# Queen's Student Managed Fund

Annual Report 2017/18

QUEEN'S UNIVERSITY BELFAST | MANAGEMENT SCHOOL


NEW YORK STOCK EXCHANGE

## INTRODUCTION BY DR BARRY QUINN

“Experience is the child of thought, and thought is the child of action” - Benjamin Disraeli

The unique QSMF learning experience continues to develop and mature. Within the management school, it compliments and promotes critical thinking with our capital market theory teaching. Outside the school, the first time experience of real money investment decisions leads to a thirst for more academic financial knowledge. Beyond the university, QSMF alumni are using their experience to secure top graduate roles in finance locally and overseas. This success is complimented by the Fund breaking through the £30,000 mark, and student management now outperforming the benchmark. The oversight team continues to beam with pride as the experiential benefits of the QSMF yields students who think critically before acting professionally.

Dr Barry Quinn
Oversight Committee

## MESSAGE FROM THE CEO

I am delighted to report another successful year for the fund, generating active returns of 4.83% and providing students with a valuable and relevant learning experience. Employers have continued to respond positively to the concept of the student managed fund with numerous students using their experiences as part of the fund to differentiate themselves in job applications and interviews.

The student committee set themselves a goal of promoting both the educational and social aspects of the fund. On an educational front, we introduced a structured learning experience, spanning quantitative and qualitative analysis, following a CFA equity research format. To complement the tools for analysing specific companies we produced a weekly economic briefing ensuring our members were informed about markets and market drivers. Analysts that went above and beyond the call of duty were rewarded with ‘senior analyst’ status, creating a position to aide sector heads and ensuring the best possible support for new members. We renewed our commitment to providing members with tangible industry qualifications with the Bloomberg Market Concepts (BMC) requisite. On the social front we held our very first SMF pub quiz in January of this year. This proved a massive success as it encouraged student members to bond and interact outside of the fund and allowed students to relax away from the pressures of studies and writing analyst reports. Additionally, we launched the SMF hoodies this year to boost the profile of the fund amongst the student body.

The tremendous efforts from all our members this year culminated in another successful pitching event, hosted by Davy in their Belfast Office. The Sector Heads successfully pitched a series of new investments and we received valuable feedback from Davy Staff. Our research, and the feedback provided from this event, influenced the changes we made to the fund this year.

I could not be prouder of how the Fund has evolved this year and I am confident that it will only move from success to success. With the unremitting support from academic staff at Queen’s and the Fund’s sponsors, Queen’s University Belfast continues to produce students ready to excel in industry and add real value for prospective employers.

James Hilland
CEO
MSc Quantitative Finance

Robert Troy
Sector Head
(Materials)
MSc Finance

## MESSAGE FROM A SECTOR HEAD

I initially decided to become part of the fund after hearing positive reviews from past members. The QSMF offered an excellent opportunity to not only build invaluable investment analysis skills in a real money fund but also to grow my social circle and work with like-minded students from a broad array of nationalities and academic programmes.

Following my undergraduate degree in finance, I decided to apply for the position of Materials sector head. Primarily, my role involved the management of 10 analysts in the preparation of equity reports with the goal to both critically assess our current holdings and provide the investment committee with pertinent recommendations. In addition, this role provided me the opportunity to actively engage with the equity screening process, whilst also offering me a platform to enhance my management and leadership skills.

The QSMF encourages the development of transferrable skills that can be used alongside your university studies and in your future career. I believe these skills will provide you with an excellent base that is attractive to many potential employers. Following my postgraduate degree, I was fortunate to secure a role with Davy Group in Dublin. My experience within the QSMF undoubtedly proved to be an integral asset throughout the interview process. I would strongly encourage anyone looking to pursue a career in investment and finance to join the fund as it continues to grow in the coming years.

Mark Willis
MSc Risk & Investment Management

## MESSAGE FROM AN ANALYST

From my undergraduate Geophysical Sciences degree I had little to no academic financial knowledge apart from reading finance related news reports and what Bloomberg had to offer. While the MSc Risk and Investment Management degree gave me all of the knowledge I needed, I found that the QSMF gave me the avenue to really apply my grasp of finance in a practical manner with real world applications.

Throughout the year I have had the opportunity to develop my skills of navigating the financial markets through the Bloomberg Market Concepts qualifications, which I also had the benefit of including in my CV. Being able to talk to recruiters and interviewers about my experience in the Fund also proved beneficial with conversations often focusing on the practical skills that I had obtained and how these would transfer into day-to-day workplace skills.

Researching and writing an analyst's report for a mining company really opened up the connection between my masters, and what I was learning through the QSMF, and my undergraduate studies. While the analyst's report was a lot of work, the Sector Heads and Executives were always available to provide assistance and advice.

The Fund provides guidelines on the information and layout of the report so you are never left in the dark. With so many other students writing reports of their own, there is always someone to ask for help, and likewise people for you to help and share your knowledge.

Throughout the year with the Fund I gained all the knowledge and skills that helped me see through the gaps and connect the dots to obtain a clearer picture of the company's financial health over the coming months and years.

## MESSAGE FROM A QSMF ALUMNI

Moh Musa
Equity Analyst at
Davy Research
QSMF CEO 2016/17

One year on from finishing my time at Queen's and CEO of the Queen's Student Managed Fund, I continue to reap the benefits. With an ever more competitive graduate market, top grades and extra-curricular activities are often no longer enough to help candidates secure the most sought-after roles in Finance. Employers want to see tangible and relevant experience. Whether it is in the form of industrial placements or a learning experience as applicable as the student managed fund, students need to be fluent in how they understand and talk about finance. Members of the student managed experience first-hand what drives markets. They develop the critical thinking skills and analytical tools necessary to analyse companies, as well as macroeconomic backdrops, ensuring in an interview format they can speak the language of a finance professional as well as being up to date with relevant information that has affected their portfolio.

The fund was the core distinguishing factor that helped me secure my role at Davy but its benefits have not stopped there. My ambition of becoming an equity analyst was realised when I used my QSMF analyst report in a further interview to secure roles within Davy's graduate programme as a sell side Industrials analyst and latterly a buy side analyst assisting on the small and mid-cap fund. For any aspiring student who is focused on a career in financial services, the student managed fund isn't preferable, it is essential.

# TO PROGRESS AND LEAD INVEST IN THE FUTURE

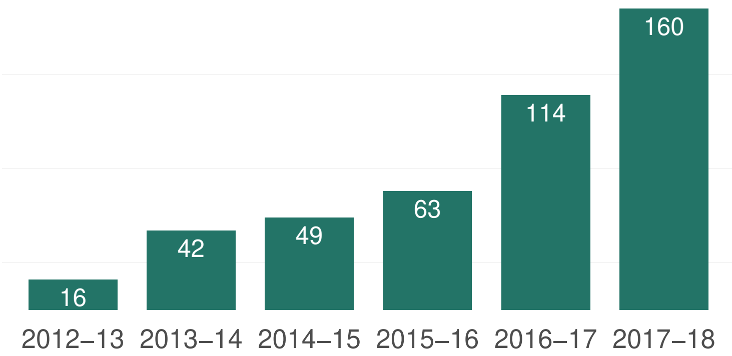
## QSMF ORGANISATIONAL STRUCTURE

Membership has continued to grow year on year since the fund began. This reflects the strong demand from students to have this type of educational club where students of all degree backgrounds can learn about investing. The Fund is hierarchical with the Student Executive Committee leading fund-wide tutorial classes and overseeing the sector heads, who each lead a team of analysts.

In addition to this, the fund is structured in a way that as students learn more and develop their skills base, they can rise up in the fund and gain more responsibilities, through promotion to Senior Analyst. The majority of new students coming into the fund start as analysts and are divided into the various sectors, based on their interests and industry knowledge.

Throughout the year, our student members worked together analysing stocks, writing company reports and delivering pitches. The majority of sectors have two sector heads who are responsible for the active management and engagement of their team of analysts. Their other responsibilities include identifying potential investment opportunities within the sector, splitting analysts into groups to research these stocks further and assist analysts in their efforts.

This process is supported by the oversight committee, comprised of academic staff and industry professionals, who act as a non-executive board. This provides our Fund with an optimal organisational structure that replicates a typical investment company.




QSMF Membership

> "The SMF was fundamental in securing two internships. Very directly through the relationship with Davy as well as the ability to 'speak finance', basic valuation skills and leveraging advice from some of the older students to get through interviews. About 15 people from 2600 applicants got into the investment management division: SMF helped me stand out and I wouldn't have got anywhere near it without the fund."

Matthew Bain
Sector Co-Head (Energy)
BSc Business Economics

## FUND GOALS

The Fund aims to secure long term, sustainable growth through responsible stock selection. Analysts seek to identify relatively undervalued stocks with long term growth strategies, supported by strong fundamentals to achieve active returns.

Membership helps students develop their technical and soft skills, increasing their employability especially in areas such as investment management, capital markets, research and trading.

## CHANGES TO THE FUND

This year we added the Macro sector. Utilising the economists within the Fund, this sector's primary function was to analyse exchange traded funds (ETFs) and create analyst reports, similar to traditional sectors. They were also responsible for sending out a weekly economic brief. This was highly useful for students as it was a great resource for them to keep up to date with global economic affairs. To further support this sector a new executive committee role was created: the Chief Economist.

