Setanta European Equity Fund (CAD)
Q3 2022

Fund Description

The **European Equity Fund** ('the Fund') is managed by Setanta Asset Management Limited ("Setanta") and is a representative account of the European Equity strategy.

The Fund is an actively managed equity portfolio which holds c.30 stocks which are located in or active in Europe. The portfolio is managed in accordance with the Setanta investment philosophy. That is, the managers seek to own good businesses for the long-term at prices below what they think they're worth, carefully considering each investment's risk profile.

The Fund is managed by the lead portfolio manager, who also looks to leverage off the experience and knowledge of his colleagues. The aim is to achieve a sensible level of diversification on a sector and geographic basis.

The investment objective of the Fund is to outperform the MSCI Europe index over the long term.

Fund Commentary

The European Equity fund returned -8.44% for the third quarter underperforming the relevant benchmark, which returned -4.29% by -4.34%. The fund is -3.50% behind year to date, returning -25.3% versus -22.6% for the benchmark. European equity markets sank during the quarter as market participants tried to digest a wide range of economic variables and what their impact may be.

(Fund Commentary continued on Page 3)

Portfolio Manager

David Byrne, 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

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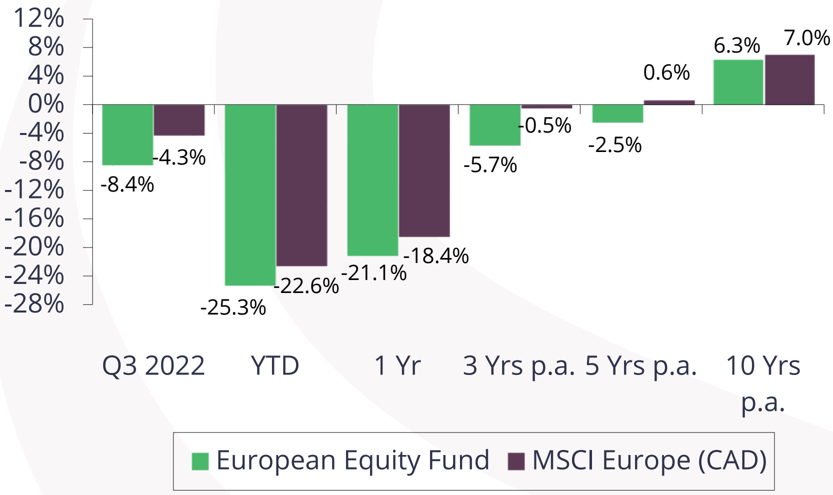
Fund Performance – 30.09.2022 (CAD)



Yearly Performance

Year %	2017	2018	2019	2020	2021
Fund	15.3	-4.3	13.8	-7.8	14.1
Benchmark	17.3	-7.2	17.5	3.5	15.3

Performance Source: Setanta Asset Management Limited. The Fund returns stated are based on the movements in the unit prices of the CLA European Equity Fund (SF037) [IEC11002] 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 Europe (CAD). **Holdings Source:** Setanta. Sector allocations based on invested portfolio only (excludes cash). **Fund Statistics Source:** Bloomberg.

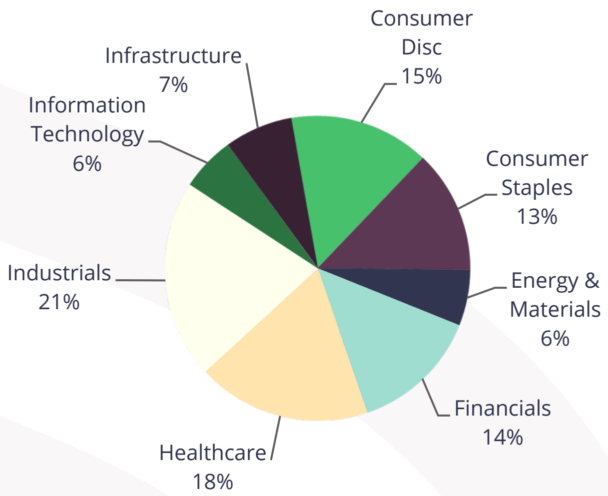
Top 10 Holdings

COMPANY	SECTOR	% OF FUND
CRH ORD	INDUSTRIALS	6.4%
DIAGEO	CONSUMER STAPLES	6.4%
DCC ORD	INDUSTRIALS	6.2%
GPE BRUXELLES LAMBERT	FINANCIALS	5.7%
NOVARTIS	HEALTHCARE	5.5%
SANOFI	HEALTHCARE	4.9%
GEA GROUP	INDUSTRIALS	4.6%
BANK OF IRELAND	FINANCIALS	4.3%
GSK PLC	HEALTHCARE	4.1%
LIBERTY GLOBAL PLC	CONSUMER DISCRETIONARY	3.7%

