QUARTERLY REPORT
Q4 2018

HAWKSMOOR
FUND MANAGERS

THE MI HAWKSMOOR GLOBAL OPPORTUNITIES FUND

The one-stop investment solution to maximise long-term real returns.

INVESTMENT WEEK
SPECIALIST INVESTMENT AWARDS 2017
WINNER
Boutique Management Group of the Year (Multiple Strategies)

INVESTMENT OUTCOME

The Global Opportunities Fund's primary aim is to deliver returns, after charges, in excess of general markets over the long term (defined as rolling periods of 5+ years). In order to achieve this, the managers will invest in a variety of financial assets, using collectives to invest in long term structural growth themes, together with exploiting inefficiencies in the closed-ended sector - i.e. investment trusts trading at a discount. The portfolio will be fully invested and whilst diversified, it will have a minimum exposure to equities of 60% . It is therefore likely that investors will see fluctuation in the value of their investment over the short term, so they need to share the managers' long term perspective in order to increase the likelihood of superior long term total returns.

INTRODUCTION

"Saru mo ki kara ochiru"
Japanese proverb meaning literally: "Even monkeys fall from trees."

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Our Team

Daniel Lockyer *Senior Fund Manager*
Financial Express aggregated track record of 13+ years running retail funds – outperformed peer group by 45%, returning 115% versus 70% (13/01/2005 to 31/12/2018)

Richard Scott *Senior Fund Manager*
Financial Express aggregated track record of 18+ years running retail funds – outperformed peer group by 211%, returning 460% versus 249% (31/12/1999 to 31/12/2018)

Ben Conway *Senior Fund Manager*
Financial Express aggregated track record of 4+ years running retail funds – outperformed peer group by 10%, returning 32% versus 22% (01/01/2014 to 31/12/2018)

Ben Mackie *Fund Manager (joined 02/01/2018)*

Hannah Isaac *Head of Fund Operations*

David Chapman *Business Development Manager*

Dan Cartridge *Assistant Fund Manager*

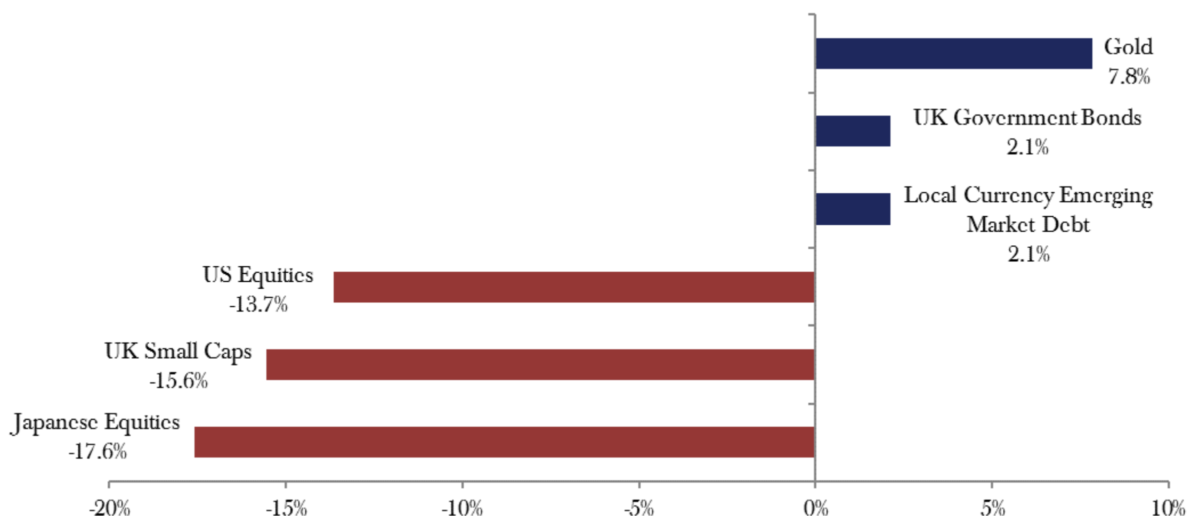
Matilda Cretney *Team Assistant*

Left to right: Richard Scott, Hannah Isaac, Daniel Lockyer, Dan Cartridge, Ben Conway