To educate our new analysts at the start of the year the committee members led tutorials, which covered different financial areas. A number of students did not come from finance backgrounds and therefore these tutorials were crucial in bridging any knowledge gaps. These tutorials eased the immediate pressure on sector heads, and provided a knowledge bank for future referral for their analysts. As a result, sector heads were able to begin the equity screening process earlier in the year.

To ensure that the Executive Committee were aware of any student concerns, a mid-year survey for both analysts and sector heads was produced and sent out. This was crucial in ensuring students received the best learning experience possible. One common remark from sector heads was that communication channels were not as strong as they could be with the executive committee, and so a 'pairing system' was introduced.

Each Executive Committee member acted as a direct point of contact for two sectors. This helped to build stronger relationships between the Executive committee and sector heads. In particular sector heads felt more comfortable asking difficult questions when this system was introduced. This also meant that the committee had greater contact with sectors as a whole, enabling committee members to assist analysts and sector heads in meeting deadlines.

## INVESTMENT STYLE

We hope to outperform our benchmark index, the FTSE 350, with a well-diversified portfolio, and to capture positive alphas through strong fundamental analysis and decision implementation over long-term time horizons. Following the rebalance we will have more of a tilt towards relative value, which would typically be stocks with low P/E or high P/B ratios. However, stocks which we believe are intrinsically undervalued with a behavioural explanation driven by negative market sentiment, which is not reflective of prevailing market conditions may also warrant investment. We are not indifferent to higher yielding growth opportunities. We have learnt lessons from our experience of holding the DB X-Trackers MSCI Pakistan ETF that sometimes upside potential is not realised and that risks do crystalize.

As the FTSE 350 is heavily exposed to risks associated with the highly publicized Brexit negotiations, we have attempted to globally diversify our portfolio through the expansion of our ETF investments. Our ETFs now account for 15% of the fund.

## MACRO OVERVIEW/RISK CONSIDERATIONS

Brexit continues as the single largest risk factor, with the chances of the UK crashing out of the EU in March 2019 without a deal seeming ever more likely. We would like to maintain a balance of UK and non-UK focused stocks, to hedge against any further decline or potential upside in sterling in the short to intermediate term. We are also diversifying our global exposure through the fund's ETFs.

Our analysis has focused on where revenues are earned, where supply chains are concentrated, where companies are domiciled and what their ultimate geographical risk exposure is. The introduction of more UK-focused companies such as BT and Lloyds, may allow us to earn a risk premium, especially with Lloyds showing such strong resolution even in the most stringent recent stress-testing scenarios. Our portfolio is balanced with some more internationally focused companies, such as Rangold, Glencore and Shell. There are diversification benefits of having a split of revenue between the UK and outside of the UK, allowing us to hedge foreign exchange and political risk. Trade weighted multilateral exchange rates show sterling is significantly below pre-referendum levels and has significantly underperformed the Euro and USD.

Sino-US relations have deteriorated and tensions have prompted fears of a trade war, under US President Donald Trump's 'America First' policy. This would significantly damage global growth expectations and would lower our outlook for the global macro environment. The Fund does not have a directional view on oil, which has experienced volatility due to complex supply-demand dynamics, though our investment in Shell gives us exposure. However, we are bullish on their prospects in markets outside of oil, such as biofuel and these sustainability projects are in-line with our strong ethical stance.

Monetary policy tightening and central bank balance sheet normalisation is likely to occur in the short to intermediate term. We expect this tightening will be led by the Fed, with the ECB and BOE following, though the latter will be a strong laggard, as the MPC will not want to put additional stress on the UK economy in the face of Brexit. Rate hikes will be gradual and approached with caution.

Our portfolio is tilted towards being overweight in defensive sectors and underweight in more aggressive sectors. Though this weighting may seem counter-intuitive, given the expected tightening of UK monetary policy going forward, our view is that the BOE will hike rates only moderately over the next year and that GDP growth will also be moderate, so our overweight in defensive sectors is justified in the short to medium term. Our positioning towards value should help us to outperform the FTSE 350, even against an uncertain political backdrop.

## PITCHING EVENTS

Following a successful pitching event last year, we were again invited by Davy to hold our annual pitching event at their Belfast offices in March 2018. Here, Sector Heads and Executive Committee members were given the opportunity to discuss how the fund has progressed over the course of the year and pitch the investments that represented the greatest upside potential for the current year.

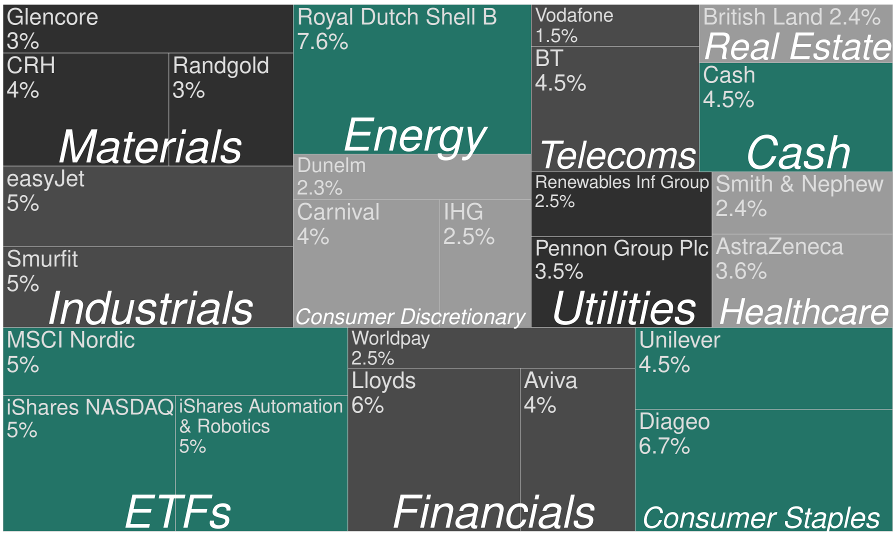
A panel of three Davy staff, Alan Werlau (Head of Investment Advisory), Moh Musa (Graduate Analyst and Ex-QSMF CEO) and Ben Banerji (Portfolio Analyst and Ex-QSMF CRO), then provided feedback on the investment cases with a Q&A session, with debate and critique encouraged.

After the pitching event, the Student Executive Committee decided which companies to include in the Fund in line with an outlined investment strategy of achieving consistent long term, positive returns by optimally managing downside risk.

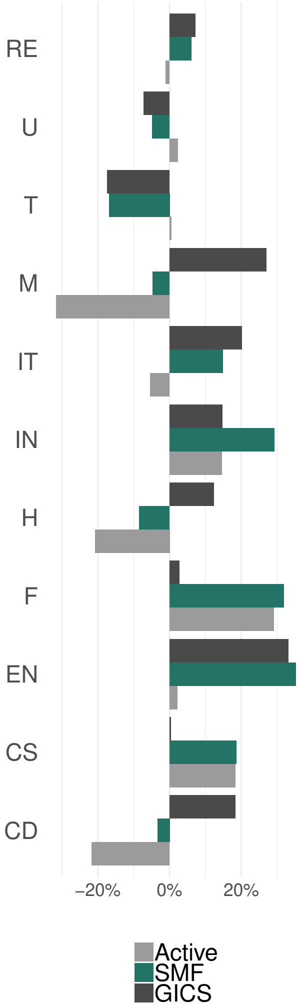
## PORTFOLIO ANALYSIS

Our fund is benchmarked against the FTSE 350, whose sectors weights guide initial portfolio construction. We use the FTSE350 GICS sector weightings as a guide for our portfolio construction. Being overweight or underweight in any given sector does not necessarily reflect whether we hold a bullish or bearish view of that sector. We invested only in companies where we see long-term value and where investments are in line with the long-term investment strategy of the Fund.

The primary aim of our portfolio construction was to diversify our holdings, both in terms of currency exposure and the markets we are exposed to. This is evident in our increased exposure to global economies through ETF investing. Furthermore we have targeted companies with strong fundamentals and business strategies that will support long-term value creation. Details of all our portfolio changes and supportive reasoning are outlined in the sector profiles.




**GICS Sector Returns**




| | Return |
|---|---|
| FTSE350 | 8.12% |
| SMF | 14.11% |
| Active | 5.99% |

Period 1st May 2017 to 24th Sept 2018.

## PORTFOLIO PERFORMANCE

Overall the fund has performed well since the last rebalance and is reaping the rewards from its long term investment strategy of identifying under-valued stocks with sound fundamentals and positive long term prospects.

