Setanta Active Multi-Asset Fund Range

Q1 2024

SETANTA
Asset Management

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Fund description

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

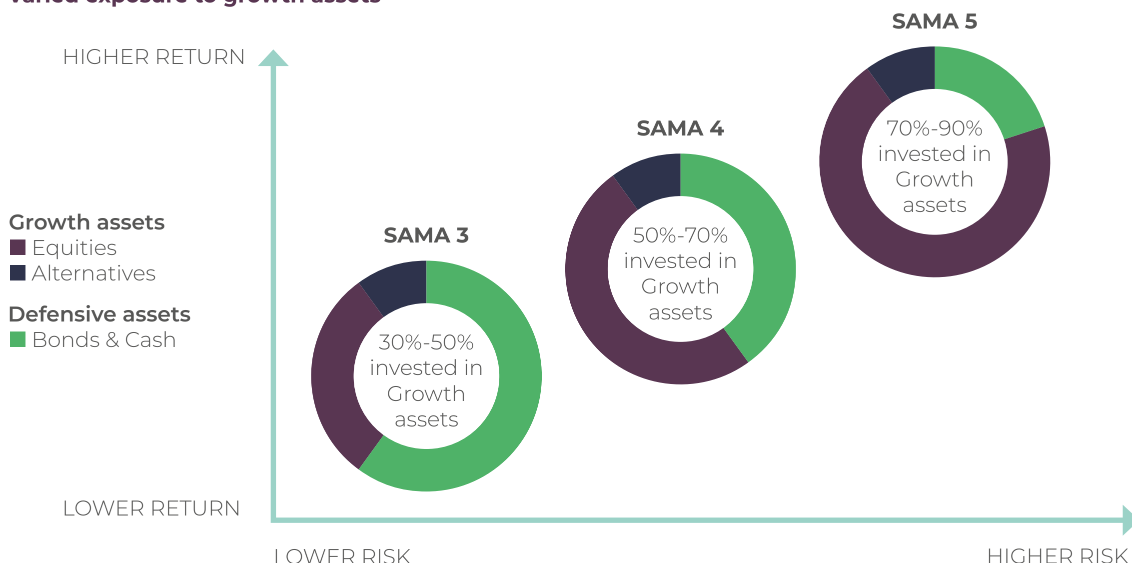
The funds are managed in line with the following core principles:

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

Three funds, three risk-return profiles

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

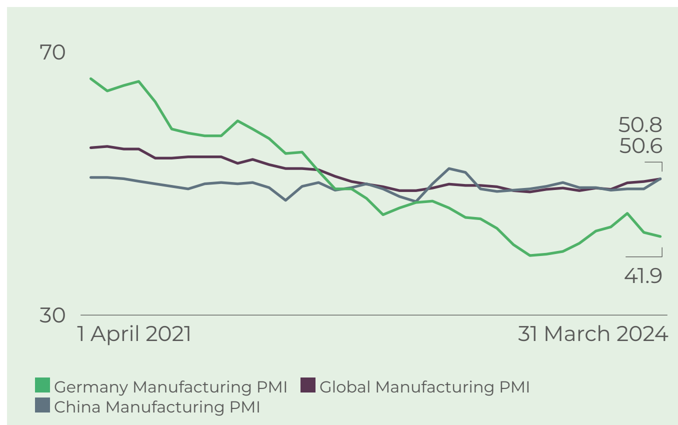
Varied exposure to growth assets



Market commentary

Financial markets saw a strong start to the year, buoyed by positive investor sentiment. Concerns of a recession were less evident, with most assets priced for a soft landing – equity multiples were above average and credit spreads were below. Economies continued to look reasonably resilient, led by the US, which delivered upgraded fourth-quarter GDP growth of 3.4%. Broad macroeconomic data pointed towards growth, with global purchasing manager (PMI) indexes in expansionary territory – although with some pockets of weakness, as China and Germany remained lacklustre.

