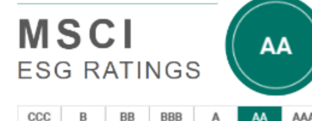
TB Saracen Global Income and Growth Fund

Quarterly Review – June 2021

SARACEN
share success



Graham Campbell
Chief Executive Officer

Bettina Edmondston
Investment Director

FOR PROFESSIONAL INVESTORS ONLY-

Retail investors should consult their financial advisers

	TB SGIG	Sector Average	Quartile
Q3 2021	+3.0%	+1.7%	1
YTD	+19.7%	+11.8%	1
1 Year	+34.2%	+21.6%	1

Source: Saracen Fund Managers as of 30 September 2021

Chance for a second bite?

Outlook

We wrote 12 months ago of the potential economic recovery, post vaccine roll out, the commitment of Central Banks to stimulate growth and the rude health of many consumers and corporates. It proved a strong buying opportunity. Given the thematic relapse in equities in recent months: bonds rallying, narrowing of market leadership and more economically cyclical businesses underperforming, we believe investors have another opportunity to invest in lowly valued, but high quality, cyclical businesses. It was always naïve to expect markets to recover in a linear trajectory after 18 months of lockdowns. The Delta variant closed the tap, just when recovery was getting firmly underway. There were other problems: businesses had run down stocks to raise cash and when the economy re-opened, there was a huge spike in demand and not enough goods in the system. This led to price spikes and shortages, which show signs of slowly easing.

In the months ahead we will hear more about supply lines and logistics. There are clearly some short-term issues, but they will eventually return to normal. However, it is also likely that companies will review their operations and many will take more control over supply and their suppliers. While demand is healthy, higher input and process costs can be passed on. With Central Banks uniformly accommodative, the risk is that inflation becomes embedded and more drastic action is required further down the line.

In the coming 6 months, we expect equity markets to benefit from a resurgent re-opening trade as our lives return to some version of normal. Economic conditions are loose and personal and corporate cash is high. A pick-up in capex will follow earnings. This will provide sustainability to the economic recovery. Lead indicators remain positive. This is a favourable environment for investing in equities. We expect this outcome to result in a more balanced assessment of the inflation risk and bonds stand to be big losers. In many ways we are back to where we started last September.

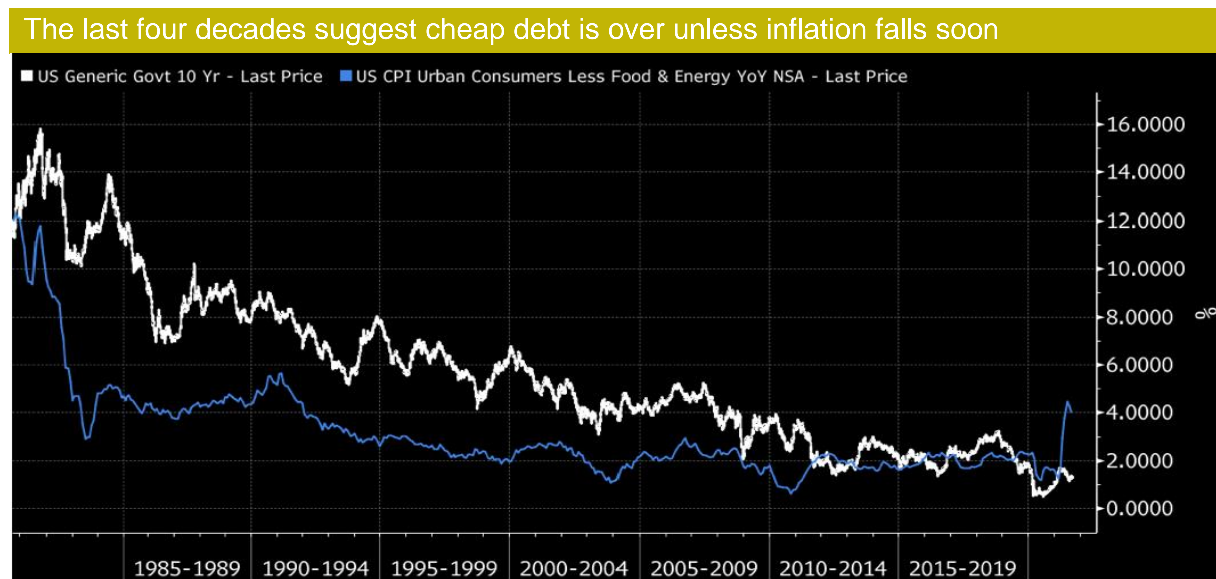
Confidence in the economic recovery translated into a rally in more economically cyclical shares and financials. After giving up much of these gains in recent months we believe the chance exists for a second bite.

