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TRUE VALUE INVESTORS

Kennox Strategic Value Fund Quarterly Investment Report

March 2015

We never know when any individual holding will perform. Investment management as practiced at Kennox involves spending a lot of time researching individual opportunities, overlaid by a focus on building a diversified portfolio (i.e. one where the underlying profit drivers are differentiated). And then being patient. This last aspect of the process is often the most difficult. Sometimes a stock just goes to sleep and the share price moves sideways for what feels like an eternity. Sometimes a stock comes under pressure due to negative developments and drops from levels when we made our initial investment. Either of these triggers additional research (double and triple checking our initial analysis) and can result in a change in the holding, but more often than not, we do nothing. Prices are more volatile than value. It can be difficult but it is this discipline (of solid fundamental research, portfolio management, and then patience) that will drive excellent returns in the future.

This quarter showed the benefits of patience.

It was pleasant to have a quarter when many of our holdings did well. Matched well with some opportune timing on Admiral (which is up nearly 20% since purchase in October), Tesco was a top performer (up 28%), as was our gold mining holding Newmont (up 21% in sterling terms), and a couple of Japanese stocks (Taisho up 27%, Canon Marketing up 23%). These stocks have been either sleepers (especially Taisho), or have been under pressure in 2014 (Tesco and Newmont). As mentioned, we don't know the timing of returns, but are confident that the philosophy works, and that good returns will follow, if we stick to our investment process.

As value managers, we are often asked what to do when valuations, globally, look stretched. Our answer is simple. Don't pay prices that imply meager returns for any equity. Equities (all equities that is) bear risk, and a commensurate return should be sought. In current markets, where bonds are no longer producing 3-5% returns, there is a temptation to buy equities at valuations that imply 3-5% returns. However, this is short sighted in the extreme, and holding cash (admittedly often at 0% returns currently) is still a more attractive risk-to-reward profile than holding equities at 3% returns.

Instead, look for equities at prices that imply at least 7-10% returns and then assess whether you feel the risk is too high. In the vast majority of cases it will be. However, just occasionally, and usually by stretching your investment horizon beyond that of the market, you will find companies where you find conviction to invest. Conviction is an interesting concept, and hard to pin point. The best test of conviction that we have found (and a test that we apply regularly to our portfolio, and daily to new investment ideas) is this: ask yourself how you would feel if you saw the stock in question 20% cheaper in a month's time. Would you be disappointed ("that was a clearly a poor investment"), or excited ("this is an opportunity to double that position"). If your tendency is to the first, then you have no great conviction.

Notwithstanding what we have said about the validity of cash as an alternative to overpriced assets, equities remain an excellent asset for the long term investor. The Fund remains committed to finding opportunities where valuations imply good returns considering the risk that is inherent in equities (and this risk is only accentuated by the current actions of central authorities). As mentioned, this requires discipline, and, above all, patience.

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Stock of Interest

Western Union

Western Union (the global remittance business that we have held in the Fund since January 2012) has had a nice little run during the quarter. In sterling terms it is up about 25%, and since our initial investment, it has returned the Fund nearly 60% or about 15% annually. Results have been good (all-be-it steady rather than rocket-fuelled), but the entry valuations have meant that "steady" provides a very nice return. We bought the stock on a 12% free cash flow yield, so the stock has only needed a very small re-rating to return us 15% per year.

This is exactly the sort of stock we look for in the Fund, and also helps answer an interesting question about sell discipline. It is true that the stock has re-rated slightly (from a 12% free cash flow yield on purchase, to a 8-9% FCF yield currently), but the valuations are still very reasonable. Beyond the free cash flow, it is trading on about 13x long-term earnings (and 13x trailing earnings), and with a reasonable yield. We have trimmed the position (from a near 6% weight to a c. 4.5% weight) as the margins of safety has narrowed, but we are very happy to hold at these valuations.

Performance Commentary

The Fund ended the quarter up 10.1% (10.0% for the Professional class). By way of comparison, the MSCI World was up 7.5%.

During the period, stocks performed well across the portfolio, with 20 stocks up more than 5%. The largest contributors were Tesco, Taisho Pharmaceutical, Western Union, Canon Marketing and Newmont, all up over 20%. It is always satisfying as stock pickers, when the best performing stocks are diversified both by geography and by sector. Counterintuitively, the UK market (the FTSE 100 was up 3%) and the US market (where the S&P 500 was up 5%) were the weakest major regions in the quarter, and yet three of our top five stocks were listed in those markets.

The weakest stock in the portfolio was Delta Lloyd which retreated 10% during a quarter in which it announced a stock issue. We have lightened our holding slightly (currently 3.6%) as the dividend looks under pressure, but remain comfortable with the business's performance and valuation.

Elsewhere, we have trimmed a number of stocks that have been performing very well for the Fund: M6 Metropole to a 4.3% position (from over 5% with the stock having rallied 50% since October 2014), and Fukuda Denshi to a 2.6% position (from c. 3.5%, with the stock having increased 50% in the last 12 months).

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Performance (total return net of fees) in Pounds Sterling to 31 March 2015

Period	Professional share class	Institutional share class	Class A share class
3 Months	10%	10%	10%
6 Months	7.0%	7.1%	7.3%
1 Year	6.1%	6.4%	6.7%
2 Years	12%	13%	N/A
3 Years	31%	32%	N/A
4 Years	30%	32%	N/A
5 Years	46%	N/A	N/A
Since launch of share class	80% (30 April, 2009)	49% (12 May, 2010)	14% (29 April, 2013)

Source: Bloomberg

Fund data as at 31 March 2015

Top 8 Stocks

	Stock	Region	Sector	Market Cap (US$m)	Fund Weight
1	ADMIRAL GROUP PLC	UK	Financials	6,300	5.6%
2	WESTERN UNION CO	N. America	Technology	10,900	4.8%
3	M6-METROPOLE TELEVISION	Europe	Consumer Discr.	2,600	4.3%
4	BP PLC	UK	Energy	119,700	4.1%
5	CHINA MOBILE LTD	Asia	Telecoms	267,800	4.0%
6	SWISSCOM AG-REG	Europe	Telecoms	30,200	4.0%
7	ROYAL DUTCH SHELL PLC	UK	Energy	195,100	4.0%
8	KONINKLIJKE KPN NV	Europe	Telecoms	14,800	3.8%

Unit Prices

As at 31 March 2015:

- Professional Share Class:
  - Income: 112.4 pence (unit price at inception, 30 April 2009: 70.08 pence)
  - Accumulation: 116.4 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Institutional Share Class:
  - Income: 113.7 pence (unit price at inception, 12 May 2010: 85.46 pence)
  - Accumulation: 118.4 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
  - Income: 113.8 pence (unit price at inception, 29 April 2013: 104.3 pence)
  - Accumulation: 118.8 pence (unit price at inception, 29 April 2013: 104.3 pence)

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