TB Saracen Global Income and Growth Fund

Quarterly Review – March 2021

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 Average	Quartile
Q1 2021	+11.5%	+5.0%	1

Source: Saracen Fund Managers as of 31 March 2021

Back to Life, Back to Normality

Cyclical and Value orientated shares have had a strong run over the past 6 months. A rising tide lifts all boats: from here we expect progress to be more modest and more company specific. Stock picking will become important again. We suspect that there is still some way to go for undervalued shares.

Some of the comments we made at the end of Q3 2020 on inflation and the likely sharp rebound in economic growth are now consensual. Rising bond yields have boosted banks and more economically cyclical business. It is perhaps surprising that ‘growth’ shares are still near peak levels despite the previous narrative of their premium ratings being justified due to lower growth elsewhere. With tougher comparatives ahead and economic activity accelerating, we expect this to be the final domino to fall.

In this quarterly, we aim to spend more time on current holdings and aim to explain why, despite a considerably rally, we think many shares remain considerably undervalued.

Background

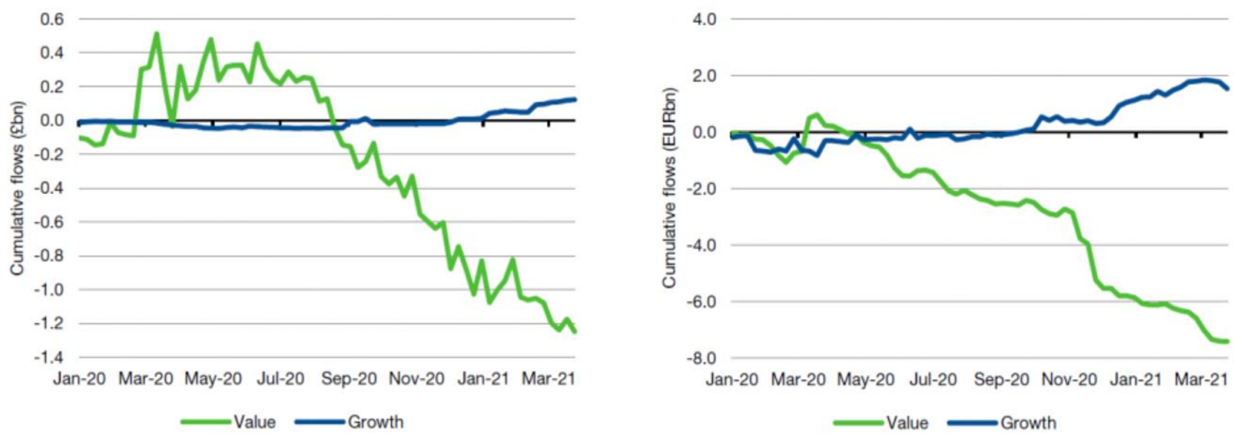
The key feature over the quarter has been the increase in bond yields in expectation of improving economic activity. As anticipated, this has benefited the more value and cyclical orientated shares. While the short-term bounce has been impressive, the chart below puts this into perspective. Relative valuations still remain around TMT bubble levels.

Value vs Growth Valuation

Source: MSCI, Morgan Stanley Research

Furthermore, it would appear that while Value shares have bounced, funds flows remain firmly growth focussed for now.

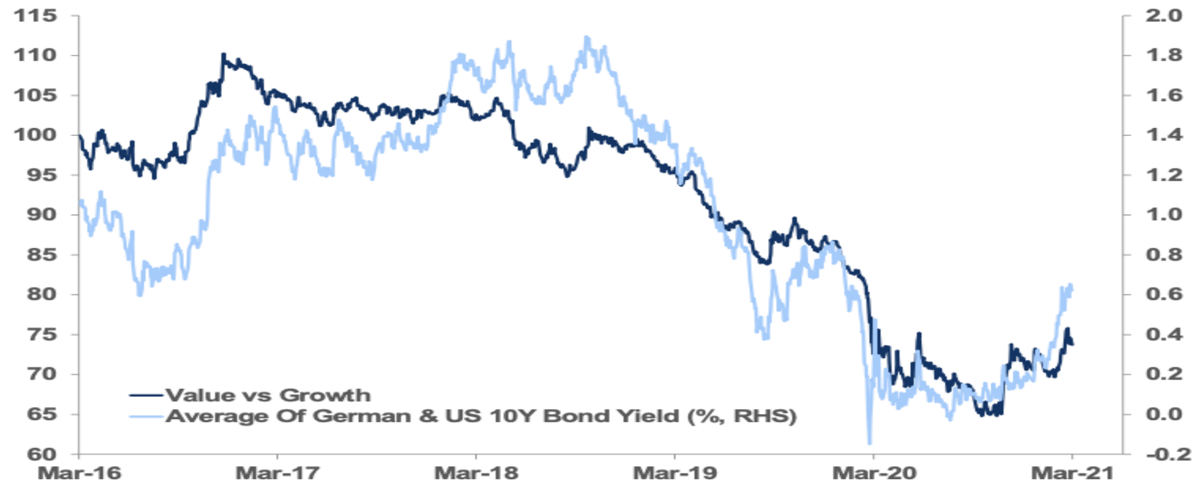
Value vs Growth Fund Flows in the UK and Eurozone



Source: Liberum, Bloomberg

There are always several narratives that appear logical to explaining historic share price movements. Many of the 'Growth' shares are seen as game-changing with demand for their products almost inelastic. It was also suggested that with depressed earnings elsewhere, it was logical that investors would pay higher premiums for growth, where it existed. There appeared to be a strong inverse correlation with bond yields that appeared to support this. As can been seen in the chart below, the recent rise in bond yields has improved the respective performance of 'Value', but there still appears some way to close the gap and for bond yields themselves to move closer to long term 'average'.

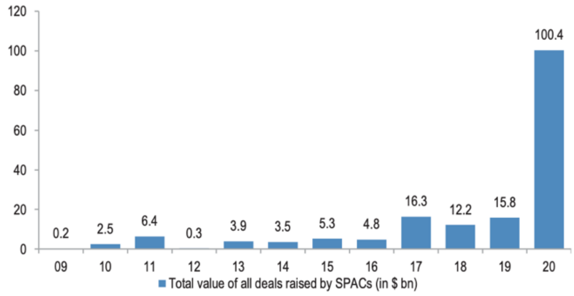
Value vs Growth performance relative to Bond Yields



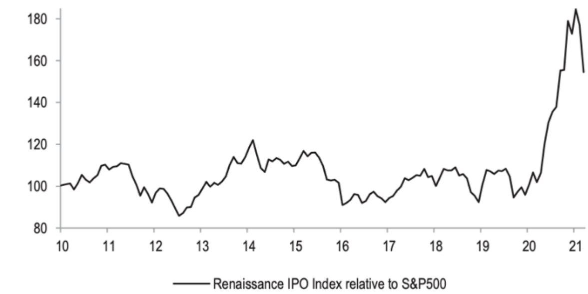
Source: MSCI, Refinitiv, Morgan Stanley Research

In the charts below we have shown the funds raised from special purpose acquisition vehicles (SPACs) and the IPO index. In our brief glance at some of the prospectuses, many companies were loss-making and valuations were 'aspirational'. Perhaps the Deliveroo IPO was a sign of a more cautious investor environment. As populations are released from lockdown, some of the like-for like numbers that were supportive during this period, may appear more challenging in the year ahead.

SPAC – total amount raised



Renaissance IPO Index rel to S&P500

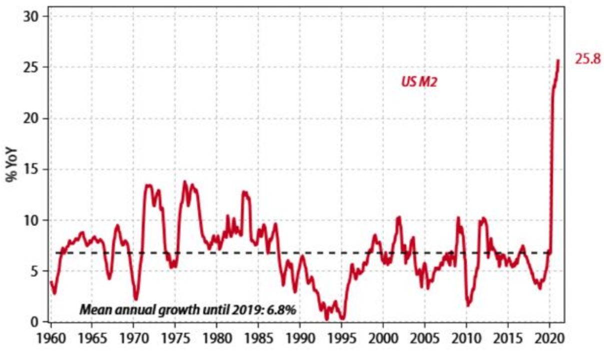


Source: Bloomberg, JPMorgan

The current environment of improving growth, higher bond yields and rising inflation expectations is a supportive backdrop for equities, particularly the more cyclical and value orientated. Earnings momentum against very weak comparables is likely to provide a tailwind.

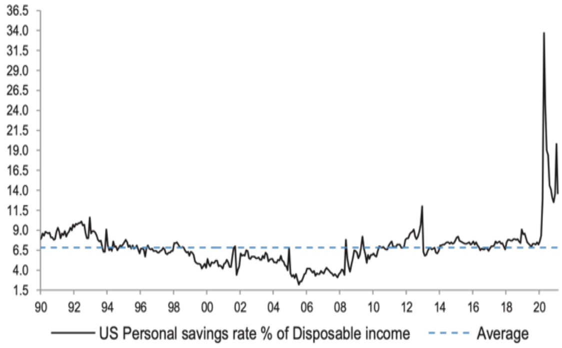
There will be a pick-up in demand, bolstered by strong government and Central Bank policy support and a high domestic saving ratio that could lead to some punchy growth (and maybe even some fun!) when we are released from lockdown.

US broad money aggregate: M2 growth



Source: Gavekal Research / Macrobond

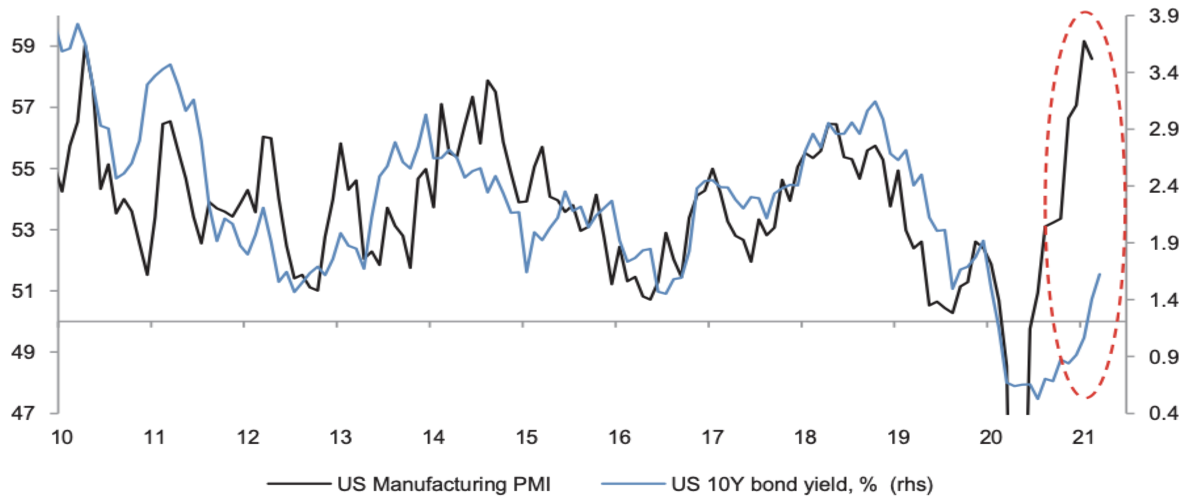
US savings rate



Source: Bloomberg, JPMorgan

The chart below, highlights the relationship between PMI and bond yields. The gap suggests that either growth will slow, bond yields will continue to rise, or some combination of the two. It feels as if the risk balance remains with bond yields!

US Manufacturing PMI and US 10Y bond yield



Source: Bloomberg, JPMorgan

Not all 'Value' shares will prosper under inflation, which implies higher long-term interest rates. It is likely to be good news for banks but bad for businesses with weak balance sheets and high indebtedness.

For what it's worth, we are finding few cyclical businesses that remain attractive and over the quarter have top-sliced some where we feel the valuation and yield is no longer as supportive as they were 6 months ago.

Before we go into the bulk of the Quarterly, we wanted to comment on the losses incurred by Archegos Capital on investment banks, which amounted to $4.7bn in the case of Credit Suisse. Two points came to mind: -

1. Do they never learn? Do some banks still not know their customers and prefer to chase short-term profits, without understanding the potential risks. At least they sacked their Chief Risk and Compliance Officer!

2. I was reminded of Buffett's views on margin trading: "if you're smart you don't need it and if you're dumb you shouldn't be doing it!"

As we have stated before, banks are leveraged businesses and we actively screen out the weak and those actively growing their Risk Weighted Assets. It's a sector where we only buy quality at attractive prices. Despite the substantial rise in share prices, valuations remain appealing and our sector weighting is close to its 20% limit.

In this Quarterly, in addition to covering the usual analysis of attribution, portfolio activity and sector weightings, we will also highlight some of the investments where we still see significant valuation opportunities, even although in some cases the shares have doubled from their lows.

Performance Review

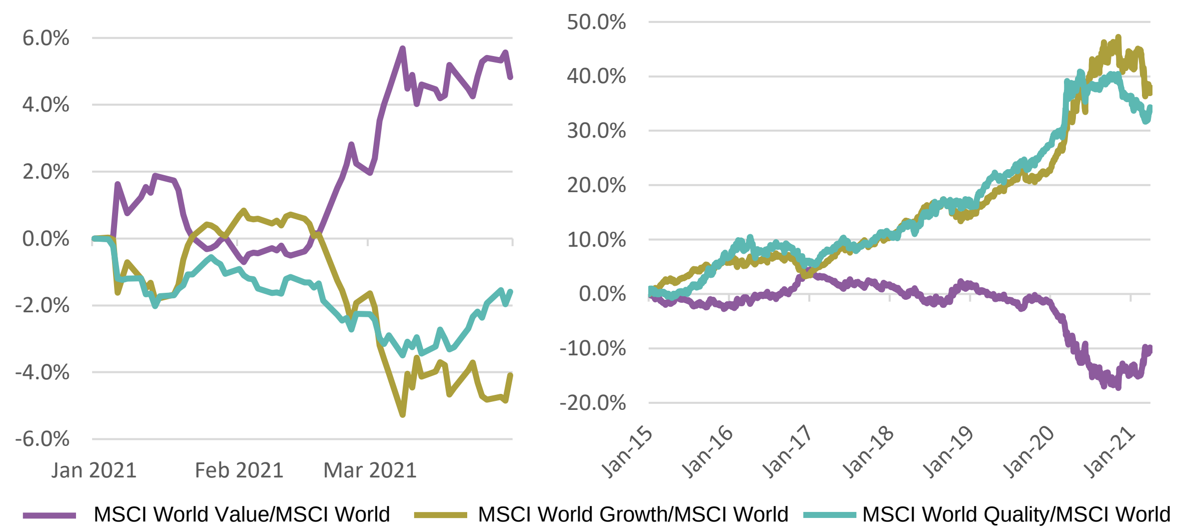
Cumulative Performance after all ongoing charges to 31 March 2021

	1 month	3 months	1 year	3 years	5 years	Since launch*
TB SGIG B Acc	+6.5%	+11.5%	+42.5%	+17.7%	+57.4%	+130%
Sector Average	+5.0%	+5.0%	+32.0%	+29.2%	+59.8%	+128%
Quartile Ranking	1	1	1	4	3	3

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

The start to 2021 could not have been any more different to last year's. US Treasury yields have rallied from below 1% to 1.7%: although still not quite back to pre-Covid levels. Inflation pressures, something we warned of in Q3 2020, are now almost consensual. Expensive technology names that were the outperformers last year underperformed YTD. This all led to Value shares outperforming Growth by almost 9% this quarter.

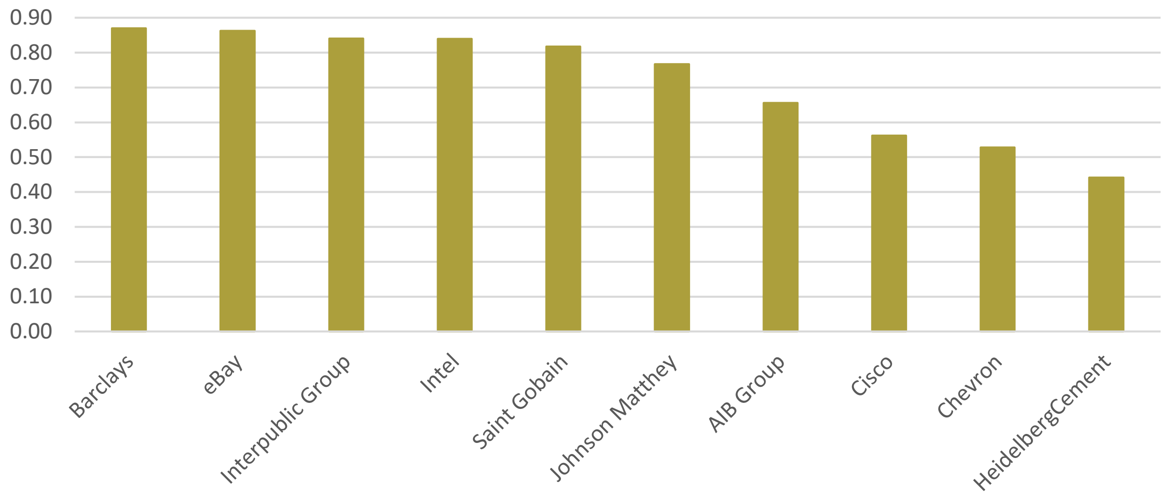
Relative performance of Value, Quality & Growth in Q1 21 & over the last 6 years



Source: Refinitiv Eikon

We have been waiting for this for a long time and although the move is quite stark in the short term, we believe it is only the start of a long outperformance of Value. Going back to the beginning of 2015 demonstrates the potential catch-up Value still has to return to parity.

Positive Contributors (in bps)



Source: Refinitiv Eikon

Despite very strong rebounds from last year many of our top performers still look attractively valued. We will expand on a few names here in more detail than usual.

During Q1, most of our holdings reported better than expected FY20 results and surprised on the upside with guidance. **Barclays** (+27%) was in this category. It also reinstated a small dividend combined with a £0.7bn share buyback program. **AIB** (+33%) also looks to resume normal dividend distributions in line with regulatory guidelines in 2021. Barclays and AIB have now rallied 132% and 189% respectively since their lows in March last year. Both businesses have capital buffers above regulatory capital requirements and trade respectively at 0.55x* and 0.5x* of their book values. We believe these valuations do not reflect the growth potential these high quality banks have in an environment of rising inflation and interest rates.

eBay (+22%) reassured the market that it can continue to grow after the pandemic. Although there is not much visibility in terms of volumes beyond Q1, a higher take-rate per transaction and moving most payments from third party providers in-house will drive both top line revenues and margins in years to come. We have taken advantage of the strong share price and trimmed our position slightly during the quarter. But due to its undemanding valuation of 15x 21 PE* and our long-term positive outlook for the company it is still within our top five holdings.

Interpublic (+24%) continues to outperform the competition due to its higher exposure to US and Healthcare advertising. Interpublic was also a front runner in integrating data analysis in its client meetings. With the acquisition of Acxiom in 2018 it has a unique approach to client data analysis and CRM work I offers to clients. We believe the company will benefit from a strong rebound in advertising, especially online, in 2021. Additionally, we expect the integrated model and cost savings to drive margins in coming years. Management's confidence was reflected in a 6% dividend increase. Despite the shares' strong run (+133% since the lows in March 2020 and +17% vs. pre-Covid levels) the valuation is still attractive at 15.2x 2021 PE* with a 3.7% dividend yield*. It is still one of our top five holdings.

Intel (+29%) for once reported better than expected numbers. But most importantly the market took comfort from the incoming CEO who is looking to re-establish Intel as the leader in chip design and manufacturing. The first signs are already visible in management's expectations that the majority of its 2023 products will be sourced internally with its 7nm process. Intel increased its capex spend for the next few years in order to build two manufacturing sites in the US. These will be used both for internal production and foundry manufacturing. The new CEO is rebuilding investor confidence and the share valuation remains attractive on 13.8x consensus earnings.

Cisco (+16%) rose as expectations for IT spending increased with the gradual return to the office.

The cyclical tilt of the portfolio was beneficial to the fund's performance on the expectation of a global economic rebound. **Saint Gobain** (+34%) noted in January that 2020 ended better than expected. The actual results showed strong margin progression, especially in North America and cash flow performance. Consequently, leverage was lower than expected and the company reinstated its dividend. On top of this, strong margin and FCF guidance for 2021 was taken positively by investors.

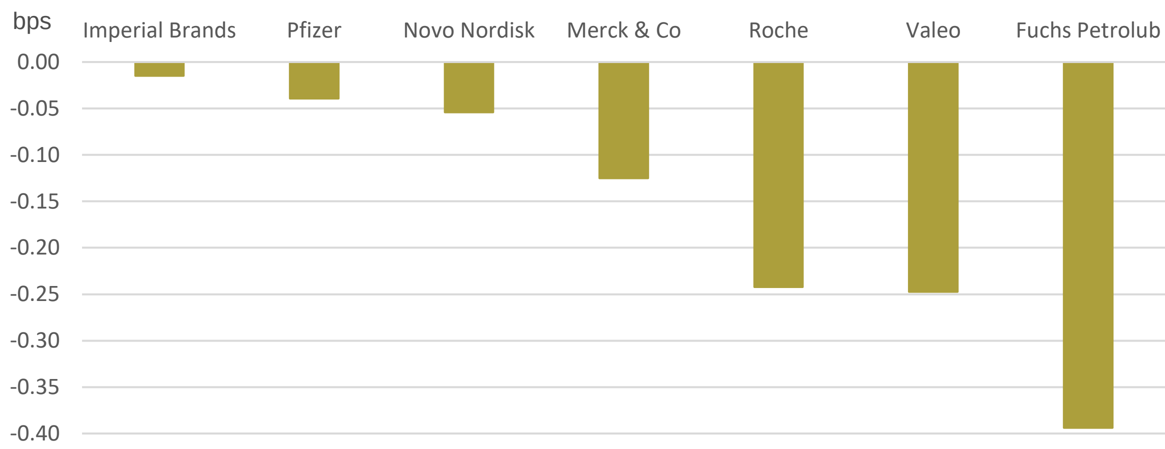
Market sentiment on **Johnson Matthey** (+24%) improved over the quarter. Investors were concerned about the company's exposure to auto catalysts, something we thought was over emphasised in JMAT's portfolio. During Q1 the narrative shifted as the company announced new capacity addition for coated catalyst membranes for use in Green Hydrogen production. This opens up a new and sustainable growth opportunity for JMAT which we believe is not reflected in its 14.4x March 2022 PE* valuation.

Just like other industrial names, **HeidelbergCement** (+27%) early on indicated that FY20 results were better than expected. Most importantly, the company reported a strong ROIC improvement and reinstated its dividend. Management was optimistic about the favourable trends in infrastructure and private residential, which bodes well for 2021 performance. Pre-Covid the shares used to trade around 10x Y1 PE*, in line with today's valuation. However, there have been quite some changes in management and strategy in the last few years. Heidelberg reduced its leverage from above 3x net debt/EBITDA in 2016 to less than 2x in 2020. Despite the various lockdowns last year the leverage was reduced further. The company implemented a strict cost control program with some of the savings being sustainable. At the start of 2021 management, headed by a new CEO, announced a range of targets for 2025. These include a 300bps increase in EBITDA margin versus 2019, ROIC sustainably above 8% and a leverage ratio target of between 1.5 and 2x. We expect Heidelberg's profitability to increase materially in coming years. This will feed through to higher cash flow and optionality for management. Additionally, Heidelberg also announced an industry leading target on carbon per tonne of cement. This should be seen as very positive, not just from an ESG perspective, but also from a profitability point of view. We therefore believe the shares should be on a higher rating going forward. And that is just based on the self-help the company is putting in place, not taking into account the positive economic outlook and the expected infrastructure spend in developed markets. None of this is reflected in the share price at the current valuation of 10.8x 2021 PE* with 3.1% yield*.

Chevron (+24%) rallied along with the oil price (+24%) on an improved economic outlook.

** Source: Refinitiv Eikon*

Negative Contributors (in bps)



Source: Refinitiv Eikon

There were only 7 names contributing negatively to the portfolio this quarter. Most of them sit in the defensive sectors which lagged the market and were also negatively impacted by FX.

Fuchs Petrolub (-9%) and **Valeo** (-10%) were the two outliers amongst our cyclical holdings experiencing some profit taking after a strong rally into the end of 2020. Fuchs is coming to the end of a multi-year investment cycle which should set it up for stronger margin and cash generation in the coming years, something that is not reflected in its valuation yet. Valeo couldn't sustain the strong performance from Q4 despite better-than-expected FY20 numbers, healthy order intake and FCF guidance that was ahead of consensus. 2021 revenue guidance was slightly disappointing but due to strong margin improvement the EBITDA guidance was in line.

Our defensive holdings were lagging slightly, in line with the market, and in most cases suffered from an FX headwind. **Roche** (-1.1%), **Merck** (-5.8%) and **Pfizer** (-1.6%) contributed slightly negatively to our performance. **Novo Nordisk** (+0.7%) was actually up in local currency but due to the strong Sterling against the Danish Krone had a negative impact on the portfolio.

Imperial Brands' (-2.8%) new CEO hosted his first Capital Markets Day where he reset the outlook for the next couple of years. 2022 will be a year of stabilising the core portfolio which should be followed by mid-single digit EBIT growth. The absence of a share buyback program hurt the share price and could not be offset by the 8%+ dividend yield.

Portfolio Changes

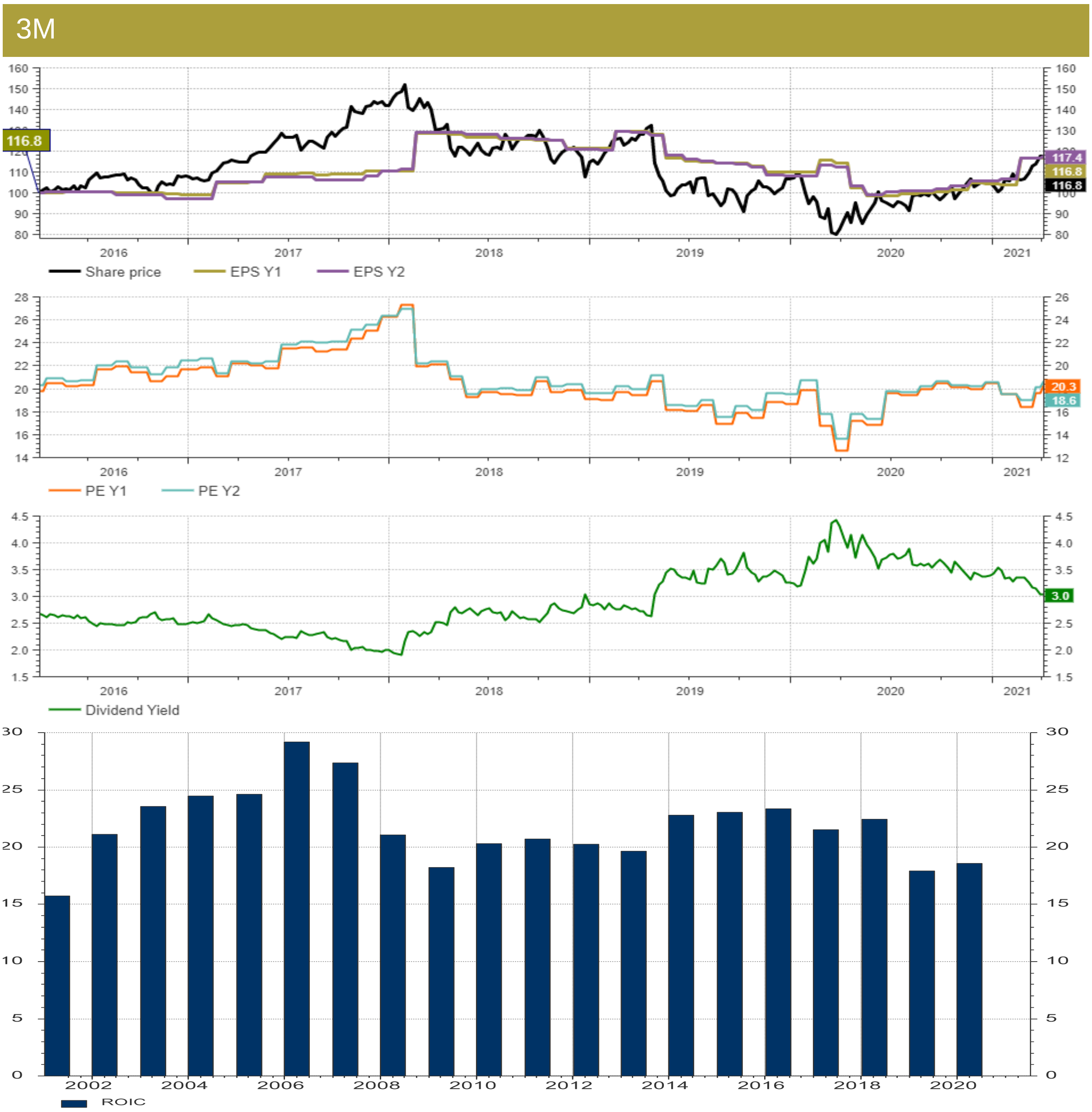
During January we initiated a position in 3M in the fund. We had researched 3M previously, but preferred to hold on to our position in DuPont where we saw value creation from the spinoff of various divisions. The latest was Nutrition & Bioscience, which merged with IFF at the end of January. Ahead of this disposal, DuPont shares rose strongly (+17% in the first two weeks of the year). It reached valuation levels which we thought were no longer justifiable, namely 31x 2021 PE* with a dividend yield below 1.5%*.

3M is a direct competitor to DuPont in many areas like automotive, electronics and construction. What drew us to 3M was the strong margin profile, cash generation, return on invested capital (close to 20%) and an uninterrupted 62-year history of dividend growth. Combined with its leading position in its fields and high investments in R&D (6% of sales) and capex (5% of sales), 3M attracted a premium to peers in the past.

However, this has evaporated in recent months. The rationale from investors was that 3M's 2020 performance was both better than expected and ahead of previous downturns. Consequently, the company would not see the usual early cycle rebound in 2021! We disagreed: the main reason it has outperformed peers operationally during the pandemic was the strong demand for its face masks. The company also managed to cut costs further than expected. Going forward, we would expect areas not exposed to face masks to recover meaningfully as economic growth picks up. We have already seen good signs of improvement in the auto aftermarket and home improvement areas as well as tentative signs in elective surgery. Additionally, we expect demand for face coverings to remain high for at least another year. Many of the cost savings will be recurring and we expect margins to further improve and remain well ahead of DuPont and other diversified chemical companies.

In short, we expect 3M's operational performance to pick up during 2021 and 2022. We also expect the shares to close the discount to their peer group. Below 17x 2021 PE* and with a 3.4% yield* we saw a great entry point into this high-quality name. We sold our holding in DuPont to finance the purchase.

** Source: Refinitiv Eikon*



Source: Refinitiv Eikon

During the quarter we sold our two travel exposed holdings; **Samsonite** and **Sabre**. Both names had a very strong rebound from their lows in March last year. Samsonite is up 188% over the year and reached pre pandemic levels. While we believe the company is managing the storm very well with cost cuttings the growth expectations appear stretched. In Sabre's case the shares rose 385% from their lows and again cost cutting will help the company in the long run. However, we felt uncomfortable about the leverage and the potential risk of an equity issuance. There is no dividend support to either share.

SGIG Portfolio strategy and valuations

The last two years have been testing for us and our clients. However, we have a clear investment strategy based on the price we pay for an investment and the potential growth. We have never wavered from this process and believed that valuation would return to the front of mind of investors. The recent quarter has strengthened our belief that we are at the start of a long awaited change in market leadership. As mentioned earlier, we expect an economic recovery in 2021 helped by government stimulus around the globe. This will lead to higher inflation and bond yields which will be beneficial for cyclical companies.

