Setanta Global Equity Fund (CAD)

Q4 2022

Fund Description

The **Global Equity Fund** ('the Fund') is managed by Setanta Asset Management Limited ("Setanta") and is a representative account of the Global Equity strategy. The Fund is an actively managed equity portfolio which holds c.80-100 global stocks. The portfolio is managed in accordance with the Setanta investment philosophy by a team of eight global sector specialists, overseen by two lead portfolio managers. The aim is to achieve a sensible level of diversification on a sector and geographic basis. Reflecting this, portfolio sector weights are generally set so as broadly similar to the sector weights in the benchmark. Within each sector, stocks are chosen through bottom-up analysis, based on investment merit. Rather than focusing on the historic level of volatility of an asset, the portfolio managers regard the probability of permanent impairment of capital as the most relevant measure of risk. In doing so, they seek to maximise downside protection by understanding the risks posed by the valuation, financial, and operational characteristics of the asset. The investment objective of the Fund is to outperform the MSCI World index over the long term.

Fund Commentary

The curtain has been drawn on an another utterly extraordinary year. The Dot Com Bubble and the Global Financial Crisis are no match for the remarkable developments of the past three years. The process of moving through, and beyond, a global pandemic, with the myriad macro and micro upheavals this catalysed, was exceptional enough. The war in Europe, and the inflation and geopolitical tensions it amplified, has multiplied these complexities and the disruption to business has been perhaps unparalleled in the modern era.

(Fund 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

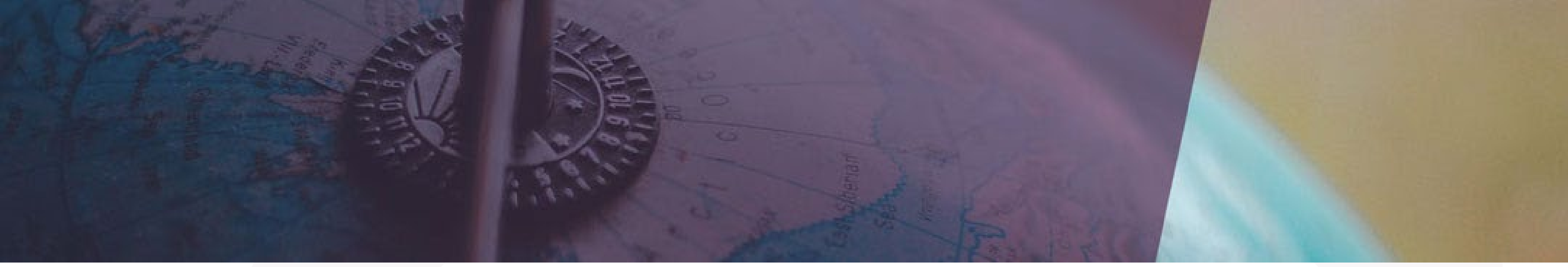
We are not afraid to swim against the tide

We consider scenarios rather than making forecasts

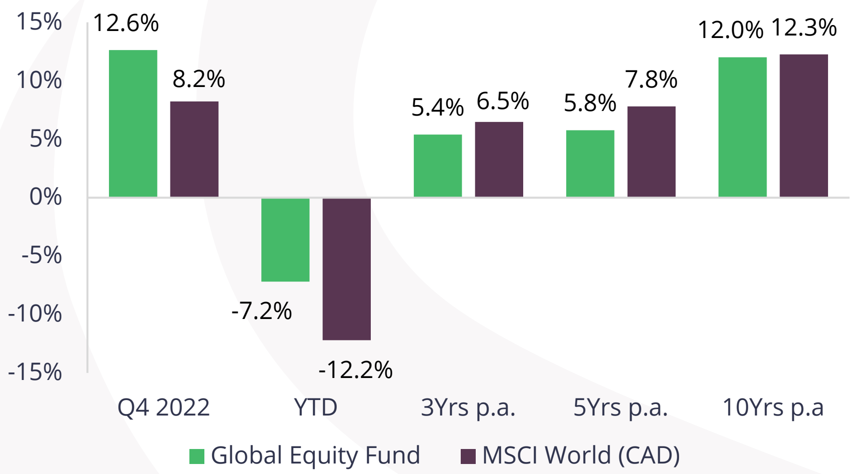
Businesses we own must have strong balance sheets

We make mistakes and always endeavour to learn from them

We will act with integrity in everything we do



Fund Performance – 31.12.2022 (CAD)



Performance Source: Setanta Asset Management Limited. The Fund returns are based on the movements in the unit prices of the London Life Global Equity Fund (S034) 4.03SAM [IEC15001] 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 World (CAD). **Holdings Source:** Setanta. Sector allocations based on invested portfolio only (excludes cash). **Fund Statistics Source:** Bloomberg.