### EQUITY MARKETS

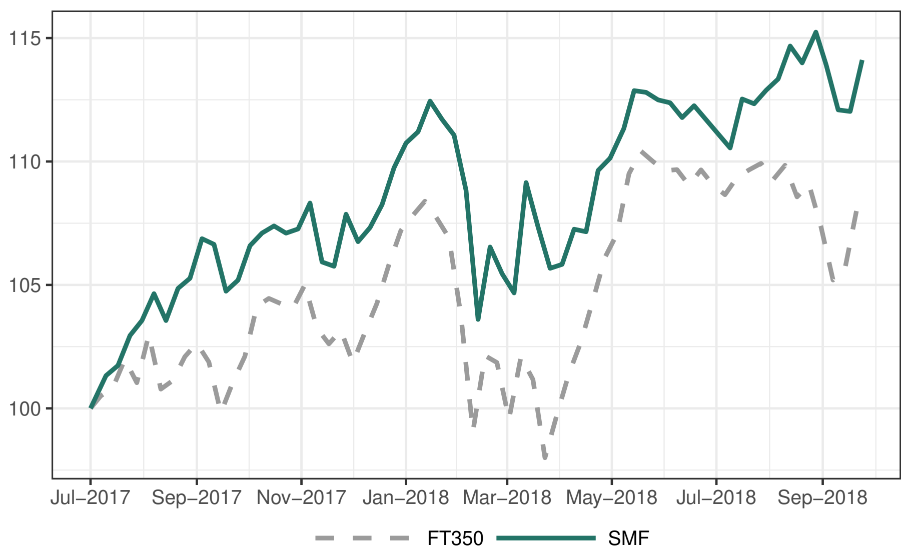
At the beginning of this year Equity markets experienced a correction with some major indices sliding more than 10%. As is always the case in the world of active investing, this correction can be attributed to a number of factors. However, many believe that the immediate cause was the hawkish message which was sent out from central banks around the globe implying inflation has become a concern and interest rate hikes could be on the horizon. As can be seen on the below chart, the SMF portfolio experienced a sharp fall of 7.3% in January. Despite this fall, our fund has borne the fruit of strategic portfolio construction and strong stock picking as we outperformed our benchmark index for the majority of the year.

### STRONG PERFORMERS

The fund has outperformed our benchmark index since the last rebalance, generating an active return of 4.29%. These active returns can be attributed to a number of key investment decisions. Focusing on the investments that were commissioned last year Smurfit Kappa and Internal Personal Finance (IPF) have been impressive performers, in particular, generating returns of 34.26% and 37.65% respectively. When rebalancing the fund last year, the fund made a strategic decision to explore investment opportunities in smaller cap stocks that may be inefficiently priced. The investment in IPF was a by-product of this strategy, as we felt the market did not fairly value the potential of IPF's expanding operations and the growth of EM credit. We have since liquidated our position in IPF as we believe the market now offers a fair value on the stock. The fund also benefited from its decision to invest in takeover targets and recoup the premium associated with M&A activity. WorldPay was acquired by Vantiv in January 2018 and as shareholders we received a portion of the cash offer and shares in the new company, WorldPay Inc. Including the cash offer, our investment in WorldPay has generated a return of 77.28%.

### POOR PERFORMERS

The positive returns generated on the aforementioned strong performers have been offset by some high profile negative returns. The fund was required to sell off its holdings in National Grid, Shire and the MSCI Pakistan tracker as they breached our maximum loss thresholds. National Grid's share price tumbled as support grew for pro-nationalisation Labour leader Jeremy Corbyn, Shire's market valuation fell as investors reacted negatively to the debt-financed acquisition of Baxalta and the MSCI Pakistan index fell as there were reported shortcomings with regards to the CPEC infrastructure projects in the region.



## CONSUMER DISCRETIONARY

Traditional retail businesses have significantly underperformed since October 2017. Dunelm's shares still substantially trail the FTSE100. This has been driven by negative real-wage pressure and Brexit uncertainty, which has made UK consumers cautious on discretionary items.

Global hotel M&A activity remains robust in 2018 as larger chains have offset decelerating US revenue per available room (RevPAR) by acquiring small, fast-growing chains. A recent example was Wyndham's agreement to acquire La Quinta's Management and franchise business. Consolidation and competition from online agents have further spurred digital-booking initiatives. Growth in Chinese travel has been integral to boosting revenue gains across the board. Cruise lines have maintained measured supply growth as they support an underdeveloped Chinese market.

### CURRENT HOLDINGS

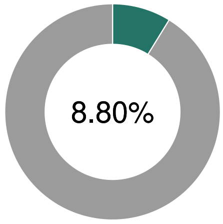
Dunelm's diverse product line has led to margin stability and modest revenue growth during a difficult retail trading period. They acquired Worldstore's platform which is expected to develop their online inventory management, while also driving efficiency gains in other areas of the business.

We hold a neutral stance on Carnival as recent earning improvements could be quickly offset by a rise in fuel costs as per OPEC's up and coming conference. Strong bookings, moderate supply gains and growth in the Asian market offer strong encouragement, however, restrictions on travel to Korea have tempered growth in an expanding market. Despite challenging year-over-year comparisons and a slow post-hurricane recovery in the Eastern Caribbean, Carnival expects revenue yields to rise to 2.5% in 2018. That view, supported by strong bookings elsewhere, is consistent with Royal Caribbean's and Norwegian's favourable yield outlook.

Intercontinental Hotels Group (IHG) is a UK based multinational hotels company and FTSE 100 constituent. We remain neutral on IHG. IHG will expand its mid-scale brands and return less cash to shareholders as it pushes to acquire more luxury and upscale chains. It will also pursue technology upgrades to save $125 million in costs each year. Past digital and integration challenges suggest potential for some choppiness, yet M&A is essential to staying competitive as the industry consolidates. IHG's asset-light model, improved U.S. hotel demand outlook and strong mid-scale presence should drive profit gains in 2018.

### PORTFOLIO CHANGES

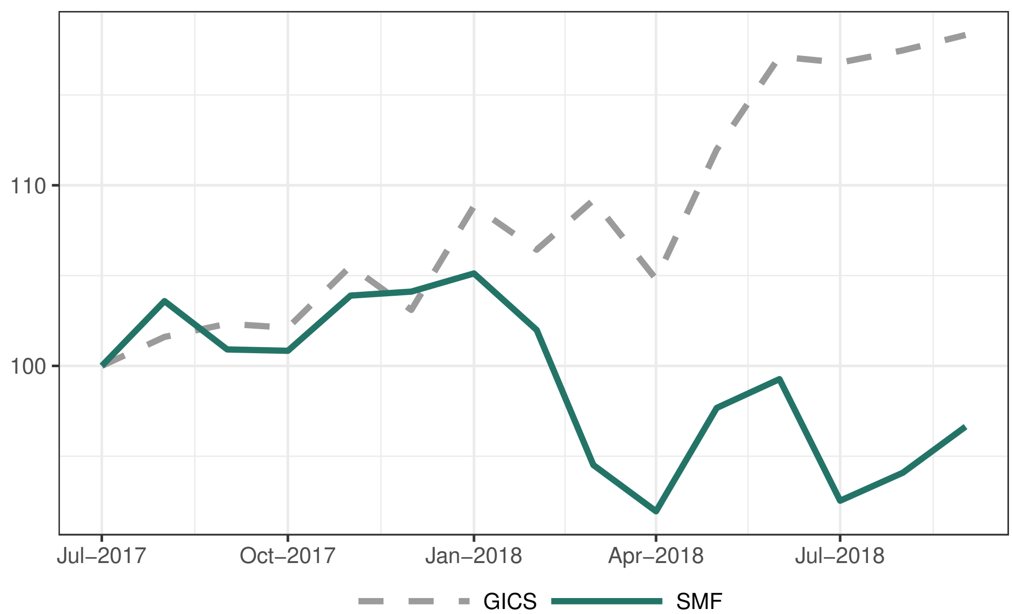
We have not made any amendments to our investments in this sector. Whilst Carnival and Dunelm have underperformed over the course of the year, we remain convinced by our initial valuation and investment thesis. Inorganic growth should add value to Dunelm's business over the remainder of 2018 and into 2019 and a strong recovery in Carnival's fundamentals should drive positive returns into 2019.




### KEY EVENTS

- Dunelm disposes of Achia in Feb 2018.
- Oil extended its three-year high as tensions in the Middle East flared following the U.S. decision to renew sanctions on Iran, OPEC's third largest producer.
- IHG is doubling down on the China market and plans to acquire or develop more luxury brands to compete against other hospitality giants.

| | Abs Return | Rtn vs FT350 |
|---|---|---|
| FTSE 350 Sector | 18.32% | |
| SMF Sector | -3.36% | -21.68% |
| IHG | 14.12% | -4.20% |
| Dunelm | -9.91% | -28.23% |
| Carnival | -5.56% | -23.88% |



## CONSUMER STAPLES

Consumer Staples consists of fairly stable companies, in terms of performance, given the non-cyclical nature of their products. The consumer staples industry as a whole, has performed better than the UK market index. The MSCI UK Consumer Staples Index has outperformed the market since 2010 (every year except 2013).

The main constituents of the sector are British American Tobacco, Diageo, Unilever, Reckitt Benckiser, Imperial Brands, Tesco, Associated British Foods, Morrison Supermarkets and Sainsbury. Much of the sector comprises household brand names, making it one of the strongest sectors in terms of high goodwill; a strong "moat" to use the analogy of Warren Buffett. As a result of the products being short-life, or perishable, the industry operates on a high cash turnover and revenue basis, rather than the large fixed asset and PPE value we see in longer-term industries.

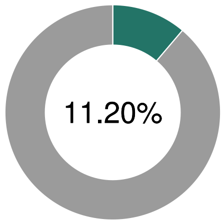
### CURRENT HOLDINGS

The inelastic demand for its products removes a large portion of systematic risk from this industry that others are often susceptible to. The consumer staples sector does face other risks however. A key risk, for example, being the cost of oil as the short life-cycle of the products means companies are extremely dependent on fast and continuous transport of goods, often from foreign countries. All things considered, however, the consumer staples sector is still seen as a relatively 'safe' investment.

