TB Saracen Global Income and Growth Fund

Quarterly Review – December 2020

Signatory of: PRI Principles for Responsible Investment

FOR PROFESSIONAL INVESTORS ONLY-

Retail investors should consult their financial advisers

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	TB SGIG	Sector Avarge	Quartile
Q4 2020	+12.2%	+8.7%	1

Source: Saracen Fund Managers as of 31 December 2020

More fun in '21!

In our previous Quarterly we noted, ("*With unusual prescience!" - Ed*.) that by the end of the year "*we will have US Elections, a likely stimulus package from the new administration, perhaps more from Europe too, maybe a Brexit deal and potentially a vaccine to Covid as several Phase III Trials read out. The equity landscape might be quite different and potentially there is much in the above that is likely to be favourable to Value based investors.*"

Most of the above was achieved in the Quarter and equity markets responded accordingly. There is greater optimism on future growth and also fewer uncertainties facing investors. In this Quarterly we highlight the change in leadership towards the Value style as confidence in a global economic recovery gathers strength. It is our contention that this 'Value' rally has much further to go.

Introduction

May we stress at the outset that we never set out to have a pure Value style. We believe the price you pay is important and any decision to purchase should be based on a determination of likely future cash flow returns, compared to the purchase price. We actively screen out ‘value traps’ and search for organic growth.

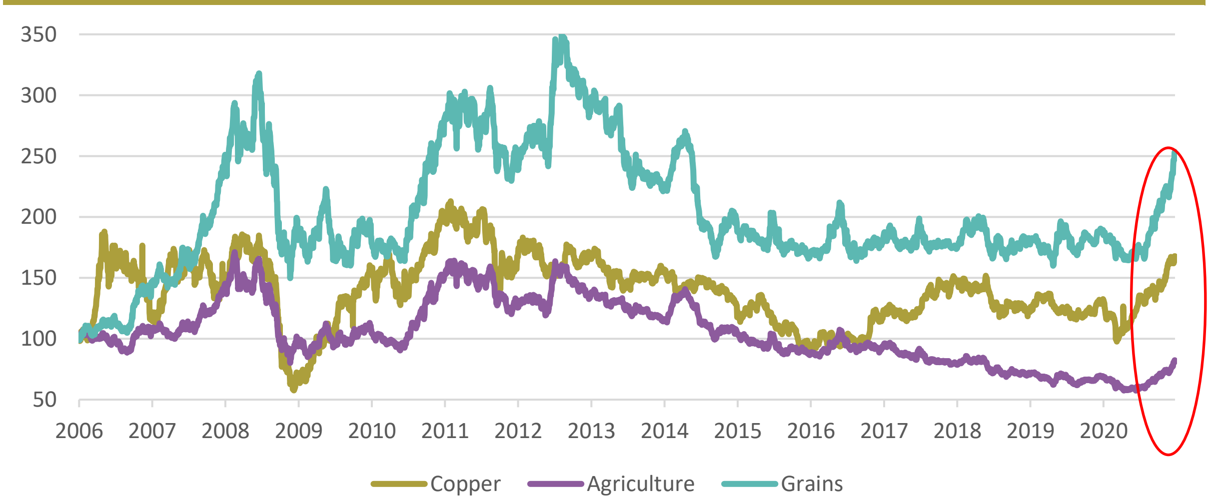
As a result, we normally sit in the GARP area, but due to extremes in the equity market, we find few businesses currently offering this characteristic. There is not much in the middle: growth appears very expensive against history and our forecast prospects, while value looks very cheap on the same measures. We also believe that a Sell Process is an important factor in investment management and risk control. Consequently, the TB Saracen Global Income & Growth fund has a much larger bias to ‘Value’ than most of the time in its 9 ½ year history.

In this Quarterly, in addition to covering the usual analysis of attribution, portfolio activity and sector weightings, we will also revisit our comments from last quarter on inflation and look at how much further the shift in style towards more cyclical and value-based investment has to run.

Inflation and Growth

One of the main factors typically required for a recovery in ‘Value’ is a rising yield curve. This results from the expectation of rising future inflation (usually from higher growth expectations). We have noted in previous Quarterlies the almost complete absence of inflation being considered as a risk by investors when contemplating investments. This position is slowly changing, but is still not taken as a serious concern, in our view. There is currently price pressure in both hard and soft commodities (see below).