Background

If there was one word that was relentlessly repeated over the last quarter, it would likely be the conviction that the recent rise in inflation was 'transitory'.

Low bond yields do not sit well with rising inflation. It is unusual for CPI to be so much higher than long bond yields as the chart below highlights. Previous occurrences were a result of the oil crises in 1975 and 1980.

The data should be a cause for concern.

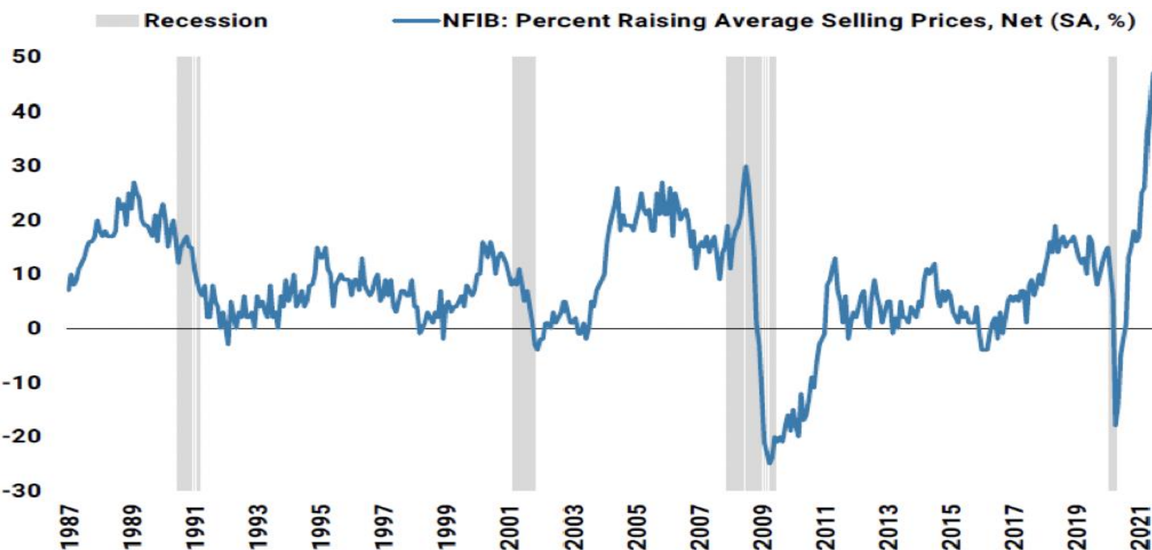


Source: Bloomberg

Analysts are increasingly using non-standard measures to assess inflation to a level that is more comfortable: it's like earnings calculations without the uncomfortable bad bits! We have looked at trimmed means as a better measure of inflation (excluding extremes at both ends) and many other measures. Cost pressures are now a regular slot in CEO commentaries, after being absent for years.

The bond market has made a huge bet that inflation is transitory. Everyone is in! Companies are raising prices and appear reasonably confident that their cost inputs can be passed on. Our concern is the high level of confidence that is weighted on the proposition that inflation is transitory is misplaced, and inflation, once established is more enduring than currently assumed.

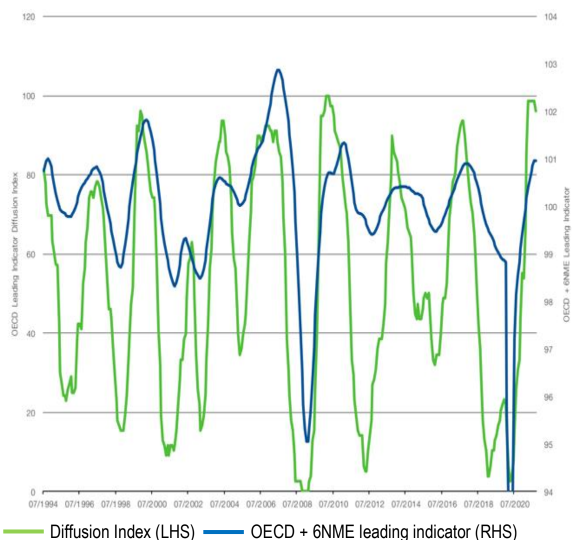
In Response to this Inflation Pressure, Companies Are Raising Prices at a Historic Clip



