QUARTERLY INVESTMENT REPORT

March 2019

A focus on risk is one of the key characteristics of Kennox's investment philosophy, and this has been reflected in recent performance. In first quarter of 2019 the Fund's performance was positive at 3.3%, but behind global stock markets which were up 10.5% in the quarter. This is in contrast to the fourth quarter of last year when the Fund held up much better than weak global markets (which fell 16% in the period prior Christmas, with the Fund off 6%). Given the strong rebound in risk appetite this quarter, it was defensive sectors that underperformed - sectors such as Communications Services (which includes the old telecoms sector). Telecom companies that have a strong competitive position in their markets but are inexpensively priced are exactly the type of company that we find interesting, examples being China Mobile or Swisscom. These types of companies can generate strong cash flows to distribute as attractive dividends, and they form a solid foundation in the portfolio. When the market is focused on growth and risk, it is not surprising that these types of companies will underperform. Their long-term investment cases, however, are not affected by this and remain very attractive.

It perhaps sums up the reversal in risk appetite this quarter that the Fund's top performer was Next, up 40%, having had the largest negative performance in Q4. Earnings results were good but not spectacular, and the share price appears to have benefited mostly from improved sentiment. Yet the stock continues to look good value as we continue to believe the risks for retail, and especially risks for Next, are overdone. It is the largest UK clothes retailer and has a strong and increasing online presence (representing about half of their sales). This positioning and its core competency in retailing have enabled it to produce robust profits and free cash flow, which have even slightly increased over the last few years. The market fears mean the company is valued at 15x our conservative view of Sustainable Earnings (having initially bought at 9x Sustainable Earnings). We feel it only needs to continue generating good, not spectacular, results and the stock could re-rate further.

Tesco performed well this quarter, up 22%, which was a similar reversal of negative performance from Q4. It also had good but not spectacular results. These results reflect that the underlying business (a very attractive franchise in the UK with some overseas gems) remains strong and it is overcoming the operational headwinds the company has faced. Importantly, the current management team's focus on a sensible but not spectacular strategy of getting the basics right, and especially about being extremely efficient and not overspending with their capital expenditures. These straightforward but not easy steps should lead to stronger returns for shareholders, as consistent and not more than decent results would turn sentiment more positive.

The energy majors in the portfolio also contributed strongly to performance in the quarter. We have written many times in our reports on our investment thesis (and please see the Thinking Aloud piece on the website for more detail). Our recent interactions with the companies have confirmed our investment thesis that their and the industry's reactions to the weakness in 2014/5 place them in a very strong position going forward. In other words, their headwinds are decreasing, and slowly but surely turning into tailwinds. BPs 35 new major projects recently delivered or coming onstream is just one example of how future profits and cash flows could be substantial. We continue to be positive on these stocks – the Fund retains 17% with holdings in Equinor, BP, Royal Dutch Shell and Exxon. Despite recent rallies in the share prices, they remain attractively priced at around 13x our view of Sustainable Earnings, with yields of 5% on average.

Sky NZ was the worst performer in the quarter, falling 27%. It has continued to see a shrinkage in revenues as it responds to increased competition, but we feel the market is exaggerating the decline. Competitive pressures will not go away but Sky retains a dominant position in the market (40% penetration rate) and has a wealth of experience in pricing expensive content (premium movies and sport), that will be very hard for anyone else to replicate. Current valuations are extraordinary, for example it currently trades at 4x our Sustainable Earnings with a 31% free cash flow yield plus a 12% dividend yield. There is a lot of bad news already baked into these prices, and we feel that the market is excessively pessimistic.

Over the quarter M1 (the Singaporean telecom) exited the Fund as it was taken private. We have had a long association with the company, having bought it at the Fund's inception, and have been very pleased with the outcome, as it contributed 10.4% by itself to the Fund's performance over this time. The way we have positioned ourselves with M1 also demonstrates Kennox's strategy. In 2009 it looked very good value at below 10x our view of Sustainable Earnings and thus was one of the top holdings at 5%. As the stock performed strongly, we trimmed the size of the holding down to 2.5% by 2014. The share price then came back, so by 2017, once it had fallen to below 13x our view of Sustainable Earnings, we added to the position once again. It remained around a 5% position until this quarter. These active decisions to trim or to add highlight how we manage valuation risk via stocks already held in the Fund, ensuring our largest positions are where we see the best opportunities.

In the portfolio, we have high quality companies trading at low valuations of our view of their Sustainable Earnings. These companies have been facing headwinds which are in the process of turning into tailwinds, an underlying dynamic which is differentiated from growth and therefore from a lot of the market. We have a portfolio of companies with diversified profit drivers. Our stocks pay attractive dividends (which lead to an attractive after-all-costs yield to our clients), a factor that doesn't matter too much in the short term, but in the long term, these dividend payments matter enormously to the risk-and-return profile for an investment.

It was reported recently that $10 trillion worth of bonds are currently trading at negative yields. This is not normal – neither in text books nor alongside any reading of economic history. In these times of quantitative easing, of inverting yield curves, of negative yields, we continue to do what we have always done, confident that the Fund is as well positioned as it can be.

Performance (total return net of fees) in Pounds Sterling to 31 March 2019

Period	Professional share class	Institutional share class	Class A share class
YTD	3.2%	3.3%	3.4%
2018	-2.5%	-2.2%	-2.0%
2017	2.1%	2.5%	2.6%
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 2019

	Stock	Region	Sector	Market Cap (US$m)	Fund Weight
1	NEWMONT MINING	N. America	Materials	19,100	6.4%
2	BP	UK	Energy	147,000	4.9%
3	CHINA MOBILE	Asia	Communication Services	209,000	4.7%
4	ROYAL DUTCH SHELL	UK	Energy	256,000	4.4%
5	NEOPOST	Europe	Information Technology	900	4.4%
6	EQUINOR	Europe	Energy	73,600	4.4%
7	MUNICH REINSURANCE	Europe	Financials	35,300	3.9%
8	YUE YUEN	Asia	Consumer Discretionary	5,600	3.8%
9	EXXON	N. America	Energy	342,000	3.7%
10	TEXWINCA	Asia	Consumer Discretionary	500	3.7%
	Total Top 10				44.3%
	19 Other Holdings				42.8%
	Cash				12.9%

Unit Prices

As at 31 March 2019:

- Professional Share Class:
  - Income: 125.50 pence (unit price at inception, 30 April 2009: 70.08 pence)
  - Accumulation: 141.00 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Institutional Share Class:
  - Income: 126.90 pence (unit price at inception, 12 May 2010: 85.46 pence)
  - Accumulation: 145.20 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
  - Income: 127.10 pence (unit price at inception, 29 April 2013: 104.3 pence)
  - Accumulation: 146.80 pence (unit price at inception, 29 April 2013: 104.3 pence)

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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