QUARTERLY INVESTMENT REPORT

June 2019

Despite all but four of the companies in the Fund releasing results during the quarter, it has been a relatively quiet time in terms of performance. The Fund was up 0.3% over the period and is up 3.6% year to date. Once again market focus has returned to interest rates, with the ECB's Mario Draghi recently giving notice that a cut in interest rates in Europe was likely, and President Trump continuing to put pressure on the Federal Reserve to follow suit: futures markets indicate that there is almost no chance that the US will retain interest rates above 2.0% for the remainder of 2019. This change in sentiment has given new fuel to the "risk-on" rebound in the markets, and increased pressures on bond yields where a staggering $12 trillion of investment grade or government bonds now trade at negative yields. Make no mistake, these are not ordinary times. Recognising this, the Fund will retain its focus on risk, through investing in high quality companies trading at rational multiples of their long-term earnings potential.

We have often talked in our quarterly reports about the importance of diversification. At Kennox, our primary focus is on making sure that the underlying profit drivers (i.e. those that effect either revenues or expenses) of our companies are not overly correlated. We look to ensure that no single factor can negatively impact revenues for a large part of our portfolio, or significantly increase expenses for a large part of the portfolio. Another important feature of diversification is to seek companies that are at different points in their operating cycle. All industries are cyclical to a certain extent (attracting competition when returns are healthy and therefore facing increasing pressure on margins and vice versa). As value investors, we typically invest in areas of the market facing cyclical headwinds (allowing us to buy them at attractive prices) and sell as these headwinds become tailwinds (where valuations typically become less favourable). Our analysis focuses on whether headwinds are indeed cyclical (a "value opportunity") or structural (a "value trap"). Whilst our new ideas will typically fall towards the bottom of the operating cycle, we like the portfolio to be spread so that those companies facing headwinds are offset by others in the portfolio that have come through the difficult times and are now enjoying tailwinds.

Within the portfolio this quarter, performance has been held back by a few of our companies nearer the bottom of their operating cycle, in particular Neopost (down 9%); Sky New Zealand (down 8%) and Texwinca (down 16%). As with any investment experiencing stock price weakness, we have re-visited our estimates of Sustainable Earnings, speaking with management at each company. In each case, we remain confident in the longer term prospects. The three companies face undeniable headwinds (Neopost and Sky NZ are re-focussing their business with new management, and Texwinca faces the threat of a trade war between China and the US), but all have core assets and competencies that are very difficult to replicate. These negative price movements are frustrating, but we believe overdone. Valuations now look exceptional. So extreme is the negative sentiment, that across the three names, we are now seeing nearly 20% free cash flow, a 9% (covered) dividend yield and around 0.5x book value. We have added a little to our positions in Neopost and Sky New Zealand, leaving Texwinca untouched as we await more clarity on trading conditions with the US. Whilst only c. 10% of Texwinca's revenue comes from direct trade between China and the US, it is likely that a worsening in the trade negotiations will put further pressure on the share price.

These positions are nicely offset within the portfolio by companies that now have operational tailwinds. Newmont Goldcorp (up 13%) is rising as gold prices begin to trend upwards (benefitting from the relative attraction of gold versus low-risk bonds that no longer provide a yield, as mentioned above). Telecom network providers (Swisscom up 10%) are starting to see power move away from handset manufacturers (where sales have started to slow), and energy majors are projecting very attractive cash-flows over the next 3-5 years as projects either completed or completing in the very near term come on-line, even if oil prices fall to nearer $50 per barrel. As a result, the portfolio feels well balanced, with excellent potential returns from stocks closer to the bottom of their cycle, and steady but attractive returns from those facing near term tailwinds.

Valuations across the portfolio remain as attractive as they have ever done. The portfolio trades at a prospective yield of 4.0% (before fees, which are taken to income) – this is as high as it has ever been and provides a very nice base return for investors. Other valuation metrics for the portfolio are equally compelling. The Price to book ratio is 1.3x (compared to 2.9x for the broader market) and the price to cash flow is 6.6x (compared to 10.7x). Whilst portfolio valuations do not guarantee good returns in the short term (see our recent thinking aloud paper on the impacts of valuation on long term equity returns), they are a very good indication of latent potential within the portfolio.

Performance (total return net of fees) in Pounds Sterling to 28 June 2019

Period	Professional share class	Institutional share class	Class A share class
YTD	3.4%	3.6%	3.7%
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 – 28 June 2019

	Stock	Region	Sector	Market Cap (US$m)	Fund Weight
1	NEWMONT GOLDCORP	N. America	Materials	31,000	7.2%
2	BP	UK	Energy	144,000	4.8%
3	ROYAL DUTCH SHELL	UK	Energy	266,000	4.8%
4	CHINA MOBILE	Asia	Communication Services	186,000	4.5%
5	NEOPOST	Europe	Information Technology	700	4.2%
6	EQUINOR	Europe	Energy	67,800	4.1%
7	WESTERN UNION	N. America	Information Technology	8,500	4.0%
8	MUNICH REINSURANCE	Europe	Financials	36,400	3.9%
9	GLAXOSMITHKLINE	UK	Health Care	101,000	3.7%
10	EXXON	N. America	Energy	327,000	3.6%
	Total Top 10				44.7%
	19 Other Holdings				42.2%
	Cash				13.1%

Unit Prices

As at 28 June 2019:

- Professional Share Class:
  - Income: 125.10 pence (unit price at inception, 30 April 2009: 70.08 pence)
  - Accumulation: 141.30 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Institutional Share Class:
  - Income: 126.50 pence (unit price at inception, 12 May 2010: 85.46 pence)
  - Accumulation: 145.60 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
  - Income: 126.50 pence (unit price at inception, 29 April 2013: 104.3 pence)
  - Accumulation: 147.30 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