Source: Haver Analytics, Morgan Stanley Research

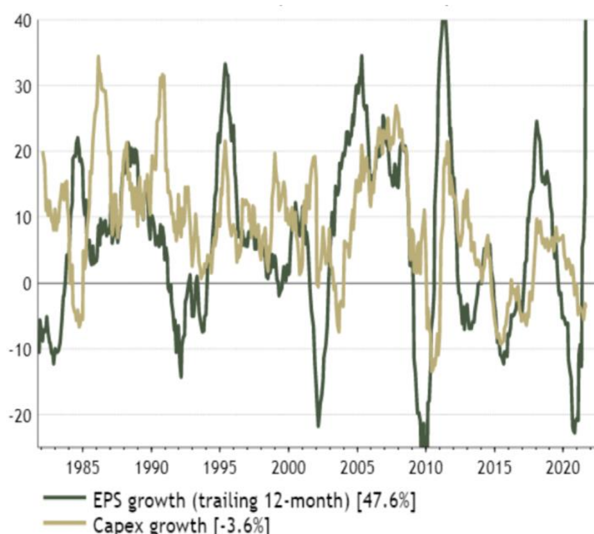
While inflation may remain obdurate, conditions for equity investment remain generally attractive. As can be seen in the charts below, OECD lead indicators remain positive and economic activity will continue to benefit from the Covid re-opening trade.

OECD leading indicators



Source: Liberum, Bloomberg
OECD + 6NME = OECD plus 6 non-member states (Brazil, Russia, India, China, South Africa, Indonesia)

Global Non-Financial Equities – EPS and Capex Growth



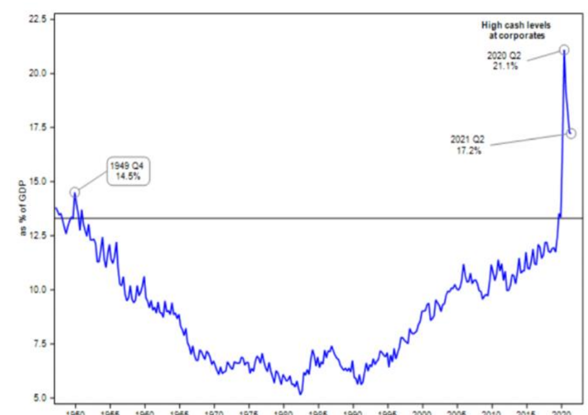
Source: Absolute Strategy Research Ltd.

There are three main levers to economic growth: Government, corporate and household. Governments and Central Banks have been doing their bit. The extreme level of monetary easing and fiscal support has resulted in the loosest financial conditions in 40 years. The charts below show the robust position of corporates and US households.

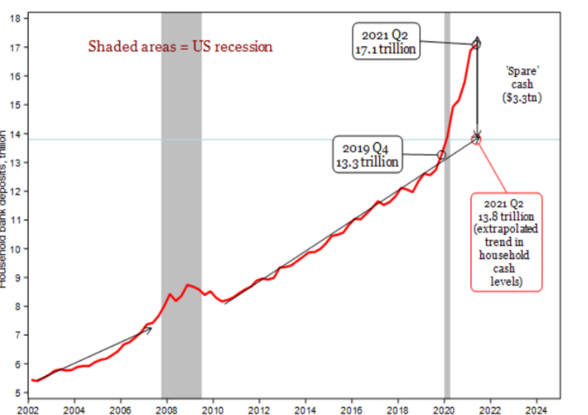
Of course, corporates have many choices how to allocate capital: acquisitions have been abundant this year. Management can also choose between spending on share buy-backs, dividends, or capex. **After several years of restraint, changing supply lines, regulatory changes, applying new technology and meeting ESG targets companies are expected to increase capex, which tends to have a higher economic multiplier than the other options.**

Similarly, household deposits have risen, as those with jobs have been constrained to spend on holidays and other luxuries. The re-opening trade activity has been dampened by the rise of the Delta variant, but personal desires to again affiliate, spend and even have fun, have not been extinguished.