We currently hold investments in Diageo and Unilever. In line with the sector as a whole, both are globally renowned names that offer heavily demand inelastic brands. Similarly, they are both expanding their global reach into emerging markets - Diageo brings in 41.8% of its revenues from Asia, Africa and Latin America, compared with a figure of 58.4% for Unilever. Additionally, we have seen very strong earnings announcements come out for these holdings. Diageo has seen returns of over 6% in the past month alone. Similarly, Unilever recently reported an increase in EPS of over 20%. Unilever has risen 5.8% in value over the year, whereas Diageo has remained largely flat.

### PORTFOLIO CHANGES

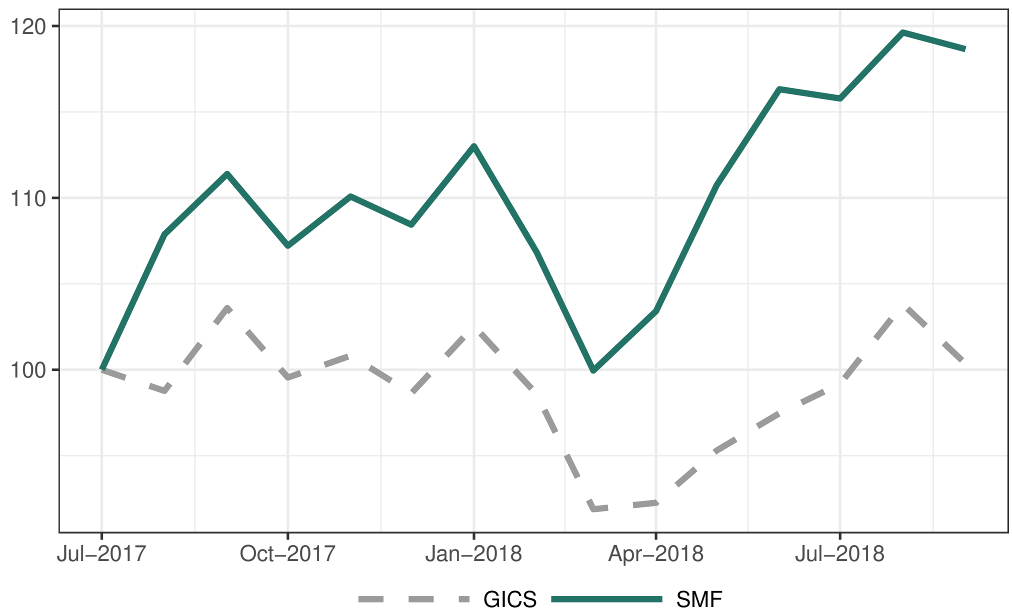
We believe that this is a resilient sector with a positive outlook. However, due to recent strong performances and the naturally high valuation of these stocks, we did not identify any standout 'value' candidates. However, of our 2 current holdings, Diageo and Unilever, we identified positive market positions that could spur continued growth in these stocks. For that reason we have determined to simply maintain our current positions in these stocks for the following year. We believe they offer a strong long term investment outlook.




### KEY SECTOR RISKS

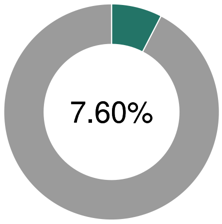
- Generally this sector is seen as defensive due to resilience to macroeconomic trends.
- Many large multinational consumer staples companies are investing heavily to expand into emerging markets. With this comes uncertainty and potential risk of failure.

| | Abs Return | Rtn vs FT350 |
|---|---|---|
| FTSE 350 Sector | 0.35% | |
| SMF Sector | 18.65% | 18.30% |
| Diageo | 23.60% | 23.25% |
| Unilever | 9.96% | 9.61% |



## ENERGY

Royal Dutch Shell (RDS) and British Petroleum, account for 97% of the Market Capitalisation for this UK sector. As expected, valuations in these two companies are correlated with movements in the price of oil. Both BP and RDS saw their share price fall through 2015 in line with the rapid oil price decline, which fell from over $100 a barrel in 2014 to under $50 a barrel by the end of 2015.




| | Abs Return | Rtn vs FT350 |
|---|---|---|
| FTSE 350 Sector | 33.14% | |
| SMF Sector | 35.25% | 2.12% |
| Royal Dutch Shell | 35.25% | 2.12% |

### CURRENT HOLDINGS

RDS represents our only investment within the Energy sector and has generated a total return of 35.25% since the last rebalance. Investors have reacted well to RDS's commitment to investing $2Bn a year in alternative energy sources and maintaining its dividend. RDS has paid out a dividend every year since the second world war and so its defensive characteristics certainly have a role to play in the market's valuation of its shares. Furthermore, management and investors alike believe it is time to reduce the dependency of Shell's share price on the price of oil. As oil supply has flooded the market, prices have remained low and put significant pressure on profit margins. By investing more in alternative energy sources Shell will simultaneously reduce this dependency and potentially reap the high returns of a growing market. Investment in alternative fuels also supports the fund's initiative of responsible investing. The company also generates approximately one third of its revenue from each of the major regions – the Americas, Europe and Asia – thus offering investors with diversification benefits across currency and geographical.

### PORTFOLIO CHANGES

We remain convinced by our initial valuation of RDS and believe its defensive characteristics will add value to the fund moving forward as we seek to generate positive, stable returns in the long term, over and above our benchmark index.

We will continue to monitor this sector for opportunities but for now stay underweight in relation to our benchmark due to the risk attributed with holding a single stock in the sector.

## FINANCIALS

While Brexit clouds linger, our outlook for UK banks has improved, with anticipated interest rate rises, improving net interest margin, and the end of legacy costs, such as PPI, by the end of 2019.

### CURRENT HOLDINGS

International Personal Finance (IPF) focuses on lower quality consumer credit, operating in the emerging markets. In a low or rising rate environment IPF should continue to provide strong returns, as there will be appetite for more credit sensitive debt where there is global economic growth. However, a higher rate environment may put pressure on borrowers' ability to repay loans and may affect overall profitability. As considerable earnings are generated overseas, any upside in sterling may dent earnings potential. Increasing regulation is a concern, particularly with the likely introduction of price caps in Romania in 2018 and tighter credit check requirements in Poland. IPF has faced increased competitive pressure in the sub-prime market, particularly in the Czech Republic.

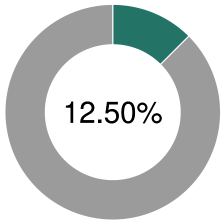
The majority of Worldpay's revenue is generated in US dollars, providing us a windfall following the decline in sterling. Growth in e-commerce and international payments means we expect robust future growth for Worldpay, even in the face of rising protectionist rhetoric. EPS has grown over the last four years, and solvency has been improved through reduced leverage. The strong fundamentals combined with growth expectations has led to Worldpay being a takeover target.

Aviva operates in insurance and asset management services with nearly 55% of profits being generated in the UK. Aviva's operating profit has met expectations of £3.07bn, with the operating ratio being 96.6%. Net premiums earned were £25.22bn. EPS has increased 127% to 0.34 over the last year, prompting speculation of a share buyback programme. Aviva has continued growth in a progressive dividend policy, with a current DPS of 27.4p. Aviva has planned to absorb the costs of external research following the introduction of Mifid II similar to the approach taken by JP Morgan Asset Management, Jupiter and Vanguard.

### PORTFOLIO CHANGES

Large changes have been made to the financial holdings. Firstly, we believed it was time to realise gains. We have fully realised gains in IPF, due to its strong performance, but identified risks moving forward. Holdings in Aviva and Worldpay have been reduced, providing a funding source for our new position in Lloyds. This also represents a geographical rebalance to have more exposure to the UK market.

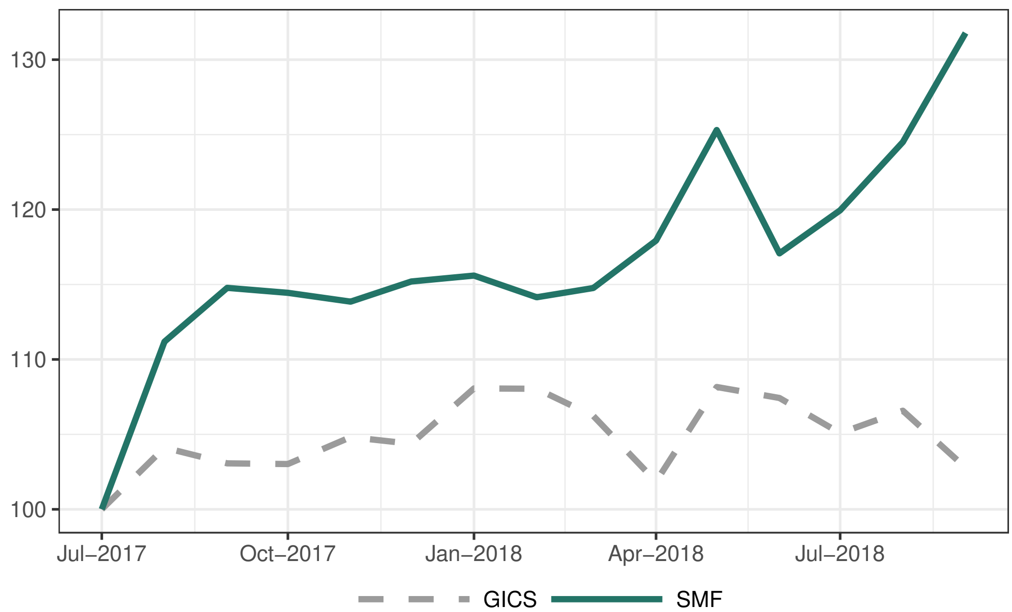
The reason for our bullish outlook on Lloyds is based on asset quality, net interest margin and the progress that has been made over the last 10 years. Lloyds is well positioned to benefit from future UK rate hikes with 56% profits from retail banking, 32% commercial banking, and 12% insurance and wealth management. Lloyd's business is very UK-focused compared to its more internationally-focused peer HSBC. Lloyds is also making a strategic shift to having a stronger online presence, using new technology to become more efficient, closing more high street branches in the process and attempting to tackle increased pressure from new online banking offerings.




