

# QUARTERLY REPORT Q2 2019



## THE MI HAWKSMOOR DISTRIBUTION FUND

The one-stop investment solution for  
income and growth.



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### INVESTMENT OUTCOME

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The Distribution Fund's primary aim is to deliver an attractive level of income. In doing this, the managers will aim to ensure the Fund's yield will always be at a premium to a composite index of financial asset classes (equities, bonds, property and cash). The intention is to increase the distribution alongside an increase in capital growth, in order to maintain an attractive distribution yield for new and existing investors. Therefore, investors should expect to receive a total return on their investment that will be somewhat correlated to financial markets given the Fund's fully invested, albeit diversified, portfolio.

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# INTRODUCTION



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## Our Team

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**Daniel Lockyer** *Senior Fund Manager*

Financial Express aggregated track record of 14+ years running retail funds – outperformed peer group by 41%, returning 128% versus 87% (13/01/2005 to 30/06/2019)

**Ben Conway** *Senior Fund Manager*

Financial Express aggregated track record of 5+ years running retail funds – outperformed peer group by 6%, returning 40% versus 34% (01/01/2014 to 30/06/2019)

**Ben Mackie** *Fund Manager*

**Dan Cartridge** *Assistant Fund Manager*

**Richard Scott** *Advisor*

**Hannah Isaac** *Head of Fund Operations*

**David Chapman** *Business Development Manager*

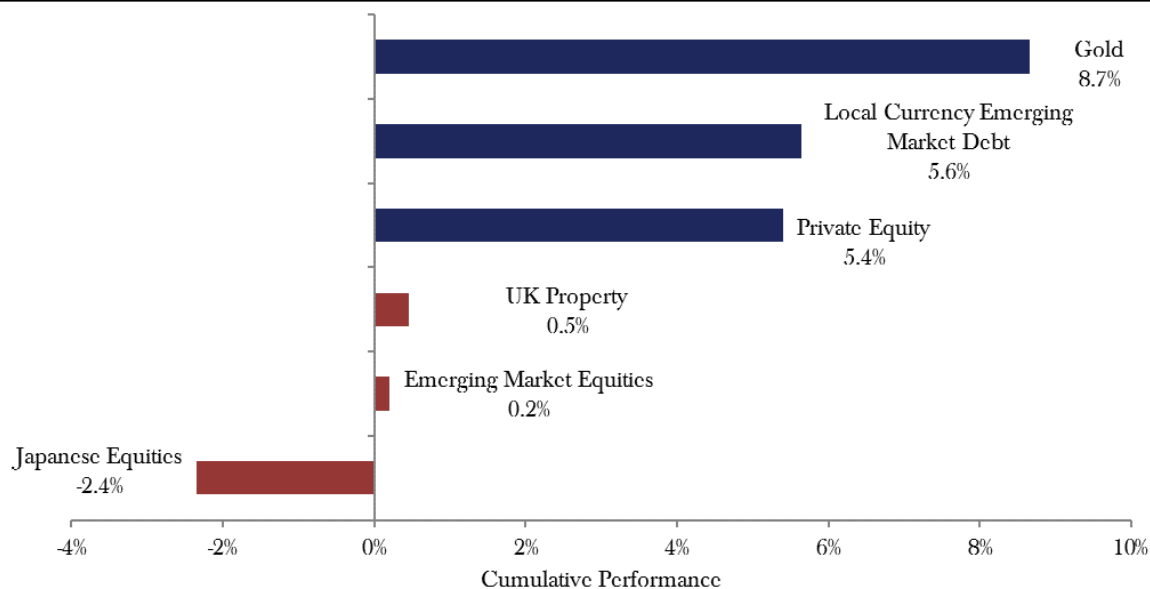


Left to right: David Chapman, Dan Cartridge, Ben Mackie, Ben Conway, Daniel Lockyer, Hannah Isaac

# MARKET PERFORMANCE



## Top and bottom three performing asset classes



Gold - ETFS Physical Property, Local Currency EMD - JPM GBI-EM Global Div Composite, Private Equity - IT Private Equity, UK Property - MSCI UK Monthly Property, Emerging Market Equities - MSCI Emerging Markets, Japanese Equities - TSE TOPIX

