Global Focus Fund (EUR) – Q1 2016

Setanta
ASSET MANAGEMENT

Fund Description

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

The Fund is an actively managed, concentrated Global Equity Fund that is invested in circa 20 stocks. As a fundamental value investor our research is designed to properly understand how each business functions and to consider pertinent risks to the business. We attempt to value each business, incorporating relevant upside and downside scenarios.

As such the Fund attempts to invest in the most attractive stocks across all the firm's strategies using a risk-return framework. Investments are made for the long-term and are based on investment merit rather than with reference to benchmark. This Fund is mandated to be fully invested in equities. Due to the concentrated nature of the Fund, performance may be volatile.

The investment objective of the Fund is to outperform the MSCI World index over periods of three years or more.

Fund Commentary

Critical Thinking and 'Repeatability'

In our view, investment success is hard-earned through the highly-skilled judgement of the potential risks confronting the businesses the investor reviews. This is what the qualitative aspect of our research process is all about. Because this aspect of our approach depends not on formulae, but on continuous critical thinking, it may appear to lack 'mathematical robustness' or 'repeatability'. But, as Berkshire Hathaway Chairman Charlie Munger put it recently, if investment success followed the application of formulae, everybody who scored 'A' in algebra would be rich. The reason this is not the case is that the real world that investors operate in is complex and fluid and navigating it requires continuous and effective critical thinking. This critical thinking is what is repeatable about our investment process and we believe it has underpinned our success over the years.

Portfolio Managers

Rowan Smith & David Coyne

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.

Irish Pensions AWARDS 2015
WINNER
Equities Manager of the Year

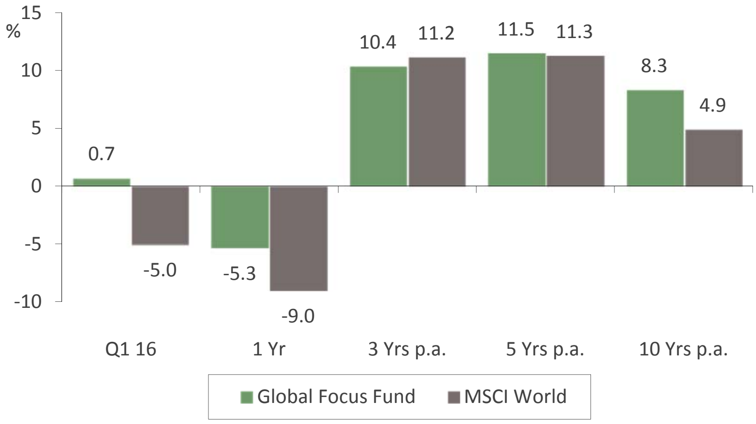
Irish Pensions AWARDS 2014
WINNER
Equities manager of the year

Irish Pensions AWARDS 2013
WINNER
Equities Manager of the Year

Irish Pensions AWARDS 2012
WINNER
Equities Manager of the Year

Setanta ASSET MANAGEMENT

FUND PERFORMANCE (EUR) – 31.03.16



Performance Source: Setanta Asset Management Limited. Benchmark: MSCI World. The Fund returns 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 (Valuation) Median ex Financials

