# Setanta Global Equity Fund (CAD)
Q1 2019

## 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 an actively managed equity portfolio which holds c.80-100 global stocks. The portfolio is managed in accordance with the Setanta investment philosophy by a team of eight global sector specialists, overseen by two lead portfolio managers. The aim is to achieve a sensible level of diversification on a sector and geographic basis. Reflecting this, portfolio sector weights are generally set so as broadly similar to the sector weights in the benchmark. Within each sector, stocks are chosen through bottom-up analysis, based on investment merit. Rather than focusing on the historic level of volatility of an asset, the portfolio managers regard the probability of permanent impairment of capital as the most relevant measure of risk. In doing so, they seek to maximise downside protection by understanding the risks posed by the valuation, financial, and operational characteristics of the asset. The investment objective of the Fund is to outperform the MSCI World index over the long term.

## Fund Commentary

We are not known for outperforming in strong market environments. And so, in the best first quarter for equity markets in a decade (+10.0% MSCI World), the Global Equity Fund lagged its benchmark by some 1.2%. (+8.8% Fund return)

*(Fund Commentary continued on Page 3)*

## Portfolio Managers

David Coyne & Sean Kenzie, CFA

## 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

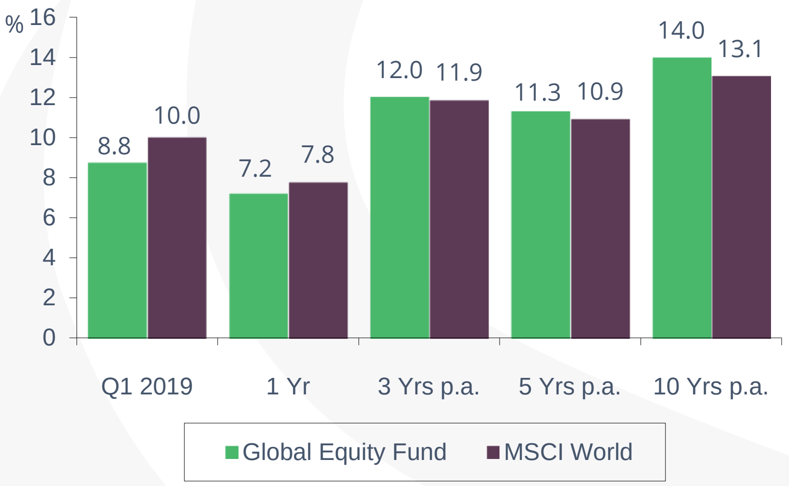
We consider scenarios rather than making forecasts

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 – 31.03.19




**Performance Source:** Unit prices: GWL. Returns are based on London Life Global Equity Account (S034 4.03), gross of management fees in CAD. Benchmark is MSCI World in CAD. The performance will be reduced by the impact of management fees paid, the amount of which varies. **Fund Statistics Source:** Bloomberg

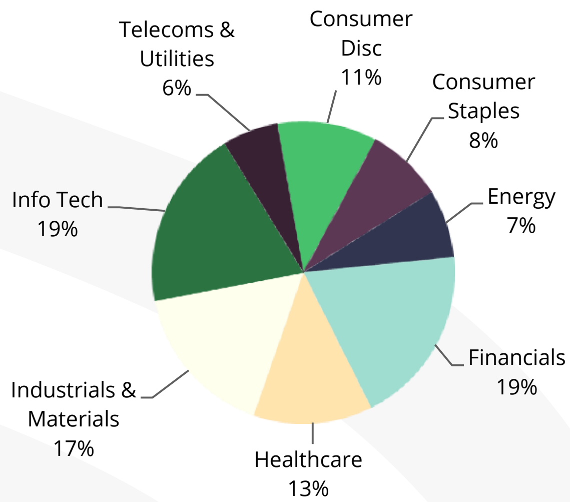
## Top 10 Holdings

| COMPANY | SECTOR | % OF FUND |
|---|---|---|
| MICROSOFT CORP | INFORMATION TECHNOLOGY | 3.0% |
| BERKSHIRE HATHAWAY | FINANCIALS | 2.9% |
| DCC | INDUSTRIALS & MATERIALS | 2.7% |
| OWENS-ILLINOIS INC | INDUSTRIALS & MATERIALS | 2.5% |
| OSHKOSH CORP | INDUSTRIALS & MATERIALS | 2.4% |
| FEDERATED INVESTORS | FINANCIALS | 2.4% |
| LANCASHIRE HOLDINGS | FINANCIALS | 2.3% |
| MELROSE INDUSTRIES | INDUSTRIALS & MATERIALS | 2.2% |
| CISCO SYSTEMS | INFORMATION TECHNOLOGY | 2.1% |
| JEFFERIES | FINANCIALS | 2.1% |

