Setanta Active Multi-Asset Fund Range

Q3 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.

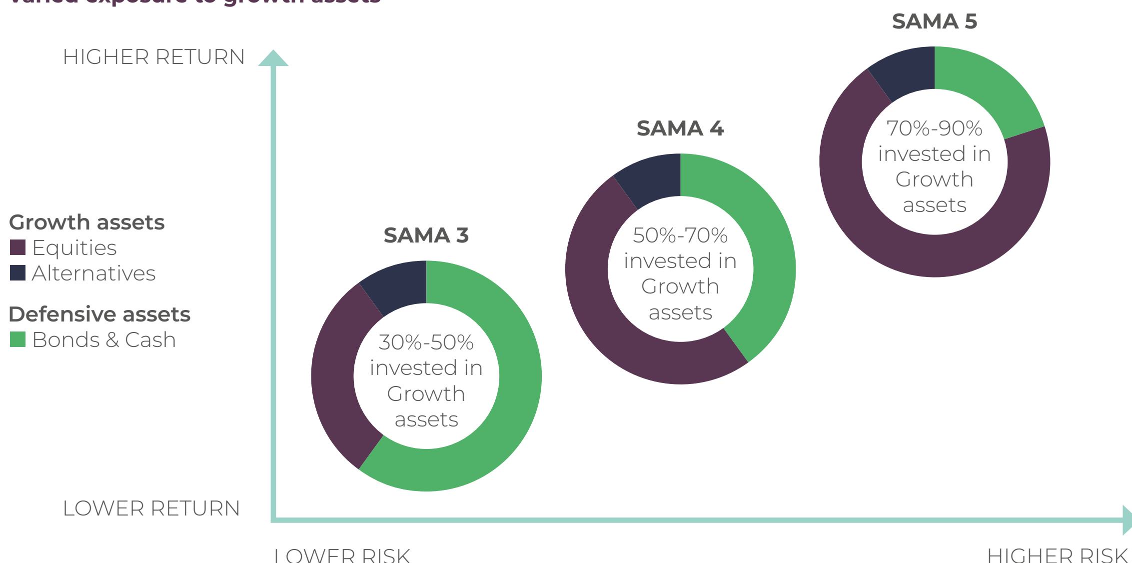
The funds are managed in line with the following core principles:

- **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



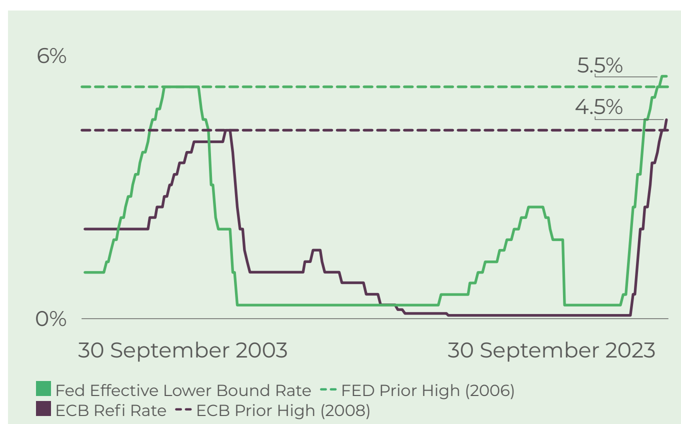
Market commentary

Over the quarter, bond yields and interest rates reached new cycle highs both in the US and in Germany, with markets now potentially targeting a 5% yield in the US 10-year treasury and 3% in the German 10-year bund.

Central bank policy

Macro data and monetary policy reassessment drove the moves. Both the European Central Bank (ECB) and the Federal Reserve (Fed) hiked interest rates during the quarter. The Fed hiked the federal funds rate by 25 basis points (bps) to 5.50% and the ECB hiked twice, by 25bps each time, with its main refinancing rate ending the quarter at 4.50%.

ECB and Fed base interest rates



Source: Bloomberg/Setanta

The Fed delivered a 'hawkish pause' at the end of the quarter. Although they did not raise rates at the September meeting, they raised the bar for the prospect of interest rate cuts, and markets increasingly priced in the 'higher for longer' narrative.

