Macroeconomic Commentary[1]

The second quarter of 2022 exacerbated existing negative sentiment from the previous quarter. The S&P 500 officially slipped into a bear market for the year and the quarter concluded as the worst first half year for developed market equities in over 50 years. The MSCI World fell by 16.2% in USD terms over the quarter, echoed by the S&P 500, Euro STOXX 50 and FTSE 100 which finished down 16.1%, 9.4% and 3.8% respectively. Inflation reached a new 40-year high in the quarter, sitting at 8.6% in the US and slightly higher at 9.1% in the UK. Accordingly, western economies witnessed the most hawkish monetary policy stance in recent history, with aggressive interest rate hikes combined with the tapering of asset purchases by central banks. Furthermore, Russia's war against Ukraine continues to impose economic and financial repercussions on those who depend on the two countries' exports, contributing to growing fears surrounding a global recession. In fixed income markets, yields on the US, UK and German 10-year bonds increased by 67, 62 and 79 basis points, respectively. The pound lost 7.3% against the US dollar and lost 2.0% against the euro.

An Anniversary

The end of the quarter brings about the Credo Dynamic Fund's (Dynamic) five-year anniversary. The past five years have flown by. It has been both exciting and rewarding, but also challenging, and at times quite tumultuous from a global and market perspective. We have experienced the pandemic, war, Brexit, global trade wars and countless other events. The Fund's flexibility has been key to delivering a 36.0% return to investors since inception, a notable outperformance over our peer group and benchmark, the IA Flexible Investment Sector, which managed a gain of 20.5% over the same period. Compared to our peers, we are proud to report that Dynamic commences its anniversary ranked 14th out of the 111 funds in the sector that have stayed the distance since launch. Given the challenging backdrop, we are pleased to have made a good start to life as a unitised fund and hope for many years ahead to continue delivering absolute performance and increasing our gap to peers. Many thanks to our investors, my co-manager Ben, and all the Credo team, whose hard work has helped us to achieve these results during tough times. Let us all hope that the next anniversary and the next five years are dramatically less eventful than the first!

Fund Commentary

Within the second quarter, Dynamic returned -5.67% over the period[2]. Whilst we never like to give up ground on an absolute basis it should be noted that we once again outperformed our peers, the IA Flexible Investment Sector, which returned -6.93% in the period[1].

Our recent commentaries have alluded to the likelihood of more challenging times ahead, given the difficult economic and inflation backdrop. The market has had a negative trajectory thus far in 2022; the pace of declines notably increased with many indices entering into a bear market (defined as a fall of greater than 20%). In recent history, when equities have undergone such a notable decline, this has been linked to a difficult economy. In such a scenario, interest rates have reduced, which has led the government bond market to eke out a positive return, softening the blow for a more balanced investor. However, in this instance, the

(1) Source: Bloomberg.
(2) Source: Bloomberg. Performance of the Credo Dynamic Fund Class A Retail Shares over the period 31/03/2022 to 30/06/2022.

fall in equities is due to inflation and higher rates causing some economic anguish, leading to bonds, particularly those with long-dated maturities, falling almost like equities. To put this into context, this was the worst first half of the year for the S&P 500 in 60 years, combined with the worst six months for the 10-year US Treasury Index since 1788 making a very tough back drop for all funds including the muti-asset world.

Equities

Turning our attention to Dynamic, the total exposure to equities fell over the quarter from 50% to 44% of the Fund. Whilst a part of the reduction was market-related, we still reduced our exposure modestly. Under the bonnet we continued to reduce our UK equity holdings favouring international equities. The UK recession risk is likely to be higher than global peers due to high power prices, weak currency, and more exposure to labour unions. Dynamic operates a core and satellite approach. The core is our efficient long-term allocation to the markets; while the satellites are used to increase returns in the good times and reduce risk in times of uncertainty. Our typical UK exposure comes from smaller companies and is held within our satellite. These companies are more exposed to the economy and market cycles, which we dynamically look to reduce in times of uncertainty.

