Setanta Global Equity Strategy (USD)
December 2020

Strategy Description

The **Global 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 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.

Strategy Commentary

Investment markets in 2020 were as dramatic, surprising and confusing as any of us at Setanta have experienced in our careers. Despite the dire macro environment that readers are all too aware of, the world stock market rose 15.9% in USD terms in 2020.

The Global Equity Strategy returned 5.4% (USD Terms; Gross of Fees) over the same period, a 10.5% relative underperformance in the year and a frustrating outcome given that we have tended to profit from adversity in the past.

(Strategy Commentary continued on Page 3)

Portfolio Managers

David Coyne & Sean Kenzie, 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

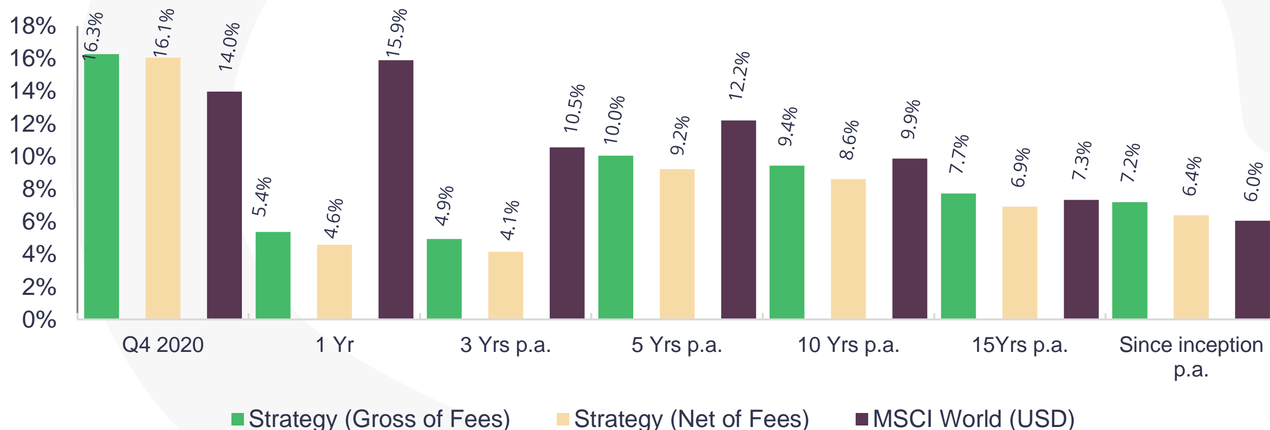
Businesses we own must have strong balance sheets

We make mistakes and always endeavour to learn from them

We will act with integrity in everything we do

Performance and Strategy data as at 31st December 2020

Strategy Performance (USD)



Yearly Performance (USD)

	2016	2017	2018	2019	2020
Strategy (Gross of Fees)	12.8%	23.8%	-8.5%	19.8%	5.4%
Strategy (Net of Fees)	12.0%	22.9%	-9.1%	18.9%	4.6%
MSCI World (USD)	7.5%	22.4%	-8.7%	27.7%	15.9%

Portfolio Valuation Statistics

PRICE/BOOK	2.0
PRICE/EARNINGS RATIO (FY 1)	18.0
DIVIDEND YIELD %	1.6
AVERAGE MARKET CAP $BN	107.9
NO. OF HOLDINGS	84
ACTIVE SHARE %	86.5
DEBT/EQUITY %	66.9

