CERNO CAPITAL

TM CERNO *Pacific*

UCITS Regional Equity Portfolio (Class B)

Q3-2022

Fund Data

NAV/Share (Class B Acc)	£13.83
Fund Size (£mn)	69
Currency Share Class	GBP (Base)
Investment Management Charge	0.75%
Ongoing Charges Figure	0.99%
Dealing Frequency	Daily
Legal Structure	OEIC (UCITS)
Co-Managers	Michael Flitton & Fay Ren
Inception Date Fund	2017
Inception Date Strategy	2009
Share Type	Acc & Inc
Ratings	CITYWIRE AAA

Investment Objectives

The Cerno Pacific portfolio is a geographically specific fund, which invests primarily across the Pacific area but also the wider emerging markets. The fund's objective is to produce capital growth over the long term through a focus on companies that are judged to be innovators or are beneficiaries of innovation through their products, services or business models. The optimal route to access the full benefit of innovation is likely to be, directly or indirectly, in the form of equity, which will be the predominant asset class in the portfolio. The manager takes an active approach to currency exposures and may hedge where deemed appropriate.

Q3 Investment Report

Fund Activity

Michael Flitton provides performance commentary and details position changes during the quarter.

Cerno Pacific and China

Fay Ren and Michael Flitton outline changes to the portfolio and their awareness of geopolitical risk of the Chinese holdings.

Fund Activity

Michael Flitton

The fund delivered a negative return of 9.2% for the quarter against a decline in the comparator index of 2.8%. This takes the YTD return for 2022 to -32.5% versus -10.0%.

The third quarter saw an intensification of the factors pressuring equity markets, and particularly companies in our opportunity set, throughout the year. First amongst these were discount rates and the US dollar. Through its own intransigence, the US Federal Reserve joined the race to contain inflation some time after the starting gun. This has necessitated ever stronger rhetoric to jawbone the bond market, which sets long term US interest rates, into compensating for the delay in lift off of short-term rates. As euphemistic references turned into a full embrace of former Fed Chair Paul Volcker's methods the market finally got the message. US 10-year yields gained almost a full one percentage point, over three months, to 3.8%.

Related to the rise in rates has been the effect of the US dollar, which rose 6% against a basket of major currencies in the quarter. As risk aversion has surged so has the desire for high quality collateral. Capital has been sucked out of riskier markets and into the global reserve currency. Risk appetite has drained out of the system creating a significant headwind for assets prices.

We can see the immediate effect on equity valuations. Aggregate portfolio valuations declined 7% against 4% for the index. Our focus on innovative businesses lends the portfolio a natural tilt towards companies with greater value in the future. As a result, higher discount rates are mechanically more onerous.

This effect played out in sector performance. There are some sectors where we simply have no exposure as our mandate of innovative businesses reveals a limited opportunity set. Consumer staples and Energy are two such sectors, both of which outperformed the broader Asian index by 8% and 4% respectively. Areas where we are more exposed performed poorly. Tech and Communication Services, for example, were both 5% weaker than the index.

Two specific areas of drag were China and Semiconductors. Of the 9% the fund fell, 7% was China and 2% was Semiconductors. For international capital, China is now firmly in the 'too hard' pile. For the past year the country has been caught in a trifecta of zero-Covid, property deleveraging, and poor economic growth. The situation is unsustainable. It is likely that zero-Covid will have to give but the authorities seem pinned by the effort to save face. While measures have been announced to stimulate the economy, animal spirits remain quiescent while a great deal of business and consumer energies is spent on the rigmarole of adhering to zero-Covid. We cannot know exactly when restrictions will ease. We do know that while the policy persists, there is little chance of a sustainable recovery in activity on the ground.

Semiconductors represent around 17% of the portfolio. The sector benefitted from an extraordinary period of tightness in 2020/2021, which is now being unwound. This is a cyclical sector and inventory driven corrections are a hallmark of its history. While a downtrend in capex and earnings is now likely, this has been priced in by the market, in our view. The long-term picture remains robust given the necessity of semiconductors as the enabling technology for trends in how people consume, what they consume, and how they

At the individual company level, the top three performance contributors were Nihon M&A (+55bps), Harmonic Drive (+35bps), and CSL (+34bps). Nihon M&A continues to recover from an organisation restructuring, which put the brakes on growth through the first half of the year. Harmonic Drive appears to be close to a bottoming in orders for its critical gears for small robots as automation demand improves. CSL meanwhile is a defensive, global pharmaceutical franchise benefitting from a steady recovery in plasma collections after significant supply disruption during Covid.

