

Setanta Global Equity Strategy (USD)

Q2 2024

Strategy Description

The **Global Equity Strategy** (‘the Strategy’) is managed by Setanta Asset Management Limited (‘Setanta’). The Strategy is available to US Investors on a separate account basis.

The Strategy is a diversified, actively managed equity portfolio. As bottom-up fundamental value investors, our research process is designed to properly understand how each business functions and to consider risks pertinent to the business. Securities are chosen by a team of global sector specialists, targeting sensible diversification across industries, geographies and market capitalizations. We value each business, with the priority to pay a price that mitigates downside risk. We aim to make investments for the long-term, all the while considering the available opportunity set.

Strategy Commentary

“Please God, just one more bubble”

Around 2002, bumper stickers with the above phrase started appearing in Silicon Valley. The dotcom period was well and truly over, but one could always dream of another period of easy money. Fast forward to the 2020s and prayers for great riches have most certainly been answered. Then – like now – the “winners” were concentrated in a relatively small number of large-cap winners (“Mag 7”), making it very difficult for active fund managers to outperform their benchmarks.

(Strategy 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

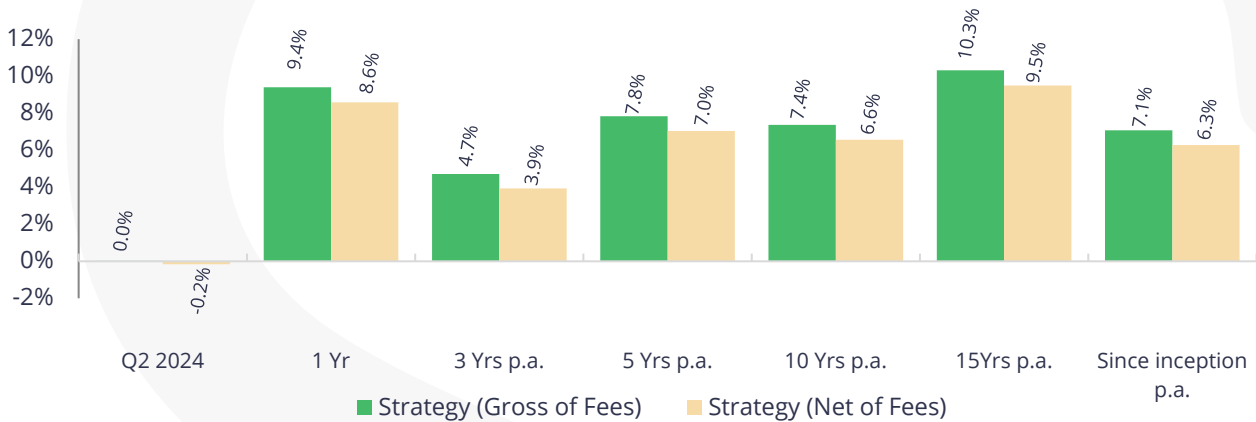
Businesses we own must have strong balance sheets

We make mistakes and always endeavour to learn from them

We will act with integrity in everything we do

Performance and Strategy data as at 30th June 2024

Strategy Performance (USD)



Yearly Performance (USD)

	2019	2020	2021	2022	2023
Strategy (Gross of Fees)	19.8%	5.4%	23.2%	-13.4%	16.5%
Strategy (Net of Fees)	18.9%	4.6%	22.3%	-14.1%	15.7%

Portfolio Valuation Statistics

PRICE/BOOK	2.5
PRICE/EARNINGS RATIO (FY 1)	16.4
DIVIDEND YIELD %	2.1
AVERAGE MARKET CAP \$BN	188.5
NO. OF HOLDINGS	74
ACTIVE SHARE %	84.4
DEBT/EQUITY %	42.8

