

# Setanta EAFE Equity Fund (CAD)

Q4 2020

## Fund Description

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

The Fund is an actively managed equity portfolio which holds c.30-50 stocks in the European, Australasian and Far East regions. The portfolio is managed in accordance with the Setanta investment philosophy. 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 can hold up to 10% cash where investments of sufficient quality cannot be found.

The investment objective of the Fund is to outperform the MSCI EAFE benchmark over the long term.

## Fund Commentary

What an eventful year 2020 has been. We experienced the onset of the COVID-19 pandemic, the UK's protracted departure from the European Union and, the sharp collapse in global stock prices in March followed by an astounding recovery which saw the MSCI World Index return 67% from its lows.

*(Fund Commentary continued on Page 3)*

## 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

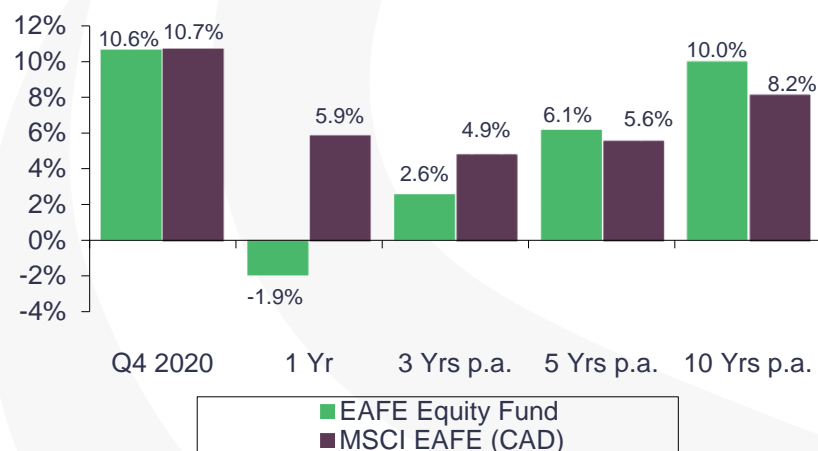
We consider scenarios rather than making forecasts

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

## Fund Performance – 31.12.2020 (CAD)



## Yearly Performance

Year %	2016	2017	2018	2019	2020
Fund	7.0	16.7	-2.7	13.1	-1.9
Benchmark	-2.5	16.8	-6.0	15.8	5.9

**Performance Source:** Setanta Asset Management Limited. The Fund returns stated are based on the movements in the unit prices of the CLA CA Managed EAFE Portfolio SF035 [IEC11007] 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 EAFE (CAD) **Holdings Source:** Setanta. Sector allocations based on invested portfolio only (excludes cash). **Fund Statistics Source:** Bloomberg.

