Setanta European Equity Fund

Q1 2023

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 manager seeks 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

For this quarters piece, I'm including a section written by our global financials sector manager, David Coyne. In it, he outlines how events played out in dramatic fashion over recent weeks, with 2 rescues either side of the Atlantic in the first quarter. It's an excellent summary of how events unfolded and how we think about assessing risk when it comes to banks. While we don't shun banks altogether, we are particularly vigilant when it comes to investing in banks due to the inherent leverage in the business model.

(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

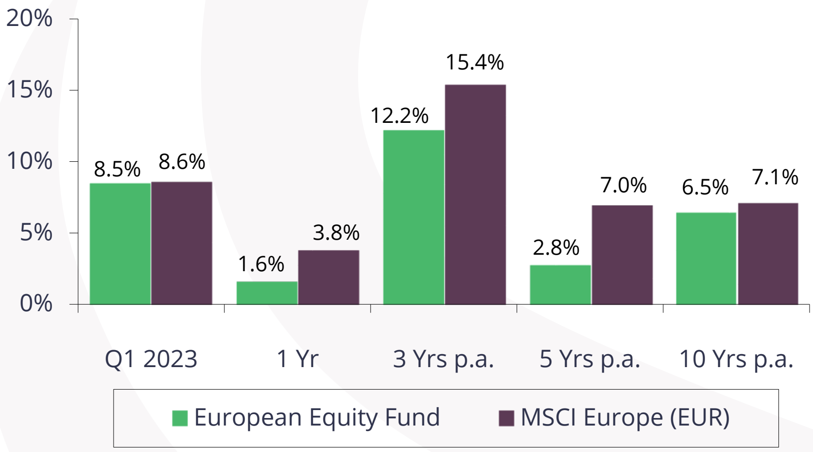
We consider scenarios rather than making forecasts

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

Fund Performance – 31.03.2023 (EUR)



Fund Statistics

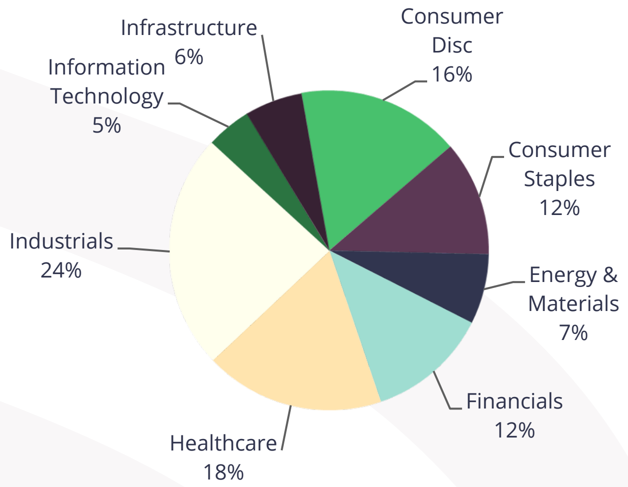
PRICE/BOOK	1.7
PRICE/EARNINGS RATIO (FY 1)	14.7
DIVIDEND YIELD %	2.2
AVERAGE MARKET CAP €BN	42.0
NO. OF HOLDINGS	32
ACTIVE SHARE RATIO %	89.3
DEBT/EQUITY %	55.7

Yearly Performance

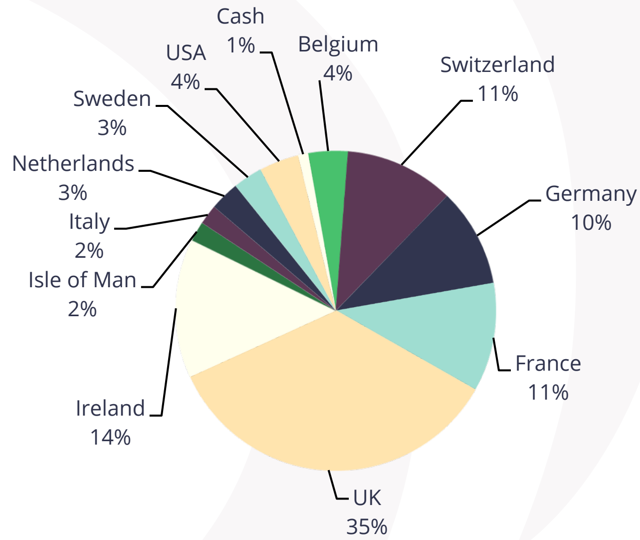
Year %	2018	2019	2020	2021	2022
Fund	-7.3	21.5	-14.0	23.5	-12.8
Benchmark	-10.6	26.0	-3.3	25.1	-9.5

