Setanta Global Equity Fund
Q4 2021

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 an actively managed equity portfolio which holds c.80-100 global stocks. The portfolio is managed in accordance with the Setanta investment philosophy by a team of eight global sector specialists, overseen by two lead portfolio managers. The aim is to achieve a sensible level of diversification on a sector and geographic basis. Reflecting this, portfolio sector weights are generally set so as broadly similar to the sector weights in the benchmark. Within each sector, stocks are chosen through bottom-up analysis, based on investment merit. 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. The investment objective of the Fund is to outperform the MSCI World index over the long term.

Fund Commentary

Global stock markets, as measured by our benchmark the MSCI World, rose a racy 31% in Euro-terms in 2021. The Setanta global equity fund outperformed by 1.4% over the year – a satisfying outcome as the fund has tended to lag very strong market returns in the past.

(Fund 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

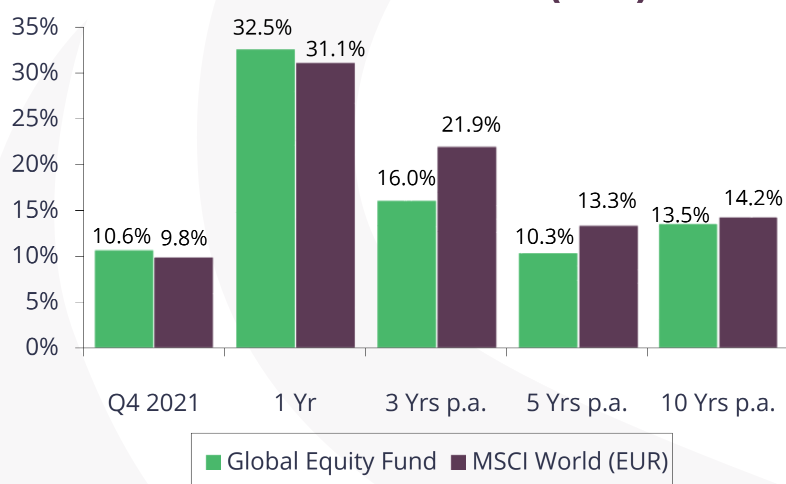
We consider scenarios rather than making forecasts

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

Fund Performance – 31.12.12 (EUR)



Performance Source: Setanta Asset Management Limited. The Fund returns stated are based on the movements in the unit prices of the ILA/CLI Setanta Global Equity Fund [P-GLB1] 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 World (EUR). **Holdings Source:** Setanta. Sector allocations based on invested portfolio only (excludes cash). **Fund Statistics Source:** Bloomberg.

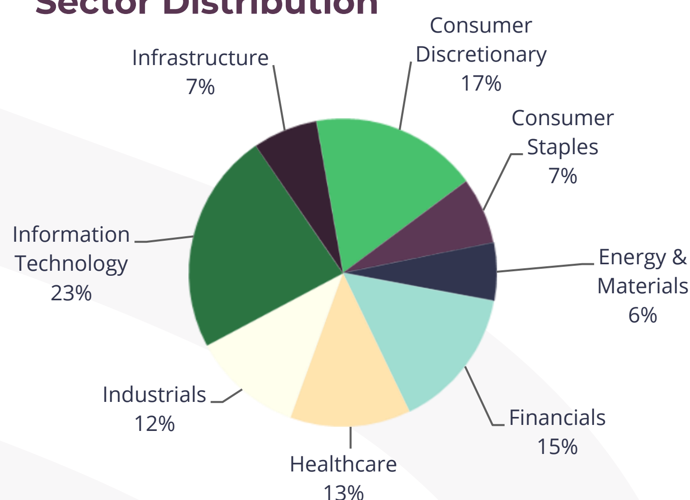
Top 10 Holdings

COMPANY	SECTOR	% OF FUND
MICROSOFT CORP	INFORMATION TECHNOLOGY	4.8%
ALPHABET INC	CONSUMER DISCRETIONARY	3.4%
BERKSHIRE HATHAWAY	FINANCIALS	3.0%
JOHNSON CTLS	INDUSTRIALS	2.8%
MCDONALD'S CORP	CONSUMER DISCRETIONARY	2.8%
ORACLE CORP	INFORMATION TECHNOLOGY	2.8%
SAMSUNG ELECTRONIC	INFORMATION TECHNOLOGY	2.7%
COSTCO WHOLESALE	CONSUMER DISCRETIONARY	2.7%
NIKE INC	CONSUMER DISCRETIONARY	2.4%
KEYSIGHT TECHNOLOGIES	INFORMATION TECHNOLOGY	2.2%