Top detractors included Kingdee (-172bps), Wuxi Apptec (-156bps), and Silergy (-85bps). After recovering in Q2, Kingdee fell significantly on concerns that economic headwinds in China would dent business appetite for digital transformation. Near term momentum is softening but the secular trends of digitalisation and localisation set the group up well over the medium term. Wuxi Apptec has been caught in the geopolitical crossfire with the US. In September President Biden signed an Executive Order to promote biotech manufacturing in the US. While this does not affect Wuxi Apptec directly, it has been perceived as raising the sector's geopolitical temperature. The market has little appetite for uncertainty. Finally, Silergy is the leading Chinese manufacturer of high-end analog semiconductors. The opportunity to displace dominant US manufacturers in local supply chains is vast. In the near term the business is sensitive to the outlook for consumer electronics, which came under pressure in the quarter.

We made several changes to invested businesses, which have the effect of high grading the quality of earnings within the portfolio. Sysmex, the global leader in haematology testing, returned to the strategy. We sold the business in January 2021 on valuation grounds and after a large round trip it is now back within range. Resmed, part of a global duopoly in sleep apnoea solutions, is also a returnee. The extended recall of its key competitor, Philips, provides a good underpinning to demand. So far, the group's ability to fully take advantage of the market opportunity has been crimped by semiconductor availability but this should ease into year end.

Bilibili and Nidec have been sold. Bili was one of our few pre-earnings businesses. As such, it has been hit hard by the switch in market sentiment towards the safety of cash flow. We continue to like the service it provides from a consumer perspective. It occupies a unique position in the China internet space with user generated content producing a powerful online community. We had remained owners to see if the company could monetise this unique offering. We are increasingly concerned about its ability to do so. However, we may revisit the business if it manages to prove out its earnings potential further down the line. Nidec faces more of an uphill battle. Its core business is brushless DC motors for a broad swathe of industrial and consumer products. It is a well penetrated industry and so limited to GDP-like growth. The long-term opportunity has been EV motors. After a strong start momentum appears to have stalled as low-end Chinese players have taken share rapidly driven by the need to thrift components as the cost of batteries rise.

Performance in 2022 has been disappointing. Outside of growth style headwinds China has been the primary detractor. Our China allocation has been reviewed. After quarter end we took action to significantly reduce exposure to mainland China dominciled companies. We detail this rationale in the following pages. Publication of this quarterly was necessarily delayed to allow a full rationale to be included here for investors.

TM CERNO *Pacific*
IN DEPTH

Cerno Pacific and China

Fay Ren

Michael Flitton

Changes to the allocation to Chinese companies Within Cerno Pacific

The Cerno Pacific strategy is focused on investing in innovative businesses in Asia. It is our belief that this approach offers investors the opportunity for long term outperformance against the market. This understanding is predicated on the superior characteristics of these businesses, including growth potential, capacity for adaptation, and resilience as well as the market's underappreciation of innovation in the Asia Pacific region.

In the past 20 years, China became a powerhouse of IP generation. The supply of skilled labour, targeted government support, and an entrepreneurial culture have combined to produce a swathe of companies creating new markets or challenging existing multinational incumbents. The opportunity set led to Chinese companies accounting for the largest set of allocations, aggregated by country of domicile.

However, in the past two year's President Xi's "common prosperity" initiatives, have moved into a higher gear and the far-reaching consequences of these has led to a review of our approach to China.

Our view had been that pragmatism and balance – the underlying philosophy that has underpinned modern China - would prevail. However, the recently concluded 20th Party Congress has impaired the likelihood of that benign set of outcomes. China, in its adapted governance model, its growing isolation on the world stage and its corporate and social missions has begun to tack in a different direction than an investor would recognise from its earlier modernisation phase.

It is clear, from the rearrangement of political seats on the standing committee, that President Xi has attained absolute control over both the Communist Party and the arms of government. Two conclusions flow from this. Firstly, he has achieved unfettered control to better impose his vision. Regulatory reforms thus far have been defendable, albeit challenging for investors in platform businesses. One chief risk is the expansion in the practical implementation of common prosperity such that entrepreneurial spirits are clipped and private company independence curtailed. Secondly, the increasingly autocratic nature of Chinese rule will embolden China hawks in and around the US administration. If capital flows are harnessed by the US administration, asset prices may become permanently untethered from business fundamentals.

