# QUARTERLY INVESTMENT REVIEW

## Quality Trust

### Performance returns (AUD)

| ANNUALIZED RETURNS (QUARTER-END) | Quarter-End | YTD | 1-Year | 3-Year | 5-Year | 10-Year | Since Inception |
|---|---|---|---|---|---|---|---|
| Quality Trust (net) | 15.89 | 15.89 | 35.65 | 18.77 | – | – | 20.50 |
| Quality Trust (gross) | 16.05 | 16.05 | 36.45 | 19.48 | – | – | 21.22 |
| MSCI World | 13.85 | 13.85 | 28.40 | 14.34 | – | – | 16.25 |
| Value Add | +2.04 | +2.04 | +7.25 | +4.42 | – | – | +4.25 |

### Major Performance Drivers

The GMO Quality portfolio had a positive return for the quarter and outperformed the S&P 500 and MSCI World indices.

There was a wide gap between winners and losers in equity markets this quarter. This was evident across sectors, with a 15% return differential between the strongest, Communications, and the weakest, Real Estate. From a geographical perspective, the U.S. outperformed the weakest major market, Hong Kong, by 20 percentage points. And, almost unimaginably, there was a 44% performance gap between the subgroups of the GICS Technology sector, with Semi-conductors in vogue while Tech Hardware decidedly was not.

The last few years have proved to be challenging for active managers with market capitalization increasingly concentrated in a few large cap tech companies – initially the FANGS, then the FAANGs, the FAANGMs, and for now The Magnificent 7[1]. Our GMO colleagues Ben Inker and John Pease explained the challenge of maintaining portfolio active share in a concentrated market in their February quarterly[2]. We believe that our benchmark agnosticism is helpful in these markets. For many years now we have had about a fifth of our portfolio in the biggest tech names but at no point have we obsessed about the aggregate or benchmark weights in these names. Instead, we focus on individual stock weights and overall portfolio diversification. Our sizing approach is straightforward; we are guided by a sliding scale related to valuation, quality, and liquidity. The actual weight combines the sliding scale and some practical judgment. At times that has had the strategy overweight the very largest companies, even relative to their weight in the S&P 500, and at other times underweight. We believe that if we can get the quality right for the portfolio, without overpaying, returns will take care of themselves.

This quarter was 2023 redux in markets; the true driving force was artificial Intelligence and particularly Nvidia, and not the work of an acronym[3]. Nvidia's stock rose 82% but there were other ways to gain exposure, even if you don't fancy your chances with Nvidia; Super Micro was up 255%! More materially to your portfolio, there was broad strength in the AI supply chain, with holdings TSMC, KLA, and Lam Research all performing well. At the same time, certain customers of Nvidia's were going great guns too. Meta has worked hard in recent years to press home its scale advantage in AI-targeted advertising, while Oracle is seeing explosive growth in the use of its cloud infrastructure to run AI workloads. All of these companies share drivers with Nvidia and Super Micro, but not their high multiples. For Nvidia, while the company's competitive advantage is manifest at this point, we believe that the stock price requires sustained 30% earnings growth rates, leaving little room for anything other than perfect execution. Nvidia may achieve that of course (earnings per share grew at 26% p.a. for the decade to 2023), but we are uncomfortable underwriting it at this point. Not owning Nvidia stock was an opportunity cost in terms of potential returns but one that was largely mitigated by other, more attractively priced AI beneficiaries.

Despite not owning Nvidia or Super Micro, the Quality Strategy did own 3 of the top 10 performers this quarter; Meta, GE, and Eli Lilly. Each could be categorized as winning for different reasons. Eli Lilly continues to reap the benefits of its innovation around GLP-1 treatments for obesity, i.e., for self-generated, organic reasons. Meta is perhaps coming to the end of its purdah after being perceived as profligate with investment, possibly unfairly, in 2022. As if to underline CEO Zuckerberg's seriousness about capital allocation, Meta appointed Hock Tan, CEO of Broadcom and so far an outstanding capital allocator, to its board in the quarter – a positive sign in our view. GE largely completed its long-term transformation from industrial conglomerate to jet engine specialist by spinning out its Vernova power business. We believe that the jet engine joint venture between GE and Safran (also held, also contributing strongly to returns this quarter) is likely to propel earnings for years to come.

