HAWKSMOOR FUNDS UPDATE
MARCH 2025

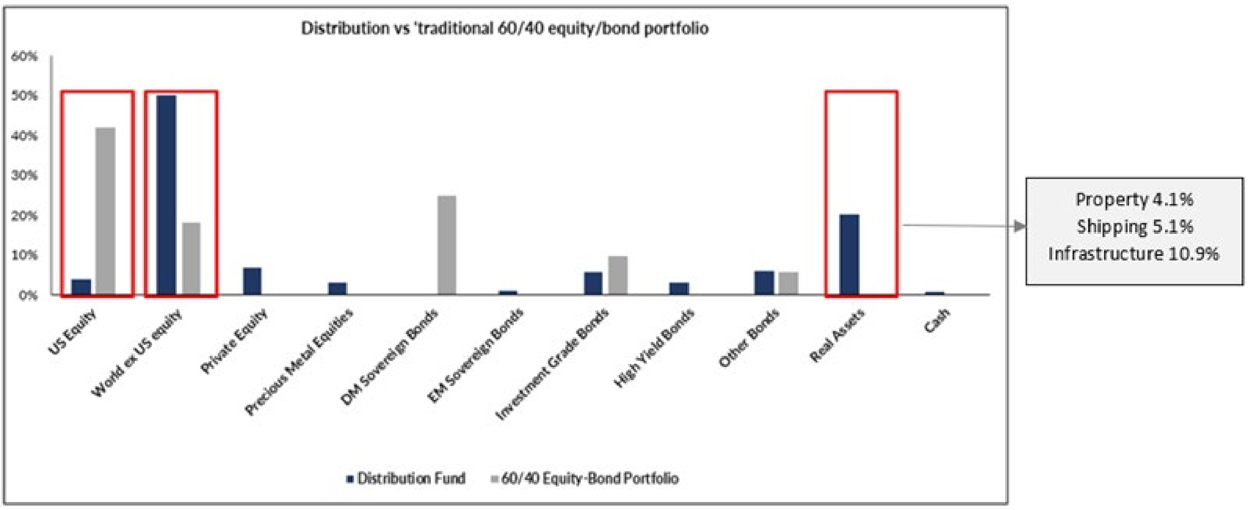
Given the heightened political noise of recent weeks and stock market weakness, we thought a brief update on what we are thinking and doing in response might be useful to you and your clients. You will know that our focus is on assessing fundamental asset class and portfolio valuations rather than attempting to incorporate macroeconomic forecasts into our thinking when constructing the fund's portfolios, and never has this process been more appropriate.

President Trump's constant presence in the news talking about peace deals and trade tariffs is causing a lot of confusion and volatility especially since it is impossible to know whether the various threats are going to be watered down, cancelled, postponed or ultimately implemented. In addition, his recent comments where he refused to rule out a potential recession in the US were not taken well by global equity markets. From what we read, even seasoned macro commentators are struggling to incorporate current US policy into their fiscal or monetary forecasts and resultant asset allocations.

Of course we are not ignorant to what's going on in the macro environment, but not trying to predict the unpredictable allows us to devote more time to fund selection, asset allocation and portfolio construction. However, in the first wave of a broad stock market setback, most assets are impacted, regardless of the relative valuations. Therefore our funds haven't been immune to the recent volatility, but looking forward we believe vast swathes of the portfolio will benefit from a broadening out of global equity markets once the dust settles. We therefore thought this would be an opportune time to remind you of our current positioning.

Asset allocation

Our valuation led approach can lead to a different asset allocation at times of extreme concentration or valuation across financial markets. The following graph shows Distribution's asset allocation compared to the asset allocation of a traditional 60/40% global equity/global bond passive portfolio. Note the biggest divergences highlighted in the red boxes are US equities, sovereign bonds and alternative assets.



Source: Internal, MSCI and ICE, 31/12/2024. 60% equities represented by MSCI World All Cap. 40% bonds represented by ICE BofA Global Broad Market Hedge GBP.

Equities

You will know that we have had a long-standing low allocation to US large cap companies based on our view that they have become extremely overvalued and have caused an unhealthy concentration in global equity markets. Our view has been that it will only need a slight shift in sentiment towards US equities to cause a reassessment of the prospective returns given the high expectations required to justify valuations. Perhaps that reassessment is currently underway as global asset allocators consider where else in the world to allocate money, other than the one-way bet that has been US equities for much of the past decade. We see plenty of value in other areas such as those mentioned in the table below:

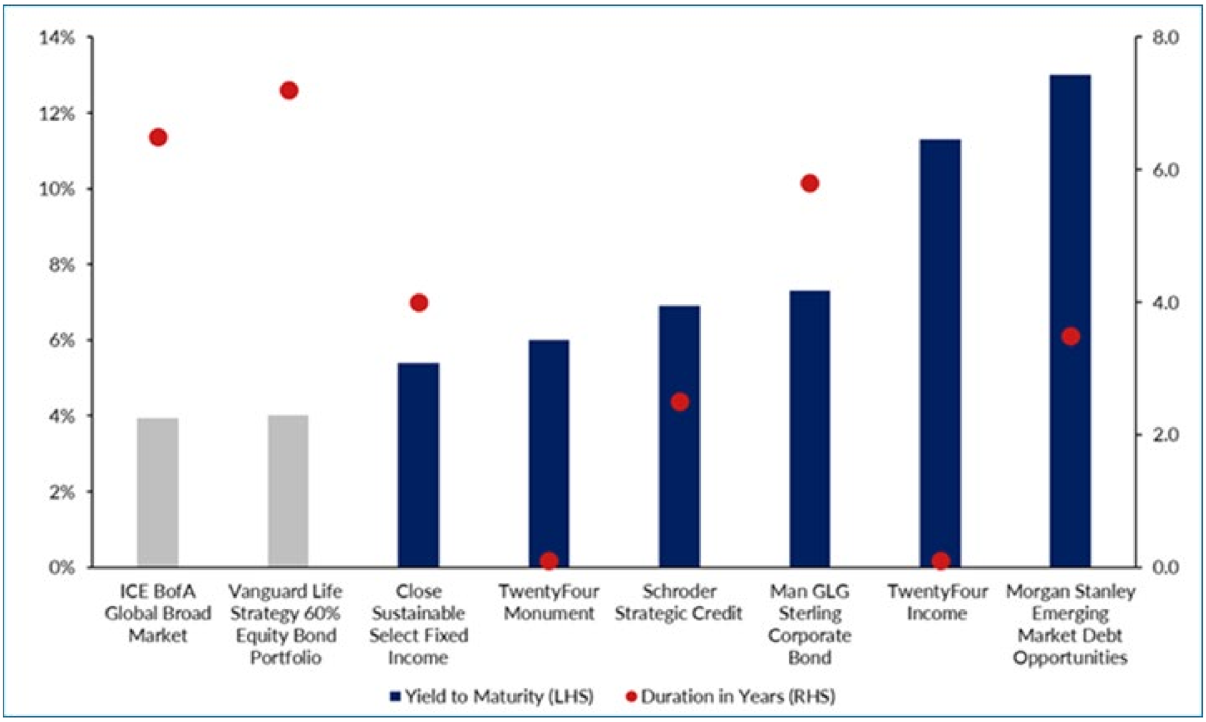
✗
MSCI World: P/E 23.0x, dividend yield 1.7%
MSCI USA: P/E 27.8x, dividend yield 1.3%

✓
CIM Dividend Income: P/E 8.1x, yield 6.1%
Prusik Asian Equity Income: P/E 7.9x, yield 5.4%
Artemis UK Select: P/E 9.2x, yield 3.2%
Teviot UK Smaller Companies P/E 10.0x, yield 4.1%
Lightman European P/E 10.8x, yield 5.2%
De Lisle America: P/E 8.7x, P/S 0.93x
Smead US Value: P/E 12.6x, yield 2.8%

Source: Each fund's own data as at 31/12/2024 and MSCI at 31/12/2024. See MSCI disclaimer on final page.

Fixed Income

Government bond yields in developed markets have risen lately making it hard for investors to make money, although because credit spreads have narrowed, corporate bonds have performed better. Fears of stagflation in the UK and US (where economic growth is flat or negative while inflation remains high) is damaging sentiment towards bonds. Meanwhile, German bund yields have spiked on the back of the newly announced removal of the debt brake in favour of supporting infrastructure and defence spending. Against this backdrop, our bond allocation remains focussed on high quality asset backed securities and other specialist credit funds alongside highly active corporate bond funds where returns have been relatively stable. The Vanbrugh Fund also owns UK index linked and US TIPS as defensive assets in the event of a slowing developed world economy, together with physical gold that is, in our view the ultimate hedge against numerous scenarios such as fiat currency debasement, ongoing geopolitical uncertainty and inflation. The following chart highlights a selection of the bond funds held in our portfolios with their yields and duration highlighted, compared with that offered by broad bond market indices.