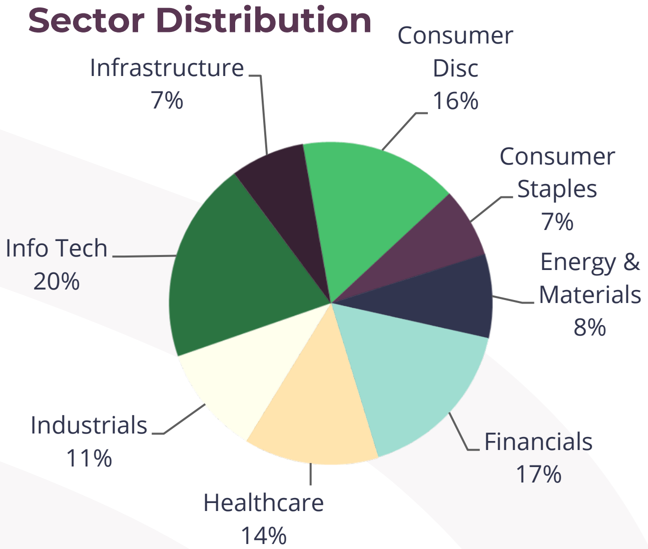
Top 10 Holdings

COMPANY	SECTOR	% OF FUND
MICROSOFT CORP	INFORMATION TECHNOLOGY	4.1%
BERKSHIRE HATHAWAY	FINANCIALS	3.8%
ORACLE CORP	INFORMATION TECHNOLOGY	3.1%
MCDONALD'S CORP	CONSUMER DISCRETIONARY	2.7%
JOHNSON & JOHNSON	HEALTHCARE	2.6%
COSTCO WHOLESALE	CONSUMER DISCRETIONARY	2.5%
NIKE INC	CONSUMER DISCRETIONARY	2.5%
JOHNSON CONTROLS	INDUSTRIALS	2.4%
ALPHABET INC	CONSUMER DISCRETIONARY	2.2%
KEYSIGHT TECH	INFORMATION TECHNOLOGY	2.2%

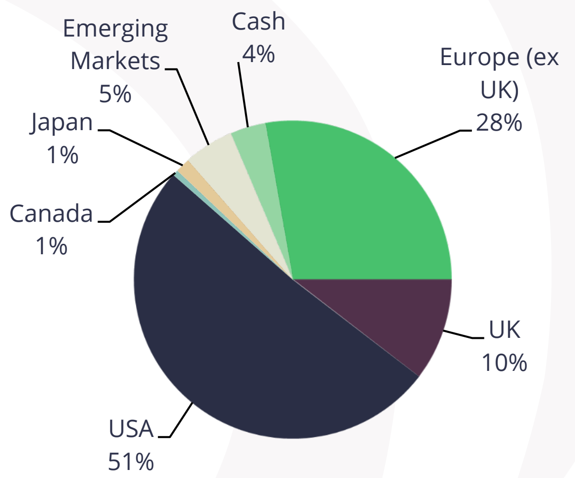
Fund Statistics

PRICE/BOOK	2.0
PRICE/EARNINGS RATIO (FY 1)	15.9
DIVIDEND YIELD %	2.0
AVERAGE MARKET CAP C$BN	176.7
NO. OF HOLDINGS	78
ACTIVE SHARE %	83.4
DEBT/EQUITY %	46.8

Sector Distribution



Geographic Distribution



Yearly Performance

Year %	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Fund	16.1	2.3	0.1	13.4	38.5	15.3	15.8	9.7	15.8	-0.7	13.8	3.4	22.1	-7.2
Benchmark	10.4	5.9	-3.2	13.3	35.2	14.4	18.9	3.8	14.4	-0.5	21.2	13.9	20.8	-12.2

SETANTA Asset Management

Macro investing

We don't usually write about "macro". That's not because we're not interested. Macro observations can inform our world view, which in turn can influence our decision making. For example, we believe the social and geopolitical developments of recent years are likely to encourage more western manufacturers to pursue some degree of production re-shoring in the future. On the other hand, we are concerned about the implications of higher energy prices for European industry. There's a risk that various European manufacturers may become less competitive in international markets if European energy prices stay elevated for years. This concern will inform our analysis of European industrial companies.

