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To: Our Investors in the Chawton Global Equity Income Fund

Quarter ended 30 September 2022

Overview

The fund increased in value by 3% over the quarter, outperforming the benchmark and comparator funds.

Although this quarter has been more stable, global equity markets have fallen sharply since the start of the year. For global sterling denominated funds such as ours, the weakness of our base currency has reduced the extent of the decline, but we were still down 12.7% YTD at the quarter end.

Since inception just over three years ago the fund has delivered a total return of 28.8%, well ahead of similar funds. Of this return, 7.7% is in the form of distributed dividends.

Our aim is to invest in companies that compound returns, resulting in capital growth and a growing income stream over time. Against a background of sharply rising inflation and interest rates, this type of company has performed less well in 2022 than companies that operate in more commoditised markets and exhibit greater cyclicality. Our comparators tend to have greater exposure to the latter.

We continue to engage with the management teams of the companies the fund owns and aim to visit them when possible. We set out in this letter our thoughts, based on recent monitoring work, on the positioning and progress of our companies within the context of their industries.

Our Partners' aim is to build the business for the long-term through steadily and constantly improving everything we do. As an example, we want to make sure we get our approach to sustainability right and report this to our investors in the best way possible. We provide an update on our progress on the work we are doing in this area.

Industry and Market Review

Equity markets stabilised during the third quarter after steep falls earlier in the year. The fund rose modestly along with global equity markets. We met a number of companies during the period, including on two trips to Scandinavia. This forms part of our ongoing monitoring of our investments. The following is a summary of our observations.

Consumer staples companies represent our largest sector weighting at 20% (as at 30/9/22) and in addition, we have a further 10% invested in beverage companies. Companies held include Procter & Gamble, Nestlé and Brown-Forman. Through providing essential items, the demand profile of companies in these sectors tends to be quite stable. Companies held in the fund are raising prices in line with increasing inflation. Although they are experiencing cost increases and supply chain issues they are maintaining, if not growing, profits. More recent information suggests the cost pressures are starting to ease.

Beverage companies are seeing more of a two-way pull, with sales growing as people go out more but demand proving a little more sensitive to price. We have noted that some smaller and less well organised competitors in beverages have struggled to address supply chain issues, including energy supply in Europe, and have seen significant drops in profitability as a result.

Unilever's board continues to reorganise its management bench, incentive structure and organisational structure to improve its performance. The CEO is to be replaced. The company has an excellent portfolio of brands and strong distribution especially in Asia. Recent management has been poor and we have built our position this year as the board has become more aligned with our objectives.

Staples companies form a strong backbone for the fund, steadily compounding in all economic conditions. We invest selectively in those who are allocating surplus capital most productively and remain comfortable with our current holdings. Such companies tend to be good dividend payers with strong track records of dividend growth.

Financial services comprise 14% of the portfolio with the majority invested in general insurance. These companies are more cyclical than other industries we invest in, but the insurance cycle is less correlated to the mainstream economic cycle. Insurance premiums are rising strongly as the industry moves into what is termed a hard market. This is caused by capital withdrawing due to poor industry underwriting results over the past few years. The insurers we invest in (Progressive Corporation (USA), Sampo (Nordics) and Berkshire Hathaway (US/global)) are selective in their underwriting, growing capacity only if they obtain the right price. They tend to prosper when conditions harden. These companies have investment portfolios mostly comprising shorter duration bonds. Whilst these will have been impacted by recent rising interest rates, the move from minimal yields to the current 3-4% we are seeing now, will substantially bolster future profitability. Against this, the industry is experiencing substantial claims as inflation globally, and hurricane Ian, hit the profitability of the US insurers in September.

We believe the portfolio general insurance companies will generate strong returns in the next five years allowing the distribution of extensive surplus capital both as dividends and share repurchases.

The portfolio is invested in industrial sectors through business services and asset light engineers. These are focused across a number of distinct markets. Those focused on manufacturing and logistical infrastructure are seeing strong demand conditions which is carrying through to increased profitability. Industrial distributors such as Fastenal and Bossard make it easier for their customers to manage supply and inventory. The engineers, such as Atlas Copco, are seeing strong demand from customers who are increasing investment in the infrastructure needed to transition to a green economy.

As growth does not require significant capital investment, these companies also generate surplus capital which they return to shareholders. Given the scale of the investment required in the next decade to move to net zero, we are looking to build our positions in these types of company.

