Setanta Active Multi-Asset Fund Range

Q4 2022

SETANTA
Asset Management

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Fund description

The Setanta Active Multi-Asset Fund Range is made up of three actively managed portfolios that hold a combination of equities, bonds, property, cash and alternatives.

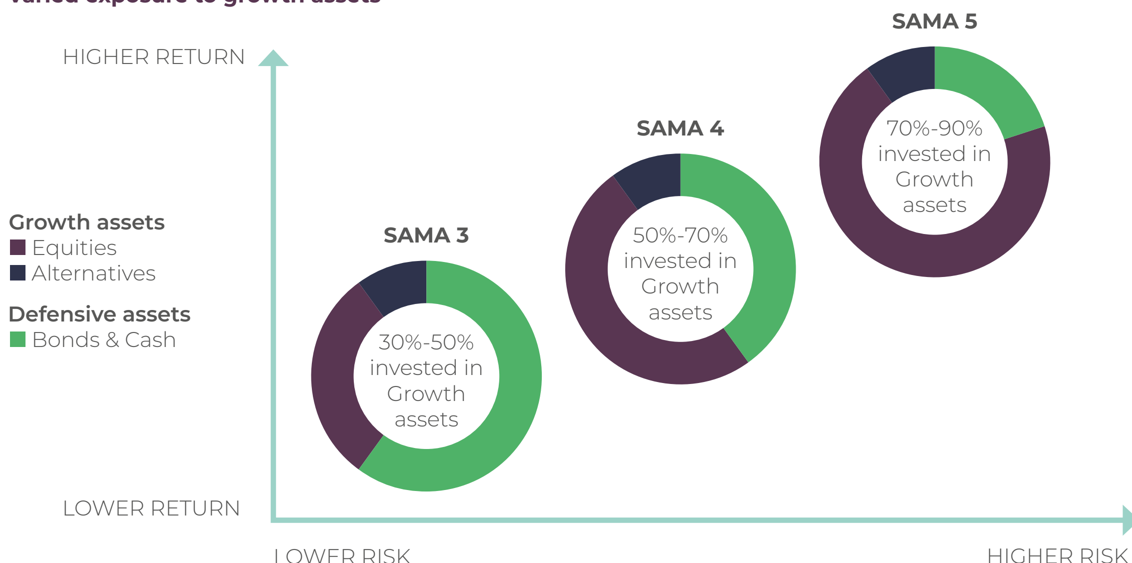
The funds are managed in line with the following core principles:

- **An asset mix that reflects the investment objectives**
  The funds' exposures across different asset types have been designed to meet specific risk and return requirements. These exposures may vary over time in line with the manager's views.
- **Consistent decision making**
  The design of each fund reflects a particular investment objective and attitude to risk. The funds are managed in a consistent manner, with investment decision making implemented consistently across the fund range.
- **Broad diversification**
  The funds are broadly diversified across a range of growth assets like equities and alternatives, and defensive assets like bonds and cash. Excess returns are driven by superior stock selection and active asset allocation.

Three funds, three risk-return profiles

Each of the three Setanta Active Multi-Asset (SAMA) Funds has a different risk and return profile based on its differing exposures across asset classes. Each fund aims to grow your investment over the medium to long term by varying the exposure to growth assets.

Varied exposure to growth assets



Market commentary

Over the course of the year, we have taken forceful actions to tighten the stance of monetary policy. We have covered a lot of ground, and the full effects of our rapid tightening so far are yet to be felt."

Jerome Powell
Chair of the US Federal Reserve, 14 December 2022

2022: a turbulent year for markets

In aviation, turbulence is an unpredictable weather phenomenon: an irregular motion of air, which may be insignificant, causing a few slight bumps, or may be extreme, forcing an airplane out of control. With the speed and magnitude of recent moves in interest rates, it is still not clear whether we will see bumps, or further extreme moves, in 2023, or which way markets will go from here.

