Setanta Income Opportunities Fund
Q3 2020

Fund Description

The **Income Opportunities Fund** ('the Fund') is an actively managed portfolio primarily comprising global equities but with the flexibility to invest in assets which offer attractive income and reasonable value. These assets include fixed income, property (including REITs) and cash. The Fund is not constrained by limitations on the level of any given asset. In practice, the Fund has had its greatest weight in equities, reflecting the breadth of that market, Setanta's expertise in that area, and the option writing strategy employed by the Fund. Nevertheless, property, fixed income and cash have all played meaningful roles in past returns of the Fund, at times, comprising up to 50% of the Fund's assets. The portfolio is managed in accordance with the Setanta investment philosophy. That is, the managers seek to own good assets 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 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 employs an option writing strategy. This entails the sale of both call and put options in return for a cash premium, representing an income stream that boosts the underlying income yield of the Fund. This strategy is employed in a conservative fashion, as all options written are fully covered.

The Income Opportunities Fund has two investment objectives:

1. To generate an annual income yield at a target rate. This is declared at the start of each financial year.

2. To achieve capital appreciation over the long term.

Portfolio Managers

Richard Doyle, CFA; David Pastor, CFA; Caroline White, 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

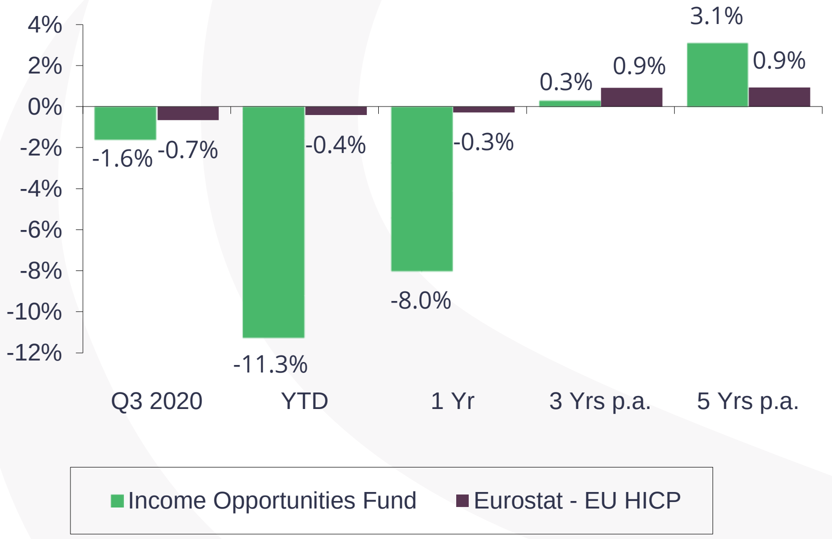
We consider scenarios rather than making forecasts

Businesses we own must have strong balance sheets

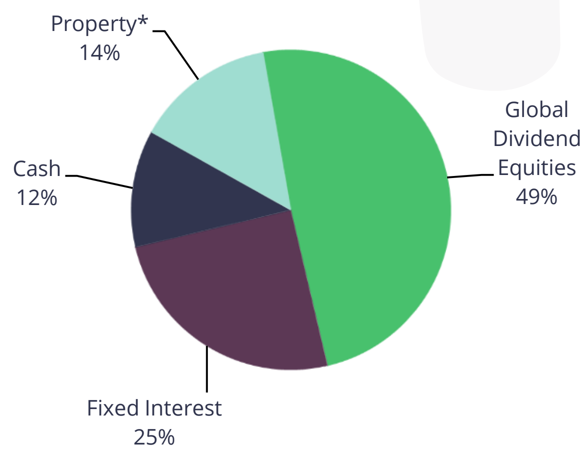
We make mistakes and always endeavour to learn from them

We will act with integrity in everything we do

Fund Performance – 30.09.2020 (EUR)



Asset Distribution



*includes 1.4% in IRES REIT

Yearly Performance

Year %	2015	2016	2017	2018	2019
Fund	10.6	9.7	2.9	-1.2	13.7
Benchmark	0.2	1.1	1.4	1.6	1.1

Performance Source: Setanta Asset Management Limited. The Fund returns stated are based on the movements in the unit prices of the ILA/CLI Income Opportunities Fund [P-INC1] and are gross of management fees. The performance will be reduced by the impact of management fees paid, the amount of which varies. **Benchmark:** Eurostat Harmonised Index of Consumer Prices (EUR). Inception as at 30.09.11 **Holdings Source:** Setanta.

