SOMERSTON ASSET MANAGEMENT

Somerton Multi Asset Fund (SMAF)

Investment Letter No.1 – July 2017

In its inaugural quarter, Somerston Multi Asset Fund (US0 class) returned 2.6%. Over the same period the MSCI World Equity Index (local currency) appreciated 2.7% and the Barclays Aggregate Bond Index was 1.5% higher. Through the quarter, the fund had average equity and bond allocations of 55% and 37% respectively. At the start of Q3 the fund increased its equity weight which stands at 71.1%.

Performance (%) US0 Class

	Jan	Feb	March	April	May	June	July	Aug	Sep	Oct	Nov	Dec	Year
2017				0.9	2.7	-1.0							2.6

Top Ten Core Equity Holdings 1 July

Name	% Fund
MasterCard	6.4%
Thermo Fisher Scientific	6.0%
Blackrock	5.9%
Cognizant	5.2%
Reckitt Benckiser	5.1%
Fresenius SE	5.0%
McKesson	4.7%
Nielsen	4.7%
Kerry Group	4.6%
Johnson & Johnson	4.4%
Top Ten	51.9%

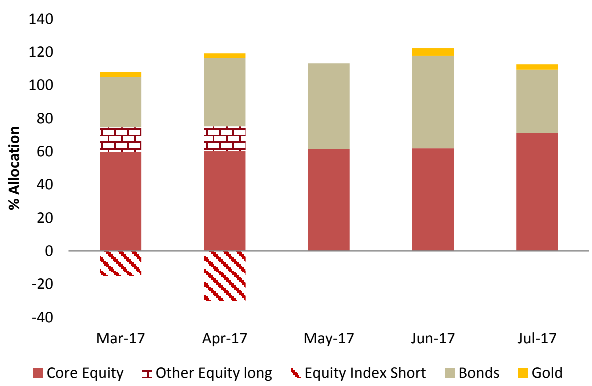
SMAF Asset Allocation - July 1 2017

Global Equity	71.1%
Government Bonds	38.3%
Gold	3.2%
Long Volatility	2.1%
Cash	-14.7%
Total	100.0%

Share Classes

	ISIN	Ticker	NAV
US0	JE00BDRXFP25	SOMAUS0	102.61
US1	JE00BDRXFQ32	SOMAUS1	102.45
GB0	JE00BDRXFM93	SOMAGB0	102.32
GB1	JE00BDRXFN01	SOMAGB1	102.16
EU0	JE00BDRXFR49	SOMAEU0	102.09
EU1	JE00BDRXFS55	SOMAEU1	101.94

Asset Allocation History



Each multi asset strategy comes with its own flavour and philosophy. Many of the most prominent Multi Asset Funds, which launched during the first bear market of the millennia, understandably have 'capital preservation' front and centre of the investment policy. Capital preservation is obviously a material tenant of any investment strategy, but while others put it as a first priority, Somerston Multi Asset Fund's primary aim is to deliver material growth in our investors' wealth. We do not view risk as an adversary, but as a partner.

We embrace opportunities without being overly concerned about the plethora of things that might, but in all likelihood, probably won't materialise. Our strategy aims to capture the major market moves, to invest with conviction and substance unless the weight of evidence implies there is a notable probability of a meaningful decline. Most of the time 'risks' masquerade as being high probability events where the greatest risk is being fooled that they are something more than they are.

That is not to say that we are overtly risk tolerant, far from it. One of the greatest opportunities to compound wealth is to avoid bear markets and re-deploy "dry-powder" at more attractive levels. Over the past 50 years, if at the beginning of the calendar year you had the foresight to know equity markets would end negatively, moved to cash and re- invested at the start of the next positive year, your investment would be 7x larger compared to a buy and hold strategy.

Compared to our peers, we have far greater flexibility to change asset allocation, minimising cognitive and behavioural biases by deploying a robust, systematic approach as a "compass" for asset allocation decisions.

The equity component of our strategy is a concentrated portfolio of high conviction, direct equity positions. We like to invest in companies with understandable business models with market leading positions which are hard to disrupt. Companies that are at the whim of their industry, with little power to influence their future, that are subject to unpredictable cyclical swings and subject to potential substantial disappointments through having concentrated client/product bases will be high risk investments, regardless of beta, volatility or valuation. We select companies with sustainable (not necessarily the highest) growth rates, and an ability to generate substantial excess cash flow. Ultimately, a company that can generate and re-invest excess cash at high rates of return, will compound value and deliver superior total shareholder returns.

As Investor's, we are faced by a wide range of uncertainties. The exactitude of many market participants' forecasts conveys a false sense of control. They are often as erroneous as the assumptions on which they rely. No analyst has the foresight to generate an accurate 12 month price forecast. Relying on these forecasts compromises potential returns by inadvertently masking risks or understating the possibility of upside surprises. We deal with uncertainties by establishing potential scenarios and assess both the probability and consequences of them happening. This develops a range of potential return outcomes we believe we should reasonably expect. In an effort to maximise risk adjusted returns, we invest in opportunities which have relatively acceptable downside and reasonable upside over the medium term. Opportunities with the greatest upside often have unacceptable downside and those with minimal downside often compromise returns.

