

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

Markets continued their advance in the second quarter of 2024 (Q2-24), rising 3% over the period and rounding off a very strong first half of the year with gains of just over 11% (as measured by the MSCI All Country World Index). Returns continue to be led by an increasingly narrow US market, with the S&P 500, Nasdaq and Magnificent 7 up 15%, 17% and 37%, respectively, year to date (YTD). Looking more closely at the US, around 60% of YTD gains have been driven by just five stocks – Apple, Nvidia, Microsoft, Amazon and Meta – with Nvidia alone accounting for almost a third of market returns at the half-year mark. In fact, in Q2-24, an equally weighted S&P 500 Index returned a negative 2.6%, marking the second-worst underperformance on record when compared to the headline index's 4% gain and the worst market breadth in well over 20 years. Against this challenging backdrop, the Fund declined 3.1% in the second quarter, with gains of 2.7% year to date (YTD).

While US markets are at or near all-time highs, things below the index level look very different, marking a difficult environment for active investors. In our recent Correspondent article "Finding value in more than just the Magnificent Seven", we wrote about this and how we are finding lesser-known opportunities. Whilst this period of underperformance is frustrating, with markets narrow and at elevated levels, we continue to believe that the opportunity to add value from differentiated stock picking remains elevated for patient investors.

Auto1 Group was the largest positive contributor, with the stock advancing 39% in the quarter. Auto1 is a leading digitally-enabled European automobile wholesaler. The company is transitioning from a growth-at-all-costs mindset to a focus on profitability. In this regard, its first quarter earnings release showed excellent progress in several key areas, most notably a strong improvement in the wholesale (B2B) business' gross profit per unit accompanied by an upgrade to management's medium-term profitability guidance for this business. This was a significant turning point for the company and in line with our expectations of profitable growth in the core wholesale business, which should be further bolstered by recently launched dealer financing products, for which our channel checks support management's enthusiasm. The more nascent retail business (B2C), which trades under the Autohero brand, is still loss making, although we are cautiously optimistic that the fortunes of this business are set to improve in the coming years. Autohero is nearing the three-year underwriting track record for its consumer lending portfolio, allowing it to secure a credit rating from one of the rating agencies. This will result in a lower cost of funding and potentially the securitisation of this lending book, allowing the company to grow this product beyond its initial test markets. Whilst there are some nuances between the US and European auto lending markets, the progress of Carvana in the US demonstrates the potential for consumer lending to drive significantly increased profitability for online platforms like Autohero. This provides attractive optionality to the investment case.

The Taiwan Semiconductor Manufacturing Company, or TSMC, was the second largest contributor, climbing 28% during the quarter. TSMC is the world's leading semiconductor foundry. With an over 50% share of global semiconductor production, including a market share north of 90% in the most advanced, leading-edge semiconductors, TSMC is quite simply one of the most important companies globally. As the world's leading foundry, TSMC manufactures and supplies its chips to the world's largest companies, including all of Nvidia's GPUs. The largest hyper scalers like Microsoft Azure and Amazon AWS rely on Nvidia for their AI chips, but Nvidia relies on TSMC to make them. It is thus a direct beneficiary of the rapid growth in high-performance computing and the buildout of "AI factories", supporting a very healthy mid to high teens revenue growth outlook whilst earning very attractive ROEs of around 25%. Unlike Nvidia, TSMC has not benefited from significant price hikes (yet), which provides positive optionality going forward for its all-important products. Considering the above, we do find it surprising that TSMC trades on 22x forward earnings, roughly half the rating of Nvidia, and this with far less optimism baked into its earnings outlook.

Airbus was the largest detractor in the quarter, declining by 25%. Its share price fell after a poor update from management in which 2024 delivery and earnings guidance was cut. Whilst we acknowledge this temporary setback, the future

remains incredibly bright for the company. Airbus manufactures narrowbody and widebody airframes in a duopoly with Boeing. The industry structure has been remarkably stable for decades, a testament to the almost insurmountable barriers to entry that new competitors face. Coming out of Covid, Airbus has emerged even stronger as competitor Boeing entered the downturn with a weak balance sheet (versus Airbus' net cash position) and then suffered a series of well-publicised technical and quality issues. Airbus now stands with a backlog of over 8 500 planes on order. Considering that annual production is currently 770 planes (and growing), this equates to a multi-year backlog which underpins our very healthy growth forecasts, with Airbus continuing to gain share in a growing industry. So, what contributed to the recent earnings downgrade? The company – and, in fact, the whole aerospace industry – is still suffering from post-Covid supply chain bottlenecks that have caused delays in the production ramp-up of Airbus' most popular aircraft family (and biggest EBIT contributor by far), the A320neo narrowbody. Despite these delays, we believe it's only a matter of time before deliveries and, therefore, profits and sustainable free cash flow ramp up to management's ambitious long-term targets, which see a production run-rate for the key A320 family that is almost 50% higher than that achieved today. In addition, Airbus has a fortress balance sheet with a €10bn net cash position, and we expect returns to shareholders to continue to increase.

Considering its size and continued strong share price performance, Nvidia's absence in the fund was a large detractor from performance. Nvidia advanced 37% in the quarter, detracting a disappointing 1.1% from relative performance. Nvidia, the key supplier of the microchips powering the AI revolution, saw its market capitalisation rise from \$420bn before the public debut of ChatGPT at the end of 2022 to a staggering \$3 trillion-plus during the quarter. In fact, Nvidia's market capitalisation hit \$3 trillion less than four months after crossing the \$2 trillion mark – a truly unprecedented and remarkable move. Despite its dominant position in a rapidly growing market, we do not think the shares are a compelling investment at current levels. While there is little doubt that generative AI marks a paradigm shift, much uncertainty remains regarding the final business models and technology choices over time. As AI workloads shift from training (building the models) to inference (using the models), we see a greater role for chips optimised for specific applications, in-house designs from hyper scalers (such as Amazon or Google) and edge devices (such as AI-optimised PCs and smartphones). Nvidia sells its product to the richest companies in the world including Amazon, Meta and Alphabet, and these businesses do not want to continue to be totally reliant on Nvidia for these key products. Given the sheer size of the numbers involved (Nvidia's projected data center revenue this year is \$105 billion, roughly the size of the entire server market before the AI frenzy, while group margins are in the mid-60% range, well above its mid-30s historic range) we fear there is a real risk that Nvidia's growth and earnings – while objectively still high – will fall short of the lofty expectations embedded in the current valuation.

The first six months of the year have been a difficult time to be an active investor, and even more so for contrarian ideas. US markets have advanced in the face of building macroeconomic and geopolitical risks; in fact, the S&P 500 has now gone almost a full year without a one-day drop larger than 2%. Whilst this complacency points to a worrying setup at the index level, we continue to find many compelling bottom-up stock ideas, often in lesser-known names. We thus remain very optimistic about the outlook for our portfolio of companies, even though the same cannot be said for markets in general.

**Portfolio managers****Neil Padoa**

as at 30 June 2024