SOMERSTON
ASSET MANAGEMENT

Somerston Multi Asset Fund (the Fund)

Investment Letter No.23 – December 2022

The Somerston Multi Asset Fund (US0 class) returned +3.4% in the fourth quarter. The MSCI World Equity Index rose by +7.5% and a composite of UK, German and US Government bonds rose by +1.2% in Q4.

During Q4, the Fund had average net equity and bond allocations of 27% and 34% respectively. The Fund starts Q1 2023 with net exposures of 34% in equities, 25% in bonds and 15% 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	1.3	3.7	-1.5	**-14.0**

Top Ten Equity Holdings

Name	**% Fund**
British American Tobacco Plc	3.2%
Pepsico Inc	2.9%
Walmart Inc	2.8%
Nextera Energy Inc	2.4%
Alphabet Inc-Cl A	2.5%
Adobe Inc	2.5%
Thermo Fisher Scientific Inc	2.4%
Unitedhealth Group Inc	2.1%
Totalenergies Se	2.0%
Intuit Inc	2.0%
Total for Top Ten	**24.7%**

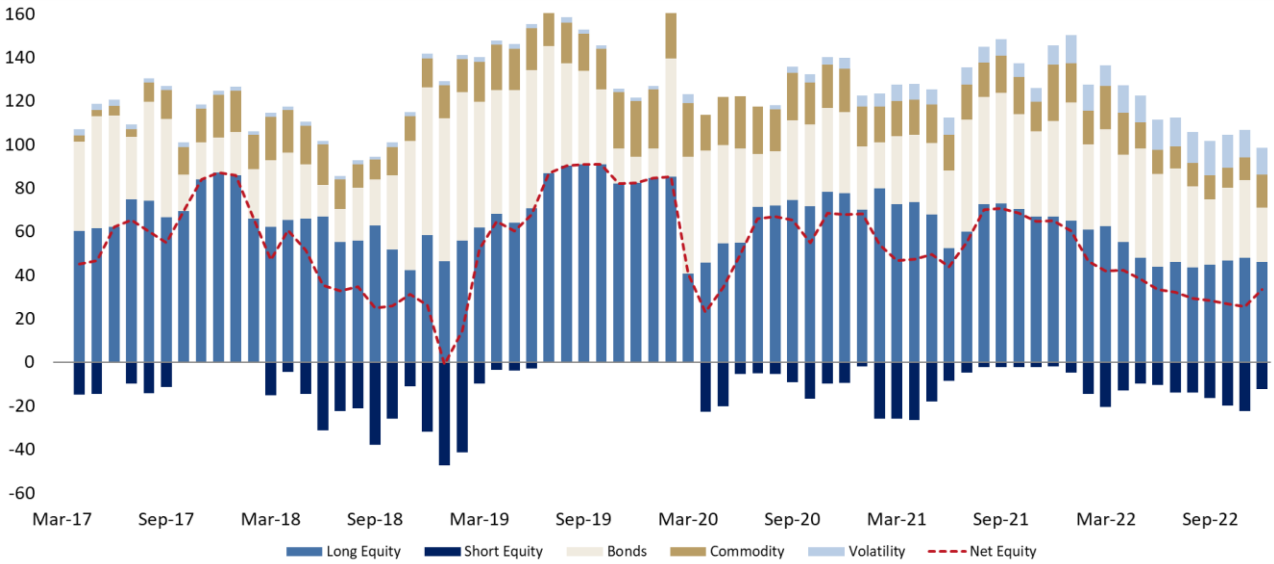
Currency Allocation

USD	92.0%
NOK	2.9%
SEK	1.5%
EUR	2.3%
GBP	1.3%
Total	**100.0%**

Asset Allocation

	Long	Short	Net
Core Equities	34.7%		34.7%
Defensive Equities	7.0%		7.0%
US Equtiies		-6.3%	-6.3%
Real Estate Equities	3.4%		3.4%
European Equities		-2.3%	-2.3%
High Beta		-2.1%	-2.1%
Small Cap Equities		-1.8%	-1.8%
Energy Equities	0.9%		0.9%
Equities	**46.0%**	**-12.5%**	**33.5%**
US Govt 10 yr. Bond	11.4%		11.4%
US Govt (+15yrs) TIPS	5.7%		5.7%
US Govt TIPS	5.0%		5.0%
Nowegian Govt Bond	2.9%		2.9%
Bonds	**25.1%**		**25.1%**
Gold Bullion Derivatives	10.9%		10.9%
Gold Miners	6.1%		6.1%
Brent Derivatives		-2.1%	-2.1%
Commodities	**17.0%**	**-2.1%**	**15.0%**
Volatility and CTA	12.4%		12.4%
Total All Assets	**100.6%**	**-14.6%**	**86.0%**
Cash and Equivalents			**14.0%**

Evolution of Asset Allocation for Somerston Multi Asset Fund



Performance

In 2022 the fund outperformed its 70/30 Equity/Bond reference point by 1.83%.

