SOMERSTON
ASSET MANAGEMENT

Somerston Multi Asset Fund (the Fund)

Investment Letter No.14 – September 2020

The Somerston Multi Asset Fund (US0 class) returned +8.3% in the third quarter. The MSCI World Equity Index rose by +6.7% and a composite of UK, German and US Government bonds rose by +0.1% in Q3.

During Q3, the fund had average net equity and bond allocations of 64% and 26% respectively. The fund starts Q4 with net exposures of 65% in equities, 36% in bonds and 22% 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	0.7	0.6	-0.6	2.1	2.8	3.3	**18.5**
2020	-0.3	-5.9	-8.5	6.9	2.4	1.8	7.4	3.1	-2.2				**3.7**

Top Ten Equity Holdings

Name	**% Fund**
Johnson & Johnson	2.5%
Mastercard Inc - A	2.5%
Thermo Fisher Scientific Inc	2.3%
Alphabet Inc-Cl A	2.3%
Intuit Inc	2.0%
Walmart Inc	1.7%
Stanley Black & Decker Inc	1.7%
Procter & Gamble Co	1.7%
Nextera Energy Inc	1.7%
Amazon.Com Inc	1.7%
Total for Top Ten	**20.1%**

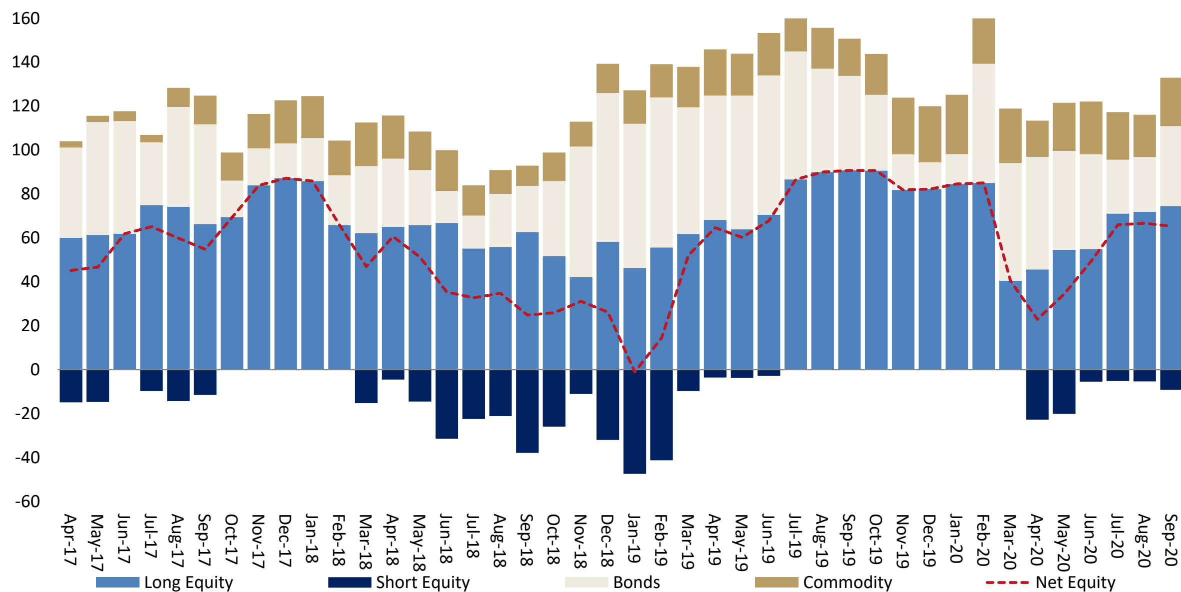
Share Classes

	ISIN	Ticker	NAV
US0	JE00BDRXFP25	SOMAUS0	124.2191
US1	JE00BDRXFQ32	SOMAUS1	120.8080
GB0	JE00BDRXFM93	SOMAGB0	117.2422
GB1	JE00BDRXFN01	SOMAGB1	114.0178
EU0	JE00BDRXFR49	SOMAEU0	113.6606
EU1	JE00BDRXFS55	SOMAEU1	110.5374

