European Capital Partners

Strategic Selection Fund European Value

Quarterly report

September 2020

This document is intended exclusively for professional or institutional clients and counterparties

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Portfolio review

Executive Summary

- **Performance overview**
    - MSCI Europe was up 0.1% during Q3 2020
    - Strategy up 2.5% (share class A Eur), outperforming market by 2.4% and MSCI Europe Value by 6.2%
    - Performance driven by stock picking: Increased focus on quality have started to yield results.

- **Portfolio changes**
    - 3 new names joined portfolio, 4 names were sold

- **Market environment & Outlook**
    - European markets took a wait-and-see approach during Q3
    - European equities are under-owned and cheap relative to the US
    - The underperformance of value has reached unsustainable levels
    - We remain true to our value investment principles we have applied over the last 2 decades at the same time putting extra focus on the quality of the businesses and sustainability of cash flows
    - Median margin of safety of portfolio 40%
    - 8% cash left to seize new investment opportunities

As it turns out, we could not escape the Covid-19 statistics as hoped for. In the last quarter there has been an uptick in the global infections as economies gradually returned normalcy. Thanks to strong government and central bank support, business conditions are clearly improving. The result: while still down 12.8% since the beginning of the year, MSCI Europe TR Index has rallied an impressive 29.4% run since the trough on March 18th. The battle against the COVID-19 is not yet won and would less likely be won until the vaccines are available.

During Q3, European stock markets took a wait-and-see approach and were stable.

The rally since the trough has so far been concentrated on a few “leaders” while many stocks have been left behind. At the end of Q3, 41% of the constituents of the STOXX 600 had their share price down 15% or more, 33% were down 20% or more and still 20% were down more than 30% !

The current market moves have a low participation rate as most institutional investors stayed on the side-lines. Flows into equity Funds start to stabilize at low levels. We view this as a good sign as the market does not appear overbought.

At ECP, the full focus is on selecting quality companies with sound balance sheets and business franchises that can produce solid earning power in normal circumstances. However, when we will get back to normalcy remains to be seen…

MSCI Europe was flattish, finishing the quarter up 0.1%. Financials and energy were the weakest sectors in Q3. We take comfort in the fact that our energy names in the portfolio withstood the overall gloom in the energy sector and did not detract to performance. In financials, we lost less than the market overall as we hold only 2 smaller positions in banks with specific investment cases, namely Bawag and Caixabank. Industrials and consumer discretionary were the two strongest sectors that contributed to market performance in Q3. It is also there were we made most return in our portfolio.

This is the second quarter in a row where our strategy strongly outperformed the market and the value index. We are particularly recomforted by the fact that the outperformance was mainly driven by stock selection.

During the quarter we added 3 names to the portfolio and sold 4. We continue to reposition the portfolio towards higher quality while not compromising on valuation. In these turbulent times where the operating environment for most companies is difficult and at the same time investment opportunities are abundant, we think it would be a mistake to continue to hold on to businesses that face long term challenges to their fundamentals. Investing in lowly valued companies that may be cheap for a reason and then hoping for the best is not a viable strategy in the current market environment.

We make all our investments on a company-by-company basis. We like to spread our investments across +/- 40 companies where a good number of companies provide high and growing cash flows in any economic environment. The other part is more of a cyclical character and we like to buy those companies when they are priced for recession.

The 3 main positive contributors in Q3 2020 were G4S (+106 bps contribution), Elekta (+70 bps) and Husqvarna (+55 bps).

The 3 holdings showing the biggest negative contribution during Q3 were Atos (-33 bps), Jeronimo Martins (-32 bps) and Anima Holdings (-31 bps).

The quality-value framework we introduced during the Covid-19 crisis has been implemented and is now being applied systematically to all our holdings and portfolio management discussions. In our opinion, it is a solid supplement to our valuation models and helps us to understand the fundamentals and valuation of every investments compared to its own history and the market overall.

Portfolio changes

We continue to follow our investment process as we have done for many years. We do so regardless of the opinion of Mr. Market. Our investment horizon is oriented towards the long-term with an average holding period of 4 to 5 years. This is the time normally needed for the market to recognise the earnings power of an undervalued company and thus for the valuation gap between the stock price and the estimated intrinsic value to close.

