30 September 2022

HAVELOCK LONDON

LF HAVELOCK GLOBAL SELECT

FUND PERFORMANCE

Cumulative Returns

1 Month	YTD	1 Year	3 Years	Since Launch
-7.0%	-7.3%	-8.6%	13.3%	19.0%

Calendar Returns

Year	Q1	Q2	Q3	Q4	Annual Return
2019	6.2%	2.9%	1.9%	3.5%	15.3%
2020	-20.9%	13.9%	1.7%	11.8%	2.4%
2021	11.0%	2.8%	2.4%	-1.4%	15.2%
2022	1.9%	-4.7%	-4.6%		

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.

FUND DETAILS

Fund Size	£80M
Fund Manager	Matthew Beddall
Fund Structure	OEIC (UK UCITS)
Fund Domicile	UK
Launch Date	21st August 2018
Base Currency	GBP
ISIN	GB00BFM7DN78
SEDOL	BFM7DN7

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

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COMMENTARY

The change in the fund's unit price for the third quarter of 2022 was -4.6%, resulting in an increase of 19% since inception in August 2018.

The negative sentiment within equity markets appeared to take a break over the summer, with stock indices rising for the first 6 weeks of the quarter before going straight back to where they had begun. Whilst it is the "excitement" of moving prices that commands headlines, it is activities in the underlying businesses that we invest in that will dictate long-term investment results. This activity operates at a much slower rhythm.

The top three positive contributors to the change in the funds unit price this quarter were:

- Daito Trust Construction, the Japanese real estate business
- Krones, the German drinks bottling machine manufacturer
- Berkshire Hathaway, the US conglomerate

Whilst the three largest negative contributors were:

- Fresenius SE, the German medical conglomerate
- Bakkafrost, the Faroese Salmon farming business
- Associated British Foods, the British consumer staples business

The change in unit price was heavily impacted by currency movements, with the British Pound falling by 8% against the US dollar during the quarter. The falling value of the pound has an equal and opposite effect on the value of investments denominated in other currencies, meaning that it has benefited the fund this quarter. Although we do not attempt to forecast or hedge currency movements, we are nonetheless very aware of the impact that they have.

By far the biggest driver of performance in the year to date has been our holdings in oil and gas companies, which have collectively contributed circa 2%. The narrative around fossil fuels has clearly shifted in the last year, with expectations on how quickly our dependency on them has reduced moving back towards reality.

We sold our holdings in Exxon and Chevron during the quarter. Both businesses were on considerably higher valuations than their European counterparts, so much so that it did not make sense to us. We introduced a new Canadian energy business into the portfolio, which we believe represents both better value than the two US majors and operates a business model that is lower risk.

The largest driver of negative performance for the year to date was Associated British Foods, which left it, arguably, at a forty-year valuation low. It has been impacted both by weak sentiment towards British companies and by concerns of falling consumer spending. The company's largest division is the clothes retailer, Primark, which has proved robust during previous recessions as consumers "traded down" to cheaper retailers. It follows that we are more optimistic about the company during hard economic times, than the consensus.

We said "goodbye" to our holding in Brewin Dolphin at the end of the quarter, following the successful completion of the sale of the business to the Royal Bank of Canada. This holding contributed circa 0.7% to the year-to-date performance. The price that we received from the takeover was above our valuation, and so we are happy to move on to pastures new.

We introduced a small new holding in an industrial Japanese company in the quarter. It is a diversified business, with the largest activity being the supply of specialist components for semiconductor fabrication plants. As well as meeting our more general investment criteria, we believe that a move towards "onshoring" the manufacture of semiconductors could provide a structural tailwind. This investment forms part of a more general push that we have made to research Japanese companies.

As of the end of the quarter the largest single negative contributor to the fund's performance has been the German medical business, Fresenius. The company owns one third of the separate Fresenius Medical dialysis business and has business units operating private hospitals and manufacturing generic drugs. It has simultaneously seen its previous high level of growth interrupted and faced both COVID and cost inflation headwinds. The company had a price to earnings ratio of around 7x at the end of the quarter, which is symbolic of it having been abandoned by many investors.

One of the biggest concerns about Fresenius amongst investors is the complexity of its conglomerate set-up, with it owning one third of the separate publicly listed dialysis business. At the end of the quarter, it was announced that the CEO would be replaced with a recently hired external candidate, as the strategy to simplify the business has not been well received by investors.

Despite the falling share price, the company has produced five years of relatively stable cashflows, with analysts forecasting a return to growth. Following the end of the quarter it was announced that the activist investor, Elliot Advisors, has taken a large stake in the business. It seems likely that they will push to break up the company, in the belief that the stock market would give it a higher valuation if it weren't a conglomerate.

We move into the final quarter of the year quietly excited about the investment opportunities in front of us. As covered in a recent thought piece[1], we see many companies currently trading at extremely low valuations. I think it possible that some of these low valuations are the product of investors stampeding for the exits in panic. We cannot know what this means for our performance in the short-term, but with all else being equal lower prices today should equate to higher long-term returns in the future.

