TB Saracen UK Income Fund

Quarterly Review – June 2020

SARACEN
share success

Signatory of: PRI Principles for Responsible Investment

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FOR PROFESSIONAL INVESTORS ONLY-

Retail investors should consult their financial advisers

	TB SUIF	MSCI UK All Cap (TR)	Relative
Q2 2020	16.2%	9.4%	+6.8%

Performance Summary

After the dramatic falls we saw in March global equity markets rebounded sharply during the second quarter, led by a remarkable recovery from the US, and NASDAQ in particular. There was some light at the end of the COVID tunnel with most leading economies beginning the process of lockdown easing to varying degrees. Volatility remains elevated but less pronounced than it was. The UK market remained a laggard, with the MSCI UK Allcap return of 9.4% well behind the MSCI AC World return of 18%. Dividend cuts and equity issuance provided further headwinds for UK investors, not helped by a confused political response to the COVID crisis and the looming spectre of Brexit.

Having endured a very difficult first quarter the Fund enjoyed a good recovery, rising by 16.2%, compared to the UK index return of 9.4%. We were helped by relatively strong rebounds in the mid and small cap indices from low bases. A summary of performance is shown below.

Cumulative Performance after all ongoing charges to 30th June 2020

	3 months	1 year	3 years	Since launch*
TB Saracen UK Income B Acc	16.2%	-19.7%	-12.1%	0.7%
MSCI UK All Cap Index (TR)	9.4%	-14.5%	-6.4%	10.4%
Sector Average	11.0%	-13.6%	-10.7%	-6.2%
Quartile Ranking	1	4	3	3

*Source: Financial Express; * launch date 01 April 2015* *Sector: IA Sector (UK Equity Income)*

Market Overview

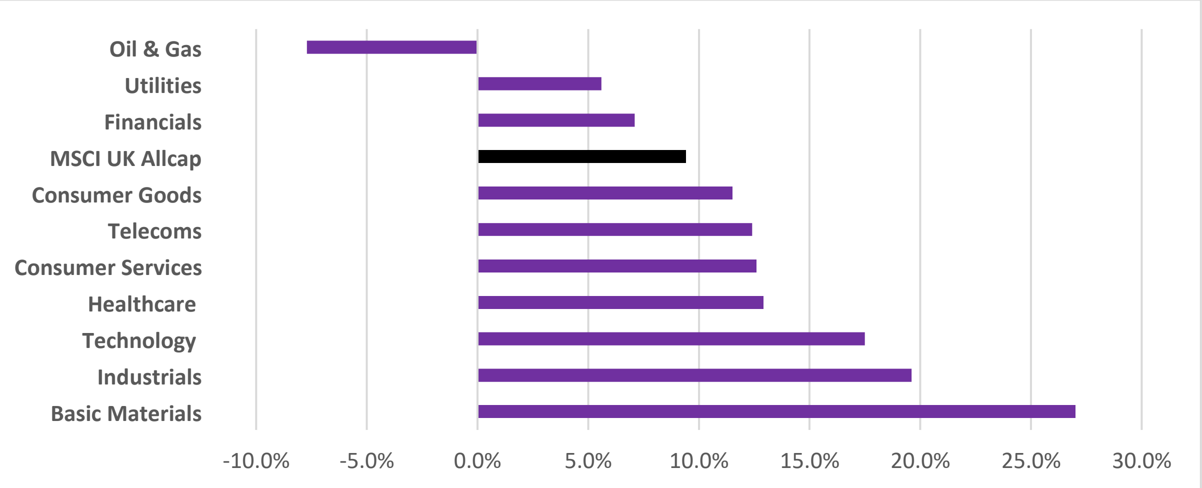
It is encouraging that after the most severe fall in economic activity in living memory, equity markets have recovered and responded to early signs of pick-up in activity from a low base in April and May. Remarkably, global equities had their best quarter since 1998 and the S&P had it best 100 day run since 1933 – rallying over 40% from the lows.

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 its 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

Given the earnings uncertainty we currently see across global markets, we have seen an expansion in price/earnings ratios as markets have recovered whilst earnings have been downgraded significantly. The data shown below from Barclays/IBES shows the MSCI World current PER trading 34% above its 20 year median. In the UK it’s a mere 19%.

Global PE Ratios – Some Longer Term Context

	Current	1st Jan	10Y Median	20Y Median	Current vs 10Y Median	Current vs 20Y Median
MSCI World	**20.2**	***17.1***	**15.1**	**15.0**	**34%**	**34%**
US	**22.2**	***18.7***	**16.2**	**15.8**	**37%**	**41%**
Europe	**17.4**	***14.8***	**13.7**	**13.6**	**27%**	**28%**
UK	15.3	*13.2*	12.8	12.9	20%	19%
Eurozone	17.5	*14.5*	13.2	13.2	32%	32%
France	17.7	*14.9*	13.5	13.4	31%	32%
Germany	17.0	*14.1*	12.4	12.7	37%	34%
Italy	16.3	*11.9*	11.4	12.5	43%	30%
Spain	14.9	*12.0*	11.8	12.7	26%	17%
Japan	**16.5**	***14.5***	**13.5**	**14.7**	**22%**	**12%**
EM	**14.0**	***12.8***	**11.1**	**11.0**	**26%**	**27%**
Brazil	14.9	*13.2*	10.6	9.8	40%	52%
Russia	7.7	*6.4*	5.2	6.1	47%	28%
India	20.8	*18.9*	16.6	15.8	25%	32%
China	13.8	*12.2*	10.5	11.4	31%	21%

