TB Saracen UK Alpha Fund

Quarterly Review – June 2020

Signatory of: PRI Principles for Responsible Investment

FOR PROFESSIONAL INVESTORS ONLY-

Retail investors should consult their financial advisers

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	TB SUAF	MSCI UK All Cap (TR)	Relative
Q2 2020	19.6%	9.4%	+10.2%

Performance Summary

The second quarter of 2020 was a very much better quarter for the Fund than the first as global equity markets rebounded sharply, led by a remarkable recovery from the US, and NASDAQ in particular. April saw the Fund recover strongly, more than capturing the bounce in the market as the mid and small cap indices regained some poise. As May unfolded the recovery became more broadly based and the Fund continued to make solid progress. June started well but the Fund faded a bit and ended up in line with the market, as some of the portfolio's current bias towards value factors unwound. The UK market remained a laggard overall, with the MSCI UK Allcap return of 9.4% well behind the MSCI AC World return of 18%.

Cumulative Performance after all ongoing charges to 30th June 2020

	3 months	1 year	3 years	5 years
TB Saracen UK Alpha B Acc	19.6%	-15.1%	-3.9%	10.0%
MSCI UK All Cap Index (TR)	9.4%	-14.5%	-6.4%	12.7%
Sector Average	14.2%	-11.0%	-5.1%	11.5%
Quartile Ranking	1	4	2	3

Source: Financial Express *Sector: IA Sector (UK All Companies)*

Market Overview

The entire quarter has been dominated by the influence of COVID19, the broad economic impact as well as the damage wrought on company profits and earnings. There has been no end of talking heads at turns terrifying and reassuring us as to the kind of world that we will wake up to when the lockdowns are over, the stores and borders are open and we can jump on a bus without taking our lives into our hands.

The truth of the matter is that no-one has a clear idea and significant uncertainty remains over the long-term economic damage from COVID19. However, it is likely that it will be material and will result in a significant loss of output , with bankruptcy filings surging on both sides of the Atlantic.

However, central banks have wasted little time in acting and the scale and speed of the policy response has probably averted the kind of liquidity crisis and credit crunch that we saw in the 2008 global financial crisis. All key banks cut interest rates aggressively while the FED and ECB restarted quantitative easing providing effectively unlimited liquidity support.

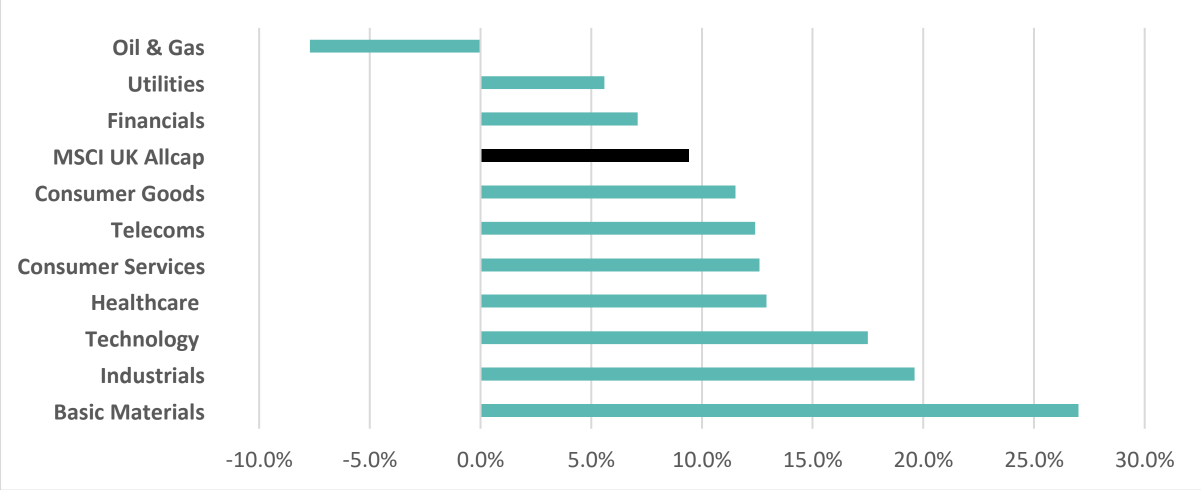
With most of the world in lockdown real personal spending collapsed in Q2 and the savings rate bounced commensurately. Whether these effects will be reversed quickly depends on the level of unemployment post lockdown. At the time of writing this looks as though it will be a major problem in the coming years with the usual knock on effects on output and GDP growth. It is an unavoidable fact that company earnings follow GDP and as expectations of global GDP growth are now around -4%, which is unprecedented in the last 50 years, it follows that the earnings fall too could be significant. That said, if previous downturns are anything to go by, equities typically rebound well ahead of employment.

Looking at the UK market specifically the small and midcap indices led the way, partially reversing some of the underperformance seen during the first quarter.

Total returns by capitalisation: 3 months to 30th June 2020	
FTSE100	9.1%
FTSE Mid250	13.9%
FTSE Smallcap	18.3%

At a sector level, the oil sector continued its miserable form and fell further as Royal Dutch slashed it's dividend and assets across the industry saw impairment. By contrast the main basic materials sector, mining, benefitted from positive pricing and safe dividend payments. Having been hit hard previously industrial companies saw strong recovery whilst healthcare delivered another quarter of positive performance. The ongoing underperformance of financials was notable, particularly banks and real estate, where low interest rates and the prospect of significant defaults and falling asset values continued to hamper share prices.