Food and copper prices have begun to rise sharply



Source: Refinitiv Eikon

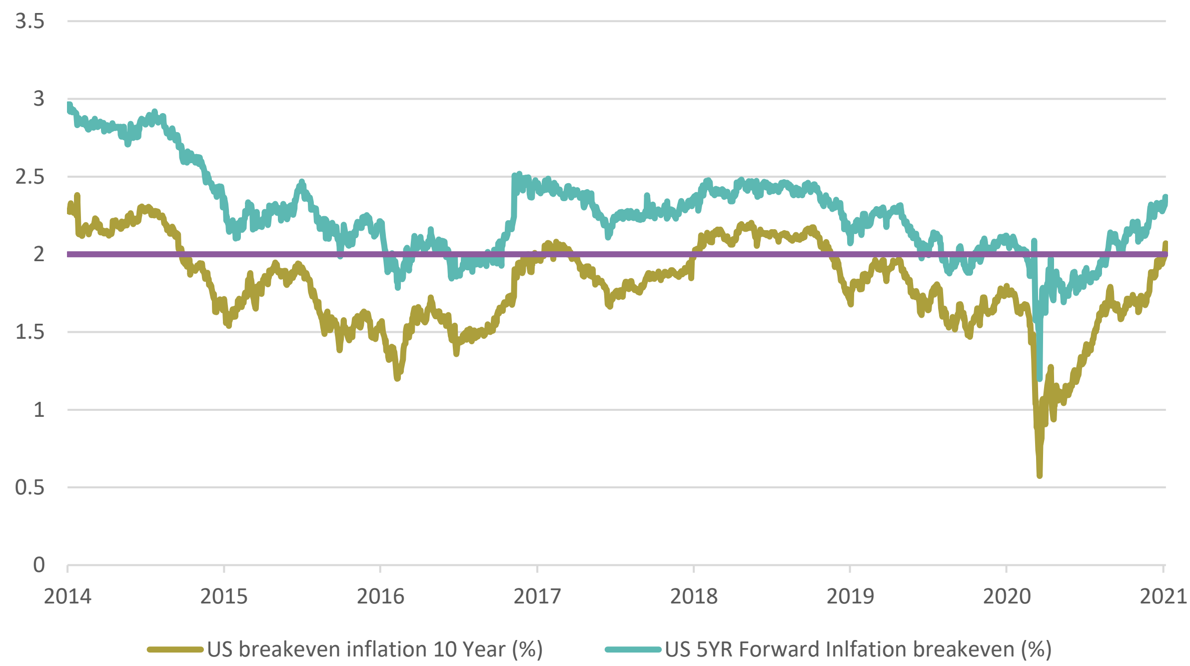
The question remains, ‘Are the price rises we are currently experiencing the result of a healthy reflation, post the Covid crisis, or is it the start of resurgent inflation?’

We have been used to the “Goldilocks” scenario, where growth has not been too high and productivity improvements etc have kept inflation in check. But what happens post a sharp recession, when governments massively expand money supply, increase debt and hold down interest rates to stimulate growth? Will they be able to restart the economy and will they be able to fine tune the levers to control inflation?

Those with memories of the 1970’s and 1980’s will remember how difficult it was for governments to subdue inflation once it got out of the bottle! With Democrats now having a clean sweep over the White House, Senate and House of Representatives, it is likely that the US will continue to increase public spending, adding to inflationary concerns.

Whether due to companies changing their supply lines, or due to shortages of skills and materials, inflation expectations for both the 5-year and 10-year periods now are around 2%.

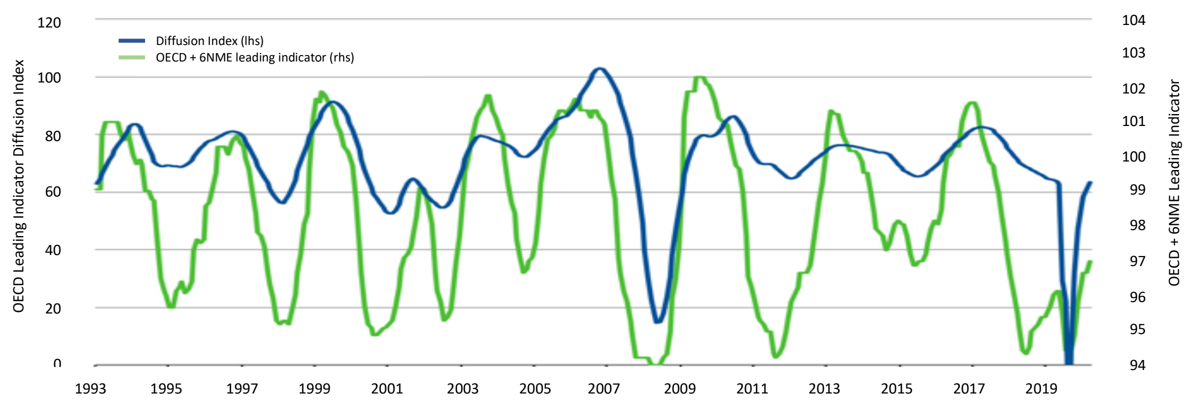
Higher inflation is almost universally expected



Source: Refinitiv Eikon

As can be seen in the chart below, leading indicators have turned up. If this momentum is maintained, as we expect, then it is likely that growth will accelerate as we come out of lockdown.

