HAVELOCK
LONDON

April 2020

LF HAVELOCK GLOBAL SELECT

Q1 2020 NEWSLETTER

FINANCIAL RATIOS OF EQUITY ALLOCATION

PRICE TO EARNINGS RATIO 8.9×

The market value of our current company holdings in relation to to their earnings over the past year. This provides an indication of the number of years of company profits that equates to the current market price of our equity assets.

DIVIDEND YIELD OF EQUITY ALLOCATION 5.0%

The dividends of our current company holdings over the past year, in relation to their current market value.

PERFORMANCE SINCE LAUNCH (%)

QUARTERLY RETURNS

QUARTER 1 2020	YEAR TO DATE
-20.9%	-20.9%
1 YEAR	**SINCE LAUNCH**
-14.1%	-14.0%

This performance information refers to the past. Past performance is not a reliable indicator of future results. This information is denominated in GBP: returns may increase or decrease as the result of currency fluctuations.

COMMENTARY

The fund's unit price decreased by 21% this quarter, resulting in a 14% total decline since the fund's inception.

This is not a comfortable opening line but reflects the reality of the sudden mood change in markets brought on by the threats of Covid-19. Governments have reacted to these threats by reaching for the "pause button", with lock-down measures causing an overnight halt in economic activity. Against this backdrop stock market prices fell, as sellers looked to make a rapid exit.

The share prices of all but one of the companies that the fund holds fell in the quarter. The exception being the French telecoms provider, Iliad, making it the top contributor. The company's founder, Xavier Niel, completed a repurchase of shares that increased his personal holding to over 70%. This, together with the world's sudden reliance on broadband networks, has been supportive of the share price. I view Niel's actions as a strong vote of confidence in the long-term success of Iliad's aggressive investments to roll out fibre optic broadband in France and launch a new mobile network in Italy. We like companies where those in charge own large stakes and are forced to eat their own cooking.

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The bottom contributor to performance has been the retailer, GAP. The company has faced declining sales, and criticism of being out of touch with consumer tastes. Robert Fisher, Chairman and son of GAP's founders was appointed interim-CEO and made a swift U-turn to cancel the outgoing CEO's plan to spin off their Old Navy brand as a separate business. A replacement CEO has now been appointed and the latest financial results showed some signs of improvement. This has however all been relegated to a side-show, as the enforced lock down has caused all their North American stores to close, with an abrupt halt to their main source of revenue. Our analysis is that the company has enough working capital to survive a 3-month shutdown without any attempts to reduce costs or borrow. The management have already acted to make material cost reductions, and our view is that with no net borrowings the company is adequately capitalised to weather a much longer storm.

The second worst contributor to performance was the UK infrastructure business Costain. The fund owns shares in Costain, together with competitor Morgan Sindall. The construction industry was selected for detailed study from a quantitative screen, and our investment thesis was partly that a deterioration in the economy may lead to increased government infrastructure spending. We believed that companies in this industry with strong balance sheets would prove more resilient than other investors were assuming. The announcement of increased UK government spending on infrastructure however only gave us fleeting pause for celebration. Costain's request for shareholders to inject £100M of equity capital into the business was met with a rapid fall in its share price. The company has no net debt and is, I believe, fundamentally sound. However, the request appears ill-timed and it has provided an experience from which I hope to learn. We move into the next quarter with just 0.4% of the portfolio invested in Costain.

As of the end of the quarter around one third of the companies we own are American, whereas the MSCI World stock index has almost two thirds of its weight in the US. Prices in British and European stock markets generally fell more heavily than in America during the quarter and the British Pound also declined by more than 6% against the US dollar. This contributed to the fall in unit price of the fund being larger than those global funds whose geographical weightings are skewed towards the US. Whilst this was a drag on performance in the quarter, I believe that it is too soon to "bank" it and conclude that America will be more resilient than other countries to the current crisis.

