Setanta Global Equity Strategy (USD)
March 2022

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

Until Russia's horrifying invasion of Ukraine, market developments were unfolding in a manner we had been expecting. The pandemic seemed to be entering a manageable, endemic phase. Consumer behaviour was normalising. Governments and Central Banks across the world were beginning to withdraw the enormous financial stimulus that had helped to define market price action since the spring of 2020.

(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

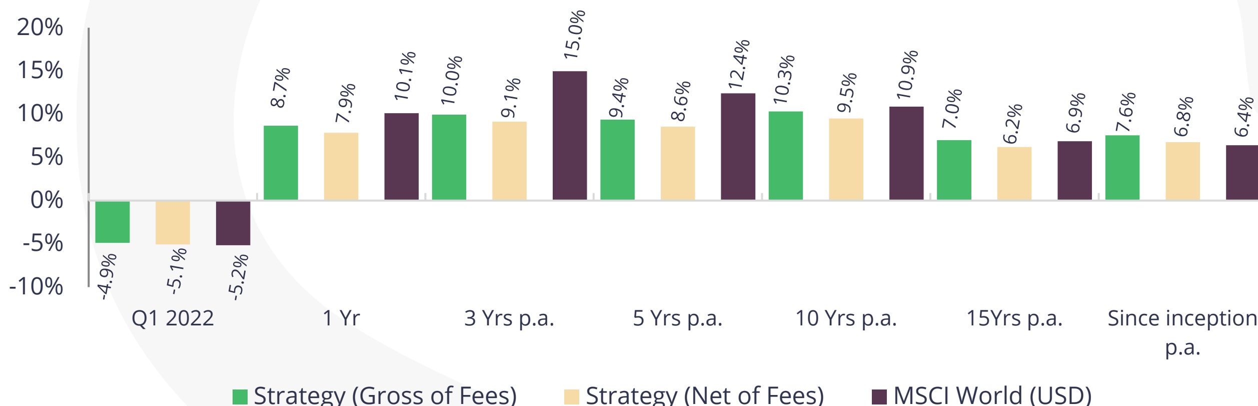
Businesses we own must have strong balance sheets

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 March 2022

Strategy Performance (USD)



Yearly Performance (USD)

	2017	2018	2019	2020	2021
Strategy (Gross of Fees)	23.8%	-8.5%	19.8%	5.4%	23.2%
Strategy (Net of Fees)	22.9%	-9.1%	18.9%	4.6%	22.3%
MSCI World (USD)	22.4%	-8.7%	27.7%	15.9%	21.8%

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 1.1127. 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).

Portfolio Valuation Statistics

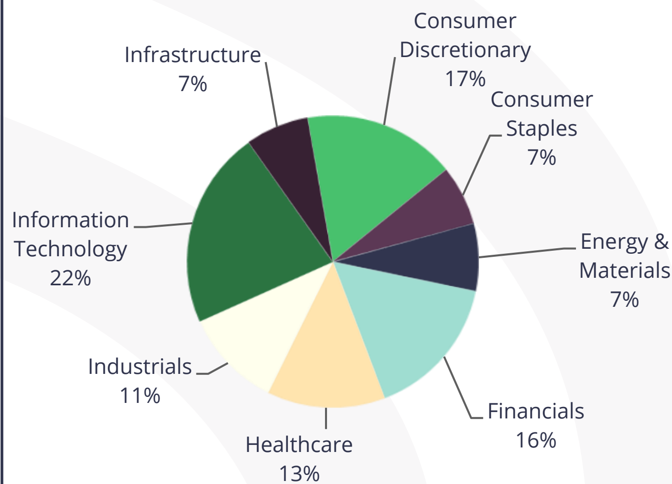
PRICE/BOOK	2.3
PRICE/EARNINGS RATIO (FY 1)	16.8
DIVIDEND YIELD %	1.7
AVERAGE MARKET CAP $BN	149.2
NO. OF HOLDINGS	81
ACTIVE SHARE %	84.2
DEBT/EQUITY %	48.8