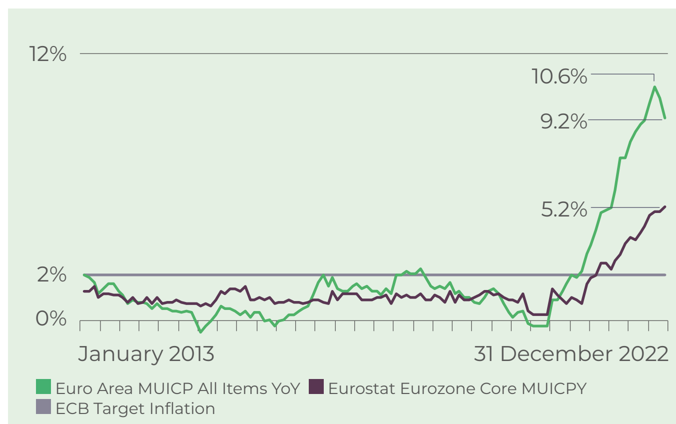
2022 was a year in which equities and bonds were simultaneously weak, and cash and commodities were some of the strongest performing financial assets. The low-to-negative correlation that we have come to expect from equities and bonds in recent years was non-existent, as rising interest rates hit both asset classes.

The year ended with a positive fourth quarter for equities, even with markets weakening in December on growing fears of recession. However, markets remain volatile, seemingly challenged by a 'perfect storm' of events, resulting in high inflation, rising interest rates and slower growth. It remains to be seen whether central bankers can pull off a 'soft landing'.

Euro area: macro outlook

While headline inflation fell over the quarter in Europe, from a 10.6% high to 9.20%, it should stay above the European Central Bank (ECB) target of 2% in 2023.

Euro area headline and core inflation



Source: Bloomberg / Setanta

The ECB will want core inflation – which excludes food and energy prices – to trend lower, before any change in policy. Stubbornly high core inflation could limit the central bank's ability to ease interest rates, even in a recession.

In particular, the Governing Council judges that interest rates will still have to rise significantly at a steady pace to reach levels that are sufficiently restrictive to ensure a timely return of inflation to the 2% medium-term target."

European Central Bank
Press release, 15 December 2022

Interest rate changes, both increases and decreases, tend to have a lagged impact on the economy. It takes time to adjust to them, and we may not yet have felt the full effect of the recent moves as the ECB base rate has increased from 0% to 2.50% over the last year, with +1.25% in quarter four alone.

The ECB plans to continue to raise rates "significantly, at a steady pace" this year and indicated two more half-point hikes in early 2023 to try to tame inflation. Markets currently agree, pricing further hikes of somewhere around +1.50%. This could prove overly pessimistic if we are to see inflation turn meaningfully lower.

Along with rate increases, there will be a significant drain of liquidity. Bonds purchased during quantitative easing will roll off the ECB balance sheet and banks will see the expiration of longer-term loans. Both remove liquidity from the financial system, increasing the risk of volatility.

Overhanging this is slowing growth, which could develop into rolling recessions across the various economies.

However, there is reason for hope in recent data – with German GDP, for example, coming in higher than expected, at +1.9% in 2022.

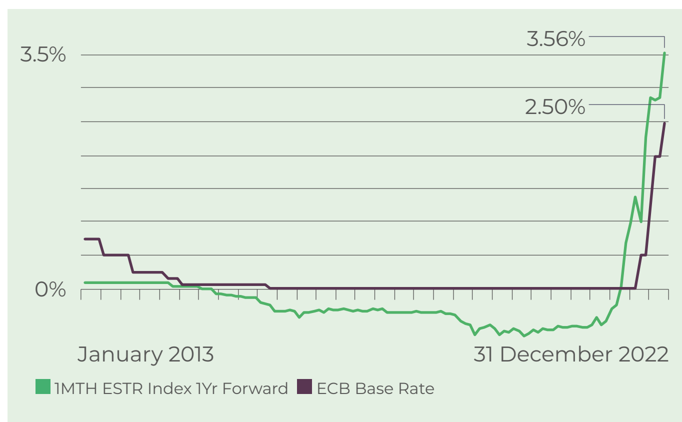
Equity versus bond positioning

For equities to offer decent long-term expected returns, stability in core inflation and interest rates is probably needed, alongside downward revisions to corporate earnings guidance, which is still too high given deteriorating fundamentals and the rising risk of recession.