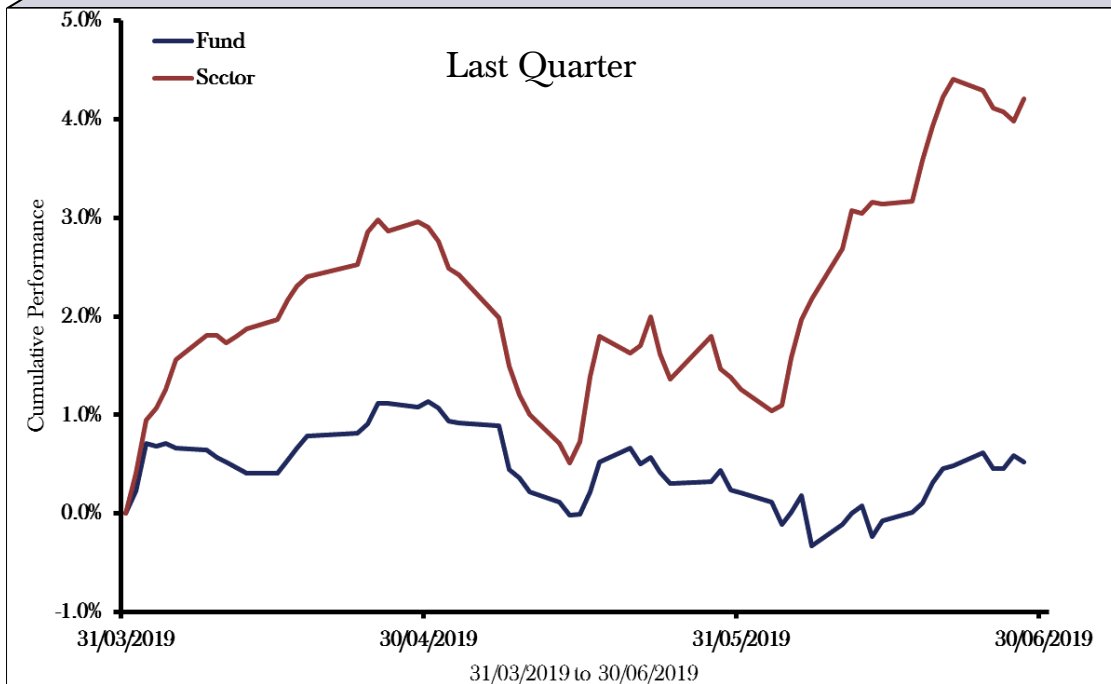
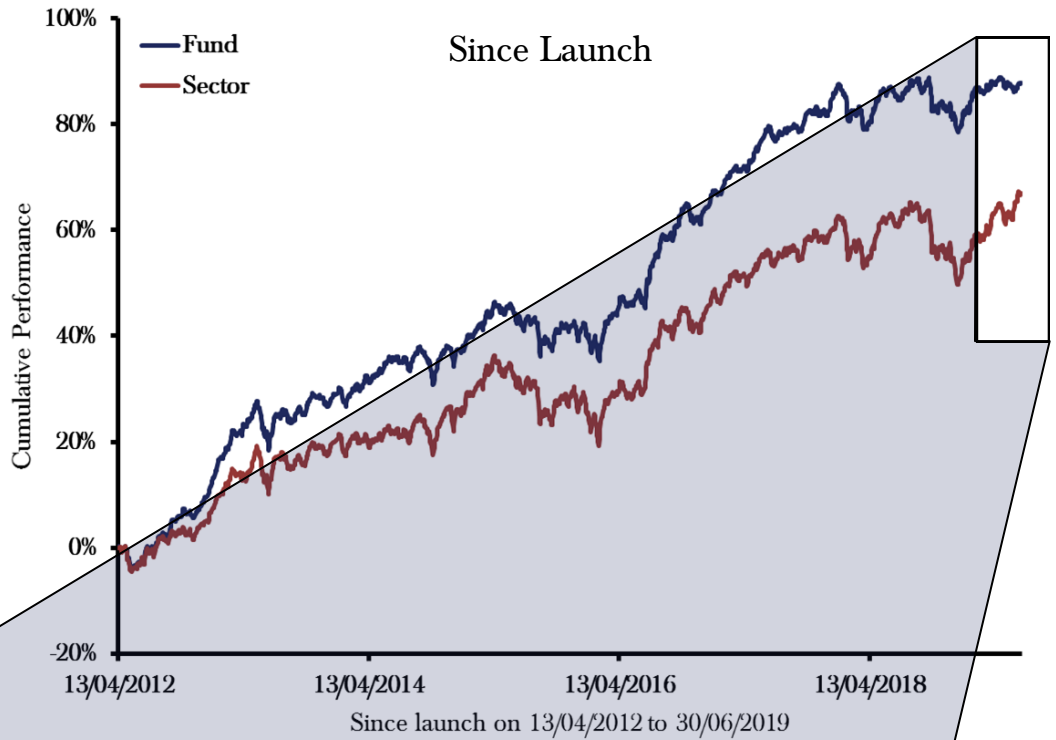
## Commentary

