Setanta Global Focus Fund
Q2 2019

Fund Description

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

The Fund is an actively managed equity portfolio which holds c.20 global stocks. 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. Stocks are chosen through bottom-up analysis, based on investment merit. Due to the Fund's concentrated nature, investments require an even greater than normal margin of safety. The Fund can hold up to 30% cash where investments of sufficient quality cannot be found. Rather than focusing on the historic level of volatility of an asset, the portfolio managers regard the probability of permanent impairment of capital as the most relevant measure of risk. In doing so, they seek to maximise downside protection by understanding the risks posed by the valuation, financial, and operational characteristics of the asset.

Fund Commentary

Is it 1999 all over again?

As regular readers will know, we are not macro investors, but neither do we operate in a bubble without regard for the mood of 'Mr. Market' (the personification of the average investor, as described by legendary investor Ben Graham).

(Fund Commentary continued on Page 3)

Portfolio Managers

David Coyne & Rowan Smith

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

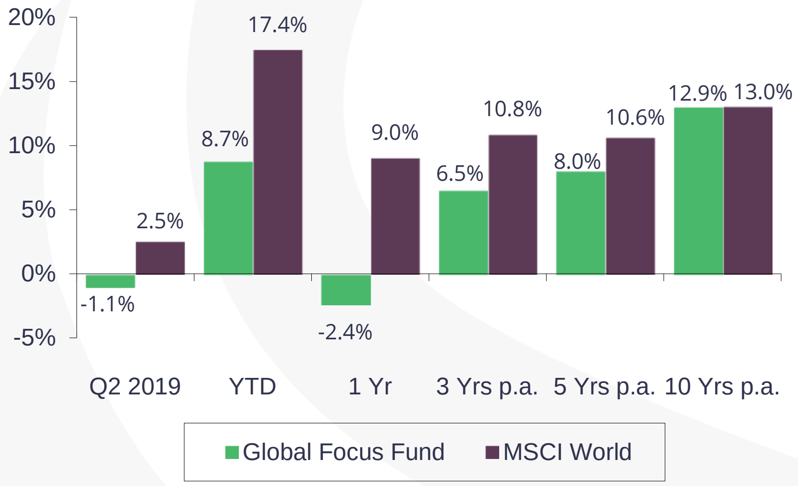
We consider scenarios rather than making forecasts

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 – 30.06.19



Performance Source: Setanta Asset Management Limited. Benchmark: MSCI World. The Fund returns stated are based on the movements in the unit prices of a representative account, based on mid to mid prices, and are gross of management fees. The performance will be reduced by the impact of management fees paid, the amount of which varies. **Holdings Source:** Setanta. Sector allocations based on invested portfolio only (excludes cash). **Fund Statistics Source:** Bloomberg

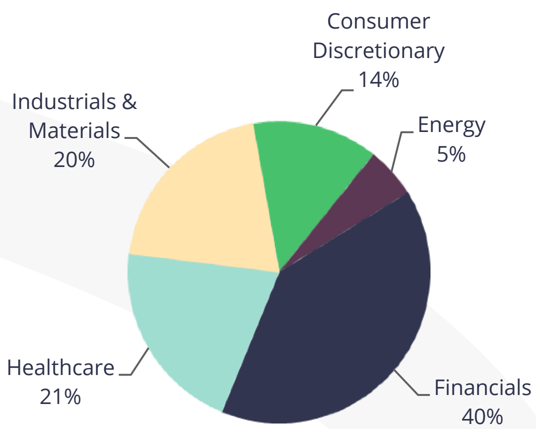
Top 10 Holdings

COMPANY	SECTOR	% OF FUND
BERKSHIRE HATHAWAY	FINANCIALS	8.8%
STERIS PLC	HEALTHCARE	8.3%
DCC	INDUSTRIALS & MATERIALS	7.5%
MINCON GROUP	INDUSTRIALS & MATERIALS	7.3%
JOHNSON & JOHNSON	HEALTHCARE	6.4%
LANCASHIRE HOLDINGS	FINANCIALS	6.2%
LSL PROPERTY SERVICES	FINANCIALS	6.0%
RICHEMONT	CONSUMER DISCRETIONARY	5.8%
FAIRFAX FINANCIAL	FINANCIALS	5.4%
RYANAIR	CONSUMER DISCRETIONARY	4.7%

