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To: Our Investors in the Chawton Global Equity Income Fund

Introduction

We are approaching the third anniversary of the launch of the Chawton Global Equity Income Fund. It has been an eventful period with plenty thrown at us. However, the fund and the firm have proved resilient in these testing conditions with the former gaining over 30%, of which over 6% is dividend income, and the latter moving to profitability.

I have been thinking carefully about how I should evolve the communication of our progress. To date, we have relied on the commentary section of the monthly Factsheet to provide colour on our specific company investments. Going forward my desire is to detach this commentary section from the ongoing monthly Factsheet and move to a less frequent but more comprehensive medium. This is consistent with our long-term approach and a desire to provide investors with greater transparency into our process and progress. The first stage of this change will be to introduce a Quarterly Letter covering investment positioning in more detail, performance, activity, and commentary on individual companies, including not just our successes but situations where we have got it wrong and how we responded and what we learnt from it.

This is the first Quarterly Letter. To be clear, the monthly Factsheet will continue and in future will be confined to facts, as it should be. Several investors have commented to me about how little information funds generally, and income funds especially, have on income. We will aim in both the Factsheet and Quarterly Letter to give much more detail on capital returns, including income, which should help investors in both gauging our progress and in their own financial planning.

I believe we are about to enter a period when our fund's attributes come into their own. The objective of the fund is to deliver a <u>growing</u> income stream for you and your families, or your clients, whilst also continuing to build capital. The growing dividend component of the total shareholder return may be increasingly important in the coming decade, and I will explain why in this letter.

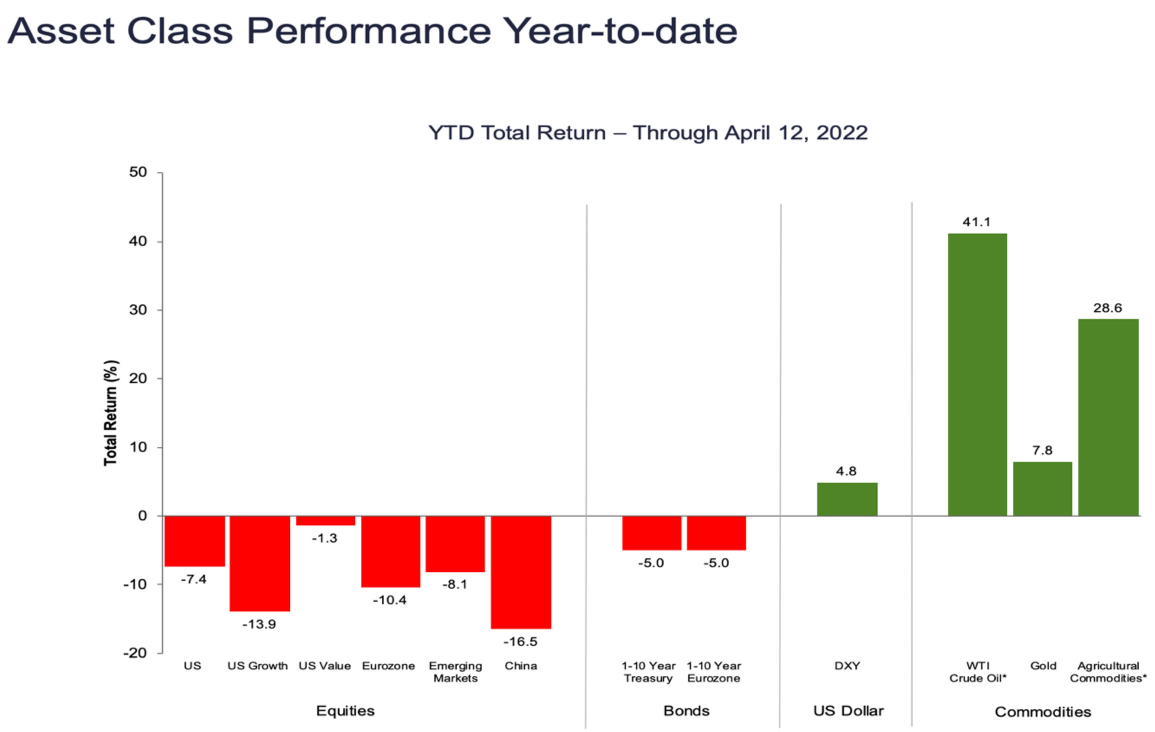
Investment Performance

Chawton Global Equity Income Fund performance is shown below for the first quarter 2022 and preceding periods. The Fund results are net of fees and charges and are compared to the benchmark index (MSCI World GBP) and the comparator group as represented by the Investment Association Global Equity Income sector.