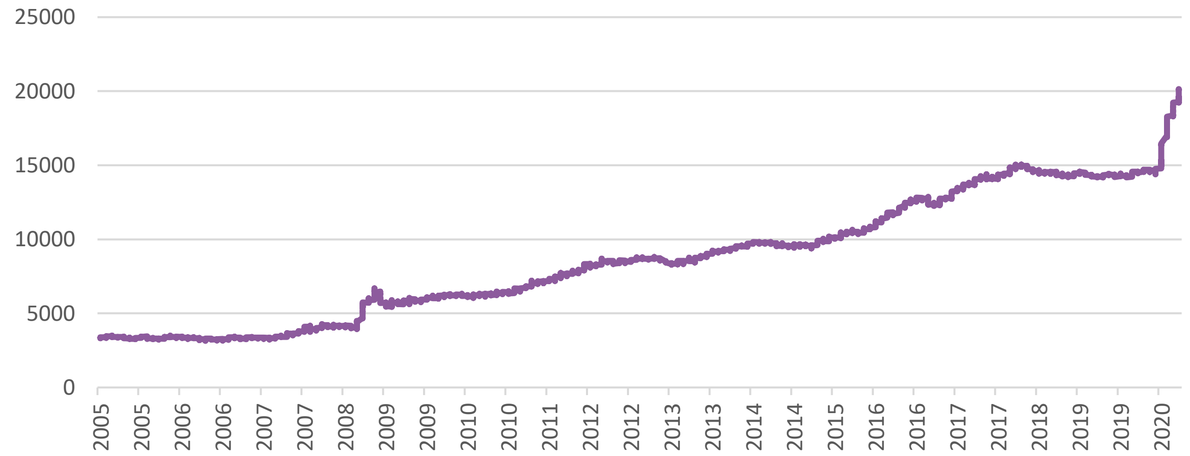
Source: IBES, Barclays

However, we would caution against extrapolating such data too far forward given it represents what could be an exceptional and temporary 2020 earnings decline.

We would observe that most economies are re-opening and initially global activity will rebound sharply from a low base. Current earnings revisions are the most negative on record and therefore the scope for bounce back significant. A second wave of infections remains a key risk but most governments should now be better prepared to handle this.

Whilst most readers will have vivid memories of the financial crisis of 2008 we believe that there are a number of crucial differences when comparing it to the COVID-19 crisis of 2020. Firstly, this is a crisis impacting Main Street not just Wall Street, with record amounts of monetary stimuli and emergency COVID support packages amounting to $ trillions worldwide. These are packages supporting the whole global economy rather than the banking sector in isolation. As a result, we are seeing vast expansion of central bank balance sheets (now c.$20 trillion – see below) and huge increases in government debt burdens emerging.

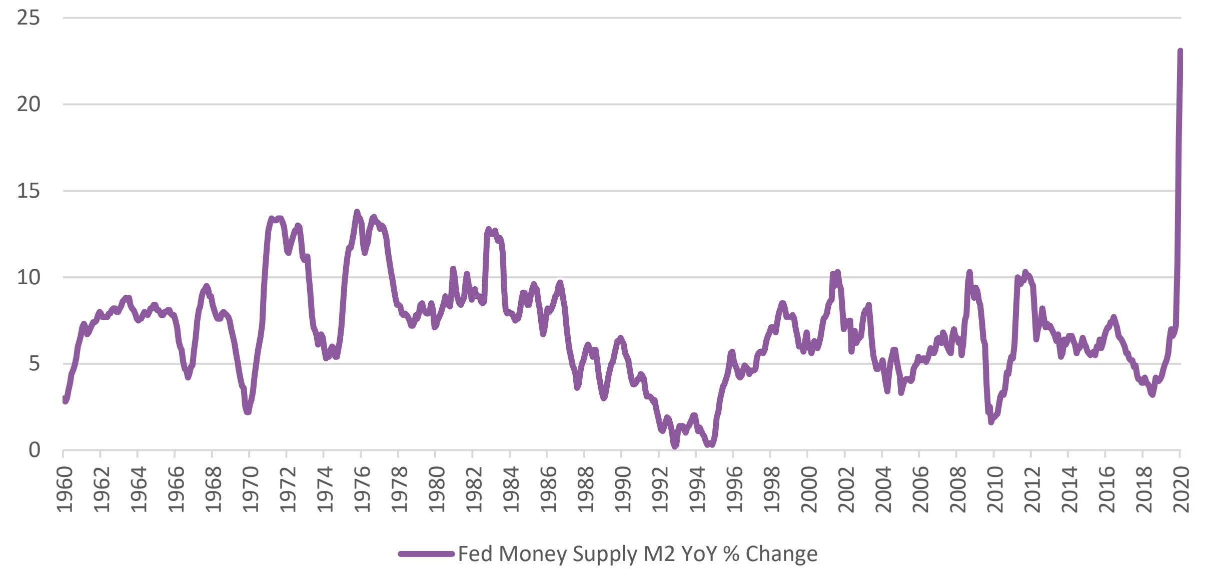
Combined Balance Sheet Fed, BoJ, ECB (in US$ billions)



Source: Bloomberg

In addition, the explosive growth seen in US money supply has also been unprecedented in recent history.

M2: The number we should've watched



All of these developments suggest that there is a considerable will from political leaders and central banks to do whatever it takes to reflate the global economy. Recent Citigroup estimates suggest that up to $6trillion could be spent on asset purchases globally over the next twelve months which are likely to support asset markets in broad terms.

All of this seems incompatible with government bond yields at all time lows and real yields which are now highly negative across all key economies. The consensus ideology now seems to be that inflation has been banished, never to return. Current policy responses and political direction would suggest that the risks to this consensus are considerable. If this orthodoxy is challenged, then it could have profound implications for future market leadership

From a UK-only perspective it would be delusional to suggest that the outlook is rosy and we face a number of additional issues that others don't have. It is clear that PM Johnson's handling of the COVID pandemic has been less than optimal and public confidence in the government is currently low. Our route both into and out of lockdown has been mired in confusion and division. Ultimately this will damage our economic and employment prospects.

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.

There remains much that we don't know at this stage. The COVID-19 crisis and it's aftermath has made forecasting across a range of macro factors such as GDP growth, unemployment rates, currencies and market earnings levels even more prone to significant error than usual. There is a real risk of unemployment rising over the 10% level in the UK as furlough unwinds and lockdown measures remain in place. This is likely to lead to a sharp fall in 2020 GDP of between 8-10%.

