



Sector Global Equity Kernel

Letter to shareholders - October 2017

Investment Review

October was another strong month in global equity markets. Net total return from an investment in the MSCI ACWI index was 2.1% bringing the year-to-date return to 19.7%. The fund was up 2.7% during the month and 16.7% on the year through October. Mega-caps outperformed again. This was particularly the case in the US where the equal weight S&P 500 index returned 1.1% whilst the market cap weighted index returned 2.3%.

Although the fund did not hold the moonshots, other positions did well. Energy and Materials sectors contributed positively and so did the fund's allocation to Japan. Although we hold a smaller allocation to the technology sector than the MSCI ACWI index, good stock picking in the sector more than mitigated the damages from the relative underweight.

All the fund's top performers in October were techs. Intel Corp (+20 bps), Teradyne (+17 bps), and Tokyo Electron Ltd (16 bps). Intel outperformed the market after reporting improved financial discipline. The fastest growth in semiconductor demand since 2010 was sending the shares of semiconductor service provider Teradyne and 3d NAND producer Tokyo Electron higher.

Bottom performers were Celgene Corporation (-31 bps), Telekomunik Indonesia (-10 bps) and Cia Saneamento Basico (-10 bps). Shares of global biopharmaceutical company Celgene was hammered due to pipeline setbacks mixed with weakness in the base business. Increased competition following Indonesia's latest spectrum auctions imply tougher operating conditions for Telekomunik Indonesia in 2018 and the shares tanked. Disappointing tariff reset figures and weaker volume growth sent shares of Brazilian water distributor Cia Saneamento Basico lower.

Performance Attribution

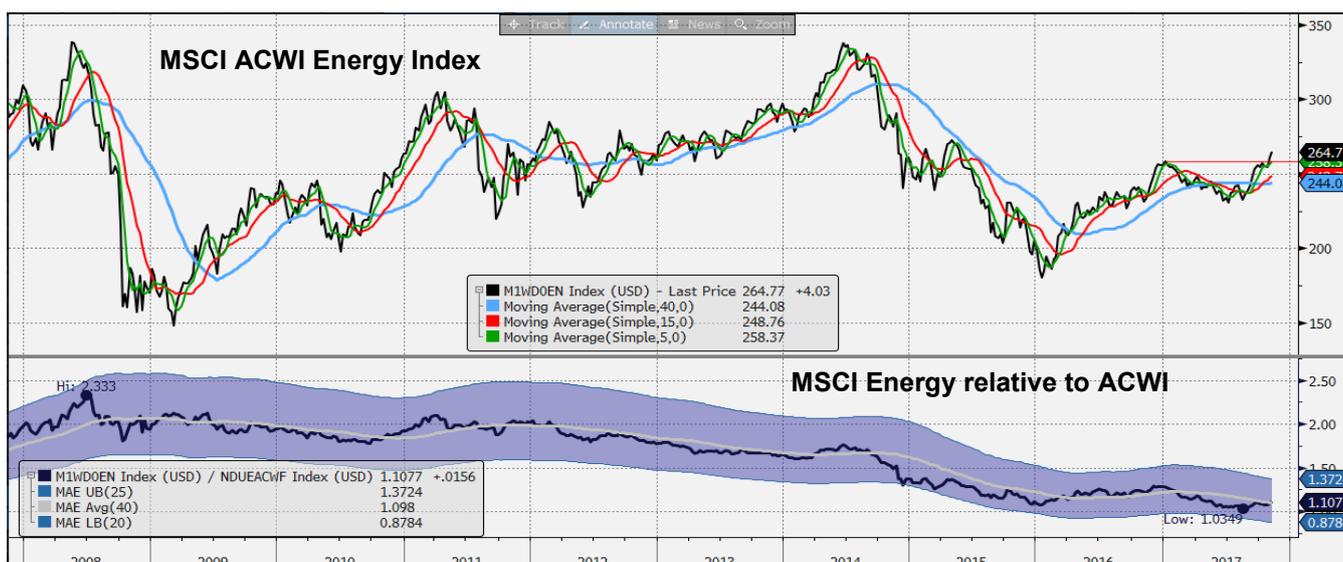
Relative to MSCI ACWI Total Net Return (USD)

