Marlborough International

January 2020

Marlborough 2019 Review

While the investment weather outside was frightful in the lead up to Christmas 2018 - completing a generally depressing year in terms of returns - this past year has evidenced the mantra that market timing is a mug's game. Completely contrary to the experience in 2018, you would have been unlucky (or careless) to lose money in 2019 in sterling terms as it was very merry for pretty much every asset class. US equities led the way with a 25% return for sterling investors, despite the pound strengthening significantly in the second half of the year. Technology stocks set the pace, with Apple's share price doubling over the year as the company overtook Microsoft to regain its number one slot as the world's most valuable company, its shares now worth $170 for every man, woman and child on the planet, equivalent to 1.6% of global production as measured by planet Earth's GDP.

Despite Brexit concerns, the broad FTSE All-Share Index of 600 leading companies climbed by over 19%. The market had actually moved sideways for eight months of the year following a fantastic first quarter's advance of 10%, but the fourth quarter saw a resurgent market, and an excellent December following the Conservative Party's devastating - at least from Jeremy Corbyn's perspective - victory, producing a robust working majority to support Boris Johnson's manifesto plans.

There were some clear and positive catalysts for equity markets' behaviour in 2019. Two key political uncertainties that weighed on economic sentiment appeared to dissipate. For the global economy, the 'Phase 1' deal between the US and Chinese administrations avoided the increase in tariffs due on 15th December. In the UK, of course, the new government now has a clear mandate to complete Brexit negotiations. This does not, however, take no deal off the table - while the UK will leave the EU on the 31st January with a withdrawal deal, we will enter a transition period during which our current trading relationship with the EU will continue while the two sides negotiate not only a free-trade deal, but also our relationship regarding law enforcement, data sharing and security. Boris Johnson has stated there will be no extension to the transition period that ends on 31st December this year; if no deal has been agreed, we will leave the EU without one. This is, in our view, more of a negotiating tactic to secure the best trade terms possible with the EU.

It is perhaps remarkable that global equities did so well in 2019, despite weakening economic data. Less surprising was the performance of government bonds; central banks' response to less-than-positive economic forecasts was to increase their commitment to stimulating economic expansion. This backdrop led to yields falling - and hence bond prices rising - as the threat of interest rate rises receded. Banks' return to stimulus in turn boosted equity investors' belief that expansion would continue for the time being, versus potential recessionary conditions. Consequently, we got a very unusual sweet spot where both equities and bonds did very well - a great boost to balanced investors' returns in 2019.

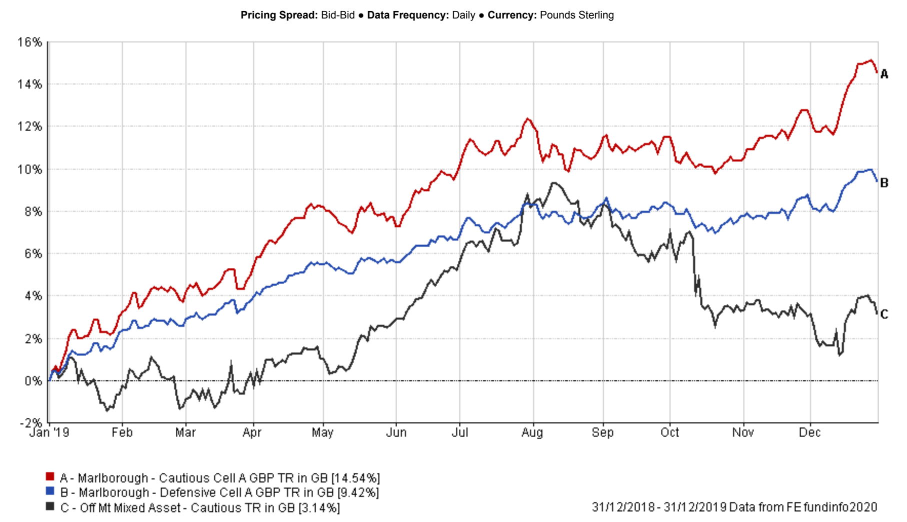
However, not all was positive for retail investors in 2019. A significant negative was the propensity for some multi-asset portfolios to be over-exposed to illiquid assets, i.e. those difficult to sell if investors decided to withdraw capital en masse. Funds managed by Neil Woodford held what have been deemed by the regulator to be excessive amounts of unquoted companies and, more recently, some UK funds investing in commercial properties had insufficient free cash to satisfy investors' withdrawal requests and were forced to temporarily suspend redemptions in order to have a controlled sale of assets. This has put pressure on multi-asset funds of funds which have exposure to this asset class.

