STONEHAGE FLEMING

6 January 2024

Dear Equity Client

GLOBAL BEST IDEAS EQUITY FUND – 2024 Annual Letter

2023 MARKET PERFORMANCE

Stock market

World equity markets delivered strong returns over 2023. The MSCI World Index (including Emerging Markets and dividends) delivered a +22.3% return over the year (in US$ terms; +15.8% in UK£ terms[1]). Markets largely recovered the losses of 2022, ending the year within 4.3% of the peak reached in November 2021 (in US$ terms; in UK£ terms a new peak was achieved at the end of last year). A sense of normality returned to markets over the course of 2023.

Backdrop

The main feature of the economic backdrop in 2023 was that, despite fears around the negative impact of higher interest rates and inflation, the US economy was much more resilient than expectations. Whilst manufacturing was relatively weak throughout the year, consumer confidence remained comparatively firm. Consumption remained above +3%, retail sales grew at +4%, government spending (with the Biden subsidies) may have been close to +4% and overall real GDP growth is expected to come in at +2.4%. A soft economic landing instead of a deep recession still remains the general view. This benign economic landscape has been a large contributor to the normalisation of capital markets.

The other main factor supporting the capital markets in 2023 has been a growing belief that US inflation is under control, and therefore that the Federal Reserve (Fed)'s tightening task may be close to completion. The view on the latter specifically firmed from October onwards with indications from the Fed that, despite them sticking to their stance of higher for longer interest rates, their thinking was moving towards the timing of cuts in 2024. This supported investor confidence with treasury rates dropping sharply and the stock market effectively doubling its to then year-to-date performance.

The sharp Growth to Value rotation in 2022 reversed in 2023. The extent of this rotation is highlighted in the table below[2]:

	MSCI World Index Performance			
	US$ Terms		UK£ Terms	
	Growth	Value	Growth	Value
2022	-29.8%	-5.8%	-20.7%	+5.4%
2023	+37.6%	+12.5%	+30.3%	+6.6%

[1] Source: Bloomberg, December 2023
[2] Source: Bloomberg, December 2023

Stonehage Fleming Investment Management Limited
6 St James's Square London SW1Y 4JU United Kingdom
t:+44 20 7087 0000 f:+44 20 7087 0001 e:enquiries@stonehagefleming.com
stonehagefleming.com

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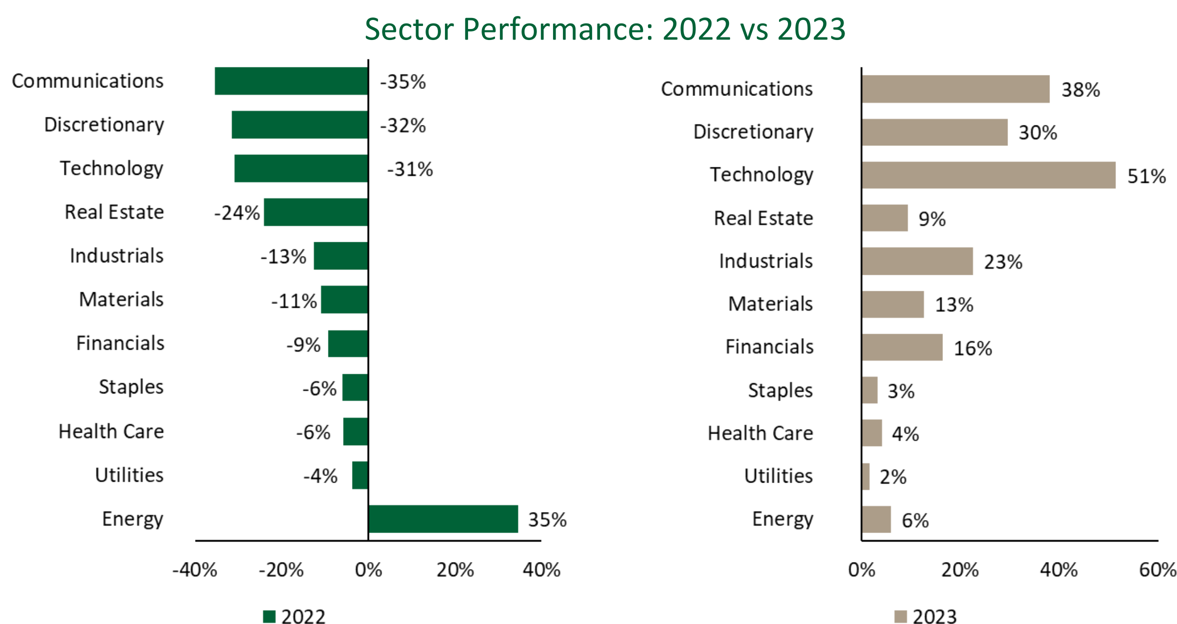
In terms of sector performance (in US$ terms), we reflect the rotation in the bar charts below[3]:



