SOMERSTON ASSET MANAGEMENT

Somerston Multi Asset Fund (the Fund)

Investment Letter No.9 – June 2019

The Somerston Multi Asset Fund (US0 class) returned +5.0% in the second quarter. The MSCI World Equity Index rose by +3.6% during Q2 and a composite of UK, German and US Government bonds increased by +2.4%. Our Composite Reference Index rose by +3.4% in the second quarter.

During the second quarter, the fund had average net equity and bond allocations of 60% and 58% respectively. The fund starts the third quarter with net exposures of 68% in equities, 63% in bonds and 19% in commodities.

Performance (%) US0 Class

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2017				0.9	2.7	-0.9	0.6	0.6	-0.5	0.6	-1.2	1.9	**4.5**
2018	4.8	-3.7	-1.0	-1.0	0.8	-0.2	0.9	0.3	0.0	-2.3	1.8	-0.4	**-0.2**
2019	1.1	-0.6	2.8	1.3	-1.8	5.6							**8.5**

Top Ten Equity Holdings

Name	**% Fund**
Fresenius Se & Co Kgaa	5.3%
Johnson & Johnson	4.8%
Rubis	4.4%
Reckitt Benckiser Group Plc	4.0%
Thermo Fisher Scientific Inc	3.9%
Alphabet Inc-Cl A	3.6%
Danaher Corp	3.5%
Kerry Group Plc-A	3.5%
Walt Disney Co/The	3.3%
Diageo Plc	3.1%
Total for Top Ten	**39.3%**

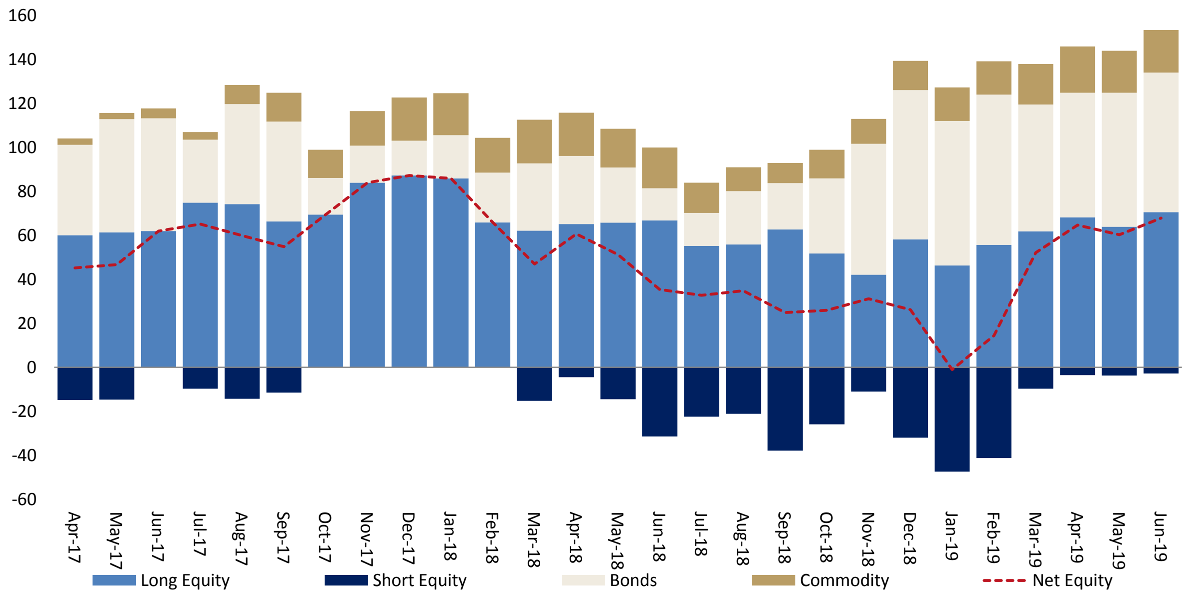
Share Classes

	ISIN	Ticker	NAV
US0	JE00BDRXFP25	SOMAUS0	109.7492
US1	JE00BDRXFQ32	SOMAUS1	107.8024
GB0	JE00BDRXFM93	SOMAGB0	105.6513
GB1	JE00BDRXFN01	SOMAGB1	103.7739
EU0	JE00BDRXFR49	SOMAEU0	103.0966
EU1	JE00BDRXFS55	SOMAEU1	101.2661