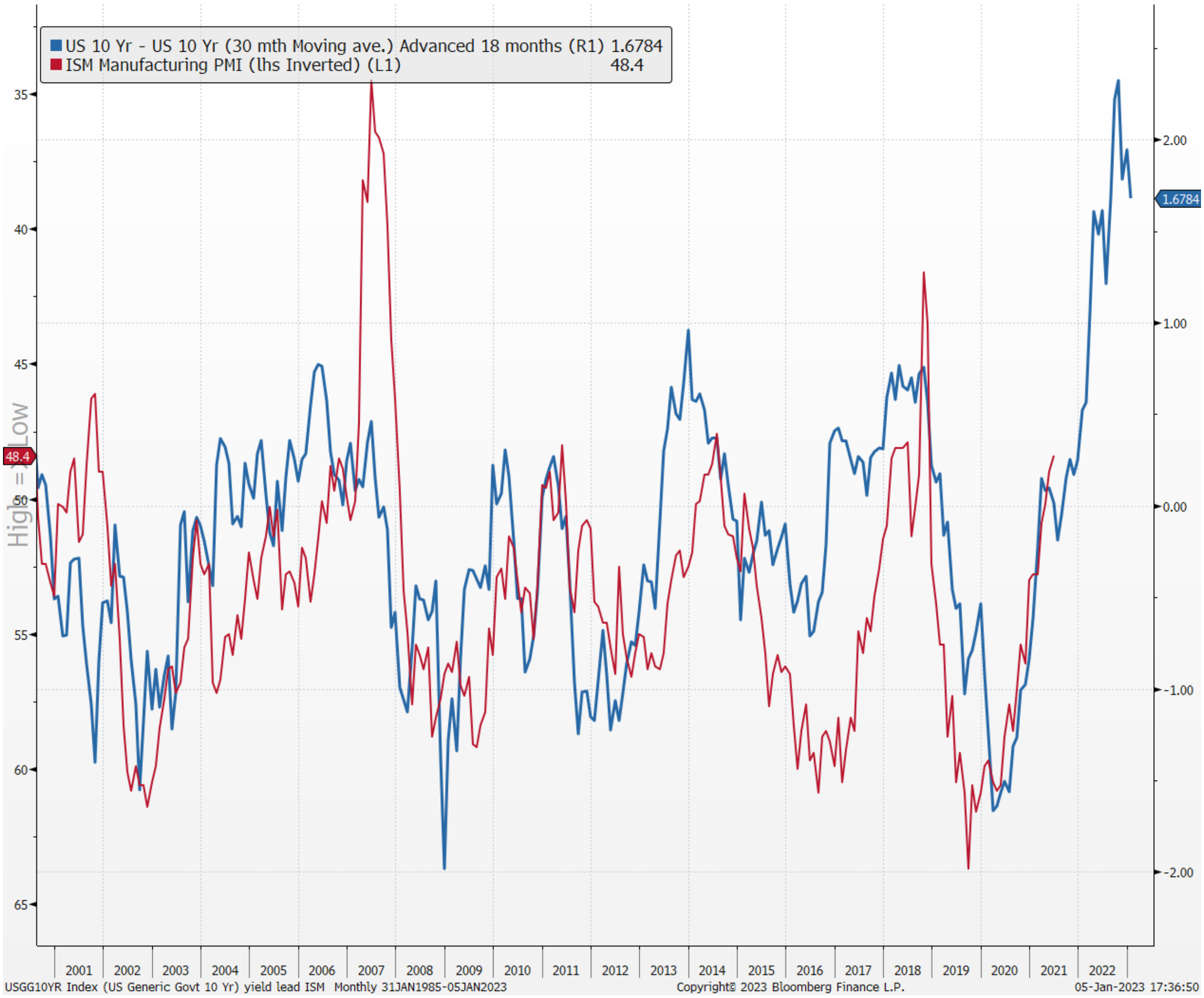
- Our equity weighting was largely cautious adding 2.6% but our core equity selection detracted 2.7% offset by macro equity strategies that added 2.1%.
- Our exposure to gold and long volatility strategies added 2.1%.
- However, while we avoided duration for the start of the year, our bond strategy detracted 2.4% as we added duration ahead of the summer, expecting credit deterioration combined with inflation moderation.

Commentary

2022 was characterised by an aggressive shift in Federal Reserve Policy. The Federal Reserve increased interest rates seven times amounting to an increase of 4.25%, from 0.25% to 4.5%. This historic pace of monetary tightening caused the Dollar to rally and put material downward pressure on both bonds and equities.

Interest rate policy works with long and variable lags. We are certain the full effect of this historic tightening cycle has not yet been fully appreciated, nor reflected in asset prices. In our view, the Fed has gone too hard, and this view has ample support. Every part of the yield curve is now inverted, and Fed Fund interest rates for deposits surpassed 2-year bond yields. Inflation implied by inflation linked bonds is only just above 2%. Leading economic indicators are being crushed. Housing markets are bleak. Yet, the Federal Reserve are ‘promising’ further hikes.

