

QUARTERLY INVESTMENT REPORT

December 2016

Looking back, 2016 was a good year for the Kennox Strategic Value Fund, in absolute terms (the Fund returned 36%), relatively (the market was up 29%), and versus a peer group (up 24%). We did this by sticking to our knitting – we did not increase turnover or materially change what we held at the beginning of the year. True to our long-term investment style, the decisions we made in 2014 and 2015 were made with a 5-10 year horizon. As such, it should come as no surprise that we retained those views and held firm to those decisions during 2015 and 2016 despite short-term performance disappointing. This is the power of patience – sometimes in investments it is best to do nothing and simply wait for your investment thesis to play out (in fact, we would contend that this is almost always the best course of action). The temptation to drop good long term investments due to short term performance is one of the biggest challenges faced by value investors. Performance in the period was driven by many of the things that had been difficult for us in 2015, including stocks such as Neopost (up 66%) and Delta Lloyd (up 56% on the back of a bid for the company). Looking at sectors, our gold miners (up 105%) and energy majors (up 57%) also did well. Patience paid off for us this year.

It is worth noting that the gold price was up about 10% in 2016, whereas the price of our gold mining shares doubled. It can be very effective to find companies where the expectations are at rock bottom, where the expectations are so low that news doesn't have to be stellar, but where even a small lightening of the gloom can substantially lift the share price. These investments are not without risk (no equity investment is) and timing of entry is fraught with difficulty (judging when a sector has reached "maximum pessimism"), but at a certain point can offer an exceptional risk to reward. We felt this was the case for the gold miners in 2015, and the same was true of Neopost, Delta Lloyd and the energy names. We will continue to hunt out such opportunities, and we feel strongly that we have found one in our newest holding, Texwinca (see the individual stock write up below).

As always, we spend our time at Kennox doing in-depth analysis to establish a conservative estimate of a company's "sustainable earnings". This is where we focus our precious research hours, testing and measuring our investment case and conviction in the strength of a company's

earnings. Sustainable to us means "non-stretch" earnings that they have been able to deliver in the past (though often not in the current period). This always means earnings which are below peak (i.e. discounting the very best years a company has experienced), but above trough earnings (providing there is good reason to believe in a reversion to mean). Our hunting ground is focused on this, seeking out companies which we believe will be able to continue to produce good profits over the long-term, but without needing to shoot the lights out to justify the price.

We do not know what 2017 will bring. We do admit to struggling to see how having an unpredictable personality such as Donald Trump in charge of the US presidency will end up being an unmitigated positive. Irrespective, we will stick to finding stocks with low expectations baked into the share prices, which we can buy on a low multiple (under 12x) of what we measure to be their sustainable earnings. Thinking this way, we can minimise the risks from Brexit and President Trump, from elections in France, Netherlands or Germany. Thinking this way, the future looks bright.

Stock of Interest: Texwinca

Texwinca is a Hong Kong listed textile company, leading the market in providing high-end fabrics to global branded clothing companies (the likes of Gap, Abercrombie and Fitch, Uniqlo, Adidas and Nike). It has done an excellent job at increasing margins in recent years by focusing in two areas: high-tech fabrics (e.g. anti-UV materials); and also on rush orders (a huge help to retailers looking to reduce their inventory burden). Texwinca benefits from operating in a small market - there are very few companies that can live up to the environmental and sustainability standards expected by a demanding western client-base. Competition for high-quality fabrics comes principally from two other HK listed competitors, each with their own unique niche.

Texwinca also operates retail stores in mainland China under “Baleno” branding. This business is facing near-term headwinds as consumers have tightened their belts in the last 18 months eliminating profits from that segment (it lost money in year-ended March 2016, before

recovering). This cyclical downturn in non-core business has impacted market sentiment significantly, and forced the share price down from recent highs of over \$9 to just over \$5. This represents a remarkable opportunity – the company holds around \$2.50 per share in cash or near-cash investments, with the core fabric business producing around \$0.50 per share in post-tax profit per year. Adjusting for the cash, this is just a 5x multiple on the core business, with no contribution from (or value ascribed to) the retail business. We expect a payout ratio of around 70% (though Texwinca often pays out more by way of specials), which equates to a yield of around 7%. The trailing 12-month yield was over 10%.

Texwinca is currently a 3.6% position in the Fund.

Performance Commentary

The Fund was up 3.7% during the quarter (institutional share class), taking full year performance to 36%. For reference, the MSCI world was up 7.1% taking year to date returns to 29%.

Positive contributions have come from several disparate areas, with 8 stocks up over 15% during the quarter. Our energy majors have been strong, with the oil price rising through the period and closing at over \$55 (Brent), on average our 4 holdings rose by 15%. At the other end of the size spectrum, our small to mid-cap holdings have also performed well. Kingmaker was up 53% during the quarter after posting good half-year results and finalising the sale of some non-core assets. Games Workshop was up 47% as overseas operations have benefitted from the post Brexit weakening of sterling. Neopost was up 22% recovering from extreme negative market sentiment - despite rising 50% over the last 6 months, it still trades at around 10x sustainable earnings and looks well placed to benefit from the increasing emphasis on e-commerce and parcel delivery.