Performance Source: Setanta Asset Management Limited. The Fund returns stated are based on the movements in the unit prices of the ILA/CLI European Equity Fund [IEC7002] 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 (EUR). **Holdings Source:** Setanta. Sector allocations based on invested portfolio only (excludes cash). **Fund Statistics Source:** Bloomberg.

Sector Distribution



Geographic Distribution



Top 10 Holdings

COMPANY	SECTOR	% OF FUND
CRH	INDUSTRIALS	8.0%
DCC	INDUSTRIALS	5.6%
SANOFI	HEALTH CARE	5.6%
DIAGEO	CONSUMER STAPLES	5.4%
NOVARTIS	HEALTH CARE	5.3%
GEA GROUP	INDUSTRIALS	5.1%
BOOKING HLDGS	CONSUMER DISCRETIONARY	4.3%
BANK OF IRELAND	FINANCIALS	3.9%
GSK PLC	HEALTH CARE	3.9%
LIBERTY GLOBAL	CONSUMER DISCRETIONARY	3.6%

SETANTA Asset Management

Commentary

Global banks in focus

On Thursday 9th of March California-based SVB Financial Group, the holding company of Silicon Valley Bank, said it needed to raise $2bn of equity capital to cover losses in its bond portfolio. The following day it was ordered to shut down. While the record books will mark SVB's death in 2023, its death note was written in 2020 when management decided to buy a large portfolio of fixed, long duration bonds (a yield pick-up on short-term bonds). This was a monumentally bad decision, made possible by a watering down in 2017 of the post-GFC Dodd-Frank Act for banks under $250bn in assets. The consequences of this original mistake took a few years to emerge. The US Federal Reserve raised interest rates in 2022 to combat inflation and SVB's long duration bonds fell in value by 17% or $15bn by year-end 2022, as disclosed in its 10-K annual filing. On a fair value basis the bank's equity was almost zero, but a well-meaning accounting convention allowed the bank to classify the bonds as Held-To-Maturity and value them at cost – giving SVB the appearance of being well capitalised. And so investors and depositors largely carried on unaware or unconcerned. There was a wrinkle, however. The vast majority of SVB's depositors were uninsured, so if any liquidity or solvency concerns were to emerge, depositors would run for the exits, which would force the bank to sell HTM assets at prevailing market prices. And the sale of even one of its HTM bonds would lead to a revaluation of whole $90bn portfolio. You know what happened next: a $211bn asset bank up in smoke. [Incidentally, following SVB's collapse I now have the distinction of knowing someone who was employed by two banks that went bust (not that he is in any way to blame). No doubt finance employees everywhere want to know where he's going to work next, bringing to mind Charlie Munger's quip All I want to know is where I'm going to die so I'll never go there.]

Despite government reassurances and interventions, SVB's collapse caused the Banking Fear-O-Meter to spike, leading the deposits being pulled from a host of other regional banks in the US. For much the same reasons, New York's Signature Bank failed a few days later while First Republic Bank (assets $212bn) was teetering on the edge at the time of writing. SVB and Signature – somehow deemed by lawmakers too-small-to-be-fully-regulated – had a whopping $320 billion of assets between them. For context, this is the equivalent of Sweden's leading bank Handlesbanken or – closer to my home – Ireland's two large lenders Bank of Ireland and AIB combined. Bigger news was to follow in Europe when confidence drained from Switzerland's Credit Suisse ($580bn in assets) and over a weekend it was frog-marched into a wedding with UBS (a marriage both banks have shunned for decades). Remarkably, the MSCI World Banks Index fell just 5% in Q1 (Euro-terms) as nerves were steadied by Central bank actions, but in our opinion, confidence remains brittle and further problems cannot be ruled out.