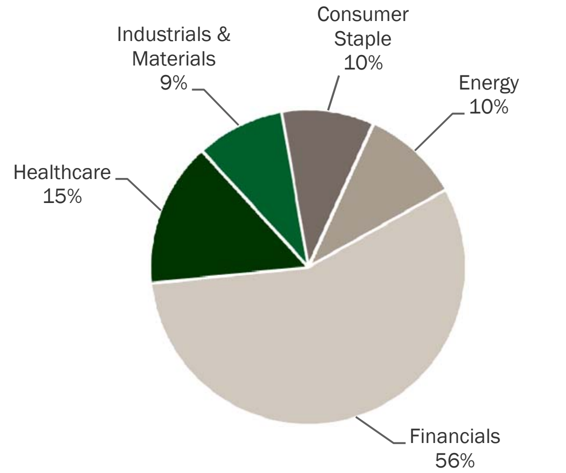
FUND HOLDINGS

COMPANY	SECTOR	% OF FUND
LSL PROPERTY SERVICES	FINANCIALS	9.0%
FAIRFAX FINANCIAL	FINANCIALS	8.5%
STERIS	HEALTHCARE	6.8%
DIAMOND OFFSHORE	ENERGY	6.7%
SYSCO	CONSUMER STAPLES	6.3%
JOHNSON & JOHNSON	HEALTHCARE	6.2%
LEUCADIA NATIONAL	FINANCIALS	6.0%
BROOKFIELD ASSET MGMT	FINANCIALS	5.9%
BERKSHIRE HATHAWAY	FINANCIALS	5.9%
MARKEL	FINANCIALS	5.3%
MINCON GROUP	INDUSTRIALS & MATERIALS	4.6%
GRANITE REAL ESTATE	FINANCIALS	3.9%
LANCASHIRE HOLDINGS	FINANCIALS	3.7%
DCC	INDUSTRIALS & MATERIALS	2.6%
NATIONAL OILWELL	ENERGY	2.1%
TESCO	CONSUMER STAPLES	2.1%
GREAT EAGLE HOLDINGS	FINANCIALS	1.2%
MELROSE INDUSTRIAL	INDUSTRIALS & MATERIALS	0.7%
CASH		12.6%

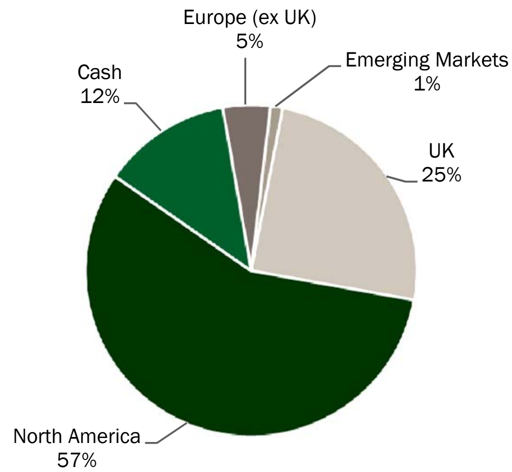
FUND STATISTICS

PRICE/BOOK	1.4
PRICE/EARNINGS RATIO (FY 1)	15.6
DIVIDEND YIELD %	2.0
AVERAGE MARKET CAP € BN	46.7
NO. OF HOLDINGS	18
DEBT /EQUITY %	51.0
ACTIVE SHARE %	98.3

SECTOR DISTRIBUTION



GEOGRAPHIC DISTRIBUTION



YEARLY PERFORMANCE

Year	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Fund	-19.7	-35.6	3.9	7.6	27.3	17.0	-2.7	-35.2	44.0	28.2	1.5	9.0	20.0	19.1	7.3
Benchmark	-12.2	-32.1	11.3	6.5	26.2	7.4	-1.7	-37.6	25.9	19.5	-2.4	14.1	21.2	19.5	10.4

A few years ago I encountered a well-respected peer who expressed his amazement that we didn't own mining stocks - they were 'cheap', trading on 'Price-Earnings multiples of 10'. Lots of investors were sucked into these stocks and have since suffered appalling losses - the earnings were, as we now know, utterly unsustainable. We didn't know this would happen but there were warning signs that alarmed us. The enormous profits these companies were making were dependent on the continued realisation of very high commodity prices. This scenario was undermined by the very manner in which these profits were being invested - in rapid capacity expansions that we now know have resulted in massive over-supply, compressing prices drastically and leaving previously super-profitable businesses in danger of going to the wall.

This is not to claim that we don't make mistakes. We have made plenty and will make more. But our willingness to open our minds to potential risk factors, to consider widely varying potential scenarios, enables us to avoid more than our fair share of mistakes. It seems to us that many industries are perhaps in greater danger than ever of undergoing radical shifts in economics because of advances in technology, the effects of globalisation and the supply-side effects cheap money. In confronting this reality, critical thinking is utterly essential.