Top 10 Holdings

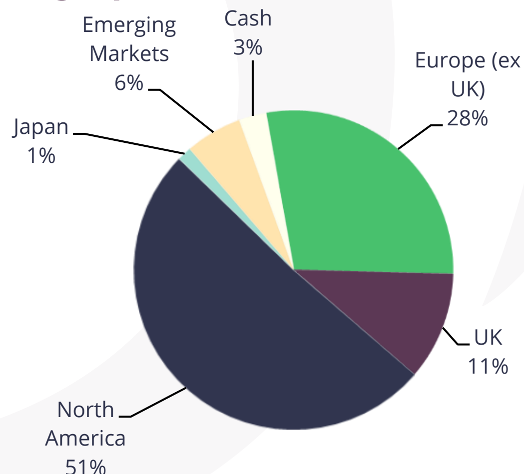
COMPANY	SECTOR	WEIGHT
MICROSOFT CORP	INFORMATION TECHNOLOGY	4.6%
BERKSHIRE HATHAWAY	FINANCIALS	3.8%
ALPHABET INC	CONSUMER DISCRETIONARY	3.4%
COSTCO WHOLESALE	CONSUMER DISCRETIONARY	2.9%
ORACLE CORP	INFORMATION TECHNOLOGY	2.7%
MCDONALD'S CORP	CONSUMER DISCRETIONARY	2.7%
SAMSUNG ELECTRONIC	INFORMATION TECHNOLOGY	2.5%
JOHNSON & JOHNSON	HEALTHCARE	2.3%
DCC ORD	INDUSTRIALS	2.2%
JOHNSON CONTROLS	INDUSTRIALS	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.

Sector Distribution



Geographic Distribution



SETANTA Asset Management

Investor expectations were readjusting accordingly and the Setanta portfolio was regaining ground that had been lost during the two previous, extraordinary years. Putin's appalling actions have created a new round of uncertainties for markets. Barring additional catastrophic developments in the conflict and, critically, assuming the global economy can return to some form of normality, we think the longer-term prognosis for the portfolio will be little changed by these events, as unconscionable as they are. Nonetheless, while the companies in which the Setanta portfolio invests have only marginal direct exposure to the Ukraine-Russia region, there will be indirect impacts that could be painful in the nearer-term. Supply chains that were placed under severe strain during the past two years and were beginning to normalise, are now being compromised again. Sanctions, port closures and transportation restrictions resulting from the invasion are compounding existing shortages, causing commodity prices to increase across the board. These stresses could hardly be coming at a more difficult time, with inflationary pressures already biting. The only saving grace is that Europe is now through winter.

Some examples of the new economic stresses:

- EU imports of natural gas from Russia account for almost 40% of consumption. Oil is closer to 25% of EU consumption and coal probably closer to 50%. Energy prices have increased substantially since supplies of oil were already struggling to keep pace with demand after years of lower upstream investment across the industry.
- Higher petroleum prices are feeding into higher prices for derivatives such as chemicals and plastics.
- The Financial Times estimates that Russia and Ukraine supply close to one third of the world's wheat exports, a fifth of global corn trade and almost 80% of global sunflower oil production.
- Russia and Belarus produce 40% of the world's Potash (a critical input in fertilizer production). Fertilizer prices had already increased substantially due to high gas prices.
- Ukraine supplies 50% of the world's neon gas, which is a critical input for semiconductor production.
- Ukrainian companies are important producers of wiring harnesses, that are used to hold the electronic cables together in cars. Some European automobile manufacturers have already curtailed production because of shortages of these and other parts.
- Russia is a key producer of high-grade nickel which is used to produce stainless steel and batteries for electric vehicles
- Shortages of building materials, including bricks, pipes and slates, are emerging in Europe, due in part to the impact that high energy prices are exerting on producers. The cost of construction materials in Europe has already risen by more than 20% in the past year, with more to come.

Commentary

These difficulties are of course accentuating the pressures on consumer budgets that were already coming under strain, thanks to inflation in prices of energy, basic materials, and food. The impact on retail prices will vary by region, depending on local market conditions, but futures prices for Wheat, Oil, Corn, and Copper have increased by approximately 80%, 70%, 40% and 20% respectively over the past year. We can therefore expect some impact on consumer spending in the coming quarters at least.