The main themes on overall sector performance have been the market uplift of AI related businesses early in the year following Microsoft's OpenAI transaction, followed by the wider awareness in the third quarter of the success of GLP-1 anti-obesity drugs when Walmart confirmed it was seeing an impact on shopping baskets. The former triggered a strong rerating of many cloud, software, semiconductor developer and related shares from their low 2022 base. The latter caused a Richter scale type of de-rating in many Food, Beverage and Health Care shares.

2023 FUND PERFORMANCE[4]

Performance

The Fund delivered a +22.5% return over the year (in US$ terms; +15.6% in UK£ terms). This has brought the compounded return since inception (August 2013) to +9.8% p.a. (in US$ terms; +11.9% p.a. in UK£ terms).

Contributions to performance

The best and worst contributors to gross performance have been as follows:

2023 Contributors / Detractors			
Largest Contributors		Largest Detractors	
Microsoft	3.3%	Estée Lauder	-1.4%
Alphabet	3.3%	AIA	-0.4%
Cadence	2.8%	Nike	-0.2%
Adobe	2.6%	PepsiCo	-0.2%
Amazon	1.8%	Thermo Fisher	-0.1%
Total	13.7%	Total	-2.2%
% of Total[5]	56.6%	% of Total	-9.1%

[3] Source: Bloomberg, December 2023
[4] Source: Bloomberg, December 2023
[5] this figure reflects the contribution, as a proportion, of the top five / bottom five contributors to the Fund's total return

The Fund has had exposure to the Fourth Industrial Revolution (4IR) theme for a while, and in 2023, benefitted largely from AI developments. All of the top five contributors are in this category. Counting all of the Fund's exposures in this category, their total contribution made up 68% of the overall Fund performance. The five worst performers have been a mixed bag, absorbing less than a tenth of overall performance. In terms of the negative effects of GLP-1 on performance, we note a total detraction of -0.4% (-2% of the total performance[6]) from the Staples and Health Care names. Most of the negative returns have been from Health Care names.

FUND ACTIVITY

We have been more active than normal in 2023, with the Fund turnover increasing to 10.4% (still considered low within the industry). The main transactions during the year have been as follows:

a) Introduced UnitedHealth
Their digital business in Optum Health with its formidable data management is of particular value to ensure best competitiveness in the industry.

b) Cut Estée Lauder by one third
The business has some operational challenges and is very dependent on the Chinese consumer and on the duty free international traveller. Furthermore, in this space we also hold L'Oréal which is firing on all cylinders. The skewed Sales and Market Capitalisation relative ratios of, respectively, 35% and 19% between the two companies prevents us from totally exiting Estée Lauder.

c) Cut Adobe by a half
We reduced our position when the stock regained lost ground following the announced $20bn acquisition of Figma in 2022 which would have had a dilutive impact from the deal from a planned equity issue.

d) Cut LVMH by one third
LVMH has numerous strategic attractions. Nevertheless, the outlook is for decelerating organic growth as spending on luxury goods moderates in some markets from a high base.

e) Switched a third of Visa to Mastercard
Whilst we have full confidence in Visa as a business, a change in its capital structure may lead to around $100bn worth of shares coming to the market over time, making Mastercard an attractive hedge during this time.

f) Sold out of Walt Disney
The business made a strategic error when over-gearing their balance sheet in order to buy 21st Century Fox. It then made further strategic errors with its digital content offering that wiped out profits and diminished the quality of the brand. Further to this, the business is still saddled with uncertainty around its leadership.

g) Sold out of AIA
Whilst we believe it is one of the highest quality businesses in Asia, the growing influence of regulation and China's macroeconomic weakness, increases its risk profile.