Bonds, unlike equities, are easier to forecast, with the starting yield a good predictor of future returns. As yields have risen significantly, to the highest in decades in some instances, you can have more comfort investing for the longer term with the added benefit of them likely resuming their role as a reliable diversifier against equities.

The collapse in the quantity of negative yielding bonds – from $18 trillion worth, globally, to practically zero – marks a broad change in global bond regimes. In December, the Bank of Japan unexpectedly increased the range it would allow the 10-year Japanese government bond yield to trade at, from +/- 0.25% to +/- 0.50%.

ECB base rate and expected rate in 1Yr



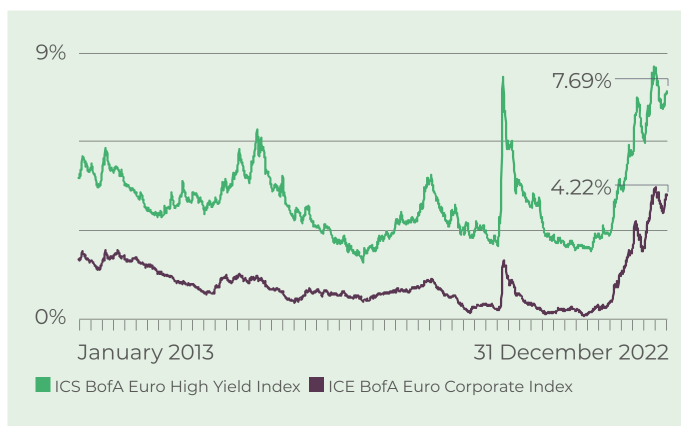
Source: Bloomberg / Setanta

Negative yielding debt: market value

Source: Bloomberg / Setanta

In Europe, investment grade corporate bonds especially, and high yield somewhat, look attractive, with yields reaching 4% and 8% respectively over the quarter. Implied default rates from the spread offer considerable compensation, even in an economic downturn.

European yields: investment grade and high yield



Source: Bloomberg / Setanta

Opportunities

If a recession does become evident, equity weakness becomes more of a problem than bond weakness. High quality duration can protect multi-asset portfolios. Meanwhile, in equities, investing in quality at decent valuations – through strong balance sheets, steady cashflows and sound management – allows for more portfolio resilience.

Investors should look at the recent repricing of certain financial assets – bonds especially – as an opportunity to gain exposure at levels not seen in decades.

Meanwhile, if the economy manages to navigate away from a recession scenario – possibly through a combination of China reopening, a warmer winter resulting in lower gas prices in Europe and falling inflation in the US – there is ample exposure in the portfolio to risk assets to drive long-term expected returns.

Fund commentary

The Setanta Active Multi Asset funds rose in value over the fourth quarter of 2022, rallying early in the period, though weakening slightly into year end.

It was a mixed bag across the various asset classes. Global equities performed strongly (+4.6%), markedly outperforming the global benchmark, through a combination of names performing well and an underweight to large technology companies, which performed poorly.

Equity market investors favoured visible, steady earnings, rather than hopeful capital gains, which suited our style of investment.

High yield bonds (+4.2%) and listed private equity (+2.5%) rose in tandem on improved investor sentiment, largely driven by hopes of a peak in inflation leading to less aggressive central banks in 2023.

Property, both directly owned through the Irish Property Fund (-2.2%) and indirectly through Global REITs (-1.6%), suffered, as did European government bonds (-1.7%), both due to the move higher in interest rates. Central bank rate rises led to both nominal bond yields and property capitalisation rates moving up, which forced prices down.