The longer-term risks are, however, more troubling. We are not geopolitical experts but clearly these military developments, and China's perceived support of Russia, have potentially very serious implications for the global economy; implications that extend well beyond near-term supply chain disruption. The modern economy has thrived through globalisation, and China has been central in that process. Not only has it become a critical manufacturing hub, but it has become a key market in itself for western goods. For some years, governments across Asia and the West have been increasingly uneasy with President Xi's growing projection of Chinese power. These recent developments have the potential to bring the world closer to a new type of cold war and an unravelling of the process of globalisation. This would have far-reaching consequences and it is difficult to know where investors could seek shelter in such a setting. Fortunately such a scenario is not in the best interests of China or the West so our base case is that pragmatism will win out. Everyone should hope that it does.

Given this backdrop, there was substantial rotation within the stock market during February and March. Shares in global energy and mining stocks were up around 30% (Euro terms) due to the expected disruption in supplies. Technology and consumer discretionary stocks were among the worst performers, falling 8-10% (Euro terms), as higher interest rates caused a rotation out of higher valued growth stocks. Overall, global equity markets finished the quarter down just 3% (Euro terms). Considering the macro developments described above, which added to already high equity market valuations, investor reaction was surprisingly sanguine. This does not mean the risks have gone away.

Strategy performance

The Setanta Global Equity Strategy was marginally ahead of the benchmark in the period (+0.2% relative). For the first half of the period, the strategy benefitted from the rotation into value stocks. Unfortunately this outperformance was surrendered following the outbreak of the war; the strategy is underweight energy and mining subsectors (substantial outperformance, per above), and overweight Europe (underperformance, due to its proximity to and greater reliance on Russia / Ukraine). Below is a summary of some of the top and bottom performers in the quarter.

Top 5 contributors	Period average weight	Total return (Euro)	Contribution to return
Berkshire Hathaway	3.4%	21%	0.7%
Exxon Mobil	1.2%	40%	0.4%
Markel	1.2%	22%	0.3%
Tenaris	0.6%	49%	0.3%
Exelon	1.4%	19%	0.2%

Commentary

Berkshire Hathaway rose 18% (U$ terms) in Q1. It is the strategy's second largest holding and a core position for nearly 10 years. Our regret is that we haven't owned it for longer. The Group is the world's biggest conglomerate, with operations in insurance, railroads, utilities, retailing and manufacturing. In addition, it owns a large portfolio of equity investments, including a significant stake in Apple (~20% of Berkshire's market cap). It has one of the world's strongest corporate balance sheets, around $150bn in net cash. Cash is a drag when the market is 'risk on' but gives plenty of reassurance when worries creep in as they did in Q1. We can think of Berkshire's cash pile as being entirely due to 'float' – money they can invest but which does not belong to them – largely coming from their insurance businesses. Rising interest rates increases the value of this float as they are more likely to be able to deploy the cash into higher return assets. Berkshire also benefitted from the market's rotation into defensive value stocks (US railroad and utility stocks were similarly strong for example). The stock's valuation is still favourable and we continue to be happy holders.

Markel also rose strongly in the quarter (+20% U$ terms), hitting an all-time high. Like Berkshire, it makes an underwriting profit on its insurance operations, alongside an insurance float that is carefully invested into public securities as well as wholly owned consumer, construction, transport and manufacturing companies. Markel has produced an excellent 11% compound growth in book value per share in the 10 years we have owned the stock, which is exactly the same as the share price total return over the same period i.e. there has been no increase in valuation (not the case for the market overall). We would be delighted if the company reproduces a similar return in the next 10 years.

With energy stocks performing well during the quarter, it is not a surprise to see two of our energy-related holdings – **Exxon Mobil** (+37% U$ terms) and **Tenaris** (+49% in € terms) – contributing so positively. Shares in US utility **Exelon** were also strong (+16% in U$ terms). In addition to benefitting from the value rotation trade, the Exelon recently spun off its electricity generation assets, leaving the remaining regulated transmission business looking relatively attractive.