[6] this figure reflects the total detraction as a result of GLP-1 effects on the Fund, stated as a percentage of Fund's total 2023 return

h) Sold out of PepsiCo
The combination of their overly aggressive pricing during the cost-of-living crisis and the risks that their carbonated soft drink and snack businesses face from GLP-1 drugs has dampened their longer term organic growth potential. A major food retailer has recently taken their products off the shelf specifically because of pricing.

i) Sold half of McDonald's
Whilst they also may face GLP-1 drug risks, we believe that it will take longer to become a material threat to organic growth. Its franchise rental income should be at less risk.

j) Introduced Linde
They are the world leader in the well organised and strong cash generative industrial gas industry.

k) Introduced Arthur J Gallagher
This business has a strongly cash generative business model earning an annuity-like commission on casualty insurance coverage without itself assuming any of the underwriting risk. It targets mainly the middle market which is a more sticky, relationship-driven type client.

l) Rebuilt Edwards Lifesciences
We believe that the potential risks that the GLP-1 drug poses for Edwards Lifesciences are exaggerated and that the share has de-rated excessively.

2024 MACRO OUTLOOK

Whilst no one can foresee even the immediate future with any degree of conviction, we currently perceive the following issues to be the most pertinent:

a) US inflation under control
Inflation dropped much quicker than many expected, but may take time to drop further to the Fed's 2% target. The main issue, though, is that the current level is already at a comfortable level for businesses to operate at and inflation is not perceived as a major capital market risk anymore.

b) Soft US economic landing
Whilst the odds for a recession keep growing, we believe the most likely outcome is a soft landing. Organic growth is expected to become scarcer, but strong business franchises should be able to continue growing, which augurs well for the Growth style of investing.

c) Stable US Bond market
We believe that we are past this cycle's peak rates and that the bond market has stabilised with normalised real rates. With a softer economic outlook, and initial views that the largest portion of the Fed's balance sheet shrinking is done (as a ratio of GDP, it has already dropped by a fifth), the debate is now firmly on the timing and magnitude of Fed rate cuts. Odds are growing for a constructive bond market, which can also be supportive of equities.

d) China economy
The continuing weakness of the world's second largest economy poses a risk to many exporters. This has already been reflected in some commodity prices.

e) Geopolitical tensions

Investors are conscious of growing regional polarisations and sanction threats. We are particularly alert to the Fund's risks in **Cadence Design Systems** and **ASML**, but are encouraged by the structural growth opportunities that AI offers them.

f) National Elections

2024 is a significant year for elections across the globe. At least 64 countries with half of the world's population go to the polls[7]. Of the most important ones in an investment context are US, India, Taiwan, the European Union, UK, Russia, Indonesia, Pakistan, and South Africa. The Taiwan election outcome, in particular, can fundamentally shape Beijing's approach to the island that it has repeatedly threatened to invade. Whilst we do not pre-empt any election outcome in our positioning of the Fund, we will remain conscious of any potential structural implications on our businesses where new information presents itself.

g) Regulatory backdrop

Investors should prepare for regulatory screws to be further tightened. Technology giants are more exposed to these risks, e.g. **Alphabet, Meta, Amazon and Apple.** **Adobe** recently had to abandon its purchase of Figma (Microsoft, with hindsight, was fortunate to get their acquisition of Activision approved). In terms of potential breakup scenarios, we calculate the sum of the parts valuations for **Alphabet** and **Amazon** to be about a quarter higher than their respective share prices. In China, their regulator continues to clamp down unexpectedly on the gaming industry with negative implications for investor sentiment.

2024 PORTFOLIO IMPLICATIONS

Along with the above potential macro issues, we believe that the following will have an impact on the businesses held in our Fund:

a) Fourth Industrial Revolution (4IR) & AI

We remain well invested for the 4IR & AI revolution, whilst keeping a very close eye on risk. We have purposely avoided the most cyclical, most competitive and the unprofitable parts of the ecosystem. Our key holdings include **Microsoft, Alphabet, Cadence, Accenture, Amazon, ASML, and Adobe.** Cadence and ASML are among the most critical enablers of AI. Microsoft, Alphabet and Amazon are all in process of democratising AI and capitalising on the demand for cloud services. We expect Accenture to capitalise on increased demand for overall technology and now specifically AI related consulting, whilst Adobe should start to see a tangible impact from the monetisation of new AI-enhanced software products.