Property was marked down as it had to offer higher yields to attract flows. The increased cost of debt within its leveraged capital structure, on concerns about a probable recession leading to tenant defaults, reduced rental income; potential equity raises in REITs to cover covenants also remain a headwind.

However, in inflationary environments, real assets like property have historically proved their worth, with lease cashflows linked to inflation, and higher replacement values, protecting real returns. The move higher in interest rates, while quicker than normal, was somewhat expected, allowing REITs time to term out debt longer term and fix funding at historically attractive levels.

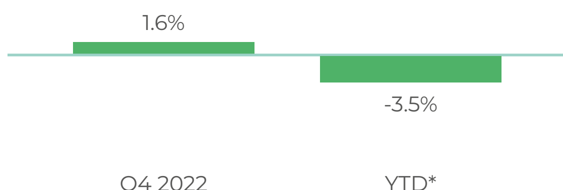
A cautious approach is warranted in 2023, and diversification across asset classes will prove critical. The fund remains well diversified and will look to take advantage of opportunities where valuations look appealing over a medium- to long-term horizon.

We will likely add to bonds across various segments, as yields have moved higher, and will lighten up on equities, given that corporate profits, operating leverage and historically high margins could come under pressure.

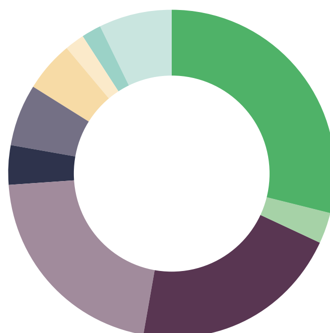
Fund performance and asset mix

SAMA 3

The SAMA 3 Fund offers diversified exposure, including equities, bonds, property, alternatives and cash, with a bias towards bond investments. This fund seeks to provide a lower level of risk and return when compared to the other funds in the SAMA fund range.



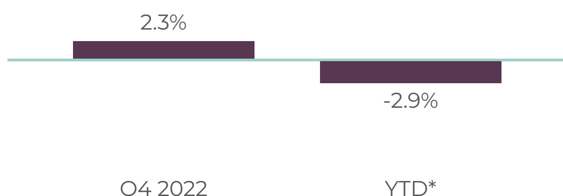
Q4 2022 YTD*



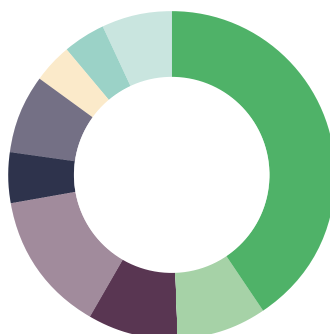
Asset class	Weight
Setanta Global Equity	29%
Emerging markets	3%
Total Equities	**32%**
Euro Government Bonds	21%
Euro Corporate Bonds	21%
Emerging Market Debt	4%
Global High Yield Bonds	6%
Cash	5%
Total Bonds & Cash	**58%**
Infrastructure	2%
Private Equity	2%
Property	7%
Total Alternatives	**11%**

SAMA 4

The SAMA 4 Fund offers balanced exposure between equities and bonds. This fund seeks to provide a medium level of risk and return.



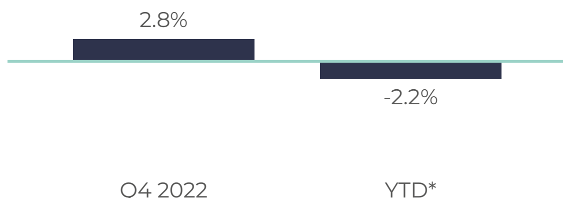
Q4 2022 YTD*



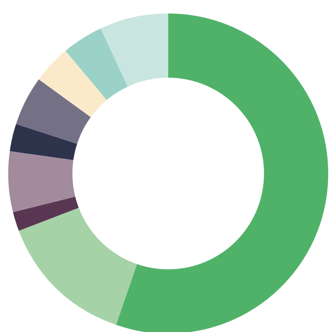
Asset class	Weight
Setanta Global Equity	41%
Emerging markets	9%
Total Equities	**50%**
Euro Government Bonds	9%
Euro Corporate Bonds	14%
Emerging Market Debt	5%
Global High Yield Bonds	8%
Cash	0%
Total Bonds & Cash	**36%**
Infrastructure	4%
Private Equity	4%
Property	7%
Total Alternatives	**15%**