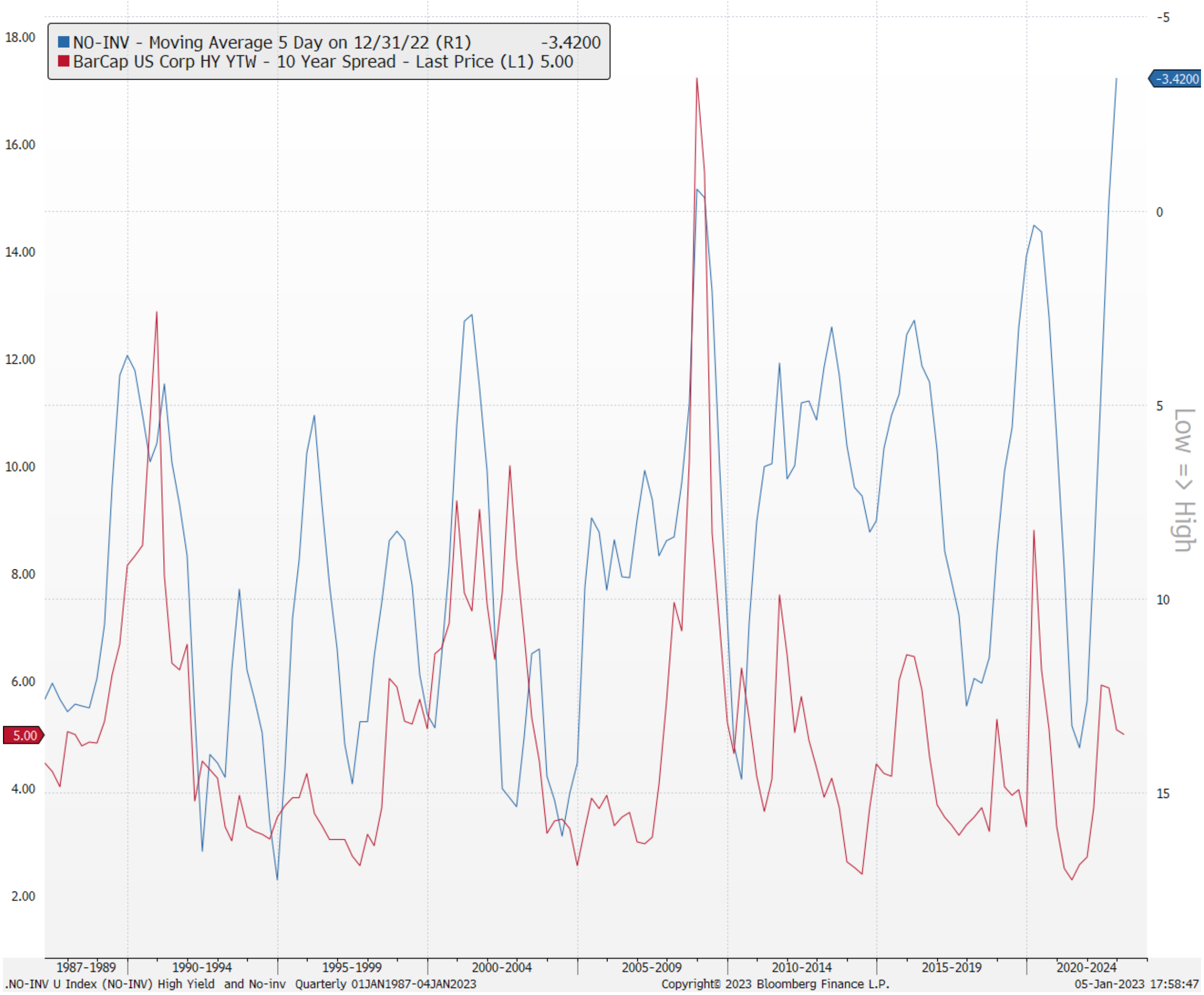
Chart 1 - US 10-year Bond Yields relative to their 30-month moving average are advanced 18 months (blue) and compared to the ISM Manufacturing index inverted (red). This degree of monetary tightening suggests a much weaker manufacturing sector is ahead of us.



Inflation is certainly high, but in our view, even without further monetary tightening, inflation is likely to fall abruptly as many of the pandemic reopening issues annualise later in the year. This is reflected by the abysmal level of new orders relative to high inventory levels and terrible performance from key inflation sensitive markets like lumber and freight.

