Chelverton European Select Fund

Five Year Retrospective

When we launched the fund five years ago, we were frequently asked what returns we were targeting. Our response was that to be a viable proposition, we needed to be able to compound long-term out-performance of both our peers and the index. Not necessarily annually, but compounding over the long-term, minimum three but really five years. When pushed on a number, we replied that 2.5% - 3.0 % net out-performance on average p.a. should put the fund around the top decile over five years, comfortably so over 10 years.

We launched the B Acc share class at £1 on 6/3/2018 and exactly five years later at £1.59, we have achieved an annualised return of 9.7%. This represents annual outperformance of peers and index of 3.0% and 2.4% respectively. In the Morningstar peer group this places the fund in the 11th percentile. In a five year period including war, a global pandemic, recession, two bear markets as well as the dominance of large cap quality growth funds, we think our report card would read – 'a decent start, in line with where we hoped to be'.

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Three Phases

We would say that within the last five years, we have experienced three broad phases:

1 2018: We had a rough start; with hindsight we launched the fund too early and hadn't researched the universe anything like to the extent we should have. This resulted in a reliance on some legacy names which didn't fit the new process properly. At the end of 2018 we had done much more research and we tightened up on both valuation and risk discipline.

2 2019-2021: Three strong years of absolute and relative performance including a very sharp bounce back from Covid lows which involved us under-performing in the bounce back, backing our smaller companies and being well rewarded in short order for doing so.

3 2022: In a difficult calendar year for equity markets and specifically European small companies, we had something of a 'soft landing' as a large cap buffer and M&A helped us negotiate the falls. We were very active during the falls, adding a number of new holdings and taking a zero-tolerance approach to balance sheet risk in the portfolio.

Source: Morningstar. As of 06/03/2023. In GBP. Time Period: Since Common Inception (06/03/2018) to 06/03/2023

We have performed better in rising markets than falling markets. This is no revelation considering our small-cap bias, and is something we are comfortable with given that we are here for the long haul and given the market's tendency to rise over the longer term. Successful investing is about more than getting the analysis right. It is often about holding nerve at points of maximum pressure – usually in draw-downs. Over the piece we're happy with the way we responded in the three periods of draw-down >10% we have experienced. The difficult start was arguably the best thing that could have happened to us.

Stock Selection

The performance analytics suggest that the stock selection effect is the strongest aspect of our performance. This is as it should be we think. We have appended stock-level attribution analysis which looks at the top and bottom contributors to performance over the five years.

We think the following points can be made:

- We still hold 13 of the top 20 contributors – we would describe at least half of these as still with very significant long-term potential- the rest 'just' still good value. We would likely hold three more if they hadn't been taken over. Three were sold on valuation/risk grounds with the remaining holding sold due to better ideas emerging at the time.
- Eight of the top 20 come from our 'Digitalisation' cluster and we still hold seven of them – illustrating the long term nature of the theme of technology under-investment in Europe.
- Geographically, not sure a huge amount can be read into the results – 10 countries feature in the top 20, eight in the bottom 20. German stocks take the wooden spoon with net five contributors but based on wide range of sectors, not sure much can be concluded from this.
- PostNL deserves a paragraph to itself... please see below.
- In contrast to still owning 13 of the top 20, we currently only own three of the bottom 20. This speaks to our desire to cut losses where investment cases have changed – especially where increasing balance sheet risk is an influence.
- A few of the losers we have cut have gone on to be very strong performers. However, these are outnumbered by the sales which continued to under-perform. 'Letting go' after realising a loss is something we can always improve at, but we tend not to beat ourselves up too much about, conscious as we are that successfully cutting losers is an important trait of being a successful portfolio manager.
- For at least half of our winners, our resolve has been tested in a significant way by a period of absolute or relative under-performance and whilst you can't load up on everything at the bottom, we think we have averaged down sensibly in many cases.

On PostNL: Feet firmly on the ground

If you follow any particular sport, you will be familiar with the concept of having a 'bogey team'. Well, it appears this concept has followed Dale into portfolio management. The bogey stock in our portfolio is the former Dutch state-owned deliverer of your daily junk mail and occasional bill: PostNL. Despite an apparently sound initial investment case each time, not only did Dale lose money on PostNL during his time at Edinburgh Partners- however not once, but twice, money has been lost on it at Chelverton. God loves a trier but in this case we should adapt the British Olympian Steve Redgrave's famous quote after exhausting himself on way to his fifth Olympic gold – 'anybody sees me go anywhere near a boat, they have my permission to shoot me'. Same applies to the Chelverton European Select and PostNL!

