Kennox Strategic Value Fund Quarterly Investment Report

December 2013

Stock markets are unpredictable, often frustrating, sometimes exhilarating, frequently rewarding, but are rarely boring. The global stock markets in 2013 were no exception. Developed markets around the world were strong with several markets, such as the US, delivering very strong returns. This was not so for most emerging markets, those highly-touted countries of the future and market darlings of not so long ago (yet more proof of the fickle nature of markets?). The returns for investors in 2013 were mostly very good, unless one backed the rare wrong horse which was most likely an emerging market or a commodity. As in any year, 2013 brought intriguing political events. 2013's featured trench warfare between the Republicans and the Democrats in the US resulting in the first government shut down in 17 years, a disturbing attempt by the Chinese to claim control over disputed airspace in the South China Sea, more lunacy in North Korea, the continuing development of economic policy by Prime Minister Abe in Japan, terrorist attacks of various levels of severity around the globe, and continued troubles in Syria and other hot spots of the world. All in all, the world and the global economy avoided any major setbacks, and this was enough to push markets higher.

How should investors be positioned for 2014? We believe that investing in expensive stocks (i.e. ones with high PE ratios and cyclically-adjusted PE ratios) is a risky proposition in the long term, even if it continues to be a profitable one in the short term. Expectations have risen with markets, and we are concerned that news and results now need to be even stronger to drive prices higher. A good example of these rising expectations is how earnings have conspicuously not come close to keeping up with share price movements, especially in the US. As well, we continue to highlight the risk of normalisation of interest rates and withdrawal of quantitative easing (QE). Unwinding this unprecedented arrangement will be fraught with risk, and investors have to be wary of trying to be too clever in timing their exit from QE-inflated assets.

With these high expectations, we are concerned that bad news might now have an exaggerated, and painful, effect. Match this with high cyclically-adjusted price-to-earnings ratios, the extreme valuations placed on some concept stocks (such as recent tech IPOs?), the high correlation of many markets and asset prices, and the dearth of outright value that we are seeing at present, and, now more than ever, investors need to be more wary of a pull-back than squeezing out the last drops of high-risk returns. Equities are a core asset class for a long term investor (and certainly can continue to run on massive injections of liquidity by QE), but investors need to be selective and conservative. If insufficient investment ideas can be found at more appealing valuations, cash is a legitimate, even attractive alternative.

Through patience and the steadfast commitment to its investment style of stock picking and value, the Fund should be attractive to a certain type of investor: one who is seeking equity exposure but in a conservative manner; who is more worried about absolute returns than relative ones; who does not feel comfortable chasing hot or fashionable or momentum assets; who can afford to take a long term view.

KENNOX
TRUE VALUE INVESTORS

Stock of Interest

Statoil

Statoil is an exceptional and unique asset, controlling around 60% of all oil and gas production from the Norwegian Shelf. In a time when many energy assets are located in challenging political locations, one that is in an ultra-safe jurisdiction is especially attractive. With the oil sector having underperformed global markets significantly in 2013, we were able to purchase Statoil on some very appealing valuations: less than 10x earnings (current, trailing 5 year average and even trailing 10 year average earnings). The company has little debt and pays a 5% dividend in Norwegian Krone. In addition, we are attracted to stocks that should be positively impacted by events which would be detrimental to the majority of global stocks. One such event is an oil price spike, especially one led by unrest in the Middle East. In that scenario (amongst others), Statoil should perform very well as it leverages its differentiated reserve base. We added Statoil to the portfolio in October, and at year end, it was a 4.6% position in the Fund.

Performance Commentary

Over the quarter, the Fund was up 1.0% (0.9% for the professional class). For reference, the MSCI World returned 5.6% over the quarter, driven largely by North America up over 7% which makes up 60% of the index.

We have been pleased with returns over the year as a whole (up 15%), and continue to focus on trimming stocks where valuations are becoming less appealing, and finding new ideas that offer exciting entry valuations. Several of our stocks that have produced very strong performance for the Fund over the year pulled back towards the year-end. As a group, Western Union, Fukuda Denshi, M1, Sankyo, Asia Satellite and Kingmaker were up an average of 25% in 2013 as a whole, but were down in the 4th quarter. Whilst this has been detrimental to the short term performance numbers, these stocks have been positive for the Fund over the longer term and remain attractive at current valuations.

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

Period	Professional share class	Institutional share class	Class A share class
3 Months	0.9%	1.0%	1.0%
6 Months	3.2%	3.4%	3.4%
1 Year	14.9%	15.3%	N/A
2 Years	25.7%	26.8%	N/A
3 Years	20.3%	21.7%	N/A
4 Years	44.9%	N/A	N/A
Since launch of share class	66.2% (30 April, 2009)	36.5% (12 May, 2010)	4.2% (29 April, 2013)

Source: Bloomberg

KENNOX
TRUE VALUE INVESTORS

Fund data as at 31 December 2013

Top 8 Stocks

	Stock	Region	Sector	Market Cap (US$m)	Fund Weight
1	WESTERN UNION	N. America	Technology	9,500	5.2%
2	SWISSCOM	Europe	Telecoms	27,200	5.1%
3	DELTA LLOYD	Europe	Financials	4,700	4.7%
4	ROYAL DUTCH SHELL PLC	UK	Energy	231,100	4.7%
5	M6-METROPOLE TELEVISION	Europe	Consumer Discretionary	2,900	4.7%
6	STATOIL	Europe	Energy	76,400	4.6%
7	TESCO	UK	Consumer Staples	44,400	4.3%
8	ENCANA CORP	N. America	Energy	13,400	3.7%

Unit Price

As at 31 December 2013:

- Professional Share Class:
  - Income: 105.3 pence (unit price at inception, 30 April 2009: 70.08 pence)
  - Accumulation: 107.4 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Institutional Share Class:
  - Income: 106.5 pence (unit price at inception, 12 May 2010: 85.46 pence)
  - Accumulation: 108.8 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
  - Income: 106.6 pence (unit price at inception, 29 April 2013: 104.3 pence)
  - Accumulation: 108.8 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.