smart | fund

SMARTFUND THISTLEDOWN INCOME FUND

Short report
Period 04 November 2012 to 03 November 2013

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Investment objective

To provide income while investing to provide some capital growth over the medium to long term.

Investment policy

To achieve the investment objective, the sub-fund will seek to invest principally in equities. The Fund may also invest in exchange traded funds (ETFs), fixed income securities (bonds) and collective investment schemes (CISs). When selecting equities for the sub-fund's portfolio the Manager will apply a 'value' based policy - including an asset in the portfolio when Thistledown's analysis and expertise suggests that a total return over the full investment cycle or longer of at least 2% over the total return that could be expected from UK equity investments over the same period (i.e. between 5 and 10 year horizons) is achievable from that asset. Achieving these target returns for each equity investment or for the sub-fund's portfolio as a whole is highly uncertain as equities are volatile assets and are expected to be the principal portfolio investment. The Manager will hold ETFs, bonds, CISs and cash when it cannot identify enough opportunities to achieve a suitable spread of equity investments with the appropriate 'value' characteristics.

The Manager will also seek to reduce investment risk by diversifying the Sub-Fund's investments across industries and countries. It will not consider the size of company or market important to its investment decision provided Thistledown and it believe the investment helps to diversify risk. Investments in assets denominated in foreign currencies will not be hedged into sterling.

The Manager must ensure that the Sub-Fund maintains sufficient cash for the purposes of maintaining liquidity. This portion of the sub-fund's assets must be represented by cash or similarly liquid assets (which may include money market instruments, deposits or units in collective investment schemes) at all times.

The Sub-Fund's portfolio and mix of asset classes will be rebalanced from time to time at the absolute discretion of the Manager.

Risk profile

The fund should be considered high risk.

Performance review

Performance Table

	Thistledown
04.11.12 to 03.11.13	**20.7%**
03.12.10 to 03.11.13	**30.9%**

PAST PERFORMANCE SHOULD NOT BE SEEN AS A GUIDE TO FUTURE PERFORMANCE

The performance figures above are based on a notional unit issued on the date of inception of the sub-fund, with an initial capital value the same as the minimum investment amount for that fund. The notional unit is based on the AMC including zero (0%) Adviser Charging and therefore reflects performance after all other expenses that would be included in the TER.

Smartfund Administration Ltd (6016828) is registered in England at 6 Broad Street Place, EC2M 7JH and is authorised and regulated by the Financial Conduct Authority under ref. 463566. Reference in this document to specific securities should not be construed as a recommendation to buy or sell these securities, but is included for the purposes of illustration only. Investors should also note that the views expressed may no longer be current and may have already been acted upon by the Investment Adviser and/or Manager. The investment service may not be suitable for all Investors and if you have any doubts you should contact your Financial Adviser. The full prospectus for this fund is available on request or at www.smartfund.co.uk. ph: 0844 801 0700

Market and Fund Review (provided by Thistledown)

Performance

This report is for the period from November 3rd, 2012 to November, 3rd, 2013. The fund returned 20% with income reinvested over the period and the UK stock market returned 21%.

Volatility

The fund's annualised volatility for the period was 6.7% compared to 12.0% for the UK stock market. The volatility of the fund, while slightly lower than last year, is broadly the same, while market volatility has fallen considerably. As we wrote last year we believe that our approach will lead to lower volatility than the market. As the fund has now been running for nearly three years with substantially lower volatility than the market we are becoming more confident that our policies are working to produce a less volatile return.

Income

The fund distribution fell this year. The underlying equity portfolio yield is around 3.4% using the last twelve months history of dividends paid. This is slightly above the UK stock market.

Expenses

This year the total expense ratio fell to 1.1% (excluding adviser charging). The main reason for this is that the fund has grown over the year and as a result the fixed costs of running it are spread more widely. We continue to believe that charging expenses to income before distribution is the most efficient way for taxpayers to meet these expenses.

Asset allocation approach

We wrote about our approach to asset allocation last year and have repeated part of this below. The fact is that holding cash in the last year has been a mistake. Financial markets have been boosted by the continuation of low interest rates and the search for yield. We are reluctant to commit all our and your capital to markets that are buoyed by low interest rates, which are in many areas statistically expensive and when the final effect of the extraordinary monetary policies is uncertain.

We believe that as clients your first concern should not be the annual performance of the fund, but the process that underlies how we invest your capital. We reason that there is a great deal of movement, or volatility, in financial markets that is random, or luck. This luck, both good and bad, can obscure the outcome of a good policy for long periods. We are convinced that our carefully diversified selection of statistically cheap stocks is likely to produce attractive returns, which should in turn perform better than the benchmark. This may sound complacent, but we think that imperturbability is required when dealing with the foibles of 'Mr. Market', while acknowledging there is a fine line between studied calmness and complacency.

