# Smartfund Thistledown Income (GBP)

Quarterly Review & Factsheet as at 31 March 2015

## 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.

## **Commentary** by Investment Adviser: Thistledown Investment Management

**INTRODUCTION**

This quarter's report is longer than normal and I hesitated before completing it. My views are not novel, so writing at length might be just vanity. I hope not. My intention is for you to gain a better understanding of how your money is invested.

**FUND RETURN**

The last quarter saw the fund return 1.5% against 4% for the UK stock market.

**THE PORTFOLIO**

The best returns came from the investment in Japan through the Morant Wright fund and in Samsung. Both investments remain lowly valued relative to markets generally.

The weakest returns came from the holding in Hewlett Packard and Microsoft. I wrote last quarter that the valuations of these companies were not elevated and their financial strength was significant. The recent results showed the financial strength intact but did reveal lower growth in profits than was expected. The next year will show whether the valuations are as low as I still believe.

The level of cash and fixed interest at 28%, a slight increase on the level last quarter, clearly held back the fund. Last quarter I wrote about the pain of holding cash in a strong market – this quarter demonstrated clearly what I was describing. It also brought more evidence of extreme behaviour by investors, which continues as I write. Switzerland has just issued a 10 year bond with a negative yield. Two comments highlight how unsafe fixed interest markets have become:

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*"bonds no longer trade like bonds. They trade like commodities – with investors speculating on the price."*
Steve Major, HSBC

*"In case you haven't done the maths – if a current bond yields zero at a price of 100.00, and rates rise a comparatively modest 450 basis points to 4.5%, then that bond price could fall to around 64.08 (it depends on how long that slide takes of course). Er.. that is going to hurt. And I've deliberately chosen the yield of 4.5% because that was the average 10-year AAA Government bond yield in the years before the start of the Global Financial Crisis in 2007." Bill Blain, Mint Partners*

The enormous intervention by central banks has distorted markets. Any sensible person wants these interventions to return economies to normal growth rates. But as an investor I worry about the repercussions of unorthodox policy and its effect on long run returns. Currently the effect is to drive up asset prices and so reduce, sometimes to zero or worse, available long run returns. This makes holding cash the least worst option.

**TRANSACTIONS**

Two new holdings were purchased for the fund with money raised from partial sales of various investments. A full investment was made in an emerging markets equity fund. This fund tracks emerging markets and when we invested yielded 5% with the underlying portfolio valued at 10 times a years earnings. Emerging markets, that held such promise for investors earlier this decade, have been poor investments in the last few years. A number of causes are cited for this but one recurring theme is that emerging market currencies will suffer when interest rates rise in the US. This is not an area where I have any particular experience but the simple table below shows this is not news, its been happening for sometime.

| Currency | Smallest amount to buy $1US | When was this | Needed today to buy $1US | Decline |
|---|---:|---:|---:|---:|
| Colombian Peso | 1767 | Dec-12 | 2597 | 32% |
| Brazilian Real | 1.55 | Jul-12 | 3.08 | 49% |
| Hungarian Forint | 178 | Apr-11 | 278 | 36% |
| Russian Rouble | 28.1 | Apr-11 | 51.79 | 46% |
| South African Rand | 6.74 | Mar-11 | 12.11 | 44% |
| Indian Rupee | 44.4 | Oct-11 | 62.29 | 29% |
| Malaysian Ringgit | 2.96 | Apr-11 | 3.66 | 19% |

This is not to say that this fall could not continue but to point out that there have already been substantial falls in these currencies.

One position is still being built and I will comment in detail if it becomes a full holding.

**INVESTMENT APPROACH**

In past reports I suggested that economic forecasting, whilst fascinating, was unlikely to make most investors money. I was pleased to have this view endorsed at a recent presentation on JM Keynes by James Ashworth of Alfreton Capital. Keynes was a keen investor for his own account and for King's College, but he went on an 'investment journey'. Starting out he was certain that economic insights would help him profit in the currency and commodity markets. They didn't and in 1920 currency speculation wiped out his capital.

*"I can only say that I was the principal inventor of credit cycle investment and have seen it tried by five different parties acting in detail on distinctly different lines over a period of nearly twenty years, which has been full of ups and downs; and I have not seen a single case of a success having been made of it."* JM Keynes.

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Bailed out by a friend and defeated by commodities and currencies he concentrated on equities.