b) GLP-1 anti-obesity drug

Whilst the positive health effects are to be applauded, we believe that some of the negative reactions from the Health Care and Staples stocks are overdone, and that this has resulted in new buying opportunities. The Fund remains exposed to **Edwards Lifesciences, Stryker, Thermo Fisher, UnitedHealth, Becton Dickinson**.

c) Interest income

Whilst we believe that interest rate levels will moderate over time, the fact remains that interest rates will remain higher for some time than those a year ago. Our businesses with very strong balance sheets that can benefit directly include **Alphabet, Accenture, Keyence, Adobe and Edwards Lifesciences.**

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[7]Source: Time, December 2023

d) Debt Refinancing
Although most businesses have fixed their debt during the ultra-low rate period, huge amounts of debt are maturing this year and require refinancing. This can benefit debt rating agencies, like **S&P Global.**

10TH ANNIVERSARY

The test
The Fund had its 10th anniversary in August. This is an important milestone to judge its philosophy and investment strategy, and to consider its merits for a long-term equity exposure, bearing in mind that the fund is still managed by the founding team. The key data points are as follows[8]:

- Ten year total Fund net return : 151.2% / 209.5% (US$ / UK£ terms)
- Comparative ten year MSCI AC net return : 121.9% / 173.8% (US$ / UK£ terms)
- Ten year compounded Fund net return : 9.6% p.a. / 11.9% p.a. (US$ / UK£ terms)
- Ten year compounded MSCI AC net return : 8.3% p.a. / 10.6% p.a. (US$ / UK£ terms)
- Total Fund AUM : $2,310m / £1,823m
- Total strategy AUM : $4.4 billion / £3.5 billion
- Total number of investors : over 1,500

Exposures[9]
Whilst our investment strategy stayed constant over the decade, the Fund exposures have changed to quite an extent:

Country / Region of Listing

Country / Region	2013[10]	2023
US	56.0%	74.3%
Continental Europe	26.0%	18.3%
UK	11.6%	0.0%

Sector Exposures

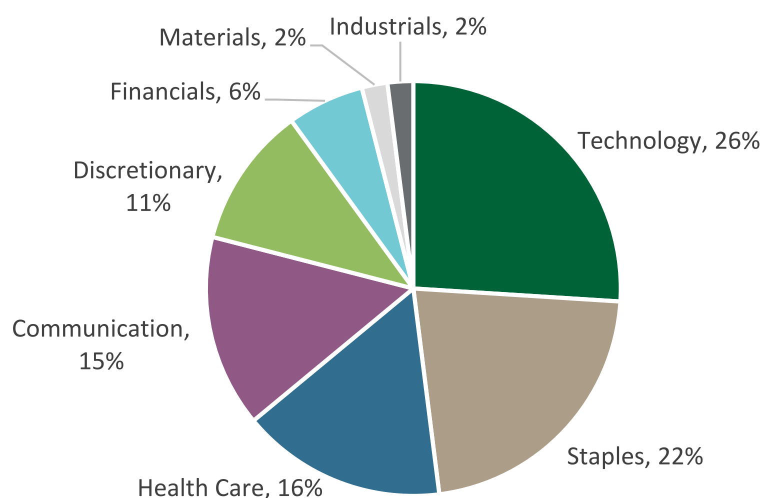
Sector	2013[11]	2023
Staples	31.7%	10.1%
Technology	17.8%	25.9%
Health Care	9.3%	22.1%

In essence, we have disinvested from the UK and lowered our European-listed exposures in favour of US-listed names over the decade. In terms of sector exposures, we started off with Staples as the dominant sector. This was largely reduced in favour of Technology and Health Care (with some Technology names having been reclassified and not included as pure Technology any more).

Attribution
Whilst we are a pure bottom-up manager, it is worth considering the proportional sector contributions to overall returns, which are summarised on the next page:

[8] Source: Link Fund Administrators (Ireland) Limited, Northern Trust International Fund Administration Services (Ireland) Limited, Stonehage Fleming Investment Management Limited and Bloomberg, August 2023
[9] Source: Link Fund Administrators (Ireland) Limited, Northern Trust International Fund Administration Services (Ireland) Limited and Stonehage Fleming Investment Management Limited
[10] December 2013
[11] December 2013

Proportional Sector Contributions to Overall Performance (2013 – 2023)



The shift in exposures over time has made a positive impact. We perceive the overall spread of returns as a positive outcome.