These observations have come into sharper focus during the 20th Party Congress held in Beijing and we conclude, for now, that the opportunity set for our investors in China is diminished. The potential for Chinese businesses to achieve scale, both within China and beyond, is now more limited.

Following the quarter's end, we initiated a reduction in our China exposure from 36% to 18% of portfolio assets. This largely entailed trimming positions across the board. However, where we believe risks are more limited, higher weights have been maintained.

We believe a flexible stance is appropriate. China is entwined with the global economy and global capital markets, which should exert a reality check on policy. More pragmatic outcomes may emerge from beneath the rhetoric. Our invested China businesses are financially robust and offer exciting growth prospects. Valuations are now attractive. Our allocations could rise if our current assessment proves overly pessimistic. Equally, if the future paths chosen results in 1) further curbing of capitalist endeavour 2) increasing geo-political risk and/or 3) risks to the free flow of goods and capital between China and the rest of the world, we would enact further reductions in the fund's exposures.

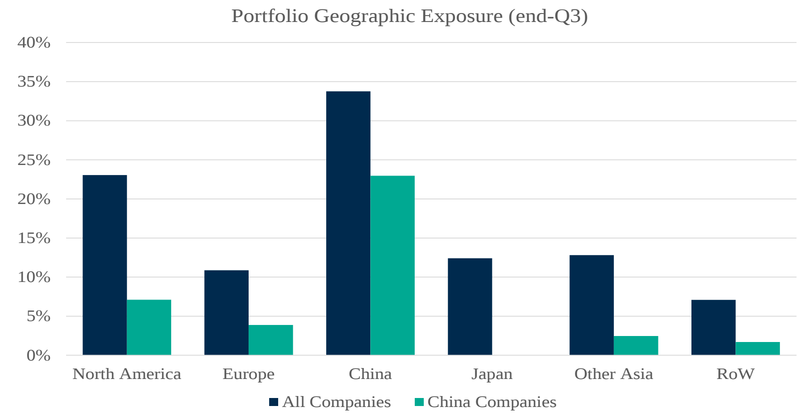
China holdings by sector and company within the portfolio

The main negative impacts experienced by the portfolio in the third quarter of the year were felt across the semiconductor and healthcare complex. The US has significantly tightened its own inputs into microchips destined for China and pressured other countries to follow suit. An executive order to reduce US biotech manufacturing reliance on foreign countries was also put forward by the Biden administration.

Although we do not believe the companies in the portfolio are at risk of business disruptions in the near-term, the impact was nevertheless felt through fragile investor sentiment over news-flow, partly contributing to outsized price action in these names. These abrupt policy moves highlight the deteriorating external environment for Chinese businesses.

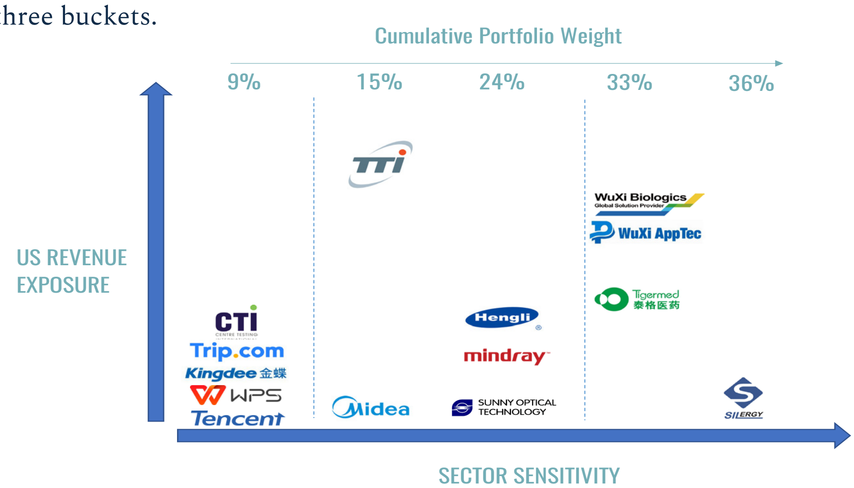
The Pacific fund selects companies on a bottom-up basis. We tend to consider a company's geographic exposure primarily through the lens of its revenue stream.