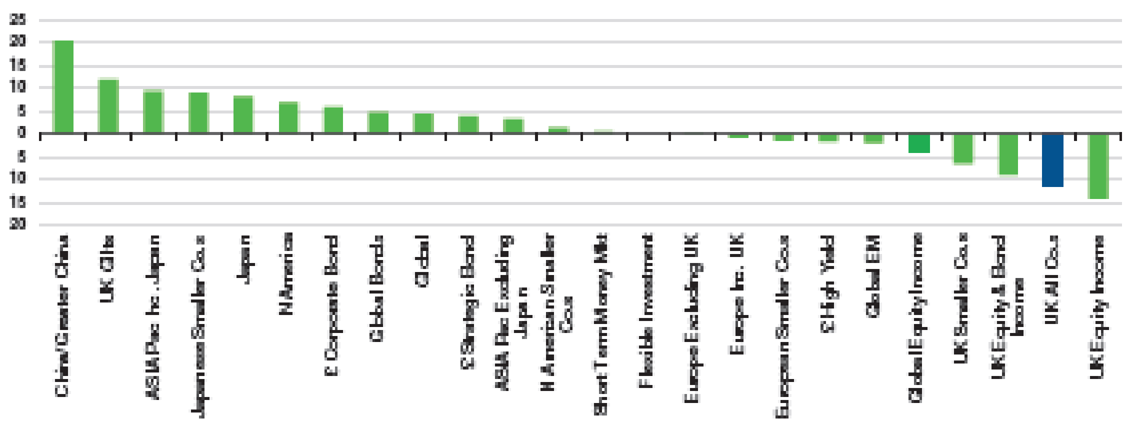
UK Sector Total Returns: 3 months to 30th June 2020



Source: Bloomberg

However, if we consider the UK market in a broader context, UK indices have continued to underperform globally over the last year. The chart below looks at the shorter term returns from the universe of IMA investment fund categories which places UK equity funds firmly in the doghouse.

IMA Global Asset Class Performance (%) – 1 Year



Source: Investment Management Association, Lipper

The recovery is bringing with it a slow decline in correlations between stocks. Yet, correlations remain remarkably high during this recovery and sector dispersion is far higher than in 2008. This indicates a market that does not differentiate much between stocks, but only between sectors.

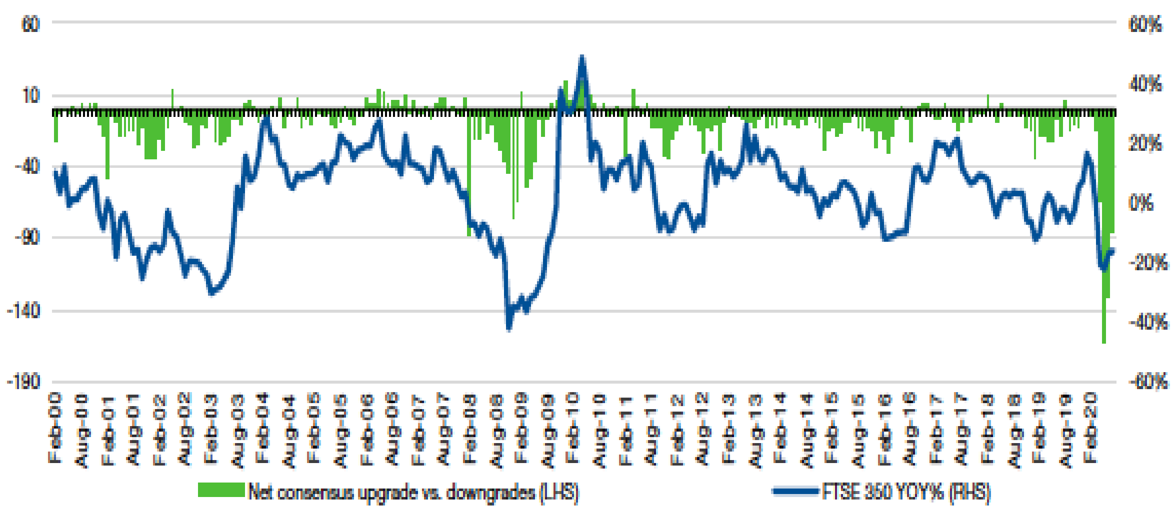
Sector Dispersion – FTSE 350

Source: Liberum, Datastream

Across the UK market and other international markets, we can conclude that the entire rebound in equities in Q2 has been as a result of PE expansion rather than EPS growth. According to data from Barclays, the current UK PE is 15.3x which is a 20% premium to both is 10- and 20-year median levels as well as being significantly higher than the 13.2x that the market traded on the 1st January 2020.

All other major markets across the globe are trading at similar or even higher premiums. We know from bitter experience that lofty PEs make earnings more vulnerable to bad news but more recently PE multiples have rebounded despite the unprecedented collapse in earnings downgrades.

FTSE 350 – Number of stocks upgraded by more than 5% v stocks downgraded by more than 5%



Source: Liberum, Datastream (N.B. Using FY2 estimates)

The market consensus in terms of EPS forecasts is that they are expected to become negative across the market cap spectrum in 2020 but recover thereafter over the following two years.

It is clear that the global recession that we anticipated in our previous quarterly is indeed coming to pass. That the UK economy will continue to suffer and that unemployment will grow to perhaps alarming levels seems all too likely. The government is throwing money at the problem and as I write rumours abound of potential cuts in VAT, a stamp duty holiday and potentially negative interest rates. All eyes are now on the recovery and its likely shape, but it will be no easy feat to bounce back from the first global recession since the Great Depression where both developed and emerging markets have negative growth.

Brexit will provide additional uncertainty and economic risk at a time when our leaders are struggling to cope with the current crisis. Sterling is likely to remain a volatile and lowly-valued currency as a result.

Portfolio Review

The portfolio has a ‘multi cap’ structure with high exposure to small and mid-cap companies, which make up 67% of the portfolio. The focussed nature of the portfolio means that the Fund has a high active share at 92%. This strategic positioning has been beneficial to our results over the years as well as offering considerable long-term flexibility.

Positive Contributors

There were a number of stocks whose performance contributed towards the outperformance of the Fund over the quarter, most notably amongst our smaller company investments.

The strongest performer in terms of contribution to return was **Halfords** (+118%) which had the luxury of staying open during lockdown as it was granted “essential” retailer status which allowed its cycle business to continue to perform as well as its garages to remain busy.