Asset Allocation

	Long	Short	Net
Long Equities	55.7%		55.7%
Long Emerging Markets	3.3%		3.3%
'Small Cap' Long Value/Short Index	2.8%	-2.8%	0.0%
Long Index futures	8.8%		8.8%
Equities	**70.6%**	**-2.8%**	**67.8%**
US Government Bonds	17.6%		17.6%
US Govt inflation linked bonds	16.2%		16.2%
UK Government Bonds	10.0%		10.0%
UK Govt inflation linked bonds	5.2%		5.2%
Euro Government Bonds	9.9%		9.9%
PIMCO Global Inv Grade Credit Fund	4.5%		4.5%
Bonds	**63.4%**		**63.4%**
Gold Derivatives	11.8%		11.8%
Gold Miners	2.7%		2.7%
Silver Derivatives	1.5%		1.5%
Gresham TAP Fund	3.4%		3.4%
Commodities	**19.3%**		**19.3%**
Long Vol fund	2.0%		2.0%
Total All Assets	**155.4%**	**-2.8%**	**152.6%**
Cash and Equivalents			**-52.6%**

Evolution of Asset Allocation for Somerston Multi Asset Fund



Performance

- The fund appreciated +5.0% in the second quarter.
- Equities contributed +2.5% to total performance.
- Our stocks outperformed by +1.8%. Okta (+49.25%) was our top contributor and Microsoft (+13.6%) and MasterCard (+12.4%) also put in noteworthy performances.
- In contrast, allocations to emerging markets and small cap value equities detracted -0.6%.
- Our bond book did well contributing +1.5% to total performance. Inflation Linked, nominal government and credit all performed strongly.
- Commodities contributed +1.2% with gold the notable standout.
- Relative value trades added +0.1%.
- Long Volatility positions lost -0.1%.

Outlook

Throughout 2018, we repeatedly warned of market repercussions from what we coined 'The Growth Tax'. We argued that a combination of rapidly rising interest rates, accelerating commodity prices and strong US Dollar that coincided with peak growth rates would cause disappointment. Those concerns proved to have merit. While we expected world equity prices to fall more than they did for longer than they did, we must remind ourselves that a series of back and fill actions of the past 18 months in response to these disappointments has led to world equities being flat over this time period.

The Financial market is a self-correcting mechanism. In contrast to the 'Growth Tax' concerns we had in 2018, falling growth rates, falling interest rates, low commodity costs and washed out investor sentiment is a 'Growth Dividend' and sets the stage for better times ahead.

