Somerston Multi Asset Fund (the Fund)

Investment Letter No.22 – September 2022

The Somerston Multi Asset Fund (USO class) returned -4.6% in the third quarter. The MSCI World Equity Index fell by -4.4% and a composite of UK, German and US Government bonds fell by -7.6% in Q3.

During Q3, the fund had average net equity and bond allocations of 31% and 41% respectively. The fund starts Q4 2022 with net exposures of 28% in equities, 30% in bonds and 11% 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	-1.0	5.2	5.2	**13.6**
2021	-0.3	0.8	-0.1	2.3	2.5	-0.2	2.2	0.5	-5.1	5.2	-1.7	3.2	**9.3**
2022	-5.9	-1.1	2.6	-3.5	-1.4	-4.1	4.3	-3.8	-4.9				**-16.8**

Top Ten Equity Holdings

Name	**% Fund**
Pepsico Inc	3.4%
Nextera Energy Inc	3.2%
Walmart Inc	3.2%
British American Tobacco Plc	3.1%
Alphabet Inc-Cl A	2.4%
Thermo Fisher Scientific Inc	2.3%
Amazon.Com Inc	2.2%
Intuit Inc	2.2%
Adobe Inc	1.9%
Danaher Corp	1.8%
Total for Top Ten	**25.7%**

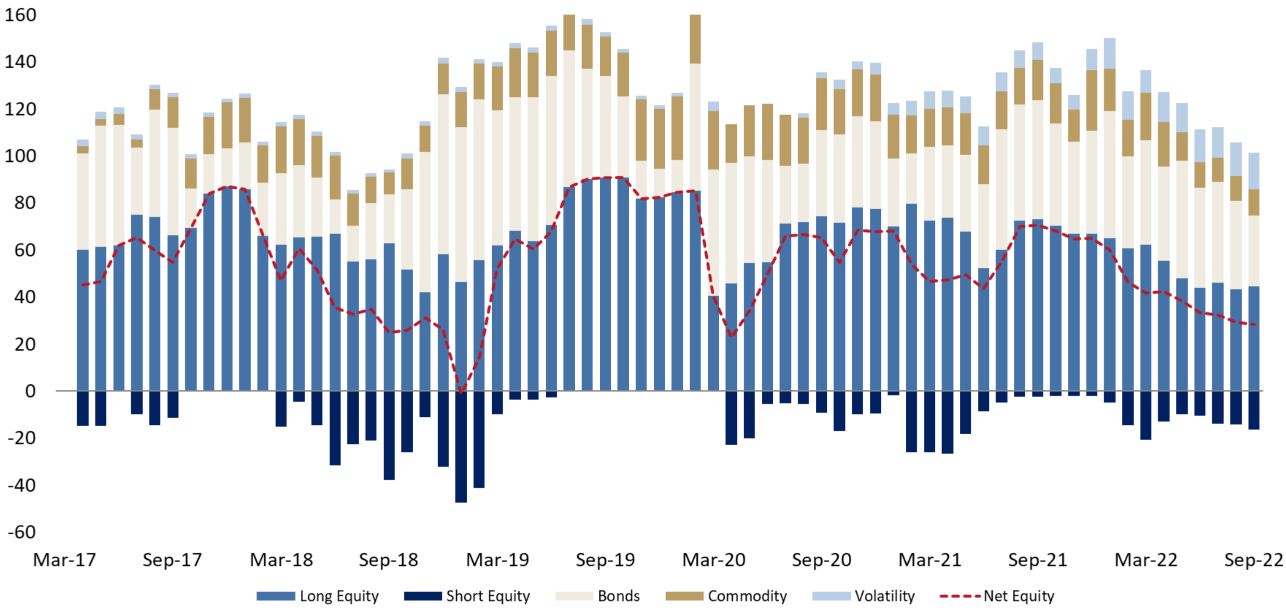
Share Classes

	ISIN	Ticker	NAV
US0	JE00BDRXFP25	SOMAUS0	123.6915
US1	JE00BDRXFQ32	SOMAUS1	117.6454
GB0	JE00BDRXFM93	SOMAGB0	114.8802
GB1	JE00BDRXFN01	SOMAGB1	109.2431
EU0	JE00BDRXFR49	SOMAEU0	109.4413
EU1	JE00BDRXFS55	SOMAEU1	104.0691

