Setanta Active Multi-Asset Fund Range

Q2 2023

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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.

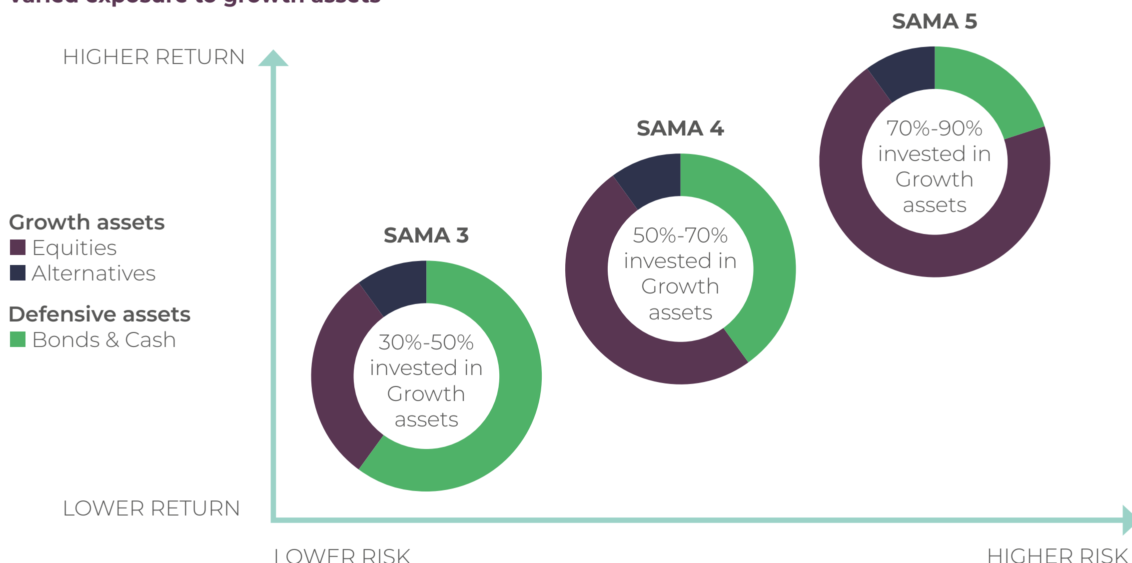
The funds are managed in line with the following core principles:

- **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

The previous quarter ended with concerns around a US banking crisis tipping the US and potentially the world into a recession, with echoes of the previous banking crisis of 2007 still front of mind. This quarter saw US markets shake off the regional banking crisis, but headlines quickly switched to the story of a potential US debt default as the debt ceiling loomed and rates continued to be hiked.

Headline inflation has fallen, although sticky core inflation will result in caution on any policy loosening from central banks, as they seem more comfortable with hiking too much rather than too little. Talk of recession in the US is moderating, with many now seeing recession pushed into 2024. However, there are concerns that lagged effects of tightening to date are really yet to be felt, as central banks remain active, reducing the size of rate increases but continuing to increase at an unprecedented pace. Rhetoric remains hawkish, with interest rate guidance higher.

The European Central Bank (ECB) hiked twice over the quarter, bringing its main refinancing rate to 4%. The Federal Reserve (Fed) hiked only once, lifting the federal funds rate to 5.25%, and then pausing in June. Any sign of rate cuts, however, looks some way off, as core inflation remains persistently high. Interest rate markets in both the US and Europe imply close to two more rate hikes by year-end, with one baked in irrespective of upcoming inflation prints early next month. The narrative has switched from likely interest rate cuts this year to rates plateauing at higher levels for longer than many expected.

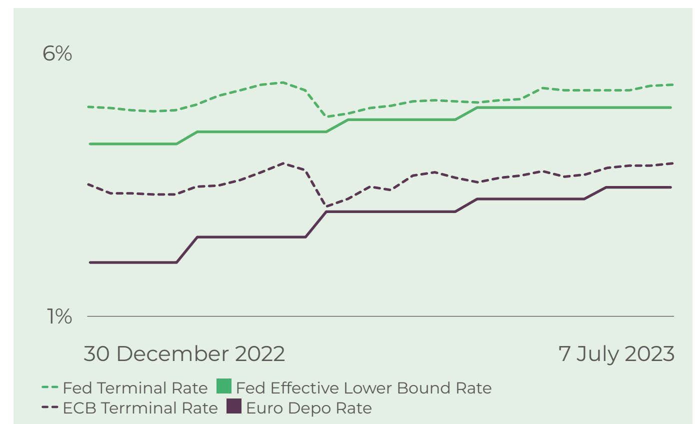
The main asset classes were broadly positive, in low-to-mid-single digits, supported by a strong US labour market with unemployment at historic lows.

