Setanta Global Equity Fund – Q3 2016 (USD)

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

The USD market value of the fund rose by 5.5% in the quarter, contributing to a 12.8% total return year to date which is 6.7% ahead of the MSCI World Benchmark. Long-term investors in the fund are on track to outperform the benchmark for the 14th year in 16 years, a cumulative outperformance over the index of 65% since 2002. While we are proud of this performance record we are ever mindful of retaining the disciplines in process and structure that contributed to building it.

Part of the discipline is long-term thinking. Investment management is an incredibly competitive industry – where success is a matter of tilting the odds in your favour over time. We often say that we have no advantage in the short term, say over a 12-18 month horizon, whereas the entire industry is set up to encourage market participants to "do something", often in response to short term events that have little to do with long term 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.

Setanta
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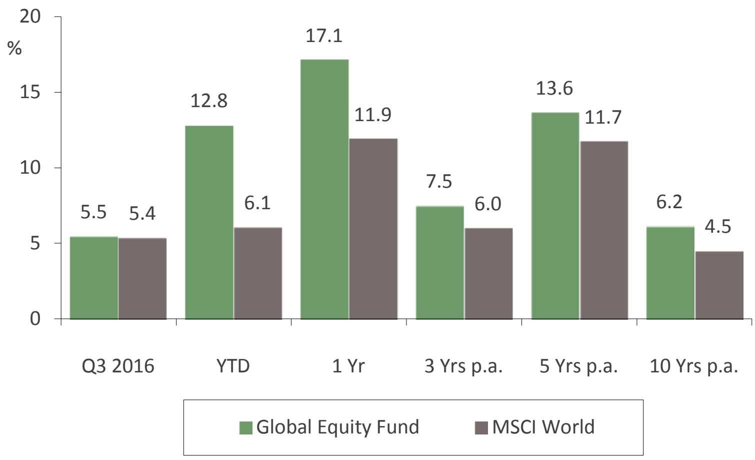
FUND PERFORMANCE – 30.09.16

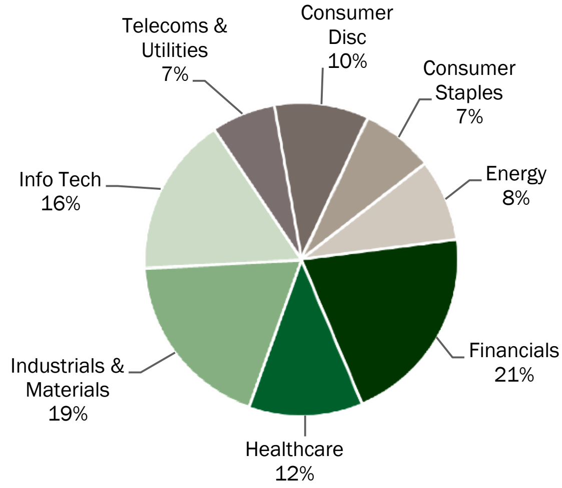


Performance Source: Setanta Asset Management Limited. Benchmark: MSCI World. The Fund returns, in USD, stated are based on the movements in the unit prices of a representative account, based on mid to mid prices, and are gross of management fees. The performance will be reduced by the impact of management fees paid, the amount of which varies. **Fund Statistics Source:** Bloomberg

FUND STATISTICS

PRICE/BOOK	2.1
PRICE/EARNINGS RATIO (FY 1)	19.8
DIVIDEND YIELD %	1.9
AVERAGE MARKET CAP $BN	56.1
NO. OF HOLDINGS	84
ACTIVE SHARE %	88.5
DEBT/EQUITY %	54.8

