

Setanta Global Equity Strategy (USD)

September 2021

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

Macro versus micro investing

The good news is that in many developed countries COVID is increasingly being brought under control and demand is fast recovering. The bad news is that the supply side of the economy is struggling to adjust.

(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

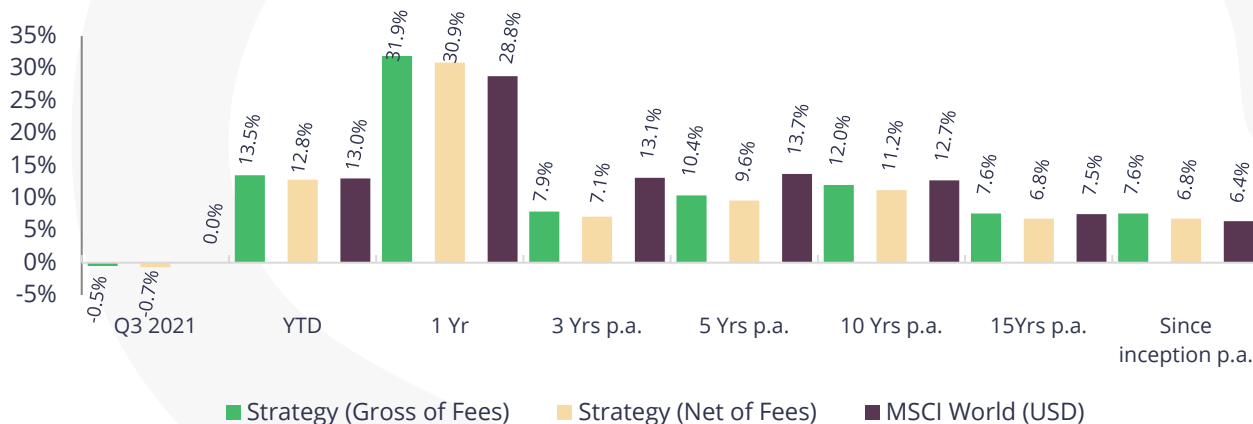
Businesses we own must have strong balance sheets

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 30th September 2021

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	2.2
PRICE/EARNINGS RATIO (FY 1)	17.2
DIVIDEND YIELD %	1.9
AVERAGE MARKET CAP \$BN	131.8
NO. OF HOLDINGS	80
ACTIVE SHARE %	85.1
DEBT/EQUITY %	57.4

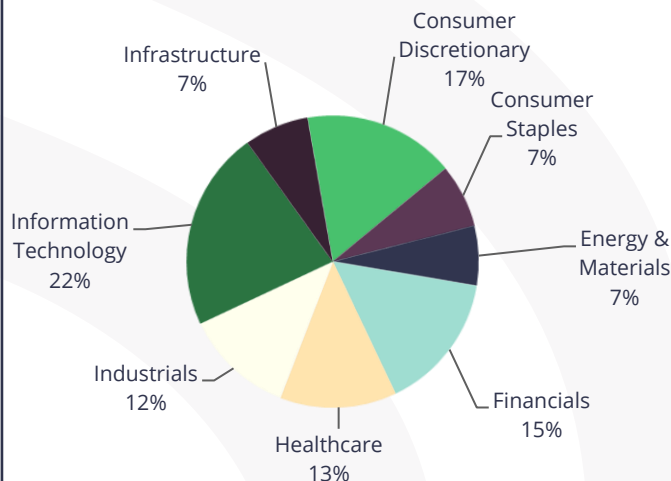
Top 10 Holdings

COMPANY	SECTOR	WEIGHT
MICROSOFT CORP	INFORMATION TECHNOLOGY	4.8%
ALPHABET INC	CONSUMER DISCRETIONARY	3.3%
BERKSHIRE HATHAWAY	FINANCIALS	2.9%
ORACLE CORP	INFORMATION TECHNOLOGY	2.9%
MCDONALD'S CORP	CONSUMER DISCRETIONARY	2.6%
JOHNSON CTLS	INDUSTRIALS	2.5%
DCC ORD	INDUSTRIALS	2.4%
COSTCO WHOLESALE	CONSUMER DISCRETIONARY	2.3%
NIKE INC	CONSUMER DISCRETIONARY	2.2%
JOHNSON & JOHNSON	HEALTHCARE	2.2%

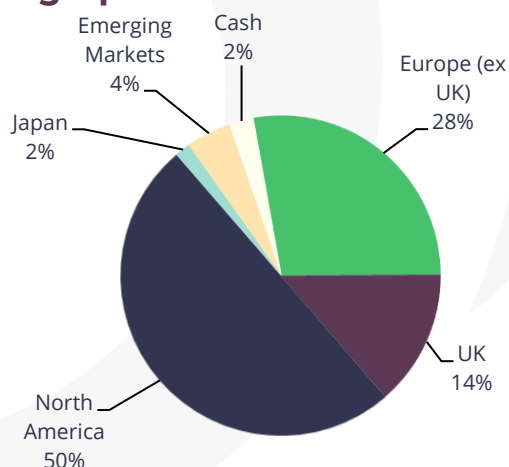
Holdings Source: Setanta. Sector allocations based on invested portfolio only (excludes cash), of the lead Euro account of the Global Equity Strategy. **Portfolio Valuation Statistics Source:** Bloomberg, based on the lead Euro account of the Global Equity Strategy, shown in USD.