Portfolio Review

The Fund has a 'multicap' structure with high exposure to small and mid-cap companies, which are currently 53% of the portfolio, having peaked above 60%. The focussed nature of the portfolio means that the Fund has a high active share, currently at 88%.

After the traumatic falls in value we endured during March it is pleasing to report that the portfolio recovered well during the second quarter as markets regained some poise. Just as many of the falls we saw previously were unprecedented in nature a number of the recent recoveries have been just as dramatic, albeit from a very low base in most cases.

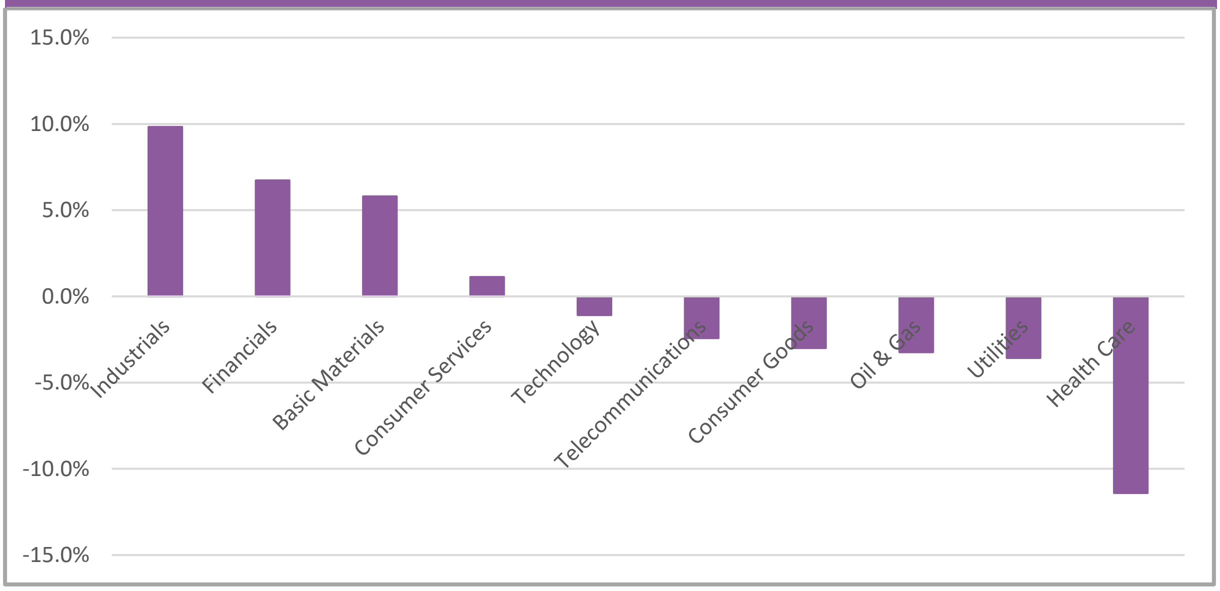
We took the view at the end of March that we should not panic and give the portfolio ample scope to recover. This ethos has broadly served us well in recent months but there remains plenty of lost ground for us to make up and many holdings have yet to deliver their recovery potential. In many cases this potential is significant in our view.

The overall structure and philosophy of the Fund is broadly unchanged and there has been no style drift in response to the COVID crisis. The key portfolio characteristics are as follows

1. We remain overweight in small/midcap and underweighted to FTSE100
2. We own a number of recovery stocks/cyclical businesses which are GDP-exposed
3. We have very low exposure to classically defensive stocks or sectors
4. Our process has a heavy bias towards value factors and a low weighting to growth

The chart below shows the Fund's current active sector positions compared to the UK index. There have been no significant changes made to the sector mix during the quarter with our preference for financials and industrials and zero weightings in healthcare and utilities remaining as before.

TB Saracen UK Income : Sector Active Weights as at 30th June 2020



Having had virtually no positive news to report in our first quarter review it was pleasing to see meaningful recovery in a number of holdings from the nadir of markets in late March. Whilst this improvement in fortunes is not yet across the board the majority of holdings responded well. We had 11 holdings rise in value by more than 20% during the period, predominantly in the financials, industrial and mining sectors.

In financials we saw significant recoveries in our three fund management holdings – **Standard Life Aberdeen** (+28%), **Jupiter** (+28%) and **Intermediate Capital** (+48%) – as they responded positively to recovery in global markets. In each case they have remained fully operational during the crisis and have continued to pay the dividends we had expected.

The mining sector has also served the Fund well, having held up relatively well in March and delivering strong gains in the second quarter. Our holdings in **Rio Tinto** (+22%) and **BHP** (+32%) continue to benefit from resilience in commodity prices and high exposure to China as well as their increasingly rare commitment to paying high levels of dividends.

The most dramatic improvements in performance came from a number of our smaller companies, a group which had been hit hardest during the market collapse in March. There were three companies which made material contributions to fund performance.

Alpha Financial Markets Consulting rose by 58% as it became clear they had continued to generate high levels of revenue and customer service during lockdown. The recent results were pleasing, and the outlook remains one of cautious optimism.

We reported on the IPO of **FRP Advisory** in our previous review and the shares have delivered strong returns since, rising by 59% over the quarter as the scale of the economic disruption has become clear. FRP have won a number of new insolvency cases recently and look set to be very busy for many years to come.

Our biggest contributor came from an unlikely source. **Halfords** had hitherto been a pretty painful investment but came roaring back to life, rising by 118% during the period as investors focussed on their leading market position in cycling and growing potential in auto repairs.

Other positive contributors included a number of cyclical businesses such as **Wood Group**, **Tyman**, **WPP** and **Vistry Group** 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%.

It is worth noting the parts of the portfolio which have yet to participate in the market recovery. These are broadly in two categories. Firstly, 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. **National Express** (-9%) is the only holding in the Fund which is exposed to the travel and leisure sector.

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.

The second main category of laggards comes from the banking and real estate sectors where a combination of bad debts, falling real estate valuations and cancellation of dividends have been a toxic combination. Both of our banks, **Close Brothers** (-2%) and **Lloyds** (-3%) have steadfastly refused to rally and remain encumbered by their 100% UK exposure and the recent cancellation of dividends. Both have announced large increases in bad debt provisions, reflecting the short term weakness we are likely to see in the UK economy.