Where property is concerned, anyone who has tried to sell a house knows the process cannot be done in a day, unlike selling most large companies' shares. Consequently, exposure to commercial property should not be used as a source of ready cash. Marlborough's range of multi-asset funds and portfolios does not have any exposure to direct, 'bricks and mortar' property. The funds are traded on a daily basis.

Looking forward to 2020, international investors worried about the prospect of a left-wing government have largely avoided UK equities during 2019, and we expect the election result to lead to a positive re-rating of UK growth equities through this year.

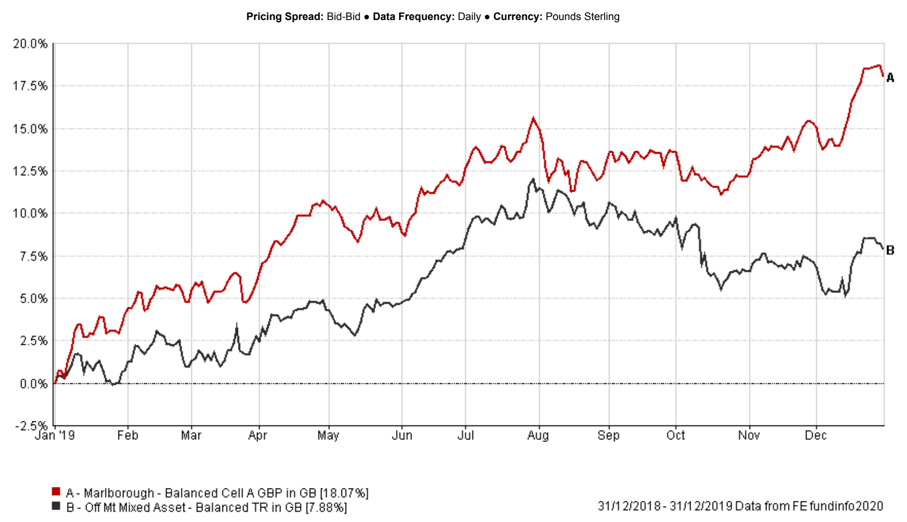
Boding well for global confidence, we note in the US the recent NFIB small-business owners' confidence indicator showed its largest month-on-month gain since May 2018. Also, US industrial production numbers rose, marking their biggest monthly increase since October 2017. Since 2020 will be an election year in the USA, it is only a matter of time before there is a more meaningful pact between China and America beyond stage one of their deal. This will have a knock-on effect for trade globally.

Marlborough Cautious and Defensive Performance 2019



Source: FE FundInfo

Marlborough Balanced Performance 2019



Source: FE FundInfo

Marlborough risk-targeted portfolios

In a complete reversal from the experience in 2018, 95% of FE Offshore mutual sectors on average returned a profit for investors.

The offshore multi-asset sector that holds a significant majority of investors' funds is Balanced, containing over 690 funds that were available throughout 2019, holding total assets of over £240bn. Thirty-nine of those funds, despite the favourable market tailwind, still contrived to lose clients' money over the year. Marlborough's Balanced fund on the other hand returned over 18%, more than 10% in excess of the average fund, ranking it 15th out of 692 funds.

As we reported last year, Marlborough's philosophy and pedigree is to focus on long-term growth prospects, particularly in small and medium-sized companies. If you are looking for a bounce in performance, you have to be on the trampoline, and as is usually the case, after being punished most in the 2018 sell-off, smaller companies rebounded the most over last year. In the final quarter of 2019, the average smaller companies fund rose by almost 14%, and 25% over the full year. The FTSE 100 index of the UK's largest companies meanwhile rose by less than 18% through 2019.

Marlborough Cautious fund rose by almost 15%, ranking sixth out of over 700 funds, while the very low volatility Defensive fund, benefitting from a 15% increase in exposure to equities implemented at the start of 2019, rose by over 9% and as a consequence delivered first decile performance in that same Cautious sector.

Marlborough's Adventurous portfolio rewarded sterling investors with almost 19% over 2019 - first quartile performance when measured against the International Equity sector, and top decile against over 400 funds constituting the Aggressive sector.

Marlborough investors who remained committed to long-term investing, rather than trying to time the market, have seen remarkable results since the funds launched in mid-2016. The Cautious fund has produced more than twice the sector returns, while Balanced has almost doubled its sector's average return.