Historic Income

	Income Earned % of Fund Value
2011	6.2%
2012	5.6%
2013	5.5%
2014	4.8%
2015	5.5%
2016	4.7%
2017	4.1%
2018	3.9%
2019	4.2%

Top 10 Equity Holdings

COMPANY	SECTOR	% OF FUND
COCA-COLA AMATIL	CONSUMER STAPLES	2.4%
SAMPO OYJ	FINANCIALS	2.2%
RICHEMONT	CONSUMER DISCRETIONARY	2.1%
SVENSKA HANDELSBANKEN	FINANCIALS	2.0%
CISCO SYSTEMS	INFORMATION TECHNOLOGY	1.9%
UNILEVER	CONSUMER STAPLES	1.9%
SMITHS GROUP	ENERGY & MATERIALS	1.7%
ZARDOYA-OTIS	INDUSTRIALS	1.7%
SK TELECOM	INFRASTRUCTURE	1.7%
BASF AG	ENERGY & MATERIALS	1.7%

SETANTA Asset Management

Commentary

During the third quarter of the year, the world continued to deal with the consequences of the COVID-19 pandemic. Policymakers everywhere grappled to balance the effects of sharp reductions in economic activity with whatever leeway they could afford for budget deficits and monetary policy. Families and businesses altered their behaviour in some ways that would have been difficult to predict ahead of the facts. The pandemic seems to have accelerated some of the trends already well in train, such as digitalisation, e-commerce, and climate change awareness, while giving rise to others with uncertain future impact (for example, lower interest rates for longer, working from home, how people travel and broader changes in consumption patterns). Who would have thought that in the middle of one of the sharpest economic contractions ever, house prices in rich and middle income countries would grow at a 5% rate year over year[1] or that the S&P 500 would reach all-time highs, while the number of unemployed rose alarmingly, and large numbers of families had to resort to governments' assistance programs.

Financial markets appeared to find a nervous equilibrium in the generally improving economic conditions as they digested some of these changes noted above and looked ahead at second waves of COVID-19 contagions in the northern hemisphere's approaching winter, yet more Brexit negotiations and the prospect of an indeterminate US presidential election. Equity indices generally made small advances in the quarter, led by some of the more cyclical sectors. 'Fear' in the market, as measured by a number of implied volatility indices, remained relatively elevated[2]. The Fund fell slightly, -1.6%, over the period.

As readers will likely know, for some time the Fund has held a large position in cash. While at times of market weakness, we have often increased the Fund's exposure to equities (such as earlier this year as COVID-19 took hold) as a general rule, we have been, and remain, wary of exposing a large proportion of the Fund to equities, given its objective of preserving and growing capital (the other objective, of course, being income generation), while also sensing that a better opportunity might be around the corner. In acknowledging that such opportunities have been both few and fleeting, we have recently been considering other ways to improve the Fund's ability to meet its two objectives.

As such, during the past quarter we allocated roughly 15% of the Fund's assets, funded from cash, to a 'laddered' portfolio of bonds. The laddered portfolio of bonds consists of small holdings in approximately 30 bonds, broadly split between sovereign bonds; government-linked bonds; and corporate bonds. Sovereign bonds are those issued by governments; in the Fund's case, they include the likes of the Netherlands; Austria; and Slovenia. Government-linked bonds cover bonds of government agencies, which are typically explicitly or implicitly backed by governments or municipalities (e.g. for the Fund, the Basque Country, a highly autonomous, and one of the wealthiest, region(s) of Spain) or are government-owned entities (e.g. Deutsche Bahn, the German state railway company, also acquired for the Fund). The corporate bonds acquired by the Fund are all issued by companies in which Setanta has particular insights through in-depth research of the issuer; in many cases, the equity of the issuer is held in a Setanta mandate. Examples include a near-dated bond in Ryanair, which, notwithstanding the current challenging environment, we believe to have ample solvency and liquidity, and a long-dated bond in Berkshire-Hathaway, the company associated with Warren Buffett and Charlie Munger, famed as conservative stewards of capital.