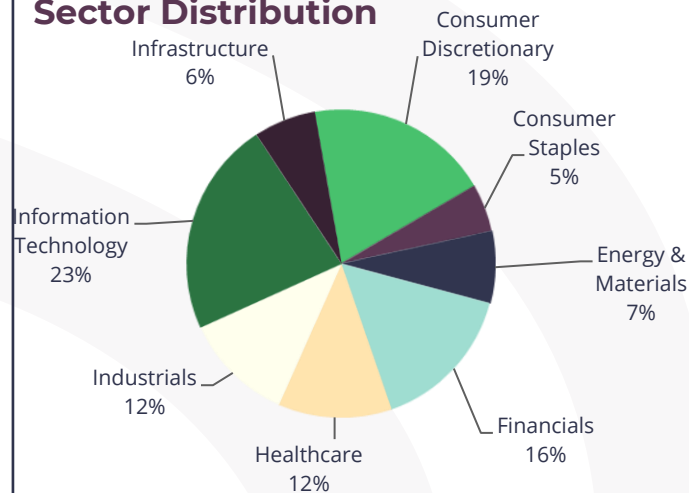
Top 10 Holdings

COMPANY	SECTOR	WEIGHT
MICROSOFT	INFORMATION TECHNOLOGY	4.8%
ALPHABET	CONSUMER DISCRETIONARY	4.5%
ORACLE	INFORMATION TECHNOLOGY	4.1%
BERKSHIRE HATHAWAY	FINANCIALS	4.0%
BOOKING HLDGS	CONSUMER DISCRETIONARY	3.4%
COSTCO WHOLESALE	CONSUMER DISCRETIONARY	3.2%
TAIWAN SEMICON	INFORMATION TECHNOLOGY	2.9%
SAMSUNG ELECTRONIC	INFORMATION TECHNOLOGY	2.8%
S&P GLOBAL INC	FINANCIALS	2.5%
DCC	INDUSTRIALS	2.0%

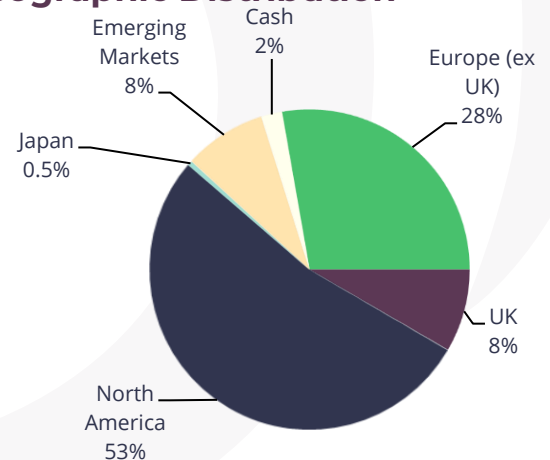
Holdings Source: Setanta. Sector allocations based on invested portfolio only (excludes cash), of the lead Euro account of the Global Equity Strategy. **Portfolio Valuation Statistics Source:** Bloomberg, based on the lead Euro account of the Global Equity Strategy, shown in USD.

Performance Source: Setanta Asset Management Limited. The returns stated are based on the movements in the unit prices of the lead Euro portfolio of the Global Equity Strategy, which has been converted to USD at FX rate 1.07175. The gross performance will be reduced by the impact of management fees paid, the amount of which varies. Net of Fees performance is calculated based on an AMC of 0.75%, which is based on a minimum portfolio size of USD25m. Inception date: December 2000.

Sector Distribution



Geographic Distribution





Q2 2024 Commentary

Whether or not this trend proves sustainable only time will tell. We believe a more even distribution of returns across the constituents in the benchmark would greatly increase the odds of improved fund performance. As would a tempering of the current extraordinary investor optimism in technology / AI-related names.

For the latter scenario, it is worth recapping the TMT crash. The period 2000 to 2003 was extremely painful for virtually all equity investors as the MSCI World Net Total Return USD fell almost 50% peak to trough between 27th March 2000 and 12th March 2003. TMT stocks bore the brunt of the fall but there were few places to hide during this sell off. Over the same period the MSCI World Growth Net Total Return USD index fell almost 60% while its equivalent Value index fell nearly 40%. The silver lining was that by late 2004 value stocks were again trading above their 2000 highs. It wasn't until 2013 that the MSCI World Growth index broke higher ground, by which time the Value index had added roughly 60% to its March 2000 high. The Setanta Global Equity Strategy was only launched mid-2000 so we cannot compare it to the full bear market period, but it outperformed the MSCI World almost 10% between end-June 2000 and end-March 2003; it subsequently outperformed by ~26% from end-March 2003 until end-2007*.