Alpha FMC (+58%) also did a good job for the fund as the management emphasised during market updates and in their recently posted full year results that the company was trading well trough the current conditions. The strong showing from **Premier Foods** (+52%) was especially gratifying to see as it was a fairly recent purchase which has come good already. We continue to believe that the company offers good value and trading remains strong. **Clinigen** (+50%) benefitted from the fact that one of its drugs is an essential component of a new cancer treatment currently going through what have been to date, very promising clinical trials. **Marlowe** (+43%) was another small company which delivered, successfully raising £40m in a placing towards the end of the quarter to shore up its balance sheet and to fund an acquisition.

In the fund management sector **Standard Life Aberdeen** (+28%) responded positively to recovery in global markets which benefitted both its core business and its Indian investments. Likewise **Intermediate Capital** (+48%) performed strongly as strong fund inflows continued and results in early June were strong as a result. Having added to our holding in **Barclays** (+22%) it was pleasing to see the shares recover and produce a solid update despite the obvious woes of the banking sector.

Our housebuilding holdings **MJ Gleeson** (+23%) and **Vistry** (+23%) had a strong start to the quarter as they announced that they were re-opening sites and getting back to work within a new socially distanced framework. That performance eased somewhat towards the end of the quarter but was still materially helpful to the Fund.

Other positive contributors included a number of cyclical businesses such as **Wood Group**, **Tyman** and **Melrose** but these were a reflection of low starting points at the end of March rather than any material changes in their outlook. In the chemicals sector **Synthomer** continued to see robust trading and rose by 17%.

Negative Contributors

It is worth noting the parts of the portfolio which have yet to participate in the market recovery.

The main group of laggards were companies which have issued equity and where we have therefore seen dilution in value. We have three holdings which have been adversely affected by this trend. **STV** (-26% return) had held up well in March but fell sharply ahead of its fundraising. We believe that the equity issue was a sensible response to difficult markets and their strategy is a sound one. We hope for strong recovery in due course. **Eurocell** (-15%) now appears well placed to invest for growth as a result of its fundraising and has good market niches in its key building products as well as a strong position in recycling materials. The new holding in **National Express** struggled a little (-15%). The shares remain extremely volatile, not helped by their CEO leaving to join Persimmon not long after the equity issue. It is difficult to predict when and if their services will get back to normality but the upside to equity holders from here could now be significant.is the only holding in the Fund which is exposed to the travel and leisure sector.

Other fallers included **Equiniti** (-18%) which had a difficult quarter mainly as a result of the fact that levels of corporate activity have dried up and interest rates have hit new lows impacting overall revenues. In addition, **Palace Capital** (-4%) slipped further as investors remain concerned about the prospects of rents being paid and the longer-term outlook for property valuations in a post-COVID world.

Portfolio Activity

The fund has 33 investments which are spread across a variety of market capitalisations. As at 30th June 2020, the breakdown of the portfolio by size was 31% in large cap, 19% in midcap and 48% in small cap/other. The Fund is currently almost fully invested with only 2% cash.

Purchases

There were four new investments made during the quarter.

The new holding in **Premier Foods** has already performed exceptionally well and our thesis that they had a solid core branded food business has been bourne out by their strong trading through the pandemic. In addition, they have made material progress in reducing debt and pensions liabilities which has seen the lowly valuation of the equity improve markedly of late.

We have followed **Euromoney** for some time and recently initiated a position following a period of poor performance as we believe that the stock now offers good value and the risks within their portfolio of businesses, notably events, are more than fully reflected in the price. The company has a number of valuable subscription and data led publishing businesses which should continue to grow steadily from here and should therefore attract a higher valuation. The current discount reflects concerns over the events business rather than the group as a whole.

We also invested in the transport business **National Express**, which recently had an equity fund raising to shore up its balance sheet and give the company the ability to bounce back quickly. The shares have more than halved this year already and the business has significant govermenet support across its key regions.

In addition, we bought the retailer **DFS Furniture**, a company we know well having held it previously. Like many retailers it has been hard hit by the lockdown which led to them raising £65m of new equity in April significantly strengthening its balance sheet. The company has a high market share and this, coupled with significant pent-up demand should allow earnings to recover rapidly as restrictions are eased.

During the quarter we also added to some existing holdings including chemicals group **Johnson Matthey** and the financial stocks **Barclays** and **Premier Miton**. We topped up on our **Premier Foods** holding ahead of their results which proved to be a well-judged move and we also added to our holding in **Melrose**.

Sales

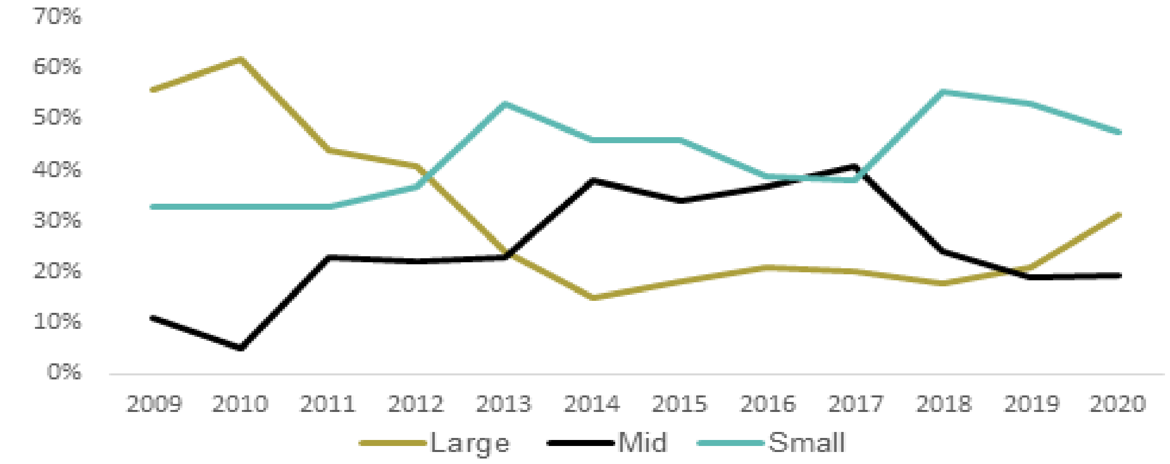
There was only one outright sale during the quarter and that was **TI Fluid Systems** where we believe that the road to recovery is likely to be a slow and difficult one.

