

UNCERTAIN TIMES, CERTAIN MEASURES

March 2020



These are clearly extraordinary and highly uncertain times from a humanitarian, social and economic perspective. Financial markets have declined at the fastest pace on record, and whilst the declines are painful we feel it is important to stress how important it is not to get caught up in the panic. **As prices fall, valuations become more attractive and the potential to deliver strong returns in the future improves.** At this point there is an enormous amount of uncertainty and this is driving some extreme price action as investors struggle to come to terms with the economic implications of the coronavirus. There is uncertainty over how long businesses may have to suspend their operations, the full degree of support that businesses and individuals will receive from the government, and how this will translate into economic data and earnings.

Certainty will come, and as the dust settles we are in a strong position to take advantage of price dislocations in investment trusts, and of low valuations across financial markets with cash levels in Vanbrugh and Distribution that are elevated relative to history. As the Funds do not have an absolute return mandate, all we can do in these volatile conditions is to try to protect capital as best we can and provide a strong foundation from which to build on in future. By way of example, since markets started falling sharply on 19th February, Vanbrugh is down 15% and would therefore need to rise 18% to recover from this decline. The UK stock market on the other hand is down 28% and would need to rise nearly 40% to recover lost ground. This highlights the benefit of protecting capital during weaker markets whilst having the flexibility to rotate into cheap areas as they emerge and position for the next phase of returns.

The Hawksmoor Fund Management Team

During these unprecedented times, we have been taking important steps to ensure that the day to day management of the Funds is not impaired in any way. We have the systems in place to enable every member of the team to work seamlessly from home, and the communication lines in place to ensure that we are all in contact and able to react quickly to opportunities in financial markets as they arise.

The Hawksmoor Funds

The Distribution Fund in particular has a strong focus on income and the security of that income. The prospective yield on the portfolio today is 4.9%. This is elevated relative to history despite Distribution having a cash position in excess of 12%. The sources of income range from property to global and regional equity income funds, to asset backed loans, ships and song royalties.

A routine part of our investment process is to check debt levels and debt serviceability of each investment trust that uses gearing (a typical characteristic for property investment trusts), learning lessons from the last financial crisis when elevated debt levels and high serviceability of debt proved painful. So far, none of our investment trusts have announced that there is going to be a hit to the income that they are able to deliver as a result of the coronavirus.

A further focus of recent months has been to ensure that we are investing with fund managers who, within their own investment process, have strong balance sheet checks and an increasing focus on businesses with

high quality and stability of earnings. **The importance of having a strong balance sheet over the next couple of months cannot be overstated.** This is clearly a highly uncertain time for businesses, so we cannot rule out that there may be some dividend cuts or freezes across some of underlying holdings. By focusing on balance sheet strength and less cyclical earnings streams, our underlying holdings should be able to navigate these uncertain times and come out of the other side in a position of strength, able to capture market share from companies that are less well prepared.

For our investment trust exposure we check the dividend cover for each of our positions, with the vast majority having fully covered dividends, and those that don't having a clear path towards achieving a fully covered dividend in the near term. **We have confidence that Distribution will continue to deliver an attractive level of income over the next year and beyond.**

The Vanbrugh Fund shares the same philosophy and investment process described above, but has a higher priority to downside protection which leads to a different portfolio and performance outcome. The Fund currently has the highest level of cash in its history at around 17%. This cash level has provided a buffer during the sharp market falls of recent weeks, and provides us with optionality to take advantage of opportunities as they begin to present themselves, with valuations becoming increasingly attractive as markets sell off.

In addition to the elevated cash level, Vanbrugh has exposure to a number of funds that have proved robust in the market sell off and indeed have delivered positive returns, such as Allianz Strategic Bond, Garraway Financial Trends and BH Global.

Meanwhile the objective of the Global Opportunities Fund allows a much higher tolerance to risk and capital losses in order to generate superior capital growth over the long term. It is therefore unsurprising that it has captured more of the downside in equity markets than Vanbrugh or Distribution with around two-thirds capture ratio.

We are increasingly optimistic about the prospective returns on offer within the investment trust sector where the sell off has been indiscriminate, but also within general equity and bond markets where valuations have become more attractive such that we may be able to embrace more beta (general market) risk, having had to seek alpha (idiosyncratic) risk over recent months.

We are acutely aware of the responsibility you have placed in us to manage your savings, and we are immensely grateful for the faith you have shown in us. As investors in all three Funds, alongside our family, friends and colleagues, we share in your experience, and we are as determined and as focused as ever to deliver good outcomes for all our clients. We are always happy to talk to investors so if you have any questions, please don't hesitate to get in touch.

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