Other investments are across a number of different sectors. Consumer facing companies, where sales are more discretionary, such as Next in apparel and Home Depot in products for home improvement, are seeing demand soften following strong performances during COVID. They potentially could be further impacted if higher interest rates result in a recession. Generally, we consider their industry positioning is strengthening as smaller competitors find life tough; Next is seeing some competitors fail and lease costs fall materially, for example.

The market values of the portfolio consumer discretionary companies are already discounting recessionary conditions. We are selectively adding to our positions which is having the effect of improving the yield profile of the fund.

Technology and media companies are seeing reduced demand as recent, venture capital backed, start-ups seek to conserve cash. More established, profitable companies continue to invest in digital marketing and transitioning IT spend to the cloud. Microsoft and Alphabet are still growing but at a much-reduced rate. The portfolio has a number of investments in the semi-conductor value chain such as ASML, and Texas Instruments. The industry serves a number of distinct markets. Investment in new manufacturing capacity remains strong as western countries seek to promote diversification from Taiwan. Supply to the auto market remains tight but supply to consumer electronics areas is starting to exceed demand. The long-term prospects of the industry look very strong driven by investments in artificial intelligence, autonomous vehicles and industrial automation. That said, we fear the unwinding of the excess capital deployed in digital start-ups will take several years and we are trimming some positions, including Microsoft.

Stewardship

We feel our investment philosophy has always implicitly valued characteristics of companies that are now explicitly valued under sustainability criteria. We are now working hard to ensure we are properly recording our research and activities necessary to qualify as a signatory of the United Nations Principles for Responsible Investment (UN PRI) and to be approved by the Financial Reporting Council as complying with their Stewardship Code.

Underpinning our approach to stewardship and sustainability is our requirement that the companies we invest in are aligned with our values and they manage the business with integrity for the long term. We look for sustainability principles to be built into long term strategic planning and we do not invest in companies allocating capital to projects with negative impact, such as fossil fuel extraction and use. Chawton actively engages with companies owned on these issues and on appropriate incentive structures. Morningstar ranks the fund as four globes out of five on sustainability with five being the lowest risk.

Investment Performance

Chawton Global Equity Income Fund performance is shown below for the third quarter 2022 and preceding periods. The Fund results are net of fees and charges and are compared to the benchmark index (MSCI World GBP) and the comparator group as represented by the Investment Association Global Equity Income sector.

	Chawton Global Equity Income Fund	MSCI World TR in GBP	IA Global Equity Income Sector
Third Quarter 2022	3.2%	2.1%	0.0%
2022 YTD	-12.7%	-9.5%	-6.4%
2021	18.2%	22.9%	18.7%
2020	14.2%	12.3%	3.3%
2019 (from 19 May)	9.3%	8.6%	NA
Since Inception 19/05/2019 – 30/06/2022	28.8%	35.6%	22.8%
Compound Annual	7.9%	9.6%	6.4%

Source: FE fundinfo as at 30 September 2022. Total return in GBP. Past performance is not a reliable indicator of future results. The value of your investments and the income derived from it can go down as well as up and you may not get back the money you invested. * Fund launch 21 May 2019

The fund's rise of 3.2% in the third quarter was ahead of the Global Equity Income Sector which was flat. However, the sector has performed relatively well this year declining -6.4% in GBP currency, compared to the fund at -12.7%. For reference, the S&P 500, in US dollars, has fallen -24.8%. Performance since inception has been +28.8%, comfortably ahead of the sector's +22.8% but behind the benchmark at +35.6%. The fund did well in 2019 and very well in 2020 as COVID broke. It failed to keep up with the exuberant 2021 markets and has lost ground in the commodity driven 2022 markets. The performance of Apple and other large index technology constituents has underpinned the benchmark's performance.

Financials contributed most strongly to performance in the quarter and most other sectors contributed modestly. However, consumer services (media companies) and consumer discretionary (retail companies) detracted. Texas Instruments, SE Banken, Costco, Unilever and Progressive were the main stock contributors and Next the main detractor.

As our fund history grows, I would recommend focusing on the compound annual return figure as the best representation of how well we are doing both absolutely and relatively. I would summarise this currently as solid, absolutely, at around 8%, which is, above average against other income funds but below average against our index. The fund has the potential to deliver more.