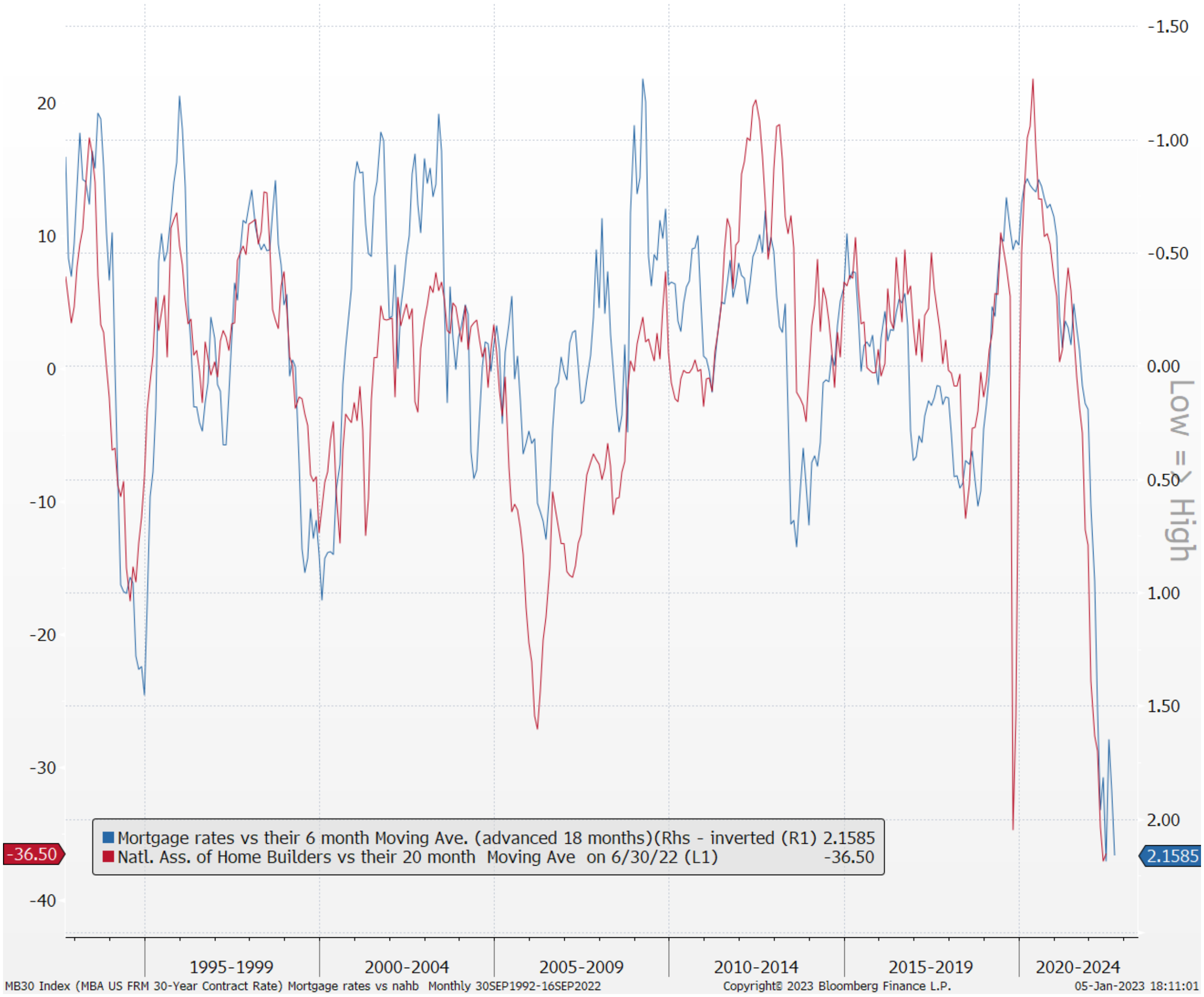
Given the extent of monetary tightening and suggestion that the full effects have yet to be fully reflected, it is surprising that financial markets appear to be pricing in a 'soft landing'. The best illustration of this is given in Chart 2.

Chart 2 – New orders minus Inventories is shown in blue & inverted and compared to High Yield Bond Spread in red. High yield spreads have risen but not by anywhere as much as one might expect compared to the collapse in new orders, indicating that the future will not be as bad as it could be. In other words, High yield is pricing a probable soft landing.



