



*An umbrella fund with segregated liability between sub-funds*

*Registration number C142346*

### **COMMENTARY – 3<sup>rd</sup> QUARTER 2016**

Global markets advanced notably this quarter, with the MSCI World Index and MSCI ACWI returning 4.99% and 4.79% respectively. The third quarter followed a tumultuous June quarter with highs and lows triggered by the Brexit vote. Investors fled to safety, and punished companies with a Brexit connection, like U.K. homebuilders. Over the ensuing three months, Brexit's impact was downgraded, with residual concerns mitigated by global macro-economic growth initiatives. The Bank of England cut interest rates in early August and the Bank of Japan unveiled a 28 trillion yen fiscal stimulus package. Meanwhile, the U.S. economy showed satisfactory progress, with the Federal Reserve intending to tighten monetary policy. The expectation of higher U.S. interest rates had a positive impact on returns for U.S. financial and cyclical stocks; conversely, defensive companies declined.

The Polaris Global Value UCITS Fund ("the Fund") was up 9.57%, surpassing the World and ACWI indices by a significant margin. We are pleased with the outperformance, attributable to absolute gains in seven of 10 sectors and more than 75% of individual stocks in positive territory. Contributors included materials companies LANXESS AG, Showa Denko, Methanex Corp. and Solvay SA. Consumer discretionary stocks such as International Game Technology Inc. and British homebuilders Persimmon, Bellway Plc and Barratt Developments also added to returns. In industrials, Finnish crane equipment dealer, Konecranes Oyj, and U.S.-based electronics distributor Wesco had double-digit returns. Detractors from Fund performance included Carter's Inc., The J.M. Smucker Co., Indian IT outsourcer, Infosys, as well as several U.S. utility and telecom companies.

### **PERFORMANCE ANALYSIS**

Fund holdings within the materials sector were up, with many posting double-digit returns during the quarter. Among the top sector performers were LANXESS, Showa Denko, Solvay SA, Methanex Corp, BHP Billiton and Linde AG. The market approved of LANXESS' recent strategic acquisitions, including the purchase of Chemours' clean/disinfect chemical unit and Chemtura, a lubricant and flame retardant business. The company is making inroads in specialty chemicals, while seeking to dispose of assets from its less-profitable rubber business. Showa Denko's petrochemical division raised earnings estimates on higher ethylene spreads; the hard disk drive media business showed positive results; and the company (in cooperation with JX Nippon Oil & Energy) agreed to purchase LyondellBassell's joint venture stake in polypropylene producer SunAllomer. As a result, Showa Denko and JX Nippon enlarged their market share of this high-demand polymer used in packaging, textiles, plastic parts and automotive components.

Independent Bank Corp., Ameris Bancorp and International Bancshares had noteworthy gains in the financial sector. Independent Bank reported decent second quarter earnings, highlighting commercial loan and core deposit growth. Ameris announced healthy quarterly metrics, with increasing revenue, higher net income from mortgage and Small Business Administration backed loans, organic loan growth and successful acquisition conversions. Swedish bank, Svenska Handelsbanken, reported second quarter profits that beat analyst estimates. The company announced higher trading income, lower loan losses and lower costs due to currency effects. German reinsurer Munich Re achieved a nearly \$1.1 billion second quarter profit, despite higher natural catastrophe claims. The Fund exited Astoria Financial as it was the subject of a takeover by New York Community Bancorp. Sale proceeds were used to purchase Puerto Rico-based bank Popular Inc. We believe the Commonwealth's largest bank is undervalued due to the local debt crisis, which may be addressed by the recently-passed Puerto Rico Oversight, Management and Economic Stability Act.

Within the industrials sector, Konecranes' stock rose after it received approval from U.S. and E.U. antitrust regulators to purchase the materials/port solutions unit from U.S. equipment maker Terex Corp. The approval is conditional on the divestment of Konecranes' STAHL CraneSystems. The company also announced improved profits on the back of cost savings efforts. U.S.-based Wesco International Inc. confirmed full year guidance,

referencing good construction end market demand that offset weakness in its energy business. Andritz, the Austrian supplier of plants and services for hydropower, pulp/paper and metals, was purchased. The company was attractive due to its recurring service-based revenue streams, solid balance sheet and acquisition track record.