> I don't have a recession in my forecast. I have pretty slow growth."

> Some of the tightening of monetary policy and some effects of credit tightening will weigh on demand in 2024."

The Financial Times, 11 July 2023, interview with New York Fed President John Williams

Terminal rates for Fed and ECB



Source: Bloomberg/Setanta

The ECB's Governing Council has responded by increasing interest rates substantially and has so far raised the policy rates by 400 basis points since July last year – the fastest tightening on record. But our job is not yet done."

Keynote speech by Luis de Guindos, Vice-President of the ECB, at King's College London, 7 July 2023

Bonds

European government bonds were steady, as higher starting yields helped bond returns, while surprisingly resilient growth and low defaults boosted credit returns. Even the ECB's announcement that its Asset Purchase Programme (APP) reinvestments were stopping – a large buyer leaving the market – did not widen yield spreads.

Ten-year bonds drifted higher by 10 basis points (bps) from 2.29% to 2.39% at the end of June, while Greek bonds rallied on the hope of an upgrade to investment grade rating, as they yielded less than Italian bonds – some recovery from the heady days of 2012.

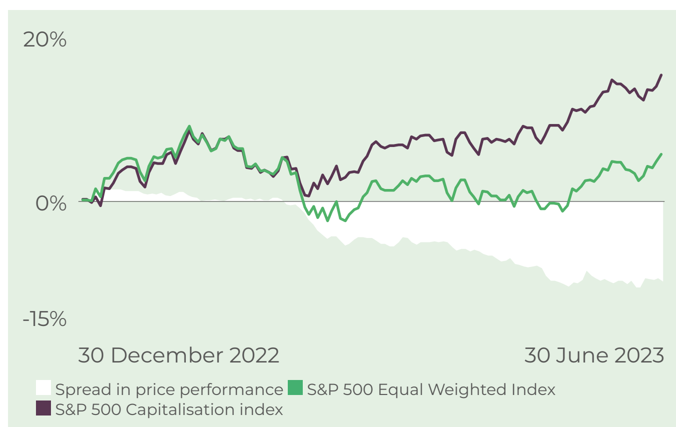
Corporate bond spreads narrowed on improved risk sentiment. Spreads on high-yield and investment-grade corporate bonds narrowed by 77bps and 13bps respectively, reversing the widening around the US regional banking sector turmoil.

Equities

Equity markets continued to push past concerns around slow growth, falling earnings expectations and higher interest rates, and the US fared well, boosted by the technology sector, which carries a higher weight in the US than elsewhere.

Positive sentiment around artificial intelligence (AI) development and adoption catapulted some stocks higher – raising concerns of a potential mini bubble as much of the market leadership is a narrow group of stocks, with participation in the rally only broadened towards quarter end. The difference in returns between the S&P 500 capital weighted index versus the S&P 500 equal weighted index shows the large dispersion in returns, of around 10%.

'Heavyweights rule': S&P 500 Index, capitalisation weighted vs. equal weighted



Source: Bloomberg/Setanta

It is interesting to note equities moving higher despite lofty valuations and such high cash rates – the last time cash offered such tantalising levels was just prior to the global financial crisis. The recent move higher in real yields could create some headwinds, leading to lower price multiples.

Outlook

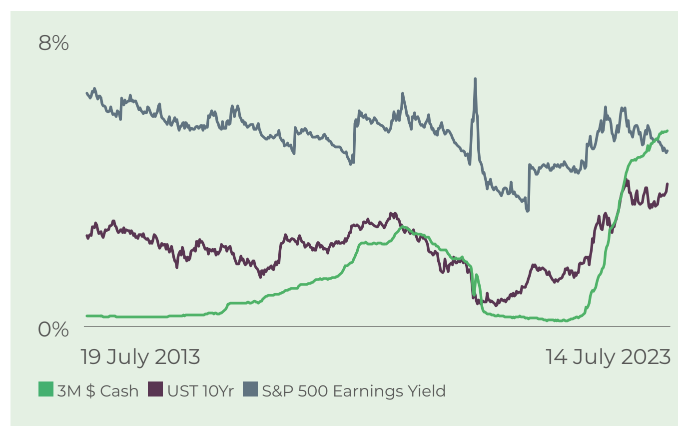
Macroeconomic data remains mixed. In Europe, manufacturing was lacklustre with services holding up marginally better.