Asset Allocation

	Long	Short	Net
Core Equities	39.3%		39.3%
EM Equity index futures	14.2%		14.2%
Dev Market Equity index futures	14.2%	-9.2%	5.0%
Small Cap Growth ETF	6.8%		6.8%
Equities	**74.5%**	**-9.2%**	**65.3%**
US Govt inflation linked bonds	10.4%		10.4%
US Government 10 yr. bond futures	4.0%		4.0%
PIMCO Global Inv Grade Credit Fund	9.0%		9.0%
IShares Inv Grade Corp Bond Fund	2.7%		2.7%
UK Government 10 yr. bond futures	2.8%		2.8%
German Govt 10 yr. bond futures	2.7%		2.7%
German inflation linked bonds	4.9%		4.9%
Bonds	**36.5%**		**36.5%**
Gold Bullion ETF	11.7%		11.7%
Gold Derivatives	5.4%		5.4%
Gold Miners	1.5%		1.5%
Platinum Derivatives	1.3%		1.3%
Gresham TAP Fund	2.1%		2.1%
Commodities	**22.0%**		**22.0%**
Volatility	2.6%		2.6%
Total All Assets	**135.6%**	**-9.2%**	**126.4%**
Cash and Equivalents			**-26.4%**

Evolution of Asset Allocation for Somerston Multi Asset Fund



Performance

- The fund returned +8.3% in Q3 versus its composite reference benchmark which rose by +4.8% equating to +3.5% outperformance during the quarter.
- Equity selection outperformed adding +0.4% to outperformance.
- Bond selection outperformed adding +0.7% to performance.
- Commodities and precious metals added +2.4% to outperformance.
- Bond and equity allocation decisions cost 0.1% together.

Commentary

The fund's strategy has fared well in recent years. Not all decisions have been correct, but the better decisions have more than compensated for the less insightful decisions. Bond and commodity strategy has been very beneficial, long volatility strategies positively contributed during Q1/Q2, equity selection has been consistently robust, conversely, equity allocation decisions have not been as timely as we would have liked, in particular reducing exposure to mitigate risk during Q2 of this year. The diversification of strategies within the fund is as important as diversification of assets and is significant differentiator for the fund.

As it stands, the Fund's present allocation appears to lacks conviction at the top level - equity|bond|commodity - but we have far higher conviction within these asset classes. Within equities, we still favour growth but less than we did before, with a growing selective preference for the 'value' inherent in small caps and emerging markets. In bonds, we prefer credit and inflation linked bonds to 'benchmark government' 10 year bonds. In commodities we continue to favour precious metals. Once again, we are beginning to build positions in long volatility strategies to hedge risks we don’t even know about, let alone when they may manifest.

Outlook

Both the recession and recovery have been very atypical and we think this continues for at least another few quarters. Sectors you would expect to rebound at the early stages of recovery have largely remained in the doldrums, whereas the sectors that thrived in the downturn have also led the recovery. Looking forward, our base case is for continued economic recovery with a gradual broadening to benefit those areas that have been most severely affected. Of course, much depends on how bad COVID will be during autumn and winter and whether (and how long) companies can tolerate present conditions, or, as in the case of Cineworld in the UK, the pain has lasted too long and is too much to bear. In all likelihood the need to be selective remains as important as ever.

Liquidity appears abundant and while there will be 'hiccups' along the way as parliaments debate and argue the merits of particular actions, liquidity is likely to remain 'on tap' until there is firm evidence that the economic impact from Covid is firmly behind us. Nonetheless, we are concerned to see bank lending standards have tightened considerably and this needs careful monitoring. If the liquidity transmission mechanism gets blocked, even more radical measures to get money into the right hands will probably be considered.

The pace of digital adoption during this crisis has been astounding. Most industries and sectors have adopted practises which improves efficiencies and renders huge swathes of jobs entirely obsolete. Consequently, while we see employment conditions improve, we suspect that it will be a long time before employment returns to levels enjoyed prior to the crisis. Data is growing at an exponential rate and companies that offer data services, storage and analytics will continue to have addressable markets that seemingly grow bigger by the day. The 'bubble' vigilantes warn that this will come to an end and valuations will mean revert. While we certainly see pockets of wild speculation (such as the Snowflake IPO hitting a valuation of 120 x FY1 revenue on its first day of trading), the true economic excess cash flow these companies are producing is highly attractive. In time, we would expect competition to drive the excess returns lower, but there is no evidence that completion is rising at a fast enough pace. In fact, as the chart shows below, genuine and sustainable high growth companies are scarce and those that are able to demonstrate genuine growth opportunities are commanding premium valuations.