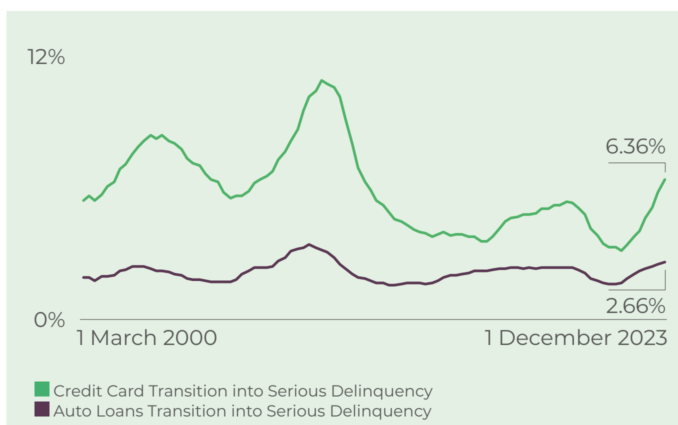
Manufacturing PMI



Source: Bloomberg, a score of 50 indicates economic activity is neither expanding nor contracting, above 50 indicates expansion.

There are some warning signs, however, with a pickup in loan delinquencies in the US, and general concern about commercial property globally and residential property in China particularly.

Loan delinquency pick up



Source: Bloomberg

The excess savings that were evident post Covid, especially in the US, have been drawn down. An argument can be made that the wealth effect may mitigate some of this concern as consumers spend their market gains – but this is predominantly a US story; Chinese investors are more leveraged into property, which has continued to fall in price and has curbed domestic demand.

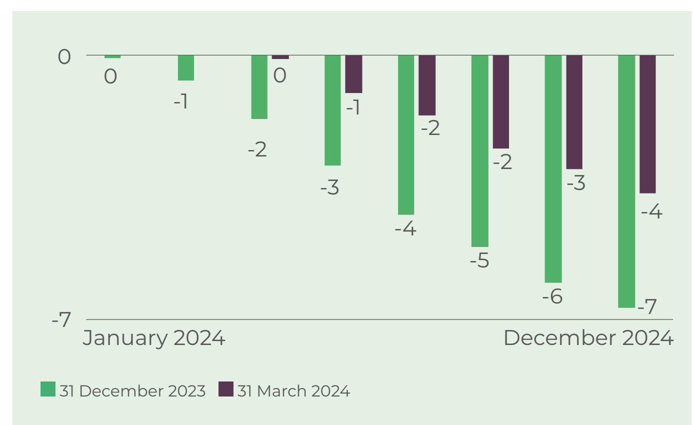
Central bank policy

Consensus a year ago was for a recession, with central banks preparing us for numerous job losses – the price to pay to get inflation under control. So far, however, inflation has been managed lower, while job losses have held steady. The issue now is that inflation is proving sticky at current levels, still above target. The recent move higher in oil, continued generous fiscal spending in the US and wage inflation are potential concerns which will have to be monitored.

Globally, there remains a trend towards easing monetary policy. Switzerland and Mexico cut interest rates in March. Only Turkey and Japan – countries with their own, unique economic issues – are continuing with rate rises.

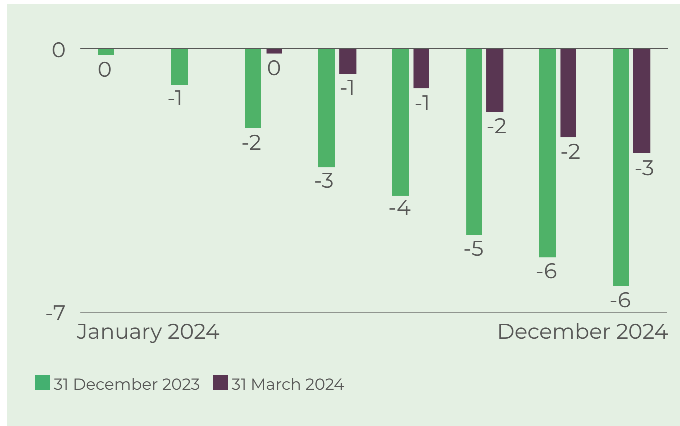
Although interest rate cuts have mostly come in emerging economies so far, the European Central Bank (ECB) and Federal Reserve (Fed) are now expected to move in the second quarter, with at least three cuts expected by year end, as opposed to the six to seven priced in at the end of December.