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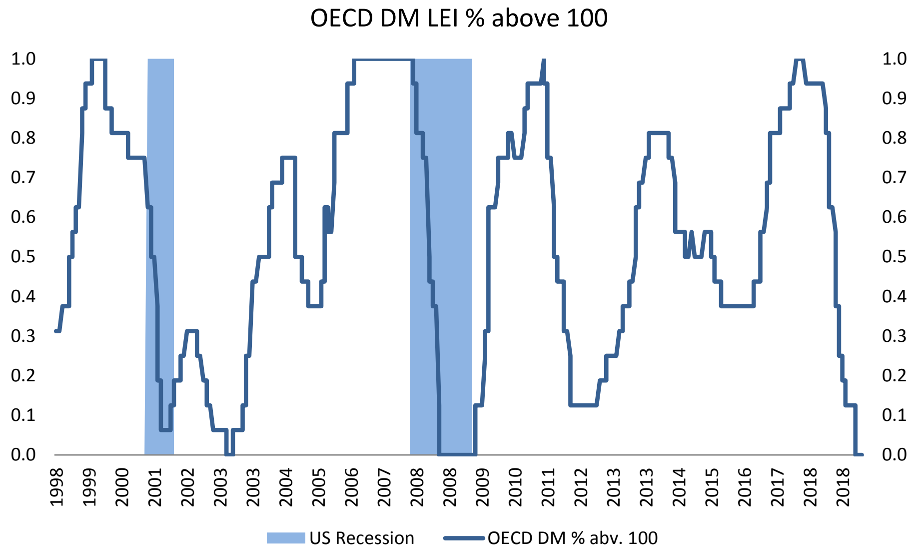
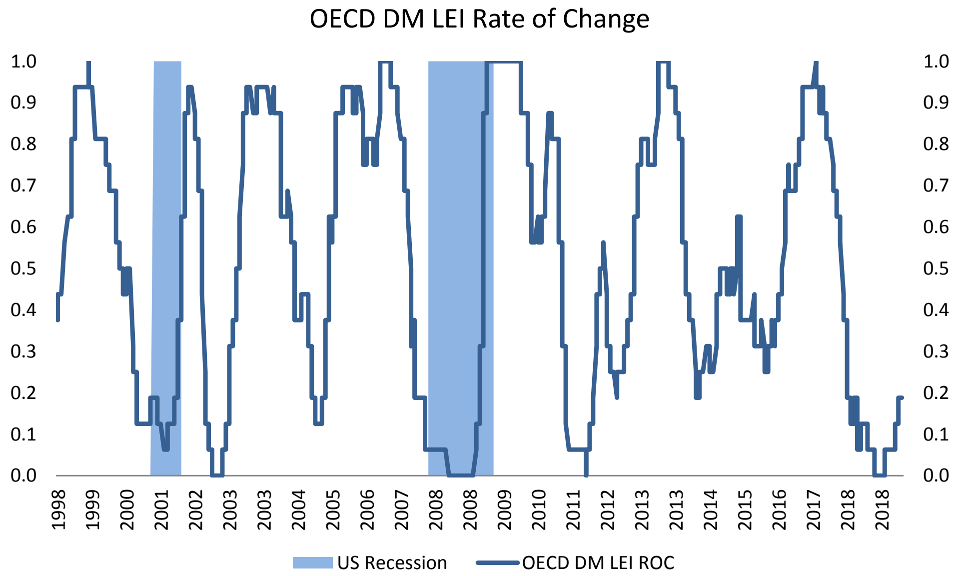
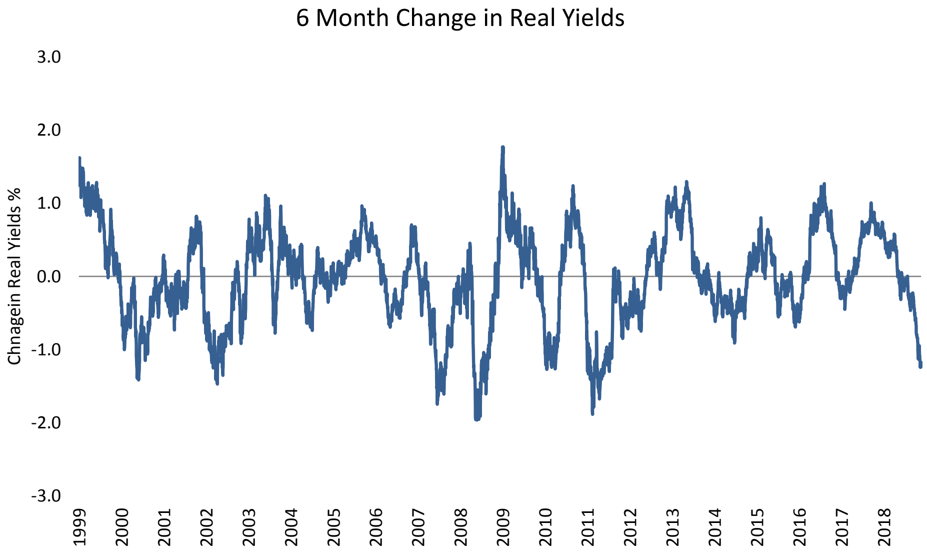
1. **Whereas in 2018 when growth was close to its peak with 100% of OECD developed market Leading Economic Indicators above 100, today 100% are below 100. This level is consistent with recessions. Markets generally put on their best performance when coming from these levels.**