During the quarter we took advantage of some strong recovery in performance in a number of the Fund’s holdings. This included trimming our positions in **Halfords** and **Synthomer** as well as **Clinigen**, following some good news regarding one of its drugs in connection with a cancer trial. **Alpha FMC** reported results that clearly demonstrated that it was coping with the current restrictions well and following a strong recovery we were happy to take some profits. Likewise, we reduced large positions in **Rio Tinto** and **MJ Gleeson** after good rallies.

Portfolio Strategy & Themes

That the portfolio outperformed in Q2 was a source of some relief. We mentioned last quarter that we were very comfortable with the underlying quality of the portfolio and we have generally been pleased with how the stocks have responded so far. The portfolio was given a bit of a boost as small and mid-cap stocks did rather better than FTSE100 stocks over the quarter and we remain significantly overweight in UK small caps as can be seen from the chart below.

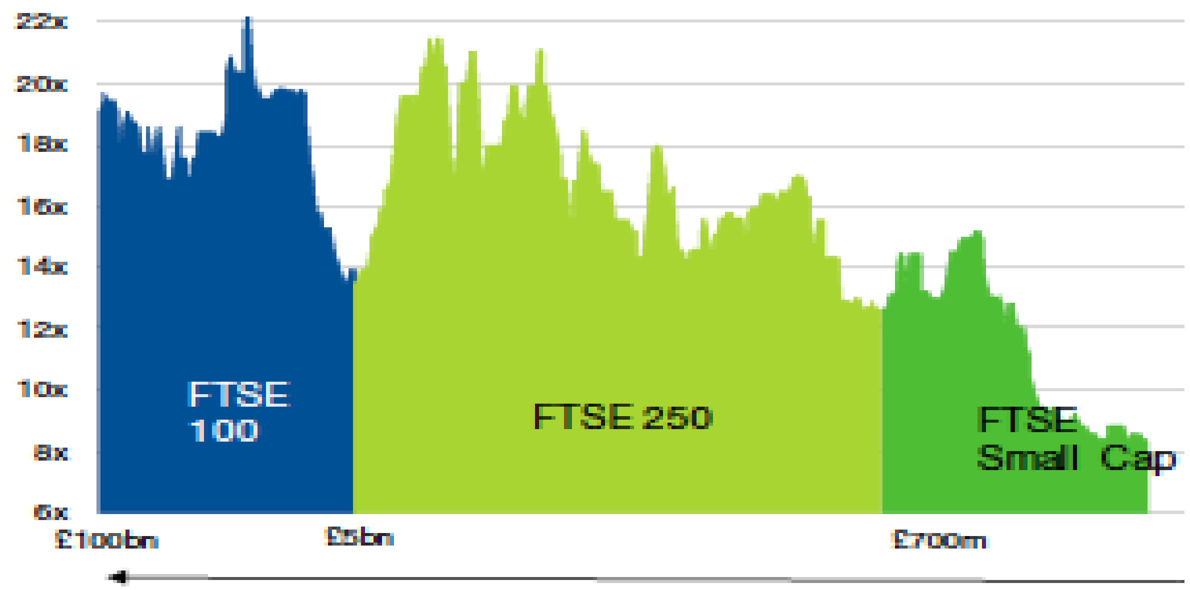
TB Saracen UK Alpha Fund – Historic Asset Mix by size



Source: Saracen Fund Managers as of 30th June 2020

That said, the smaller end of the market cap spectrum remains very cheap in comparison to its larger peers as is demonstrated in the following chart.

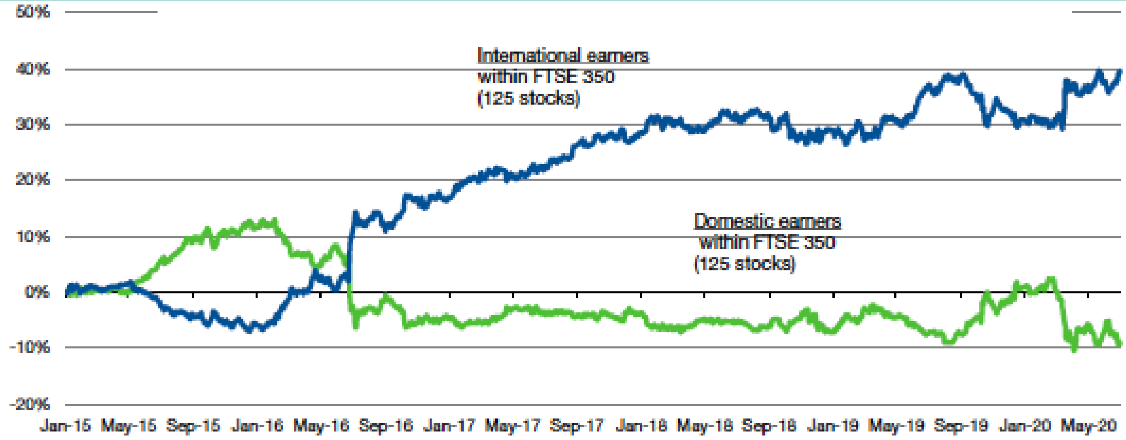
!2m Forward Rolling Median PE – Largest To Smallest



Source: Liberum, Datastream

Companies that generate most of their earnings abroad continue to outperform domestic earners. To some extent, this is unsurprising given the lockdown in the UK while other countries opened up in June.

