QUARTERLY INVESTMENT REPORT

June 2018

The Fund advanced 7.1% during the second quarter, driven by a strong performance from our energy holdings and helped by a weak sterling.

The gloom that had firmly settled over the energy sector looks to have lifted, buoyed by a rising oil price and a healthy results season. Our four energy majors returned 20% over the period. It is astonishing how frugally the market is valuing these businesses versus their underlying performance. We met with **Royal Dutch Shell** in June. Shell has moved from a "growth in production at all costs" mentality to a "return on capital" model. This change, admittedly forced on them by 2014's rapidly retreating oil price, has meant that Shell has made rapid strides towards a portfolio of oil assets that can break even at a $40 per barrel oil price, and gas assets that will generate enormous cash flows as electricity demand increases. Shell is projecting Free Cash Flow (i.e. after capex) of between $25bn and $30bn per year over the next 3 years, assuming an oil price of $60. The oil price is $78 at the time of writing, and the market cap of Shell is $280bn, so effectively we are holding this stock at c. 10% free cash flow yield. Shell is a 4.7% position for us. We continue to believe that the energy majors are under-appreciated by the market and are very comfortable with our overall 18% exposure to the sector (across **Shell, Exxon, BP and Equinor**).

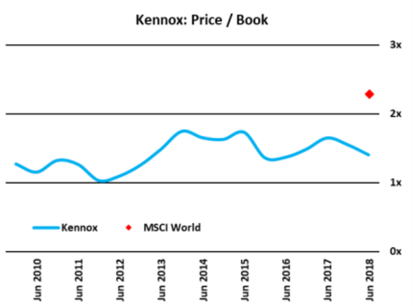
Our retail stocks also fared well during the quarter, with **Next** and **Gap** up 27% and 11% respectively. Next and Gap had each fallen over 50% from highs before we took our initial positions in early 2017, leaving each at very undemanding valuations (around 10-11x our view of Sustainable Earnings). The rapid recovery in the share prices has left them less attractively priced (at 17x and 16x Sustainable Earnings respectively) and we have taken money off the table in both cases, leaving our total exposure at 4.7%. This our usual practice: trimming positions as they move through 15x Sustainable Earnings and selling as they reach 20x. Against this, we look to add to stocks in the portfolio where the valuations are the most appealing. During the quarter we added to our holdings in **Sky Network Television, China Mobile, Texwinca** and **M1**, all at under 10x Sustainable Earnings.

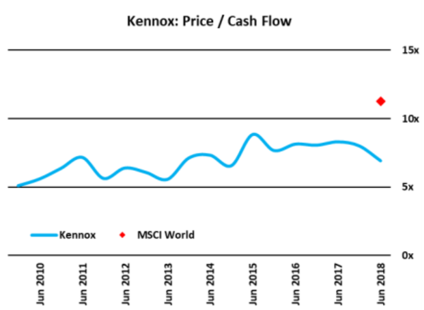
In Japan, a couple of our stocks have fallen back after good runs in 2017. **Canon Marketing Japan** retreated 18% on weaker Q1 results. We trimmed Canon Marketing Japan heavily in 2017 as the share price rose 50% and it is currently a 2.4% position. We are content to hold – it has retained annual earnings guidance and we believe that the long-term investment case has not changed. Similarly, **Star Micronics** (a Japanese exporter of precision lathes) which had risen over 60% in the previous 12 months retreated 10% in the second quarter on cooling global trade expectations. We remain comfortable with our 2.5% position.

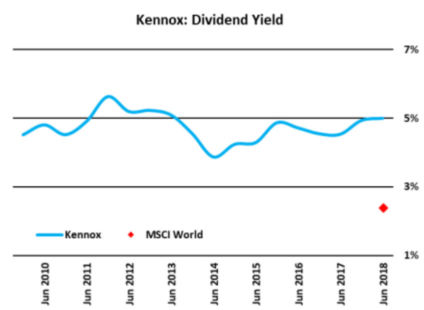
Sticking consistently to our well-defined buy/sell discipline means we are able to rotate the portfolio effectively, keeping our valuation metrics reasonably constant and at a significant discount to the market over time. Today the portfolio is as good value as it has been in the period since the start of this extended bull run in 2009 across multiple valuation metrics. (We have included a few key valuation indicators below).

