

FUND PERFORMANCE

Cumulative Returns

1 Month	YTD	1 Year	3 Years	5 Years	Since Launch
-2.4%	1.9%	11.6%	19.8%	47.7%	52.2%

Calendar Returns

Year	Q1	Q2	Q3	Q4	Annual
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%
2023	3.4%	-3.0%	-0.1%	9.6%	9.8%
2024	2.6%	-0.7%			

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	£182M
Fund Manager	Matthew Beddall
Fund Structure	OEIC (UK UCITS)
Fund Domicile	UK
Launch Date	21 st August 2018
Base Currency	GBP
ISIN	GB00BFM7DN78
SEDOL	BFM7DN7

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

Havelock London
19 Eastbourne Terrace
London, W2 6LG
Tel: +44 (0)20 3637 7300
www.havelocklondon.com

Waystone Group
PO Box 389
Darlington, DL1 9UF
Tel: +44 (0)345 9220044
www.fundsolutions.net

COMMENTARY

The fund's unit price fell by 0.7% in the quarter, taking the total increase in unit price to 1.9% for the year to date and 52% since inception of the fund.

The second quarter of the year did not feel particularly distinct from the first, with the prospects of Generative AI and the future path of interest rates still consuming much of the attention in markets.

Attention was diverted towards politics at the end of the quarter, due to the UK, French, and US elections. Markets were momentarily unsettled by the risk of a "hard-right" party governing France, but did not flinch at the widely expected Labour victory in the UK. Concerns about President Biden's suitability for a second term continue, but we will have to wait until at least November before the US elections cease to be newsworthy.

The future path of interest rates continues to be a product of central bank views on inflation and economic strength. Although I have nothing original to add on this subject, it is worth noting that at the start of the year the consensus was that the Fed would make six rate cuts¹, whereas the actual number to date is zero. This is a reminder that very little in markets is ever a "given".

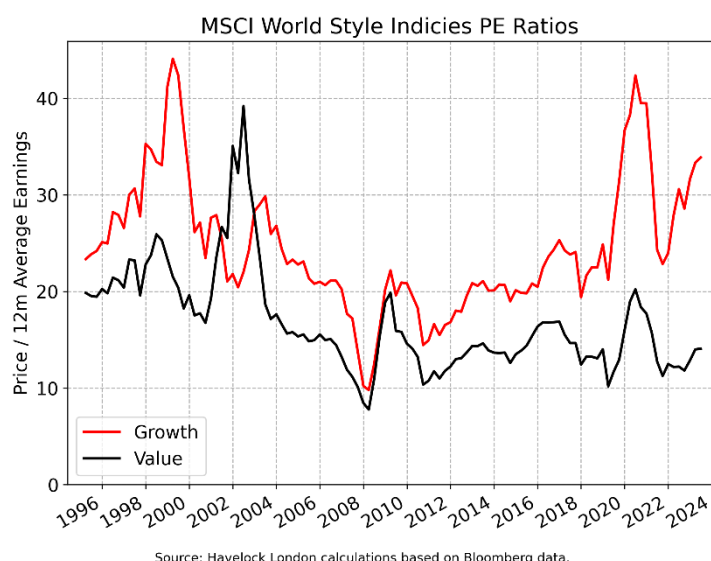
In what follows, I return to the familiar theme of "growth" versus "value". Although I suspect there may be some reader fatigue on this subject, excitement on the prospects of AI is driving high valuations and creating more grist for my mill. I finish the letter with an update on our portfolio, containing an overview of performance in the first half of the year.

¹ <https://www.ft.com/content/d7e7b202-dd36-4337-92cf-8045f171cea8>

Where do we go from here?

Our modus operandi is to be bottom-up investors, studying companies that we think might make for overlooked bargains. This, however, doesn't entirely free us from thinking about the bigger picture both within markets and the world at large. As we zoom out from "micro" to "macro", we have to make do with abstractions as the complexity of the real world otherwise becomes overwhelming.

One such abstraction is "value" versus "growth". Although it seems absurd to categorize 1000s of companies as either displaying one characteristic, or the other, it is a simple and convenient approximation of two different investment approaches. I, like many other value investors, have been quick to highlight the increasing premium that investors have paid to own "growth". This is shown below by the price earnings ratios of the MSCI World Growth and Value indices.