SAMA 5

The SAMA 5 Fund offers exposure weighted towards equity investments. This fund seeks to provide a higher level of capital growth.



Q4 2022 YTD*



Asset class	Weight
Setanta Global Equity	56%
Emerging markets	14%
Total Equities	**70%**
Euro Government Bonds	2%
Euro Corporate Bonds	6%
Emerging Market Debt	3%
Global High Yield Bonds	5%
Cash	0%
Total Bonds & Cash	**16%**
Infrastructure	4%
Private Equity	4%
Property	7%
Total Alternatives	**15%**

Performance Source: Setanta Asset Management Limited. The actual Fund returns stated are based on the movements in the unit prices of the Fund and are gross of management fees.

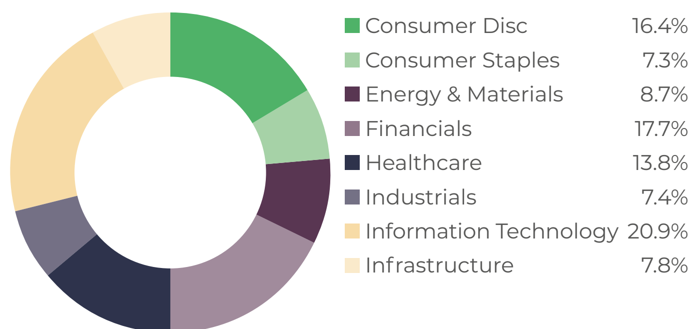
*Fund launch date 24 May 2022. Asset class weightings as at 31 December 2022.

Setanta Global Equity Strategy – the growth engine

The Setanta Global Equity portfolio is the growth engine of our multi-asset funds. The portfolio provides capital growth, as the businesses it is invested in compound in value over time.

The Setanta Global Equity strategy is the flagship equity strategy of the firm, with a strong 20+ year track record. It is managed by eight portfolio managers, who work as a team and challenge each investment idea as a core part of their investment process.

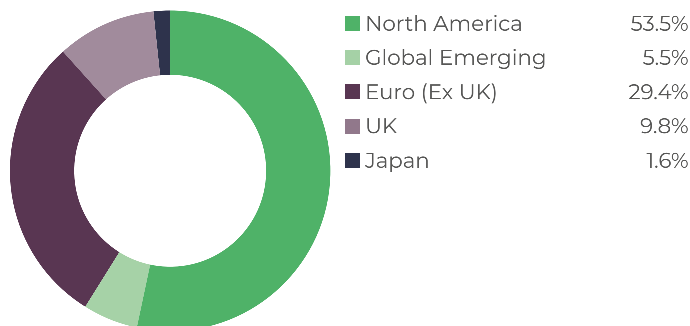
Sector distribution



Top 10 equity holdings

Company	Sector	% of fund
Microsoft	Information Technology	**4.2%**
Berkshire Hathaway	Financials	**3.8%**
Oracle	Information Technology	**3.2%**
Mcdonald's	Consumer Discretionary	**2.8%**
Johnson & Johnson	Health Care	**2.7%**
Nike	Consumer Discretionary	**2.6%**
Costco Wholesale	Consumer Discretionary	**2.6%**
Johnson Controls	Industrials	**2.5%**
Keysight Technology	Information Technology	**2.4%**
Alphabet	Consumer Discretionary	**2.4%**

Geographic distribution



Source: Setanta Asset Management, as at 31 December 2022.

