QUARTERLY INVESTMENT REPORT

December 2019

The share prices of the vast majority of the portfolio stocks (23 out of 28) recorded gains in their local currency over Q4. However, like all global funds which report in sterling, our Q4 returns were impacted by the significant strengthening of sterling against all major currencies following the UK general election in December (for example, sterling was up 8% against the yen, 7% against the dollar and 5% against the euro). This brought the Fund's quarter-end return to -0.4% and 2019 year-end return to 4.8%.

Looking at portfolio performance in Q4 (with individual stock returns expressed in their local currency), our strongest stocks throughout Q3 – Western Union and our gold miners (Newmont Goldcorp & Yamana) – continued their upward trajectory in Q4. Western Union was up 16% in Q4 and 63% in 2019. With the strong performance we have continually been evaluating our holding, especially as the run in the share price does not appear to have been spurred by any significant change to operating performance. However, the company maintains unique advantages, being the dominant market leader in an industry with very high barriers to entry. Despite the run in the share price it is valued at 15x our view of Sustainable Earnings, meaning it continues to look good value. It is a 4.8% position. Our gold miners, Newmont Goldcorp and Yamana, were up 15% and 23% in Q4 respectively. This helped push 2019 performance to 31% and 62% respectively. It is noteworthy that gold miners performed so well during a year in which global stock markets rose markedly. As a traditional safe haven asset class, it illustrates that there is an element of scepticism in the rapid market appreciation. We have written extensively in other quarterly updates this year on why we like owning these companies, and they continue to provide a key role in the portfolio. Newmont Goldcorp trades at 16x Sustainable Earnings and despite a small trim in December remains our biggest holding (7.9%). Yamana trades at 17x Sustainable Earnings and is a 1.8% position.

On a further positive note, Quadient (formerly Neopost) was up 14% in Q4 on the back of an improved sales outlook. It continues to leverage its extensive customer relationships to re-orientate the business towards e-commerce and digitalisation of both the payments process and customer management functions. Meanwhile, its legacy franking machine business continues to generate substantial cash flow. Whilst this re-focusing of the business has not been straightforward, the business now has positive momentum which is not yet reflected in the share price. We have met with the CEO, in place since 2018, on multiple occasions and believe in his strategy for the transition. It is encouraging that the positive sales outlook released in Q4 was across all new divisions of the business while the mail business continued to hold up well. Valuations, at 8x our view of Sustainable Earnings and 20% Free Cash Flow yield, continue to price in extreme pessimism, and therefore a substantial opportunity. Quadient is a 4.8% position.

Sky New Zealand (a 1.5% holding) was the weakest performer in both Q4 and 2019, down 37% for the quarter and 59% for the year. Like Quadient, the company is in the middle of a transition as the industry moves towards providing streaming services and competitive pressures intensify. These are significant headwinds, yet the move in the share price feels to have greatly exaggerated the impact to Sky. It continues to be the only provider of satellite TV, an advantage in a country with remote populations and therefore lower quality internet access. Sky is present in a third of homes in New Zealand and is improving its streaming services rapidly (allowing access to its content on mobile phones). Significantly Sky also retained the rights to rugby union, the number 1 sport in the country, for a further 5 years and to international cricket. As with Quadient we interact with management frequently (the new CEO was appointed earlier this year) and have rigorously challenged our investment thesis. Shares trade at 6x our conservative view of Sustainable Earnings, and whilst it remains a small position to reflect the inherent risks, any slight improvement in sentiment (or a possible take-over given the frugal valuations) would result in a significant increase in the share price.

2019 saw global stock markets enter their 10th year of the bull market, the longest on record. The US stock market has only been as highly valued by CAPE as it is today in 1929 and 2000. The FTSE All share and Euro Stoxx 600 reached all-time highs and the Nikkei reached its highest level since the heady days of the late 1980s. Accommodated by central banks, in 2019 investors chose to downplay increasing economic and political uncertainty and continue to pursue high growth stocks, driving the global market up a further 23%. Tech continued to dominate, with the largest cap stock prices registering huge rises (e.g. Apple, up a staggering 93%). This performance has further stretched valuations – Google/Alphabet, Microsoft and Facebook each now trades at over 50x 5-year earnings. We recently raised concerns about Valuation Correlation, the convergence of global funds into a very similar style of investment: those trading at peak multiples of peak earnings.

By contrast, the Kennox portfolio is one of a diminishing number of funds dedicated to finding undervalued opportunities, and therefore offers genuine diversification to our clients - a high conviction strategy, comprising 28 companies, each a leader in its own market, trading at attractive valuations (every company we own is at less than 20x our view of Sustainable Earnings, with the portfolio average at 14x). The portfolio includes cash generative telecoms companies and energy majors, alongside best-in-class gold miners and idiosyncratic names such as Western Union and Quadient discussed above.

Whilst a little frustrated that our returns this year are well behind the market we will not deviate from our investment philosophy and believe our portfolio (offering undemanding upside with reduced downside risk) is well set for whatever stock markets have in hold in 2020 and beyond.

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

Period	**Professional share class**	**Institutional share class**	**Class A share class**
2019	4.5%	4.8%	5.1%
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 December 2019

	Stock	**Region**	**Sector**	**Market Cap (US$m)**	**Fund Weight**
1	NEWMONT GOLDCORP	N. America	Materials	36,000	7.9%
2	WESTERN UNION	N. America	Information Technology	11,000	4.8%
3	QUADIENT	Europe	Information Technology	900	4.8%
4	EQUINOR	Europe	Energy	67,000	4.6%
5	CHINA MOBILE	Asia	Communication Services	172,000	4.6%
6	BP	UK	Energy	129,000	4.3%
7	ROYAL DUTCH SHELL	UK	Energy	235,000	4.3%
8	MUNICH REINSURANCE	Europe	Financials	43,000	4.0%
9	TESCO	UK	Consumer Staples	33,000	4.0%
10	GLAXOSMITHKLINE	UK	Health Care	118,000	3.9%
	Total Top 10				47.2%
	18 Other Holdings				40.3%
	Cash				12.5%

Unit Prices

As at 31 December 2019:

- Professional Share Class:
    - Income: 124.10 pence (unit price at inception, 30 April 2009: 70.08 pence)
    - Accumulation: 142.80 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Institutional Share Class:
    - Income: 125.40 pence (unit price at inception, 12 May 2010: 85.46 pence)
    - Accumulation: 147.40 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
    - Income: 125.50 pence (unit price at inception, 29 April 2013: 104.3 pence)
    - Accumulation: 149.20 pence (unit price at inception, 29 April 2013: 104.3 pence)

Charles L. Heenan (Investment Director)

Geoff Legg (Investment Director)

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