 Source: Financial Express Analytics GBP total return

MARKET PERFORMANCE

Top and bottom three performing asset classes



Commentary

The final quarter of 2018 was a challenging one for investors in global financial markets, with the negative returns generated by many global equity indices being the worst for a single quarter since the Great Financial Crisis a decade ago. It should not come as a big surprise that such a difficult quarter occurred on the back of the world's central banks in aggregate moving from a period of quantitative easing to quantitative tightening. Tighter monetary conditions, combined with ongoing friction in US-China trade negotiations, ongoing Brexit uncertainty and signs (albeit muted) of slowdowns in the growth of some major economies sparked indiscriminate selling across many financial markets. The performance of the S&P 500 in the US had decoupled from the majority of global equity market indices for much of the year as it rose when most other equity markets were down. This decoupling ended sharply during the quarter with the index down 13.7% in local currency terms.

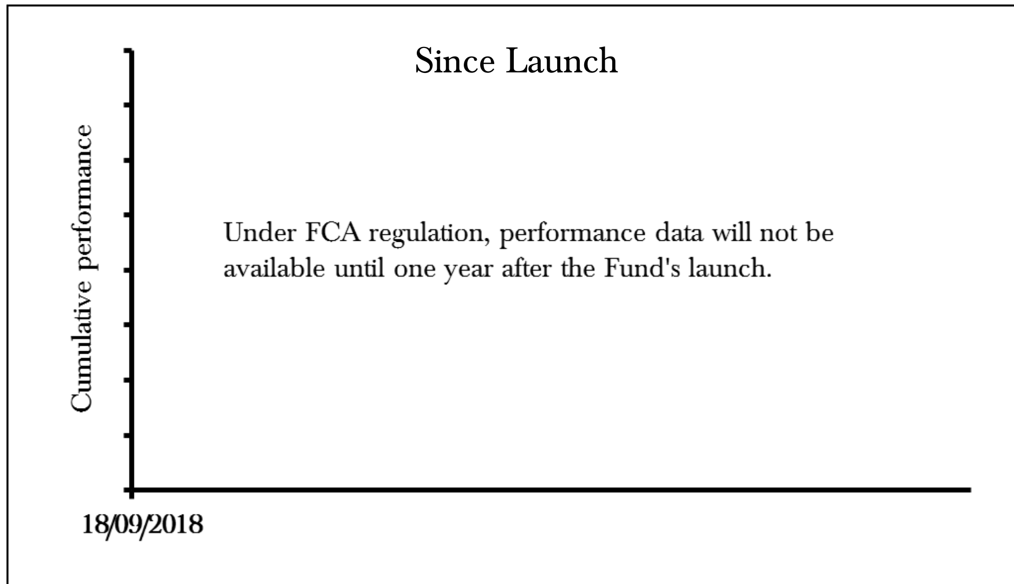
UK equity markets suffered further pain during the quarter, with the share prices of smaller, domestically focussed companies amongst the worst performing asset classes globally. Brexit negotiations continued to dominate UK headlines, culminating with Prime Minister Theresa May delaying a vote by Parliament on her Brexit deal the day before the vote was due to occur, exacerbating investor concerns. The price of sterling relative to other currencies has been a good proxy for the current state of Brexit negotiations and has had a material impact on the returns UK based investors have achieved from any unhedged overseas exposure.

Whilst global equity markets experienced turmoil, investors sought safer havens, resulting in a rally in the gold price and in government bonds. The gold price rally had a knock on effect on the share prices of gold mining companies, which were amongst the top performers over the quarter.

Indices: Gold - ETFS Physical Gold, UK Government Bonds - Bloomberg Barclays Sterling Gilts, Local Currency Emerging Market Debt - JPM GBI-EM Global Div Composite, US Equities - S&P 500, UK Small Caps - MSCI United Kingdom Small Cap, Japanese Equities - TSE TOPIX.

