# Setanta Global Equity Fund
Q4 2023

## Fund Description

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

## Fund Commentary

### Market structure at extremes

The MSCI World Net Total Return Euro Index was up an outsized 19.6% in 2023. In addition to bullishness around the potential for AI, the global economy remained in good shape despite interest rates rises put through over the preceding 18 months. Towards the end of the year, and with inflation moderating, investors began pricing in interest rate cuts in 2024, providing a boost to equity markets generally.

*(Fund Commentary continued on Page 3)*

## Portfolio Managers

David Coyne & Sean Kenzie, CFA

## Our Investment Principles

We do not believe markets are efficient

We invest below our estimate of intrinsic value

We invest in businesses rather than buying stocks

Preservation of our clients' capital is key

Investing is a marathon, not a sprint

We are not afraid to swim against the tide

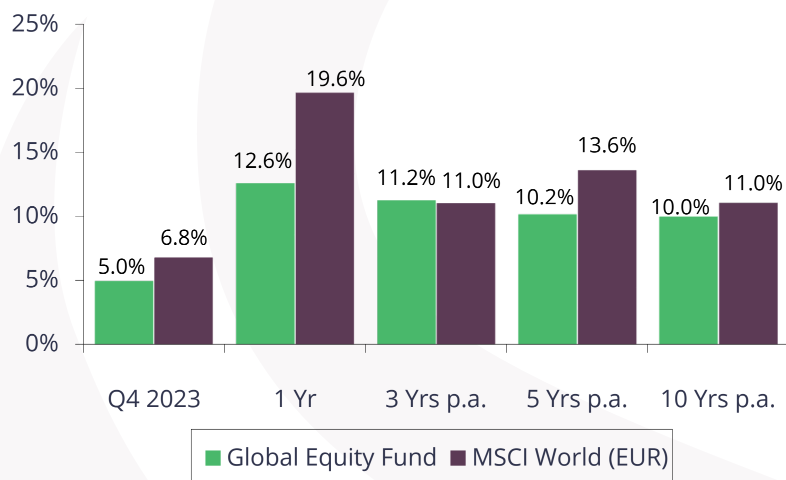
We consider scenarios rather than making forecasts

Businesses we own must have strong balance sheets

We make mistakes and always endeavour to learn from them

We will act with integrity in everything we do

## Fund Performance – 31.12.23 (EUR)




**Performance Source:** Setanta Asset Management Limited. The Fund returns stated are based on the movements in the unit prices of the ILA/CLI Setanta Global Equity Fund [P-GLB1] and are gross of management fees. The performance will be reduced by the impact of management fees paid, the amount of which varies. **Benchmark:** MSCI World (EUR). **Holdings Source:** Setanta. Sector allocations based on invested portfolio only (excludes cash). **Fund Statistics Source:** Bloomberg.

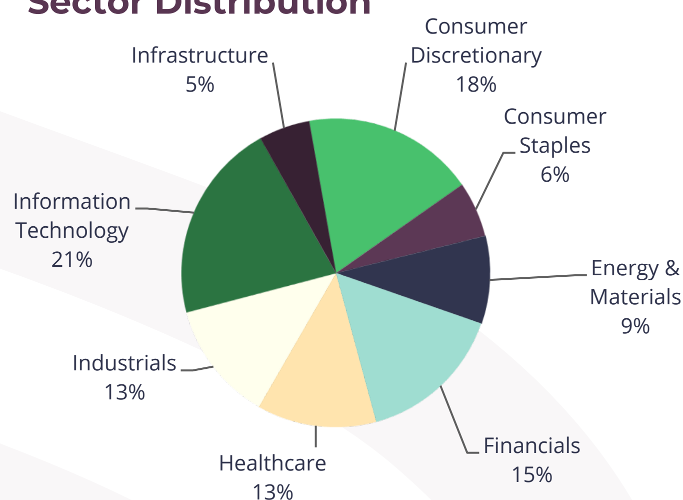
## Top 10 Holdings

| COMPANY | SECTOR | % OF FUND |
|---|---|---|
| MICROSOFT CORP | INFORMATION TECHNOLOGY | 4.7% |
| BERKSHIRE HATHAWAY | FINANCIALS | 3.9% |
| ORACLE CORP | INFORMATION TECHNOLOGY | 3.2% |
| COSTCO WHOLESALE | CONSUMER DISCRETIONARY | 3.1% |
| ALPHABET INC | CONSUMER DISCRETIONARY | 3.1% |
| BOOKING HLDGS | CONSUMER DISCRETIONARY | 3.1% |
| SAMSUNG ELECTRONIC | INFORMATION TECHNOLOGY | 3.0% |
| S&P GLOBAL INC | FINANCIALS | 2.2% |
| DCC | INDUSTRIALS | 2.1% |
| MCDONALD'S | CONSUMER DISCRETIONARY | 2.1% |

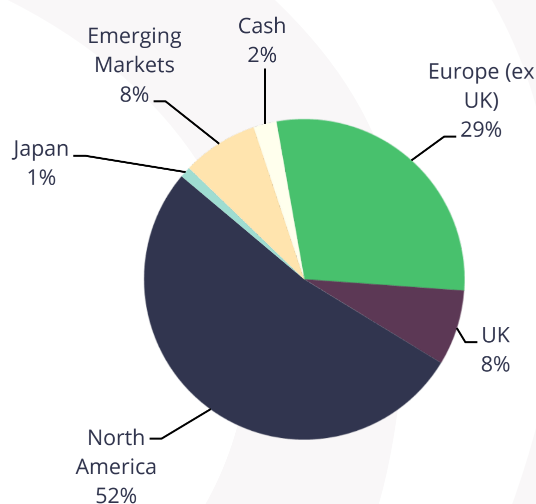
## Fund Statistics

| | |
|---|---|
| PRICE/BOOK | 2.4 |
| PRICE/EARNINGS RATIO (FY 1) | 15.5 |
| DIVIDEND YIELD % | 2.1 |
| AVERAGE MARKET CAP € BN | 146.4 |
| NO. OF HOLDINGS | 78 |
| DEBT/EQUITY % | 47.9 |
| ACTIVE SHARE % | 83.6 |

## Sector Distribution




## Geographic Distribution

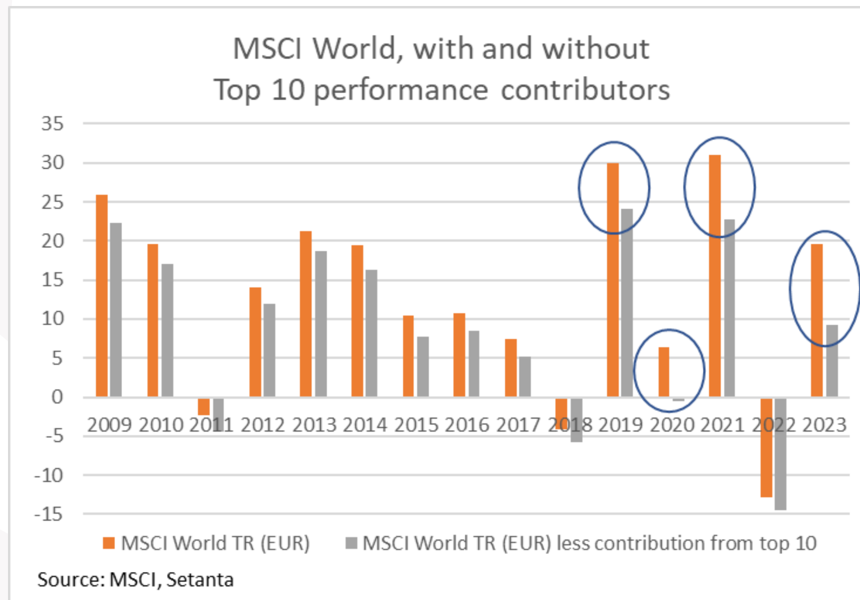



## Yearly Performance

| Year % | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Fund** | 32.2 | 16.2 | 0.9 | 14.1 | 24.5 | 20.6 | 9.0 | 16.2 | 8.8 | -3.9 | 22.0 | -3.3 | 32.5 | -7.7 |
| **Benchmark** | 25.9 | 19.5 | -2.4 | 14.1 | 21.2 | 19.5 | 10.4 | 10.7 | 7.5 | -4.1 | 30.0 | 6.3 | 31.1 | -12.8 |

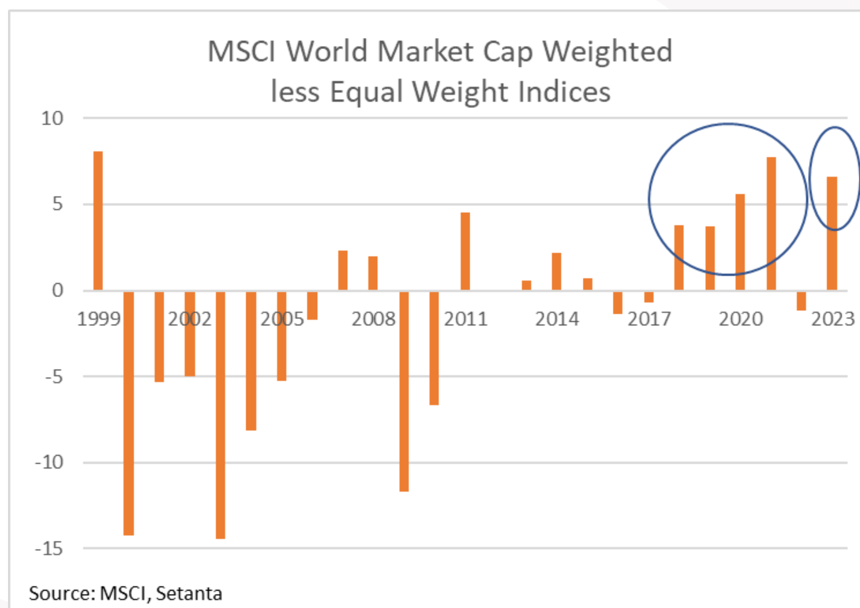
# Commentary

The headline stock market return for 2023 was far from broad based. Over 10% of the index's return (more than 50%) came from just ten stocks[1] – similar to the 2019-2021 period, but far greater than the previous ten years that we examine below.



Source: MSCI, Setanta

The MSCI World Equal Weighted Net Total Return Index (Euro) – a proxy for the "average" stock – chalked up a nice return of +13% in 2023, but nevertheless substantially lagged the headline benchmark (also similar to the 2019-2021 period). In a historical context this is anomalous. In fact, the equal weighted index has outperformed the vastly more popular market cap weighted index by 1.1% p.a. over the last 25 years, despite lagging by 4.2% p.a. in the last five years. Big companies certainly have advantages (scale, brands, patents etc.), but historically their size has worked against them (law of large numbers, mistakes, hubris). Meanwhile smaller companies succeed out of necessity and some of these end up as the largest companies of the future.