Equity valuations are made up of two key components: the underlying companies' earnings and the price (the multiple) the market is willing to pay for these earnings. The price of the US market has come down from peaking at over 26x (Price/Earnings) at the tail of 2021 to 17x presently. This is approximately in line with the long-term average, which typically provides attractive long-term returns. However, in the short term, we have some concerns about the economic backdrop, particularly the effect that a recession, interest rates, and inflation may have on company earnings. So far, analysts have been both slow and reticent to reduce earnings forecasts. We feel this may prove to be a rose-tinted view and are thus weary that earnings downgrades could cause further damage.

On this basis the Fund's equity allocation is at the lower end of our range since inception showing that we remain cautious. We maintain a reasonable equity exposure via the core element of the Fund should the global economy and, in particular the US, muddle through the challenges that lie ahead.

Turning to individual stock performance; there were no notable shocks or surprises, so it was simply the case that our largest positions had the largest attrition on the Fund. Polar Capital Technology Trust plc (Polar) and the S&P 500 equally weighted tracker ETF are the two largest equity holdings in Dynamic by some margin and collectively cost the Fund 1.75%. We continue to believe there is strong merit in the more established technology names within Polar, which will deliver long-term value especially from this discounted level. The S&P 500 equally weighted ETF is an efficient broad based US stock market exposure, without doubling our technology exposure, as these are already overrepresented in the traditional index.

Although there were stocks like the broader markets that produced a negative return, there were also winners. For example, GSK (formally known as GlaxoSmithKline) showed notable strength due to its hefty dividend, defensive nature, and the eagerly anticipated spinoff of its consumer health division. However, we have recently trimmed back some of the gains. Little-known FRP Advisory Group plc (FRP) was our largest contributor to performance. We have owned a small position in this reasonably priced growth company since its listing in early 2020. FRP is a professional service firm which derives most of its revenue from restructuring advisory or insolvency practitioners. As our economic worries grew, we added to the position in the belief that it is an excellent diversifier to the broader equity allocation and portfolio. Pleasingly the stock proved to be a shining light in a tough period gaining over 25% in the quarter and contributing approximately half a percent to Dynamic's performance.

Fixed Income

Whilst government bonds tend to move inversely to equities in times of distress as people flock to the lowest risk investment option, corporate bonds tend to be swayed in the same direction as the equity market, albeit with notably less volatility. At its most simple, if bond investors are worried about the economy, especially a recession, that would imply some companies might get into trouble, and the probability of bankruptcy and defaults increases, i.e., getting your money back! The bonds we look at are starting to become attractive again as yields have shot up in the last few weeks of the quarter to levels last seen in the pandemic (which proved to be a fantastic buying opportunity for those who bought equities or corporate debt).

Of course, the yield alone does not tell the whole story as central bank interest rates have increased to combat inflation from the artificially low rates post-pandemic. One typically assesses bonds on the spread above the risk-free rate (i.e., the excess return above government bonds for taking on the corporate's credit risk). On this metric, the picture is also attractive and whilst we have not reached the levels seen in the pandemic, it shows that corporate paper returns offer some of the best opportunities over the last decade.

Our favoured space to invest is usually on the cusp of investment grade and high yield paper. Over time this has proved the best risk-adjusted place to invest as more speculative credits run the risk of higher defaults, whilst higher-rated credits do not yield enough to give satisfactory long-term results. We are not calling the bottom or jumping in with both feet but have sharply increased our exposure to corporate debt from a low of 19% midway through last year to over 30% currently. This increase brings us back just below our average weighting to fixed income since the Fund launched. The focus has been on high-quality companies and shorter-dated bonds with less interest rate risk. Importantly this gives a pool of capital which is returning to us over the next three years; at the time of their respective maturities, we can reassess the investment landscape to see the best place to invest. Dynamic has initiated positions in or added to names such as Barclays, Investec, BP, Vodafone, and Centrica. Our current bond portfolio now has a yield of 7.5%, with an average duration of under four years. Whilst these yields cannot quite compete with current inflation, expectations are for inflation to moderate, and if reality is close to expectations, this income stream will look highly attractive in absolute and real terms by next year.