The chart shows that investors have been willing to pay an increasingly high multiple of earnings for the growth index in the last fifteen years. This "multiple expansion" has created a performance tail wind for growth investors, that has left many companies looking expensive relative to history.

The big question is what does this mean for prospective future returns? Does "growth" face a prolonged period of underperformance versus "value"?

I see three possible explanations for the current high premium being paid for growth, each of which would lead to a different conclusion about the future:

- There is a rational reason why investors are paying such a high premium.
- Investors aren't paying a high premium, because price earnings ratios misstate it.
- The high premium is irrational.

Prior to 2022 "conventional wisdom" suggested the elevated premium for growth stocks was rational, because interest rates were so low. For the benefit of readers who live in a cave, the argument was that earnings in the distant future had become more valuable in terms of "today's money", implying a "bird in the hand" was worth "one in the bush" and not "two".

Given today's higher rates, the interest rate justification for this premium isn't credible. Could it be that the premium has increased this year because markets are "discounting" interest rates falling back to previous levels? Given that the growth index price earnings ratio is higher than at most times when rates actually were close to zero, this argument seems like a stretch.

There have been, and will be, other rationalisations for the premium. For example, that Generative AI will unleash a new wave of earnings growth for a select group of companies. I haven't seen an explanation that I find credible, but it doesn't mean that one doesn't exist.

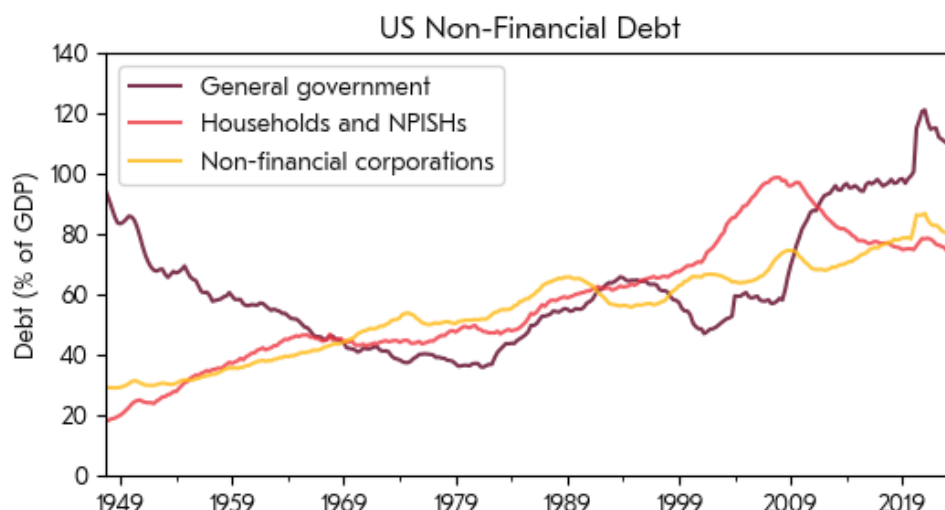
The second possibility is that an analysis based on price earnings ratios is misstating the premium. This argument holds more sway with me, as "earnings" are a complex and somewhat artificial construct. For example, many highly valued companies derive their earnings from intangible assets, and it can be argued² that accounting rules tend to understate profitability in this instance. Similarly, a recent paper³ used a measure termed "economic profits" to show a small group of large companies making an outsized contribution, but did not venture onto what valuation investors should pay to own them.

Given that the growth index is also at an historically high premium based on price-to-cashflow and enterprise-value-to-EBITDA ratios, I am sceptical of "new paradigm" type explanations. I do however accept that price-earnings ratios, or the style indices themselves, might be misrepresenting the size of the premium that investors are paying for growth companies.

The third explanation is that the high premium is irrational, and that it represents a "bubble". Clearly, we all rationalise things differently, and so perhaps what is irrational to me isn't to others?

My preferred explanation is that the high premium is the product of governments and central banks underwriting risk in markets. Again, for the benefit of cave dwelling readers, the 2008 crisis was handled by "pumping" liquidity into the financial system, with central banks using newly created money to purchase financial assets. The majority of these assets were government bonds, and so the net effect was both to raise asset prices and put money into government coffers. The same approach was repeated during the COVID crisis.

The chart below shows US non-financial debts since 1948, broken down between government, households and companies. The chart for the UK looks very similar, but I focus on the US given its dominance in financial markets.