Bottom 5 contributors	Period average weight	Total return (Euro)	Contribution to return
Johnson Controls	2.4%	-17%	-0.5%
Keysight Technologies	1.9%	-22%	-0.5%
Playtech	1.9%	-20%	-0.4%
Nike	2.1%	-17%	-0.4%
Melrose Industries	1.3%	-22%	-0.3%

Johnson Controls fell 17% (U$ terms) in Q1. This followed a large gain made in 2021 (+77%), as the company executed well on its ongoing transformation post the Tyco integration. The company laid out three-year targets in late-2021 and it is likely that investors are now debating whether ongoing supply chain challenges may impact on-budget delivery of their cost savings program. In addition, the company has a mid-teens revenue exposure to Europe and the Russia-Ukraine war could hamper their 6-7% organic growth expectations. Both of these factors are near term in nature versus an attractive longer-term technology opportunity. Prior to the launch of their OpenBlue digital platform, each $1 in revenue from equipment installed drove $5 in services revenue over the life of the equipment. OpenBlue increases the services revenue opportunity to $10. Additionally, there is a positive secular demand in the company's favour – commercial buildings account for some 40% of global greenhouse gas emissions and upgrading to modern HVAC systems such as Johnson Controls' is a good way for countries to hit their ambitious decarbonisation objectives.

Commentary

Keysight provides electronic design and testing services. Like Johnson Controls, the 24% fall in Q1 (U$ terms) followed a strong performance in 2021 (+58%). Keysight's stock price peaked in late December 2021 and traded down in line with many US technology peers. Keysight reported its Q1:22 results in mid-February, which we believe were strong. We especially liked the 4th consecutive quarter of +20% order growth. While this order growth gives us confidence in the revenue generating capability of the company over the coming year, near term sales are likely to trail orders as Keysight is supply constrained due to component shortages. This as well as slight margin pressure resulted in share price weakness. However, we believe the future is looking brighter than ever. Its management has done a tremendous job of diversifying the business and it's no longer just a play on 5G mobile telephony. Keysight will likely see several more years of strong revenue growth from 5G, but also it will benefit from its increased exposure to structurally growing end markets like electric vehicles (EV) and autonomous vehicles (AV), semiconductor testing and 400G technology used by hyperscale operators. These revenue growth opportunities coupled with attractive valuation give us confidence that Keysight's share price will be a good source of outsized returns for our investors over the coming years.

Playtech stock price fell 18% (GB£ terms) in the quarter, which followed an 83% rise in 2021. Most of this decline came towards the end of January when it became evident that the proposed acquisition of Playtech by Australian company Aristocrat was doomed to fail. This came to pass in early February as the acquisition failed to secure 75% of votes in favour of the deal. Over the past 6 months a plethora of Asian based investors have independently built-up stakes in Playtech, totalling close to 30% of the outstanding shares; it was these shareholders that voted against the deal, leaving Aristocrat unable to proceed. The proposed deal was at £6.80 per share and the share price immediately fell down to a £6 level where it remains today. It has since become apparent that these Asian shareholders are also interested in acquiring Playtech and they have formed a consortium with TTB Partners in Hong Kong to explore making their own offer for Playtech. We remain hopeful that a new offer greater than £6.80 will be tabled for Playtech.

Nike's results continue to shine, due to strong top line growth and increasing margins. In particular Nike is having huge success with its online direct-to-consumer offering, which now accounts for 26% of group sales. The margin difference between their 3rd party wholesale channel (such as Footlocker) and online direct is substantial. We think Nike direct channels, including online direct, will grow to 50% or more in 5 years, which should lift Nike's gross margin – and in time the operating margin – to new highs. The stock nonetheless fell 19% (U$ terms) in the quarter, as higher P/E stocks like Nike were sold off. We believe over the medium- and long-term shareholders will be well-rewarded.

Melrose is largely exposed to two key end markets, Automotive components and Aerospace components. Underlying demand for new cars seems to have fully recovered to 2019 levels or higher. The difficulty has been that OEM production has been constrained by a shortage of components, primarily semiconductors. This problem was easing in recent months but the invasion throws a potential new spanner in the works given the scope for further supply-chain challenges. At this point Melrose management is hopeful that automotive customers can find alternative component sources but visibility remains limited at this juncture. We believe that the supply chain issues will eventually be resolved. Management has done a good job managing costs and cash flow over the past two years. The Balance Sheet has improved materially and the auto business is primed to see meaningful margin improvement when underlying demand can be fully realised. The aerospace division is a bit further behind, with demand for wide-body aircraft (long-haul) still lagging, but narrow body (short-haul) demand is recovering. Management expects to have largely completed the aerospace division restructuring by the end of this year such that margins should have potential for substantial expansion as demand recovers over the next few years. In short, we still see significant value in the business.