We introduced two new companies into the portfolio this quarter, both of which have exposure to the agriculture sector. They both suffered from recent weak results following a warm winter that led to a reduction in demand for their products. Our valuations for both companies are based on a model of their longer-term earnings, whilst we believe other investors have fixated on the type of "bad" year that is to be periodically expected in this industry. We believe that the value we see in both companies is underpinned by their balance sheets, with low levels of debt and current share prices that are materially below their accounting book values.

The value-style of investing that we pursue did, in general terms, see worse performance than its growth orientated counterpart in the quarter. We continue to see many widely held "growth" companies looking expensive relative to their underlying economics, with price multiples that are towards the high end of their historic range. We do not know if this will continue but remain resolute in avoiding investments where we believe undue optimism is required to justify their price.

As a reminder all the companies that we invest in are backed by an analysis of their "raw numbers" that leads to a model (or algorithm) to value their business. Whilst the numbers provide the primary driver of what we own, the qualitative description above forms part of our ethos of understanding the businesses that we invest in. We continue to believe that the combination of human and machine helps us make better decisions that balance being objective whilst understanding the context behind the numbers.

What happens next?

I believe that the implications of the Covid-19 virus remain unclear. It is not clear how quickly vaccines might be developed, if its spread will slow with warmer weather or the number of us who have already contracted it without symptoms and may then be immune.It is not even clear what the disease's true mortality rate is. As the crisis continues, I also

believe we do not yet know how governments will balance the health risks against the economic cost of remaining in lockdown. Whilst the scientific uncertainty continues and lockdown durations are unknown, I believe that discussions of what an economic recovery will look like are premature.

Governments and central banks have been rushing to underwrite the economic costs, with a combination of easier lending and government spending. To me this silently ushers in an acceptance of Modern Monetary Theory[1] - the idea that a country can print money during a downturn without risk of rampant inflation. I cannot judge if this theory is right or wrong, but it has hallmarks of "this time is different" about it that cause me concern. In simple terms the threat of a prolonged shut down makes owning shares in a company look unattractive whilst the threat of Governments printing money makes owning cash or government bonds look unattractive. Which way are we to turn?

My opinion is that well-run companies with strong balance sheets will endure the current crisis and be ready and waiting for a resumption of business, whenever that might be. The threats that I see on the horizon are (i) owning companies saddled with too much debt, (ii) owning companies with price-multiples that are close to their historic highs and at risk of large falls and (iii) the risk that governments printing money leads to surprise inflation. Furthermore, with long term interest rates below official inflation targets buying Government bonds right now comes with a risk of loss of purchasing power in the long term.

Our approach to these threats is to redouble our efforts to ensure that we are invested in companies that have the strength to survive a few bad years, coupled with the deployment of some of our dry-powder cash as, and when, we think appropriate. Our overarching objective is to hold a portfolio that we believe will be robust in a range of scenarios.

[1] https://en.wikipedia.org/wiki/Modern_Monetary_Theory

This is the opinion of the author at the time of writing and it may change. The company examples used are for illustrative and information purposes only. Every attempt is made to ensure this information is correct or up-to-date. This is not a recommendation or investment advice and you must not use it to make investment decisions.

The data in this document is sourced from the fund accountants as at 31.03.20 unless otherwise specified.
The data used to calculate the financial ratios of the equity allocation is sourced from Bloomberg.

INVESTMENT RISKS

The value of investments in LF Havelock Global Select (the fund) may fall as well as rise. Investors may not get back the amount they originally invested. Investments will also be affected by currency fluctuations if made from a currency other than the fund's base currency. Past performance is not a reliable indicator of future results.

Potential investors should not use this document as the basis of an investment decision. Decisions to invest in the fund should be informed only by the fund's Key Investor Information Document (KIID) and prospectus. Potential investors should carefully consider the risks described in those documents and, if required, consult a financial adviser before deciding to invest. The fund can invest more than 35% of its value in securities issued or guaranteed by an EEA state listed in the prospectus.

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The Key Investor Information Document (KIID) and prospectus are available in English from:

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