CREDO

Fund Commentary

The third quarter of 2023 saw the Dynamic Fund achieve a return of 2.0% over the period[1]. This performance contrasted with both the benchmark and peer group (the IA Mixed Investment 40-85% Shares sector), which returned -0.2% over the same period[2]. Since its inception, Dynamic has outperformed the benchmark by an impressive 18.4%.

The positive momentum witnessed in the first half of the year faded in the third quarter. The Artificial Intelligence and "Magnificent Seven" (Nvidia, Tesla, Meta Platforms, Apple, Amazon.com, Microsoft, and Alphabet) fervour took a momentary pause after being the primary market drivers in recent periods.

Concurrently, the concept of "higher for longer" became more entrenched in markets. Although short-term interest rates have not notably changed their trajectory, the pace of central bank rate adjustments has slowed. This has tempered the hope for a swift reduction in interest rates, leading to a notable increase in longer-term interest rates. This shift has implications for the relative value of different asset classes within the portfolio.

In the UK specifically, the inflation rate has begun to normalise, aligning with global peers. This normalisation has provided some relief, as there was a period when it seemed that inflation in the UK was more deeply rooted. While this has resulted in some weakness in sterling, although it will not help the domestic inflation problem or anyone's travel plans, it has also served as a cushion against the dip in global markets.

Positioning

At the end of the period, the asset allocation remained largely unchanged: 45% in equities, 41% in fixed income, and 14% in liquid alternatives. This distribution maintains a finely tuned equilibrium among the three asset classes. Given that yields on the corporate bond portfolio align more closely with long-term returns from equity markets, we are maintaining a substantial position in corporate bonds. This bond allocation is carefully balanced between short-dated issues for reduced volatility and steady returns, and higher-yielding or longer-dated issues to introduce an element of excitement.

In terms of equities, action in the quarter was relatively subdued. The primary addition was Dynamic's acquisition of Bellevue Healthcare Trust plc (Bellevue). We have held Bellevue in the past, aiming to benefit from technological advancements in the medical sector. This investment trust holding is also tactical, offering the opportunity to buy at a discount to net assets and potentially exit at the underlying asset value in the coming months. This approach exemplifies our commitment to nimble and active investing in investment trusts.

[1] Performance of the Credo Dynamic Fund Class A Retail Shares over the period 30/06/2023 to 30/09/2023.
[2] Source: Bloomberg, FE Analytics.

Contribution and Attrition

Gresham House plc (Gresham), the largest single-line equity holding, stood out as the clear top performer in the period. Its acquisition by US-based private equity firm, Searchlight Capital, in July 2023 for £470 million, representing a 55% premium to the prevailing share price, contributed approximately 1.5% of alpha.

Gresham is a UK specialist asset manager that offers a unique selection of investment opportunities predominately in closed-end investments. For example, it provides opportunities in battery storage, a key enabler of the renewable revolution that helps stabilize the power supply in the face of solar and wind energy's inherent volatility. Additionally, Gresham is one of the leaders in forestry investments, a sought-after asset class valued for its environmental sustainability, steady growth, and the generation of valuable carbon credits.

Our decision to acquire Gresham was founded on its promising growth potential, the exceptional quality of its business, and the seasoned expertise of its management team, who had strategically aligned themselves with a significant shareholding. In the long term, we are sorry to lose an asset that we believe would deliver multiples of returns to investors, but we are delighted with the short-term boost to performance. This is Dynamic's third significant holding that has been taken out in the last three years, all delivering significant value to investors. These holdings have all been UK equities that are relatively niche, leaders in their field, profitable, have strong balance sheets and reasonable value, and strong management teams. We remain focused on finding the next high-quality company that we believe will deliver value to shareholders and has the potential to be the next takeover candidate.

In the fixed income segment of the portfolio, spread tightening in the largest names resulted in positive returns for investors, in addition to the income generated. This spread tightening combined with the Gresham takeout provided most of the alpha against Dynamic's peers. For example, IG Group 3.125% 2028 began the period yielding over 9% but ended yielding less than 8%. This contraction in future returns led to a more than 7% capital gain in the period. The portfolio still yields approximately 9% until the underlying respective maturities, which we believe represents an attractive return, competitive with other asset classes.