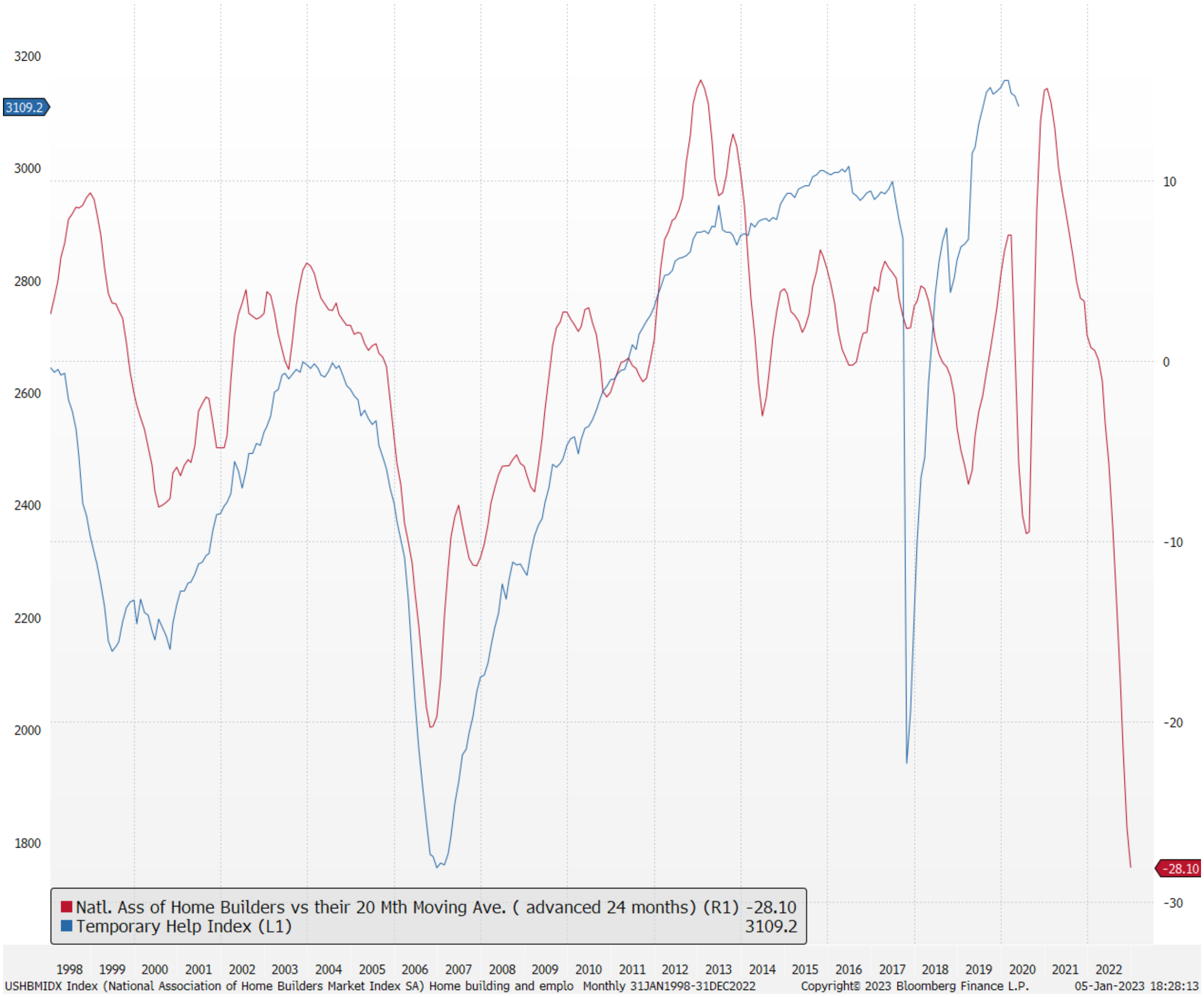
In our view, the last domino to fall is employment. Employment has been incredibly resilient, but is likely to change, increasing the odds of a hard landing. Housing and associated durable goods industries are one of the largest employers in an economy. As interest rates rose, mortgage rates increased and with only a 6-month lag, Home Builders sentiment started to collapse.

Chart 3 – The change in Mortgage rates (Blue) are inverted and advanced by 6 months and compared with Home Builder Sentiment (Red). The record increase in mortgage rates is matched by the record collapse in Home Builder sentiment.



