

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

Performance

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. 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. In contrast, the global bond market declined by 1% over the quarter, bringing its YTD decline to -3%. The Fund declined 1.5% for the quarter, underperforming the benchmark.

While our fixed income holdings again outperformed over the quarter, delivering a positive return compared to the index's decline, our equity holdings lagged the market.

Fund positioning

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.

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.

Outside of equities, we have slowly increased the Fund's exposure to residential real estate, which now sits at nearly 3%, including holdings in the US, Germany and Australia. US Apartment REITs surged in a 2021 post-COVID rally, only to slump from 2022 onwards as demand slowed, occupancies decreased, and inflation pressured cost bases. In addition, certain markets suffered excess supply from a mini-construction boom. Higher interest rates, of course, increased borrowing costs (on variable notes and new issuance of debt). The outlook is, however, more favourable in certain supply constrained sub-markets. Single-family home costs are expected to remain high, and for many, renting is now more affordable than owning a home. In addition, both wage growth and employment have been strong. We added two REITs this year, acquired at approximately 4.5% starting dividend yields with earnings streams that we expect to grow 5-6% per year, which should deliver shareholder returns of c.10% before any closing of the NAV discount.

In fixed income, we continue to favour the short end of the curve and have kept the Fund's duration low. Credit spreads have reduced, and high yield bonds have rallied, leading us to have relatively low credit exposure, and to reduce high-yield exposure (two instruments were sold, and one matured). Finally, we added c.2% to inflation-linked bond exposure at real yields over 2%.

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

- 61% effective equity
- 7% in real assets (listed infrastructure and property)
- 5% in high yield fixed income
- 8% in inflation-linked assets
- 17% in investment-grade fixed income instruments

The remaining 2% was invested in various other assets.

Outlook

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.

Thank you for your support and interest in the Fund.

Portfolio manager

Neil Padoa

as at 30 June 2024