Asset Allocation

	Long	Short	Net
Core Equities	34.6%		34.6%
Developed Market Equities (US)		-6.8%	-6.8%
Developed Market Equities (EUROPE)		-2.9%	-2.9%
Emerging Market Equities		-2.4%	-2.4%
Real Estate Equities	3.5%		3.5%
Small Cap Equities		-4.3%	-4.3%
Defensive Equities	6.6%		6.6%
Equities	**44.7%**	**-16.3%**	**28.3%**
US Govt Inflation Linked Bonds	5.2%		5.2%
US Govt (+15yrs) Inflation Linked Bonds	5.7%		5.7%
US Government Ultra Long bond futs	6.8%		6.8%
US Government 10 yr. Bond	12.2%		12.2%
Bonds	**29.9%**		**29.9%**
Gold Derivatives	7.1%		7.1%
Gold Miners	6.8%		6.8%
Copper Derivatives		-2.6%	-2.6%
Commodities	**13.9%**	**-2.6%**	**11.3%**
Volatility and CTA	15.6%		15.6%
Total All Assets	**104.1%**	**-19.0%**	**85.1%**
Cash and Equivalents			**14.9%**

Evolution of Asset Allocation for Somerston Multi Asset Fund



Commentary

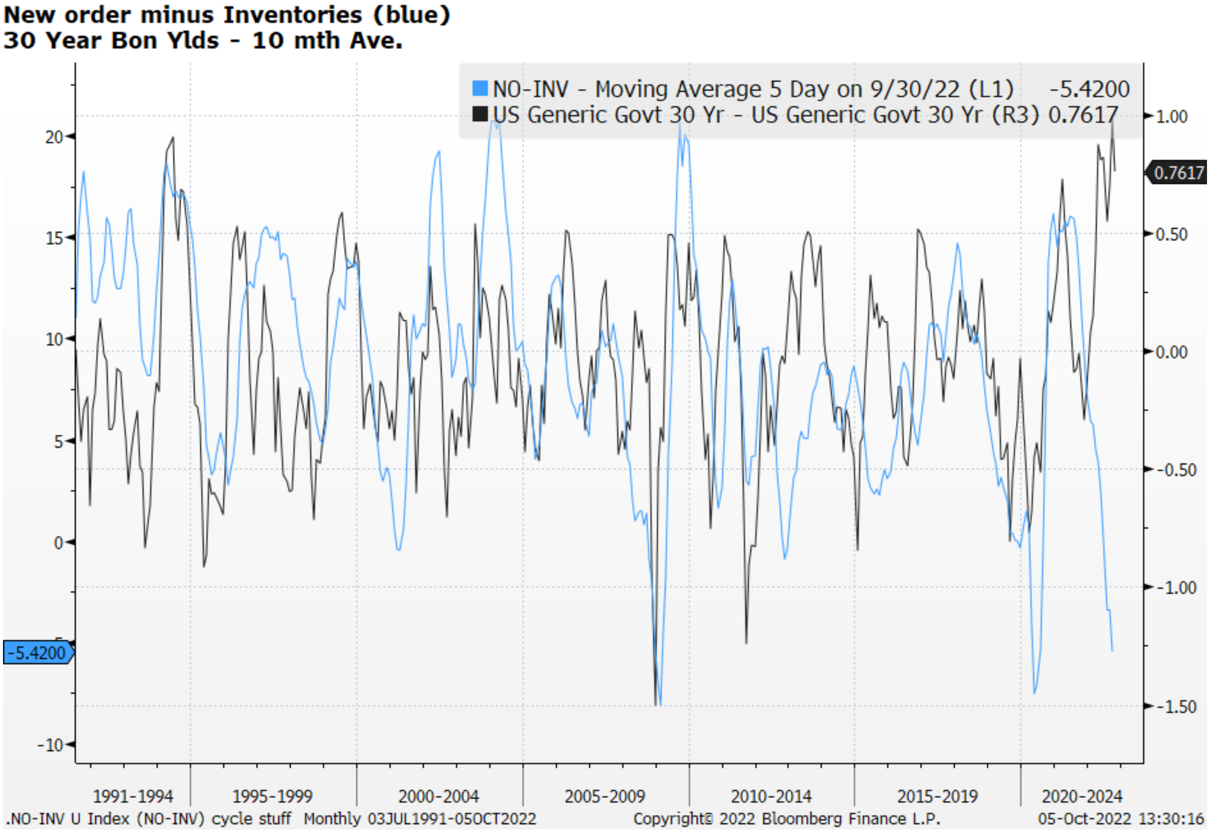
While we have outperformed a typical 70/30 Equity/Bond benchmark that is down 20.25% year to date, we would have expected a far greater degree of outperformance given our asset allocation. We have been largely underweight equities with a bias for defensives, we have held no credit risk preferring high quality US government debt, we held reasonable a position in gold bullion and made a decent allocation to strategies that benefit from volatility.