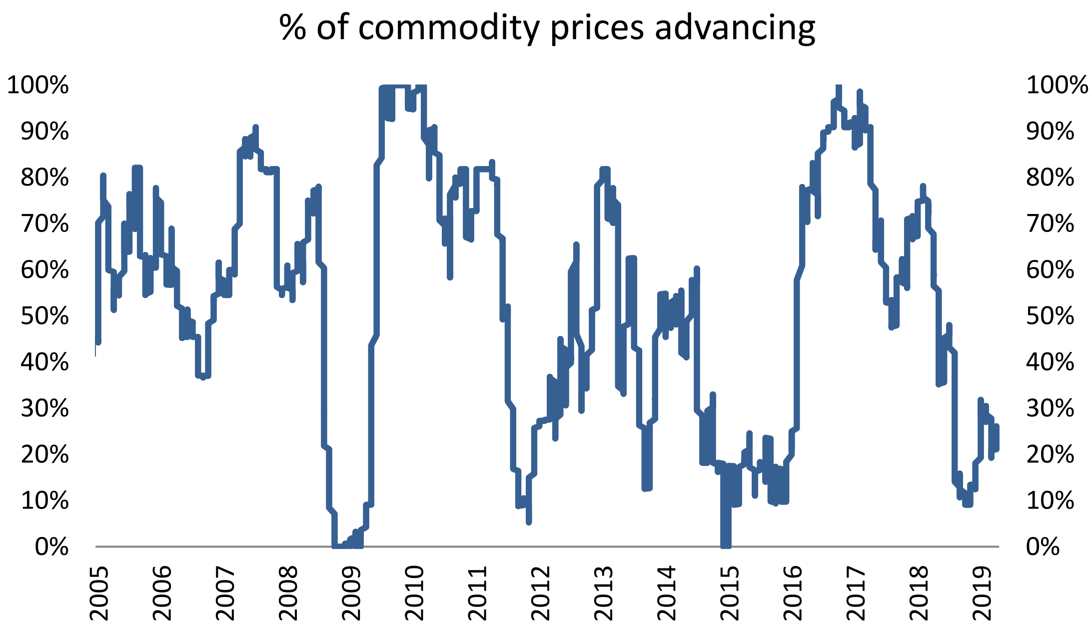
2. **Whereas growth was *decelerating* from its peak in 2017/2018, today it is becoming 'less bad' from its nadir.**



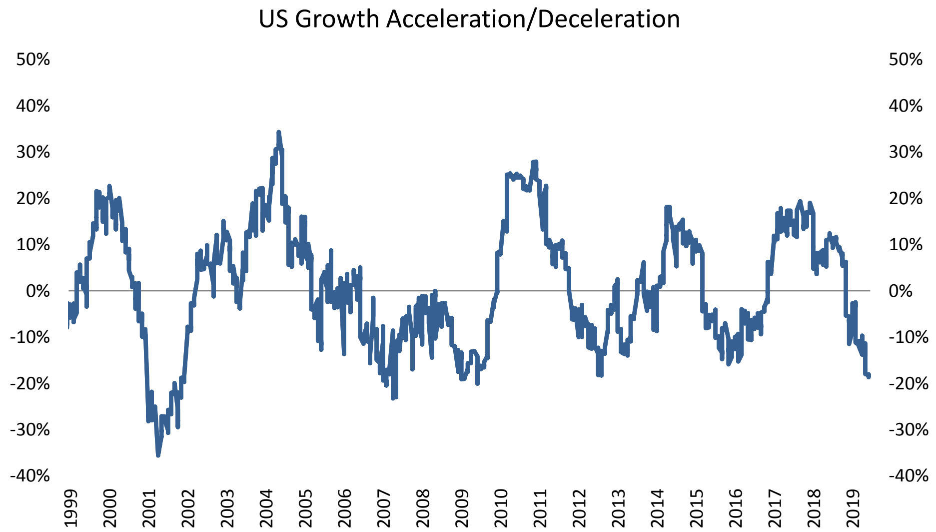
3. **Whereas real yields were accelerating quickly in 2018, increasing the cost of capital and lifting the discount rates, real yields have now collapsed, reducing the cost of capital and reducing the discount rate.**