Source: Bank of International Settlements

² https://www.morganstanley.com/im/publication/insights/articles/article_intangiblesandearnings_us.pdf

³ https://www.morganstanley.com/im/publication/insights/articles/article_stockmarketconcentration.pdf

This chart tells multiple stories. It shows the rapid build-up of household debt prior to the 2008 financial crisis, and how the subsequent deleveraging came at the expense of increased government borrowing. It also shows how the shortfall in economic activity during the COVID crisis was funded by a second large increase in government debt.

I believe that the net effect is that most investors have rationalised paying a large premium for the most successful companies, because it appears that central banks will intervene in the event of a large market decline. I do not assume this pattern of “privatised gains” and “socialised losses” must continue, but I can see why others would.

The previous chart also shows how all three categories of borrower have become increasingly indebted over the long term, such that total debt levels in the economy are at a post-war high. I believe that this lies behind many of the political challenges that we currently see, but that is a story for another day!

Economist, Hyman Minsky, theorised that long periods of prosperity and investment gains encourage diminished risk perception and a build-up of debt, that will ultimately end with a “Minsky Moment” collapse in asset prices. The build-up of debt in the world’s major economies is without doubt, and I think that the high premium investors are willing to pay to own growth companies is one of many pieces of evidence that suggest a diminished perception of risk.

The different interpretations of the high premium currently being paid for “growth” would lead to different conclusions about the future. If the premium is rational, or non-existent, then there is no reason for concern. If on the other hand it is irrational, investors in the most expensive companies will likely experience future returns are at best disappointing and at worst stomach-churningly awful.

It would be bold to say that you believe any one of these explanations with complete certainty. I prefer to think in terms of probabilities, and I put a higher likelihood on the premium being irrational, but accept that it is also possible that one of the first two explanations is correct. Only if you are very confident that the high premium is justified, should you be “all in” on growth.

Many investors will draw the conclusion that they wish to guard against the risk of a fall in asset prices by owning the highest quality assets, but this ignores the price paid to purchase them. This approach didn’t work in the late 1960s and early 1970s, when investors in blue chip “Nifty Fifty” companies were subject to a subsequent decade of disappointing returns⁴.

Returning to where I started, “value” and “growth” are crude abstractions of a complex reality. The high price earnings multiple for the MSCI World Growth index is driven by individual companies, like Nvidia, each of which will have their own narrative. In the same way that not all “growth” stocks will be overvalued, not all “value” stocks are sub-par duds.

I think that it is the combination of the quality of what you own, and the price you pay, that will best guard against loss of capital. This is the approach that we use, and I believe why we were able to sidestep the large falls in asset prices during 2022.

I do not know what will happen next, but the amount of debt in the world’s major economies puts us in uncharted territory. For this reason, I think it is dangerous to assume that the “status quo” in markets must continue. My best guess is that central banks and governments will sooner, or later, pull back from underwriting the risk of investing, which will place a renewed importance on valuations.

⁴ <https://www.clearfinances.net/nifty-50-bubble/>

Portfolio Update

Our equity holdings had an aggregate price earnings ratio of 12.8x at the end of the quarter, and a forward price earnings ratio of 10.9x (based on consensus earnings forecasts). The disparity between the two is mainly due to a small number of special situations, where depressed earnings in the previous year are expected to recover.

With myself, Matt, and Gregor, we have greater research bandwidth than for most of the fund's history. Given this, our views on the quality of the underlying businesses, and the overall valuation multiple, I believe that the fund has strong opportunity set and is well positioned for the future.

We made a small number of changes to the portfolio in the quarter, substituting those ideas judged to be close to our intrinsic value estimate with ones where we see greater potential. In what follows I provide an overview of these changes, as well as details of some of the more interesting company specific news. I finish the update with further details on the fund's performance.

Core Holdings

Three of our four retail businesses released results in the quarter.

Card Factory reported annual results, delivering a 10% year on year increase in revenue, a 12% increase in net income, and a resumption of their dividend. The company has a price earnings ratio of 6.7x, despite expectations of continued growth. We have been impressed by the company's management, and made further additions to the holding during the quarter.