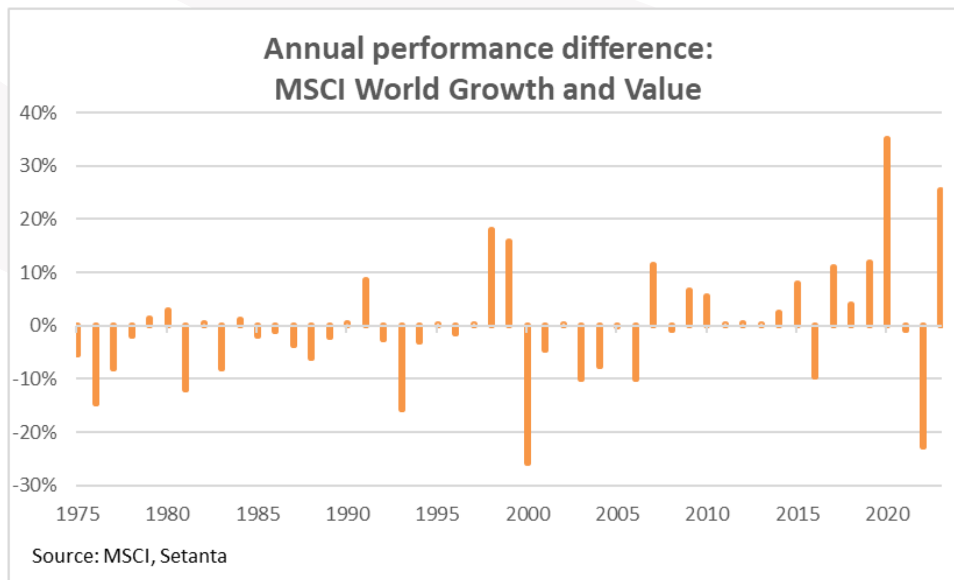
Source: MSCI, Setanta

[1]Apple, Microsoft, Nvidia, Amazon, Meta, Tesla, Alphabet, Broadcom, Eli Lilly and AMD

# Commentary

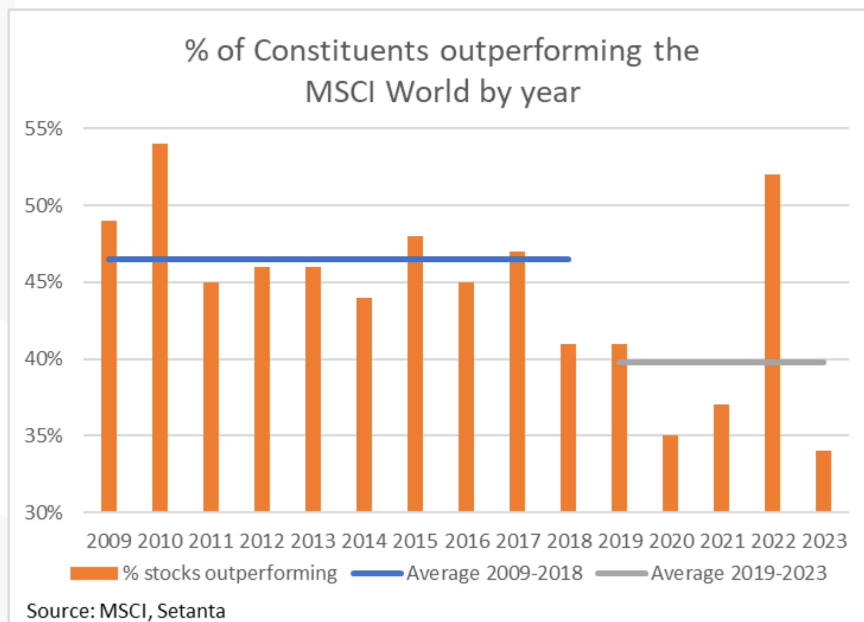
Indeed, it is very rare for the largest companies to outpace the market for long periods of time. Of the current top ten crop, only Microsoft was there in 2000. IBM and AT&T were the tech champions of the 1980s and 1990s but today are a shadow of their former selves. Similarly, the big oil companies in the 1980s, the conglomerate Japanese companies in the late 1980s, the dot.coms in the late 1990s and the giant banks in the mid-2000s. This is not a forecast for the largest companies today, but it's certainly a cautionary observation.

Yet another striking feature of 2023 was that "growth" stocks outpaced "value" stocks. Now, we aren't the biggest fans of such stock classifications – indeed, Setanta's tagline Value is more than a number embodies our belief that it is wrong to choose stocks based solely on quantitative growth or valuation metrics. Nevertheless, performance extremes can be a signal that something is amiss. In 2023, the MSCI World Growth Index outperformed its Value counterpart by 25%[2], comfortably the second largest annual differential (after 2020) since these benchmarks were created in 1975 (albeit this reversed value's large outperformance of growth by 23% in 2022).