The second quarter of 2019 proved to be another strong one for global financial markets, which continued to rally after the challenging end to 2018. Concerns regarding the maturity of the business cycle and slowing global economic growth persist, whilst geopolitical tensions remain front and centre with the US-China trade conflict unresolved and the Conservative leadership contest adding further uncertainty to the Brexit melodrama. Despite those risks and in the face of elevated valuations, equity and fixed income markets continued to rise with aplomb. Heightened UK uncertainty saw the 10 year UK gilt yield fall below 1%, though perversely the UK equity market rose over 3%. The signals from bond and equity markets have become bifurcated not just in the UK but globally, as government bond yields declined sharply. One stark example being Germany, where the 10 year bund yield reached an all time low of -0.35%. Whilst bond markets signalled lower global growth, which in turn implies weaker corporate earnings, equity markets ignored those signals and continued to rise, buoyed by the prospect of the US Federal Reserve cutting short term interest rates. Lower interest rates only help justify higher equity valuations if earnings and cash flow growth is unaffected in the long term. Time invariably will prove one of the two financial markets correct, but economic data currently lends more support to the bond market's moves.

The gold price reached a six year high during the quarter as real interest rates in the US continued to decline markedly, reducing the opportunity cost of holding gold, and rising geopolitical tensions saw investors flock to the precious metal. Gold equities performed strongly on the back of this. Meanwhile, weakness in the US dollar relative to emerging market currencies improved sentiment towards emerging market debt. Whilst reliance on US dollar funding for EM countries has declined significantly in recent years, the perception of the dollar's importance remains, meaning currency swings impact shorter term performance. The rally, which saw spreads compress, came on the back of a more difficult 2018, leaving EMD valuations still broadly attractive. Japanese equities have continued to struggle, with the latest round of corporate reporting seeing further deterioration in earnings, although valuations remain undemanding. Retail property in the UK continues to be hit hard by the structural decline in high street shopping, with property funds marking down retail property values. The strong performance of logistics property resulted in a small positive return overall.

3 Chart Source: Financial Express Analytics local currency total return 31/03/2019 - 30/06/2019. UK equities - MSCI United Kingdom. German bund yield - Reuters, 01/07/2019

