ALMA CAPITAL

Alma Hotchkis & Wiley US Large Cap Value Equity Fund

Hotchkis & Wiley

A sub-fund of Alma Capital Investment Funds SICAV

As of 30 September 2019

Fund description

- Investment objective: seek current income and long-term capital growth by investing in a concentrated portfolio of large US companies
- Investment process: analyse long term company fundamentals through in-house bottom-up research aiming to identify undervalued stocks
- The fund typically holds 40 to 60 securities and generally invests in companies with a market capitalization above $3 billion
- Benchmark: Russell 1000 Value Index
- Investment strategy mirrors the Large Cap Fundamental Value strategy managed by the Investment manager since 1980

Investment manager: Hotchkis & Wiley Capital Management, LLC

- Hotchkis & Wiley is a SEC-regulated, Los Angeles-based investment adviser founded in 1980, specialised in value equity and high yield bond strategies
- Employee owned firm: 90% of the investment team and 67% of all employees own equity
- Investment team has over 23 years average investment experience and 15 years average tenure at Hotchkis & Wiley
- George Davis, the CEO of Hotchkis & Wiley and senior portfolio manager of the fund, has over 30 years of investment experience. He coordinates the day-to-day management of around $27 billion of equity value assets
- Hotchkis & Wiley manages $30 billion

Cumulative performance (%)

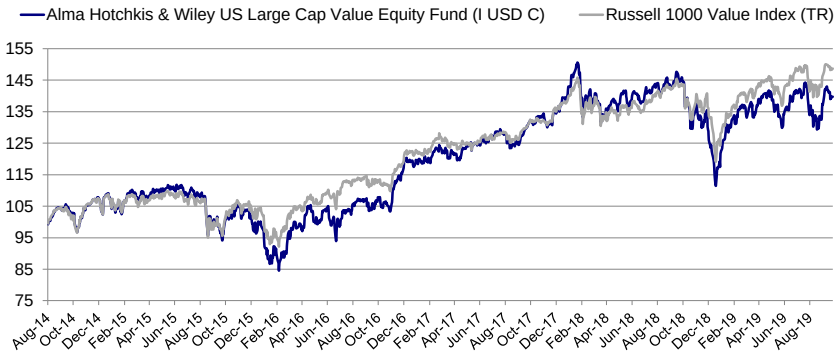
	1 M	3 M	6 M	YTD	1Y	3Y	ITD
I USD C shares	4.54	-0.49	3.85	18.62	-3.25	30.87	39.72
R USD C shares	4.55	-0.50	3.83	18.61	-3.27		
Russell 1000 Value Index (TR)	3.57	1.36	5.25	17.81	4.00	31.04	48.67

