QUARTERLY INVESTMENT REPORT

June 2022

The last six months have been quite the rollercoaster for global equity markets, with the MSCI World index down 11% in 2022 to date. The Fund has returned +9% so far this year.

Having rallied briefly at the end of the first quarter, global markets fell a further 9% during the second quarter. The Fund remained relatively robust over the quarter, down 2% (in part due to our gold miners giving back some of the significant gains made in the first quarter).

In recent commentaries we have been saying that we see markets as having reached an inflection point – certainly they feel markedly different from for the markets of the majority of the last decade. Since the launch of the first round of quantitative easing following the global financial crisis in 2008 markets have been dominated by a fear of deflation and an environment of ever decreasing interest rates. Since late 2021, markets have been overshadowed by the opposite: the reality of inflation and the fear of rising interest rates.

It has become clear that this new market paradigm has reinvigorated investor interest in the concept of Value investing, with some dipping their toes back in the Value pool (though most have yet to fully commit). For those who remain undecided, we would respectfully suggest that adding an exposure to Value could be a useful counterweight in growth-dominated portfolios. However, a word of caution – choose your value wisely. “Value” is a broad term and not all will prove well suited to the environment ahead. We do not expect plain sailing, and with that in mind, remain focused on the many and varied risks that face investors, some of which we highlight below.

Looking at performance within our portfolio. Of our 28-stocks, 23 have outperformed global markets over the first 6 months of 2022. As one might expect, our energy holdings have performed well (up 40% on average), but so too have many other solid, frugally priced holdings. **KPN** (the leading Dutch mobile and broadband provider) is up over 30% year to date, with our portfolio of telecoms providers up over 20% on average. **Canon Marketing Japan** (a provider of office hardware and IT solutions) is up 16%. **Yamana**, a very well positioned Canadian mid-tier gold miner, is up nearly 25%. Amongst the laggards are Currys and Admiral, two of our three holdings exposed to the UK consumer – an area of the market that has sold off rapidly. (Our third UK holding is Tesco. Considered a staple, it is a beneficiary when consumers look for a lower priced basket). Currys is a very solid business with exceptional fundamentals (it has leading market shares in both the UK and Nordics, a burgeoning online offering that now constitutes approximately 50% of sales and carries no financial leverage). That it now trades on c. 6x our view of its longer-term earnings potential indicates just how out of favour the sector has come (weaker competitors, some of which may go out of business, trade on similar multiples), and we retain a 2% position in the Fund.

We were very pleased to have the opportunity to speak at the London Value Conference in May (and to see so many attendees – a testament to the renewed interest in Value investing). At the conference we highlighted three risks close to our hearts that that have been overlooked in the extended bull market. These risks are starting to be recognised by the market and, with that, the Fund is beginning to see rewards.

1. **Most industries have received an abundance of capital over the last decade.** This slowly feeds into increased supply, until margins start to retreat and profits suffer. We find it far more interesting to look for industries that have underinvested, therefore benefitting from the opposite market dynamic (a reduction in supply and hardening of pricing power as competition decreases). This is most readily seen in our gold miners. From when the gold price first peaked at just over $1,800 per troy ounce in 2011 until recently that industry had been in a bear market, starved of investment in new reserve exploration. The near impossibility of an increase in supply in the industry, coupled with the emergence of inflation which increases demand, make this a very interesting opportunity. Our portfolio of three miners (**Newmont**, **Yamana** and **Newcrest**) now boasts a free cash flow yield of c. 8% – a valuation point we can't recall seeing in many years.

Energy is another seriously under-invested industry, where we also have several holdings. It is right to be concerned about the impacts of a recession on the energy sector, but by far the bigger issue facing energy markets is the chronic lack of investment. Since 2013, capex amongst the biggest 50 oil producers has fallen from a peak of c. $600bn to estimates for 2022 of just over $300bn[1]. That in a period where oil consumption has increased by c. 10% to over 100m b/d. The tight supply/demand balance is further exacerbated by China and the US releasing oil from their strategic reserves. Should we run into a supply shortfall, there is little wiggle room short of seeking additional supply from Russia or Saudi Arabia. As a result, our energy majors look very well positioned to profit from difficult market conditions, and at a c. 15% free cash flow yield, they are not expensive even after recent share price performance.