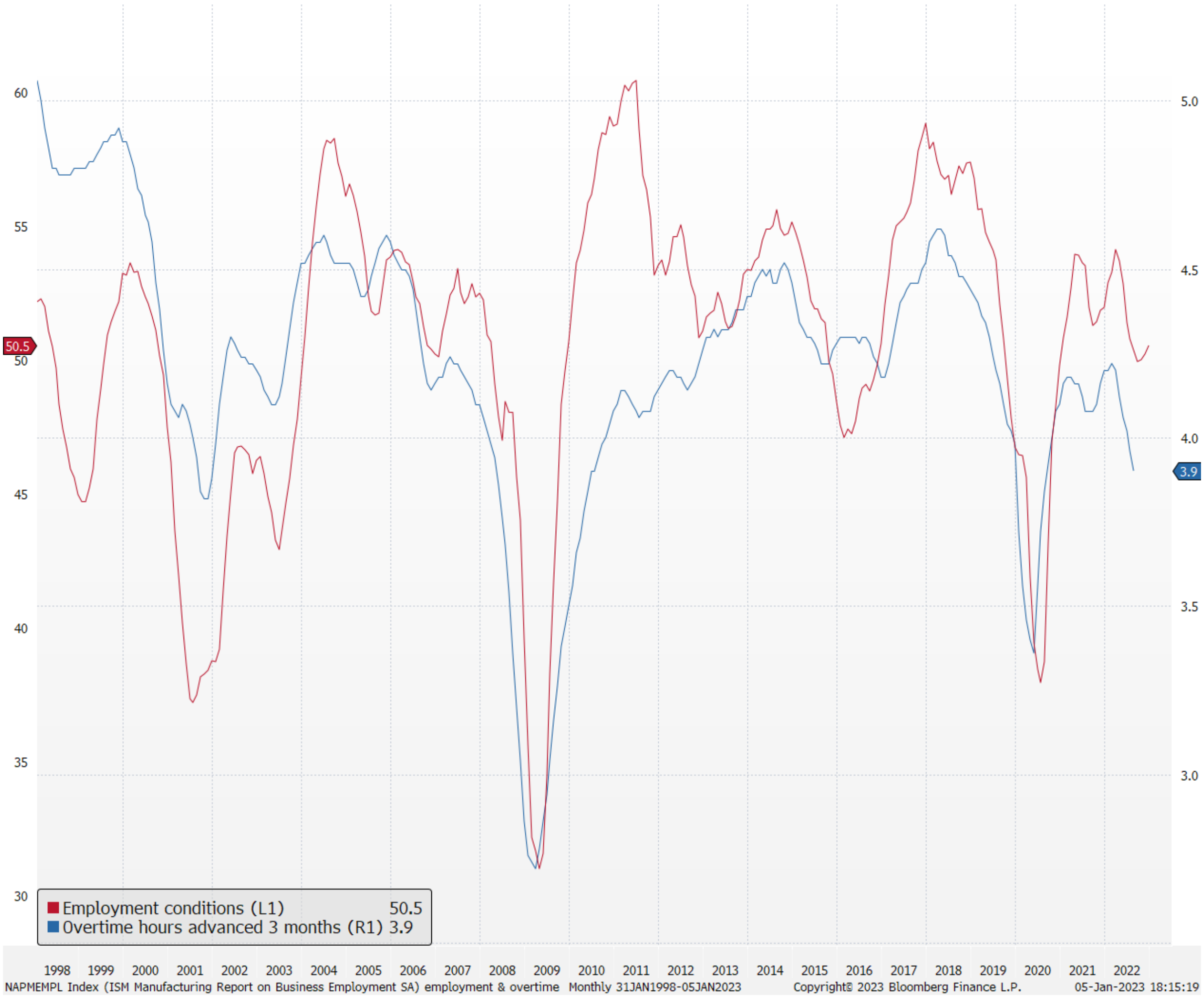
As home builder sentiment contracts, so too do sales volumes and home prices. Homebuilders work through what they have and about two years after a peak in home builder sentiment, we start to see employment roll over. Home builder sentiment peaked in January two years ago and right on que, employment conditions are now looking shaky.

Chart 4 – The National Association of Home builder Sentiment (Red) advanced 24 months compared to temporary help Index (blue). Temporary Help conditions are often the first to roll over and potentially have quite a way to fall.



Overtime hours are falling, temporary help is moderating, and public company announcements of cost controls and layoffs have become a daily occurrence. We cannot eliminate the odds of a soft landing, but with lending standards tightening, a Federal Reserve intent on tightening further before seeing the true impact of what they have already done, real wages declining and employment on the cusp of turning down, it looks more likely that we are in for a harder landing than financial markets appreciate.

Chart 5 – Overtime hours (blue) lead employment conditions by 3 months



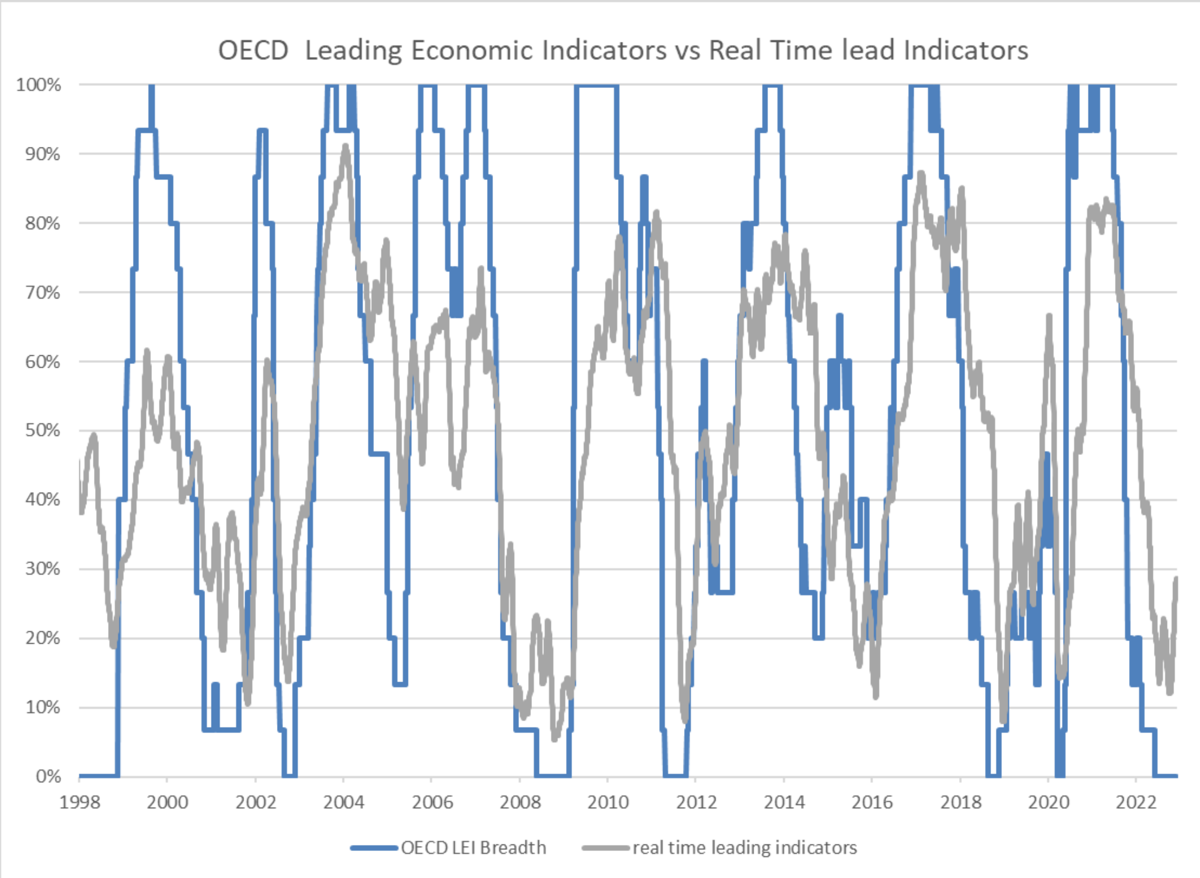
But there is light at the end of the tunnel. In contrast to last year, we believe there is much for investors to look forward to later in 2023. Firstly, valuations have improved for almost all assets; Secondly, lead indicators which monitor the most sensitive parts of the economy are on the floor and will most likely move higher later this year; and lastly, if we are correct that inflation falls rapidly in the second half of 2023, and employment starts to deteriorate, investors can look forward to an end in the tightening cycle.