Alternatives

Dynamic's allocation to alternatives grew post-pandemic as we became somewhat nervous about equity valuations as well as the negligible yields on corporate credit. The increase in alternatives was allocated to income producing investment trusts with a diversified portfolio of underlying assets, including song royalties, renewable power, and infrastructure. The sector seemed somewhat of a panacea, and our conviction has been rewarded. Most of the Fund's holdings held firm in tricky equity and bond markets, and we even saw some outsized gains. For example, Gresham House Energy Storage Fund plc (Grid) utilises batteries to take power from the national grid during gluts of supply and low prices, and then pumps it back during times of the day when there is a deficit and higher prices. Therefore, this is a beneficiary of volatility in intraday power prices and performed in line with our high expectations. The star performer, however, was private equity minnow Literacy Capital plc (Literacy). This fund, which ex-Capita CEO Paul Pindar chairs, rose by a third over the quarter as its underlying assets continued to deliver strong performance. Although it only listed nearly a year ago, Literacy has more than doubled our initial investment. Whilst Literacy may look a little expensive in the short term as it trades at a premium to its assets, it has invested so shrewdly in fast growing companies that have provided regular and consistent earnings upgrades that it has traded at a premium ever since its listing. We see further upside on gems like Literacy and Grid, so remain long term holders.

Notwithstanding the successes we have been involved with, we have however slightly reduced our allocation to income alternatives to increase exposure to the bond market as outlined above. Additionally, we have added a wider breadth of alternatives, for example, we reintroduced the AQR Managed Futures Fund (AQR) to the portfolio. This fund follows trends in a broad array of markets, including commodities, currencies, equities, and fixed income and stands to benefit when the trend is both negative and positive. The fund typically does best in more adverse equity market conditions when trends are more pronounced. We last held this around the time of the pandemic, but the market moves were too short-lived for the benefit of the strategies to take hold. As this has been a more drawn-out sell-off, this strategy is coming to its fore, and is up 30% year to date. A position such as AQR is an important part of a diversified portfolio, especially in challenging market conditions although this is likely to be reduced from the current weighting when the managers become more constructive on risk assets.

Looking forward

The story of this quarter reads a lot of doom and gloom, which is unsurprising given market investment returns.

Whilst we concede it is likely that stocks could fall further if company earnings do decline, historically, large drawdowns accompanied by a recession have proven to be an excellent time to increase equities or add to one's broader investment portfolio. This may feel counterintuitive, but the market is a forward-looking animal and participants will no doubt start looking towards the next phase of the cycle, which is inevitably an economic expansion. A key feature of Dynamic is flexibility; in this scenario there would be no hesitation in notably increasing our stock exposure like we have done with bonds this quarter.

Unfortunately, there is no crystal ball to help with investing, and the next phase of the market will be driven by the economy, inflation, and subsequent earnings announcements. In the interim, our positioning is well suited to the current environment with equity exposure at the bottom of our range, alongside high yielding short duration fixed income and a wide breadth of alternative assets. In addition, we remain focused, motivated, humble, and as always will be highly flexible in these exceptional times.

Please find further details on the current positioning below.

Rupert Silver, Lead Portfolio Manager

DYNAMIC FUND

UK Equities	%
Gresham House plc	2.4
FRP Advisory Group Limited	2.2
K3 Capital Group plc	1.9
North Atlantic Smaller Companies	1.6
TP ICAP plc	1.4
Total UK Equities	**16.9**

International Equity Funds	%
DBX S&P 500 Equal Weighted	6.5
Polar Capital Technology Trust	5.5
Worldwide Healthcare Trust plc	2.5
iShares MSCI World Value ETF	1.9
Robeco Global Conservative Equities Fund	1.9
Total International Equity Funds	**23.4**

Overseas Equity	%
Alphabet Inc	2.6
Amazon.Com	0.7
Prospect Resources Ltd	0.6
Total Overseas Equity	**3.8**

Alternatives	%
AQR – Managed Futures UCITS Fund	3.8
TwentyFour Income Fund Ltd	1.8
Hipgnosis Songs Fund Ltd	1.7
Amundi Breakeven Inflation USD 10Y EFT	1.5
The Renewables Infrastructure Group Ltd	1.5
Total Alternatives	**21.9**

Fixed Income	%
Burford Capital plc 6.125% 26/10/2024	1.9
Sainsburys Bank plc Var 23/11/2027	1.7
Vodafone Group plc Var 03/10/2078	1.6
Severn Trent plc I 11/07/2022	1.2
Co-operative Group Ltd 5.125% 17/05	1.1
Total Fixed Income	**30.2**

Cash	%
GBP	3.8
Total Cash	**3.8**