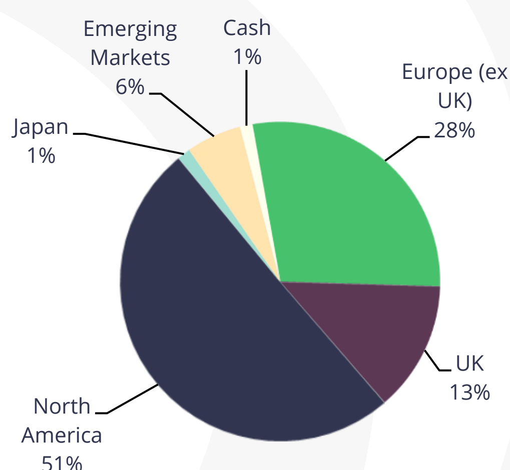
Fund Statistics

PRICE/BOOK	2.3
PRICE/EARNINGS RATIO (FY 1)	17.8
DIVIDEND YIELD %	1.5
AVERAGE MARKET CAP € BN	132.4
NO. OF HOLDINGS	80
DEBT/EQUITY %	52.7
ACTIVE SHARE %	85.5

Sector Distribution



Geographic Distribution



Yearly Performance

Year %	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Fund	-36.6	32.2	16.2	0.9	14.1	24.5	20.6	9.0	16.2	8.8	-3.9	22.0	-3.3	32.5
Benchmark	-37.6	25.9	19.5	-2.4	14.1	21.2	19.5	10.4	10.7	7.5	-4.1	30.0	6.3	31.1

SETANTA Asset Management

It was also achieved while sticking to our conservative and research-driven process that has proven out over the fund's 21-year history.

In many ways 2021 was a notable year in financial markets. Global M&A hit a record $5.8 trillion according to Refinitiv, easily surpassing the previous (ill-fated) record of $4.4bn set in 2007, while Bloomberg reported that a record $600 billion of capital was raised through IPOs, around 40% higher than in 2007. On the economic front, two significant new COVID 'waves' Delta and Omicron held back economies from fully realising their potential output in 2021, although rising high vaccination rates are helping to decouple the link between infection and hospitalisation, which is very positive. Still, ongoing restrictions contributed to significant supply chain bottlenecks across many industries. With demand strong and supply constrained, inflation spiked to around 5% in the US and Europe, the highest inflation levels in decades. The jury remains out on whether the inflation is the result of temporary supply side factors that will naturally correct or a consequence of years of ultra-loose monetary policy. In any case, it would appear that the global interest rate cycle is on an upward path.

Stocks were strong across the board, but there were some key takeaways. While "growth" and "value" indices performed similarly (following an 80% cumulative outperformance of growth over value in the previous four years), the valuation of what we term "super-premium" companies (high quality, strong and predictable growth) continued to rise and some of them look to us to be in over-priced territory. US stocks outperformed handsomely (+37% in Euros), aided by the strong Dollar, while Europe (+27% in Euros) and Asia (+11% in Euros) lagged. This continues a long trend. The weight of US stocks in the MSCI World index has increased from 52% to 67% in the last decade, driven in no small measure by the meteoric rise of FAANGs, tech disruptors etc., which are predominantly quoted in the US (the fund's US weight is unchanged over this time).

Sectors where demand is outstripping supply rose sharply in 2021, for example semiconductors (+64% in Euros) and autos (+45% in Euros). Banks were strong (+42% in Euros) due to reduced risk of loan losses as economies reopened, as well as expectations of margin improvement when interest rates rise. Also, energy stocks rebounded (+53%), following a number of years of revenue and profit pressures. Among the laggards in 2021 were telecoms (+3% in Euros), utilities (19% in Euros) and consumer staples stocks (+20% in Euros).

Performance review

The fund rose 32.5% in Euro-terms in 2021, 1.4% ahead of benchmark. As often happens, relative performance wasn't a smooth path: the fund was ~4.5% ahead of benchmark by mid-May, was lagging by November but rallied into year-end when growth stocks sold off as investors began to price in interest rate increases in 2022 and beyond. Directionally the fund broadly tracked the MSCI value index (+31% in Euro-terms in 2021) over the course of the year. The huge outperformance of growth over value in the last decade was greatly helped by low interest rates. The extent to which that trend might unwind will depend on how far rates rise. We expect the fund would outperform a value-led market, though as we have said before we are not classic value.

