of our clients' capital is key

Investing is a marathon, not a sprint

We are not afraid to swim against the tide

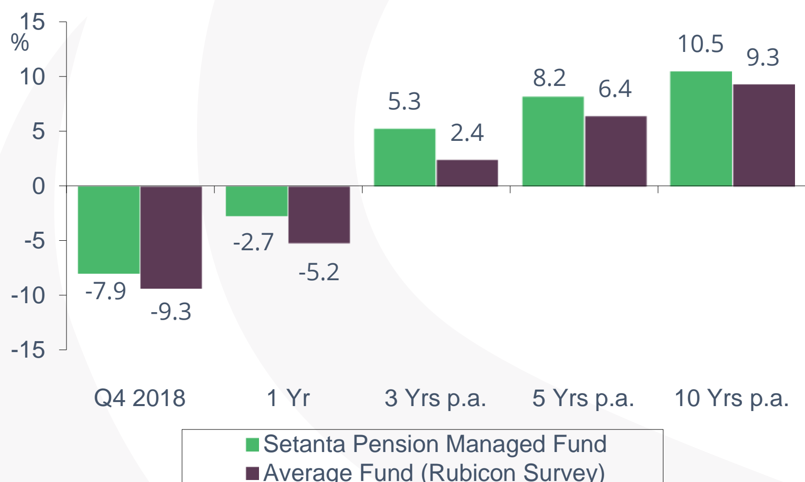
We consider scenarios rather than making forecasts

Businesses we own must have strong balance sheets

We make mistakes and always endeavour to learn from them

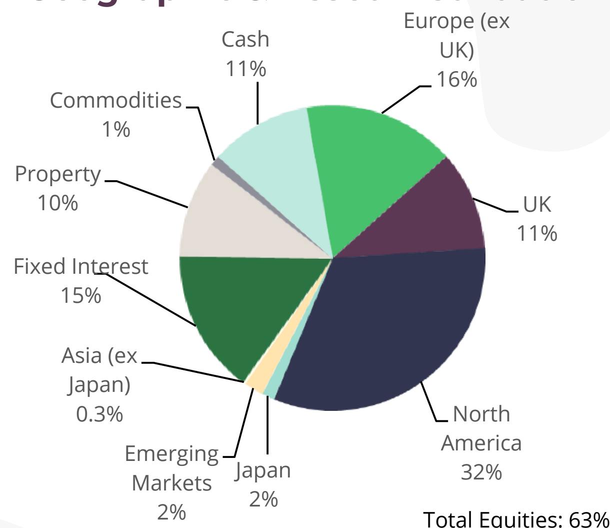
We will act with integrity in everything we do

Fund Performance – 31.12.18



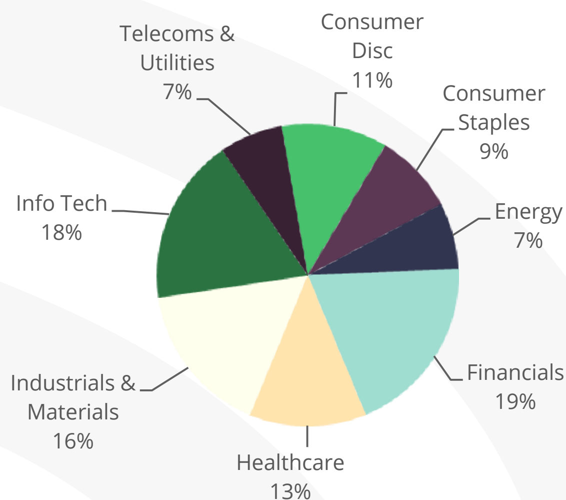
Performance Source: Setanta Asset Management Limited. Benchmark: Rubicon Pension Managed Fund Survey. The actual Fund returns stated are based on the movements in the unit prices of an institutional series of the Fund and are net of management fees. Credit Rating Source: S&P

Geographic & Asset Distribution



Total Equities: 63%

Sector Distribution



Top 10 Equity Holdings

COMPANY	SECTOR	% OF FUND
BERKSHIRE HATHAWAY	FINANCIALS	2.0%
MICROSOFT CORP	INFORMATION TECHNOLOGY	1.8%
DCC	INDUSTRIALS & MATERIALS	1.7%
OWENS-ILLINOIS	INDUSTRIALS & MATERIALS	1.6%
FEDERATED INVESTORS	FINANCIALS	1.5%
LANCASHIRE HOLDINGS	FINANCIALS	1.5%
ERICSSON	INFORMATION TECHNOLOGY	1.4%
OSHKOSH CORP	INDUSTRIALS & MATERIALS	1.4%
MELROSE INDUSTRIES	INDUSTRIALS & MATERIALS	1.3%
JEFFERIES FINANCIAL	FINANCIALS	1.3%

Fixed Interest Portfolio

CREDIT RATING WEIGHTING		
CREDIT RATING TYPE	ASSET TYPE WEIGHTING	BENCHMARK WEIGHTING
AAA	16.75%	21.16%
AA	41.35%	37.45%
A	25.09%	18.75%
BBB	16.81%	22.65%
	100%	100%

Yearly Performance

Year %	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Fund	9.1	-1.8	-29.6	22.9	9.5	0.5	14.2	18.5	17.8	8.3	12.2	6.8	-2.7
Benchmark	13.3	-3.9	-35.6	22.0	11.3	-3.6	14.3	16.6	15.6	9.5	5.9	7.3	-5.2

Commentary

Government debt helped act as a buffer in the quarterly drawdown (+1.5%), and contributed to absolute performance over the year (+1.4%). Our credit underperformed into year end, delivering -4.0% for the year, though we would expect a recovery post illiquid seasonal mark downs.

