HAVELOCK
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HAVELOCK GLOBAL SELECT

FUND PERFORMANCE

Cumulative Returns

1 Month	YTD	1 Year	3 Years	5 Years	Since Launch
-1%	4.6%	14.6%	20%	48.7%	56.1%

Calendar Returns

Year	Q1	Q2	Q3	Q4	Annual
2019	6.2%	2.9%	1.9%	3.5%	15.3%
2020	-20.9%	13.9%	1.7%	11.8%	2.4%
2021	11.0%	2.8%	2.4%	-1.4%	15.2%
2022	1.9%	-4.7%	-4.6%	14.3%	5.9%
2023	3.4%	-3.0%	-0.1%	9.6%	9.8%
2024	2.6%	-0.7%	2.6%		

This performance information refers to the past. Past performance is not a reliable indicator of future results. This information is denominated in GBP: returns may increase or decrease as the result of currency fluctuations.

FUND DETAILS

Fund Size	£184M
Fund Manager	Matthew Beddall
Fund Structure	OEIC (UK UCITS)
Fund Domicile	UK
Launch Date	21st August 2018
Base Currency	GBP
ISIN	GB00BFM7DN78
SEDOL	BFM7DN7

The Key Investor Information Document (KIID) and prospectus are available in English from:

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COMMENTARY

The fund's unit price increased by 2.6% during the third quarter, taking the total increase in unit price to 4.6% for the year-to-date and 56% since inception of the fund.

Most of the excitement in markets in the past quarter came in August, when the reversal of currency carry trades appeared to "crash" Japanese financial markets. I penned a thought piece on this at the time, and so will avoid repeating it here. For me, it served as a reminder of the fragility of the status quo in markets as when there was a rush for the exits, liquidity was nowhere to be found.

The Federal Reserve made their much anticipated rate cut at the end of the quarter. I can't help wonder if the decision was ultimately made because they were as bored as me of the endless speculation about when it would happen. Then again, probably not!

I make light of the Fed's decision because our approach is to focus on the long term and not get drawn into forecasting macroeconomic factors. I believe that much of the future is unknowable, and hence that our energy is best spent understanding the businesses that we invest in. What I would say is that I expect the future to be as highly varied as the past. I believe that the more you understand about market history, the less inclined you are to think that you know what is around the next corner.

Is passive investing creating opportunity for value investors?

The evidence is that the average active fund has produced disappointing results for investors. This means that to be an active fund manager you either need to believe that you are better than average or brazenly ignore reality. Not being one to put my head in the sand, I spend a lot of time thinking about our sources of "edge" that I think make us better than average.

For us to deliver outperformance, this edge needs to be big enough to cover the fees that we charge, as it is the combination of edge and fees that determines if a fund has "alpha". The fact that the average active fund has historically underperformed passive equivalents, is as much a reflection of fees being too high as it is managers struggling to "beat the market" with their investment decisions. It is this thinking that informed our decision to cap the fees that the fund charges.

The disappointing record of active management is rationalised in the academic community with the "efficient market hypothesis". This is the idea that all available information is rapidly assimilated into market prices, such that beating the market isn't just hard, but is impossible. The theory relies on lots of information wonks diligently reading annual reports, and the like, such that share prices immediately reflect their collective wisdom.

Whilst I don't believe the efficient market hypothesis to be true, it is a good approximation.

Where the argument for markets being efficient gets interesting, is that as more money flows to be invested passively, there will be fewer people crunching the numbers. This then means that prices should be less representative of "all available information", making it is easier to have an edge.

The famed "quant" Cliff Asness recently penned an opinion piece[1] where he makes the case that markets have become less efficient. Asness specifically states the case for there being more opportunity to profit from value investing, based on evidence of market prices being more disconnected from underlying corporate results. He puts forward three possible reasons why this might be so:

1) The rise of passive investing.
2) Very low interest rates.
3) The negative impact of technology (or "gamification" of markets).