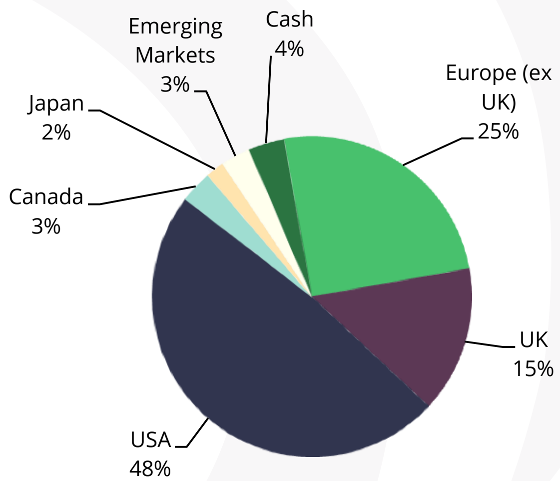
## Fund Statistics

| | |
|---|---|
| PRICE/BOOK | 1.9 |
| PRICE/EARNINGS RATIO (FY 1) | 15.8 |
| DIVIDEND YIELD % | 2.4 |
| AVERAGE MARKET CAP C$BN | 91.6 |
| NO. OF HOLDINGS | 87 |
| ACTIVE SHARE % | 86.3 |
| DEBT/EQUITY % | 55.0 |

## Sector Distribution




## Geographic Distribution




## Yearly Performance

| Year % | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Fund | -7.4 | -26.8 | 16.1 | 2.4 | 0.1 | 13.4 | 38.5 | 15.3 | 15.8 | 9.7 | 15.8 | -0.7 |
| Benchmark | -7.5 | -25.8 | 10.4 | 5.9 | -3.2 | 13.3 | 35.2 | 14.4 | 18.9 | 3.8 | 14.4 | -0.5 |

SETANTA Asset Management

# Commentary

None of the stocks in the Fund did particularly badly, rather an aggressive rebound in "FANG"-type stocks which we have written about many times, were the principal detractor from relative performance. Equity markets continue to move relentlessly higher amid mixed economic data since the US Federal Reserve reversed course from rate hikes and balance sheet reduction in January. It feels like this economic cycle is at a very interesting point with high valuations and strong profit margins meeting mounting stresses in labour markets, trade tensions, raw materials inflation and a potential Chinese/European economic slowdown.

Our message here is consistent – we do not try to predict economic outcomes, happily leaving that to market participants more "confident" than ourselves. Rather, we think about macro-economics in terms of reacting to the valuations offered to us by the market as well as stress testing our assumptions on existing and proposed investments; particularly in terms of how might a company's capital structure and operational leverage dynamics affect a company's prospects in a poor economic environment and an ever changing competitive landscape.

Take Melrose Plc the UK listed private equity-like industrial company; at a recent prospective investor meeting, we were challenged on how we could continue to own Melrose given prevailing Brexit uncertainty. Surely, from a risk management perspective we should reduce or sell the position? Two of Melrose's key businesses (70% Sales), post-acquisition of GKN Plc, are a Driveline automotive business selling primarily drive shafts to a range of auto manufacturers and an aerospace business selling aero structures to a the large aircraft manufacturers. Quite publically, some of the auto manufacturers are leaving the UK, in part to consolidate their footprints elsewhere. The obvious danger here is in the auto business, with fast moving supply chains, cannot countenance border delays and a number of GKN customers, notably Jaguar Landrover who announced they are moving full production of product to Slovakia from the UK. On the aerospace side, Airbus CEO Tom Enders went on record warning the aerospace group may pull out of the UK in a "no-deal" Brexit scenario. Surely we should reduce risk here? It was an interesting question.