US corporate sector cash & cash equivalent (as % of GDP)



US household bank deposits (US$), actual data with Longview forecast



Source: Longview Economics, Macrobond

In summary, all three forces are driving in the same direction. While growth is strong, nervousness and volatility will increase as we approach changes in Central Bank monetary policy. Nevertheless, it is early days in the recovery and we remain convinced that the accommodative bias will result in a sustainable recovery in economic growth.

The theme of this Quarterly is a second chance. A year ago, we saw the beginning of a sharp rally in more economically cyclical businesses. As time has progressed, bond yields have fallen again and interest has waned. This is highlighted in the chart below.

Across the world, value has sunk back to lows relative to growth

Source: Bloomberg

The final part of the matrix is valuation. While we remain wary of the simplistic Value/Growth categorisations, we do note that we have companies in the portfolio like, St Gobain or Wienerberger which have changed significantly in the past 5 years: they have sold off peripheral businesses, improved returns, changed their product portfolio and operations to be more ESG aligned, yet have been derated over the period. The divergence on Valuation between the TB Saracen Global Income & Growth portfolio, and the Index and Peer Group will be highlighted later in this report.

We also note that the most expensive shares have become more expensive, and that market breadth has declined. The chart below shows the S&P against the number of shares hitting 3-month highs.

Narrowing market leadership

Source: Bloomberg

If we are correct and the massive fiscal and monetary stimulus, combined with excess savings by households begin to drive the economy to pre-pandemic levels, it is likely that asset purchases will be reduced towards the end of the year and interest rates will rise sometime thereafter.

In this scenario we expect more economically cyclical businesses to experience a strong recovery in earnings (still from historically low valuations) and banks to outperform due to rising long-bond yields and stronger lending growth.

Nevertheless, this will be a nervous time for investors as they try to become accustomed to the shift in monetary policy.

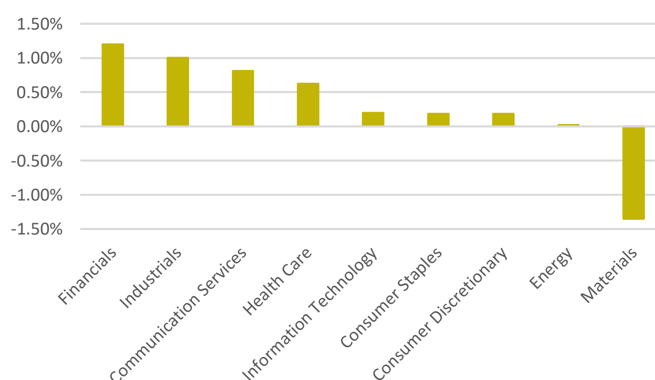
Graham Campbell
Bettina Edmondston

30th September 2021

Fund Review

The fund had a strong start to the quarter with economically cyclical names like Financials, Industrials and Consumer Discretionary outperforming. However, towards the end of Q3 TB Saracen Global Income & Growth lost some of the outperformance as Materials suffered when the market became concerned about a slowdown in economic growth. Overall, Financials were the strongest contributor as it became clear that Western Central Banks were considering reigning in their bond purchase programs and as expectations for interest rate increases were being pulled forward. Materials were the only negative sector contributor.

Sector	Average Weight	Contribution to Portfolio
Financials	19.1%	1.20%
Industrials	14.6%	1.00%
Communication Services	4.6%	0.81%
Health Care	15.9%	0.63%
Information Technology	10.2%	0.20%
Consumer Staples	7.7%	0.19%
Consumer Discretionary	9.3%	0.19%
Energy	3.4%	0.02%
Materials	15.1%	-1.35%



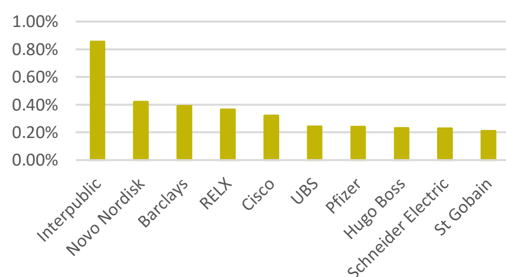
Source: Saracen Fund Managers, Refinitiv Eikon. Data close to close (fund valuation noon to noon)