Income opportunities (-4.6%), Property (0.6%) and Commodities (-8.2%) while mixed, all helped diversify over the period.

Turning to the markets, while global economies are still growing (albeit slower), Q4 was a reminder that financial markets can be leading indicators (topping out before the fundamental data) while also subject to the whims of investor sentiment and illiquid seasonal effects.

Financial assets for the most part had a torrid Q4, primarily in the last month of the year (seasonal goodwill was just not present!). As is the market norm, reasons abounded, from a hawkish fed (more hikes and a balance sheet reduction on auto pilot) to grinch-like sentiment from investors across the risky asset spectrum (as concerns grew of peak economic growth and earnings).

All this, while markets have to come to terms with even the dovish ECB officially ending their price insensitive buying (though reinvestment of maturing debt will continue for some time). The fact that central banks are stepping away (reduced flow being more telling than reduced stock for sentiment) at a time when there is an increase in geopolitical angst is unfortunate.

The fact that central banks should be reducing their distortions of the market is not really under great debate as employment is near recent peak levels and inflation is around target, it's more the uncertainty it creates as investors extrapolate Armageddon from collapsing equity multiples to spiking credit spreads. It's worth noting that most base rates are either negative or at very low levels historically, so monetary policy, is far from restrictive just yet.

However, concern also stems from the fact that investors have gotten used to very low interest rate levels, so even marginal moves are enough to spook sentiment. Even with forward rates implying very low levels out five to ten years from now. Rate rises are easier to swallow when growth is above trend and central banks are deemed behind the curve, but more difficult to digest when growth may be falling below trend and fears of a policy error arise.

The reversal of financial repression was never going to be easy, in fact the bigger shock would have been if they had extradited themselves in a non-volatile manner. While we saw volatility spike early in Q1, only to trend lower, post the Q4 spike, it has remained above average, with this regime change likely to become the norm over the medium term.

One positive from the large Q4 drawdown was the fact that high quality government debt acted somewhat of a buffer, with yields falling with the rush to safe havens. While the reaction was not as positive as pervious market wobbles, it still warrants holding such low yielding assets in a multi-asset portfolio. A concern however (and I appreciate there are many), is that longer dated bond yields are close to trading below shorted dated ones, creating an inverted yield curve, normally a harbinger of an impending recession. Though the timing of which can be sometime into the future, with risk assets continuing to perform in the medium term.

Commentary

Other bonds fared less well, as across the credit spectrum, the rise in equity volatility, late cycle concerns and evidence of high leverage coupled with looser covenants let to widening credit spreads across the investment and sub-investment grade markets. This, along with some technical headwinds (low broker/bank ability to hold inventory & ETF driven sales) led to a vacuum, where wide bid/offer spreads and gaps down were needed to clear orders. With that in mind, credit is getting back to reasonable levels (though not cheap) as underlying fundamentals and low default levels look to underpin current valuations.

There has been an undoubted mark down in valuations across the various asset classes. Depending where you look, we are just cheaper than the most recent past, with competition still amongst the "least bad" place to allocate money.

One area that has cheapened up back to long term historical levels is emerging market debt (EMD). A stronger dollar, rising local US rates and falling commodities recently led to a knee jerk reduction in capital flows.

While some EM are in various bouts of adversity (Argentina & Turkey), others have actually increased reserves, lowered dollar dependency and have inflation well under control (through independent central banks). They are suffering to a certain extent for previous sins ("Original Sin" as was termed their over-reliance on US dollar issued debt), while more recently they have been following the straight and narrow path.

How the ongoing move towards de-globalisation though tariffs and protectionism will play out is impossible to call, though it's probably fair to say it's not likely to be good (even aside from making America great again, time will tell).

Much has been made of presidential moves towards targeting bellwethers (Amazon & Apple), calling out Federal Reserve Chairmen (potentially sacking Powell) and government shutdowns (ongoing), but these are not unprecedented. We have form as they say, with historical attacks on US Steel from JFK, Nixon targeting then chairman Arthur Burns and Reagan prone to the odd shutdown. While the outcomes were not good, life went on, the world rotated, and over time markets recovered.

Suffice to say, watching any asset you own fall in value (especially sharply) is unpleasant at best, it feels particularly worse into year end too! However, allowing for a longer-term horizon helps to cognitively soften the blow. A longer-term perspective should allow for the prudent allocation of capital at a time when capital is rushing for the exit, being a liquidity provider at a time of panic often allowing for purchases of financial assets below their intrinsic value.

It's also worth remembering that we have had a very good run of it. Returns across-multi asset portfolios have benefitted from cheap money and low inflation, some amount of giveback is expected. The end of a bond bull run from the 1980's means we may have to get used to simultaneously lower to negative stock and bond returns, with stagflation (an inflationary recession) not beyond the realms of possibility.

This is where adherents of value investing (though investment in robust balance sheets coupled with sustainable free cash flows) should over time navigate any worrisome macro fundamentals. It also brings back into the frame cash as a reputable asset, while low yielding (especially in Euro), it offers good upside optionality to the patient and disciplined investor. We will continue to try and invest as prudently as possible, for as long as possible, while looking to have a reasonable level of diversification within the fund.

David Ryan – Portfolio Manager

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