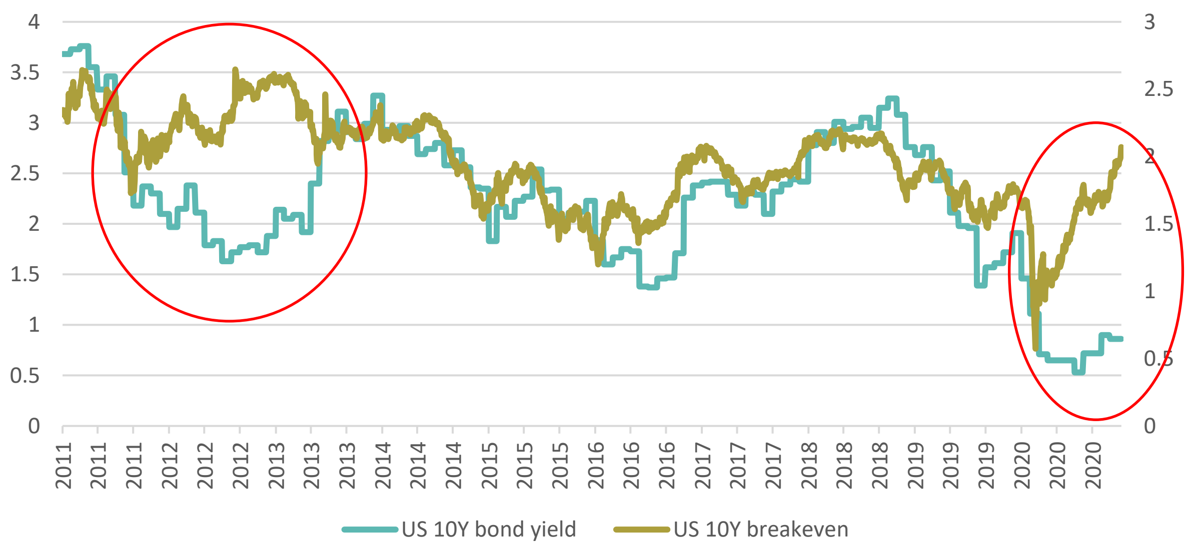
OECD leading indicators



Source: Liberum, Bloomberg
**OECD + 6NME = OECD plus 6 non-member states (Brazil, Russia, India, China, South Africa, Indonesia)*

Despite the huge fiscal stimulus and money supply expansion, it is notable that the 10-year bond yields remain flat. There is logically a close relationship between inflation and bond yields: this appears to have broken down at present. To re-connect, either inflation expectations will need to collapse along with real economic growth or bond yields will have to rise to meet rising inflationary expectations, or of course some combination of the above as per 2011-2013. The risk appears to be with bond yields. Further steepening would likely be supportive to banks and cyclical businesses.

US 10Y breakeven and 10Y bond yield (%)



Source: Refinitiv Eikon

Our contention remains, that global growth is picking up and will be sustainable. There has been a notable improvement in the performance of more economically cyclical, 'Value' and financial shares. Valuations remain attractive and the chart below puts this rally into context. We believe that this has much further to run and it is possible that businesses will be re-rated into rising earnings.

Value vs Growth Valuation

Source: MSCI, Morgan Stanley Research

Performance Review

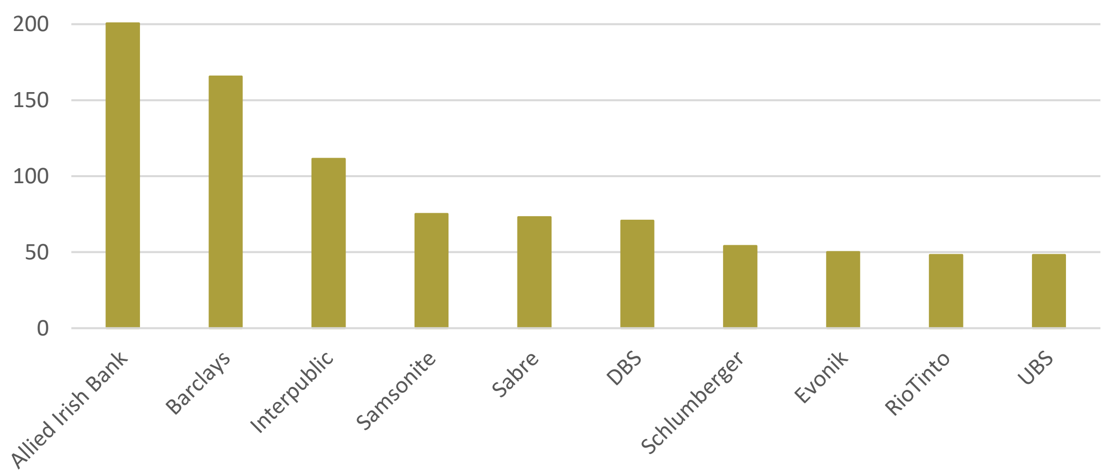
Cumulative Performance after all ongoing charges to 31 December 2020

	1 month	3 months	1 year	3 years	5 years	Since launch*
TB SGIG B Acc	+1.6%	+12.2%	-3.7%	-1.6%	+43%	+105%
Sector Average	+1.6%	+8.7%	+3.3%	+15.4%	+57%	+117%
Quartile Ranking	2	1	4	4	3	3

*Source: Financial Express; *launch date 7 June 2011Sector: IA Sector (Global Equity Income)*

With the rotation in the equity market the fund had a strong finish to the year. Value strongly outperformed Growth in Q4, as did financials and more economically cyclical businesses.