The Global Equity strategy:

Highly selective

We look for good-quality, durable businesses that are out of favour for one reason or another.

Risk averse

We buy conservatively financed companies, which are run by trustworthy management and have a shareholder focus.

Compounding in value

We are diligent and patient investors, expecting the long-term results of the equity portfolio to mirror the growth of the companies within it.

The curtain has been drawn on an another extraordinary year.

The Dot Com Bubble and the Global Financial Crisis (GFC) 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 Ukraine, 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.

Portfolio activity

Portfolio new buys and full sells were below average in recent quarters. At year end there were 77 stocks in the portfolio. We remain happy with the core of the portfolio, although 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 Global Equity portfolio by weight has been held for 10 years or more – solid evidence that, when we say we are long term, we mean it.

During the fourth quarter, 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 has 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. While its origins are in the US, the business is now well diversified by geography and customer segments, and it continues to deploy significant growth capital in Europe and Asia where markets are less mature.

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; this creates barriers to entry for competitors and thus pricing power for Equinix. As digital economies grow, Equinix's unrivalled 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. 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

Environmental, social and governance

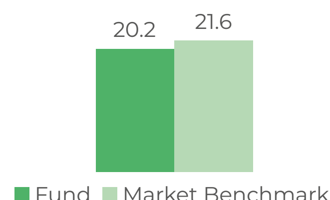
Setanta believes it is its responsibility as an investment manager to consider the environmental, social and governance (ESG) impacts of the companies it invests in. Companies that are actively engaged in addressing ESG challenges are more likely to make a greater contribution to society, which can, in turn, create opportunities for investors. By the same token, those that lag behind can present risks. Setanta integrates ESG factors into its fundamental research process. When it believes there are ESG factors material to its investment decisions, it addresses them in its research reviews and engagements with companies. Setanta is a signatory to the UN-supported Principles for Responsible Investment (UNPRI).

ESG risk score

Risk Score*	Fund	Market Benchmark
Overall	20.2	21.6
Environmental	4.1	4.8
Social	8.2	8.8
Governance	7.4	7.7

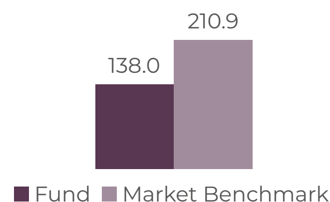
Overall ESG Risk Rating

The Environmental, Social & Governance (ESG) Risk Rating measures the degrees to which a company's economic value is at risk due to not considering ESG factors using a calculation of the company's unmanaged ESG risks.



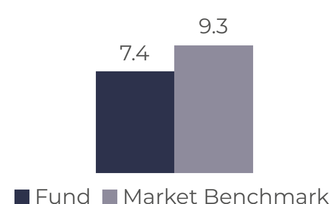
Carbon intensity

Carbon intenstity is a metric used to compare company emissions across industries. The absolute emissions is divided by total earnings with the figure expressed in tonnes of carbon dioxide equivalent per million USD of total earnings.



Fossil fuel

Fossil fuel involvement measures the percentage of earnings that companies get from thermal coal extraction, coal-based power generation, oil and gas production, oil and gas based power generation and oil and gas related products and services.



ESG Metrics based on P-SAMA4 Fund. *A lower score indicates a lower level of unmanaged ESG risk and potential risk to the economic value. Note: ESG Risk Scores and Carbon Metrics are currently calculated for Shares and Corporate Bonds only Information correct as of 31 December 2022.
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Key advantages of the fund range

Actively managed

Clear and consistent investment philosophy, high-conviction approach

Value approach

Discipline and patience allow us to take advantage of mispriced opportunities.

ESG built-in

Article 8 Multi-Asset fund range

Global Equity engine

Level of exposure consistent with risk rating of each fund

Investment expertise

Highly experienced, stable and award-winning investment team

Risk rated

Generate long-term capital growth within the appropriate risk parameters

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IMPORTANT INFORMATION

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Signatory of: