Setanta Global Focus Fund

Q4 2019

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 equity portfolio which holds c.20 global stocks. The portfolio is managed in accordance with the Setanta investment philosophy. That is, the managers seek to own good businesses for the long-term at prices below what they think they're worth, carefully considering each investment's risk profile. Stocks are chosen through bottom-up analysis, based on investment merit. Due to the Fund's concentrated nature, investments require an even greater than normal margin of safety. The Fund can hold up to 30% cash where investments of sufficient quality cannot be found. 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.

Fund Commentary

2019 was a dramatically positive year for almost all investing asset classes. Equities turned in a particularly stellar performance, with the widely-followed MSCI World benchmark up 30% (total return, Euro) – the biggest calendar year increase in the index since 1999. Whether this gain was justified is another story altogether. In general we think real value is thin on the ground, while investor underwriting standards are often low and risk appetites high.

(Fund Commentary continued on Page 3)

Portfolio Managers

David Coyne & Rowan Smith

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

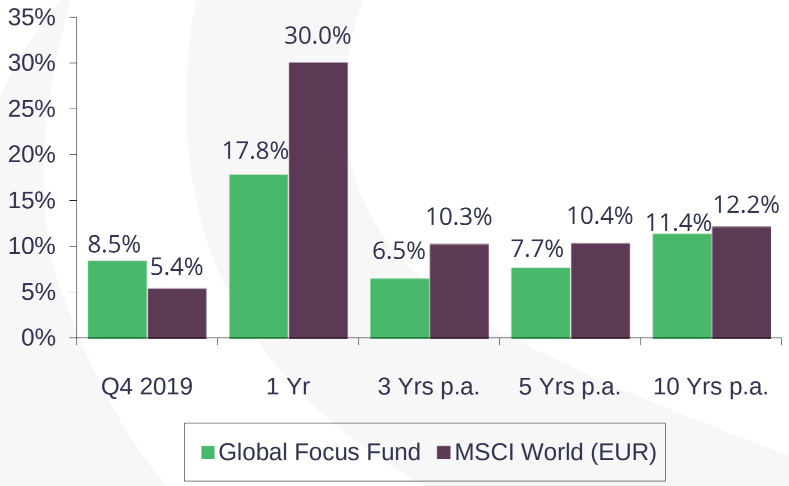
We consider scenarios rather than making forecasts

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 – 31.12.19 (EUR)



Performance Source: Setanta Asset Management Limited. The Fund returns stated are based on the movements in the unit prices of the ILA/CLI Setanta Global Focus Equity Fund [IEC4001] and are gross of management fees. The performance will be reduced by the impact of management fees paid, the amount of which varies. **Benchmark:** MSCI World (EUR). **Holdings Source:** Setanta. Sector allocations based on invested portfolio only (excludes cash). **Fund Statistics Source:** Bloomberg