The turning point in 2000 came when the venture capital and IPO funding machine suddenly turned off. It quickly became clear that many TMT companies were not sustainable and were burning through cash. IT and telecom equipment spending was slashed, as was advertising. Today the sums of money being discussed to build out the Generative AI infrastructure is staggering – over \$1 trillion according to Goldman Sachs. One difference now is that much of this spend will come from deep pocketed technology and utility companies. The question is whether they will be able to get a return on this investment and the jury is still very much out. No killer apps have been developed yet. High capital and operating costs may prove prohibitive for replacing labour. And there are still doubts about its capabilities (e.g. hallucinations). Deep pocketed or not, spending will not continue indefinitely if there isn't money to be made.

And there are signs of speculative spending. Dell reported that nearly half of its financing receivables originated in the quarter to end-May were lower quality, versus 15% or less in each of the prior four years, which broker Morgan Stanley attributes to an increase in AI servers sold to Tier 2 GPU cloud providers. Such demand is more likely to fall away quickly.

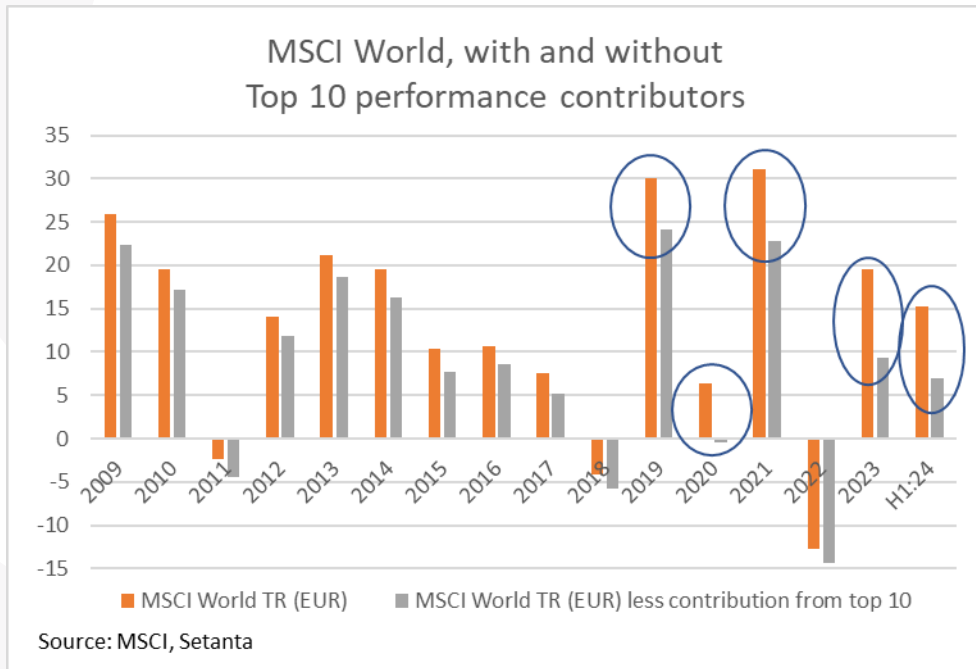
Market concentration concentrates

If we thought 2023 was a milestone in market concentration, the phenomenon was as strong if not more acute in H1:2024.

