Setanta EAFE Equity Strategy (USD)

September 2020

Strategy Description

The **EAFE Equity Strategy** ('the Strategy') is managed by Setanta Asset Management Limited ("Setanta"). The Strategy is available to US Investors on a separate account basis.

The Strategy is an actively managed equity portfolio, with a long-term investment horizon. Our aim is to invest in EAFE (Europe, Asia and Far East) companies that are trading below their intrinsic value. Our investment process seeks to invest in companies that exhibit a combination of low financial risk, low operational risk and low valuation risk.

We believe that if we can invest in companies that possesses these characteristics then we can reduce the risk of a permanent loss of capital and enhance our chances of outperforming our benchmark over the long term. The investment objective of the Strategy is to outperform the MSCI EAFE index over the long term.

Investment Philosophy

We in Setanta do not believe the market is efficient. Our aim is to purchase and own assets at a price below a reasonable assessment of their worth. This is where we focus our resources. Our process is akin to assessing a part ownership of a business rather than trading a security. This assessment of value must always encompass a thorough understanding of where this value is derived. We have a long term investment horizon and risk management is always central. We regard risk as the potential for permanent impairment of value. Integrity is a key tenet of our professional DNA and we embrace a culture of continued learning.

Portfolio Managers

Rowan Smith; Fergal Sarsfield, CFA & Conor Walshe

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

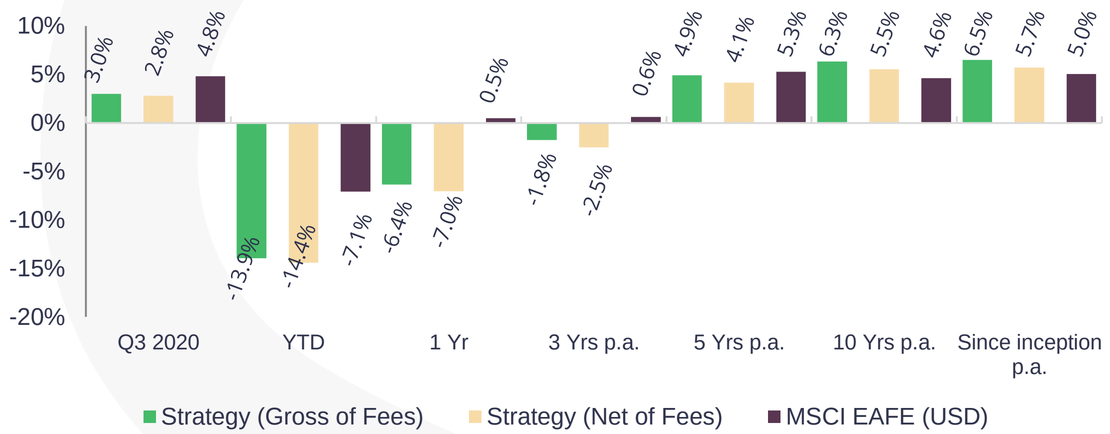
Businesses we own must have strong balance sheets

We make mistakes and always endeavour to learn from them

We will act with integrity in everything we do

Performance and Strategy data as at 30th September 2020

Strategy Performance (USD)



Yearly Performance (USD)

	2015	2016	2017	2018	2019
Strategy (Gross of Fees)	4.4%	10.8%	24.9%	-10.7%	19.1%
Strategy (Net of Fees)	3.6%	10.0%	24.0%	-11.4%	18.2%
MSCI EAFE (USD)	-0.8%	1.0%	25.0%	-13.8%	22.0%

Portfolio Valuation Statistics

PRICE/BOOK	1.4
PRICE/EARNINGS RATIO (FY 1)	17.1
DIVIDEND YIELD %	3.2
AVERAGE MARKET CAP $BN	37.8
NO. OF HOLDINGS	34
DEBT/EQUITY %	62.5
ACTIVE SHARE %	90.5

