Setanta EAFE Equity Fund (CAD)

Q3 2021

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

Inflation, Inflation everywhere, but it's only transitory, right??

To use a soccer parlance, quarter three was a game of two halves. The first part of the quarter continued in the same vein as the first two quarters, markets up strongly on the back of the reopening trade, dovish monetary policy, and strong performance from the growth cohort as the US 10-year Treasury yield fell from 1.73% in March 2021 to 1.19% at the end of July.

(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

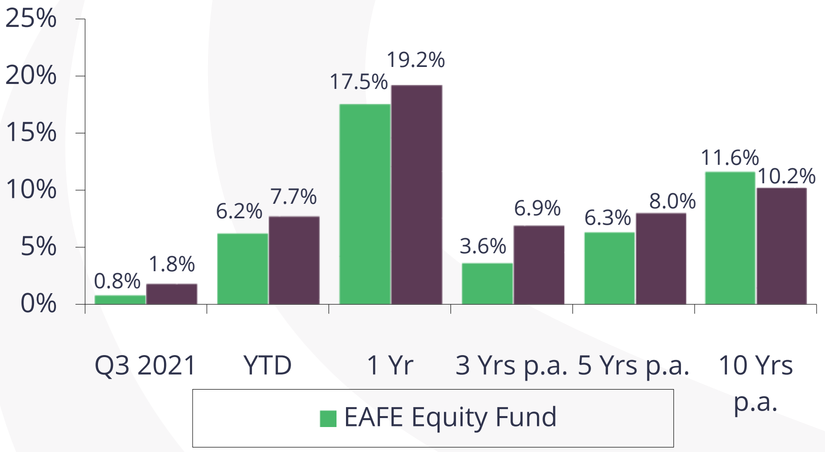
We consider scenarios rather than making forecasts

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 – 30.09.2021 (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.

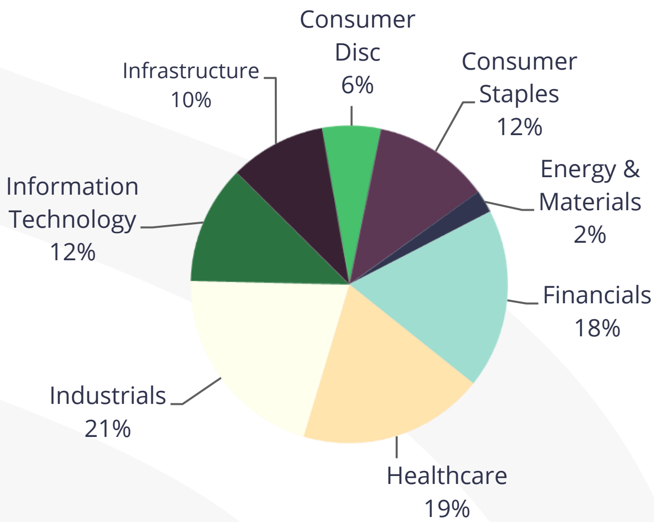
Top 10 Holdings

COMPANY	SECTOR	% OF FUND
GPE BRUXELLES LAMBERT	FINANCIALS	7.0%
DCC	INDUSTRIALS	5.5%
ALCON AG	HEALTHCARE	4.9%
SAMSUNG ELECTRONIC	INFORMATION TECHNOLOGY	4.5%
LSL PROPERTY SERVICES	INFRASTRUCTURE	4.4%
DIAGEO	CONSUMER STAPLES	4.2%
GEA GROUP AG	INDUSTRIALS	3.8%
GLAXOSMITHKLINE	HEALTHCARE	3.5%
BANK LEUMI	FINANCIALS	3.5%
UNILEVER PLC	CONSUMER STAPLES	3.5%