However, we don't believe we can effectively translate our observations on geopolitics, the current inflation problem, or the trajectory of interest rates – all of which are understandably hot topics – into meaningful portfolio actions. These kinds of problems are multi-layered, extremely dynamic and exceptionally complex. It isn't clear to us today that there are obvious mispricings related to these matters. Should we ultimately have extreme economic outcomes attributable to these factors, either positive or negative, these will look obvious in hindsight. However, we don't believe the outcomes are obvious today. We do believe the leaders of the world's major economies understand that everyone benefits from international trade. History also shows us that the global economy is extremely adaptable. So, we believe our effort is better spent on analysing the economic building blocks of industries and businesses that interest us. This approach reflects our experience, but we admit to taking a leaf out of the Berkshire Hathaway book here. At the 1998 Berkshire Hathaway shareholder meeting, Warren Buffett was asked about macroeconomic trends that would develop over the subsequent decade. To paraphrase his reply:

"We don't think about that. It's unknowable. If we started focusing on those issues, we would miss a lot of big things. We think about things that are both important and knowable"

Buffett went on to elaborate that Coca Cola listed in 1919 at $40 per share and fell to $19 within the first year due to various operating problems. Not only that, but (paraphrasing him again);

"…if you had had perfect foresight at that time, you would have seen the great depression staring you in the face, World War 2, atomic bombs, and the social order being questioned. You could always find a reason to postpone the purchase of Coca Cola shares. But these were not the important things to see – the important thing to see was that Coca Cola would eventually sell one billion servings per day…. the share today (dividends reinvested) is worth well over five million dollars."

We are not claiming to have a 1920s version of Coca Cola in the portfolio, but we completely understand where Buffett is coming from. We're in the camp that believes today's difficulties will be overcome and we continue to try to focus on things we think are important and can have a credible view on.

Performance review

For the full year, the fund fell 7.2% (CAD-terms, gross of fees), 5% ahead of its benchmark the MSCI World (-12.2%, CAD). Since end-Q3 2020 – when COVID beneficiary stocks hit their peak and soon after which economies commenced reopening – the fund has outperformed by over 11%. While we still have relative ground to make up from 2019 and the first nine months of 2020 ("growth blowout" followed by "pandemic winners", both of which we were underexposed to), the more recent performance is encouraging. It is also reassuring that the fund has held in relatively well in a falling market, which it has tended to do in the past. Below is a discussion of the top and bottom contributors to fund performance over the course of the year.

Commentary

2022 Top 5 Contributors to Performance	Sector	Contribution, Euro	Performance, Euro
Exxon Mobil	Energy / Materials	0.9%	100%
Bank of Ireland	Financials	0.5%	80%
O-I Glass	Industrials	0.5%	47%
Tenaris	Energy / Materials	0.4%	82%
Constellation Energy	Infrastructure	0.4%	74%

Without doubt, the best performing sector in 2022 was Energy, up a massive +57% per the MSCI World Energy Index in Euro (for context, the next best sector was Utilities, +2.5% in Euro). This was the second year in a row the Energy sector has occupied top spot, but you may recall that the Energy sector was the worst performer in 7 of the 10 years up to 2020. In a way, this long period of underperformance can explain Energy's outsized performance in the last 2 years. We can agree that the world must decarbonise, but it will take many years for habits, processes and technology to adjust. In the meanwhile, investors are pressuring companies to reduce or stop investments in new oil and gas infrastructure and this lack of new supply gives an advantage to existing assets – some of which could produce bumper profits for many years. Also Russia's invasion of Ukraine has shifted thinking about energy security, which should be generally favourable for Western energy companies. The energy sector investment narrative has thus changed very materially: many companies will die, but their death may take longer than previously expected. Over the course of the year, the share prices of **Exxon Mobil** (global major) and **Tenaris** (seamless steel pipes for energy and other industries) rose 87% and 82% in local currency respectively, while **HF Sinclair** (US refiner) increased 62% – fine performances in a down market.