Underlying fund updates

Special Situations Fund

For the full year 2019, the P shares finished up 19.71%. This compared to +13.79% for the SmallCap ex-IT Index, +11.61% for AIM and +25.03% for the FTSE 250.

In December we initiated a position in leading ventilation product supplier Volution. Production problems have been resolved at its Reading facility, increasing capacity by 50%. With industry-leading scale and range, the group is well placed to increase its margins through scale and efficiency especially as organic growth improves in a more stable macro environment and as environmental drivers and regulation increases. We are delighted that our holding subsequently rose 25% during the month.

Top performer in the month was Renew Holdings (+40%), the engineering services group supporting UK infrastructure in the transport, energy and environmental sectors. Other winners were industry-leading supplier of concrete-levelling equipment, Somero Enterprises (+39%), and secure data erasure and mobile device diagnostics provider, Blancco Technology (+29%).

Larger trades saw us initiate a position in Pets at Home following strong interim results in which like-for-like sales growth exceeded 7%. The retail side of the business is performing well, while the maturing veterinary business will boost margins. Pet owners have a very high lifetime value ('LTV') and the company is doing an admirable job of bolstering its Club membership. Finally, while Amazon poses a threat - as it does to all retailers - the inability to offer a full suite of products and services to pet owners should keep Pets at Home relevant.

Multi Cap Income Fund

For the year 2019, the P shares rose 26.8% compared with the FTSE All-Share TR Index up 19.2%. The fund remains top quartile for total returns compared with its sector both for one year and also over a three-year period.

Winners this month included Dunelm (+c.37.5%), which rose on the back of a trading update saying 2020 pre-tax profits would be stronger than previously expected. This was due to better sourcing gains but also a new digital platform that has seen all customers transitioned successfully. Cenkos (+c.41%) jumped following the news of their previous co-founder, Andy Stewart, acquiring a significant stake to now hold 7.43% of the company. Hyve Group (+c.24%) shot up on news of the acquisition of two US retail industry conferences for c. £64m (via an over-subscribed equity placing). Hollywood Bowl (+c.14.%) delivered strong full year results with like-for-like revenues up 5.5%, operating profits up 14.3% and net debt down almost 16% to just £2.1m. The final dividend was raised 22% and a special dividend was also declared.

UK Multi-Cap Growth Fund

During 2019, the value of the Fund appreciated by 29.2%. This compares with the performance of the FTSE 100 which rose 17.3%, the FTSE 250 which went up by 28.9% and the FTSE SmallCap which climbed 18.8%.

Whilst improved sentiment buoyed appetite for more domestic cyclical stocks, our more growth and internationally exposed stocks continued to outperform on the back of strong trading updates. Tesco rose by 11% after the company announced the possible sale of its businesses in Thailand and Malaysia. These assets are valued c.$9bn and could result in a material return of value to stakeholders. Dart Group rose by 14%, buoyed by the collapse of Thomas Cook. With over £300m net cash on its balance sheet, and with partially overlapping routes and non-overlapping customer base, Dart is ideally placed to take market share. Other strong performers included GB Group, Liontrust Asset Management and the London Stock Exchange. During December we marginally reduced large and strong performing holdings in Genus, Rentokil and Gamma Communications and reinvested the proceeds into existing smaller holdings such as Future Plc, WH Smith, Intermediate Capital, BooHoo and Liontrust.

We continue to invest in UK and internationally exposed businesses that are leaders in niche structural growth markets and demonstrate strong market share growth. High returns on invested capital allow target companies to re-invest for future expansion, resulting in compound earnings growth over many years.

US Multi-Cap Income Fund

The US equity market closed 2019 on a high note with the S&P 500 returning 3% in dollar terms during December and over 31% for the full year. The fund trailed the index and peers during the month but finished the full year well ahead of both standards.

Apple was the Fund's best performing stock during December. Apple is one of the world's foremost providers of smart phones and consumer technology. On top of that, the company has been building a burgeoning ecosystem of recurring services that leverage their hardware. As this new source of stable revenue grows and offsets some of the cyclicality of phone product cycles, investors have shown a willingness to pay more for the stock that was trading at depressed multiples of free cash flow. We continue to see value in their franchises and expect shares to be supported by abundant and growing free cash flow and a healthy balance sheet.