The case of SVB is particularly interesting because its unrealised losses were disclosed and the casual observer might wonder how so many sophisticated investors could have been caught off guard. The primary problem is that banks are highly levered and their complexity means it can be very hard to see what's going on from the outside. Disclosures about interest rate hedges – which, if in place, could offset bond losses suffered by SVB and others – are generally lacking. And the consequences of asset revaluations are magnified by the leverage. An investor in banks has to be always switched on. They are certainly not sleep-at-night stocks.

Our long-held approach to investing in banks is one of extreme caution, an understanding that things can go wrong quickly. However, we don't think it makes sense to rule them out of bounds. They do have unique advantages. They have the privilege of taking in deposits, which can be loaned out at higher rates, and if depositors panic and want their money back in a hurry, banks can depend on a lot of Central Bank liquidity support so long as they've done nothing stupid on the asset side of the balance sheet. The necessary but not sufficient attributes of a good bank investment are stable and rational competition, a (relatively) simple business model, competent management that prioritizes its reputation and its balance sheet at all times, and government policies and regulations that try to prevent excesses.

Commentary

We have received a number of enquiries from clients about our banking exposures since SVB went bust. We can confirm that Setanta did not own SVB (nor indeed have we owned any US bank since 2020). We cannot claim to have foreseen the looming problems. However, we do give ourselves credit for sticking faithfully to the attributes listed above. It's no coincidence that we were not invested in Credit Suisse for example, which looked to us an enormously complex, risk-taking entity with a weak compliance culture – one that stumbled from scandal to scandal in recent years (Archegos, Greensill Capital, spying scandal and more).

In the European Equity fund we also consciously decided to limit the exposure to lenders. The fund currently holds just one bank, Bank of Ireland, which accounts for just under 4% of assets at the time of writing.

Bank of Ireland exhibits the type of characteristics we look for in a lender– good country fundamentals, a limited number of rational competitors (down from five to three following the recent exits of KBC and Ulster Bank), a strong regulator (a transformed situation versus the Financial Crisis), prudent loan book and balance sheet management (highly liquid, small HTM book that is we think is fully hedged) that should see it through current banking sector fears. We added BoI in early 2020 and has been an exceptional performer since (up nearly three-fold). Its RoE is also on an improving trend and growth looks to be finally picking up following years of deleveraging (consumer / business balance sheets are now in rude health – also a transformation versus the Financial Crisis). Bank of Ireland shares were +5% (Euro-terms) in the quarter.

Transactions during the Quarter

We initiated one new position during the quarter, **Deutsche Boerse**. Deutsche Boerse is one of the largest providers of market infrastructure worldwide. Its business spans much more than a traditional stock exchange. As well as owning Xetra; the dominant exchange for German equities and European domiciled ETFs, they also own Eurex; the leading European derivatives franchise, EEX; the largest power trading platform globally, ISS; a leading provider of data solutions for the investment management industry, Investment Fund Services; a fund distribution platform and Clearstream; an International Central Securities Depositor (ICSD). In each business unit they are a market leading provider with a strong regulatory backdrop creating a natural barrier to entry. These business units also require scale to operate effectively and once achieved it serves as another barrier to entry. Scale begets scale and this gives us confidence that Deutsche Boerse's business model is both robust and sustainable and will facilitate continued growth in the future. Revenues have compounded at 8% pa over the past 10 years with cash flow primarily being reallocated into acquisitions in adjacent markets as well as a healthy return to shareholders via dividends. We believe we are being given the opportunity to invest in a high-quality compounder at reasonable valuations.

David Byrne, CFA, Portfolio Manager

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IMPORTANT INFORMATION

The European Equity Fund is managed by Setanta Asset Management Limited and is a representative account of the European Equity strategy. The performance shown is the performance of a representative account (ILA/CLI European Equity Fund [IEC7002]). 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 available on a separate account basis to institutional investors however 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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