Income-generating alternatives, such as song royalties, real estate, and infrastructure, have been hit by relative value to income alternatives. When cash at the bank yielded nothing (or even negative in certain currencies), investors were biting your hand off for a 6% return on an alternative. However, now that government bonds offer a risk-free return of 5%, alternatives must recalibrate and have yet to find their equilibrium.

While a small holding, Round Hill Music Royalty Fund Limited demonstrated impressive returns over the period. Although we had only recently started buying this position and had not yet achieved a full position, it emerged as the second-highest performer, receiving a bid at a 67% premium to its recent share price. This marks Dynamic's fourth takeover in three years.

Switching to positions where the Fund lost some ground, we are pleased to report that no position had a material adverse effect on the portfolio over the period (defined as reducing NAV by more than 1%). The most significant attrition came from sports betting and gaming company, Entain plc. Despite exciting developments in its joint venture with BET MGM within the rapidly expanding US market, the company's recently reported results fell short of expectations. Whilst Entain plc is currently out of favour, it remains a strong and growing company, trading at an attractive valuation. Given its current share price, one could envisage it as an enticing target for acquisition by a competitor, especially if the share price remains low. We maintain our confidence in the long-term potential of the company and continue to add to the position.

Looking Forward

Market expectations have undergone significant shifts this year, from recession fears and aggressive interest rate cuts in the Spring, to hopes of a soft landing in the Summer, and most recently, a prolonged period of higher interest rates.

A near-term recession remains a distinct possibility, with various economic indicators pointing in this direction, or at best a period of sluggish growth. While precise probabilities and the timing of such an event remain uncertain, it's clear that elevated debt levels and interest rates are beginning to exert their influence. The true pulse of the economy is best gauged through employment figures. As long as individuals remain employed with a steady cash flow, they are likely to meet their financial obligations and continue spending in the broader economy. This presents the current paradox: while numerous indicators suggest a potential recession, the job market continues to exhibit resilience and strength.

Currently, we find it difficult to adopt an overly optimistic stance towards stocks. As a result, our exposure to equities remains at the lower end of our range. It's crucial to note that we consistently uphold a long-term structural allocation to equities. This is not only due to the inherent challenge of timing markets but also because historical data demonstrates that, in the long run, the market has consistently rebounded from adversity to offer the highest returns among all asset classes.

In the short term, we will observe how events unfold. Should the going get tough for a period, our bond holdings will help to protect the portfolio and provide a healthy income. Additionally, the short-term bond maturities in the portfolio enable the Fund to increase the equity weighting, taking advantage of tactical opportunities of reduced valuations.

Simultaneously, we will be actively searching for promising opportunities across the full spectrum of asset classes. An area of interest we are considering is the discounted valuations of UK-based stocks. Since the Brexit referendum, the UK stock market has somewhat fallen out of favour. This shift in sentiment has not escaped the notice of both private equity firms and international investors. We anticipate this trend to persist, providing us with fertile ground for uncovering high-quality, undervalued companies.

Please find further details on the current portfolio positioning below.

Benjamin Newton – Portfolio Manager

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Portfolio Top Holdings[3]

UK Equities	%
FRP Advisory Group Limited	2.8
Entain plc	2.2
Aberforth Smaller Companies Trust plc	1.4
British American Tobacco plc	1.2
Rolls-Royce Holdings plc	1.2
Total UK Equities	12.5

Listed Alternatives	%
Hipgnosis Songs Fund Limited	2.8
Gresham House Energy Storage Fund plc	1.7
BH Macro Ltd	1.8
Literacy Capital plc	1.7
Assura plc REIT	1.3
Total Listed Alternatives	13.6

International Equity Funds	%
DBX S&P 500 Equal Weighted	7.1
Polar Capital Technology Trust	6.0
Bellevue Healthcare Trust plc	2.5
GQG Global Equity Fund UCITS	1.9
iShares MSCI World Small Cap	1.8
Total International Equity Funds	31.2

Fixed Income	%
IG Group Holdings Plc 3.125% 18/11/2028	2.9
BP plc Perpetual	2.5
Investec plc Var 06/03/2033	2.3
Co-Operative Group 08/07/2026	2.1
Barclays plc Var 14/11/2032	1.8
Total Fixed Income	40.9

Overseas Equity	%
Rheinmetall AG	1.2
Total Overseas Equity	1.2

Cash	%
GBP	0.6
Total Cash	0.6

[3] *Portfolio positions of the Credo Dynamic Fund as at 30/09/2023.*