# TB Saracen UK Alpha Fund

## Quarterly Review – March 2021

FOR PROFESSIONAL INVESTORS ONLY-

Retail investors should consult their financial advisers

**David Clark**
**Investment Manager**

| | TB SUAF | MSCI UK All Cap (TR) | Quartile |
|---|---|---|---|
| **Q1 2021** | +9.5% | +5.5% | 1 |

*Source: Saracen Fund Managers as of 31st March 2021*

# The End of the Beginning

## Performance Summary

The first quarter of 2021 got off to a very good start and during all three months of the quarter the fund posted positive returns both on an absolute basis and on a relative basis. It is gratifying to have lapped the comparisons from March 2020 in good shape as that month was one to forget. The fund benefitted from its exposure to mid-cap and especially small cap stocks during the quarter as the FTSE 100 stocks lagged their smaller counterparts. In addition, the fund's bias away from the more highly rated end of the market helped contribute towards the strong returns over the quarter. The portfolio was also helped by its exposure to the Consumer Discretionary area of the market where the fund's holdings in Halfords, Vistry and DFS Furniture served it well. Although we have seen a rally in some of our hitherto underappreciated holdings, we believe that their re-rating is far from over and they will continue to deliver.

***Cumulative Performance after all ongoing charges to 31st March 2021***

| | 3 months | 1 year | 3 years | 5 years |
|---|---|---|---|---|
| **TB Saracen UK Alpha B Acc** | 9.5% | 70.0% | 30.3% | 61.3% |
| **MSCI UK All Cap Index (TR)** | 5.5% | 25.3% | 7.3% | 32.8% |
| **Sector Average** | 5.8% | 38.0% | 14.7% | 38.9% |
| **Quartile Ranking** | 1 | 1 | 1 | 1 |

*Source: Refinitiv Eikon* *Sector: IA Sector (UK All Companies)*

## Market & Economic Overview

March this year was the anniversary of the first COVID-19 related lockdown as well as the huge set back that we saw in markets at that time. It seems like a very long time ago that we were entering the first stages of the pandemic but time is a great healer and the world now has several vaccines. The UK in particular seems to be doing very well at rolling these out. There is genuinely light at the end of the tunnel, though it is likely to be some time before things are absolutely back to normal.

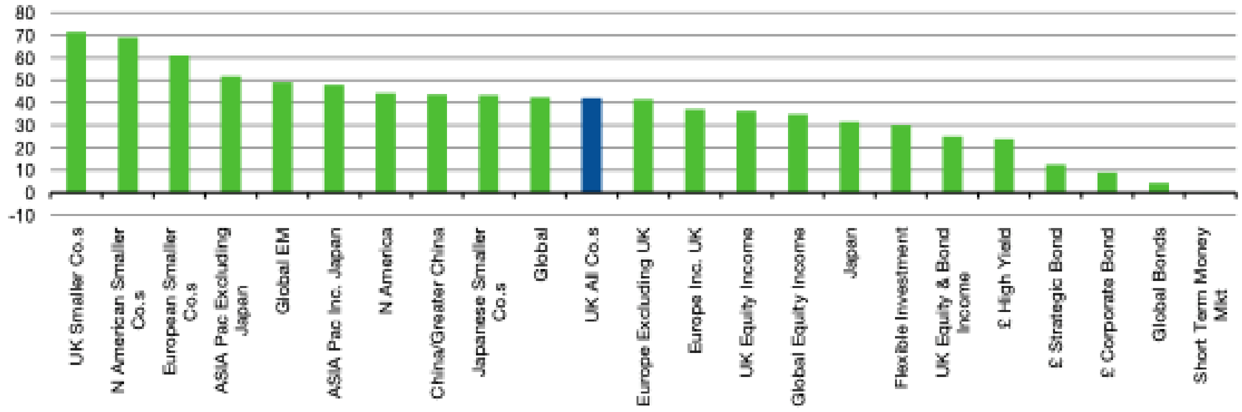
Overall cyclical and value stocks have had a strong recovery in the last six months but it is interesting to note that, despite the performance, ratings are still undemanding in many areas and we would be of the opinion that there is still some way to go for these stocks.

The first quarter returns illustrate perfectly the material outperformance coming from small cap stocks versus the FTSE100 index. A closer look at the individual stock valuations in the Mid 250 shows that the larger stocks in that index are amongst the most expensive and have been doing most of the 'heavy lifting' in terms of performance.

| Total returns by capitalisation: 3 months to 31st March 2021 | |
|---|---|
| **FTSE100** | +4.97% |
| **FTSE Mid250** | +5.35% |
| **FTSE Smallcap** | +9.60% |

The chart below shows that the powerful performance that we have seen from the UK small caps should not necessarily be seen in simply a local context. These stocks were, by some margin, the best performing stocks over the last twelve months though it must be admitted that the lion's share of this was in the last six months. As a result, it is inevitable that some of the fund's holdings are looking a bit more stretched in terms of valuation than they have done for some time. This has always been, and will always be, a key tenet of the Saracen approach and we are very mindful not to push our luck too hard.

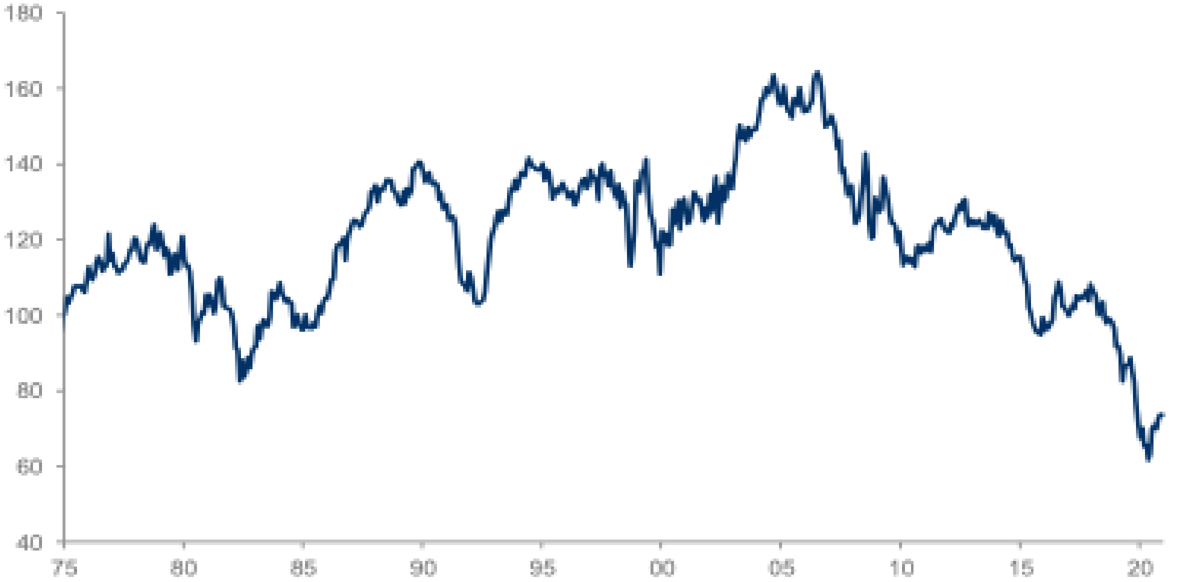
**IMA Global Asset Class Performance (%) – 1 Year**




*Source: IMA, Lipper, Liberum*

That said, we can see clearly from the chart below that although value stocks have had a period of performance the full extent of the lost ground over the last several years has in no way been made up.  This is, of course, a very long-term chart which we have included here to demonstrate the point in as much context as possible.

**UK Value v Growth Price Performance**

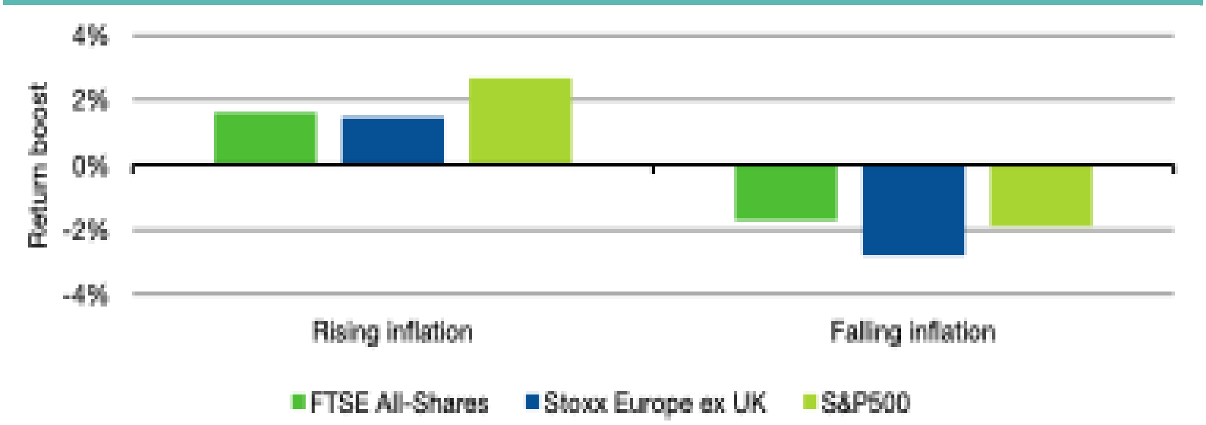



*Source: Morgan Stanley Research*

During the last quarter the UK market has seen significant inflows into equities.  This is in direct contrast to the experience of the last 5 years or so.  This is likely a reflection of several factors among them the fact that the UK equity market remains substantially cheaper than their European or American peers.  In addition, thanks to the faster vaccine roll out, UK domestic earners may well be less impacted by the pandemic than their international peers. It is also true that the sector composition of the UK equity market is such that it should perform better than its European peers both in times of rising inflation and the more stable inflation that we might expect to see in 2022 and beyond.

The chart below illustrates the relative inflation sensitivity of the different global regions.

**Inflation Sensitivity of Different Regions**



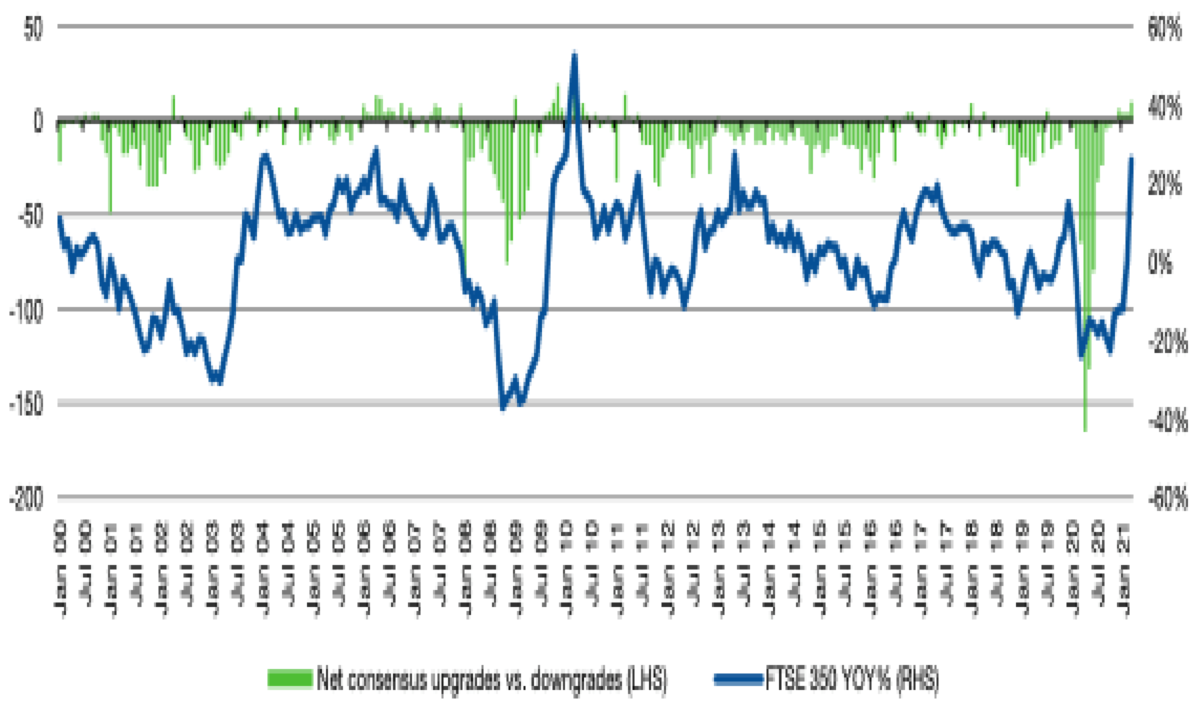

*Source: Liberum, Datastream*

It is perhaps worth pointing out that we have been concerned about the prospects of rising inflation for some time even when the possibility was barely mentioned by our peers. We were concerned that rising commodity prices, wage inflation and increasing demand that may struggle to be satisfied in the short term would all collaborate to stimulate the re-emergence of inflation in many markets. We are still of this opinion but it would appear that this has become something of a consensual trade now. It seems that the introduction of the fiscal stimulus in the US has focussed many commentators' minds as such packages are inflationary by nature.

An inflation outlook such as this has significant implications for sector and stock performance in equity markets and we will discuss these further later on.

We are continuing to see a significant number of large net earnings upgrades in the UK. The current streak of months with stronger upgrades than downgrades is the longest since the recovery after the financial crisis in 2009. To some extent this reflects the fact that analysts took a knife to their forecasts in quite a harsh manner this time last year. This is understandable as at that time it was unclear how companies would navigate the coronavirus lockdowns and the attendant problems of working from home, maintaining existing business, looking for new clients, steering their way through cost cutting scenarios and attempting to stay solvent in order to survive the shutdowns.

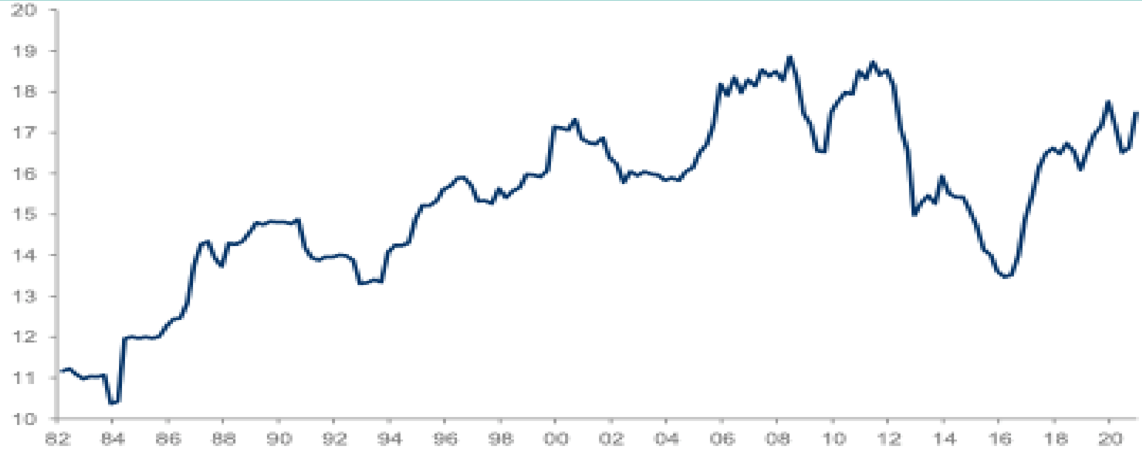
**FTSE350: Number of Stocks Upgraded by More than 5%v Stocks Downgraded by More than 5%**




*Source: Liberum, Datastream N.B. We use FY2 estimates*

The chart below demonstrates that overall EBITDA margins are now almost back to pre-pandemic levels further underlining the pace and extent of the bounce-back we have seen in the UK.

**MSCI UK ex Financials EBITDA Margin (%)**

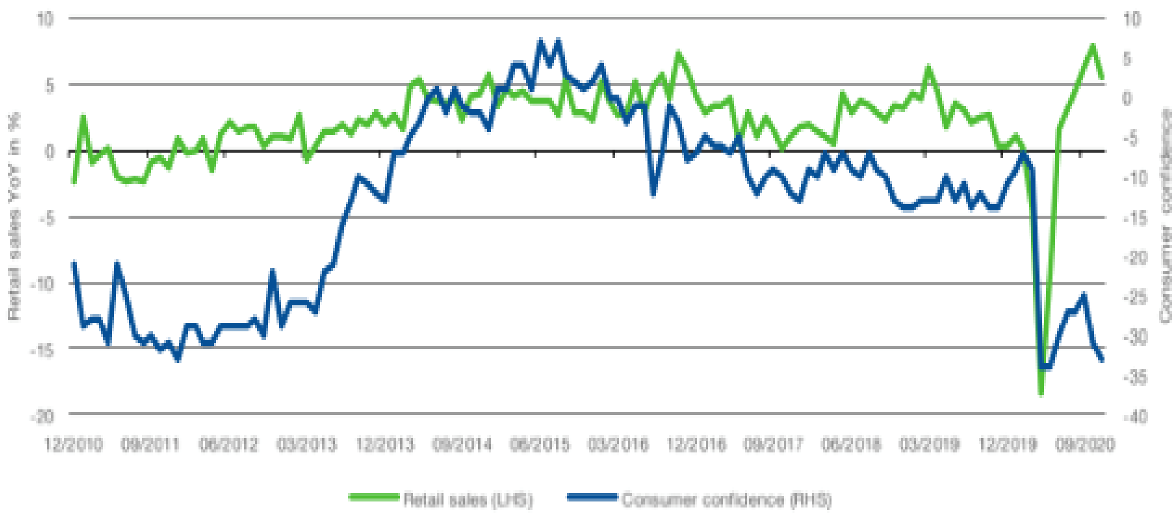



*Source: Morgan Stanley Research*

In the UK we have all the attendant fun and games associated with Brexit. As we mentioned in our last quarterly, we have at least been spared the ignominy of a 'No Deal' Brexit but we cautioned that there would likely be some short-term adjustments of trading procedures as all parties became more familiar with the new regime. This has indeed come to pass and the process has been far from hiccup free. Extra costs are being absorbed by both importers and exporters and this may also feed through to higher prices and further inflationary pressures, at least until the bottlenecks are sorted out.

There remain some silver linings. Although overall consumer confidence is very weak, the savings ratio in the UK is still high. It is a matter of some conjecture among analysts as to how much of that will be drawn down in the form of pent-up demand and additional spending as the retailers, bars, restaurants and leisure facilities open up. If this were to fall back to more normal levels then it would likely lead to a hefty boost to the economy. The stamp duty holiday has been extended, which is doing the UK housing market no harm though this is due to stop around Q3 2021.

**UK Retail Sales and Consumer Confidence**




*Source: Liberum, Bloomberg*

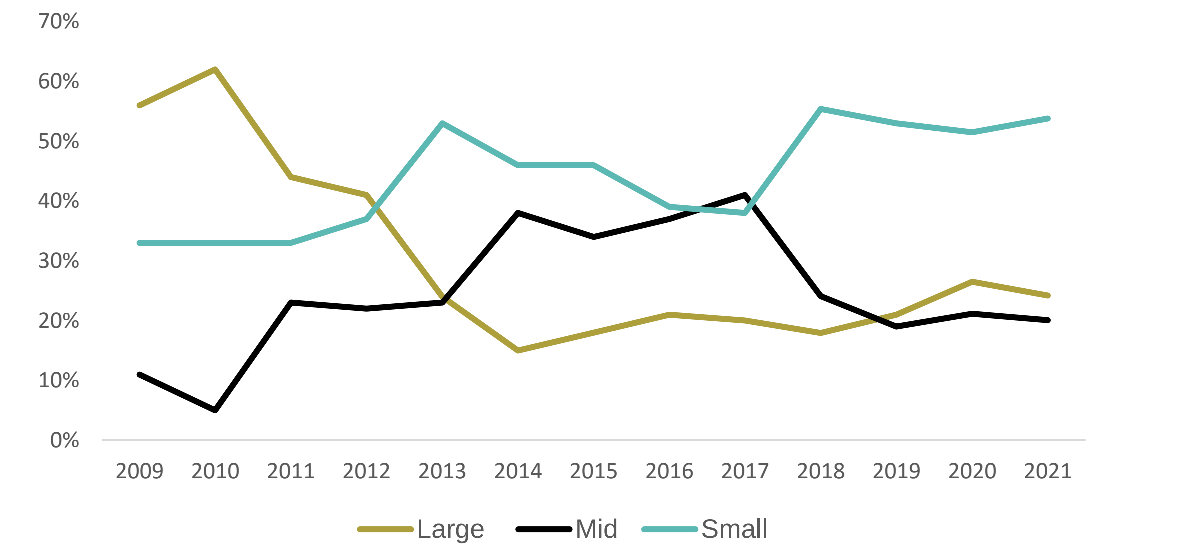
We shall see how the economy will adjust once all the government support mechanisms are removed but it is a racing certainty that unemployment will increase. The bill for these measures has only begun to be presented by the UK Chancellor and we do know that from 2023 corporation tax will rise from 19% to 25%. An increase had been expected but perhaps not one quite so high and this will inevitably hit corporate earnings as firms adjust.

## Portfolio Review

The portfolio has a 'multi cap' structure with high exposure to small and mid-cap companies, which make up 75% 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.

The Fund's flexible, multi-cap structure remains in place with a meaningful exposure to small caps at its core, currently at 55% of the Fund.

**TB Saracen UK Alpha Fund – Historic Asset Mix by Size**

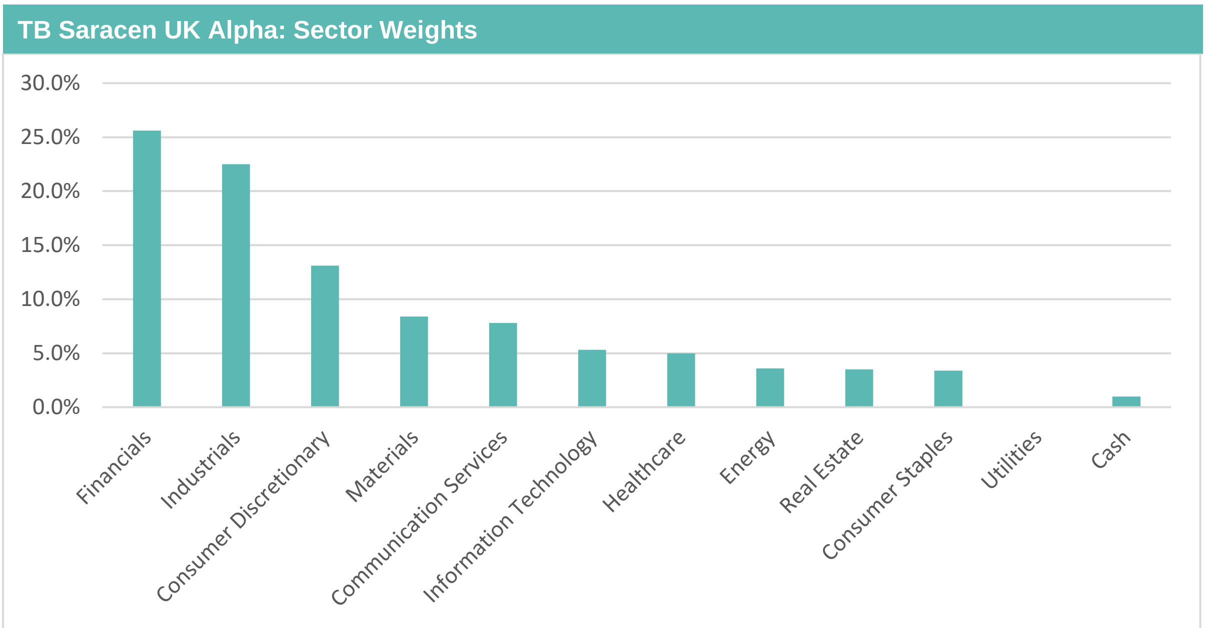



*Source: Saracen Fund Managers as of 31st March 2021*

We are again very pleased to report a strong quarter for the Alpha fund. We have long argued that a number of our portfolio holdings were simply too cheap. The catalyst of the announcement of a workable vaccine let market participants feel comfortable in looking through the problems of 2020 and into 2021 and beyond with more confidence. It was this confidence which led to the re-rating of a number of small and mid-cap stocks to the benefit of the fund coupled with the fact that the UK is doing very well in rolling out the vaccine versus its international peers.

We remain very positive on the smaller end of the market where we believe that much better opportunities can be found and where forward valuations are generally much less demanding than those large and especially mid cap stocks despite the rises in prices that we have seen recently.

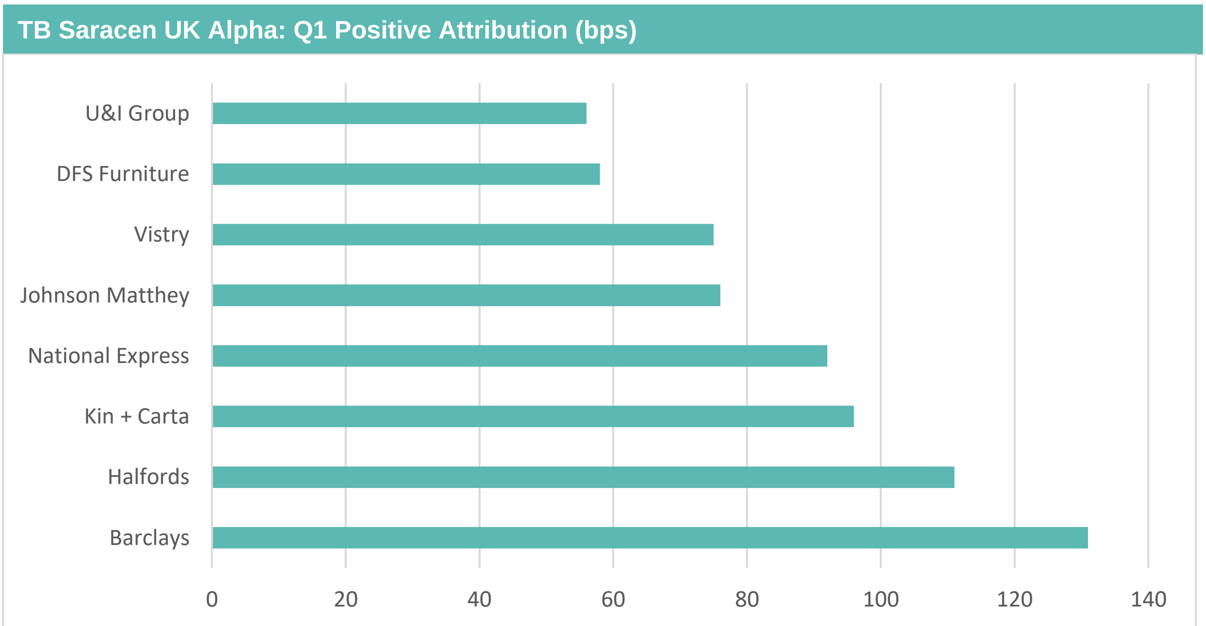
The sector chart below illustrates the relative positioning of the Alpha fund currently, with its very limited exposure to those normally defensive sectors and higher exposure to industrials and financials, which tend to be more domestically orientated and, in the case of the industrial companies that we hold, predominantly small and mid-cap stocks.




*Source: Saracen Fund Managers as at 31st March 2021*

## <u>Positive Contributors</u>

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




*Source: Saracen Fund Managers as at 31st March 2021*

The strongest contributor to return was **Barclays** (+27%) which continued its run of good performance which began last October as market participants woke up to the fact that this company was actually in good shape and in no way expensive.

Likewise, **Halfords** (+42%) continued its run of excellent performance also on the back of good results which highlighted just how much the nation is taking to its bicycles. Additionally, the integration of the recent acquisitions is going well.

Our holding in **Vistry** (+16%) continued its strong run after posting very positive results and a confident outlook statement.

**Kin+Carta** (+25%) reported that the conversion of the company from the old St. Ives was ow complete and that it was wholly involved in its digital transformation work. In addition, the company stated that demand was increasing sharply as corporates have accelerated the move to digital as a result of the coronavirus pandemic.

**DFS Furniture** (+24%) announced very positive results and that sales were continuing to grow despite the lockdown. Lead times for sofas are now of the order of four months plus and the company surmised that consumers seem to be spending money on their homes whilst in lockdown as they cannot spend it elsewhere.

**U&I** (+51%) helped with the performance of the fund as it built on well-received interim results and announced that the CEO was stepping down.

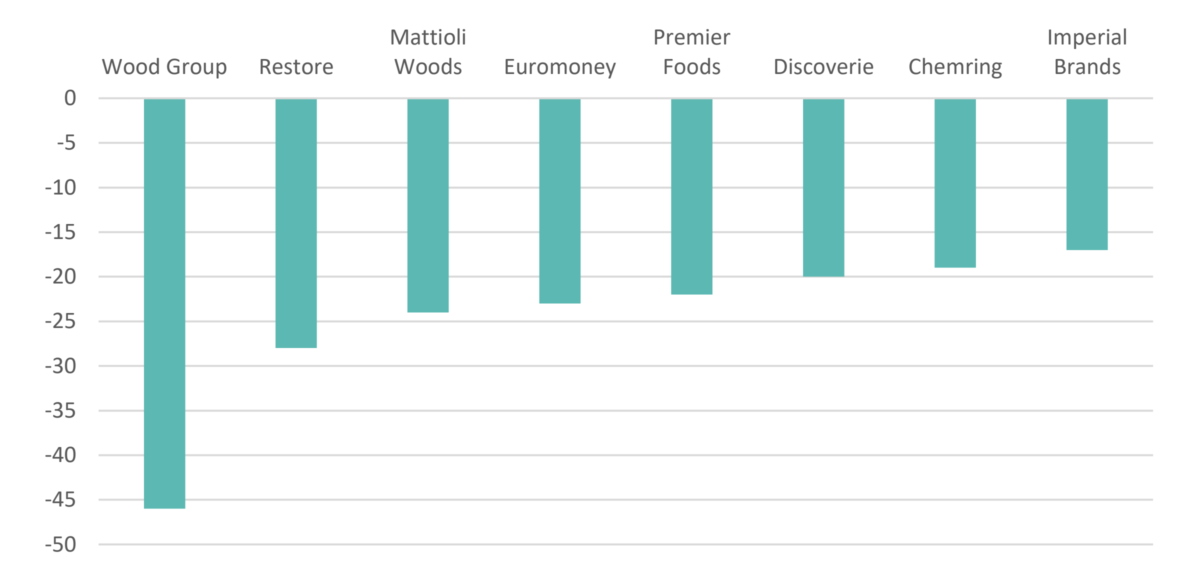
**Johnson Matthey** (+24%) announced the appointment of a new CFO as well as an investment in new capacity to produce products that enable the production of green hydrogen. There has been a recovery in auto sales during the quarter which has been beneficial for the group and the company is expecting results at the upper end of analysts' expectations.

**National Express** (+30%) disclosed its full year results in the middle of March which illustrated that the company was very badly hit by the pandemic as earnings fell around 64%. The group said that they had seem some recovery in Q4 of 2020 but there is still some way to go to get back to pre-pandemic levels. The government's pledge of £3bn in support of the UK's bus network is welcome.

## Negative Contributors

Although the performance of the portfolio has been very strong over the first quarter of 2021 it is pretty much inconceivable that we would get everything our own way. As such there were a few stocks which struggled a bit during the period in question.

**TB Saracen UK Alpha: Q1 Negative Attribution (bps)**




*Source: Saracen Fund Managers as at 31st March 2021*

**Wood Group** (-13%) has disappointed in terms of its share price performance of late after announcing slightly dissatisfying full year results which confirmed that the group was suffering from some near-term headwinds and a lower order book. However, the management went on to state that there was a marked improvement in momentum of contract awards of late and that debt had been substantially reduced. Additionally, an increasing proportion of work is now coming from its environmental business.

**Imperial Brands** (-3%) has been struggling as it attempts to realign its business. We reviewed the business carefully during the quarter and although the stock may hold some attractions for income investors, we saw little prospect of any meaningful capital gain and exited the position.

**Discoverie** (-1%) has been a long-term holding for the fund. We have long believed that this was an excellent stock and during the period we were pleased to see the group issue a statement confirming that its results would be at the top end of analysts' expectations.

Another fund favourite is **Restore** (-14%) which has had quite a good pandemic apart from its shredding business. We remain sanguine as we believe that the company has a robust strategy, market leading products and excellent long-term prospects.

**Mattioli Woods** (-10%) announced its interim results in February which, unsurprisingly, had been hit by pandemic problems and its numbers suffered accordingly. However, the long-term outlook remains good, trading is in line with expectations and the company is well positioned for growth both organically and by acquisition.

**Chemring** (-7%), is a long standing holding for the fund, and underperformed over the quarter despite issuing a positive AGM statement. We remain believers in the strength of the business model and the quality of management.

As a result of the lack of conferences and exhibitions, **Euromoney** (-11%) has continued to slide. The company's other businesses are suffering in the current environment as well but not to nearly the same extent. We continue to believe that the business is undervalued.

**Premier Foods** (-5%) drifted a little during the period which was perhaps to be expected given its stellar performance during 2020. The stock remains cheap and we are happy holders.

## Portfolio Activity

The fund has 34 investments which are spread across a variety of market capitalisations. As of 31st March 2021, the breakdown of the portfolio by size was 24% in large cap, 20% in midcap and 55% in small cap/other. The Fund is currently fully invested with only 1% cash. It was a quiet quarter in general for portfolio activity as we were content to sit back and let the stocks do what they are supposed to do. Our patience with a few of the names we have been invested in has been rewarded somewhat.

### Purchases

We topped up on some **TT Electronics,** which we first purchased last October, following a period of underperformance that we alluded to above. The company has a high and growing exposure to defence and medtech, and a lot of exposure to data and industrial automation, all of which should in time drive a better rating for the shares.

We also bought some more **FRP Advisory** for similar reasons. We believe this to be an excellent business and we are firmly of the view that the company will benefit meaningfully when the Chancellor's support measures such as the furlough scheme cease, and business is forced to return to normal. Unfortunately, there will be corporate casualties of this and FRP are well placed to benefit.

### Sales

The fund made only one outright divestment during the quarter which was **Imperial Brands** where we struggle to see a strong likelihood of any capital gains to be made from this stock.

Some judicious trimming seemed in order as the quarter progressed as a number of stocks performed well and we deemed it prudent to take a little profit. The stocks that we gave a bit of a haircut to were **Kin+Carta**, **Inspecs**, **Barclays** and **Standard Life Aberdeen** as well as **U+I** and **STV**.

## 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 34 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 75% of the fund with large companies at 24% and cash 1%

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. It is important to emphasise that we only ever invest in companies from the bottom up – we do not allocate to sectors, markets or any other arbitrary groupings. Each potential investment is judged on its own merits. That said, we sometimes find it convenient to consider our portfolio in terms of stocks with similar characteristics. Currently we find it useful to think of the portfolio exhibiting the following traits:

**Core growth (42%* of portfolio assets)**

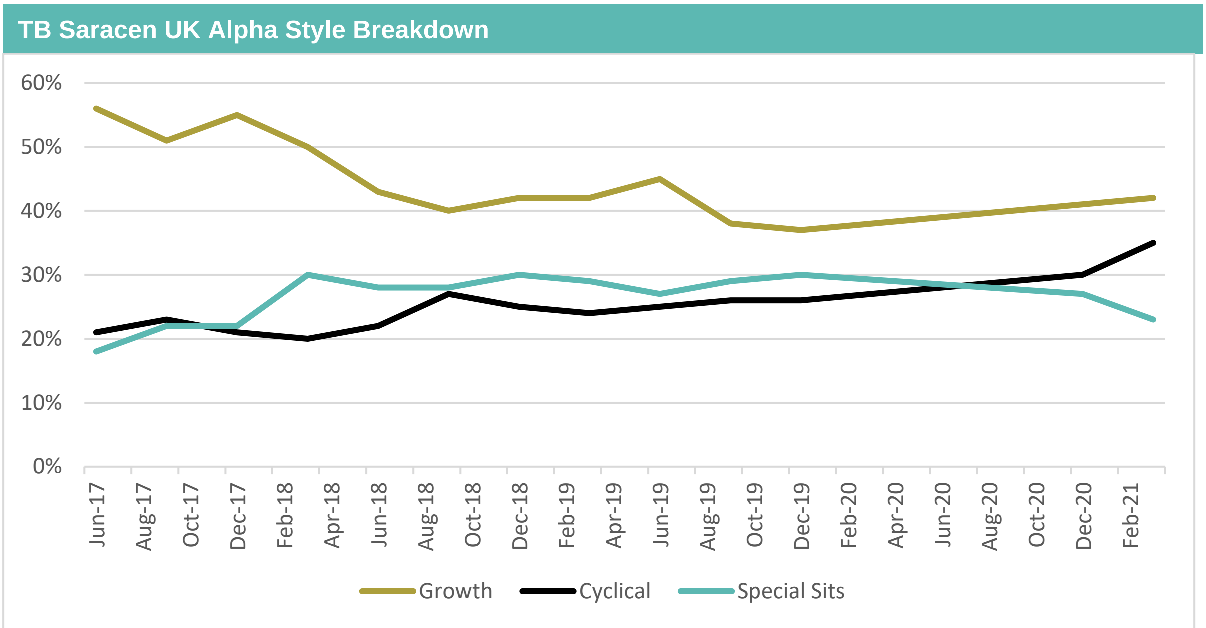
We would expect the largest component of the fund's assets to be held in core growth companies, businesses which can deliver consistently strong compound earnings growth rates over a long-time period, allowing us to hold them for many years to come. The exposure to this segment has reduced from nearer 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 (23%* 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 (34%* 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 31st March 2021, Source: Saracen Fund Managers*

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. Following the recent rally in value stocks in the UK it would be fair to say that there are less opportunities in the value arena now than before, but they are still there.

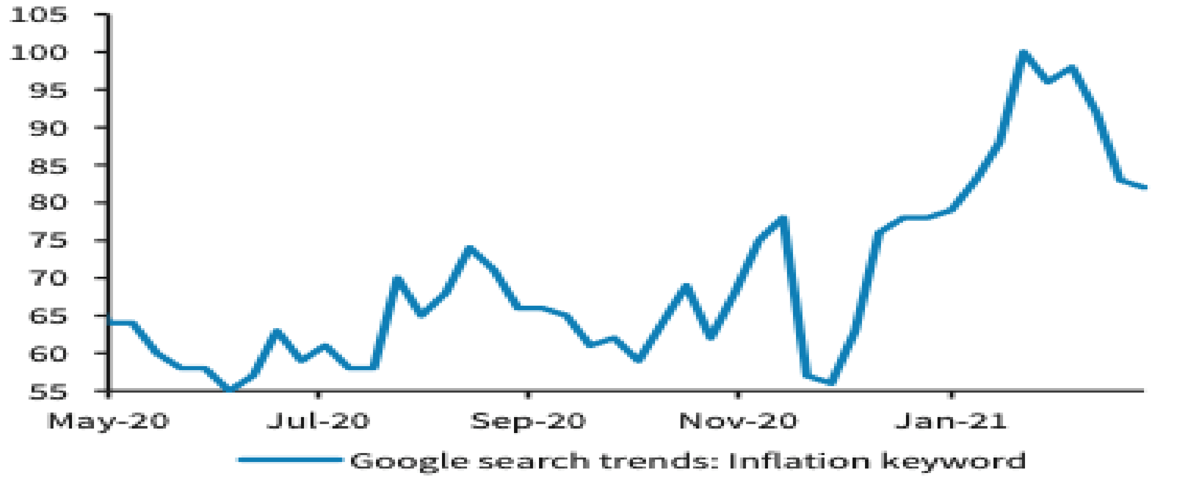
## Outlook

Although we have been pleased to see that the growth vs value debate has swung a bit more in favour of value in recent months, we do believe that there is still more to go for in performance terms. Viewed within a historic context over any decent time period the pendulum still has some way to swing. As rates have sold off this has helped the value trade and, in a global context, cyclicals have led markets higher. This may suggest that a lot is already in the price now but we would argue that a favourable policy, growth and earnings outlook will likely support further upside in equities. It may be naïve to suggest that this will be at the same pace as recent quarters but we do think that the general direction is still northwards.

As we mentioned earlier, progress with vaccines and the build-up of household savings coupled with the various stimuli put in place by governments sets a positive background tone for further progress for equity markets. Although the pace across different economies will vary it does look more likely than not that a global recovery is on track driven by the US and China and fuelled by an unprecedented US fiscal package.

In the UK earnings momentum is positive and year on year comparables are set to turn very favourable particularly for the more cyclical and value-oriented stocks. A smidge of caution is required as, in the medium term, higher corporate taxation will pose a threat to earnings, corporate activity and capital returns. In addition, as we alluded to earlier, inflation is now something everyone is thinking about.

**Google Word Search: Inflation**

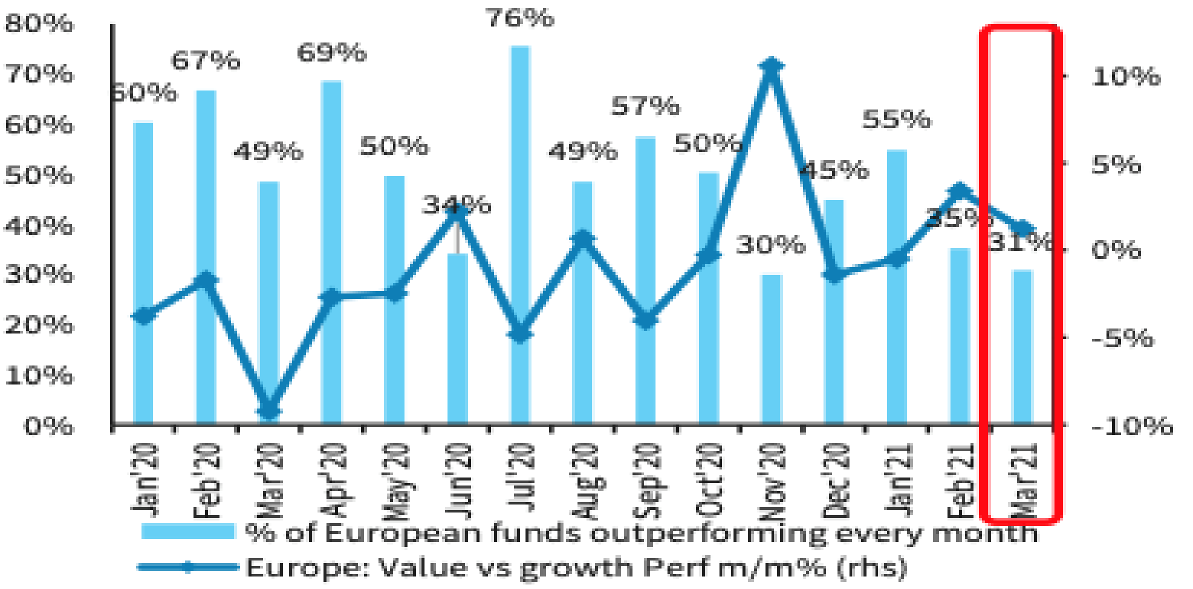



*Source: Google Search Trends, Barclays Research*

It is worth mentioning that history shows us that inflation is better for equities than bonds, but not in extreme deflation or hyperinflationary regimes, which we do not expect.

We make no apology for continuing to assert that we believe valuation is a crucial component of equity analysis and the rotation that we have seen towards value stocks, whilst beneficial to the Saracen funds, has generally been something of a 'Pain Trade' for fund managers. The chart below shows that across Europe, only a very small proportion of European fund managers beat their benchmark in March 2021.

**% of European Funds Outperforming Every Month**

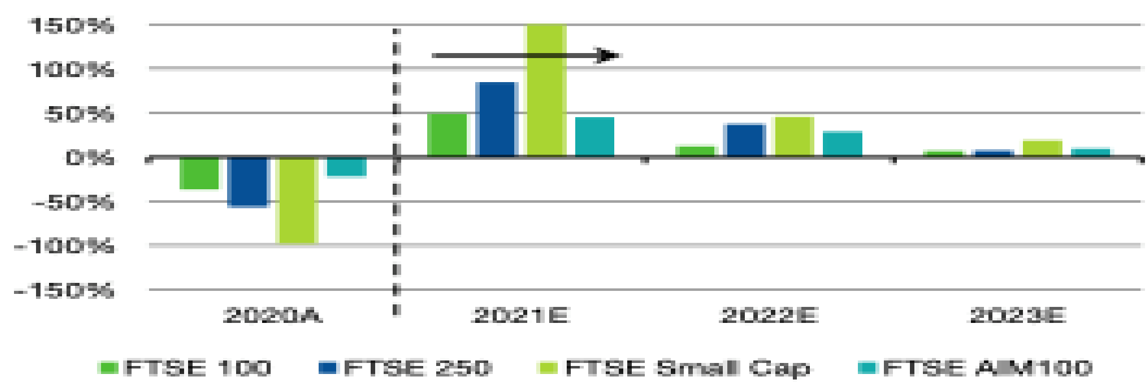



*Source: Bloomberg, Barclays Research*

As we know 2020 was a brutal year for earnings as the lockdowns to hold back the pandemic resulted in the worst GDP growth outcome since the Great Depression. UK EPS are expected to finish 2020 down 37% and the Eurozone is not too far behind at 29% with the likes of Spain and Italy doing significantly worse than that. However, if one goes by analysts' consensus then the UK and Europe are set to deliver the highest levels of EPS growth this year as they had the biggest fall. In fact, UK EPS revisions are looking much more attractive than European ones at this time. One should temper this with a bit of realism as, in aggregate, their earnings will, in all probability, fall below 2019 levels. We are well aware that input costs are rising, but so too are revenues which, coupled with cost saving measures taken over the last 12 months, should help ameliorate the worst of the margin pressure.

Anecdotally, we are hearing that asset allocators are showing a lot more interest in the UK, but the long-term outflows that we have seen in connection with Brexit have a long road to recover. The UK has no real exposure to technology sectors and is dominated by defensives and value stocks and is also, unsurprisingly, very sterling sensitive.

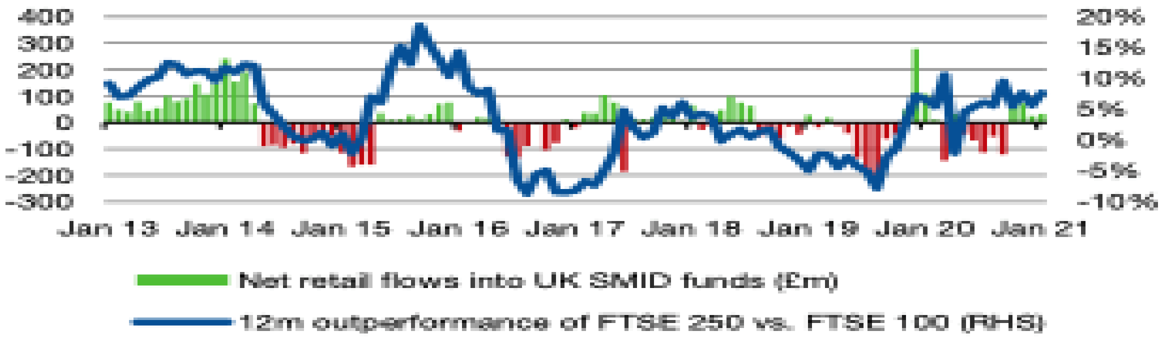
**Consensus UK EPS Growth Forecasts Ex Resources**




*Source: Liberum, Datastream*

As with everyone else in the market, we keep a close eye of flows in and out of UK retail funds and it would seem that with the sustained performance of small and mid-cap stocks versus the large cap stocks investor flows have come back into SMID funds. In the meantime, income funds continue to lose money in the UK.

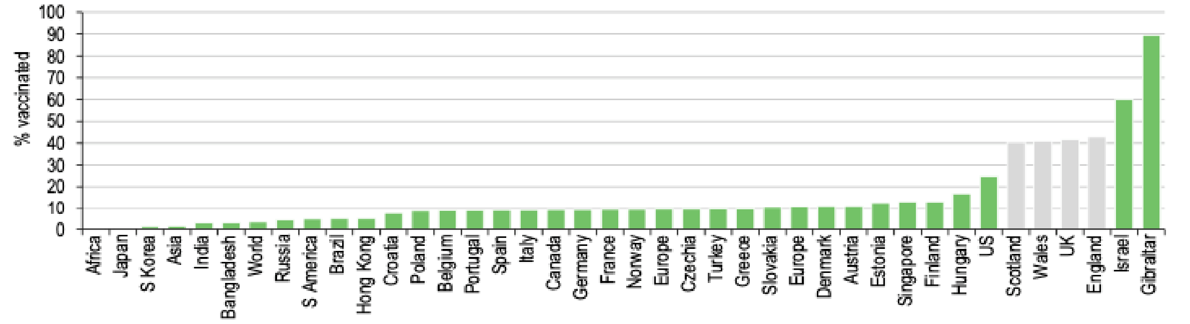
**SMID Retail Flows v FTSE250**




*Source: Liberum, Datastream*

We are no experts on pandemics and with especially fluid news flow there is little point in making too many near term predictions. However, it is demonstrable that the UK has done particularly well in a global context in terms of vaccinations.

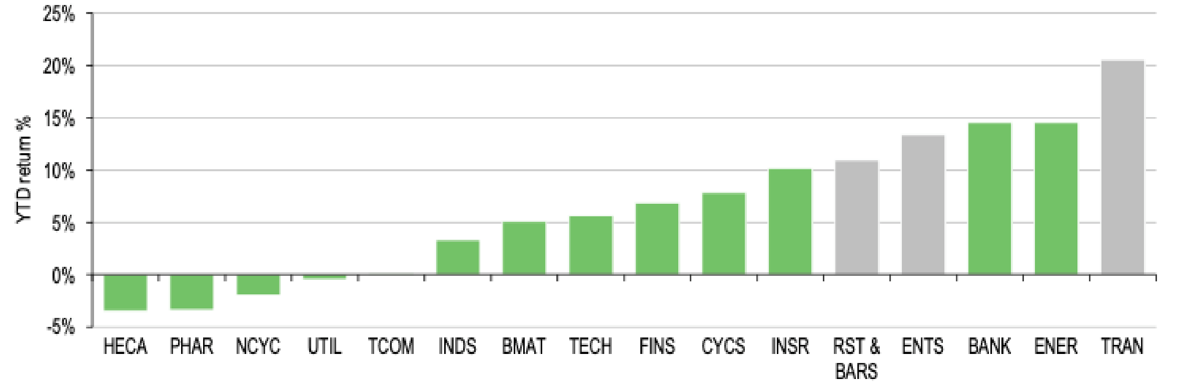
**Global Vaccination Rates**




*Source: Govt Stats, Our World in Data, Edison Research*

What is clear is that we are nearing the end game of this process. As a result, some of the more exposed sectors have begun to recover and though it may not feel like it the UK Transport, Leisure and Entertainment sectors have all performed very well in the year to date.

**UK Sector Returns Year to Date**




*Source: Refinitiv, Edison Research*

## Conclusion

The bottom line is that we remain positive on the UK equity market. While we do not expect super-normal returns from here there is little doubt in our minds that the bulk of UK plc will emerge from the coronavirus lockdowns in reasonable shape. Not necessarily good shape, but reasonable. Some companies have surprised us (and themselves) by barely missing a beat and adapted to a company wide 'working from home' dynamic with enviable ease.

However, we do know that not all companies are created equal and, at this stage, assessing just how much lasting damage the pandemic has done is very difficult. We will inherit an economy enduring higher unemployment, very much more government debt and other scars that may take years to heal.

The COVID crisis has increased GDP growth dispersion across all nations. Protectionism is on the rise as are populism and social unrest. With Brexit now behind us, a new relationship is starting between the UK and the EU, with many unknowns.

The IPO market has stayed open throughout and the pipeline is very heavy at the moment. However, the recent disappointing float of Deliveroo may cool appetites somewhat. The fact that the IPO market is quite crowded will likely lead investors to be more selective and may push back on valuation which would be no bad thing. UK IPO candidates include money transfer start up Wise and cyber security firm Darktrace.

We have spoken before about the likelihood of a pick-up in M&A activity as a result of low valuations in the UK and the fact that potential private equity suitors have a great deal of cash to deploy. There have been a number of approaches in the first quarter including on line gaming company Gamesys and motorway service station operator Applegreen. We would expect there to be more to come.

That the pandemic will have many long-term implications for society, the economy and financial markets over the long run seems all but certain. The most obvious point is that there is much more debt in the system. We know that interest rates will remain low and governments have less room to manoeuvre and face a dilemma on when to taper the support schemes that kept many businesses and households afloat. While a rebound in earnings should help bring back corporate leverage in 2021, debt heavy balance sheets may reduce the ability of companies to invest.

However, at the current time it does not seem unrealistic to think that by the end of 2021 the UK economy will have made up a great deal of the ground it lost in 2020. But as Sam Goldwyn once said “It is difficult to make forecasts, especially about the future,” and forecast risk remains high in all territories including the UK. The most obvious risk is that there will be further waves of virus-related lockdowns further stifling economic activity and forcing ever more businesses to the wall.

At the present time though, that seems unlikely and at Saracen we are cautiously optimistic that economic activity will get back to normal over the short to medium term depending on the industry. In the meantime, we remain alert to the possibility of mispricing of stocks as recovery unfolds and look to take advantage of any anomalies.

Once again, we thank you for your continued support and wish you and your families good health.

**David Clark**
**31 March 2021**

**Important information:**
**This information should not be construed as an invitation, offer or recommendation to buy or sell investments, shares or securities or to form the basis of a contract to be relied on in any way and is by way of information only. Taxation levels, benefits and reliefs may all vary depending on individual circumstances and are subject to change. Subscriptions will only be received, and shares issued on the basis of the current Prospectus, Key Investor Information Document (KIID) and Supplementary Information Document (SID). These are available, in English, together with information on how to buy and sell shares, on-line at www.saracenfundmanagers.com. Issued by Saracen Fund Managers Ltd, 19 Rutland Square, Edinburgh, EH1 2BB, authorised and regulated by the Financial Conduct Authority. Registered in Scotland No. 180545.**

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

**This Factsheet is for professional Investors only.**

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**ACD & Fund Administrator – T Bailey Fund Services Limited (TBFS), 64 St James's Street, Nottingham, NG1 6FJ Tel: 0115 988 8274**
**Custodian – The Northern Trust Company, 50 Bank Street, Canary Wharf, London, E14 5NT**

**Depositary – NatWest Bank PLC, 135 Bishopsgate, London, EC2M 3UR**

**Regulatory Status:**
**FCA Recognised: Yes**
**Scheme Type: OEIC**

**Issue date – 13$^{3h}$ April 2021**