QUARTERLY INVESTMENT REPORT

December 2020

The Fund was up 5% in the 4th quarter, providing some respite after nine difficult months in which Value stocks (even those with strong franchises and robust balance sheets) were largely ignored.

Fund performance in 2020 was disappointing. While holding up slightly better than the market in the February-March sell off, overall our sector leaders lagged in the strong market rebound of the 2nd and 3rd quarters. This was frustrating, but we are not downhearted. Looking forward, we are confident that the scene is now well set for a sustained period of significant portfolio outperformance. On this, we would encourage you to look at our recent paper *"A decade of Momentum"* and video *"Kennox in Conversation: with Russell Napier"* – both can be found on our website*. It's early days, but in the 4th quarter we may have seen our first "green shoots", initial signs of the vast latent potential within our portfolio.

Many of the companies that had held us back in the first half of 2020 delivered strong returns in the 4th quarter and look well set to continue delivering. For example, our energy holdings were amongst the top performers in the 4th quarter. As approval of vaccines gained pace and the markets eyed an end to the pandemic, some of the extreme negative sentiment around these stocks eased. **Royal Dutch Shell** was up over 35% in the quarter with **Equinor**, **BP** and **Exxon Mobil** up 14%, 15% and 16% respectively. There is a long way to go for these prices. For example, with oil prices now at over $50 per barrel, **Shell** is likely to generate c. $20bn in free cash flow. That compares to a market cap of c. $140bn after the share price rise, or just 7x free cash flow. This remains an incredibly low valuation multiple for a company providing what remains a critical resource for society and one for which we currently have no realistic scale alternative.

Other strong performance in the final quarter came from **Texwinca** (up 35%), **Quadient** (up 34%) and **M6 Metropole** (up 28%). Each of these companies looks well positioned for further gains, with strong cash flow generation and solid balance sheets. All had suffered early in 2020 as the market continued to reject all but an ever-diminishing list of large cap growth stocks. These three companies represent 10% of the portfolio and trade at an average free cash flow yield of c. 20%. They could each double in price and remain at a significant discount to the market as a whole, such is the scale of opportunity.

Our gold miners (**Newmont**, **Newcrest** and **Yamana**), which had performed very well over the first half of the year, pulled back slightly in the 4th quarter, reducing the Fund's overall performance. Gold mining is one of the few sectors to have experienced a reduction of investment over the last decade when most other sectors have taken advantage of an ever-decreasing cost of capital to double down on capital expenditure. This retrenchment started back in 2013 (after the gold price first peaked in 2011). Whilst that means we are already seven years into the tightening of the capital cycle, the near 20-year time lag from investment to gold production means that positive momentum of the last five years looks set to run for a decade or more. We expect to enjoy further substantial upside from our gold miners.

Our confidence is also buoyed by valuations across the portfolio – currently at some of the most attractive levels we have seen in our 14 years running the strategy. The portfolio trades at 12x our estimate of Sustainable Earnings, 1x Price to book and with a c. 4.5% dividend yield comfortably covered by cash flow. Importantly, we also have significantly less leverage than the broader market. On average the portfolio has 2.7x leverage (total assets to equity) compared with 6.2x for the MSCI World Index and 6.9x for the MSCI World Value Index. The world will emerge from the pandemic with unprecedented levels of debt and many of the more leveraged companies will not survive if the cost of capital returns to meaningful levels.

We have taken advantage of these exceptional valuations, reducing our cash position from 11% to 5%. The cash went into the names where the price moves in early 2020 looked most excessive to us: those with Sustainable Earnings multiples in the single digits and primed for their operations to recover from the depths of the pandemic. For example, we added to **Royal Dutch Shell**, **BP** and **Singapore Telecommunications**. We also added a new position in **Stella International**, a pan-Asian footwear manufacturer specialising in high quality shoes for luxury brands and with exposure to the fast-growing luxury athletic shoe trend. In the toughest of environments, with many orders postponed, **Stella** expects to be around breakeven for the year. A rock-solid balance sheet (net cash, and with positive cash flow generation even in a difficult year) ensures they will make it through this tough period. We bought at c. 10x our Sustainable Earnings estimates.

We firmly believe that valuations are fundamental to generating good absolute returns. We also believe that many pitfalls remain for the global economy and hence for markets. The combination in the portfolio between quality companies and exceptional valuations therefore feels especially relevant. We are well aware that recent times have been hard for our investors and that it requires courage to allocate capital to Value and away from Growth strategies. However, for those that do, the rewards have the potential to be substantial, both in absolute and relative terms.

* *"A decade of Momentum" – https://www.kennox.co.uk/Decade_of_Momentum.pdf*

"Kennox in Conversation: with Russell Napier" – https://www.kennox.co.uk/kennox-in-conversation-with-russell-napier/

Fund Data – 31 December 2020

Performance (total return net of fees) in Pounds Sterling

Period	Professional share class	Institutional share class	Class A share class
2020	-11.3%	-11.1%	-10.9%
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	48,000	7.5%
2	ROYAL DUTCH SHELL	UK	Energy	140,000	5.1%
3	NEWCREST MINING	Asia	Materials	17,000	4.5%
4	QUADIENT	Europe	Information Technology	700	4.4%
5	EQUINOR	Europe	Energy	56,000	4.3%
6	SINGAPORE TELECOM	Asia	Communication Services	29,000	4.2%
7	BP	UK	Energy	73,000	4.2%
8	TESCO	UK	Consumer Staples	32,000	4.1%
9	FUKUDA DENSHI	Japan	Health Care	1,500	4.1%
10	CHINA MOBILE	Asia	Communication Services	116,000	4.0%
	Total Top 10				46.3%
	18 Other Holdings				48.9%
	Cash				4.8%

Unit Prices

As at 31 December 2020:

- Professional Share Class:
  - Income: 107.90 pence (unit price at inception, 30 April 2009: 70.08 pence)
  - Accumulation: 126.70 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Institutional Share Class:
  - Income: 109.10 pence (unit price at inception, 12 May 2010: 85.46 pence)
  - Accumulation: 131.10 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
  - Income: 109.10 pence (unit price at inception, 29 April 2013: 104.3 pence)
  - Accumulation: 133.00 pence (unit price at inception, 29 April 2013: 104.3 pence)

Charles L. Heenan
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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

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