Fund launched on 6 August 2014

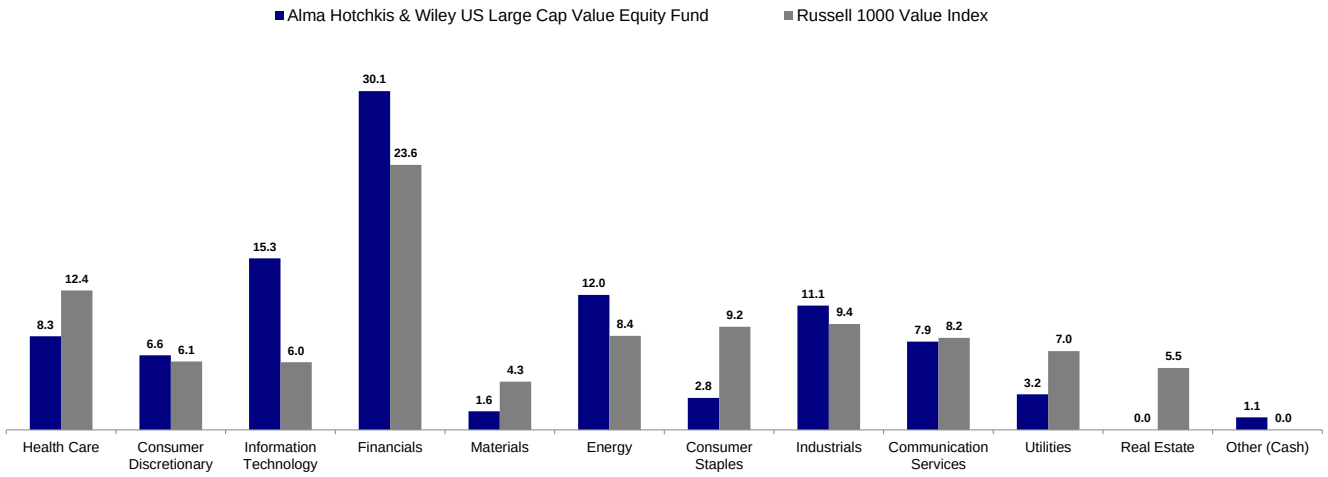
Portfolio characteristics

Main indicators	Fund	Index
No. of securities	51	765
Weighted Average Market Cap ($ bn)	116.8	114.6
Median Market Cap ($ bn)	38.7	9.4
Projected P/E Ratio FY2 (x)	11.2	13.9
Price / Normal Earnings (x)	8.4	14.7
Price / Book (x)	1.4	2.0
Price / Sales (x)	1.1	1.5
Projected EPS Growth (%)	5.9	5.7
Active share (%)	88.1	-

Performance (Indexed - Base 100)



Sector breakdown (% NAV)



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Top 10 positions details

Security name	Sector	% NAV
WELLS FARGO & CO	Financials	5.09
GENERAL ELECTRIC CO	Industrials	4.62
AMERICAN INTERNATIONAL GROUP	Financials	4.49
MICROSOFT CORP	Information Technology	3.98
CITIGROUP INC	Financials	3.72
GOLDMAN SACHS GROUP INC	Financials	3.70
ORACLE CORP	Information Technology	3.27
HEWLETT PACKARD ENTERPRISE	Information Technology	3.14
GENERAL MOTORS CO	Consumer Discretionary	3.11
COMCAST CORP-CLASS A	Communication Services	2.63
	TOTAL:	**37.74**

Investment manager's commentary

Market:

The S&P 500 Index returned +1.7% in the third quarter of 2019, and is now up more than +20% since the beginning of the year. The Federal Reserve's FOMC lowered the Fed Funds rate by 25 basis points for the second time this year, which now stands at 2.0% (upper bound). With inflation benign and economic growth modest, albeit positive, the rate cut was widely expected and triggered little reaction from equity markets. The price of crude oil spiked following the drone attacks on Saudi refineries, but this was short-lived and WTI crude finished the quarter down -8%. Energy was the S&P 500's worst-performing sector, declining -6% in the quarter. It has been the index's worst-performing sector over the past year returning -19% (WTI has declined -27% over the past year), and has been the worst-performing sector in three of the past four calendar quarters. Utilities +9%, real estate +8%, and consumer staples +6% were the best-performing sectors in the quarter. These are also the top three sectors, by far, over the past year. The S&P 500 is up 4% over the past 12 months but these three sectors are up considerably more: utilities +27%, real estate +25%, and consumer staples +17%.

Concerns about slowing economic growth and a possible recession have become increasingly pervasive amid erratic trade negotiations and geopolitical uncertainty (e.g. Brexit in the UK, potential impeachment proceedings in the US). As a result, treasuries rallied during the quarter with the yield on the 10 year note falling below 1.5% in late August—for about a week, the 2-year treasury yield exceeded the 10-year treasury yield. This caught investors' attention because contemporary recessions have been preceded by similar 10-year/2-year yield curve inversions. The time between inversion and recession has varied significantly, from several months to more than 2 years.