Commentary

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

2021 Top 5 Contributors to Performance	Sector	Contribution, Euro	Performance, Euro
Microsoft	Technology	2.7%	64%
Alphabet	Discretionary	1.9%	78%
Johnson Controls	Industrials	1.7%	91%
Playtech	Technology	1.7%	95%
Costco	Discretionary	1.3%	63%

2021 Bottom 5 Contributors to Performance	Sector	Contribution, Euro	Performance, Euro
Samsung Electronics	Technology	-0.1%	-4%
Melrose Industries	Industrials	-0.1%	-4%
Sandstrorm Gold	Industrials	-0.1%	-7%
Alfresa Holdings	Healthcare	-0.2%	-19%
Lancashire Holdings	Financials	-0.4%	-21%

Microsoft is the largest position in the fund and its share price again rose strongly in 2021. Recall that in the middle of the last decade the market believed Microsoft was extremely vulnerable to disruptive forces and its ability to maintain a sustainable earnings base was being severely questioned. The appointment of Satya Nadella in February 2014 was a key moment. He embraced change, made Microsoft products openly available on competing platforms, shifted to a software-as-a-service (SaaS) business model for their software products, identified the huge opportunity that the shift from on-premise computing to off-premise computing (cloud) presented and became a strong number 2 player to AWS, and invested in consumer technology platforms like Gaming (acquired Minecraft) and professional social platforms (acquired LinkedIn). The success of the strategy is clear to see today, as the stock has compounded at over 30% p.a. since Nadella's appointment. Microsoft has been held in the fund through this period and we continue to view it as one of the world's strongest businesses.

Alphabet is a rather recent addition to the fund, having been added in Q4:19 just before the outbreak of COVID. The group was a huge lockdown beneficiary, as general search and online shopping boomed, and people consumed more YouTube. Google's advertising revenues have continued to perform very strongly even as economies have reopened, with more retailers adapting their business models to capitalise on consumers' growing desire for online shopping, a trend we expect to continue.

Johnson Controls has been something of a transformation story. A few years ago it disposed of non-core businesses and now focuses on providing air systems, security and fire safety systems for buildings. Management has enhanced its conversion of accounting profit to cash flow, improved margins and returns and is putting a bigger emphasis on services, where they significantly lag peers. Helping in this regard is their whole building system. As you can imagine, air quality systems have been in high demand through COVID as companies look to make workplaces safe for their employees. With some 40% of global carbon emissions being generated by buildings, Johnson Control's addressable market has dramatically expanded as companies look to save on energy consumption and reduce their carbon footprint.

Johnson Control's share price has more than doubled since pre-pandemic and the valuation multiple has expanded, so the stock is discounting some of this good news. However, we are convinced that structural – and not just cyclical – factors will continue to drive the company's revenue growth (we estimate ~6% is achievable). Some cost cutting initiatives could deliver profit growth in excess of this.

We received excellent news on **Playtech** during Q4 as the company was the subject of a bid by Australian firm Aristocrat that was almost 60% above its undisturbed price. The stock has since traded through the offer price of £6.80 per share as two other entities have also expressed an interest in acquiring the company. Firstly, Gopher Investments (which has already agreed to acquire Finalto, Playtech's financial markets divisions) considered making a full offer for the company before deciding against it. Secondly JKO Play is carrying out an ongoing evaluation with a view to making a firm offer by the deadline date of January 26th, 2022.

Setanta became the largest shareholder in Playtech and portfolio manager Fergal Sarsfield in particular has actively engaged with management and the Board to improve governance, the quality of the Board and financial disclosure. While we recognised the quality of Playtech's assets, we were underwhelmed by the way in which they were being managed. We engaged with the company to help simplify the business and to focus on core markets and growth opportunities. During our tenure we have assisted the company in the selection process for a new Chairman, as well as the addition of two new independent directors.

The main detractor from fund performance in 2021 was UK-based specialty insurer **Lancashire**, which insures property, aviation, energy and marine risks. Unfortunately, industry losses have been well above normal in four of the last five years, mainly due to natural catastrophe losses. Swiss Re believes 2021 insured losses were U$112bn, the 4th costliest year on record (2017 was the costliest at ~U$160bn). Lancashire has not been immune to these loss trends. Global warming is at the centre of the debate over whether current insurance pricing is adequate. Are weather-related events more frequent, more powerful? Or is it simply an unlucky clustering of losses? Although we think it's the latter, no one can tell conclusively.