In the consumer discretionary sector, International Game Technology had solid second quarter results, backed by higher lottery sales in Italy and North America. The company achieved three consecutive quarters of growth, while simultaneously paying down the up-front costs for Italian lotto concessions. U.K. homebuilders referenced positive industry trends, with 10% or more increases on post-Brexit reservations. We bought additional shares of the homebuilders on the second day after the Brexit vote. Carter's Inc. underperformed, as it revised down sales and guidance due to weak wholesale and international business. Lower margins were due to increasing capital expenditures related to expansion, technology and marketing.

In the IT sector, HP Inc. announced its intention to acquire Samsung's printing business. With this transaction, HP expands its printing business in Asia and gains new printing technologies and 6,500 patents. The stock was up more than 20% at quarter end. Samsung Electronics advanced, notwithstanding the lithium battery problems late in the quarter. The company reported its biggest operating profit in two years on strong Galaxy S7 sales, as it increased cellphone market share. The stock price rose further on news of management's proactive restructuring efforts to avoid tax and/or share count issues in a changing regulatory environment. On the opposite spectrum, Infosys declined after lowering its annual sales forecast. The entire IT outsourcing industry is facing competition from customizable internet-based/cloud software.

In consumer staples, The J.M. Smucker Co. encountered deflationary headwinds in the core foods segment. According to the Department of Labor, the "food at home" index dropped 1.9% over 12 months; the price index for meat, poultry and eggs was down 6.5% during the same period. This put pressure on J.M. Smucker, which was relying on its acquisition of pet food business, Big Heart, to make up the difference. However, Big Heart's volumes and sales were down in the second quarter.

Telecom sector stocks detracted, including U.S.-based Frontier Communications and Verizon Communications. Frontier announced second quarter earnings that incorporated assets from its recent wireline acquisition. Revenues on a consolidated basis were below expectation, but Frontier raised its estimate of integration savings from \$700 million to \$1.2 billion. Verizon detailed subpar earnings, with lower total operating revenues. However, the company continued to execute complementary acquisitions, including Yahoo's core web assets, workforce management company, Fleetmatics, and IoT solutions company, Sensity.

As previously referenced, defensive sectors ruled performance in the first half of 2016; this quarter favored cyclicals. As a result, utilities were down, with Fund holdings ALLETE Inc. and NextEra Energy Inc., each dropping more than 5%. ALLETE saw second quarter 2016 results impacted by lower sales to taconite customers.

In healthcare, the EpiPen debacle and ensuing drug price discussion impacted the entire pharmaceutical industry, including Teva Pharmaceutical and Novartis AG. Teva was also hit with negative rulings on three of its patents, opening up to generic sales. The withdrawal of health insurers from state exchanges created by the Affordable Care Act strained the relationship between the current Administration and insurers. Participation in loss-making exchanges is part of the health insurers' justification for consolidation (i.e. the merger between Anthem Inc. and Cigna). However, these mergers are being challenged by the Department of Justice. As a result, portfolio holdings in Anthem and UnitedHealth Group Inc. were down slightly.

## **INVESTMENT ENVIRONMENT AND STRATEGY**

Our unwavering value philosophy, focused on identifying companies with free cash flow and conservative balance sheets, directed our investment process. This discipline proved fruitful over the past quarter and has contributed to year-to-date outperformance through the quarter ended September 30, 2016. We continue to seek out stocks that may enhance the valuation profile of the Fund and lead to satisfactory returns. Over the past year, attractively valued companies have been predominately focused on two sectors: financials and materials, and a few countries: Japan, the U.S. and other Asian economies. Analyst travel has ensued. We look forward to sharing our findings in the months ahead. We appreciate your comments and feedback.

Regards,  
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