Our gold miners retreated during the quarter, with Newmont down 9% and Yamana down 30%. We are still very comfortable with the longer term outlook for the sector, where recent cuts in investment have resulted in a near-certain reduction in supply over the next cycle. Short term fluctuations are likely to continue, and whilst the recent quarter is disappointing, 2016 gains of 127% (Newmont) and 83% (Yamana) have been exceptional. The yen also weakened significantly during the quarter, falling 9% against the pound, and reversing a substantial proportion of earlier gains. This impacted the sterling-term returns of our predominantly domestic Japanese portfolio. Star Micronics (a Japanese exporter of machine tools) fared well in these conditions, rising 27% in yen, and 16% in sterling-terms. Elsewhere, M1 (one of three Singaporean telecom companies) fell 19% on news of the government offering a fourth license. That market is already fully penetrated, and we see the risk to mid-term returns as limited, and more than reflected in the now exceptional valuations (at around 11x sustainable earnings).

Performance (total return net of fees) in Pounds Sterling to 31 December 2016

Period	Professional share class	Institutional share class	Class A share class
3 Months	3.6%	3.7%	3.7%
YTD	35.4%	35.8%	36.2%
2015	-4.3%	-4.0%	-3.8%
2014	-1.5%	-1.1%	-0.9%
2013	15%	15%	4.3%*
2012	9.4%	10%	N/A
2011	-4.4%	-4.0%	N/A
2010	21%	12%*	N/A
2009	15%*	N/A	N/A

Source: Bloomberg. Performance figures are total return generated from the accumulation units since their launch (29 April 2013), and from the income shares prior to that.

* Share classes launched mid-year: Professional on 30 April 2009; Institutional on 12 May 2010; and Class A on 29 April 2013.

Fund Data as at 31 December 2016

Top 10 Stocks

	Stock	Region	Sector	Market Cap (US\$m)	Fund Weight
1	NEWMONT MINING	N. America	Materials	18,100	6.2%
2	NEOPOST	Europe	Technology	1,100	4.9%
3	EXXON	N. America	Energy	374,300	4.3%
4	BP	UK	Energy	123,300	4.2%
5	WESTERN UNION	N. America	Technology	10,500	4.1%
6	ROYAL DUTCH SHELL	UK	Energy	230,600	4.0%
7	STATOIL	Europe	Energy	60,800	3.9%
8	CANON MARKETING	Japan	Consumer Discr.	2,500	3.7%
9	TEXWINCA	Asia	Consumer Discr.	900	3.6%
10	FUKUDA DENSHI	Japan	Health	1,100	3.4%
	Total Top 10				42.3%
	20 Other Holdings				45.4%
	Cash				12.4%

Unit Prices

As at 31 December 2016:

- Professional Share Class:
 - Income: 127.70 pence (unit price at inception, 30 April 2009: 70.08 pence)
 - Accumulation: 137.20 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Institutional Share Class:
 - Income: 129.10 pence (unit price at inception, 12 May 2010: 85.46 pence)
 - Accumulation: 140.30 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
 - Income: 129.10 pence (unit price at inception, 29 April 2013: 104.3 pence)
 - Accumulation: 141.20 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) 131 563 5440 or email him at pboyle@kennox.co.uk. Our website is www.kennox.co.uk

This document has been issued by Kennox, which is authorised and regulated by the Financial Conduct Authority. It is important that you read this information before proceeding, as the distribution of the information contained in this document in certain countries may be restricted by law and persons who access it are required to inform themselves of and to comply with any such restrictions.

The information in this document does not constitute, or form part of, any offer to sell or issue, or any offer to purchase or subscribe for shares, nor shall this document or any part of it or the fact of its distribution form the basis of or be relied on in connection with any contract. Interests in any investment funds managed by Kennox will be offered and sold only pursuant to the prospectus relating to such funds. An investment in the Fund carries a degree of risk and is not suitable for retail investors. Kennox has not taken any steps to ensure that the securities referred to in this document are suitable for any particular investor and no assurance can be given that the stated investment objectives will be achieved. Investors in the Fund will not benefit from the rules and regulations made under the Act for the protection of investors, or from the UK Financial Services Compensation Scheme.

Kennox may, to the extent permitted by law, act upon or use the information or opinions presented herein, or the research or analysis on which it is based, before the material is published. Kennox and its personnel may have, or have had, investments in these securities.

The information contained in this document has been taken from sources considered by Kennox to be reliable but no representation, warrant or undertaking is given as to its accuracy or completeness.

The law may restrict distribution of this document in certain jurisdictions; therefore, persons into whose possession this document comes should inform themselves about and observe any such restrictions.