### KEY EVENTS

- Vantiv made a 397p offer to buy Worldpay in August 2017.
- Mifid II came into effect in January 2018.
- Lloyd's £1.9bn MBNA takeover in June 2017.

| | Abs Return | Rtn vs FT350 |
|---|---|---|
| FTSE 350 Sector | 2.78% | |
| SMF Sector | 31.78% | 29.00% |
| Aviva | -0.69% | -3.47% |
| IPF | 37.65% | 34.87% |
| Worldpay Group * | 77.28% | 74.50% |



## HEALTHCARE

### CURRENT HOLDINGS

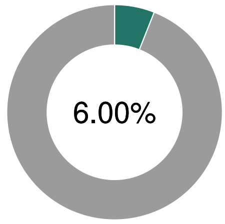
Shire's stock price fared poorly during the year with profit warnings because of competition from new generic drugs. Shire have warned that alternative drugs may also reduce their margins. In accordance with SMF by-laws, we liquidated our position in Shire as it had exceeded our loss threshold of -20%.

After selling Shire, the only remaining healthcare stock that the fund held was AstraZeneca. They are implementing their new strategy which has altered the company from a business that had an abundance of cash but few projects to the exact opposite. A big win for the company this year was gaining US approval for their lung cancer drug. This gave the company a boost and reflected that their riskier strategy was paying off. This was also a boost to their share price throughout the year. Their current P/E is 33 which is in line with the sector averages; however, it is relatively inexpensive for one of the fastest growing drugs companies. Due to this we continue to hold our position in AstraZeneca.

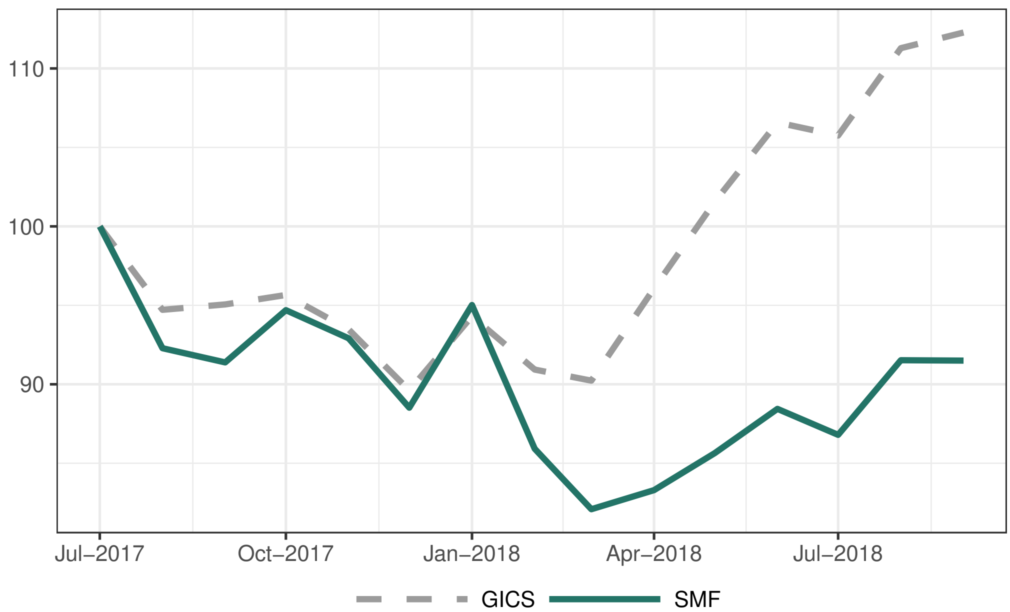
### PORTFOLIO CHANGES

As highlighted above, fund limits were breached by Shire and the ultimate decision was to remove this from our portfolio in March 2018. AstraZeneca's performance has been considerably stronger in recent months and outlook is improving. One new addition has been brought in to increase investment into a sector that we believe has positive long term potential.

We have invested in Smith and Nephew as a replacement to the previously sold Shire. Our overall exposure to the Healthcare sector remains the same, representing approximately 6% of our overall fund value. Smith and Nephew hold market leadership positions in hip and knee implants. This adds diversity to our healthcare sector as it is not a company focused on drugs. Furthermore, Smith and Nephew have a presence in over 100 countries adding a geographical diversity which is necessary with the uncertainty of Brexit. In March, Smith and Nephew replaced their CEO which was viewed as a positive move by the market. The new CEO plans to improve sales and margins in which there is a large scope to do so. Margins are around 5 points less than some competitors and therefore, there is much work to be done. We think the introduction of this new CEO will speed up the process and therefore, help their revenues. Smith and Nephew are priced cheaply in comparison to the sector with a P/E of 19 which is well below the sector average of 33 and thus, we believe it is a good time to buy this stock.




| | Abs Return | Rtn vs FT350 |
|---|---|---|
| FTSE 350 Sector | 12.28% | |
| SMF Sector | -8.50% | -20.78% |
| Shire | -24.36% | -36.64% |
| AstraZeneca | 19.27% | 6.99% |



## INDUSTRIALS

With the FTSE350 sector index up only 3.82%, the QSMF holdings in Smurfit Kappa and Hays Plc, up 34.26% and 27.48%, have respectively outperformed. The Industrials sector in the UK has proven to be extremely bullish, with a strong presence of buy ratings in the sector despite exceptional increases in price; clearly analysts have a very positive outlook for performance in the remainder of 2018.

Deloitte and Cushman Wakefield have a strong positive outlook for the sector's performance for the remainder of 2018, as strong e-commerce growth drives demand for transportation and packaging, while commercial and professional services are backed by strong fundamentals. This is all despite the most significant upcoming regulatory challenge to face the Industrials sector: Brexit.

### CURRENT HOLDINGS

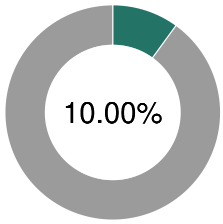
Our sector analysts expressed confidence in the continued strength of the sector, producing buy or hold recommendations on the majority of companies analysed. Analysts were keen to reiterate the strength of our holding in Smurfit Kappa, citing strong underlying fundamentals, good scope for growth and a continued focus on improvement and innovation. However, due to the share price inflation caused by the acquisition interest of key rival International Paper, we believe it is wise to liquidate a portion of our position to capitalise on these gains.

The performance of Hays, the UK's largest talent recruiter, has been fairly positive in recent years. Fundamental growth and expanding business units have seen the company progress substantially in a time when many companies have struggled. However, with political uncertainty in the UK, many specialist professionals appear reluctant to commit their futures to Britain. With the shares at a 15 year high and P/E at 19.75 we believe now is a good time to liquidate our position, realise our capital gains and explore other investment opportunities.

### PORTFOLIO CHANGES

Despite the strong performance of Hays, we have deemed this year as the most appropriate time to capitalise the gains we have made on this investment due to macro uncertainties with the business moving forward,. We have also decided to slightly reduce our holding in Smurfit Kappa, to allow for greater investment into our new purchase of EasyJet.

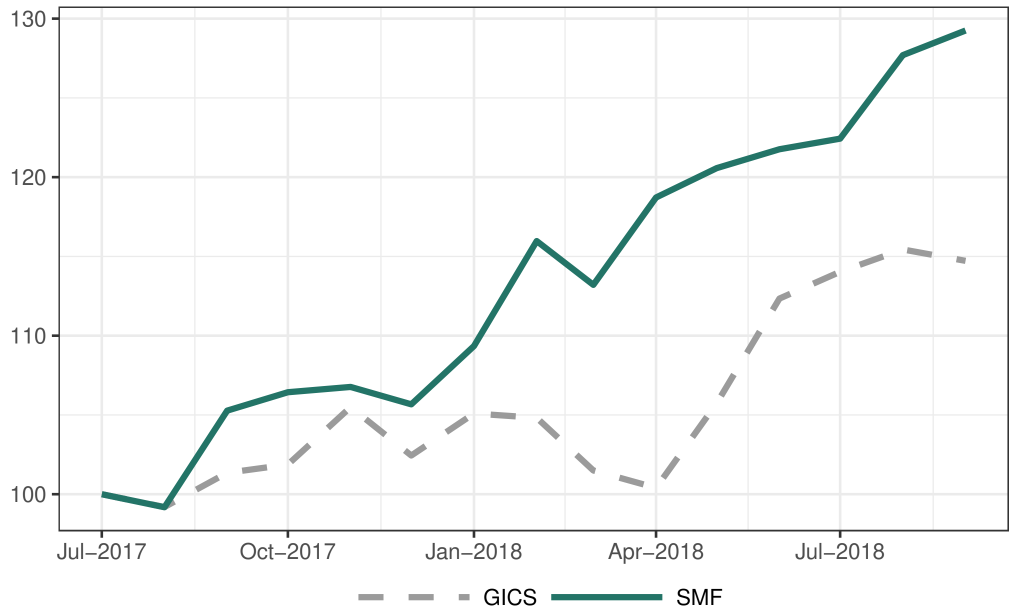
In December 2017, EasyJet confirmed the acquisition of Air Berlin's operations at Berlin Tegel Airport. This is part of their strategy to solidify their position amongst Europe's major airports. The low-cost airline carried almost 10% more passengers in 2017 than in 2016 with its load factor increasing to 93%. The travel and leisure sector presents a number of investment opportunities. The dividend yield of 4.1% could potentially mean that EasyJet's stock can help overcome inflation risk. As such, now could be the best time to buy EasyJet for the long term. We have introduced EasyJet which now represents approximately 5% of our overall fund value.




