TB Saracen Global Income and Growth Fund

Quarterly Review – June 2021

SARACEN
share success

MSCI ESG RATINGS AAA

Signatory of: PRI Principles for Responsible Investment

FOR PROFESSIONAL INVESTORS ONLY-

Retail investors should consult their financial advisers

Graham Campbell
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	TB SGIG	Sector Average	Quartile
Q2 2021	+4.2%	+4.3%	3
YTD	+16.1%	+10.0	1
1 Year	+25.2%	+21.8%	2

Source: Saracen Fund Managers as of 30 June 2021

Sustainable recovery?

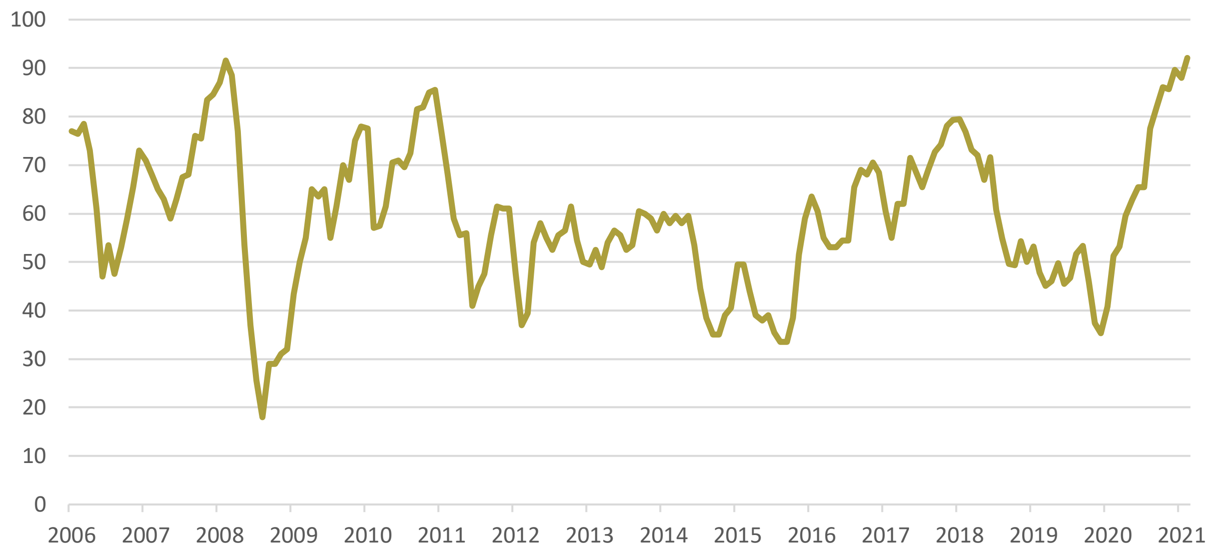
Outlook

Fund performance over the next six months will depend on the confirmation of our assertions that we are experiencing a sustainable global recovery that will drive a recovery in earnings. The key word here, is of course 'sustainable'. We have seen a sharp bounce from depressed levels, as economies began to open up and the consumer returned from lockdown. Many key leading indicators have turned sharply positive and inflation has again made an appearance. The re-opening trade has not disappointed!

Over the years we have found that it is constructive to critically assess the data and attempt to estimate where the risks sit within the assumptions. In the following few paragraphs, we would like to consider some of the, frankly startling, economic charts and why we expect the global recovery to continue and what this means for portfolio positioning.

In many ways it is not a surprise that inflation has taken off: global supply lines were fractured by the pandemic and businesses de-stocked to conserve cash. When the economies re-opened, the consumer returned and supply could not meet demand, which led to inflation. Some of this will be transitory as the Fed and other Central Banks expect. Nevertheless, it is interesting to estimate what is priced into markets and to consider the risks if bond purchasing is reduced and interest rates have to rise to control growth and inflation?

ISM Manufacturing Prices – Greatest pressure on costs since the GFC

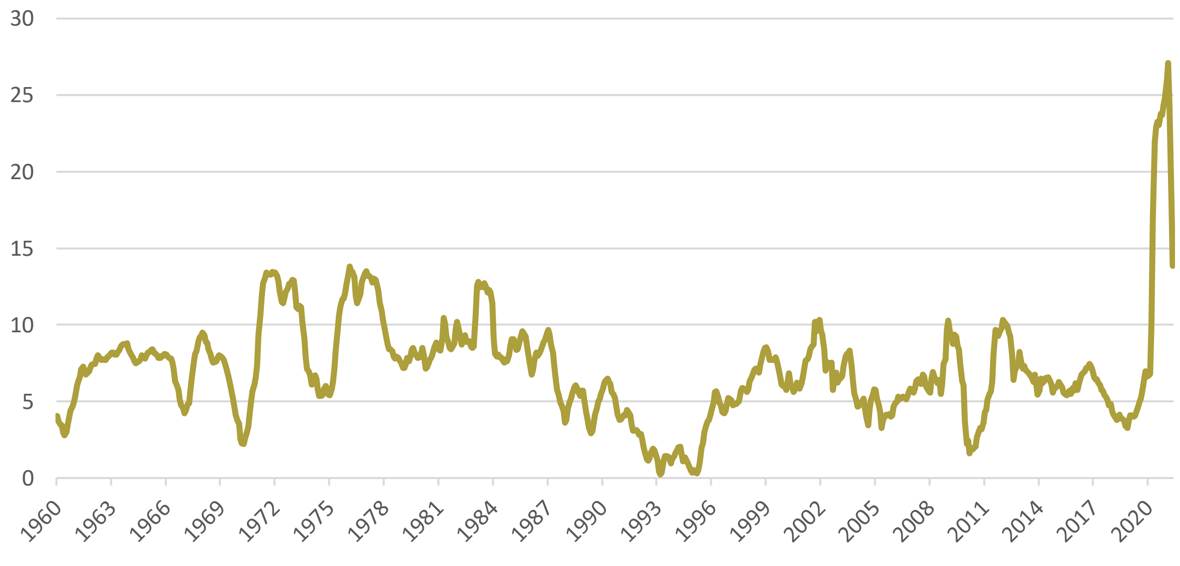


Source: Refinitiv Eikon

It is likely that when supply chains re-open and warehouses are re-stocked, that some of the pressure will ease. Our concern is that many charts are already showing extreme measures and investors appear to be assuming that it is different this time and 'mean reversion' is an historical anomaly. There are several narratives that consign inflation to history.

It appears clear that actions taken by the Fed and others are 'accommodative', namely; they will err on the side of caution to ensure that the economic recovery is on a firm footing, before taking action.

US M2 money supply growth (%) – US money creation has never been this strong



Source: Refinitiv Eikon

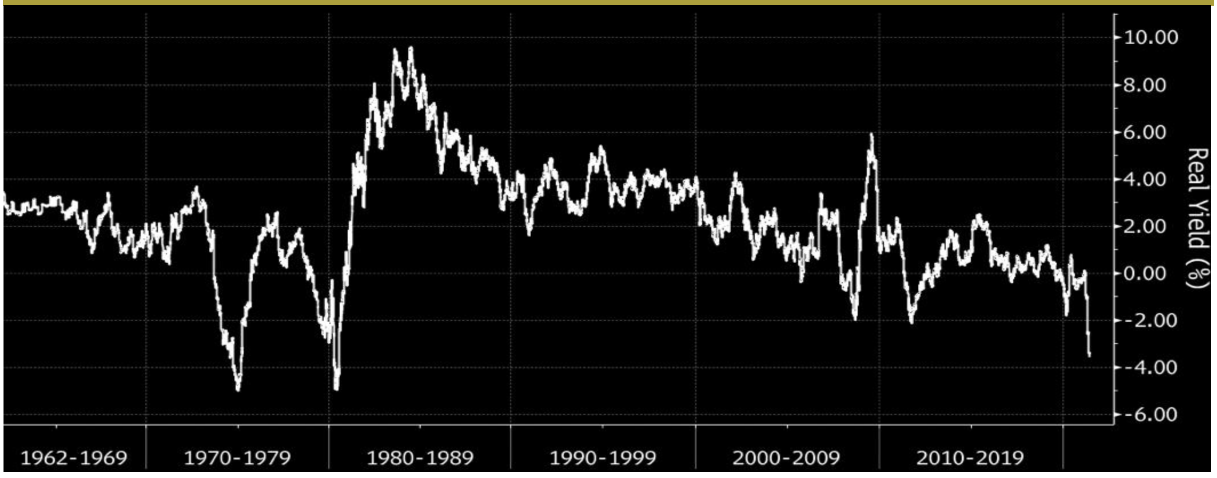
The result of this extreme level of monetary easing and fiscal support has resulted in the loosest financial conditions in 40 years.

US Financial Conditions Index – Financial Conditions are the loosest in four decades

Source: Refinitiv Eikon

The clear anomaly to us appears to be the reaction of bond markets which, despite all this pump-priming post the Fed meeting are indicating that inflation will only be transitory. As can be seen in the chart below, real yields have rarely been this low.

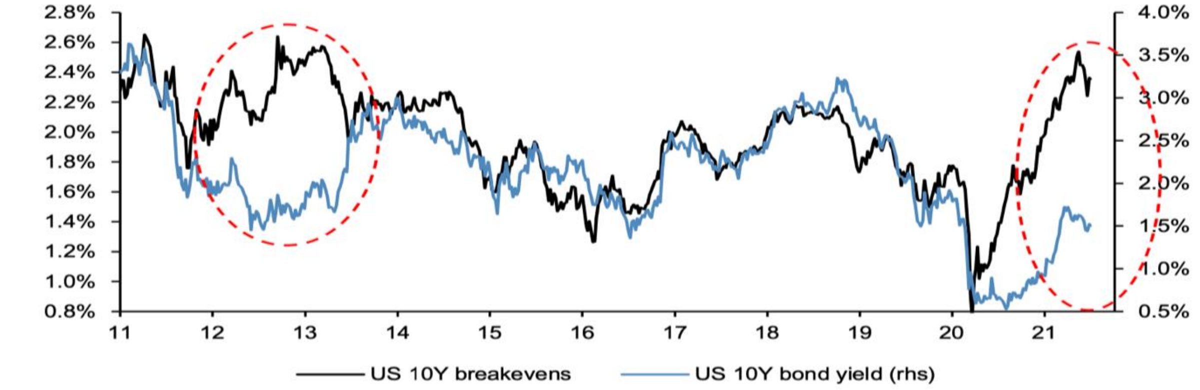
US Govt 10 Y - US CPI Urban Consumers Y/Y – Compared to inflation, 10Y yields were last this low in 1980



Source: Bloomberg

Something has to give! The chart below highlights the increasing divergence between the 10-year breakeven yield and bond yields. There has been disparity before, but rarely this large. As we have noted before, the risk appears to be with bonds.

US 10Y breakevens and 10Y bond yield – The gap has to close



Source: JP Morgan, Bloomberg

If we are correct and the massive fiscal and monetary stimulus, combined with excess savings by households begin to drive the economy to pre-pandemic levels, it is likely that asset purchases will be reduced towards the end of the year and interest rates will rise sometime thereafter.

In this scenario we expect more economically cyclical businesses to experience a strong recovery in earnings (still from historically low valuations) and banks to outperform due to rising long-bond yields and stronger lending growth.

Nevertheless, this will be a nervous time for investors as they try to become accustomed to the shift in monetary policy.

Graham Campbell
Bettina Edmondston

30th June 2021

Background

The two sharply contrasting visions of the recovery were played out in the last quarter. On one side we have the view that the global economic recovery will be sustained and we are back on the path to recovery. In contrast, others fret over the sustainability of earnings and fear that low growth and low levels of inflation will continue to persist.

The conflict between these two paths explained most of the sector movements over the last quarter with the fulcrum around the Fed Open Markets Committee (FOMC) meeting of 15th and 16th June.

The Fed has two objectives: maximise employment and keep prices stable with inflation around 2%. With inflation running well above target, there was concern that a more hawkish policy would emerge. However, with uncertainty still surrounding the jobs market the FOMC decided to keep short-term borrowing costs at near zero levels and to continue to purchase $120bn of bonds per month.

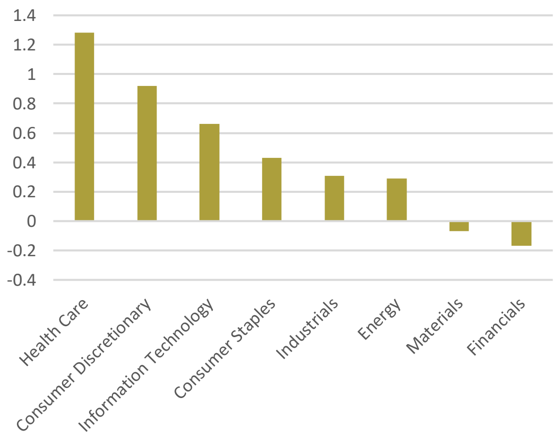
The performance of SGIG over the quarter reflected the above, with the fund being ahead for April and May, but giving up relative performance post the Fed meeting.

There were few surprises on the earnings front, with most economically exposed businesses noting a healthy rebound in activity. While the flat yield curve is a headwind for banks, many have the cushion of being able to write back some of the large provisions taken through Covid. Activity in the portfolio remains low and is described below with attribution.

Fund Review

The fund had a strong start to the quarter with economically cyclical names like Industrials, Financials and Consumer Discretionaries outperforming. The market was also characterised by so called Value names doing better than Growth names. However, towards the end of Q2 TB Saracen Global Income & Growth lost some of the outperformance after the Fed minutes led to a swift change in the market. This meant that Financials had a negative contribution to the portfolio's return while Health Care was the main positive contributor on a sector level.

Sector	Average Weight	Contribution to Portfolio
Energy	3.90%	0.29
Materials	11.76%	-0.07
Industrials	18.67%	0.31
Consumer Staples	8.45%	0.43
Health Care	15.84%	1.28
Consumer Discretionary	7.65%	0.92
Financials	19.62%	-0.17
Information Technology	14.50%	0.66



Source: Saracen Fund Managers, Refinitiv Eikon. Data close to close (fund valuation noon to noon)

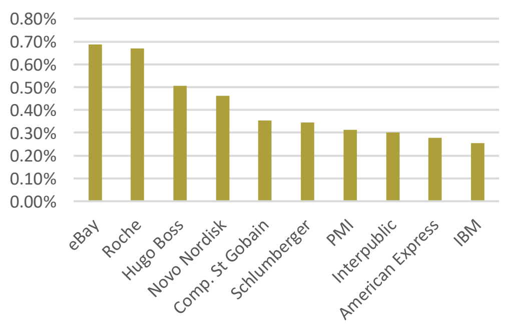
Our top 10 contributors were a mixture of mainly Consumer Discretionaries (eBay and Hugo Boss) who could hold on to their initial gains and Defensive names (Roche, Novo Nordisk, Philip Morris). On the negative, we saw a pullback in Financials (Barclays, Axa, UBS, AIB) and profit taking in some Industrials (Evonik, HeidelbergCement, Fuchs).

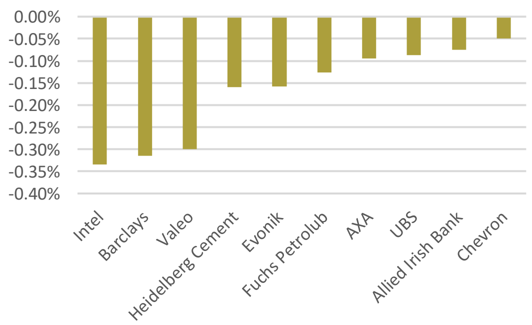
Top Contributors

Stock	Portfolio Weight	Contribution to Portfolio
eBay	4.28%	0.69%
Roche	4.19%	0.67%
Hugo Boss	1.42%	0.51%
Novo Nordisk	2.04%	0.46%
Saint Gobain	3.61%	0.35%
Schlumberger	2.11%	0.34%
Philip Morris	3.55%	0.31%
Interpublic	3.95%	0.30%
American Express	2.04%	0.28%
IBM	3.51%	0.25%

Top Detractors

Stock	Portfolio Weight	Contribution to Portfolio
Intel	2.86%	-0.33%
Barclays	3.17%	-0.32%
Valeo	2.30%	-0.30%
Heidelberg Cement	2.38%	-0.16%
Evonik	2.31%	-0.16%
Fuchs Petrolub	2.41%	-0.13%
AXA	1.34%	-0.09%
UBS	2.63%	-0.09%
Allied Irish Bank	2.14%	-0.07%
Chevron	1.79%	-0.05%





Source: Saracen Fund Managers, Refinitiv Eikon. Data close to close (fund valuation noon to noon)

Top contributors

eBay (+16.8%) had a weaker start to the quarter as its Q2 outlook fell short of expectations. However, during May and June the shares rallied as the market became more comfortable with the company's long-term positioning in the e-Commerce market. eBay also appointed a new CFO from JetBlue to replace its interim CFO. Additionally, eBay received the final regulatory approval for the sale of its global classified ads business to Norway's Adevinta for which it will receive $2.5bn in cash and 540m shares. eBay also sold its South Korean unit for $3.6bn.

Roche (+14.3%) signed a deal with the EU for about 55,000 doses of a potential treatment for COVID-19 based on a cocktail of monoclonal antibodies developed by itself and Regeneron.

Hugo Boss (+34.7%) continued its strong run from Q1 amid takeover rumours from Frasers Group, which have been denied. The new CEO started on 1 June, and we expect an acceleration in top line and margins over coming years. The shares have rerated strongly this year and are back to pre Covid levels reflecting the markets increasingly positive outlook for the company.

Novo Nordisk (+21.6%) started the quarter strongly amid expectations for approval of their new weight loss drug. The FDA duly approved Wegovy in June and Novo Nordisk followed with a swift launch in the US during June. Wegovy is a once weekly injection for chronic weight management in adults with obesity or overweight with at least one weight-related condition (such as high blood pressure, type 2 diabetes, or high cholesterol). Wegovy is the first approved drug for chronic weight management in adults with general obesity or overweight since 2014.

Saint Gobain (+9.1%) advanced after posting very strong Q1 numbers. Like for like sales were up over 14% versus market expectations of around 9%. All divisions beat consensus and both volume and pricing were strong. While the shares had a phenomenal run in the last 15 months, the short term valuation is still only 13.5x, Y1 PE. The medium-term outlook remains attractive. After a cultural change over the last few years we expect the quality of Saint Gobain's earnings to lead to a sustainable higher earnings multiple.

Top detractors

Intel (-11%) fell at the start of the quarter despite reporting a strong Q1. The company could not reassure investors on its' ability to meet demand from new factories against a background of a global shortage of chips. The shares also suffered from another one quarter delay to Intel's Sapphire Rapids product. The shares clawed some of the early losses back, but still closed lower over the period. We believe the new CEO will appoint industry experts to remedy Intel's manufacturing problems and the company can regain its lead position over the coming years. This potential is not reflected in a valuation of 12x Y1 PE with a 2.4% dividend yield.

After a strong bounce in the 1st quarter, Financials drifted during the quarter. **Barclays** (-9.9%), **AXA** (-7.6%), **UBS** (-4.7%) and **AIB** (-4.1%) retreated further in June after the FOMC's meeting on the 15th & 16th. The Fed continues to assess monetary policy and the timing of any reduction in bond purchases. We still believe that inflation will remain above trend for longer than anticipated and will lead to a steepening of the yield curve when this is appreciated. We therefore keep our weighting in Financials close to our self-imposed sector limit of 20%.

Valeo (-13.6%) reported sales above expectations in April and reiterated its FY outlook. Nevertheless, the shares drifted due to concerns over the shortage of computer chips hurting auto production and slowing the supply chain. We believe Valeo will be one of the main beneficiaries of the long term trend to auto electrification. The company is number one or two in most of its divisions and markets and continues to gain market share. The growth potential in outer years when electric cars become mainstream are not reflected in the valuation of 9.5x 2022 PE.

Heidelberg Cement (-7.3%) actually had a positive profit warning at the start of the quarter with Q1 operating of EUR223m vs. market expectations of EUR92m on the back of strong cost cutting and margin improvements. We expect another strong set of numbers at the half year and view the company as a beneficiary of upcoming infrastructure spending. (See below in Portfolio Changes).

After a strong start **Evonik** (-7.4%) saw some profit taking in the latter part of the quarter.

Portfolio Changes

During April we re-initiated a position in HSBC in the fund. This was funded by the disposal of Prudential. For further details please see our blog on this portfolio change.

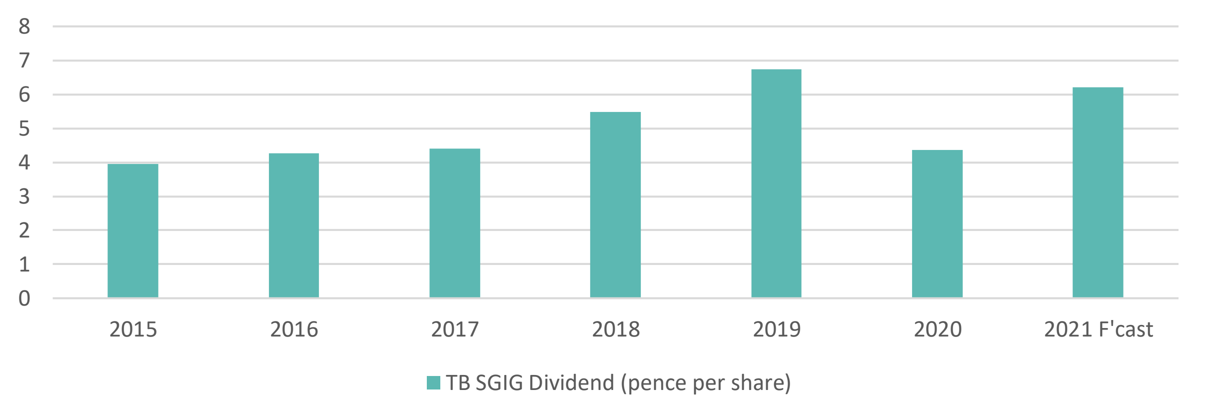
Portfolio activity was again low over the quarter. We took some profits in outperforming names at the start of the quarter like **Schneider**, **Johnson Matthey** and **American Express** and reinvested proceeds in laggards like **Bristol Myers Squibb**, **Valeo** and **Roche**. We also increased our holding in **Heidelberg Cement** where we think valuations do not reflect improving prospects or reflect the self-help by management to improve returns and ESG targets At 9.6x Y1 PE and with a 3% yield the shares are trading at a multi-year low.

Fund Dividend

We target a strong dividend growth over the long-term. 2020 was impacted by the pandemic and many companies cutting or cancelling their dividend. During H1 2021 there was a recovery in pay-outs, but some companies still opted to keep their distributions low, or in the case of many banks were prohibited to return to the 2019 levels. With this backdrop the TB Saracen Income & Growth Fund declared an interim dividend of 2.77p, which is an increase of 10% compared to last year's interim dividend.

For 2021 we expect further recovery in H2 in payments. Based on Refinitiv Eikon forecast of 2.6% yield for the fund and a 30 June closing price of 238.53p we expect a FY dividend of 6.20p, which would be an increase of 42% compared to 2020 and almost back to 2019 levels.

Saracen Global Income & Growth Fund's dividend



Source: Saracen Fund Managers, Refinitiv Eikon

SGIG Portfolio strategy

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	13.1	18.6	-5.5
Dividend Yield 1Y FWD	3.4%	1.9%	+1.5
P/CF 1Y FWD	12.4	32.8	-20.4
Net Debt/EBITDA 1Y FWD	1.55	2.77	-1.22
Return on Capital Employed	16.8%	14.1%	+2.7
Refinitiv ESG Score	77.6	68.0	+9.6

Source: Refinitiv 30/06/21

Drilling into our top ten holdings, we would highlight again the relative low valuations and attractive yields with an average of 14x Y1 PE and 3.3% yield.

SGIG top 10 holdings			
Stock	Portfolio weight	P/E 1Y FWD	Dividend Yield 1Y FWD
Interpublic Group	4.1%	14.4	3.3%
Cisco	3.8%	15.7	2.7%
Roche	3.8%	17.4	2.7%
Saint Gobain	3.6%	12.8	2.9%
eBay	3.6%	16.6	1.0%
Barclays	3.5%	7.2	4.4%
Philip Morris International	3.5%	15.5	4.9%
IBM	3.4%	12.8	4.5%
Danone	3.4%	17.3	3.2%
DBS Group	3.2%	11.7	3.9%

Source: Refinitiv 30/06/21

We pointed out in the last quarterly review that 2021 will be volatile and that stock picking will become more important again. We have seen a temporary reversal of markets at the end of Q2 but it is our belief that we will continue to see a continuation of the recovery of economically cyclical businesses.

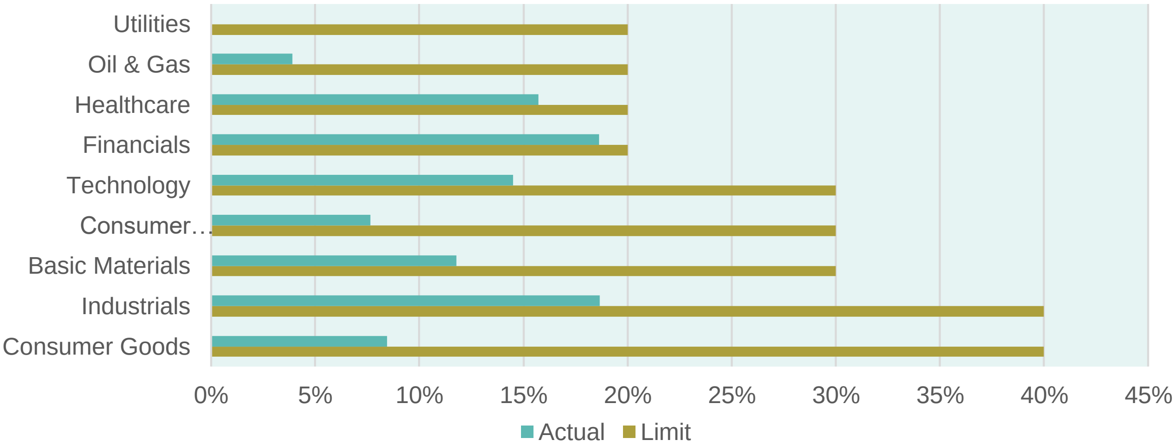
We, therefore, retain large weightings in selective companies that are classified in the following sectors:

- **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)

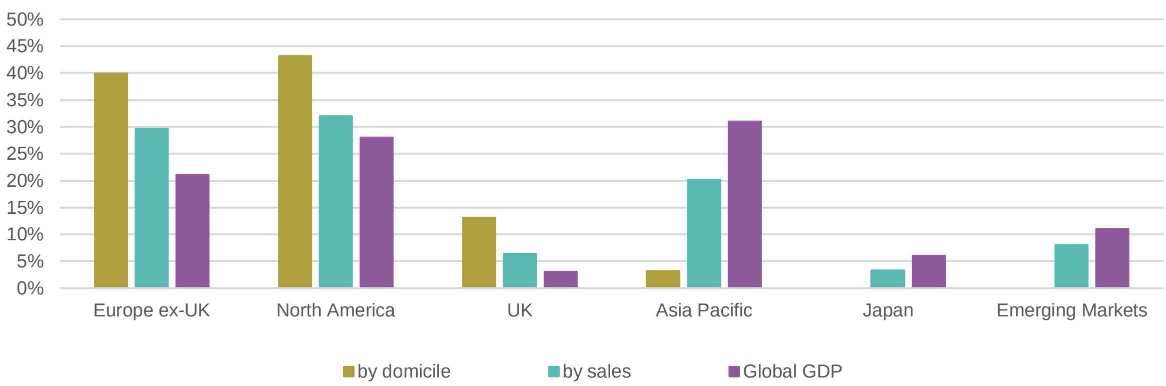
TB SGIG sector split



Source: Saracen Fund Managers as at 30/06/21

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

SGIG geographical split



Source: Saracen Fund Managers as at 30/06/21

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.

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

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