Another phoenix-from-the-flames story is **Bank of Ireland**, which rose almost 80% (local currency) in 2022 following a 50% increase in 2021. We bought the stock in Q1 2020. We felt its steep valuation discount to other European banks was unjustified, that returns had troughed and were more likely to improve after years in the doldrums. This was just a few weeks before the full implications of COVID became evident and we watched in horror as the price collapsed by ~60% over the following couple of months. The government's COVID payment schemes as well as banks' willingness to provide interest payment holidays to suffering borrowers were key to managing through the worst of the situation. Since then borrowers have gotten back on their feet and Bank of Ireland profits have recovered. The Irish economy is performing well, credit costs remain well behaved and, like most banks, it is benefiting from rising interest rates. Giving an additional boost to Irish banking margins is that two large competitors (Ulster Bank and KBC) have exited the market, leading to a glut of customer deposits and so less pressure to pass interest rate increases by the ECB on to savers. In contrast these higher rates are putting pressure on wholesale-funded competitors. The share price not only recovered its initial COVID-induced fall but had increased by +270% from purchase by year end. Having now closed its relative valuation discount, gains from here could be more modest.

O-I Glass, the glass bottle manufacturer, was another strong performer in 2022. We discussed this investment in the Q2:22 report so interested readers can refer back. In summary, it's been a difficult investment since purchased in 2011. More recently industry supply-demand has been favourable and profits are expected to recover to pre-pandemic levels.

Constellation Energy, discussed in more detail in the Q3:22 report, was also up significantly. It owns a fleet of US electricity generation assets, mostly fixed-cost nuclear. In 2022 profits were buoyed by high electricity prices, but the game changer was the new Inflation Reduction Act, which provides the company an attractive framework for investing in new nuclear assets. This has positively flipped the investment story from a stable or even shrinking asset base to a growing one over the medium and long-term.

Other notable performers were insurers **Lancashire** and **Markel** (+27% and +7% respectively, local currency) on the strengthening insurance pricing environment, while healthcare companies (**UnitedHealth, Novartis, Johnson & Johnson** +6-8%, loc) and food & beverage companies (**Pepsico**, **McDonald's**, sausage casings maker **Viscofan**, +1-10%, loc) all benefited from the rotation into quality, attractively priced companies.

2022 Bottom 5 Contributors to Performance	Sector	Contribution, Euro	Performance, Euro
Alphabet	Discretionary	-1.2%	-35%
Microsoft	Technology	-1.1%	-23%
Samsung Electronics	Technology	-0.8%	-27%
DCC	Industrials	-0.8%	-34%
Ericsson	Technology	-0.7%	-42%

The largest negative contributors to performance in 2022 were **Alphabet**, **Microsoft** and **Samsung Electronics**. All three have been exceptional performers over the long term and we remain very positive on their futures if they – like many other technology / consumer discretionary peers – face near term cyclical challenges.

For **Microsoft** the digitisation of IT continued to grow at a rapid pace brought about by the onset of COVID. The company has been a major beneficiary of this trend and experienced an almost doubling of profits from pre-pandemic levels. Towards the end of 2022 we began to see a pause of some cloud migrations, as customers continued to digest the rapid expansion that took place in the earlier phase of the pandemic. Also, as cloud revenues (around half of group total) are generated on a usage basis, slower economic activity means cloud providers will feel some pain. Standing back, we are very bullish as corporate cloud penetration is below 30% and will likely increase over the long-term providing Microsoft with a strong growth tailwind.

Similarly, **Samsung** has been a large beneficiary of the digitisation of economies. As the largest memory producer in the world and comprising close to 60% of Samsung's earnings, the increase in demand for cloud services and data drove supernormal demand for memory (DRAM). Again like Microsoft, many customers invested heavily and are now digesting this increase in capacity and this is leading to an excess supply of DRAM which is impacting memory pricing. The positive is that memory producers are cutting back on their own capacity expansion plans, which will bring the market back into equilibrium over the medium term. We don't see any material change to the long-term growing demand for memory.

Alphabet is primarily an advertising business. The boom in ecommerce and digital entertainment during COVID played beautifully into the hands of search engine Google and video sharing platform YouTube as grounded businesses scrambled to reach remote customers. We were fortunate to buy the stock just before COVID broke. In the two years to 2021 the group posted revenue growth of 60% and underlying profit growth twice that rate.