*"My purpose is to buy securities where I am satisfied as to assets and ultimate earning power and where the market price seems cheap in relation to these. If I succeed in this, I shall simultaneously have achieved safety-first and capital profits"*
*JM Keynes*

If you need evidence of his genius this comment, from the 1930s, could have been made by Benjamin Graham the so-called 'Dean of Wall Street' and the father of value investing. Yet Graham spent his whole career focused on investing while Keynes invested part time; apparently he spent most of the morning in bed reading the financial papers. The results were excellent. King's College became the wealthiest college at Cambridge as a result of his efforts with the wonderfully named Chest (endowment). His own portfolio was even more successful.

What lessons are there for us as investors? The first is obvious – don't forecast. The second is to concentrate on trying to buy at prices that are cheap. It worked for him and academic work since shows it works in many different markets. It's what I am trying to do.

But there are significant differences in the investment philosophy I use on your behalf. (The less said about the intellectual gulf between your manager and Keynes the better)

*'One's knowledge and experience are definitely limited and there are seldom more than two or three enterprises at any given time in which I personally feel myself entitled to put full confidence '* JM Keynes

Your fund will always have more holdings than two or three. It will also not be geared – Keynes used margin to gear his portfolio up to 80%. Not using borrowing will lead to lower overall returns but to date those returns have been delivered fairly steadily, and generally with cash in reserve – I will do my utmost to avoid calling on friends to bail me out!

Finally, and this is a point that is critical to the management of this fund.

*"Accurate timing of market tops and bottoms…. is beyond anyone's ability"* JM Keynes

Why am I trying to time investment in the market, if not accurately, at least broadly? After all this policy has reduced returns to date. The reason is valuation. There might seem to be little difference between macro-economic forecasting and relying on valuations as a guide to investment but there is. Success. In the last 20 years there have been two periods when market valuations appeared high and sentiment seemed excessive. Holding cash in the run up to those market peaks was mentally draining, threatened the commercial viability of those firms that did so, but was ultimately rewarding.

The valuation of the US stock market using long run measure is as extended as 1929 and only beaten by 2000. The table below shows the Shiller PE (roughly today's price divided by the average of earnings for the last 10 years adjusted for inflation)

| Peak Year | Peak Value | Trough Year | Trough Value | % fall to trough | % fall to average |
|---|---|---|---|---|---|
| 2000 | 42 | 2009 | 15 | 64% | 60% |
| 1966 | 22 | 1974 | 8 | 64% | 20% |
| 1936 | 21 | 1942 | 9 | 57% | 11% |
| 1929 | 28 | 1933 | 7 | 75% | 30% |
| NOW | 27 | ? | 10* | 63% | 37% |

* This assumes the trough is the average of the last four values.
** The average used is 17.

Source: Robert Shiller from gurufocus.com

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As I write the ratio is 27. As the table makes clear the market could fall a fair way from here to simply return to the average and a long way if it was to fall to the average trough. What is also quite possible is that the valuation touches the levels seen 15 years ago, the all time top, in which case the market could rise a further 60%. It's actually easy to make a case that today's environment could promote an even larger bubble than 2000 given the extreme valuation for government bonds. But there is also every reason to think that investing at or below the long run averages leads to much better returns. The pressure to perform is likely to keep professional investors in the market long after they believe it is rational to be there – that's the power of career risk and the commercial imperative. I am more concerned with the long-term returns to your and my assets than the short-term returns that are important in league tables and regular quarterly assessments. I trust that what I have written this quarter explains why and hope that in due course my caution will reward us all. Thank you as ever for your support.

# Smartfund Thistledown Income (GBP)

## Quarterly Factsheet as at 30 June 2015

### Investment Objective

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

### Investment Process

The Smartfund Thistledown Income Fund aims to provide a reasonable income while preserving the real value of the capital over the long term. The Manager believes this objective is most likely to be met by following a 'value style', and being sensibly contrarian. This means that the fund will try to invest in areas that are demonstrably cheaper than average and where the majority of other investors are not interested. However, the Manager believes it is essential that the investments have strong fundamentals and particularly that companies do not have large debts.

