QUARTERLY INVESTMENT REPORT

June 2024

Much has been said about the rise and rise of passive investing. We understand the allure – in recent times, low fees have been coupled with great performance as a small number of large companies have driven indices to new heights. Passives are by no means a poor investment in general, but we need to be a bit more wary at the tail end of a long bull market, and at any time they sit best alongside a portfolio of actively managed funds. Those active funds must justify the higher costs. Closet index funds (i.e. those that are afraid to deviate too far from a benchmark used to compare their performance) have no place in the new world of investing and many that are not truly active are finding it hard to retain assets under management. This feels reasonable. As a brief look down our top holdings will attest, Kennox fits nicely into the “truly active” bucket. We hold none of the stocks that are driving global equity returns and derive our performance from stocks that are unlikely to be represented (or at least not materially so) in any of our clients’ other holdings, whether they be active or passive.

In the second quarter, the Fund returned 5%, taking year to date returns to 8%. Much of that return has been derived from companies that will not be known to most. For instance, the best performing stocks in the quarter were **Yue Yuen**, **Texwinca**, **Stella International**, **VTech**, and **Pan American Silver**.

Looking at a couple of these will give a feel for just how differentiated the stocks driving our performance are from the broader market narrative. **Stella International** is a Hong Kong listed manufacturer of high-end fashion and sports shoes. Though listed in Hong Kong, it is really Pan-Asian. It is owned by a Taiwanese family, and the majority of manufacturing takes place in Vietnam, Indonesia and the Philippines. Things are going very well for them currently: the market is picking up after inventory destocking amongst sports shoe retailers through 2023; they are increasing their capacity from 60m pairs of shoes a year to closer to 85m pairs over the next few years; and margins are increasing as they slowly shift their product range to the higher end. Very few competitors are able to attract fashion clients (think Balenciaga and Balmain, but Nike Jordans as well), or the will to operate in batch sizes of hundreds of thousands rather than millions. But this is where the best margins are to be found and where Stella specialises. Whilst things are going well and shares have been strong (up over 30% in the quarter), it remains frugally valued at c 10x expected 2024 earnings, a 10% free cash flow yield, a 7% dividend and with 20% of the Market Cap in net cash. It is an 8.4% position and the Fund’s biggest holding.

Texwinca is also worth a look. It is a manufacturer of textiles in China that has been having a tougher time of late, as a slower retail market has fed through to lower orders for the fabrics Texwinca provides. Shares jumped this quarter as the market reacted to earnings that were close to double absolute trough levels in 2023. The shares remain incredibly cheap despite the 40% jump during the quarter. We see normalised earnings at around HK$200m (with free cash flow significantly higher) versus a market capitalisation of HK$1.4bn, so around 7x earnings. The company has net cash of around HK$0.8bn and further $500m in long term investments and is a so called “net-net” (current assets less all liabilities is worth more than the entire market capitalisation of the business). Texwinca is a 1.9% position.

Elsewhere, we added **B&M European Value Retail** (or just B&M for short) towards the end of June. B&M is a highly effective retailer, with discount stores in the UK and France. This is an out-and-out growth stock, trading at value prices. Discount retailers are doing very well as the consumer remains under pressure. B&M sells general merchandise alongside longer lasting consumer goods and is a good complement to the likes of Aldi and Lidl with little stock overlap. They often target sites where there is already an Aldi or Lidl, as their stores tend to thrive in their locality. They know what they are good at and have a complete focus on price. They don't deliver (it's a loss leader), they don't advertise (they'd rather use this money to reduce prices), they don't have window displays (they require staff to maintain), they don't sell clothes (changing rooms are an inefficient use of retail space), and they don't have fridges or freezers (they are expensive to run and chilled goods are expensive to distribute). All of this allows them to keep prices around 15-20% cheaper than at Tesco, Asda, Morrisons and Sainsbury's. In terms of growth, they currently have around 750 stores in the UK, and aim to grow this to over 1,200 at a rate of about 45 stores per year. In France, they have just 120 stores, but see it as a market with similar potential to the UK in the longer term. Despite this growth potential (and track record of delivery – revenue has grown 60% and net profit has doubles since before Covid in 2019), the company trades at just 12x current year forecast earnings and pays a 7-8% dividend. B&M is a 2.4% position.

Amongst the negatives for the Fund during the quarter was **Quadient** (down 9% in the quarter). The shares sold off as the mid-term growth outlook detailed at the capital markets day in June underwhelmed the market. This is the "commentators curse" in action: we covered Quadient in our last quarterly. Management is guiding to 3% p.a. EBIT growth in the near term, and whilst this does little to excite, it certainly justifies higher valuations than those we are seeing now at c. 8x earnings.

When looking at the market's reaction to Quadient's 3% growth projections, it's interesting to compare to a company like Apple. Apple has 381bn in revenue (3% below revenue to September 2022) and earnings of $100bn (less than 1% above earnings in 2022). For that "growth", you pay a heady 32x multiple. Nvidia is growing like a weed, but trading at over 70x earnings – what happens when the clamouring for AI chips slows, or a "reasonable" alternative is found to be sufficient?

We know where we would prefer to have our money invested. Looking at valuations across the portfolio, the stocks trade at c.10x current earnings, with a c. 10% free cash flow yield and a 4.5% dividend (recall that we take fees to income, so the dividend paid out from the Fund is lower).

For those so inclined, passive investing will get you plenty of exposure to the mega cap companies currently hogging the limelight, perhaps too much exposure. Where one seeks diversification, it is important to ensure that it really is diversified, or as we put it last quarter, "pointing in a different direction".

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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 at clients@kennox.co.uk. Our website is www.kennox.co.uk

Fund Data – 28 June 2024

Performance (total return net of fees) in Pounds Sterling

PERIOD	SHARE CLASS	
	CLASS I	CLASS A
YTD	7.6%	7.7%
2023	8.0%	8.2%
2022	12.6%	12.9%
2021	10.1%	10.5%
2020	-11.1%	-10.9%
2019	4.8%	5.1%
2018	-2.2%	-2.0%
2017	2.5%	2.6%
2016	35.8%	36.2%
2015	-4.0%	-3.8%
2014	-1.1%	-0.9%
2013	15%	4.3%*
2012	10%	N/A
2011	-4.0%	N/A
2010	12%*	N/A
2009	N/A	N/A

Source: Kennox. 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 I on 12 May 2010; and Class A on 29 April 2013.

Top 10 Holdings

STOCK	REGION	SECTOR	MARKET CAP (US$M)	WEIGHT (%)
STELLA INTERNATIONAL	Asia	Consumer Discretionary	1,500	8.4
SHELL	UK	Energy	229,500	7.2
NEWMONT CORP	N. America	Materials	48,500	6.5
SINGAPORE TELECOM	Asia	Communication Services	33,500	4.5
AGNICO EAGLE MINES	N. America	Materials	32,500	4.5
FUKUDA DENSHI	Japan	Health Care	1,500	4.3
CANON MARKETING	Japan	Information Technology	3,500	3.9
YUE YUEN	Asia	Consumer Discretionary	3,000	3.8
EQUINOR	Europe	Energy	86,500	3.8
YOUNGONE HOLDINGS	Asia	Consumer Discretionary	800	3.7
TOTAL TOP 10				**50.5**
20 OTHER HOLDINGS				49.0
CASH				0.5

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