Prior to the above described changes to the portfolio, the geographic revenue exposure looked as follows:



As a ratio of total portfolio exposure, Chinese companies held at the end of Q3 collectively generated 15% of revenues from overseas, of which 7% was from the US. This latter number has now been reduced by half through position sales. Historically, we have viewed high overseas revenue as a positive indicator of competitive success. However, with escalating geopolitical tension this overseas exposure increasingly represents a risk.

For simplicity of illustration, we conceptualise geopolitical exposure on two scales: sector sensitivity and foreign/US revenue exposure. Clearly, this approach does not encapsulate all the risk factors and the lines are not always clear cut. The chart below shows how we positioned the companies held end of Q3 on that scale, loosely grouping the companies into three buckets.



The first bucket is represented by companies in strategically sensitive sectors, with high (>50%) overseas revenue exposure. Collectively, this bucket has been trimmed back from 12% of the portfolio to 3%, the greatest reduction in terms of exposure.

The CXOs fall squarely in this bucket. The strategic sensitivity of the biotech sector means any news flow can result in outsized price action. **Wuxi Apptec** and **Wuxi Biologics** both have >60% overseas revenue share, of which US clients represent a large proportion (c.50% each), as the US hosts the largest number of pharma and biotech companies globally. **Tigermed** is relatively more shielded as it trades on the A-share market, with only 24% US revenues and is less subject to foreign capital swings in the Hong Kong market.

Wuxi Biologics was placed onto the 'Unverified List' (UVL) in February this year, causing an industry wide sell-off at the time. It was subsequently taken off the list on 7th October, after routine inspections were completed in their China facilities by the US Department of Commerce. Valuations on both companies now stand two standard deviations below their historic averages, where previous growth premiums over slower growing global peers have closed despite pipeline momentum remaining robust. Wuxi Apptec recently posted its Q3 profit alert expecting +78% growth in revenues and +82% growth in net income, both beating expectations.

Fundamentally, the utility function these companies provide to their customers is still critical. End-to-end biopharma outsourcers have enabled the rise of the independent US biotech industry. Indeed, despite the headline sensitivity, so far both companies have continued to receive new contracts from foreign customers. However, being exposed to the strategically sensitive biotech/pharma industry, a mandated curb, similar to that of the semiconductor embargo preventing US clients or US persons (passport/green card holders) from working with a Chinese company, is no longer inconceivable. Being the most exposed in this regard, Wuxi Biologics was sold in full.

Another area of sensitivity is semiconductors. We own one Chinese semiconductor company in the portfolio, **Silergy**, which produces analog semiconductors used across consumer electronics, industrial, communications, and auto applications. The latest round of US semiconductor embargo aimed at curbing Chinese development in advanced chips specifically target advanced nodes '14/16nm and below'. Silergy falls outside the scope of restrictions as the company mostly works on mature nodes beyond 90nm. Analog semiconductors are relatively 'off the radar' as the most advanced nodes are focused on the logic semiconductor space. Therefore, the firm does not require additional licensing or face business disruptions in the near-term. But again, we cannot rule out a further broadening of the semiconductor export controls from the US, which may jeopardise their operations in the future. We are now cautious in this space.

In the second bucket, we place companies in sectors that are not typically considered strategically sensitive but do have medium to high international revenue exposure. The exposure in this segment was reduced from 15% to 10%.

The company with the highest US revenue exposure in the portfolio is **Techtronic Industries** (**TTI**) at c.70% group sales. Despite the high US exposure, we view TTI as low risk given its retail B2C nature. The company makes branded power tools including flagships Milwaukee and Ryobi sold to both professional tradesmen as well as individual consumers. TTI has been building capacity in Vietnam and the US, targeting <50% capacity from China by end-FY22, to reduce its logistic footprint and circumvent tariffs through a more diversified manufacturing base.

While there has been greater vocalisation with respect to onshoring or "friendshoring", Chinese companies doing businesses overseas have been investing in manufacturing capabilities outside the country to be closer to their local customers too. Similarly in the case of **Hengli**, a maker of hydraulic components and solutions for the heavy machinery industry, it is building a facility in Mexico to better serve their US clients, which represents c.20% of its sales.

Mindray (medical devices) and **Midea** (home appliances) both have relatively high overseas revenues at c.40% each. Both companies are very well diversified globally across both developed and emerging markets, with <10% sales from North America. Mindray has largely avoided geopolitical impact to date despite being in the healthcare space. Its North American sales growth has outpaced domestic in the first half of this year (+37% vs. +22% YoY, albeit a smaller base). The situation may change but being a highly cost-effective player delivering comparable quality against their global peers, the proposition of their products is still attractive at a time when hospitals globally are trying to cut down on costs. The company has planned five offshore facilities and is pro-actively targeting at least 60% core raw material self-sufficiency within the next 3 years.