Over this time the share price roughly tracked the growth in profit, leaving the valuation broadly unchanged. Alphabet will probably experience a modest decline in revenues and profits in 2022 as advertisers batten down the hatches in the face of a weaker consumer, but after the share price fall in 2022 the stock is now on a valuation on 20x P/E or less. Of course, we could be wrong on the magnitude of a pullback in advertising demand. However we think obsessing about near term profits misses the bigger picture. Google and YouTube are unique and very valuable assets. They are not just gaining advertising dollars from traditional media – they are also creating new demand. For example, consider retailers looking to create an omnichannel brand and shopping experience with both physical and digital touchpoints, Google / YouTube are ideally placed to take an outsized share of that incremental spend. Also, we believe Alphabet's bottom line is understated and think the company could undertake a series of self-help measures to improve profitability. This is a point recently picked up by activist fund TCI, who sent a letter to the Board urging them to exercise cost discipline in this "new era of slower revenue growth", saying that the company has too many staff and that cost per employee is too high. TCI also pointed out the high and continued losses in its Other Bets division, which includes Waymo (autonomous driving), is bleeding billions every year without a clear path to monetisation. We continue to be very excited about Alphabet's future and think that the current share price sets the stage for strong future returns.

A longstanding holding, **DCC** is a marketing and distribution business servicing clients in Europe and beyond across three verticals: Energy, Technology and Healthcare. The energy business, which accounts for around two thirds of group profits, primarily supplies fuel oils and liquified petroleum gas to commercial, industrial, and residential customers. The business has a terrific track record of internally funded cash flow growth, underpinned by adaptability to changing market conditions. For example, DCC once operated in the waste treatment, recycling and food industries but disposed of these businesses, in turn bulking up in more attractive areas. This adaptability continues to this day with management expanding the technology and healthcare businesses, and within energy expanding into greener offerings including biofuels, biogas, EV charging, solar and heat pump services.

Aside from some recent, fairly minor bumps, financial results have remained strong in recent years. The stock however has derated substantially and after a sharp decline in 2022 now trades on under 10x earnings. It seems that the market has no confidence in management's plan to transition the energy business to incorporate "greener" solutions. We believe the market has this all wrong. Many of DCC's traditional gas and fuel customers are off-grid and will likely be dependent on traditional fuels for many years. Meanwhile DCC is already beginning to enjoy high returns on new services that it can now offer because of the energy transition. These include EV charging on their forecourts; providing biofuels where supply is available; arranging solar and heat pump installation for their customers. We believe the energy business will transition slowly and DCC will have time to adapt. The stock seems extremely cheap to us.

The share price of **Ericsson**, the Swedish company that provides equipment and software to mobile telecom operators across the world, fell sharply during the year. There were two key reasons for the weakness. Firstly, there are allegations of payments to unknown intermediaries in Iraq at a time when ISIS controlled swathes of the country. Secondly, it reported disappointing interim financial results in 2022 because of inflationary pressures and emerging spending weakness among telecom network operators, including the especially profitable US customers.

Ericsson has an ostensibly very strong market position with key competitor Huawei somewhat handicapped by geopolitical overhangs and Nokia having struggled to match Ericsson's development capabilities. Furthermore, we think the aforementioned compliance issues will be resolved and the stock looks very cheap, trading on around ten times the earnings it produced in recent years. Nonetheless we are concerned by the recent deterioration in the business. While we have decided to retain the position for the moment, we are watching developments closely and may decide to exit if our comfort level falls further.

Portfolio Activity

Portfolio new buys and full sells were below average for the year – for example, new stocks accounted for less than 3% of the fund at year end. At year end there were 78 stocks in the fund. We remain happy with the core of the portfolio, though pruning of investments that don't meet our quality and valuation criteria should be expected as a matter of course. The market may also offer up better alternatives than current holdings and if quality stocks correct you might see a modest pickup in activity. Note that 50% of the current portfolio by weight has been held for 10 years or more – solid evidence that when we say we are long term, we mean it.