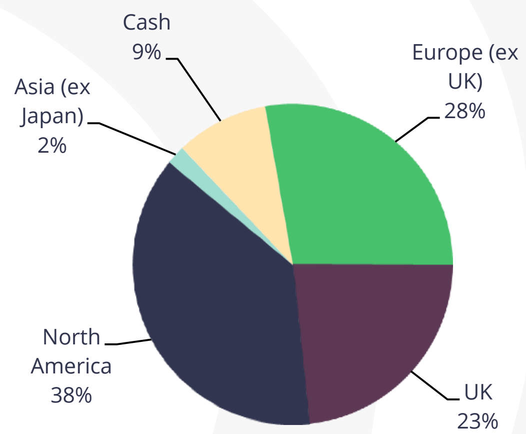
Fund Statistics

PRICE/BOOK	1.5
PRICE/EARNINGS RATIO (FY 1)	15.7
DIVIDEND YIELD %	1.9
AVERAGE MARKET CAP € BN	49.2
NO. OF HOLDINGS	19
DEBT /EQUITY %	37.4
ACTIVE SHARE %	93.7

Sector Distribution



Geographic Distribution



Yearly Performance

Year %	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Fund	17.0	-2.7	-35.2	44.0	28.2	1.5	9.0	20.0	19.1	7.3	11.7	9.7	-6.4
Benchmark	7.4	-1.7	-37.6	25.9	19.5	-2.4	14.1	21.2	19.5	10.4	10.7	7.5	-4.1

SETANTA Asset Management

Anecdotally it appears to us that investors' willingness to accept higher risks for lower expected returns has increased and should give the cautious investor give pause for thought.

Stock markets are at all-time highs. As measured by the MSCI World Total Return in Euro (our benchmark), equities have risen around 15% per annum compound since their March-2009 low. It seems crazy to think that had you perfect foresight of the coming Global Financial Crisis in June 2007 and sold out of equities, you would have missed out on a very respectable compound return of 6% per annum through a buy-and-hold strategy in the 12 years since then.

When stock markets go up by more than their profits, the result is multiple expansion. This has been a feature of the last decade. Arguably the least biased valuation measure is the Cyclically-Adjusted P/E (aka the "Shiller P/E"), which is based on average inflation-adjusted earnings from the previous 10 years. The current Shiller P/E for the US stock market is 30x, a level that has only been higher during the technology bubble between 1997 and 2001 (peaking at 44x in 2000). We can argue the toss what the *correct* US Shiller P/E should be. To take two yardsticks, the average over the last c.150 years is 17x and the average over the last 10 years is 25x. "On the expensive side" is a fair-to-understated summary.

One-quarter of all issued sovereign debt globally has a negative yield, according to Bloomberg. Issuers with less than stellar credit histories are doing a brisk trade. Less than four years ago Greece was an *enfant terrible* of the sovereign bond world and its 10-year bonds were yielding more than 18%. In March this year, the Greek state issued a 10-year bond with a 3.9% coupon. At the time of writing that same bond was yielding 2% (unbelievably, the same as US Treasuries). All being equal, low interest rates can justify higher equity market valuations, but things aren't always equal. For example, zombie companies are more likely to be kept alive by low interest rates, resulting in more competition for customers, lower corporate profit margins and consequently a structurally lower stock market valuation. This broadly describes the Japanese economy and stock market over the last few decades.

Parts of the IPO market appear frenzied, particularly so-called 'disruptor' companies. A noteworthy example is Beyond Meat, the maker of plant-based protein foods that taste like meat. It listed in early May and 'popped' 163% on its first day of trading; by the end of the quarter it had risen by 544%. With a market cap of $9bn, the stock trades on 78x the $115m of revenues it made in the year to March 2019, off which it made a $30m net loss. Naturally, it is expected that Beyond Meat will grow, as customers look for healthier and more environmentally friendly alternatives to real meat. The questions are: how fast and how profitably. *Very* is the market's current response (notwithstanding the likelihood it will face many current and future competitors). Overall the IPO market looks less frothy than in 1999/2000 and we've seen estimates of 200 IPOs and $70bn in capital raised expected in 2019, which compares to 486 and $92bn respectively in 1999. That said, the current rush to float is being at least partly driven by memories of the Q4:18 stock market sell off, when appetite for IPOs suddenly dried up.