The global economy remains vulnerable, with the lagged effects of policy tightening yet to be fully felt, and valuations look full – with bonds reflecting more concern than equities, given the inverted yield curves.

A recession, evident in Europe, is yet to occur in the US as its economy is showing a surprising degree of strength. Recession in the US may, therefore, be pushed out to next year – or may not happen at all.

Most assets seem priced for this kind of benign outcome; time will tell. If we continue to see slower growth and stubborn central banks, valuations start to look stretched as earnings are expected to recede.

'Cash is king': 3M cash, 10Yr Treasury and S&P 500 earnings yield



Source: Bloomberg/Setanta

Fund commentary

The SAMA Fund range gained by +1.8% to +3.6% over the quarter, with the year-to-date returns gaining by +4.9% to +8.1%.

Listed Private Equity (+7.1%) and Global Equity (+5.3%) both performed strongly. Notable Global Equity portfolio performers included Microsoft, Oracle and Alphabet ('AI beneficiaries') – up 15-28% in euro terms over the quarter.

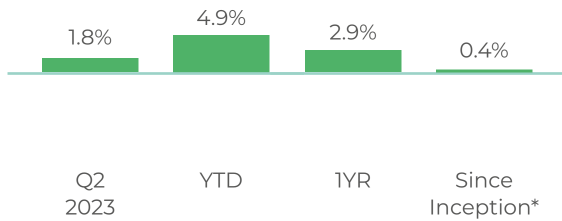
Exposure to Irish property through the Irish Property fund (-2.94%) and Irish Residential Property fund (-2.78%) lagged over the period; both remain negative year-to-date.

In fixed income, Emerging Market Debt (+2.6%) and Global High Yield (+0.9%) performed strongly, while investment grade Corporate Bonds (+0.5%) and Intermediate (1-10 year) Government Bonds (+0.04%) were marginally positive. Short-dated bond exposure (1-5 years) fell in value (-0.3%) as the ECB continued its march higher in rates, leading to more rate-sensitive bonds bearing the brunt of the underperformance.

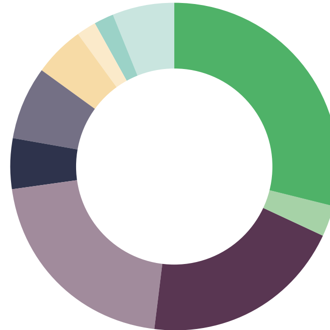
Fund performance and asset mix

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.



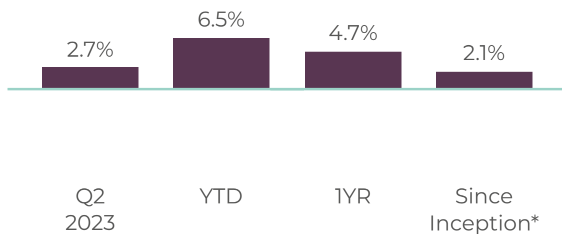
Q2 2023	YTD	1YR	Since Inception*
1.8%	4.9%	2.9%	0.4%



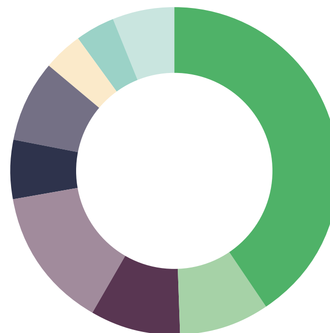
Asset class	Weight
Global Equity	29%
Emerging markets	3%
Total Equities	**32%**
Euro Government Bonds	20%
Euro Corporate Bonds	21%
Emerging Market Debt	5%
Global High Yield Bonds	7%
Cash	5%
Total Bonds & Cash	**58%**
Infrastructure	2%
Private Equity	2%
Property	6%
Total Alternatives	**10%**

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.