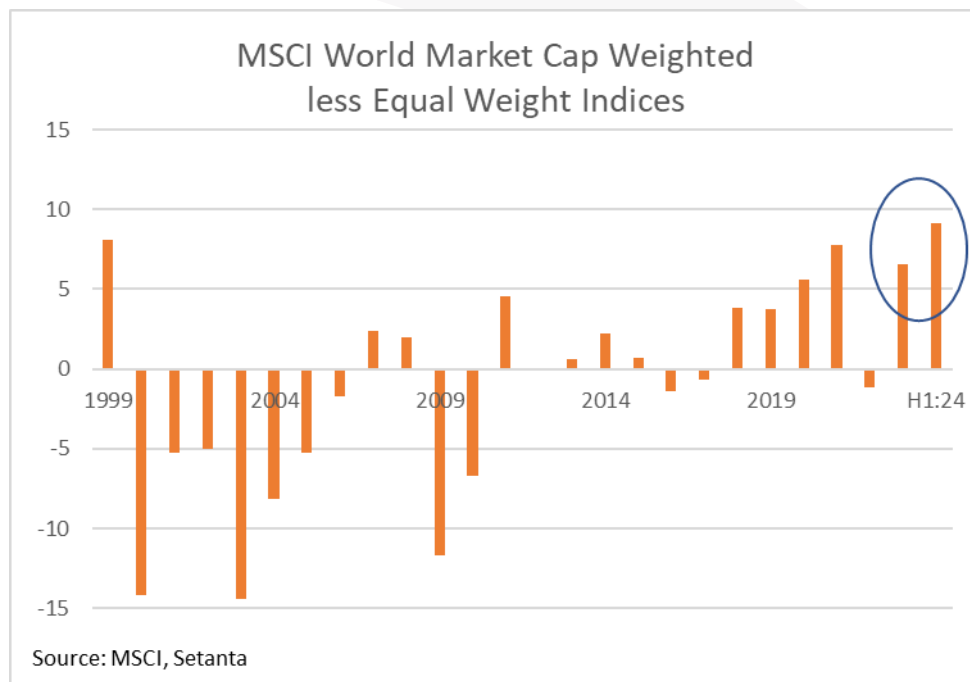
The first point is the impact of the top 10 contributors to the performance of the MSCI World (Euro), headlined by Nvidia contribution – possibly the largest ever contribution of any stock to the index.

*Sources: MSCI, Bloomberg and Setanta.

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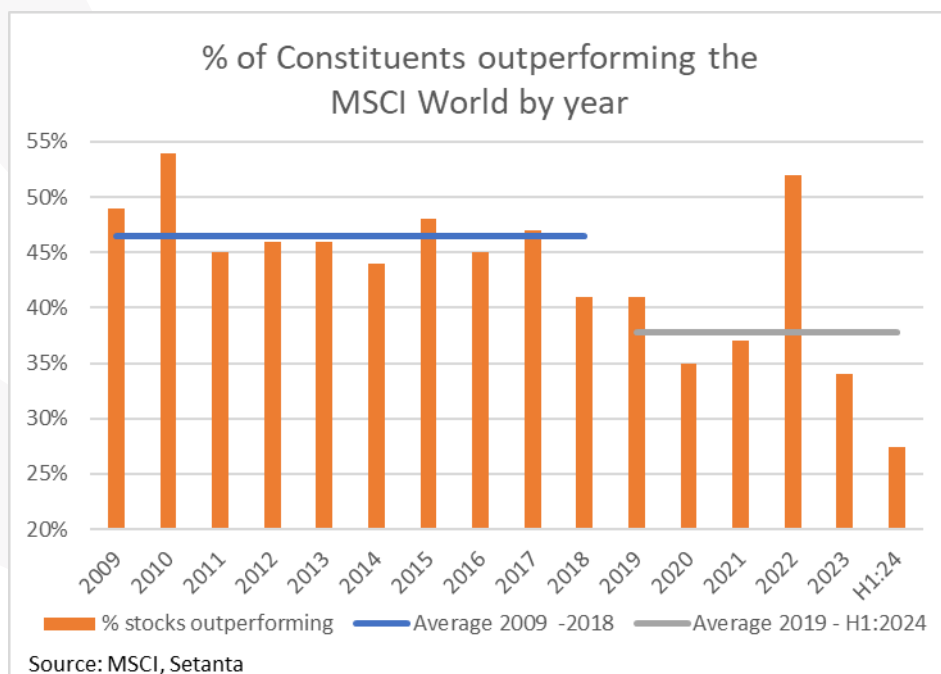


Next is the difference between the market cap and equal weighted MSCI World, which at over 9% in H1:24 was higher than any other ANNUAL period since 1999 (as far back as we can go). As you can see from the chart, things can swing violently the other way, as was the case in the early 2000s.