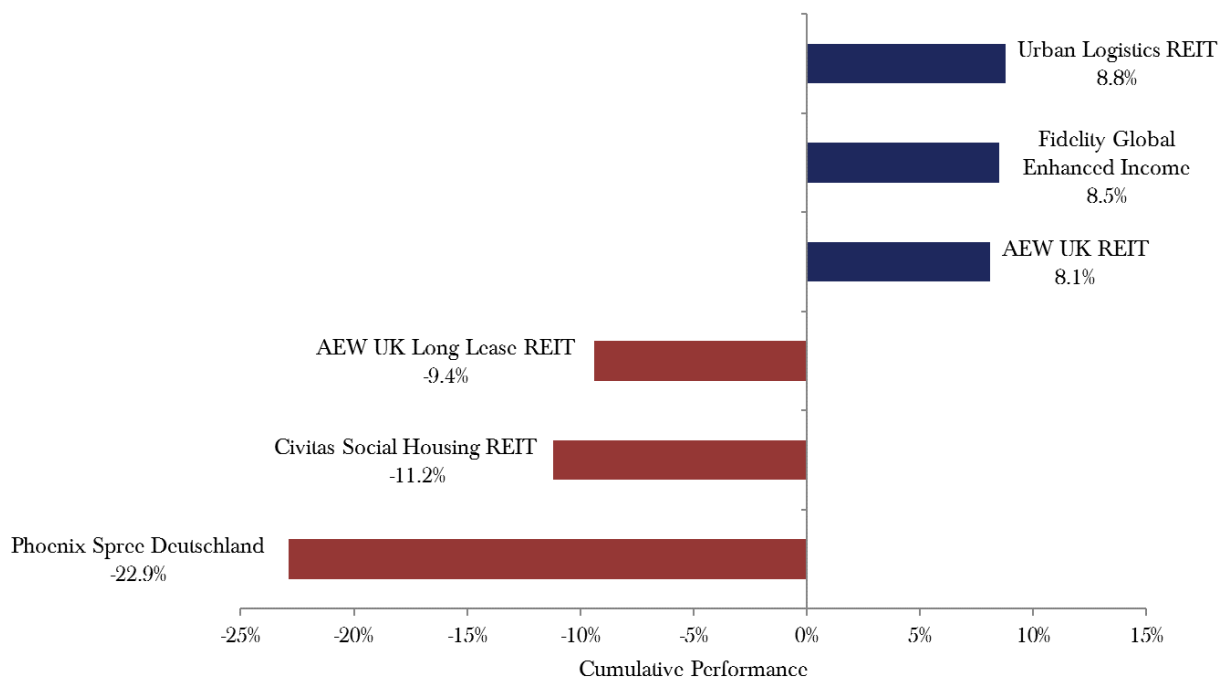
# DISTRIBUTION FUND PERFORMANCE



# DISTRIBUTION FUND PERFORMANCE



## Top and bottom three performing funds



### Best performers:

- **Urban Logistics REIT** (UK property) - the release of an impressive set of full year results to the end of March 2019 during the quarter re-confirmed the continued strong dynamics in logistics properties and resulted in a rally in the share price
- **Fidelity Global Enhanced Income** (global equities) - 'quality' companies that the fund manager favours outperformed amid broader equity market strength resulting in the fund generating a high total return
- **AEW UK REIT** (UK property) - after a period of share price weakness borne via poor sentiment as opposed to deteriorating fundamentals the discount to net asset value (NAV) widened. This move reversed during the quarter as the share price moved up to par. A good set of results in late June culminated in a further rally into the end of the quarter

### Worst performers:

- **AEW UK Long Lease REIT** (UK property) - the releasing of a property following the administration of the previous tenant on slightly less favourable terms and ongoing uncertainty over the future direction of the trust saw the share price continue to drift lower
- **Civitas Social Housing REIT** (UK property) - previous falls in the share price resulted in the trust being removed from the FTSE 250, with forced index selling pushing the price lower. The release of a decent set of results towards the end of the period has seen a recovery in the share price
- **Phoenix Spree Deutschland** (Berlin residential property) - a proposed 5 year rent freeze in Berlin severely impacted sentiment towards the shares and the discount widened. The favourable supply/demand dynamics in the city should serve to underpin the NAV, and we are confident the managers can pivot the portfolio towards condominiums for sale to mitigate some of the