MasterCard is our largest holding (6.4%). The majority of the World's payment transactions continue to be in cash and the opportunities to convert into digital payments remain substantial for both MasterCard and Visa. There is a lingering perception new technologies will disrupt the payment system. We have spent considerable time researching the threats. Many of the online 'wallets' use either MasterCard or Visa networks to process payments (including PayPal). While there is a 'brand' threat by not using a 'card' with the MasterCard logo, the increase in volumes of transactions is a net positive. Global payments through the MasterCard and Visa networks are largely frictionless and 'safe'. Replication of this infrastructure is almost impossible to imagine however, block chain represents a viable alternative technology and poses a not insignificant threat. MasterCard is investing heavily in its own block chain technology to manage this risk and the parallel potential advantages it might bring to its existing network.

ThermoFisher is the second largest holding (6.0%). It is the cornerstone of advanced clinical research providing much of the equipment and technological processes required to undertake cutting edge pharmaceutical and life science research. The acceleration in life science research and adoption of new biological drugs is unlikely to abate with increasing longevity. Thermo is the market leader in these areas with 70% of its revenues coming from consumable products used in the equipment they sell. These revenues are recurring in nature making the business highly defensible. Management have been very good capital allocators and have made insightful and highly accretive acquisitions that have enhanced their range of product and service offerings and strengthened their networks.

Blackrock is our third largest holding (5.9%) and our only financial company in the portfolio. Most of the asset management industry is under severe margin pressure from seemingly perpetual increases in regulatory costs and investors' growing preference for passive, lower fee products. Ishares is the largest passive ETF asset management group in the world. Of Blackrock's $5.1 trillion of AUM, 62% is in passives and of the total $200 billion in net inflows in 2016, 70% was towards passive investments. Blackrock's dominance in the passive space, its leading edge risk management technology and innovation makes Blackrock one of only a few asset management companies to be boasting strong organic growth with improving margins.

Markets are driven by changes in perceptions of growth, credit, inflation and interest rates. Surprises to widely held expectations induce large allocation changes which cause price volatility. In such circumstances, where we assess the probability of an adverse market outcome to be beyond our threshold, we will actively reduce exposure to our preferred asset class of equities, recognising other asset classes and sectors are likely to flourish and they should constitute a large part of the portfolio.

Notwithstanding the spectre of geopolitical risks, which presently appear to be elevated, right now the most important market dynamic is the 'rate of change' of bond yields. After President Trump's election we saw yields rise rapidly in response to higher inflation expectations. The hope for reform transpired to be overstated, at least for now, but rapidly rising bond yields caused rotation away from Growth and Quality stocks to Value stocks largely represented by financials and commodity sectors. A 'balanced portfolio' of Quality/Growth stocks and investment grade bonds materially underperformed during the post Trump election period. Should inflation pick up in a genuine and substantial way, accompanied by rapidly rising bond yields, we would expect similar rotation to reassert itself. We see this as a low probability event.

In the last week, there appears to be a coordinated Central Bank change of attitude with the Bank of England, ECB and Federal Reserve, changing their language from 'accommodative' to 'tightening'. The respective economies are facing very different dynamics. In the UK, there are signs of inflation and an absence of real growth. This is causing real wages to fall, giving the Carney cause for concern. High inflation in the UK is largely temporary; a result of the fall in Sterling since the Brexit vote. Sterling has since stabilised and we would expect inflation will ameliorate in the next 6 months. Raising rates at this juncture would probably do little for inflation and could meaningfully harm real growth prospects, not to mention increase headwinds for an already fragile residential property market.

In Europe we have seen what appears to be the most notable change in language in the face of data, that while improved, hardly warrants tightening.

In the US, there are further signs of recovery and inflation, but even here, growth remains meagre by historical standards.

As we stand today, we do not see a substantive rationale for materially higher yields nor do we see an excuse for Value to sustainably outperform Growth. High aggregate debt levels together with deflationary technological leaps forward are undermining genuine inflationary pressures. Real wages and capital investment remain at tepid levels undermining aggregate demand. The situation is not drastic but it is not great either and we prefer stocks that can do well irrespective of economic conditions.

Bond yields rising too fast would pose a material risk to asset values. The cost of capital would eventually erode cash flows and valuations would compress to reflect the higher risk free rate.

We anticipate yields to be range bound in the near term and we stick with a healthy allocation to high quality, reasonably valued stocks (71.1%), we hedge against deflationary risks through holding US and UK government bonds (38.3%) and we are modestly exposed to gold miners (3.2%) to reflect a low, but not immaterial probability that the reflationary trade may gain momentum.

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