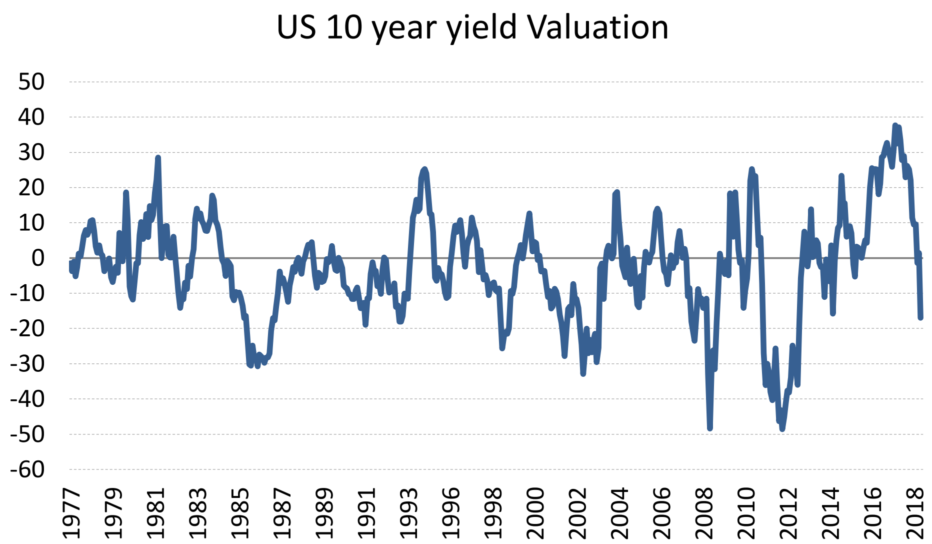
4. **Whereas commodity prices (and oil in particular) had risen significantly, increasing costs for all and reducing disposable income, this year commodity prices have fallen, reducing prices for all.**



5. **Last year, Central Banks had a tightening bias; today they have an easing bias.**
6. **Last year, the US was the strongest economy with the most hawkish Central Bank which led to a strong US Dollar. This year, US growth is slowing abruptly and the Federal Reserve will probably cut interest more than any other Central Bank. The combination of slower economic growth and faster rate cuts should lead to a weaker US Dollar. This will improve the cost of external debt and global US Dollar liquidity.**

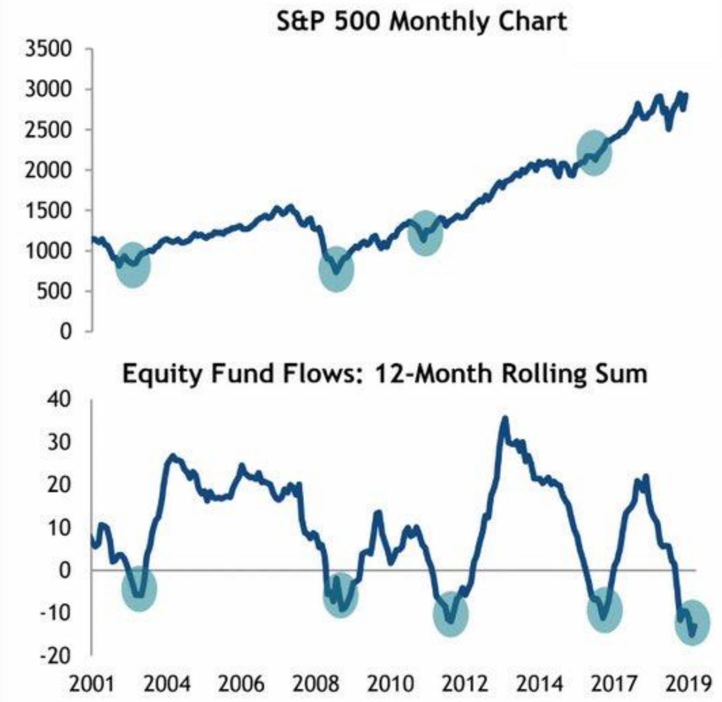


7. **Last year the US 10 year yield was above 3% and offered great value on our models. Today it is flirting with breaking down through 2% and appears a little expensive. The 'Great Rotation', a phrase banded around by the bulls in 2017and 2018, where investors sell bonds and buy equities, looks more likely today than it has for many years.**



