Setanta EAFE Equity Fund (CAD)

Q2 2020

Fund Description

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

The Fund is an actively managed equity portfolio which holds c.30-50 stocks in the European, Australasian and Far East regions. The portfolio is managed in accordance with the Setanta investment philosophy. 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 can hold up to 10% cash where investments of sufficient quality cannot be found.

The investment objective of the Fund is to outperform the MSCI EAFE benchmark over the long term.

Fund Commentary

As shown in the chart on page two, the Setanta EAFE Equity Fund under-performed the MSCI EAFE index in the second quarter and further trails the index on a year-to-date basis. The market recovery from the trough in Q2 was fostered by the anticipated reopening of economies and a significant shift in investor psychology, away from fear and towards greed, as central banks injected liquidity into the financial system on an unprecedented scale. While the market recovery from the trough was sharp the Setanta EAFE Equity Fund was unable to keep pace.

(Fund Commentary continued on Page 3)

Portfolio Managers

Rowan Smith; Fergal Sarsfield, CFA & Conor Walshe



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

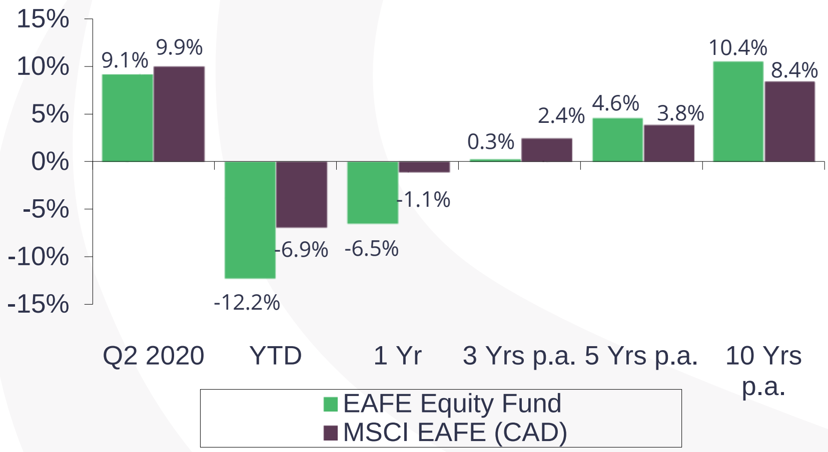
We consider scenarios rather than making forecasts

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 – 30.06.2020 (CAD)



Yearly Performance

Year %	2015	2016	2017	2018	2019
Fund	25.2	7.0	16.7	-2.7	13.1
Benchmark	19.0	-2.5	16.8	-6.0	15.8

Performance Source: Setanta Asset Management Limited. The Fund returns stated are based on the movements in the unit prices of the CLA CA Managed EAFE Portfolio SF035 [IEC11007] 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 EAFE (CAD) **Holdings Source:** Setanta. Sector allocations based on invested portfolio only (excludes cash). **Fund Statistics Source:** Bloomberg

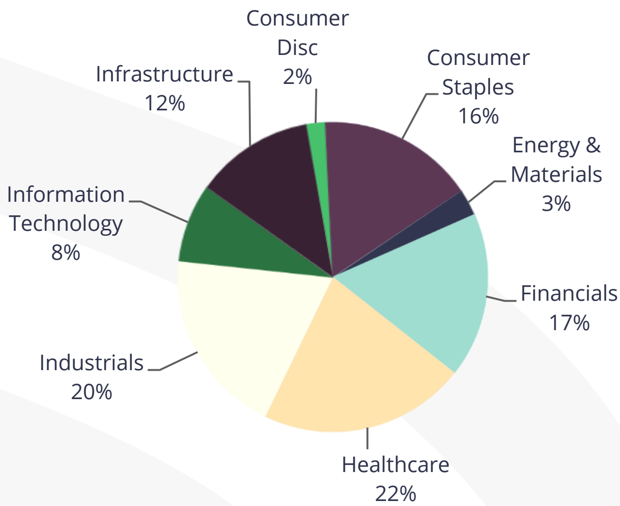
Top 10 Holdings

COMPANY	SECTOR	% OF FUND
DCC	INDUSTRIALS	6.4%
GPE BRUXELLES LAMBERT	FINANCIALS	5.3%
ALFRESA HOLDINGS	HEALTHCARE	5.1%
UNILEVER	CONSUMER STAPLES	4.0%
ALCON AG	HEALTHCARE	3.8%
KDDI CORP	INFRASTRUCTURE	3.8%
NOVARTIS AG	HEALTHCARE	3.8%
COCA-COLA AMATIL	CONSUMER STAPLES	3.8%
SANOFI	HEALTHCARE	3.7%
LANCASHIRE HOLDINGS	FINANCIALS	3.6%

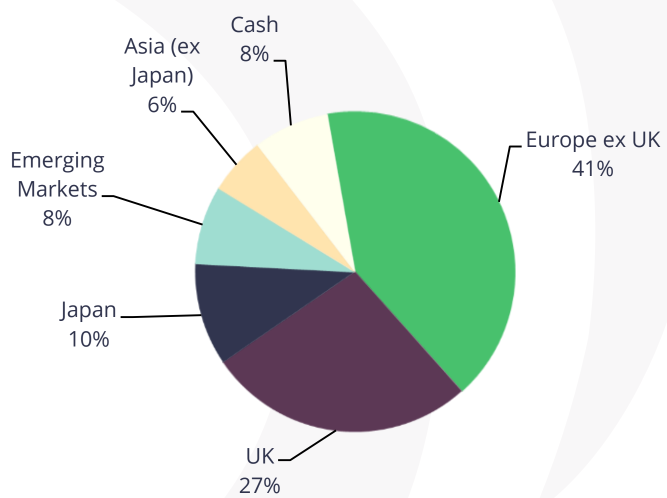
Fund Statistics

PRICE/BOOK	1.4
PRICE/EARNINGS RATIO (FY 1)	15.7
DIVIDEND YIELD %	3.2
AVERAGE MARKET CAP C$BN	50.1
NO. OF HOLDINGS	35
DEBT/EQUITY %	63.5
ACTIVE SHARE %	90.0

Sector Distribution



Geographic Distribution



SETANTA Asset Management

Commentary

We are both surprised and disappointed by the under-performance of the fund thus far in 2020. Coming into 2020 we felt the Fund was well positioned. We were not predicting a recession as such, but felt prepared for the possibility of a more challenged market backdrop. We had some cash on hand, were underweight the Consumer Discretionary, Materials and Financials sectors and had overweight positions in Consumer Staples and Healthcare. The Setanta EAFE Equity Fund has out-performed in weak markets in the past, and we have always tried to use such periods of stress to further enhance the return profile of the fund. Since we have not changed our investment approach at all, the Fund's under-performance so far this year is something of a head-scratcher for us.

One likely reason is that this particular recession is unusual with large swathes of the economy forcibly shut-down. Many industries have been impacted far more severely than would be the case in a more "normal" recession and the stronger companies have been unable to demonstrate superiority over weaker competitors. Coca Cola Amatil, the bottler of Coca Cola products in Australia, New Zealand and Indonesia, has seen unprecedented volume reductions this year because customers have simply not been in a position to consume the product. In Diageo's case, bars and restaurants have been closed; the "on-trade" business is the most profitable segment so COVID-19 has created an unexpected headwind for its profit margin. Ryanair's customers have not been allowed to fly. So the unusual nature of the economic shock served to undermine the resilience of the portfolio – a resilience we would have expected to be demonstrated in anything close to a normal recession. To add a wrinkle to this theme, there are narrow pockets in a few industries, pockets that we have been under-exposed to, that have been seen as winners from the lockdown. These include niches in the Healthcare (suppliers to the vaccine or diagnostics industries for example) and Technology sectors (companies that enable online payments, facilitate working from home, etc). Some of these winning stocks have gained substantially this year and we have had no exposure here.

From a sector perspective, the key drivers of our underperformance in H1 have been Consumer Staples and Industrials. As touched on already, our exposure to Beverages through Coca Cola Amatil, Thai Beverage and Diageo has hurt us as demand has been disproportionately impacted by lockdown restrictions to contain the coronavirus. These are strong companies which can weather the storm and possess the brands and distribution capabilities to thrive longer term. In Industrials, Melrose (addressed later) and Ryanair have been significant detractors. While the near term outlook for air travel is difficult, Ryanair has a significant cost advantage over its rivals combined with a healthier balance sheet and should be well positioned to take market share in the coming years.

Zeroing in on the stock level, two positions in the fund in particular – Melrose and Bank of Ireland – have had a significantly negative impact on performance in the first six months of 2020 and are worth examining in a little more detail.

Since its first deal in 2005, Melrose's management team has established a strong track record in acquiring underperforming businesses, improving them and then selling at a higher valuation. This year, the company has been hit by a perfect storm. The GKN deal brought significant exposure to the aerospace and automotive industries which have been particularly badly hit by the coronavirus outbreak. Asset sales planned for 2020 have been delayed and balance sheet leverage has exacerbated the weak trading environment. We believe this is a strong management team that has proven adept at taking out costs in the past. Capex and working capital actions are already delivering cash savings. Such preservation actions mean that £1bn of committed bank facility headroom in place at the start of year is still expected to be there at the end of the first half. The next bond refinancing is not until September 2022. While it will take time, we expect the aerospace and automotive industries to recover in due course. Melrose's management team can ensure it is in a position to capitalise on this healthier backdrop in the future.

Commentary

Bank of Ireland has been hit by concerns over the potential for a sharp increase in non-performing loans, declining net interest margin, weak loan growth and a highly uncertain economic outlook. There is no doubt that the trading outlook is tough but we feel this is more than reflected in the large discount to book value which the company currently trades at. It is in a much better capital position than when entering the Global Financial Crisis and without the large property developer exposure. Risk weighted asset requirements for capital purposes are already much higher for Irish banks relative to their European peers. We are hopeful that lessons have been learned from past experience and that lending practices have been prudent over the last 10 years. The formation of a government in Ireland at the end of June opens the way for improved business support schemes. Recent credit issuance from the two leading Irish banks has attracted strong interest from investors in contrast to the underperforming equities.

We believe another reason for the Fund's underperformance is that market conditions feel somewhat abnormal, which may in turn be distorting the integrity of market pricing.

The US Federal reserve launched its first program of quantitative easing (printing money to buy government backed bonds) in 2008. The Balance Sheet of the Federal Reserve increased from c.US$0.9 trillion to c.$2.2 trillion during "QE1". As of Summer 2019, the Fed's Balance Sheet summed to US$3.8 trillion. One year later the Balance Sheet exceeds US$7 trillion, is still growing by the week, and may be on pace for c.$10 trillion by year end. Remember, QE was supposed to be a temporary intervention. Other central banks around the world have adopted similar strategies. We don't know whether QE and its variations are appropriate or not but we suspect it might be impacting the equity market significantly. It seems likely that some of the liquidity that QE injects into the bond market spills into the equity market and the numbers here are huge. Furthermore the really low discount rates it helps engender push equity valuations higher, especially for long-duration investments (read "Growth Stocks").

"Because of the Fed's interventions, market prices and credit spreads don't have the information content that we think they have....The Fed is mucking up what prices mean."

- Peter Fisher, former U.S. Treasury and Federal Reserve Bank of New York official.

Perhaps one upshot of this has been the accelerating under-performance of value stocks in 2020. We are always wary of reading too much into data derived from such blunt classifications as "value" and "growth" but we do believe that the under-performance of value stocks supports our contention that the pricing structure of the equity market has become distorted. The past eighteen or so months in particular has seen value stocks lag significantly. It may not be a coincidence that this period began around the time that the Fed, spooked by a sharp decline in equity markets, reversed course from quantitative tightening to a renewal of quantitative easing.

MSCI EAFE Value/MSCI EAFE Growth January 1999 – June 2020

Source: Bloomberg in Euro

Our portfolio will typically not look like a classic, perhaps stereotypical, value portfolio. However valuation has always been important to us, and we believe this backdrop has proven to be a headwind for our portfolios.

We believe that, probably for various reasons, the pricing structure of the market seems imbalanced. There are numerous peculiar examples of this that we have come across in recent months. One particularly strange case is Indivior PLC, a UK headquartered pharmaceutical company. Indivior was once part of the Reckitt Benckiser Group but was spun off from the parent in 2015. Its main listing is in London, but there is a US listed ADR that has become a favourite of day traders (and algorithmic funds that are likely front running these day-traders). Based on the economic claim of the ADR, it should normally trade at a price five times that of the main UK listing. In fact it has done this quite steadily from 2015 to May 2020, but the ADR pricing has, since May 2020, become detached from reality. On May 26th, the ADR traded at a ratio of 50 times the price of the UK line. On June 17th the ADR traded at 25 times the price of the main UK line. ADR volume traded on each of those two days was 30-40 times that of a normal trading day. These ADR price ratios implied ADR price downside of more than 80%. From its intraday high on May 26th, the ADR price has declined by more than 60%. At the time of writing the ADR trades at 12 times the price of the local UK line, a ratio that appears still far too high to us. Trading volumes in the ADR remain substantially elevated. This continues to look like a localised price bubble to us. We think it's unlikely to be the only bubble.

Commentary

Less extreme, but striking nonetheless, is that there are many high quality companies that we follow but don't own, some of which are currently trading at extremely high valuations (over fifty times earnings). It feels to us that valuation spreads, between what has been popular with investors and the rest, have widened this year, perhaps as a result of the combination of near-term earnings uncertainty and ultra-low interest rates. Against this backdrop we believe discipline is especially important and we are treading carefully.

Under-performing is psychologically difficult. We take pride in our work and are determined to do the best we can for our clients. So it hurts us when our performance lags. However we can't allow the rearview mirror to dictate what we do now. We must make each decision with as much objectivity as possible, taking all of the relevant factors on merit and thinking about what the next five years or so may hold for the respective businesses. These are the things we have always tried to do. We have found this approach to be successful in the past and we will continue to manage your money this way in the future. Thank you for your continued support.

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IMPORTANT INFORMATION

The EAFE Equity Fund is managed by Setanta Asset Management Limited and is a representative account of the EAFE Equity strategy. The performance shown is the performance of a representative account (CLA CA Managed EAFE Portfolio SF035 [IEC11007]). The strategy is available on a separate account basis to institutional investors however current and prospective clients should not assume identical performance results to those shown would have been achieved for their account if it was invested in the strategy during the period. Clients of the firm may receive different performance than the representative account. Client performance may differ due to factors such as timing of investment(s), timing of withdrawal(s), client-mandated investment restrictions and the portfolio not being fully replicated for new accounts or new flows. Investors should consider the investment objectives, risks, charges and expenses carefully before investing. See 'WARNING' and IMPORTANT INFORMATION' sections below.

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