Setanta Global Equity Fund (CAD) – Q2 2018

Setanta
ASSET MANAGEMENT

Fund Description

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

The Fund is a diversified, actively managed equity portfolio. As bottom-up fundamental value investors, our research process is designed to properly understand how each business functions and to consider risks pertinent to the business. Securities are chosen by a team of global sector specialists, targeting sensible diversification across industries, geographies and market capitalizations. We value each business, with the priority to pay a price that mitigates downside risk. We aim to make investments for the long-term, all the while considering the available opportunity set.

Fund Commentary

While renewed talk of global trade wars and political uncertainty in Italy and Spain caused some very short lived bouts of volatility, the second quarter was a relatively calm period for markets. We can't tell when the next bout of market stress will occur but such times can be rewarding. Indiscriminate selling can allow us to buy into quality companies which were previously too expensive for our liking. Recent experience could lull one into a false sense of steadily rising equity markets being the norm. However, these times of stress happen more often than you'd think. Between 1980 and 2017, an exceptionally positive period for equities, the average intra-year drawdown for the S&P 500 was almost 14%. At a stock level, that volatility can obviously be much higher.

(Fund Commentary continued on Page 3)

Portfolio Managers

David Coyne & Sean Kenzie, CFA

Investment Principles

- We do not believe the market is efficient.
- We aim to make investments at a price below our assessment of intrinsic value.
- We make an investment in a business rather than trade securities.
- We believe risk is the possibility of permanent impairment of value.
- We make investments for the long term.
- We invest where we see value and are not afraid to be contrarian and swim against the tide.
- We don't make forecasts, we consider scenarios.
- We demand financial strength from the companies we invest in.
- We will act with integrity and communicate with our clients in a manner representative of our investment style.
- We have the humility to know we make mistakes and embrace the need to continue learning through both experience and study.

Irish Pensions AWARDS 2015 WINNER Equities Manager of the Year

Irish Pensions AWARDS 2016 WINNER Equities Manager of the Year

Irish Pensions AWARDS 2014 WINNER Equities manager of the year

Irish Pensions AWARDS 2013 WINNER Equities Manager of the Year

Irish Pensions AWARDS 2012 WINNER Equities Manager of the Year

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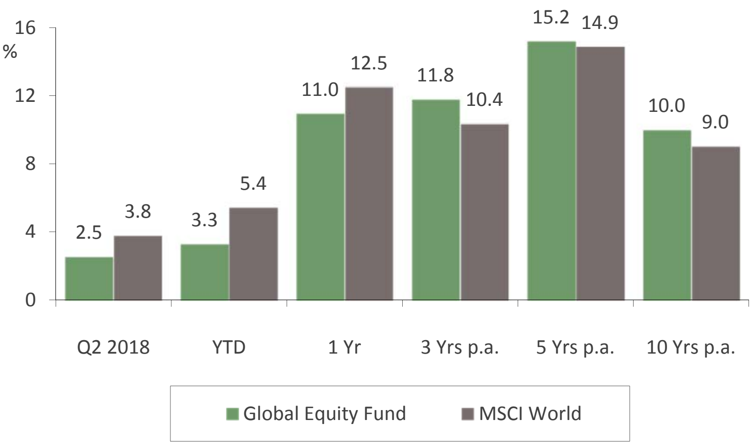
FUND PERFORMANCE – 30.06.18 (CAD)

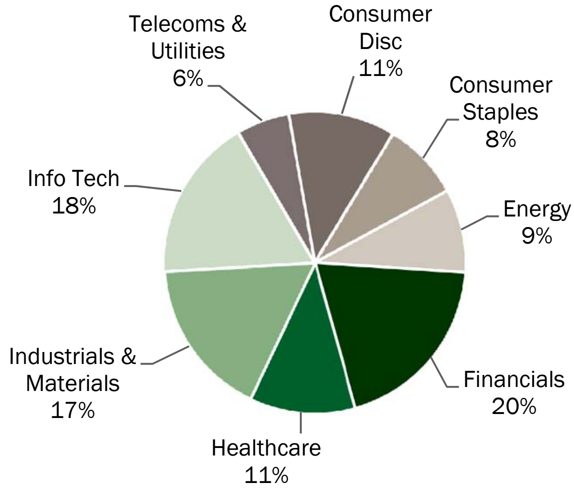


Performance Source: Unit prices: GWL. Returns are based on London Life Global Equity Account (S034 4.03), gross of management fees in CAD. Benchmark is MSCI World in CAD. The performance will be reduced by the impact of management fees paid, the amount of which varies. Fund Statistics Source: Bloomberg