8. **Sentiment is broadly negative and the market often does what it can to prove the majority wrong.**

Figure 1: Despite New Highs, Equity Outflows at Record



Data Source: Haver, ICI, SunTrust IAG; includes Mutual Funds & ETFs
Past performance does not guarantee future results.

We would expect equities to be 'cheap' at this stage of the cycle. They are not. The range of probable returns is therefore much reduced and risks are higher than they might otherwise be. However, the cycle is turning favourably with all the requisite hallmarks of better times 6-9 months out. Investors must look to what will be, not what it is. In the absence of an exogenous event, the environment for equities is shaping up favourably.

Accordingly, we continue to add to equities and reduce duration in bonds. Within US bonds, we see particular value in inflation linked bonds and 2 year bonds. Inflation expectations have fallen markedly in recent weeks. If growth resumes at the end of this year or early next, inflation expectation may rise again – especially if the US Dollar weakens. As many have already written, the US yield curve is very flat. The US 10 year bond now yields 2% whereas the 2 year bond yields 1.8%. The 0.2% pick up for 8 years does not seem particularly compelling!!

Our belief that gold serves a vital purpose in portfolios has not been particularly well rewarded until recently. Throughout history, there are periods where gold has been the best performing asset by far. If you think of gold as a very long dated, zero coupon, inflation protected, risk free asset denominated in US Dollars, it is no surprise that Gold does very well when nominal yields (the discount rate) fall faster than inflation and the US Dollar is under pressure! Moreover, gold has underperformed to such a large extent in the last decade, especially relative to money supply and indebtedness; it has the potential for significant catch up. We increased our allocation during the quarter.

In summary, we are bullish of equities. We expect US Dollar weakness to provide several opportunities in the months ahead, including emerging markets and value as a theme. We want to remain overweight bonds but selectively in Germany, US inflation linked and short dated US bonds.

We are taking our 'risk on' investments through equities, but within commodities we remain bullish gold.

Equity Review

- The core equity positions had a strong quarter in both absolute and relative terms.
- Total return of our core equity book was +5.4% vs MSCI World benchmark +3.6%.
- At quarter end the core equity allocation was 56% representing 83% of the total equity book.
- In April we sold our remaining position in AO Smith and increased our holding in Estee Lauder. We also switched our remaining holding in Cognizant into Accenture.
- In July, we took profits in Okta, Pepsi and Diageo. We shifted allocation to the value side of our equity book, topping up Rubis and Fresenius and also added to our position in Alphabet.
- Strong outperformance of the fund's Technology, Consumer Staples, Communication and healthcare companies was the principal contributor to outperformance.

Equity markets rallied, largely on the expectation of more supportive central bank policy and easing trade war tensions. As such, the cyclically exposed industries outperformed and our overweight allocation to the healthcare (+1.9%) and consumer staples (+2.9%) sectors weighed on performance. Financials was the top performing benchmark sector (+6.4%) and our underweight allocation was also a drag. Despite these headwinds, high quality growth stocks performed well and our equity basket comfortably outperformed the benchmark.

Our technology sector holdings were particularly strong; Okta (+49.25%) was our top contributor and Microsoft (+13.6%) and Mastercard (+12.4%) also put in noteworthy performances.

Okta is an industry leader (in cloud computing identity management), protected by significant barriers to entry from its dominant market position and leading AI technology. Its business model is asset and capital light, scalable and highly profitable; ROCE is 65%. Okta has a broad, diversified client base with thousands of existing customers. It generates recurring revenues, with a low monthly fee of just $1 - $8 per user, average contract duration of 2.5 years and high customer retention. In the fullness of time, we expect these characteristics to translate into a highly profitable, stable and predictable business. However, whilst we are excited by Okta's potential, we are conscious of the heightened uncertainty that comes with young, high growth businesses and limit ourselves to a very small position. Okta posted solid results during the quarter, with revenue growth accelerating to over 50% YoY, and the share price rallied hard as a consequence; we top sliced our position in July on valuation grounds.

