SKAGEN Focus A

All data in EUR as of 30/09/2019 unless otherwise stated.

Promising rotation into value assets

The end of Q3 turned out to be a rather interesting period, particularly for value investors like ourselves, as we observed a rather powerful rotation into value assets. The fund therefore ended the quarter with a decent absolute return. We believe there are several different factors at play behind the emerging rotation into value. The backdrop to this is an exceptionally long period of value underperformance; indeed, specific contrarian value areas of the global equity market have not traded this cheaply since the financial crisis of 2008/2009.

We believe that the market is starting to sense a new wave of stimulus coming through, primarily via synchronised monetary easing globally, to meet the perceived threat of recession, which is gradually building worldwide. Our view is that even limited changes to the interest rate picture will negatively alter the valuation dynamics of more expensive areas of global equity. Areas currently trading exceptionally cheaply include lumber and pulp markets, Japanese small/mid-caps, European banks and auto-parts. Overall, we believe there is a huge rotation potential from expensive quality to inexpensive risk as the gap between the two areas is still near extreme levels.

Key buys
On that topic, we can disclose a new holding in the well-capitalised German-based auto-parts and tyre producer Continental, which we believe offers exceptional value at current levels and comes with tangible catalysts for re-rating in the next 2-3 years. Times are tough in the sector, with massive price pressure from original equipment manufacturers (OEMs) and an overall transition to electric vehicles, but we think Continental will continue to play a significant role in the space. The company will spin-off its Powertrain business and execute upon a restructuring to streamline the company structure and cut costs. We also added a position in US food retailer Kroger, which is the second largest grocery retailer in the US. Kroger operates with a healthy balance sheet and currently produces a very attractive free cash flow yield for investors even in a fairly difficult market climate. We believe the company is much better positioned in the online segment than perceived and has an innovative edge with its overall offering.

Contributors
The top performing position in the quarter was Austrian-based integrated energy company OMV, which entered the portfolio around one year ago. The market seems to be starting to appreciate the above-average free cash flow yield and strong balance sheet, with decent growth prospects from a mid-term perspective. The French cable producer Nexans has also performed strongly this year and since entering the portfolio one year ago. The shares briefly reached our price target and we reduced the position accordingly.

Following the merger announcement of CBS and Viacom, to which the share price of both companies reacted negatively, we decided to concentrate our holding in Viacom. CBS and Viacom shares will trade in tandem as the share swap ratio is set and we think there is some likelihood of a higher price ratio for Viacom shares, especially in the A-share class. In general, we think the market underestimates the duration of strong cash flow and the potential for synergies between the two entities.

Since reducing our position in lumber producer West Fraser and pulp producer Canfor Pulp and acknowledging that we entered these investment cases too early, we have now marginally increased the positions again. Lumber and pulp prices have started to recover and the shares trade at multi-decade low valuations to normalised earnings. We observed a similar re-rating in the West Fraser stock price late in the quarter.

Photo: Bloomberg

Photo: Bloomberg

The investor Michael Burry, who rose to fame for betting against subprime mortgage funds and featured in the film The Big Short, recently stated: "*It is not hard in Japan to find simple extreme undervaluation – low earnings multiple, or low free cash flow multiple. In many cases, the company might have significant cash or stock holdings that make up a lot of the stock price*." He also highlighted a number of investments in the Japanese small/mid cap area, which he referred to as the "value trade of the decade". His views reflect the base-line assumptions in our investments in JapEx, Teikoku-Sen-I, Bank of Kyoto, Pasona and Toyota Industries. These companies hold quality non-core assets, which make up a substantial part of the respective market caps, if not the total market cap at inception points. In addition, they hold several company-specific catalysts for revaluation within 2-3 years.

Outlook
At quarter end, the portfolio consists of 35 positions with a top-10 concentration of 46% and, as you would expect from a value investor, a markedly lower price/book multiple than global equity market averages at below 1.0 with a still decent portfolio return on equity just shy of 10%. The aggregated upside to our price targets is in excess of 50% with a 2-3 year investment horizon at the end of the quarter.

Quarterly Report

SKAGEN Focus A

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The fund is a concentrated global equity fund with a mandate to invest in all cap-sizes, geographies and sectors globally. With our concentrated portfolio of 30-35 core positions, we aim to generate absolute returns at a controlled level of absolute risk.

