FOR PROFESSIONAL INVESTORS ONLY

Sanlam FOUR

Q2 2018 — **Quarterly Newsletter**

Sanlam FOUR Active UK Equity Fund

Performance Review

The fund modestly outperformed the benchmark in the quarter. Positive selection was the main driver in the period as good results announcements sparked rallies in several holdings, most notably Sophos, ITV, Bloomsbury Publishing and Integrafin. Sainsbury also gained on news of the proposed "merger" with Asda. The largest detractors were IQE, which continues to suffer from profit taking and investor scepticism, and housebuilder Crest Nicholson, which fell following a disappointing trading update. The fund also suffered some relative performance drag from not holding a number of large cap stocks that performed well as "defensive" stocks returned to favour in the second half of the quarter.

We substantially increased our position in Integrafin at the start of the quarter, and then in May purchased a new position in Micro Focus, and in June added a position in XP Power. These were funded from profit taking in Royal Dutch Shell and Sainsbury. Several other positions were trimmed, including John Laing, BAT and Vodafone. In contrast, we used price weakness as an opportunity to top-up holdings in Whitbread, Paddy Power and Imperial Brands.

Portfolio Characteristics	
TE	2.6%
VaR	5.2%
% in cash	1.6%
No. of holdings	40
Aum	£42.1m
active share	55.3%
yield	4.2%

	Inception	QTR	YTD	1yr	3yrs	5yrs	Since Inception
A Accumulation GBP	02/04/07	9.8	1.4	9.4	4.6	6.3	5.5
MSCI UK		9.4	1.4	8.2	9.3	7.9	5.4

Performance beyond one year is annualised.

12 Months to	Jun-18	Jun-17	Jun-16	Jun-15	Jun-14
A Accumulation GBP	9.4	30.1	-19.6	3.5	14.7
MSCI UK	8.2	16.7	3.4	-0.2	12.3

Source: Sanlam FOUR, Morningstar and Lipper as at 30/06/2018.

Past performance is not an indicator of future performance.

Market Recap

Following the correction in markets in the first quarter, the second quarter has broadly been one of tentative recovery and consolidation, notwithstanding several negative influences.

Further policy tightening by the US Fed (both higher short term rates and the unwinding of QE) has been an important influence on markets, prompting a rally in the dollar and causing US 10 year bond yields to briefly exceed 3%.

In Europe, the main negative drag has come from renewed political tensions following the election of a radical anti-EU government in Italy, and the widening scope of Trump's trade policy, with escalating tit-for-tat tariffs starting to have an impact on corporate confidence.

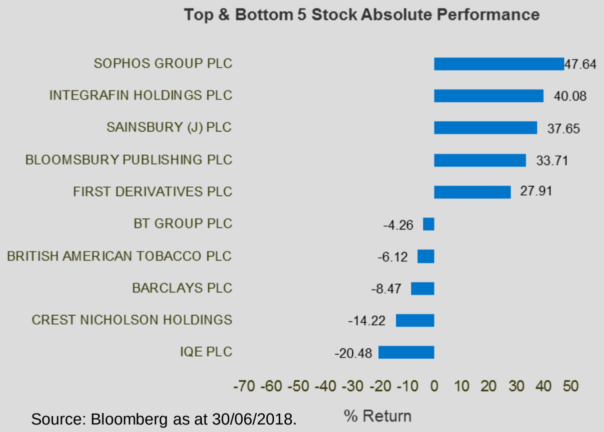
The Chinese market has undoubtedly seen a trade related deterioration in sentiment, but also as the effect of earlier policy shifts to restrict credit growth have started to be felt.

Finally, emerging markets in general have suffered from concerns that dollar strength undermines their financial position (some countries have high levels of US dollar denominated debt) and they are viewed as the main losers from shrinking dollar liquidity.

Against this backdrop, the UK equity market has been surprisingly resilient, rallying sharply in April and early May, followed by a modest consolidation in the remainder of the quarter. Furthermore, investors seem unfazed by the fact that Brexit negotiations have made no meaningful headway. Positive influences have been the US dollar rally benefitting overseas earners, a higher oil price supporting the oil majors, and, ironically, sluggish growth possibly postponing any interest rate increase.