Performance Commentary

Performance is ultimately the way in which we must be judged and is something most investors expect to hear about. But I often find myself conflicted when writing about it, as it is noisy and often only loosely

[1] https://www.havelocklondon.com/commentary/uninvestable/

related to what is happening in the portfolio companies. Furthermore, I believe that short-term performance can become a distraction and draw investors into making bad decisions.

I am clearly accountable for long term performance, and the "long term" is made up of a series of "short terms". What then is my problem with narrating the short-term? It is that it tends to be dominated much more by the things that we cannot predict – changes in investor sentiment, macro-economic events and corporate "bumps in the road".

What we believe we can predict, is the long term cashflows generated by the businesses that we invest in. We, of course, cannot hope to make precise predictions, but we attempt to forecast reasonable ranges over a number of years. This opinion on future cashflows, together with a view on how management teams will use them, translates into predicting a range of reasonable valuations for a business.

What do I mean by a range of reasonable valuations? You can think of this as us producing two valuations for a business, the first and lower based on a pessimistic view of the future and the latter and higher based on an optimistic view. On the balance of probability, we think the actual outcome will be likely to sit somewhere in between these two extremes.

We proceed on the basis that if we consistently buy well run companies, at prices that are below our range of valuations, long-term performance will follow. This rests on the idea that in the long-term stock price movements will reflect the underlying economic performance, or cashflows, of a business.

You should expect to receive some commentary on short-term performance in my quarterly updates, but I nonetheless view it as a side-show to what is happening in the underlying portfolio companies.

Forecasting

Our approach of trying to predict long-term cash flows sets us at odds with many investors who "don't believe in forecasting". This is uncomfortable, especially since I have heard many investors whom I admire utter these words.

We certainly do not believe in point forecasting – the idea of spuriously precise forecasts about the future. I think that when many investors say they do not believe in forecasting, it is this school of thought that they are distancing themselves from.

Forecasting, in the more general sense, means forming a set of views about what the future will look like. Whether explicit, or not, investors cannot escape from forming views on the future when making decisions. Even when purchasing a passive stock index investment, you are implicitly forecasting that the group of companies behind it will be worth more in the future than they are today (including, of course, any dividends they pay).

Much like Goldilocks, and her taste in porridge, I think the best investors sit somewhere in between the two extremes – neither using precise forecasts nor none at all.

Bumps in the Corporate Road

One of the sources of short-term noise that I mention above is corporate "bumps in the road", and I believe that even the best run companies will experience periodic setbacks. When we invest in a company I see the management teams as our business partners, and I believe the stock market generally does not reward them for honesty. In my experience corporate statements that contain even a hint of bad news are followed by share price falls, which encourages a rose-tinted outlook.

I saw an example of this earlier in the year, when one of the companies that we invest in warned the stock market about the impacts of cost inflation, with the share price subsequently falling. The company operates in an effective duopoly. Its main competitor provided no such warning and experienced no fall in price. The nature of their businesses is that it would be very hard for the two companies to experience different levels of cost inflation – which left me with the conclusion that it is only the communication of these pressures that set them apart.

It should then go without saying that we place a high level of importance on the openness and honesty of management communication when we make investment decisions.

Geographic Risk

I thought that I would end my quarterly commentary with a few words on currency risk.

Our approach to investing does not view the holdings in our portfolio, relative to a benchmark, as a source of risk. This is not the case for all investors, with deviations from an appropriate benchmark often labelled as "active risk". The most prominent global stock index is probably the MSCI World Index, which currently has a 70% weight to companies listed in the US. Defining risk as deviations from this would label a more geographically balanced portfolio as particularly risky. This seems perverse to me.

We do not think that the country that a company is listed in provides sufficient information about its geographic exposures, because so many businesses are global in nature. Our own internal risk measure uses the regional sources of revenue for each of the companies that we own, which we think is a better guide to geographic risk. With that said the country of listing is a simple proxy, and hence one that is widely used by investors.

Our weight in US listed stocks at the end of the quarter was 22%, and our estimate of the share of revenue from the US was 28%. This compares to the US economy being around 16% of world GDP.

The 18% fall in the value of the Pound against the US Dollar for the first three quarters of the year equates to an 18% tailwind for the value of US holdings in a portfolio. This means that the concentration risk of having very large US exposure has paid-off for many British investors. I think it likely that these extreme levels of concentration will only be viewed as a "risk" as, and when, there is a fall in the value of the dollar. This is not something that we can predict, which is the reason we avoid extreme levels of concentration to any one country.

Matthew Beddall
CEO, Havelock London

Unless otherwise stated all numerical data was courtesy of Bloomberg.

IMPORTANT INFORMATION

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.

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.

Performance Data

All performance information is for the A-Accumulation share class, which is the longest running share class for the fund. 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.

The data in this document is sourced from the fund accountants unless otherwise specified. The data used to calculate the price to earnings ratio is sourced from Bloomberg.

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