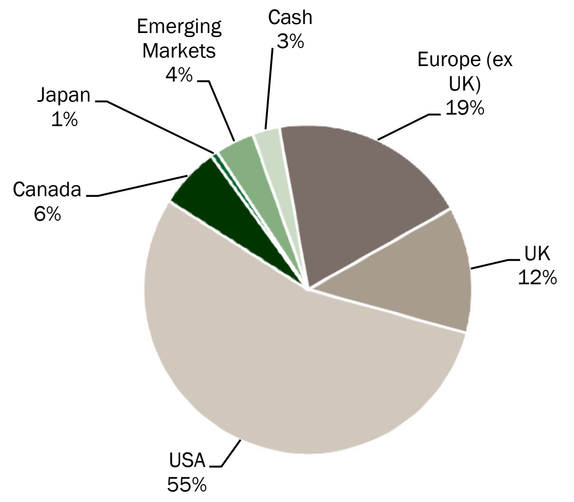
SECTOR DISTRIBUTION



TOP 10 HOLDINGS

COMPANY	SECTOR	% OF FUND
DCC	INDUSTRIALS & MATERIALS	3.2%
BERKSHIRE HATHAWAY	FINANCIALS	3.0%
OSHKOSH	INDUSTRIALS & MATERIALS	2.9%
OWENS-ILLINOIS	INDUSTRIALS & MATERIALS	2.9%
CRH	INDUSTRIALS & MATERIALS	2.9%
FAIRFAX FINANCIAL	FINANCIALS	2.8%
LEUCADIA NATIONAL	FINANCIALS	2.5%
FEDERATED INVESTORS	FINANCIALS	2.4%
SAMSUNG ELECTRONIC	INFORMATION TECHNOLOGY	2.3%
JOHNSON CONTROLS	INDUSTRIALS & MATERIALS	2.2%

GEOGRAPHIC DISTRIBUTION



YEARLY PERFORMANCE

Year %	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Fund	-17.5	15.1	10.7	8.0	25.8	-6.9	-24.6	15.9	3.0	0.1	13.3	38.9	15.4	16.3
Benchmark	-21.0	10.0	6.4	6.7	19.6	-7.5	-25.8	10.4	5.9	-3.2	13.3	35.2	14.4	18.9
Over/(under) Performance	3.5	5.1	4.3	1.3	6.2	0.6	1.2	5.5	-2.9	3.1	-	3.7	1.0	-2.2

Viewed through the lens of behavioural finance, this phenomenon was studied by two gentlemen called Benartzi & Thaler (1995) who termed it *myopic loss aversion*, basically meaning that investors evaluate their portfolios on a short-term basis, and as a result overemphasise short-term gains and losses and weigh losses more heavily than gains. Such is the pressure for performance in this industry, where underperformance is not tolerated even over short time frames; it's not surprising that participants feel compelled to "do something!". Equally, is it not surprising when investors herd into the same sorts of investments irrespective of price, preferring to avoid the burden of responsibility of succeeding unconventionally; or as John Maynard Kenyes (1936) puts it, preferring to fail conventionally. Witness the current valuation excesses in that cache of stocks termed low-volatility.

We take a multi-year view. For us a long-term investment horizon is the "inefficient frontier" in the investment universe, which – as a friend of mine eloquently puts it – *"is disfavoured by the psychology of human masses and discouraged by the compensation structure of most market participants".*

However, like most things in life, backing up the *idea* of long term thinking with the practical reality of *doing* is the hard thing – and the part where most people fall away. At Setanta we have embedded this approach over a long period of time, to the point it is almost self-regulating – i.e. repeating the same habits over long period of time help embed the discipline into our investment culture. We have aligned our compensation structure with creating long-term value, where 80% of the team's incentive compensation is derived from value created over a 3-5 year period, again with the intention of strengthening that habitual feedback loop.

Evaluating businesses over a long time horizon often puts us on the opposite side of consensus opinion. To us, a clear example of this is with current fund investment Oshkosh Corp. Oshkosh (OSK) designs and manufactures specialty vehicles, reporting in four segments: Access Equipment, Fire & Emergency vehicles, Cement & Bin trucks and military tactical vehicles.

Leaving aside, in the interests of brevity, how we are impressed by management's operational and capital discipline since the proxy fight initiated by Carl Icahn in 2010 – let's hone in on the valuation. The share price traded at circa $30-35 between January and March this year.

Those pre-disposed to the near term at the time honed in on the pertinent fact that some 70% of the company's revenues are leveraged to construction activity, where sales & margins hit a cyclical peak in the US in FY 2014. Some sell side analysts essentially capitalised a poor near term outlook for Access Equipment and used this as the anchor for their valuation targets.

In our view the $30-35 market price per share bore no relationship to what a rational buyer would pay for each part of the business. Looking at the business segments ex-Defence (see chart below), the Access Equipment segment was bought in 2006 for $3.1bn and under their ownership improved peak margins & returns by approximately one-third. Even accounting for the fact that OSK may have overpaid for this business, our analysis conservatively pegs Access's value between $3.1-3.5bn. A similar exercise, using multiple sources, for the other non-defence divisions summed to an equity value of $2.4-3.1bn for the equity value of the business, or $32 to $42 per share, depending on assumptions. Again, this contrasted with a share price of $30-35 over the period.

