

Setanta European Equity Fund (CAD)

Q2 2021

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

Equity markets continued their advance in the second quarter of 2021. While Q1 saw a trend towards "value" outperforming "growth" and cyclicals outperforming defensives, we witnessed something of a reversal in favour of growth names later in Q2. The market remained quite firmly in "risk-on" mode. A clear illustration of this is junk bond yields, which have been falling to record lows.

(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

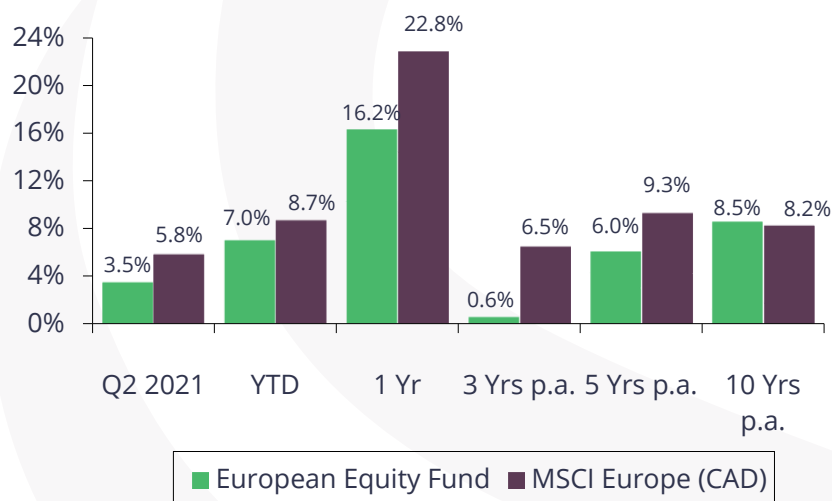
We consider scenarios rather than making forecasts

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 – 30.06.2021 (CAD)



Yearly Performance

Year %	2016	2017	2018	2019	2020
Fund	-0.8	15.3	-4.3	13.8	-7.8
Benchmark	-3.9	17.3	-7.2	17.5	3.5

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.

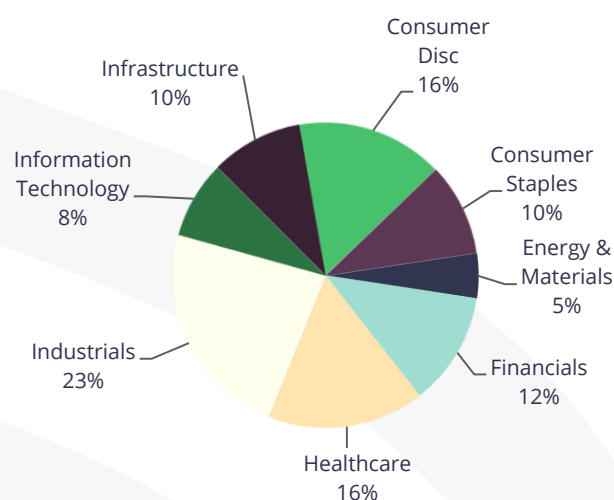
Top 10 Holdings

COMPANY	SECTOR	% OF FUND
CRH	INDUSTRIALS	6.7%
DCC	INDUSTRIALS	6.6%
GPE BRUXELLES LAMBERT	FINANCIALS	6.1%
ERICSSON	INFORMATION TECHNOLOGY	5.1%
DIAGEO	CONSUMER STAPLES	4.9%
GLAXOSMITHKLINE	HEALTHCARE	4.6%
SANOFI	HEALTHCARE	4.6%
NOVARTIS AG	HEALTHCARE	4.5%
LIBERTY GLOBAL PLC	CONSUMER DISCRETIONARY	4.2%
GEA GROUP AG	INDUSTRIALS	3.9%