	Oct
Total Net Return in Basis Points:	
The Fund	274
MSCI ACWI (NDUACWF)	208
Excess Return	66
Contribution from our investment style (risk premium harvesting)	-7
Size Effect	-13
Company Goodness (quality)	7
Value	-4
Momentum	3
Contribution from our active bets (alpha)	33
Sector	14
Country / Currency	4
Stock	15
Contribution from risk factors on which we do not have a view and expenses	40
Other	40

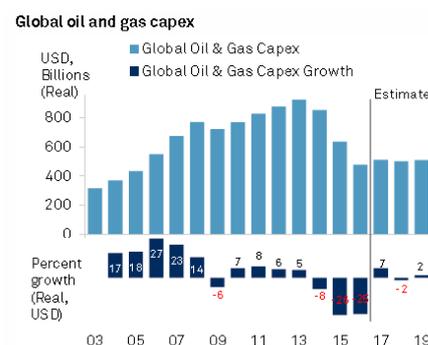
Source: Bloomberg Global Fundamental Risk Model

Investment Outlook

Since the summer of 2008, the energy sector has underperformed the broader equity market by more than 60% on a net total return basis. There were numerous false starts when it appeared that the underperformance was over and a new upcycle was about to begin. We had stayed away from the sector since the launch of the fund and until fourth quarter last year. In order for us to invest in a cyclical sector like energy, we require three things to be in place: A positive outlook for sector profitability, the outlook must not be fully discounted in the share prices, and finally we want to see signs of accumulation. Although the outlook and valuation elements were in place for some time, it was the accumulation criteria that only fell in place during the late summer of 2016.



The dramatic plunge in the oil price in 2014 led to an unprecedented 50% decline in global oil and gas capex (chart from S&P). The volume of conventional resources sanctioned for development last year fell to 4.7 billion barrels, 30 percent lower than the previous year as the number of projects that received a final investment decision dropped to the lowest level since the 1940s. Although some recovery is expected during 2017 and during the next couple of years, this would normally be an attractive spot in the capital cycle in which to invest. As the industry focus on improving utilization and productivity from previous investments, cash flow generation is improving on the margin. Shell-shocked industry executives as well as their shareholders are not as trigger happy as during the heydays of the previous up cycle. With the exception of U.S. shale, we reckon that the oil price needs to be meaningfully higher for longer to ignite an excessive capex cycle again. This creates a positive skew for the longer term (post 2020) oil price outlook.



Another important aspect for the energy investor is that environmental factors are driving demand for 'sweet and light' products. Thanks to a synchronized upswing in the global economy, and more stringent environmental criteria, demand for 'ultra low sulphur diesel' is now particularly strong. However, the bottleneck is refinery capacity meaning that for the time being the economic benefit goes to the refiners.

There is however substantial short-term risk. Speculative length in the crude futures markets poses short term downside risk to the crude price, and although inventories are dropping at a rapid clip, they remain elevated. There is already a geopolitical risk premium in the price. Thus we are more bullish on the oil price in 2020 than the price today. Thus at this stage in the energy cycle, it is our opinion that integrated oil and refiners offer the

best risk reward. Natural gas could also surprise on the upside as demand growth is strong. An important driver here is that China is shifting electricity production from natural gas instead of coal.

We have built an energy portfolio that reflects our liking for integrateds and refineries with exposure not only to oil but also to natural gas. Due to long duration in nearly all risk assets, perhaps the biggest risk for all investments is the interest rate risk and this is also an important consideration in our portfolio construction.

A good proxy for duration in equities is simply Price / Dividend. Expected gross dividend yield on global equities (MSCI ACWI) is 2.5%, translating into a duration of some 40 years. Although we don't hold a view that rates are going up (we don't have a view on this at all) we do believe there must be an asymmetry which is skewed the wrong way for the investor. It would appear more likely that rates could go up more than they can go down from here. Thus we seek a portfolio with lower duration than the market. A typical reason for higher interest rates is higher inflation. Because energy prices represent a meaningful component of consumer price inflation, it is quite likely that a higher inflation also means higher energy prices. Thus there is a natural inflation hedge in any energy portfolio.

The fund is currently holding an energy portfolio comprising 11 names accounting for 11% of the net asset value. The portfolio is geographically diversified with listing in Hong Kong, South Korea the US and Europe and the indicated dividend yield is nearly 4%. A duration of 25 years should hold meaningfully lower interest rate risk than the broader market with a duration of 40 years. There is also the additional "shock absorber" that there should be stronger correlation between inflation and dividends from energy companies than between inflation and dividend payments from other sectors on average. Thus the energy stocks help reducing the risk of unexpected inflation.

In our investment analysis we make high case and low case scenarios in order to identify opportunities where we believe the potential upside is higher than the downside. In the low case, we consider what we think would be the stock market's expectations for normalised profitability during the next cyclical trough. The expected earnings power is divided by a discount rate (WACC) to arrive at the expected stock price. Our rule of thumb (from observing and participating in previous bear markets) is that the discount rate rises by 300 bps when the market goes from bull to bear. Let's look at SK Innovation, a South Korean refiner to illustrate how we do it. The average Cash Return on Invested Capital (CROIC) during the last seven years was 6.4%. In fiscal year 2016, it was 9.5%. The implicit discount rate, or WACC (not shown) is currently 4.1%. In the low case, when the future look highly uncertain, we assert that the market would adjust down their expectations for normalised profitability to 4%. We add 300 bps to the prevailing discount and get a WACC of 7.1%, a downside of 31% for the stock.

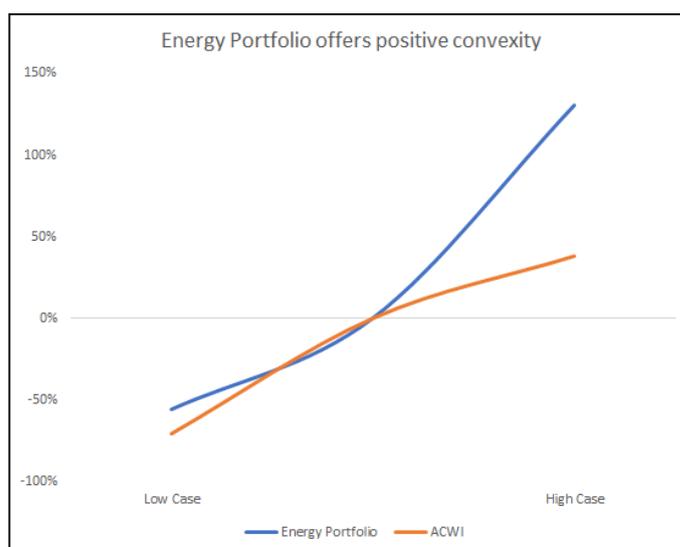
Energy Portfolio Scenario Analysis									
	Cash Return on Invested Capital		Indicated Div Yield	Low Case (2021 CroiC)			High Case (2021 CroiC)		
	Avg 7-year	2016		CROiC	WACC	Return	CROiC	WACC	Return
SK Innovation	6.4%	9.5%	1.5%	4.0%	7.1%	-31%	10.0%	4.1%	81%
CNOOC	9.4%	1.0%	3.9%	1.0%	7.5%	-41%	10.0%	4.5%	215%
ConocoPhillips	3.9%	-2.8%	2.0%	1.0%	7.6%	-66%	12.0%	4.6%	131%
Caltex Australia	6.7%	7.0%	4.6%	5.0%	6.9%	-30%	10.0%	3.9%	101%
Chevron	4.6%	-2.4%	3.7%	2.0%	6.7%	-42%	8.0%	3.7%	90%
Total	3.8%	1.0%	5.1%	2.0%	7.6%	-50%	8.0%	4.6%	106%
Royal Dutch Shell	3.7%	-0.1%	6.0%	2.0%	7.6%	-69%	9.0%	4.6%	93%
Repsol	1.7%	1.2%	4.8%	1.0%	8.7%	-88%	7.0%	5.7%	153%
Statoil	4.0%	-1.4%	3.9%	2.0%	8.5%	-92%	9.0%	5.5%	220%
Valero	6.5%	6.7%	3.4%	3.0%	7.5%	-58%	12.0%	4.5%	142%
Exxon	4.8%	1.2%	3.7%	2.0%	6.5%	-49%	10.0%	3.5%	103%
Average	5.0%	1.9%	3.9%	2.3%	7.5%	-56%	9.5%	4.5%	130%

In the high case, when the sky is blue, normalised profitability expectations goes to 10%. However, because the current discount rate is already very low and central bankers have begun to normalise monetary policy, instead of reducing the discount further, we keep it at the prevailing 4.1%. All the upside must thus come from improving profitability. The high case scenario translates into an upside of 81%.