Walt Disney was another top performer rising 25.8% during the quarter. Disney's Studio Division is booming and major investments into its parks have started to pay off, as they begin to attract a broader demographic. Most importantly, during the quarter Disney hosted its Investor day proving the first detailed guidance for its Direct-to-consumer strategy (Disney+ and ESPN+ Live streaming services). Lots of financial guidance and content details were provided, removing uncertainty which had been holding back shares. The market reacted positively to the prospect of a much more aggressive rollout, giving Disney a better chance of catching up with Netflix. Disney's World leading content, financial strength and box office monopoly are a huge competitive advantage for its streaming service. In addition, Disney are investing heavily in the ESPN+ offering to transform the way we view sports. We consider this is under appreciated by the investing community.

Alphabet (Google), was our worst performing stock (-8.0%) weighed down by disappointing results and increased regulatory risks. Revenue growth decelerated to 19% last quarter from a historic run rate of 22-24%, as developed market ad revenues disappointed. Google has been transitioning to AI driven advertising strategies, where-by they price ads based on their likely success and return potential. That improves the ROI for advertisers and improves Google's long term value proposition, but it is marginally negative for Google in the short term. At this stage, revenue deceleration looks most likely related to this transition rather than anything more sinister. In contrast to revenues, earnings were better than expected, other bets where less of a drag on profitability, cloud performed strongly and youtube continues to grow fiercely. The DOJ anti-trust investigation is another concern that has weighed on shares. The process will take many months or, more likely, years to come to any conclusion. With Alphabet shares falling c. 20% from their April high much is priced in and the share price looks cheap on any metric. Even if the DOJ investigation resulted in the company being broken up, the sum of the parts valuation on a stand along basis would be far higher than the share price is today - excluding its $113bn cash pile. Alphabet is the global leader in AI with access to more data than virtually any other company in the World. Its core business is stable with huge barriers to entry and its quality and sustainability is comparable to our quality peer group, which commands a valuation premium. Alphabet is more profitable than this peer group and is growing revenues and earnings faster. However, it trades at a steep discount on every metric we look at. We have increased our holding into recent weakness.

Reckitt Benckiser also disappointed, falling -2.6% during the quarter. Indivior, a company previously owned by Reckitt's, was charged by the US department of Justice for falsifying data on one of its opioid drugs. Reckitt's owned Indivior at the time, and fell -7.5% on concerns it may also be liable. However it looks like Reckitt's is protected by an indemnity clause and is co-operating fully with the DOJ and unlikely to be charged. We maintained our position and benefitted from the rally into quarter end but the shares still have some catching up to do. More recently Reckitts announced the appointment of new CEO Laxman Narasimhan; chief commercial officer at Pepsi. Laxman has transformational leadership experience and was responsible for the long term growth strategy and online sales platform performance at Pepsi. Fresh blood with the potential to shift gears in their e-commerce channel which has hampered growth has been positively received by shareholders. We are confident the new CEO will hasten Reckitts return to market leading growth but are somewhat unsettled by the potential for a margin reset as the company transitions. Nevertheless, we struggle to see how a c20% P/E discount to its peer group can be justified.

Fresenius SE fell 4.4% during the quarter. A combination of minor operational missteps, end-market uncertainty and investor panic caused Fresenius shares to sell off sharply over the last 12 months, and they remain out of favour. However the share price is now undeniably cheap on any metric. We struggle to understand how a high quality, defensive, diversified health care company like Fresenius, which delivers a persistent 5-6% organic revenue CAGR; can trade at such a steep discount to the market and over one standard deviation below its historic valuation levels. Whilst 2019 will be a year of investment and transition, expectations are now rock bottom and if management manages to demonstrate a return to historic stability the share price will re-rate materially higher, whilst downside risks are limited. Fresenius is our largest holding and we used the share price weakness to increase our position.

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