Market implied number of 0.25% ECB cuts



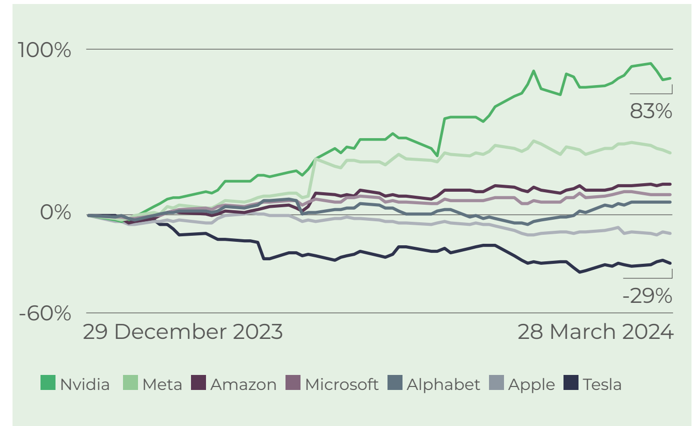
Source: Bloomberg

Market implied number of 0.25% Fed cuts



Source: Bloomberg

Magnificent Seven performance divergence



Source: Bloomberg

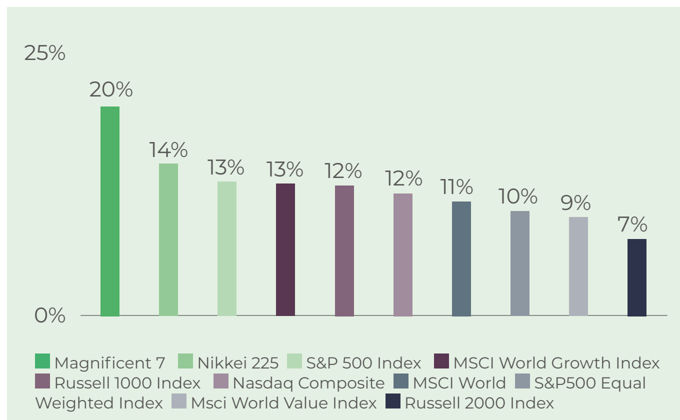
Equities

Equities have shrugged off higher rates so far, rallying into quarter end, with growth stocks and developed market equities performing strongly. Following on from last year, major tech companies continue to lead. Equities are supported by earnings growth, high margins and the hope that generative artificial intelligence (AI) business models expand, with investors expecting a pickup in capital expenditure initially, with a productivity boom to follow.

Interestingly, it was the Japanese Nikkei and not the Nasdaq that posted the best returns. Investor confidence in Japan has grown as the country has moved towards interest-rate normalisation and more shareholder-friendly governance has taken hold.

Growth outperformed value in style, and large caps continued to outperform small caps. Broadening intra-market participation is continuing, as the equal-weighted S&P held its own against the market-cap weighted index. Elements of weakness – like Tesla (-29%) and Apple (-11%) – are apparent within the 'Magnificent Seven', with performance becoming more concentrated in fewer names.

Equity market performance over quarter

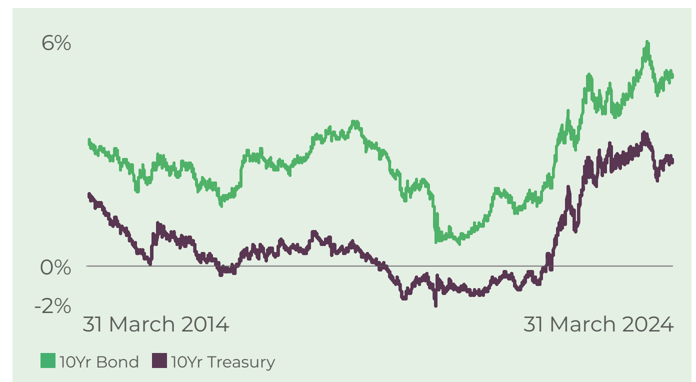


Source: Bloomberg

Bonds

Government bonds, along with rate-sensitive assets like property and REITs, struggled. Government bond yields drifted higher as central banks failed to deliver on expected rate cuts and inflation remained stickier than expected.

