Kennox Strategic Value Fund Quarterly Investment Report

December 2014

Equity investing is an inherently optimistic occupation. The stock market is the home of dreams, and this is its great strength and one of its great benefits to society. It seeks out new products and services, waters them with funds and financing, and allows them to flourish. This allows more money than pure logic would dictate to be allocated to exciting emerging technologies. Naysayers are right more often than not, but this is forgotten in light of successes that fulfil their promise. In other words, advances in technology and science are often funded by (or rather, at the expense of) the optimism of equity markets.

Value investing exploits a different aspect of the market. While focus is drawn by the hot or the popular asset of the moment, less exciting assets can fall by the wayside, to levels where they offer excellent returns, often with lower levels of risk.

In 2014, the popular asset to hold was the US. It generated the vast majority of all returns globally (the UK, Europe and Japan have all been flat or down during the year). As valuations soared in response to money flowing into the market (as often as not from corporate buybacks as opposed to external investors), we found less and less to be attractive there. We are more attracted to quality companies whose valuations remain grounded and therefore offer more upside looking forward. Watching others profit from investments in the US has been uncomfortable, but being the last to join the party (or for that matter the last to leave) will likely prove even more painful.

Energy is an example of an area where there are interesting opportunities. With the oil price halving, energy is understandably out of favour and was the worst performing sector of 2014. We have sold Encana (the most exposed of our companies to a sustained low oil price environment), but remain positive on the integrated oil majors. Oil majors are more resilient to swings in the oil price as they benefit from the extreme price movement in smaller exploration companies (providing M&A opportunities to replenish reserves at appealing prices) and are able to reduce their costs as pressure is passed on to the oil services sector. Oil services, of which we hold none, typically fare the worst as oil prices fall (and this was the case in the second half of 2014). At some point this area too will offer attractive investments for brave investors willing to take a long term view.

While energy was clearly a drag on performance for the Fund in 2014, this was offset by successes elsewhere. Japan has proved a fertile hunting ground with three stocks (Fukuda Denshi, Canon Marketing and Star Micronics) each returning over 20% (in GBP terms). There are some exciting tailwinds in that market and valuations remain at levels where we are happy to retain a reasonable weight (13.5%). Telecoms have also proved profitable. The sector has been out of favour as disruptive technologies have threatened the status quo. However, cash flows remain resilient, and several of our holdings (in particular China Mobile and Swisscom) have performed well.

Finally, we added Admiral (the UK car insurance company) at the start of the fourth quarter. Pressures within the sector enabled us to buy a market leading company that is well placed for future cycles. It is our "stock of interest" below.

We remain as committed as ever to finding quality companies at sensible valuations, and will continue to focus on areas of the market where we feel long term value is under appreciated by an impatient market.

Stock of Interest

Admiral Group

Admiral Group is a Cardiff based car insurer, deriving over 80% of its revenue from its UK portfolio of insurance brands (Admiral, Diamond, Bell and elephant.co.uk). Outside the UK, it also has a number of fast growing international brands (including the US, Spain, Italy and France) and a range of price comparison websites.

Car insurance premiums dropped by a quarter in the last year, putting pressure on margins across the industry. However, Admiral has a significant cost advantage over the majority of the UK market, with expense ratios of circa 15% compared to an industry wide average of 25%. Admiral is now one of only a few companies writing business profitably in the UK.

The CEO and founder Henry Engelhardt owns 12% of the business, and runs a tight ship, but one where staff appear happy and motivated. It has significantly lower attrition rates than the industry as a whole, and has frequently been voted as one of the top employers in the UK.

The company returns excess cash through dividends. In 2014, dividends totalled around 8%, and since listing in 2004, Admiral has paid a total of £1.5bn compared to a current market cap of £3bn.

Insurance pricing is cyclical in nature, and we believe Admiral Group is the best placed to benefit as pricing strengthens.

Performance Commentary

The Fund ended the year down 1.2% (1.4% for the Professional class) having fallen 2.7% over the quarter (2.7% Professional class). By way of comparison Europe and the UK were down over the year (MSCI Europe index was down 2.8% and the FTSE 100 index was down 2.7%) and Japan was flat (using the Nikkei 225 index). In sharp contrast, the US, which accounts for 60% of the MSCI World Index, was up 18% in the year, driving the MSCI World up 12%.

During the fourth quarter, the fall in the oil price and its impact on energy stocks had a significant impact on the portfolio. Our energy stocks generated a 3% drag on performance. Elsewhere, two of our largest holdings bounced strongly after weaker third quarters: M6 Metropole (our stock of interest last quarter) and Western Union each contributed approximately 1% to performance.

Over the year energy again has been significant. Price falls in the second half more than offset gains in the first half leaving a full year impact of -1.2%. As the gold price has fallen, shares in Yamana and Newmont (our two gold miners) have also retreated, resulting in a cost to the Fund of 1.3%. On the positive side, Japan (contributing 1.5% from our 14% allocation) and telecoms (contributing 2.0% from our 15% allocation) have been the largest contributors to performance.

We continue to hold Tesco as a 3.5% position, having added to our position during the fourth quarter at c. £1.90. Whilst we expect the operating environment to remain extremely challenging for the next few years, we believe that the current share price significantly undervalues the business.

Performance (total return net of fees) in Pounds Sterling to 31 December 2014

Period	Professional share class	Institutional share class	Class A share class
3 Months	-2.7%	-2.7%	-2.6%
6 Months	-5.2%	-5.0%	-5.0%
1 Year	-1.4%	-1.2%	-1.0%
2 Years	13%	14%	N/A
3 Years	24%	25%	N/A
4 Years	19%	20%	N/A
5 Years	43%	N/A	N/A
Since launch of share class	64% (30 April, 2009)	35% (12 May, 2010)	3.4% (29 April, 2013)

Source: Bloomberg

KENNOX
TRUE VALUE INVESTORS

Fund data as at 31 December 2014

Top 8 Stocks

	Stock	Region	Sector	Market Cap (US$m)	Fund Weight
1	M6-METROPOLE TELEVISION	Europe	Consumer Discr.	2,300	5.5%
2	WESTERN UNION CO	N. America	Technology	9,400	5.3%
3	ADMIRAL GROUP PLC	UK	Financials	5,700	5.2%
4	DELTA LLOYD NV	Europe	Financials	4,300	4.4%
5	CHINA MOBILE LTD	Asia	Telecoms	240,400	4.4%
6	ROYAL DUTCH SHELL PLC-B SHS	UK	Energy	213,300	4.2%
7	BP PLC	UK	Energy	114,900	3.9%
8	SWISSCOM AG-REG	Europe	Telecoms	27,100	3.8%

Unit Prices

As at 31 December 2014:

- Professional Share Class:
    - Income: 102.2 pence (unit price at inception, 30 April 2009: 70.08 pence)
    - Accumulation: 105.8 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Institutional Share Class:
    - Income: 103.3 pence (unit price at inception, 12 May 2010: 85.46 pence)
    - Accumulation: 107.6 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
    - Income: 103.3 pence (unit price at inception, 29 April 2013: 104.3 pence)
    - Accumulation: 107.8 pence (unit price at inception, 29 April 2013: 104.3 pence)

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