At the beginning of the year, the quality score of our portfolio (ex. financials) was a little bit below that of the market. Following our journey towards quality, as of the end of Q2 2020, our portfolio (ex. financials) is now of a better quality score than the market and we continue to look for and hold more quality companies.

The median margin of safety of our portfolio, ie the current discount of the stock prices to our fair value, is 40%.

Earnings for this year should not be confused with the underlying earning power of the businesses we are invested in as they are momentarily depressed due to the impact of the pandemic. Even on 2020 estimates our portfolio looks cheap compared to the market. For example the median current year PER of our portfolio company is 20 times (vs 22 times for the market).

At the same time the balance sheets are strong. It takes the median company in our portfolio 1.5 years to reimburse its debt (net debt / ebitda) vs 3.1 years for the market overall.

The investment process aims to identify companies with undervalued earnings power without any geographic, sector or market capitalisation considerations.

Portfolio purchase activity was pretty much as usual during the quarter with the addition of 3 new names. On the sell side we however needed to sell 4 positions before our fair value was reached. As described above, we find it difficult to hold on to businesses that face structural challenges despite the low valuation.

⇒ BUY

We have bought LafargeHolcim, STMicroelectronics and Michelin during the quarter

⇒ SELL

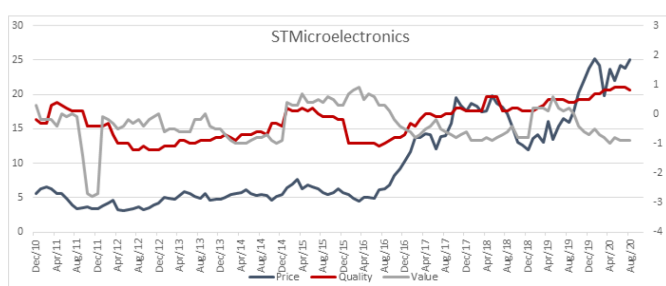
During the quarter, we sold our positions in Danone, Hugo Boss, ISS and Rolls Royce.

In case of Danone, we found a better replacement for a given quality score from the perspective of our Quality-Value framework.
For us, apparel maker Hugo Boss was another victim fallen to the onslaught of e-economy in the disrupted retail segment. We could not foresee a feasible options to correct the course available to the management to revive the brand and its value proposition for targeted consumer segment.
The business model of ISS was stress-tested during the Covid-19 crisis and our worst fear about it came true. ISS over the past years has shifted its client base to Global Key client in order to have more visibility in the business, however it came at the expense of its bargaining/negotiating power, which has negatively impacted its FCF generation ability. Last thing we want to have in a portfolio is a company which is a price-taker.
We continue to believe in the razor blade business model of Rolls-Royce, however Covid-19 has severely hit the prospects at the company, to add to it the inherent risks involving ramp-up of engine platforms made the risk-reward not very appetizing to us. And we were proven right as within weeks of our exit, the company went for huge capital raise to remain buoyant and maintain credit ratings.

Investment cases

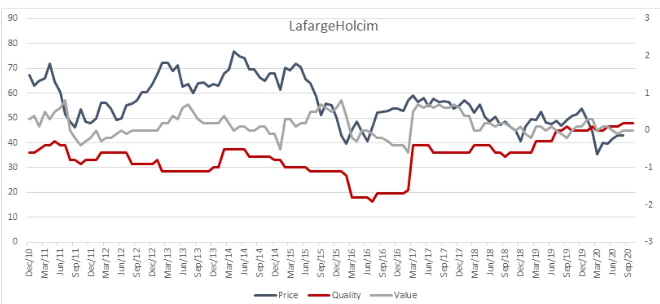
STMicroelectronics

STMicroelectronics is a large, broad-based semiconductor manufacturer with leadership positions in wide range of analog and discrete product offerings. STM's products are used for a variety of applications in the four end-markets: automotive, industrial, personal electronics and communications equipment, computers, and peripherals. About 60% of revenue comes from the industrial and automotive segments where STM is well positioned in the Electric vehicles, Automated Driver Assistance systems and IoT segments. For more than a decade, STM under-delivered on profitability metrics and growth compared to its European peers due to (1) it competing in the commoditized segment of semiconductor value chain and (2) its type customer engagement/operating model being out of favor amongst the wider customer base. However, that changed in the period after 2015 when the management redirected its R&D spend on to next generation technologies and newer areas of opportunities. As it is evident in our Quality-Value framework, the growth and profitability has been consistently improving thereafter. And also, as the world is slowly transitioning to themes of IoT, EV and 5G, STM's clientele is more willing to opt for risk-sharing agreements, STM's historical expertise, than in the past during the period of mature technologies. Hence, we believe STMicroelectronics should no longer trade at discount to incumbent European semiconductor names.



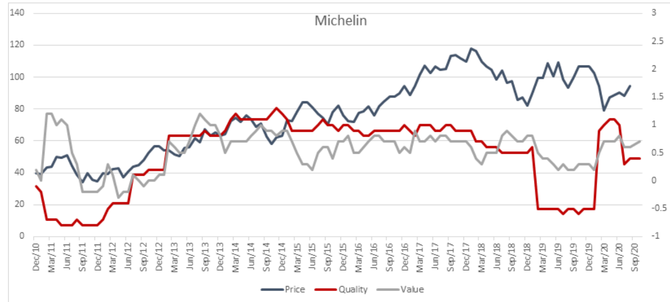
LafargeHolcim

LafargeHolcim is another neglected name we added to the portfolio during the quarter. Due to the nature of the industry it operates in and the strategic missteps taken by previous management Lafarge traded at steep discount to its asset-light European peers and to its own earning power. However, things changed for good with the arrival of new management in 2017. Current management has a proven track record and has already shown tangible turnaround results by cutting down almost half a billion in operating costs and exiting loss-making geographies. As the business is repositioned to profitable, and growing product segments/geographies, alongside continued efficiency improvement and fiscal tailwinds, we are confident that LafargeHolcim shares would close the gap to its intrinsic value.



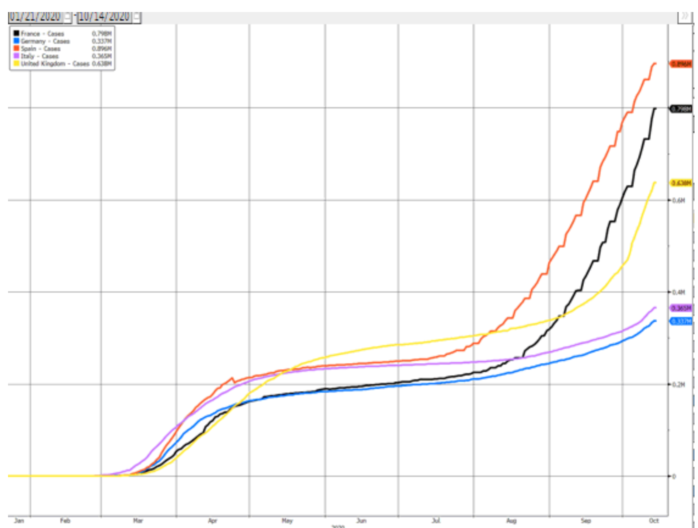
Michelin

Michelin is a leading global automotive tyres manufacturer which we found trading at a bargain during the peak of Covid-19 crisis. Around 25% of its' sales goes to OEMs and remaining 75% is towards replacement demand, via various sales channels to end consumers. In a scale driven industry, Michelin has over the period captured c.14% of the global market shares. Under the new strategy, Michelin is rapidly increasing its exposure to Asia and Specialty tyres, both high growth end markets, as is evident from the recent three acquisition it closed. Specialty tyres, with operating margins of c.20% compared to group margins of c13%, proved its resilience/attractiveness during the Covid-19 crisis. In comparison to its historical track-record of volatile FCF generation, Michelin has consistently generated on average EUR 1 billion of FCF in last five years. On the back of industrial footprint consolidation, improving product mix, and increasing resource allocation towards high growth/ high margin specialty tyres segment, we believe Michelin will prove to be one of the best names in European auto names.