Whether the Federal Reserve over tightens, forcing a financial accident, needs to be seen. However, we have started to slowly increase our equity exposure. Until we see a decisive move higher in leading indicators or valuations improve significantly, providing a 'fat pitch', we will not get ahead of ourselves.

Specifically, many of the ‘quality compounders’ have cheapened to levels where we feel content with the starting valuation, emerging markets look to have equity and currency markets that are attractively valued, supported by the Chinese Central Bank employing an easing policy, and we are looking to slowly introduce short to medium term investment grade credit to take advantage of higher yields.

2022 was a tough year, but the ingredients of better conditions at some point in 2023 look to be assembling. We will be patient.

Chart 6 – Various leading indicators are close to negative extremes



Core Equity

Presently, top-down forecasts project earnings to decline -9% next year whilst bottom-up forecasts project growth of 11.1%. Both cannot be correct. Bottom up analysts often wait until fourth quarter results are released in February to true-up their full year forecasts for the next year. In times of stress, the relatively conservative top-down forecast are often more reliable. Our perspective is that given the lagged effect of last year's runaway inflation, surging interest rates and reduced fiscal support, the burden facing consumers and businesses is likely to intensify moving forwards and bottom up forecasts will need to come down meaningfully. Accordingly, we steer away from cyclical stocks or where we believe earnings are susceptible to meaningful downgrades.

We are concerned by the number of businesses that relied on inflation as their primary driver of revenue growth last year. Of the 9.3% reported revenue growth for the largest companies in the US in Q3, 7.2% was due to inflation (ie price increases rather than volume growth). An increasing number of consumer businesses, including sports apparel and household products, are experiencing declining sales volumes but continued revenue growth through hiking prices. As Inflations moderates and pricing power diminishes, companies that have been relying on this mechanism for growth, and that haven't managed their cost base, are going to find life increasingly difficult. With inventories rising rapidly and input costs sticky, the record margins companies have been achieving will come under pressure. Accordingly, we reduced our exposure to Pepsi, Walmart and NextEra and topped up Adobe and Alphabet.

The companies within our equity book delivered good operational performance during the year and demonstrated both pricing power and volume growth. For some of our holdings, price performance did not live up to fundamentals. Whilst this is disappointing, it creates an opportunity moving forwards. Starting valuations are now more attractive and we are confident fundamental merit will eventually be realised. We enter the new year with optimism that our portfolio of defensive, high-quality companies should perform well in the current environment.

Notable Holdings

Intuitive surgical was our top performer during the quarter rising +41.6%. Intuitive Surgical is a pioneer in robotic surgery, principally selling its Da Vinci family of robot systems, which cost between \$500'000 and \$2'500'000. Intuitive leverages its installed base through the sale of high margin accessories, consumables and services. Less than 2% of the World's major surgical procedures involve robots so the potential addressable market is huge. The industry is growing at 20-25% pa and Intuitive has an 80% market share. Intuitive struggled over the last 12 months as resurgent covid cases and hospital staffing issues put pressure on surgical volumes. Hospitals, which face inflationary pressures and budget constraints, have cut their capital spending programs and Initiative's share price declined -49% in response. Intuitive is a high growth, high ROE, healthcare business with strong cashflow generation, so its share price typically trades at a steep premium to the market. As the present issues are short term and cyclical the disproportionate fall in the company's share price presented an opportunity to build our position into a more modest valuation. Over the last quarter intuitive rebounded strongly as investors expectations proved conservative and in Q3 procedure growth bounced back strongly rising +20%. The company has been hoovering up shares into weakness, buying back over $1.6bn YTD. They have a $2.5bn buyback program remaining and a strong war chest for future capital allocations with over $7.4bn cash on their balance sheet and no debt.

