Sanlam FOUR Active UK Equity Fund

Performance Review

The fund underperformed the benchmark in the quarter as a result of the net effect of stock selection factors. There were no dramatic moves but underperforming stocks simply outnumbered those outperforming the market. The largest negative impact came as a result of Sophos shares falling in response to a reported slowdown in sales, while IQE continued to suffer from a concerted shorting effort despite the company reiterating bullish sales and profit expectations. Not holding AstraZeneca also impacted negatively as the stock rallied on rising hopes for the company's immuno-oncology drug pipeline.

Whitbread provided the most significant positive impact on the news that Costa Coffee was to be sold to Coca Cola for a price well in excess of analysts expectations. Also benefiting was Wood Group, following a reassuring trading update. Other gainers were John Laing, rallying from rights issue technical weakness in Q1, BT on the news of management change, and Micro Focus benefiting from the sale of a software business and share buy-back.

Portfolio Characteristics	
TE	2.7%
VaR	5.0%
% in cash	0.5%
No. of holdings	41
Aum	£32.7m
active share	57.5%
yield	4.5%

	Inception	QTR	YTD	1yr	3yrs	5yrs	Since Inception
A Accumulation GBP	02/04/07	-2.8	-1.5	4.6	6.9	3.9	5.1
MSCI UK		-0.4	0.9	5.8	11.6	6.8	5.2

Performance beyond one year is annualised.

12 Months to	Sep-18	Sep-17	Sep-16	Sep-15	Sep-14
A Accumulation GBP	4.6	16.0	0.7	-5.5	4.8
MSCI UK	5.8	11.0	18.4	-5.9	6.0

Source: Sanlam FOUR, Morningstar and Lipper as at 30/09/2018.

Past performance is not an indicator of future performance.

Market Recap

The third quarter of 2018 has seen the UK market drift off again, in line with other European markets. Interestingly, global market returns have been surprisingly diverse with strong economic growth driving the US higher and Japan also gaining on the back of stimulus measures. In contrast, Pacific ex-Japan and emerging market equities have been weak.

The strong US economy, consequent tightening of monetary policy and support for the US dollar are now creating an increasingly divided and potentially unstable global economic backdrop. The US trade war with China has also become a more serious factor that is dampening "animal spirits" outside the US.

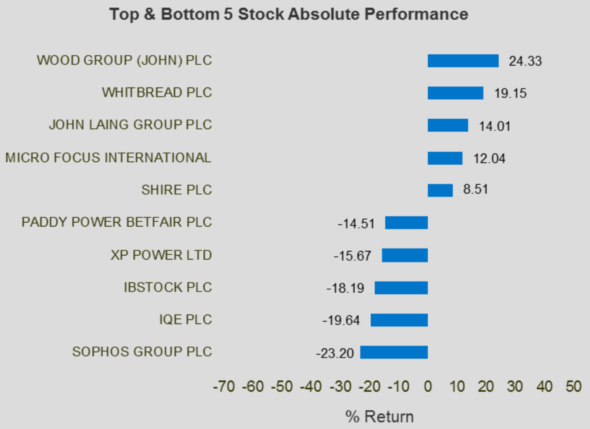
In the UK the lack of progress on Brexit negotiations is worrying at this late stage. Although headline UK economic growth appears satisfactory, confidence has undeniably been impacted by this uncertainty. This is evident in the poor relative performance of sectors exposed to the domestic economy, such as construction, real estate and electricity utilities. In contrast, the top performer was healthcare, which benefits from defensive international earnings.

A rising oil price has also been a notable feature, particularly towards the quarter end. This helped the performance of the oil and gas sector, and oil services companies.

Notwithstanding the overall reasonable level of global economic growth, investor sentiment has become more cautious, with risks seeming to be more elevated. This somewhat skittish mood is reflected in the "risk off" climate, with many economically sensitive industrial stocks being de-rated, partly due to trade war concerns, but also on the simplistic basis that this economic cycle is now very mature and therefore surely at risk of faltering.

The UK environment reflects the combination of these global risks and the confusion of an uncertain Brexit outcome. This has resulted in equity valuations falling to levels that might ordinarily be regarded as cheap, but without clarity on a Brexit deal investors have continued to shun many of these value opportunities. The relative weakness of banking stocks and housebuilders perhaps best illustrates this dilemma facing investors.