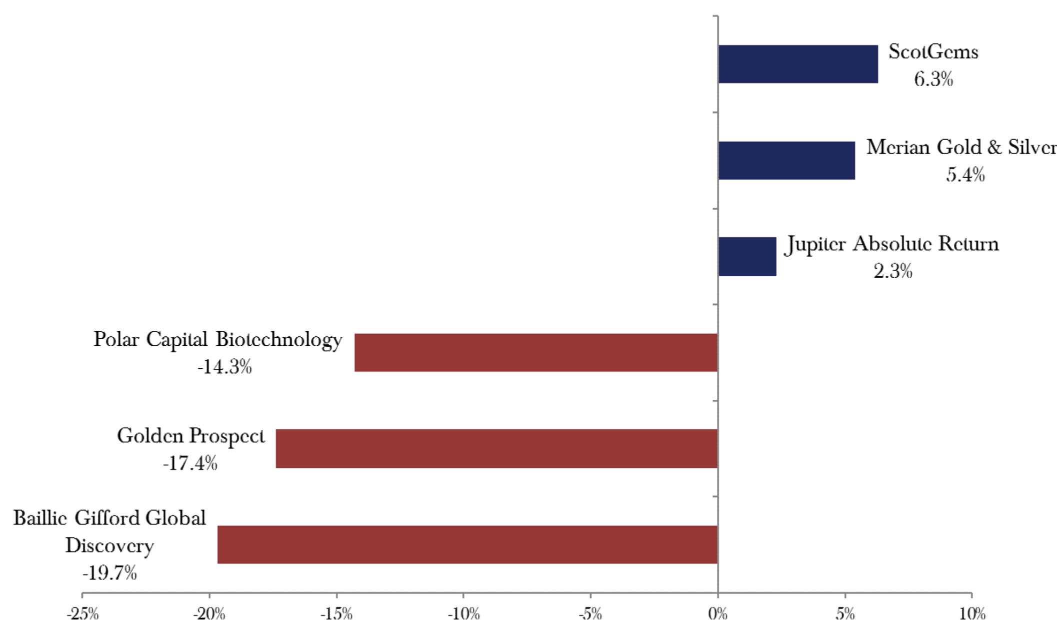
 Source: Financial Express Analytics local currency total return 30/09/2018 - 31/12/2018

GLOBAL OPPORTUNITIES FUND PERFORMANCE



GLOBAL OPPORTUNITIES FUND PERFORMANCE

Performance by holding (top three and bottom three)



Best performers:

- **ScotGems** (emerging markets equities) - a significant narrowing of the discount to net asset value (NAV), combined with resilient NAV performance drove performance in the quarter.
- **Merian Gold & Silver** (gold & silver equities) - as investors sought safer havens with sharp falls across global equity markets the gold price experienced a material rally, resulting in a strong quarter for the performance of gold mining shares. Silver also began to rally towards the end of the quarter, which proved beneficial for silver miners.
- **Jupiter Absolute Return** (absolute return) - market conditions proved favourable for how the fund is positioned.

Worst performers:

- **Polar Capital Biotechnology** (thematic equities) - weakness in the share prices of the biotechnology sector, especially in the US, resulted in a poor quarter.
- **Golden Prospect** (gold & silver equities) - poor performance from the portfolio's investee companies, despite a more positive sector backdrop, resulted in a weak quarter.
- **Baillie Gifford Global Discovery** (global equities) - the portfolio's exposure to highly-rated growth companies, many of which are listed in the US, led to unsurprisingly weak performance given the market backdrop.

 Source: Financial Express Analytics GBP total return 30/09/2018 - 31/12/2018

GLOBAL OPPORTUNITIES FUND ACTIVITY

By holding

Purchases/Increases:

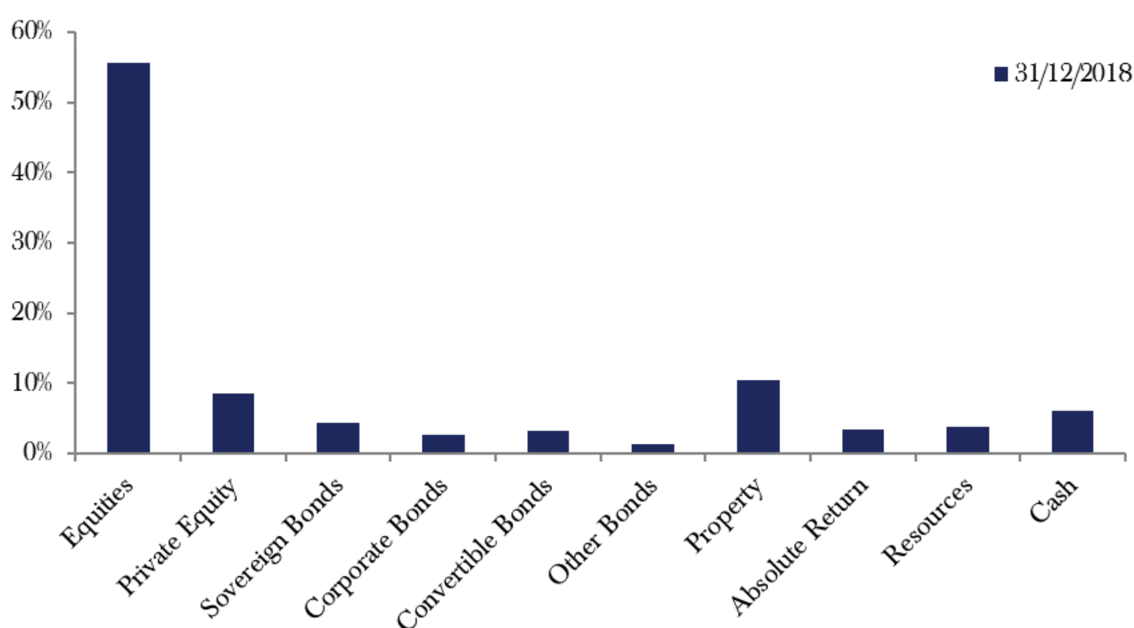
- Artemis Alpha Trust
- Augmentum Fintech
- Blue Whale Growth
- Cape Wrath Focus
- Jupiter Absolute Return
- Tufton Oceanic Assets

Disposals/Reductions:

- BB Healthcare Trust
- Pacific Horizon

After a strong run in both the share price and the net asset value (NAV), we exited the holding in BB Healthcare trust. We also exited the position in Pacific Horizon to fund higher conviction ideas. We added to Jupiter Absolute Return as a result of higher conviction in the way the portfolio is positioned and to reflect the positive diversification benefits it brings to the Fund. We strive to identify and back talented managers who are able to demonstrate significant potential. During the quarter we introduced a position in Blue Whale Growth fund, managed by Stephen Yiu. In addition, we increased our holding in Artemis Alpha Trust. The trust has languished on a discount to net asset value (NAV) as a historically large exposure to unquoted companies has proved deleterious to performance. We have confidence that new lead manager Kartik Kumar, who has already demonstrated his ability to transform the portfolio, will prove himself to be an excellent manager over the long term. We introduced Augmentum Fintech to the fund, we have high conviction that the managers Richard Matthews and Tim Levene are well positioned in the private equity space to take advantage of an excellent long term growth opportunity. In addition, we supported the C share raise for Tufton Oceanic Assets, which offers an attractive level of total return and diversification by asset class, with the trust owning and leasing out ships. We also introduced a position in Cape Wrath Focus fund, increasing UK equity exposure on weakness.

By asset class



This chart calculates the asset breakdown on a look through basis of the underlying holdings, therefore there may be differences in the breakdown shown here and on the pie chart on page 7.

 Source: Internal

GLOBAL OPPORTUNITIES FUND HOLDINGS

Absolute Return 3%
Jupiter Absolute Return

Multi-Asset 2%
Henderson Alternative Strategies

Bonds 8%
Ashmore Emerging Markets Short Duration
Ashmore Emerging Markets Total Return
Ranger Direct Lending Fund

Property 11%
AEW UK REIT
Phoenix Spree Deutschland
Tufton Oceanic Assets
Urban Logistics REIT
Warehouse REIT