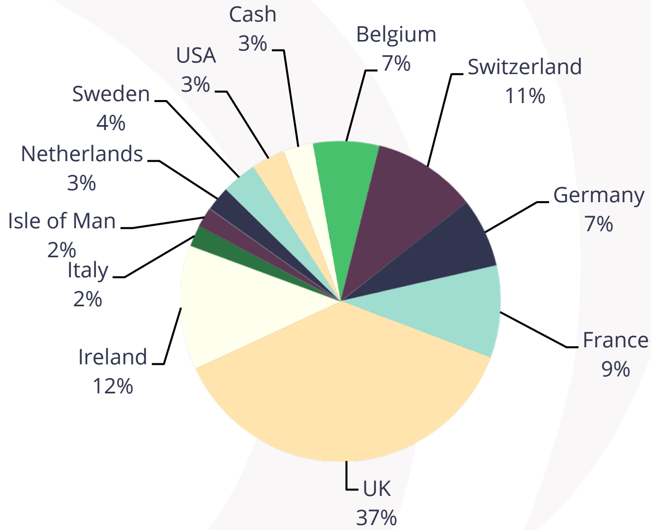
Fund Statistics

PRICE/BOOK	1.5
PRICE/EARNINGS RATIO (FY 1)	11.8
DIVIDEND YIELD %	2.6
AVERAGE MARKET CAP C$BN	50.5
NO. OF HOLDINGS	31
ACTIVE SHARE RATIO %	88.2
DEBT/EQUITY %	59.9

Sector Distribution



Geographic Distribution



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Commentary

With inflation persistently high central banks around the world have been raising rates aggressively, in an effort to contain it. Many European countries are also struggling to secure energy sources and those that do are paying brutally high prices. Whilst the lights are still on, the probability of energy rationing and blackouts becomes a very real possibility over the coming months. Energy is still the lifeblood of economies. Modern economies simply don't perform without it. European economies are heavily reliant on imported fossil fuels to produce and transport goods. Against this backdrop it's not surprising to see the industrial heartland and consumer facing businesses in Europe struggle. This set of circumstances, if it were sustained for more than a few quarters, could leave once perceived strong businesses struggling for survival. At Setanta, we focus on the long term when investing in quality companies with sensible balance sheets to ensure they have the wherewithal to cope with challenging economic backdrops. We also look for our holdings to have pricing power afforded through some combination of strong market positions, stable industry structures, brands and / or customer switching costs. While the short-term underperformance of the fund in the most recent quarter is disappointing, we feel our companies should be able to navigate the current environment better than most over the long term.

The UK endured some additional volatility when the new Prime Minister, Liz Truss, and Chancellor of the Exchequer, Kwasi Kwarteng, introduced a mini budget with unfunded tax cutting measures which were poorly received by the markets and required intervention in the gilt market by the Bank of England. We admit to being worried about the deterioration in the UK's long-term governance, competitiveness, and relevance. While we have an overweight position in UK quoted stocks, this overstates the exposure to the domestic UK economy with holdings like Diageo, GlaxoSmithKline, Ferguson, Lancashire, Unilever and Haleon deriving the vast majority of their earnings overseas.

Q3 Performance Drivers

In a time of market turmoil, we would ordinarily look to our Healthcare holdings as a source of relative stability. Unfortunately, **GlaxoSmithKline** (-27% in Stg), **Sanofi** (-19% in €) and **Haleon** (-9% in Stg) were all caught up in litigation concerns revolving around heartburn drug Zantac. GlaxoSmithKline marketed the original prescription only drug in the US and subsequently participated in an OTC (over the counter) joint venture. From 2000 onwards, the exclusive US OTC rights passed through the hands of Pfizer, Boehringer Ingelheim and latterly Sanofi. Haleon is GlaxoSmithKline's consumer health business which was spun off in July this year.

In 2019, an independent lab identified a substance called NDMA in Zantac. Low levels of NDMA are commonly found in food and water. However sustained exposure to NDMA at high levels creates a potential risk of cancer. The FDA ran its own tests on Zantac samples and found NDMA at low levels (similar to that in food and water) and decided to take no action. Subsequent tests confirmed that NDMA levels do increase over time, especially if the product is stored at higher temperatures, which might raise the level of NDMA above the acceptable daily limit. As a result, in April 2020 the US FDA requested that Zantac be withdrawn from sale. GSK and Sanofi had already begun to exit the market prior to this announcement. A number of other global regulatory authorities including the Canadians and Europeans have followed the FDA's lead and the product is no longer sold in the major markets. The issue blew up again in August 2022 although there do not appear to have been any material new developments. The companies contend that the scientific claims of the claimants are highly questionable and there have been a number of independent studies that seem to support their position. The complex ownership history of the US OTC rights, and the likelihood that various (potentially contested) indemnities have been provided as the rights changed hands over the years makes it very difficult to assess who has the most exposure. The market quickly priced in enormous pay-outs relating to the litigation. Unfortunately, there is now an information vacuum until the court cases proceed but our sense is that the selloff is probably significantly overdone.