The upside of the move higher in bond yields, especially longer dated bond yields, is that recent Fed comments indicate this may mean no further rate hikes are necessary – a notable pivot from what was said at Jackson Hole, their annual economic symposium.

The European Central Bank (ECB), through forward guidance, pointed to reliance on data dependency from here, with the door left well and truly ajar for further rate moves.

Good economic news is deemed bad news for rate cut expectations, and renewed fears of inflation remaining sticky are also expected to keep rates at high levels. Particularly concerning were crude oil staging a comeback over the quarter, rallying to over $90 per barrel, and growing risks to food prices from El Niño affecting weather patterns and crop yields.

> We have tightened policy significantly over the past year. Although inflation has moved down from its peak – a welcome development – it remains too high. We are prepared to raise rates further if appropriate, and intend to hold policy at a restrictive level until we are confident that inflation is moving sustainably down toward our objective."

25 August 2023, 'Inflation: Progress and the Path Ahead', Chair Jerome H. Powell at 'Structural Shifts in the Global Economy', an economic policy symposium sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming

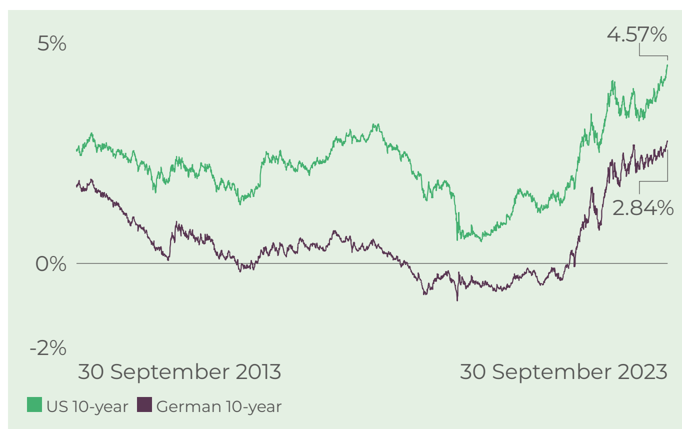
> "...is the door open or is the door closed? You know, there was a beautiful theatre play by De Marivaux, who said that a door has to be either opened or closed. But this is theatre."

14 September 2023, monetary policy statement and press conference, Christine Lagarde, President of the ECB, Luis de Guindos, Vice-President of the ECB, Frankfurt

Bonds

Longer duration bonds led the selloff in the US and Europe, resulting in a 'bear steepening' (the spread between short-term and long-term bonds widening due to rising long-term rates). Yields rose and prices fell across the yield curve, but with more of a move at the long end than at the short end. Markets finally priced in what central banks had been saying, that there will be no rate cuts in the near term.

German and US 10-year government bond yields



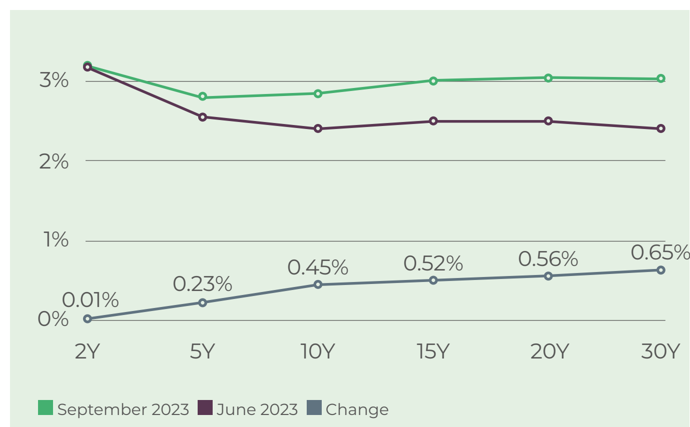
Source: Bloomberg/Setanta

The US yield curve steepened at one its fastest paces over the last 10 years, driven by a re-pricing higher of long-term real rates as markets lowered recession risk, with investors demanding more yield to lend for longer.