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 1.159. 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



Commentary

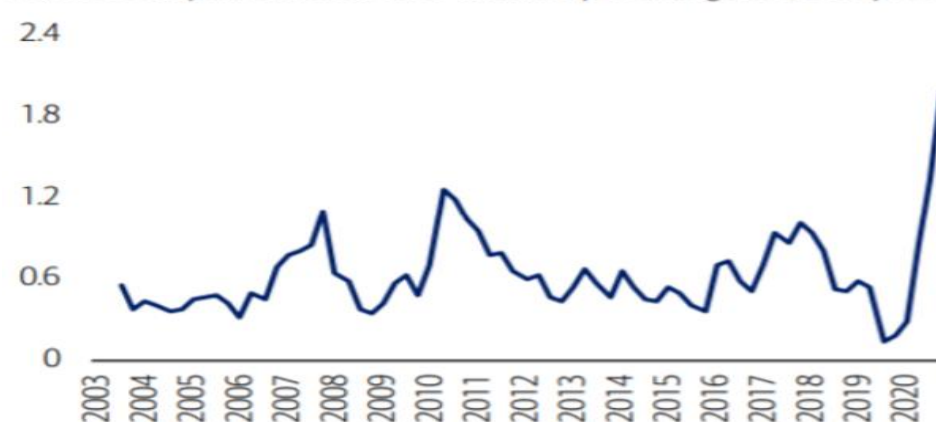
Over the last year there have been supply-demand imbalances in discrete pockets of the economy – for example, the well-publicised lack of availability of chips caused most global auto companies to shut production for lengthy periods earlier this year. However, the problems have only got worse in recent months. A lack of shipping capacity has led to record container freight rates, with the Drury World Container Index for major east-west trade routes currently over \$10,000 per 40-foot box versus an average of about \$1,600 for the previous 10 years. Similarly, ports, distribution centres, and road and rail hauliers are unable to deal with the increased demand due to a combination of labour shortages and inflexible infrastructure. Global factory production has also struggled to keep up, especially in Asian countries where mandated COVID lockdowns are still in force, hitting supplies of shoes to Nike for example. Higher distribution costs are a given and – worse – some customers will not get orders filled for the busy Thanksgiving and Christmas periods. The global supply chain is being stretched beyond its ability and it could be several years before bottlenecks get fixed. Indeed, some companies or industries may need to rethink their outsourced overseas production strategy by investing in their own facilities closer to the customer.

Elsewhere, a severe imbalance in global natural gas market has emerged, the combination of strong Asian and European demand and some supply disruptions. European gas prices have risen a dizzying four-fold from the start of 2021, which is having a devastating effect on European electricity prices and a range of global commercial activities, from fertilizer to animal feeds, plastics to the fizz in fizzy drinks.

There is upward pressure on wages too, not only among hourly workers where supply could still be impacted by pandemic payments. In the recently conducted CNBC Global CFO Council, 84% of CFOs said it is harder to hire employees now. More generally, Bank of America research found that mentions of inflation on earnings calls by S&P 500 companies jumped to record levels in Q2:21, with labour costs carrying much of the blame.

Exhibit 10: Mentions of “inflation” jumped nearly 1100% YoY to a record high

S&P 500 companies’ mentions of “inflation” per earnings call (2003-present)



Source: BofA Global Research

Official inflation rates are on the increase. In the US, the Core Personal Consumption Expenditures Index – the Fed’s preferred gauge of underlying inflation – increased 3.6% year-on-year in August, the highest rate in 30 years and well above the Fed’s own 2% target. Many consumers feel official inflation stats understate the true rise in the cost of living, and soaring house prices and rents in countless major cities around the world is quickly becoming a political battleground. If we are to believe monetary policymakers, the recent pickup in inflation is “transitory” and this may prove to be the case. However, the longer inflation persists and the higher it goes, the greater the likelihood that people and businesses demand to be compensated now for fears of reduced purchasing power in the future.



Commentary

Once out, that genie can be very hard to put back in the bottle. This scenario could have serious implications for stock markets because it would call into question the sustainability of zero interest rates – the lynchpin of economic growth, elevated optimism, and extended stock market valuations over the last decade.

Does this mean that we are poised to make major defensive changes to the portfolio? In short, no.

We strongly believe that having a macro view which guides investment choices is not a smart long-term strategy. Of course, it would be fantastic to be defensively positioned ahead of a market sell off – indeed some macro investors became household names by shorting stocks on the eve of the global financial crisis in 2007. However, in our opinion, consistently calling the macro picture right is very difficult, chiefly because it requires the prediction of a chain of complex events and if just one of these assumptions is incorrect the overall conclusion is likely to be wrong. By and large, the macro soothsayers of the financial crisis have been unsuccessful since – one hit wonders, you might say. For another great example of why macro investing is so hard, look no further than the last 18 months: the economic outlook appeared extraordinarily challenging and immunology experts predicted it could take years to discover an effective vaccine against COVID. An investor that acted on that singular view would have missed out on tremendous stock market gains over the course of 2020 and 2021 to date.