[2]MSCI World Growth Net Total Return Euro less MSCI World Value Net Total Return Euro

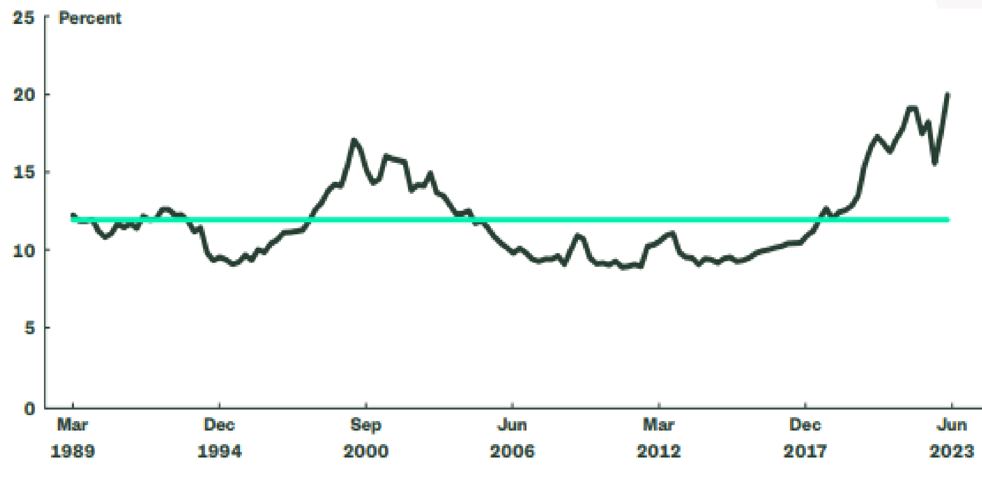
Another way of slicing the market's performance in 2023, just 34% of stocks in the benchmark beat the benchmark. This is similar to the skewed pandemic years 2020 and 2021 but far from the typical mid-40s percentage pre-pandemic.



Source: MSCI, Setanta

To emphasise the point, 49% of stocks in the MSCI World lagged the benchmark return by 10% or more in 2023. This was more than twice (22%) the percentage of stocks that outperformed the benchmark by 10% or more and they were concentrated in the high growth consumer and technology sectors. Such a heavy skew of outsized losers versus winners is not typical – the average in the 2009-2018 period was 36% and 31% respectively – and results in funds being bifurcated between haves and have nots.

At year-end 2023, just eight (out of ~1,500 stocks in the benchmark) companies accounted for 20% of the MSCI World by weight, a record high going back to the late 1980s – see below a chart from SSGA. The eight companies are all in the consumer / technology sphere. It calls into question the appropriateness of popular benchmarks such as the MSCI World and the S&P 500 (which is even more concentrated) as a performance yardstick for diversified equity funds. The Setanta Global equity fund is skewed away from mega caps towards midcaps. Approximately 12% of the fund is in stocks with a market cap of more than €500bn while 45% are in those with a market cap of less than €50bn. The equivalent figures for the benchmark are 20% and 32%.



Source: MSCI, FactSet, State Street Global Advisors. Data as of June 30, 2023.

As these charts demonstrate, the last five years have been extreme from a market structure point of view, not to mention from a performance standpoint: the MSCI World +13.6% per annum in Euros is high in a historic context, especially so given the global pandemic that hit hard economic output and supply chains, geopolitical tensions that included a couple of regional wars, and the stoking of inflation for the first time in a decade or more that necessitated a rise in interest rates from zero.

**Three- and five-year fund review**

The fund underperformed the MSCI World Net Total Return Euro Index in 2023, 12.6% versus 19.6%, but is slightly ahead over the last three years.

A five-year (2019-2023) fund v's benchmark comparison includes the particularly difficult pre- and through-COVID period – a deficit we are still trying to recoup. In this period the fund rose 62% (Euro) cumulatively compared to +89% for the benchmark, with just 11 consumer / tech and healthcare stocks explaining three-quarters of this underperformance[3]. With a nod to the market structure difficulties highlighted earlier, the fund was modestly ahead of the World Equal Weight Index (cumulative +57%) and the World Value Index (cumulative +58%) over the five years. We are confident that a reversion of the market to historic trends would benefit the fund's relative performance.

