GMO

YEAR-END LETTER FOR 2023

Asset Allocation & Systematic Equity Teams: Equity Dislocation Strategy

Dear Client,

We hope that this letter finds you and your loved ones enjoying a pleasant and fruitful start to 2024.

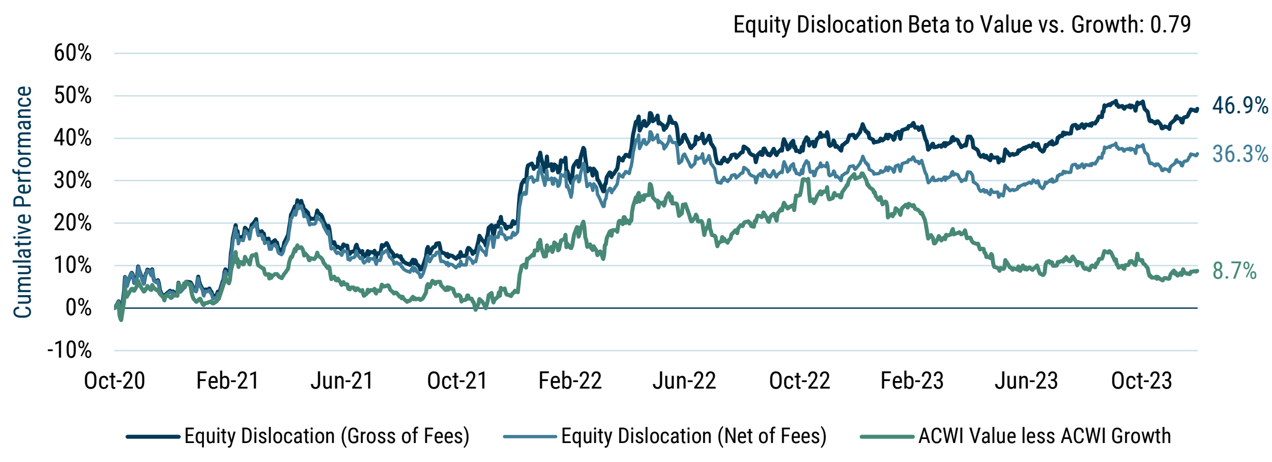
Equity Dislocation Celebrates Its Third Birthday

The Equity Dislocation Strategy, which was designed to exploit the extraordinary dislocation in the valuation of value stocks and growth stocks, turned three years old toward the end of 2023, and we can look back with some considerable satisfaction. The strategy, which is 100% long cheap value stocks and 100% short expensive growth stocks, returned an impressive 12.0% per annum gross of fees (9.7% per annum net of fees) for the three years ending December 2023. This leaves it well ahead of the MSCI ACWI Value-minus-MSCI ACWI Growth return (3.6% per annum), ahead of equities (MSCI ACWI returned 5.8% per annum), and ahead of cash (J.P. Morgan U.S. 3-Month Cash Index returned 1.8% per annum).

Of course, it has not all been plain sailing, and the resurgence of growth in 2023 could have proven to be a significant stumbling block. By the time the year had come to a close, MSCI ACWI Growth had outperformed MSCI ACWI Value by an incredible 21.4% for the year. Against the backdrop of this severe headwind, we are delighted that the strategy delivered a modest positive return in 2023.

As the dislocation between value and growth stocks remains at a top decile level compared to history, we believe that the strategy offers considerable upside potential from here, as well as diversification benefits as it is broadly uncorrelated to traditional assets. Equity Dislocation remains the biggest single position in the Asset Allocation team's flagship unconstrained Benchmark-Free Allocation Strategy.

EXHIBIT 1: EQUITY DISLOCATION STRATEGY PERFORMANCE



Data from 10/31/2020 to 12/31/2023
The above information is based on a representative account in the Strategy selected because it has the fewest restrictions and best represents the implementation of the Strategy.

A Closer Look at 2023 Performance

Stocks had an excellent 2023, with MSCI ACWI rising 22.2%, as MSCI ACWI Growth returned 33.2% while MSCI ACWI Value lagged far behind at 11.8%. While acknowledging that the strategy's 4.3% return gross of fees (2.1% net of fees) was lackluster from an absolute perspective, in the context of the performance of value and growth, it was a genuinely gratifying outcome. The drivers of the substantial performance differential versus a naïve index replication implementation of value versus growth was the successful stock selection approach coupled with effective risk control.