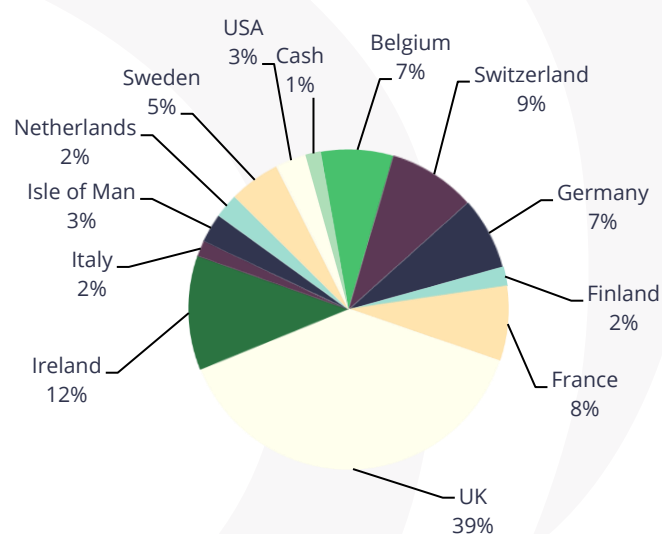
Fund Statistics

PRICE/BOOK	2.0
PRICE/EARNINGS RATIO (FY 1)	18.9
DIVIDEND YIELD %	1.9
AVERAGE MARKET CAP C\$BN	59.8
NO. OF HOLDINGS	30
ACTIVE SHARE RATIO %	90.0
DEBT/EQUITY %	75.1

Sector Distribution



Geographic Distribution



Barclays US Corporate High Yield Bond Index Yield to Worst, 2000-2021



Source: Bloomberg

What makes these levels even more striking is the concurrent degradation in credit standards. As Grant's Daily notes; "so-called covenant-lite structures featured in 85.2% of total loans outstanding in May, per S&P's LCD unit, up from about 66% five years ago and just 17% in 2007". Credit valuations at record highs in spite of record low credit protection. We think this backdrop is instructive about the pricing of risk more generally in financial markets.

Against this backdrop, the Setanta European Equity Fund lagged the MSCI Europe Index in the first six months of the year. It has been frustrating that our fund has been firmly out of favour during the past eighteen months in particular. It doesn't seem to us to be justified by fundamentals. The highly unusual nature of the pandemic induced recession in 2020 adversely impacted many holdings that had historically proven to be reasonably shock resistant. Now that these businesses are recovering, other more cyclical companies have been surmised to be greater beneficiaries of 2021's huge rebound in demand and bottleneck induced industrial price inflation. The coincident backdrop of valuation multiple inflation is also proving to be something of a headwind for our style. With a concentrated portfolio and active share in excess of 90%, a portfolio such as ours can easily lose a lot of ground against a benchmark quite quickly when some of its positions are out of favour. The converse is also true: the portfolio can gain a lot of ground quickly. We don't feel the need to change our approach and we hope that our patience, and yours, will be rewarded.

In the following paragraphs, we look at some of the main stock drivers of the fund's performance in the first half of 2021.

Booking Holdings and **Ryanair** have been laggards in the first half of 2021 as the effects of the pandemic continue to linger. The initial euphoria of having several successful vaccines has since receded somewhat as new variants of the virus provide new problems to deal with. Both businesses are particularly exposed to the European leisure travel customer and should benefit when planes are flying and hotels are being booked.



Commentary

We think leisure travel demand will return but it looks like there will still be bumps in the road in the journey to get back to full capacity. Both businesses are conservatively financed and we expect them to be aggressive when demand normalises.

In our Q1 report, we touched on the share price weakness in **Lancashire**, the specialist insurance company. To recap, last summer the company raised equity capital to fund an expansion in business, on foot of firming pricing across the industry. This backdrop remains favourable, and we think results could be very strong for the next few years. However, Lancashire's discipline in the face of the weak pricing environment of previous years meant that the company made little money from 2017 – 2020 so the stock remains a "show-me" story. We continue to see the potential for a re-rating as results begin to improve this year.