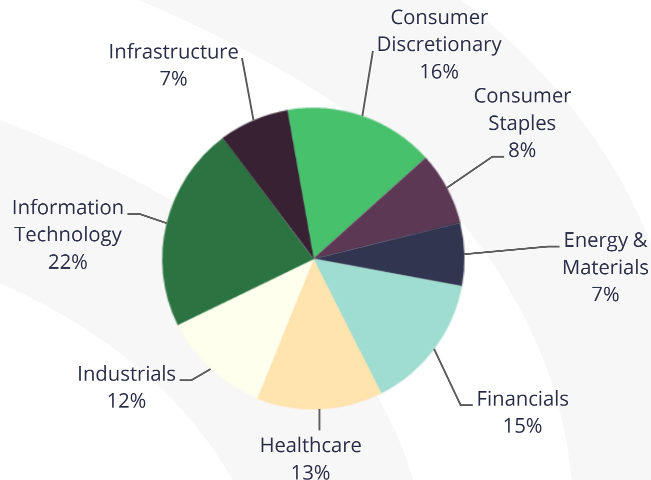
Top 10 Holdings

COMPANY	SECTOR	WEIGHT
MICROSOFT CORP	INFORMATION TECHNOLOGY	4.2%
BERKSHIRE HATHAWAY	FINANCIALS	2.7%
SAMSUNG ELECTRONIC	INFORMATION TECHNOLOGY	2.7%
MCDONALD'S CORP	CONSUMER DISCRETIONARY	2.6%
ERICSSON	INFORMATION TECHNOLOGY	2.4%
NIKE INC	CONSUMER DISCRETIONARY	2.3%
ALPHABET INC	CONSUMER DISCRETIONARY	2.3%
ORACLE CORP	INFORMATION TECHNOLOGY	2.3%
JOHNSON & JOHNSON	HEALTHCARE	2.3%
BOOKING HOLDINGS	CONSUMER DISCRETIONARY	2.3%

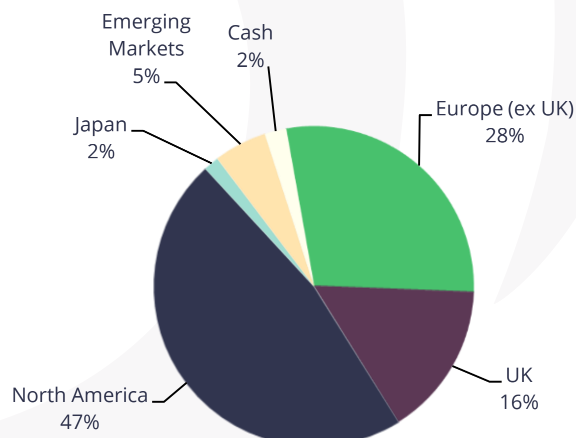
Holdings Source: Setanta. Sector allocations based on invested portfolio only (excludes cash), of the lead Euro account of the Global Equity Strategy. **Portfolio Valuation Statistics Source:** Bloomberg, based on the lead Euro account of the Global Equity Strategy, shown in USD.

Performance Source: Setanta Asset Management Limited. The returns stated are based on the movements in the unit prices of the lead Euro portfolio of the Global Equity Strategy, which has been converted to USD at FX rate 1.22355. 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: December 2000. **Benchmark:** MSCI World (USD).

Sector Distribution



Geographic Distribution



SETANTA Asset Management

Commentary

The year ended on a more positive note with the strategy outperforming by 2.3% (USD Terms; Gross of Fees) in the fourth quarter.

Commentators have latched on to the term “K-shaped recovery” to describe how some businesses have suffered terribly as a result of the pandemic-induced lockdown, while at the same time a far smaller number thrived. In 2020 around 100 stocks in the MSCI World (out of 1,600) rose more than +50% in Euro terms, including an eye-popping +670% from cult stock Tesla. This relatively small cohort of “winners” skewed the overall index – consider that the average stock rose just 1% in 2020, while the median stock fell marginally (-0.5%). The Global Equity strategy owned none of the benchmark’s top 100 in 2020 and just two non-benchmark holdings that increased by more than 50% (Smiths Group +81%, purchased near its March low, and TSMC +77%). Clearly this was a major headwind for us.