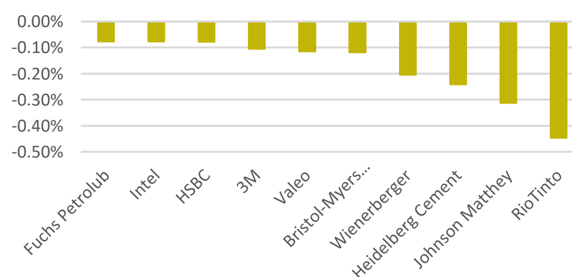
Our top 10 contributors were a mixture of Financials (Barclays and UBS), helped by a change in monetary policy, Industrials (RELX, Schneider Electric and Saint Gobain), Healthcare names (Novo Nordisk and Pfizer) and some company specific performers (Interpublic, Hugo

Boss and Cisco). Materials (Rio Tinto, Johnson Matthey, Heidelberg Cement, Wienerberger and Fuchs Petrolub) were the main negative contributors towards the end of the quarter due to the economic slowdown concerns.

Top Contributors		
Stock	Portfolio Weight	Contribution to Portfolio
Interpublic	3.9%	0.85%
Novo Nordisk	2.3%	0.42%
Barclays	3.4%	0.39%
RELX	2.6%	0.37%
Cisco	3.9%	0.32%
UBS	2.9%	0.24%
Pfizer	1.6%	0.24%
Hugo Boss	1.3%	0.23%
Schneider Electric	2.8%	0.23%
Saint Gobain	3.7%	0.21%

Top Detractors		
Stock	Portfolio Weight	Contribution to Portfolio
Rio Tinto	2.4%	-0.45%
Johnson Matthey	2.3%	-0.31%
Heidelberg Cement	2.4%	-0.24%
Wienerberger	2.4%	-0.20%
Bristol-Myers Squibb	2.1%	-0.12%
Valeo	2.2%	-0.11%
3M	2.2%	-0.10%
HSBC	1.3%	-0.08%
Intel	2.8%	-0.08%
Fuchs Petrolub	2.5%	-0.07%





Source: Saracen Fund Managers, Refinitiv Eikon. Data close to close (fund valuation noon to noon)

Top contributors

Interpublic (+21.8%) started the quarter on strong footing after reporting almost 20% organic growth for Q2 in June, or 8% compared to Q2 2019. This was driven by a rebound in advertising but also by market share gains. The company increased its FY organic sales guidance and margin. The shares continued their strong performance throughout the quarter, and we took advantage of this to lock in some profits. However, at 15.4x 2021 and 14.6x 2022 consensus PE with a 2.9% yield we feel the shares are still attractively valued. *(Source: Refinitiv Eikon)*

Novo Nordisk (+18.3%) launched Wegovy, its once weekly injection for chronic weight management in adults with obesity or overweight with at least one weight-related condition (such as high blood pressure, type 2 diabetes, or high cholesterol). Wegovy is the first approved drug for chronic weight management in adults with general obesity or overweight since 2014. The launch was one of the most successful in pharma history with over 14,000 new prescriptions filled in the first 15 weeks after launch. This led to a temporary supply shortage for the starting 0.25mg dose. Novo aims to fulfil all prescriptions by the year end. We had high hopes for Wegovy but were still surprised by strength of the launch. We continue to see Novo Nordisk as the leader in diabetes, which unfortunately remains an area of global growth.

Barclays (+11.5%) and **UBS** (+8.5%) were two of our strong financial performers that received a lift from higher interest rate expectations. UBS showed very strong performance across the

board with Q2 revenue up 16% y/y, costs below expectation, adjusted profit up 71% and an increase in CET to 14.5%. Barclays equally showed a strong improvement with better-than-expected trends for Barclays card and lower costs driven by the investment bank division. The CET ratio of 15.1% was above expectations. The company confirmed a 2.0p interim dividend and that it is accruing for a FY21 dividend of 6.0p.

RELX (+14.1%) saw three of its four divisions outperforming in H1 and said it sees scope for FY organic growth to be above historical trends. The main positive for us was the STM division delivering 4% organic growth. We are pleased that concerns about losing market share or profits due to a shift to an open access model seem to be receding and RELX's valuation is recovering. RELX also surprised the market with a more generous increase of its dividend by over 5%.