In Europe, widening sovereign spreads of peripheral debt led the steepening of the European yield curve.

Bond markets are also very aware of fiscal spending and large current deficits – the increased supply of bonds will help neither the supply/demand balance nor market sentiment. This has started to build 'term premium' back into the yield curve, where investors demand higher yields to compensate them for the risk that interest rates may rise over the life of a bond.

German yield curve

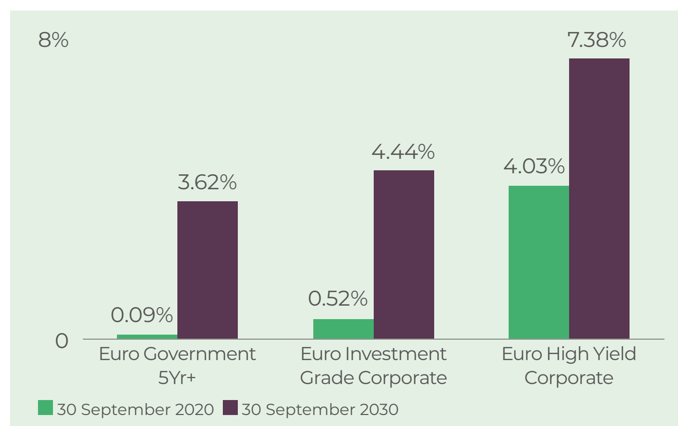


Source: Bloomberg/Setanta

Corporate bonds are looking attractive within a balanced portfolio. Credit spreads remained resilient despite the rise in real rates. Within investment grade bonds, interest rate coverage is high and leverage low, they offer reasonable expected returns at current starting yields.

Further down the credit spectrum, high yield bonds, offering attractive yields of over 7%, could see losses as defaults increase while recovery values trend lower.