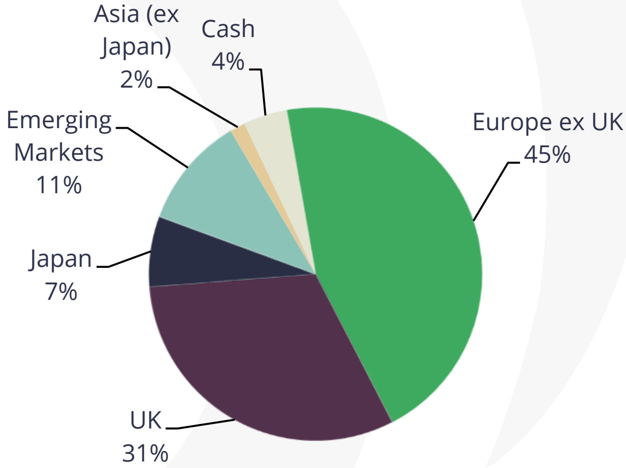
Fund Statistics

PRICE/BOOK	1.9
PRICE/EARNINGS RATIO (FY 1)	14.8
DIVIDEND YIELD %	2.5
AVERAGE MARKET CAP C$BN	76.0
NO. OF HOLDINGS	36
DEBT/EQUITY %	45.1
ACTIVE SHARE %	92.5

Sector Distribution

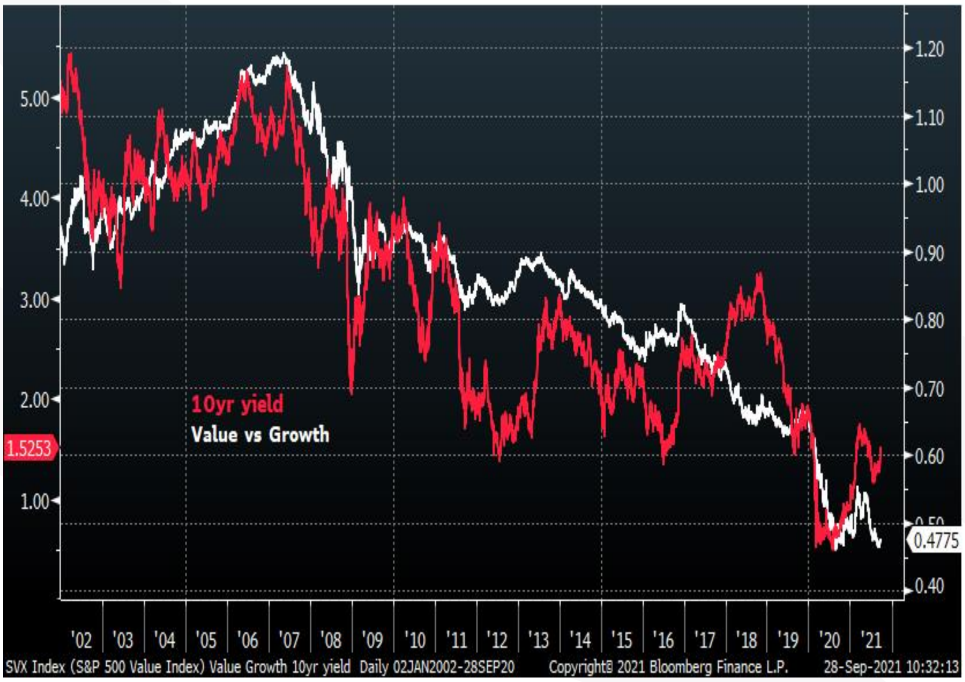


Geographic Distribution



SETANTA Asset Management

In this type of risk on environment we can sometimes struggle to keep pace. Continuing the sporting parlance our investment style is more suited to marathon running rather than a 400m sprint, and while more recently we may have lost some 400m sprints we have proven over the longer term that we can and do win the marathon. We always manage our investors' assets for the long term and despite the significant headwind of a longer-term decline in yields which is more conducive to an investment strategy focused on growth over value we have still managed to maintain positive long-term outperformance with our EAFE Equity Strategy outperforming the benchmark by 1.4% p.a over the last 10 years, in CAD terms.



Source: Bloomberg

Considering the historically low interest rate environment as well as the many inflationary issues that appear to be on the horizon is it reasonable to believe the rhetoric from Fed Chair Jerome Powell and his global counterparts that inflation is only transitory and that interest rates will remain at artificially low levels over the medium to long term?

Let's look at some of the pressure points which are putting upward pressure on inflation. We do not have a clear view on whether they are transitory or not, we're merely trying to evaluate all potential outcomes and use this as we manage our clients' assets for the long term.

Note: Commentary is representative of the Setanta EAFE Equity Strategy with official benchmark as at 30th September 2021.