Of course, valuations are always 'relative' and with bond yields so low, one wonders whether the ultimate comparator will stay so unattractive and make everything else appear so attractive. There are certainly increased risks to bond yields but we consider authorities will provide 'yield compression' at the belly of the curve for so long as they can. Rising yields are not welcomed by governments whose debt burden is at historic levels and tax receipts are on the floor.

A major risk for financial markets is widespread deleveraging. History provides snippets of examples of what happens when leverage gets universally taken down and it involves a collapse in all asset prices: equities, bonds and commodities. With interest rates so low for so long, the desire to obtain leverage has been obvious, and debt levels are especially high in the corporate and government sectors. While we are not certain of events that would procure aggressive widespread deleveraging in the near term, and the associated fire sale of assets to reduce debt levels, a time will come when this becomes the most appropriate action. Authorities have continually encouraged risk taking in the past 25 years. This has natural limits and increasingly unconventional policies suggest that the end of this perpetual 'risk on' environment may be nearing an end. The timing of widespread deleveraging is incredibly difficult to know for sure but it is one of the most acute risks we face as there are few hiding places to preserve wealth. Since the launch of the fund we have allocated to long volatility strategies to hedge this type of risk. We took profits on this allocation on 1st April. We have now introduced that exposure back to the Fund. We have started with a modest exposure and expect to add over time as markets rally and complacency sets in.

In summary, we are not expressing any strong views on the relative attraction of the main asset classes themselves, preferring to express conviction within these asset classes. We continue to like 'growth' companies but expect selective 'value' sectors to slowly rebound as the economic recovery broadens out in the next few quarters and we are overweight emerging markets. Within bonds we continue to prefer inflation linked bonds and credit and in commodities we are overweight precious metals. The presidential election will introduce short term volatility but we have no ability to know more than the market in this matter. The ebb and flow of each candidates fortunes will be readily discounted by asset prices in the short term but the country's fundamentals will be little changed in the medium term.

Core Equity Strategy

Our core equity book rose +6.5% during the quarter outperforming the broad market by 0.4%.

Some of our top performing holdings were defensive businesses that are beneficiaries of the Covid pandemic. Both Thermo Fisher (+22%) and Danaher (+22%) are involved in hundreds of covid vaccine, diagnostic and therapeutic trials. Walmart (+17%) has shown it has mastered the online retail experience.

We remain underweight Energy and Financial stocks that continued to underperform.

The energy sector is weighed down by supply/demand imbalances, ESG exclusions and now the prospects of a green minded Biden presidency.

Persistently low interest rates, increasing competition and troubled loan books continue to suppress financials.

Our underweight allocation to both Energy and Financials has helped relative performance. The structural issues remain a hurdle for investment.

We are cognizant that vaccine progress or control of the disease could be a game changer for markets, potentially leading to a significant rally in those companies that lagged most this year and where we are underweight. We got a taste of this in September, when large tech companies rolled over. Declines at Apple, Amazon, Microsoft, Facebook and Google accounted for over 40% of the index decline during the month. The September rotation is a stark reminder of the speed at which market biases can revert and the need to maintain a healthy degree of portfolio diversification.

We have gradually added cyclical and value exposure to our book where we feel confident that these companies will emerge stronger in their industries. Stanley Black & Decker, Rubis and Enbridge were all growing sales and earnings steadily before the crisis and their share price declines now offer cyclical upside. Johnson and Johnson and Roche have suffered on the back of delayed elective procedures/prescriptions but they remain stable quality businesses that now trade at a discount to the market.

Despite our appetite to increase diversification as the pandemic hopefully hits a nadir, our equity book remains significantly overweight growth, technology and defensive companies. The risk of a

bad covid winter is high. Vaccine hopes are starting to fade and they are getting pushed back. Covid cases are spiking across Europe in particular. Regional and even national lockdowns are once again on the cards. Fiscal fatigue is also starting to bite. Newly announced job support schemes are less generous than those instigated in March. Small businesses PPP loans are expiring and whatever isn't forgiven will convert to regular loans. Central banks can only do so much.

None of this bodes well for economic growth or for value stocks that are most exposed to the economic strains and structural changes imposed by Covid. Growth stocks may have reached extreme valuations relative to value stocks, but growth remains scarce and uncertainty is high. When we factor in technology companies' superior growth, superior profitability and superior earnings visibility within our portfolio, the valuation premium does not look unreasonable.

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