Associated British Foods released a strong set of interim results, with profit margins recovering to historic levels. As with many of our UK holdings, they used the low valuation of their shares to launch a buyback program, which reduced their share count by 4% in the last 18 months. A combination of recovered margins, and fewer shares, meant earnings per share in the last 12 months were 30% higher than a year ago. We reduced the holding during the quarter, as a rally in the share price following the results pushed it to a narrow discount to our estimated intrinsic value.

Shimamura, the clothes retailer, released annual results and an updated management plan. Unlike most of our Japanese investments, we treat it as a core holding, albeit with returns on shareholder capital at the bottom of our acceptable range. The reason for the low returns is because of high levels of cash on the balance sheet. The updated management plan increased the dividend policy to pay out 35% of profits, rather than 25%. This fell short of what many investors were expecting, as even with their plans for store refits, cash levels seem excessive.

The biggest disappointment within our industrial holdings was the announcement that the CEO of tractor manufacturer CNH Industrial, Scott Wine, will be leaving the company. The board recruited the CEO of Iveco, which was previously a subsidiary of CNH, to rejoin the business and replace him. We continue to believe that sentiment has been too focused on the short term, and that the low valuation makes it an attractive opportunity. Its shares are currently on a 6.7x forward price earnings ratio, which is around half that of their major competitor Deere & Co.

We added two new European industrial holdings during the quarter, TKH Group and Verallia, and sold one, Hexpol.

TKH are the dominant manufacturer of automated tyre building machines, a manufacturer of specialist cables and fibre optics, and provide a number of specialist "vision" (camera)

products. They are expecting weakening results this year due to destocking by a number of their customers. Our view is that, like many such businesses, the share price is too anchored to short-term earnings, and does not fully reflect the competitive strength they have within their various niche markets. The addition dovetailed with us selling our holding in Hexpol, which as a supplier of specialist rubber compounds, is also heavily exposed to the automotive tyre market.

Verallia is the dominant European manufacturer of glass bottles, and has been a high return on capital business. Its debt levels are towards the top end of what we look for within our Core holdings, but it is highly cash generative. Because glass bottles are expensive to transport, a broad geographic footprint gives it a cost advantage over many smaller competitors. In recent years the company has improved margins by supplying more complex shaped bottles for the premium drinks market. As is the case with TKH, we believe short-term earnings weakness provided an opportunity for us to invest at an attractive valuation.

We sold our holding in Japanese car manufacturer, Subaru, as the company's share price had moved towards our estimate of intrinsic value. Their margins have been boosted by the combination of strong trading in their key North American market, and the weak Japanese Yen. As we cannot be confident on either continuing, our valuation of the business looks pessimistic relative to recent results.

We exited our holding in the French data and polling business, Ipsos, and added a holding in its UK competitor YouGov. As is the case with TKH and Hexpol, the buy and sell decisions were unrelated, and only appear like a "switch" within hindsight. We bought shares in YouGov following the recent large share price fall, with our work on competitor Ipsos having sped up the research process due to familiarity with the industry.

Asset Based

The management of Air Lease continue to see the supply difficulties of Air Bus and Boeing as being good for the economics of their business. They evidenced this by having sold planes at a premium to their accounting value this year, and by examples of lease rates that are circa 15% higher than two years ago. Despite this the company continues to see its shares trade at a discount to the net accounting value of their assets.

Handelsbanken saw a fall in its share price following the release of first quarter results. Under the watch of new CEO, Michael Green, costs increases took investors by surprise, albeit that they were driven by increased levels of business activity. We had been reducing our holding during the first quarter following record earnings, and used the subsequent price falls as an opportunity to reverse this decision.

The Texan bank, Prosperity Bancshares, completed their merger with West Texan competitor, Loan Star, during the quarter. I had a call with management to discuss their views on commercial real estate markets, and they continue to see little evidence of distress within their loan book. This appears to be a consequence of the strength of the Texan economy and the conservative nature of their lending decisions.

We sold our holding in Argonaut Gold, following a takeover offer from Alamos Gold. It was a very small holding for us, but one where our initial thesis proved too optimistic. The company operates in North America and although attractively priced versus the value of its gold reserves, had been struggling with operational issues at a new mine.

Special Situations

Japanese companies that could benefit from “governance reform” continue to be a key area of research within this part of the portfolio. We have targeted companies that are fundamentally sound and could easily boost returns on capital by returning excess cash to shareholders. Transcosmos and Fukuda Denshi were two new additions in the quarter, taking the total number of such investments to seven.

