HAVELOCK
LONDON

31 December 2022

LF HAVELOCK GLOBAL SELECT

FUND PERFORMANCE

Cumulative Returns

1 Month	YTD	1 Year	3 Years	Since Launch
1.4%	5.9%	5.9%	25%	35.9%

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%	14.3%	5.9%

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	£106M
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 year was 5.9%, of which 2.6% came from dividend payments. This takes the total increase in unit price since inception to 35.9%.

This time last year I wrote:

Despite my concerns, equity markets continued to appear full of ebullient sentiment. Central Banks underpinned market prices, as they funnelled "printed" money into the financial system on an unprecedented scale. Their actions risk many participants consciously, or otherwise, having a sense of invincibility and belief that equity markets only ever deliver double-digit returns.

The ebullient sentiment of 2021 was abruptly halted, with the MSCI World Index falling by 18%, or 8% when expressed in British Pounds. The NASDAQ index, which contains more companies at the epicentre of this ebullience, fell by 33%, or 25% in British Pounds. This mood change in markets was, in a large part, due to high levels of price inflation having curtailed the "easy money" environment. Interest rates have now risen to levels not seen since 2008, and central banks are starting to reverse their large-scale purchases of government bonds.

Given this backdrop, I am delighted that the fund delivered a positive return. Our "quality value" approach of investing in decent companies at reasonable prices kept us away from the corners of the stock market that saw the heaviest falls. Having criticised others for developing a sense of invincibility, I now need to ensure that the same doesn't happen to me!

We went into 2022 owning a collection of businesses that had a weighted average price earnings ratio of 14x, or 12.4x based on Bloomberg's analyst forecasts of earnings. As of the end of 2022 these ratios were 12.7x and 12.0x, which with all else equal suggests that the portfolio is cheaper now than a year ago, despite the positive performance. As a long-term investor I care about more than just next year's earnings, but these statistics fit with my view that our opportunity set remains healthy. What these ratios also tell me is that the increase in the value of our portfolio is matched by an increase in the earnings power of the businesses we own. This is what we want to see.

Before discussing performance in more detail, I wanted to highlight that as of January the fund will move to be part of the Investment Association (IA) Global Equity sector. It was previously in the IA Flexible Investment sector, and the new categorisation is aligned to how it has been managed and means that it will be compared to a more appropriate group of competitor funds.

Year End Performance Review

The top five contributors in descending order of their impact on the annual change in the fund's unit price were:

- The Dutch holding company, Prosus.
- The US conglomerate, Berkshire Hathaway.
- The European Energy company, Royal Dutch Shell.
- The German industrial company, Krones.
- The European Energy company, Total Energies.

Prosus indirectly owns almost one third of the Chinese technology giant, Tencent. It was by far the largest performance contributor, with a portfolio level return of 1.9%.

Our holding in Prosus came from a research project on Chinese technology companies, motivated by the large price falls that followed the Chinese authorities moving to constrain their activities. We like the Tencent business, and its leader Pony Ma, because they have demonstrated an ability to adapt. We formed the view that the future of the company was not solely dependent on domestic Chinese gaming, where their activities were most restrained, and that the political risk was not so extreme to make it uninvestable.

Shares in Prosus have historically always sold at a discount to the value of their holding in Tencent, but in 2022 this discount moved to extreme levels. The ability to gain exposure at what appeared to be a "double discount" offered, in our view, a compelling opportunity versus the risk. The holding subsequently benefited twice over as (1) the Prosus discount narrowed and (2) China eased COVID restraints and granted the company new domestic gaming licenses.

Berkshire Hathaway has been a core holding of the fund since inception and has had a large weight in the portfolio due to our view on its valuation, its heavily diversified nature, and its defensive balance sheet. The holding returned 0.8% at a portfolio level, but this was driven by the rising value of the US dollar, with its actual share price ending the year almost where it started.

Taken collectively our Oil and Gas holdings delivered a 2.7% return at the portfolio level. This represents the return from both Royal Dutch Shell and Total Energies, together with US companies Exxon and Chevron, and the Canadian energy business, Prairie Sky Royalties. The last of these was a newly introduced holding that has replaced the two American companies.

The fourth largest contributor, Krones, is a German manufacturer of beverage packaging machinery. They offer solutions for cans and bottles and have seen growing demand to retrofit production lines to use recycled plastic. Since the easing of COVID restraints the company has had a record order backlog, which allowed them to increase their prices in response to cost inflation. We started following the company last year and established a holding during March and April this year, since when the price has moved higher.

