Macroeconomic Commentary[1]

As with much of the preceding year, the final quarter of 2019 was characterised by all things Brexit and the US-China trade dispute. With progress being made with regards to both, developed market equities made strong gains over the quarter; the S&P 500, FTSE 100 and Euro STOXX were all up 9.1%, 2.7% and 5.2%, respectively. The Conservative Party won a comfortable majority in the December General Election, paving the way for Boris Johnson to push through his Brexit Withdrawal Agreement. The Conservative Majority provided a welcomed boost to UK equity markets, with banks, housebuilders and utilities having the most to gain. The pound also rallied as a result, up 7.9% against the US dollar and up 4.8% against the Euro. A "phase one" trade deal between the US and China and the fact that the US did not follow through on its promise to impose tariffs on EU auto exports, provided a further catalyst to global trade and equity markets. In the fixed income market, the yield on developed market government bonds increased, with the yield on US, UK and German 10-year bonds all decreasing by 25, 33 and 39 basis points respectively, as the political uncertainty which had surrounded 2019 appeared to be reducing.

Fund Commentary

The final quarter of the year saw the Fund return 4.3%, outperforming the IA Flexible Investment Sector (the benchmark) which rose 2.8% over the period[2]. We are pleased to report another top-quartile quarter, adding to our outperformance since inception.

The final quarter of 2019 was very much a tale of two halves, split by the general election in December. The run-up to the event was a nerve-racking time for UK managers. Although it looked an almost certainty that Johnson would get the most votes, the risk was if it would be large enough to form a government. In the weeks leading up to the vote, the probabilities of a Corbyn government oscillated between around 20% and 40%. Whilst we intend to make no political assertions, it was widely thought that a Labour government would have been very damaging for UK business, assets and financial markets. A survey within the investment management sector viewed this as a greater danger than Brexit. Our mission statement for the Fund is to generate equity "style returns" but without the associated volatility. Whilst our animal instincts were saying buy UK plc as a Tory government was the most probable result, we felt we had to cater for the potential fallout if the "outsider" won, especially in light of so many polling upsets in recent years.

Our longer-term investors will know the Fund operates a core and satellite approach. The core is exposed to the markets with a long-term outlook, so we ignore the "noise" and stay invested for the long run. The satellite portion, however, allows for tactical positioning giving us the fluidity to tilt the portfolio and risk depending on the market backdrop. The election period was a period of high activity and in the run-up, we tilted the portfolio to the defensive side by selling some less liquid positions, adding to cash, to fixed interest and increasing our overseas weighting. When the "bookies" were predicting a probability of a 40% chance of a Corbyn government it didn't feel outlandish to have 40% exposure to foreign assets, which would help to moderate the risk of our large exposure to the UK. The markets got the result they had hoped for so the day after the result we pivoted somewhat into more domestically focused UK equities which we believe offer strong relative value due to significant headwinds surrounding Brexit and the election which seemed to be rapidly

(1) Source: Bloomberg.

(2) Source: Bloomberg, FE Analytics. Performance of the Credo Dynamic Fund Class A Retail Shares over the period 30/09/2019 to 31/12/2019.

disappearing. With hindsight, this switch to risk-off will have cost us a small amount of performance over the election. However, this illustrates the importance we place on risk mitigation, the value of the core holdings and why the majority of the Fund is positioned for the long term and avoids such "noise".

Turning to our individual positions over the quarter the biggest contributor was Impax Asset Management Group plc ("Impax"), interestingly a new addition in the period. Impax is a boutique specialist asset manager focused on the transition to a more sustainable global economy. For some time, we have not only admired the efforts taken by firms with an environmentally focused direction but also noticed the strong acceleration in market attention. Whilst much of the asset management world appeared to be evolving in this direction, we felt Impax was a pureplay way to benefit from the theme. The shares continued to rerate throughout the quarter culminating in a pop after results in December.