One of the more difficult (but smallest) position in the portfolio this year has been **Sunny Optical**, our smartphone camera and lens maker. The company adjusted their earnings downwards significantly on lengthened replacement and de-spec cycles from their OEM customers. However, it has continued to gain market share in a challenging market, entering the Apple supply chain for the first time with one camera in the newly released iPhone 14 series. Their strong balance sheet allows them to continue their R&D efforts in auto camera components, maintaining global #1 position, with capacity to further make investments in AR/VR and build out infrastructure in India and Vietnam.

The final bucket consists of companies with almost exclusively domestic revenues and/or of little strategic importance. This is represented by consumer internet platforms (**Tencent & Trip.com**), B2B software (**Kingdee & Kingsoft Office**) and service players (**Centre Testing**). The software and service names should benefit from a top-down push for digitalisation and import substitution over the medium to long term. The exposure in this segment was cut from 11% to 6%, more on account of near-term domestic policy risk, such as the continuation of zero-covid, than geopolitics. While we have maintained a position in Trip.com, where we see its business as low sensitivity, Tencent's ubiquitous platform remains in the crosshairs for authorities. It was sold in full, from an already low level (1%).

What we are looking to see from the retained companies is their agility to manoeuvre around policy shifts and proactively make the necessary provisions to facilitate supply chain resilience. The international expansion efforts made by these businesses in the past have been helpful in at least partially offsetting domestic demand weakness this year. Most importantly, to ensure that the intellectual property and customer relationships that they have built are strong enough to safeguard their revenue streams. In simple terms, bar an outright embargo, the companies must prove that they are valuable enough to their customers. This applies not only to the Chinese companies in the portfolio but across the board.

The standing data that follows this text is based on exposures at the end of the quarter. These exposures have been changed since the end of the quarter.

- Fay Ren & Michael Flitton

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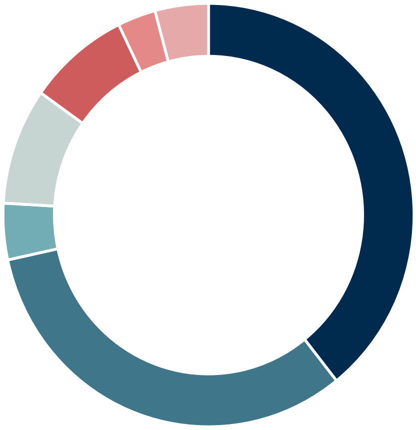
FUND FACTS



Geographic Exposure

- China/Hong Kong - 36%
- Japan - 33%
- Taiwan - 12%
- Australia - 8%
- Korea - 4%
- Singapore - 4%
- LATAM - 3%

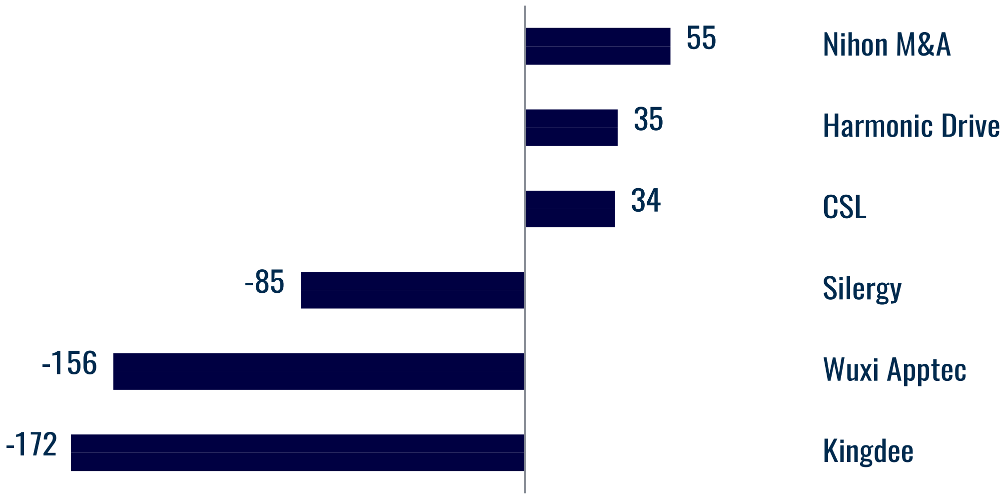
Top 10 Holdings

CSL	5.7%
Denso	5.6%
Shenzhen Mindray	5.2%
TSMC	5.1%
Samsung Electronics	4.2%
Nihon M&A	3.7%
Trip.com	3.6%
Advantech	3.6%
Harmonic Drive	3.5%
Techtronic	3.4%