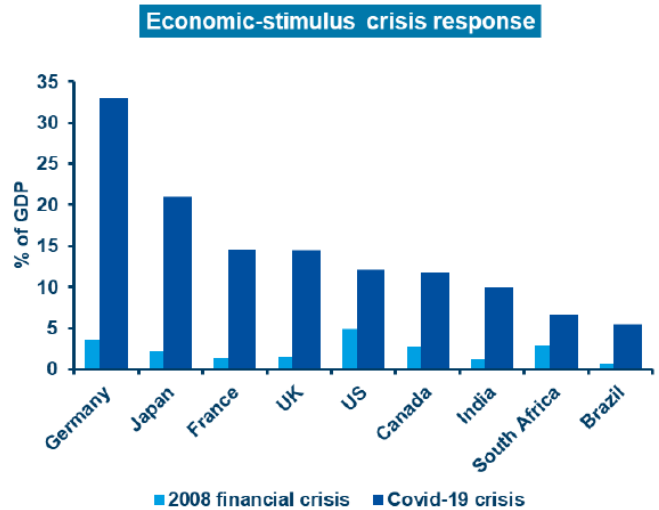


Market environment & outlook

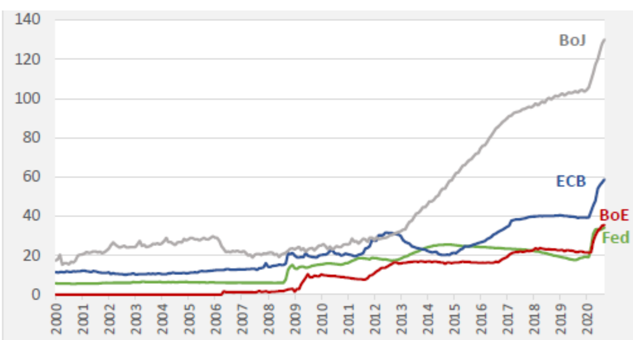
We can not escape the fact that any view on the financial markets is determined by the evolution of the pandemic. As can be seen on the Bloomberg graph below, new infections of Covid-19 have been increasing over the past 3 months in Europe, especially in Spain (red line), France (black) and UK (yellow). We will not muse extensively about the reasons of this worrying trend, however as investors we conclude that the virus will stay with us for longer and any attempt to return to normal social and business conditions will ultimately result in an increase of infections. The better news is that, at least for the moment, the symptoms of the virus appear for many patients less virulent and in some cases the positively tested patient is asymptomatic. Covid-19 remains a pandemic and a major threat to mankind that will unfortunately stay with us till a vaccine or a treatment can be deployed.



We believe there has been decisive management by policy-makers (states, central banks, multilateral organizations) with **enormous amounts of the government and central bank support.**



Central Bank Balance Sheet (% GDP)

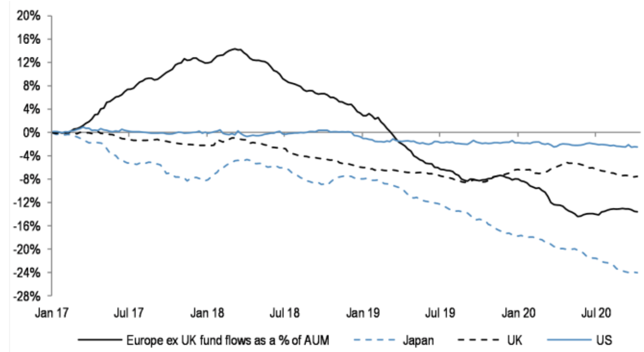


Source: Myria AM

Below, we tried to sum-up the positive reaction of this stimulus into one single graph. The black line is the Citigroup Economic Surprise index for the Eurozone. Economic forecasters were taken twice by surprise by the pandemic. First negatively when the pandemic hit than positively by the better than expected economic data. and the economies continue to surprise positively as indicated by the Citigroup Eurozone Economic Surprise Index that is almost back to pre-crisis level. In red we show the IFO German Manufacturing business expectations. **During the lockdown, manufacturing companies had a doom view on the prospects of their businesses. This has recovered since and expectations are currently higher than they were at the beginning of the year.** Finally, the blue line shows the Markit Eurozone Composite PMI. The picture is somewhat similar to the IFO index: however it includes the service part that is dragged down by the sanitary restrictions.