Our investments in small real estate businesses such as **U&I Group** (-1%) and **Palace Capital** (-3%) have not been a happy tale so far in 2020 with their illiquidity and exposure to falling rents and asset values leading to large falls in both capital and dividends. We believe that the real estate sector will require consolidation and restructuring going forward to be relevant in a world where retail, leisure and office assets are likely to remain under considerable pressure.

Portfolio Activity

The fund has 33 investments which are spread across a variety of market capitalisations. As at 30th June 2020, the split of investment was 47% in large cap, 25% in midcap and 28% in small cap/other and, following some recent additions, the portfolio is currently fully invested.

Purchases

There were four new stock purchases made during the quarter. They are all businesses with leading market positions in their sectors, and we believe that they add both diversification and quality attributes to the existing portfolio. In the cases of Euromoney, DFS Furniture and Johnson Matthey we were able to invest at valuations which have been significantly reduced as a result of shorter-term, COVID related concerns.

Euromoney is a business we have tracked for some time but has previously been too expensive for us to consider. It has an events business (roughly 30% of revenues) which has been impacted severely by COVID and is unlikely to return to what it was. However, they have a number of valuable subscription and data led publishing businesses which will continue to grow steadily from here and could attract high valuations going forward. The discount valuation reflects current problems in events rather than the future potential for the group as a whole. We also expect a recovery in dividends to previously healthy levels before too long.

DFS Furniture is a company we know well, having held it in the Fund previously. Like many retailers it has been hit hard by lockdown which led to them raising £65m of new equity in April. Whilst the dividend has been passed for now we believe that they will be in a position to resume payments in 2021. Given their high market share and significant pent-up demand we hope that earnings will recover rapidly as restrictions are eased and the sharp decline in the shares offered us a very attractive entry point

Tate & Lyle has been rehabilitating itself in recent years, reducing its exposure to commodity food products and developing a leading ingredients business. The split between these two factors is roughly 50/50 now, with the more mature businesses being run for cash and efficiency, providing cashflow to invest into the higher growth activities. Despite some headwinds of late in some of their food commodities they have continued to pay their dividend and we see potential for the shares to re-rate as the ingredients business becomes the majority of group earnings.

Johnson Matthey is a world leader in catalysts and technologies related to platinum group metals. Whilst the group's largest exposure is to the automotive sector it has a number of promising developments coming through in areas such as pharmaceuticals, lithium batteries and hydrogen. The autos sector is going through a period of economic and structural change which has impacted the valuation of the shares materially of late. As a result, a very low value is being ascribed to the emerging technologies despite their huge long term potential. Whilst the dividend has been reduced it has potential to rebuild nicely from here as the economic situation improves and electric vehicles become more prominent.

We added to several holdings in the financials sector during the quarter, where share prices had been particularly badly affected. These were in **Jupiter**, **NewRiver REIT** and **Phoenix**, with the latter company now the largest holding in the Fund and an important source of dividend income. Towards the end of the period we added to some small and midcap holdings which had been left behind including **Gateley**, **Headlam** and **National Express**, the latter after a £230m equity issue had led to further price weakness.

Sales

There was one holding, **TI Fluid Systems**, which was sold outright from the portfolio during the quarter. Given it's 100% exposure to the automotive sector we think the path to recovery will be slow and, with the shares having recovered somewhat, we took the opportunity to exit.

We reduced the large positions in **Halfords** and **FRP Advisory** after they had enjoyed significant price appreciation as markets recovered. Both remain as holdings within the Fund.

Fund Income Update

In our previous quarterly review we outlined our initial thoughts regarding the significant declines in dividends which had been announced in response to the COVID-19 crisis.

At that point we had seen more than £15bn of cuts and, at the time of writing now, we estimate that the loss of UK dividends in 2020 will be c.£30bn, a 30% reduction in the underlying number of £99bn paid in 2019. No less than 48 of the FTSE100 constituents have seen dividend payments fall so far in 2020.

Having initially seen cuts in cyclical sectors such as travel and leisure, construction, retailing and manufacturing, financial sectors such as banks and insurers were also forced to cancel dividends as political pressure was brought to bear. Royal Dutch Shell has cut its dividend by 66% and BP seems likely to follow. As the crisis has evolved we have seen the strong as well as the weak defer or cut payments.

Our analysis of previous financial crises over the past century which we outlined in April saw declines in dividends ranging from 25% to 55%. **With regard to the forecast dividend yield for the UK market in total our current central case estimate would be for a fall of 30% in 2020 and a recovery of 20% in 2021, giving a decline of 16% over the two year period. Using Bloomberg estimate data this equates to a yield on the index of 3.9% over the next year and 4.7% in year two.**

Turning to the Fund's income specifically. For income-based strategies such as ours the significant disruption to dividend payments has been painful, coming at a time of year when dividends are traditionally at their most plentiful. This has lead to a 60% fall in the Fund's interim dividend which has been proposed at 1.0p per income share (2019: 2.5p)

Now that a fuller picture has emerged regarding the loss of expected dividend income we are now able to give shareholders clearer guidance with regard to this year's income payments. In doing so we have taken account of the following potential barriers to dividends recovering