As was remarked last month, this volatile and confusing macro-economic and geopolitical environment has made for some erratic sector moves, leaving company specific factors as the main driver of returns. Food Retailing has been by far the best individual sector on the back of the Asda deal and more generalized sector recovery hopes lead by Tesco, although Oil & Gas also performed strongly on the back of oil price strength. On the downside, Financials and Telecommunications have under-performed, the latter reflecting poorly received results from both BT and Vodafone.

Performance Attribution



Source: Bloomberg as at 30/06/2018.

The fund's modest outperformance stemmed largely from stock selection with Sophos, ITV, Bloomsbury Publishing and Integrafin all beating expectations. The first two are situations where market confidence had wavered recently, so good results were reassuring. The latter two are new holdings, purchased n the belief that the market valuation failed to recognise the growth rate and quality of the businesses.

Sainsbury also deserves a mention, with the shares gaining following announcement of the deal to buy Asda. Management (and analysts) predict substantial cost savings and buying synergies, while the consolidation in the sector should also lead to more disciplined pricing generally.

A partial recovery in Paddy Power Betfair is another notable event, which is well positioned to benefit from the US's lifting of the ban on sports betting and consequent opening up of this potentially vast market for legal sports betting.

Conversely, two stocks have been significant detractors, namely IQE and Crest Nicholson. In the latter case this reflects the sluggishness in the housing market, particularly at the top end of London. That said, Crest's shares are extremely lowly rated on under 7x current year earnings offering a dividend yield of over 8%. IQE's recent weakness follows a stellar rise last year when the shares gained over 260%. Having peaked last November at 178p, the shares are now trading around 100p. Undoubtedly the price high was excessive in the short term; indeed, we sold a substantial amount into the rally. However, this quarter we have added to our holding again as we believe the company's high growth prospects are being falsely questioned.

Finally, relative performance was also negatively impacted by the good performance of a handful large companies that are not held, most notably Diageo, Tesco and Astra Zeneca.

Key purchases

- **Micro Focus**: this software company manages mature IT enterprise systems. The business is highly cash generative, providing a high return and pay out to shareholders, as well as an ability to fund acquisitions. Last year's major HP Enterprise business acquisition has proven more difficult to integrate than expected, prompting a sharp fall in the shares in March. We believe this presents an excellent buying opportunity.

- **XP Power**: this company designs and sells electrical power controllers to major blue-chip OEM's in the industrial, healthcare and technology sectors. Historically a distributor of third party equipment, their close customer relationships have allowed them to develop their own highly successful design and manufacturing business.

Other investments in the period included our significantly increased holding in Integrafin, owner of the Transact investment platform. This business is gaining market share in a growing market and benefits from recurring revenue and thus a high quality of earnings growth.

There were no outright disposals in the quarter but we took partial profits in Sainsbury's following news of the Asda deal, cut our Vodafone holding down to a neutral position, trimmed Royal Dutch Shell following oil price strength and reduced BAT (switching additional funds to Imperial Brands).

Market Outlook

Notwithstanding the partial recovery in most markets in the last quarter, there has been no return to the bullish market sentiment prevailing at the start of the year, with many negative risk factors currently overhanging markets. Fed monetary policy will continue to tighten liquidity for the foreseeable future, although the ECB and Bank of Japan remain more supportive of growth. Furthermore, simplistic interpretations of the flattening yield curve are not necessarily a fair indication of deteriorating growth prospects provided that inflation remains modest and policy responsive to macro news.

The new market bug-bear is the escalating global trade war waged by Donald Trump, which has turned out to be much wider than simply targeting China, and is now in grave danger of derailing business confidence. Given Trump's impulsive, unpredictable and irrational approach to policy setting, markets face real uncertainty as to how events will unfold.

Against this backdrop, markets might remain volatile, but, for the time being, so long as global growth is intact and recession risks still low, the line of least resistance for equities is upwards.

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Important Information