	Chawton Global Equity Income Fund	MSCI World TR in GBP	IA Global Equity Income Sector
First Quarter 2022	-8.7%	-2.4%	-1.1%
2021	18.2%	22.9%	18.7%
2020	14.2%	12.3%	3.3%
2019 (from 19 May)	9.3%	8.6%	NA
Since Inception 19/05/2019 – 31/03/2022	34.7%	46.2%	29.7%
Compound Annual	10.4%	13.5%	9.1%

The quarter represents a reversal in fortune of the fund and contrasts to the strong performance during 2021 and 2020 when COVID was at its height, and over which period our fund was +35.0% versus the IA Global Equity Income Sector average of +22.6%.

The following graphic from Goldman Sachs shows various asset class performance over the quarter demonstrating that sectors and factors we tend to avoid such as commodity areas and 'value stocks' (generally poorer quality companies) outperformed.



My experience over my career is that these short sharp reversals where quality (as defined by sustained high return on capital) companies underperform, and less good companies (as defined by returns on capital at or below the cost of capital) outperform, occur from time to time. This is normally due to a confluence of events that cause demand across the economy to exceed supply, much as we are seeing now. Lower quality companies tend to operate in less attractive industries where barriers to entry are lower and competition higher meaning that supply can be increased quickly. Higher quality companies, meanwhile, continue their steady compounding and soon retake the lead.

Investment Position and Outlook

Equity markets have had a good recent run; the MSCI World Index GBP (our benchmark) has compounded at an annual rate of 13.7% in the last ten years (to 31 March 2022). The very long-term return from the S&P (going back to 1825) is just under 10% (Source S&P) so recent returns are considerably in excess of what we might consider the normal level of returns. These are nominal returns that include inflation; and higher inflation has helped boost nominal returns in the past. However, inflation has been low in the last ten years; instead, it has been innovation and growth along with benefits of globalisation that have underpinned these good recent returns.

So, what will the future hold? At this point I should point out that we adhere to Warren Buffett's principle that it is very difficult to predict both macro-economic and market developments. Our approach is to invert and instead select companies that are high quality, resilient, with demonstrated longevity, and are currently well managed. This should enable them to navigate whatever the future holds and importantly gain strength from adversity. Whilst difficult times and lower share prices are troubling for all investors, with our strategy, they most likely mean better long term returns for our investors!

Going back to the future - in contrast to the last decade, inflation has made a comeback in the present and could well persist. I will not go into the detail on the causes and how they may change other than to observe that I do think the transition to a less resource intensive, more circular economy, does require higher prices. The negative aspect of this is that interest rates must rise to counter the threat of runaway inflation. This in turn negatively impacts the valuation of all productive assets through a reduction in the present value of future cash flows. This has been a factor in the fund's recent fall in net asset value.

However, the resilience of the companies we hold tends to manifest in two key characteristics that are highly beneficial in times of higher inflation. Firstly, the companies do not require much physical capital to both operate and to grow, and generally have high margins. They are therefore far less vulnerable to rising costs of capital equipment and less impacted by rising operational expenses.

Secondly, because their products or services are highly valued by customers, they have pricing power and can raise prices in line with inflation. The net effect of this it to improve growth in profitability in nominal terms. The following quotes from the latest results of major portfolio companies' evidence this:

'Organic sales…increased 10%. The organic sales increase was driven by a three percent increase in shipment volumes, <u>five percent from increased pricing</u>, and a two percent increase from positive geographic and product mix.'