### KEY SECTOR RISKS

- Concerns over the cyclical nature of the aviation industry, as this has shown to highly influence EasyJet's performance in past years.

| | Abs Return | Rtn vs FT350 |
|---|---|---|
| FTSE 350 Sector | 14.72% | |
| SMF Sector | 29.25% | 14.53% |
| Smurfit | 34.26% | 19.54% |
| Hays | 27.48% | 12.76% |



## INFORMATION TECHNOLOGY

The IT sector is especially subject to potential takeovers from private equity firms. The increased likelihood of picking a potential takeover target in the IT sector is certainly a draw to this somewhat highly volatile market. One potential candidate we have recognised as displaying consistent growth is Softcat who have seen their share price grow by more than 55% in the last year. However, in the last month the volatility of this industry has been apparent with a decline of over 7%. Overall, whilst this sector may offer significant upside potential, we cannot ignore the equally significant risks attached to investments in this sector.

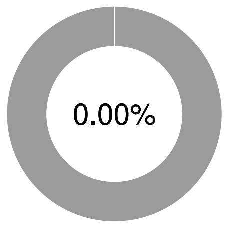
### CURRENT HOLDINGS

At the beginning of the year our only holding in this sector was PaySafe. We initially invested in PaySafe in 2015 and increased our holding in 2016, following a drop in the market price below our valuation. PaySafe was acquired by Blackstone Private Equity earlier this year and so our holding was liquidated. The acquisition offer valued the company at £3bn, a 13% premium on the all-time high market cap.

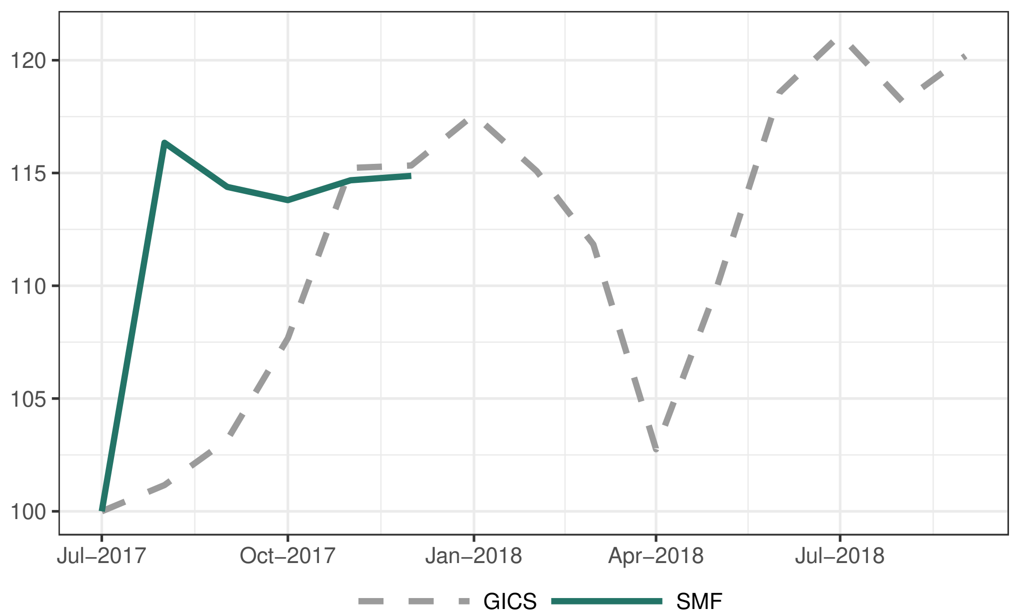
### PORTFOLIO CHANGES

The IT Sector Team have identified Rightmove as a strong buy opportunity. Rightmove is a fantastically profitable organization. They have led the way in digitalizing the property market, since listing in 2006. Rightmove have grown substantially throughout the years and this has been reflected in the growth of their share price of over 950% since listing. However, a potential risk is that the property portal and online advertising industry is expanding too rapidly and is possibly too profitable, hence motivating large competitors entering this market. Most notably, Facebook are planning an expansion into this market. Furthermore, Rightmove are not immune to shocks of the UK housing market, as displayed by their share price dip on the day of the EU referendum result.

Given these highly volatile movements in the shock price, we are not completely convinced on the long term sustainability of 'Rightmove' as an investment as so we have increased our holding in the Nasdaq ETF to compensate for our low single stock tech exposure.




| | Abs Return | Rtn vs FT350 |
|---|---|---|
| FTSE 350 Sector | 20.20% | |
| SMF Sector | 14.87% | -5.32% |
| PaySafe * | 14.87% | -5.32% |



## MATERIALS

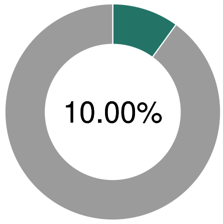
### CURRENT HOLDINGS

The fund invested in Glencore and Randgold at the last rebalance. In the midst of a relatively volatile environment owing to heightened tensions in geopolitics and the correction in equity markets in January, the price of gold climbed 7% in the last 12 months to tread the previous highs of June 2016 ($1,360/70/toz). Unfortunately, the established positive correlation between Randgold Resources' (RRS) and the price of gold did not entirely manifest as anticipated. Following the release of disappointing Q1 results RRS share price dropped sharply by 7.5%. This revelation would expectedly cause concern and throw caution toward our inherent strategy of utilising RRS as a bespoke hedging instrument. However, the poor performance, whilst disappointing, came as no great surprise to the company who have proved to be extremely adept operating in one of the most volatile regions of the world in West Africa.

The decision last year to increase the fund's weighting in Glencore proved fruitful. Glencore's share price edged 30% higher over the previous 12 months to trade at the same highs of 2014; a considerably encouraging sign and a testament to the effective strategic measures put in place by management to turn the company around after a dismal period. A positive revelation of trading profit expectations to reach the $3bn mark in May has helped assuage our concerns over the group's exposure to heightened geopolitical risk in Russia and the Democratic Republic of Congo.

### PORTFOLIO CHANGES

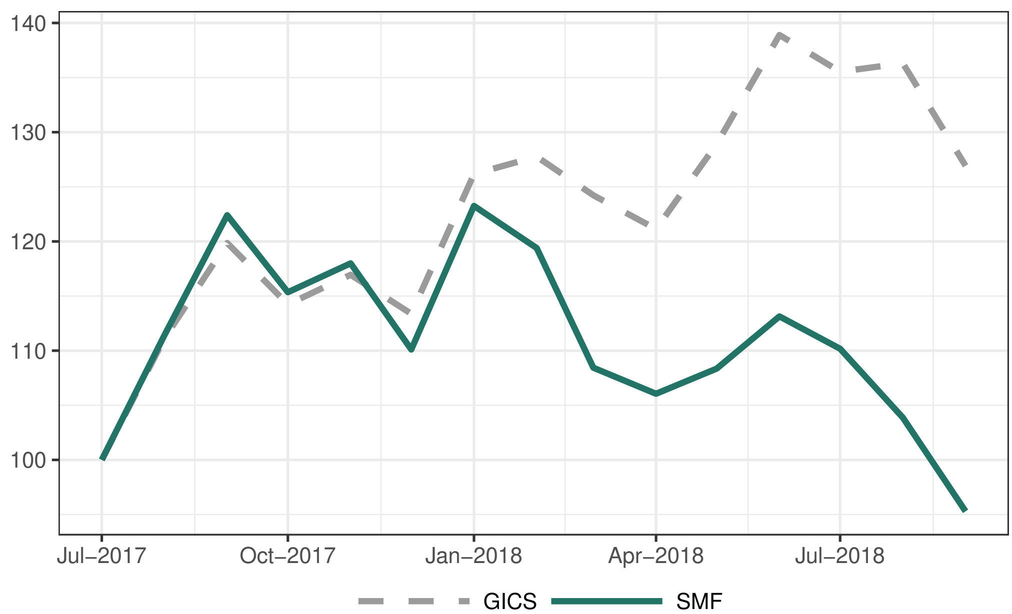
Our strongest buy recommendation is Irish building materials company Cement Roadstone Holdings (CRH) plc. Recommendation is grounded in the belief that the company is ideally positioned to capitalize on strengthening macroeconomic fundamentals. The relatively meagre performance over the previous 12 months has left the company attractively valued and poised to benefit significantly from the financial and operational synergies arising out of the recent large scale acquisitions of Ash Grove Cement and Suwannee Cement. As a result we have reduced our positions in Glencore and Randgold.




### KEY EVENTS

- Continued synchronised global growth adds positive pressure on demand for metals.
- Copper bolstered its bullish trend from the previous year rising 20% in the last 12 months to trade around the $6,800/MT mark.
- Despite a sharp dip in March 2018 to date, zinc is trading 18% higher than its position 12 months ago.
- Randgold's $2 per share dividend pay-out makes it one of the highest percentage dividend payers in the sector with forecasts expecting this to edge higher.

| | Abs Return | Rtn vs FT350 |
|---|---|---|
| FTSE 350 Sector | 26.92% | |
| SMF Sector | -4.71% | -31.63% |
| Randgold | -24.39% | -51.31% |
| Glencore | 12.10% | -14.82% |



## TELECOMMUNICATIONS

The overall sector has disappointed in recent years due to negative market sentiment over falling revenues, earnings, dividends and shareholder returns. The two worst performers have been Inmarsat and TalkTalk, where there have been dividend cuts, with TalkTalk still trying to recover from the hacking scandal in November 2015. We maintain a pessimistic outlook on both companies.

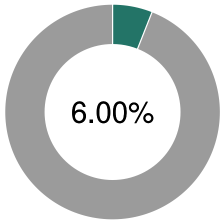
### CURRENT HOLDINGS

Our current holding of Vodafone has been a source of income and relative stability with a volatile macro and political environment. Vodafone announced plans in February 2018 to buy Liberty Global's Eastern European and German cable networks in a deal worth up to €18bn. The market has not reacted well to this news and it is possible that there could be a downgrade of Vodafone's debt to below investment grade which would significantly increase their cost of capital. However, the increased growth rate as a result of this deal would offset a larger discount factor in discounted cash flow analysis. This deal will increase Vodafone's presence outside of the UK, where only 14.5% of revenue was generated last year.

### PORTFOLIO CHANGES

We want to underweight Vodafone and overweight BT, which would lower our risk through diversification, and we wish to be overweight in the overall sector which we believe is an aggressive move in a defensive sector. The negative market sentiment around BT leaves ample scope for upside surprises over a long-term horizon.

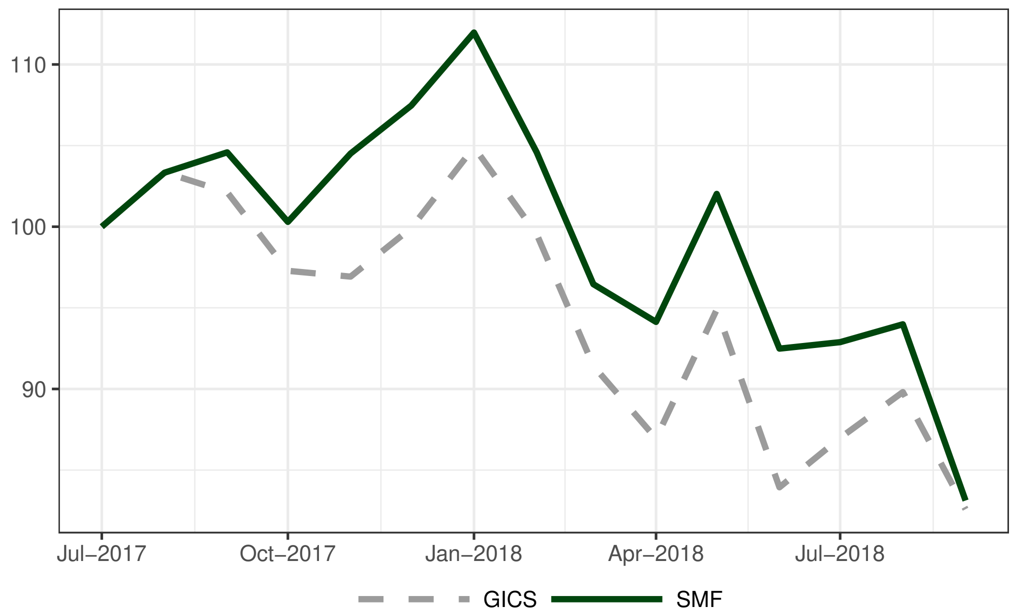
BT, in contrast to Vodafone, has increased its focus on the UK market, where over 80% of its revenue is generated. There are diversification benefits of having a split of revenue between the UK and outside of the UK and this allows us to hedge foreign exchange and political risk premia. BT's fall in share price was initially the result of an accounting scandal in Italy, with associated fines of £42m. BT has already invested heavily in acquiring EE for £12.5bn in 2016 and is spending billions on exclusive football rights for its pay TV service. We expect to see strong growth for BT following this investment in the TV and mobile segments of the quad play market. BT has the best forward P/E ratio of 8.34 compared to Vodafone having 21.42. However, Vodafone has the lowest price to book ratio of 0.93 compared to BT with 2.88. Both companies have high growth potential and our rationale is value, but both companies have a history of strong dividends with BT's current dividend yield being 6.49%.




### KEY EVENTS

- Vodafone plans to buy Liberty Global's eastern European and German cable networks in a deal worth up to €16.5bn.
- Vodafone merger with Indian rival, Idea Cellular, is to gain regulatory approval to create the largest provider in the market in terms of subscribers and revenue.
- Ofcom has taken a tough stance on BT's ownership of Openreach and is insisting on more investment in the fibre infrastructure. CityFibre is working with Vodafone to build new fibre infrastructure which is expected to be in use by a million customers in over twelve cities.
- BT has had a change of strategy and is expected to cut costs and 13,000 jobs in a restructuring move, with more emphasis on faster broadband for customers. BT will also move from its central London headquarters.

| | Abs Return | Rtn vs FT350 |
|---|---|---|
| FTSE 350 Sector | -17.41% | |
| SMF Sector | -16.87% | 0.54% |
| Vodafone | -16.87% | 0.54% |



## UTILITIES

The main stocks capturing attention in this sector normally operate in areas involving electric, gas and water firms. However, as utilities require significant infrastructure, these firms often carry large amounts of debt. The main competitive risks within this industry come from regulators and policy makers. Competition can be easily manipulated with legal, technical and licensing restrictions.

### CURRENT HOLDINGS

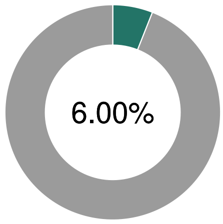
The Renewables Infrastructure Group Ltd (TRIG), is a renewable investment trust, holding its main investments in wind and solar energy. We initially invested in renewable energy as we believed it was likely to experience growth, over the long term, as political pressures continue to direct investment into alternate energy sources. Our convictions remain the same despite the stock gaining 8.04% over the year. Furthermore, TRIG's business strategy is focused on long term value creation through consistent and stable dividend growth. This is in accordance with the Fund's long-term value investment ideology.

We liquidated our position in National Grid in March as it had exceeded our loss threshold hold of -20%. Whilst, there may be long term value in National Grid, we did not foresee a quick turnaround in the fortunes of the business or an obvious strategy that company management could pursue to increase company value in the short-term. Earnings per share have fallen from 73p to 59.5p (18.5%) over the past year and are expected to fall to 56.89p in 2019. Given the losses already incurred and the negative short term outlook, we have decided to pursue other investment ideas.

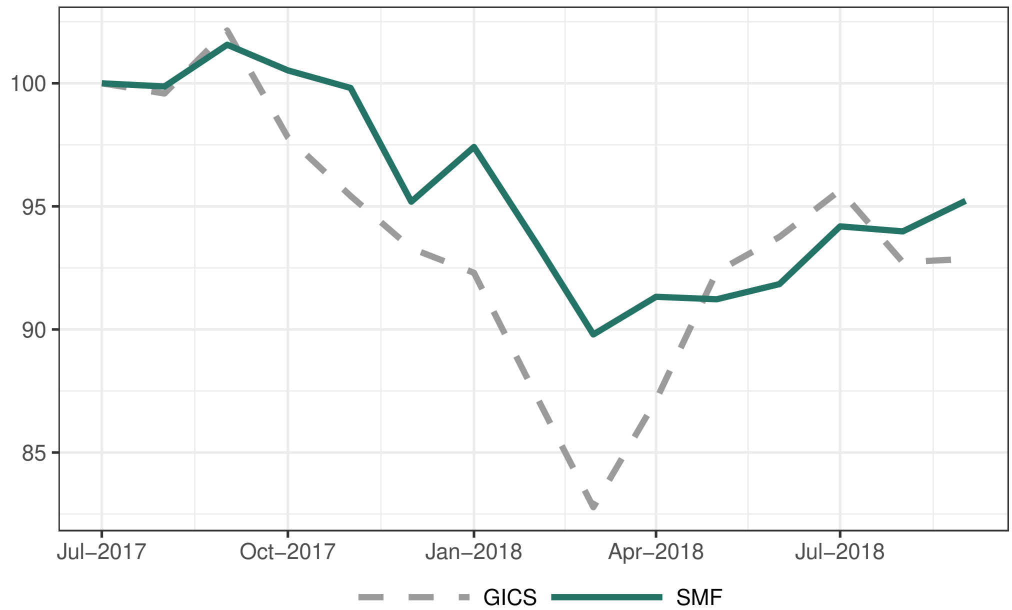
### PORTFOLIO CHANGES

We have decided to invest in Pennon following our liquidation of National Grid. Pennon is a water utility and waste management company, with operations primarily centred in south England. Pennon is showing strong signs of solid fundamental growth, with the 2017/18 half year EPS increasing by 23.2% from 2016/17, significantly outperforming the annual EPS growth average for the utilities sector of 4.3%. Pennon have also shown strong dividend growth of 7.9%. The primary risks to this company, as many in the industry, are associated with meeting stringent quality requirements and reducing the effects of pollutants in their operations, both of which Pennon appear to be dealing with well.