By contrast, we firmly believe that making many well-informed micro decisions has a far greater chance of success. Not only are companies easier to analyse and value than economies, when diversified across geographies and industries, making one wrong stock decision does not mean being wrong on the next.

So, we aren't placing all our chips on the narrative supply chain begets higher inflation, which begets higher interest rates. We always try to think how our portfolio of companies would fare under a range of scenarios. The narrative outlined above is just one future path, albeit a significant one that is not being priced into general market valuations. In any case, it's a very complex narrative with no clear answers. Most companies that make "stuff" to one degree or another rely on a long and convoluted supply chain. Figuring out how our companies could be impacted by a shortage of this or price increases in that would be an impossible task, made even more difficult by hedges and supply agreements that may be in place. At the very least though we would expect a heightened level of choppiness in company profits (including our own) over the next year or two.

Rising inflation is something investors have not had to think seriously about since the 1980s so there would undoubtedly be some nasty surprises and lessons to be (re)learned for us and others. The best hedge against inflation is to have a strong and well-invested brand, high switching costs or a customer value proposition that is far ahead of competitors. Our portfolio is skewed towards quality companies and we are confident many will be able to pass on increased input costs to their customers – think Heineken, Costco, Nike, TSM, Medtronic and S&P Global, among others, as good examples of this. However, we would be foolish to think that all our companies would get through unscathed. This is an area we will continue to monitor.

What about higher interest rates? As it relates to balance sheets, we insist that our companies are financially strong, have termed-out debt and an ability to keep the business well-invested. Higher interest rates could impact leveraged or weaker competitors and we would also hope several of our holdings would be able to capitalise – Berkshire Hathaway, DCC, Steris and Melrose are good examples of this. However, it's likely the bigger impact of higher interest rates would be on valuations – especially on high growth and speculative companies to which the Strategy is under-exposed. We would be confident that we would pick up relative performance in such a market de-rating and at the same time try to also upgrade the quality and growth potential of the portfolio.

For now, all this is conjecture, what ifs and maybes. As always, being ready is all that we can do while we wait.



Commentary

Q3 portfolio review

The Strategy slightly lagged the MSCI World in Q3 and year-to-end September was +13.5% (USD terms, gross of fees), ahead of the benchmark return of +13.0%.

Among the standout performers in Q3 were Alphabet (+12%, Euro), Costco (+16%, Euro), Alcon (+19%, Euro) and Bank Leumi (+17%, Euro).

Alphabet has been a strong performer since added to the portfolio in 2019. COVID was helpful for general search in Google, which has driven advertising revenues. Also, YouTube continues to win increased viewership from linear TV.

Newly added to the portfolio in 2020, **Costco** continues to execute well by growing same stores sales (bigger basket sizes) and new store openings. By virtue of its limited stock keeping units (SKUs), Costco should be better placed to manage supply chain issues versus other retailers.

Eye care company **Alcon** reported excellent Q2 results. Alcon was spun out of portfolio holding Novartis in 2019 and we increased the Strategy's ownership in 2020 and again in 2021. COVID negatively affected elective eye surgeries, into which Alcon sells machines, lenses, and consumables. With restrictions lifted, demand rebounded strongly. Investments in new products since its spin out are also beginning to contribute.

Held in the Strategy since 2008, Israel's largest **Bank Leumi** also reported good Q2 results, which not only proved out its strong credit culture out the far side of COVID lockdowns, but also continued to show the progress management is making towards creating a leaner bank capable of competing and partnering with FinTechs.

Among the laggards in Q3 were Oshkosh (-16%, Euro), Samsung (-11%, Euro) and Sandstorm Gold (-25%, Euro).

Specialty commercial and military truck manufacturer **Oshkosh** was weaker as management warned that supply chain challenges, coupled with higher steel and labour costs, will persist through the next few quarters. Beyond that, Oshkosh should benefit from both pricing and strong replacement demand from rental companies in addition to the recent contract win to replace the US Postal truck fleet becomes revenue producing.

Samsung was one of the Strategy's top performers in 2020 (+48%, Euro). This was on the back of very strong demand for memory chips, as WFH and demand for cloud services boomed. Roll-forward into 2021, the stock has been a laggard. The main reason is the fear of lower future sales of both PCs and smartphones post COVID, both of which are key drivers of demand at Samsung's key memory division. Samsung has also been impacted by disruptions in the production of its white goods in Vietnam, though this will not have a material impact on profits.

Sandstorm finances gold mining companies in return for the right to purchase a percentage of gold produced at a fixed price. Naturally, its financial performance and share price are leveraged to the price of gold and annual production, as well as expectations for key mines due to come on stream in the future. The development of one of its major future assets (Hod Maden) continues to be pushed out – previously it was 2023, now it's 2025 – and this weighed on the shares in the quarter. We continue to be bullish on its long-term future.

Q3 portfolio review

There were no portfolio new buys or full sales during the quarter.

David Coyne, co-lead Portfolio Manager



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