A second theme has been UK mid-caps, where we continue to see examples of misunderstood companies trading at extremely depressed valuations. Our holding in Next 15 Group was sold during the quarter, as its share price had moved towards our estimate of intrinsic value. We also reduced our holding in Future, following a rally in its share price after it announced results. We added a holding in SigmaRoc, which is a niche materials business that we believe to be more resilient and have greater pricing power than the consensus view fully appreciates.

Johnson Matthey has been a long standing holding for us, and one where our initial thesis proved too optimistic. We have been supportive of the turnaround plans of CEO, Liam Condon, which recently led to the proceeds of a non-core disposal funding further share buybacks. We were, however, disappointed to see CFO, Stephen Oxley, announce that he will be leaving next year, given that the transformation of the business is still a work in progress.

Performance

By far the largest positive contributor to the change in unit price in the quarter was the British publisher Future, which delivered a 1.9% return at a portfolio level. We saw the company as a special situation, where we felt that the risk of disruption from AI was being over estimated. The catalyst for a major “re-rating” was the release of a set of “business as usual” half yearly results. Like many of our UK investments we are happy to have seen a buyback program that took advantage of the low share price.

The second largest contributor was Air Lease, which sits within our asset backed category. The continued media attention on supply challenges at Boeing and Air Bus, appears to have made the investment case for the company more widely appreciated, albeit that it hasn’t experienced a very large re-rating. We continue to see the company as an attractive investment, given the discount discussed above.

The table below details the top 10 contributors to performance in the first half.

Company	Portfolio Level Return
Future	1.92%
Air Lease	0.76%
Berkshire Hathaway	0.57%
Hiscox	0.45%
Nippon Television	0.44%
Tsubakimoto Chain	0.35%
Horiba	0.33%
Subaru	0.30%
Shell	0.28%
Associated British Foods	0.28%

Following 12 months of targeted research I am gratified to see a number of Japanese companies in this list, albeit that the entire impact on the portfolio of our Japanese holdings

was only +0.2%. This performance was, however, after the headwind of the Yen falling by 12% against the Pound. Although I have no idea what the catalyst for the Yen to reverse course might be, my opinion is that it represents an asymmetric risk where the chances of a large reversal are greater than a continued slide. We now have around 15% of the portfolio invested in nine Japanese companies, with a preference for domestic businesses with earnings that are more insulated from currency moves.

The next table shows the top 10 detractors from performance.

Company	Portfolio Level Return
Warner Bros Discovery	-1.44%
Prosperity Bancshares	-0.48%
Rohm Co	-0.46%
Shimamura	-0.44%
Argonaut Gold	-0.43%
CNH Industrial	-0.40%
LG Corp	-0.21%
Nabtesco	-0.20%
Fresenius SE & Co	-0.17%
Johnson Matthey	-0.13%

Listing the fund's losses is psychologically uncomfortable, but they are a reality of investing.

The largest losses create the most discomfort, and top of this list is Warner Bros Discovery. We continue to believe that the company's ability to generate cash, and the quality of its media rights underpin its valuation. It has generated similar sized free cashflows to Netflix, but is currently only valued at around 1/5th of its size (based on enterprise values). The total amount of shorting in Warner Bros Discovery stock has been increasing this year, such that 5.4% of its shares (free float) are held short. Although hard to substantiate I believe that this represents an asymmetric risk, whereby the chances of short-sellers liquidating their holdings in a hurry make a reversal more likely than a continued slide.

The second largest loss came from Prosperity Bancshares. The words "regional US bank" are bound to send shivers down your spine, but the reason we own it is because the current management team have an exemplary 20-year track record of both growing the business and disciplined lending. Our expectation is that earnings will start to improve, as low yielding "held to maturity" securities are reinvested at much higher rates.

Not all of our investment theses will play out as we hope, but you should expect no less than complete honesty from us about what has and hasn't worked. The below quote from the famed value investor Sir John Templeton sums up my current views on our two worst performing holdings:

"To buy when others are despondently selling and to sell when others are avidly buying requires the greatest fortitude and pays the greatest ultimate rewards."

Finally, it just remains for me to thank you for your continued support. I wish you all a pleasant summer, and I will look forward to updating you further in three months' time.

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 WS 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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