European government, corporate investment grade and high yield bond yields



Source: Bloomberg/Setanta

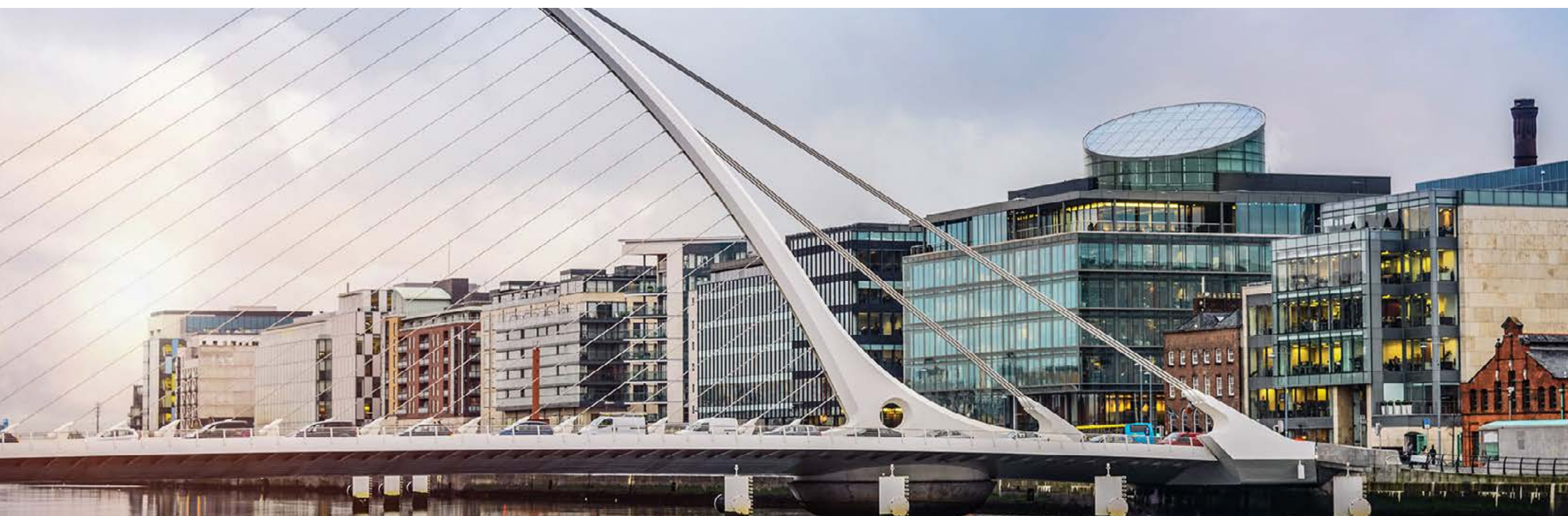
Equities

Risky assets, especially long duration technology stocks, struggled with the rate increases, with the Nasdaq underperforming the S&P 500. The equity/bond correlation has turned positive once again with bonds selling off alongside equities, raising concerns of a repeat of last year where balanced portfolios suffered.

Falling recession risk has not boosted equity performance, as rate cuts are now less likely. Normally, a bear steepening of bonds has been 'risk-on' due to growth picking up. This seems less so currently, and, even if we do see growth go lower, there is little central banks will do given current inflation concerns.

When rates are thought to have peaked out, one may expect risk assets to rally. However, we have seen AI-driven optimism softening, with mega-cap stocks starting to underperform the rest of the market, despite robust earnings expectations.

Rising interest rates have tended to push equity multiples lower. This means earnings will have to work harder to drive stock returns going forward, which could prove difficult in an environment where margins are under pressure from higher funding and input costs. This should favour those stocks with low leverage and resilient pricing power.



Fund commentary

The SAMA Fund range fell by -1.0% to -1.5% over the quarter, with the year-to-date returns gaining by +3.0% to +4.5%.

Those markets susceptible to rising rates struggled. Longer dated bonds (-1.8%), listed infrastructure (-5.2%) and both direct property (-4.8%) and Indirect REITs (-2.4%) were lower. Equities, both global (-2.5%) and emerging markets (-0.1%), were also weak as concerns grew that rising interest rates could force price multiples lower. However, our underweight to some of the larger technology names detracted from performance.

Listed private equity (+7.8%), short-dated government bonds (+0.3%), investment grade bonds (+0.4%) and high yield (+0.2%) bonds were positive over the period.

Over the quarter, we allocated from global equities into investment grade corporate bonds.

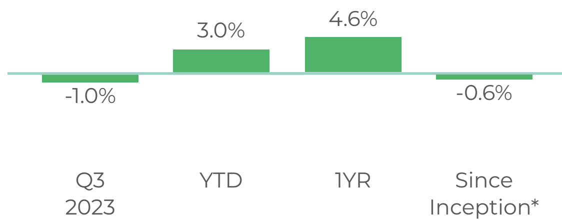
The move higher in government bond yields has dragged all bond yields higher. The added pickups in yields from investment grade corporates are at reasonable levels (~150bps) given very low expected default rates and high recovery values.

While growth may be slowing, and we have yet to really feel the effects from the aggressive hikes in interest rates globally, leverage is low and interest rate coverage is high in investment grade credit currently, giving some confidence that attractive expected returns should be achieved.

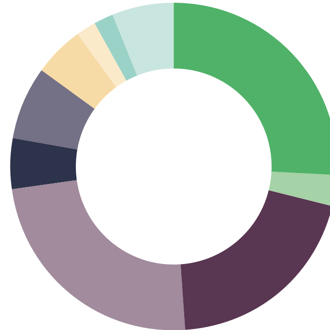
Fund performance and asset mix

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.



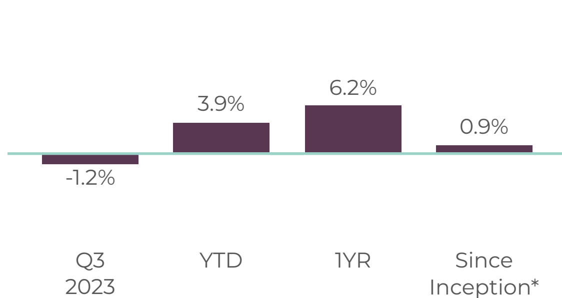
Q3 2023	YTD	1YR	Since Inception*
-1.0%	3.0%	4.6%	-0.6%



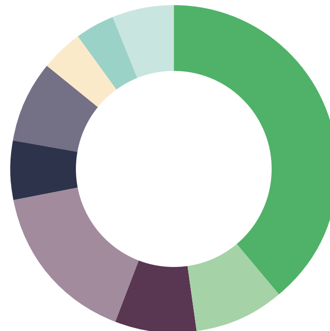
Asset	Weight
Global Equity	26%
Emerging markets	3%
Total Equities	**29%**
Euro Government Bonds	20%
Euro Corporate Bonds	24%
Emerging Market Debt	5%
Global High Yield Bonds	7%
Cash	5%
Total Bonds & Cash	**61%**
Infrastructure	2%
Private Equity	2%
Property	6%
Total Alternatives	**10%**

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.



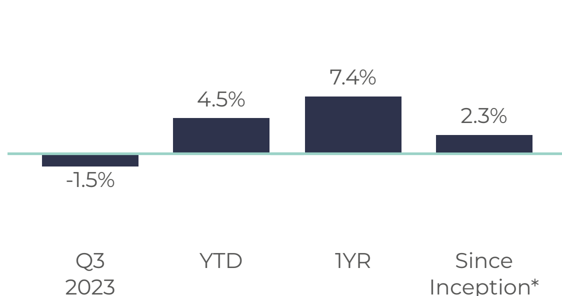
Q3 2023	YTD	1YR	Since Inception*
-1.2%	3.9%	6.2%	0.9%



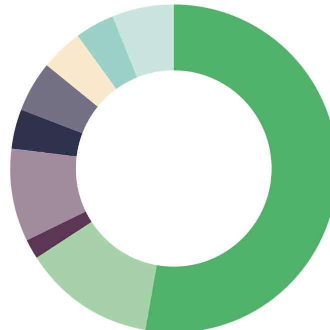
Asset	Weight
Global Equity	39%
Emerging markets	9%
Total Equities	**48%**
Euro Government Bonds	8%
Euro Corporate Bonds	16%
Emerging Market Debt	6%
Global High Yield Bonds	8%
Cash	0%
Total Bonds & Cash	**38%**
Infrastructure	4%
Private Equity	4%
Property	6%
Total Alternatives	**14%**

SAMA 5

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



Q3 2023	YTD	1YR	Since Inception*
-1.5%	4.5%	7.4%	2.3%



Asset	Weight
Global Equity	53%
Emerging markets	13%
Total Equities	**66%**
Euro Government Bonds	2%
Euro Corporate Bonds	9%
Emerging Market Debt	4%
Global High Yield Bonds	5%
Cash	0%
Total Bonds & Cash	**20%**
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.

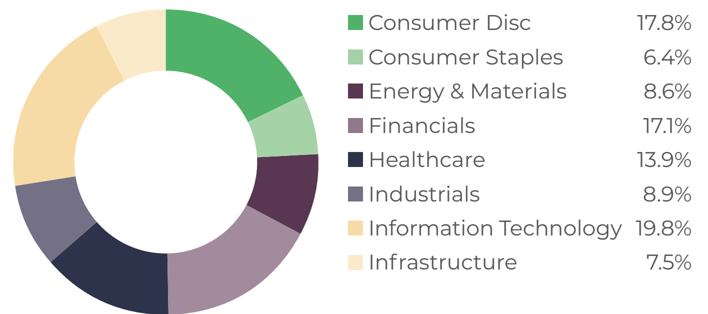
*Fund launch date 24 May 2022. Asset class weightings as at 30 September 2023.

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.

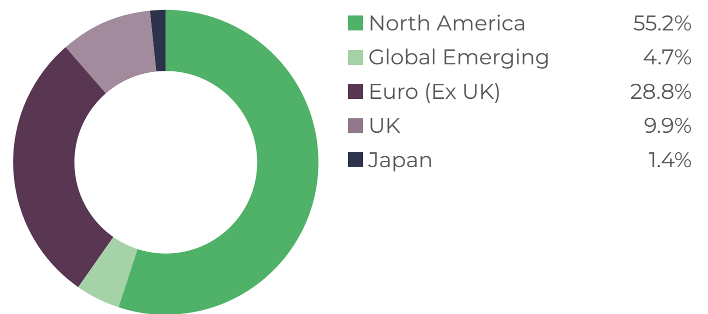
Sector distribution



Top 10 equity holdings

Company	Sector	% Of Fund
Microsoft	Information Technology	**4.8%**
Berkshire Hathaway	Financials	**4.2%**
Oracle	Information Technology	**3.4%**
Alphabet	Consumer Discretionary	**3.2%**
Booking Hldgs	Consumer Discretionary	**2.9%**
Costco Wholesale	Consumer Discretionary	**2.9%**
Mcdonald's	Consumer Discretionary	**2.6%**
Samsung Electronic	Information Technology	**2.5%**
S&P Global	Financials	**2.1%**
Nike	Consumer Discretionary	**2.0%**

Geographic distribution



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

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.

Global Equity Strategy – importance of balance sheet strength

A significant development during Q3 was the rise in long-term interest rates. As I write this, the 10-year US treasury and 10-year German government bond yields are 4.8% and 3% respectively, up from 3.5% and 1.9% at the beginning of 2023 and up from 0.5% and -0.6% at their lows around 2020. These benchmark rates are the lingua franca for investors of all stripes, ultimately determining how global assets are valued. Yields are up because inflation has remained high and investors fear that short term interest rates will remain higher for longer.

One can say that interest rates have simply reverted back towards their long-term average. And yet it would be something of a minor miracle if interest rates could rise so far and so quickly and for there not to be some fall out, somewhere. Save for consumers cutting back on discretionary purchases (see below), to date there are few signs of economic strain. The big drivers – employment, house prices – continue to hold in well for now and financial markets are relatively calm.

The Setanta investment approach has always emphasised balance sheet strength as a protective shield for the equity holder, and the current crop of fund holdings is no different. To demonstrate, of the fund's top 20 holdings (accounting for almost 50% of the fund), ten have net cash on their balance sheets while we estimate a further six would be able to pay off all their debt within 3-4 years (calculated using an estimate of free cash flow, i.e. after interest, tax and capex – not some EBITDA nonsense). Where debt levels are a bit higher, like with McDonalds and Oracle, the business quality is exceptional. We don't always get it right because things can come from leftfield, but it's a mindset that has helped protect performance in the past. Overall, we think our portfolio of holdings is in pretty good shape to navigate choppy waters should they emerge, and we are ready to act if dislocations appear.

Performance review

Notable outperformers include energy stocks **HF Sinclair** (US refiner, +29%), **ENI** and **Exxon Mobil** (integrated oil companies, +18% and +11% respectively), all of which are beneficiaries of higher oil prices. Also strong in Q3 was **Charter Communications** (+20%). You may recall last year the company announced it was going to step up its investment in the business for the next few years, which would divert cash flows from share buybacks. The market reacted negatively to this despite assurances from management that the return on the investments was attractive, but this year investors have become more agreeable to the idea and the stock has regained some of its lost ground. **Booking Holdings**, the parent of Booking.com, was also strong, as the stock rose 14% in Q3 and over 50% in the year to end September. The company takes a percentage of the spend on hotel room nights booked on its platform and has particular strength in Europe.

Consumers are choosing 'experiences over things', which is good for the travel sector. The strong US dollar has also helped, boosting inbound tourism from the US into Europe. Booking expects to make record profits in 2023. We really like the business longer term, but there is a question mark over whether current demand will be sustained into 2024 because we have seen dampened demand across a number of consumer companies, as highlighted by a couple of the fund's consumer staples holdings below. In light of this, we are keeping an eye on Booking's valuation.

Among the underperformers was **Pernod Ricard**, the world's second-largest producer of wines and spirits and owner of 240 brands including Jameson whiskey, Absolut vodka, Glenlivet scotch as well as its two eponymous aniseed liqueurs. The company reported good results in August but warned that the three months to September would be weak in the US and China. We were surprised that the stock reacted so negatively to this news (-21% in Q3). Management noted that China is experiencing general economic weakness, hitting sales of their premium cognac brand Martel. There has also been a slowdown in demand in the US which is leading to some industry destocking, while the best performing category in the US is tequila where Pernod has less exposure than peers. Aside from these near-term challenges, the company is in rude health and, given its favourable valuation of ~16x earnings (5-year average 22x), we increased our position shortly after the quarter end.

Also under pressure was **Estee Lauder**. The company sells a range of beauty products but it makes most of its money in premium skincare, a particularly attractive segment of the broad consumer staples category. The company has a particularly strong position among Chinese consumers, which has helped grow group revenues by 6% p.a. over the last 25-30 years. This company snapshot splintered somewhat in the last year. China's re-emergence from Covid lockdowns has proven a challenge. Consumers probably overbought and / or reduced their usage of beauty products during Covid and retailers have had to adjust down their inventories. And in truth the company has not managed the situation as well as peer L'Oreal. During the quarter, the Chinese government-imposed restrictions on daigou shoppers – individuals that purchase for profit goods outside of China on behalf of people living in China to avoid duty/tax or to access supply. This move has delayed the recovery in Estee's travel retail division by a few quarters, contributing to a ~26% fall in the share price over the quarter. Importantly, there is nothing to suggest that EL has lost market share in China or that its products are less desirable. The longer-term picture is that consumption of beauty products in China is still very underpenetrated versus markets such as the Korea and Japan, but right now there is a demand air pocket. Estee's valuation looks high (mid-30s PE) for the next 12 months, but assuming an operating margin of 15-16% (versus peak 20% and current 11%), then it's trading on ~25x. If the company can get back on a growth track, we think the stock can recover and deliver attractive long-term returns.

While there are specifics relating to Pernod and Estee Lauder, a recurring theme of a weakening consumer has emerged in recent months and quarters. Among the fund's holdings, we note Q3 share price weakness in **Nike** (footwear & apparel, -12%), **Richemont** (luxury goods, -24%), **Heineken** (premium beer, -10%) and **Kerry Group** (food ingredients, -11%). Each of these has attributes we seek out when investing – strong brands, good growth prospects and healthy balance sheets. We expect to remain shareholders over the medium to long term, but near-term results could be tricky.

Portfolio activity

Three stocks made their way out of the fund during the quarter. There were no new stock additions, and proceeds from the sales were spread across existing holdings.

The three sales were Groupe Bruxelles Lambert, Sandstorm Gold and Vodafone.

Groupe Bruxelles Lambert (GBL) was the most meaningful sale, having recently accounted for 1.3% of the fund. The company is a family-controlled financial holding company. It has investments in a range of European public and private companies, e.g. Pernod Ricard, SGS and Adidas account for ~50% of current gross NAV. It can be thought of as an investment fund with very low operating costs, a low level of financial leverage and, at the time of purchase in Q3 2015, it was trading at a ~25% discount to the fair value of its assets. We considered the likelihood of the

NAV discount closing to be low (it had been this way for most of its history) but it struck us as a heads-we-win, tails-we-don't-lose-much scenario. It turned out to be the latter. In the eight years we owned the stock, the discount gradually widened to 35-40% but nevertheless still generated a passable mid-single-digit annualised return. We had many conversations with the company about how they could narrow and perhaps even take advantage of the NAV discount. In fairness to management and the board, they simplified the company structure and increased share buybacks during our ownership period. However, we don't believe these actions went far enough and we weren't optimistic that a major strategic change was forthcoming. In particular, we questioned management's strategy of recycling more capital into private assets, whose valuations are inherently more subjective, rather than buying back their own stock in more substantial size. In the end, we decided that our capital was better served elsewhere and topped up other financial holdings: S&P Global (ratings, financial data and analytics), Tryg (Scandinavian property/casualty insurer) and Bank Leumi (Israel's leading bank).

