

Setanta European Equity Fund (CAD)

Q3 2020

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 which holds c.30 stocks which are located in or active in Europe. 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.

The Fund is managed by the lead portfolio manager, who also looks to leverage off the experience and knowledge of his colleagues. The aim is to achieve a sensible level of diversification on a sector and geographic basis.

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

Fund Commentary

The third quarter saw a continuation of the recovery in equity markets seen in the previous quarter and unfortunately the Setanta Europe Fund was unable to keep pace. The outperformance of "growth" stocks versus "value" stocks was another recurring feature.

(Fund Commentary continued on Page 3)

Portfolio Manager

David Byrne, CFA



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

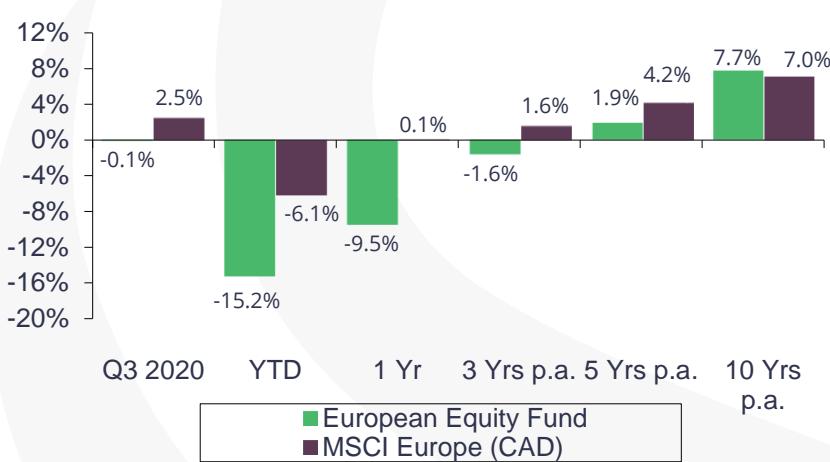
Businesses we own must have strong balance sheets

We make mistakes and always endeavour to learn from them

We will act with integrity in everything we do



Fund Performance – 30.09.2020 (CAD)



Yearly Performance

Year %	2015	2016	2017	2018	2019
Fund	27.7	-0.8	15.3	-4.3	13.8
Benchmark	16.5	-3.9	17.3	-7.2	17.5

Performance Source: Setanta Asset Management Limited. The Fund returns stated are based on the movements in the unit prices of the CLA European Equity Fund (SF037) [IEC11002] 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 Europe (CAD). **Holdings Source:** Setanta. Sector allocations based on invested portfolio only (excludes cash). **Fund Statistics Source:** Bloomberg

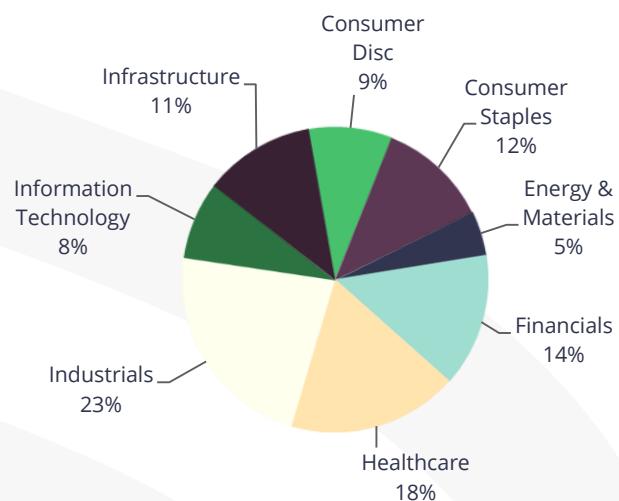
Top 10 Holdings

COMPANY	SECTOR	% OF FUND
DCC	INDUSTRIALS	7.3%
GPE BRUXELLES LAMBERT	FINANCIALS	5.8%
UNILEVER	CONSUMER STAPLES	5.8%
CRH	INDUSTRIALS	5.6%
ERICSSON	INFORMATION TECHNOLOGY	5.3%
SANOFI	HEALTHCARE	5.1%
GLAXOSMITHKLINE	HEALTHCARE	5.0%
NOVARTIS AG	HEALTHCARE	4.8%
LANCASHIRE HOLDINGS	FINANCIALS	4.1%
DIAGEO	CONSUMER STAPLES	4.1%

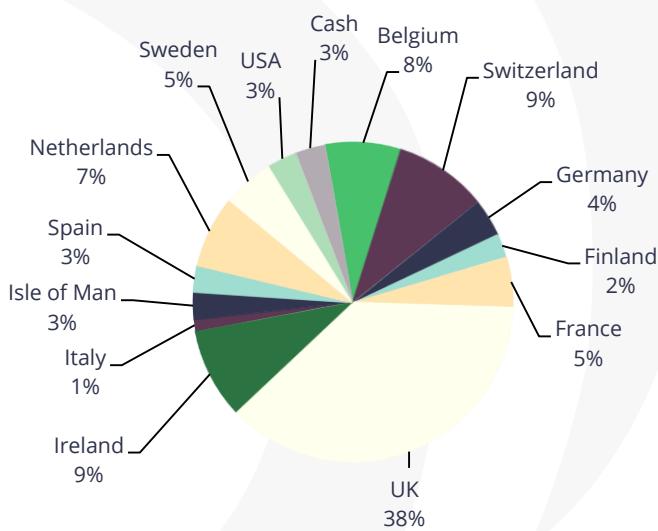
Fund Statistics

PRICE/BOOK	1.6
PRICE/EARNINGS RATIO (FY 1)	18.2
DIVIDEND YIELD %	2.5
AVERAGE MARKET CAP C\$BN	51.0
NO. OF HOLDINGS	29
ACTIVE SHARE RATIO %	88.7
DEBT/EQUITY %	96.0

Sector Distribution



Geographic Distribution



Commentary

While the Europe region lacks the FANMAG stocks which have been such a driver of global returns, the popularity of “growth” stocks has nonetheless been evident here also. In the three months ended September, the MSCI Europe Growth Index was up 3.82% in Euro terms versus a slight decline of -0.32% for its Value counterpart. The difference is even starker when looking at the first nine months of the year with the MSCI European Value Index underperforming by 12.5% compared to the Growth Index.