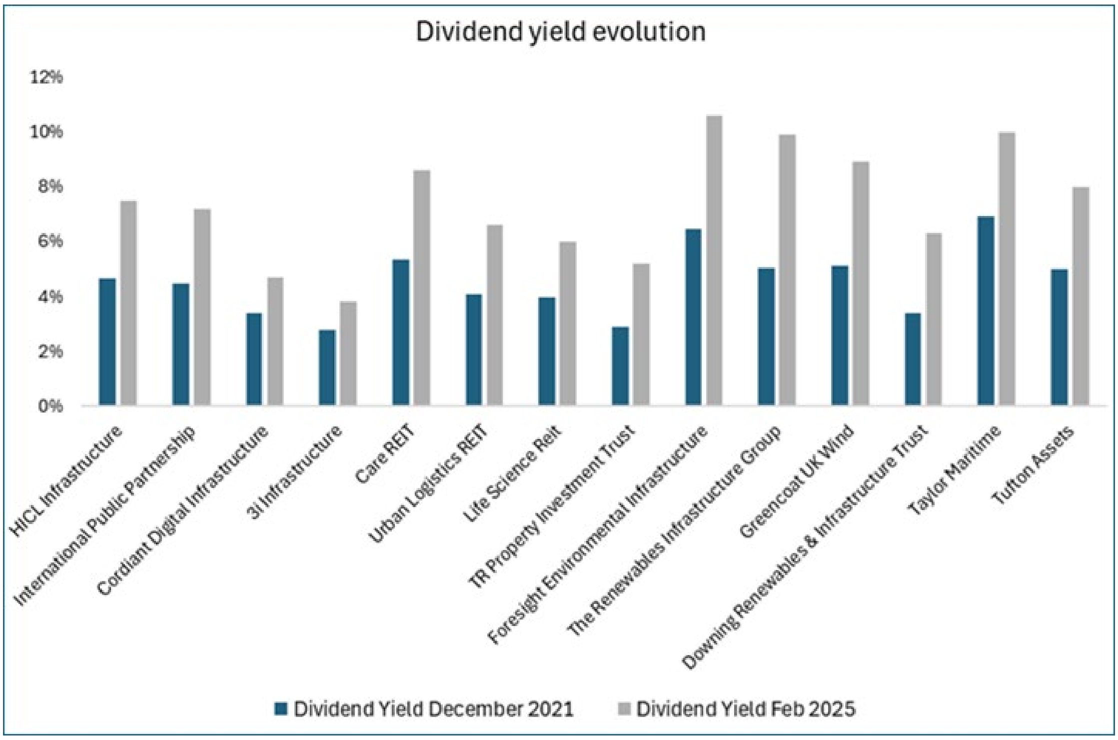
*Source: Fund factsheets and ICE, 31/01/2025. * Calculated on a look-through basis.*

Alternative Assets

Our access to alternative assets is a key differentiator versus peers and is primarily achieved via investments trusts where discounts across the sector are at historic wide levels - only previously witnessed in times of crises. There are valid questions as to whether the net asset values (NAVs) for alternative assets are accurate and we are sceptical in many cases. However, the assets we own have been rigorously assessed with the respective management teams, and our level of engagement with the boards of directors has never been higher in order to gain comfort on capital allocation plans and strategies that will unlock shareholder value (e.g via discounts narrowing). Most of the infrastructure and property trusts have demonstrated the veracity of their NAVs through asset sales at or close to carrying value and have sensibly used proceeds to either repay expensive debt or return capital via share buybacks and/or increased dividends. Further, activist investors have become involved in the sector, being attracted to the value on offer. Finally, merger and acquisitions are increasing with private equity or overseas buyers seeking to acquire a ready-made portfolio of assets cheaper than they could create themselves. Indeed the Funds have benefitted from the recent BBGI Global Infrastructure and Care REIT takeover approaches.

Source: Numis 24/01/2025

Discount widening amongst alternative investment trusts has resulted in extremely attractive yields both in absolute terms and relative to competing assets including sovereign bonds and credit. This relative value looks particularly attractive when considering the fixed coupons of nominal bonds against the progressive dividend policies of many alternative investment trusts. The following chart demonstrates the extent to which yields in the alternative investment trust space have increased over the past few years. Crucially we believe these yields to be sustainable. Dividends in most cases are well covered and are often derived from long term contracted cash flows backed by high quality counterparties. These high starting yields form a strong foundation for total returns and mean investors are being paid to wait for some of the aforementioned catalysts for discount narrowing to materialise.



Source: Hawksmoor February 2025

Conclusion

We feel our funds' portfolios are very attractively valued. Our positioning is highly differentiated versus peers. We stand to benefit should US equity performance continue, and investors become increasingly discerning – for example by recognising the incredible value on offer across many different asset classes. Indeed many of the funds' underlying investments are at trading at historically low valuations, whether they are UK equities valued at similar levels during the Great Financial Crisis, smaller companies generally or investment trusts trading on elevated yields or record discounts. Although the near term outlook remains especially uncertain while major countries' governments are implementing their newly adopted policies having only recently been elected and President Trump flip flops daily on trade policy, on a medium to long term time horizon (in our case at least 3 years), we are extremely optimistic for the prospective returns on offer in our portfolios.

As always, please feel free to get in touch to discuss this further or ask any other questions you or your clients may have.

Thank you for your ongoing support.

Regards,
Daniel, Ben, Ben and Dan

IMPORTANT INFORMATION