BUYS

	Stock	Sector	End of year weight
Q1	Netflix	Discretionary	0.6%
	EssilorLuxottica	Discretionary	1.0%
Q2	Estee Lauder	Staples	0.6%
Q3	-	-	-
Q4	Equinix	Infrastructure	0.4%

Sells

	Stock	Sector	Start of year weight
Q1	Liberty Global	Discretionary	1.3%
	Liberty Latin America	Discretionary	0.1%
	Sysco Corp	Staples	0.1%
Q2	Origin Enterprises	Staples	0.6%
	JD Wetherspoon	Discretionary	0.3%
Q3	NCR	Technology	0.7%
	Hewlett Packard Enterprises	Technology	0.6%
Q4	Hellenic Telecom	Infrastructure	0.4%

During Q4 we sold out of Greek mobile and broadband provider **Hellenic Telecom** (OTE). The stock was originally acquired in 2009, after a significant drop in the share price in the early days of the GFC. While holding OTE was a painful experience through the 2010s, recent performance has been strong, as a recovering Greek economy and good take up of telecommunication services, along with limited competition, has enabled the company to generate significant free cash flow, which it used to reinstate and grow its dividend and buy back shares. While we sold at a modest valuation, there are some clouds on the horizon – including the risk that populist government policies could reduce cash flows to shareholders. Moreover, we believe the switch into Equinix improves on the quality and diversification of the overall portfolio.

Equinix is a large and diversified data centre company which rents out floorspace and provides ancillary data centre services required for the digital transformation of economies. It is the largest "retail" data centre operator in the world with commanding market shares in many of the most relevant connectivity markets in the world. While its origins are in the US, the business is now well diversified by geography and customer segments and continues to deploy significant growth capital in Europe and Asia where markets are less mature.

Commentary

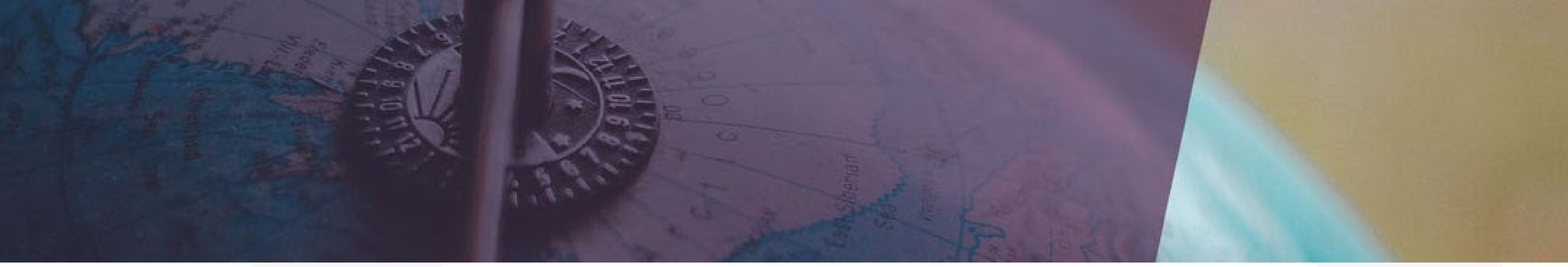
Equinix's growth strategy is underpinned by the attractiveness of its existing assets, especially its retail data centres where customers' need for minimal latency creates valuable ecosystems that in turn draw in more customers, creating barriers to entry for competitors and thus pricing power. As digital economies grow, Equinix's unrivalled existing footprint and client base will put it in prime position to build new locations and fill them with customers, existing and new.

The company seeks to capture those opportunities both via organic deployment of capital and M&A. Organic growth is achieved through development of new data centre space, as well as capital-efficient colocation (where Equinix facilitates interconnections between customers through cross-connects) and pricing, while M&A has historically played a strategic role in enabling quick deployment of the platform in desired markets. We expect high single digit or higher growth in profit-per-share over time due to a combination of top line growth and operating leverage.

Equinix trades at a valuation premium to its closest peer Digital Realty. We think this is well deserved, due to the clarity and consistency of its strategic vision, which is expected to lead to a more stable and better-quality growth path. If the investment case turns out as we think, we expect to earn a 10%+ per annum total return over the medium and long term, anchored by a well-covered dividend yield of almost 2% and high single digit dividend growth.

David Coyne, Co-lead portfolio manager

*Also contributing to this edition was colleague **Rowan Smith**, who wrote the opening section on macro investing as well as some of the stock commentaries.*



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