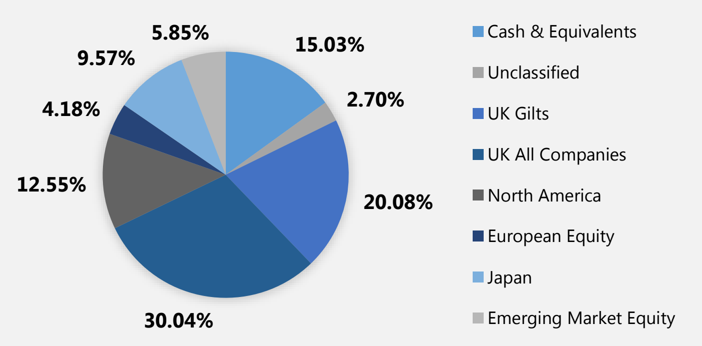
The fund has a bias to UK equities. It will not invest more than 4% in the equity of a single company, with the exception of collective funds. The Manager will hold cash or fixed interest when there are no suitable investments identified. The fund will also hold overseas equities that meet the 'value style' criteria as well as collective or exchange traded funds where the underlying markets meet the same criteria.
Despite the large percentage invested in equity, the process includes a 'margin of safety' to avoid a permanent loss of capital. This is provided by holdings with low valuations and a robust financial position. The Manager believes the investments held will be re-valued by the market and in the meantime provide a reasonable income. The Manager will not chase 'flavour of the month' sectors or companies and as a result is less concerned with stock market fluctuations than fundamental changes in the position of the businesses they have invested in.

Given this investment process the Manager considers their objective will be achieved if the income of the fund grows in-line with or ahead of inflation over time. This means that the fund, particularly if it holds cash in a rising market, is likely to produce returns that are significantly different to the UK equity indices.

**For more information about the investment process, visit: www.thisim.com or email: funds@thisim.com**

| Asset Class | Top 10 Holdings | Weights (%) |
|---|---|---|
| UK Gilts | iShares FTSE UK Gilts 0-5 | 20.08 |
| Cash & Equivalents | Cash | 9.82 |
| Japan | CF Morant Wright Nippon Yield | 9.57 |
| Cash & Equivalents | Legal & General Unit Trust Manager | 5.21 |
| North America | Hewlett-Packard | 3.85 |
| UK All Companies | Vodafone | 3.77 |
| UK All Companies | City of London Investment Group | 3.49 |
| Europe excluding UK | Svenska Handelsbanken | 3.48 |
| UK All Companies | Scottish and Southern Energy | 3.39 |
| North America | AT&T | 3.34 |

### Asset Allocation




### Annualised Volatility

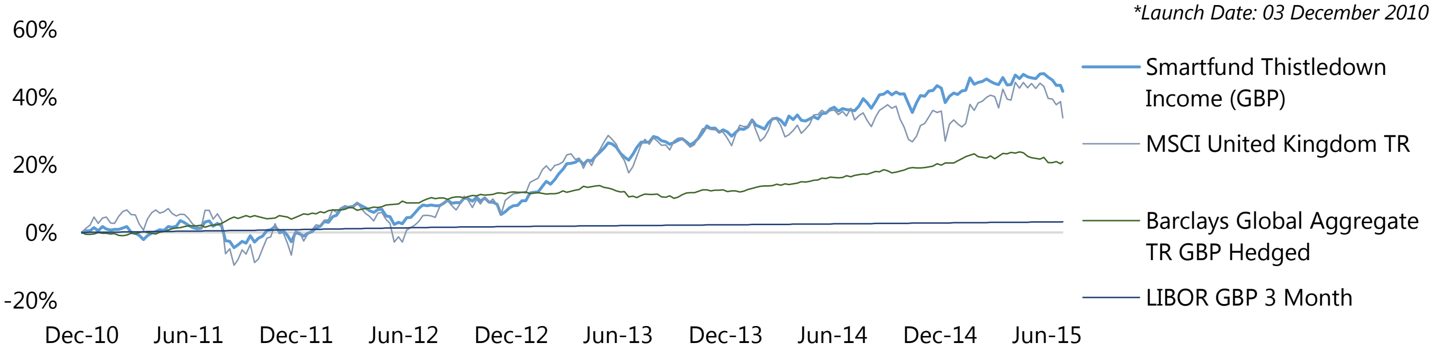
| | |
|---|---|
| Smartfund Thistledown Income (GBP) | 7.11% |
| MSCI United Kingdom TR | 11.23% |
| Barclays Global Aggregate TR GBP Hedged | 2.55% |
| LIBOR GBP 3 Month | 0.06% |

| Discrete Performance * | Q2 2013 - 14 | Q2 2012 - 13 | Q2 2011 - 12 | Q2 2010 - 11 | Q2 2009 - 10 |
|---|---|---|---|---|---|
| Smartfund Thistledown Income (GBP) | 3.9% | 10.7% | 14.9% | 4.3% | - |