2. **The market has become increasingly consensus driven**, leaving a selection of incredibly expensive stocks that are almost universally held with investors happy to turn a blind eye to valuations, believing there is safety in the herd. We look to avoid overcrowded trades at all costs. In an article in Forbes in 1979, Warren Buffet wrote: "you pay a very high price for a cheery consensus". A quote that would have been equally fitting over 40 years later when earnings multiples for growth assets reached peaks not seen since the dot.com bubble in 2000. Whilst market forces driving the dot.com bubble and the recent bubble have been different, the expansion of multiples has been startlingly similar. In both cases markets accelerated until multiples peaked at almost twice their long-run average (around 40x compared to long run averages of closer to 20x[2]). It is worth noting that in each of the seven years following the market peak in 2000 Value outperformed Growth, with the MSCI World Value index returning a compound +32% and the MSCI World Growth index -27%. The most obvious overcrowded trades of the recent bull market have been the US (up 335% in the last decade, compared to just 130% for the rest of the world[3]) and the technology sector (up 524% over the same period, and over 700% before the recent collapse). To our detriment (to this point), we have held very little of either, but urge caution to those who are still heavily invested.

3. Debt levels have soared in every area: government, corporate and retail. We are concerned about the over-leveraged. Looking specifically at the corporate sector, with ever-decreasing interest rates, taking on more and more debt has been seen as good business sense. This won't last. With rising interest rates, many of those that are highly geared will face pressure on earnings as the cost of servicing those

[1] Source Raymond James, quoted in the FT: https://www.ft.com/content/5f41ca00-96b4-40d8-beb1-df84a91ced93
[2] Source: Bloomberg. Earnings multiples for the MSCI World Growth Index
[3] Source: Bloomberg. Returns for the S&P500 vs MSCI World ex United States in GBP

debts increases. Our portfolio has leverage of 2.3x (compared to 6.1x for the broader market[4]), 35% of the portfolio is net cash and over 80% of the portfolio has net debt to EBITDA multiples of less than 2x.

As we highlighted in a paper back in March ("Investing at an inflection point"), we firmly believe that the new market paradigm is here to stay for the foreseeable future. At least in part because the level of debt in the system (coupled with the current cost of living crisis) will make it difficult to curb inflation.

In the sort of rocky markets that all investors are now experiencing, a high conviction portfolio of market leaders in under-appreciated areas of the market, with little or no financial leverage and producing a c. 10% free cash flow yield is a very sensible way to invest.

[4] Source: Bloomberg. Leverage measured as total assets to equity, and using the MSCI World Index for comparison

Fund Data – 30 June 2022

Performance (total return net of fees) in Pounds Sterling

PERIOD	SHARE CLASS		
	CLASS P	CLASS I	CLASS A
YTD	8.9%	8.9%	9.1%
2021	9.6%	10.1%	10.5%
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: Class P on 30 April 2009; Class I on 12 May 2010; and Class A on 29 April 2013.

Top 10 Holdings

STOCK	REGION	SECTOR	MARKET CAP (US$M)	WEIGHT (%)
EQUINOR	Europe	Energy	112,500	7.4
NEWMONT CORP	N. America	Materials	47,500	6.7
SHELL	UK	Energy	192,000	6.7
EXXON	N. America	Energy	361,000	5.2
BP	UK	Energy	89,000	5.0
YAMANA GOLD	N. America	Materials	4,500	4.6
SINGAPORE TELECOM	Asia	Communication Services	30,000	4.4
CANON MARKETING	Japan	Information Technology	2,500	3.8
KPN	Europe	Communication Services	14,500	3.6
SWISSCOM	Europe	Communication Services	28,000	3.6
TOTAL TOP 10				**51.0**
18 OTHER HOLDINGS				47.8
CASH				1.3

Unit Prices

As at 30 June 2022:

- Class P Share Class:
    - Income: 125.40 pence (unit price at inception, 30 April 2009: 70.08 pence)
    - Accumulation: 151.20 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Class I Share Class:
    - Income: 126.70 pence (unit price at inception, 12 May 2010: 85.46 pence)
    - Accumulation: 157.20 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
    - Income: 126.80 pence (unit price at inception, 29 April 2013: 104.3 pence)
    - Accumulation: 160.40 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

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We do not track, nor are we constrained by, a benchmark. Reference to the MSCI World, MSCI World Value and IA Global indices are for comparative purposes only.