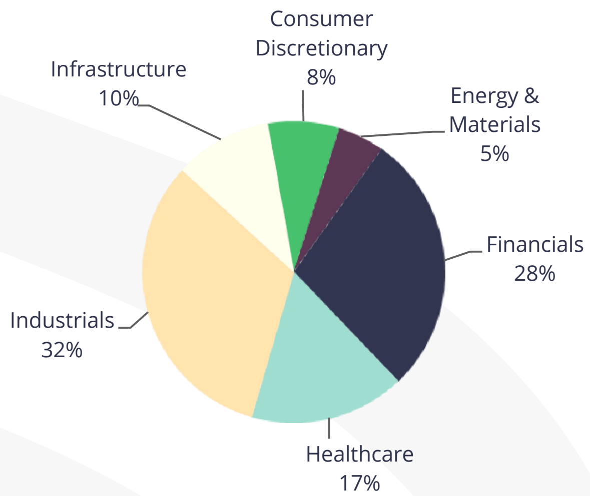
Top 10 Holdings

COMPANY	SECTOR	% OF FUND
BERKSHIRE HATHAWAY	FINANCIALS	9.5%
RYANAIR	INDUSTRIALS	9.2%
STERIS	HEALTHCARE	8.6%
LSL PROPERTY SERVICES	INFRASTRUCTURE	8.3%
DCC	INDUSTRIALS	7.4%
MELROSE INDUSTRIES	INDUSTRIALS	7.4%
LANCASHIRE HOLDINGS	FINANCIALS	7.3%
JOHNSON & JOHNSON	HEALTHCARE	6.8%
MINCON GROUP	INDUSTRIALS	6.5%
RICHEMONT	CONSUMER DISCRETIONARY	5.5%

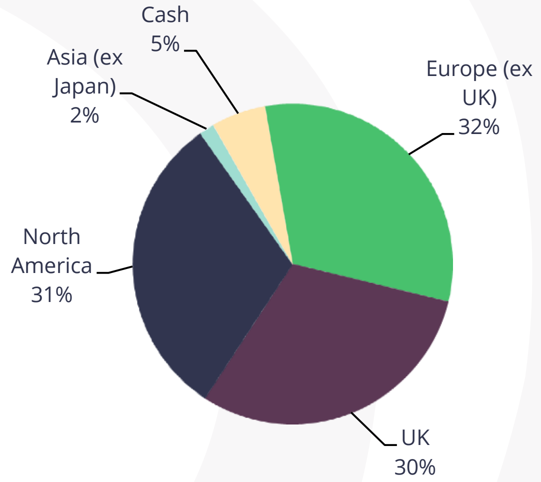
Fund Statistics

PRICE/BOOK	1.7
PRICE/EARNINGS RATIO (FY 1)	16.8
DIVIDEND YIELD %	1.7
AVERAGE MARKET CAP € BN	57.6
NO. OF HOLDINGS	17
DEBT /EQUITY %	49.3
ACTIVE SHARE %	95.7

Sector Distribution



Geographic Distribution



Yearly Performance

Year %	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Fund	-2.7	-35.2	44.0	28.2	1.5	9.0	20.0	19.1	7.3	11.7	9.7	-6.4	17.8
Benchmark	-1.7	-37.6	25.9	19.5	-2.4	14.1	21.2	19.5	10.4	10.7	7.5	-4.1	30.0

SETANTA Asset Management

Commentary

As discussed in the Q2:19 report, the fund had broadly kept pace with the market in the 10 years up to the end of 2018. However it trailed the benchmark by 12% in 2019 and is now regrettably behind over all periods. The concentrated nature (c.20 stocks) of the fund means that performance is much more likely to deviate materially than its more diversified big brother, the Global Equity Fund (c.90 stocks). With larger position sizes, investment mistakes have a disproportionately large impact on the fund. The same is true when we hold investment winners and while we have made some excellent investments, we made a couple of mistakes too many in the last decade, notably Tesco and Diamond Offshore.

A high cash weight averaging c.10% since 2014 has also dragged on performance. In the context of generally high valuations, it reflected our desire to have cash available to take advantage of material sell offs in stocks we would like to own (or own more of) at lower prices. Unfortunately there have been few such opportunities in the last 5 years. With the benefit of hindsight we were too cautious.

Regarding 2019, we should note that Setanta funds tend not to do as well in strong "risk on" markets. Also 'growth' stocks outperformed their 'value' counterparts to an extreme degree versus history in 2019. We are sticking to our tried and tested investment process which balances risk as well as return.

Value versus Growth

We tend to largely ignore investment style conversations, but it was hard to ignore the debate in 2019. According to MSCI, growth stocks have outperformed value stocks in 11 out of the last 13 years since 2007, cumulatively by more than 50% over this period, and by a record 11.6% in 2019. Such a trend flies in the face of decades of previous academic research, which showed a clear preference for value. We have often referred to ourselves as value investors, so clients may have genuine questions over whether our approach is still fit for purpose.

