# Setanta Income Opportunities Fund
Q3 2022

## Fund Description

The **Income Opportunities Fund** ('the Fund') is an actively managed portfolio primarily comprising global equities but with the flexibility to invest in assets which offer attractive income and reasonable value. These assets include fixed income, property (including REITs) and cash. The Fund is not constrained by limitations on the level of any given asset. In practice, the Fund has had its greatest weight in equities, reflecting the breadth of that market, Setanta's expertise in that area, and the option writing strategy employed by the Fund. Nevertheless, property, fixed income and cash have all played meaningful roles in past returns of the Fund, at times, comprising up to 50% of the Fund's assets. The portfolio is managed in accordance with the Setanta investment philosophy. That is, the managers seek to own good assets 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 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 employs an option writing strategy. This entails the sale of both call and put options in return for a cash premium, representing an income stream that boosts the underlying income yield of the Fund. This strategy is employed in a conservative fashion, as all options written are fully covered.

The Income Opportunities Fund has two investment objectives:

1. To generate an annual income yield at a target rate. This is declared at the start of each financial year.

2. To achieve capital appreciation over the long term.

## Portfolio Managers

Richard Doyle, CFA; David Pastor, CFA; Caroline White, 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

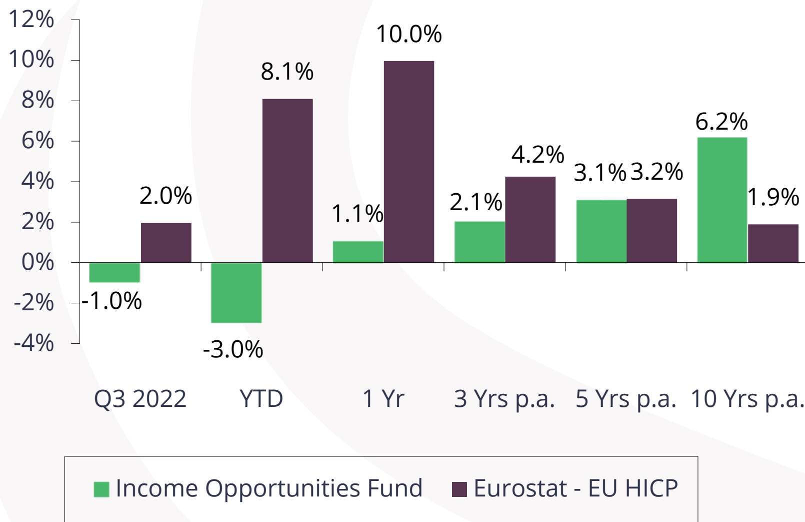
We consider scenarios rather than making forecasts

Businesses we own must have strong balance sheets

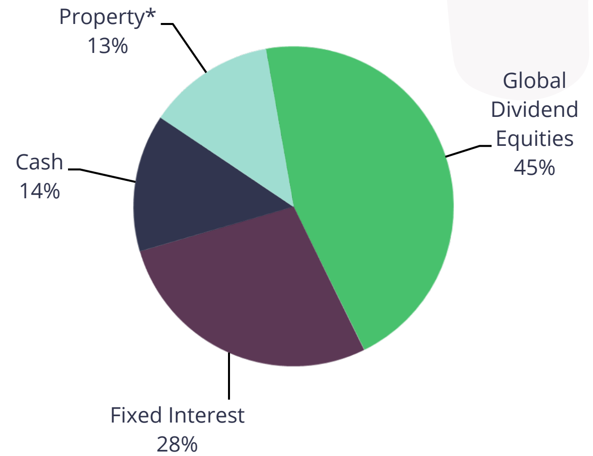
We make mistakes and always endeavour to learn from them

We will act with integrity in everything we do

## Fund Performance – 30.09.2022 (EUR)




## Asset Distribution




*includes 2.1% in IRES REIT

## Yearly Performance

| Year % | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|
| **Fund** | 2.9 | -1.2 | 13.7 | -5.6 | 11.9 |
| **Benchmark** | 1.4 | 1.6 | 1.1 | -0.3 | 5.0 |

**Performance Source:** Setanta Asset Management Limited. The Fund returns stated are based on the movements in the unit prices of the ILA/CLI Income Opportunities Fund [P-INC1] and are gross of management fees. The performance will be reduced by the impact of management fees paid, the amount of which varies. **Benchmark:** Eurostat Harmonised Index of Consumer Prices (EUR). Inception as at 30.09.11 **Holdings Source:** Setanta.