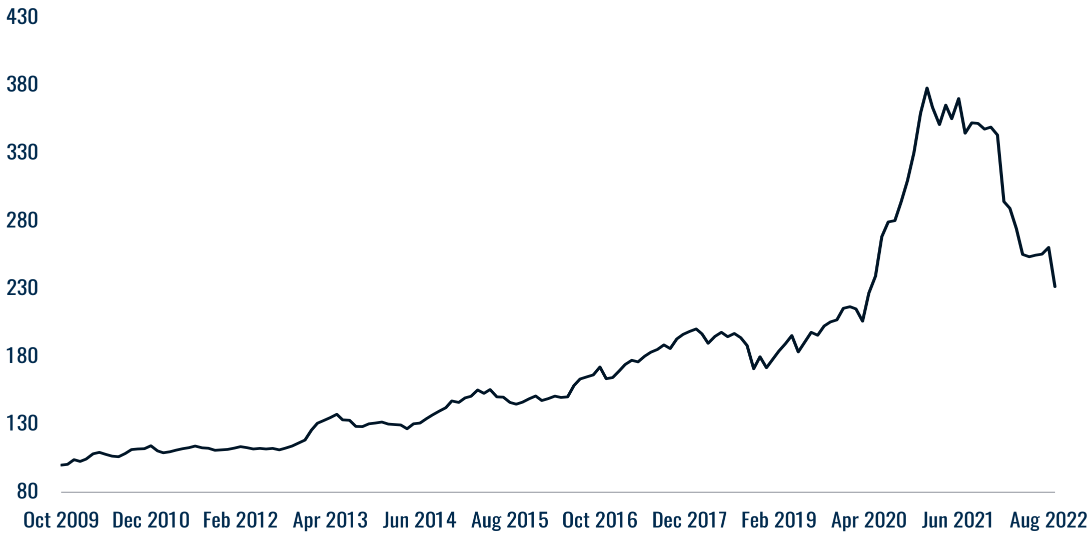
Allocation by Sector

Information Technology	33%
Industrials	27%
Health Care	21%
Consumer Discretionary	9%
Communication Services	6%
Materials	1%
Cash	3%

Top/Bottom Quarterly Contributors (bps)



Performance Since Inception



Performance is based on a Net Asset Value (NAV) price basis with income reinvested, net of fees. Past performance is not a guid to future performance.

Performance

Year Ended	Sep 2022	Sep 2021	Sep 2020	Sep 2019	Sep 2018
Net Performance	-34.2%	+19.6%	+45.3%	+8.0%	+1.3%

***Inception as a UCITS: 27 January 2017**

Fund Codes

	ISIN:	SEDOL:	Bloomberg:
A Acc	GB00BDCJ9Z32	BDCJ9Z3	TMCPEAA LN
B Acc	GB00BDCJB138	BDCJB13	TMCPEBA LN

Key Fund Information

NAV/Share Class (Acc)	£13.83
Fund Size (£mn)	69
Currency	GBP (Base)
Authorised Corporate Director	Thesis Unit Trust Management (Authorised and regulated by FCA) Exchange Building St John's Street, Chichester, West Sussex PO9 1UP
Fund Custodian	The Northern Trust Company
Auditor	Pricewaterhouse Coopers LLP
Fund Legal Structure	UK OEIC (UCITS)
Inception Date - Fund	January 2017
Fund Saving Structures	SIPPs, ISAs & JISAs
Key Fund Documents	cernocapital.com/cerno-pacific
Ongoing Charges - Class A (incl. Management Fee)	Management Fee 1.00% Other Fees (incl. running costs) 0.24% OCF 1.24%
Ongoing Charges - Class B (incl. Management Fee)	Management Fee 0.75% Other Fees (incl. running costs) 0.24% OCF 0.99%
Transaction Costs	Explicit Costs 0.08% Implicit Costs 0.10%*
Initial Charge	5% - waived as standard
Contact	Tom Milnes 020 7036 4126 tom@cernocapital.com

*We have only started calculating this data from 1st July 2021, and as such this is an estimate based on the available data so far