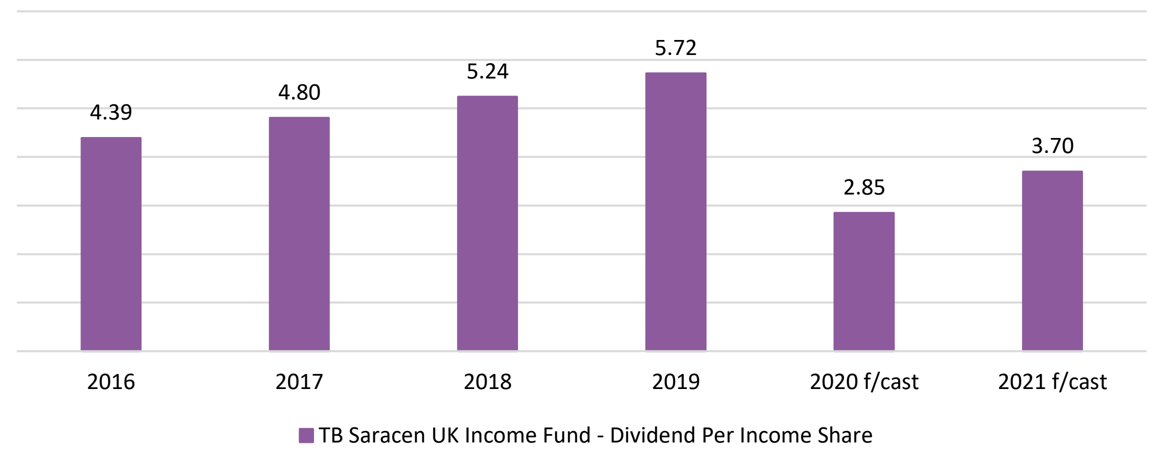
- Recent equity issuance for balance sheet strengthening which preclude dividends resuming quickly
- Regulatory and political pressure coming to bear, particularly in the financials sector
- Exposure to government furloughing and loan schemes

Our central case now is that the fund dividend payment for calendar 2020 will fall by 50%. This would imply a current yield on the income shares of 3.6% (as at 30.6.20). This now represents what we regarded in March as a worst case and reflects a detailed bottom-up model of the worst case scenario based on the current portfolio remaining exactly as it is now.

At the time of writing 21 fund holdings have suspended or cut their dividends but, in the majority of cases, we expect these deferrals to be temporary. As we look towards 2021 the outlook for dividends is far from clear and the scale and timing of payments may be subject to variance, particularly in the early part of 2021. **However, our current bottom-up expectation is that we would expect a 30% recovery on the reduced 2020 payout**.

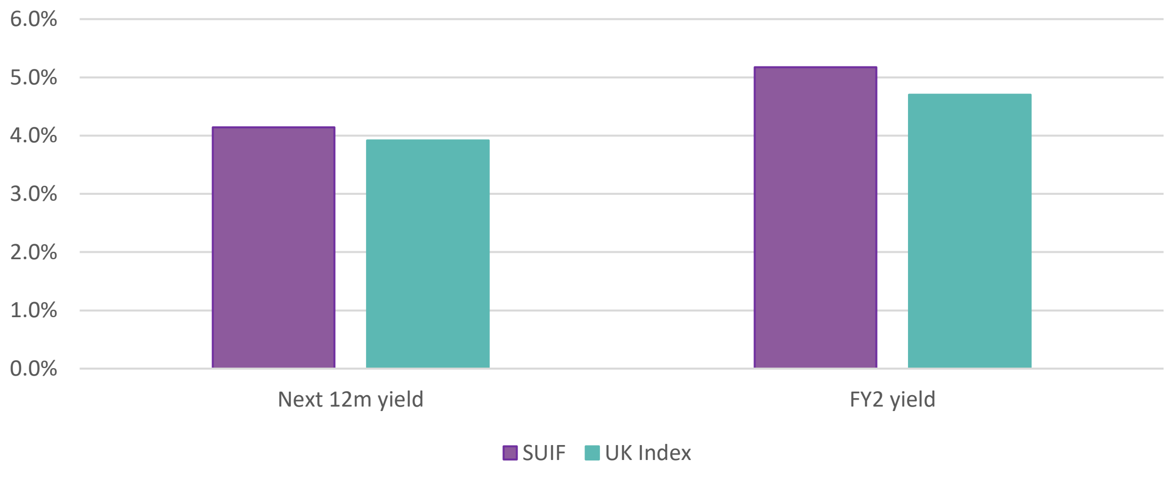
The chart below depicts our strong recent income history and the impact of our new forecasts on dividends for 2020 and 2021.

TB Saracen UK Income Fund Dividend



If we combine the forward forecast dividend yields for both the Fund and the UK index over the next two years from today we still have the portfolio offering an attractive, albeit reduced, dividend yield of more than 5% in early 2022. This compares to an income return of effectively zero today from cash and UK gilts.

Fund v Index Forcast Dividend Yields



Source: Saracen Fund Managers, Bloomberg

Whilst we would acknowledge that this loss of income is disappointing, we would prefer to give investors a realistic assessment of the impact the current crisis has had and also an assessment which we believe represents a worst case scenario. We hope that by doing so the Fund shall have the ability to surprise on the upside from this base, especially in 2021, and that most of the dislocations we are currently seeing prove to be temporary.

We have made a variety of assumptions with regard to dividends at a sector and stock level in this analysis and have made allowances for a number of restricting factors.

Should any readers wish more detail on the stock by stock assumptions we have applied please do get in touch. We would be happy to share our thoughts with you.

Outlook

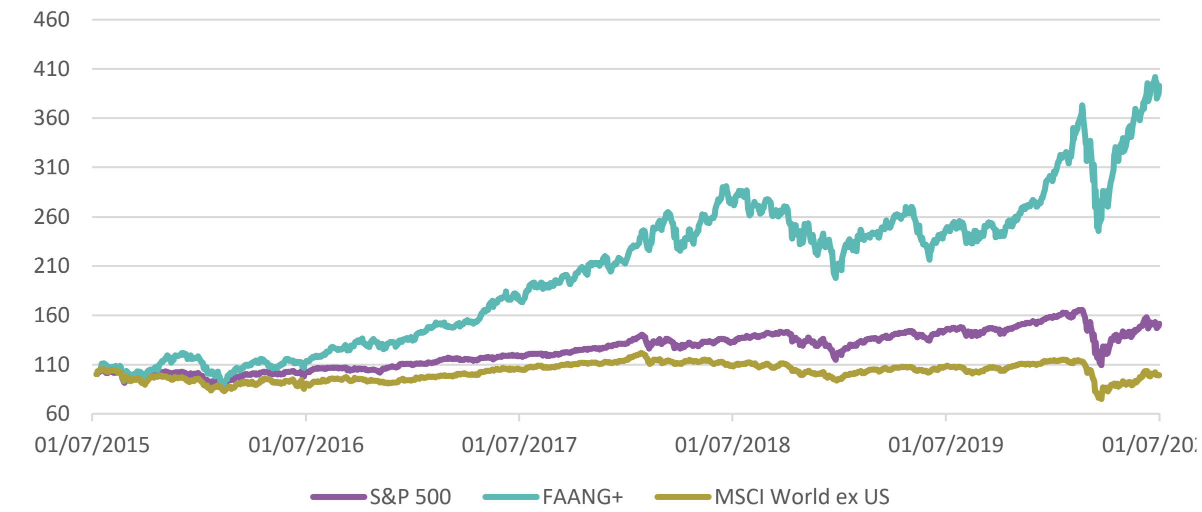
Once again it has been a quarter of high dramas. Having endured the fastest 30% drawdown in history during the first quarter it was then followed by the best 100 trading days on the S&P since 1933 and the best quarter for global equities since 1998.