Certainly, being underweight equities has benefited the fund by 5.8% and exposure to long volatility strategies also drove outperformance of 2.4%. Gold has fallen modestly detracting 1% this year but the most acute and unexpected detractor has been the performance of government bonds which has detracted 2.2% on a relative basis and 7% on an absolute basis.

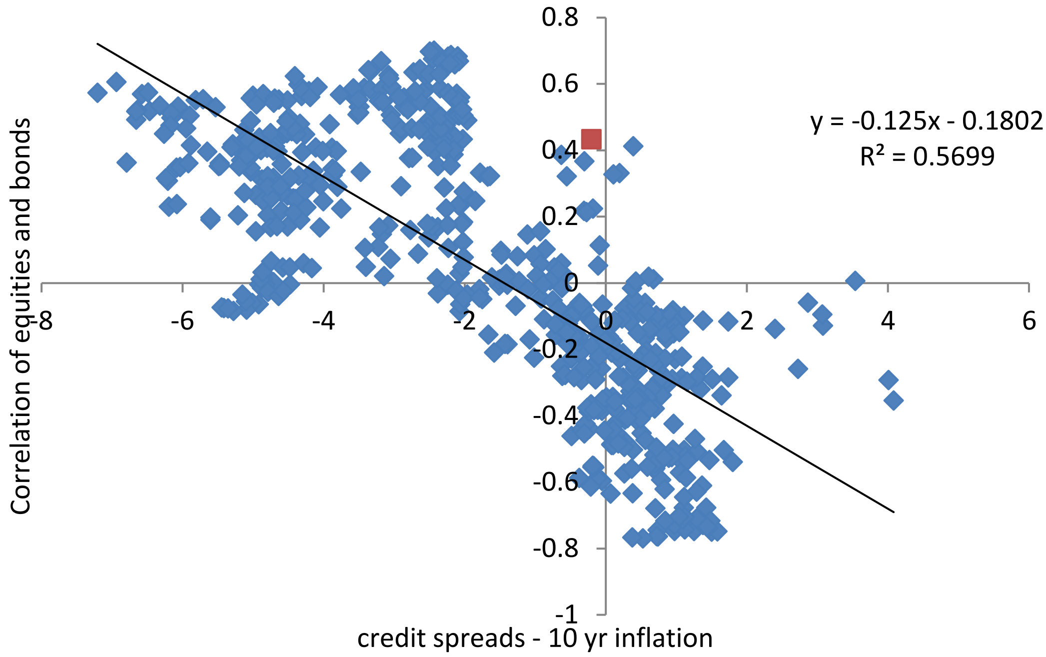
Low correlation between asset classes is the main benefit of a multi asset portfolio. Yet this year, Equities, Bonds, Precious Metals and Real Estate have performed in lockstep.

We have high conviction of the role for government bonds and we are drawn to their prospective returns. Firstly, the divergence between bond yields and leading economic indicators is becoming highly unsustainable. As an Example, chart 1 shows 30 year US government bonds are 0.76% higher than their own 10 month average (Black), yet the five month average of new orders relative to inventories is tumbling (Blue).