His view is that it is actually the third of these that is driving a reduction in market efficiency, and the quotes I provide below are my attempt to give you a succinct summary of what he wrote (the emphasis is my own).

"Imagine some fraction of the market passively hold the index and the rest are active traders/investors trying to outperform. Now divide this active group in two (this is the obnoxious part). One group are sharks, the other minnows. Minnows make bad decisions based on emotion, story, tastes that are not relevant for risk and return, and behavioral biases. Sharks outperform by taking the other side of the minnows' misguided positions. Well, <u>if indexing has grown, whether this has made markets more or less efficient comes down to whether more sharks or more minnows moved to indexing</u>. If more sharks have moved, the remaining sharks should have an easier time making money over the long term as there is less competition in betting against the minnows, but the minnows have more influence than they used to at the short to medium term. Prices are a dollar-weighted average of opinions, and if a larger fraction of this is misguided, so will be prices."

[1] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4942046

"I think the rise of indexing and the super low interest rates of the last 10-15 years may have had exactly this effect (more crazy, and crazier, minnows, fewer rational G&D [Graham & Dodd[2] / value] disciples), but I conjecture that's a relatively small part of the story. I'm far more certain that social media, the overconfidence that come when people think all the world's data is at their fingertips, and gamified, fake-free, instant, 24/7 trading has done so in a significant way.

"Put simply, it should be more lucrative for those who can stick with it [value investing] over the long-term, but also harder to stick with. More lucrative seems obvious. If the rational active investor makes money from the minnows making errors, then they should make more if those errors are generally bigger. But, it also seems obvious that it's harder to actually do. The periods of underperformance will be more severe and last longer."

Whilst this story clearly "suits my book", it also resonates with what we observe. After six years of running the fund, I am more convinced than ever that "time horizon" is one of our major sources of edge. This is as much about focusing on the likely long-term earnings power of a business, as it is about owning them for extended periods.

I believe that many corners of the market are increasingly short-term, and not driven by a rational appraisal of fundamentals. This creates opportunity, but as Asness says, trying to capture it makes for an uncomfortable ride. In order to stay the course, you have to have done enough homework, otherwise the first bump in the road will leave you wanting to capitulate.

By way of example, one of our holdings went up 54% during the last quarter, only to fall back by 26% in the final week. Without getting into the weeds, it is hard to see that this level of volatility was justified by the news coming out of the company, with management reaffirming their guidance for full year profits. It is however a company with a relatively high level of retail ownership, and we believe that this price action has been driven by these folk more than the professionals who own it.

Although I give an extreme case, we often see a level of stock price volatility that appears disconnected from any reasonable interpretation of the facts. I believe that this is because of the dominance of people who aren't acting based on long-term fundamentals.

Clearly my views, and those of Cliff Asness, argue in favour of fundamentals driven value investing having at least some weight in your portfolio. I increasingly view it as a "time horizon arbitrage", but this means that you need to be willing to judge the results based on years and not months.

Portfolio Update

As of the end of the quarter the top five contributors for the year to date were Future (a UK publisher), Newmont (a gold miner), Berkshire Hathaway (the famed behemoth), TP ICAP (a financial intermediary), and Nippon TV (a Japanese broadcaster). The five largest detractors were Warner Bros Discovery (a media company), Teleperformance (an outsourcing business), Verallia (a maker of glass bottles), Rohm (a semiconductor manufacturer) and Argonaut Gold (a gold miner). As a reminder I limit a detailed performance commentary to just twice a year, so as to not be drawn into discussing short-term market volatility.

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[2] Ben Graham and David Dodd wrote the definitive value investing book *Security Analysis* in the 1930s.

There was a reasonable amount of turnover in the quarter, due in the main to a combination of introducing a large new core holding, continued activity amongst our UK special situations investing, and several new and diversifying asset-based opportunities. Although there are considerable benefits of inactivity in investing, we will act when we believe it is justified by a shifting opportunity set, which is where we have found ourselves.