Kennox portfolio v MSCI World across a broad range of key metrics

Since 2009, we have delivered a return of 130% (annualised 9.5% net) whilst consistently refreshing the portfolio (exiting positions as they reached full value and replacing with sector leaders as they became available at excellent valuations). Importantly, performance has not simply come at the expense of expanded valuation multiples. This is wholly consistent with our objectives – it means that today the portfolio is very attractively valued in a market where valuations of quality stocks have become increasingly stretched. Our valuations clearly differentiate the portfolio from a passive exposure to the markets and they give us great confidence in the potential performance of the Fund.







	Kennox Portfolio	MSCI World
Price/Book Value	1.4x	2.3x
Price/Cash Flow	6.9x	11.3x
Dividend Yield	5.0%	2.4%
Financial Leverage	2.2x	5.9x
Price/Sustainable Earnings	12.5x	>20x⁺

Source: Bloomberg; Kennox

⁺Kennox estimate. The calculation of Sustainable Earnings requires detailed analysis at a company-specific level to assess that company's long term earnings potential. As such, assessment of index valuation is approximate, informed by longer term valuation metrics such as price to 5-year average earnings (23x for the MSCI World Index at 30 June 2018).

Performance (total return net of fees) in Pounds Sterling to 30 June 2018

Period	Professional share class	Institutional share class	Class A share class
YTD	2.3%	2.4%	2.6%
2017	2.1%	2.5%	2.6%
2016	35.4%	35.8%	36.2%
2015	-4.3%	-4.0%	-3.8%
2014	-1.5%	-1.1%	-0.9%
2013	15%	15%	4.3%*
2012	9.4%	10%	N/A
2011	-4.4%	-4.0%	N/A
2010	21%	12%*	N/A
2009	15%*	N/A	N/A

Source: Bloomberg. Performance figures are total return generated from the accumulation units since their launch (29 April 2013), and from the income shares prior to that.

* Share classes launched mid-year: Professional on 30 April 2009; Institutional on 12 May 2010; and Class A on 29 April 2013.

Fund Data – 30 June 2018

	Stock	Region	Sector	Market Cap (US$m)	Fund Weight
1	NEWMONT MINING	N. America	Materials	20,200	6.1%
2	EQUINOR	Europe	Energy	88,700	5.3%
3	BP	UK	Energy	153,000	4.8%
4	ROYAL DUTCH SHELL	UK	Energy	295,000	4.7%
5	NEOPOST	Europe	Technology	900	4.5%
6	TAISHO	Japan	Health	10,600	4.1%
7	CHINA MOBILE	Asia	Telecoms	182,000	4.0%
8	TESCO	UK	Consumer Staple	33,300	3.9%
9	M1	Asia	Telecoms	1,100	3.8%
10	TEXWINCA	Asia	Consumer Discr.	600	3.8%
	Total Top 10				44.9%
	18 Other Holdings				42.1%
	Cash				13.0%

Unit Prices

As at 30 June 2018:

- Professional Share Class:
  - Income: 129.70 pence (unit price at inception, 30 April 2009: 70.08 pence)
  - Accumulation: 143.30 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Institutional Share Class:
  - Income: 131.10 pence (unit price at inception, 12 May 2010: 85.46 pence)
  - Accumulation: 147.30 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
  - Income: 131.20 pence (unit price at inception, 29 April 2013: 104.3 pence)
  - Accumulation: 148.60 pence (unit price at inception, 29 April 2013: 104.3 pence)

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If you have any questions on Kennox or the Kennox Strategic Value Fund, please contact Peter Boyle on +44 (0) 131 563 5440 or email him at pboyle@kennox.co.uk. Our website is www.kennox.co.uk