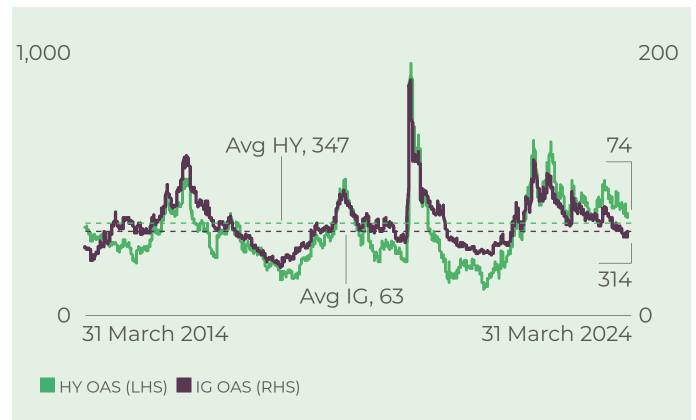
Higher yields in Q1



Source: Bloomberg

In credit, both investment grade and high yield outperformed as spread-tightening helped offset some of the yield increases. Levels are, however, expensive, with premiums paid above government yields (spreads) close to historic lows.

Tightening credit spreads



Source: Bloomberg

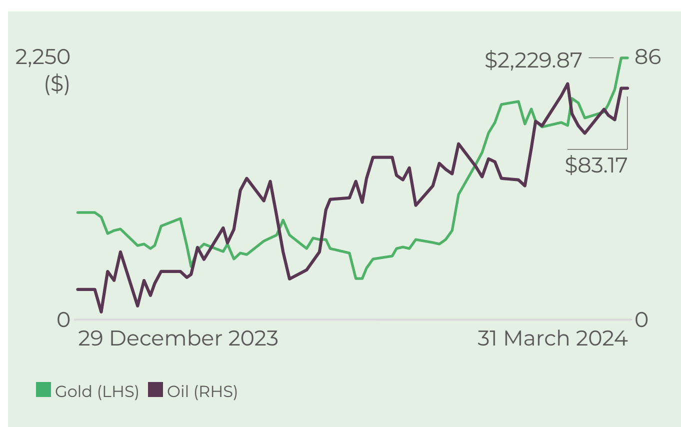
Commodities

Commodities performed strongly as oil and gold rallied, with gold rising to all-time highs.

Oil was bolstered by supply and demand issues, leading to a tight market. Supply was further constrained by OPEC+ extending its curtailment of production (roughly 5% of global output), while strong economic growth has boosted demand. A continued move higher in energy, stoking inflation, could force central banks to stay put, with both equities and bonds likely to suffer.

Gold rose to over $2,200 per ounce at the end of March, with geopolitics flaring in the Middle East

Rallying gold and oil prices



Source: Bloomberg

and real yields expected to move lower (interest rates adjusted for inflation). Gold, historically, has been a reliable store of value in times of economic and political uncertainty, although it is less effective against inflation. With the lagged effects of rate rises yet to be felt and geopolitical risk broadening, some exposure is warranted in a diversified portfolio.

Final thoughts

This year is a heavy election year, with seven of the 10 most populous nations in the world going to the polls. The potential re-election of Donald Trump is the most debated. Concerns remain around his spat with the Fed (he prefers looser monetary policy), his tariff policy and his potential to use executive orders to achieve his policy goals. However, it is worth remembering that there are branches of government in place to keep Trump within the guardrails. Nevertheless, markets are likely to be volatile in and around the election, but the result should have little effect on broad economic trends and may offer some opportunities.

