Castlebay Investment Partners

Quarterly investor letter December 2016

Our guiding principles:

- **Transparency & alignment of best interests with our fellow shareholders**
- **Adherence to our investment philosophy and process**
- **Independence of thought in order to avoid the market herd**
- **Focus on costs: management fees capped, low stock turnover**

2016 - A year in review: Proof, if it were needed, of the dangers of forecasting macro events!

Dear fellow shareholders,

2016 was certainly a year of big surprises! A year when the unexpected came to the fore, Brexit and the US election result were two obvious examples. Opec and Non Opec members agreeing greater production discipline was another that helped the oil price recover some lost ground. As we review the year it is a chance to look at what we did well and what we did not so well.

However, this presents us with a challenge. How do we define success and failure with regard to managing the fund? I started my career at Ignis Asset Management (now Standard Life Investments) and spent many happy years there. Each December the fund managers would meet and have a process day. The idea was to review the past year and identify what went well and not so well, distilling the lessons learned into a few key aspects that could then be utilised in the future management of money. In principle this is a fine idea. Generally, performance in most endeavours improves quickest when we have short 'feedback loops'. Golf, for example, is a game with very short feedback loops. My position in the deep rough, left of the fairway gives me a pretty clear idea that I hooked the ball. I can then set about trying to correct my mistake thereby improving both my accuracy and consistency. Importantly, the next shot will quickly show me how well I have corrected my swing!
Investment, however presents a different challenge—in two main areas:

1) after making an investment, the feedback loop tends to be much longer.
2) the mismatch between the market's perception of a company and the underlying fundamentals can persist for some time.

The Ignis process day would have been even better served analysing decisions made over three years and longer. The power of incentives becomes evident if performance is measured and rewarded over short (12 month) periods. If this is the case then investment decisions will almost inevitably focus on this short timescale, even if this impacts long term returns.

Our analysis highlights how well we have invested since the fund launched, in businesses whose fundamentals can continue to perform strongly; and whether we have paid too much for the privilege. Measuring performance over 12 months– the short term, can often reflect only the vagaries of Mr Market. This nervous individual tends to lurch regularly between fear and greed. Our fund enters its third year at the end of January 2017 and whilst we view this still as the short term, it is a better period over which to judge performance than merely the time it takes the third rock from the sun to orbit its star.

We have made mistakes in 2016. Capita has been the most significant detractor to our fund performance, reducing the Net Asset Value by 2.8%. Operationally Capita has had issues with regard to cost overruns and a contractual dispute with a client. The shares have been weak as the market has started to discount the potential of a rights issue. Interestingly, in 2011 Capita had also fallen out of favour with the market before recovering strongly. Such valuations can often offer investment opportunities, provided that we believe that the longer term potential of the business is intact. However, over the shorter term we have been too quick to add to our Capita position as the share price has continued to weaken. Rolls Royce has been the other main negative contributor to performance over the last 23 months. It has suffered a number of earnings downgrades due to weaker demand in its civil aerospace and marine businesses in particular. However, Rolls Royce's performance both operationally and in share price terms has started to recover and over the longer term we believe that its strong products and market position will further improve returns.

Fund Attribution 28th Jan 15 –End Dec16 Bottom Ten Companies	Attribution %
Capita	-2.8
Rolls Royce	-2.0
Shire	-1.2
Pagegroup	-0.6
Indivior	0.0
AstraZeneca	0.0
Croda	0.1
BHP Billiton	0.1
Mitie Group	0.3
Imperial Brands	0.3

Petrofac, the oil & gas service provider, has been the largest contributor to performance since launch. Whilst the share price has been volatile, our valuation framework has allowed us to allocate capital when the market has undervalued the company, due to a weak oil price environment. We believe that the company will return to its historic profitability in time, which will further enhance cash flows and shareholder returns. Wood Group and Rotork have found themselves in a similar position to Petrofac with their end markets dominated by the oil market and sentiment towards the sector. The first quarter of 2016 provided an excellent opportunity to buy these companies at distressed valuations. Intercontinental Hotels has changed its business model from physical ownership of Hotel buildings to one of a franchise model. This model requires less invested capital, allowing higher returns to be made. Strong cashflows and an attractive valuation at purchase have generated strong returns for our fund.

Fund Attribution 28th Jan 15 –End Dec16 Top Ten Companies	Attribution %
Petrofac	3.6
InterContinental Hotels Group	2.1
Rotork	2.1
Kone	1.7
Wood Group	1.7
Admiral Group PLC	1.4
BG Group	1.2
Serco	1.1
Rio Tinto	1.1
Reckitt Benckiser Group	0.9

When analysing performance—looking at both the failures and successes, it is worth remembering the maxim, delivered by American coach Lou Holtz. "You're never as good as everyone tells you when you win; and never as bad as they say when you lose!"

We wish you a prosperous and healthy 2017 and thank you for your continued support.
Yours,

David F Ridland

The value of investments can fall as well as rise and you may not get back what you invest.