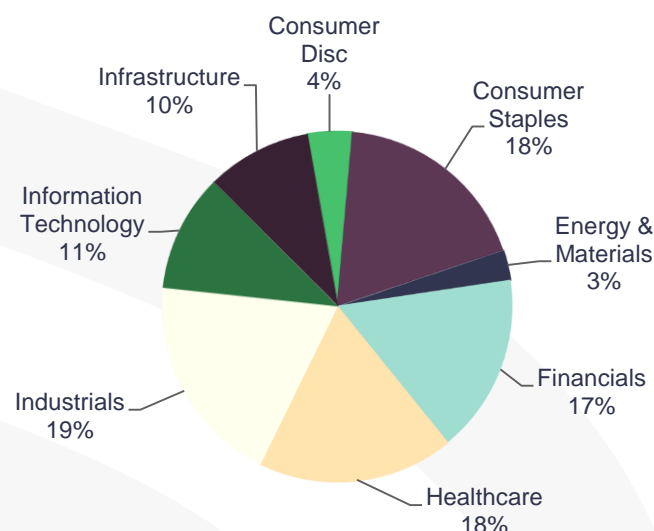
## Top 10 Holdings

COMPANY	SECTOR	% OF FUND
GPE BRUXELLES LAMBERT	FINANCIALS	6.4%
COCA-COLA AMATIL	CONSUMER STAPLES	6.1%
SAMSUNG ELECTRONIC	INFORMATION TECHNOLOGY	5.8%
DCC	INDUSTRIALS	4.9%
ALCON AG	HEALTHCARE	4.4%
UNILEVER PLC	CONSUMER STAPLES	4.1%
RYANAIR	INDUSTRIALS	4.0%
ALFRESA HOLDINGS	HEALTHCARE	3.9%
THAI BEVERAGE PCL	CONSUMER STAPLES	3.9%
NOVARTIS AG	HEALTHCARE	3.7%

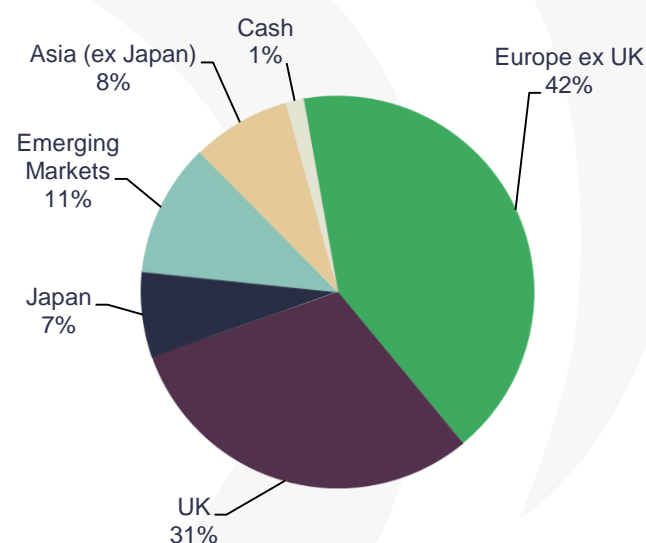
## Fund Statistics

PRICE/BOOK	1.7
PRICE/EARNINGS RATIO (FY 1)	15.7
DIVIDEND YIELD %	2.4
AVERAGE MARKET CAP C\$BN	59.4
NO. OF HOLDINGS	34
DEBT/EQUITY %	65.9
ACTIVE SHARE %	94.1

## Sector Distribution



## Geographic Distribution





# Commentary

Unfortunately 2020 was also a year in which we underperformed our benchmark. Our disciplined risk averse approach naturally steers us away from the high growth, high momentum segments of the market, those same segments which rebounded the strongest and led the charge as the MSCI EAFE benchmark returned +5.9% (CAD terms) for the year. We are clearly disappointed to have under-performed significantly in 2020, the EAFE Equity Fund generated returns of -1.9% (CAD terms) underperforming our benchmark by -7.8%, marking our worst one year relative return since the strategies inception. But we will remain disciplined and true to our philosophy and process that has served us and our clients very well over the longer term. We believe that this is the right course of action especially at a time when so many market participants have become ill-disciplined, are acting irrationally and chasing momentum.

## Snake Oil

In thinking about the current behaviour in markets I often wonder if there are aspects of today's market which are reminiscent of the late 19th century and the Snake Oil salesman? A phrase which often conjures up images of seedy profiteers trying to exploit an unsuspecting public by selling it fake cures. In Western movies, the Snake Oil salesman was a travelling doctor with dubious credentials, selling fake medicines with boisterous marketing hype and a shill who would often attest to the value of the product in an effort to provoke buying enthusiasm.

- › Can we draw parallels between the Snake Oil era and what we are seeing in markets today?
- › Do companies like QuantumScape and Nikola have dubious business models generating zero revenues and selling nothing but hope of an as yet unproven technology?
- › Are global central banks with their helicopter money and exploding balance sheets acting as a form of shill instilling a sense of confidence in society to spend and speculate indiscriminately, leading to strong demand for and increased momentum behind cryptocurrencies like Bitcoin, SPAC's and IPO's?