Doing similar analyses on the other names, we arrive at a downside risk estimate of 56% for the overall energy portfolio. The enormous downside risk is a reflection of energy’s high exposure to global economic growth and the prevailing low discount rate. However, using similar assumptions on the broader equity market, the comparable downside for the MSCI ACWI index is a stunning 71%. Discounting cyclically high profits at historically low discount rates is a risky business! We think the portfolio represents protection during the next bear market by capturing about 80% of broader market losses.

Whereas the portfolio offers some defensive qualities, the main reason for holding it is the upside relative to the downside. Energy offers value here. In the high case, the portfolio represents upside in the vicinity of 130% if the new lower cost base combined with higher oil and gas prices sends profitability to 9.5%. A scenario we believe is no stretch if only the global economy holds up for a bit longer. Again, doing a similar analysis on the broader market we believe there could be further upside of 38% in the blue sky scenario.

The chart below describes why we find our portfolio so attractive relative to the market. The portfolio’s 130% upside versus 56% downside represents positive convexity. The broader market’s 38% upside versus 71% downside represents negative convexity.

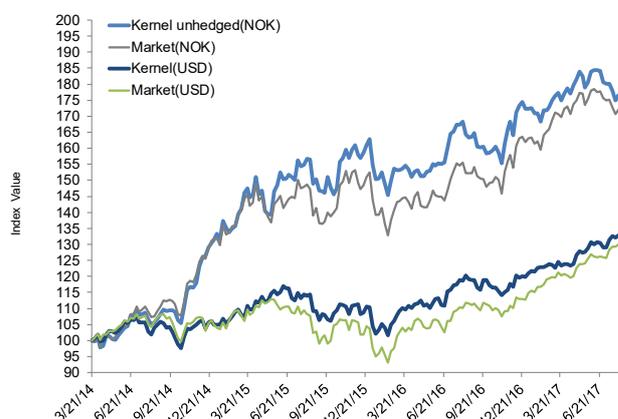


The supply / demand characteristics of energy stocks are currently positive with clear signs of accumulation. However, speculative positioning in the oil market is a bit long for our taste thus there could be some near term volatility which would have a negative impact on the energy stocks. Thus this may well be another false start before we actually embark on the next multi-year trend of energy outperformance. Considering the amount of debt in the world today, the risk of a ‘deflationary bust’ must be considerably higher than average. We have enormous respect for this risk scenario and because it would likely result in a global recession of epic proportions, should it happen, energy would fare badly. Thus if future price action is going to stop us out of the energy positions like last spring, so be it. This is risk management. Whipsaw cost is the cost of managing risk. The benefit from incurring the whipsaw cost, is that whenever there is a major trend emerging, there is a high probability we ride it.

Sector Global Strategies team			
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Analysis of Returns

	Kernel (USD)*	**Market (USD)	Kernel Unhedged (NOK)	***Market (NOK)
NAV at month end	137.42	237.67	1,008.50	1,944.60
Month to Date	2.7%	2.1%	5.6%	4.9%
Year-to-Date	16.6%	19.7%	10.9%	13.8%
Last 3 Months	5.6%	4.4%	9.3%	8.2%
Last 6 Months	10.2%	10.2%	5.3%	5.3%
Last 12 Months	21.0%	23.2%	19.7%	21.9%
Kernel since Inception*	37.4%	31.8%	87.9%	80.0%
Compounded growth, p.a	9.2%	7.9%	19.9%	17.6%
Standard deviation(Wkly)	9.7%	11.0%	12.7%	12.3%
Sharpe Ratio(Wkly)	0.97	0.76	1.41	1.38
Best Month	5.3%	7.8%	8.8%	7.4%
Worst Month	-5.0%	-6.9%	-6.3%	-7.3%
Positive Return	68%	66%	70%	68%