Performance in the final quarter of the year was helped by our holdings in UK and Hong Kong listed companies. Both countries have during the year been labelled as "uninvestable" by market pundits and like bees to a honey pot, we were attracted to the opportunities that panic creates. The narrative in both countries has come back from the brink, with share prices rising accordingly. This is not to say that we will always invest where others fear to tread, but we wish to think for ourselves and not blindly follow the consensus.

The top five detractors, in descending order, were:

- The Taiwanese lens manufacturer, Largan Precision Technologies.
- The British consumer goods conglomerate, Associated British Foods.
- The German health care business, Fresenius SE.
- The American furniture company, Miller Knoll.
- The American media company, Warner Brothers Discovery.

Largan Precision Technologies has profited from the growth of the mobile phone industry, as one of the largest suppliers of camera phone lenses. We invested in the business knowing that sales of smart phones were slowing but felt the consensus view over-estimated how quickly this would occur. The company then faced additional challenges during COVID, as both their factories and those of their customers were forced to close, causing sales volumes to decline. Furthermore, rising tensions with China weighed on all Taiwanese share prices.

On re-examining our thesis, against the backdrop of the general fall in stock markets last year, we felt there were better opportunities elsewhere, and so our holding in Largan was sold with a portfolio level loss for the year of 0.7%. The combination of it being effectively a "single line" business beholden to phone manufacturers, a lack of shareholder disclosures, and the security threats in Taiwan, meant that it was not a high conviction investment.

Associated British Foods is best known for its Primark chain of clothing stores, but also owns many other mostly food related businesses. The company is controlled by the founding Weston family, which includes the current CEO as one of their number. The share price fell this year, as sentiment focused on a slower than hoped recovery at Primark and the pace at which price increases offset cost inflation. My view is that the market consensus is too fixated on the short-term, whereas the management are plotting a course to ensure the long-term health of the business. Our conviction in this investment remains unchanged, irrespective of the 0.7% portfolio level loss.

Fresenius SE featured on last year's worst performers list, and so is particularly deserving of further explanation. The company owns one third of a publicly listed dialysis business (Fresenius Medical), runs a chain of private hospitals in Europe (Helios) and manufactures generic drugs (Kabi). It has been subject to cost price pressures but has also fallen out of favour with the stock market over its corporate structure.

The structure whereby Fresenius SE owns one third of Fresenius Medical is not liked by stock market participants, and a strategic review led by the previous CEO advocated replicating it in other divisions, rather than removing it. This led first to share price falls, and then to the CEO being replaced! Irrespective of whether it was a sensible strategy, it was evidently not what most shareholders wanted.

Our view on Fresenius SE is that it is a company underpinned by decent businesses, which are faced with cost inflation pressures that appear more than reflected in the company's low valuation. The new CEO has corporate restructuring experience and is undertaking a full review of the business. We are happy to continue owning the shares, based on our view of the value of the business, the credibility of the CEO and a belief that the corporate structure is something that can be easily fixed.

The US Furniture business, MillerKnoll, is the product of Herman Miller having purchased their competitor, Knoll. Both companies represent high quality brands, with loyal followings. The takeover was partly funded with debt, and its logic depends on the management delivering on their cost saving plans. The company has faced cost inflation and supply chain pressures, but at the same time has seen solid demand for their products. This led to the company diverting cash to fund higher inventories, meaning that debt levels have further increased. Although now only a small holding for the fund it remains under close watch, as the debt levels are now much higher than when we originally bought the holding.

Warner Bros Discovery represents another takeover situation, with the smaller Discovery having taken over the larger Warner Bros. The combined business is managed by Discovery CEO, David Zaslav, whose no nonsense approach is at odds with the free spending ethos behind the media "content wars". The newly combined company has a first-class film and TV back catalogue but has seen a rapid deterioration in advertising spend.

David Zaslav is overseeing a major restructure of the business, which means that the post-merger results are dominated by restructuring charges, albeit many that are non-cash. I believe the negative earnings have left the share price somewhat untethered, as many market participants struggle to know how to value the business. I also believe that the restructuring is laying the groundwork for healthy cashflows in the future. Although more highly leveraged than we would like, the finance costs are locked in for many years at low interest rates. Despite the large fall in the company's share price, we are supportive of the turnaround effort and are comforted by seeing other investors on the shareholder register whom we respect.

I will end the performance commentary with a few words on currency movements. The British Pound fell by 10.7% against the US Dollar in 2022, which cushioned British investors who own American companies from the full force of price declines. The average weight of our US holdings in the last year was 24.5%, and so the impact of the currency move provided less of a tail wind than for the MSCI World stock index with its 69% weighting. I do not know what will happen in currency markets in the year ahead but am aware that if the fall in the Pound reverses it will create headwinds.