Investment decisions

We report quarterly on the transactions in the portfolio in our newsletter. This report will concentrate on the few decisions that worked really well or badly over the period.

UTV was the strongest performer during the year rising 69%. It is interesting that its earnings have not met our expectations but its cheap initial rating and the exposure to a possible cyclical recovery proved attractive to investors and lead to a significant rerating of the shares.

Hewlett Packard, bought during the period was the next best performer rising 56%. Our investment thesis was simple – the company had strong finances and its cheap rating gave no credit to a number of market leading positions. The new management has improved cash flow, strengthening the balance sheet and appears to have stabilised the business. Even after its rise it remains one of the cheaper companies in the portfolio.

The worst performance was produced by City of London Investment Group. This small fund management business specialises in investing in closed end funds for US Endowments. The balance sheet was strong and the valuation looked cheap. The fact is that Emerging Markets, where the bulk of their investments are, have fallen out of favour. We have retained the holding in the belief that the current gloom towards emerging markets is overdone and that in the meantime various management initiatives will support a dividend yield of nearly 10%.

Turnover

Six holdings were sold during the year, three because they met our targets and three where the investment thesis was wrong. This is a higher turnover than we would expect normally.

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Outlook

We wrote last year that we try not to spend much time worrying about the macro issues, preferring to review companies and their valuations. This remains the case. We could profit if we could forecast macroeconomic outcomes, but we have no skill in this area and are sceptical of others ability. Warren Buffett remarked. “Forecasts reveal more about the forecaster than the future” However, we do look at valuations and here a couple of remarks might help you understand our current caution.

First, GMO, the US investment management firm, have for many years published every month, estimates of future returns. These are based on an expectation that various parameters used to measure the market revert to the mean over a seven-year period. The record of these measures is impressive. They are currently forecasting losses over the next seven years from US equities – with the exception of ‘quality’ companies.

Second, we went recently to the Columbia University Students Investment Management Association annual presentation. The speakers included Joel Greenblatt, a legendary investor. He spoke about the valuation of the market. His firm, the splendidly named Gotham Asset Management, has a proprietary database of the largest 3000 companies in the US. They have recast the reported numbers since the ’90s, a huge task that took nearly seven years. They show that the top 1000 companies are valued in line with long-term averages; with the following twist, a simple average of the valuations, that is NOT weighted by their market capitalisation, suggests companies are in the top 30% of valuation – smaller companies are more highly rated than large companies. Second, the next 1000 companies are valued at the 97th percentile – only 3% of the time in the last 25 years have small companies been more expensive.

We are convinced by the measures referred to which explains our caution, but there is a caveat.

We have been thinking about the contrasting valuations of large and smaller companies over the last year as it has a real impact on the portfolio. It is a given that interesting investments are more likely to be found in under researched smaller companies than in the corporate titans, yet at present these under researched companies are often expensive, while large companies appear not to be. This was the case with Vodafone and Microsoft, neither of which, even now, is more highly rated than the market. We have been casting around for an explanation for this. The most obvious one would be that the large companies are not going to grow at the same rate as the smaller companies, which may be the case, but has probably always been the case while this valuation difference is relatively recent. We think that the most likely explanation is that active managers are reacting to the ‘institutional imperative’ Passive funds are eating the active managers’ lunch. Their response is to vaunt their ability to find and analyse less covered investments. Cheap mega caps hardly fit the bill – why pay active fees to buy a handful of really large companies – so they do not get the marginal investment dollar. This may sound ‘too clever’ as an explanation, but the fact remains that large companies are cheaper than smaller companies to an unusual extent and they offer real opportunities to invest for long term gain.

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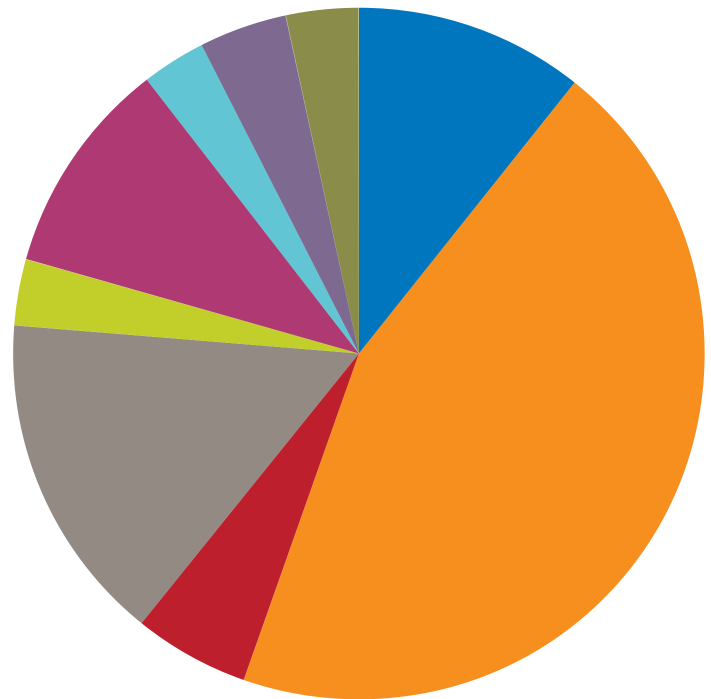
Top 10 holdings