The last two years have been extremely challenging. A cocktail of rock bottom interest rates and piqued animal spirits fuelled unbridled speculation in parts of the market (especially so-called disruptive technologies, a good many of which we think could turn out to be duds). The prolonged period of low interest rates lifted valuations generally, but especially the broader cohort of higher growth companies, to which the strategy has been underexposed. Conversely, our value tilt fared relatively poorly as the value-growth differential reached an extreme. Somewhat related, we think we were dealt an unlucky hand by the pandemic, as businesses that could be expected to hold up well in a variety of weak economic environments were hit hard. For example: Sysco the dominant US distributor of foods to the restaurant industry (-18% in Euro, 2020); alcoholic beverage companies Heineken and C&C group which make higher margins in on-trade than off-trade (-9% and -47% respectively); UK pub-restaurant chain J.D. Wetherspoon which was shut for most of the year (-36%); French pharmaceutical Sanofi whose travel vaccine business was severely impacted (-9%); and Saga which saw a normally reliable demand for its cruise and travel services to the over-50s shut off (-67%).

We want to reassure you that we are working hard to remain clear-headed and to address strategy underperformance. Most importantly we still believe that our investment fundamentals (highly selective; risk averse; long term; valuation focussed) is fit for purpose. We think the underperformance in the last two years is largely a function of the market’s irrationality for a certain investment type and that our discipline will be proven out in time.

We think the value-growth elastic band is reaching its snapping point. Recent research suggests that on some measures value stocks are as cheap relative to growth as they have been in 100 years. While Setanta is not a “classic value” manager, we are pretty certain that even a partial unwind of this valuation discrepancy will benefit the strategy’s relative performance. The timing and magnitude of this can only be guessed at, but things could turn quickly in our favour – especially so for our COVID-affected holdings, which we guesstimate at around a quarter of the portfolio. Economies will reopen and impacted businesses will get back on their feet. Anticipation of this led to sharp rebounds in strategy holdings Bank of Ireland (+108%), First Citizens (+73%), Applegreen (73%), NCR Corp (63%), Tenaris (+57%), Melrose Industries (+56%) and many others in Q4. These moves helped the strategy gain over 11% in Q4 (2% ahead of benchmark) in what we hope is just the start of a performance recovery.

Additionally we are doubling down on our efforts to re-underwrite the portfolio and compare holdings side-by-side with better quality and faster growing companies that we don’t currently own. Although the strategy owns many great businesses already, in the past we have passed on some due to above-average starting valuations. This is more of a mind-set tweak than anything more fundamental. Relative valuation and risk aversion will always be to the forefront for us and higher starting valuations require even higher confidence in the future trajectory of cash flows.

Given how popular such stocks are currently it is unlikely there will be significant changes to the portfolio near term. We expect better opportunities will be down the road as our COVID-hit holdings recover. In the meantime we are doing the research now so we are ready to act on opportunities.

Performance review

The strategy fell 5.4% (USD Terms; Gross of Fees) in value in 2020 versus the benchmark MSCI World which rose 15.9% for a 10.5% relative underperformance.

In keeping with prior year-end reports, below is a table and discussion of the top / bottom five contributors to strategy performance over the course of the year.

2020 Top 5 Contributors To Performance	Sector	Performance (USD)	Contribution (USD)
Microsoft	Technology	+43%	+1.7%
Taiwan Semiconductor	Technology	+93%	+1.2%
Samsung	Technology	+58%	+1.0%
Ericsson	Technology	+39%	+0.9%
Nike	Consumer Discretionary	+41%	+0.8%

2020 Bottom 5 Contributors To Performance	Sector	Performance (USD)	Contribution (USD)
Melrose Industries	Industrials	-23%	-1.0%
Fairfax Financial	Financials	-33%	-0.6%
Exxon Mobil	Energy & Materials	-36%	-0.6%
Saga	Financials	-64%	-0.5%
Wetherspoon	Consumer Discretionary	-31%	-0.5%

The biggest contributors to strategy performance in 2020 were Technology and Consumer Discretionary companies – perhaps no great surprise as these two sectors were by far and away the best performing global sectors in the year (+32% and 26% in Euro terms, respectively).