# DISTRIBUTION FUND ACTIVITY



## By holding

### Purchases/Increases:

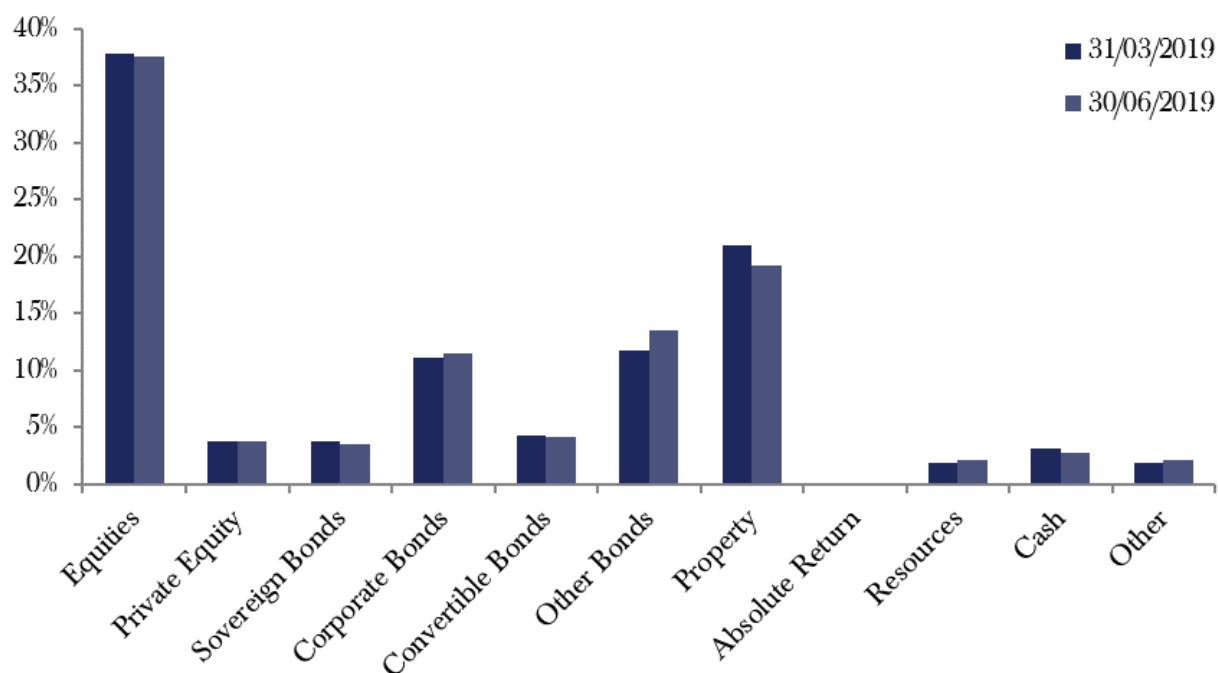
- Edinburgh Investment Trust
- Fidelity Global Enhanced Income
- GCP Asset Backed Income
- Jupiter Emerging & Frontier Income Trust
- LXi REIT
- TwentyFour Income
- Urban Logistics REIT

### Disposals/Reductions:

- Chelverton UK Dividend Trust
- GCP Asset Backed Income
- ICG Longbow Senior Secured UK Property Debt
- Impact Healthcare REIT
- Man GLG UK Income
- Mobius Investment Trust
- Schroder Income Maximiser