Against this background we are pleased to report better results for the Fund during the period. We have remained resolute in our pursuit of value and have resisted the considerable temptation to change our course and process during these testing times. In our discussions with investors, it is clear that some have all but given up on value factors and now view value investors as something of an endangered species.

In many ways the challenges we face remain broadly similar to those we outlined in our April review and we continue to approach them with confidence and vigour.

Market leadership has been unusually tight, particularly in the US. Year-to-date around 85% of the move in the S&P 500 index is explained by just five stocks –Facebook, Amazon, Microsoft, Apple and Alphabet. It is hard to see how this level of concentration can continue - it is more likely that for markets to progress from here, leadership will have to broaden.

This Market Has FAANGS+



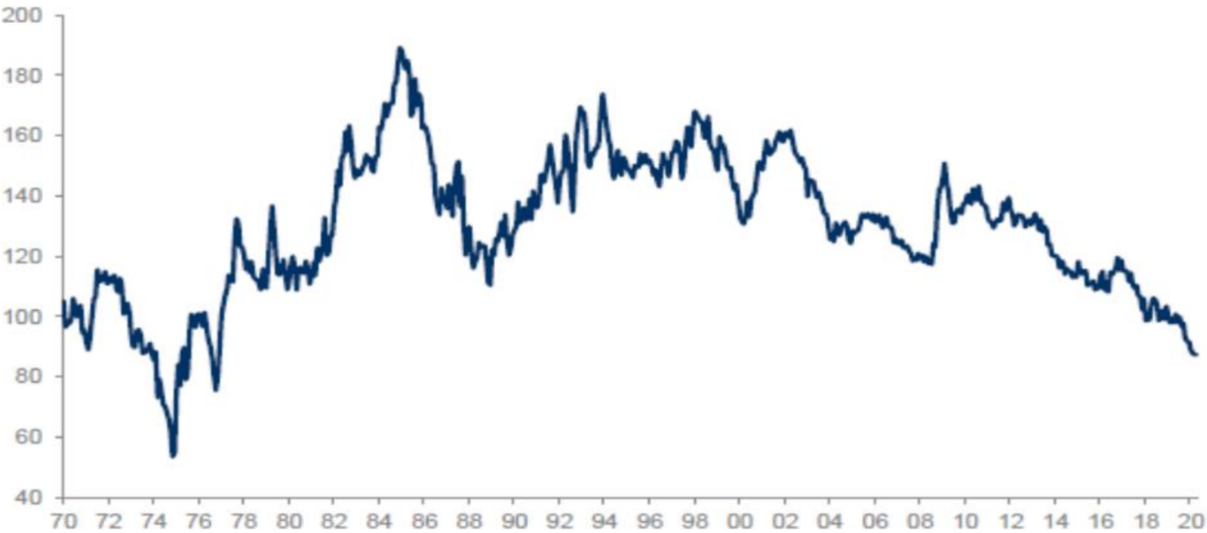
Source: Bloomberg

Given the vastly different index structures there is no direct read-across to the UK market from this phenomenon. However, the principles are the same across all markets - large pools of assets chasing a limited number of high-growth companies at any price.

As UK equity investors we have long come to accept that we invest in a market and economy which is broadly loathed by investors. There have been various good reasons for this and during this crisis there have been many businesses swimming naked when the tide has gone out. The failures at a corporate level have been amplified by our political leaders having been found wanting during the COVID pandemic.

Despite some attempts at reversing course during 2019 the relationship between UK and global equities has once again resumed its previous downward trend.

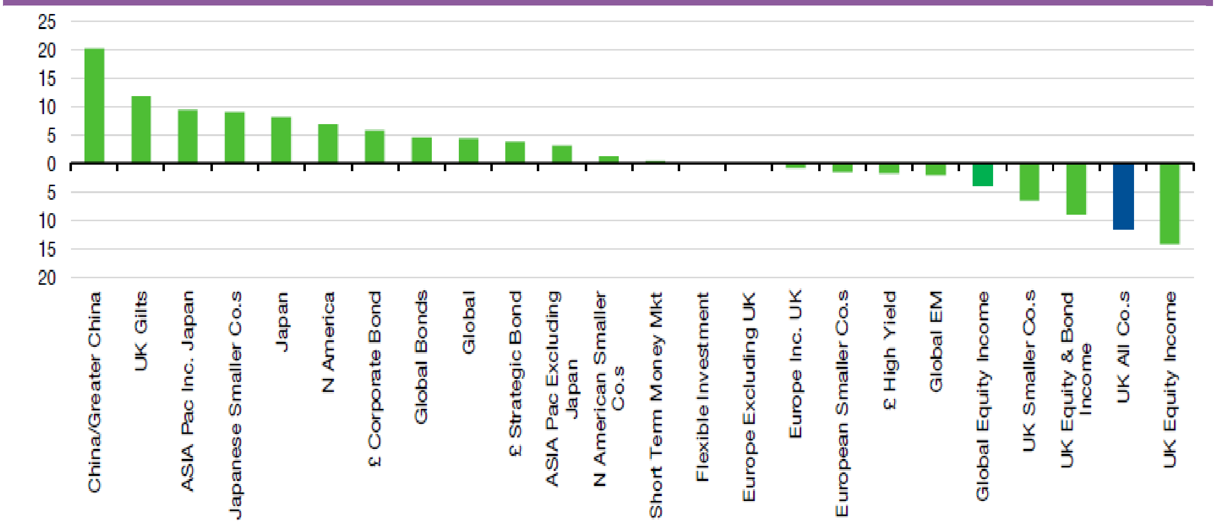
UK v World Equity Price Performance



Source: MSCI, IBES, Morgan Stanley Research

This is also plain to see in the shorter term returns from the universe of IMA investment fund categories which places UK equity funds firmly in the doghouse. If one has any remaining faith in mean reversion, then we hope this augers well as a contrarian indicator for future returns