The fund remains well diversified, with government bonds more likely to act as a diversifier in weak environments given higher starting yields and central banks with ample room to cut rates into weakness.

Fund commentary

The SAMA Fund range rose by 2.3% to 4.7% over the first quarter.

Equities got off to a strong start, with economies continuing to look resilient and shrugging off the higher interest rates. Global equity (+7.3%) and emerging market equity (+3.8%) both rose over the quarter, with our strongest performers in the industrials sector as we began to see global manufacturing activity pick up.

Government bonds gave up some of the gains made at year-end as stickier-than-expected inflation reduced rate cut expectations for 2024. Short-dated government bonds (-0.48%) and long-dated government bonds (-0.80%) both fell over the quarter. On the other hand, credit gained as income and tightening spreads managed to offset the yield increases. Investment grade (+0.4%), high yield (+1.0%) and emerging market debt (+0.03%) all gained over the quarter.

Listed private equity (+9.7%), listed infrastructure (+2.0%) and global REITs (+1.9%) also continued to gain over the period. However, Irish direct property, both residential (-2.7%) and commercial (-2.4%), struggled as office vacancy rates remained elevated and office space take-up was well below the long-term average.

Some equity markets are now hitting all-time highs, driven by higher equity multiples rather than any great expectation of stronger earnings. We have been nervous of the simultaneous move higher in both bond yields and equity multiples – this would not normally be the case, especially when the shift higher in yields is driven by stickier inflation and market expectations of fewer interest rate cuts this year. Inflation risk remains, with further escalation in the Middle East risking oil-price volatility.

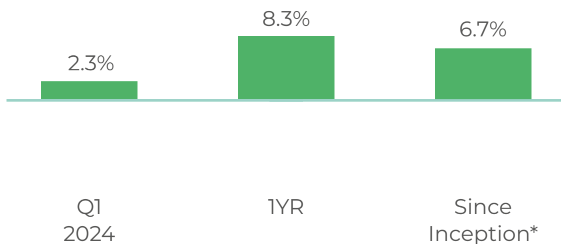
Towards the end of last year, we reduced our equity allocation in favour of investment grade corporate bonds, leaving the portfolio a little more defensive. Bonds should offer diversification, but we need to be mindful of several factors, including the turn in interest rate and inflation expectations, national elections in 2024, and an economic soft landing that has started to encounter some turbulence.

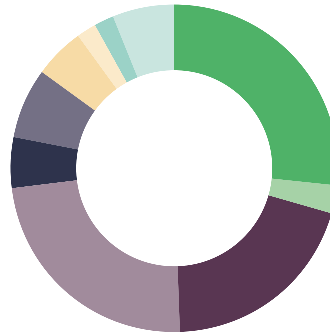
Note: all returns in euros

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.

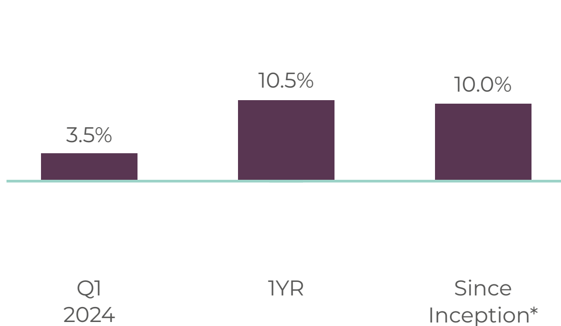


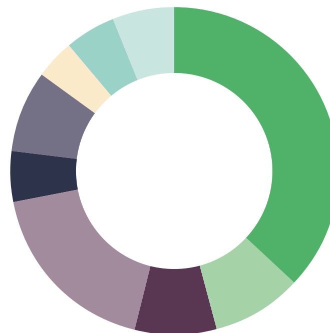


Global Equity	27%
Emerging markets	3%
Total Equities	**30%**
Euro Government Bonds	20%
Euro Corporate Bonds	24%
Emerging Market Debt	5%
Global High Yield Bonds	7%
Cash	5%
Total Bonds & Cash	**60%**
Infrastructure	2%
Private Equity	2%
Property	6%
Total Alternatives	**10%**

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.

