VT Thistledown Income Fund

Quarterly Factsheet

30th June 2018

Objective

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

Investment Manager

Dominic Fisher OBE
Thistledown Investment Management Limited
Further information is available at
www.thisim.com

Investment style: Value

Thistledown are value investors who buy shares in companies that they calculate to be selling below their intrinsic value. This is determined through detailed financial and industrial analysis, combined with a valuation approach that focuses on both stockmarket and corporate worth.

Key Fund information

Fund size	£13.7m
Number of investments	33
Price (Z Acc)	132.2093p

Investment performance

Growth (%)	3m	1y	3y	5y	Inception
Fund (Z Acc)	1.6	2.0	34.6	54.8	90.7
MSCI UK IMI Net	9.3	9.2	31.5	51.0	90.4

Annualised Volatility

Fund (Z Acc)	6.8%
Benchmark	14.5%

Top 10 investments

Asset class	Holding	%
UK Gilts	UK Gilt 22/07/2018	14.4
UK Gilts	iShares UK Gilts 0-5yr UCITS ETF	7.5
Japan	Morant Wright Fuji Yield Fund	7.2
UK Gilts	SPDR Barclays 1-5 Year Gilt UCITS ETF	6.2
Emerging Market Equity	SPDR S&P Emerging Markets Dividend ETF	4.7
Emerging Market Bond	iShares Emer Mrkts Local Govt Bd UCITS ETF	4.2
US Bonds	iShares $ Ultrashort Bond UCITS ETF	4.1
UK All Companies	BP PLC	2.3
UK All Companies	Lloyds Banking Group PLC	2.2
UK All Companies	SSE PLC	2.1

Fees & charges

Annual management charge	1.00%
Performance fee	None
Initial charge	None
Ongoing charges (31 Dec 2017)	1.40%

Yield & dividends

Yield	1.62%
Quarterly dividend (ex date 29 Jun 18, paid 13 Jul 18)	0.8759p

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Security codes & other Fund Information

SEDOL (Z Acc)	BYYP644
ISIN (Z Acc)	GB00BYYP6442
SEDOL (Z Inc)	BNGXQZ0
ISIN (Z Inc)	GB00BNGXQZ01
Shares in Issue (Z Acc)	4,009,577
Market Value (Z Acc)	£5.3m
Launched	December 2010

Available on the following platforms

- Alliance Trust Savings
- Cofunds
- Hargreaves Lansdown
- Transact

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Investment Commentary

INTRODUCTION

What a difference a quarter makes. Last quarter the fund was ahead of the market for all periods, and now it is barely ahead since inception. Why? Because, although the fund rose 2%, the UK stock market rose 9%. I have warned that the fund might lag a rising market. And it's happened before. In the last quarter of 2011, the fund rose 3% while the market rose 8%. Still, it is very uncomfortable to lag this much. I'll write about the outlook later, but first I'd like to emphasise what won't change. I won't try to 'catch up' with the market move of the last quarter. I am convinced that a disciplined value policy works over time. I am even more convinced that attempting to catch up won't work. It would mean focussing on the stock market and its progress, not on mispriced companies. There is no reason to think this change of focus would work, and there are plenty of reasons to believe that a value policy will. After all, although the returns have lagged recently, the fund has delivered the same performance as the market with far less invested since it started.

WHAT HAPPENED?

First holding cash and bonds in a fast-rising market is a mistake but is the unavoidable effect of being cautious. I have repeatedly written that the US stock market is overvalued and advised caution. Little has changed to challenge that view. I write little because, while valuations remain very high by historical standards, the fears that rising interest rates or President Trump's actions would hit the US economy have proved unfounded. You'd have to be blind not to see the strength of the US economy. I read today that the number of workers voluntarily changing jobs has reached a 17-year high. This strength is excellent news for the country but does not alter my view that longer term returns depend on valuation and valuations remain very high in the US. (As an aside I have an acquaintance that knows the US oil industry well. He says that in the shale oil regions there is effectively zero unemployment, while many people look for work. The reason: the workers fail random drug tests required of heavy machine operators.)

Second investments outside the UK held back returns. The culprits were the Emerging Markets fund, the holding in Samsung and the Japanese company Pasona. The investment in Emerging markets has not returned much since it was purchased and fell significantly this quarter. The reasons for investing still hold; emerging markets are lowly valued; the fund is well diversified and pays a reasonable dividend. Samsung has been an excellent investment for us, but the threat of a trade war does challenge such an export lead business. I cannot quantify the danger but continue to believe that Samsung is the most undervalued large technology company globally. Pasona is an unusual situation and investors were disappointed with announcements during the quarter. But at the current price, because of the company's investment in another quoted company Benefit One, investors attach a negative value to the primary business, which seems wrong.