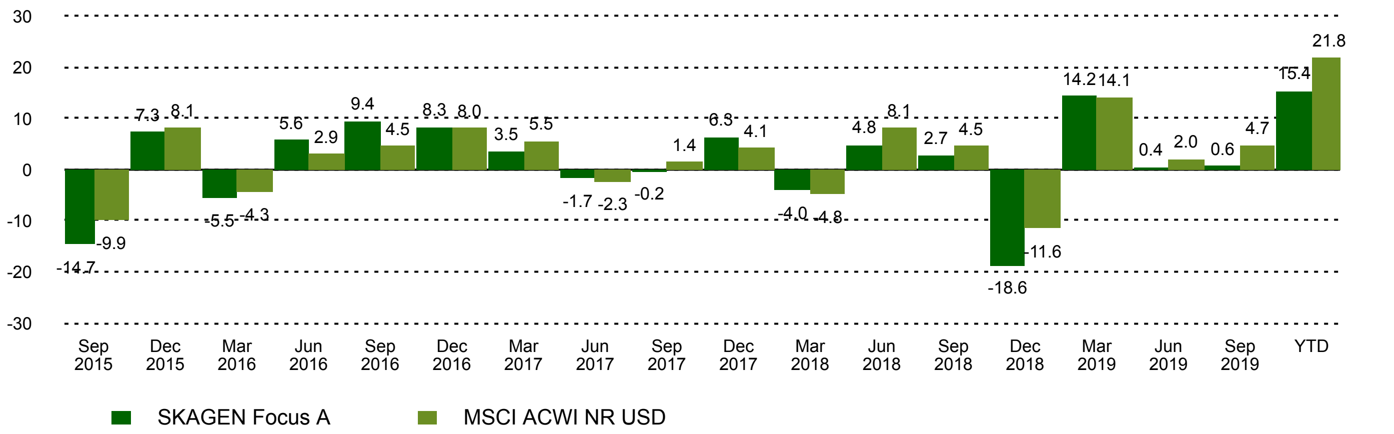
Fund Facts

Type	Equity
Domicile	Norway
Launch date	26.05.2015
Morningstar category	Global Flex-Cap Equity
ISIN	NO0010735129
NAV	12.43 EUR
Fixed management fee	1.60%
Total expense ratio (2018)	0.8%
Benchmark index	MSCI ACWI NR USD
AUM (mill.)	175.12 EUR
Number of holdings	35
Portfolio manager	Jonas Edholm

Historical performance (net of fees)

Period	SKAGEN Focus A	Benchmark index
Last month	3.8%	3.2%
Quarter to date	0.6%	4.7%
Year to date	15.4%	21.8%
Last year	-6.1%	7.7%
Last 3 years	4.3%	10.9%
Since start	1.1%	6.2%

Quarterly Performance



Contributors in the quarter

Largest contributors

Holding	Weight (%)	Contribution (%)
OMV AG	5.27	0.84
American International Group	7.10	0.81
Japan Petroleum Exploration	3.19	0.59
STMicroelectronics NV	3.50	0.57
Nexans SA	2.52	0.52

Largest detractors

Holding	Weight (%)	Contribution (%)
Ivanhoe Mines Ltd	4.24	-0.55
Viacom Inc	3.12	-0.53
SoftBank Group Corp	2.04	-0.36
Sao Martinho SA	4.42	-0.31
MagForce AG	1.72	-0.31

Absolute contribution based on NOK returns at fund level

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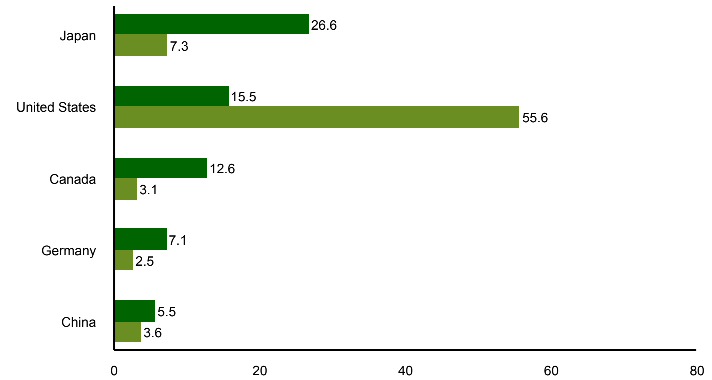
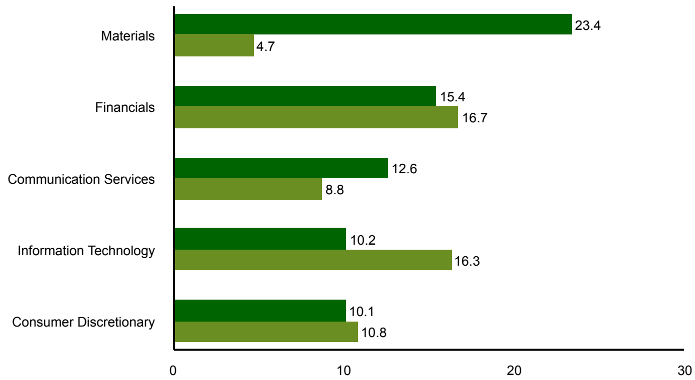
Top ten investments

Holding	Sector	Country	%
American International Group Inc	Financials	United States	5.6
China Unicom Hong Kong Ltd	Communication Services	China	5.5
OMV AG	Energy	Austria	5.2
Bank of Kyoto Ltd/The	Financials	Japan	4.8
Hitachi Ltd	Information Technology	Japan	4.6
Sao Martinho SA	Consumer Staples	Brazil	4.4
Toyota Industries Corp	Consumer Discretionary	Japan	4.0
Ivanhoe Mines Ltd	Materials	Canada	3.9
STMicroelectronics NV	Information Technology	Switzerland	3.8
Roxgold Inc	Materials	Canada	3.7
Combined weight of top 10 holdings			45.6

Country exposure (top five)



Sector exposure (top five)



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Important information

Unless otherwise stated, performance data relates to class A units and is net of fees. AUM data as of the end of the previous month. Except otherwise stated, the source of all information is SKAGEN AS. Historical returns are no guarantee for future returns. Future returns will depend, inter alia, on market developments, the fund manager's skills, the fund's risk profile and subscription and management fees. The return may become negative as a result of negative price developments. You can download more information including subscription/redemption forms, full prospectus, Key Investor Information Documents (KIID), General Commercial Terms, Annual Reports and Monthly Reports from our local websites or our local representatives. Statements reflect the portfolio managers' viewpoint at a given time, and this viewpoint may be changed without notice. This report should not be perceived as an offer or recommendation to buy or sell financial instruments. SKAGEN AS does not assume responsibility for direct or indirect loss or expenses incurred through use or understanding of this report. Employees of SKAGEN AS may be owners of securities issued by companies that are either referred to in this report or are part of a fund's portfolio.