QUARTERLY INVESTMENT REPORT

March 2017

The world has not ended despite Donald Trump now calling the White House home. On the other hand, it would be difficult to say that it has been a calm first couple of months in office, with the chance of a serious incident undoubtedly increased. With the tenuous situation in Syria and across other parts of the Middle East, questions over growth and debt in China, and instability and existential questions for the European Union and the euro, risks have multiplied significantly. In this environment, the central question for investors is how should one be positioned.

Managing risk, at Kennox, means a focus on sector leading companies where we have conviction in their five- or ten-year outlook and buying only when they are available at very attractive valuations (up to 12x our view of their sustainable earnings). We are unapologetic about repeating that investment returns are dependent on both the success of the company and the price you pay for it. With so much of the market trading on excessive earnings multiples, investors can be tempted to overpay and we see this as the largest risk in the current investment environment.

A focus on risk also means a focus on diversification: limiting the Fund's exposure to any one factor that could affect the profits of a large percentage of the portfolio. This is distinct from positioning the Fund for certain specific future events (such as a hard Brexit, or the fruition of a Trump policy). On a global level, there are too many issues and too many potential outcomes for it to be prudent to run an outcome-dependent investment strategy.

Over the quarter, we have refreshed the portfolio by adding two new names and selling down stocks where rising expectations have led to expanding valuations, eroding our margin of safety.

First, the buys. We initiated positions in Next and Gap, two retailers which have fallen out of favour, off 50% from highs. Expectations, and hence valuations, for both are especially low and we feel that the market has over-reacted significantly. These are exceptional companies (the largest clothes retailer in the UK on one hand, and the third largest globally on the other). Such frugal in-prices indicate very attractive returns even on very conservative assumptions about performance.

These are exactly the sort of opportunities that we can get very excited about - see the Stocks of Interest section below for more. We also topped up Texwinca, a recent addition in Q4 2016, and it is now the fourth largest stock in the portfolio.

Regarding our trims, Admiral is a prime example – many will recall that we bought the stock in the autumn of 2014, quickly making it a top three position for the Fund. At that point, the car insurance industry in the UK was going through a difficult time, with competition and price pressures. We felt that Admiral was the industry leader having a cost advantage over its competitors, and it was available on exceptional valuations: we bought on 12x our view of conservative long term sustainable earnings. As industry pricing has improved so too has Admiral's share price and what was once one of our largest holdings does not feature in our top 15 holdings now. We also exited two smaller positions completely – Kingmaker and Games Workshop – taking good profit as they hit our risk threshold of 20x our estimate of sustainable earnings.

Rotating from stocks where expectations have risen into new and exciting holdings where expectations (and valuations) are lower is a core part of our philosophy. These actions continue to refresh the portfolio and we are pleased to see that we still find the portfolio on under 12x of our assessment of the companies' sustainable earnings. Despite the economic and political risks currently in play, we are excited by the portfolio: quality companies, inexpensively priced, and with great potential upside.

Stocks of Interest: Next Plc & Gap Inc

We have invested 4% of the Fund across two leading clothes retailers, with a 2% position in each of Next plc and Gap Inc.

Next Plc.

NEXT is the UK's largest clothing retailer and distributes through three main channels: NEXT Retail, a chain of around 540 stores; the NEXT Directory, a direct mail catalogue and transactional website with nearly 5 million active customers; and NEXT International, a predominantly franchise business across Europe with approximately 200 stores. At the helm is Lord Wolfson, a canny retailer who has earned the trust of investors and a reputation for straight-talking.

NEXT remains well positioned for a market that demands a coherent online strategy. It generates nearly 50% of revenue from this sales channel, and does so with higher margins than from the stores - NEXT's online business is the best offering in the market by some margin.

NEXT is an interesting case study on the severity of a market reaction when a company goes through a tougher period after 15 years of continuous growth and clearly highlights the importance of price and valuations. With operating profits falling 4% (to January 2017) NEXT has de-rated from an optimistic 20x earnings to a staggering 9x, costing its shareholders 60% of their investment.

Gap Inc.