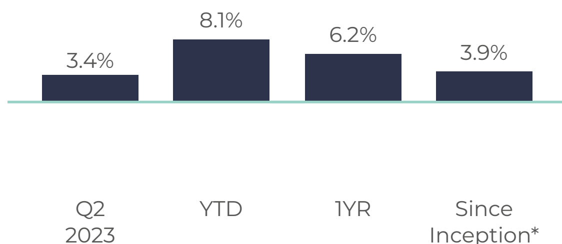
Q2 2023	YTD	1YR	Since Inception*
2.7%	6.5%	4.7%	2.1%



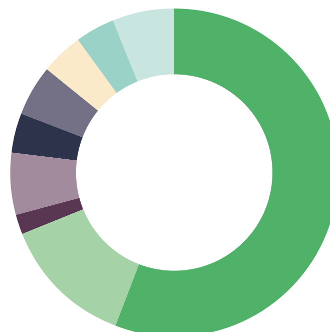
Asset class	Weight
Global Equity	41%
Emerging markets	9%
Total Equities	**50%**
Euro Government Bonds	9%
Euro Corporate Bonds	14%
Emerging Market Debt	6%
Global High Yield Bonds	8%
Cash	0%
Total Bonds & Cash	**37%**
Infrastructure	4%
Private Equity	4%
Property	6%
Total Alternatives	**14%**

SAMA 5

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



Q2 2023	YTD	1YR	Since Inception*
3.4%	8.1%	6.2%	3.9%



Asset class	Weight
Global Equity	56%
Emerging markets	13%
Total Equities	**69%**
Euro Government Bonds	2%
Euro Corporate Bonds	6%
Emerging Market Debt	4%
Global High Yield Bonds	5%
Cash	0%
Total Bonds & Cash	**17%**
Infrastructure	4%
Private Equity	4%
Property	6%
Total Alternatives	**14%**

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.

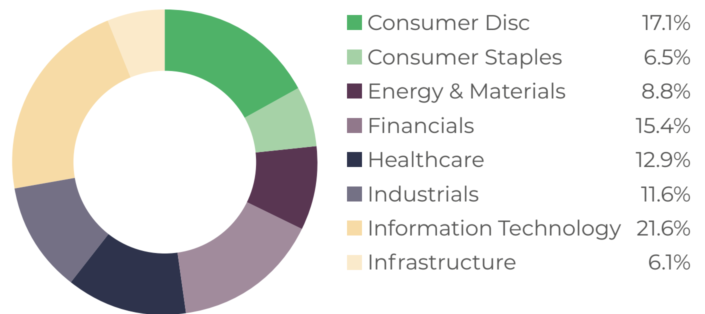
*Fund launch date 24 May 2022. Asset class weightings as at 30 June 2023.

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

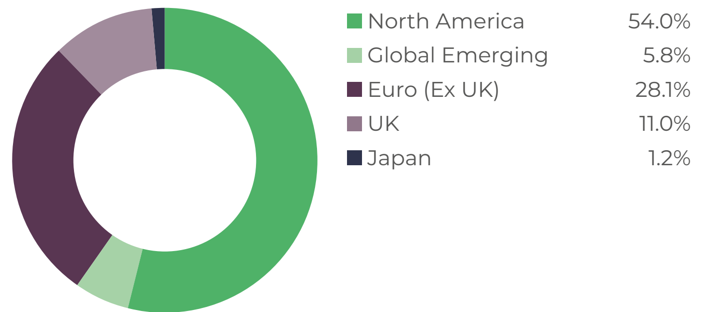


Top 10 equity holdings

Company	Sector	% of fund
Microsoft	Information Technology	**4.9%**
Berkshire Hathaway	Financials	**3.8%**
Oracle	Information Technology	**3.6%**
Alphabet	Consumer Discretionary	**2.8%**
McDonald's	Consumer Discretionary	**2.8%**
Costco Wholesale	Consumer Discretionary	**2.7%**
Booking Hldgs	Consumer Discretionary	**2.5%**
Samsung Electronic	Information Technology	**2.5%**
Johnson & Johnson	Health Care	**2.2%**
Nike	Consumer Discretionary	**2.2%**

Source: Setanta Asset Management, as at 30 June 2023.

Geographic distribution



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.