Pennon, expects to make £17m in savings per annum from 2019 after a major review of its services, while its water division has recorded £80m of cost savings since the start of the current regulatory period in 2015. More improvements in this area could allow Pennon to raise dividends boosting the yield even further than its current rate of 5.68%.




| | Abs Return | Rtn vs FT350 |
|---|---|---|
| FTSE 350 Sector | -7.14% | |
| SMF Sector | -4.78% | 2.36% |
| TRIG | 8.04% | 15.17% |
| National Grid * | -19.06% | -11.92% |



## REAL ESTATE

Real estate is an industry with great potential. The investment actions of many financial institutions has caused a shift in focus from purely prime real estate to portfolios with increased locational and land use variety. However, the growing investment potential of this industry has brought about new risks that need to be considered in any new positions introduced into the portfolio.

### CURRENT HOLDINGS

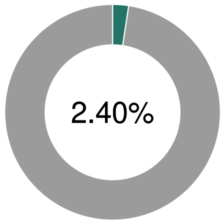
Currently, the only Real Estate holding in the QSMF portfolio is British Land, one of the UK's largest companies in the sector. British Land holds a large portfolio of retail, commercial and leisure property, with a strong focus on London property. Holding a strong portfolio of top quality London based property has worked well for British Land in previous years, however new uncertainty around Brexit stands to threaten this.

In the year just passed, we have seen a number of large multinational companies announce relocations away from the UK capital to other cities across Europe. Although the impact may not be direct as British Land's property portfolio is largely residential, the indirect effects of reduced demand and potentially decreasing rents could negatively influence British Land's performance.

However, we are a long term fund and we believe that the outlook for the company remains positive. Although there are concerns regarding Brexit and its effects on the Real Estate industry in the UK, British Land is still excellently positioned as one of the premium real estate companies of the UK. A wide portfolio of high class assets with growing diversity we believe will see this company weather the Brexit storm and come out strong on the other side.

### PORTFOLIO CHANGES

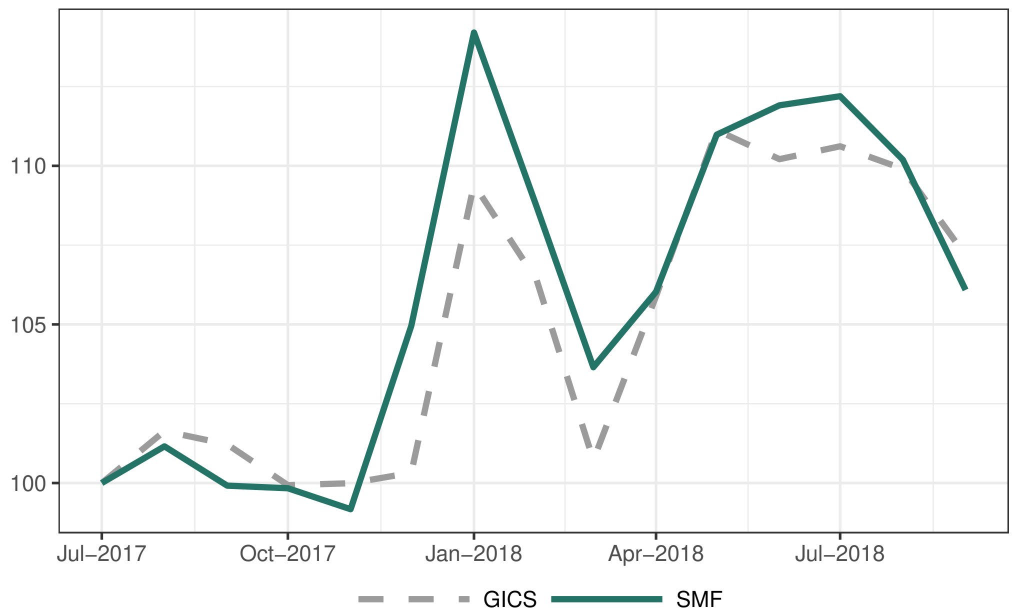
Our analysts invested considerable time attempting to identify strong players in an industry filled with much uncertainty. However, it was decided that we should not extend our position to companies we felt would bring significant exposure to these uncertainties. Our position in British Land was maintained due to positive long term outlooks and their strong market position.




### KEY EVENTS

- Announcement of ambitious industrial developments in Sheffield, expanding their portfolio outside of London.

| | Abs Return | Rtn vs FT350 |
|---|---|---|
| FTSE 350 Sector | 7.18% | |
| SMF Sector | 6.09% | -1.09% |
| British Land | 6.09% | -1.09% |



## MACRO

The newly-formed macro team took responsibility for the fund's ETF investments this year and as a result, the sector has seen several changes take place over the past 9 months. Our analysts originally focused on a top-down strategy, primarily on a country-by-country basis; however, they were also encouraged to pursue areas that may offer higher yield through investment in growth industries. The major benefits of ETF investment in the fund stems from the increased potential for diversification and the ability to gain exposure to geographies and industries that other sectors of the fund are unable to access.

### CURRENT HOLDINGS

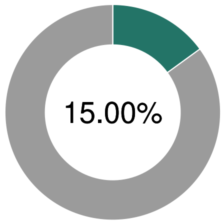
Over the past year our ETFs investments experienced mixed fortunes with the NASDAQ and Robotics (BOTZ) benefiting from significant positive returns over the previous 12 months. However, the DB X-Trackers MSCI Pakistan ETF faced contrasting results, experiencing a relatively large loss as a result of shortcomings in the production and efficiency of the CPEC infrastructure projects in the region – a key motivation behind the original purchase of the product. As a result of this, the team decided to sell our holdings in the Pakistan ETF.

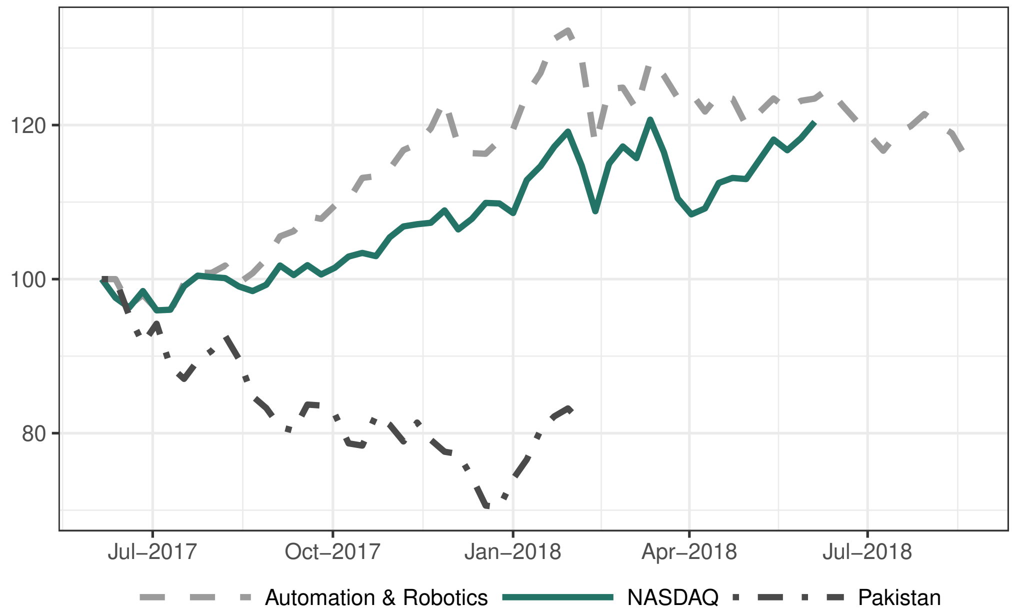
### PORTFOLIO CHANGES

After thorough research of several ETFs, the DB-X Tracker MSCI Nordic was chosen as the new ETF addition to the fund. This ETF offers us exposure to the Norwegian, Danish, Swedish and Finish economies. All regions have historically maintained a strong current account surplus (Finland recorded a current account deficit of €519M) and have been actively investing in its private sector. Furthermore, most economies (Sweden, Denmark and Norway) have seen simultaneous growth in their budgetary surplus and government spending, meaning that government spending has room for sustainable growth in the future offering a potential catalyst for economic growth if needed. The outlook is positive, with the latest Nordic Outlook report from Danske Bank Research forecasting above trend growth, with GDP increasing year on-year by 2.7% over 2018, with 2017 seeing the highest annual rate of growth since early 2015.

Credit growth (as measured by loans to private sector) has been positive and expanding for quite some time, adding large value to the private sector. Additionally, the money supply has also been increasing since around 2015 meaning income levels in these economies are rising. Overall, Nordic economies are set to undergo positive economic change over the foreseeable future, with little visible risks. Domestic economic fundamentals are on favourable trends - both the external sector, with its hefty trade surpluses, and the government sector, also with large surpluses - providing ample space for the private sector to expand and see continued progress. Low inflation and lax monetary policy, despite falling unemployment and strong growth, signals that Nordic economies are not approaching their full capacity. This environment is conducive to a successful investment in the nations' stock market indices.

We have also increased our holdings in the NASDAQ and BOTZ ETFs in lieu of limited single stock exposure to the IT sector. Our overall ETF exposure is now 15% of fund value.



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## ACKNOWLEDGEMENTS

We would like to express our gratitude to all those who have supported QSMF in various ways through its development, launch and ongoing operations. In particular we would like to acknowledge the support received from the Queen’s Annual Fund, for which we are extremely grateful.

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