For the second year in a row the strategies largest performance contributor was **Microsoft**. The company, directly benefitted from the shift to work-from-home, as well as the ongoing move by corporates from on premise to cloud computing; its earnings grew by c.15-20% in 2020. TSMC and Samsung indirectly benefited from the WFH trend and cloud computing. Also helping both companies are the difficulties Intel is having in efficiently manufacturing leading edge chips. The American giant has stated it is considering focussing on chip design and outsourcing production; **TSMC** and **Samsung** would be Intel's only two credible options. Earnings at these two companies likely grew c.50% and c.30% respectively in 2020. **Ericsson** continued to benefit from the growth in 5G mobile technology, Western governments restricting use of Huawei by telecom companies and poor execution by its only major non-Chinese competitor Nokia. **Nike** we think, will be a winner in the shift to online shopping, even as profits shrunk by 25-30% in 2020. Its exceptional brand strength and direct-to-consumer capabilities should in time lead to superior economics than the traditional wholesale-led model.

In all these five cases valuation multiples have expanded. However, according to Bernstein Research the top 1,500 US companies returned 17% (USD terms) in 2020 with 25% of that return coming from multiple expansion and -7% coming from earnings growth. In this context, we do not believe their relative value has deteriorated.

Melrose was the largest performance detractor entering the teeth of the pandemic with elevated leverage while aerospace and automotive end markets almost completely shut down from a demand and production standpoint. 2020 immediately became all about preserving cash which the company did a fantastic job, setting up a base for reinvesting into margin development as demand recovers.

Commentary

We added to Melrose in the 90-95p range from where the stock doubled into year-end as the market regained confidence in their balance sheet, particularly with the upcoming sale of subsidiary Nortek, and news of the vaccinations brought line of sight to a return in end-market demand.

Also down sharply in 2020 was Exxon Mobil, in sympathy with the rest of the energy sector, where investor sentiment is still reeling from the collapse / fracturing of OPEC discipline and negative oil prices for a brief but chaotic period. Although the oil price recovered somewhat, it remains well down on 2019. There has been a tremendous amount of pain in the oil sector since 2013. Up to last year Exxon's low cost-base and integrated exploration-refining-upstream model helped it deal with the environment better than many peers, but in 2020 (and somewhat uniquely in an historic context) both refining and upstream were distressed, leading to losses. Looking to the future, a lot of capacity has been taken out of the industry and no new dollars are being invested. The major swing factor in the oil demand equation is transportation, which has been hit badly as a result of COVID (work from home, tourism collapse). A partial recovery in transport demand is expected in 2021, which will benefit Exxon and its peers; more than that could be a major boon for the sector. Exxon trades at a valuation equal to its book value – on that measure, easily its cheapest point since the mid-1990s.

DCC was covered in detail in the Q3 report here .

JD Wetherspoon, the UK pub-restaurant chain, suffered as a result of being shut down for large parts of the year. Although it was reasonably well financed for most business conditions – with debt in issue roughly matching the value of its property portfolio – the company decided to issue fresh equity in May to buttress its finances. Wetherspoon lost over £100m in the six months to end July. It has been roughly breakeven since and is expected to make a small profit in 2021. The silver lining for Wetherspoon is that a lot of competitors will go out of business and that in sunnier times it could make a lot more hay.

Also on the list of biggest detractors is Fairfax, which was sold in June, the reasons for which were discussed in the Q2:2020 commentary.

Portfolio Activity

Portfolio buys and sells for the year are listed below. In total six new stocks were added, while there were ten full sales. A number of the sales were in stocks that were already small, having been reduced in previous periods. New stocks / full sales for the first three quarters were discussed in previous reports, so the discussion below will just be on quarter 4.

	Buys			Sells		
	Stock	**Sector**	**End of year weight***	**Stock**	**Sector**	**Start of year weight***
Q1	Charter Comms Smiths Group Bank of Ireland	Infrastructure Energy / Materials Financials	1.0% 0.6% 0.7%	Harley Davidson NortonLifeLock Occidental Petroleum	Consumer Disc IT Energy / Materials	0.3% 0.8% 0.5%
Q2	SEI Investments	Financials	1.3%	Fairfax Financial Covetrus	Financials Healthcare	1.9% 0.1%
Q3	-	-	-	Henry Schein HP	Healthcare IT	0.7% 0.5%
Q4	Costco Nestle	Consumer Disc Consumer Staples	1.7% 0.5%	Proximus AT&T Telia	Infrastructure Infrastructure Infrastructure	0.2% 0.2% 0.1%