Source: Bloomberg

Positionning in European equities remains extremely defensive with a lot of investors still on the sidelines. We take note however that outflows out of European equities have slowed recently.

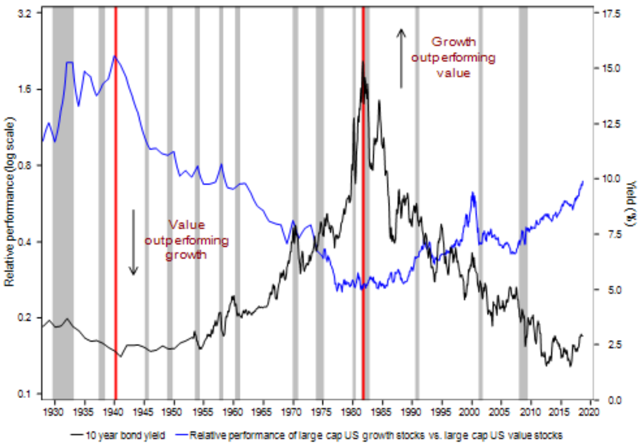


Source: JP Morgan

Value as an investment style has continued to underperform. 100 EUR invested in the European value index three years ago are worth 80 EUR today (black line). 100 EUR invested in the Growth Index are worth 122 EUR today (red line).

At the same time, despite the underperformance of value since the financial crisis the long term track record for value remains intact as can be seen in the below:

- Relative performance of large cap US growth vs. value* stocks shown against US 10 year bond yields -



Source: Longview Economics, Macrobond, Ibbotson & Associates. (*) Data merges indices from Ibbotson & Associates and MSCI.
Past performance is no indication of future results

There are in our opinion 2 additional readings in this graph: first the strong correlation between interest rates and the outperformance of value. In other words, we need interest rates to go up for a sustained rebound in value. Secondly, if underperformance of value becomes extreme like in 1999/2000 with the Internet bubble, the rebound of value is brutal and quick even without a fundamental change in the direction of interest rates.
Our suspicion is that we are just at such a moment as underperformance of value has become extreme during the COVID pandemic. For the value managers who are able to convince their investors to stay put, I believe the rebound in value stocks could be of as an epic dimension as its recent underperformance. It is indeed a very good moment to be price sensitive in investing.

Conclusion

You may accusing us of lagging imagination or being lazy in our reporting. However, we decided our conclusion should remain exactly the same as at the end of Q2:

"

We need to remember that Covid-19 is an exogenous shock. It has not been triggered by unsustainable financial excesses and the subsequent tightening of monetary and credit conditions that characterized previous financial crisis. That is important because it implies that our economies (households, governments and corporates) are not in a painful deleveraging mode. The current crisis, however difficult it is, will therefore be relatively limited in time.