Positive Contributors



Source: Refinitiv Eikon, Saracen Fund Managers

Cyclical companies were the main positive contributors to the fund's performance in Q4 following the approval of the Pfizer COVID-19 vaccine in November. During Q4 banks finally started to outperform as results across the board were better than feared. Most importantly, impairments and provisions were lower than expected. Many banks also indicated they will be ready to pay a dividend as soon as regulatory restrictions are lifted. **Allied Irish Bank** (+85%) and **Barclays** (+52%) also benefitted from a last-minute Brexit deal between the UK and the EU in December. **DBS** (+26%) and **UBS** (+23%) contributed nicely, too. Despite these big moves we still see plenty of upside in our financial holdings and our exposure remains close to our 20% sector limit.

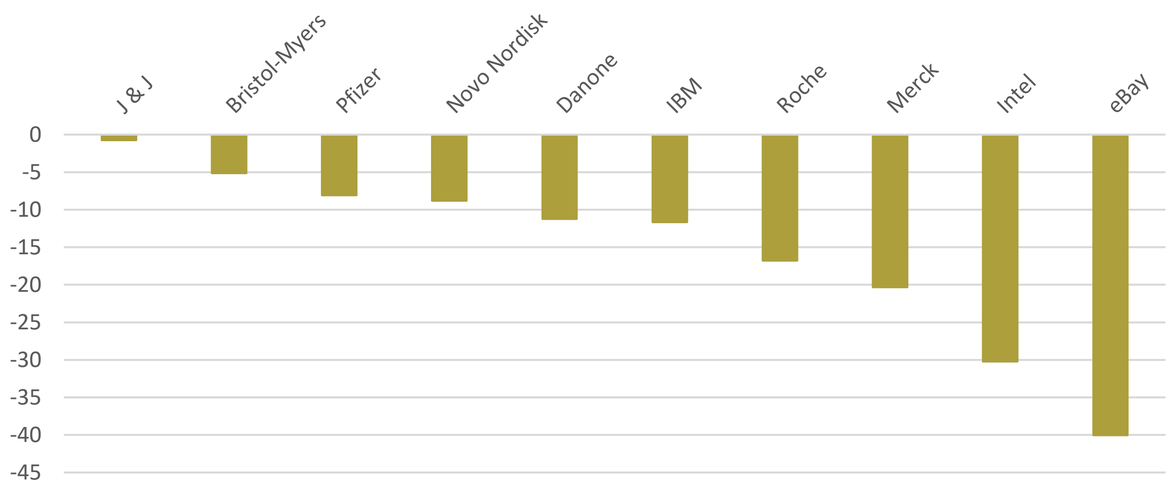
Interpublic (+41%) reported Q3 results, 60% above expectations, outperforming peers in a resilient US market. The company also announced a new CEO as of January 2021. Interpublic is still attractively valued at 14.4x Y1 PE with a 4.4% yield.

Travel related names like **Samsonite** (+76%) and **Sabre** (+86%) saw a huge bounce after the vaccine approval and as the market started to look through to the end of the pandemic. Although both companies still look attractive in the long run, we took some profits in the short term to keep each position around 1% of the portfolio, due to the potential wide range of our forecast outcomes.

Industrial companies benefited from the expectations for economic upswing in 2021 and the approval of European and US stimulus packages towards the end of the quarter. **Schlumberger** (+40%) rallied with the oil price (+26%) while **Rio Tinto** (+18%) followed the Iron Ore price higher. Rio Tinto is still trading below 10x 2021 PE with a 6.4% yield.

Evonik (+21%) raised its FCF guidance again with Q3 results and confirmed that Q4 began strongly. The market is also getting more enthusiastic with Evonik's strategy of becoming less cyclical and is willing to put a higher multiple on the shares.

Negative Contributors



Source: Refinitiv Eikon, Saracen Fund Managers

eBay (4%) suffered as stay at home beneficiaries gave up some previous gains after the approval of the Pfizer vaccine. However, at 14.3x 2021 PE we believe eBay remains very cheap and we used the weakness in the share price to increase our holding.

More defensive holdings in Staples and Healthcare sectors lagged the market rally. **Danone** (-2%) made the surprise announcement of replacing its CFO and reported underwhelming Q3 sales, down 2.5% organically. Management announced a strategic review of all products, brands and assets; something we were hoping for and factored into our analysis. We see tremendous earnings and valuation upside potential and again used the weakness to increase our position.

Pharma holdings (**Merck** (-2%), **Roche** (-2%), **Novo Nordisk** (-3%), **Pfizer** (+2%) and **Bristol-Myers Squibb** (+3%)) all underperformed a very strong market. The weaker USD against Sterling was also a negative.

Our technology holdings saw profit taking at the start of the quarter. **Intel** (-5%) continued to struggle as it reported Q3 gross margins below expectations and under pressure. Intel claimed to have made some progress with fixing the delayed 7nm chip production, but were still considering outsourcing some of the manufacturing.

We believe Intel's market leadership position and R&D firing power is underappreciated. While there are some short-term headwinds, the long-term trend of growth in data remains unchanged. The potential to outsource could actually help gross margins in the long term. At the end of the quarter Third Point, an activist investor, declared an interest in the equity and highlighted necessary changes to unlock the long-term value. We view this intervention as an encouraging sign and expect some positive changes throughout 2021, which are not reflected in Intel's valuation of 11x 2021 PE.

Portfolio Changes

After making numerous changes to the portfolio in March and given the significant upside to many of our current holding, we made very limited adjustments to the portfolio during the quarter. We do not expect to make many major changes unless there is significant share price volatility. Most of the investments in the portfolio have some way to go before we estimate they are near fair value.

We are often asked why we rarely buy IPOs. We prefer the security of investing in global leading businesses with a track record of success, profitability and cash flow to pay dividends. IPOs rarely have these attributes and valuations often require investors to take their dynamic growth prospects on trust.

Throughout the quarter took profits in strongly performing cyclical shares like **Saint Gobain**, **Rockwell**, **Rio Tinto**, **DuPont**, **Fuchs Petrolub** and **Evonik**. The bounce in financial shares meant we had to top-slice holdings to maintain our 20% sector limit. We used proceeds to initiate a new position in **RELX** and increased holdings in laggards such as **Chevron**, **General Dynamics**, **Michelin** and **Wienerberger**. We also added to our positions in **Cisco**, **Danone**, **Roche** and **Novo Nordisk** on valuation grounds.

We have owned **RELX** (or Reed Elsevier as it was known then) in the past and have researched the company for years. It has remained on our Wish List due to its sustainable revenue growth, cash conversion, progressive dividend payments, healthy balance sheet and strong ROIC. The areas where RELX operates have long-term attractions. Within its four divisions it is exposed to academic research and the publication of high-end journals (STM), Risk & Business Analytics, Legal Analytics and Exhibitions. The Data Analytics side in particular offers strong growth potential, due to the ever more complex world we live in and the need of companies to have a greater understanding of their customer bases.

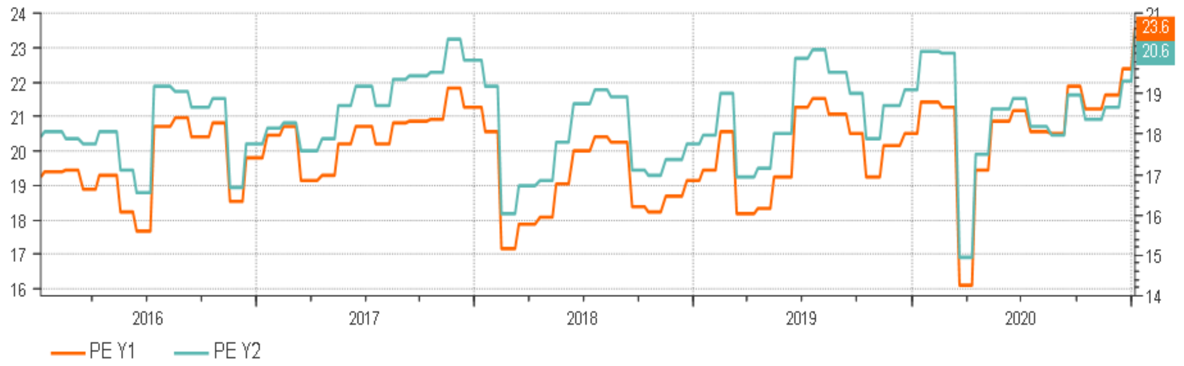
We delayed purchasing shares for two reasons, namely; we wanted to fully understand the risks attached with regards to a shift in business model in the STM division from ‘subscription only’ to ‘open access’. Secondly, we required a greater certainty of the downside risks to our earnings forecasts.

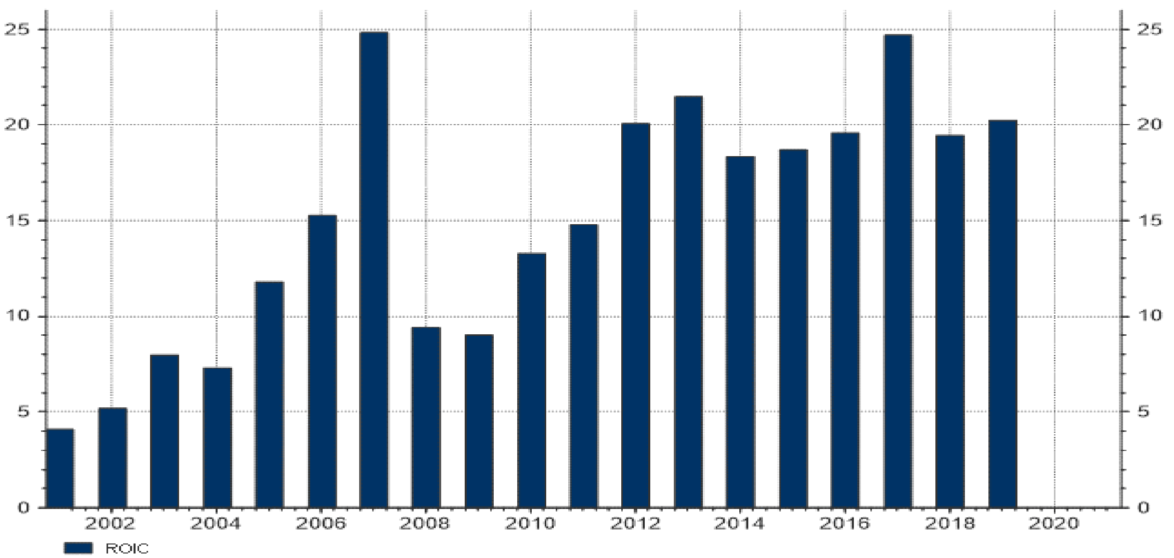
After various contacts with the company in recent months we improved our understanding of RELX’s strategy and became more comfortable in the outlook for academic journals. In addition, the appointment of a new divisional CEO has led to a change on RELX’s position in contract negotiations. Since then, we have seen one dispute with the Dutch universities settled and we expect the two main outstanding contracts in Germany and the University of California to be resolved in due course.

The perceived risks have impacted valuation in recent years and led to a derating of RELX shares. In addition, in 2020 the Corona virus has adversely impacted the Exhibition division. It is our belief that the demand for physical exhibitions will return fairly quickly once restrictions are lifted. During this crisis RELX has experimented with virtual exhibitions and the uptake has been surprisingly positive.

We like to buy high quality businesses at attractive valuations. With our increased comfort in RELX’s strategy, especially within STM, we felt that RELX shares had reached a buying level with the 2021 PE ratio below 17x on our estimates. At the same time the dividend yield is a solid 2.5% and the company has avoided a dividend cut during 2020. Additionally, the ROIC profile remains strong at close to 20%. We initiated a 1.5% position, which we will increase on any share price weakness.

RELX





Source: Refinitiv

SGIG Portfolio strategy and valuations

The last two years have been testing for us and our clients. However, we have a clear investment philosophy and have stuck to our process. There has been no style drift. It is encouraging that Q4 2020 finally brought some reward. As mentioned earlier, we expect an economic recovery in 2021 as with the help of vaccines, life returns to normality. With governments and Central Banks all committed to growth we expect the recovery to be sustainable. This will likely lead to inflationary pressure and higher bond yields, which will be beneficial for cyclical companies and financials.

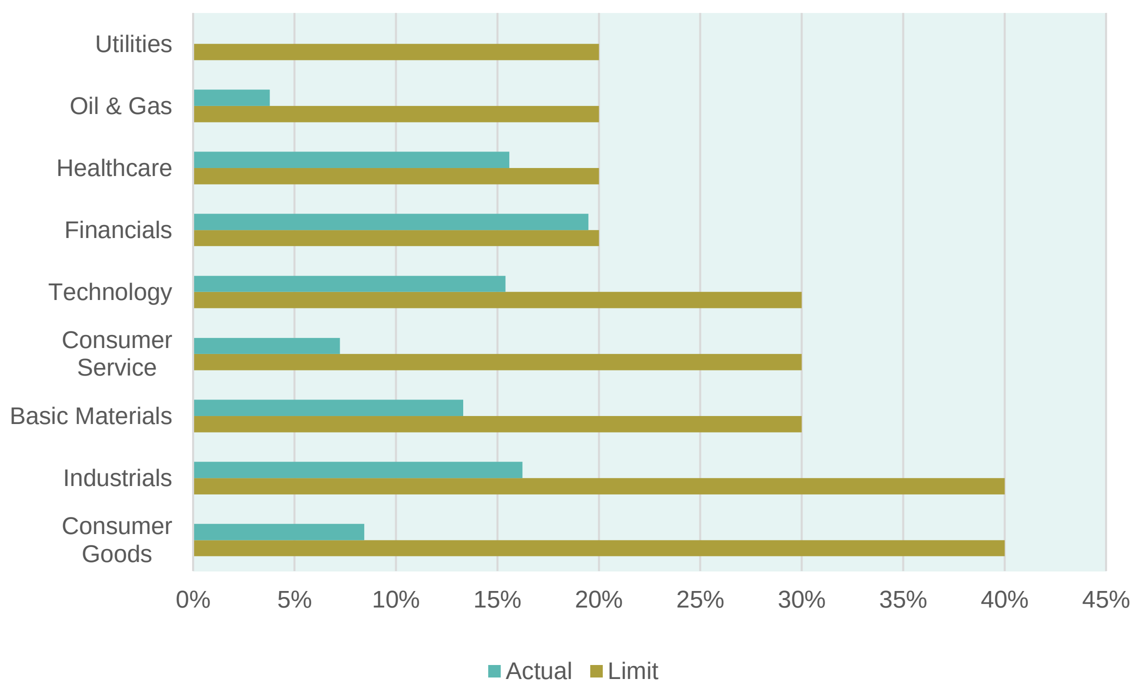
We, therefore, retain large weightings in selective companies that are classified in the following sectors:

- **Industrials**
- **Basic Materials**
- **Financials**
- **Healthcare**

And we continue to find limited value in bond proxies like:

- **Consumer Staples** (expensive for expected growth)
- **Utilities** (limited growth and too much debt)
- **Telecoms** (limited growth and too much debt)

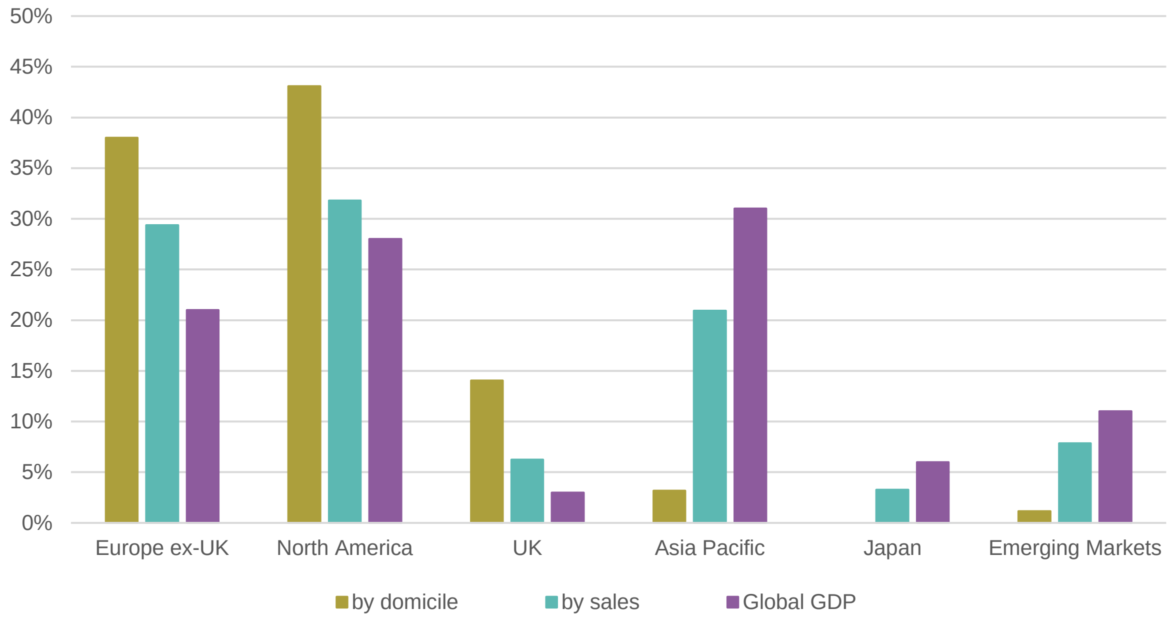
TB SGIG sector split



Source: Saracen Fund Managers as at 31/12/20

The fund's sales exposure remains closely aligned with global GDP distribution:

TB SGIG geographical split



Source: Saracen Fund Managers as at 31/12/20

The fund remains cheap on all metrics. The table below highlights its value characteristics. It is important to point out that there has been no style drift with the fund. It remains firmly in the large cap value bucket. This fund will do very well during a cyclical upturn.

SGIG value characteristics versus FTSE All World index

Characteristic	TB SGIG	FTSE All World	+/-
Best P/E 1Y FWD	13.4	16.7	-3.3
Best Dividend Yield 1Y FWD	3.5%	2.7%	+0.8
Best P/CF 1Y FWD	9.9	23.1	-13.2
Best P/B 1Y FWD	1.65	1.8	-0.2