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The percentage of stocks outperforming the index was just 27% (See table below) in H1:24. Recall that on average 47% of constituents outperformed each year between 2009 and 2018, but in recent years this has fallen sharply.



Finally, we note that the top 10 stocks accounted for 25.5% of the MSCI World at 30th June 2024, an all-time high level of concentration for the index (which was launched in 1986). It was 20% on 31st December 2023. The 2000 peak was 17% and the average since 1989 was 12%*.

Q2:2024 performance review

The Strategy was flat over the quarter, lagging the benchmark performance of 2.6%. For the year to date, the strategy performance was +5.4% versus the benchmark 11.7% (USD Gross of fees). A large portion of the underperformance can be explained by AI proxies Nvidia, Meta, Amazon and Broadcom, where we hold no position. To be clear, we do not have an extreme negative on the potential for AI. In fact, some of our holdings could be beneficiaries longer term, including Microsoft, Alphabet, Oracle and TSMC. These four stocks together accounted for a not insignificant 16% of the strategy at quarter end, which we think is far lower than the benchmark exposure¹. Setanta are considering the AI phenomenon very carefully as the benefits of the technology and the fortunes and share prices of related companies are undoubtedly highly correlated to more than just the technology itself (e.g. demand, supply chain, anti-trust actions, geopolitical tensions).

¹ "AI" ETFs typically include Microsoft, Apple, Nvidia, Amazon, Meta, Alphabet, Broadcom, Tesla, ASML, AMD, Oracle and Qualcomm (among other); these names accounted for >25% of MSCI World at June-2024.

*Sources: MSCI, Bloomberg and Setanta.

Q2 2024 Commentary

Among stocks held, the following were the largest positive contributors to performance in Q2:

2023 Top 5 Contributors to Performance	Sector	Gross Contribution, Euro	Gross Performance, Euro
Alphabet	Discretionary	0.8%	22%
TSMC	Technology	0.6%	29%
Oracle	Technology	0.5%	14%
Costco	Discretionary	0.5%	17%
Microsoft	Technology	0.3%	7%

Four of the strategies top five performance contributors came from the technology realm, very much reflecting the market environment. We have commented extensively on most of them in recent reports, so no need to repeat. One that is worth highlighting is **TSMC**. For the uninitiated, it is the most important company you've never heard of (although it's been a holding in the strategy since 2007). TSMC is the dominant manufacturer of leading-edge microprocessors for 3rd party chip design companies, such as Nvidia and Apple. Its sustainable manufacturing advantage is the result of enormous scale, continued investment which maintains / grows its technology lead (a new leading edge fab costs tens of US\$ billions), lower costs, lower chip defects and reputation. Whatever about the sustainability of demand in the near term, we are bullish on TSMC's long-term prospects. It is a technology and company agnostic play on increasingly powerful microchips deployed in the global economy. The stock represents good value despite its strong run year-to-end-June (67% in US)*.

Retailer **Costco's** share price continued to rise, as monthly sales figures during the quarter showed strong footfall, boding well for upcoming sales and profits. It capped an excellent circa 140%* performance since the stock was added to the strategy in 2020. A decomposition of this return is instructive. Costco's earnings have risen by circa 60%* over the period, with the balance explained by dividends and an increase in the price-earnings multiple, from 35x to circa 50x*. Costco is an excellent company, which is why we were prepared to pay a considerable valuation premium back in 2020, but the current multiple is looking stretched. We cut back its weight in March and will continue to weigh alternative options going forward, but there is a broader point to make. Dependable, high-quality companies have been bid up by investors and we regularly see such stocks trading at excessive valuations. Costco is very much at the upper valuation limit of what we are prepared to hold and we estimate we are underweight this cohort versus the benchmark. It is another reason to be cautious on the general market.

*Sources: MSCI, Bloomberg and Setanta.