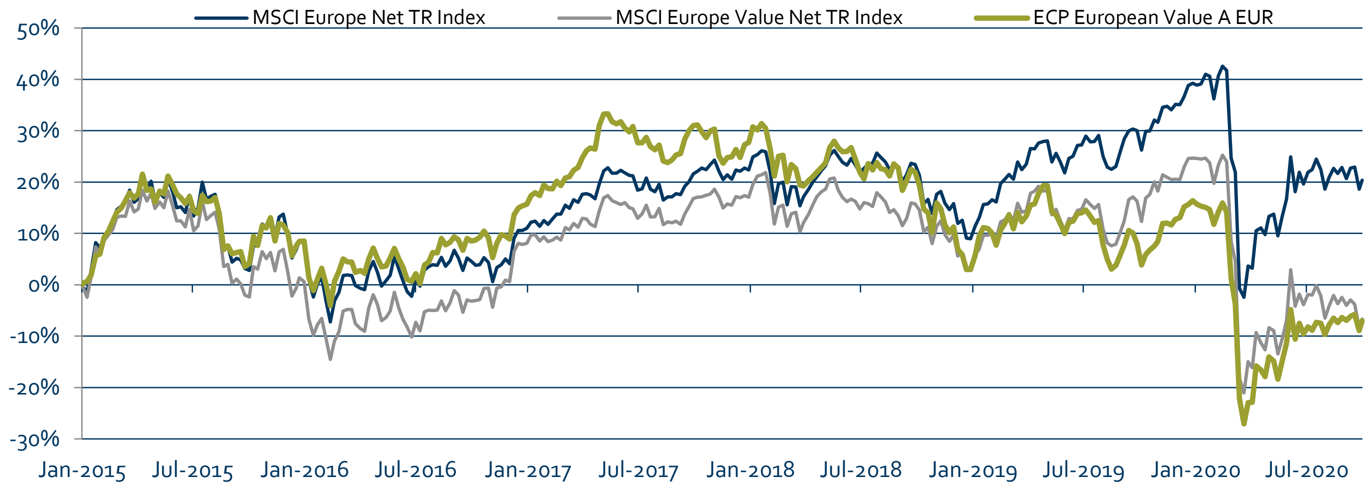
Mr Market is excessively focusing on 2020 earnings and extrapolates the earnings produced this year to perpetuity. While the current crisis is severe and it is difficult to estimate its lengths and therefore its economic impact, we can be certain of one thing: it is an external shock that will last months and not years. For those investors taking a longer-term view on the earning power of the companies they analyze, a sea of opportunities is opening in the current market correction. To date, ECP has not been a forced seller, on the contrary we have new high-quality names while keeping some dry powder in terms of cash.

Market timing does not work for us and we have again seen investors selling ownerships in great businesses (called stocks) at the nadir of the crisis missing the rebound. Staying invested in solid undervalued businesses is key to long term investment success. "

Portfolio profile

Performance analysis

Cumulative performance since inception[1]



Performance statistics

	European Value (A EUR share class)	MSCI Europe NR	MSCI Europe Value NR
Since inception	-6.98%	20.37%	-6.65%
3 years	-29.00%	-1.03%	-20.10%
1 year	-13.95%	-7.76%	-20.17%
YTD	-19.66%	-12.75%	-24.50%
6 months	17.41%	12.71%	6.66%
3 months	2.52%	0.10%	-3.75%
1 month	0.11%	-1.41%	-3.47%

Risk statistics (3 years rolling- annualised)

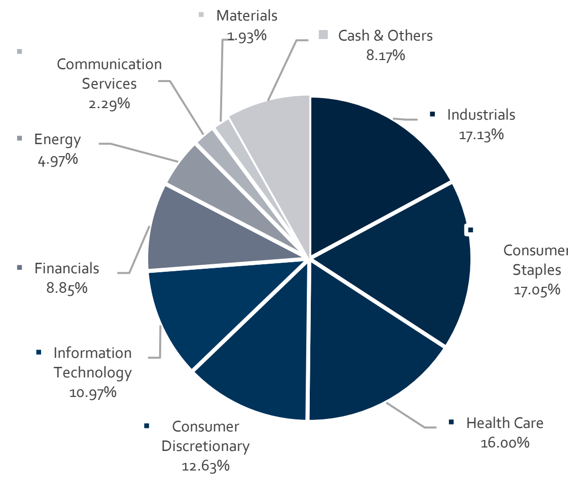
	European Value (A EUR share class)	MSCI Europe NR	MSCI Europe Value NR
Standard deviation	21.15%	19.33%	22.54%
Sharpe ratio	-0.64	-0.01	-0.31

		MSCI Europe NR	MSCI Europe Value NR
European Value	Tracking error vs. index	6.77%	7.51%
	Active share vs. index	87.1%	88.6%
	1 yr Beta vs. index	0.89	0.75