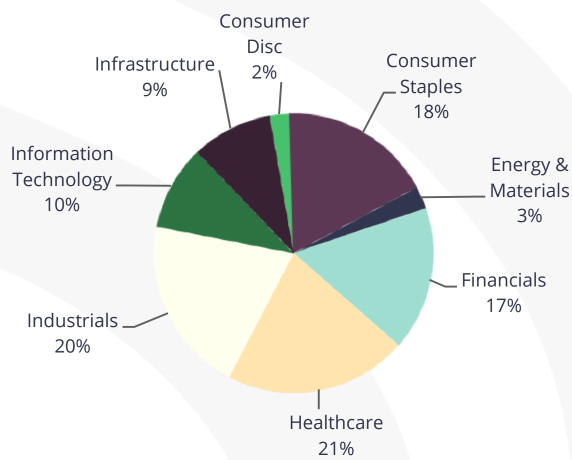
Top 10 Holdings

COMPANY	SECTOR	WEIGHT
GPE BRUXELLES LAMBERT	FINANCIALS	6.3%
DCC	INDUSTRIALS	6.2%
ALFRESA HOLDINGS	HEALTHCARE	5.0%
UNILEVER	CONSUMER STAPLES	4.5%
SAMSUNG ELECTRONIC	INFORMATION TECHNOLOGY	4.2%
COCA-COLA AMATIL	CONSUMER STAPLES	4.2%
ALCON AG	HEALTHCARE	4.1%
NOVARTIS AG	HEALTHCARE	3.7%
SANOFI	HEALTHCARE	3.5%
RYANAIR	INDUSTRIALS	3.4%

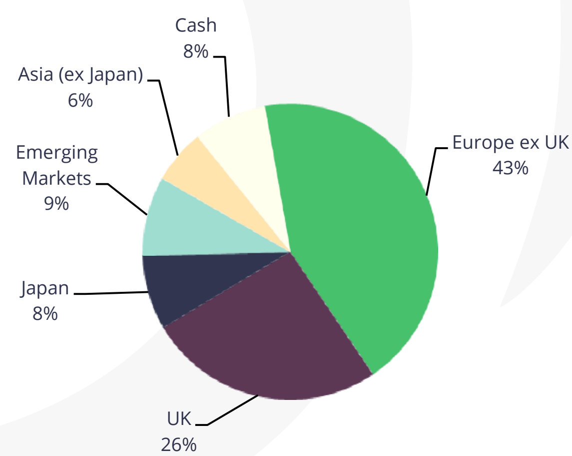
Holdings Source: Setanta. Sector allocations based on invested portfolio only (excludes cash), of the lead CAD account of the EAFE Equity Strategy. **Portfolio Valuation Statistics Source:** Bloomberg, based on the lead CAD account of the EAFE Equity Strategy, shown in USD.

Performance Source: Setanta Asset Management Limited. The returns stated are based on the movements in the unit prices of the lead CAD portfolio of the EAFE Equity Strategy, which has been converted to USD at FX rate 0.7486431. The gross performance will be reduced by the impact of management fees paid, the amount of which varies. Net of Fees performance is calculated based on an AMC of 0.75%, which is based on a minimum portfolio size of USD25m. Inception date: January 2004. **Benchmark:** MSCI EAFE (USD).

Sector Distribution



Geographic Distribution



Strategy Commentary

The third quarter saw a continuation of the recovery in equity markets seen in the previous quarter and unfortunately the Setanta EAFE Strategy was unable to keep pace. The outperformance of “growth” stocks versus “value” stocks was another recurring feature. While the EAFE 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 EAFE Growth Index was up 8.1% in US$ terms versus a gain of 3.2% for its Value counterpart. The difference is even starker when looking at the first nine months of the year with the MSCI EAFE Value Index underperforming by almost 20% 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 EAFE 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 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**, **Coca Cola Amatil**, **Ryanair** and **Thai Beverage** have been disproportionately impacted by the COVID-19 outbreak and offer good long-term growth prospects in a more normalised environment.

Strategy Commentary

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. 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 Strategy’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 two biggest detractors from performance were KDDI and DCC. Here we find two contrasting tales with respect to the investment cases.

Our initial investment in **KDDI** in Q1 2018 was predicated on an attractive market structure with three sizeable operators, muted price competition, limited impact from virtual operators and an ability to monetise increased data usage. The surprise resignation in late August of Shinzo Abe as Japanese prime minister has seen Yoshihide Suga rise to power. He has been very critical of high mobile tariffs in Japan in the past and re-iterated this stance on coming to power. This was swiftly followed by NTT, in which the Japanese government has a large stake, buying out minorities in its mobile subsidiary NTT Docomo which is the largest player in the market. The concern is that this deal is politically motivated to deliver price cuts with negative implications for industry profitability. We cut our position in KDDI following this news.

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 strategy benefited from strong performance by Ericsson and Coca Cola Amatil. **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. **Coca Cola Amatil’s** first half results were well received as the company delivered cost savings and good cash flow generation in the face of negative volume and mix trends. Further planned cost cuts were announced. Volume trends were improving in the second half as lock down restrictions eased.

The under-performance of the Setanta EAFE Strategy 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.

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IMPORTANT INFORMATION

The EAFE Equity Strategy is managed by Setanta Asset Management Limited. The performance shown is the performance of the lead CAD portfolio of the EAFE Equity Strategy. This account has the longest performance track record. The strategy is available on a separate account basis to institutional investors however 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' sections below.

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