FTSE 350 – Domestic v International Performance

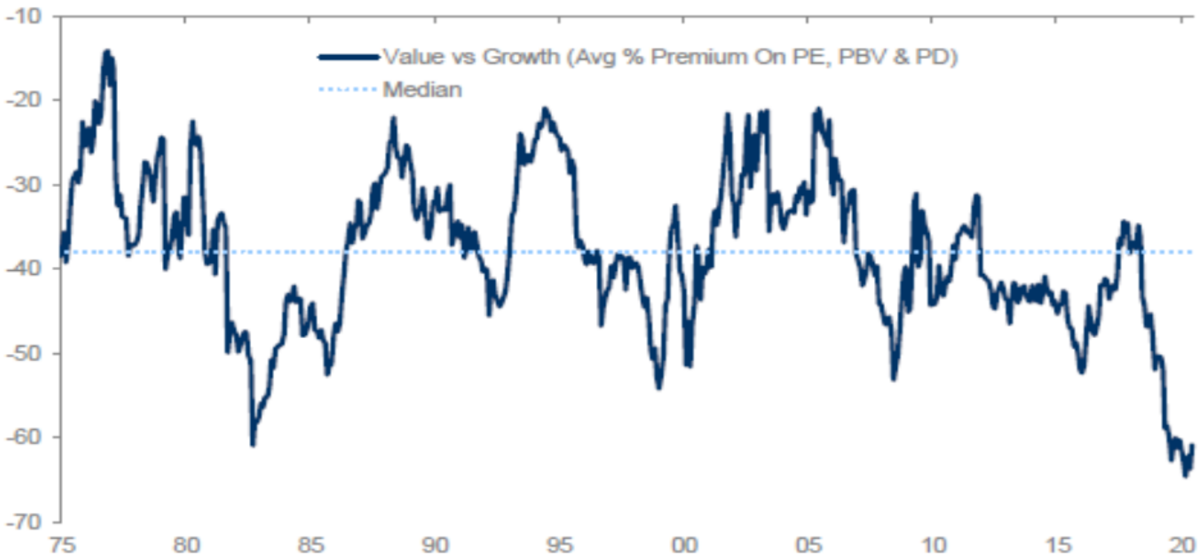


Source: Liberum, Datastream

In addition, as we often comment upon, UK value stocks have continued to underperform growth stocks. While the Alpha Fund is not a 'value' fund per se, we are of the opinion that valuation does actually matter when considering the relative merits of stocks and we have been reluctant to chase the heady multiples that characterise many a growth stock these days. As a result, the fund was disadvantaged by the continuing performance of the growth stocks.

The discrepancy in the valuations by style is clearly illustrated in the following chart.

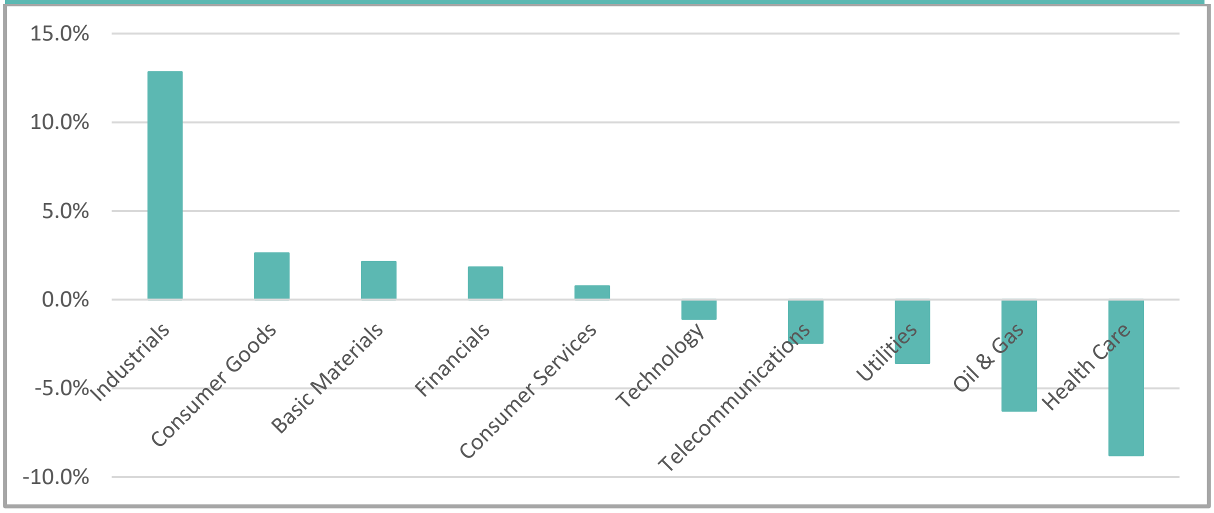
UK Value v Growth Valuation Discount



Source: MSCI, Morgan Stanley Research

The chart below illustrates clearly that that we have very limited exposure to the normally defensive healthcare sector and rather more exposure to industrials and financials, which tend to be more domestically orientated and, in the case of the industrial companies that we hold, predominantly small and mid-cap stocks. The industrials holdings are a wide and varied group of businesses with limited correlation to each other, but we believe that they are of a superior quality with positive long-term growth drivers which will stand the portfolio in good stead for some time to come.

TB Saracen UK Alpha: Sector Active Weights



Source: Saracen Fund Managers as at 30.6.20

All of this means that we tend to be long sterling assets simply due to the nature and structure of the fund. Despite this headwind the fund performed well through the quarter which is testament to the underlying quality of company within the portfolio and the fact that many of them have continued to trade unimpeded throughout the lockdown period.

Within the Financials sector we have seen some good recent performance from our asset management stocks such as Intermediate Capital and Mattioli Woods but our investments in small property stocks remain a laggard. This is perhaps not surprising as many commercial landlords have struggled to collect the rents due to them and there are ongoing structural pressures in retail assets in particular and more uncertainty re the future uses of office space

Although the oil price looks to have bounced off the bottom, at least for the time being, the fund has only a very limited exposure to the oil sector. We are still not tempted however, given the structural pressures most of the sector continues to face.

