QUARTERLY INVESTMENT REPORT

March 2022

The Fund returned 11% over the quarter in the face of falling markets. Strong performance in times of adversity is valuable for investors, and below Kennox lays out reasons why we believe there is longevity in this performance.

November 2021, it turns out, saw a marked shift in the global investment environment. Inflation has not proved as transitory as many had hoped, and the markets' perceptions of risks have swung widely. Investors have already seen large moves in some assets – US government bonds, for instance, or the rise in energy stocks versus the drop in many tech names. Is this new environment also "transitory"? Kennox believes it is becoming a braver and braver stance to expect a swift and painless switch back to the old investment environment of the last decade. It is only sensible that investors have exposures, and we suggest significant exposures, to areas of the market that can do well in the new landscape. As Kennox believes most investors have yet to come to terms with this, this trend has a long runway ahead.

Whether this is the regime change it appears to be is the most important question facing investors at present. More and more of the signals and indicators that Kennox tracks lead us to believe this is the case. The causes of the return of inflation do not appear to be as clear-cut as expected, nor easily solved. Energy and commodity markets were very tight at the end of 2021 and the start of 2022, even before the shock of the Russian invasion of Ukraine. Leverage remains higher than ever, and the US bond market's recent softness is raising uncomfortable questions about further significant losses for holders of bonds, as well as having weighty repercussions as the world's most widely accepted risk-free rate. Many areas of the stock market, and in particular equities in the US and consensus tech names, remain very heavily owned and therefore at risk of a collapse in sentiment, as happened recently to former market darlings Netflix, PayPal and Facebook/Meta Platforms. Marking this time apart from the last few decades, and especially the Global Financial Crisis in 2008/9, the current troubles of disrupted commodity markets, supply chains and wider inflation cannot be solved by central banks' quantitative easings and continual cuttings of interest rates.

In this light, it is no surprise that areas that benefit from this new landscape, such as gold and energy, were the top performers for the Fund this quarter with **Equinor**, **Newmont** and **Shell** being the top three contributors to the Fund's performance. Kennox is convinced that the current environment strongly favours these stocks, and, importantly, will do so for an extended period.

The energy sector offers a useful first case study. The narrative regarding the energy market is fed by many underlying drivers, but Kennox suggests that the sector primarily is experiencing a classic cycle in a classically cyclical industry. Large investments in the early 2000s by all players, old and new, were followed by the period after 2015 which paired poor profitability with a dreadful outlook for the industry. Almost toxically out of favour, management teams were under enormous pressure to cut and then cut again their capital expenditure budgets, with investor and media opprobrium for any that hesitated. The pandemic's disruption to prices only drove the stake in further. Similar to innumerable other cycles over history, investment got squeezed, companies downsized, and weaker competitors exited the sector. Beyond this regular cyclical pattern, the current situation sees other factors that continue to distort this market. Covid restrictions and isolations rendered it impossible to do full and proper maintenance on rigs and fields, further squeezing production capabilities. Lastly, the focus on climate change and ESG factors has ramped up significantly in the last few years, and one doesn't need to spend long on social media to see that the pressure to conform is crushing. Managements are understandably reticent to dial back anytime soon on their ESG promises via a ramp up in capital expenditure.

Even before the conflict in Ukraine, tightness was evident in the energy markets with such signs as spiking gas and electricity prices in Europe, low global inventories, and OPEC+ not meeting their own production targets. Throwing proverbial gas on the fire, the West's attempt to shut a large chunk of Russian energy out of markets is very possibly explosive. New projects in this industry can take years or even decades to arrive, so significant increases in supply are impossible in the near term. The best outcome was to hope to not find ourselves in this situation in the first place, as there are no quick fixes or easy ways out. Consumers (which is all of us) now only have the recourse of trying to find offsets for this decline in living standards. One obvious course of action is a meaningful allocation to the energy majors, whose sector-leading and diverse operations leave them extraordinarily well positioned over a timeframe which can be measured in years not months. Kennox sees these holdings as core on a similar time frame.

There are many well-discussed reasons amongst investors as to why to have some exposure to gold. In this commentary, Kennox will highlight one reason in particular – governments' current obsession with solving all of society's problems. Currently there is a tidal wave of pressure on politicians to take away all the troubles of the world, continuously expanding the role and scope of government. As a society, we are asking too much. Sadly, governments cannot do it all; they cannot prop up the labour market (via furloughs), bail out the fertiliser companies (squeezed by high gas prices), prop up the electricity suppliers (also squeezed, this time between capped customer prices but uncapped input prices), pay all the pensioners (including the public servants whose pensions are multiple times more generous than any private pension), ramp up defence spending (war has returned), play catch up on education (a swath of the most vulnerable children have lost two years of schooling due to covid disruptions), and increase funding for the stretched NHS (which is far behind the curve on almost any non-covid measure). Anything left over should be pushed into refreshing and building more and better infrastructure.

Do all these government interferences matter? With inflation already high, with pointed questions around the sustainability of government and all other debt, with the central banks already having thrown the kitchen sink at financial and covid-related problems over the last decade, we should be wary of governments' increased and extended promises. Governments' drive to solve more, more complex and more expensive problems have been a recipe for monetary disasters as long as humans have had governments. This applies especially to governments with easily pliable fiat currencies at their disposal. Investors might have to look after themselves, not rely on governments. If Kennox's assessment here is even partly correct, the tailwinds for gold, as a financial asset that is no one else's liability and with no financial counterpart, will last for a decade or more. Not just a quarter. Kennox is not currently considering selling any of its Newmont shares.

The telecommunication companies in the Fund were also top performers this quarter, with **China Mobile**, **Singapore Telecommunications** and **KPN** all featuring in the top ten contributors to performance. Long seen as dull, their steadfastness is suddenly becoming more attractive to investors who are starting to reward their hardy cash flows and reliable dividends. These are underpinned by the operators' oligopolistic positioning providing mobile, broadband and other communication services now seen as essential for consumers, not as optional extras. The market's attention is returning to the attractions of dull and safe over excitement. Such are our times.

At times of such broad uncertainty, with markets herding and crowded, volatility will remain a feature. For Kennox this quarter the difficult side of volatility came in the form of **Quadient**, **Stella International** and **Currys**, the three stocks that held the Fund back the most. We feel that all three are excellent examples of opportunity for those willing to look but this quarter we will highlight Stella International as a prime example. A manufacturer of fashion and sports shoes with facilities across Asia and listed in Hong Kong, Stella's recent results show the strength of their operations, with growth in sales and profits, increasing prices, and robust cash flows. With a pristine balance sheet, the company also has an attractive pipeline of business. Yet the market is overlooking these strengths and the stock trades at c.10x our view of its long-term earnings potential. Backing this up is a mouth-watering 9% covered dividend yield. Investors will need to pick through the pitfalls and volatility of the wider markets in these times, but those with the inclination and the patience can find exceptional opportunities, such as Stella.

We live in an investment landscape which looks unlike any seen in decades. Assets once seen as "risk-free" now come laden with both nominal and inflation-adjusted risk. Excessive leverage could again become a millstone for stretched debtors, as it has many times in history. Crowded trades may unwind. But the investment outlook is occluded and investors will chase assets that can perform, causing some assets to melt up, not down, on the back of the significant economic tectonic shifts which will drive profitability for years. Kennox positioned for this landscape a long time ago, knowing what would matter but not when. The "when" has arrived – and examining the trends closely, Kennox believes that this "when" will be with us for some time to come.

Fund Data – 31 March 2022

Performance (total return net of fees) in Pounds Sterling

PERIOD	SHARE CLASS		
	CLASS P	CLASS I	CLASS A
YTD	11.4%	11.5%	11.6%
2021	9.6%	10.1%	10.5%
2020	-11.3%	-11.1%	-10.9%
2019	4.5%	4.8%	5.1%
2018	-2.5%	-2.2%	-2.0%
2017	2.1%	2.5%	2.6%
2016	35.4%	35.8%	36.2%
2015	-4.3%	-4.0%	-3.8%
2014	-1.5%	-1.1%	-0.9%
2013	15%	15%	4.3%*
2012	9.4%	10%	N/A
2011	-4.4%	-4.0%	N/A
2010	21%	12%*	N/A
2009	15%*	N/A	N/A

Source: Bloomberg. Performance figures are total return generated from the accumulation units since their launch (29 April 2013), and from the income shares prior to that. * Share classes launched mid-year: Class P on 30 April 2009; Class I on 12 May 2010; and Class A on 29 April 2013.

Top 10 Holdings

STOCK	REGION	SECTOR	MARKET CAP (US$M)	WEIGHT (%)
NEWMONT CORP	N. America	Materials	63,000	7.7
EQUINOR	Europe	Energy	123,500	6.9
SHELL	UK	Energy	209,500	6.2
YAMANA GOLD	N. America	Materials	5,500	4.7
BP	UK	Energy	96,000	4.5
EXXON	N. America	Energy	349,500	4.4
SINGAPORE TELECOM	Asia	Communication Services	32,000	4.2
SKY NEW ZEALAND	Asia	Communication Services	400	4.0
NEWCREST MINING	Asia	Materials	18,000	4.0
CHINA MOBILE	Asia	Communication Services	152,000	4.0
TOTAL TOP 10				**50.7**
18 OTHER HOLDINGS				48.1
CASH				1.2

Unit Prices

As at 31 March 2022:

- Class P Share Class:
  - Income: 129.00 pence (unit price at inception, 30 April 2009: 70.08 pence)
  - Accumulation: 154.80 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Class I Share Class:
  - Income: 130.40 pence (unit price at inception, 12 May 2010: 85.46 pence)
  - Accumulation: 160.90 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
  - Income: 130.60 pence (unit price at inception, 29 April 2013: 104.3 pence)
  - Accumulation: 164.00 pence (unit price at inception, 29 April 2013: 104.3 pence)

Charles L. Heenan

(Investment Director)

Geoff Legg

(Investment Director)

If you have any questions on Kennox or the Kennox Strategic Value Fund, please contact Peter Boyle on +44 (0) 131 563 5440 or email him at pboyle@kennox.co.uk. Our website is www.kennox.co.uk

Kennox Asset Management, 23 Melville Street, Edinburgh, EH3 7PE, Scotland, UK. Registered Number: SC302037

We do not track, nor are we constrained by, a benchmark. Reference to the MSCI World, MSCI World Value and IA Global indices are for comparative purposes only.