The timing of the next economic slowdown and/or recession is unclear but it is certainly possible in the near to intermediate term, and we acknowledge this as a legitimate risk. In periods leading into economic slowdowns, intuition would suggest that equity investors should gravitate toward stocks with less economic sensitivity. For the most part, this was a winning strategy during the early 2000s recession. During that period, richly valued internet, telecom, and media stocks cratered and many less cyclical stocks outperformed. In today's market, however, the richly valued stocks are the non-cyclicals, which suggests that an economic slowdown is already priced in—perhaps overly priced in. As noted above, utilities, real estate, and consumer staples—non-cyclical sectors—have outperformed more cyclical areas significantly. Consequently, the valuation dispersion between certain market segments is uncommonly wide.

To illustrate our approach given the current state of affairs, consider the thesis behind our overweight position in banks and underweight position in utilities. The S&P 500 Bank Index trades at 10.9x consensus earnings, which is 9% below its long term average of 12.0x. The S&P 500 Utilities Index trades at 21.0x consensus earnings, which is 45% above its long term average of 14.5x. Returns-on-equity for the two indexes are similar1. Dividend yields are also similar but because valuations are so different, utilities have to pay out about 2/3 of their earnings in dividends while banks pay out about 1/3 of their earnings to arrive at similar yields2. Because banks retain more of their earnings, it has allowed them to amass capital and strengthen their balance sheets, and in recent years, buyback their own stock. Given the information above, for the two indexes to generate equivalent returns going forward, one of several things would need to occur. The valuation gap would need to widen even further, utilities would need to accelerate earnings growth, or banks would need to suffer a major destruction of capital. To us these seem like unlikely scenarios because the valuation gap is already near an all-time wide, organic growth prospects for utilities are limited, and banks have accumulated near record levels of excess capital on their balance sheets to protect against a downturn. Thus, we view banks as superior risk-adjusted investments irrespective of near-term economic growth.

The portfolio continues to trade at a large discount to the market. The portfolio trades at 8.4x normal earnings compared to 14.7x for the Russell 1000 Value Index and 25.7x for the Russell 1000 Growth Index. It trades at 1.4x book value compared to 2.0x and 7.6x for the value and growth indices, respectively. This valuation discount combined with healthy balance sheets and good underlying businesses has us confident about the portfolio's prospects as we look forward.

Fund:

The portfolio underperformed the Russell 1000 Value Index in the third quarter of 2019. Stock selection in industrials, technology, and communication services hurt relative performance, along with the underweight positions in REITs, staples, and utilities. Positive stock selection in healthcare and financials were the largest positive contributors in the quarter. The largest individual detractors to relative performance in the quarter were General Electric, Discovery, Corning, Marathon Oil, and Ericsson; the largest positive contributors were Vodafone, Wells Fargo, AIG, Medtronic, and State Street.

Largest New Purchases: 3Q 2019

UnitedHealth Group (UNH) is the largest and most diversified managed care organization, in an industry where scale is a significant competitive advantage. UNH has the largest and fastest growing share in Medicare Advantage, the biggest opportunity in managed care. UNH is well positioned in Medicaid as well, another growth opportunity. The company's valuation is about in line with the value index, but this is a high quality business with above average growth prospects, it produces sticky and stable earnings, and it has a good balance sheet.

Fund facts

Fund total net assets: $102.04 M

Base currency: USD

Fund domicile: Luxembourg

Fund type: UCITS SICAV

Management fee: 0.75% p.a.

Depositary, Administrator, Transfer Agent: BNP Paribas Securities Services (LU)

Dealing: Each day with a 1-day notice. Cut-off time : 5 pm CET

Management company: Alma Capital Investment Management (LU)

Investment manager: Hotchkis & Wiley Capital Management, LLC (US)

Fund managers: George Davis, Scott McBride, Judd Peters, Patty Mckenna, Patrick Meegan

Countries where the fund is registered:
France, Germany, Luxembourg, Switzerland, United Kingdom, Austria

Institutional USD Capitalisation share class
Isin: LU0963547111 Ticker: ALDCPBI LX Launch: 6 August 2014
Retail USD Capitalisation share class
Isin: LU0963547970 Ticker: ALDCBRU LX Launch: 21 November 2017

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