Gilead Sciences was one of the fund's weakest performers this month. Gilead is a biopharmaceutical company and the dominant global leader in HIV therapies. Drug pricing has been a key political debate in the US recently. The Democratic primary election has cast a brighter spotlight on the industry. This has weighed on drug makers and Gilead is no exception. Regulatory pressure on pricing is a concern but we see Gilead's HIV franchise as more insulated than many pharmaceuticals. In addition, we view Gilead's current valuation presenting a favourable risk reward profile and see limited downside in shares today.

European Multi-Cap Fund

European equity markets continued their positive momentum in December following the result of the UK election and encouraging comments relating to trade talks between the US and China. Both small and microcap indices outperformed the large cap index.

For the full-year 2019, MSCI index returns were +19.99%, +21.28%, and +15.89% for the standard, small and micro-cap indices respectively, while the fund's P share returned +22.69% (all in sterling). It should be noted that sterling strengthened against the Euro during the year by +6.32%.

In December the best performers for the fund were Finnish accountancy group Talenom (valuation discount to quoted peers closing), Swedish automotive fastener supplier Bulten (acquisition of international fastener business PSM International), Swedish casting technology business Sintercast (system upgrade order from a customer), French test system manufacturer Microwave Vision (signed a significant defence development contract).

Complete sales were made of French reinsurance company Scor (company's next strategic plan provides only modest upside to current share price), Spanish swimming pool equipment vendor Fluidra (concerns over demand in the US following weaker new housing starts) and Norwegian embedded software group Data Respons (sold following the bid from AKKA Technologies at 20% premium).

Despite ongoing threats to world economic growth from ongoing trade deal negotiations (both US/China and UK/EU), the IMF is expecting to see a slight rebound in growth for 2020. IMF European GDP growth forecast is 1.8% for 2020 citing a pickup in external demand).

During the last few months of 2019 the fund saw three takeover bids (Cramo at a 30% premium, Swedol at a 30% premium and Data Respons at a 20% premium). This demonstrates that there are still attractive companies across Europe which remain undervalued. We believe that these opportunities are most prevalent in the less well-researched smaller segment of the market. Given this and our focus on well-managed companies capable of significant expansion over time, we remain confident about the fund's outlook. Valuation levels remain at the high end of their historic range, reflecting the continued very low interest rates in most countries.

Global Bond Fund

Global bond markets produced significant returns last year through a combination of lower government bond yields, on the back of further reductions in short-term interest rates, and a tightening of credit spreads across all sectors and rating categories, as Central Bankers further loosened the monetary taps. The strength of the pound dampened returns for sterling-based investors somewhat but in US dollar terms total returns on the US Corporate (both Investment Grade and High Yield) and Government bond indices were around 14% and 7% respectively. These returns, far in excess of prevailing yields at the start of the year, have taken capital values to new heights, thus suppressing the

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Marlborough **CAUTIOUS** — View fact sheet

Marlborough **BALANCED** — View fact sheet

Marlborough **ADVENTUROUS** — View fact sheet

distribution yield levels for all but the most aggressively positioned bond funds. In addition, we have forsaken some extra yield by gradually increasing the credit quality of the fund throughout the year, as the economic cycle matures, to provide some protection against a deterioration of credit conditions in the event of any further slowdown of economic growth.

Graham Bentley
January 2020

Risk Warnings

The following is a summary only of some key items in the Prospectus. Investors in Protected Cell Company (PCC) must have the financial expertise and willingness to accept the risks inherent in this investment. **Capital is at risk. These are the author's views at the time of writing and may be subject to change. These opinions should not be construed as investment advice. The value and income from investments can go down as well as up and are not guaranteed. An investor may get back significantly less than they invest.** Past performance is not a reliable indicator of current or future performance and should not be the sole factor considered when selecting funds. Our fund of funds range invests for the long-term and may not be appropriate for investors who plan to take money out within five years. The funds will be exposed to stock markets. Stock market prices can move irrationally and be affected unpredictably by diverse factors, including political and economic events. The funds have significant exposure to bonds, the prices of which will be impacted by factors including; changes in interest rates, inflation expectations and perceived credit quality. When interest rates rise, bond values generally fall. This risk is generally greater for longer term bonds and for bonds with higher credit quality. The funds invest in other currencies. Changes in exchange rates will therefore affect the value of your investment. The funds may invest a large part of its assets in other funds for which investment decisions are made independently of the fund. If these investment managers perform poorly, the value of your investment is likely to be adversely affected. Investment in other funds may also lead to duplication of fees and commissions. Shares may not be redeemed otherwise than on any Dealing Day. There will not be any secondary market in the shares of the Company.

Regulatory Information

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