

Temple Bar Investment Trust

Three months ending 30 April 2020

The following commentary gives the views of the investment manager at the time of publication.

Key points

- The FTSE All Share Index fell sharply as the coronavirus spread
- The Trust underperformed its benchmark, given the poor performance of value equities
- The leading detractors from relative returns included Capita, after a disappointing update
- We believe the sell-off has presented some exciting opportunities

Market background

As the coronavirus spread from China, the first months of 2020 saw declines in global stock markets of a speed and magnitude unparalleled since The Great Depression. In all, the FTSE All Share Index declined by about 19% over the three months, with a partial recovery in April insufficient to offset the steep falls in March as global economic activity came almost to a standstill.

Almost all equities lost ground, but cyclical sectors (such as energy, financials and industrials) – i.e., those comprising businesses whose ability to generate revenues is more closely linked to the health of the economy – sold off more heavily. Defensive equity sectors (such as health care, consumer staples and utilities) – which comprise companies whose products or services tend to be in demand almost whatever the state of the economy – outperformed the wider market.

Performance review

The Trust underperformed the benchmark. For the most part, this reflected the fact that we focus primarily on 'value' equities – i.e., stocks whose longer-term value and potential we believe is underappreciated by the market – rather than company-specific factors.

The pandemic has been painful for value investors. This is because the stocks that had been flashing 'value' prior to the crisis, such as financials and industrials, were precisely those in the firing line as markets moved sharply into 'risk-off' mode. Financials, auto suppliers, energy and travel-related stocks – which are well represented in the Trust's portfolio – all suffered more than the broad market.

At the stock level, the primary detractors from relative returns included outsourcing and IT company Capita (one of the companies whose share-price performance in the period was not just a consequence of the pandemic). Its shares fell after the company announced weaker-than-expected 2019 results, with the chief executive commenting that the turnaround could take longer and cost more than expected. However, other detractors from relative returns primarily reflected investors' flight from businesses perceived as cyclically exposed. They included building-supplies companies SIG and Travis Perkins, low-cost airline easyJet, and Royal Bank of Scotland.

Contributors to relative returns included Tesco, which held up better given the non-discretionary nature of its offering (the supermarket reported a 30% rise in sales in the first weeks of the coronavirus outbreak as UK consumers stockpiled good and other necessities before the lockdown). Broker TP ICAP also contributed, with investors regarding the company as better-placed than many of its peers to weather more challenging economic conditions. Finally, our exposure to companies that produce precious metals – which tend to be perceived as 'safe-haven' assets in uncertain times – contributed to relative returns.

Outlook and strategy

While we are very mindful that the period under review has been difficult for investors, we think it is important that we maintain an eye on the normalised profitability of businesses. We did not buy the companies in the portfolio on assumptions of buoyant economic growth, but simply on our assessment of what a normal, low-growth world looks like. We think we will eventually return to such an environment and that our stocks will prove to have been significantly discounted in the market sell-off. As we discuss later, we see more potential upside in the portfolio today than we have for many years.

Before that happens, conditions could be tough, and companies need to be strong enough to make it to the other side of a recession in reasonable shape. It is worth remembering that, though few people predicted an imminent pandemic, markets have been anticipating a decline or recession for the last several years, even as

Past performance is not a reliable indicator of future results, losses may be made.



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stock indices continued to rise. Consequently, as we were constructing the portfolio – focusing on the least-loved companies, which we expected to recover most strongly from a downturn when it eventually materialised – we made sure to purchase, by and large, businesses with strong balance sheets that could comfortably withstand a recession. So although we entered the current crisis with a portfolio that leaned towards more cyclical stocks, it generally comprised companies with strong balance sheets.

One feature of the sell-off in cyclical shares is that it was indiscriminate of balance-sheet strength. Companies with strong balance sheets were marked down just as much as those with weak ones. That has meant we have been able to take advantage of the market dislocations to make investments which we believe will stand us in good stead over the coming years. In many cases, we have been able to trade out of lower-conviction holdings into higher-quality, higher-conviction companies with similar or greater upside.

After the very sharp drop in the market, we bought a basket of positions in the UK housebuilders (Barratt Developments, Bellway, Redrow and Taylor Wimpey), having previously only had exposure to the sector via McCarthy & Stone (which we added to). It is an industry where there is strong underlying demand, a sector that should be able to fairly readily return to its pre-coronavirus workings, and one where the valuations of the shares looked particularly attractive after their declines.

We have always viewed easyJet as a long-term winner in the airline industry and, with it particularly affected by events, we progressively increased our existing holding. COVID-19 will leave the airline sector with some challenges, but to compensate for this it seems likely that a lot of weaker capacity will leave the industry, which will speed easyJet's market-share gains.

Sharp stock-market falls tend to be fairly indiscriminate and this one gave us the opportunity to buy quality stocks that we had previously viewed as too expensive. We became shareholders in kitchen retailer Howden, engineer Melrose, flexible office space provider IWG and the retailer Frasers Group (previously known as Sports Direct).

We continue to find a lot of attractive opportunities in the more cyclical areas of the UK market, such as industrials, financials and consumer stocks, and are currently analysing companies in each of these sectors. We would emphasise that no great economic boom is required for these companies to recover. A 'normal' year such as any of the last three or four would do. The opportunity to add international names remains attractive, too, with similar areas of interest in the current opportunity set (industrials, travel, tourism), and more generally with leading global businesses selling off dramatically in the past couple of months and still trading at attractive valuations today. This leaves us very excited about both the opportunity set and our current portfolio.

Looking at simple valuation metrics and comparing them to the broad market, the portfolio is cheaper today (i.e., it offers the most upside) than at any point in the past 14 years, outside of the crisis period. As ever, such calculations are only a rough guide and our assessment of fair value is clearly subjective. But directionally at least, all we can say is that this assessment feels about right.



Specific risks

Borrowing/leverage risk: The Company can borrow additional money to invest, known as leverage. This increases the exposure of the Company to markets above and beyond its total net asset value. This can help to increase the rate of growth of the fund but also cause losses to be magnified.

Charges to capital risk: A portion (60%) of the Company's expenses are charged to its capital account rather than to its income, which has the effect of increasing income (which may be taxable) whilst reducing its capital to an equivalent extent. This could constrain future capital and income growth.

Company share price risk: The Company's share price is determined by supply and demand for such shares in the market as well as the net asset value per share. The share price can therefore fluctuate and may represent a discount or premium to the net asset value per share. This can mean

Interest rate: The value of fixed income investments (e.g. bonds) tends to decrease when interest rates and/or inflation rises.

Equity investment: The value of equities (e.g. shares) and equity-related investments may vary according to company profits and future prospects as well as more general market factors. In the event of a company default (e.g. bankruptcy), the owners of their equity rank last in terms of any financial payment from that company.

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