QUARTERLY INVESTMENT REPORT

March 2023

The Fund was up 1.3% over the first three months of 2023. Turning to one other timeframe we consider significant, the Fund has returned 17% since the market environment fundamentally changed in November 2021.

This quarter's performance for the Fund lagged global markets but was ahead of declining value indices (the MSCI World index was up 5.7%, led by such names as the $2 trillion stocks Apple & Microsoft; MSCI Value was down 1%).

Whilst this quarter's performance is a tad uninspiring, any short-term disappointment we feel is offset by our optimism for the future, due to the advantageous positioning of the Fund. Let's consider this positioning.

The principal day-to-day focus for Kennox is the operations & strategies of individual companies, tracked alongside the value that the market assigns to each company's earning streams. An illustrative case study is **Stella International**, a manufacturer of high-end shoes (we have discussed the company in these reports before, such as 3Q22 here). In March, the company reported their annual results for 2022, which were positive across the board. Operating margins increased to 8%, progressing towards a target of 10%, a level that it used to regularly achieve. Earnings followed margins upwards, rising by about 30% and backed up by even stronger cash flow where the unwinding of some working capital augmented the cash naturally generated from their ongoing operations. Stella also has a very clean balance sheet with minimal debt – in fact, the company holds significant net cash representing about a quarter of the market value of the company. The market, however, continues to overlook the positives, valuing Stella on only 7x earnings, at a c.20% discount to book value and with a dividend yield over 10% dividend (which is well covered by that robust cash flow). For a company that is a strong competitor in its niche market displaying a long history of success, this is very inexpensive.

It wasn't so long ago that investors thought such miserly valuations had been consigned to the history books, what with the efficiency of modern markets. As happy holders of stocks such as Stella, we are pleased that this clearly is not the case.

Perhaps we could highlight another segment of the portfolio which we find especially compelling: **our four Japan stocks** all trade at book value or less, each with big net cash reserves (averaging almost half of the market value of the companies), and all with solid operations. Recently the Tokyo Stock Exchange has been scolding their listed companies to increase efforts to raise their prices above book value, finding it vaguely embarrassing that so many of its listings are so inexpensive. In February, several companies saw their share prices jump when they took concrete action, actions such as Citizen Watch announcing a buy back for about one quarter of its outstanding shares, or Honda Motor announcing a buy back for a further $500m of its shares (you can read more about this from Bloomberg here). This increases the peer pressure felt by similar Japanese corporations, which includes our holdings, to ensure that their share prices more accurately reflect their inherent strengths.

Whilst waiting (mostly) patiently for the markets to recognize the value in our Japanese holdings, Kennox can be proactive. Over the last few years, we have been regularly engaging with each of our Japanese companies to suggest that maintaining such large financial reserves is not efficient, nor in the long-term interests of patient committed shareholders – with the tangible example being inflation eroding the value of these financial assets. To date none of our holdings have undertaken such significant moves as those of Citizen or Honda Motor. But consistent engagement, possibly reinforced by those positive local role models, should further enhance returns for shareholders.

The first quarter of 2023 saw several momentous events in global markets. Three US banks of consequence failed, and a critically wounded Credit Suisse was unceremoniously pushed into the arms of its competitor UBS. Besides the obvious seriousness of a banking crisis in the world's largest economy, several of the authorities' actions should be noted as especially meaningful. First off, by guaranteeing all deposits at the US banks involved, for the foreseeable future the authorities have effectively backed the entire deposit base of the US banking system – how could they face down the accusations of hypocrisy when wealthy individuals and IT companies were bailed out but not the next lot of poor worthy depositors, whomever they might be. Although consistent with the trend of continuously intensifying government interventions, writing a blank cheque this enormous, a promise that the authorities obviously cannot honour in full, further undermines their already thin credibility.

Secondly, in their efforts to calm the turbulence, the authorities have challenged well-established market concepts, such as ownership rights, or fair pricing for market participants. For instance, the Credit Suisse merger wiped out some bondholders (the Additional Tier 1 ones) but threw a not inconsequential $3bn bone to equity holders, who by almost any interpretation are subordinate in seniority to bondholders. This upends the established priority of ownership. Another example is the US Federal Reserve's recent special lending facility which accepts at face value bonds trading at prices well below that. This is a stunning and arbitrary transfer of wealth and risk from the private sector to the taxpayer. As necessary as these actions might be seen in the crux of a crisis, the unintended consequence is to undermine faith in the markets themselves, prioritising an arbitrary and short-term interpretation of what is in the interest of the wider good over the long-term smooth functioning of markets.

How should investors tread in these extraordinary markets? Kennox has discussed how we believe the portfolio is well positioned for our times, especially via three characteristics: under-invested, under-owned, under-leveraged (such as this discussion in the quarterly commentary here – 2Q22). Stella and the Japanese holdings are concrete examples of the three, which Kennox further instils across the portfolio. Firstly, there will be advantages to companies that operate in areas of the economy that have seen limited investment and therefore decreased competition (i.e. "under-invested"). Secondly, companies priced at low valuations offer attractive return profiles, a margin of safety with additional upside potential on any positive developments (i.e. "under-owned"). The portfolio remains attractive on low valuations, both absolute and relative. Lastly, leverage is at last attracting the market's attention. Pockets of excess from the extended times of easy money will continue to bubble up to surface and Kennox would be surprised if the recent banking wobbles are the last problems arising from leverage in this cycle. Kennox holds no banks, and the balance sheets of our companies exhibit low levels of leverage across the board.

Opportunities arise when a wide gap exists between reality and appearance[1]. This past period of easy money has allowed narratives and appearances to stray far from pragmatism and reality. Current markets offer many opportunities, coming from over- and under-investment in various industries in the global economy, from the market's crowding and herding, and from the authorities' monetary actions of the last few decades. This is what allows Kennox to be fundamentally optimistic about the prospects for the Fund, in the face of, or even because of, the challenges facing investors at present.

[1] Edward Chancellor describes a notable episode via a conversation between the banker Felix Somary and JM Keynes prior to the market turbulence of 1929; page 95 of The Price of Time (2022).

Fund Data – 31 March 2023

Performance (total return net of fees) in Pounds Sterling

PERIOD	SHARE CLASS		
	CLASS P	CLASS I	CLASS A
YTD	1.2%	1.2%	1.3%
2022	12.3%	12.6%	12.9%
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 (%)
SHELL	UK	Energy	205,500	6.6
NEWMONT CORP	N. America	Materials	39,000	5.8
BP	UK	Energy	118,500	5.8
EXXON	N. America	Energy	446,500	5.7
EQUINOR	Europe	Energy	96,000	5.4
YAMANA GOLD	N. America	Materials	5,500	5.1
SWISSCOM	Europe	Communication Services	33,000	4.5
SINGAPORE TELECOM	Asia	Communication Services	31,000	4.5
TESCO	UK	Consumer Staples	24,000	4.4
CANON MARKETING	Japan	Information Technology	3,000	4.3
TOTAL TOP 10				**52.0**
17 OTHER HOLDINGS				45.9
CASH				2.1

Unit Prices

As at 31 March 2023:

- Class P Share Class:
  - Income: 127.80 pence (unit price at inception, 30 April 2009: 70.08 pence)
  - Accumulation: 157.80 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Class I Share Class:
  - Income: 129.20 pence (unit price at inception, 12 May 2010: 85.46 pence)
  - Accumulation: 164.50 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
  - Income: 129.40 pence (unit price at inception, 29 April 2013: 104.3 pence)
  - Accumulation: 168.00 pence (unit price at inception, 29 April 2013: 104.3 pence)

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