Q2 2024 Commentary

The largest performance detractors in Q2 were:

2023 Bottom 5 Contributors to Performance	Sector	Gross Contribution, Euro	Gross Performance, Euro
Nike	Discretionary	-0.4%	-19%
Melrose	Industrials	-0.3%	-17%
DXC	Technology	-0.3%	-28%
CRH	Industrials	-0.3%	-13%
Ryanair	Industrials	-0.3%	-22%

Nike* reported its full year results for its fiscal year at the end of the month. Disappointingly, the company guided sales for the year to May-2025 be down by mid-single digits. Nike has been a fund holding since 2009. It has been a fabulous performer over this time (+12-13% p.a.), despite a >50% pull back in the last 18 months. Why has the stock been weak of late and why do we continue to hold it? In hindsight, it is clear that in 2021 demand for Nike products was high, as were investor expectations. This was at the tail end of COVID and certainly Nike was not the only consumer company to show elevated profits. Secondly, a few years ago Nike had decided to increase its direct-to-consumer exposure, believing it would be able to cut out retailers and allow it capture more of the selling price for itself. It seems it over-played its hand. Retailers faced with reduced Nike stock filled their shelf space with alternatives, including some newer brands like Hoka and On. A further impact was a shift in consumer footwear preference to certain adidas and other styles, forcing Nike to discount a greater proportion of its products, which resulted in a margin hit. Investors were clearly hoping management would get back in track on fiscal year 2025, hence the weak sales outlook was taken very negatively. While the market is down on the stock, Nike is still an exceptional company, one of the most recognisable brands in the world. It is the clear leader in footwear globally with a deep catalogue of models and styles that it adds to annually. Its dominant market share in the US is especially valuable, explaining why Nike earns consistently higher margins than its closest peer adidas. Longer term Nike will likely continue to benefit from the global growing trend towards comfort, fitness, premiumisation and increasing female sports participation, to name but a few. Competition may have increased in recent years, but this is something we have seen in the past and Nike has always prevailed. We cannot tell if Nike will be "on trend" in 2025 but are confident they'll hit the right notes with consumers over time. We estimate that Nike trades on low-20s P/E, on a conservative estimate of earnings. We feel the market is heavily discounting the lack of near-term earnings certainty (contrast this with the Costco discussion above).

DXC* fell sharply following results and an outlook that more than hints at a continued difficult profit outlook. We sold out of the holding in Q1 and Q2, see below.

*Sources: MSCI, Bloomberg and Setanta.

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Portfolio activity

In Q2 we bought two new stocks (Coloplast and Core & Main) and sold six (BASF, Dowlais, DXC Technology, Novartis, Pfizer and SEI) and believe the changes have improved the quality of the portfolio. At quarter end the strategy held 74 stocks.

We opened a modest position in **Coloplast***. Coloplast is a Danish company that is the global market leader in both the Ostomy and Urology chronic care categories. Coloplast supplies ostomy bags to patients across the world who have a stoma (a surgically created hole in the intestines, often related to cancer treatment). Coloplast also supplies intermittent catheters to patients who require assistance in emptying their bladders, often due to severe injury or paralysis. We estimate these two business lines account for over 70% of the company's profits and Coloplast has a global market share of about 40% in each of these categories. These products are consumable in nature producing a reliable profit stream. We have followed the company for well over a decade and in our view, Coloplast is by far the strongest operator in the industry and we think the company will continue to gain market share in the longer term. This business model is highly profitable and cash generating enabling a combination of high dividend payouts and strong growth. The holding accounted for 0.5% of the strategy at quarter end, funded by a trimming of our larger healthcare weights, Alcon and Steris.

Core & Main* is a US distributor of water, wastewater, storm drainage and fire protection products, selling into large, planned projects, such as repairing municipal water, sewer systems and pipelines. It has a US national distribution and a broad range of suppliers and customers. Sales are split equally between New Construction and Repair & Replace. Core & Main and Ferguson (already a strategy holding) are the only two national players, each claiming around 17% market share.