Even though the backdrop has been extremely challenging, we set high standards for ourselves and strive to have good performance over all 3–5-year periods. As such we are examining all aspects of our investment approach so that we can improve our decision-making process, while still remaining true to our value-oriented, fundamental approach. Good fund management requires constant review in order to get ahead of competing investors and changing business economics.

[3]Between 2019 and 2023 Apple, Microsoft, Amazon, Alphabet, Meta, Nvidia, Tesla, Broadcom, ASML, Eli Lilly and Novo Nordisk contributed 30% of the index's 89% return. The fund held just two of these stocks, Microsoft and Alphabet, which contributed 10% to fund performance. Thus the net contribution of this group of 11 stocks was negative 20%, or 76% of relative underperformance of the fund over the five-year period.

For example, around five years ago we concluded that excess caution was preventing us adding higher quality, faster growing companies to the portfolio and that elevated P/E ratios can still represent excellent value. This change led to the additions of top-quality companies such as Alphabet (2019), Costco (2020), S&P Global (2021), Essilor (2022) and Sonova (2023). These stocks have added to fund performance but in the past may have been overlooked. The stock market sell off in 2022 was a good opportunity to add more of these types of companies at attractive valuations. Unfortunately we were too slow to react. We know we need to be better at taking advantage of such scenarios in the future.

**2023 Performance Review**

The following is a list of the largest positive contributors to fund performance in the year:

| 2023 Top 5 Contributors to Performance | Sector | Contribution, Euro | Performance, Euro |
|---|---|---|---|
| Microsoft | Technology | 2.2% | 53% |
| Booking Holdings | Discretionary | 1.4% | 70% |
| Alphabet | Discretionary | 1.2% | 53% |
| Costco | Discretionary | 1.1% | 44% |
| Melrose Industries | Industrials | 0.4% | 74% |

**Microsoft** stock rebounded from last year's near 30% sell off. The company continues to benefit from robust demand across the range of its services, notably cloud. In addition, it is hoped that the company's investment in OpenAI, the owner of ChatGPT, will drive sustainable growth in future years as AI capabilities are integrated across the group's various platforms. Meanwhile at Alphabet, in addition to being caught up in the growth-stock-sell off in 2022, this time last year investors were worried that generative AI was a threat to Google search and the ad revenues it generates. Those concerns proved short lived as the stock powered forward for the remainder of the year due to strength in digital advertising. We continue to be vigilant of the longer-term threat to search from AI.

We discussed Booking in the Q3 report. The stock rose again in Q4, while we continue to watch its valuation which could be stretched if demand for travel softens. Costco rose by 20% in Q4. The retailer continues to post impressive growth in customer traffic as consumers flock to its low-cost membership model. Investors are also anticipating an increase the membership fee it charges its customers, which would give a nice boost to earnings. Lastly, global aerospace parts business Melrose raised full year profit guidance during the quarter, which helped push the stock up by some 20%. Its Engines division has seen particularly strong margin expansion driven by good aftermarket trading from higher volumes, increased scope and positive pricing. There was also a mix benefit as lower margin original equipment volumes are constrained by industry supply chain issues. In addition, Melrose announced a new agreement with GE Aerospace which broadens the company's participation in the GEnx engine programme which is expected to deliver an incremental $5bn of sales over the 30+ year life of the engine.

| 2023 Bottom 5 Contributors to Performance | Sector | Contribution, Euro | Performance, Euro |
| --- | --- | --- | --- |
| Estee Lauder | Staples | -0.5% | -42% |
| DXC | Technology | -0.3% | -17% |
| Keysight | Technology | -0.3% | -10% |
| Nextera | Infrastructure | -0.2% | -20% |
| Johnson & Johnson | Healthcare | -0.2% | -12% |

We have written much about **Estee Lauder** in recent reports. To summarise, the elongated effects of the pandemic on China (the company's largest market) caused a drop in demand, made worse by excess inventories at retailers, which has taken far longer than expected to fix. The company had another profit warning in the most recent quarter which caused another leg down in the stock price, but these losses were regained into year-end as investors began to price in the odds of a recovery in calendar year 2024 and beyond.