Activity

Over the 3 months to the end of September 2022, we completed the sale of two positions and initiated two new positions in healthcare which we will discuss in a future letter. We currently own 34 stocks.

During the period, we also visited Sweden and Denmark and met with a number of portfolio companies.

Major Purchases:

No major purchases were completed.

Major Sales:

TSMC (Taiwan) – completed exit
Roche (Switzerland) – completed exit

TSMC

TSMC has become the dominant player in the semi-conductor manufacturing side of the industry where all the sub-industry returns go to the cutting-edge producers with scale and know-how. With Intel seemingly having given up, we are down to TSMC and Samsung as chip size reduces to 7nm and below. Our analysis suggests that TSMC should be able to maintain this positioning for the next ten years and that the market will grow in this period driven by a multitude of applications.

However, the company is rendered higher risk through the geographical concentration of its manufacturing assets in Taiwan; a country under increasing military threat from its close neighbour China. This has prompted political intervention in the industry globally with the aim of ensuring security of supply of advanced chips whilst seeking to reduce China's access to the same.

TSMC have recognised this and are investing capital in facilities in Arizona in the USA and Japan. Additionally, the US government has intervened to cause Intel to reverse their decision to exit and instead invest to build their advanced semi capability. This will take time though, not least because of the lack of technicians with the requisite expertise outside Taiwan. In the meantime, the risks of owning TSMC outweigh the benefits whereas the positioning of ASML, held in the fund, as the monopoly supplier of the lithography equipment required to build these foundries, has improved. We therefore completed the sale of TSMC near the start of the quarter and will look to increase the position in ASML at an appropriate price.

Roche

Over the last 15 years, Roche’s cash flow returns on capital have been consistently above the cost of capital and around 20% in the last ten. A progressive dividend has followed on with 33 years of growth and a payout ratio of 44% supporting around a current 3% yield. However, the quirks of the Swiss withholding tax system means that UK funds such as ours suffer the full impact of a 35% tax, reducing the yield by a third.

The sustainability of high returns is underpinned by patent protection which endure for 20 years; in practice, this narrows to 10-15 years given approval time. However, the nature of this model whereby off-patent drug revenues have to be replaced before any growth can be generated renders such companies low growth but with high levels of surplus capital. This underpins the dividend growth but is diluted by the withholding tax.

An aggressive share buyback strategy would be worthy of consideration. In November 2021 the group did announce a large share buyback reducing the share count by almost 7%. However, this was a reactive move to the proposed sale by Novartis of its stake in Roche. Prior to this, Roche had not reduced its share count materially for over 20 years.

Having explored the possibility of the Swiss government honouring its double taxation treaty with the UK, which would reduce the tax to 15%, we concluded that this is unlikely. As a result, we have reduced our estimate of intrinsic value by 20% and this, combined with the emergence of other opportunities in healthcare, has resulted in the sale of our position.

Scandinavian Company Meetings Log - Atlas Copco, SE Banken, SAMPO, Carlsberg

I made several trips to Scandinavia during the quarter and met the management of both companies owned in the fund and in some cases, their suppliers, customers or competitors. Brief highlights are as follows:

Atlas Copco

The company provides advanced equipment used by other manufacturers such as powerful compressors, vacuum pumps and factory tooling equipment. Management highlighted the decentralisation of their operating units. They use the metaphor of 23 ships, corresponding to the underlying operating entities that make up the 4 divisions, each plotting their own course to get to a destination the centre has outlined. When deciding on investment in projects and acquisitions to grow, the centre provide broad guidelines; namely that the investment must be in an area that is internally or externally already number 1 or 2 in its market, the application must be critical, there is a good after market opportunity and the product is capable of standardisation with bespoke fine-tuning by customer. It is then up to the local management teams to identify and execute on opportunities that fulfil these criteria.

Management also emphasised that energy efficiency is a common theme in their product range, both in terms of the superiority over competitor products and in new applications. For example, compressors are now being used to pump air under the hulls of large ships resulting in less energy usage.

The de-centralised structure and the engineering innovation contribute to the company’s strong competitive advantage. The former also renders their capital allocation very adaptive to future opportunities making this a core holding.