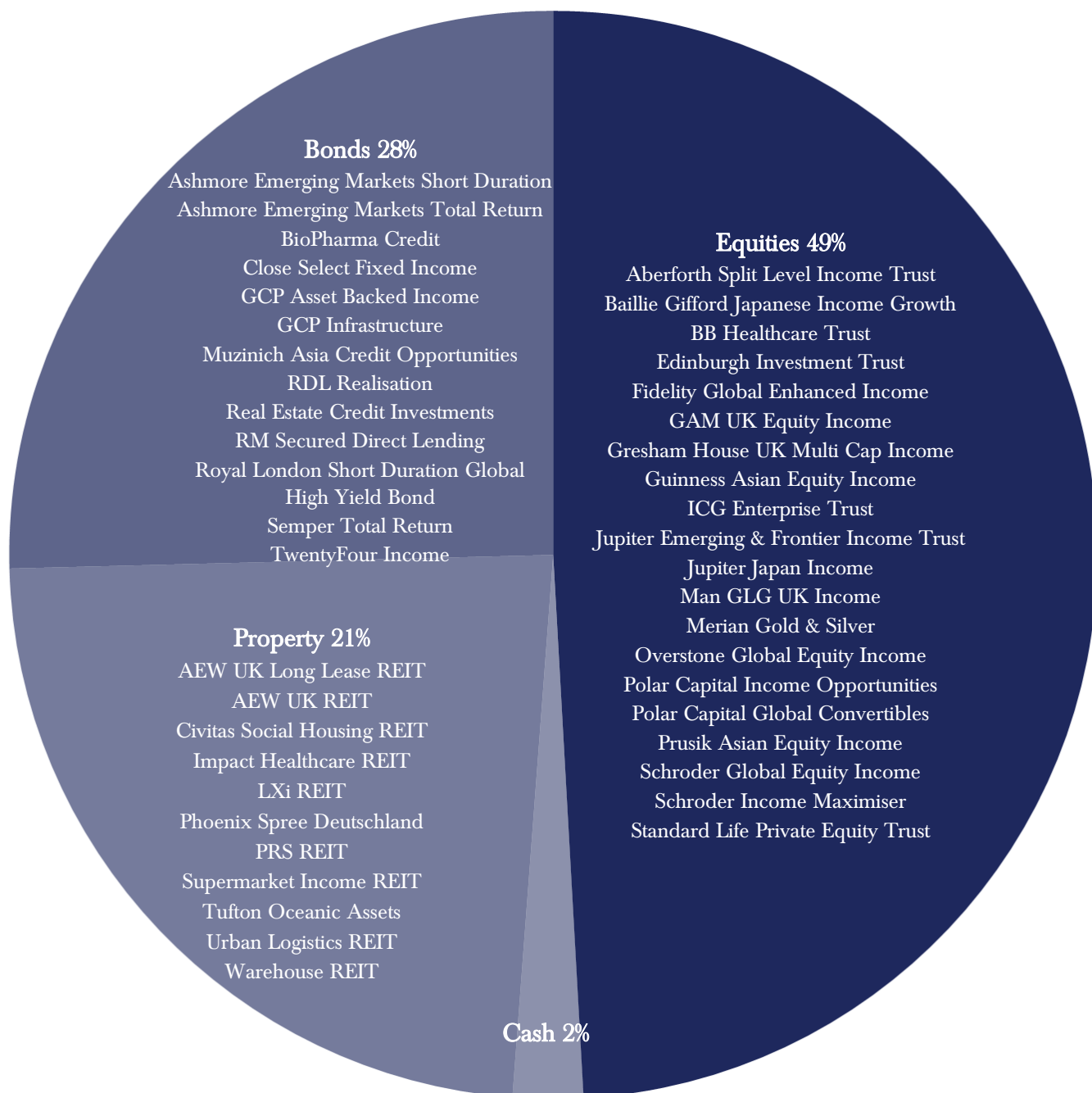
We adjusted our UK exposure during the quarter, selling our position in Chelverton UK Dividend Trust, before trimming Schroder Income Maximiser and Man GLG UK Income in order to facilitate the introduction of Edinburgh Investment Trust on an attractive 13% discount to net asset value (NAV). We increased our position in Fidelity Global Enhanced Income as rising volatility in global equity markets should help boost the yield generated from the covered call overwriting of the fund. A review into our emerging market equity exposure led to the sale of Mobius Investment Trust and an increase in the position in Jupiter Emerging & Frontier Income Trust, which yields well in excess of 4.5%. Impact Healthcare meanwhile was trimmed after a strong run in the share price. We re-introduced LXi REIT via its latest placing at a price nearly 10p below the prevailing share price, whilst Urban Logistics was topped up on weakness ahead of its full year results. The results were impressive and saw the share price rise strongly. ICG Longbow was sold to finance more attractive alternatives, including reintroducing a position in TwentyFour Income. We opportunistically reduced our position in GCP Asset Backed Income early in the period, correctly anticipating that they would seek to raise money in the not too distant future. We bought back the shares close to 4p below where we had been selling them.

## 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.

# DISTRIBUTION FUND HOLDINGS



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.

*“The best way to find out if you can trust somebody is to trust them.”*

Ernest Hemingway

Trust is perhaps the most important element in a decision to invest with an active fund manager, particularly when the cost of doing so is typically more expensive than with a passively managed alternative. This is because the validation of that decision is only evident after a reasonable period of time – it cannot be measured instantaneously like it would be for a plumber tasked with fixing a leaking tap.

## Trust in our process

A rigorous and repeatable investment process is something most fund managers should be able to demonstrate, and we at Hawksmoor Fund Managers are no different. This should give some reassurance as to the pattern of performance investors should expect from an investment in an actively managed multi-asset Fund of funds such as ours.

However, we believe we need to do more to justify an investment in our Funds.