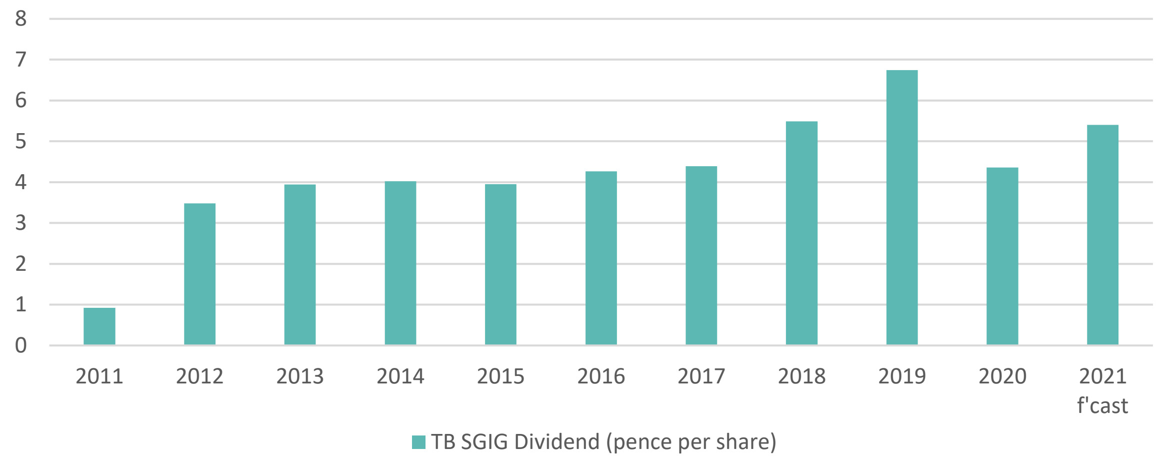
Source: Refinitiv 31/12/20

Dividend

We pride ourselves on having grown the dividend every year since the fund was launched in June 2011. However, as we have made clear since March, the impact of COVID-19 and the reaction from some Governments and Regulatory authorities across the globe meant that the fund's dividend would fall in 2020.

The fund declared a final dividend of 1.84p. The total dividend for the year is 4.36p which equates to an historic yield on the fund of 2.8%. This dividend is lower than we expected, partly due to the strength of Sterling, especially in H2 and partly due to banks still being prohibited from distributing earnings.

TB SGIG Dividend



Source: Saracen Fund Managers, Refinitiv as at 31/12/20

We expect the decline in income to be temporary given the unprecedented degree of fiscal and monetary stimulus, which should create a strong rebound when the lockdowns are removed. Looking into 2021 we would also expect any regulatory ban on banks to pay a dividend to be lifted, or at least diluted. Indeed, we view the overwhelming majority of the dividend cuts as temporary and expect payments to normalise in 2021. **We expect the fund to yield approximately 3.5% based on our 2021 forecasts.** This would not only represent significant year on year growth (+24%) but also compares favourably against the wider equity market and bonds.

Investment Approach

TB Saracen Global Income & Growth Fund aims to provide a long-term return from investing in a portfolio of low risk, highly liquid global equity securities. There is an explicit recognition that income is an important factor for many investors and a significant contributor to long-term investment returns.

We have a focussed and highly differentiated portfolio of 40-60 quoted global companies, a high conviction fund with a significant active share, which is currently 95%. There is no formal benchmark for the fund, although we do report performance against the IA Global Equity Income Sector.

We aim to invest in global-leading businesses which can sustainably grow their revenues, their profits and ultimately, their dividends. We are attracted to businesses which have high and sustainable margin profiles, create value by generating a return on investment above the weighted average cost of capital and have a strong Balance Sheet. We also like to see directors owning shares in the business and being remunerated on total shareholder returns as opposed to an earnings-per-share measure, which can be easily manipulated. However, the most important things that we look for in an investment are an attractive valuation and a starting yield of more than 2%. We don't simply buy great businesses at any price - they must be demonstrably cheap!

Our Wish List for Companies

- Global Leading Businesses
- Long-term revenue growth potential
- Positive return on equity spread
- Sustainable margins
- Strong Balance Sheet
- Acceptable Worst Case (extent and likelihood)
- **Attractive valuation and starting dividend yield more than 2%**
- Alignment of interest with directors

We have a long-term approach and the turnover in the fund has, on average, been less than 20% per annum since the fund was launched.

Outlook

We believe we have a portfolio of high-quality businesses that are significantly undervalued given our estimate of their prospects. Equity markets have bounced due to increasing certainty around Brexit, US elections and particularly the roll-out of Covid-19 vaccines. Sentiment remains fragile and any delay in vaccine roll-out or genetic changes to the virus that reduce efficacy would be taken poorly.

Nevertheless, it would appear that we are in the final phase of the pandemic and news-flow should begin to improve in the coming weeks.

We continue to be optimistic that the underlying pent-up demand from individuals and actions by governments will stimulate a recovery in economic growth. Consequently, we retain a portfolio bias to more economically cyclical businesses and remain near our maximum weighting in financials.

Many of our holdings are still cheap compared to their history and our view of their prospects. The recovery in 'Value' potentially has a long way to go and we believe many investments have the potential to be re-rated into rising earnings.

We also have seen a noticeable pick up in M&A and activists buying stakes in companies that are out of favour, many of them at the value end of the market. It is becoming clear that if the market doesn't recognise the true worth of these companies, there are others who will.

Thank you for your continued support and patience during these challenging times. We hope you and your families stay safe and you are able to have more fun and prosperity in 2021!

Graham Campbell
Bettina Edmondston

31st December 2020

For further information on TB Saracen Global Income and Growth Fund please contact:

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