Global central banks have been acting in unison for a number of years trying to stimulate growth by keeping rates low and pumping money into the system. In the same way as the Snake Oil salesman's shill tried to stimulate sales through his miraculous recovery it can be argued that central banks whether intentionally or unintentionally are encouraging market participants to become more frivolous and less risk averse in their attitudes. This attitudinal change has acted as a catalyst for momentum investing where buying begets buying. Rising prices attract new buyers which in turn attracts further buyers leading to a decoupling from fundamentals which is very evident when decomposing equity market returns in 2020.

We haven't been able to gather data for the EAFE universe but we believe this data from Bernstein Research is representative of what has happened in EAFE markets. According to Bernstein Research the top 1,500 US companies returned 16.7% in 2020 with 25% of that return coming from multiple expansion and -6.6% coming from earnings growth. Drilling down even further into individual sectors it shows that the Technology sector returned 43.8% with 30% points coming from multiple expansion and 10.6% coming from earnings growth. We do recognise the impact lower rates for longer has on the multiples market participants are willing to pay for companies, especially companies with growth well into the future. Nonetheless it's difficult to fathom how any rational investor would be willing to pay 25% more for an asset over the space of one year, especially when the earnings growth for that asset has declined. If we couple that with the IPO market we can't help but feel that there is some level of irrationality at play in markets today. According to the WSJ, companies raised \$167.2bn through 454 IPO offerings in 2020 compared with the previous full year record of \$107.9bn in 1999.





# Commentary

So while equity markets in 2020 have not been kind to us or our clients we do feel strongly that our disciplined approach in seeking out quality companies that are trading at fair prices is the best long term strategy. We will not be buying any Snake Oil.

## 2020 Portfolio Review

The Setanta EAFE Equity Fund is a concentrated bottom up portfolio comprising of what we believe are mispriced high quality companies. For this reason we tend not to pay much attention to sector or geographic attribution. However, our risk averse nature naturally leads us to be mindful of our exposures to various different industry sectors and geographies and it also helps us explain our performance.

## Stock Attribution

Our top 5 positive contributors for 2020 were Samsung, Coca Cola Amatil, Ericsson, Alcon and Ryanair.

- › Samsung with its market leading position in DRAM memory is a clear beneficiary of the growth in digitisation and cloud computing and with COVID-19 accelerating the trend for both it resulted in strong share price performance for Samsung in 2020.
- › Coca Cola Amatil as discussed further on in the report is the subject of a takeover bid.
- › Ericsson is benefitting from the launch of 5G as well as reduced competition due to government restrictions on Huawei and poor execution by Nokia.
- › Ryanair has surprised us in 2020. 1) In a year in which travel related companies got hit hard, Ryanair initially sold off aggressively only to rebound even stronger. And 2) As the market leading low cost carrier with the strongest balance sheet we believe it is primed to come out of this crisis in an even stronger position.
- › Alcon is an extremely high quality company in a market which we believe is relatively immune to economic shocks. This has played out in 2020 and despite the stock initially selling off it rebounded strongly and finished the year +6.5% in local currency.

The 5 largest detractors to Fund performance in 2020 were Melrose, Merlin Properties, Bank of Ireland, DCC and Bank Leumi.

- › Melrose is in a tough spot at the moment with high debt levels post the acquisition of GKN and exposure to segments like Aerospace and Auto's which have been hit hard due to COVID-19. Hence the material underperformance of the shares. However we believe the balance sheet can be strengthened with the sale of Nortek Air which we hope will be completed in 2021 and there is a strong management team in place who are good stewards of capital.
- › Merlin Properties is no longer a portfolio holding. It was sold at a steep loss in Q3 as we believe that the longer term consequences of COVID-19 will have a material impact on the value of Merlin's property assets. Changing habits brought about by COVID-19 like increased working from home and accelerated growth of ecommerce are not conducive to a company with almost 70% of its assets in commercial and retail real estate.