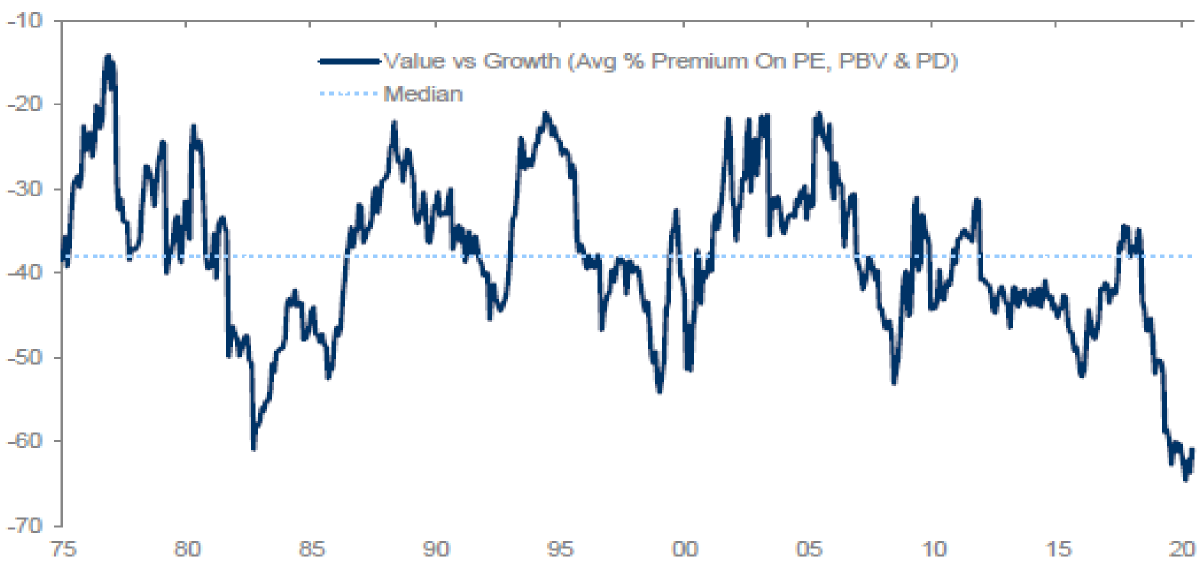
IMA Sector median returns (1 year)



Source: IMA, Lipper

Regular readers will be aware that the Fund employs a value-based process. The value premium remains elusive and valuations remain at levels way below the severe selloffs seen in 2000 and 2008. The current discount sits at 65%, compared to a long run average of just over 35%. Whilst we are used to being somewhat out of fashion and going against the grain, the current market circumstances for value investors are as hostile as any we have seen previously.

UK Value v Growth Valuation Discount

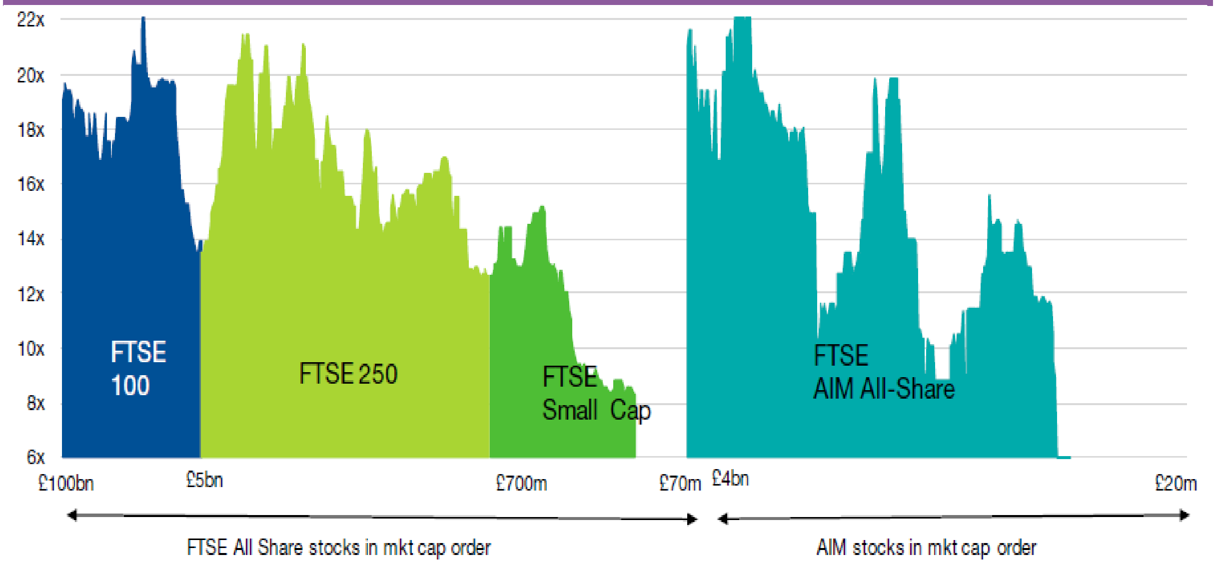


Source: MSCI, Morgan Stanley Research

Our commitment to investing in medium and smaller companies remains a key part of the Fund's philosophy and affords us the opportunity to cast our net far away from the maturity of the majority the FTSE100 index.