In recent years Lancashire has been growing and diversifying into less commoditised, less capital-intensive lines of business. This not only reduces its exposure to large natural catastrophe losses but should increase the group's RoE. We think this strategy is sound and are excited at the prospect of a large uplift in profits and returns if industry losses normalise. However, management will need to deliver following what is likely to be another loss year in 2021, along with a low share price. As the largest shareholder in the company, Setanta will continue to engage with management and the Board for ways to best realise value.

Portfolio Activity

Portfolio buys and sells for the year are listed below. In total four new stocks were added, while there were eight full sales. At year end there were 80 stocks in the fund, eight fewer than two years ago. All recent stocks sold have had a common theme: we had lost faith in them, either the business model was under threat from increased competition or from changed consumption patterns post-COVID, or our confidence in management had fallen. We believe their replacements are superior businesses with better growth prospects operating in less competitive industries.

New purchases and full sales for the first three quarters were discussed in previous reports, so the discussion below will just address Q4.

Commentary

	BUYS		
	Stock	Sector	End of year weight
Q1	S&P Global	Financials	1.1%
Q2	Electronic Arts	Technology	1.2%
Q3	-	-	-
Q4	Tryg A/S	Financials	1.1%
	Tencent	Technology	0.4%

	SELLS		
	Stock	Sector	Start of year weight
Q1	Jefferies Financial Group	Financials	0.5%
	Applegreen	Discretionary	0.5%
	Tupras	Energy / Materials	0.2%
	NOV Inc	Energy / Materials	0.1%
Q2	Saga	Financials	0.4%
Q3	-	-	-
Q4	Cisco Systems	Technology	1.7%
Q4	First Citizens Bancshares	Financials	1.3%
	Drax Group	Infrastructure	0.3%

Scandinavian insurer **Tryg** was added in Q4. Structurally Scandinavia is a very attractive insurance market. Each of Denmark, Sweden and Norway have a small number of rational competitors and are among the most efficient insurers in the world. Also, customer churn is low because, unlike most other countries, insurance policies auto-renew in Scandinavia and in general customer satisfaction levels are very high. These factors make it very difficult for new entrants, which gives us confidence that the industry structure and attractive profitability will endure. Denmark-headquartered Tryg is Scandinavia's largest non-life insurer, following the acquisition of RSA's Swedish and Norwegian businesses in late 2019. With regional scale, Tryg (along with competitor Sampo, held in other Setanta funds) is in an advantaged position to invest in leading-edge pricing algorithms, automate customer journeys and back-end processing, lower claims handling costs, improve customer risk selection and lower fraudulent claims. We expect that these investments will allow Tryg to grow their lead over competitors and continue to take share of industry profits. We believe Tryg shares could deliver a mid-to-high single digit annual total return, which we think is attractive compared to alternatives. This is a high-quality, low risk company that we would be very happy to add to if the share price drops.

Also added in Q4 was **Tencent**. Its ubiquity in China has earned it the label of "the operating system of China". To give a sense of its reach, it is China's version of Facebook, YouTube, Nintendo, Shopify, Netflix, Spotify and PayPal all rolled into one on the consumer side, Azure (cloud) and Slack (workplace communication) on the enterprise side, in addition to a first-rate venture capital arm. The WeChat "super app" is at the core of the group, which its 1.2bn users use to read the news, socialise, play games, listen to music, shop and pay, among other things. We expect new apps will be added to the eco-system over time. The more services offered, the lower customer acquisition costs and the greater the platform's usage, which both increase customer lifetime value. This positive feedback loop also raises the barrier to entry for other apps and platforms.

Tencent has deliberately held back on monetising its userbase in the short-term in order to enhance the company's potential in the long term. For example, Tencent earns just 11% of online advertising spend in China, despite accounting for 36% of time spent on all apps. Although its gaming profits will probably be under pressure as a result of the government's recent restrictions on game time for minors, overall we judge the company will be able to produce double-digit profit growth for years to come. Alongside the operating businesses, Tencent's venture capital investments have been incredibly fruitful and based upon the company's most recent fair value assessment account for >40% of group market cap. Even valuing the investments at a conservative 60% of fair value, Tencent was valued at just 25x our estimate of "sustainable earnings" at time of purchase.