Costco, the 5th largest retailer in the world increased the price of its own brand tissues by 11% as it tries to cope with inflationary and supply chain pressures. Here's what Richard Galanti, Costco CFO, recently said on an earning's call:

"The factors pressuring supply chains and inflation include port delays, container shortages, COVID disruptions, shortages on various components, raw materials and ingredients, labour cost pressures and trucker and driver shortages".

There are a lot of reasons in here, but we can distil them down into supply and demand related issues.
On the demand side there is no doubt that demand is stronger than expected as the global economy returns to normal post Covid. As this Covid induced demand splurge returns to more normal levels it is reasonable to believe that port delays and container shortages will sort themselves out but on the supply side there are issues which may be more structural in nature.

Let's start with trucking. According to the American Trucking Association (ATA) trucks move roughly 73% of the nation's freight by weight. It's an industry employing 3.6m truckers whose average age is 57. It's an industry suffering from a chronic shortage of truck drivers and it's only getting worse. The number of truck drivers has been in structural decline for many years, but it's gotten progressively worse over the past decade. It's estimated that there are only 480 truck drivers per 1,000 trucks compared to a market in equilibrium back in 1992. Additionally, there is an acute shortage of truck drivers with an estimated shortfall of 60k drivers in the US presently and expected to reach 160k by 2028.

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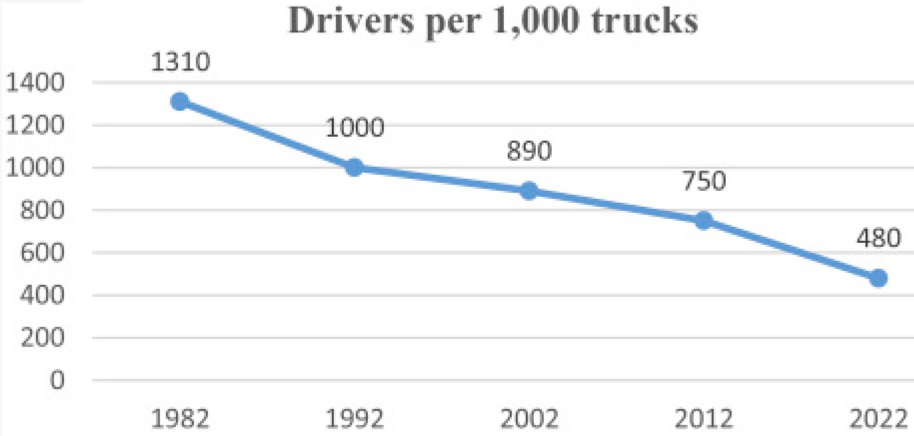