Procter and Gamble Fiscal Year 2022 Third Quarter Results

'Organic Growth reached 7.6%, with real internal growth of 2.4% <u>and pricing of 5.2%</u>'

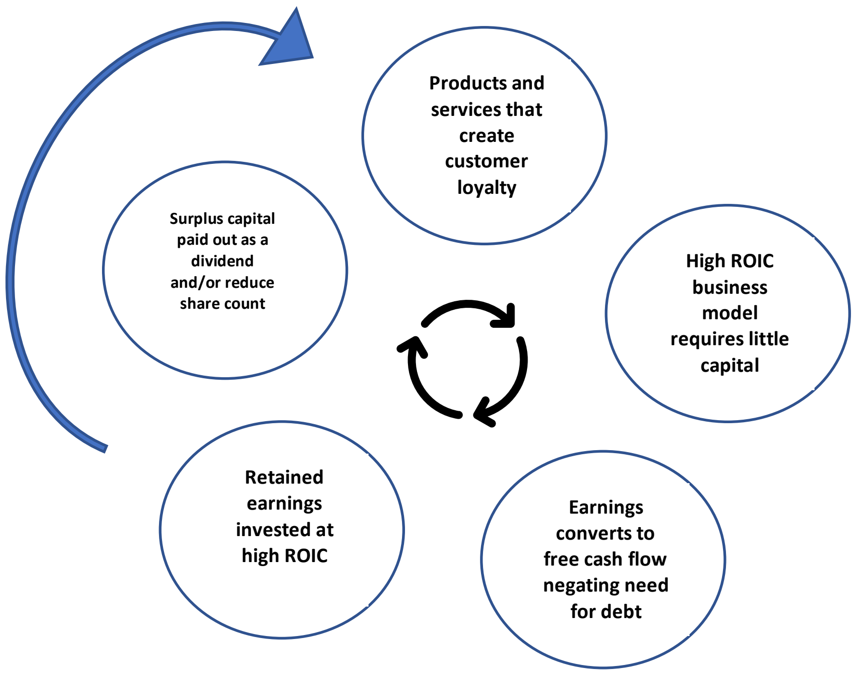
Nestle Q1 2022 sales report

In contrast, more capitally intense companies, which sell commoditised products, are unable to recover the much greater percentage rise in their costs through pricing and therefore see a reduction in profitability and more worryingly, (because many are indebted) a reduction in free cash flow.

Our dividend paying companies therefore have an advantage as they will be able to generate surplus cash flows, which they can use to grow their dividend year in year out. Importantly, in the rising interest rate environment dynamic I referred to above, reducing the present value of capital growth, the dividend becomes a large component of the total shareholder return. These dividend growers are also more attractive than bonds with their fixed coupons.

It is important to remember that dividend growth is the outcome of each company's strategy and business model rather than the cause of the increased return. The starting point for identifying companies likely to be able to deliver long term sustainable dividend growth is the excellence of the product or service it offers followed by the attractiveness of the business model and management's capital allocation skills. Our investment philosophy flywheel shows the virtuous circle and sets the criteria a company must achieve to be a candidate for the fund.

Our Philosophy Flywheel:



ROIC = Returns on Capital

Activity

Over the 12 months to the end of March 2022, excluding the pruning of some sub-scale positions, we sold five investments and purchased five. We currently own 33 stocks.

Major Purchases since 1 April 2021:

Unnamed company A (USA)
Unnamed company B (USA)
T Rowe Price (USA)
Bossard AG (Switzerland)
Bloomsbury Publishing (UK)

Major Sales since 1 April 2021:

HDFC Bank ADR (India)
Sichuan Swelfun (China A)
Magellan Financial Group (Australia)
Belimo (Switzerland)
Kone (Finland)

Two of the purchases relate to companies where I am still building the position and therefore am unable to name. I will comment on these in detail in due course. T Rowe Price, Bloomsbury Publishing and Bossard were the subject of management commentaries in the June, August and November 2021 factsheets respectively. These can be accessed on our website.

Sales were made for a mixture of reasons. Belimo AG and Kone were sold on valuation grounds. Belimo (building temperature and water flow controls); is a company I greatly admire but ESG investors have driven up its share price to a level where it is discounting over 20 years of high ROIC and good growth. Kone (elevators) is also highly valued but less egregiously than Belimo. However, with the collapse of the Chinese property market, growth is going to be more difficult over the next ten years. Sichuan Swelfun is the minority listed Chinese subsidiary of Diageo selling local spirit; Baiju. It has fantastic prospects, but I am concerned that the political risk of the authoritarian government, combined with a weak legal system in the country, renders the predictability of future outcomes more difficult. This is not reflected in the current valuation. HDFC, the largest and best run private bank in India I also view as attractive but after many years of excellent founder led management, they are in the midst of transitioning to a new management team with unproven ability at a time competitor private banks have upped their game.

Magellan Financial Group, the Australian Fund manager, I quite simply got wrong and is subject to more detailed analysis below through which I seek to learn from my mistakes.