Investment Approach

The TB Saracen UK Alpha Fund’s investment objective is to achieve a long-term total return above the total return of the MSCI UK All Cap Index.

We have a focussed portfolio of 33 quoted UK companies making up a ‘best ideas’ fund with a very high active share, currently at 92%. We generally ignore index construction considerations and each position within the portfolio must be meaningful enough to make a difference to shareholder returns. Our approach is ‘multi-cap’ with significant investments in smaller and medium sized companies and correspondingly limited exposure to the largest companies found in most UK equity portfolios. Mid and small caps are currently 67% of the fund with large companies at 31% and cash 2%

We like to be patient shareholders in businesses and invest for the long-term. If the underlying business is performing as we expect and the valuation is palatable, we remain invested. Stock prices can be volatile in the short-term and we take advantage of this by adding to existing holdings if prices weaken and trimming large positions if valuations get out of kilter at any point. Valuation is key in every decision we make.

We spend very little time responding to what is in the news or analysing economic data. Most macro factors are unpredictable and volatile in our experience. Instead our time is spent searching for companies which the fund can invest in. These companies will fall into one of the following categories:

Core growth (42%* of portfolio assets)

We would expect the largest component of the fund’s assets to be held in core growth companies, businesses which can deliver consistently strong compound earnings growth rates over a long-time period, allowing us to hold them for many years to come. The exposure to this segment has reduced from nearer 60% in early 2018 due to the scarcity value and high ratings being applied to growth companies, which led us to take profits in various holdings.

Special situations (28%* of portfolio assets)

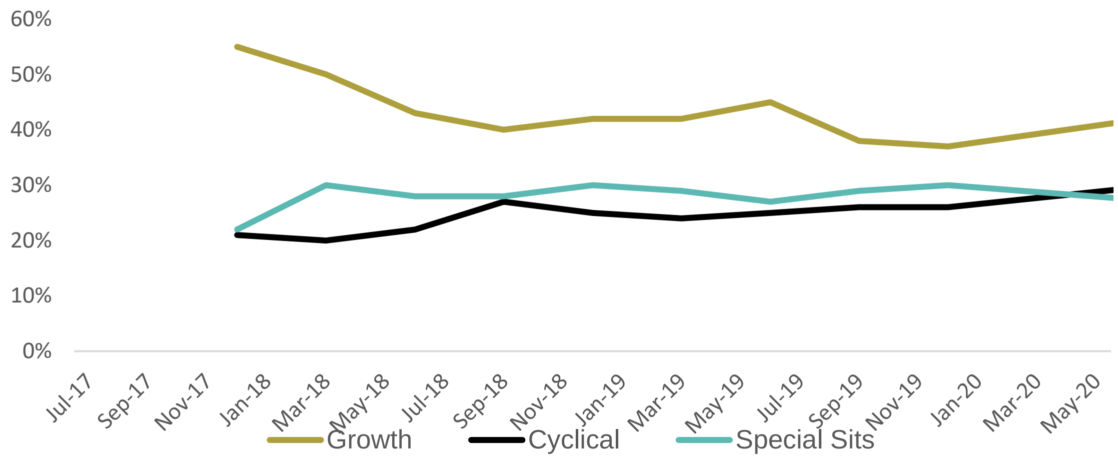
The special situations investments are businesses where the long-term prospects may not be sparkling but where we see significant catalysts for change. These catalysts would include new management and takeover / breakup potential. During 2018, we saw takeover bids for four portfolio companies, but we only had one in 2019, IFG Group. Patience is often required with this approach, but it can be highly rewarding if executed well. This type of investment should be able to perform even in challenging stock market conditions.

Cyclical recovery (29%* of portfolio assets)

The final group are good quality, cyclical businesses where we recognise that economic conditions may not always be ideal, but the company has sufficient strength of management and balance sheet to justify an investment.

**asset mix shown as at 30th June 2020, source Saracen Fund Managers*

TB Saracen UK Alpha Fund Style Breakdown



Source: Saracen Fund Managers 30th June 2020

With this structure in place the Fund is designed to be style agnostic and is able to take advantage of both 'value' and 'growth' opportunities when they arise. At this point in time there are far more potential investments emerging in the former category than the latter.

Outlook

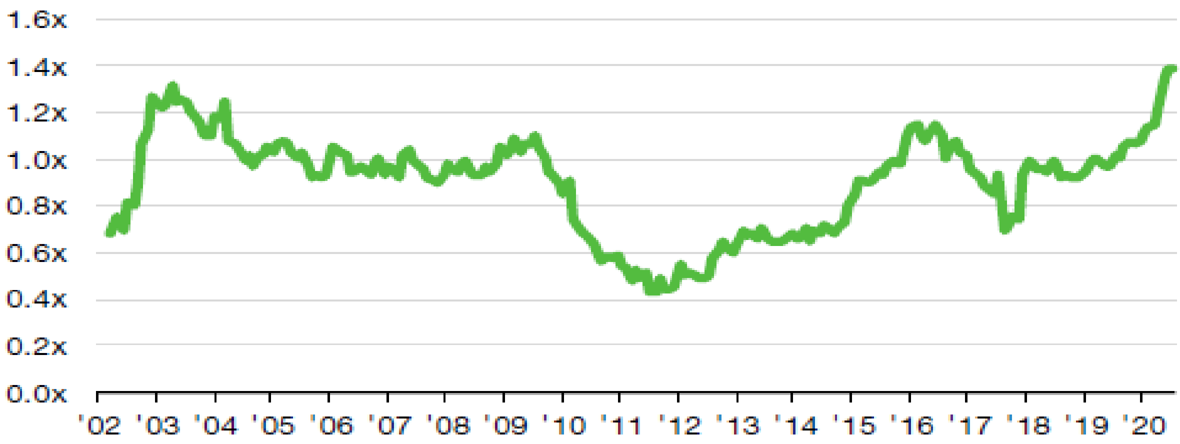
Shutdowns resulting from COVID19 have slashed nearly two decades of growth from the UK economy in just two months. It is very easy to be swept up by the COVID developments to the exclusion of all else but the world keeps turning and there are a couple of events on the not too distant horizon that have the potential to upset the political apple cart, namely the US Presidential elections in November 2020 and the Brexit negotiations. On the 30th June 2020 the last possible deadline to ask for an extension of the transition period passed, and it looks as though negotiations between the UK and the EU remain stuck. I haven't even mentioned the possibility of further trade wars.