Our analysis was telling us that relative to the price a rational buyer might pay for the non-defence business, we were essentially getting the defence business for free.

Segment	average	good
Access Equipment	3,100	3,600
Fire & Emergency	800	900
Commercial	700	900
Corporate expense	-1,200	-1,300
Total Enterprise Value	3,400	4,100
Net Debt/Pension	-1,024	-1,024
Equity	2,376	3,076
Defense Business + Optionality	2,000	3,000
Incremental expense	-100	-300
Total Equity including JLTV	4,376	6,076
Shares O/S (m)	74	74
$ per share ex Defense	$32	$42
Setanta Value on Defense Business	$26	$36
Share Price March '16	$33	$33
Setanta Est. of Value	$58	$78

OSK's defence business at the time became far more valuable after winning the US military contract to replace the Humvee vehicle which had become entirely outdated. The contract was for 17,000 vehicles, known as Join Light Tactical Vehicles (JLTV's) rising (assuming a follow-on contract) to 55,000 vehicles through 2040 – each vehicle with an average selling price of $350,000. Not only was the contract valuable per se, but the stability to the overall earnings stream would imbue OSK over the medium term would likely result in multiple expansion on top of the net present value of the contract itself.

And the sell side analyst I spoke with entirely agreed – even had a tab on their valuation model with an NPV of $6-8 per share for the initial 17,000 contract. However, none of this value, or the likely multiple expansion, made its way into this analyst's share price target for the company. The fact that the JLTV contract didn't start to ramp until outside the 12-24 month forecast period effectively meant the contract didn't exist framed in this analyst's (and by extension the majority of the market's) perspective. Instead the analyst was myopically focused on capitalising cyclical weakness in the construction-related businesses to derive a short term price target.

We meaningfully increased our position in OSK, estimating the long-term value of the company at almost double the prevailing price in Jan-March 2016.

Portfolio Activity

Luxury goods company **Richemont** was added to the portfolio. The owner of the Cartier watch and jewellery 'maison' has fallen out of favour with investors as a result of sagging recent demand for its products, particularly from Chinese consumers. Richemont has its eye very much on the long term and we are very confident it will be successful. In the words of Chairman Johann Rupert: "To grow 15% dividends and earnings [over 20 years], you need to have a sustainable competitive advantage and the only way that we know how to maintain a sustainable competitive advantage is to grow the brand equity of the various Maisons, because that brand equity will give you, will create demand and will result in pricing power."

In addition the company retains a very strong balance sheet for the purpose of being in a position to act opportunistically when real opportunities present themselves. We really like to see that sort of prudence as well as long term optionality in the businesses we invest.

We added Test & Measurement market leader **Keysight Technologies** to the fund. Spun out of Agilent in Q4 2014, its strong market position and industry-leading margins have gone relatively unnoticed and are not reflected in current valuation. At almost 3x larger than the closest competitor, scale and brand awareness both serve as significant competitive advantages. Cash flows redeployed into R&D & Software development will help sustain the durability of the business longer term. Moreover the medium term potential to benefit from 5G Testing in the coming years should allow Keysight to experience robust profitable growth. Part funding this purchase was our remaining stake in Lexmark, which was sold after the buyout by Apex Technology was approved.

We added **Pernod** to the fund in the consumer staples sector. The company had de-rated relative to its peers due to a high level of debt, poor cash conversion and a sharp decline in Chinese cognac consumption as well as increased competition in US vodka. Undervalued in our judgement is the deep collection of high quality brands (40% sales from aged spirits), high emerging market exposure where growth is strongest and an improving cash conversion and leverage picture.

We added **Redes Energeticas Nacionais**, the Portuguese regulated utility, to the fund. In our view the business is effectively a cash cow, with a clear mandate to pay excess returns to shareholders, and has a very low business risk. Financial risk (interest rate sensitivity) is somewhat naturally hedged by features of the operating business and with a dividend yield of 6.5% the company is inexpensive relative to the opportunity set in that sector.

Sean Kenzie – Portfolio Manager

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