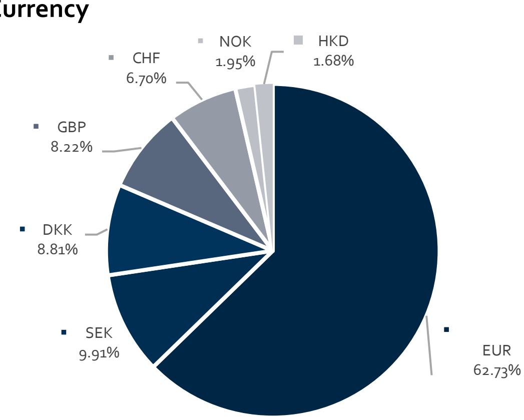
[1] The sub-fund ECP Flagship European Value has been managed by the same investment manager, with the same investment strategy and a comparable fee structure since 1 January 2015. The sub-fund has been managed under the legal form of an Alternative Investment Fund according to EU Directive 2011/61/UE until 8 August 2015 when it was converted into its current UCITS status according to EU Directive 2009/65/EC. The historic performance, return and risk data presented herein cover the full period from 1 January 2015 to date.

Portfolio's breakdown (%)

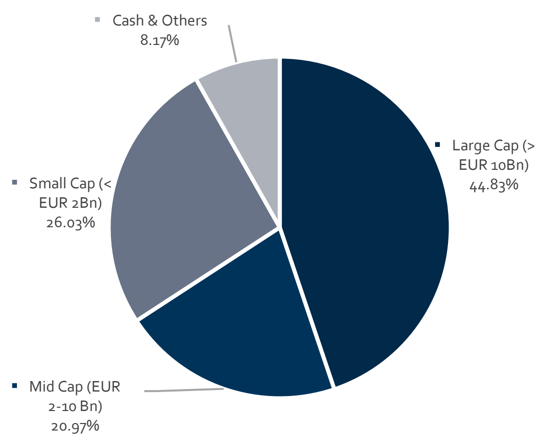
By Sector



By Currency



By Market Cap (*)



Fund Key Facts

- **Legal Form**: UCITS Compliant Luxembourg SICAV
- **Investment Manager**: European Capital Partners
- **Management Company**: European Capital Partners
- **Custodian**: Banque de Luxembourg
- **Administrator**: European Fund Administration
- **Auditor**: Deloitte Audit
- **NAV frequency**: Daily

European Value

	A EUR	I EUR	C EUR
ISIN Code	LU1169207518	LU1277321912	LU1768645753
Investor focus	Retail	Institutional	Retail
Inception date	08/08/2015 (*)	28/08/2015	28/02/2018
Max. Mgt fees	1.50%	0.80%	0.90%
Performance fee	-	-	-
Min. subscription	-	EUR 1mn	-
Registered in	LU, DE, CH, SE, FR, NL		LU, DE, NL

