Setanta Income Opportunities Fund

Q1 2019

Fund Description

The **Income Opportunities Fund** ('the Fund') is an actively managed portfolio primarily comprising global equities but with the flexibility to invest in assets which offer attractive income and reasonable value. These assets include fixed income, property (including REITs) and cash. The fund is not constrained by limitations on the level of any given asset. In practice, the Fund has had its greatest weight in equities, reflecting the breadth of that market, Setanta's expertise in that area, and the option writing strategy employed by the fund. Nevertheless, property, fixed income and cash have all played meaningful roles in past returns of the fund, at times, comprising up to 50% of the fund's assets. 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 fund is managed by three portfolio managers, who also look to leverage off the experience and knowledge of their colleagues. The aim is to achieve a sensible level of diversification on a sector and geographic basis.
The fund employs an option writing strategy. This entails the sale of both call and put options in return for a cash premium, representing an income stream that boosts the underlying income yield of the fund. This strategy is employed in a conservative fashion, as all options written are fully covered.

The Income Opportunities Fund has two investment objectives:

1. To generate an annual income yield at a target rate. This is declared at the start of each financial year.

2. To achieve capital appreciation over the long term.

Portfolio Managers

Richard Doyle, CFA; David Pastor, CFA; Caroline White, 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

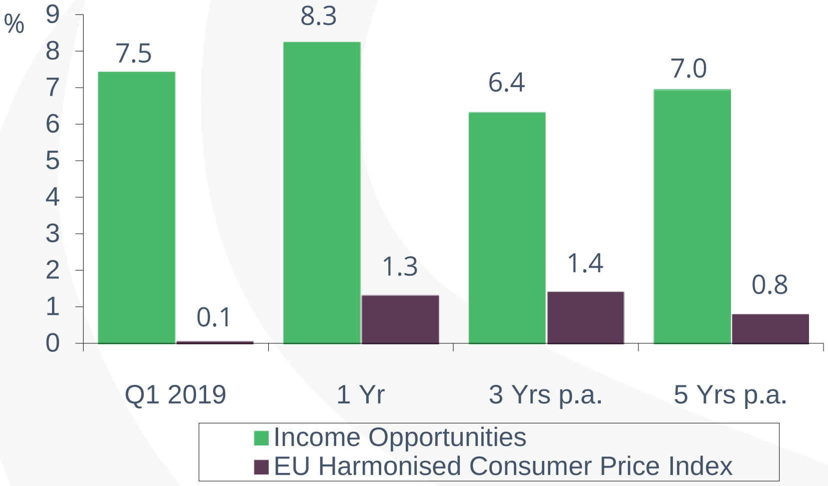
We consider scenarios rather than making forecasts

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



Yearly Performance

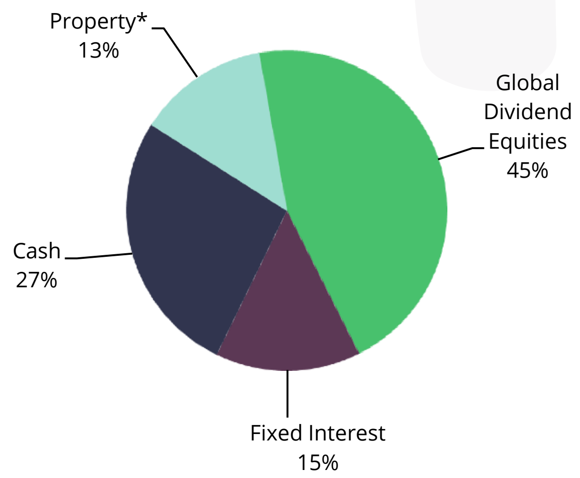
Year %	2014	2015	2016	2017	2018
Fund	8.4	10.6	9.7	2.9	-1.2
Benchmark	-0.2	0.2	1.1	1.4	1.6

Performance Source: Setanta Asset Management Limited. Benchmark: European Harmonised Consumer Price Index. Fund returns are shown gross of management fees. The performance will be reduced by the impact of management fees paid, the amount of which varies.
* Inception as at 30.09.11

Top 10 Holdings

COMPANY	SECTOR	% OF FUND
HARLEY DAVIDSON	CONSUMER DISCRETIONARY	2.1%
SAMPO	FINANCIALS	1.9%
GLAXOSMITHKLINE	HEALTH CARE	1.8%
PROXIMUS	TELECOMS & UTILITIES	1.8%
SAGA	FINANCIALS	1.7%
COCA-COLA	CONSUMER STAPLES	1.7%
BASF	INDUSTRIALS & MATERIALS	1.7%
FORTESCUE METALS	INDUSTRIALS & MATERIALS	1.6%
BOLSAS Y MERCADOS	FINANCIALS	1.6%
VODAFONE GROUP	TELECOMS & UTILITIES	1.5%