All the bonds bear at least an investment grade rating (and all but one of those maturing beyond 2024 are rated at least 'A', one of the highest credit ratings). As they are all denominated in euro, there is no currency risk. The bonds' maturities range from 2021 to 2028, spread over that time, giving the portfolio its 'laddered' profile and reducing its overall duration risk (i.e. sensitivity to interest rate changes).

[1] Knight Frank Global House Price Index see link
[2] VIX average Q3 2020: 27%. VIX 10 year trailing average: 17%

Commentary

We believe that the portfolio improves the ability of the Fund to achieve its two objectives, while preserving flexibility to take advantage of other opportunities that might emerge (the ‘laddered’ nature of the portfolio means that a portion matures each year). While the overall contribution to the fund’s total return will likely be modest, we estimate that in a full year these bonds will contribute materially to the income generation of the fund (the bonds have a weighted-average coupon of just under 3.0%). Combined with the Fund’s existing bond holdings, which are typically held as larger weights reflecting their greater value potential, the Fund’s overall weight in bonds is now 25%.

Looking at some of the major equity performances this quarter, the Fund’s holdings in the IT sector are noteworthy. We have found fertile ground for stock picking in the less fashionable areas of IT (that is, not the so-called ‘FAANGs’). These include TSM, Samsung, Intel and Cisco, which we consider to be established incumbents in the provision of IT hardware. TSM, Samsung, and Intel are relatively capital intensive as they invest heavily in physical plant, while all four of the companies also invest materially in R&D to produce the next generation of IT hardware that powers computing and telecommunication advances. They have tremendously solid balance sheets and good track records of returns, and while subject to their respective product sales cycle, they've generally been able to grow revenues, profits and dividends over time.

Over the quarter however, two of these stocks, Intel and TSM, took two very different paths. **Intel** fell sharply on comments from its new CEO about its future manufacturing strategy, while the same piece of news seemed to reinforce the perception of **TSM** as a long term winner in the outsourcing of chip fabrication. This followed confirmation that Apple would replace Intel chips for its range of personal computers, which although marginal in terms of Intel's revenue was seen by some as indicative of Intel's waning market position.

We believe Intel remains a force within the industry, holding dominant market shares in both the growing server computer processing unit (CPU) market, and the more mature personal computer CPU market. It invests heavily in its current business and future growth applications such as autonomous driving, artificial intelligence, and quantum computing among others with one of the biggest capex and R&D budgets in the sector. The company's innovative designs, customer relationships and manufacturing expertise helped it achieve its current dominant position. We believe a multiple of 11x earnings and a dividend yield of 2.5% combined with substantial share repurchases undervalues the company.

As for TSM, its investments in the relentless pursuit of semiconductor fabrication excellence, customer focus, and the massive barriers to entry in scale manufacturing of cutting edge chips are paying off, as it pulls away from its peers. After the recent significant upward re-rating, it trades on a 2% dividend yield, with the likelihood of significant growth, as it continues to capture share of a growing market.

**All figures in euro, unless stated otherwise; fund performance stated gross of fees.*

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IMPORTANT INFORMATION

The Income Opportunities Fund is managed by Setanta Asset Management Limited and is a representative account of the Income Opportunities strategy. The performance shown is the performance of a representative account (ILA/CLI Income Opportunities Fund [P-INC1]). For this life assurance product, investors should refer to the relevant policy conditions available through Irish Life and via www.irishlife.ie. The strategy is also available on a segregated basis or a UCITS mutual Fund via Beresford Funds ICAV. 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' below.

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