Gap has grown into one of the largest clothes retailers in the world. Its portfolio of well recognised brands includes Gap, Old Navy and Banana Republic. The company has a history of producing robust cash flows and profits whilst also managing to buy back a significant proportion of shares (the number of shares in circulation has halved in the last 10 years).

There remains exciting potential for growth both through its online offering (currently just 16% of revenue) and overseas (especially in emerging markets where they have excellent brand recognition but low penetration). Gap's focus over the last 3 years has been to decrease the time taken for new product concepts to reach the shop floor – in many cases, this has moved from over a year to under 3 months. This is transformational, but only just starting to feed through to operational improvement – a small increase in average selling price (or decrease in promotional activity) would deliver a marked improvement in results. Nonetheless, the shares are pricing in a lot of potential bad news: even using their lowest earnings for the last 15 years as a conservative worst-case scenario, it is trading at just 11x.

Performance Commentary

The Fund was up 1.6% during the quarter (institutional share class). For reference, the MSCI world was up 4.9%, driven by the tech sector (up 10%). We retain the view that taking rational long-term views on technology borders on the impossible, and are comfortable sitting on the side-lines for this particular rally.

For the Fund, the two strongest performers were our two French holdings. We were especially pleased that the best performing stock in the portfolio was Neopost, our second largest holding at the start of the quarter. Its strategy of offering new business products and services to its existing SME customer base is starting to bear fruit, and recent results show that sales growth in these new areas is now offsetting any contraction in the traditional franking business. With the realisation that the outlook is not anywhere near as bleak as was being priced (at under 10x earnings, with strong cash flows and a healthy dividend), the stock was up 28% over the quarter, and

has more than doubled since its troughs of early 2016. Neopost's strategy and execution continues to be on track, and we are happy holders, pleased to have our patience justified in this stock. Our other French stock, M6 Metropole, was the second best performing stock over the quarter. The market warmed to the outlook for the company as recent results showed historic high levels of advertising, profits and audience. Adding to its attraction, the stock yielded almost 5% with significant net cash on the balance sheet.

After strong moves last year, our energy holdings held the Fund back this quarter. Our holdings (energy majors) are blue chip stocks in an industry where there has been a substantial supply-side reaction to falling oil prices. This reduction in investment will impact supply, not in the short term, but in the medium term. On that time horizon, the shares look very attractive, having been de-rated versus a strong bull-market over the last 3 years.

Performance (total return net of fees) in Pounds Sterling to 31 March 2017

Period	**Professional share class**	**Institutional share class**	**Class A share class**
3 Months	1.5%	1.6%	1.6%
2016	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.

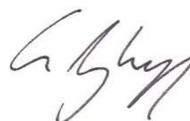
Fund Data – 31 March 2017

	Stock	Region	Sector	Market Cap (US$m)	Fund Weight
1	NEOPOST	Europe	Technology	1,300	5.9%
2	NEWMONT MINING	N. America	Materials	17,500	5.7%
3	M1	Asia	Telecoms	1,400	4.3%
4	TEXWINCA	Asia	Consumer Discr.	900	4.1%
5	EXXON	N. America	Energy	340,000	3.9%
6	WESTERN UNION	N. America	Technology	9,700	3.8%
7	ROYAL DUTCH SHELL	UK	Energy	221,000	3.8%
8	BP	UK	Energy	114,000	3.8%
9	GLAXOSMITHKLINE	UK	Health	102,000	3.6%
10	STATOIL	Europe	Energy	56,100	3.5%
	Total Top 10				42.5%
	20 Other Holdings				48.3%
	Cash				9.2%

Unit Prices

As at 31 March 2017:

- Professional Share Class:
  - Income: 129.5 pence (unit price at inception, 30 April 2009: 70.08 pence)
  - Accumulation: 139.2 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Institutional Share Class:
  - Income: 131.0 pence (unit price at inception, 12 May 2010: 85.46 pence)
  - Accumulation: 142.5 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
  - Income: 131.1 pence (unit price at inception, 29 April 2013: 104.3 pence)
  - Accumulation: 143.4 pence (unit price at inception, 29 April 2013: 104.3 pence)



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