This critical thinking must be deployed continuously and extend in every direction to hope to achieve long-term investment success. Put to one side the inescapable strategic complexities facing globally-integrated industries functioning in the modern world, ever changing with technological advances. Consider the humble data of financial accounting – accepted by many to be about as pure as information gets. Not everything is as it seems, even in this domain. When we analyse the trading performance of a business or its financial position, we need to frame our thinking to recognise the differing dynamics of each business and the specific way the management has chosen to present the relevant information. Templates designed to crunch these numbers risk producing misleading information, leading to poorly informed investment decisions.

Consider the following example: Two hypothetical companies, X and Y are, in most respects, highly similar economically but report radically different financial statements because of differences in assumptions made by management. In some other respects they differ economically, yet the accounting treatments suggest otherwise. Some items below will help explain further.

- X classifies an outlay as an expense whilst Y capitalizes it, creating an asset
- X depreciates assets over 15 years, whilst Y depreciates over 10 years
- The Balance Sheet of X contains a substantial provision against a potentially major legal liability, whereas the Balance Sheet of Y, facing exactly the same issue, has no such provision (its management assess the probability of pay out to be lower)
- X has borrowed to own its facilities, booking a liability on its Balance Sheet, whilst Y leases its facilities so these obligations are off-Balance Sheet
- X reports vastly greater cash flow than Y simply because, unlike its peer, it owns less than 100% of many of its subsidiaries (cash flow statements are prepared gross of minority interests)
- Y reports a vastly higher return on equity than X, in part because it wrote-off the value its intangible assets years ago whereas X did not
- X recognises as an expense adverse changes in the local currency value of its overseas debt, whilst Y recognises this in equity, bypassing the profit and loss account altogether.
- X reports a $50 million amortisation expense relating to customer relationships it once acquired. These relationships are actually not depleting but the accountants require a cost be booked – this is not a real expense. Y books a $50 million amortisation expense relating to the degradation of its software assets. Software does deplete so this is a real expense.
- X has cash deposits held in the US banking system valued at $200 million. Y has cash, held under government restriction in Venezuela (it cannot repatriate this), valued at $100m using an artificially inflated exchange rate. Y has a further $100 million cash held in Europe. The accounts ignore the tax liability that would be incurred if Y tried to repatriate this $100m. Both Balance Sheets show equivalent values.

This example highlights the challenges in analysing and comparing audited accounts! In our opinion, adjustments are required to the audited financial statements of the vast majority of companies in order to analyse the information in the most meaningful way. There are often two other sets of shadow “accounts” used by many investors: the adjusted numbers produced by management and the further adjusted numbers produced by sell-side analysts. These are often very poor representations of reality, designed to make the businesses seem more profitable than they really are – beware: here be dragons.

Unless there is critical thinking brought to bear at each stage of the research process, decision making risks being compromised by ill-considered or sullied information. The real world is complex and unstable and it takes experience, awareness and adaptability to be a successful investor. The Setanta team has cultivated an investment process centred on critical thinking. This approach guides us each day. Some see "value" with Price Earnings multiples of 10 - we see just one piece in a complex jigsaw.

Transactions

We added a small position in National Oilwell Varco Inc (NOV). NOV is a manufacturer of rig equipment and ancillary products and services. It has a dominant position in the oil and gas industry serving both the drilling and production segments. The company’s equipment enables customers to improve productivity and the high quality of its products is valued by customers, enabling NOV to attain high market shares in its key segments. Clearly lower oil prices are a negative for the business but substantial reductions in investment by the producers has laid the foundation for a potentially significant recovery in oil prices in the years to come (Oil Services company Baker Hughes said recently that the number of rigs drilling for oil and gas in the US is the lowest since the 1940s). Critically, with a fairly modest net debt position and with this debt well termed-out into the future, NOV is in a good position to weather the difficulties that low oil prices present, should recovery be further out than we expect.

Rowan Smith – Portfolio Manager

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