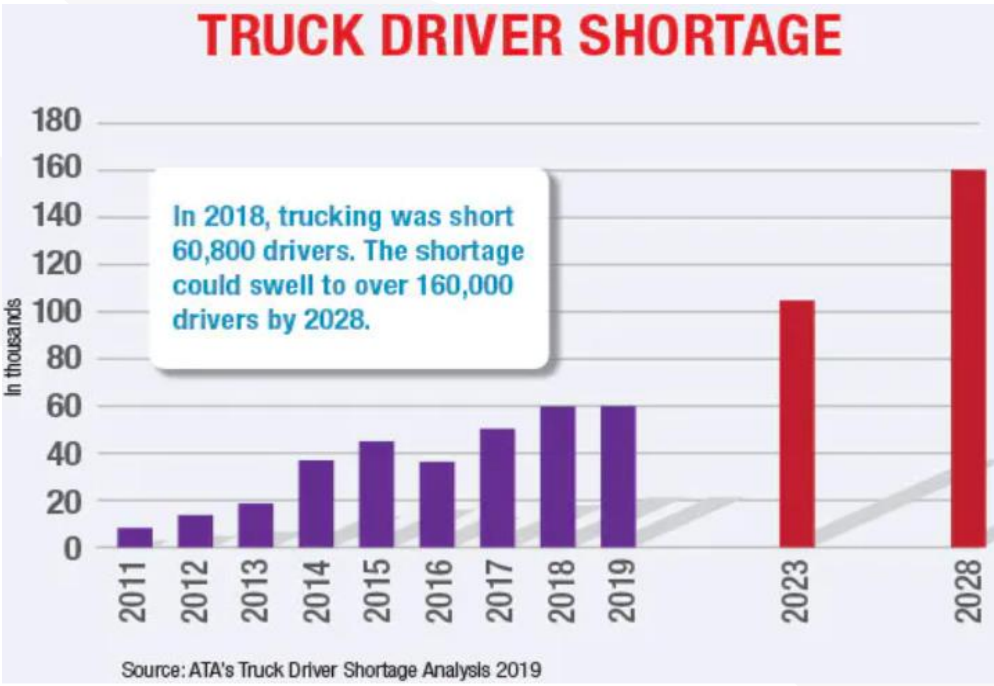

With autonomous driving and autonomous trucking expected over the next 10 years it's not surprising that there are fewer entrants into the industry than retirees. Why would anyone want to pursue a career in trucking where their career span may only be 10 years or less?

So, what does this mean? Trucking companies are facing higher costs of doing business, fuel prices are rising, and trucking companies are having to pay higher salaries to keep drivers as well as attracting new entrants into the workforce. It's likely they will charge product manufacturers more to transport their goods from factory floor to shop floor, product manufacturers will charge retailers more and retailers in turn will have to increase the prices they charge consumers. Inflation, inflation, everywhere. But is it transitory?

Another pinch point causing inflationary pressures mentioned by Richard Galanti was raw materials and ingredients. Again, one can argue if these price rises are temporary or not.

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Q3 2021 Commentary

Energy in one form or another is a key input in the production of goods and services, transportation of goods, as well as heating and lighting our homes and businesses. There is currently a shortage of energy globally and this is leading to dramatic increases in energy prices. While increased energy demand and consequently prices may be partially attributable to the post Covid splurge we must also recognise that there are structural issues at play here too which may impact the energy market over the medium to longer term. There has been a focus globally on reducing carbon emissions and moving away from fossil fuels as a source of energy, but this has come without a ready-made substitute that gives a constant stable supply of energy at the same prices.

Coal and gas plants are being decommissioned and no new capital is being allocated to coal mining, resulting in high coal and carbon prices. This in addition to the spike in demand due to Covid catch up, low European gas storage levels as inventory is being used to meet additional demand and unfavourable weather conditions leading to record low hydro reservoirs is creating a perfect storm for higher for longer energy prices.

Russia is the world's 3rd largest coal supplier and the largest supplier into the European market. Europe has been closing thermal coal power stations as well as setting higher environmental standards for burning coal. This has resulted in Europe having less demand for Russian coal but also making it more expensive for Russia to produce coal suitable to meet these higher standards.

With decommissioning of thermal coal power stations and reduced imports of coal and LNG from Russia, European gas storage sites are just under 75% full, the lowest level for this time of year in more than a decade.

We also have a situation in the Nordics where low rainfall and higher than normal temperatures in August and September have resulted in reservoirs running at low levels. Water is the Nordic region's most important source of electricity. Norwegian hydro levels are at their lowest in more than a decade for this time of year. The filling level was 52% for the week of Sept 20th, the lowest since 2006 for that week.

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This is creating a perfect storm in the Nordic region where according to Bloomberg, Nordic power prices were 5x higher in September than a year ago. This has even led to Swedish utility Oresundskraft AB to ask some of its industrial customers to be flexible in their consumption.