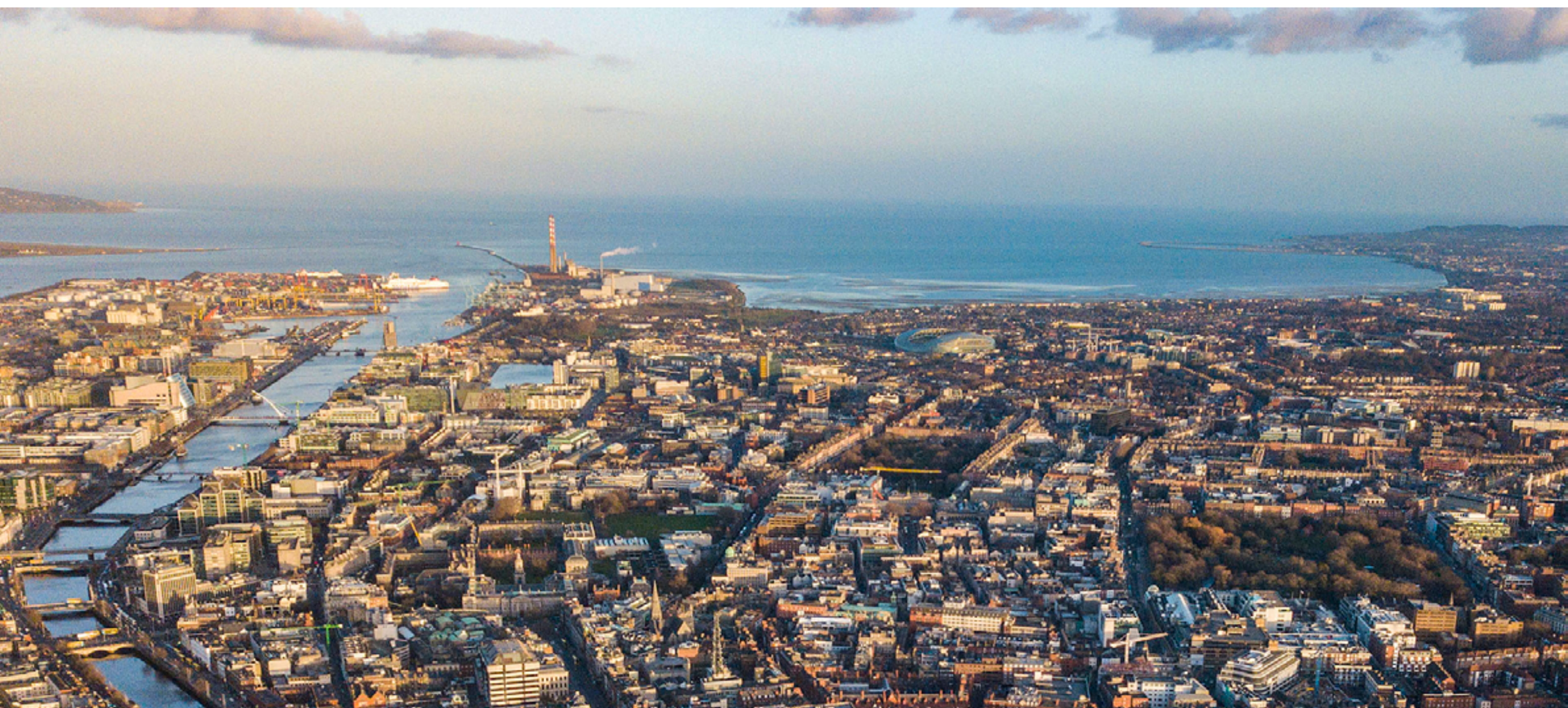
Setanta Global Equity portfolio commentary

There was a somewhat elevated level of portfolio activity during the quarter as we added four new stocks (full positions in Ferguson and Nextera, and starter positions in Sonova and PayPal) and sold out of three (Constellation Energy, Tesco and Euroapi). Below we offer the investment rationale behind the decisions.

Ferguson – previously known as Wolseley – is a distributor of plumbing, heating and related products to professional tradesmen. Today, Ferguson sells primarily in the US (national footprint), having exited its poorly positioned European operations over the last decade or so. The company has a balanced exposure to steady renovation/maintenance spending versus more volatile new build (60/40%), while there is a near 50/50% split between sales to residential and non-residential end markets. Ferguson sits between highly fragmented supplier and customer bases and is usually the number one or two player, with typical market shares of 10-20% across its different divisions. Its scale results in greater bargaining power with suppliers (estimated ~3% price advantage over smaller competitors), an ability to reliably stock a wide number of products (very important for the customer), more resources to invest in technology/automation/omnichannel distribution (better efficiencies) and an ability to develop its own brand offering (twice the gross margin of non-own brand). The combination of these and other factors have enabled Ferguson to earn very attractive economics in the US historically and we estimate the group has the potential to earn a c.20% return on invested capital over the cycle. Management targets 7-12% p.a. revenue growth over the medium term, made up of market growth, pricing, market share gains and 1-3% from acquisitions. It also believes there is scope for modest margin expansion. The group's balance sheet is good order.