Cash 5%

Equities 71%
Artemis Alpha Trust
Artemis Global Select
Aubrey Global Emerging Markets Opportunities
Augmentum Fintech
Baillie Gifford Global Discovery
Baillie Gifford Japanese Income Growth
Blue Whale Growth
Cape Wrath Focus
Downing UK Micro-Cap Growth
Gabelli Value Plus Trust
Genesis Emerging Markets
Golden Prospect
Guinness Asian Equity Income
HG Capital Trust
ICG Enterprise Trust
Jupiter Emerging & Frontier Income Trust
Jupiter Global Emerging Markets
Jupiter Global Emerging Markets
Jupiter Japan Income
Man GLG Undervalued Assets
Merian Gold & Silver
Mobius Investment Trust
Oakley Capital Investment s
Pantheon International
Polar Capital Biotechnology
Polar Capital Global Convertibles
Polar Capital UK Value Opportunities
Prusik Asia
Schroder Global Recovery
ScotGems
Woodford Patient Capital

Each fund has been allocated to an asset class for this pie chart, therefore there may be differences in the breakdown shown here and on the asset allocation chart on page 6.

 Source: Internal as at 31/12/2018

JAPAN: ONCE BITTEN, TWICE SHY?

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Throughout history, financial markets have gone through bull (rising) and bear (falling) phases but in most cases tend to recover eventually so that any correction is a mere blip many years later. For example, the 35% crash in UK equities back in 1987 is barely noticeable in the long-term chart below (Figure 1)

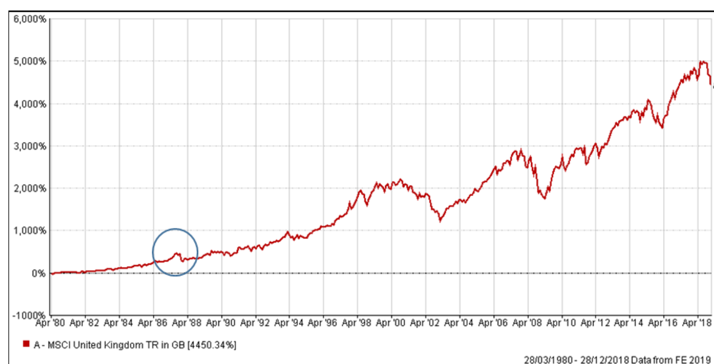

Figure 1

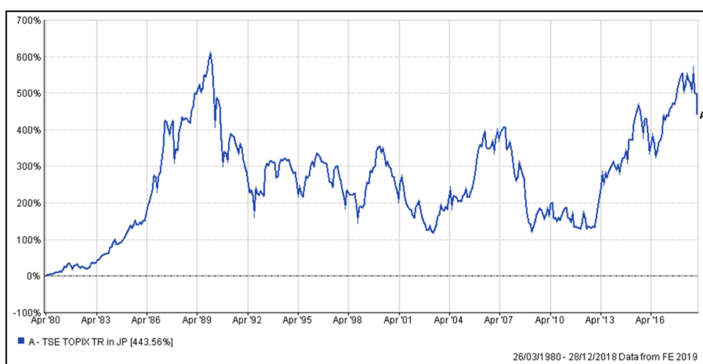

Figure 2

But spare a thought for Japanese investors who have perhaps witnessed the deepest and most prolonged bear market in history in both equity and property markets. See Figure 2 of the Topix Index over the same period.

The 1980s was a booming time for Japanese assets with the stock market increasing 600% during that decade and that exuberance extended to the property market. It has gone down in folklore that the value of the Imperial Palace in Tokyo was worth more than the whole of California. Japanese property values remain a long way below the values reached in the 1980s while the stock market is close to regaining the lost ground 30 years on, during which time most other stock markets are a long way ahead of previous peaks. It is therefore understandable why many investors, both domestic and foreign, choose to ignore Japanese equities having been scarred by past experiences.

Looking back on these episodes one can only wonder how such extreme valuations ever came to exist. But history is littered with examples of investors getting sucked into the latest 'get rich quick' craze, whether it be the Tulip mania in the 17th century, the dot com bubble in the late 1990s or the very recent bitcoin craze. So how can one be confident of not making a similar mistake in the future?