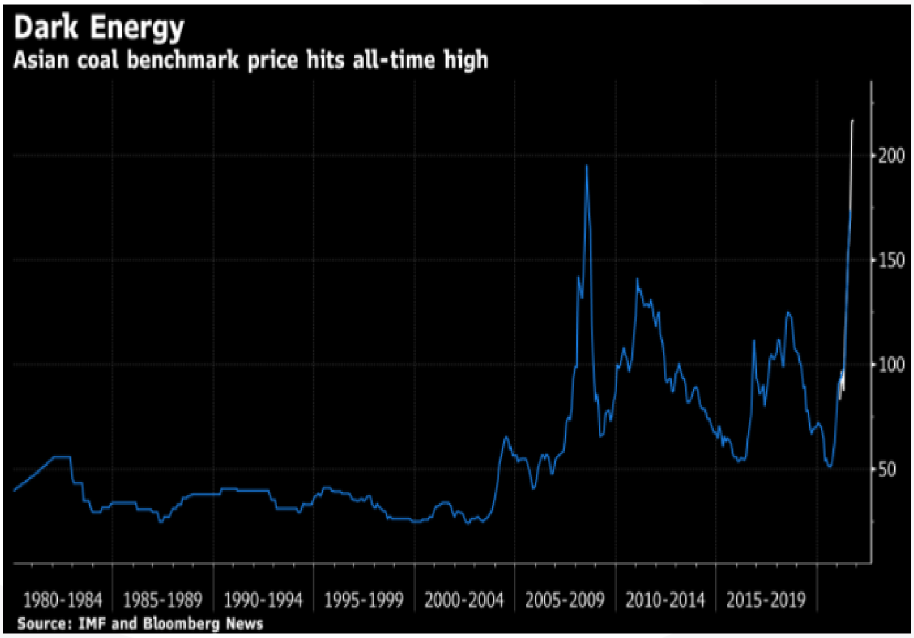
Moving over to the East, China is also experiencing energy shortages. China is the world's largest producer of coal with coal accounting for 70% of the nation's electricity generation but as the manufacturer to the world it still relies on coal imports to help meet its energy demands.

China is at loggerheads with Australia and has banned coal imports from Australia due to an Australian led investigation into the origins of Covid, the results of which China did not like. Without Australia they are looking to Russia and Russia is more than willing to divert coal and LNG that was initially earmarked for Europe to China but that still isn't enough to meet its insatiable energy needs. This quote from the Nikkei shows the impact rising coal prices and stricter energy intensity targets in China are having on the global supply chain:

"Several key Apple and Tesla suppliers halted production at some of their Chinese facilities to comply with Beijing's tighter energy consumption policy, putting supply chain continuity at risk during a peak season for electronics goods including the latest iPhones".

But industrial production is a major contributor to China meeting its economic growth targets and to progressing President Xi Jinping's common prosperity goals. So, while on the one hand China wants to be seen to be doing good in terms of cutting carbon emissions, on the other hand they need to maintain high production levels to continue their economic development. Reports over the past week have suggested that China has ordered its state-owned energy companies to secure energy supplies at all costs. This means more LNG tankers and Russian coal supplies will be diverted east compounding the energy crisis in Europe even more.

With China doing all it can to secure supplies, thermal coal prices, the benchmark price for Asia as the world's largest market for energy, hit their highest on record last week with high quality thermal coal at Newcastle port in Australia reaching $203.2 a ton, breaking the previous record set in July 2008. Also, the cost of LNG in both Asia and Europe are about $190 a barrel of crude oil equivalent.



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Q3 2021 Commentary

Without a demand side shock, it's hard to see how the energy bottlenecks get resolved in the short term. Companies are unwilling to commit capital to "dirty" energy while "green" energy is not sufficient to take up the slack. With gas storage facilities running lower inventory levels, a further increase in energy demand as winter approaches, and the ongoing transitions away from cheap fossil fuels, one can't help but question the central bankers' belief that inflation is only transitory.

On top of the bottlenecks in trucking and energy, there is also a serious shortfall in the supply of semiconductors which cannot be overcome easily or in the short run. It costs $15-20bn to build and equip a semiconductor fab and about two years to complete. Despite Japan, US and Germany all looking to address this, it falls to three companies to address the supply/demand imbalance: TSM, Intel and Samsung. While they are all intent on increasing fab capacity, the market expects that it will be well into 2022 before the chip shortage can be addressed in any meaningful way.

So, with bottlenecks right across the supply chain and increased geo-political risks especially between the US & China the mood music from the market may be beginning to change. Predicting the future path of inflation is very difficult given the huge variety of potential inputs and the one thing certain about point estimates is that they will be wrong. While the twin forces of technology and globalisation have served to contain inflationary pressures in recent decades, there does appear to be increased risk to the upside on inflation currently.

If inflation isn't transitory then we may be facing a shift away from the low interest rates that have underpinned the global economy over the past decades. This scenario is not a given by any means but if it arises, and is sustained, it could have meaningful consequences for financial markets in the coming years. As always, we will remain observant and adaptive in our thinking as we manage our clients' assets for the long term.

The strategy did not make any new additions or disposals during Q3.

Fergal Sarsfield, Portfolio Manager

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