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IN FOCUS

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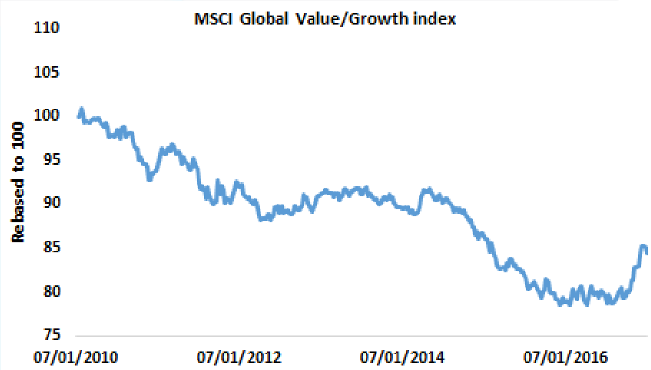
Value versus growth and the Castlebay Portfolio



Past performance is not a reliable indicator of future returns

Company	Sector	Position
Intercontinental Hotels	Leisure	5.9%
Rio Tinto PLC	Basic Materials	5.7%
Victrex PLC	Basic Materials	5.7%
Rotork	Industrials	5.5%
Wood Group PLC	Energy	5.4%
Petrofac Ltd	Energy	5.0%
Aveva Group	Technology	5.0%
Serco Group PLC	Support Services	4.6%
Page Group	Industrials	4.1%
Kone Oyj	Industrials	4.0%
Tesco PLC	Consumer	3.6%
Capita PLC	Support Services	3.5%
Admiral Group PLC	Financials	3.4%
Rolls-Royce	Industrials	3.0%
AstraZeneca PLC	Healthcare	2.9%
BHP Billiton PLC	Basic Materials	2.9%
BAE Systems PLC	Industrials	2.8%
BATs	Consumer	2.5%
Colgate	Consumer	2.4%
Craneware PLC	Technology	2.4%
Burberry Group	Consumer	2.3%
Unilever PLC	Consumer	1.9%
Reckitt Benckiser	Consumer	1.8%
Imperial Brands PLC	Consumer	1.7%
Croda	Basic Materials	1.6%
Cash	Cash	10.8%
Total		**100.0%**

The latter part of 2016 saw the long awaited recovery of Value against the Growth style of investing. A number of high quality companies in our investment universe (below), have for some time been too expensive to buy. Our cash levels have remained high for this reason, however, we have maintained our discipline and been patient. In the second half of the year we have seen a number of these company valuations weaken, as value orientated companies have been more in favour. The cash of nearly 11% will allow us to allocate more capital in the year ahead, when there is a greater balance between quality and valuation in our investment universe. 2017 promises to be eventful, with a new US President; European elections and negotiations on the UK's exit from the EU. Opportunities will likely present themselves!

Investment Universe: Getting to know companies and how they change over time.

UK Companies				
Admiral Group	Page Group	Wood Group	Hargreaves Lansdown	Spirax-Sarco Engineering
Aveva Group	Petrofac	A.G Barr	Hilton Food Group	Brooks Macdonald
Astrazeneca	Reckitt Benckiser	Aggreko	Howden Joinery	Craneware
BAE Systems	Rio Tinto	Avon Rubber	IMI	Dillistone Group
BHP Billiton	Rolls Royce	Burberry Group	RELX	James Halstead
British American Tob	Rotork	Diageo	Renishaw	Jarvis Securities
Capita	Serco	Domino's Pizza	Restaurant Group	Nichols
Croda Intl	Tesco	Dunelm Group	Sage Group	RWS Holdings
Imperial Brands	Unilever	Elementis	Servelec Group	STHREE
Intercontinental Hotels	Victrex	Fidessa Group	Shire	

International Companies				
Colgate Palmolive	Accenture	Coca Cola	Johnson & Johnson	Novo Nordisk
Kone OYJ	AXFood	Domino's Pizza	Microsoft Corp	Pepsico
	Brown Forman Corp	Industria de Diseno Textile	Nike Inc	Roche Holding

Quality Table		
Key metrics	VT Castlebay UK Equity	Market
Return on Equity	32%	24%
Operating Profit Margin	20%	13%
Net debt to equity	48%	77%
Cash conversion	126%	92%
Free cash flow yield	3.4%	3.4%

2016 also saw the introduction of our Investment Universe. Our modus operandi has always been to balance Quality with Valuation. As our approach has evolved over many years, it seems increasingly useful to focus on a restricted number of companies in our universe. Once we define them as high quality we then determine if the market is offering us these companies at attractive valuations. Hence the first quarter of 2016 saw the first publication of our investment universe of 63 companies from the whole of the UK Equity market and from developed International markets, from which we will invest.

Total Costs of Investment in 2016

You will see at the top of the first page that two of our guiding principles are Transparency and a focus on Costs. Unlike most of our peers we pay the ongoing costs associated with the fund from our Annual Management Charge. This means that the Annual Management Charge is capped and is the same as the Ongoing Charges Figure. At the end of each calendar year we also publish the transactional costs which reflect the number and cost of transactions carried out in the fund.

The number of transactions remained low and our turnover, calculated in accordance with the FCA guidelines, was negative because there were greater inflows of cash into the fund compared with the dealing activity.

VT Castlebay UK Equity Fund	01 Jan16 -31 Dec16
Portfolio Turnover Rate*	Negative
Voluntary Commission	£3,456
Fund Flow Commission	£1,464
Total Commission Paid	**£4,920**
Percentage of Fund NAV	0.03%
Transaction Taxes	**£14,989**
Percentage of Fund NAV	0.09%
Additional Cost of Investment	**0.12%**

Source: Valu Trac

Voluntary commission occurred when we made an investment decision to buy or sell position in the fund. The fund flow commission has been generated when we have increased existing positions in the fund as a result of new flows of capital to the fund. Our low turnover approach to investment means that we will invest and hold companies generally for the long term, thereby reducing the ongoing costs of the fund. The transactional costs are divided by our end of year NAV of £15.1M and added to our Annual Management Charge to calculate our total cost of investment for 2016.

The value of investments can fall as well as rise and you may not get back what you invest.

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