US utility **NextEra** was added to the fund in June and became something of a stock market casualty when it fell more than 25% in late September and early October. Recall that NextEra operates two businesses: a regulated utility in Florida (FPL) as well as a range of unregulated assets under NextEra Energy Resources (NEER). NEER has invested substantially in renewable energy for 30 years. It has an excellent reputation as a developer of new power generation assets, a portion of which they sell to free up capital for the development of new assets. In this way, NEER has grown its capacity by 7% p.a. over the last 10 years and created value for shareholders.

By September, investors were increasingly becoming concerned that the spike in general market borrowing costs could challenge NEER's medium term growth ambitions. Adding to the air of negativity around renewables, around the same time European renewable energy developer Orsted announced a large write-down of US offshore wind projects, due to operational issues, while wind turbine manufacturer Siemens Gamesa similarly announced a loss relating to warranties on equipment not performing as expected. Both cases highlighted the difficulties faced by the still-nascent offshore wind energy sector, where the operating environment is harsh and engineering is being pushed to limits to improve its price competitiveness relative to fossil fuel generation assets. We believe that NextEra will emerge through the sector's difficulties relatively unscathed. It has wisely eschewed offshore wind and instead focused on onshore wind and solar where the economics and operating conditions are much better understood. NextEra already has financing in place to fund its development program for a few years. While current borrowing conditions are less favourable than they were, there is still a huge need for the US to modernise its electricity infrastructure over the longer term and we are confident that electricity prices can adjust to compensate capital providers and encourage them to keep their wallets open. We added to the fund's weight in NextEra during this period of share price weakness and were rewarded as the stock recovered strongly into year end.

# Commentary

**Portfolio activity**

As is customary, a summary of new stocks and complete sales is included in the table below. See earlier commentaries for more details on the buys and sells in Q1, Q2 and Q3.

| BUYS | | | |
|---|---|---|---|
| | Stock | Sector | End of year weight |
| Q1 | Ryanair | Industrials | 0.9% |
| Q2 | Ferguson | Industrials | 1.6% |
| | NextEra | Infrastructure | 1.4% |
| | Sonova | Healthcare | 0.7% |
| | PayPal | Financials | 0.6% |
| Q3 | - | - | - |
| Q4 | Home Depot | Discretionary | 1.0% |

| SELLS | | | |
|---|---|---|---|
| | Stock | Sector | Start of year weight |
| Q1 | Close Brothers | Financials | 0.6% |
| Q2 | Constellation Energy | Infrastructure | 1.0% |
| | Tesco | Staples | 0.5% |
| Q3 | GBL | Financials | 1.3% |
| | Sandstorm | Industrials | 0.6% |
| | Vodafone | Infrastructure | 0.4% |
| Q4 | Lowe's | Discretionary | 1.0% |

In Q4 we report just the purchase of Home Depot and sale of Lowe's. You may wonder why we have decided to switch from one excellent US home improvement store to another. Both Lowe's and Home Depot are dominant in the US big box home improvement market. Both have managed to increase sales over the last couple of decades with only a very limited increase in floor space. Both are very profitable and have used this cash to buy back a whopping 63% and 55% respectively of their shares outstanding over the last 20 years. And both stocks have performed well, up 13% and 15% per annum over 20 years. However, there are some differences. Lowe's store footprint is more suburban focused, while Home Depot's is more urban. Also Home Depot has a greater exposure to professional tradespeople. Both of these factors help Home Depot's store economics: professional customers buy more volume, allowing Depot to turn their inventories faster, which enables them to have a greater range of SKUs at competitive prices, which draws in more professional customers.

The pandemic period improved Lowe's positioning as suburban dwellers spent their COVID cheques and higher savings on home office equipment, white goods and other home improvements. As a result, Lowes outperformed Home Depot by 25% between 2019 and 2023. We are concerned that this could reverse. Not only that, but the Lowe's balance sheet is more indebted than Home Depot, so any revenue retrenchment would take a higher toll on profits. Lowe's was first purchased for the fund in 2010. We say goodbye to it now but will continue to closely follow this quality, advantaged company.

***David Coyne, Portfolio Manager***

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