Performance Attribution



Source: Bloomberg as at 30/09/2018.

The fund underperformed during the quarter as a consequence of the net effect of stock selection factors. Several significant positive contributors were insufficient to make up for a larger number of negative impacts.

The main positive impact came from our large holding in Whitbread as the shares rallied strongly on news of the agreed sale of Costa Coffee to Coca Cola for £3.9 billion. This price is around £1bn more than the value that had been attributed to this business previously, thus prompting the 19.1% rise in the shares.

Other positive factors were gains in Wood Group (+24.3%) on the back of strong H1 results, which showed the benefits coming through from the acquisition of Amec Foster Wheeler completed a year ago. Also gaining were BT Group, Micro Focus, Hipgnosis Songs (see later) and John Laing, which recovered from the earlier technical weakness triggered by the large rights issue in Q1.

On the negative side the main factor was continued profit taking in our technology holdings, namely IQE(-19.6%),Sophos (-23.2%) and First Derivatives (-11.2%). Together, these three stocks detracted nearly 1% from performance. All three continue to see strong underlying growth and we remain confident in their prospects.

Several of our domestic UK exposed companies suffered from concerns surrounding trading prospects and Brexit related economic risks, including ITV, Ibstock ,Tui, Howden Joinery, Crest Nicholson and Great Portland Estates.

Finally, not holding AstraZeneca detracted from relative performance as this large index constituent (3%) gained 14.8% on enthusiasm for the delivery of the new immuno-oncology drug pipeline.

Key purchases

- **Hipgnosis Songs**: this is the first UK listed music royalties fund. It holds a diversified catalogue of premium songs and is set to capitalise on the new tech-driven monetisation model, with streaming revenue having grown by 48% p.a. over the last five years, a trend that is set to continue.

- **CRH Holdings**: this is a leading global building materials group operating principally in the US and Europe. The group is strongly cash generative and well positioned to benefit from US infrastructure spending, European recovery and portfolio restructuring opportunities. The shares are cheaply rated at a significant discount to US peers.

- **Anglo American**: this globally diversified miner provides exposure to copper, coal, iron ore, platinum and diamonds. While still playing catch up with the likes of Rio Tinto and BHP in terms of raising productivity and cash returns, this is an opportunity that is now being grasped. The stock trades at a 20% discount to its larger peers and is vulnerable to corporate activity.

These purchases were funded by the disposal of Glencore, which is likely to be dogged for some time by the US DOJ investigation into fraud and money laundering. We also took the remainder of our profits in Sainsbury following the ASDA deal. Finally, we sold out of Vodafone, having already moved underweight, on reflection of our longer term concerns for low returns in the face of intense competitive and technological pressures to restrain pricing despite needing to sustain a high rate of capex.

Market Outlook

Global economic growth trends remain intact for the foreseeable future, notwithstanding numerous risk factors, most notably US monetary policy tightening and aggressive trade policy. That being said, although the US economy is clearly strong, growth elsewhere is more moderate and this much more desynchronized state of affairs presents growing risks. The stronger dollar emanating from US strength and policy tightening, both exacerbated by the fiscal stimulus impacting from the start of this year, is destabilizing for dollar indebted emerging markets, while Chinese currency weakness only serves to inflame a more belligerent US approach to trade.
Market weakness therefore is reflective of risks to growth even though there is no immediate threat and current momentum is secure. Monetary policy can remain accommodative in most of the rest of the world, even as the US Fed needs to respond to domestic growth.

As US short rates continue to rise put further near term upward pressure on long bond yields, at some point bond investors will believe that enough has been done and the risk of a Fed policy mistake will undermine equity confidence. At the time of writing we are currently witnessing a minor version of this but equities are likely to recover given the still favourable near term growth outlook. It is nevertheless a warning that excessively strong US growth is a double edged sword for markets.

In the meantime the UK and Europe can continue to haggle over the terms for Brexit and the uncertainty will continue to weigh on consumer, corporate and investor sentiment. Any deal will do at this point to restore confidence!

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Important Information