FUND STATISTICS

PRICE/BOOK	2.0
PRICE/EARNINGS RATIO (FY 1)	16.3
DIVIDEND YIELD %	2.0
AVERAGE MARKET CAP C$BN	84.7
NO. OF HOLDINGS	89
ACTIVE SHARE %	87.5
DEBT/EQUITY %	53.3

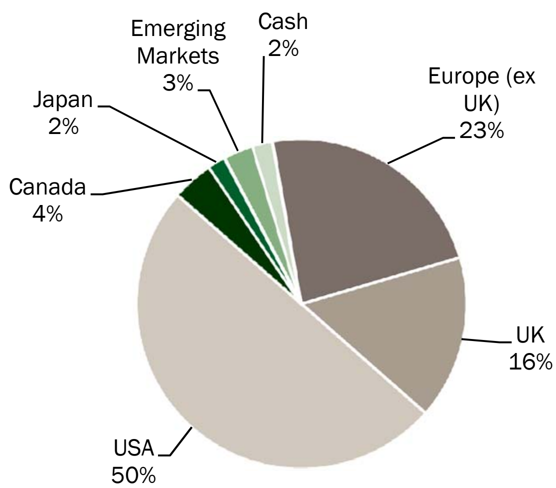
SECTOR DISTRIBUTION



TOP 10 HOLDINGS

COMPANY	SECTOR	% OF FUND
MICROSOFT	INFORMATION TECHNOLOGY	2.9%
DCC	INDUSTRIALS & MATERIALS	2.8%
BERKSHIRE HATHAWAY	FINANCIALS	2.7%
MELROSE INDUSTRIES	INDUSTRIALS & MATERIALS	2.5%
JEFFERIES FINANCIAL GROUP	FINANCIALS	2.5%
NIKE INC	CONSUMER DISCRETIONARY	2.4%
OWENS-ILLINOIS	INDUSTRIALS & MATERIALS	2.3%
OSHKOSH	INDUSTRIALS & MATERIALS	2.3%
CRH	INDUSTRIALS & MATERIALS	2.3%
FAIRFAX FINANCIAL	FINANCIALS	2.3%

GEOGRAPHIC DISTRIBUTION



YEARLY PERFORMANCE

Year %	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Fund	24.1	-7.4	-26.8	16.1	2.4	0.1	13.4	38.5	15.3	15.8	9.7	15.8
Benchmark	19.6	-7.5	-25.8	10.4	5.9	-3.2	13.3	35.2	14.4	18.9	3.8	14.4

Portfolio movements

There were a few significant stock moves in the quarter, both positive and negative. The fund lagged the benchmark by 1.3% in the quarter and for year to date was behind by 2.1%. We are happy with the fund's holdings by and large and are not unduly concerned by this short-term underperformance.

With the improved investor sentiment towards oil, it's perhaps no surprise that our energy holdings occupied the top performance slots**. Diamond Offshore, HollyFrontier, Occidental Petroleum** and **Imperial Oil** were up 30-50% in Q2. **Ericsson** was also up strongly (+29%) following results that suggest growth is returning after a number of difficult years; our purchase in Q3 2017 was timely. Also strong was **Nike**, which surged 30% in the quarter to a new high. Nike is a long-time portfolio holding and is up around seven-fold since first purchased in the summer of 2009.

Among the weaker performers were **Owens-Illinois** and **Federated Investors**, two of the larger weights in the fund, which were down 18% and 25% in the quarter (and 22% and 32% year-to-date) respectively (all Euro-terms). There was no material bad news on US-headquartered glass packager Owens-Illinois. Short-term investors probably latched on to the slight weakness in 'mega beer' sales (a limited exposure for O-I) as well as currency moves that will probably crimp O-I's near-term profits. To our surprise, O-I has gotten no credit from investors for achieving operational and financial improvements over the last 2+ years. We expect that continuing evidence of operational stability and improving cash flows will ultimately be rewarded with a re-rating of the shares.

US-based asset manager Federated invests almost $400bn across a diversified range of funds on behalf of clients. We like the fact that this is a financially strong, family-owned and -run business that is managed for the long term. In recent quarters it has suffered outflows from its 'flagship' equity fund, due to weak short-term investment performance, a reversal of big inflows into the fund in 2015/16 when performance was strong. The pace of outflows quickened in the latest quarter and this caused sell-side analysts to cut their future profit forecasts by 10-12% (i.e. a lot less than half the fall in the share price year-to-date).