If your local stock broker didn't get you an allocation to your favourite IPO, perhaps not all is lost. A recent Financial Times article highlighted how stocks with similar names or ticker symbols, are seemingly being bought in error by people desperate for a piece of the action. A recent example was Zoom Video Communications, the $20-odd billion company that listed in April (first day pop +74%). At the same time, volume of shares traded in Zoom Technologies, a tiny $5 million market cap company which has been listed since the early '90s, were four times the norm and the share price doubled. It reminds us of a local story from the height of the 2000 bubble, when a frantic private client called his broker saying "Get me shares in Mountain High". His broker replied "Hmm, I've never heard of a company called Mountain High. Do you mean Riverdeep (a hot Irish media IPO)?" Client: "Yeah, whatever. Just buy it".

Commentary

Private equity groups are aggressively competing with each other to invest the $2.5 trillion of 'dry powder' they have available to make acquisitions, a record amount and double what they had at their disposal in 2007/08, according to data provider Prequin. Not only are valuations paid rising but, according to S&P Global Market Intelligence, more than 50% of private equity buyouts are now financed with recorded Debt-to-EBITDA greater than 6x, eclipsing levels see in 2007. Some industry veterans warn that the above statistic doesn't fully reflect the true leverage ratios due to the current pervasive use of "adjusted EBITDA" numbers, which can account for 30% or more of regular EBITDA (itself a construct of the private equity world).

We are finding today's market difficult to navigate. Quality established companies, which have proved a rich hunting ground for Setanta portfolios in the past, have in many cases substantially re-rated and are too expensive for our tastes. However, as will be outlined below, there are pockets of opportunity.

Performance Review

As of end 2018 the Fund had participated pretty well in market strength, out-performing during the preceding ten year bull market. In light of these market conditions and the Fund's relatively conservative positioning (cash weighting in the 10%+ region; low levels of financial leverage; low exposure to long-duration growth companies which are often very sensitive to interest rates) the performance of the Fund was reasonably satisfying. Investments in Granite Real Estate, Steris Plc, Berkshire Hathaway, Johnson & Johnson and Markel worked out as hoped. The Fund remains invested in the latter four companies.

There were two particularly disappointing investments in this period. Tesco, since sold, fell victim to adverse developments on both the demand- and supply-side of its industry with new competitors, sticky industry capacity, and shifting consumer behaviour combining to erode what had been strong economic fundamentals at the company. Diamond Offshore, the offshore drilling contractor in which the fund remains invested, has been severely impacted by significant overcapacity in its industry, brought about by the growth in shale oil and the corresponding decline in the oil price. We feel extremely disappointed with the result of our investment in Diamond in particular. However as at the end of 2018, the "winners" had more than offset these detractors since the beginning of the bull market in 2009.

The relative performance of the fund in the first half of 2019 has been very disappointing. In Euro terms, the MSCI World Index advanced by 17.4% in the period, versus 8.7% for the Global Focus Fund. In such periods of acute market strength our funds tend to lag, given our conservative disposition. Against such a background, some of our holdings have produced a negative return this year and remain out of favour despite little or no change in the underlying business environment for these companies. Ryanair's share price declined in the first half, and has now halved in little more than a year, as industry overcapacity impacts near-term results, and Brexit worries loom. We don't think the long-term prospects for the business have changed that much and believe the stock is undervalued currently. LSL property Services, the UK estate Agency and Property Surveying business has achieved admirable business results against a tough market backdrop characterised by a soft UK housing market and rising online competition. Brexit worries are overhanging here too. The stock is trading on under ten times our estimate of earnings, the dividend yield is 5% and we believe the stock is neglected and undervalued. The share price of Melrose Plc, the industrial holding company, has suffered from concerns about its exposure to the weakening automobile production cycle, to which it acquired exposure as a result of its acquisition of GKN in 2018. We believe there are discrete opportunities to improve the profitability of GKN that can help offset the negative effects of an industry downturn and we don't believe these opportunities are reflected in Melrose's share price.

So while relative performance has been poor so far this year, we believe that the portfolio is in reasonably good condition and we are hopeful that the performance deficit can be recouped.

To all of our investors: thank you for your support as we continue to work diligently to manage your capital.

David Coyne & Rowan Smith – Portfolio Managers

Contact Details:

Setanta Asset Management Limited,
Beresford Court,
Beresford Place, Dublin 1, Ireland.

Brendan Moran, Tel: + 353 1 612 4962
Email: brendan.moran@setanta-asset.com
www.setanta-asset.com