TB SARACEN UK ALPHA FUND QUARTERLY REVIEW No.7 SEPTEMBER 2016

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SARACEN
share success

Craig Yeaman

Fund Performance

	SGF Beta	MSCI UK All Cap (TR)	Relative
Since 30/06/16	14.4%	7.7%	6.7%

Source: Saracen Fund Managers

After the disappointing performance the Fund endured in the aftermath of the EU referendum on 24th June, we are pleased to report a strong recovery over the third quarter. Our strategy remains unchanged – we remain focused primarily on mid and small-cap companies as we believe they have the ability to outstrip the wider market over the medium-to-long-term. In addition, the portfolio remains concentrated with 30 holdings. There have been a number of changes to the names held over the last three months which will be discussed later in the report.

Currency movements and the prospects for UK and European growth remain key battlegrounds for investors post the referendum. Following a sharp decline in late June, the pound has continued to drift against the US dollar and the euro. Recent UK economic indicators and confidence surveys suggest a more stable economic position than the initial worst fears however this is likely to remain fragile with future investment intentions uncertain. In the light of the historic UK rate cut to 0.25% in August, medium-dated gilts are now yielding 0.6%, an all-time low. This has major implications for the funding of pension schemes going forward. German and Japanese bond yields are in negative territory highlighting the unchartered landscape which investors must navigate.

The Good

As could be expected from a strong quarter, the good performers handsomely outweighed those shares which disappointed.

MJ Gleeson, the fund's largest position, proved to be the best performer over the third quarter with a rise of 41%. To some extent, this was fuelled by the shares collapsing after the June referendum. Nevertheless, the company announced preliminary results at the top end of expectations with, very importantly, an upbeat assessment of future prospects.

Galliford Try, a new holding for the UK Alpha Fund, jumped 34% following our purchase of the shares in August. The company was caught in the maelstrom following Brexit as investors sold first and thought secondly. Galliford also reported strong numbers during the quarter and commented that so far, it is 'business as usual'.

Another new holding for the fund, **Amec Foster Wheeler**, proved to be another star performer for the fund during the third quarter, the shares having increased by a third.

Hill & Smith, a mainstay of the portfolio, rose 26% after reporting bumper profits. Once again, management are very confident about future prospects for the group. **STV Group** also rebounded 25%, due a combination of solid results and shares being sold off at the end of last quarter.

Other notable performers included **RPC**, the European leader in rigid plastic packaging, and **Restore**, the number two player in the UK in document management, both 22% stronger. These companies have also been held for a number of years and performed admirably for the fund.

The Bad.... (And the ugly)

Happily, only five of our holdings finished the quarter in negative territory, and those which did so were UK-centric consumer stocks.

Our holding in **Bonmarche** lost 22% as the company reported a second profit warning, citing unseasonably warm weather. A new Chief Executive Officer has been hired in an attempt to reverse the fortunes of the business.

Talk Talk continued its recent underperformance and finished the quarter 9% lower. The market is sceptical on targets put in place by management and are, at present, unwilling to give them the benefit of the doubt. The UK market is going through a period of change and it will be interesting to see what happens in the sector as a whole, and, from our point of view, with Talk Talk in particular.

IFG surprised the market by replacing its CEO after only two years. possibly, in no small part, to lacklustre results. Consequently, it is quite possible predators will be looking at this company. The business itself has two strong divisions, one in wealth management and the other in platforms. With meaningful cash on its balance sheet, the management team need to deploy it wisely or, potentially, find itself the target of a takeover.

Other holdings which fell during the quarter were **Card Factory**, down 5% and **Pets at Home**, off 1%. General Retail stocks remain unloved by the market and although these companies are defensive by their very nature, nevertheless remain off investors' radar screens.

Market Background

Over the quarter we saw a welcome recovery in the FTSE 250 and FTSE Small Cap indices which rose 10.7% and 12.1% respectively. Both indices are back above their pre-referendum levels having fallen sharply in the weeks following the result The FTSE 100 also continued to perform stoutly, adding 7.1% over the three-month period. This led to an increase of 7.8% on the FTSE All Share (Total Return). Against this, Beta shares returned 14.4%.

Looking at specific sectors over the three months, there was a huge divergence between the best and worst performing. Telecoms were down 3% whereas Technology leapt 38%. There were some large upward moves in the quarter with Basic Resources 21% stronger, Autos & Parts up 20% with Banks and Construction & Materials both 19% better. Oil & Gas and Utilities had muted returns alongside Telecoms.