In the aftermath of both COVID and Brexit the structure of the UK economy is likely to change materially, perhaps in ways that are currently difficult to forecast. We are of the belief that equity markets are more likely than not to continue their recovery into H2 and 2021 and beyond. This does not mean that there will not be a contraction in GDP in 2020 – there will be, and it will be considerable. The UK will be doing well if that is limited to single digits. There is still a significant risk of a second wave of the pandemic and any further lockdowns would clearly have a detrimental effect on household consumption, unemployment and investor sentiment.

However, there are likely to be further asset purchases from the Bank of England in due course and possibly further interest rate cuts, which will be set against a backdrop of a UK earnings collapse of 35-50%. We do believe that earnings are likely to rebound sharply next year, but such a rebound will not be evenly spread across all sectors. Indeed, such sector dispersion has been particularly evident since late February when COVID began rearing its ugly head.

As if all this wasn't enough, companies have been assuming much more debt onto their balance sheets to facilitate their survival through lockdown and beyond and while the overall levels are not of themselves too worrisome it is clearly another headwind to be negotiated, as the chart below demonstrates.

FTSE 350 – Net Debt/EBITDA (12m Forward) (x)



Source: Liberum, Datastream

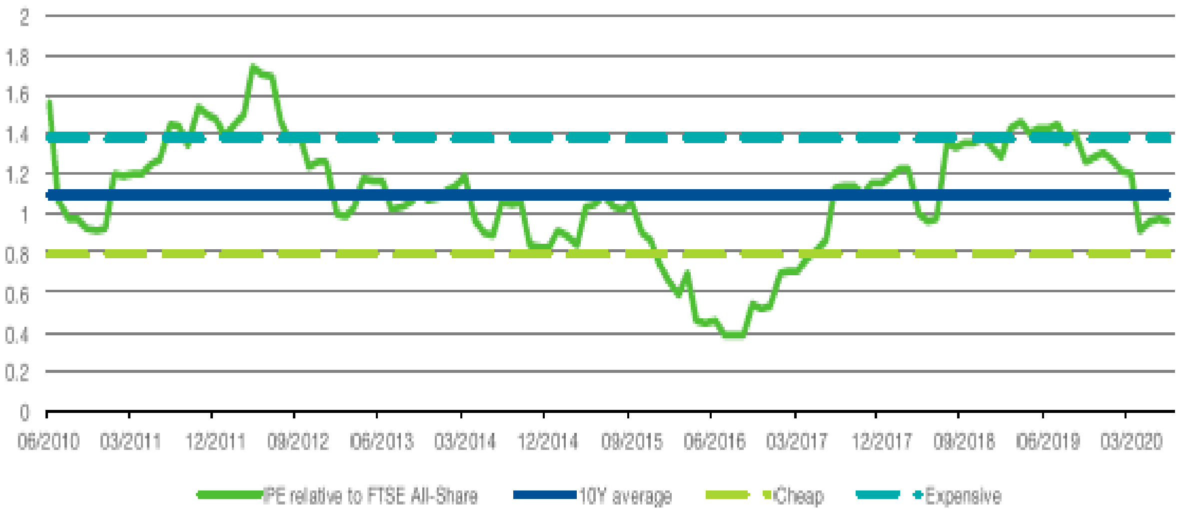
Although the portfolio has seen a decent recovery since Q1, we still believe that many of our stocks still have some way to go in terms of performance. On balance we believe that COVID 19 is a manageable event and many of our holdings have demonstrated as much over the last few months. We have spent a great deal of time at Saracen talking to the managements of the companies we hold and also to the managements of companies whose share prices have been hit hard during recent weeks that we had previously avoided as we deemed them on the expensive side. It is all but inconceivable that there have not been over-reactions in share price terms and we are keen to take advantage of these.

We have highlighted before that the UK market may be particularly attractive to potential raids by private equity buyers as it has been the worst performing developed market over recent time periods. We are beginning to get a sense of the companies that are well positioned to be long term survivors of this pandemic and those that will struggle for some years to come.

At a global level in terms of risk and return the IT sector and the healthcare sector have been performing well. This is perhaps to be expected given that they generally enjoyed 'essential' status during the lockdown but their valuations have become very stretched compared to history and, although we like both these sectors of the economy, we are struggling to find stocks that comfortably fit our buying criteria. This discrepancy is particularly pronounced at the smaller end of the market.

As investors will know, the Fund has a significant exposure to UK small caps as well as the Mid 250. In this area of the market too we can see that these stocks are generally attractive versus their long-term averages and it is here that we have been concentrating our research efforts in recent weeks.