Market-cap Observations

From a size perspective a performance summary is as follows:

Segment	Average Allocation to Segment	Proportion of Performance Contributed	Top Three Stocks
Large Cap >£5bn	39.7%	26.0%	Novo Nordisk Novartis* Roche*
Mid Cap £2-5bn	12.2%	8.6%	D'Ieteren* Valmet* Signify*
Small Cap £500m- £2bn	18.7%	20.1%	ASM International* BE Semiconductor* Arcadis*
Micro Cap <£500m	24.7%	45.3%	Recticel* CPL Resources Ordina*

Source: Chelverton Asset Management and Bloomberg data.
Performance period 07/03/2028 - 06/03/2023.
**Stocks still held in the portfolio*

The above table assumes the full contribution stays in the size category – for example, Recticel started as a micro-cap but is now a small cap by our definition.

One of our most significant observations over the last five years is just how inefficient the small cap universe is. Sure, we expected this to some extent and of course we were aware of the well-documented small-cap effect. However, it's only in digging around that we have been pleasantly surprised that the mis-pricings are more abundant than we could have hoped five years ago.

A recurring question we receive is if we are so positive on small caps, why not go all-in and remove our large cap holdings. The table above suggests large caps have fallen short in their contribution. This is not the only aspect to consider however. Large caps should have lower volatility and protect in draw-downs. The three periods of draw-down the fund experienced confirmed that large caps helped us and proved their worth to the portfolio. For example, in the 2022 sell off, peak to trough, the fund fell-22% while our large cap contribution was 'only'-12%.

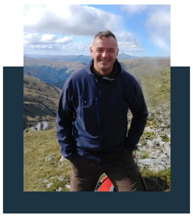
Our Learnings

Here are some things we have learnt, continue to learn and re-learn (!) on a regular basis:

- Don't think you can time the market with flows and use of cash.
- Don’t try to retrofit stocks to an appealing sounding top down narrative (the ‘defensive cluster’ of 2021).
- Don’t allow reporting or marketing, i.e. short term cycles to influence investment decisions.
- Stories must always be supported by cashflows, valuation and balance sheet.
- Don’t angst about selling stocks too early or indeed selling them at a bad time. We are playing valuation arbitrage; as long as long-term returns are decent and we fill the hopper with new ideas, we will be just fine.
- Do not buy PostNL. Ever again. Even if it changes its name or primary activities!
- Always look at the valuation of a company, not the recent share price performance. If a stock is cheap and fits the process, own it- sure we can average in, but don’t wait for a short-term share price pull back.
- Always look gift horses in the mouth. But also remember that markets are inefficient – it might just be as cheap as it looks!
- Don’t get bored with ideas if the share price hasn’t gone up yet – re-read the case notes. Remember, we liked it when we bought it and if nothing has changed then it's just time arbitrage. Be patient.

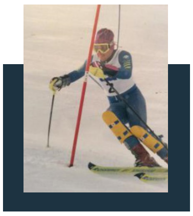
Final Thoughts

Dale Robertson



" On a personal level one of the most positive aspects of what we have done is remove ‘style anxiety’ from the equation. This occurred at Edinburgh Partners for me when managing money in a certain style - you become reliant on the style being in favour. I have always felt that the majority of investors consider the usual factors: growth, valuation, quality etc, but it’s what gets prioritised which sets the tone for the approach. A growth investor might prioritise the presence of a competitive moat with valuation as a lower priority. Our equal insistence on value <u>and</u> growth is significant and ensures we have a healthy balance, not overly skewed to either extreme. The focus is on making money, not out-performing a style.

Gareth Rudd



" Building out a process based on a strong valuation discipline, combined with cashflow analysis at its heart, has been an extremely rewarding experience over the last five years. A process needs to be comprehensive enough to be credible, but also relatively easy to articulate. I think we have achieved this (my straw poll is always whether my mum can understand it – which she almost can!). I am fond of saying that every day is a school day, and in investment management I really believe this to be true. I feel that despite my many years in the industry, I am always learning – new themes, ideas, companies, and from (frequent) mistakes. The good news is when it comes to investment management, I think we do improve with age like a fine wine! Having the correct balance between confidence and humility is key to managing investments. It’s a privilege to do so, and with 5 years down, I genuinely feel as though we are just getting started.

We have had fun. We continue to learn. We have made some great investments and we have made some poor ones. We are optimistic – not just about the current portfolio and its exposures, but about the ability of our philosophy and process to guide us through the ups and downs which lay ahead. It's a joy getting out of bed, motivated by finding a new idea, learning about a new technology or working through a challenge...to the next 5 years we say... bring it on!