FTSE 100	+ 7.06%
FTSE 250	+10.66%
FTSE Small Cap	+12.10%
FTSE All Share (TR)	**+7.78%**
3 months to 31/09/16	

Portfolio Activity

At the end of September, SGF had 30 investments which were spread across a variety of market capitalisations – the split of the investments was as follows: FTSE 100 23%, FTSE 250 29% and Small Cap/AIM 45% with the remaining 3% being held as cash.

The three-month period under review saw an almost unprecedented level of activity within the fund as five stocks were sold and four new companies purchased. This was primarily as a result of the opportunities which came to light following the vote.

Stocks Sold

Over the course of the third quarter the five stocks sold in the fund were **Entu**, **Weir Group**, **Elementis**, **Keller** and **Rathbone Brothers**. Entu was sold following another disappointing update from management and we felt the money could be better invested elsewhere. Keller exited the fund due to concerns over its Australian and Asian businesses. Although its most important market, North America, continues to perform well, we have concerns this might not be enough to avoid a downgrade to expectations.

The remaining three stocks which exited the fund; Weir Group, Elementis and Rathbone Brothers, were sold on valuation grounds. We are keen on all of the stocks but felt ratings were up with events. The fund had held Weir Group since inception in March 1999 so this was not a decision we took lightly. That said, the share price was anticipating upgrades and YTD the shares had increased 42%. Rathbones is the quality company in the UK Wealth Manager space but we feel the rating fully reflected this situation.

New Stocks

Four new stocks were over the last quarter: **Amec Foster Wheeler**, **Galliford Try**, **Clipper Logistics** and **Standard Life**.

We bought **Amec Foster Wheeler** following extended weakness in the share price post Amec's acquisition of Foster Wheeler. This, combined with a low oil price, drove the share price from over £12 to below £5. The shares were bought just above the £4.30 level and following the purchase the company has reported results 10% ahead of very low expectations. We expect the company to sell a division in order to de-gear its balance sheet. If this happens, it could be the catalyst for new investors to look at the stock.

The fund added **Galliford Try** after the share price had been savaged after the referendum result. This is a company we had been monitoring for a while and the opportunity arose to take a meaningful position in the fund. The shares were purchased on an historic rating of 7.3x and a dividend yield of 8.5%.

Clipper Logistics is a leading provider of added-value logistics and e-fulfilment services to the retail industry. Value-added logistics is an outsourcing business model running warehousing, stock management etc for British American Tobacco and Philip Morris together with a variety of clothing retailers such as Supergroup. John Lewis and Marks & Spencer are also two important customers.

Standard Life is transforming from a traditional life company into an asset manager. Standard Life Investments (SLI) is widely acknowledged to be a good asset manager with an excellent diversity of both product and distribution channels (e.g. 65% of inflows in 2015 came from overseas clients). SLI is likely to be c50% of group profit this year with improving cash earnings and, therefore, supports the strong record of dividend growth since demutualisation.

Over the quarter we increased our position in two of our holdings, **Prudential** and **Restore**. Additionally, we also reduced two of our larger positions in the fund – **MJ Gleeson** and **Hill & Smith**.

Outlook

They say a week is a long time in politics; the same is certainly true in the stockmarket. If we cast our minds back to the end of the second quarter, doom and gloom was the over-riding sentiment of market participants. Fast forward three months and the view appears to be 'Brexit? What Brexit?'. We are, by our very nature, bullish on the long-term direction of markets but even we have been somewhat surprised at the resilience post the referendum.

Prospects for investors are now more uncertain than they have been since the financial crisis of 2008. The ongoing Brexit process is likely to be lengthy and this adds up to a considerable period of risk, not just for the United Kingdom, but for large swathes of Europe too. from a global perspective, we also have the U.S. presidential election looming and we are now living in a period of unprecedented central bank manipulation, none of which offers much comfort.

Looking at the UK Alpha Fund more specifically, we remain convinced there is significant potential value to be unlocked from the portfolio. We believe our flexible 'multi-cap' approach will serve us well as we continue to target a superior return for our shareholders.

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Risk factors you should consider before investing:
Past performance is not a guide to future performance. The value of investments and the income from them may go down as well as up and you may get back less than the amount invested. A full list of the risks applicable to this Fund can be found in the Prospectus. All fund performance figures calculated on a single price basis.

This Factsheet is for Professional Investors only.

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Regulatory Status:
FCA Recognised: Yes
Scheme Type: OEIC

Issue Date: 30 September 2016