Fund Manager KPIs

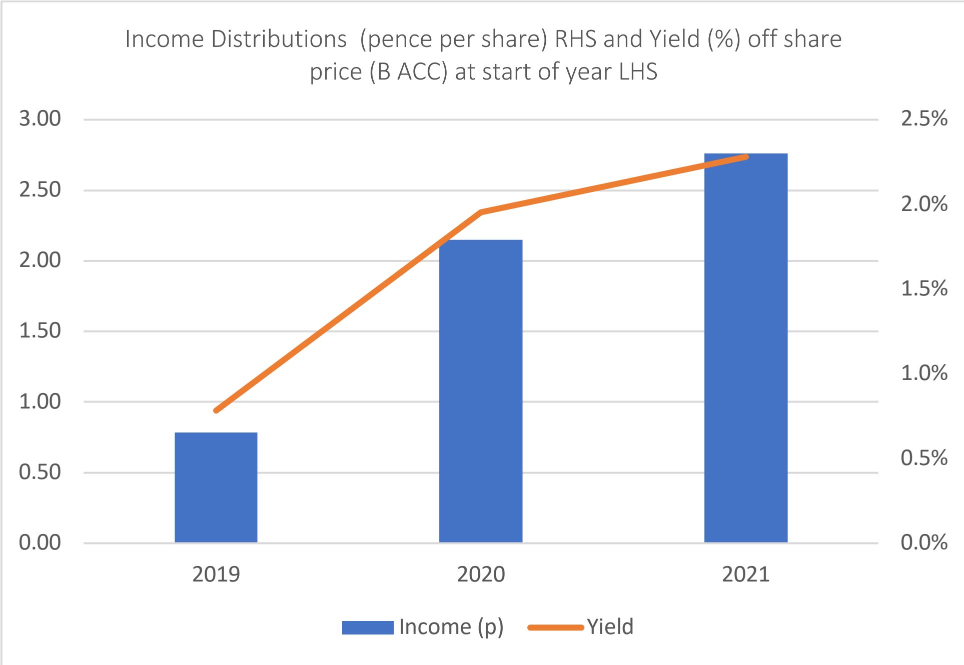
In a recent commentary which can be found on our website here I discussed how key performance indicators (KPIs) could be used to track the effectiveness of fund managers. I set out in the table below the KPIs, I suggest in the article, as at the end of the quarter, a year ago and at inception.

Portfolio Fundamentals	31 March 2022	31 March 2021	30 June 2019
Return on Capital	17%	16%	18%
Gross Margin	52%	56%	56%
Operating Margin	26%	26%	28%
Net debt/EBITDA	1.1	1.7	1.1
Revenue 5 year CAGR	9%	9%	10%
Dividend per share 10 year CAGR	11%	11%	12%
Forward Price Earnings Ratio	23	28	19
Forward Dividend Yield	2.3%	1.8%	2.2%

There are of course a multitude of factors, both qualitative and quantitative, that influence these figures and so they should be considered in very broad terms. For example, COVID would have had a downward effect on historic revenues and dividend compound annual growth (CAGR). Observe though that return on capital is high, margins are at levels representing well-positioned companies, financial leverage is low and aggregate revenue and dividend growth healthy.

Distributions

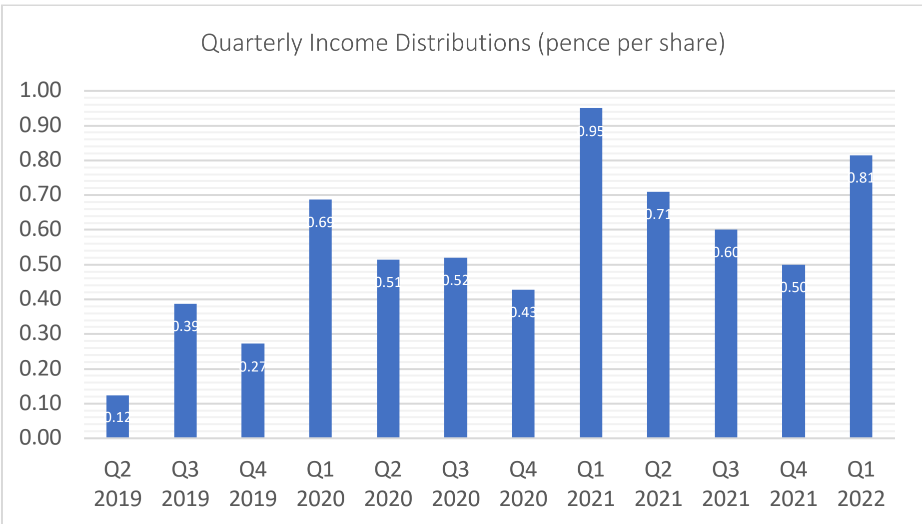
The fund pays dividends quarterly based on the dividend income received during the quarter. The income distributions made so far by the fund can be summarised in the following graph:



Source: Chawton Global Investors LLP

The chart also illustrates the yield that would have been achieved if the shares had been held from the start of the year (using the B Class Acc. units GBP). In 2021, investors would have received a yield of 2.3%.

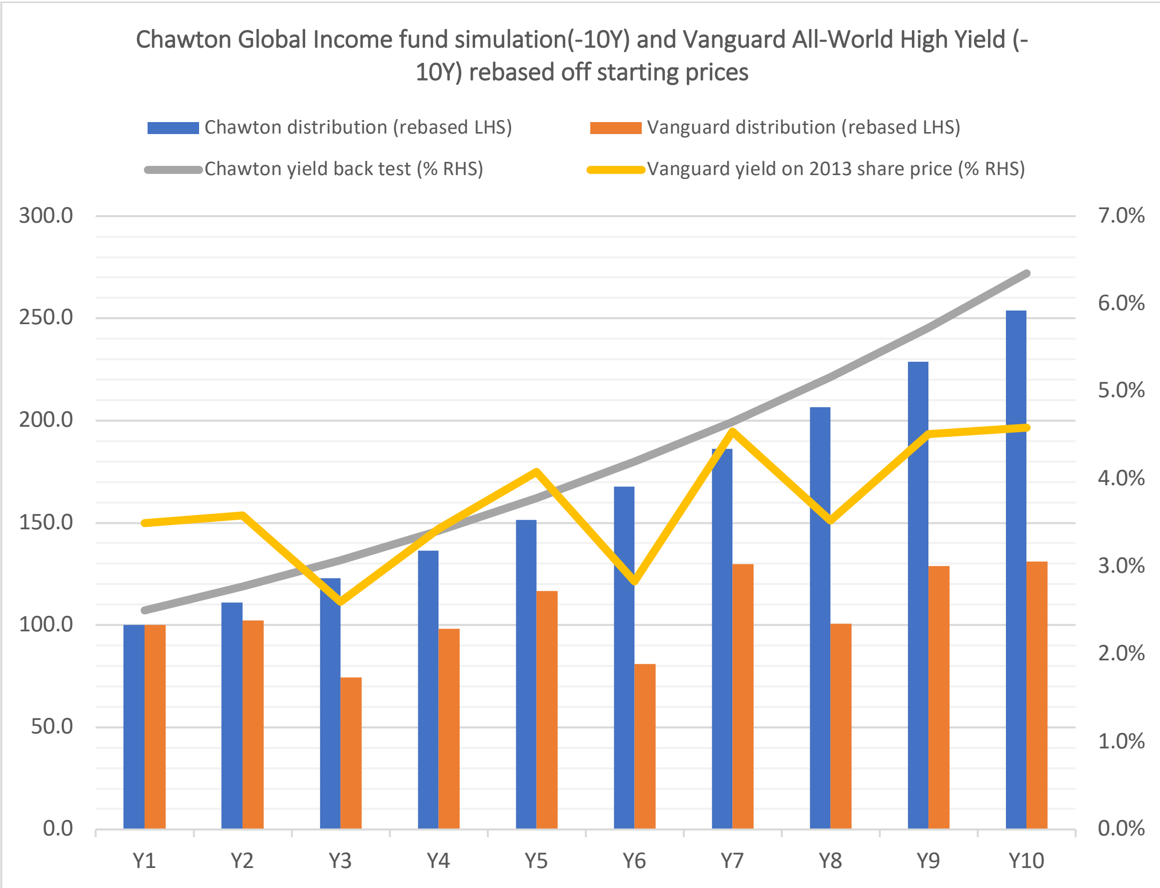
Currently we do not smooth how we distribute the quarterly payments to our investors which therefore tend to be larger in the first two quarters of the year. This is because European companies tend to pay their dividends once a year, soon after their year-end, which is most commonly end of December or March. US companies tend to pay quarterly dividends and UK companies; semi-annually. The quarterly payment pattern therefore looks like this:



Source: Chawton Global Investors LLP

You will also note that the distribution made in Q1 2022 is actually lower than the comparator period in 2021. This is because several portfolio companies paid special or catch-up dividends at the start of 2021 as the perceived economic effect of COVID was less severe than anticipated. This mostly related to the fund's bank and insurance company holdings. That said I estimate that 2022 total distribution will exceed that of 2021 for two reasons. Firstly, fund holdings are expected to increase their dividends significantly. Secondly, portfolio changes have improved the yield profile of the fund and increased the number of quarterly payers.

We consider one of the most important attributes of this fund to be the potential for dividend growth. In the following chart, I compare the performance of a passive equity high-yield fund over the last ten year to a simulation of the performance of the Chawton Global Equity Fund over the same period (the yield the current portfolio would have delivered over the last ten years).



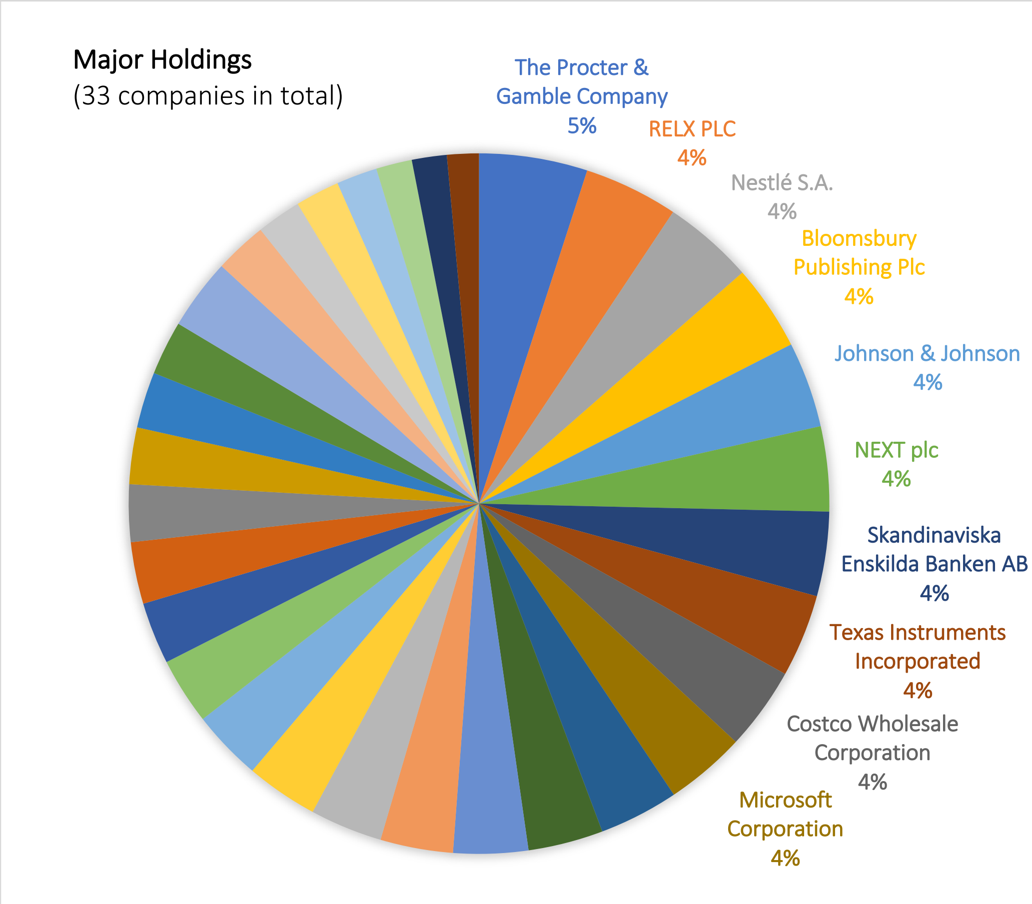
Source: Chawton Global Investors LLP

Please note past performance cannot be relied upon as a guide to future performance. The value of investments and any income from them may go down as well as up.