Among the key tenets of our investment philosophy at Hawksmoor is to ensure every investment has a sound valuation support with a margin of safety. We hope and expect this anchor will lessen the chance of us overpaying for anything and therefore reduce the risk of a permanent loss of capital. We believe that the starting valuation of any asset relative to its prospects is the key determinant of future returns and this is what is attracting us to ensure a meaningful proportion of our investors' capital is allocated to Japanese equities at a time when many other mainstream equity markets appear expensive relative to their history and to prospective returns. But valuations alone are not sufficient to make an investment case. There are a number of other reasons why we believe Japan is on an improving trend.

Almost a third of companies in the Topix hold more than 30% of their total market capitalisation in cash, a function of management also being scarred by the bursting of the stock market bubble in 1989. They spent the following decades paying off debt and building up a cash store for a rainy day. This inevitably caused Japanese returns on equity to shrink to very low levels, which, combined with poor corporate governance giving low prominence to minority shareholders and long periods of deflation, led global investors to seek better returns elsewhere and caused domestic investors to allocate more to government bonds.

 Source: Financial Express Analytics total return 31/12/2018 both charts are in local currency showing the respective experiences of the domestic investors

The political climate is among the most stable in Japan's history. Prime Minister Abe, appointed in 2012, is set to be the longest serving leader since 1868 if he remains in power in 2019. His very progressive economic policy, often referred to as Abenomics, has drawn scepticism over recent years for lack of progress in achieving the stated targets of beating deflation, stimulating economic growth and implementing structural reforms. One of his first acts as Prime Minister was to appoint Governor Kuroda as head of the Bank of Japan, with the task of reflating the economy. Extraordinary loose monetary policy, including buying equities and bonds as part of its Quantitative Easing program, combined with a big fiscal stimulus seem at last to be having an effect.

According to Oldfield Partners (managers of the Overstone Global Equity Income Fund) GDP per capita has risen by 0.65% per annum over the last decade, equal to the rise in the US and ahead of the UK and France. This statistic can partly be explained by the different demographics as Japan have a much older and therefore wealthier population. Demographics in Japan has long been a negative dynamic but Abe is taking steps to turn this around. As well as providing support for women to return to the workplace, Abe is taking a controversial stance in relaxing the hitherto strict immigration rules to help ease the shortage of workers. Currently there are more than three job vacancies for every one applicant and this will only worsen as the population falls by approximately half a million a year. This dynamic is at least helping to combat deflation as wages are rising to attract quality staff as unemployment is at record lows.

Among the myriad reforms implemented, addressing the demands of shareholders for better governance and focus on returns on equity (ROE) has been high on the agenda. A relatively new equity index, the JPX Nikkei 400 Index only includes the highest ranked companies based on certain criteria including a 3-year average ROE and operating profit. This has created a catalyst for many companies to change their approach as they competed for inclusion. Dividends are now much more commonplace to the extent that the 1.5% yield available from Japanese equities is now comparable to that of American equities but crucially dividend growth should be greater from Japanese companies given their relatively low payout ratio. Share buybacks and corporate acquisitions are also more common today than before as cash is spent much more wisely. Another demonstration of corporate governance improvements has been the increased involvement of independent directors on Japanese company boards. In 2010, only 50% of listed companies had an independent director compared to 100% today.

Further, Japan is home to some of the world's leading innovative companies specialising in high-specification technology, such as robotics, that is relevant to the new world we live in. This creates a fertile environment for active global stock-pickers. Lastly, it is an unloved area, understandably because of the history of negative returns, with international equity funds reported to be the most underweight to the region than at any time since 2002.

We are encouraged by the positive economic backdrop for the first time in many years, stability in the political environment, sustained improvements in corporate governance and valuations that seem to reflect Japan's historic problems rather than the exciting future prospects. Consequently, we believe this progress will ultimately result in better total returns for shareholders than in many other stock markets around the world over the long-term. While every investment carries risk and in Japan's case, a growing reliance on trade with China and the unshakable short-term correlation of the stock market performance with the direction of the Yen and global stock markets (perfectly illustrated in the last few weeks of 2018!) on balance we believe Japanese equities are worthy of a decent allocation in our Funds.

Daniel Lockyer
Senior Fund Manager

HAWKSMOOR
FUND MANAGERS

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