Cisco (+8.2%) reported FY numbers which were better than expected and showed a strong order book which bodes well for growth in coming years.

COVID-19 vaccine sales drove a strong beat and raise for **Pfizer** (+14.9%). News that some countries are starting to administer children with a COVID-19 vaccine and that adults might receive a booster vaccine later this year or next led to a more optimistic outlook for 2022.

Hugo Boss (+17.7%) hosted an Investor Day with its new CEO Daniel Grieder presenting the company's new 2025 strategy and financial targets. Going forward, the emphasis will be on driving top line growth, gaining market share and FCF generation. The main 2025 target is EUR4bn in sales and an EBIT margin of 12% were positively received by the market and the shares seem to be attracting new investors.

Top detractors

Material names were the main performance detractors for the fund in Q3. **Rio Tinto** (-18.6%), **Johnson Matthey** (-13.6%), **Heidelberg Cement** (-10%), **Wienerberger** (-8.6%) and **Fuchs Petrolub** (-3.1%) all suffered amid concerns that inflation and supply chain constraints could lead to a severe slowdown in economic growth. Rio was hurt by the decline in iron ore prices after production cuts in China. Similarly, JMAT saw downgrades due to the decline in precious metal prices, although this does not affect the underlying fundamental business. Sentiment on Heidelberg Cement and Wienerberger deteriorated towards the end of the quarter in line with rising energy costs, which are a main input cost factor for both companies.

Fuchs Petrolub and **Valeo** (-5.2%) themselves don't see many supply chain constraints. However, their client base, the auto OEMs, are still struggling with computer chip shortages, which has led to production cuts, which in turn results in order delays for the supplier companies.

3M (-4.8%) is another name that was impacted by higher input costs and delays in the supply chain and auto manufacturing process. However, this should be a short term set back as demand is still strong. Once supply chains are fully functioning again 3M should revert to its 3-5% organic growth target with sustainable margin improvement.

None of the above-mentioned names are experiencing a severe slowdown in demand. We believe once supply chains are functioning again, these companies can make up temporarily lost revenues fairly quickly and as leaders in their fields should be able to gain market share. Coupled with pricing power we see attractive medium-term returns. Valuations at these levels are undemanding with e.g. Rio Tinto trading on 12x and 6.7x consensus 2021 and 2022 PE respectively with a 17% yield. 2022 consensus PEs for Johnson Matthey, Heidelberg Cement and Valeo are just 10.4x, 7.4x and 9.9x respectively. *(Source: Refinitiv Eikon)* In short, we believe these companies remain undervalued while being at the forefront of big structural growth themes like infrastructure building, new housing or electric vehicles.

Portfolio Changes

During August we initiated two now positions: **Avient** and **China Mobile**. For more information please click here. We financed this through the sales of Imperial Brands and Organon and through profit taking in strongly outperforming names like, such as eBay, Pfizer, Rockwell, Roche, Interpublic, and Saint Gobain.

During the quarter we took some profits from top-slicing **Novo Nordisk**, **Hugo Boss**, **American Express** and **Schneider** to manage their position sizes. We used the proceeds to increase our position in **HSBC** to a meaningful level.

SGIG Portfolio strategy

The fund remains cheap on all metrics. The table below highlights its value characteristics. It is important to point out that there has been no style drift with the fund. It remains firmly in the large cap value bucket yet with high quality characteristics. We expect the fund to do well during a cyclical upturn.

SGIG value characteristics versus FTSE All World index					
Characteristic	TB SGIG	MSCI World	+/-	Select peer group	+/-
P/E 1Y FWD	12.1	18.7	-6.6	16.0	-3.9
Dividend Yield 1Y FWD	3.5%	1.8%	+1.7	3.2%	0.4%
P/CF 1Y FWD	11.2	30.6	-19.4	16.4	-5.1
Net Debt/EBITDA 1Y FWD	1.4	2.3	-0.9	2.0	-0.6
Return on Capital Employed	16.1%	15.0%	+1.1	15.3%	0.8%
Refinitiv ESG Score	78.2	69.9	+8.3	74.6	3.6

Source: Refinitiv 30/09/21
Select peer group: Artemis Global Income, Evenlode Global Income, Guinness Global Equity Income, Veritas Global Equity Income