TRANSACTIONS

I invested in TI Fluid Systems and sold the investment in Persimmon.

TI Fluid Systems

The company was floated on the UK stock market last year, but the constituent companies have been on and off the stock market several times during my career. The business supplies fluid systems to the automotive industry. Fluid systems are brake lines, fuel lines, coolant lines and fuel tanks. The parts are supplied globally to most of the large car manufacturers. It is the market leader with around a third of the total market. The company valuation is roughly eight times earnings, a nearly 50% discount to the broad market. Here is why.

First, the flotation allowed Bain the private equity investor to sell part of its stake, but it retains a significant stake which overhangs the market. Second, the automotive industry is reckoned to be in decline given the rise of electric cars. Finally, the company management work in the US, the company financial reports are in €, and it has a listing on the London Stock Exchange. This combination does not help investors understanding. The most intriguing aspect of the company is that it believes that hybrid and electric vehicles are an opportunity for it and not a threat. Competitors support this belief. If they are right earnings could grow substantially and for many years and the company deserves to be valued much more highly.

Persimmon

The fund bought Persimmon immediately after the Brexit referendum and has made over 50% since. It has been in the news for the extraordinarily large bonus paid to the Chief Executive. I take the view that the size of this bonus shows how unexpectedly good the current trading environment has been for the housebuilders. It won't last. The money raised will probably be reinvested into other UK consumer businesses where current trading is less favourable.

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OUTLOOK

I wrote in the fund's annual report that following Warren Buffett, I was prepared to look foolish and unimaginative given the level of speculation in markets represented by takeover activity, underwriting standards and the excitement around cryptocurrencies. I may be missing the point. The fund does not operate in a vacuum. I am the largest investor, but it relies on your continued support. Are you prepared to look foolish and unimaginative? I know that it is difficult to stand back when other investors are making easy money, and lots of it, buying companies that are leaders in today's exciting businesses. It is just that if money is easy to come by common sense suggests something is wrong. I think that speculation and easy money drive the current bull market which will end badly like the two that proceeded it. In the meantime, I'll keep looking for good investments for the fund while maintaining high levels of bonds and cash.

OBSERVATIONS

Good companies don't always make good investments.

One of our investments, Kulicke and Soffa Industries, supplies capital equipment to electronic chip manufacturers. It recently held an analyst's day. The company discussed its business objectives for the next three years. It then presented a range of profits for 2021. These suggest the share price should be around $48 today, against $27. (See reasoning below) The first investment in Kulicke and Soffa was in April 2015 at $14 by October 2015 the price had fallen 40%, and the fund trebled its investment. In March 2016, I presented the company to investors in Madrid. The presentation bombed. Three attendees told me what a mistake it was to present it. I saw a company with a dominant market position in a growing but mature industry, stable gross margins through industry cycles and a balance sheet full of cash. They saw a cyclical company, where profits had fallen 75% in the last two years, which had no plans to return money to shareholders and was making low returns on invested capital.

Another investment in the fund is Svenska Handelsbanken. The bank has a unique business model, and as a customer, I know how good it is. The bank has been particularly good at avoiding crises; its competitors have been bailed out by shareholders or the Swedish government, it has not. It has high returns on capital, barely recorded losses in the financial crisis and is the most highly regarded bank by customers in all its markets. I presented this bank to a conference in the summer of 2015 as a high-quality investment, which it is. My presentation was well received. The price has since fallen around 30% to the same level as five years ago.

Most investors want to buy good quality businesses, but if the quality is evident the price reflects it, and future returns are likely to be unexciting. The opposite also applies. I think the quality of the leading technology companies is evident today; the prices reflect this and future returns will be low.

K&S SIMPLE MODEL

The company forecast earnings in a range of $4 to $4.75 by September 2021 at its July 10th analyst day.

If this is achieved earnings will have risen by over 20% per annum since 2018 as new applications for vehicles, lighting add to a growing core business.

I believe investors will be prepared to pay a market multiple for those earnings. Today that would be 17 times. Using the low profit forecast investors should pay 17 times $4 = $68 in September 2021.

Discounting that value at 10% to today gives a price of $48.

Clearly any number of things can turn out differently, but this is the basic logic.