Importantly, 91% of the outperformance has been created through stock selection[12].

<u>Reminders</u>
Investing is a continuous learning process. We summarise below a few of the lessons we have been reminded of over the past decade:

a) Investing in global operators works better than moving money regionally. Many investors mistakenly tactically sold US shares on the basis that the region appeared more expensive than others and then got caught in regional complications and currency volatilities. They can rather own quality exposure in a region through a global operator.
b) High gearing seldom works for long, despite low interest rates. Walt Disney is a good example of its debt structurally holding it back despite the low interest rates.
c) Humankind rarely change their habits permanently – many thought that Zoom would structurally replace the office and travelling. Many airline and hotel stocks are currently trading close to new highs.
d) Do not underestimate the leader in its field. An excellent buying opportunity arose last year when many investors dumped Alphabet shares given the fear that Bing will structurally unsettle Google.
e) The market often overreacts on bad news. The success of the GLP-1 anti-obesity drug resulted in some of the largest ever market value losses in Staples and Health Care stocks. Only some of those losses have structural merit.
f) You stack the odds in you favour if you focus on holding only the best quality businesses, and you can rest assured that their stocks will recover much quicker following a macro-driven setback.

[12] Source: FactSet, August 2023

Strong Franchises
The Fund's portfolio currently has the following overall characteristics[13]:

- Operating margin: 30.1%
- ROIC[14]: 20.6%
- Net Debt / EBITDA[15]: 0.6
- 3-year expected earnings growth: +13.5% p.a.

These are characteristics of high quality companies. All of these companies have further improved over the past year.

RESPONSIBLE STEWARDSHIP & ENGAGEMENT

We continue to elevate and enhance our engagement with our companies, with the joint objective of delivering long-term sustainable growth and of owning what we believe to be the highest quality companies that are also responsible stewards of our capital. Our work is validated by Stonehage Fleming's ongoing status as signatories of both the UK Stewardship Code and the UN Principles of Responsible Investment. On ESG specifically, the Fund continues to merit its 5-Globe designation from Morningstar.

In 2023 we actively voted in 27 shareholder meetings and we engaged with all companies in the Fund on a broad range of both investment- and ESG-related topics (we will shortly publish our detailed Annual Report on this activity on the Fund's website).

We engaged with all our companies on the UN's Global Compact Principles 1 & 2 on human rights. We also engaged with some on their environmental impact and the investments they are making to meet their long-term targets, others on their regulatory risks, others on their strategic initiatives and others on their AI-related risks, diversity & inclusion.

In our voting activity we always prioritise efforts to improve corporate governance. This year we continued to vote in favour of independent Board and Committee Chairs and we objected to elections of Directors with excessive Board tenure if classified as "independent". In a similar vein, in 2023, we regularly cast a dissenting vote against the reappointment of auditors with especially long tenures (for example, EY has been the auditor of McDonald's for 59 years). Under a new initiative we were asked, for US companies, to vote on the frequency on which we should get a non-binding vote on Director remuneration. In all cases we voted to keep it an annual vote.

With increasing levels of ESG related legislation coming into force, 2024 will see us increasing the level of disclosures we make, in particular on the important topic of climate change. Investors will be able to find this information, and more, on our website (www.stonehagefleming.com/gbi/esg).

IN SUMMARY

2023 was a strong recovery year for the Fund. Its philosophy and strategy has created excess value since inception, with solid compounding returns.

[13] Source: Bloomberg, December 2023
[14] ROIC= Return on Invested Capital
[15] EBITDA = Earnings Before Interest, Tax, Depreciation & Amortisation

Overall macroeconomic and capital market conditions have largely stabilised following the hugely disrupted global landscape caused by the Pandemic and then the Fed's most aggressive tightening programme ever. The Fed deserves credit for normalising the economic backdrop of the world's largest capital market, earlier than many expected, and despite continued economic uncertainties – as will always be the case.

Last year we were more active in making adjustments to the portfolio, so that it may continue to deliver on its mandate. We are most grateful for all the support from so many investors, some for over a decade already, and we continue to invest in our business to give us the very best chance to continue delivering.

With appreciation and kind regards

Gerrit Smit
Partner – Head of Global Equity Management

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