*Sector Global Equity kernel Class P USD since inception March 19th, 2014

**JMSCI AC World Daily TR Net USD, NDUEACWF

***JMSCI AC World Daily TR Net with fx rate from source: WM Reuters 4 pm London time

Class P USD	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2017	1.6%	1.6%	0.0%	2.4%	1.8%	(0.0%)	2.7%	1.6%	1.2%	2.7%			16.6%
2016	(5.0%)	0.5%	5.1%	1.2%	(0.6%)	2.2%	4.0%	(1.0%)	0.8%	(2.9%)	1.8%	1.9%	7.7%
2015	0.7%	3.3%	(0.0%)	2.1%	2.1%	(0.4%)	0.2%	(5.0%)	(3.2%)	5.3%	(0.3%)	(0.3%)	4.1%
2014			1.7%	1.2%	1.2%	2.4%	(3.3%)	2.6%	(3.9%)	1.9%	2.0%	(0.6%)	5.0%

*Class P USD from inception on March 19, 2014

Analysis of Risk and Performance Attribution

Portfolio Exposure	% of NAV	Number of Positions	Sector	Contr to NAV (BPS)	% of NAV	Top 10 Performers	Contr to NAV (BPS)
Long		100	Consumer Discretionary	26	9	Intel Corp	20
Active Share		93%	Consumer Staples	7	6	Teradyne Inc	17
Ex-ante Risk							
1D VaR (95%)		0.8%	Energy	25	10	Tokyo Electron Ltd	16
Annualized Standard Deviation		8.2%	Financials	6	12	Be Semiconductor Industries	13
Beta		0.94	Real Estate	9	8	Hitachi Ltd	12
Tracking Error		2.5%	Health Care	-7	5	Pilgrim'S Pride Corp	12
Company Goodness*							
Equity/Capital (incl leasing liabilities, etc)	Kernel	Market	Industrials	52	11	Infinion Technologies Ag	11
Free Cash Flow to Sales (LFY)	79%	79%	Information Technology	126	12	Taiwan Semiconductor Manufac	11
CFROI (5 yr median)	8.3%	6.6%	Materials	29	14	Cadence Design Sys Inc	10
CFROI Consensus Forecast (FY1 & FY2 Avg)	8.5%	8.0%	Telecommunication Services	-8	5	Old Dominion Freight Line	10
	9.6%	7.6%	Utilities	6	4		132
			Cash & Equivalents	-1	2		
				270	100		

Valuation & Income*	Kernel	Market	Market	Contr to NAV (BPS)	% of NAV	Worst 10 Performers	Contr to NAV (BPS)
Tobin's Q	1.6	1.5	United States	143	48	Celgene Corp	-31
Economic Price / Earnings	21.5	23.6	United Kingdom	13	4	Telekomunik Indonesia-Sp Adr	-10
Economic Price / Earnings (10 Yr median)	18.0	19.0	Canada	1	2	Cia Saneamento Basico De Sp	-10
EV / EBITDA (LFY)	9.0	11.0	Brazil	-10	1	Mondi Plc	-9
Market Implied CFROI	7.0%	7.7%	Australia	9	5	Valeo Sa	-8
CFROI (lowest of 5yr median and forecast)	8.5%	7.6%	China	24	5	Sanderson Farms Inc	-7
Premium on Break-Up Value (EV)	8%	13%	Hong Kong	0	1	Elisa Oyj	-7
Return to Intrinsic Value			India	0	0	Origin Energy Ltd	-6
Low Case	-10%	-19%	Singapore	0	0	Leroy Seafood Group Asa	-5
Base Case	7%	0%	South Korea	6	1	Mfa Financial Inc	-5
High Case	38%	28%	Taiwan	11	1		-98
Dividend Yield	3.0%	2.5%	Japan	64	12		
Trends*							
Cumulative CFROI Revisions (6 mnths,bps)	Kernel	Market	Austria	0	0		
Relative Price Momentum (6 months)	22	0	France	-9	5		
	6.4%	0.0%	Germany	11	1		
			Italy	-2	1		
			Netherlands	15	3		
			Spain	2	1		
			Switzerland	5	3		
			Denmark	0	0		
			Finland	-6	1		
			Norway	-4	4		
			Sweden	0	0		
			Other Countries	-2	2		
				270	100		

*) All numbers represent the median of Kernel positions and the median of the MSCI ACWI index constituents

Source: All calculations are based on input from CSFB, Morgan Stanley International and Bloomberg

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