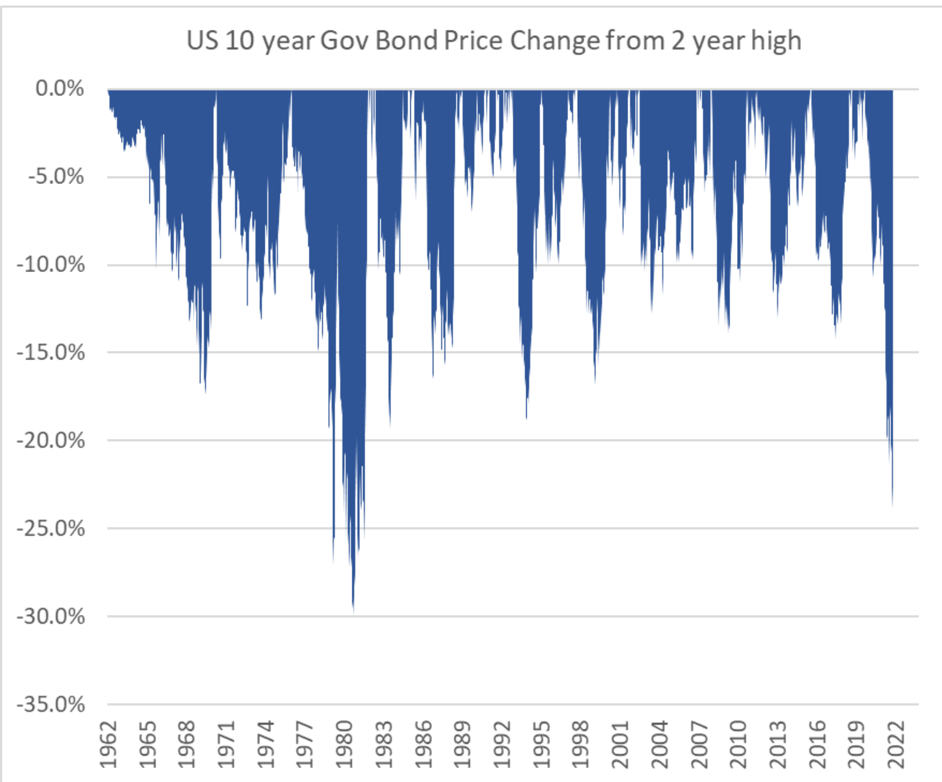
Chart 1:



Bonds hate inflation and love credit deterioration. Chart two covers data from 1972. It shows variability of the equity/bond correlation versus credit spreads minus long term inflation. The downward sloping line indicates that equity/bond correlations move negative when credit spreads are high relative to inflation. The red plot shows where we are today - credit spreads equal long-term inflation. Based on data since 1972, the equity/bond correlation should be -0.15, instead its +0.42. Furthermore, we expect inflation to fall and credit to deteriorate widening the gap between this relationship and equity/bond correlations even more.



Finally, on a price only basis, US 10-year Government bonds are 25% from their two year high. The second largest fall in history.

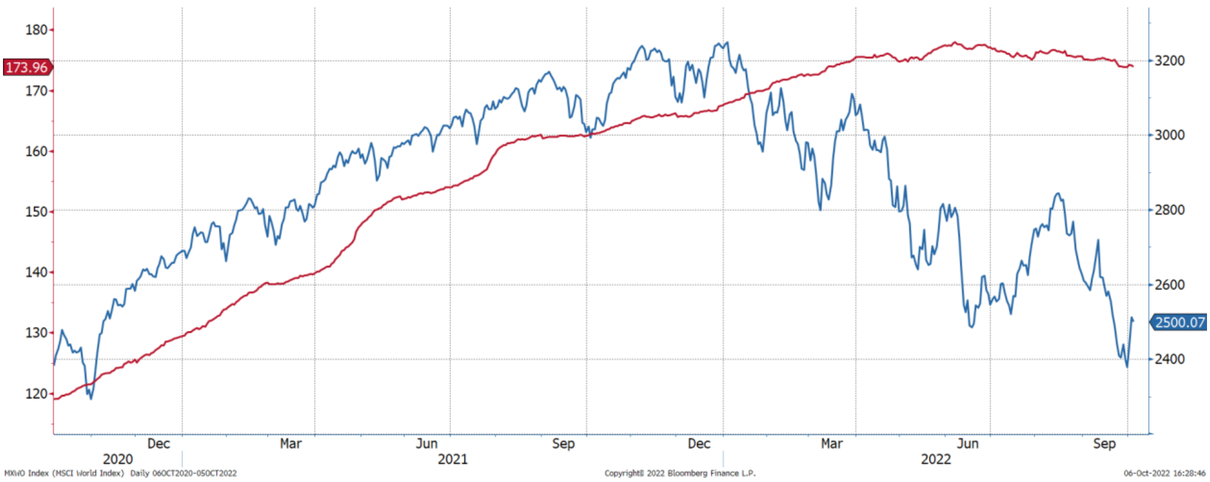


A combination of divergent fundamentals, strange correlation characteristics in the macro context and being deeply oversold, suggest that Government bonds are in for a better period, particularly versus equities. Moreover, that should benefit defensive equities, REITS and gold.