## Top 10 Equity Holdings

| COMPANY | SECTOR | % OF FUND |
|---|---|---|
| NWS HOLDINGS LTD | INDUSTRIALS | 2.0% |
| MEDTRONIC PLC | HEALTHCARE | 2.0% |
| UNILEVER PLC | CONSUMER STAPLES | 1.9% |
| JOHNSON & JOHNSON | HEALTHCARE | 1.9% |
| SWEDISH MATCH | CONSUMER STAPLES | 1.9% |
| PROCTER & GAMBLE | CONSUMER STAPLES | 1.9% |
| BANGKOK BANK | FINANCIALS | 1.8% |
| SAMPO OYJ | FINANCIALS | 1.7% |
| SANOFI | HEALTHCARE | 1.7% |
| SK TELECOM | INFRASTRUCTURE | 1.5% |

## Historic Income

| | Income Earned % of Fund Value |
|---|---|
| 2011 | 6.2% |
| 2012 | 5.6% |
| 2013 | 5.5% |
| 2014 | 4.8% |
| 2015 | 5.5% |
| 2016 | 4.7% |
| 2017 | 4.1% |
| 2018 | 3.9% |
| 2019 | 4.2% |
| 2020 | 3.9% |
| 2021 | 4.1% |

# Commentary

Last quarter, we pondered on the appetite of Central Bankers to stay on the path of increased interest rates, given the associated economic pain. Indeed, interest rates feature prominently in the fortunes of some of the Fund's holdings, as described below. During the quarter, central bankers met at the Jackson Hole Economic Symposium in U.S.A. and emphasised that they would do whatever it takes to halt, and reverse, the current course of inflation. Federal Reserve Governor, Jay Powell stated:

*"While higher interest rates, slower growth and softer labor market conditions will bring down inflation, they will also bring some pain to households and businesses. These are the unfortunate costs of reducing inflation. But a failure to restore price stability would mean far greater pain......We are taking forceful and rapid steps to moderate demand so that it comes into better alignment with supply, and to keep inflation expectations anchored".*

This 'hawkishness' on the part of the Federal Reserve bank caused markets to slump following a rally earlier in the quarter. Share prices began to incorporate the effects of higher interest rates, such as higher mortgage and debt costs and the likelihood of lower economic growth and pressure on corporate profit margins. This development was compounded later in the quarter, due to concerns over the course of U.K. fiscal policy under new Prime Minister, Liz Truss, whose administration unveiled the biggest package of tax cuts there in decades. Market participants took it badly, heavily selling U.K. government bonds, an action amplified by some forced selling on the part of some liability-driven pension funds. This, in turn, sent the British pound down to an all-time low against the US dollar. In this chaotic background, the Bank of England had to make an unexpected intervention in the U.K. government bond market, announcing its intention to buy bonds to ensure market stability. Government bonds weakened across the board, while credit spreads on corporate bonds increased. Elsewhere, there are signs that China's economy is creaking due to a combination of ongoing COVID-related lockdowns as well as a potential residential property slump, as demonstrated by 'striking' house buyers, while political tensions with Taiwan remain elevated. Meanwhile Russia's war on Ukraine continues. Amidst its far-ranging consequences are a substantial increase in energy costs, particularly in Europe, which, along with other inflationary pressures, is expected to squeeze disposable incomes in the region over the coming months. This has given rise to substantial government interventions to alleviate the burden on consumers, as well as industry.