Sandstorm Gold is a gold royalty company. It acquires gold purchase agreements with companies that have advanced development projects or operating mines. It was first purchased for the fund in 2013. At the time, we had analysed the mining industry and didn't like what we saw. Mining companies are highly operationally leveraged, requiring huge amounts of capex with little visibility into the return likely to be generated. However, we spotted what looked like an attractive niche: companies that provide financing to mining companies in return for receiving gold at a predetermined discounted price to market value. We liked that the royalty companies have a very low cost base (they typically employ just a handful of people) and are diversified across many projects (and so less dependent on the success or failure of any one mine). There are some excellent royalty companies out there, but unfortunately Sandstorm turned out to be a poor investment, declining modestly over 10 years in the midst of an equity bull market. In hindsight, Sandstorm in 2013 was subscale and, in order to grow, issued equity. Between 2013 and 2016, shares outstanding doubled – more than we expected – but at that point we received assurances from management that the company was sufficiently large and diversified and that dilutive equity issues were in the rear mirror. However, in 2022 the company made two major acquisitions totalling $1.1bn, financed by a 50% increase in shares outstanding and by increasing financial leverage (a significant departure from its past). Having already harboured misgivings about their capital allocation (choosing which project to finance is key to success in this business), our exit was just a matter of when and not if. Sandstorm accounted for 0.6% of the fund at year-end 2022. We cut back our holding over the course of 2023 and sold our final shares in July. The proceeds were invested into Ryanair and Ferguson.

Vodafone is a telecommunications provider, with key operations in Germany, the UK, Italy and Spain. It was also a long-term holding and, in truth, has been long earmarked for sale. The telecoms business is brutally competitive and requires high levels of capex every few years. Regulators in Europe have taken a particularly strong consumer-first approach, making it hard for operators like Vodafone to make an attractive return on investment. As with many value traps, there was always the prospect of better times ahead coupled with what seemed like terrible investor sentiment and a depressed share price. Over the years, we saw consolidation as being helpful for future returns, only to see new competitors emerge (new licences issued). Some very profitable revenue sources disappeared, notably the ban on mobile roaming surcharges across the EU in 2017. The potential for operators to monetise sharply rising mobile data usage was ultimately competed away. Vodafone itself sold off assets over the years but proceeds have primarily gone towards debt reduction measures rather than into shareholders' pockets. Meanwhile the operating performance of remaining businesses has been under constant pressure and there are now fears that the company is not generating enough cash to cover its dividend. We should have sold out of Vodafone years ago, but at least we had the good sense to keep our exposure limited to ~0.5% of the fund over the last 7-8 years and, in a broader context, the fund was underweight telcos versus the benchmark. The proceeds raised were invested in Nextera.

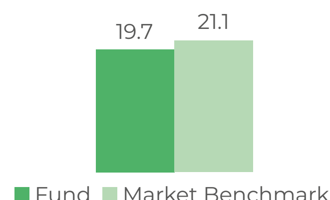
Environmental, social and governance

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.

Overall ESG Rating Score*



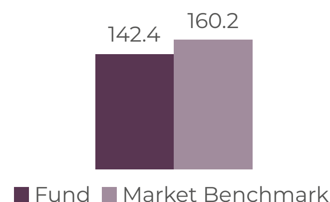
Sustainalytics' ESG Risk Ratings measure a company's exposure to industry-specific material ESG risks and how well a company is managg those risks. This multi-dimensional way of measuring ESG risk combines the concepts of management and exposure to arrive at an absolute assessment of ESG risk. Sustainalytics 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 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.

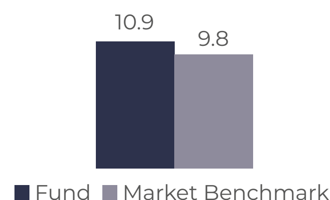
tCO_2/US$m



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.

Weighted average %



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 September 2023. Copyright © (2022) Sustainalytics. All rights reserved. This factsheet contains information developed by Sustainalytics. Such information and data are proprietary of Sustainalytics and/or its third-party suppliers (Third Party Data) and provided for informational purposes only. They do not constitute an endorsement of any product or project, nor an investment advice and are not warranted to be complete, timely, accurate or suitable for a particular purpose. Their use is subject to conditions available at https://www.sustainalytics.com/legal-disclaimers

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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