Core Equity

Equity markets started the quarter strongly on the back of a resilient earnings season and easing inflationary pressures. MSCI World Index rose 12% from July to mid-August but the summer rally was short lived. In August US core PCE Inflation exceeded expectations rising +4.9% YoY and spooked the market. Any hope that central banks would take a more dovish stance was then crushed at the Jackson Hole Summit with the FED delivering a clearly hawkish guide. The Fed, Bank of England, ECB and other central banks all raised rates during the quarter. Global equities plunged and following the weakest September in 20 years the MSCI World Index ended the quarter down -4.4%.

After a fall of -21.9% YTD, stocks have now derated to more modest levels reflecting higher discount rates. However, we are yet to see a meaningful deterioration in earnings expectations with forward projections for the next twelve months having fallen just -2.3% from their peak in June. As a result, equity valuations have moderated and the forward P/E of MSCI World is now 14.4x, over one standard deviation below its five-year average.



MSCI World Price: **Blue Line**
MSCI World 12-month forward EPS: **Red Line**

We expect the next phase of this equity bear market to be driven by a further deterioration in economic conditions and increasingly negative earnings revisions.

Whilst the Q2 earnings season was surprisingly resilient for most businesses, forward guidance was much more conservative and companies reporting towards the end of the period showed greater signs of stress. Margins are increasingly under pressure as businesses struggle to pass on soaring costs. Inventories are growing and becoming problematic and supply imbalances are unwinding. Companies are freezing hiring plans or starting to lay off workers (notably in the technology sector). Several companies have started to warn ahead of the Q3 reporting season which kicks off in October.

In this environment we would expect high quality equities with resilient business models to outperform as they have done historically. The core equity portfolio with its defensive and high-quality tilt should perform relatively well. The table below highlights the historic outperformance of quality factors when earnings are falling.

Best-Performing Factors When EPS Fall

Peak In NTM EPS	Trough In NTM EPS	ROA	Net Income Margin	ROE	Asset Turnover	Free CF to EV	Receiv. Turnover	Oper. Margin	EPS Growth	Interest Coverage
Jan-86	May-86	10.0%	7.9%	10.9%	4.7%	9.0%	0.4%	5.7%	4.4%	10.5%
Sep-89	Apr-91	36.9%	29.9%	19.2%	11.7%	16.6%	12.9%	16.6%	14.6%	29.0%
Sep-00	Nov-01	0.5%	2.6%	3.6%	5.3%	36.4%	-0.1%	1.3%	-11.1%	-1.9%
Oct-07	May-09	7.4%	4.4%	6.8%	2.7%	16.8%	3.2%	-1.5%	2.1%	14.5%
Sep-14	Mar-16	4.8%	4.3%	6.6%	7.0%	1.9%	8.2%	0.8%	4.0%	-0.1%
Feb-20	May-20	14.7%	15.0%	9.0%	7.9%	-1.3%	7.5%	8.9%	11.7%	11.4%
	Avg	12.4%	10.7%	9.3%	6.6%	13.2%	5.4%	5.3%	4.3%	10.6%
	Hit Rate	100.0%	100.0%	100.0%	100.0%	83.3%	83.3%	83.3%	83.3%	66.7%

S&P 500 Factor Performance High To Low (Q1 vs Q5), Sector Adjusted

Highest Hit Rate And Best Performance When Earnings Are Falling

The quality and defensive characteristics of the core equity portfolio are shown below with the MSCI World Quality Index shown for comparison (as at 31/08/2022).

Quality Characteristics		
	Core Equity	**MSCI Quality**
ROE	17.3%	14.1%
ROCE	12.4%	9.2%
EBITDA Margin	29.8%	21.9%
FCF Margin	20.6%	12.5%
Assets/Sales	2.0	7.4
YoY Earnings Correlation	77.5%	50.0%

Defensive Characteristics		
	Core Equity	**MSCI Quality**
Exposure to Defensive Sectors	53.4%	26.6%
Interest as % EBITDA	4.8%	7.7%
Altman Z (>3 good)	6.9	4.8
Beta	0.95	1.00
Beta < 1	58.1%	
Beta < 0.8	33.2%	

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