Portfolio activity

The strategy exited Liberty Global and made two new investments in Netflix and EssilorLuxottica.

Liberty Global is a cable operator, providing TV and broadband services in various countries in Europe. We first bought it in 2014 and we were certainly attracted to the fact that shrewd investor John Malone, whose long and successful history with the US cable industry had earned him the nickname "cable cowboy", was Chairman and largest shareholder. What we didn't appreciate at the time was how tough the European regulatory and competitive environment would prove to be. In the face of this challenge, management has done its best to engineer a better outcome, including making select in-market acquisitions to enhance scale, as well as making disposals at attractive prices in markets where it felt at a competitive disadvantage. On the face of it, the stock is trading at an attractive valuation – double digit free cash flow yield – and the company is carrying out meaningful share repurchases which could prove to be very value enhancing. Unfortunately, we see no let-up of the tough regulatory and competitive environment and we are conscious of the company's considerable financial debt load, a combination that could lead to a negative outcome for shareholders. Portfolio manager David Byrne decided the balance of risk and reward was tilted too much to the former, especially compared to the prospects for two alternative stocks he had on the bench.

Commentary

David has been following **Netflix** for nearly 10 years and the Setanta equity team has had numerous lengthy discussions on it. Over this time we decided to sit on sidelines. While we could see the potential, in the early years it was very difficult to handicap the odds of it becoming the dominant streaming service globally. Then as time went on and Netflix's path to success became clearer, its valuation rose by more than we were willing to pay. In recent months the market's rotation out of growth, followed by management guidance for lower-than-expected new subscribers in Q1:22, left the share price 20% and then almost 50% down from its mid-November high, which gave David an opportunity to take a starter position. Longer term Netflix should have advantaged economics over its competitors. It can sustainably invest the most in new content because it can spread the cost over a 220 million subscriber base that is far bigger than anyone else (#2 streamer Disney+ has 130 million subscribers). This in turn should draw in more subscribers, especially in Asia where it is underpenetrated. The quality and breath of Netflix's offering enables it to charge its subscribers ~6-8% more every year without impacting on churn rates (which are very low). Looking forward a few years, we can see a growing cash machine with investment in content potentially moderating. The investment isn't without risk. Netflix is still in "build out" mode and steady-state profitability is not entirely clear yet. We are also wary that increasingly desperate and deep-pocketed competitors could look to out-spend each other trying to acquire content and subscribers, potentially ruining the economics for all. We have kept the position size on the small side for now (~0.7% of strategy at quarter end) and we will continue to watch and learn.

The second addition was eyewear group **EssilorLuxottica**. The company is the product of a 2018 merger between Italian sunglasses and frames maker Luxottica (owner of Ray-Ban and Oakley brands) and leading global lens maker Essilor. This was followed in 2019 by the acquisition of GrandVision, which operates over 7,000 opticians across Europe and the Americas, adding to the group's existing physical store networks Lenscrafters and Sunglass Hut. The resulting group is one-of-a-kind in the industry, with the ability to design and make frames and lenses, as well as sell to the customer either through independent opticians, its own stores or online. The emerging online channel in particular is interesting. There is an opportunity for EssilorLuxottica to pocket the difference between selling glasses through high-cost physical stores and low-cost direct-to-consumer, which as mentioned above is what portfolio holding Nike has been doing in recent years. Taking a step back, demand for corrective eyewear is structurally growing. Not only is there an aging population tailwind, but people's increased use of screens is leading to a step-change in eye degeneration and so a greater need for corrective eyewear. EssilorLuxottica spends far more on R&D than anyone else in the industry. As a clear leader in lens innovation and coatings, the company could take an outsized share of growth. EssilorLuxottica was ~0.4% of the strategy at quarter end and we may increase this weight over time.

Rowan Smith & David Coyne, Portfolio Managers

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