Value and growth means different things to different people. For example, MSCI and other index providers define value as stocks that are cheap on various statistical measures, such as a low price-to-earnings ratio, while growth stocks are companies that have higher historical and projected future sales and profit growth rates. Under their approach, value stocks are for the most part distinct from growth ones. This is at odds with Warren Buffett, who famously said that value and growth are joined at the hip. We side with Buffett. We think of value investment as a qualitative endeavour that conflates the value of an asset with its price. Quite clearly, growing profitable companies are worth more than shrinking unprofitable ones and we'll look to own them where we think they are cheap based on a conservative estimate of their future cash flows.

But no matter the definition, the general feeling is that growth stocks have been the place to be, irrespective of price. Why might this be? One major reason is the current low level of interest rates. The German 30-year bond yield was 0.3% at year-end against 4% a decade ago. Over the same period, the 30-year US Government bond yield halved to 2.3%. Not only is it likely that low interest rates have stimulated global economic activity, but they have reduced the discount rate investors apply to future company profits. A lower discount rate increases the theoretical value of all companies but disproportionately so the value of long-term profitable growers, which are longer duration assets. The sanguine demand backdrop and relaxed investor mood was certainly beneficial for the share prices of *perceived* growth companies in 2019. We caution that should high expectations for future profits fail to be met, or should the low discount rate reverse, then some of these 'growth' stocks could be hit very hard at some point.

Commentary

Meanwhile, the underperformance of quantitative 'value' stocks over the last decade should theoretically give us plenty of investment opportunities. Here we are careful not to rush headlong in because rather than just looking at a low price relative to current or next year's profits, we need to consider the ability to reinvest those profits at good rates of return, balance sheet strength, management quality and potentially disruptive technologies facing the business down the road. Quite often those 'value' stocks are not as cheap as they appear, all things considered. As our tagline says, *value is more than a number.*

We don't wade into the value-growth debate very often. Our portfolios tend not to be populated by bargain stocks as MSCI would define it, so you should not assume we will keep apace if the MSCI Value index outperforms significantly. We too have less exposure to high growth companies, so if that type of stock continues to perform well we may lag again. Our North Star has always been to judge investments individually and on merit, balancing risk and reward – not based on labels of growth or value. In this regard we believe our approach is as relevant as ever. We are relatively happy with the current portfolio in the context of generally high equity valuations, anchored off a low equity discount rate. We are confident that should investors become less sanguine the fund will do relatively well as it has done in such periods in the past.

Performance review

As mentioned already, the fund lagged the benchmark during the year, 18% versus 30%. The top and bottom three contributors to performance are listed in the table below.

2019 Top 3 Contributors To Performance	Sector	Contribution (EUR)	Performance (EUR)
Steris	Healthcare	+3.5%	+47%
LSL Property Services	Infrastructure	+2.6%	+39%
Melrose Industries	Industrials	+2.6%	+59%

2019 Bottom 3 Contributors To Performance	Sector	Contribution (EUR)	Performance (EUR)
Mincon Group	Industrials	-0.9%	-9%
Diamond Offshore	Energy	-0.7%	-22%
Covetrus	Healthcare	-0.6%	-68%

Source: Bloomberg, Dec 18 – Dec 19 (in EUR) based on the ILA/CLI Setanta Global Focus Equity Fund [IEC4001]

The largest contributor to performance in 2019 was **Steris**, a stock we have been invested in since 2010. The business has performed extremely well and the stock has performed even better over this period. In 2019 alone, the stock produced a total return of 47% in Euro terms. To refresh readers, Steris manufacturers and sells a range of equipment used to disinfect and sterilise medical equipment in hospitals, clinics, laboratories and pharmaceutical production facilities. It sells the hardware, the chemical sterilant used in the hardware, and also services the equipment. Over the years it has also built up and expanded a significant sterilisation service business. It offers a range of services including cleaning and repair of tools such as endoscopes and contract sterilisation for medical device manufacturers in which Steris will sterilise single use medical products (band aids, pacemakers, for example) before transportation to the end user.

Reported results in 2019 have been strong across all business units with margins expanding alongside growing revenues. Furthermore the company continues to invest in all of its businesses giving us confidence that the company's competitive position is well insulated and that profits can continue to grow nicely for years to come. The management team deserves great credit for the successful implementation of a strategy that centred on broadening the company's skill-set without straying far outside its areas of strength and expertise and without stretching financial resources. Valuation has moved up sharply with the stock now trading at over 25 times our fairly conservative estimate of earnings. We think the stock is still worth holding on to as we see the risk profile as low and believe the long-term growth outlook remains attractive.

Melrose PLC returned almost 60% in Euro terms, recovering from a negative return in 2018. To refresh readers, Melrose is essentially an industrial holding company that specialises in business turnarounds. The largest acquisition in its history, GKN Ltd, was completed in 2018. GKN's business interests primarily encompassed the production and sale of components for the automotive and aerospace industries. GKN was widely considered to have strong engineering and production capabilities and many, deep customer relationships but perennially achieved rates of profitability below levels that investors believed was attainable for a business of its calibre. Melrose management believed it could improve the performance of GKN quite materially. However the acquisition appeared to be getting off to an inauspicious start when the auto industry entered a fairly broad-based slowdown shortly after the deal closed. It was the contention of the Melrose management team that there were enough sources of potential self-improvement in the auto division to substantially weather any slowdown in demand. However investors were sufficiently concerned that the share price declined by over 20% in 2018. As the dust has begun to settle, the company's published results suggest that management's contention was correct – while there has been a fairly modest decline in revenues for the automotive business, this has been offset by cost reduction measures such that divisional profits have been insulated. Furthermore the aerospace business has been performing very well. We are hopeful that trading conditions might be a bit more supportive for the group in 2020 which would clearly help the share price further. We are also hopeful that 2020 might present opportunities for Melrose to dispose of parts (or perhaps all) of Nortek, the company it acquired in 2016 and significantly improved the performance of. This would further demonstrate to investors the strength of the Melrose management model and would allow the group to reduce the level of group borrowings further.

The bottom three contributors to performance were **Mincon**, **Covetrus** and **Diamond Offshore**. Covetrus and Diamond have been discussed in previous reports. Covetrus was a spin out that we received from Henry Schein in Q1:19. While its shares fell by a large percentage, luckily its small fund weight limited its impact on overall fund performance.

Irish company Mincon was the largest absolute detractor from performance. The company provides drill bits and other parts of the 'drill string' to the mining, oil and gas, and construction industries. Mincon was partially floated in 2013, with the Purcell family remaining as part of the management team and retaining a majority ownership of the company. We bought a position for this fund in late-2014 following a near 50% decline in the share price from IPO. A large part of Mincon's sales come from repeat orders (drill bits wear out), giving us confidence that the business would hold up despite the falling commodity prices that weighed on investor sentiment at the time.

We liked management's long-term vision for the group. They believed that through product innovations, targeted acquisitions and a high-touch customer service, the company could take a greater share of the premium end of the global bit market from the large incumbents, Swedish giants Sandvik and Atlas Copco. This story has largely played out. However, profits and cash flows have been held back by some production problems in 2018 and 2019 (too much demand!), which required heavy investment in new plant and inventory, as well as development costs for future products. These issues have held the share price back in the last 12-18 months, but we believe management is now largely on top of the problems and the coming few years should be very exciting for sales, profits and cash flows. We remain positive on the shares, despite the c.10% decline in 2019.

Portfolio Activity

During the year we sold out of **Henry Schein** and **Jefferies Financial Group**, as discussed in the Q3 report. The sales proceeds (as well as some cash) were used to top up our holdings in Ryanair and Melrose, whose share prices had fallen to more attractive levels. **Covetrus** was a spin out of Henry Schein that we received in Q1:19 and was discussed in the Q1 and Q3 reports.

The fund ended the year with just over 5% cash.

David Coyne – co-lead fund manager

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IMPORTANT INFORMATION