We at least try to ask questions first before shooting and so looking at the facts we could see that:

- Both Melrose businesses, Aerospace & Driveline, have global footprints.
- Both are mainly supplying UK customers from UK plants.
- Speaking to the management about the supply chain risk of both businesses, they cannot determine the full customer risk i.e. risk to customer from other suppliers importing parts from Europe to UK. If customers start making decisions Melrose would react with them, indeed it would make sense to better align footprint with demand in both these businesses. GKN Driveline has a plant in Slovenia nearby to where Landrover is relocating.
- The prevailing share price of c£1.60 was already discounting a negative scenario for margin development.
- The market (implied sum-of-the-parts valuation at £1.60) ascribed very little probability to Melrose being able to improve margin, when much of the prospective improvement was in their hands (costs, operational improvement and better procurement practices).
- Melrose has a very strong track record of delivery, 2.3x average return on equity invested (23.6% IRR) since 2005 off 600bps average margin improvement based on similar actions as planned for GKN. GKN has a lower starting base (bought for a good price) and therefore less required margin improvement to meet return target.

# Commentary

So what may have looked like a sensible "top-down" macro-economic decision to simply take "Brexit-Risk off the table" does not stand up to the "bottom-up" micro-fundamental approach we take to decision making. We retain our ownership of Melrose based on our judgement on the resilience of the margin improvement case over the next five years – which we will continue to judge versus the market's valuation as events unfold.

One of the central themes of an "away day" we had in December was the tension between good investments and good businesses which seems particularly acute today. In short the type of durable, high quality businesses we like, that can compound in value over time, regularly trade at wide valuation premiums to the market. Conversely, the traditionally-defined "value" segment has underperformed for some time now and, albeit typically less durable businesses may offer a better hunting ground for investment opportunity. Of course, there is a spectrum here but we must be vigilant in not compromising on business quality in an effort to meet certain prospective return expectations. Furthermore, we must avoid overpaying for what we judge as business quality and durability. It is a fine line to tread in this market environment.

Looking backwards, the Fund does exhibit a strong tendency to do well in times of market stress, and in a variety of different market backdrops (see chart below).

| Period | Backdrop | Benchmark | Relative performance |
|---|---|---|---|
| Jan – Mar 2001 | **Post-technology bubble** | -10.1 % | 0.2 % |
| May – Sept 2001 | | -22.8 % | 0.4 % |
| Mar – Sept 2002[1] | | -34.5 % | 4.8 % |
| Nov 2002 – Mar 2003 | | -17.7 % | 5.2 % |
| Oct 2007 – Mar 2008 | **Global Financial Crisis** | -21.4 % | 4.5 % |
| May 2008 – Feb 2009[2] | | -38.9 % | 2.6 % |
| Feb – Sept 2011[3] | **European government debt concerns** | -14.6 % | 2.7 % |
| July – Sept 2015 | **European bank concerns, Chinese economic weakness** | -11.0 % | 2.9 % |
| Nov 2015 – Feb 2016 | | -10.9 % | 1.2 % |
| Sept – Dec 2018[4] | **Interest rate worries, trades wars, 'FANG' sell-off** | -12.0 % | 1.4 % |

**Source:** Table shows the worst 10 month-end peak-to-trough declines in MSCI World (EUR) v's ILA Global Equity fund (EUR), Dec 2000 and Dec 2018

# Commentary

**Portfolio activity:**

Parmalat is one of the largest milk and dairy products manufacturers in the world. We built a position in the company back in late 2010/early 2011, on attractive valuation grounds and with the added optionality that the Lactalis Group, the controlling shareholder, would ultimately try to take the company private. During our holding period, we worked closely with other institutional shareholders to prevent the numerous attempts by Lactalis to  buy-out the minority shareholders at below our estimate of fair value. At the end of 2018, Lactalis finally exceeded the 95% ownership threshold resulting in the buy-out of minority shareholders. We had expected this to play-out sooner than it did but the buy-out price of €2.85/share, represents a fair price and a premium to our original purchase price. We exited our position in Q1 2019.

*Sean Kenzie – Portfolio Manager*

# Commentary

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