Drilling into our top ten holdings, we would highlight again the relative low valuations and attractive yields with an average of 13.1x Y1 consensus PE and 3.9% yield. *(Source: Refinitiv Eikon)*

SGIG top 10 holdings			
Stock	Portfolio weight	P/E 1Y FWD	Dividend Yield 1Y FWD
Barclays	3.8%	7.2	3.7%
IBM	3.7%	12.1	4.7%
Philip Morris International	3.6%	14.4	5.0%
Interpublic	3.6%	14.5	2.9%
Saint Gobain	3.6%	11.3	3.2%
Cisco	3.5%	15.7	2.7%
Danone	3.5%	17.2	3.2%
DBS	3.5%	11.4	3.8%
Roche	3.4%	17.0	2.7%
Svenska Handelsbanken	3.2%	10.6	7.0%
Top 10 average	**35.4%**	**13.1**	**3.9%**

Source: Refinitiv 30/09/21

We pointed out earlier this year that 2021 will be volatile and that stock picking will become more important again. We have seen a cut in growth expectations for the rest of the year and into 2022, which is not surprising after the strong growth in Q2 and the continued disruptions to supply chains. However, we do not believe that we will see negative economic growth next year. Once supply chains are functioning again companies will be able to fulfil the still healthy demand. Coupled with price increases we see attractive growth for our holdings into 2022.

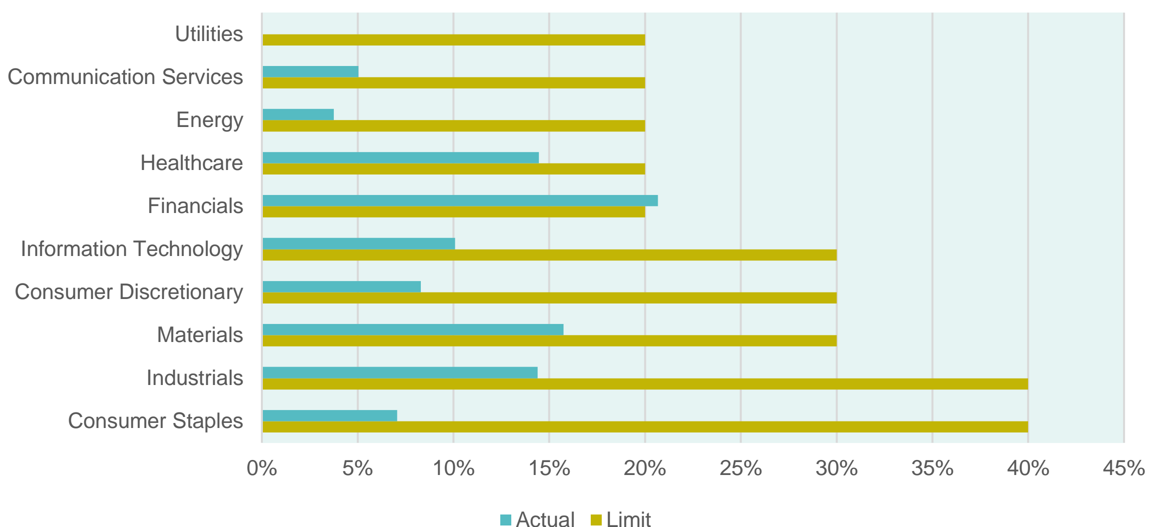
We retain large weightings in selective companies that are classified in the following sectors:

- **Industrials**
- **Materials**
- **Financials**
- **Healthcare**

And we continue to find limited value in bond proxies like:

- **Consumer Staples** (expensive for expected growth)
- **Utilities** (limited growth and too much debt)
- **Telecoms** (limited growth and too much debt)

