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Amity International Fund – Q4 2016 Commentary

Quarter to end December 2016

Performance

	3 Month	1 Year	3 Years	5 Years	10 Years
Fund Performance (B share class)	4.45%	24.38%	26.32%	64.77%	132.15%
FTSE World TR GBP	6.90%	29.59%	50.49%	105.91%	141.67%
IA OE Global	5.65%	23.92%	36.26%	81.71%	94.57%
Quartile	3	2	4	4	2

Source: Morningstar. Figures compared on a Bid to Bid basis with Net Income Reinvested.

Review

The final quarter of 2016 was an eventful end to an eventful year. Global market sentiment was dominated by the Presidential elections in the US and Brexit in the UK. The market's exuberant reaction to Donald Trump's win was in stark contrast to the pre-election sentiment. The populist stimulatory policies and corporate-orientated cabinet appointments have been particularly well-received with the Russell 2000 index rising almost 14% post November 8th. Consensus interpretation has been pro-cyclical equities and inflation, driving further corrections in Treasuries on expectations of faster monetary tightening. With the US 10-year yield breaching 2.5% during December, the Fed's indications on the pace of future tightening will be heavily scrutinised, particularly given the recent performance of the US (and Global) Financials sector.

An additional impact of the uncertain political backdrop has been currency volatility, with Sterling falling over 5% during the quarter, to a 31 year low against the US Dollar. There remains a pressing need for clarity with regard to the UK Government's plans for Brexit, effectively justifying the continued weak performance of the pound. Using long-term purchasing power parity, either The Economist's BigMac index or The Organisation for Economic Co-operation and Development (OECD), Sterling looks undervalued. However, the increasing interest rate differential between the UK and US, and brinkman-like negotiations with the EU could exacerbate this undervaluation in the short term.

In Asia, Chinese Purchasing Manager's Index (PMI) and Producer Price Index (PPI) data has shown continued improvements while consumption looks to be recovering. The Bank of Japan continued to manage the yield curve, while the Yen continues to weaken, depreciating from ¥/$105 to ¥/$117 in the last quarter.

Performance and Activity

In terms of performance, the fund returned almost 25% in 2016, finishing second quartile relative to the wider global equity sector.

Towards the end of October we travelled to Taiwan and Hong Kong to meet over 30 companies, including several of our existing holdings. An existing holding, Hop Fung, which makes packaging in Hong Kong, provided extensive detail on their investments in sustainable production and debottlenecking. The stock was one of the best performers in Q4, gaining 34% in GBP terms, surpassed only by the sharp recovery in Singapore energy-related holdings, Ezion (37%), and Vard Holdings, which returned over 50% following a bid from its majority shareholder.

Sticking with the theme of merger and acquisition activity, the fund's largest holding, NXP Semiconductors received a confirmed bid from US wireless semi-conductor peer Qualcomm, however the offer looks relatively low and requires 80% of shareholders to accept, hence we are retaining our position and monitoring developments. Additional corporate activity involved General Electric (GE) and Baker Hughes, with GE proposing to inject their service assets into a new, "best-in-class" company which would include all of Baker Hughes' assets.

In terms of portfolio activity, we established a new holding in US, Alphabet and in Japan, Zojirushi. Following a relatively lacklustre performance year to date, Google's parent looks attractively valued with significant upside potential from increased focus and attention on selective growth initiatives in 2017 and beyond. Alphabet was funded by the sale of AT&T, which has outperformed the former by c.20% this year and faces potential political intervention surrounding their defensive, fully-priced bid for Time Warner. Zojirushi is a manufacturer of industry leading vacuum-insulation consumer products and a beneficiary of rising urbanisation and desire for healthier eating. Additionally we sold Malaysian utility, Tenaga Nasional, due to concerns regarding upcoming regulatory outperformance potential and ability to execute a potential capital structure review.

An additional company we established a holding in following a recent meeting in China is Tarena International. Tarena teaches students vocational IT programming languages such as C+, Java, .net, Android etc. using classrooms in China and online. Once students successfully complete, Tarena's vast employment network and reputation facilitates a 90%+ placement rate. As the new economy continues to emerge, there continues to be a chronic shortage of people who can write programming code, particularly as non-IT focussed enterprises embrace the digital opportunity.

Within Japan, we reduced our holding in Sumitomo Mitsui Financial Group following very strong performance, in favour of Sony, which offers attractive value.

Outlook

Market leadership over the last five years has been predominantly growth-orientated; however 2016 began to see improving relative performance from value-characterised stocks. Should the global economy continue to recover from its low-growth trajectory, value stocks should continue to find favour. Europe and Asia continue to be attractive regions from this valuation perspective.

The first hundred days of the incoming US Administration will likely set the tone for the year in terms of policy prioritisation – expectations of corporate and consumer tax reforms could support net profit margins, equity market valuations and discretionary spending. Meanwhile a stronger dollar, rising mortgage costs, immigration restrictions and international trade protectionism all pose headwinds to both the domestic and wider global economy and markets. Fed Policy appears increasingly dependent on short-term employment and inflation data, which is likely to create incremental volatility in the short-term. Three to four 25 basis point rate hikes is the current central case, which still leaves interest rates low in a long-term context. The Trump administration's attitude towards sustainable issues will set an important narrative and could hinder the positive direction of travel experienced in 2016.

The UK outlook for 2017 is uncertain, with the implementation of Article 50 likely to act as a reminder of the difficult period of negotiation ahead. With European elections throughout the year, it is unclear how much will be decided this year and that will increasingly raise the prospect of an abrupt and disruptive departure from the European Union in 2019. A transitionary period may become the only option for both parties.

In terms of regional allocation, the Amity International Fund remains cautiously positioned, maintaining a significant relative underweight exposure to the US equity market. Those US companies we do hold are either defensive in nature or have a global earnings stream that provides some insulation from domestic volatility. Globally, we continue to seek companies with strong sustainable fundamentals that are not reliant on political outcomes.

Further Information

To obtain further information please speak to your normal EdenTree representative, visit www.edentreeim.com or call our support team on 0800 011 3821.