Near-term risks include the impact from higher interest rates / tightening credit conditions on general demand, a greater than expected reversal of pulled-forward demand from COVID and price deflation that could crimp margins by more than we expect. These may add volatility to near-term earnings but should not detract from the attractive longer-term opportunity. Ferguson was funded by partial sales of Johnson Controls and OI Glass

Nextera Energy is a diversified US utility with a long track record of developing clean energy assets. It operates two main businesses: a regulated integrated utility in Florida (FPL), and Nextera Energy Resources (NEER) which is a mix of mostly unregulated businesses operating across the US and Canada. US regulated utilities may earn an allowed return on equity (RoE), with an ability to outperform this rate through efficiencies. Thanks to a strong operating performance, FPL has been able to match or outperform its regulator-allowed 10.5% RoE over the last decade while growing operating assets at a mid-to-high single-



digit annual rate while maintaining high levels of service quality and affordability. Growth is helped by Florida's strong economy and above-average population growth (more demand requires more generation assets and electricity grids).

NEER is one of the largest independent power producers in the US. It was launched around 30 years ago, beginning with wind assets, and since then has added marketing and trading capabilities, transmission and gas infrastructure and has a strong position in the nascent battery and green hydrogen markets. We believe NEER has significant sustainable advantages, including its strong reputation with regulators; customer relationships that enables it to match its long-duration assets to demand (>90% of revenues contracted for an average 15 years); scale advantages such as in the procurement of generation equipment; and low finance costs. NEER has grown its capacity by 7% p.a. over the last 10 years. The US, like elsewhere, has a significant need to overhaul its energy infrastructure. The Inflation Reduction Act (IRA) provides very strong support for renewables investment. As a pre-eminent renewable asset developer and operator, Nextera has a clear capability to reinvest earnings at attractive rates of return. We believe the company can grow earnings and dividends by high single digit rates over a long period of time. Nextera's valuation is high relative to peers at c.25 P/E, but we feel it is well deserved given the visibility of future growth and a best-in-class management team known for its execution and forward-thinking culture.

Sonova Holding is a Swiss-based hearing aid company. Our healthcare portfolio manager Rowan Smith has followed Sonova and its peers with interest for about 20 years. There are just five hearing aid wholesale manufacturers globally (Sonova has a leading 25% share) and market shares have remained quite stable over time with no significant new entrants. We like that improvements in hearing aid technology tend to be incremental, not revolutionary, e.g. smaller form factor, more adaptable to varying noise levels. Also, hearing aid demand is very stable, partly because more than 50% of industry volume consists of replacement units. We think industry sales should grow above GDP, helped by demographics (hearing loss is closely correlated with age) and increased availability of products in underpenetrated parts of the world. Hearing aid wholesale manufacturing is extremely profitable, with good margins and low capital requirements.

In most markets, hearing aids need to be prescribed by a trained professional. Customers go to a retail store to undergo a hearing test, be advised on a suitable product and have their hearing aid settings adjusted as required. In the past, we were concerned to see hearing aid manufacturers enter into the retail space. This was a move to control the customer relationship and protect the brand, but retail is a more fragmented/competitive business, and we feared it could have a detrimental impact on group financial performance. However, Sonova has managed this transition reasonably well even as retail has grown to around a quarter of profits.

By our conservative estimates, Sonova was trading at a P/E of 25x at the time of purchase, with the potential to deliver a mid-to-high single-digit annual total return. We have added a starter weight in the holding and may increase this over time.