In an analysis of the US market in Q3, the broker Baird highlighted that high valuation, high quality (measured by return on equity or capital) and high growth factors are outperforming. We have observed similar trends in the European region this year. There has been a lot of commentary that the value style of investing is dead after a prolonged period of underperformance. At Setanta, we look to invest predominantly in above average quality companies at valuations around or below average. In the current market environment, the latter part of that equation has become more difficult. In a low interest rate world, growth and durability become more attractive. Is the lesson that we should buy growth companies at any price? The argument goes that if you are right about the quality of the business, time can reduce the cost of overpaying through compounding.

The current “value versus growth” debate brought to mind the two contrasting quotes listed below which are taken from a recently published book entitled “The Psychology of Money” by Morgan Housel.

“The four most dangerous words in investing are “it’s different this time.”” – John Templeton

“The twelve most dangerous words in investing are “The four most dangerous words in investing are “it’s different this time.”” – Michael Batnick.

The author argues that history does not provide a perfect guide to the future. Instead he posits that the further you look back in history, the more general your takeaways should be. Investing evolves but some lessons are timeless.

At Setanta, we believe the problem with a “growth at any price” approach is that it leaves very little margin for error. Sustaining growth over the long term is challenging. Analysis by Bernstein shows that just 6% of S&P500 companies sustained >5% year-over-year earnings growth for five consecutive years in the 1980-2019 period. Less than 1% managed the same feat for 10 years. Looking back at the 9 largest technology stocks as of March 2000, only two have surpassed that level of market cap since. Justifying very rich multiples on the basis that today’s successful companies can grow far into the future carries significant risks. There will be big winners which garner a lot of headlines but there is likely to be a long tail of disappointments too.

We continue to try to be disciplined on price while acknowledging selectively that high quality companies with good growth prospects at attractive returns merit higher multiples. Our increased weighting in **Alcon** this year is an example of this. We also believe that some of our other holdings like **Diageo**, **Ryanair** and **Heineken** have been disproportionately impacted by the COVID-19 outbreak and offer good long-term growth prospects in a more normalised environment.

One element of the “value versus growth” debate which has evolved over time results from the marked shift towards investing in intangible assets which are often expensed immediately (R&D, marketing etc.) versus tangible assets which are capitalised and then depreciated over time. As a result two classic measures of value, the Price to Book and Price to Earnings multiples, have become less relevant. This has likely exacerbated the underperformance of “value” strategies in the current environment. Our approach at Setanta has always been that value is more than a number. It is not a choice between value represented by low multiples on the one hand and growth on the other.

Commentary

Our process has never been driven by an overt focus on low P/E and low P/Book stocks. Looking at our portfolio, we are underweight the Financials and Energy sectors, two areas of the market where one can find an abundance of stocks on low Price to Book multiples.

Looking at the Fund's performance in Q3 from a sector perspective, our underweight positions in Consumer Discretionary and Materials were a drag but this was offset by our underweight in Energy. At the stock level the 2 biggest detractors were Lancashire and DCC.

Lancashire had a very strong run in H1 as the insurance market hardened significantly with prices up in the region of 20%. UK insurance peers reported numbers in the last quarter that showed a bigger exposure to COVID related expenses than previously thought. Although Lancashire has lower exposure to COVID related settlements sentiment in the sector seemed to drag the share price of Lancashire lower. The outlook, we believe, remains positive for Lancashire.

DCC's share price weakness may reflect concerns about the longer term sustainability of the liquid fuel distribution business. Ultimately, we feel that liquid based fuels will play an important role in fulfilling energy needs for some time to come as demand trend shifts and the required infrastructure investment will not happen overnight. Where the shift to electric vehicles has been quicker in Norway, DCC has invested and is making attractive returns. The company made two small energy acquisitions in the quarter at attractive multiples and the M&A pipeline has improved according to management. With a proven ability to create value from acquisitions, we see this as a positive development.

On a more positive note, the Fund benefited from strong performance by Ericsson and Playtech. **Ericsson** delivered strong results for the second quarter with network sales and EBIT margin beating market expectations. This was on the back of good growth in North East Asia and North America. Group targets for 2020 and 2022 were maintained. **Playtech** has rebounded strongly from March lows. The core B2B gaming business has performed better than expected. Business related to retail has also been improving and the group is also seeing opportunities to partner with firms in the United States as more States regulate gaming activities.

The under-performance of the Setanta European Fund in the year to date is disappointing. While we seek to learn constantly, we don't believe the current period is highlighting something fundamentally wrong with our process. We continue to focus on quality companies with durable franchises managed for the long term and conservatively financed while retaining our valuation discipline as we seek to ensure we don't overpay.

Transactions during the Quarter

There were no transactions during the quarter.

David Byrne, CFA – Portfolio Manager



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