Portfolio Changes

Our measured turnover for the year was negligible, not because the portfolio was unchanged, but because of the large inflows that the fund experienced. When new money flows into the fund we will direct it towards holdings that we want to up-weight, and we will liquidate overweight holdings to service redemptions. During the year, we removed eleven companies from the portfolio and added fourteen.

Our holding in Brewin Dolphin was the only involuntary sale, as the company was taken private by the Royal Bank of Canada, albeit at a price that we were happy to be a seller.

We sold three small holdings in British industrial businesses, Carrs Group, Castings and Dewhurst. All three are small capitalisation stocks, and the discount to their valuations were not large enough for us to accept the constraints on their liquidity. Our holding in Largan Precision Technologies, as detailed above, was sold based on us having decided that it no longer met our investment criteria, despite still looking cheap.

Holdings in the two US Energy majors, Exxon and Chevron, were sold after increases in their share prices closed the discount to our valuations. The decision was helped by us seeing better opportunities elsewhere in the energy sector. We also sold two utility company holdings, OGE Energy and Tokyo Gas. Both had converged on our valuations, but we also felt that we had underestimated the commodity price risk in both businesses after seeing the impact of the 2021 Texas blackouts.

Our holding in the Japanese automotive business, Subaru, was sold as the price converged on our valuation. This valuation was conservative, but with higher interest rates increasing the cost to consumers of buying a car on finance, together with the challenges of a move to electrification, we are less enthusiastic about the business.

We sold our holding in UMB Financial, which was one of two regional US banks that we own. The discount to our valuation had closed, and we felt that there was a better risk-reward ratio from concentrating our holding into Prosperity Bank. Although both banks have a history of being conservatively run, we felt that Prosperity sets the benchmark in this regard.

Three of the fourteen new holdings are companies that we have owned before. These were the British homewares retailer, Dunelm, the mining company Rio Tinto, and the British housebuilder Taylor Wimpey. In all three cases it was falling prices that motivated us to add them back into the fold. I consider our investment into the German industrial business, Krones, as a new holding, but for the sake of full disclosure we did fleetingly own shares in the company in 2021. We previously started to establish a position, but a rapid increase in share price caused us to halt and sell down what was then an inconsequential holding.

Two of the new holdings give exposure to the Chinese economy. The first of these, Prosus, is detailed in the performance section, and predominately just gives exposure to the Chinese technology company Tencent. The second holding is in a Hong Kong listed business called, Haitian International, that is the world's largest manufacturer of plastic injection moulding machines. The company is still controlled by the founding family and gives broad exposure to the domestic Chinese economy. Although most of their machines are sold in China, they do have international operations that stand to benefit from a trend towards manufacturing moving back "onshore".

We established new holdings in Associated British Foods and Warner Bros Discovery. Both companies were covered in the performance section. Despite making negative contributions in the last year, my enthusiasm is unabated. They are both run by very experienced CEOs who are focused on the long-term, are underpinned by durable franchises and appear to be out of favour with investors that focus on just next year's earnings.

PrairieSky Royalties was added to the portfolio and is a Canadian energy business. The company earns royalty revenues from third party operators who extract natural resources from their properties. This model somewhat insulates the business from cost price inflation and means that it has a simple structure and high profit margins. The company effectively replaced our holdings in Exxon and Chevron.

We added three small holdings in Japanese industrial businesses, following an extended piece of research into opportunities in the country. We see lots of tentative evidence of the Japanese stock market being a fertile hunting ground for value investors, but we are well aware that the language barrier and disclosure standards puts us at a disadvantage. Having multiple smaller holdings is one way in which we can reconcile these two perspectives.

We established a small holding in the British financial services company, Hargreaves Lansdown. This was motivated by the company's large share price falls and further research into the sector following the takeover of Brewin Dolphin.

The final new holding was added at the very end of the year and is a semiconductor business. It is a sector that we have studied and invested in before. We are still in the process of establishing our holding here and so are not disclosing further details at this stage.

The Year Ahead

I do not know what 2023 will deliver for investors. Is the worst behind us, or was last year just the first act of a longer-run drama? Given the sheer scale of central bank money creation in the last decade, and the associated growth in debt, I feel more aligned to the idea that it was just the first act.

Based on what I see and hear, I believe that the consequences of both higher inflation and higher interest rates will take time to work their way through the economy. Simple examples of this lag are that many borrowers only feel the impact of high interest rates when they are forced to refinance, and many employers only raise salaries once a year.