Adidas declined -30% (in €) in the quarter. The company issued a profit warning in July with Chinese market weakness persisting. The ongoing Better Cotton Initiative controversy has seen domestic brands take market share at the expense of western brands like Nike and Adidas. A weaker consumer backdrop, China's zero-Covid policy and supply chains coming back on line after a period of disruption have all contributed to inventory build-ups across the sporting footwear and apparel sector. Higher markdown activity is necessary to clear through elevated and imbalanced inventory levels. CEO Kaspar Rorsted announced his intention to leave his role in 2023 in a mutual agreement with the board. We have added to our position in Adidas on weakness. Ultimately, we believe there is real heritage in the brand built up over decades of investment and that scale is critical in terms of brand building, sponsorship deals and distribution. Healthy living trends should be supportive of growth over the medium term and a shift to digital potentially allows the company to capture more share and margin.

On a more positive note, **Lancashire** was up +23% (in Stg) as it recovered from share price weakness earlier in the year, spurred on by a low valuation and hope that insurance losses from the war in Ukraine will not be as bad as previously feared. **Bank of Ireland** continued its advance climbing +9% (in €) as it reported reassuring half year results and looks to be on a credible path towards a 10%+ Return on Tangible Equity aided by the market exit of Ulster Bank and KBC, the beneficial impact of rising interest rates on net interest margin and the accretive impact of the KBC loan book and Davy Stockbroker deals. **Diageo** was another relative outperformer in the period rising +8% (in Stg). The company reported impressive results for the year to June 2022 with strong top line growth and margin expansion. Management continues to see benefits from premiumisation trends and has not seen any signs of down trading to date. The spirits category held up relatively well through the Global Financial Crisis and looks to be displaying good resilience once again.

Transactions during the Quarter

We sold **Fortum** and **Melrose** during the quarter. We initiated a new position in **Air Liquide** and received a new position in **Haleon** as a spin-off from Glaxo SmithKline. **Fortum** is owner and operator of a number of different power generation assets, mainly located in Europe. They operate hydro, nuclear and fossil fuel assets. Over the past 18 months it was developments at their subsidiary, Uniper in Germany that alarmed us most. As the war in Ukraine unfolded the price of gas rose exponentially and this exposed a fundamental flaw in Uniper's business model as they found themselves unable to take delivery of contracted gas. We felt, at the time, it was impossible to determine with any degree of certainty the equity position of Fortum and for that matter sustainable profits in their business segments. With this in mind, we felt the capital was best redeployed into Air Liquide.

Air Liquide is a global leader in the production and supply of industrial gases to a wide range of end markets. Air Liquide's end markets include mobility, healthcare, electronics, chemicals and industrial users. In many instances there are no alternatives to the gases Air Liquide's supplies to customers. Many of Air Liquide's customers require large amounts of product where in some cases Air Liquide operate on a customers' premises. The business is very cash generative with decent returns on capital and a solid growth outlook. In addition to traditional business lines, the business has potential to capitalize on a number of initiatives as the world transitions from fossil fuels to more sustainable energy sources. We bought a small position, at what we believe was an attractive valuation, with the potential to add to it over time.

Commentary

We sold out of our position in **Melrose**, a name we have held in the portfolio since 2014. By way of reminder, the company's model is based on acquiring under-performing industrial / manufacturing businesses, improving them, selling at a higher valuation, and returning proceeds to shareholders before starting the process all over again. Management established a strong track record of value creation through a number of transactions since their first in 2005. Their most recent significant deal was the 2018 acquisition of GKN which makes parts for car companies and aircraft manufacturers and had continually missed margin targets in the years preceding Melrose's takeover. While restructuring efforts have proceeded as planned under Melrose's stewardship, the Covid-19 pandemic, supply chain difficulties and macroeconomic concerns have given rise to a weak aerospace and automotive demand backdrop negatively impacting profits. In September, management announced its intention to split the business into two separately listed entities, focused respectively on Aerospace and Automotive, both of which will become acquisition vehicles. They do not wish to sell assets now on the cheap but see this move as facilitating new deals. We were concerned by the change in business model away from returning capital to shareholders and being left with a relatively small, potentially illiquid auto parts stock. Notwithstanding management's track record prior to GKN, we decided to exit the position.

In July we inherited a small position in **Haleon** as a result of GlaxoSmithKline spinning off its consumer health business. The company holds leading positions in Over-the-Counter, Vitamins, Minerals & Supplements and Therapeutic Oral Health. Their top selling brands including Sensodyne, Voltaren, Centrum, Polident, Advil, and Panadol. These categories offer decent growth prospects. With increased investment in Advertising & Promotion and renewed focus on brand building, management is targeting 4-6% top line growth and moderate margin expansion. Within weeks of the spin, Haleon was hit bit by the Zantac litigation news discussed earlier. We continue to hold the position.

We would like to thank all of our clients for their continued support.

David Byrne, Portfolio Manager

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