Kennox Strategic Value Fund Quarterly Investment Report

March 2013

Equity investing contrasts greed and fear, return and risk, absolute returns and volatility. Absolute returns were the firm focus of the first quarter of 2013, as the stock markets of the world were in a buoyant mood. In fact, to our mind, there has been a slightly unnerving absence of volatility during the quarter – even the Cypriot banking disaster put little more than a dent in the market's run. Against this backdrop, the Fund returned a very attractive 11%. With so much liquidity flushing through the system and interest rates still at all-time lows, it is very possible that markets continue to run. If they do, we would expect to continue to deliver good absolute returns (although very possibly below those of the market). Our focus, however, is on the downside, particularly as the market appears to be taking a very nonchalant view of risk at present. It is with this balance of participating in running markets but keeping an eye on the worst case scenario that we have delivered strong returns over the longer term with the "sleep-well-at-night" factor of lower volatility and lower drawdowns.

With this in mind, it is interesting to look back twelve to eighteen months to see how we have been blending risk and return, and how the portfolio has changed to reflect that blend. Several of our stocks have "popped" during that period, having had a significant jump in share price. This is pleasing, and reflects a key part of our investment philosophy: if you buy high-quality undervalued companies, and remain patient, the market will eventually revalue those shares. However, as the share prices increase, the "margin of safety" is eroded, so the stocks become less attractive to us and should hold a lower weight in our portfolio. This seems self-evident, but for the most part we find that stocks behave as Giffen goods – the higher the price, the more investors want to own them. Our constant challenge is to avoid this behavioural bias.

Reflecting this, Asia has come down from 20% of the Fund twelve months ago to around 12% now. We have lowered our weightings as our stocks (particularly some of the small caps in Hong Kong) have performed well there. Europe has increased slightly, and counter-intuitively North America has increased as well (counter-intuitively as North America is not known for the type of stocks we prefer: companies on non-peak earnings, with little or no debt and that pay dividends). We have had a relatively small exposure to North America ever since the Kennox investment team came together in 2007, and until recently have only found two opportunities there (Mattel which we sold in June 2010, and Johnson & Johnson). Over the last year we have found two further opportunities that are each very attractive and differentiated from the rest of the portfolio.

In terms of specific stocks, Munich Re was one of the biggest stocks in our portfolio eighteen months ago when the share price was much lower, and we have been trimming its size in its recent strength; we have also sold some shares in Johnson & Johnson as it has been running. Actions such as these have freed up money to fund our five new ideas since the end of 2011 (Tesco, Delta Lloyd, Encana, M6-Metropole Television, and Western Union).

We were very pleased to have made good absolute returns over this period, and believe that we can continue to do so if the markets remain buoyant. At the same time, we feel we are well positioned for an increase in volatility and we continue to search out the next good buying opportunities. We remain patient, and expectant.

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Stock of Interest

Western Union

Western Union is the world's leading provider of cross-border remittance payments, being approximately four times the size of their nearest competitor. This strength enables them to negotiate lower commission rates whilst still providing their global agent network (they have over 500,000 field agents) with better revenue opportunities than from their competitors. With the largest online money transfer platform in the world and some key mobile network partners, they also stand to benefit from an increase in the digital money transfer market.

The share price dropped sharply by around a third in October 2012 after the company announced that they would be cutting pricing to increase market share in key transfer corridors. This fall left Western Union trading on near 5-year low prices. We feel the market is underestimating the strength of Western Union's business, which has sustainable free cash flows well in excess of 10%. Kennox added the company to the portfolio in February 2013.

Performance Commentary

The Fund returned 11.3% over the quarter (11.2% for the professional class). For reference sake, the MSCI World returned 15.4% over the quarter.

We are always disappointed to underperform global stock markets. But we are not surprised that our style did not keep up with markets that have moved sharply in a short period of time. We are still confident that we will meet our performance objectives: good absolute returns (such as those of last quarter) but with lower volatility and drawdowns than the market. What is needed is time – our time frame has always been, and continues to be, five years or longer. We watch and monitor performance closely over shorter time periods, to ensure that we are on track. However, we cannot be distracted from what is most important: the long term. This Fund is best suited to clients with a similar outlook.

Performance (total return net of fees) in Pounds Sterling to 31 March 2013

Period	Professional share class	Institutional share class
3 Months	11.2%	11.3%
6 Months	12.5%	12.7%
1 Year	16.8%	17.4%
2 Years	16.5%	17.5%
3 Years	30.5%	N/A
Since launch of share class	60.8% (30 April, 2009)	31.8% (May 12, 2010)

Source: Bloomberg

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Fund data as at 31 March 2013

Top 8 Stocks

	Stock	Region	Sector	Market Cap (US$m)	Fund Weight
1	SWISSCOM	Europe	Telecoms	24,300	4.6%
2	M6-METROPOLE TV	Europe	Consumer Discretionary	2,000	4.6%
3	TESCO PLC	UK	Consumer Staples	47,000	4.4%
4	WESTERN UNION	N. America	Technology	8,300	4.2%
5	DELTA LLOYD	Europe	Financials	3,300	4.2%
6	CANON MARKETING JAPAN	Japan	Consumer Discretionary	2,200	4.1%
7	ETFS PHYSICAL SWISS GOLD	Gold	Gold	N/A	4.1%
8	SANKYO	Japan	Consumer Discretionary	4,400	3.9%

Unit Price

As at 31 March 2013:

- Professional Share Class: 104.00p (unit price at inception, 30 April 2009: 70.08 pence)
- Institutional Share Class: 105.30p (unit price at inception, 12 May 2010: 85.46 pence)

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