Although I suspect we have not yet seen the full consequences of this shift in regime, I do not pretend to know what they will be. I would like to think that this changed environment will favour value investors like us, as higher interest rates make capital scarcer, which in turn makes market participants more discerning. I will report back on this score in a year's time!

We continue to see many quality businesses available to buy for attractive prices. This judgement is not based on a comparison to the historically high valuations that we saw in the last couple of years, but a much longer view of history. With all else being equal I would expect to see fewer changes to our holdings this year, but this will ultimately be dictated by the opportunities that the market presents to us.

Both Neil, and I, are delighted with the progress of our business. With assets under management above £100M the company is now self-sustaining, with a performance track record to be proud of. We will strive to remain humble and move forward wanting, as always, to own a portfolio that will be robust in a range of future economic scenarios.

Quality

In the last decade quality has become something of a buzz word in investing. This year's bonus material for the motivated reader is a treatise on this subject. Congratulations on making it this far!

I suspect that no right-minded investment manager would set out their stall based on saying they look for poor quality businesses. Hence just talking about quality, without giving more detail, risks being vacuous.

With a background in quantitative finance, I am familiar with how "quality", for some investors, has become synonymous with a narrow mathematical definition. I think of this a bit like choosing a life-partner based on their MENSA test results (or perhaps some other critical statistic that gets your pulse racing). It might influence your decision, but it is unlikely to tell you everything that you need to know.

Within investing a company's return on equity, or return on invested capital, have become the go-to measures of quality. Both express the size of company profits, relative to the financial resources required to generate them. By way of example, the MSCI Quality index goes a bit further, using a combination of return on equity, a company's debt to equity ratio and the variability of its profits. Basing investment decisions on such metrics make sense for portfolios that hold many stocks, but in a more concentrated portfolio I believe that such narrow definitions are inadequate. As far as the life partner analogy goes, I'd advocate for a concentrated portfolio of one, where narrow definitions make no sense at all!

The specific risk with a narrow definition of quality becoming popularised, is that it influences the behaviour of company management and sets up a feedback loop. I see some risk that this has already happened with a measure like return on equity. A company management that takes on additional debt to repurchase their shares, will see their return on equity increase. This type of "mortgaging the family farm" will work during the good times, but risks creating problems during lean years, which runs counter to the idea of "quality".

The philosophical message behind this is that financial markets are not part of the natural world but are social constructs. The ability for theories to feedback and influence behaviours is the reason why I do not believe there are immutable laws that govern markets.

When evaluating the quality of a business we look at quantitative measures, but also want to understand the context behind them. For some businesses certain accounting measures can be based on rather flaky logic. An example of this is that within bank accounting rules, a company can elect to hold fixed income investments for sale or until they mature. In the former case they must immediately recognise a loss in value from rising interest rates, whereas if they decide on the latter, they can ignore it. This means that a bank with a high return on equity could be of superior quality or might just be adept at gaming the accounting rules!

We place importance on qualitative measures of quality, many of which look at company management. We like companies where there is a clear alignment of interest between management and shareholders. This means that we like companies where executives and directors have large shareholdings. A particular favourite of mine is to look at the clarity and credibility of a CEO's communication. Does what they say make sense or is it devoid of content and overladen with jargon?

The nature of a company's business model also tells us a lot about its quality. We like companies that have strong competitive positions, where it is hard for competitors to "eat their lunch". We are not alone in this regard, and the Buffett/Munger characterisation of looking for companies with "wide moats" has well and truly entered the investment management lexicon.

The financial markets have no shortage of intelligent and competitive individuals, and so it is to be expected that any company that is obviously "high quality" will command a premium. Our investment approach is to place equal importance on the price that we pay to the quality of what we are buying. Hence, we generally find ourselves in a trade-off between the quality of a company and how cheap its share price looks.

With a growing number of investors chasing the very "best" quality, such companies have commanded increasingly steep premiums. Our response to this has been to invest in cheaper companies where we convince ourselves that the underlying business is of "decent" quality. However, we have also bought some "not so cheap" businesses because we think they are "really good" quality. It is hard to characterise this with words alone, and so measures like the portfolio level price earnings ratios give a less ambiguous guide as to the situations we are investing in.

If I was to summarise my views on quality — it is that it is in the eyes of the beholder. Furthermore, a good business only makes for a good investment at the right price.

Matthew Beddall
CEO, Havelock London

Unless otherwise stated all numerical data was courtesy of Bloomberg. All index performance numbers are expressed including the impact of dividends.

IMPORTANT INFORMATION

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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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