FTSE 250: PE Ratio Relative to FTSE All Share

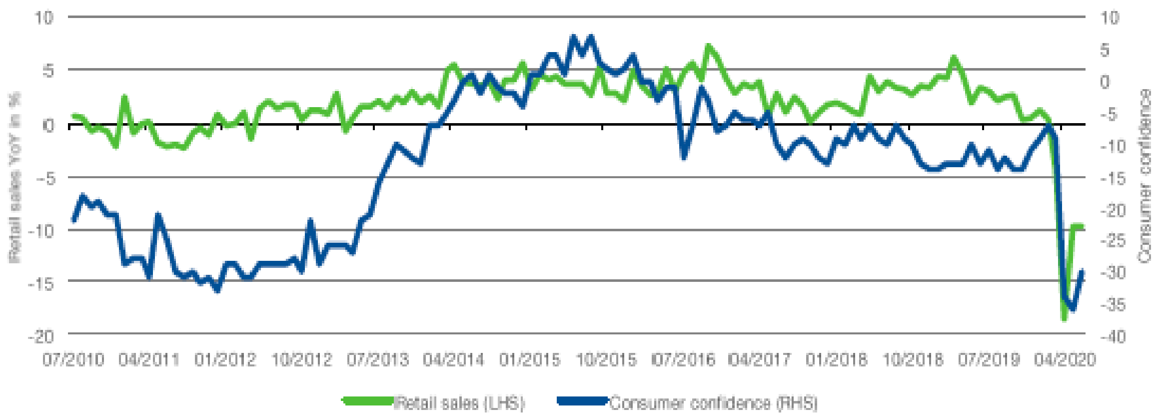


Source: Liberum, Datastream

We are confident that there will be opportunities for sound long term investments within this area especially for companies whose business model is 'COVID resilient'.

It would be naïve to expect bounce backs to be rapid across the board. We are, after all, living through a period that has experienced the worst decline in business confidence ever recorded and consumer confidence readings are rivalling those experienced during the global financial crisis. That said, the month of May saw a surprising rebound in both retail sales and consumer confidence, albeit from a very low base (see below).

!2m Forward Rolling Median PE – Largest To Smallest



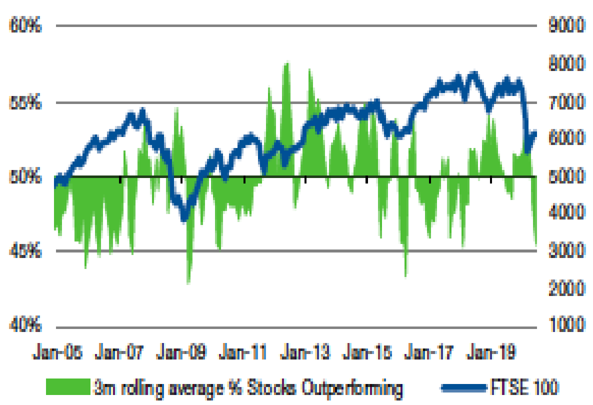
Source: Liberum, Datastream

So, what of the immediate future?

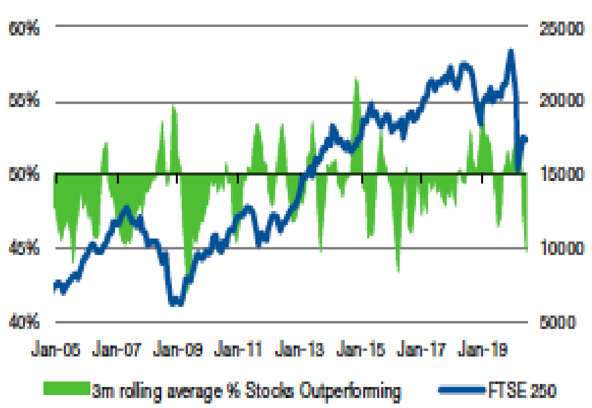
It has become abundantly clear that there will be no easy return to normality for sectors such as airlines, leisure including restaurants and pubs, general retail and property. Sectors such as healthcare and IT have traded well throughout lockdown and have been rewarded with very toppy ratings. Internationally diversified stocks have markedly outperformed domestic earners.

Market leadership is narrowing quickly showing that the recovery is losing breadth and more and more concentrated in a few names as shown below.

FTSE 100 - % Stocks Outperforming



FTSE 250 - % Stocks Outperforming



Source: Liberum, Datastream

There will be corporate failures both small and large. Some companies will require significant restructuring and we have seen this already with some of the airlines. In real estate Intu has already gone bust and as EBITDA contracts for many, debt covenants are perilously close to being breached, which explains the plethora of share issuance that we have seen to date to shore up balance sheets.

We see no immediate causes for alarm as we review the Alpha Fund portfolio. It would have been easy to have been panicked out of some of our investments post the very tricky first quarter, but we did not do so. We were very mindful of not missing the upside in performance having experienced the downside.

This strategy was broadly successful during Q2 and, as previously commented on, we took advantage of more attractive valuations on offer in some stocks that we had been tracking for some time. We will continue to do this and we will also take some money off the table as the performance of our existing holdings comes through as we expect. We remain committed to investing in mid and small companies, which remain the majority of our portfolio.

We have not shirked the responsibility of carefully reassessing all of our holdings in the light of this new era that we find ourselves in. If we believe that any of our holdings are unlikely to be able to negotiate the new forms of challenge they face we will not hesitate to recycle that cash in a more productive fashion.

We think it unlikely that M&A will pick up until the broader economic conditions are more certain or have been properly accounted for, though there will be bargains tempting the rather full private equity coffers.

It is inconceivable to us that the concept of valuation no longer matters. As we have demonstrated, even though we eschew extended multiples that does not mean that we cannot deliver strong performance. The Alpha Fund has a long history of doing just that and has flourished post testing periods of performance in the past.

The ongoing COVID19 pandemic means that 2020 will go down in history as a year of severe economic and social upheaval. This has been a trying period for many businesses and for individuals. It has been surprisingly difficult to give up many of the day to day freedoms that we have enjoyed living in the UK. As we come to the end of the lockdown period let us hope that we can put this period behind us and move forward to a brighter and better future – which we are sorry to say may mean talking about Brexit again!

We thank you for your continued support during these times and, of course, hope that you and your families stay safe and well.

We will keep readers up to date with further thoughts and actions over the coming weeks and months.

David Clark, Scott McKenzie
8th July 2020

Issue date – 8th July 2020