Alongside our proven investment process is a belief that **investors in the Funds are not just our clients, but our partners as co-investors in Funds in which we ourselves, our friends and family are invested.** We aim to give our investors an excellent service, where access and ongoing dialogue with us as their fund managers are a given. Many fund managers regard their funds as ‘products’ (some even call them that) which gives the impression that investors, once invested, are left alone.

## Trust in our teamwork

One of the key issues arising from the well-publicised suspension of the Woodford Equity Income Fund is its heavy exposure to illiquid holdings despite promising investors the ability to trade the fund daily.

Our full-time job involves scouring and ongoing monitoring of the fund universe to identify best-in-class managers and investing in the most attractively valued asset classes, using the most appropriate structure for that asset class, i.e. whether open-ended (unit trusts or open-ended investment companies (OEICs)) or closed-ended (investment trusts).

Investors in our Funds can take comfort from the fact that **our portfolios are highly diversified across a range of high quality funds, bringing together the talents of a variety of managers** into a single actively managed holding. Furthermore, that trust in the benefits of teamwork extends to our Funds which have always been managed by the whole team at Hawksmoor Fund Managers, rather than by an individual.

## Trust in our controls

However, it is not just our process and philosophy that ensures that the liquidity of our underlying investments matches the daily liquidity of our Funds. There are strict internal and external controls to ensure this remains so. First and foremost, the Hawksmoor Funds are structured as Undertakings for Collective Investments in Transferable Securities (UCITS) which place greater restrictions on what fund managers can do. In contrast, many other funds-of-funds are structured as Non-UCITS Retails Schemes (NURS) that constrain their managers to a far lesser degree.



The relevant protections include that a UCITS fund cannot:

- have a single investment representing more than 10% of the portfolio
- have investments issued by the same group representing more than 20% of the portfolio
- own more than 20% of the assets in another fund
- invest in open-ended funds that own ‘immovables’, i.e. highly illiquid assets such as physical property or gold

These restrictions are monitored by the fund managers, Hawksmoor’s own Compliance team, the Funds’ Authorised Corporate Director (Maitland Institutional Services) and their Custodian (Northern Trust).

### Trust in our experience

As multi-asset investors, **we use investment trusts to access less liquid assets such as property, private equity and specialist debt**, since they have fixed capital and do not have to manage inflows and outflows. We never have and never will own property or any other illiquid asset within an open-ended fund due to the inherent liquidity mismatch between the underlying investments and the daily dealing mechanism offered by most open-ended funds. This discipline ensured we avoided the suspensions in the property sector in 2016 and we did not invest in the Woodford Equity Income Fund due to concerns about the underlying portfolio.

A drawback of investment trusts is the potential for a more volatile return profile given their shares trade on the stock market. They are therefore subject to supply and demand which can cause the share price to move independently and with a greater level of volatility than the value of the underlying assets, resulting in a discount or premium to net asset value. As active managers, this can provide trading opportunities but it does mean investor sentiment can be a significant driver of short-term performance.

We have witnessed this recently in a couple of our real estate investment trusts (REITs), Civitas Social Housing and Phoenix Spree Deutschland, where negative newsflow questioning their business models has caused sharp share price falls, even though the net asset value and our confidence in the managers’ ability to generate attractive returns over the medium to long-term remains intact.

Such share price falls, whilst painful, should be temporary and store up value that we hope will be unlocked in the future.

### Trust in our reputation

Unfortunately one thing any fund manager cannot guarantee is future performance, but we hope that the above explanations provide some degree of comfort that **we take the responsibility of the wealth entrusted to our care extremely seriously**. We also hope that it is clear that we have investors’ interests at the forefront of everything we do.

Together with our rigorous investment process, we hope that the disciplines we impose on ourselves give our investors in the Hawksmoor Funds the greatest chance of seeing their desired outcomes achieved. We constantly consider what might go wrong, and do our best to protect our investors against downside risks, because as the veteran investor Warren Buffett said *“It takes twenty years to build a reputation and five minutes to ruin it. If you think about that you’ll do things differently.”*

**Daniel Lockyer**  
*Senior Fund Manager*

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## CONTACT INFORMATION

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## RISK WARNINGS AND OTHER INFORMATION

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