**percentage growth for the 12 month period up to the end of the full quarter.*

| Cumulative Performance | 3M | 6M | 1YR | 3YR | Since Launch* |
|---|---|---|---|---|---|
| Smartfund Thistledown Income (GBP) | -1.0% | 0.4% | 3.9% | 32.2% | 41.7% |
| MSCI United Kingdom TR | -2.8% | 1.2% | -0.2% | 29.7% | 33.9% |
| Barclays Global Aggregate TR GBP Hedged | -2.1% | -0.1% | 3.4% | 11.0% | 20.8% |
| LIBOR GBP 3 Month | 0.1% | 0.3% | 0.6% | 1.7% | 3.1% |

**Launch Date: 03 December 2010*




***Past Performance is not a guide to future returns.***

# Smartfund Thistledown Income (GBP)

## Quarterly Factsheet as at 30 June 2015

### Fund Information

| | |
|---|---|
| Fund Manager | Smartfund Administration Ltd |
| Investment Adviser | Thistledown Investment Management Ltd |
| Depositary/Trustee | HSBC Bank plc |
| Fund Launch Date | July 2014 |
| Fund Currency | GBP |
| IMA Sector | Unclassified |
| Fund Type | OEIC UCITS |
| Shares | Income |
| Minimum Initial | £3,000 |
| Minimum Additional | £500 (£250 for regular payments) |
| Minimum Withdrawal | £1,000 (£40 for regular withdrawals) |
| Income payment | Monthly |

| Fees | AC Class | Z Class |
|---|---|---|
| Maximum Initial Charge | 3.00% | 0.00% |
| Annual Management Charge | 1.00%* | 1.00% |

** This represents the typical AMC a new investor would pay. This will vary depending on the adviser charging agreed between the adviser and investor.*

| ISIN | AC Class | Z Class |
|---|---|---|
| Smartfund Thistledown Income (GBP) | GB00BNGXQY93 | GB00BNGXQZ01 |

### Investment Opportunities

- Unit Trust
- ISA
- ISA Transfer
- SIPP (via 3rd party links)
- Offshore Bonds (via 3rd party links)

The Smartfund Thistledown Income Fund is available within a wide range of life and pension products, both onshore and offshore. For full details of where our range of Smartfunds is available please visit www.smartfund.co.uk.

### Thistledown

Thistledown Investment Management Ltd was founded by Dominic Fisher to provide an investment management service that he would want for himself. The firm is an independently owned investment management firm that uses a 'value style' investment approach that it believes has the best chance of producing above market returns over time. The firm's principals, who have worked in financial markets for over 20 years, have a substantial personal investment in the funds managed by Thistledown, including the Smartfund Thistledown Income Fund. As such they have a strong interest in common with investors in the Smartfund Thistledown Income Fund.

Prior to Thistledown, Dominic was a Director and portfolio manager at OLIM Ltd for UK charities, individuals and investment trusts with an income bias. The bulk of his career was spent with Mercury Asset Management managing charity portfolios. Dominic is Chairman of the investment sub-committee of Armed Forces Common Investment Fund and a Director of Aberforth Geared Income Trust plc.

**For more information about the investment adviser please visit:**
**www.thisim.com**
**or email:**
**funds@thisim.com**

### Performance Data

On the 14 July 2014 Smartfund Thistledown Income AUT was converted into Smartfund Thistledown Income ICVC. The fund continues to be managed to the same investment objective and policy. The performance contained in this factsheet is the historic performance of a representative unit in Smartfund Thistledown Income which was launched on 3 December 2010. This representative unit carried an ongoing Annual Management Charge of 1.00%.

### Important Information

Past Performance is not a guide to future returns. The value of an investment and the income from it may fall as well as rise so you may not get back the amount invested. Potential investors in the fund should speak with their financial adviser before making any decisions.

This document relates to one share class available for a sub fund of the Smartfund Thistledown Smartfund. A free English language copy of the ICVC prospectus, the key investor and Supplementary Information documents relating to this share class are available on the website or copies can be requested from Smartfund Administration Limited at 6 Broad Street Place, London EC2M 7JH.

Smartfund Administration Limited is authorised and regulated by the Financial Conduct Authority. Smartfund Administration is a Praemium company.

### Contact details

Smartfund Administration have a dedicated Client Services Team (0844 801 0700) who are available to answer any questions you may have on a day to day basis. Calls may be monitored and recorded for training purposes.