**Toronto Dominion**, ('TD'), one of Canada's major banks, is very much an interested party in the central bank developments mentioned above. As a traditional bank, it typically benefits from rising interest rates as its ability to raise its lending margin increases, albeit while navigating through the currents of a slowing economy, such as lower growth and a weaker property market. TD operates mainly in Canada and U.S.A; indeed, it is the fifth largest bank in North America, as measured both by assets and deposits. The Canadian banking market is an attractive one, in which five major banks cater to the needs of nearly 40m people in a stable, wealthy, and open, economy that has both abundant natural resources and a huge market on its doorstep. In U.S.A, TD's assets are mainly on the eastern seaboard, and in some of wealthiest areas there. Its CET1 ratio, a regulatory measure of capital strength, is the highest among the major Canadian banks. Its Canadian residential loan book has an average loan-to-value of less than 50%, affording a sizeable buffer in troubled times; likewise, the group as a whole has a low dependence on interbank funding (which tends to be less reliable in times of strife), due to its huge deposit base. Over the past five years, TD has been able to achieve an impressive Return on Equity of 15%. TD's share price weakness during the quarter afforded us an opportunity to take a position for the Fund at what we regard as favourable valuation, namely a Price \ Book of 1.6x and a 4.0% Dividend Yield.

The fund declined 1% in value over the quarter. This was mainly due a fall in the value of its equity holdings, as discussed below. The Fund’s bond holdings rose over the quarter, boosted by a rise in its dollar-denominated bonds, reflecting the dollar’s strong performance against the euro. Among the equity holdings, **GSK** (formerly Glaxosmithkline) and **Sanofi**, two pharmaceutical companies, were material contributors to this fall having been among the strongest performers in the prior quarter. This reflected concerns about their involvement in the sale of Zantac, a heartburn drug, which some scientific studies have linked to an increased risk of cancer. Although this is arguably not ‘news’, its mention in a recent research report resulted in both stocks falling sharply, implying substantial losses. We believe that the scientific evidence, and similar cases in the past, do not support this implication. **Terna**, **National Grid**, and **REN**, three utility holdings that are principally oriented to the transmission of electricity in Italy, U.K., and Portugal respectively also performed weakly. This was to a backdrop of sharply rising interest rates, traditionally a headwind for utilities, due to the relatively fixed nature of their returns as well as concerns over new administrations in Italy and the UK that want (see above!), or are expected, to change political direction.

In contrast, **Lancashire Holdings**, a global specialist insurer and **Federated Hermes**, a US-based asset manager, both had good quarters. Lancashire benefitted from a relatively benign North American hurricane season to the quarter end (the season typically runs from mid-summer to end autumn) in addition to greater confidence that any losses relating to Russia’s war on Ukraine will be lower than previously expected. Federated, which has a substantial money market fund business, is benefitting from rising interest rates, enabling it to substantially increase margins on products, which had previously been constrained by the very low interest rate environment. Lancashire should also benefit from increased interest rates, as they tend to ‘harden’ the insurance market, due to a reduction in capital available to more speculative competitors. Both companies had relatively low valuations at the start of the quarter, allowing scope for good performance, while Federated has also been repurchasing its own shares.

*All figures are in euro, unless otherwise stated; performance figures are gross of fees, unless otherwise stated.*

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## IMPORTANT INFORMATION

The Income Opportunities Fund is managed by Setanta Asset Management Limited and is a representative account of the Income Opportunities strategy. The performance shown is the performance of a representative account (ILA/CLI Income Opportunities Fund [P-INC1]). For this life assurance product, investors should refer to the relevant policy conditions available through Irish Life and via www.irishlife.ie. The strategy is also available on a segregated basis or a UCITS mutual Fund via Beresford Funds ICAV. Current and prospective clients should not assume identical performance results to those shown would have been achieved for their account if it was invested in the strategy during the period. Clients of the firm may receive different performance than the representative account. Client performance may differ due to factors such as timing of investment(s), timing of withdrawal(s), client-mandated investment restrictions and the portfolio not being fully replicated for new accounts or new flows. Investors should consider the investment objectives, risks, charges and expenses carefully before investing. The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities. See 'WARNING' and IMPORTANT INFORMATION' below.

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