PayPal is a brand known to you all: a payments company makes it easier and safer to make digital transactions. It is a beneficiary of the secular growth in ecommerce and digital payments. PayPal is one of the few double-sided payment networks, sitting between consumers and merchants. Consumers use PayPal because it is free to use and widely accepted by merchants (who pay a transaction fee), which draws more users into the network. PayPal has an estimated 15% market share of global ecommerce payments, making it three to five times bigger than its closest competitor. Such scale gives the company tremendous advantages. This is reflected in the company's historic mid-to-high teens operating margin (Setanta calculated) and strong growth. As an asset-light company, PayPal does not need much capital to grow, resulting in a high conversion of profits into cash flow, which the company has historically used to buy back stock and make acquisitions. PayPal became a COVID darling stock but, as economies reopened and ecommerce trends stalled/reversed, the shares gave back all the pandemic gains and more, prompting us to investigate a possible investment. Greater competition in payments has emerged in recent years, including from Apple and Google

Pay and 'buy now pay later' companies. However, we think PayPal still has a bright future with untapped potential to offer what rivals cannot. A changing mix shift is putting some pressure on group margins, but the company expects that increased scale and efficiencies and new products will offset this in the coming years, driving profits upwards. With the stock trading at its lowest ever valuation (we estimate a low 20s P/E at the time of investment), we decided to take a starter position with a view to adding as we get more evidence that the company can continue to thrive in the face of competitive threats.

The most notable portfolio exit was **Constellation Energy**. Constellation Energy was a spin-off from US utility Exelon, following its decision to split into two: the regulated assets remained with Exelon (which we continue to own) while the unrelated assets were put into Constellation Energy. Constellation has had a favourable wind behind it in the last couple of years. For one, the company's profit outlook was boosted by the rising prices of fossil fuels, which pushed up wholesale power prices while only modestly impacting its power generation costs given its large nuclear generation fleet. Secondly, whereas there was previously some uncertainty about the role for nuclear in the US power market, the aforementioned IRA bill explicitly supports it as a clean energy source of the future, materially increasing the company's reinvestment opportunities. Following a near doubling of its share price in just over a year, we decided to cash in and invest the proceeds in Nextera where we believe the prospects are better.

We concluded some time ago that British retailer **Tesco** was not a core long-term holding – UK retailing is too competitive – so this was a case of waiting for the market to offer us a fair exit price. We sold some shares in Q1 and completed the sale in Q2. The proceeds from the Tesco sale were added to existing holding **Estée Lauder**, which released weaker than expected profits for the quarter ended March. We believe the company is high-quality, a market leader in the growing premium skincare market, where brand loyalty is high and margins are very attractive. The current difficulties are due to stocking and inventory management by customers in its key Chinese market who have only recently emerged from an extended COVID lockdown.

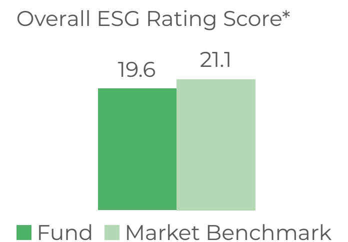
Euroapi was also sold in Q2. We received shares in the company via a spin-off from another portfolio holding, French pharmaceutical Sanofi. Euroapi is a relatively a small company and a miniscule holding for us. After some research, we concluded this was not a stock we wanted to continue to own.

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).

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.

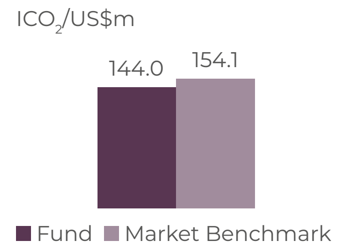


Sustainalytics' ESG Risk Ratings measure a company's exposure to industry-specific material ESG risks and how well a company is managng those risks. This multi-dimensional way of measuring ESG risk combines the concepts of management and exposure to arrive at an absolute assessment of ESG risk. Sustainalytics identifies five categories of ESG risk severity that could impact a company's enterprise value.

Negligible	Low	Medium	High	Severe
0 – 10	10 – 20	20 – 30	30 – 40	40+

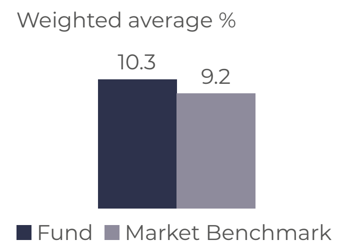
Carbon intensity

Carbon intensity 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 30 June 2023.
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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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WARNING: Past performance is not a reliable indicator of future results. The price of units and the income from them may go down as well as up and investors may not get back the amount invested. The return may increase or decrease as a result of currency fluctuations. Forecasts are not a reliable indicator of future performance.

Signatory of: