QUARTERLY INVESTMENT REPORT

September 2022

In our last quarterly commentary, Kennox noted that the markets resembled a roller coaster. This remains an ongoing theme of 2022 – the roller coaster ride continues.

Up to the quarterly market peak in the middle of August, global investors looked past any fears about persistent inflation, rising interest rates and slowing economies. Growth assets rallied, led by traditional favourites and the US was up 18% in seven weeks (note: all performance data is measured in sterling), the tech sector was up 21%, and stocks such as Amazon and Tesla were up 37% and 38% respectively. Markets overall were up 14% in this period.

This optimism looked, and was, premature. In the second half of the quarter, as worries returned in abundance, many of those gains evaporated and the market finished the quarter up 2.8%.

Like performance earlier in the year, the Fund did not fully participate in the growth-dominated rally in the first half of the quarter but held up much better in the less thematic and choppier second half. Over the quarter, the Fund ended down 2.1%. With the markets starting to recognize the advantages of the types of stocks Kennox holds, the Fund has been able to grind out a year-to-date return of 6.8%. A respectable though not remarkable return, this remains well ahead of falling global markets (world markets are down 8.9%).

The top two performing stocks over the quarter were **Stella International** and **Canon Marketing Japan** (CMJ), up 20% and 17% respectively. Kennox relishes finding idiosyncratic stocks, distinctive opportunities that don't fit neatly into a thematic box but are overlooked in the market for whatever reason. Stella and CMJ are excellent examples.

Stella International is a Hong Kong listed manufacturer of high-end fashion and athleisure shoes with production facilities across Asia, with Vietnam, Philippines, Indonesia and Bangladesh representing about three quarters of its manufacturing capacity. Clients include such diverse brands as Nike or Under Armour, Balmain or Balenciaga, Cole Haan or Diesel, Merrills or Uggs. The pandemic was obviously a difficult time for the industry, but the company traded profitably throughout and, as often happens with survivors, has emerged stronger. Stella's recent results show the strength of its operations, with growth in sales and profits, increasing prices, and robust cash flows. Although there are concerns about a slower second half of 2022, longer term the company has an attractive pipeline of business and potential for expansion, particularly via a new facility in Indonesia. The company also sports a very strong balance sheet, with a significant net cash position. The market is overlooking these strengths and the stock trades at under 10x our view of its long-term earnings potential, its Sustainable Earnings (SE). Current profitability makes our SEs look conservative. Backing this up is an astonishing dividend yield, over 10%, covered by the recent strong profitability. Stella is a 4.3% holding for the Fund.

CMJ is also an idiosyncratic gem, different though it is to Stella. CMJ is the marketing and distribution business in Japan for parent Canon. Traditionally the distribution arm for Canon's hardware offerings such as cameras and copiers, the company has evolved over the years into several independent and appealing business lines. CMJ provides solutions to a range of businesses across Japan, spread across large corporate customers but also the difficult-to-reach SME segment. This positions the company to benefit from the durable strengths of domestic corporate Japan. Longer term, profitability is improving as CMJ evolves towards higher margin offerings, especially those IT solutions. Shorter term, it posted strong results recently despite product shortages caused by supply chain interruptions. CMJ continues to run a very conservative balance sheet with next to no financial debt and significant cash balances, a substantial war chest for any rainy day. The company has been pushing up its dividend over time and currently yields 2.5%. Trading at 14x SE, it is a 4.6% position in the Fund.

Further top performers and contributors to Fund performance this quarter were our energy names, lead by **BP** and **Exxon Mobil**. The oil & gas industry has underinvested in new capacity since the depths of the cycle in 2014/5 and markets are only now recognising that the global economy is nowhere near weaned off these energy sources. Due to the long lead times for new supply to come onstream, tightness in energy markets will continue for longer than the market is pricing in, and this remains an exceptional opportunity. We have written repeatedly on energy in recent commentaries, and investors also might want to refer to our recent Fossil Fuels at a Time of Transition paper.

Holding the Fund back in this current roll of the roller coaster was Newmont, with weakness in the gold price aligning with less-than-exemplary results for the company. Recently, production has been slightly disappointing with cost inflation hurting sentiment. These are surmountable problems for a company with robust long-term assets. We stand firmly by the points made in the 1Q commentary on why gold looks so attractive at present. If anything, recent developments increase our conviction. Developments such as the Bank of England pivoting from monetary tightening via QT to emergency loosening, buying even more bonds in the Liability Driven Investment crisis. If confidence in government finances falls away due to actions such as these or otherwise, the number of hiding places will be few. In a world awash with leverage, the blue-chip name in this uncorrelated and unloved industry, the owner of a wide spread of mines with long reserve lives is enormously attractive. Newmont yields 5% and trades at 10x SE.

Having looked at several individual ingredients in the Kennox portfolio, all of which look exceptional in this environment, let's return to a couple of big-picture points as to why Kennox believes the Fund is especially well positioned for whatever might come. First, the portfolio is driven by a different dynamic to most of the market, a dynamic of underinvestment and recovery, and not the out-and-out growth which the market has been chasing in the last decade. Underinvestment describes situations where there are limited supply increases or outright decreases across an industry. The companies that come through these difficult periods will thrive, emerging leaner and facing less competition, and driving a recovery in profitability and earnings. Energy as mentioned above is an excellent example.

Second, the Fund remains risk-focused, with two specific risks a particular focus at present – valuations and leverage. This positioning is a key ingredient for what makes the Fund different to the growth markets that dominated in the last decade, markets which were typified by expanding valuations driven by seemingly never-ending earnings growth and a staggering increase of leverage across the board. Since a repeat of these extraordinary conditions now seems less and less likely (for instance, the period of historic low interest rates looks firmly behind us), a portfolio built with these risks in mind is especially desirable. For the Fund, leverage is at fractions of those across the market: one third of the names are net cash, 60% under 1x EBITDA, and only 10% of the names at 2.5x or higher. Equally, valuations are at a significant discount to market and sit at attractive absolute levels, with median PER levels at under 9x current earnings, for instance.

The investment landscape has changed in the last year, the return of not-so-transitory inflation changing the mindset of both politicians and market participants, limiting any path back to the old ways. Markets will likely continue to be rocked by LDI-type air pockets and other episodes as concealed risks emerge from a long leveraging-up cycle. In this new world, investors need to consider investing in a fundamentally different way to what thrived in the unique period of the last decade. New themes and areas of the market, not the ones that dominated the last decade, are where the richest seams of opportunities will flourish.

Kennox is becoming increasingly confident, even with this roller-coaster backdrop. Kennox's investment style can identify idiosyncratic opportunities such as Stella and CMJ, offering uncorrelated and attractive risk-to-return profiles that can perform in any market. Underinvestment and recovery as an investment theme can hold up in difficult markets and economic conditions, as well as in smoother sailing. Leverage and valuation metrics such as those of the Fund offer a further margin of safety.

Having patiently sat through an extended environment that didn't favour our thinking and positioning, Kennox is excited to see tailwinds continue to develop for our stocks, and our investment philosophy

Fund Data – 30 September 2022

Performance (total return net of fees) in Pounds Sterling

PERIOD	SHARE CLASS		
	CLASS P	CLASS I	CLASS A
YTD	6.4%	6.7%	6.8%
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 (%)
EQUINOR	Europe	Energy	108,000	7.7
SHELL	UK	Energy	182,500	7.1
EXXON	N. America	Energy	364,000	5.8
NEWMONT CORP	N. America	Material	33,500	5.8
BP	UK	Energy	91,500	5.6
SINGAPORE TELECOM	Asia	Communication Services	30,000	5.0
YAMANA GOLD	N. America	Materials	4,500	4.9
CANON MARKETING	Japan	Information Technology	3,000	4.6
STELLA INTL.	Asia	Consumer Discretionary	800	4.3
STAR MICRONICS	Japan	Industrials	500	3.7
TOTAL TOP 10				**54.4**
18 OTHER HOLDINGS				44.4
CASH				1.2

Unit Prices

As at 30 September 2022:

- Class P Share Class:
  - Income: 122.60 pence (unit price at inception, 30 April 2009: 70.08 pence)
  - Accumulation: 147.80 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Class I Share Class:
  - Income: 124.00 pence (unit price at inception, 12 May 2010: 85.46 pence)
  - Accumulation: 153.90 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
  - Income: 124.10 pence (unit price at inception, 29 April 2013: 104.3 pence)
  - Accumulation: 157.00 pence (unit price at inception, 29 April 2013: 104.3 pence)

Charles L. Heenan	**Geoff Legg**
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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