Another notable contribution came from Elegant Hotels Group plc ("Elegant"). We had always felt this small Caribbean hotel operator was intrinsically undervalued, so it was nice to see Marriot come to a similar conclusion and announce its intention to acquire the company in October. At the opposite end of the market capitalisation spectrum, we would point out Alibaba Group ("Baba") which in dollar terms had a gain of around 21% in the quarter although this would have been slightly less when translated back to sterling. If Elegant was the minnow in our Fund in terms of company size, Baba, as we affectionately call it, is ironically the 800-pound gorilla. Baba is an emerging market commerce conglomerate that was founded 20 years ago but already has $56bn in annual revenue. It operates four distinct business segments: commerce, cloud, media/entertainment, and innovation. The company's mission is to "make it easy to do business anywhere" and it brings this to reality with 64% growth in Alibaba cloud and their Southeast Asia logistics business that grew 100% in the last year. We are excited as the company continues to benefit from the Chinese shift towards online. We have a strong long-term belief that there is much upside on the table and the valuation is still reasonable with a forward P/E in the 20s.

When assessing the attribution of collectives, our largest contributor was our holding in the FTSE 250. As discussed, we see value in the UK market and believe the exciting and dynamic growth stories can be found in this more domestically focused index rather than the FTSE 100. Although the FTSE 100 has some great companies, it will often be more influenced by currency movements which can act as a brake on performance with the majority of revenues coming from overseas.

Oakley Capital Investments ("OCI") is another fund worth a mention. This listed private equity fund comprises of 15 companies across the consumer, education, technology, media, and telecom sectors. We have followed OCI since its IPO in 2007 and Oakley Capital's founder Peter Dubens prior to the launch. OCI is one of the best performing private equity plays in the listed arena yet can sometimes trade at a wide discount to its underlying asset value, at times by as much as 30%. Dynamic bought a position when we felt the portfolio was performing strongly, the group's corporate governance had been strengthened and that discount to asset value was too wide. In December, OCI sold one of its portfolio companies, WebPros, a supplier of automated web hosting software to CVC, at a 92% premium to the carrying value. This led to a 19% rise in the share price over the quarter. We remain happy holders and envisage both further growth in the value per share and a narrowing of the discount as the company continues to perform.

Whilst the strategy of buying good quality funds at a discount to NAV worked very well for OCI and has served us well throughout the years it isn't always fool proof. Crystal Amber Fund Ltd ("Crystal") is a very

concentrated portfolio and operates as an activist investor mainly in the UK public markets. Unfortunately, the underlying holdings of this fund had a terrible quarter,leading to the discount to widen and causing further bifurcation from fair value.

Whilst in a strong market the equity positions above got most of the headlines we should point out all assets classes in the fund performed well. The vast majority of our fixed income is invested in corporate bonds (rather than government bonds) where spreads tightened materially over the period. Notable gains were made in our longer-dated insurance names such as ReAssure Limited, Pension Insurance Corporation, and Nationwide Building Society ("Nationwide"). Nationwide as the largest holding, had the strongest attribution to the Fund benefiting not only from its high coupon but also its exposure to the UK housing market, which is expected to benefit without the Labour overhang. The listed alternative asset class which we view as lower volatility than equities more like a bond proxy, also performed well albeit with lower trading activity. In particular, the newly floated Octopus Renewables Infrastructure Trust plc fund delivered a 7.5% gain in the 3 weeks since its listing in early December.

Looking Forward

We ended 2019 on a positive note and look forward to 2020 with confidence. Valuations do appear "toppy" especially in the US but potential stumbling blocks such as weaker economic data, Chinese/US trade talks and the risk of a no-deal Brexit seem to be dissipating. We enter 2020 with some enthusiasm for the UK, which we think is very much under-owned by global investors presenting us with some unique opportunities. We ended the year with an above-average weighting to equities at 57% of the portfolio and have tilted the portfolio exposure more towards the UK with over 70% exposure to sterling assets on a look-through basis. We believe the strong balance sheets of high-quality UK financials continue to improve, yet yields remain relatively compelling; subsequently, we have slightly extended the duration of our bond portfolio and increased the weighting toward subordinated issues. Although you will note our more positive tone for the UK, we still believe an asset allocation of 43% to lower volatility instruments such as fixed income and listed alternatives has an air of prudence for the later stages in such a long cycle.

Rupert Silver, Lead Portfolio Manager

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