Integrated oil company Total Energies was our second strongest position rising +23.6% over the quarter. High oil and gas prices, record refining margins and gas stockpiling in Europe drove a two-fold increase in net income over the quarter vs prior year levels. Total delivered 40bn Euros of free cash flow, its highest ever recorded and more than it generated in the prior three years combined. Management returned excess cash to shareholders with special dividends and a $6.5bn buyback delivering a total shareholder yield of 12.0% over the year. Shareholder activism and ESG goals have driven an unprecedented capital discipline in the oil sector during this upcycle. CAPEX remains well below trend and European oil companies expect to decrease oil and gas production by 2-5% annually for the foreseeable future. It is increasingly likely that the World oil market will be undersupplied when the global economy recovers. Total is reinventing itself as a diversified energy company, divesting its non-core, low margin/low ESG assets and focusing its capital investments on renewable energy, LNG, and it has the strongest high quality hydrocarbon pipeline of any of the majors. It is uniquely growing its hydrocarbon output until 2030 which puts it in a very strong position if the World is undersupplied. In the short term, we have some concerns around oil demand given the macroeconomic uncertainty and total has the most stable earnings profile of the oil majors with the lowest sensitivity to oil and gas price volatility, so it is a relative safe haven within the industry.

Valero was another top performer rising +18.2% during the quarter. Valero is the World's largest refiner and the second largest biofuel producer with a key presence in the gulf of Mexico. YTD Valero's results far exceeded expectations with strong product demand, high international pricing and low-cost US feedstocks driving record refining margins. Capacity utilisation has been running at over 90% as there has not been enough refining capacity globally to rebuild depleted reserves whilst the economy re-opened. Many refiners were forced to shut down permanently as a result of the pandemic, funding for refiners has dried up due to environmental concerns and Russian refiners have effectively been shut out of international markets. Global product inventories remain low but they have started to normalise for most distillates other than diesel (which continues to see huge demand as a replacement for industrial gas). We remain constructive on Valero as a company but following the phenomenal performance this year the share price now looks expensive. Earnings are based on record margins and record utilisation that cannot persist indefinitely. Valero is highly sensitive to the oil price, which is a risk if the global economy deteriorates. It is also sensitive to the spread between Brent and WTI and to US crack spreads, both of which have been cyclically favourable. We sold our position at year end.

nick.wakefield@somerston.com

alan.lemaistre@somerston.com

01534 822392

Disclaimer

Any information in this Document may not be suitable for all investors. Investors must make their own investment decisions using their own independent advisors and reviewing relevant offering material (including the Final Offering Document). Any investment decisions must be based upon an investor's specific financial situation and investment objectives and should be based solely on the information in the relevant offering material.

The Fund's manager, Somerston Asset Management Limited (the "**Manager**") believes the information contained in this Document to be reliable but does not warrant its accuracy or completeness. The information contained herein is preliminary in nature and is not and does not purport to be complete. Any estimates contained herein may be subject to change without notice. No guarantee or representation is made that the investment program set out in this Document, including, without limitation, any investment objectives, diversification strategies, or risk monitoring goals, will be successful, and investment results may vary substantially over time. Investment losses may occur from time to time. Nothing herein is intended to imply that the Manager's investment methodology may be considered "conservative", "safe", "risk free" or "risk averse".

No person, including (without limitation) any of the members, shareholders, directors, officers, partners, employees or advisers of the Manager or its associates, accepts any liability whatsoever (whether direct, indirect, incidental, special, consequential, punitive or otherwise) for any loss arising from any use of the information, opinions or other statements contained herein or otherwise arising in connection therewith (including in the case of negligence, but excluding any liability for fraud) and, accordingly, liability is disclaimed by all such persons to the maximum extent permitted by applicable law or regulation.

No Investment Advice

The information contained herein does not constitute advice and should not be relied upon for any purpose. No approvals have been given by the Jersey Financial Services Commission in respect of the contents of this Document or the circulation of any offering document in relation thereto.

The information contained herein is not intended to influence you in making any investment decisions and should not be considered as advice or a recommendation to invest. This Document is for information only and provision of this Document does not in itself constitute any kind of service provided by the Manager. Furthermore, this Document does not purport to describe all of the risks associated with investment or the other matters described herein. Income from or the price or value of any financial instruments may rise or fall.

Somerston Asset Management Limited is regulated by the Jersey Financial Services Commission.

The Somerston Multi Asset Fund is regulated by the Jersey Financial Services Commission.

Warning

PAST PERFORMANCE IS NOT INDICATIVE OR A GUARANTEE OF FUTURE RESULTS. NO ASSURANCE CAN BE MADE THAT PROFITS WILL BE ACHIEVED OR THAT SUBSTANTIAL LOSSES WILL NOT BE INCURRED.