The blue bars, which represent the Chawton distribution, grew significantly whilst the Vanguard red bars grew marginally. The net effect of this is that although the Vanguard yield, the yellow line, starts off higher, by year 5 Chawton exceeds this and by year 10, the Chawton yield, on the original year one acquisition cost, will be substantial at 6.3% and growing. In simple terms this is a graphic illustration of a key tenet of our investment philosophy, namely the power of compounding!

Portfolio and stock attribution

The following pie chart shows the largest holdings in the fund:



Since inception almost three years ago the main contributors and detractors to performance are shown below (note that the average weight does not necessarily reflect the timing of purchases and sales that also feed into the contribution). The analysis shows that the contribution of our top 4 contributors ranges from 2.6% to 5.0% which contrasts to our 4 largest detractors where the range is just 0.7% to 0.8%. This suggests good risk management but also is consistent with our fundamental belief in running with our winners with a view to holding them for multi-year periods.

Top	Average weight	Return	Contribution
ASML	3.3%	245%	5.0%
Costco	3.3%	133%	3.2%
Texas Instruments	3.7%	78%	2.7%
Fastenal	3.1%	91%	2.6%

ASML, the Dutch listed maker of advanced semi-conductor manufacturing equipment, has been the star performer.   It is effectively a monopoly supplier of the equipment necessary to make the 5 nanometer and 3 nanometer chips used in the latest smart phones and high-powered computers needed for artificial intelligence and gaming. Costco has also delivered great performance as it steadily rolls out is bulk discount retailing concept across the USA and increasingly internationally.

Bottom	Average weight	Return	Contribution
Magellan Financial	2.3%	(50%)	(0.8%)
Hornby	0.5%	(50%)	(0.7%)
Netflix	1.6%	(24%)	(0.7%)
Unilever	0.9%	(15)%	(0.7%)

Magellan Financial is an Australian active fund management company founded and run by the very able Hamish Douglas. However, weaker recent investment performance was compounded with personal problems that led him to temporarily leave the business and the share price collapsing after a significant client took back their money. We fully exited the holding in 2021.

Referring to my philosophy flywheel above, my mistake was to misjudge customer loyalty. This in turn was a function of over-reliance on a key man and low customer switching costs in a competitive industry. There are also powerful substitutes such as passive fund management and 'alternatives' such as private equity. All the other components of the flywheel are very strong, with very low asset intensity meaning that significant capital can be returned to shareholders without detriment to supporting fast growth. My second learning point here is that such strengths should not blind one to weakness in one component. Balance across all is key.

I have recently, and with great frustration also excited a position in Netflix and there are parallels in lessons learnt. Loyalty (which I believed strong) is now being tested and again the company suffers from low switching costs, competitors, and powerful substitutes, notably sport-orientated TV and gaming. The business is also more asset intensive at this stage in its lifecycle as it invests in content to drive loyalty.

Contrasting these to the winners; ASML has very high customer loyalty as it has no effective competition and there is no other way to make these advance chips to act as a substitute. Costco wins on low price and service but has cemented loyalty through an annual membership scheme. Both are more asset intensive than Magellan but have a better balance across the flywheel.

Lessons:

- Focus on the resilience of customer loyalty
- Be cautious of low customer switching costs in more competitive industries
- A good balance of strengths is preferable to being very strong in some criteria and weaker in others.

Conclusion

Whilst it has been an eventful start for both the firm and the fund, I believe both are proving resilient and laying the groundwork for future success. Performance has been good absolutely and relatively good over COVID, although this has dissipated somewhat as economic growth accelerates and the 'incoming tide lifts all boats'. Our newly introduced Fund Manager KPIs suggest the fund has the characteristics to deliver good performance in future years underpinned by an aggregate return on capital in the high teens. This supports our objective of superior dividend growth over time which will result in attractive income levels for long-term investors compared to competing products. The current portfolio comprises 33 high quality companies We have had some notable stock successes and we believe companies held have the potential to deliver further strong shareholder returns over the coming years.

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I hope this letter has provided greater insight into our process and progress. Please do not hesitate to contact me if you have questions or would like me to run through our associated presentation.

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As a concentrated equity portfolio of typically less than 50 stocks the fund may involve higher volatility and therefore higher risk for those with shorter term investment time horizons (under 5 years). The value of an investment and the income from it can fall as well as rise as a result of market and currency movements and you may not get back the amount originally invested. You should therefore regard your investment as long term. Details of the risk factors are included in the fund's prospectus available at www.tbaileyfs.co.uk/funds

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