Top Twenty Contributors

Company	BPs	Perf	Comment/Action (where taken)
ASM International *	748	1034%	Semiconductor capital equipment – company dominates an expanding niche
BE Semiconductor *	611	418%	Semiconductor capital equipment – structural theme – company dominates an expanding niche
D'Ieteren *	415	307%	Belgian holdco – key asset Belron (trades as Autoglass) huge growth + more proactive group mgmt.
Arcadis *	378	162%	Dutch engineering consultant – was a turnaround at purchase, now a steady grower on reasonable valuation
Recticel *	348	133%	Belgian industrial group underwent a restructuring and now is a pure-play insulation company
CPL Resources	329	86%	Irish recruitment consultant – we lamented the takeover of this group
Ordina *	312	159%	Dutch IT services – steady grower, improving margins and strong capital returns
Sword *	304	114%	French IT services – strong organic growth coupled with excellent sales of group assets
Valmet *	281	146%	Finnish capital goods – returns have improved as service/maintenance increased in mix
Limes Schlosskliniken *	268	229%	German/Swiss mental health treatment – self funded roll-out progressing well
KnowIT	264	73%	Swedish IT services – grew rapidly – we sold as valuation got quite a bit ahead of itself
Novo Nordisk	247	135%	Insulin & diabetes leader – we sold as got uncomfortable with the growth/value equation
TXT E-Solutions *	227	165%	Italian IT services – executing well on both organic growth and opportunistic M&A
Siili Solutions *	225	65%	Finnish IT services – delivering on both growth and margin improvement
Proact IT	220	71%	Nordic reseller of IT equipment – we sold after rerating
Artefact	196	102%	French digital marketing agency – another one we were sorry to see getting taken over
Novartis *	188	66%	Pharma – get rich slowly and steadily has its place in diversified all-cap portfolio
Roche *	176	62%	See Novartis above
Swedish Match	173	56%	Taken over by Philip Morris – was a long-flagged/anticipated M&A target on a reasonable valuation
Zurich Insurance Group	168	74%	Steady grower + good dividend returns – sold as rerated and had better ideas

Source: Bloomberg 05/03/2023
** Stock still held in 07/03/2023 portfolio*

Top Twenty Detractors

Company	BPs	Perf	Comment/Action (where taken)
PostNL	-329	-76%	Dutch postal services – got our timing badly wrong here – twice – sold latterly as balance sheet concerns reignited
Huddly *	-262	-84%	Norwegian meeting room cameras – so far we have got the market potential wrong here – hindered by poor execution / mgmt. change
Bank of Ireland	-215	-58%	Sold during covid period – we consolidated bank holding into better capitalised ING – would have been better holding on
GAM Holding	-205	-68%	Asset manager- was an early value stock case – was right decision to sell
Knaus Tabbert	-148	-54%	German camper vans – we sold during 2022 in our 'zero-tolerance to balance sheet risk' purge
Serviceware *	-143	-56%	German software which measures efficiency – got timing wrong but believe long term case intact – deep value and growth
Fugro	-137	-42%	Part of the mis-timed investment in energy capex 2018/2019 - underestimated balance sheet risk at the time here
Subsea 7	-130	-53%	2018 we played Energy Capex 1.0 – got timing wrong and now back involved albeit not with Subsea 7
Unicredit	-115	-34%	Italian bank we switched into smaller better capitalised financial (Banca IFIS) – both subsequently did well
AMS-Osram	-115	-53%	Austrian semi-company – was a turnaround case but balance sheet deteriorated so we sold
Borr Drilling	-112	-26%	As for Subsea 7 and Fugro from 2018/2019 – was right decision to sell as needed recapitalised
Banco Santander	-107	-34%	Was sold as part of consolidation of bank holdings post-covid – performed modestly since so probably correct decision
Alkemy *	-96	-29%	Italian digital marketing agency – we bought this after Artefact taken over (see top 20) – timing not great but confident will come good
Ringmetall	-90	-37%	Small German industrial - sold as had better ideas – looks like right decision – performed moderately since
Vidrala	-85	-34%	Spanish glass maker – was hoping would be more defensive but volatility of input costs made us seek other ideas
ICF Group	-83	-40%	Italian speciality glue maker – not as steady a top line as we had hoped so we sold - done nothing since we sold
Bayer	-75	-33%	German value trap – although has perked up of late we got out well
Renault	-70	-22%	French value trap – sold as part of value/growth reappraisal at start of 2019
TKH Group	-69	-52%	Dutch industrial conglomerate – hadn't done much wrong but had better ideas at time
Kion	-65	-28%	German – forklift trucks - we sold as off balance sheet risks underappreciated – got this right

Source: Bloomberg 05/03/2023
** Stock still held in 07/03/2023 portfolio*

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