Holdings	as at 03.11.13 %*
iShares FTSE UK Gilts 0-5	10.71
CF Morant Wright Nippon Yield	10.15
UTV Media Plc	6.05
BAE SYSTEMS ORD	4.59
Hewlett-Packard	4.58
Svenska Handelsbanken	4.29
Aberforth Smaller Companies Trust	4.11
PHAUNOS TIMBER FUND LD ORD NPV	4.06
iShares FTSE UK Dividend Plus	3.89
Microsoft	3.81

Holdings	as at 03.11.12 %*
iShares FTSE UK Gilts 0-5	16.87
CF Morant Wright Nippon Yield	9.38
UTV Media Plc	4.20
AT&T Inc	4.07
PHAUNOS TIMBER FUND LD ORD NPV	4.06
Scottish and Southern Energy	4.02
WAL-MART STORES INC USD0.10	3.95
Svenska Handelsbanken	3.85
CAPE PLC ORD GBP0.25	3.83
iShares FTSE UK Dividend Plus	3.82

*Calculated as a percentage of Net Asset Value

Asset allocation as at 03.11.13*



- UK Gilts 10.7%
- UK All Companies 44.7%
- Europe excluding UK 5.4%
- North America 15.5%
- Global Emerging Markets 3.1%
- Japan 10.1%
- Global 3.0%
- Unclassified 4.1%
- Cash 3.4%

*Calculated as a percentage of total value of investments

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Notional units

You should be aware that units for Smartfund operate very differently to a conventional unit trust. Units in the Smartfund Advantage are created and priced uniquely for each unit holder. For further information on how the unit price is calculated, you should refer to the Prospectus. If you have already invested in the Smartfund you should login to check your own current and historic prices.

The figures below are based on a notional unit issued on the date of inception for the fund, with an initial capital value the same as the minimum investment amount for the fund, i.e. £3,000.00.

Notional Unit Price

	Highest price	Lowest price
04.11.12 to 03.11.13	£3,925.78	£3,143.75
Inception to 03.11.13	£3,925.78	£2,841.63

Net Asset Value for Notional Unit

03.11.12	03.11.13
£3,251.94	£3,925.78

Distribution Statement for Notional Unit

Distribution Payment Dates	Distribution Amount (£)
December 2012	4.79
January 2013	8.10
February 2013	1.03
March 2013	3.30
April 2013	8.14
May 2013	12.96
June 2013	19.83
August 2013	1.24
September 2013	3.92
November 2013	15.54
Net income	**78.85**

The sub-funds accrue distributions on a daily basis and pay any income available to the unitholder on a monthly basis, up to three and a half months in arrears. All distributions are paid net of income tax.

Total Expense Ratio (TER)

	03.11.13
Annualised Total Expense Ratio (TER)*	1.09%

* The TER reflects the annual operating expenses of the SMARTfund to the average daily net asset value of each sub-fund. This does not include any Adviser Charging which is specific to each individual unitholder.

Adviser Charging: the amount of remuneration that the Investor agrees with their Adviser that the Manager will pay the Adviser for services provided.

Sub-fund details

Fund Manager	Smartfund Administration Ltd 6 Broad Street Place London, EC2M 7JH
Investment Adviser	Thistledown Investment Management Ltd Otham Manor, Otham Kent ME15 8RW
Trustee/Depositary	HSBC 8 Canada Square Canary Wharf London, E14 5HQ
Auditor	BDO LLP 55 Baker Street London, W1U 7EU
Investment Adviser Start Date	03 December 2010
Fund Launch Date	03 December 2010
Fund Accounting Date	03 November
Fund Currency	GBP
Fund Sector	Unclassified
Fund Type	Authorised Unit Trust
Distribution Policy	Paid Monthly

Other information

The information included in this document is designed to enable Investors to make an informed judgement on the activities of the fund during the stated period and the results of those activities at the end of the period. More information regarding these activities and performance of this fund over this period can be obtained from the Manager. The Long Report is available on request from the Manager.

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