Synthetic Risk and Reward Indicator

Lower Risk
Potentially Lower Reward

Higher Risk
Potentially Higher Rewards

1	2	3	4	5	**6**	7

(*) Transformed from an AIF launched on 01/01/2015

Portfolio holdings

Company Name	Sector	Industry Group	Country[1]	Market cap
ABB LTD-REG	Industrials	Electrical Equipment	SWITZERLAND	Large Cap
ADIDAS AG	Consumer Discretionary	Textiles, Apparel & Luxury Goo	GERMANY	Large Cap
ANIMA HOLDING SPA	Financials	Capital Markets	ITALY	Small Cap
APPLUS SERVICES SA	Industrials	Professional Services	SPAIN	Small Cap
ASML HOLDING NV	Information Technology	Semiconductors	NETHERLANDS	Large Cap
ATOS SE	Information Technology	IT Services	FRANCE	Large Cap
BAWAG GROUP AG	Financials	Banks	AUSTRIA	Mid Cap
CAIXABANK SA	Financials	Banks	SPAIN	Large Cap
CLOETTA AB-B SHS	Consumer Staples	Food Products	SWEDEN	Small Cap
DUERR AG	Industrials	Machinery	GERMANY	Small Cap
ELEKTA AB-B SHS	Health Care	Health Care Equipment & Suppli	SWEDEN	Mid Cap
EXOR NV	Financials	Diversified Financial Services	NETHERLANDS	Large Cap
FLSMIDTH & CO A/S	Industrials	Machinery	DENMARK	Small Cap
FRESENIUS SE & CO KGAA	Health Care	Health Care Providers & Servic	GERMANY	Large Cap
G4S PLC	Industrials	Commercial Services & Supplies	BRITAIN	Small Cap
HENKEL AG & CO KGAA	Consumer Staples	Household Products	GERMANY	Large Cap
HUSQVARNA AB-B SHS	Consumer Discretionary	Household Durables	SWEDEN	Mid Cap
JERONIMO MARTINS	Consumer Staples	Food & Staples Retailing	PORTUGAL	Large Cap
JOHN WOOD GROUP PLC	Energy	Energy Equipment & Services	BRITAIN	Small Cap
JOST WERKE AG	Industrials	Machinery	GERMANY	Small Cap
KONINKLIJKE PHILIPS NV	Health Care	Health Care Equipment & Suppli	NETHERLANDS	Large Cap
LAFARGEHOLCIM LTD-REG	Materials	Construction Materials	SWITZERLAND	Large Cap
MATAS A/S	Consumer Discretionary	Specialty Retail	DENMARK	Small Cap
MICHELIN (CGDE)	Consumer Discretionary	Auto Components	FRANCE	Large Cap
NORMA GROUP SE	Industrials	Machinery	GERMANY	Small Cap
NOVARTIS AG-REG	Health Care	Pharmaceuticals	SWITZERLAND	Large Cap
NOVO NORDISK A/S-B	Health Care	Pharmaceuticals	DENMARK	Large Cap
ONTEX GROUP NV	Consumer Staples	Personal Products	BELGIUM	Small Cap
ORIGIN ENTERPRISES PLC	Consumer Staples	Food Products	IRELAND	Small Cap
PRADA S.P.A.	Consumer Discretionary	Textiles, Apparel & Luxury Goo	ITALY	Large Cap
PUBLICIS GROUPE	Communication Services	Media	FRANCE	Large Cap
RECKITT BENCKISER GROUP PLC	Consumer Staples	Household Products	BRITAIN	Large Cap
SAGE GROUP PLC/THE	Information Technology	Software	BRITAIN	Large Cap
SANDVIK AB	Industrials	Machinery	SWEDEN	Large Cap
SANOFI	Health Care	Pharmaceuticals	FRANCE	Large Cap
SAP SE	Information Technology	Software	GERMANY	Large Cap
STABILUS SA	Industrials	Machinery	LUXEMBOURG	Large Cap

Company Name	Sector	Industry Group	Country[1]	Market cap
STMICROELECTRONICS NV	Information Technology	Semiconductor	SWITZERLAND	Large Cap
SUBSEA 7 SA	Energy	Energy Equipment & Services	BRITAIN	Small Cap
SUPERDRY PLC	Consumer Discretionary	Specialty Retail	BRITAIN	Small Cap
SWATCH GROUP AG/THE-BR	Consumer Discretionary	Textiles, Apparel & Luxury Goo	SWITZERLAND	Large Cap
TOTAL SE	Energy	Oil, Gas & Consumable Fuels	FRANCE	Large Cap
UNILEVER NV	Consumer Staples	Personal Products	BRITAIN	Large Cap
VISCOFAN SA	Consumer Staples	Food Products	SPAIN	Mid Cap
STMICROELECTRONICS NV	Information Technology	Semiconductor	SWITZERLAND	Large Cap

[1] Country of Risk as defined by Bloomberg

Key risk factors

- **Equity**: The Fund may be affected by stock price variations, the scale of which is dependent on external factors, stock trading volumes or market capitalization.
- **Currency**: Currency risk is linked to exposure to a currency other than the Fund's valuation currency, through direct investments.
- **Liquidity Risk:** A decreased or insufficient liquidity in the markets could negatively impact the prices at which positions are bought or sold by the sub-fund.

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In **Germany**, the paying agent is Marcard, Stein & Co, Ballindamm 36, D-20095 Hamburg.