# Commentary

- › The market is presently unsure of how DCC will navigate the pending energy transition from fossil fuels to greener technologies over the coming years. This has led to downward pressure on the share price but from our perspective we continue to see DCC deploy capital in areas where they can generate mid double digit returns and believe the market may be overestimating the impact energy transition will have on their business.
- › Bank of Ireland and Bank Leumi are both primarily domestic banks with strong market positions in their respective markets. Banks have remained in the value camp for the past few years and as 2020 saw the largest divergence between growth and value both banks materially underperformed. The prospect of increased loan impairments, lower interest rates for longer and slower loan growth due to COVID-19 provided a tough backdrop for bank shares in 2020. They both have strong brands and are investing to ensure they remain strong in the midst of increased competition from neo banks and the growth in digital banking.

As mentioned, sector and geographical exposure are outputs of our bottom up stock picking Fund but we highlight below some of the more pertinent areas which have impacted performance over the past year.

- › Our largest sector overweight is in Healthcare, a sector which performed strongly relative to the MSCI EAFE benchmark (+4% relative). However stock specific issues at Alfrexa and GlaxoSmithKline impacted our performance in this sector. Both businesses, normally resilient in the face of a recession, have been adversely impacted by the unique profile of the COVID recession. However, we see these pressures as temporary.
- › Energy is our lowest sector weight with only one company, ENI, making up 0.9% of the Fund. Energy was also the sector which underperformed the most relative to the MSCI EAFE benchmark so this was a marginal positive for the year.
- › Industrials also performed strongly (+3% relative to the benchmark). However, as mentioned above, Melrose and DCC meant we didn't fair out so well.
- › Geographically speaking our largest underweights, Japan and Germany were two of the stronger performing markets which didn't help us throughout the year. We are actively looking for companies in both markets but we are yet to find a company to add to our existing investments in these countries.
- › Unfortunately the UK was one of the weakest performers in 2020 and it's also a market in which we have been materially overweight (+10% relative) for quite some time. We believe we own high quality UK domiciled companies that are presently mispriced and we expect that over time these companies will perform strongly for us.

## Portfolio Activity in Q4 2020

There was some minor portfolio activity during Q4 where we added marginally to some companies as well as trimming back others. Of more significance is our new position in Adidas as well as the proposed acquisition of portfolio company Coca Cola Amatil by Coca Cola European Partners.

We have built up our knowledge base of Adidas over the past 10 years. It also forms approximately 20% of the NAV of another portfolio company, Groupe Bruxelles Lambert. It has become apparent to us that the sports footwear/apparel market is increasingly becoming a duopoly where the two largest players, Nike and Adidas continue to take share in a growing market and where their scale allows them to dominate branding for major sports teams and stars across many different codes. This makes it very difficult for competition to enter and gain a foothold.



# Commentary

On top of this, the route to market is also changing with the COVID-19 pandemic bringing forward digitisation and large branded goods companies now going direct to consumer. We believe this direct to consumer model can help improve profitability as well as improving operational efficiency and inventory management.

Coca Cola Amatil has been a portfolio holding since January 2018. In October 2020 Coca Cola European Partners offered to buy Coca Cola Amatil in a deal worth A\$12.75 per share for ordinary shareholders. We are of the opinion that A\$12.75 undervalues Amatil and as one of their larger shareholders we have been in ongoing discussions with the board and their investment bankers in relation to achieving a higher price for shareholders. We believe CCEP are being very opportunistic attempting to acquire a high quality asset at a time when the share price is depressed due to COVID-19 and earnings are at an unsustainably low level.





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## IMPORTANT INFORMATION

The EAFE Equity Fund is managed by Setanta Asset Management Limited and is a representative account of the EAFE Equity strategy. The performance shown is the performance of a representative account (CLA CA Managed EAFE Portfolio SF035 [IEC11007]). 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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