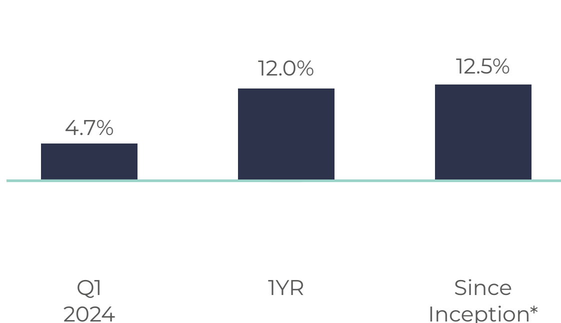


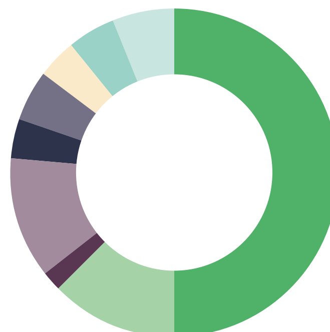


Global Equity	37%
Emerging markets	9%
Total Equities	**46%**
Euro Government Bonds	8%
Euro Corporate Bonds	18%
Emerging Market Debt	5%
Global High Yield Bonds	8%
Cash	0%
Total Bonds & Cash	**40%**
Infrastructure	4%
Private Equity	5%
Property	6%
Total Alternatives	**14%**

SAMA 5

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





Global Equity	51%
Emerging markets	13%
Total Equities	**64%**
Euro Government Bonds	2%
Euro Corporate Bonds	12%
Emerging Market Debt	4%
Global High Yield Bonds	5%
Cash	0%
Total Bonds & Cash	**22%**
Infrastructure	4%
Private Equity	5%
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.

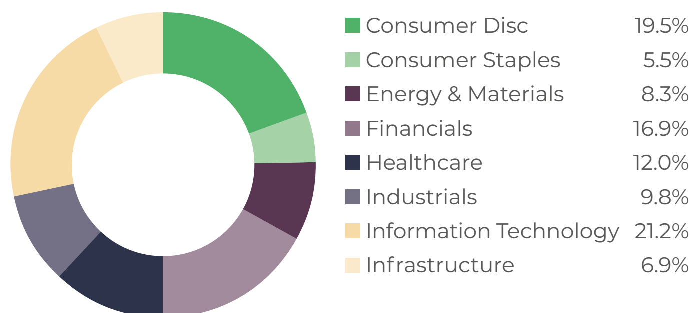
*Fund launch date 24 May 2022. Asset class weightings as at 31 March 2024.

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.

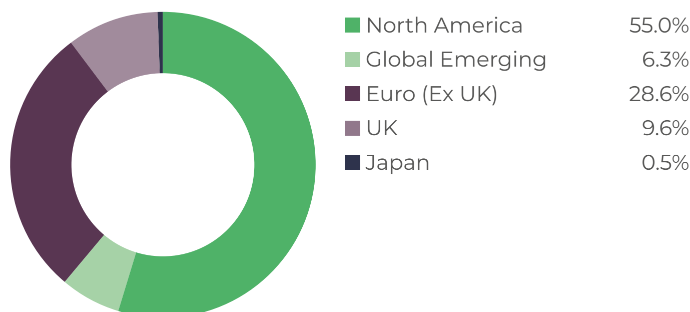
Sector distribution



Top 10 equity holdings

Company	Sector	% Of Fund
Microsoft	Information Technology	**4.8%**
Berkshire Hathaway	Financials	**4.4%**
Oracle	Information Technology	**3.9%**
Alphabet Inc	Consumer Discretionary	**3.9%**
Booking Hldgs	Consumer Discretionary	**3.3%**
Samsung Electronic	Information Technology	**3.1%**
Costco Wholesale	Consumer Discretionary	**2.8%**
CRH	Industrials	**2.2%**
S&P Global	Financials	**2.2%**
Taiwan Semicon Man	Information Technology	**2.2%**

Geographic distribution



Source: Setanta Asset Management, as at 31 March 2024

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.