Municipalities, utilities and developers want projects delivered on time and budget. A distributor who can reliably and flexibly provide a broad range of products including unforeseen last-minute needs is important. Industry growth is seen at 2-4% over the next 5 years and Core & Main should be able to continue to take market share. Its scale affords benefits in better procurement, a broader product offering with superior availability, resources to invest in technology and automation to support inventory management. The fragmented competitor set also offers acquisition opportunities where procurement, back-office synergies and revenue benefits can help deliver attractive returns. Over the next 5 years, management targets a 9% sales CAGR via market growth, market share gains and acquisitions. In addition, they expect further margin expansion through operating leverage. They should be able to deliver growth at a c14% return on invested capital while cash conversion should be healthy in a normal environment. A starter position was initiated, with consideration given to our existing weight in peer Ferguson as well as our overall exposure to US construction (CRH, Oshkosh and Johnson Controls).

BASF* was added to the strategy in 2019. It is a global chemicals behemoth whose 'Verbund' culture of deep integration of its production facilities has been instrumental to its success. However, the costs of doing business in Europe for chemical producers have been rising, due to mounting regulatory hurdles and to the impact of Russia's war on Ukraine on the availability of natural gas as a 'feedstock' for chemical plants. While BASF's actions, such as substantial investment in lower-cost regions, like China, might aid it in the long-term, we consider alternative stocks, such as those discussed above, as having better prospects. We had sold down our weight in BASF in the last year and sold our remaining shares in Q2.

*Sources: MSCI, Bloomberg and Setanta.



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DXC came into the portfolio in 2017 as a spin out from HP Enterprises. The company provides corporate IT services such as consulting, analytics, applications, business process and security services. Traditionally, DXC helped customers manage their on-prem IT operations. As corporates have shifted their technology systems into cloud infrastructure such as Azure and AWS, DXC now offers services to customers making the difficult cloud transition. It has also been a difficult transition for DXC. Firstly, IT outsourcing is ultra-competitive. The rise of IT offshoring, particularly Indian players like Cognizant and Infosys, have placed significant pressure on fees and pricing. Secondly, they have had to carefully manage their own cost base, including how many employees they have serving their declining traditional on-prem business. These two issues have proven challenging for management and profitability has been pressured. While the stock looks cheap on certain valuation metrics, we are not enthusiastic about the company's prospects and sold down our position from earlier in 2024.

SEI is a US-based global provider of investment processing and operations solutions, selling to banks, investment advisors and investment managers. At the time we bought for the strategy in 2020 we anticipated a turnaround in profitability in its Private Banking division, which at one time was the largest contributor to group profits. This has begun to play out. However, we are now less positive on what gains can be made from here. Competitive pressures have increased and downward pricing on contract renewals will offset new customer wins, meaning that at a group level SEI will struggle to deliver upside surprise to investors in the coming years. Cash raised was used to increase our holdings in ICE and Nasdaq, the financial exchange companies we purchased in Q1.

Recall from last quarter's strategy report that we bought Roche, the Swiss healthcare company. This was funded by a sale of peer **Novartis**, which was not completed until early Q2. We believe both companies are similarly positioned, but Roche is cheaper and more out of favour with investors. Also sold in Q2 was **Pfizer**, which had been a very small holding for a number of years.

Finally, we sold **Dowlais**, the auto parts company that made its way into the portfolio in 2023 via a spin out from Melrose. We initially decided to hold onto the relatively small position on the basis that cost cutting and restructuring efforts could eventually give rise to significant earnings growth on the back of a recovery in automotive industry volumes. This has not played out and the last year has reminded us that auto parts is a highly competitive space with an unclear transition to electric vehicles.

David Coyne, Portfolio Manager

Contact Details - Western US Investors:

Suite S8-17,
Eight Floor,
190 Simcoe Street,
Toronto,
Ontario,
M5T 2W5.

Rocco Vessio,
Mobile/Cell: 647-823-4813

E-mail: rocco.vessio@setanta-asset.com
www.setanta-asset.com



Contact Details – Eastern US Investors:

Setanta Asset Management Limited,
Beresford Court,
Beresford Place,
Dublin 1,
Ireland.

Alan Hickey, Director of Business Development

Mobile/Cell: +353 87 941 6847

Email: Alan.Hickey@setanta-asset.com
www.setanta-asset.com



IMPORTANT INFORMATION

*Source: Stock price and index returns are from Bloomberg.

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