

Please note that the commentary is for the retail class of the Fund.

Performance and fund positioning

In a welcome reversal to a torrid 2022, the past year offered healthy returns for most asset classes, with global equities leading the charge. A very strong fourth quarter rounded off an excellent year for equities, with the MSCI All Country World Index gaining 11% over the three-month period and returning 22% for the full year. The Bloomberg Barclays Global Aggregate Bond Index also rallied, returning 6% for the year. Against this favourable backdrop, the Fund returned 8.8% for the quarter (1.0% behind the benchmark) and 14.2% for the year (1.3% behind the benchmark).

Although the Fund's equity holdings kept pace with global markets, its relatively conservative fixed income positioning, with a duration meaningfully shorter than that of the index, resulted in underperformance against the benchmark as a sharp dive in yields across the board drove the bond index up over 8% in the fourth quarter.

Looking at these headline returns suggests that 2023 was an easy year to navigate, but this could not be further from the truth. The year started amidst significant concern regarding the level and trajectory of global inflation and interest rates ("higher for longer"), with many market participants referring to the start of a new equity regime and calling for a complete shift away from so-called growth stocks into traditional value sectors trading on low multiples (but at the expense of lower or no growth, or earnings cyclicality). But the complete opposite happened, with market returns driven by large-cap US technology and software growth stocks, as evidenced by the Nasdaq Composite's 45% advance. US market returns also narrowed significantly with outsized gains from the Magnificent Seven (consisting of Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta and Tesla), which returned (simple) average gains of over 100% for the year!

A mix of factors drove this outcome. Inflation started to moderate and then subside around the globe, with key policy rates in many markets now expected to decrease after what has been an extremely sharp tightening cycle. This led to a Goldilocks-type scenario, especially in the US, with growth holding up better than expected ("soft landing") alongside declining inflation, a dovish pivot from the US Federal Reserve Board and meaningful declines in market interest rates. Calendar year 2023 also saw Generative AI burst into the spotlight with the launch of ChatGPT, which created a lot of hype (40% of S&P 500 Index companies mentioning AI in their second-quarter earnings call) and contributed strongly to returns for the Magnificent Seven and many other software names.

At quarter-end, the portfolio was positioned as follows:

- 61% effective equity
- 7% in real assets (listed infrastructure and property)
- 8% in high yield fixed income
- 7% in inflation-linked assets (primarily US Treasury index-linked bonds)
- 8% in investment-grade fixed income instruments
- 4% in short-dated US T-bills

The remaining 5% was invested in various other assets.

The Fund's fixed income positioning is diversified by issuer, type of instrument (including both government, corporate and inflation-linked bonds) and duration, although aggregate positioning is conservative with a relatively short duration. We feel this is appropriate following the strong rally in both risk-free yields and credit spreads in the fourth quarter. Contribution from fixed income holdings was strong for the year (+9% versus 5.7% for the benchmark) though as mentioned above the return of 5.4% in Q4-23 lagged the benchmark's 8.1%.

We added to both property and infrastructure holdings over the year (with exposure increasing from c.3% at the start of the year to 7% by the end) and were pleased with >20% contributions from each of these asset classes in aggregate.

In terms of equities, Spotify was a top contributor to fund returns in 2023, with the stock gaining 142% over the year. Spotify is the world's leading audio platform, offering users access to music, podcasts and now audiobooks. Spotify has long been able to generate impressive revenue growth of over 20% per annum driven by subscriber gains. Still, its earnings profile has been lacklustre, with the company moving back into a loss-making position in 2023. While we believe this investment will result in strong future returns – with the company solidifying its place as the leading music platform and dethroning Apple as the leader in podcasting – this lack of operating leverage has been a source of concern for the market.

It was thus very pleasing to see a strong focus on profitability from Spotify and its founder, Daniel Ek, over the course of the year, culminating in a workforce reduction plan in which over 20% of its global staff base will be made redundant. Ek emphasised the need to be more efficient and again reiterated Spotify's medium-term target of an operating margin north of 10%, with the company on its way to sustained profitability after years of investment. The market rightly took this very positively, with Spotify falling into a small group of companies able to show accelerating revenue growth whilst taking out costs. We continue to believe that Spotify offers a multi-year growth opportunity, driven by significant pricing power, strong subscriber growth and new vertical launches, coupled with rapid margin expansion off an artificially low base towards its 10% plus medium-term targets. As such, we remain happy holders although we have reduced our position size following the strong share price move.

Both DoorDash and Uber were strong contributors to returns last year, with the shares up 102% and 147%, respectively. We discussed both companies in our Q3-23 commentary, having built positions in both at very attractive levels after a bruising 2022 sell-off in which longer-duration names were indiscriminately sold off. DoorDash is the leading on-demand delivery platform in the US with a portfolio of fast-growing international markets, while Uber comprises both its ride-hailing division, in which it is the clear global market leader, as well as its earlier stage on-demand delivery business. As discussed last quarter, both businesses continue to perform strongly on the back of superb execution with sustained revenue growth alongside impressive margin gains. Both generate positive and growing free cash flow and boast fortress balance sheets. We continue to hold both names but have reduced position sizing after an extremely strong year in which both stocks moved closer to our estimate of fair value. We continue to see a favourable growth outlook and significant potential for ongoing margin improvements due to internal cost efficiencies, new revenue streams (including advertising) and more rational end markets.

Expedia (+73%) is an online travel agency (OTA) with a comprehensive offering, including flights, hotels, alternative accommodation, and car rentals. The structural growth characteristics of the industry are well understood; leisure travel demand is resilient and growing, and bookings continue to shift online. But Expedia has suffered from idiosyncratic issues historically, allowing its brands to compete with one another for web traffic, having multiple tech stacks leading to duplicate costs, and the lack of a clear loyalty programme. This led to revenue growth and margins below that of its larger European-focused peer, Booking.com.

Our work indicated that these issues have now been resolved, with the company de-emphasising certain smaller long-tail brands, migrating to a new uniform tech stack, and launching its One Key loyalty programme. Revenue growth has started to accelerate towards management's double-digit target, and margins have expanded to 21-22% on an adjusted EBITDA basis, well above pre-Covid levels in the high teens but still far below Booking.com's margins in the mid-thirties. We believe that Expedia has turned the corner. While this has been partly recognised by the market with the share up strongly in 2023, Expedia still trades on a very attractive free cash flow yield of 10%, with its shareholder-friendly management team applying most of this towards share repurchases.

Interactive Brokers (IB) lagged the strong fourth-quarter market rally and thus detracted slightly from returns. IB is a US-listed multinational online broker, offering its professional and non-professional clients a platform to trade various asset classes, including stocks, bonds, and derivatives. IB's moat is its highly automated, low-cost structure enabling it to offer the lowest prices while earning a highly attractive EBIT margin of around 60%. This has proved popular with clients, as evidenced by historic account growth of around 20% per year. IB generates around 40% of its revenue from interest earned on client cash, and this contributed to its underperformance, with the market questioning this earnings base in a declining interest rate environment. In our view, the market has been overly focused on this data point; we believe that IB can conservatively grow both revenue and earnings in the low double digits, which is attractive considering its starting valuation of only 14 times earnings, excellent management team and strong balance sheet.

Equity exposure has reduced over the year given a wider opportunity set across asset classes, a strong market rally and less (though still attractive) upside in the specific stocks we hold.

Outlook

Market performance in 2023 was US-led and narrow, with the Magnificent Seven reaching 30% of the S&P 500 Index market capitalisation. Geopolitical risk is pronounced. We thus expect 2024 to be another eventful year. As always, we can't predict the direction of markets or interest rates in the near term and aim to focus on what we can control, which is finding and researching good investment ideas across the capital structure. On that note, our team continues to find attractive opportunities below the index surface level in areas of the market that remain discounted. We believe it is a productive environment for investors with a long-term time horizon, and we remain excited about the portfolio that we are invested in.

Thank you for your support and interest in the Fund.

Portfolio managers

Neil Padoa

as at 31 December 2023