Narrow market leadership

The global equity portfolio generated strong returns during the quarter. The main theme that drove equity markets in 2023 remained in place: exceptional returns from a narrow set of companies. The market overall was buoyed by the view that inflation is under control, while interest rates may have peaked and are expected to decline in the coming quarters.

Portfolio activity

During the quarter, we added four new stocks and exited three existing holdings.

We bought two US financial exchanges, **Intercontinental Exchange** (ICE) and **Nasdaq**. Exchanges are fantastic businesses as they earn high margins, have very high barriers to entry, grow over time and do not require much capital. They facilitate trading of a growing range of products including stocks, bonds, ETFs, commodities and interest rates across cash markets, futures and derivatives. The history of exchanges is typically one of strength if not dominance by region and/or product. Once a venue develops dominance, it attracts even more customers and volume, and tends to hold its advantage indefinitely (a loss of dominance is quite rare).

Over time, exchanges have proven adept at growing by developing new products that can in turn be traded and cleared on exchanges. Customers (both financial and industrial) enjoy reduced counterparty risk, better pricing, and ease finding buyers and sellers. Another area of growth for exchanges has been their ability to monetise the vast amounts of must-have trading data that they gather.

Following demutualisation and privatisation around the turn of the century, exchanges modernised (from pits to electronic trading) and began to consolidate, realising they could achieve significant cost (and even some revenue) synergies. The M&A phase has likely concluded, and today only a handful of exchanges serve the major markets of the world. In more recent years, many of the large exchanges including Nasdaq and ICE have sought to create value by deploying their prodigious cash flows into acquisitions in areas where they can leverage their know-how and or customer relationships – more on this below.

ICE was set up in 2000 by current CEO and Chairman Jeff Sprecher, who sought to capitalise on the deregulation of the US energy market and the demise of Enron in 2001, which encouraged buyers and sellers to trade safely in a centrally cleared exchange. Since then, through acquisitions and organic investments, ICE has built up leading franchises in energy and commodity futures, cash equities and options, fixed-income data and analytics, and indices. It has proven something of a trailblazer in modernising and growing these businesses. The common thread running through the group is data and technology.

In the last five years, ICE has acquired a series of businesses (most recently with the $13bn purchase of Black Knight) that serve the mortgage industry in the US. At first glance this looks a left-field move, but the group's core data and technology capabilities can be applied to this heretofore disjointed, low-tech, labour-intensive industry. ICE is essentially reinventing how the mortgage industry operates and we believe it will emerge as the dominant player and standard-setter. The long-term revenue and profit opportunity is very large.

Nasdaq was founded in 1971 and went public in 2002. It is best known for its exchanges (both in the US and in the Nordics), where it earns trading and listing fees along with fees on licencing its indices and data. More broadly, Nasdaq has an excellent reputation as a technology leader. Its strategy is to be the trusted fabric of the world's financial system. The platforms and trade management services it uses to run its own exchanges are sold to other exchanges and financial companies. It sells systems to financial institutions to help them manage trading risks and identify and report suspicious financial activity. These are global, scalable businesses that should offer Nasdaq years of profitable organic growth opportunities.

While we are positive on exchanges generally (indeed we now own four exchanges across Setanta strategies), we decided that ICE and Nasdaq were particularly attractive for the global equity portfolio. They generate high levels of recurring revenue and cash flow, are well-diversified by product and geography, and we are positive on their non-exchange strategies, which we think will excel over time. Fundamentally, we think both are attractively valued given their

strengths and growth potential. Together we believe they will deliver us market-beating returns at lower-than-average risk. The purchases were funded by a complete sale of Federated Hermes.

