Setanta European Equity Fund (CAD) – Q3 2017

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ASSET MANAGEMENT

Fund Description

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

The Fund is an actively managed equity portfolio, with a long-term investment horizon. Our aim is to invest in European companies that are trading below their intrinsic value. Our investment process seeks to invest in companies that exhibit a combination of low financial risk, low operational risk and low valuation risk. We believe that if we can invest in companies that possesses these characteristics then we can reduce the risk of a permanent loss of capital and enhance our chances of outperforming our benchmark over the long term.

The investment objective of the Fund is to outperform the MSCI Europe index over the long term.

Fund Commentary

Ten Years on…

It was roughly this time ten years ago that global stock markets peaked before the onset of the global financial crisis. The crisis first unfolded slowly, then quickly and suddenly in late 2008 it seemed that the entire financial system was on the brink of collapse. Central banks should be given credit for their response which infused liquidity and confidence into a system that was seizing up. Though the economic recovery from this harrowing time has been soft by historical standards, stock markets have produced quite remarkable returns in the intervening years.

(Fund Commentary continued on Page 3)

Portfolio Managers

Fergal Sarsfield CFA & David Byrne CFA

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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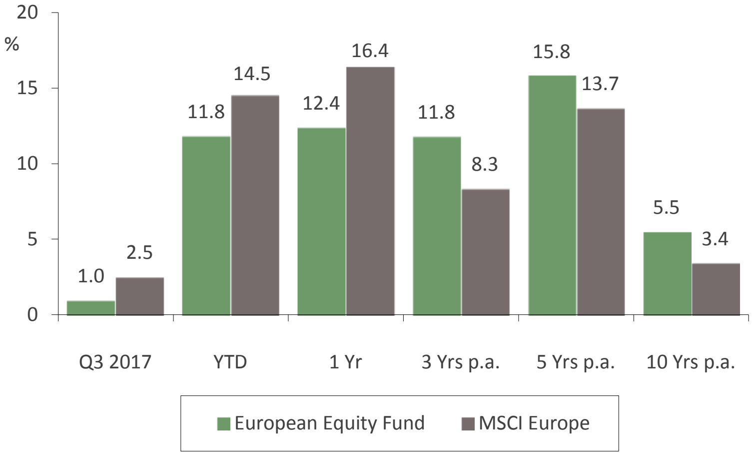
FUND PERFORMANCE – 30.09.17 (CAD)



YEARLY PERFORMANCE

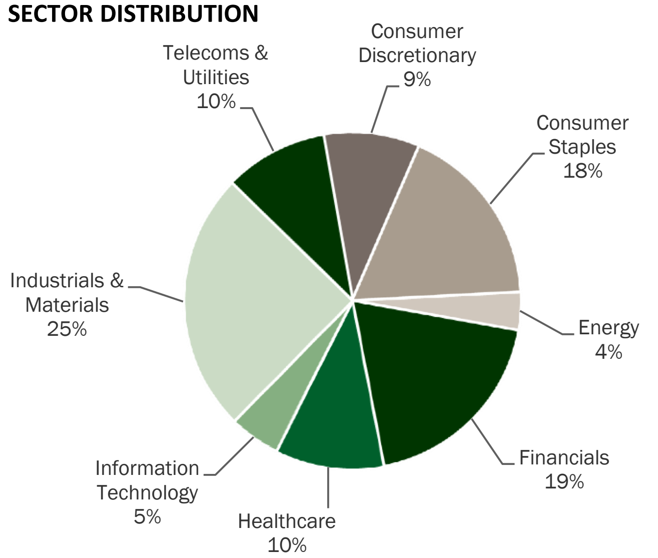
Year %	2012	2013	2014	2015	2016
Fund	18.0	35.8	1.3	27.7	-0.8
Benchmark	16.5	33.6	2.3	16.5	-3.9

Performance Source: GWL Unit Prices. Based on CLA European Equity (SF037). Returns are in CAD and are gross of management fees. Benchmark is MSCI Europe. The performance will be reduced by the impact of management fees paid, the amount of which varies. **Fund Statistics Source:** Bloomberg

FUND STATISTICS

PRICE/BOOK	2.0
PRICE/EARNINGS RATIO (FY 1)	17.5
DIVIDEND YIELD %	3.2
AVERAGE MARKET CAP C$BN	53.4
NO. OF HOLDINGS	28
ACTIVE SHARE RATIO %	87.3
DEBT/EQUITY %	65.1

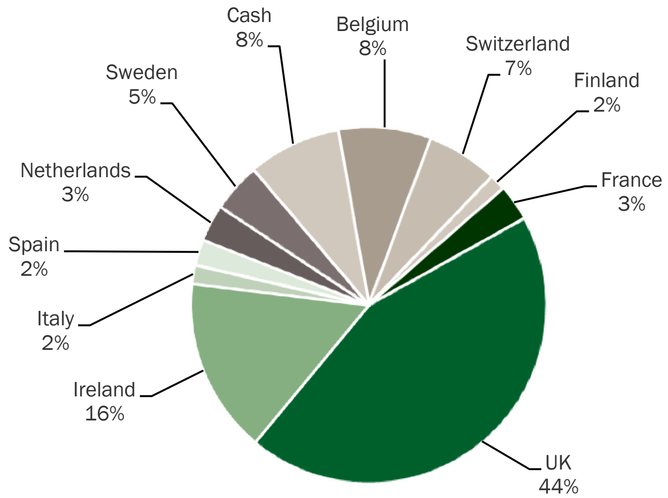
SECTOR DISTRIBUTION



TOP 10 HOLDINGS

COMPANY	SECTOR	% OF FUND
DIAGEO	CONSUMER STAPLES	6.4%
GPE BRUXELLES LAMBERT	FINANCIALS	6.2%
DCC	INDUSTRIALS & MATERIALS	6.0%
MELROSE INDUSTRIES	INDUSTRIALS & MATERIALS	5.8%
ORIGIN ENTERPRISES	CONSUMER STAPLES	4.6%
ERICSSON	INFORMATION TECHNOLOGY	4.5%
LSL PROPERTY SERVICES	FINANCIALS	4.0%
SMITHS GROUP	INDUSTRIALS & MATERIALS	3.4%
VODAFONE	TELELCOMS & UTILITIES	3.4%
UNILEVER	CONSUMER STAPLES	3.4%

GEOGRAPHIC DISTRIBUTION



Since the peak of October 2007, immediately prior to the crisis, to today, the S&P 500 has produced an annualised total return of over 7% (dividends reinvested). Given the enormous value destruction that occurred during the crisis this is pretty stunning. One must attribute at least some of this to the extraordinary monetary policies in place throughout the period. Vanishingly low interest rates, quantitative easing and pretty overt assurances from the central banks to support the markets through any hardship have led us to where we are today. While we take great interest in how this backdrop is unfolding we don't make macro forecasts since we view this part of the markets to be too competitive and not a good source of investment returns. Therefore we won't dwell on this backdrop, but some observations that we have on today's markets are as follows:

- Volatility levels remain very low by historical standards. Even the recent worrying developments on the Korean peninsula had almost no effect on markets.
- Central Banks are beginning to unwind the extremely stimulative monetary policies that have become the norm for almost a decade, yet there has been essentially no market impact observable. If these policies had been so helpful, won't their absence have consequences? Nor has the shift towards what might be referred to as "political populism" across the western world dented markets.
- According to Moody's Analytics, 75% of new loans in the leveraged loan market (new borrowings raised by already indebted companies) are "covenant-lite". Covenants protect investors by placing limits on the issuer and the pervasiveness of "cov-lite" issuance suggests investors are acting in a complacent manner. Bloomberg quotes a senior covenant officer at Moody's: "it's basically the worst it's ever been in terms of loan covenant protections".
- We don't pay much attention to market level valuation metrics – we find these to be flawed in numerous ways and value each company of interest based on its merits. On this basis we have been struggling for some time to find many new investment ideas, with companies that meet our quality criteria often being priced too richly. Valuations are not extremely high but are high nonetheless and we suspect that whenever the next recession hits there may prove to be little or no valuation support for those companies that ultimately prove to be over-earning in today's economy.

These observations, particularly with respect to valuation levels, make us nervous. We are not calling a market top or the start of a new crisis. It is quite conceivable that the next bear market might be many years away. But we think it makes sense to act cautiously. We continue to focus on good businesses that we think are quite shock-resistant and as always we spend a lot of time thinking about the durability of each company's earnings.

Portfolio Changes

We conceded defeat on **Tesco** and sold the position. Since our initial investment in 2012, the stock fell by around 40%, which we are frankly embarrassed by. What seemed like temporary business challenges that were fixable proved to be structural changes that impacted Tesco in a significantly adverse manner. The variant offering from Lidl, Aldi and other discount stores gained a lot more market share than we expected, increased industry capacity and helped customers to change their buying patterns in a manner that hurt Tesco, as its business model relies on high volumes. To top things off the previous management team, in our view, performed very poorly. The replacement CEO, Dave Lewis, appointed in 2014 has taken a number of steps to return the company to its original strengths. So far, he seems to be doing a good job and business trends are improving. He and his actions are the main reasons we remained invested for so long but ultimately we are concerned that the competition in the industry is likely to remain fierce and may hamstring the business. We found a superior investment opportunity in Japan, and hope to discuss this in our next report when our buying should be completed.

COMMENTARY

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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 providing 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 bidding on some low quality service contracts which have depressed 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.

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