QUARTERLY INVESTMENT REPORT

June 2020

Global stocks continue to swing around market sentiment regarding the Covid-19 pandemic, the largest economic shock since the second world war, and governments' subsequent fiscal and monetary actions. On the back of the monetary floods and rising optimism about an economic recovery, markets rebounded this quarter. The Fund rose 9% over the period.

Leading the rise were our gold miners, up about a third in sterling terms for Newmont, about 50% for Newcrest and with Yamana almost doubling. Gold had fallen in March in the indiscriminate sell off for all asset classes, a true sell-what-you-can moment. After this liquidity-driven drop, the gold price has been rising as it gains favour with investors seeking genuine diversification. The increasing gold price has unsurprisingly been a significant boon for our gold mining holdings. Take this as a case study of how our contrarian value style works. At Kennox, we find opportunities where temporary headwinds and the ensuing market pessimism push share prices down excessively. It is imperative to get conviction that the headwinds are temporary – if so, we have a genuine opportunity; if the headwinds are permanent, it is a value trap and one to be avoided. The gold mining industry is just now hitting its sweet spot in this headwinds-to-tailwinds progression, its bear market having started all the way back in 2011. Management teams in the industry have focused in on their best assets, rationed capital, cut weaker projects, slashed costs and taken the steps to make the businesses more resilient and robust. All three of our gold miners have made sensible strategic moves that position them well for the future. With tailwinds set to continue, the gold miners form a core of the portfolio, and we continue to search out other opportunities that will play out as well as this.

Looking at other top movers in the Fund over the quarter, many were rebounding from excessive drops in March. We were fortunate to have held up reasonably well when markets were at their weakest, but some prices of our stocks were hard hit and have subsequently recovered. Munich Reinsurance, Western Union and Equinor are good examples – all strong, market-leading companies, well positioned for the long term. On the other side, the largest detractor was a share that was especially strong in March, Fukuda Denshi, which sells medical respiratory equipment. Having been one of the small number of shares in the world that rose in the darkest days of March, it gave back some of its gains as the market worried less about the pandemic.

Quadient was another notable detractor over the period, due to the market's concern for the short-term outlook for their businesses. We had a call with senior management in June and worked through the outlook and positioning for the different business segments. The largest segment, mail related services, was impacted by the Covid-19 lockdowns but continues to perform acceptably with almost no defaults and with the contracts being renewed and extended more-or-less as anticipated. All businesses want to minimise contact for their employees, and franking machines will remain much more appealing than trips to the post office. The other segments (customer experience management, business processing automation, parcel lockers) all help their customers with efficiency and digitalisation, and these offerings all look especially well positioned for the new normal of increased remote working. The immediate uptake of these businesses has been slowed as clients had prioritised the pressing issues of Covid-19, but longer term the outlook is even better than before. In short, Quadient's businesses look in fair to good shape, with high levels of recurring revenues, attractive new areas to continue expanding into, and a business model that generates large amounts of cash. Valuations, though, are starting to look extreme. Our analysis leads us to believe that Quadient can achieve our estimate of €100m for their Sustainable Earnings in the medium term. The market is pricing the company on 4x this earnings figure. Even if we are out by 50%, the company would still be on under 10x earnings, and at a level of profits which we are confident they would be able to grow. This is a very attractive investment.

There are opportunities and valuations in the portfolio that remind us of those reached in the early 2000s, a time of especially fruitful opportunities. Quadient, a robust business trading at 4x our view of Sustainable Earnings as mentioned above, is one example. China Mobile has a much stronger offering than its two competitors in China, giving it a powerful competitive advantage and the ability to generate enormous amounts of cash. With no debt on the balance sheet, this extraordinary franchise is available at under 10x our view of Sustainable Earnings and at a 6% yield. Texwinca's core business is performing well, growing even at present. Sentiment is so negative that it trades on 0.3x book, which we see as a conservative estimate of its break-up value, with net cash making up over 80% of its market capitalisation, and that is to say nothing of the strong franchise they have with robust earnings potential. Shell was promising only a few months ago to return $25-30 billion a year to shareholders, such were the strength of its operations and the stage of the capital cycle, with past spending about to turn into future cash flows. If we apply a haircut of half or more, we find an unquestioned survivor and leader in an industry that is finally seeing significant supply cut backs (an example being the Chesapeake bankruptcy in June), and which is available at valuations that imply excellent double-digit returns. Looking across the portfolio at other valuation metrics, such as cash flow, book value, or dividend yields, the portfolio trades at much more desirable levels than the market in general. Across a range of measures, the portfolio's valuations remain exceptionally attractive.

All investors face an outlook as uncertain as at any time in a lifetime. The course of the pandemic is creating black holes in the economy and financial markets the ramifications of which have yet to be seen (examples include commercial property or aviation leasing or mass unemployment). At the same time, the returns for the winners will be enormous. It is unknowable when and how this will play out. Most sensible is for investors to have balance across their investments – to position conservatively focusing on risk as well as reward, and to ensure there is genuine diversification in their holdings, not simply by geography and sector but by underlying profit driver, and by performance style (such as the headwinds-to-tailwinds progression mentioned above).

The Fund remains selective, holding a diversified group of sector leaders with low levels of debt – we expect these to be the survivors in their industries. All are priced at extremely attractive levels. This positions the Fund as well as is possible for this environment, able to capture substantial upside whilst focused on avoiding wealth shocks that could materialise if the macro-economic recovery is not as smooth as markets appear to be expecting.

Fund Data – 30 June 2020

Performance (total return net of fees) in Pounds Sterling

Period	Professional share class	Institutional share class	Class A share class
YTD	-10.8%	-10.7%	-10.6%
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.

Top 10 Holdings

	Stock	Region	Sector	Market Cap (US$m)	Fund Weight
1	NEWMONT CORP	N. America	Materials	50,000	8.4%
2	NEWCREST MINING	Asia	Materials	18,000	5.5%
3	CHINA MOBILE	Asia	Communication Services	138,000	4.6%
4	TESCO	UK	Consumer Staples	27,000	4.2%
5	SWISSCOM	Europe	Communication Services	27,000	4.1%
6	EQUINOR	Europe	Energy	48,000	4.1%
7	GLAXOSMITHKLINE	UK	Health Care	102,000	4.0%
8	ROYAL DUTCH SHELL	UK	Energy	122,000	4.0%
9	FUKUDA DENSHI	Japan	Health Care	1,300	4.0%
10	BP	UK	Energy	78,000	3.8%
	Total Top 10				46.7%
	17 Other Holdings				42.4%
	Cash				10.9%

Unit Prices

As at 30 June 2020:

- Professional Share Class:
  - Income: 110.20 pence (unit price at inception, 30 April 2009: 70.08 pence)
  - Accumulation: 127.40 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Institutional Share Class:
  - Income: 111.40 pence (unit price at inception, 12 May 2010: 85.46 pence)
  - Accumulation: 131.70 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
  - Income: 111.40 pence (unit price at inception, 29 April 2013: 104.3 pence)
  - Accumulation: 133.40 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