Management recognises their sales efforts in the last few years were lopsided towards the flagship fund (this is being addressed). They continue to invest in the business and recently purchased a majority stake in UK-based Hermes Asset Management, the former in-house manager of the British Telecom pension scheme. This looks a particularly interesting move as Hermes is a specialist in socially responsible investing, an increasingly popular client choice. Federated is a very careful, infrequent acquirer, placing huge emphasis on cultural fit, so integration risk for Hermes is low. The headline valuation multiple of Federated is around 10x profits, a substantial discount to the market, indicating investors expect a continued decline in profits. While this might come to pass, we think the odds of a positive investment outcome 3-5+ years from here are high.

Finally to **Symantec** where in May it emerged that a whistle-blower had accused the company of accounting irregularities. The timing was very unfortunate for us as we were in the process of selling out our remaining holding (to fund the purchase of Playtech). The stock fell over 30% and has languished since. Symantec is carrying out an investigation into the matter and until then investors are operating in an information vacuum. At the current share price we have decided to hold on.

Transactions

Portfolio activity during the quarter was on the light side of normal, with one purchase and one sale.

In the IT sector we purchased **Playtech**, the largest global provider of software and gaming content to the online gambling industry. Its business model is to provide content and IT infrastructure to online gambling operators and in return they receive a percentage of the gross gaming revenue generated by the operator. With online gambling penetration continuing to increase and more and more global markets regulating online gambling, Playtech is in a prime position to benefit from these structural tailwinds. Its healthy balance sheet, strong dividend and attractive valuation all combined to warrant an initial investment in this market leading company.

Kennametal was sold out during Q2, although in reality it was a tiny position in the end (just 0.14% at end Q1:18), having been sold down from a c.1% fund weight over the previous year as we took advantage of a very strong share price. Kennametal is one of three dominant global companies selling carbide cutting tools used in a variety of 'heavy' industries. We first purchased it in 2012, which was not ideal timing as Kennametal's oil and mining customers were hit hard by the collapse in commodity prices from 2013. This led to a sharp fall in Kennametal's profits and by early 2016 the share price halved from our initial purchase level. We were always aware that Kennametal was a cyclical company, but most importantly it had a sound balance sheet to ride out the weak demand environment, which gave us confidence to hold on (and in fact double-down our ownership) in expectation of better times. Our patience was ultimately rewarded as the share price rapidly recovered in 2016 and 2017, peaking at twice our initial purchase price. This is a good example of how sound businesses can overcome unexpected, temporary difficulties.

Stepping back a little, we were originally attracted to the Kennametal business model because 80% of its products are consumable and the industry was consolidated. Kennametal's customer base has a relentless drive for productivity increases, which supports demand growth of 3x GDP in an upcycle. Kennametal's products comprise a negligible portion of their customers' component costs, but can impact up to 40% of their cost of operations via time savings, machine usage, tool changeover and breakdown time.

While Kennametal was able to demonstrate material improvement in the financial metrics investors focus on, particularly in margin and returns improvements over a cycle, we had a deeper concern that management was overly focusing on cost reductions and reducing R&D. The cash flow savings were invested in non-adjacent industrial support and service businesses in an attempt to reduce Kennametal's business cyclicality. The stock market has cheered them on (for now).

We watched as its two main competitors Sandvik and Iscaar followed a different path of innovation, based around the idea that their businesses existed as a productivity driver for their customers. They invested heavily in R&D, which has allowed them slowly take market share from Kennametal and ultimately achieve far greater pricing power by focusing on the tangible value they create for the customer. For us theirs is a superior long term strategy and is ultimately why we sold out of Kennametal.

The fund currently owns 89 stocks. Including a couple of spin-outs of existing holdings, 70% (both by number and weight) of the current portfolio has been held for 5 years or more. The corresponding figure for stocks held for 10 years or more is 30%.

Setanta 1: Big Data 0 (with a tip of the hat to the on-going soccer World Cup)

In last quarter's report we highlighted an investment proposition that we had considered but decided not to pursue. To refresh readers, the company in question was Sigma Pharmaceutical, one of the big three drug distributors in Australia. We discussed how the stock screened as attractive based on a variety of quantitative measures (step forward, Big Data) but we decided against pursuing it based on qualitative risk factors that we felt were troubling, including the potential for a substantial contraction in profits should Sigma lose its largest customer; a possibility that looked very real to us. In the first week of July, that reality came to pass when management confirmed that the customer in question was not renewing its contract. The share price has fallen by 50% from the level at which we reviewed the investment case; a decline more or less in line with the contraction in profit now expected by management as a result of the contract loss. This case reinforces the critical importance of the qualitative analysis of a business, particularly with respect to risk.

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