SE Banken

This is one of the four dominant banks in the Nordics. Management is concerned their retail customers are facing considerably higher costs through interest rate rises and inflation. However, their stress tests indicate this is not a risk for their mortgage book. They have been very conservative in their provisioning. They have capped their exposure to real estate companies at 10% of the loan book unlike some competitors.

In the highly consolidated, efficient and therefore profitable Scandinavian banking market, SEB’s strength is in the corporate side both large and small. This covers a range of services, including working capital management, bond issuance, equity issuance and foreign exchange. The bank is far more efficient than European competitors. Management told us that the net interest margin is rising and given they already achieve a high return on equity, they will be able to forsake some short-term profit to invest in long term growth. The main European banks need to improve their returns from low levels and so will be unable to follow. However, expanding US banks are a threat.

The meeting confirmed our alignment of objectives through investing for the long term.

SAMPO

The Nordic general insurance companies achieve even higher returns on equity than their banks. This is due to consolidation but also because the structure of the market favours direct sales reducing the impact of brokers and price comparison sites. Sampo is the largest operative in this oligopoly. Management indicated that whilst the bulk of the business is personal (auto and household) insurance, recently two large international players pulled out of the industrials (business) market leading to much stronger pricing in that segment.

Capital allocation has been mixed and management defended their recent acquisition of Hastings in the much less attractive UK market. Having recently divested of their holding in Nordea, where they struggled to achieve an adequate return on equity, we are concerned the good work will be undone by attempts to grow in the UK market. We expressed our view that at the current market value of the company, share repurchases are a better allocation of capital.

This is a strong player in an attractive market and we are engaging to ensure optimal capital allocation.

Carlsberg

The company held an investor day in Copenhagen which showcased their new strategic plan. Carlsberg has one of the best management teams in the portfolio and its strategic planning is exemplary. In the beer brewing industry, local scale is important and markets tend to consolidate down towards a duopoly and only they achieve high returns on capital. The group has a diversified portfolio with the majority of revenues from countries where they do occupy such a position. However, there are some significant countries, notably UK and France, where they do not. This means that although the business is good it is somewhat reliant on good management to keep it that way.

Management seek to address this through corporate restructuring – essentially exchanging assets with competitors to consolidate or divest their business. If this is not possible, their approach is to focus on premium brands which can be regional or even global and therefore have the requisite scale. The group is very strongly positioned in parts of India and China with effective local domination and potentially strong growth pathways. However, their eastern European operations have been impacted by the Ukraine war. Unfortunately, the excellent CFO is to leave. There is still work to do and my concern is how the group would fare if succession results in a less competent management team.

We reduced our exposure to the parent company following the visit given our concerns but retain our full weighting in Carlsberg Malaysia where their market position is strong in the region covered by the subsidiary (Malaysia and Singapore).

Conclusion

Equity markets stabilised during the third quarter after steep falls earlier in the year. The fund rose modestly along with global equity markets. We met a number of companies during the period, including on two trips to Scandinavia.

Our observations suggest whilst portfolio companies are facing short term pressure on costs, their strong industry positioning, good operational management and long-term mindset renders their short-term profitability more resilient and enables them to increase long-term competitive advantage.

The large consumer staples weighting in the fund provides backbone as they can compound in all weathers. We consider insurance companies in the fund are entering a positive phase in their cycle. We are looking to add to our industrially focused companies given the strong demand likely for the transition of infrastructure to net zero over the next ten years.

We have trimmed back some of our exposure to technology companies as we consider the recent boom in venture capital funded digital marketing and IT spend has yet to fully unwind. We are making some changes to our healthcare stocks and looking to selectively add to consumer discretionary stocks on valuation grounds.

We are now working hard to ensure we are properly recording our research and activities necessary to qualify as a signatory of the United Nations Principles for Responsible Investment (UN PRI) and to be approved by the Financial Reporting Council as complying with their Stewardship Code.

I hope this letter has provided greater insight into our process and progress. Please do not hesitate to contact me if you have questions or would like me to run through our associated presentation.

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As a concentrated equity portfolio of typically less than 50 stocks the fund may involve higher volatility and therefore higher risk for those with shorter term investment time horizons (under 5 years). The value of an investment and the income from it can fall as well as rise as a result of market and currency movements and you may not get back the amount originally invested. You should therefore regard your investment as long term. Details of the risk factors are included in the fund's prospectus available at www.tbaileyfs.co.uk/funds