Inception Date: 23-Sep-20

Performance for the year of inception is less than a full calendar year. Returns shown for periods less than one year are not annualized.

**Risks:** Risks associated with investing in the Fund may include Market Risk - Equities, Management and Operational Risk, Focused Investment Risk, Non-U.S. Investment Risk, and Currency Risk. For a more complete discussion of these risks and others, please consult the Trusts Product Disclosure Statement.Returns shown for periods greater than one year are on an annualized basis. To obtain performance information to the most recent month-end, visit www.gmo.com.

Performance data quoted represents past performance and is not predictive of future performance.Net returns are presented after the deduction of management fees and incentive fees if applicable. These returns include transaction costs, commissions and withholding taxes on foreign income and capital gains and include the reinvestment of dividends and other income, as applicable.

The inception date of the fund is 23 September 2020. The inception date of the performance data above is 24 September 2020, the first full day that the GMO Quality Trust was fully invested. Performance data using an inception date of 23 September 2020 would produce a different outcome and compare fund performance over a period different to that reflected in the benchmark performance. The GMO QualityTrust ARSN 643 940 872 ("the Trust") is issued by GMO Australia Limited ABN 30 071 502 639, AFS Licence No. 236 656.

### *Major Performance Drivers Cont.*

On the debit side, given buoyant markets, the strategy saw relative weakness in the more defensive parts of the portfolio. Consumer Staples and Health Care names were found toward the bottom of the performance table. UnitedHealth's stock, for example, was buffeted by a cyber-attack in March followed by the announcement of weaker Medicare rates than expected. Nestle's results disappointed, with growth coming from pricing rather than volume. Despite signs of organic improvement late last year, Nestle's shares trade at their lowest relative multiple for many years.

We took the opportunity to add to Apple on weakness in the quarter – we believe that the strength of the company's installed base continues to provide a competitive advantage despite challenges in China and continued scrutiny from regulators. More generally, we continued to trade from growthier names into the core quality and quality value part of your portfolio. In this spirit we participated in the placing of shares in consumer health business Haleon by one of its former owners, Pfizer. Should the cross-sectional volatility evident in this quarter's markets prove a harbinger of trouble, your portfolio's lower beta – around 0.9 for the quarter – may provide some reassurance.

Portfolio weights, as a percentage of equity, for the securities mentioned were: Nvidia (0.0%), Super Micro (0.0%), TSMC (3.0%), KLA (2.0%), Lam Research (3.1%), Oracle (3.0%), Meta (4.0%), GE (1.0%), Safran (3.6%), Eli Lilly (2.8%), Vernova (0.0%), UnitedHealth (4.0%), Nestle (1.5%), Apple (2.9%), Haleon (1.0%).

[1] We note that each new acronym bakes in an updated round of hindsight bias so the performance effects are perhaps overstated in terms of practical usefulness.
[2] Magnificently Concentrated by Ben Inker and John Pease, available on www.gmo.com.
[3] The Magnificent 7 have been instrumental in or are likely to benefit from advances in AI of course. They have other commonalities too. For example they are global companies with exposure to the world economy, with geo-political benefits and risks associated with their shared U.S. domicile. Because of their fortress-like competitive advantages, which have led to their dominant market positions, they have tended to attract more regulatory scrutiny than the average business. Nevertheless they don't necessarily win or fail together – this quarter both Apple and Tesla fell in rising markets.

## PRODUCT OVERVIEW

The GMO Quality Trust seeks to generate total return by investing primarily in equities the Focused Equity team believes to be of high quality.

The team believes that companies with established track records of historical profitability and strong fundamentals – high quality companies – are able to outgrow the average company over time and are therefore worth a premium price. The Trust's disciplined approach uses both quantitative and fundamental techniques to assess the relative quality and valuation of global companies and aims to exploit a long-term investment horizon while withstanding short-term volatility.