KENNOX
TRUE VALUE INVESTORS

Kennox Strategic Value Fund Quarterly Investment Report

September 2013

Since the beginning of year, the Fund is up 14%. As we move into the last quarter of 2013, it's an appropriate time to look at what has gone well and what not so well this year.

Turning first to geographies, returns have been very strong in Europe, and also strong in Asia and Japan. In Europe, the three "new" stocks (purchased since the beginning of 2012) have performed well, especially Delta Lloyd and M6 Metropole. Europe has had more than its share of flaws but this environment has meant that prices were attractive, giving an opportunity to buy good companies at very reasonable valuations. The Fund has a low exposure to North America due to profits being at peaks and to the bias against dividends and for buy backs, often financed via debt. Until these metrics change, we will not rush in.

Regarding sectors, Consumer Discretionary is a bit of a catch-all sector but this area has done well for the Fund this year, driven by M6 Metropole, mentioned above, as well as some of our smaller companies such as Kingmaker Footwear in Hong Kong. Energy has been a notable laggard but the lack of performance from our energy stocks is not worrying. Rather, we see it as a good example of balance in the portfolio – we would be more concerned if all stocks were moving up uniformly, thus increasing the likelihood that all may drop at the same time at some point in the future. Having a few stocks and sectors that have yet to perform is desirable. Telecoms have been good middle performers for us in this period but they have done us very well over a three year period, helped by such stocks as SmarTone and AsiaSat of Hong Kong, and M1 of Singapore. These are good examples of how we think about portfolio management: we do not guess which part of the portfolio will do well over any one period but aim to build a balanced, diversified portfolio which can perform over many different time periods and in different market environments.

While the vast majority of the stocks in the portfolio have done well in 2013, there are a few that have held us back. Fujikon of Hong Kong, for instance, has performed poorly in this period. However, this stock performed extraordinarily well over the last two years (up 5x from trough to peak) so it is not surprising to see it slow down. Canon Marketing has not been strong either, the rise in share price has not been sufficient to offset the weakness in the yen. This company still has 60% of the market cap in cash and is trading at 0.8x tangible book and we are happy to continue to hold.

Over the course of the year, we've held high levels of cash, and continue to have a small holding in gold, both of which have been a drag on relative performance in these bullish markets. Although they have not made positive contributions recently, the role of both in the portfolio should not be underestimated – they will be extremely helpful when market volatility returns.

We scour the world constantly for new stocks but currently find they are typically too expensive, have profits too close to peaks, or are too risky and cyclical. Now is not the time to sell higher quality assets for lower quality ones. We have not found anything that we would prefer to hold than what we already do.

We are happy that the portfolio has balance and consists of quality stocks at attractive prices. In other words, we cannot think of any better way to get risk-aware, conservative exposure to the equity markets. In these times, of US government infighting and shutdowns, of the continuing aberration of exceptionally low interest rates, of the extraordinary experiment of quantitative easing, being conservative seems the only rational course of action.

Stock of Interest

Swisscom

Swisscom is the former state owned national telephony company (i.e. the equivalent to Britain's BT), and remains 57% owned by the Swiss government. It still enjoys a market leading position in the Swiss market providing fixed line, broadband, mobile and television services both to residential customers and businesses. In 2007, it branched out into Italy by acquiring Fastweb, an Italian domestic provider of fixed line, broadband and digital TV.

In April 2009 (when Kennox launched the UK Fund) Swisscom traded at about CHF 300, was rated at a price/earnings ratio of 10x and yielded almost 7%, particularly attractive when received in the safe-haven currency of Swiss Francs. Three and a half years later, the stock has returned over 80% for the Fund (both capital appreciation and dividend income). In sterling terms, the return has been over 100%. However, as they have begun to turn around the Italian business, and worked down the debt burden they took on with that acquisition, the business is still trading on less than 14x earnings (both trailing 12 months and trailing 5 years). Whilst we would prefer companies on closer to 10x earnings, for the defensive nature of the revenue streams and the very attractive dividend (still over 5%) in Swiss Francs, we are very happy still to be owners.

Performance Commentary

The Fund returned 2.4% over the quarter (2.3% for the professional class). For reference, the MSCI World returned 1.6% over the quarter.

The Fund continued to deliver absolute returns over the period, in spite of some market weakness in August.

Our objective is to achieve good absolute returns over the longer term while striving to take on the lowest equity risk possible. The Fund is up 14% since the beginning of 2013, with lower draw downs and volatility. This is consistent with our objective.

Performance (total return net of fees) in Pounds Sterling to 30 September 2013

Period	Professional share class	Institutional share class	Class A share class
3 Months	2.3%	2.4%	2.4%
6 Months	2.4%	2.6%	N/A
1 Year	15.2%	15.6%	N/A
2 Years	25.9%	27.0%	N/A
3 Years	28.3%	30.1%	N/A
4 Years	46.3%	N/A	N/A
Since launch of share class	64.7% (30 April, 2009)	35.2% (12 May, 2010)	3.2% (29 April, 2013)

Source: Bloomberg

KENNOX
TRUE VALUE INVESTORS

Fund data as at 30 September 2013

Top 8 Stocks

	Stock	Region	Sector	Market Cap (US$m)	Fund Weight
1	M6-METROPOLE TELEVISION	Europe	Consumer Discretionary	2,700	5.7%
2	WESTERN UNION	N. America	Technology	10,300	5.4%
3	SWISSCOM	Europe	Telecoms	24,600	5.3%
4	DELTA LLOYD	Europe	Financials	4,300	4.9%
5	ROYAL DUTCH SHELL PLC	UK	Energy	209,900	4.6%
6	TESCO	UK	Consumer Staples	45,100	4.6%
7	ENCANA CORP	N. America	Energy	12,800	3.8%
8	FUKUDA DENSHI	Japan	Health	800	3.5%

Unit Price

As at 30 September 2013:

- Professional Share Class:
  - Income: 106.3 pence (unit price at inception, 30 April 2009: 70.08 pence)
  - Accumulation: 106.4 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Institutional Share Class:
  - Income: 107.6 pence (unit price at inception, 12 May 2010: 85.46 pence)
  - Accumulation: 107.7 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
  - Income: 107.7 pence (unit price at inception, 29 April 2013: 104.3 pence)
  - Accumulation: 107.7 pence (unit price at inception, 29 April 2013: 104.3 pence)

Charles L. Heenan
(Investment Director)

Geoff Legg
(Investment Manager)

If you have any questions on Kennox or the Kennox Strategic Value Fund please contact Peter Boyle on +44 (0) 131 240 3870 or email him at pboyle@kennox.co.uk.

Our website is www.kennox.co.uk.