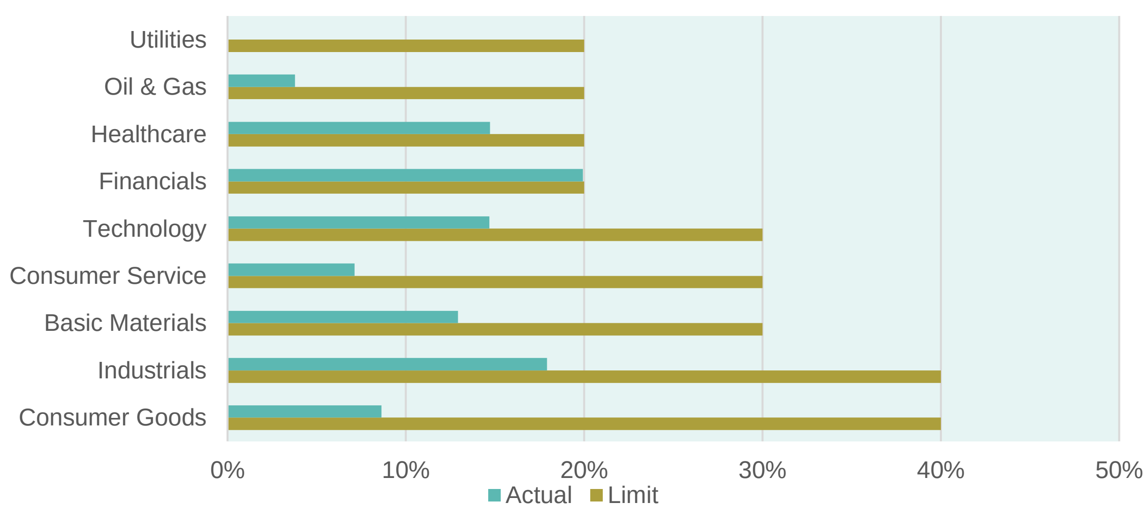
We, therefore, retain large weightings in selective companies that are classified in the following sectors:

- **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)

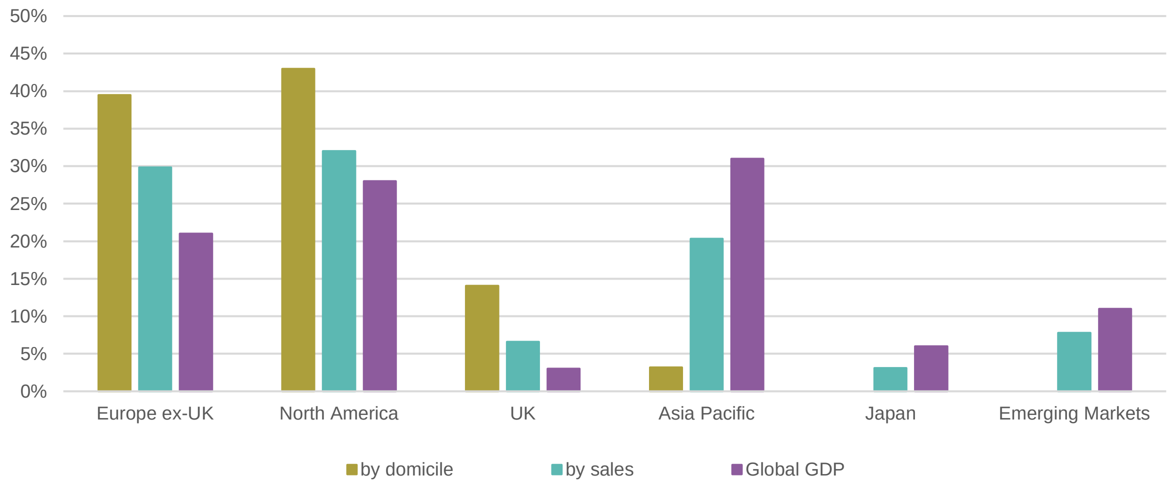
TB SGIG sector split



Source: Saracen Fund Managers as at 31/03/21

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

TB SGIG geographical split



Source: Saracen Fund Managers as at 31/03/21

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	+/-
P/E 1Y FWD	13.6	19.1	-5.5
Dividend Yield 1Y FWD	3.4%	1.6%	+1.8
P/CF 1Y FWD	10.6	35.5	-24.9
Net Debt/EBITDA 1Y FWD	1.33	2.53	-1.2
Return on Capital Employed	16.8%	14.2%	+2.6
Refinitiv ESG Score	77.4	67.8	+9.6

Source: Refinitiv 31/03/21

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 it is far too early to consider reducing exposure to many of the 'Value' businesses, as the shares still appear very attractive. The ongoing strength of the global economy from government and Central Bank stimulus and the prospect of higher inflation and bond yields is likely to remain supportive to their earnings.

In recent years valuations have resulted in the portfolio having a much larger 'Value' bias than say 3 years ago. We do not expect to make many changes in the Quarters ahead. We have always attempted to invest in growth businesses, but we remain disciplined on the price we will pay.

It appears that many cyclical businesses have anticipated/discounted a full recovery. As this may still take some time to play out progress is likely to be more modest and more company specific. We believe the portfolio is well placed to benefit in this scenario.

Thank you for your continued support. We hope you and your families stay safe and you are soon able to have more fun and prosperity in 2021!

Graham Campbell
Bettina Edmondston

31st March 2021

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

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