In the technology sector, we initiated a position in **Cognex**, a provider of vision automation systems which enable customers to automate manufacturing and logistics operations. In its very simplest form, vision automation (VA) uses software and hardware to replicate human vision, with software replicating brain function and hardware replicating the eye. The real value is in the software, and this is the core of what Cognex does. VA is a high-growth industry (mid-double digits year-on-year) and Cognex has an objective of growing revenues at >15% CAGR over the medium-to-long term. Cognex consistently invests a mid-teens percentage of sales into R&D to help maintain and build its competitive advantage. Cognex earns gross margins that are sustainably in the 70% range, while operating margins have tended to be in the mid 20% range.

The VA market is concentrated. Cognex's rival Keyence is the technology and market-share leader; due to its broad product set and customer base, Keyence is doing a better job at maintaining revenue growth through the current industry demand weakness. While Cognex also has leading technology, it has a smaller range of both products and customers and has seen its operating margin fall to the mid-teens level. As demand recovers back to trend and Cognex expands its product offering, we expect Cognex's margins and earnings to recover strongly. We have taken an initial small position following a more than 50% selloff in the stock in the last two years, with a view to adding more, hopefully at lower levels.

The other new holding added was Swiss pharmaceutical **Roche Holdings**. Roche focused on biopharmaceuticals and diagnostics, and has particular strength in oncology historically while also boasting a good presence in neurology and immunology. Management continues to invest significantly in R&D, but market expectations around the pipeline are low. New products due to launch – mainly in oncology and neurology – should help support reasonable earnings growth over the coming years. Roche also has drugs in development in two major categories (Alzheimer's and Obesity), to which the market is attributing little value. We feel these represent cheap options. Operating margins of 25% suggest scope for further efficiencies when compared to peers. The business is generating strong cash flow and currently offers a 4% dividend yield. Sales during the quarter were Federated Hermes, Charter Communications and Astellas Pharma.

Federated Hermes was sold to make room for the purchases of ICE and Nasdaq. Asset management as a business has some nice characteristics. There are economies of scale (to a point), the business benefits from rising asset prices over time, and growth does not consume capital. However, the sector is also very competitive and there is pressure on fees over time.

While the valuation of Federated Hermes looks low (~10x P/E), profits can be somewhat cyclical and growth is likely to be pedestrian or perhaps non-existent over time. We believe your capital has a better chance of outperforming in ICE/Nasdaq, both of which have greater growth prospects and total shareholder return potential.

Astellas Pharma was another portfolio holding with which we decided to part ways. Management's 2025 business plan (set out in 2021) called for revenue growth and margins to materially expand, but they have disappointed on both fronts. Indeed, the core margin in FY23 was below where it was when the plan was announced. Likely reflecting these disappointments, senior management was changed. Last year the company made a significant acquisition, but doubts are now emerging about the duration of the IP of the acquired firm's main product, raising concerns that the deal has destroyed value. In short, we lost confidence in the board, senior management, and Astellas' ability to allocate capital sensibly.

Charter Communications posted underwhelming full-year results; on the conference call, management highlighted a tough and incrementally toughening competitive environment. The call also confirmed that a significant part of the customer base (5m customers) receives federal support, which may be at risk in coming months.

The original investment case relied on the superiority of Charter's broadband cable product and a well-behaved competitive environment. While Charter's broadband offering is indeed better than that of competitors, it is becoming clear that fixed wireless technology offered by rivals is 'good enough' for many customers. It is therefore probable that Charter will face higher customer churn, potentially for a long period of time. We fear that the US broadband/cable TV market could go the way of European telecom markets, whose history is one of tough competition, low growth, margin pressure, reduced cash generation and years of unattractive stock returns. Also, while Charter's valuation is low, it is now apparent that its financial leverage (which looked acceptable in an environment of low competition/churn) is no longer advisable. The sales proceeds were invested across other holdings in our Infrastructure sector.

Key advantages of the fund range

Actively managed

Clear and consistent investment philosophy, high-conviction approach

Value approach

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

ESG built-in

Article 8 Multi-Asset fund range

Global Equity engine

Level of exposure consistent with risk rating of each fund

Investment expertise

Highly experienced, stable and award-winning investment team

Risk rated

Generate long-term capital growth within the appropriate risk parameters

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IMPORTANT INFORMATION

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Signatory of: