TB Saracen UK Alpha Fund

Quarterly Review – June 2021

SARACEN
share success

David Clark
Investment Director

MSCI ESG RATINGS
CCC | B | BB | BBB | A | AA | AAA
AA

Signatory of:
PRI Principles for Responsible Investment

FOR PROFESSIONAL INVESTORS ONLY-

Retail investors should consult their financial advisers

	TB SUAF	MSCI UK All Cap (TR)	Quartile
Q2 2021	+9.1%	+5.6%	1
1 Year	+55.2%	+21.0%	1
3 Years	+22.5%	+3.8%	1

Source: Saracen Fund Managers as of 30th June 2021

Robust Growth to Come

Outlook

I hope that it is not premature to say that the developed world does appear to be recovering rapidly from the COVID induced recession that we all suffered from March 2020. We have had a bit of a false dawn before when the winter wave of the pandemic proved to be a bit more severe than most (though by no means all) commentators had foreseen. It does now look like an economic bounce back of some sorts is under way and although the Delta strain of the virus still casts something of a shadow over some sectors, notably hospitality, leisure and tourism, most economic leading indicators are suggesting robust growth to come in H2 21 and beyond.

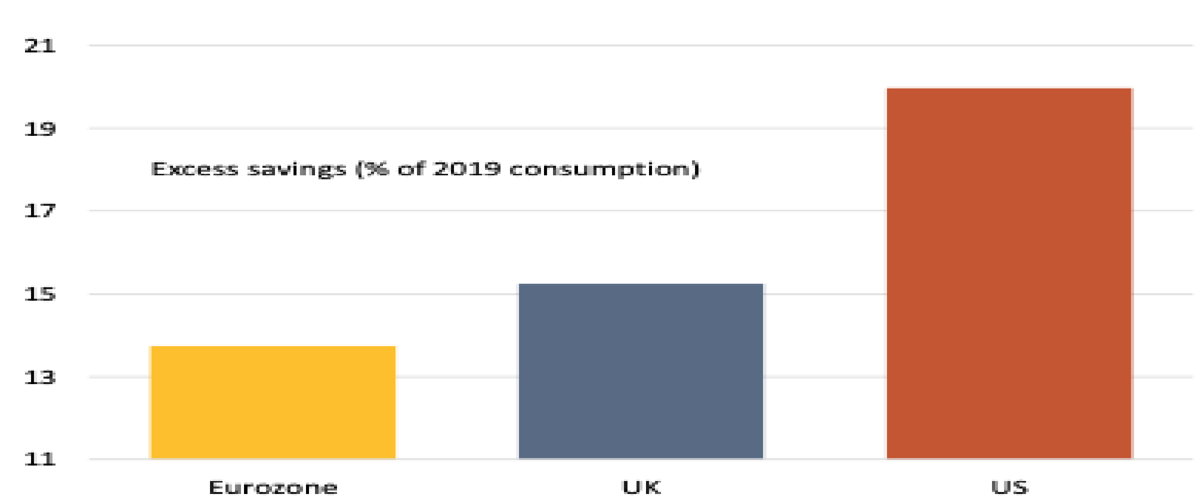
Of course, there are risks attendant with this, the most obvious being that a new strain of the virus rears its head and the already administered vaccine prove to be much less effective against it. Another concern surrounds the potential for higher rates of inflation, and we believe this is a real issue and will discuss it further later. It is also worth pointing out that policymakers have to play their part in the recovery and recognise that it would be a mistake to overplay their hand and impose excessive tax rises or onerous regulatory burdens on individual companies as well as industries. Earnings revisions remain firmly in positive territory – up 10% over the last 3 months in aggregate in the UK (*Source: MSCI, Morgan Stanley*) but despite this the UK market still appears to offer good value against its international peers.

David Clark
7th July 2021

Background

It is clear that consumers are keen for the situation on the streets to normalise and this, coupled with the fact that the savings ratio has gone up markedly during lockdown suggest considerable pent-up demand. In the UK savings are around 15% above normal levels and a similar picture is evident across the Eurozone and the US as is amply demonstrated by the chart below.

Excess Household Savings as a % of 2019 Consumption



Source: Berenberg

It is also clear that the macro environment is becoming a little more difficult for equity markets as policy makers are discussing the tapering of QE measures and the recent Fed meeting appears to have fuelled further concern around this point. In addition, a return of higher yields in the coming months as corporates begin to reinstate their dividends might suggest to some that the recent outperformance of 'Growth' over 'Value' will not persist. Indeed, it may be that we should expect plenty of 'mini reversals' in sector and style performance over the summer.

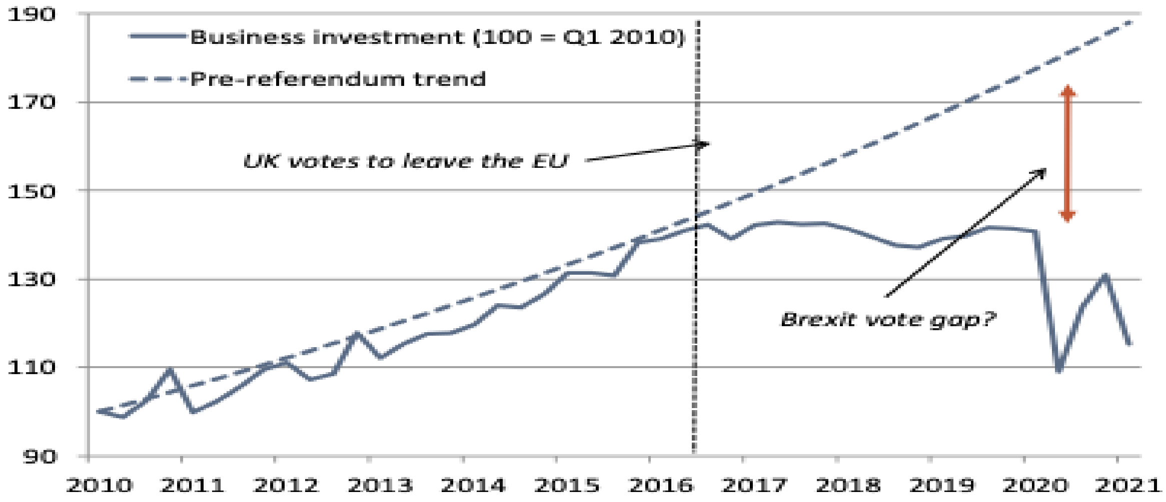
Worthy of discussion here is our long-held view that the risks to inflation are on the upside. There are a number of reasons for this including the fact that commodity prices, including oil, have been rising sharply which pushes up companies' input costs, encouraging higher prices thereby fuelling inflation. Wages too are on the up for all sorts of reasons, among them the lack of immigrant labour from Europe and beyond, as well as students working from home. It is not just the hospitality sector that is struggling to find staff, other sectors are too. In the first quarter of this year pay growth in the UK was 4.6%, the fastest rise since 2007 and workers in low wage sectors are enjoying particularly strong increases with annual pay rising 6.1% in retail and 11.3% in leisure.

It is also interesting to note that the tactics used by the central banks to combat the Global Financial Crisis by what is euphemistically called 'printing money' (no money is actually "printed") are in and of themselves inflationary. This did not matter at first as the excess liquidity was used to prop up the ailing banking sector, but it matters now. This money is going into real people's bank accounts via furlough and business support schemes. More money in circulation means rising prices.

As such, it seems sensible to assume that the recent spike we have seen in inflation will keep it at elevated levels, at least when compared to recent history during the remainder of 2021 and into 2022.

Many businesses paused their plans for capital investment after the Brexit vote in June 2016. The pandemic then delivered another setback. In Q1 2020 business investment was 21% below its pre-Brexit vote trend (see chart below). A partial recovery amid less elevated uncertainty can support investment in the next few years.

UK Real Business Investment



Source: ONS

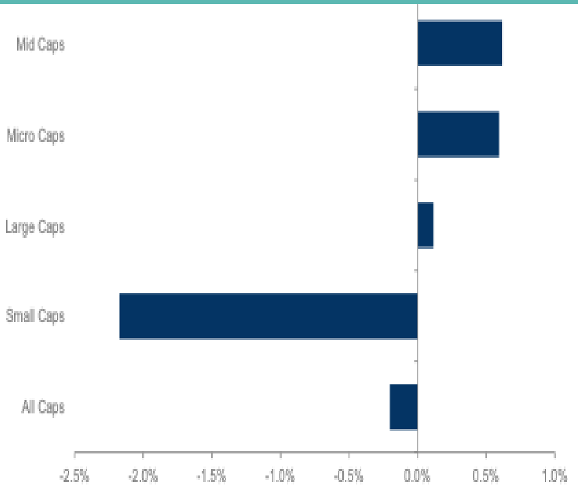
The outlook for trade remains uncertain as total trade is likely to remain depressed relative to pre-COVID levels for a while due to the drop in EU trade caused by Brexit. Based on the 3-month average to April, UK exports to the EU were down 24.5% versus the same period in 2019 while imports were down 29.0%.

Overall, the medium-term risks are fairly evenly balanced. The global backdrop is strong and there will likely be productivity upsides as well as a normalisation of the levels of cross border trading. However, this is not a given and there is always the possibility of an UK/EU trade skirmish which would do the economy no favours. As if all that and inflation were not enough, we cannot lose sight of the tail risk of Scottish independence which would seriously destabilise domestic politics as well as economic policy.

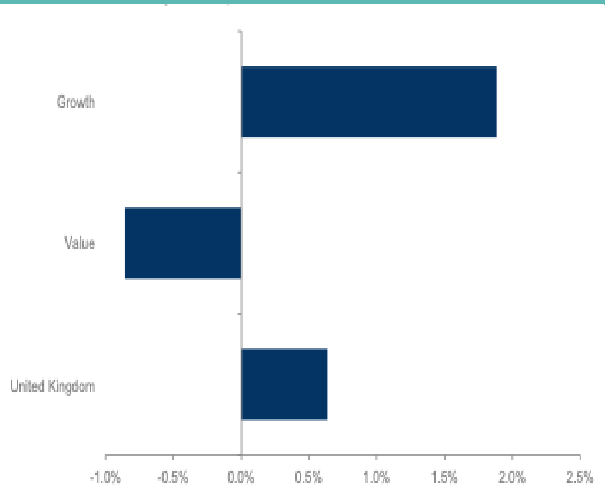
Portfolio Review

The portfolio had two good months and one disappointing month in Q2. April and May were strong as confidence grew that the path towards the easing of COVID restrictions was becoming clearer, that the UK's vaccination programme was being rolled out successfully and the incidence of new infections had fallen sharply. The fund struggled a bit more during June as its small and mid-cap bias as well as its 'value' tilt did it no favours. This is shown clearly in the two charts below.

UK Size Perf Over Last Month



UK Style Group Perf Over Last Month

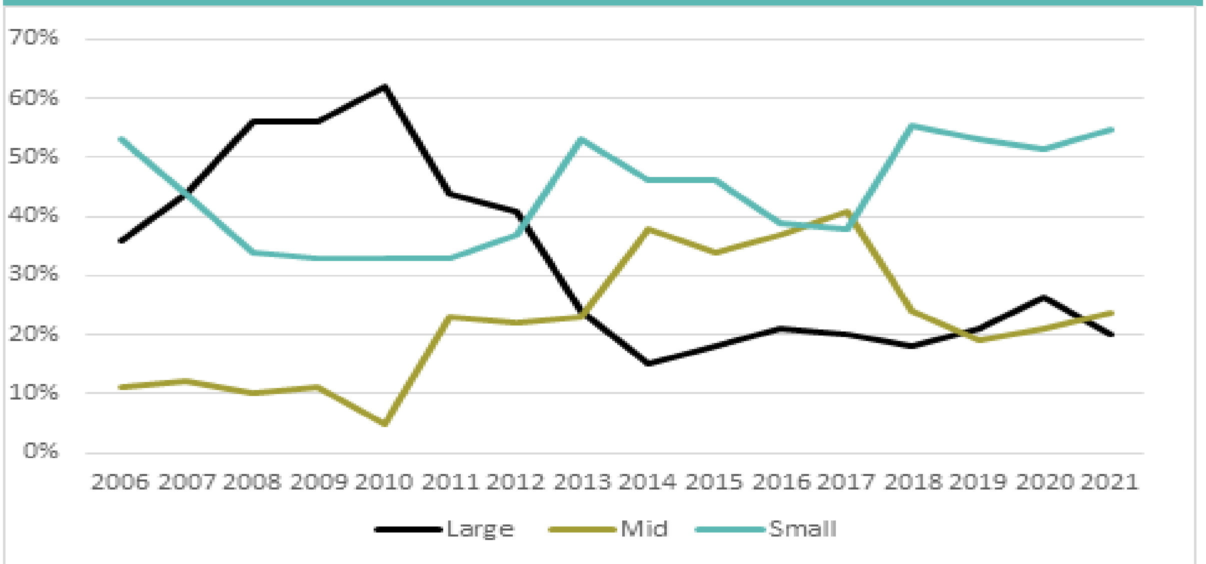


Source: MSCI, Morgan Stanley Research

The portfolio has a ‘multi cap’ structure with high exposure to small and mid-cap companies, which make up almost 80% of the portfolio. The focussed nature of the portfolio means that the Fund has a high active share at 98%. 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 as illustrated in the chart below.

UK Alpha Fund Breakdown by Market Capitalisation



Source: Saracen Fund Managers as of 30th June 2021

Contributions

Top Contributors		
Stock	Portfolio Weight	Contribution to Portfolio
Kin + Carta	3.65%	1.57%
Alpha FMC	3.28%	1.05%
Equiniti	1.80%	0.88%
Premier Miton	4.76%	0.83%
FRP Advisory	3.22%	0.82%
DiscoverIE	1.97%	0.75%
Tyman	3.83%	0.71%
Intermediate Cap	3.70%	0.60%
Premier Foods	3.61%	0.54%
Marlowe	2.56%	0.53%

Source: Saracen Fund Managers as of 30th June 2021

Top Detractors		
Stock	Portfolio Weight	Contribution to Portfolio
Wood Group	2.74%	-0.57%
Barclays	5.14%	-0.45%
Clinigen	1.98%	-0.41%
National Express	2.66%	-0.39%
Melrose	1.78%	-0.16%
Standard Life	3.09%	-0.13%
Prudential	2.06%	-0.03%
STV	2.51%	-0.01%
U + I	0.92%	0.02%
DFS Furniture	2.75%	0.07%

Source: Saracen Fund Managers as of 30th June 2021

Positive

- Kin + Carta: Meaningful returns achieved as company benefits from the transition to digital.
- Alpha FMC: Trading strongly through the pandemic and gaining market share from the 'Big 4' consultancies.
- Equiniti: On the receiving end and beneficiary of a takeover bid by a private equity firm in May.
- Premier Miton: Very well received interim results showing strong increase in AUM and robust fund performance.
- FRP Advisory: Full year trading update in May suggests revenue will increase by around 25% and EBITDA up 22%.

Negative

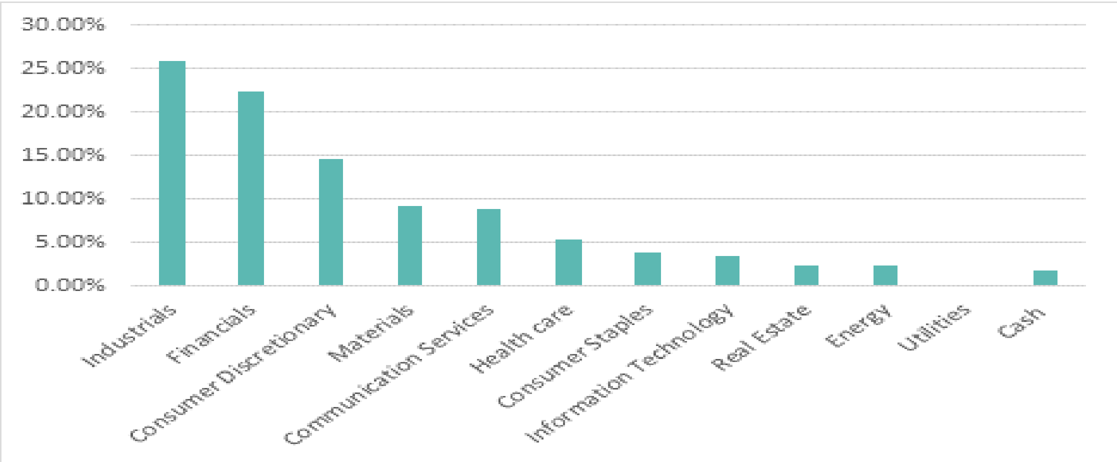
- Wood Group: Poor results as well as another reorganisation and the failure to hit self-imposed debt reduction levels.
- Barclays: Drifted along with all the Financials during the quarter especially post the FOMC meeting in mid-June.
- Clinigen: Disappointment as clinical trials pushed further out and lack of NHS activity as a result of COVID.
- National Express: Poorly understood stock which is trading well but currently in a very unloved area of the market.
- Melrose: Underlying trading respectable but the company has warned that the chip shortage will likely hit its auto business.

Portfolio Activity

It was a relatively quiet quarter in terms of changes to the portfolio. We exited Q1 2021 with the fund in good shape and through April we were content to let the stock holdings do what they are there for. In May we exited our position in Prudential having made some decent money and we also took some profits in Kin + Carta, U + I as well as Marlowe. In June we exited our position in Equiniti as it was taken over and topped up our position in Chemring as well as initiating a new holding in Brickability.

We bought Brickability in a placing of stock that was undertaken to finance the acquisition of a company called Taylor Maxwell. Brickability is a leading supplier of bricks and other building materials to the UK construction industry and is well-positioned to consolidate the fragmented UK building products supplier space. The acquisition of Taylor Maxwell looks to be positive for Brickability because It brings further diversification to the group from both a product and customer standpoint which is integral to Brickability's ethos of cross-selling and customer wallet size up-selling. It fully scales up and consolidates Brickability's brick merchanting and factoring position to the point of unquestionable industry relevance.

Sector Breakdown



Source: Saracen Fund Managers as of 30th June 2021

UK Alpha Strategy

The UK Alpha fund is a multi-cap fund which is constructed from the bottom up. We do not manage it with any thought of generating income and consequently would normally expect the yield to be low. Typically, we invest only in stocks where we se a clear valuation anomaly and do not have any set targets as to small, mid or large cap exposure.

As it happens just now, although we would argue that the UK market is in general looking quite attractive on valuation grounds, we have even more reasons to be optimistic regarding the small and mid-cap segments of the UK equity market. These include, but are not limited to:

- **Valuation**: Small and mid-caps are trading at a discount to large caps on most metrics.
- **Structural**: Passive money is affecting the volatility adjusted returns of large caps more than small and mid-caps.
- **Technical**: The outperformance of small/mid-caps tends to be greatest during the 2 years of a post-recession recovery.
- **Monetary**: Current outlook for interest rates and economic growth both favour small/mid-caps.

- **Historic**: These are the usual reasons for small/mid outperformance – the companies grow faster, the key beneficiaries of M&A, more widely owned by those with s
- **'Skin in the game'**, poorly covered by analysts etc.

This is why the fund is currently positioned the way that it is and is likely to be so until some or all of these factors are no longer the case. In addition, we keep our turnover to a minimum which is usually around the 30% mark per annum.

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 33 quoted UK companies making up a 'best ideas' fund with a very high active share, currently at 98%. 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 almost 80%% of the fund with large companies at 20% 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 be that growth, cyclicality deep value or a special situation of some sort.

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

Regulatory Status:
FCA Recognised: Yes
Scheme Type: OEIC

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