Whilst we have enjoyed a meaningful recovery in SMID indices during this quarter we would observe that a clear valuation disconnect has been established the further down the market capitalisations we go. This can be rationalised to varying degrees. In times of crisis investors tend to seek more liquid safe havens and UK smaller companies also suffer from higher levels of domestic exposure and cyclicality in general. However, we do see a multitude of opportunity in smallcaps at present, providing the underlying quality and margins for error are there. The valuation gap is summarised nicely in the following chart.

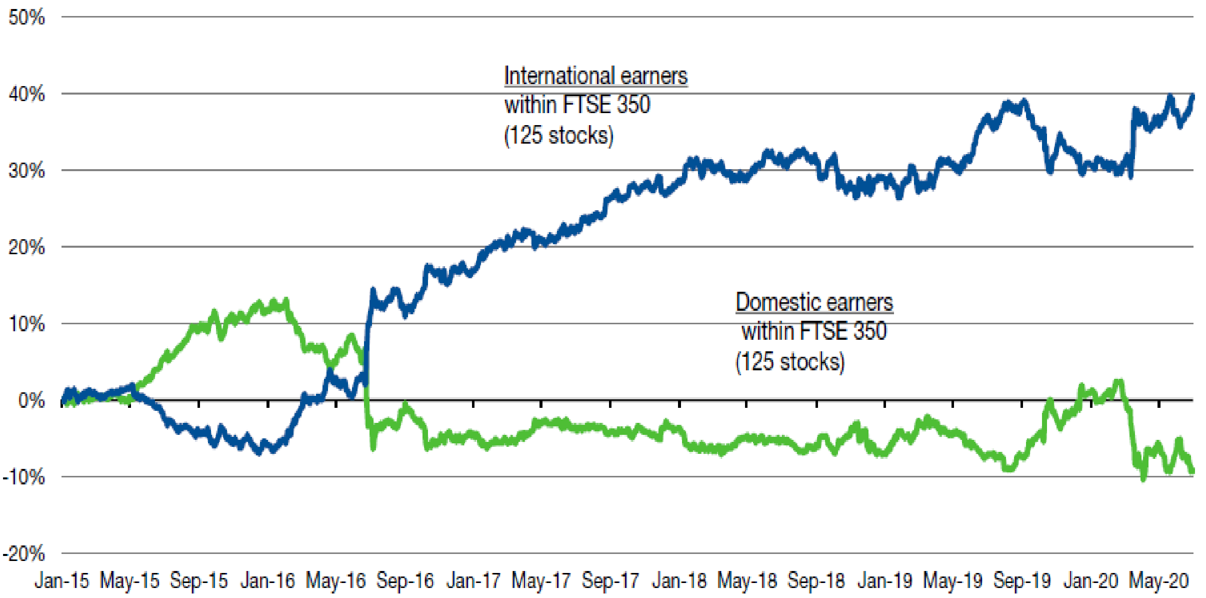
12 month forward median PE ratios by size factor



Source: Liberum , Datastream

Our final thematic observation would be the disconnect between the valuation of domestic and international earnings across UK equity markets. This was a theme that we utilised to the advantage of the Fund during the latter part of 2019 prior to the finalisation of Brexit but this has unwound significantly in 2020 so far. Whilst we acknowledge both the earnings and the Brexit risks inherent here, we are happy for domestic earnings to remain a feature of the portfolio today given their recent performance and valuation gaps. It is a position which would clearly benefit from a strong £ should that ever come to pass.

FTSE 350 – Domestic v International Performance



Source: Liberum, Datastream

To reiterate, the key characteristics of the current portfolio are as follows

1. We remain overweight in small/midcap and underweighted to FTSE100
2. We own a number of recovery stocks/cyclical businesses which are GDP-exposed
3. We have very low exposure to classically defensive stocks or sectors
4. Our process has a heavy bias towards value factors and a low weighting to growth

We are pleased to report better results for the Fund during this period, but we are mindful that there remains much work still to do to get back to our previous standards of performance.

In this report we have shared our thoughts regarding the outlook for dividend income for the next two years. Whilst our dividend guidance is not where we would have wished it to be it is important to be realistic about the challenges faced. Our priority now is to ensure we are fit and ready to take advantage of any recovery.

Whilst our value ethos has proven painful of late, we hope that the worst is now over. It feels like we have reached the end of the limits of monetary policy. The massive fiscal stimulus we are now seeing should hopefully benefit our positioning if inflation returns and bond yields rise from currently abnormally low levels.

Valuation will eventually matter and our core process and philosophy of focussing on value will not change. We have seen good opportunities to buy stocks that previously we would have deemed too expensive for our portfolios. Our recent purchases of Euromoney and Johnson Matthey we see as good examples of this and we will continue to add to selected holdings at attractive prices and rotate out of problem stocks into better quality plays, thus upgrading the portfolio as we go. A key benefit we have had from our changed working lives is that our access to companies has rarely been greater and the conversations are now far more open and frank. These discussions are affording us opportunities to reassess existing holdings quickly whilst opening up a range of new ideas.

We would expect markets to remain volatile and subject to disappointment over the summer. Whilst investors have begun to look through the virus impact on short-term numbers, results in the second half of 2020 may bring a reality check. Concerns over rising COVID-19 cases as economies begin to reopen and rising unemployment once the furlough schemes are withdrawn may also impact sentiment. There will be many more corporate failures as a result of this crisis, and it will be interesting to see if M&A activity picks up during the downturn given the substantial cash resources available to private equity funds

In conclusion, we see great scope for the Fund to continue the initial recovery seen during the second quarter given the low levels of valuation in the portfolio. The ongoing challenges are clear but our immediate focus is to continue to rebuild some of the capital lost so far in 2020 ahead of a meaningful improvement in income during 2021. We shall remain focussed but open minded in our approach and we believe that our flexible, ‘multi-cap’ approach will serve the fund and our investors well over the longer term.

Thank you for your continued support during these challenging times. We 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.

Scott McKenzie, David Clark
8th July 2020

Important information:
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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 – 8th July 2020