Core Holdings

We introduced a significant new holding this quarter, Teleperformance, which is a French listed "customer experience" business. In simple terms this means that it operates outsourced call centres, but it has diversified beyond this to provide "omni-channel" support, via email, chatbots, and WhatsApp. The company was a past stock market darling, with a price earnings ratio of more than 50x in 2021. Since then, it has de-rated to an historic ratio of 9x, and a prospective ratio of just 6x this year's expected earnings. This is in a large part due to fears that generative AI will disrupt its business.

We believe that the immediacy of the impact of AI on Teleperformance's business is being over-estimated, in part because of their track-record of adaptation, and the fact that they are already experimenting with it. It has historically been very cash generative, with a large number of blue-chip clients, and hence we view it as a quality business with a strong incumbent position. It seems likely that it will however face margin pressures, but we feel that this risk is already reflected in the current market price.

We sold the fund's holding in Dunelm during the quarter. It is a business that we have come to know and like, with an impressive track record. The decision was entirely based on our view of its intrinsic value, and a belief that there was better value to be had elsewhere. The sale funded the purchase of another UK listed retail business, which is a niche luxury goods retailer. This company has a strong track record, with sales having been surprisingly resilient during previous downturns. We felt that it represented an attractive opportunity based on the purchase price, their dominant competitive position, and a credible strategy for delivering further growth.

We also sold our holding in the shipping company Moller Maersk. It is a holding that we believe represented good value, but on reflection I felt that our thesis for owning it was weak, and hence that it was a relatively low conviction holding. As a consequence, I felt that the capital could be better deployed elsewhere.

Asset Based

We introduced three new holdings that each represent a claim on scarce resources. Given the relative unpopularity of these types of businesses, we see them as both attractively valued in their own right, and believe that they can provide a hedge against loss of purchasing power. In a world that is awash with government debt, I see a risk of currency debasement being used to bring it back to more manageable levels. They complement existing holdings, such as the gold miner Newmont, and form part of our strategy to want to be "robust in a range of scenarios".

The first of the three is a US natural gas producer, the second an investment vehicle that owns a stock of uranium, and the third an owner of agricultural land in Asia. In all three cases we see a clear argument for growing demand and or shrinking supply, such that we see evidence of the commodity prices underlying each to be subject to asymmetric pricing pressures. I think it is important to view this not as us making "macro calls", but as an attempt to preserve capital in an environment where the consensus view appears to ignore the fragility that we think exists "beneath the surface" of markets.

We added Power Corporation of Canada into the portfolio, which is an investment vehicle that has large ownership stakes in several insurance related businesses. The businesses that it owns are attractive to us in their own right and mostly quoted public companies. That it is valued by the stock market at a discount to the sum of its parts, means that we view it as a situation where we are getting a "double discount" to become part owners of several decent businesses.

Special Situations

We purchased a holding in the US retail business, Victoria's Secret. The company has a strong brand and dominant market position, but is seen as having somewhat lost its way in the past few years. The business has recruited a new CEO, with a strategy to take the brand back to its roots by relaunching their annual show. She joins from competitor Savage X Fenty that was founded by the singer Rihanna, and she has a track record of growing fashion brands. We believe that we paid a fair price for the business in its current form and are receiving something of a "free option" on the turnaround being a success.

We purchased one small new Japanese holding, as part of our more general thesis around investing in cash-rich Japanese companies. The company constructs apartment buildings, and the cash and investments held on its balance sheet are such that almost no value appears to be ascribed to its actual business. As with all such Japanese situations we cannot know what the catalyst to "unlock" this value will be, but believe the direction of travel in Japan is such that we want to own a handful of such opportunities.

We completely sold the holding in the British chemicals business Johnson Matthey in the quarter. It has been a long-standing position, and arguably remains undervalued. We were disappointed to see that the company's CFO decide to leave whilst a turnaround is still underway, had grown more sceptical about the near-term demand for hydrogen as an energy source, and felt increasingly discomfort about its dependency on the automotive business. It was disappointing to sell the holding at a loss, but we set it against the risk of developing an unhealthy emotional attachment to long standing holdings[3].