Commentary

Costco is a company that portfolio manager David Byrne has followed for many years. It is a subscription-based grocer. Its huge stores stock a limited number of high quality products. It uses its enormous scale to buy cheaper than any of its competitors, passing those savings on to customers, which draws more people into becoming subscribers – the classic virtuous cycle. This customer value proposition makes Costco relatively immune from the threat of online. Costco makes very little profit margin on the sale of products (about 1%), instead making nearly all its money from customer subscriptions, which reliably renew at around 90%. The Costco format has proven very popular outside its home markets (including Canada and Mexico, the UK, Japan, Korea, Taiwan and more recently China), something that has eluded other large retailers such as Walmart, Carrefour and Tesco, to name but a few. In addition to adding more subscribers to its existing 800 stores, Costco will continue to open new stores both at home and abroad. This gives us a high degree of confidence that Costco can continue its track record of generating consistent, profitable growth – we think revenues and profits will grow by around 7% a year over the next decade, mainly through volume growth and a little product price inflation, with only marginal increases in its membership fee. At the time of purchase we valued Costco at c.2.5% free cash flow-to-Enterprise Value, allowing for expansionary investment. Along with profit growth this should give us an attractive total return. The purchase of Costco was funded by a partial sale of US home improvement retailer Lowe's. This is another quality retailer that, along with Home Depot, dominates the US market. For context, Lowe's grew annual revenues and profits by 5% and 10% over the last eight years. In 2020 it logged spectacular growth (20% and 40% respectively) as consumers spent record amounts doing up their homes and home offices. The stock price mirrored the rise in profits, but we fear that the results reflect a pull-forward of demand that will not easily be repeated, meaning its valuation could be a lot higher than its headline Price-Earnings ratio suggests. Lowe's, like Costco, should be resilient against the online threat and we like the industry structure, but we felt it prudent to halve its weight in the portfolio.

Nestle is another we have followed for some time. The Nestle investment case was first examined in 2017 by portfolio manager Louis Meagher but as the research was being done the stock rallied, valuation did not look so compelling and it was unclear how effective the new CEO Mark Schneider would be. Over the past three years, operating performance has clearly improved – faster top-line organic growth, margin improvement and higher ROIC. Valuation levels today are up only slightly from 2017 levels due to the growth in earnings but Louis is now more confident that Schneider can gradually transform Nestle into a best-in-class operator, meaning the company should command a premium valuation multiple. A starter position was bought in December following a c.10% pull-back in the share price, at which point it was trading on a free cash flow yield of 4% (after growth capex). Assuming Nestle can grow revenues and profits at 3-4% per annum (below the company's 4-6% target) the investment should deliver a decent return, especially in a sector context. We hope to add to Nestle's weight at more attractive levels. The purchase was funded through a trimming our positions in Unilever and PepsiCo. Although Unilever currently trades at a discount to Nestle and could see a stronger post-COVID rebound due to a different product mix (e.g. out-of-home ice cream, personal care items), top-line growth has been lower quality and we are concerned that management has underinvested in the business. The decision to trim our weight in PepsiCo was purely on valuation grounds.

The three sales in Q4 were all telco companies, which were already small positions in the strategy. **Telia** and **Proximus** are the old monopoly operators in Sweden and Belgium respectively. Tough regulatory and competitive environments have meant subpar returns on their substantial network investments over the last decade. In hindsight we were foolish to think this would correct itself. In the case of **AT&T**, the stock is cheap on a headline P/E basis, but it is highly indebted and has made some highly questionable strategic moves, most notably the deals to buy DirecTV for $68bn in 2015 and Time Warner for $100bn in mid-2018. A rally in the share price in Q4 provided an opportunity to fully exit.

David Coyne – co-lead Portfolio Manager

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The Global Equity Strategy is managed by Setanta Asset Management Limited. The performance shown is the performance of the lead Euro portfolio of the Global 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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