Macroeconomic Commentary[1]

Equity indices for the developed world were generally down last quarter, with the MSCI World Index paring 4.8% in sterling terms[2]. This during a period that saw investor fear (as measured by the VIX Index[3]) hit its highest level since China's stock market crash in August 2015. In the US, the Federal Reserve saw a change of leadership as Janet Yellen gave way for Jerome Powell, while the S&P 500 Index finished the period 0.8% lower in local currency terms. Elsewhere, the UK made a number of concessions in coming to a 21-month transition deal with the EU, this included an agreement requiring Northern Ireland to comply with EU regulation in absence of a better alternative. Despite this, the FTSE 100 Index and EURO STOXX 50 Index declined 7.2% and 3.7% respectively, both in local currency terms. In fixed income, the 10-year sovereign yield on US Treasuries, UK Gilts and German Bunds rose to 2.7%, 1.4% and 0.5% respectively.

Fund Commentary

The first quarter of 2018 was unfortunately our first negative quarter since inception, with the Fund returning -2.41% for the period and 3.73% since inception[4]. Although always disappointing to report a negative absolute return, we managed to protect investors' capital as the benchmark returned -3.93% over the period; which increased our alpha since inception as our benchmark is only up 0.80%.

Coming into the period, we were almost fully deployed and invested for the long-term. Given a return of market volatility due to concerns related to a normalization in interest rates and regulation in the large technology names, we rotated the portfolio to higher quality investments with greater downside protection and ample liquidity to ensure we can remain nimble throughout a broad array of market environments. Within the context of long-term history, the sell off that occurred within the quarter is common place, however market participants had become a little accustomed to the muted volatility levels of 2017. We retain our positive outlook and believe our holdings can continue to deliver returns to investors.

We have previously noted that we deployed a portion of the Fund's excess cash into a diversified Asian Pacific investment that has a bias towards emerging market technology; where valuations are more attractive and there is a reduced regulatory risk to the industries. The team identified Pacific Horizon, an investment trust, that owns some highly attractive assets yet which was trading at over 10% discount to its underlying value. We are pleased to note that the theme paid dividends earlier than anticipated and due to a combination of underlying performance and a reduction in the discount, Pacific Horizon was our number one performance contributor over the period.

(1) Source: Bloomberg.

(2) Source: Bloomberg. For the period 29/12/2017 to 29/03/2018.

(3) VIX is the ticker symbol for the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility.

(4) Source: Bloomberg. Performance of the Credo Dynamic Fund Class A Retail Shares over the period 29/12/2017 to 29/03/2018.

Preference shares ("Prefs") are known for their steady income streams rather than capital returns so it was nice, albeit surprising, to see Aviva prefs in our Top 10 performers. It was certainly an interesting quarter for owners of UK prefs when Aviva announced it was looking at redeeming their irredeemable prefs. This caught the market off guard, as these shares, over recent years, have risen steadily to a significant premium due to their high and steady income stream. At the time of the announcement the Fund did not have a holding in the prefs and we were able to take an objective assessment whilst the sector sold off quite dramatically. We felt the market had reached a level by which the investment provided attractive risk-adjusted returns, cognisant of the downside risk of the potential redemption. Later in the period, Aviva announced, after much highly publicised clamour, to rescind its intention to redeem and subsequently the whole sector sharply rebounded. We remain holders after the recent spike and although happy with their performance, we regrettably could not obtain a full position size due to illiquidity.

In the smaller companies' sector, we continue to find opportunistic investment despite the weaker investment climate. For example, Learning Technology Group plc had a strong quarter of performance after the e-learning company's results came in "materially ahead" of expectations in terms of both operating income and cash flows. Additionally, another notable performer was MPX Bioceutical, which the Fund invested in as part of an institutional placing for the medical marijuana company to ramp up production; not a typical investment but we note the political tailwinds for the sector.

In terms of attrition, it was no surprise to see our holding in the MSCI World Index tracker at the top of the list. This tracker gives us low cost exposure to the largest companies in the world. It is a cheap way to have exposure to global growth and is liquid. It has been our largest holding since the Fund's inception but of course mimics the performance of global indices and has been further hindered by the pound's strength.

A detractor within our smaller company's sector was Arena Events Group plc. This UK listed small company erects seating and corporate hospitality for some of the world's greatest sporting events such as Wimbledon and the PGA Golf Tour. At the end of the quarter the company announced a legal action regarding a US contract, causing a 20% fall in the share price on the news. At first instance this looks like a one off fine so we think the market may well have overreacted. Arena is one of our less liquid investments and illiquidity can of course create bigger swings on both the up and downside. A brief call with management gave us the confidence to add to the position at a price we deemed attractive. We will continue to monitor the investment closely and will be meeting management following their upcoming results shortly. We would like to reiterate that we believe our access to management can give us an edge and is one of the reasons we have a bias towards the UK market.

Looking Forward

We retain our outlook that we are in the latter stages of a bull market. On a global basis the picture appears relatively strong and fiscal stimulus in the US is expected to filter through to company earnings in the next quarter. Rising interest rates, trade wars and any short-term impact to earnings from the oppressive winter weather in Europe are however obvious risks to an otherwise rosy investment outlook, hence we maintain an element of caution and balance to the portfolio.

Rupert Silver, Co-Portfolio Manager

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