We sold three UK midcap holdings, YouGov, H&T Group, and Puretech Health. Each had only a very small weight in the portfolio, and they were all purchased as part of our more general thesis that flows out of the UK stock market have created interesting value opportunities. Across all three we had made a slight profit, but they all represented something of a "side show" and so we decided to divest and redeploy the capital elsewhere.

US Exceptionalism and AI Frenzy

I finish by highlighting a couple of thought pieces that I felt were worth sharing. Not surprisingly both contain messages that align with my own views, and so my enjoyment of them is not without risk of being due to "confirmation bias". If your cup is already overflowing, then please stop reading now!

The US Hedge Fund, Bridgewater Associates, produced a good analysis[4] on the US stock market's outperformance in recent history. They show that the outperformance has been driven by a combination of revenue growth, margin expansion, and rising P/E multiples in roughly equal proportion. They then argue that these cannot be counted on to repeat going forward.

[3] https://thedecisionlab.com/biases/the-sunk-cost-fallacy
[4] https://www.bridgewater.com/research-and-insights/us-exceptionalism-drivers-of-equity-outperformance-and-whats-needed-for-a-repeat

They illustrate how the level of earnings per share growth priced into the US market appears demanding, versus that of other developed markets. The relevance to investors is that with the US now commanding a 72% weight in the MSCI index, and many portfolios heavily weighted towards it, it is worth knowing the level of earnings growth that you implicitly need to be "made whole".

The second piece[5] is from David Chan, who is an investor in AI, and a partner at the US venture capital firm, Sequoia Capital. He reasons as to what level of total AI related revenue is needed to justify the amount currently being spent on AI infrastructure. He does this by reasoning backwards from Nvidia's revenue selling AI chips. It appealed to me as it is an attempt to view the AI boom in an objective way.

He comes to a surprisingly sober conclusion given that he works in the heart of Silicon Valley:

"Speculative frenzies are part of technology, and so they are not something to be afraid of. Those who remain level-headed through this moment have the chance to build extremely important companies. But we need to make sure not to believe in the delusion that has now spread from Silicon Valley to the rest of the country, and indeed the world. That delusion says that we're all going to get rich quick, because AGI [Artificial General Intelligence] is coming tomorrow, and we all need to stockpile the only valuable resource, which is GPUs."

Just as I finished writing this piece, the head of the FCA, Nikhil Rathi, published a speech[6] describing why he expects heightened volatility in markets to be a constant, and how the rise of technology is feeding into this. I mention it as it is well aligned both with the opinion piece from Cliff Asness described above, and our concerns about the fragility of markets.

If you have made it this far thank you for taking the time to read the letter, and for your continued support.

Matthew Beddall
CEO, Havelock London

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[5] https://www.sequoiacap.com/article/ais-600b-question/
[6] https://www.fca.org.uk/news/speeches/predictable-volatility

IMPORTANT INFORMATION

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Investment Risks

The value of investments in WS Havelock Global Select (the fund) may fall as well as rise. Investors may not get back the amount they originally invested. Investments will also be affected by currency fluctuations if made from a currency other than the fund's base currency. Past performance is not a reliable indicator of future results.

Potential investors should not use this document as the basis of an investment decision. Decisions to invest in the fund should be informed only by the fund's Key Investor Information Document (KIID) and prospectus. Potential investors should carefully consider the risks described in those documents and, if required, consult a financial adviser before deciding to invest. The fund can invest more than 35% of its value in securities issued or guaranteed by an EEA state listed in the prospectus.

Performance Data

All performance information is for the A-Accumulation share class, which is the longest running share class for the fund. This performance information refers to the past. Past performance is not a reliable indicator of future results. This information is denominated in GBP: returns may increase or decrease as the result of currency fluctuations.

The data in this document is sourced from the fund accountants unless otherwise specified. The data used to calculate the price to earnings ratio is sourced from Bloomberg.

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