There is a wrinkle in the story though. Tencent is a Chinese Variable Interest Entity, or VIE, a company structure that exists to circumvent rules prohibiting foreign ownership of Chinese internet assets. The structure involves a Chinese operating company which owns and operates the assets, and another holding company listed in the US or Hong Kong with a series of contracts that simulate ownership. Shareholders of VIE companies do not own any shares in the operating company, which is a risk. While no Chinese regulatory body has officially approved the VIE structure, they have existed for 21 years and are widely deemed to have unofficial approval.

Political tensions have grown of late. The SEC has indicated it doesn't want Chinese companies raising capital in the US, which contributed to large share price drops for US-listed Chinese VIEs in 2021, such as Alibaba (-50%). Separately China banned new VIEs in areas of national security and cracked down certain activities in the wider tech sector. While Tencent is listed in Hong Kong and so is safe from US rule changes, the general uncertainty caused its shares to weaken considerably. We recognise that any regulatory change banning VIE structures could be catastrophic for shareholders and we have given this a lot of thought, over many years. We think China is highly unlikely to significantly change the status quo because such a move would cut off a major source of investment needed to develop its digital economy. It is likely that existing VIEs will retain their status with Hong Kong as their natural home. Also, we like how Tencent has looked to stay on the right side of the CCP, unlike some of its peers which have at times been too aggressive and profit focused. We bought an initial position in Tencent after a fall of nearly 50% from its February high and will look to opportunistically buy more.

In addition to the above two purchases, in Q4 we received shares in **SK Square** due to our ownership of Korean company SK Telecom. SK Square is currently comprised of SK Telecoms' former technology investments, chiefly a stake in semiconductor manufacturer Hynix. We are currently weighing our options. There is very little detail about SK Square's strategy, how they plan to invest and allocate capital. This warrants a sizeable valuation markdown, but with the shares trading at a steep 60-70% discount to NAV, we have decided to hold on for a more opportune time to sell.

Cisco, First Citizens and Drax were sold in Q4.

Cisco Systems was a long-term holding in the fund – in fact it has been ever-present since the fund's inception in mid-2000. It was one of the so-called 800-pound gorillas of the first tech bubble (with a valuation that in retrospect was far too high). Cisco remains the dominant supplier of switch gear and routers into corporate customers. However, it has been fighting a rear-guard action in recent years due to the shift to off-premise computing, the rise of hyperscalers and their ability to source cheaper white box network equipment. We have seen this future coming for a number of years but held on to our shares due to a cheap valuation. Our patience was rewarded and we sold in Q4 following a more than doubling of the share price in the last 5 years. While there could still be more upside in Cisco, we felt the risk-reward was more favourable in Tencent and Electronic Arts, where the sales proceeds were distributed.

First Citizens Bancshares was first bought for the fund in May 2009. Its conservative, long-term approach has proven very successful – especially in times of economic stress – with very low-cost branch deposits funding the very low risk medical loans. In October 2020, First Citizens announced it was merging with CIT Group, which loans to a disparate range of mainly business customers. CIT stock had sold off sharply during the initial phase of COVID-19 on fears that a prolonged pandemic would lead to high levels of loan losses. Terms for the all-share merger were agreed just weeks before the positive vaccine news broke in November – in effect, First Citizens had agreed to swap its highly-valued shares for cheap CIT stock and over the next few months its stock price more than doubled.

However, as we conducted our own research into CIT we became uncomfortable with the deal. CIT is a very complex bank. Its high funding costs means they have to target higher margin but higher risk lending (e.g. equipment leasing, railcar leasing, factoring) to generate a sufficiently adequate return on equity. Managing these risks is difficult, requiring specialist bankers and careful risk management. CIT's own record was patchy at best and First Citizens' management certainly has no experience of such loans. We spoke to former employees of both First Citizens and CIT and the message was consistent: the banks are a strategic mismatch. Given the size of the merger (doubling assets), the starkly different cultures and approaches to lending, a smooth integration is less than assured. First Citizens delivered a 7-fold return over the fund's 12 year holding period, but with this deal we think its risk profile has changed for the worse. The proceeds were invested in Tryg.

Finally, the fund sold its remaining stake in the UK power generator **Drax**. We acquired the position in 2015 and have seen the company transition from using carbon-intensive feedstock to responsibly sourced biomass. Drax's stock price rallied through 2021 partly on the back of a spike in UK electricity prices. While we believe there may be still quite a bit of value in the stock, especially in a scenario of sustained high energy prices in the medium term, there are also significant risks to consider, primarily the concentrated bet on the future status of biomass as a 'green' feedstock for electricity generation.

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