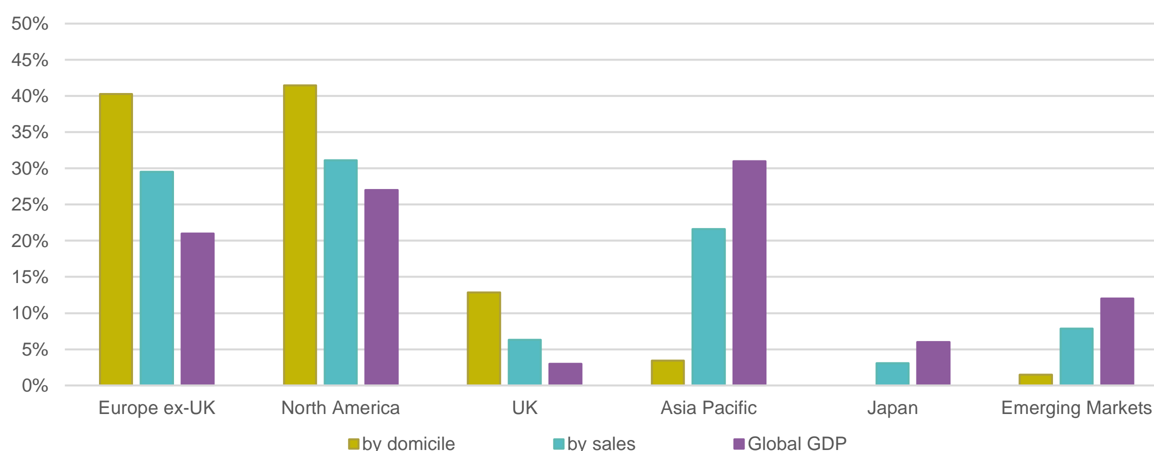
TB SGIG sector split



Source: Saracen Fund Managers as at 30/09/21

The fund’s sales exposure remains closely aligned with global GDP distribution:

SGIG geographical split



Source: Saracen Fund Managers as at 30/09/21

Investment Approach

TB Saracen Global Income & Growth Fund aims to provide a long-term return from investing in a portfolio of low risk, highly liquid global equity securities. There is an explicit recognition that income is an important factor for many investors and a significant contributor to long-term investment returns.

We have a focussed and highly differentiated portfolio of 40-60 quoted global companies, a high conviction fund with a significant active share, which is currently 94%. There is no formal benchmark for the fund, although we do report performance against the IA Global Equity Income Sector.

We aim to invest in global-leading businesses which can sustainably grow their revenues, their profits and ultimately, their dividends. We are attracted to businesses which have high and sustainable margin profiles, create value by generating a return on investment above the weighted average cost of capital and have a strong Balance Sheet. We also like to see directors owning shares in the business and being remunerated on total shareholder returns as opposed to an earnings-per-share measure, which can be easily manipulated. However, the most important things that we look for in an investment are an attractive valuation and a starting yield of more than 2%. We don’t simply buy great businesses at any price - they must be demonstrably cheap!

Our Wish List for Companies

- Global Leading Businesses
- Long-term revenue growth potential
- Positive return on equity spread
- Sustainable margins
- Strong Balance Sheet
- Acceptable Worst Case (extent and likelihood)
- **Attractive valuation and starting dividend yield more than 2%**
- Alignment of interest with directors

We have a long-term approach and the turnover in the fund has on average, been less than 20% per annum since the fund was launched.

For further information on TB Saracen Global Income and Growth Fund please contact:

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Bettina Edmondston (bettina@saracenfundmanagers.com)

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Important information:
This information should not be construed as an invitation, offer or recommendation to buy or sell investments, shares or securities or to form the basis of a contract to be relied on in any way and is by way of information only. The historic yield reflects distribution payments declared by the fund over the previous year as a percentage of its share price. Taxation levels, benefits and reliefs may all vary depending on individual circumstances and are subject to change. Subscriptions will only be received, and shares issued on the basis of the current Prospectus, Key Investor Information Document (KIID) and Supplementary Information Document (SID). These are available, in English, together with information on how to buy and sell shares, on-line at www.saracenfundmanagers.com. Issued by Saracen Fund Managers Ltd, 19 Rutland Square, Edinburgh, EH1 2BB, authorised and regulated by the Financial Conduct Authority. Registered in Scotland No. 180545.

Risk factors you should consider before investing:
Past performance is not a guide to future performance. The value of investments and the income from them may go down as well as up and you may get back less than the amount invested. A full list of the risks applicable to this Fund can be found in the Prospectus. All fund performance figures calculated on a single price basis.

This Quarterly Commentary is for professional Investors only.

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Custodian – The Northern Trust Company, 50 Bank Street, Canary Wharf, London, E14 5NT

Depositary – NatWest Bank PLC, 135 Bishopsgate, London, EC2M 3UR

Regulatory Status:
FCA Recognised: Yes
Scheme Type: OEIC

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