Asset Distribution



*includes 1.8% in IRES REIT

Historic Income

	Income Earned % of Fund Value
2011	6.2%
2012	5.6%
2013	5.5%
2014	4.8%
2015	5.5%
2016	4.7%
2017	4.1%
2018	3.9%

Fund Commentary

As keen observers of financial markets, we often reflect on the fickleness of investors' sentiment and the oftentimes wild gyrations in asset prices that accompany it. In the last quarterly commentary, we highlighted some of the markets' worries and how eventually 'fear' caused a sharp fall in equity markets into the year end. Only a few months later, the S&P 500 has risen +15% to the end of March (in euro terms) and is close to its September 2018 lifetime peak. European markets have experienced a similarly steep recovery from their December lows. It seems that markets are seeking the silver lining to the previously-identified clouds. On the monetary policy side, after its recent rate hike, the US Federal Reserve bank has taken a much more 'dovish' stance. In Europe the European Central Bank extended its targeted long term repurchase operation, providing support to many financial assets. In the world of the real economy, the signals are mixed, as global trade and European economies slow, while some US indicators flash amber.

As enthusiastic readers of these commentaries, you no doubt know that at Setanta we don't believe we can profit in calling how the macroeconomic situation will evolve. In our view, there are too many factors that are subject to unpredictability. Instead, we focus on studying a company's competitive advantages, and its industry structure, in our search for sustainable economic returns that will in time result in good fund performance. Thinking more about what characterises Setanta's investment style, we found an interesting framework in Howard Marks' latest book, "Mastering the Market Cycle". In it, Mr. Marks, a well-regarded value investor, describes investment activity in equities across three dichotomies: cycle positioning \ asset selection, aggressiveness \ defensiveness and skill \ luck.

How does this apply to the Income Opportunities Fund? At Setanta, every investment case incorporates asset selection, emphasising our knowledge of intrinsic value as the main driver of investment returns. This is accompanied, to a lesser extent, with a consideration of the how the investment is affected by the broader industry and economic cycle. This brings to mind our purchase of **IRES** a number of years ago. At the time, the young company was building a portfolio of residential assets in Dublin, Ireland at prices below replacement value and attractive rental yields that would enable it to pay good dividends in the future. The Irish economy, and the Dublin area in particular, had experienced an extreme residential property bubble. After the bursting of this bubble, house prices and rent levels both collapsed. Construction of new residential housing stock remained at a fraction of the recovering economy's needs for years, starting to recover only from 2017. Our experience with this stock has been very good, reflecting both cash returns through dividends and capital appreciation, as residential rent levels have recovered at a fast pace since our investment.

With regards to risk attitude, the Fund's income style very much leans towards defensiveness (vs. aggressiveness), as high dividend paying companies tend to be well-established entities with mature businesses and high cash flow. Setanta's investment approach overlays an additional degree of conservativism as we shun excessive leverage and also try to ensure that the investments we make have a 'margin of safety'. Over the life of the Fund we have witnessed the rise and fall of a number of high dividend paying, but risky business models, that by and large we have been able to avoid (e.g. fast growing banks, but highly exposed to credit risk and \ or with mismatches in their assets and liabilities). We have owned and continue to own some banks, but not all of them are created equal. We favour entities with a long term orientation and conservative lending practices, appropriate incentives for staff and strong capital ratios. We believe that **Svenska Handelsbanken**, a fund holding, to be a prime example of those. It has a unique long-term culture, a highly decentralised structure and a long track record of superb credit underwriting, spanning good and bad times.

Finally as regards, skill vs ‘luck’, we believe that the longer the time period, the greater the role that skill plays, hence our focus on longer-time periods of performance. This is not to say that ‘luck’, which we consider to be unexpected events, whether fortunate or unfortunate, doesn’t have influence, especially in the short term. Our recent purchase of **Fortescue Metals Group** has provided a total return of well over 100% (in euro terms) in a matter of months. We think that this partly reflects the low valuation of the stock and some of the actions of Fortescue over this time (achieving much better prices for its iron ore products, while also initiating a share buyback and paying a special dividend). However, we recognise that an unanticipated event also played a role in the stock’s performance. An unexpected reduction in the supply of iron ore caused iron ore prices to rise sharply, from which Fortescue benefitted. This unexpected reduction in supply was a consequence of restrictions placed on Vale, a competitor of Fortescue and a major supplier of iron ore, due to the bursting of one of its dams. We note that this event was foremost a tragedy for hundreds of people, either killed or injured in the disaster.

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