US EQUITIES

In November the Fund returned -1.78% compared to the S&P 500 with -0.73%. This month the top performing stocks were Advanced Micro Devices, Apple and Costco, up 31.7%, 10.3% and 9.7% respectively. The worst performing stocks were Sabre, Iovance and Global Blood Therapeutics down -27.5%, -23.0% and -22.6% respectively.

Stock News

This month we have written a slightly shorter letter as we are about to travel to the US to see companies which we will write about next month. We are visiting 3 states, predominantly in the south.
We have written in recent months about the divergence we see in valuations between certain "loved" stocks in the benchmark compared to others and how we believe this is possibly due to the ability (or desire) on the part of management to provide the market with guidance or not. This was highlighted this month by the divergence in stock reaction on the day of the earnings announcement for Zimmer and McKesson. Simply put, McKesson provided precise earnings guidance for the next 12 months whereas Zimmer did not. We are somewhat skeptical whether McKesson has a more effective crystal ball than Zimmer as both companies are subjected to similar pandemic related concerns that affect demand volumes within their businesses - Zimmer with orthopedic implants and McKesson with distributed pharmaceuticals and vaccines. Either way we see this as a useful insight into what the market will reward currently.
While we are believers that markets revert to the mean over time, the devil in this detail is what constitutes "over time". This has been the challenge for us in the last 6 months where pandemic concerns have 2

fluctuated which has put recovery – at least in the mind of the market – on hold. We will concede it seems we have been too early to invest in stocks such as Sabre and, ideally, we would be purchasing now after the stock has been punished in recent days. Typically, we do believe that being early, while frustrating, does ultimately work in our favour. A recent example was Aon that we took advantage of during the midst of the 2020 market sell off and was a substantial drag on performance for almost a year before it "took off". Corteva would be another that was volatile in the first few quarters before the stock stabilised and started to perform.

As explained with MCK above, we believe the market is skittish currently and stock valuations seem to teeter – only to be pushed to excess one way or another depending on narrative and the market's mood on the day. Naturally, the investment trap is to begin to question if we are being overly dogmatic with our adherence to fundamentals and latent drivers of value creation. The Fund currently has what we would consider an unusually large number of stocks whose valuation we believe will revert to the mean. Over the course of a year, we would expect to find the odd stock that we believe is of a high-quality business that has been temporarily sold off for whatever reason. Often, we would seek to take advantage of them assuming that the business, management and underlying trends were all strong enough and the company had latency that would allow it to subsequently outperform. Currently we would include the following names in this category – Fidelity National, Take-Two, T-Mobile, Sabre, Burlington Stores, Zimmer and that is not to mention an entire sector such as biotech. We have taken positions in these names during the last 6-9 months and slowly increased them over the period which, to date, has not helped performance. That we have been able to assemble a portfolio of strong business at such discounted valuations is we believe exciting for future performance. Normally, we would hope to see these types of stocks revert in some way back to the mean relatively soon - we will have to wait to see when this "normal" will revert.

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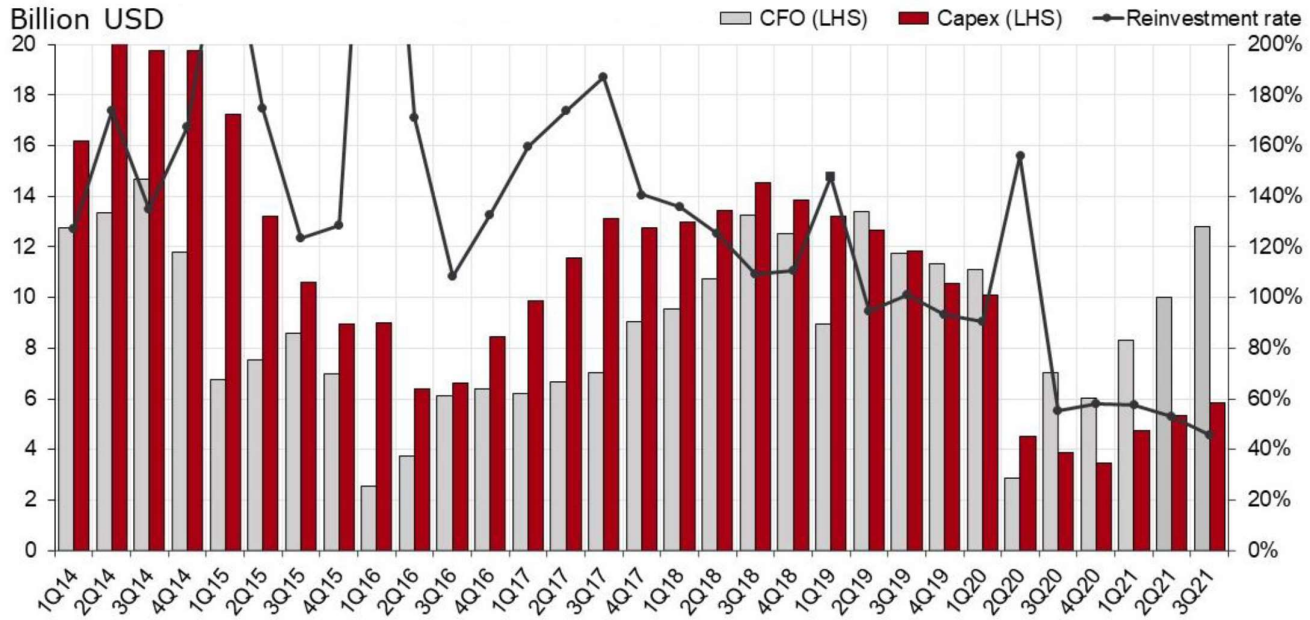
Here It Comes



*The peer group of 39 dedicated US shale oil companies adjusted for CRZO, JAG, SRC, EPEG in 4Q19; NBL, ROSE, SNEC, AXAS, CHAP, HKRS, LONE in 3Q20. Current peer group of 21 shale producers accounts for 40% of expected 2021 US shale oil output; 3Q21 values for REI and ROCC are estimated.
Source: Company reporting; Rystad Energy research and analysis

Our experience has shown that latency can be so often hidden in plain sight and it only takes a few smart decisions by management to begin to unlock. We have written before regarding the remarkable cohesiveness around US domestic oil and gas producers capital allocation this year and the "wall of cash" that is coming back to shareholders as a result. In this case the latency was the underlying revenue generation of the industry and the trigger was the across the board decision to just stop spending. The above chart shows the gross cash coming into the public producers (in grey) and their spending on equipment and property (in red) and how the incoming cash has recovered while the spending has stayed subdued. There are recent new efficiency improvements like utilising such techniques as simul-frac and at the margin electric pressure pumping and 3D printing, however, the biggest driver we believe has simply been the switch away from growth at all costs. Gone are the days of the land grab and today the operators are behaving like a mature industry.

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