Melrose was also a drag on performance in the six months to June. It boasts an excellent track record in acquiring under-performing industrial / manufacturing businesses, improving them, and then selling at a higher valuation. However, its aerospace (in particular) and automotive exposure as well as financial leverage have weighed heavily on the share price since the pandemic's onset. Management has done a very good job with cost cutting and cash preservation. The H2 2020 profit performance and recent trading update were very reassuring, and the company is on course for meaningful recovery over the coming years. Profit margin targets for 2023 for the Automotive and Powder Metallurgy businesses have been retained while the goal for Aerospace has only been slightly lowered. The sale of the Nortek Air Management business for £2.6 billion has placed the balance sheet in a much stronger position and provides further evidence of management's ability to execute on its Buy, Sell, Improve model and deliver significant value creation for shareholders.

LSL, the UK property services company, delivered a very impressive set of results for 2020 against a tough backdrop. The Financial Services and Surveying businesses performed particularly strongly. The year ended well with large estate agency transaction backlogs and activity levels year to date have been very robust. The company is confident of delivering significant profit growth in 2021. We recently met with the new CEO, David Stewart, and were impressed with his plans to develop the business with a greater focus on Financial Services. There is potential for LSL to deliver strong results over the next few years.

DCC, the distributor of fuel, healthcare, and technology products, enjoyed a share price bounce in the first half. The company delivered an excellent 7% growth in operating profit (3% organic) in the year to March 2021 despite some Covid-19 related headwinds for elements of its business. Cash conversion was very strong and there was an upturn in Return on Capital Employed. A number of acquisitions, a source of significant value creation in the past, were completed in the past year. Investors seem somewhat concerned about the sustainability of the energy businesses. We think the fuel transition will take many years to play out and believe the management team, which has proven adept at adapting to changing circumstances, is fully capable of successfully managing the business through this period. Significant M&A optionality still exists given the strong balance sheet. The stock valuation remains very attractive in our view.

Diageo's shares benefited from a strong trading update for the year to June 2021, forecasting organic operating growth of at least 14% year-on-year. The underlying demand tailwinds of premiumisation and spirits taking share from beer and wine remain intact. The company has enjoyed particularly strong performance in the North American market where consumer demand has been very resilient. Europe has seen strong execution in the off-trade while the on-trade benefits from partial re-opening. Continued recovery is coming through in Africa, Asia Pacific and Latin America.



Commentary

Shares in **Swatch** and **EssilorLuxottica** continued to recover on expectations that business demand is in the process of normalising.

Transactions

There were no transactions during the second quarter

Concluding Remarks

On this side of the Atlantic, we are currently enjoying the European soccer championships. It is now 45 years since one of the most famous moments in the tournament's history. The 1976 final between West Germany and Czechoslovakia (the former now part of a unified Germany, the latter subsequently split into two countries) went to a penalty shoot-out to decide the winner. The chance fell to Antonin Panenka to seal the victory for Czechoslovakia. Conventional wisdom was that penalties should be struck to the corner of the net to evade the goalkeeper's reach. Panenka had other ideas and had been practising a new technique in training for some time. He ran up at pace but then chipped the ball very gently towards the centre of the goal. The German goalkeeper Sepp Maier, anticipating a shot low to his left, had already dived out of the way and the trophy was Czechoslovakia's. Soccer writer Ben Lyttleton commented on the subject. "Czechoslovakia was a Communist country, so doing something so creative and spontaneous, which felt impulsive and impudent was really counter to what the country's ethos was about. I spoke to Panenka about what would have happened if he'd missed that penalty. He said he spoke to some politicians afterwards and they said he would have spent 30 years underground, working in the mines". Panenka trusted in his practised technique to go against prevailing attitudes and this style of penalty kick bears his name to this day.

At Setanta, risk aversion is one of the key pillars of our approach. Our first thought when making an investment is what can go wrong. This feels like it runs against the prevailing speculative mood in markets over much of the last 15 months. There is a sense that investors are being complacent and not seeking compensation for risks that in reality are still present. We are remaining consistent in our approach and not letting current market attitudes to risk infect our thinking. We continue to believe that above average quality companies bought at a fair price and held for the long term can deliver excellent investment results.

David Byrne – Portfolio Manager



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