THE MAGNIFICENT SEVEN

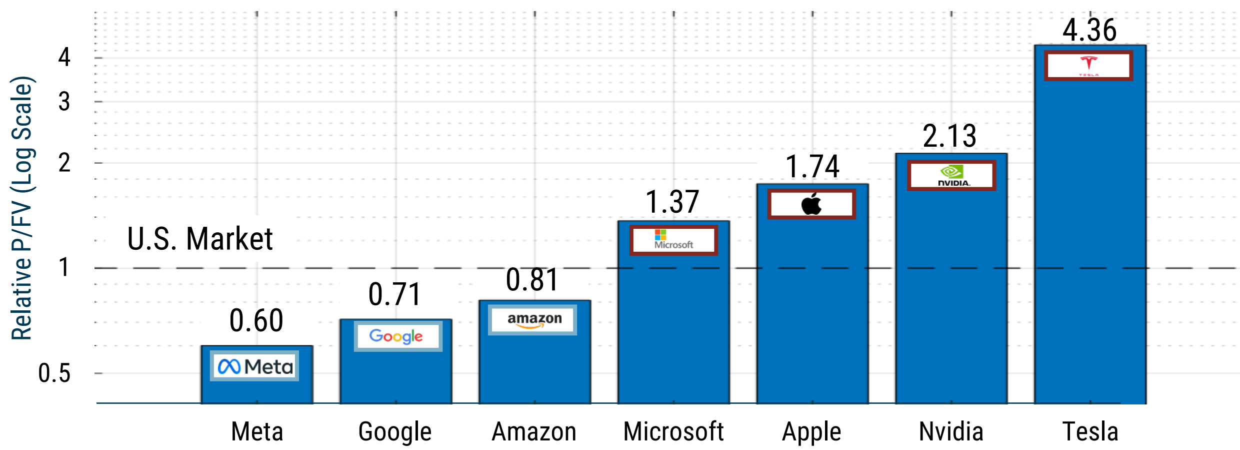
The so-called Magnificent Seven – Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla – were responsible for an incredible 56% of the total performance of the MSCI ACWI Growth Index. Through this outperformance, they grew from a weight of 24.1% of the MSCI ACWI Growth Index at the start of the year to some 33.3% at the end. Shorting these stocks at market cap weight would have cost the naïve ACWI Value-minus-ACWI Growth approach approximately 19% in performance.

Given the breadth of the opportunity set, we understand that it is not necessary to take on such significant idiosyncratic stock risk to capture performance as the spread between value and growth narrows. We have set a maximum exposure of 1% of the portfolio in any individual name, and size positions accordingly. This approach has limited, for example, the detrimental effect of being short a high-flying name like Tesla in the strategy.

The other key difference between the Equity Dislocation Strategy and a naïve implementation is in the area of stock selection. We do not consider whether a stock is badged as "value" or "growth," but rather our price/fair value (P/FV) model takes an objective view of valuation that allows for both the quality of the stock and its growth potential. Looking at the Magnificent Seven through this lens, only Tesla appeared egregiously expensive enough to feature as a short in the strategy.

EXHIBIT 2: HOW MAGNIFICENT ARE THE SEVEN?

Magnificent Seven – P/FV Relative to U.S. Market



As of 9/30/2023 | Source: GMO

In fact, three of the seven stocks have a P/FV of less than one. Indeed, Meta and Alphabet (Google) have been stalwarts of the long portfolio and Amazon is a recent addition.

ARTIFICIAL INTELLIGENCE

In the late spring, another potential challenge for traditional value models reared its head in the guise of Artificial Intelligence (AI). The excitement around the potential growth for players in this area propelled share prices hurtling skyward.

Nvidia, the world leader in AI computing, saw its share price explode from $146 at the start of the year to $378 by the end of May (a gain of 159%). Traditional value models can tend to be backward-looking and may have deemed this to be a gross overvaluation, but the P/FV model also considers company fundamentals by reference to shorter term indicators, like analyst estimates, rather than waiting for changing corporate prospects to flow through and impact accounting data. Our P/FV estimate moved from 2.1 at the start of the year to just 2.5 at the end of May, which is certainly expensive, but not so much so that our process sought to short the stock. Through quickly allowing for changing expectations, through analyst estimates and positive stock price momentum, we avoided the detrimental impact that taking a short position in Nvidia could have caused.

In fact, the Equity Dislocation Strategy has a net short position of about -5% in companies that we have identified as AI stocks, whereas ACWI Value-minus-ACWI Growth has exposure closer to -40%.

U.S. REGIONAL BANKING CRISIS

The strategy not only did an excellent job of avoiding shorting potentially damaging growth stocks, but it was also successful in its banks exposure, an area more traditionally associated with value investing.

Unsurprisingly, given the favorable valuations of banks, the strategy is net long with an average long exposure of 6.4% and an average short exposure of only -0.7%. This could have led to a performance drag as MSCI ACWI Banks returned 15.2% in 2023, underperforming broad equities by 7%.

NET PERFORMANCE OF BANKS WITHIN EQUITY DISLOCATION STRATEGY [1]

	Return %	*Weight %*	*Contribution %*
Equity Dislocation Long	29.7	6.4	1.79
Equity Dislocation Short	-3.4	-0.7	0.03

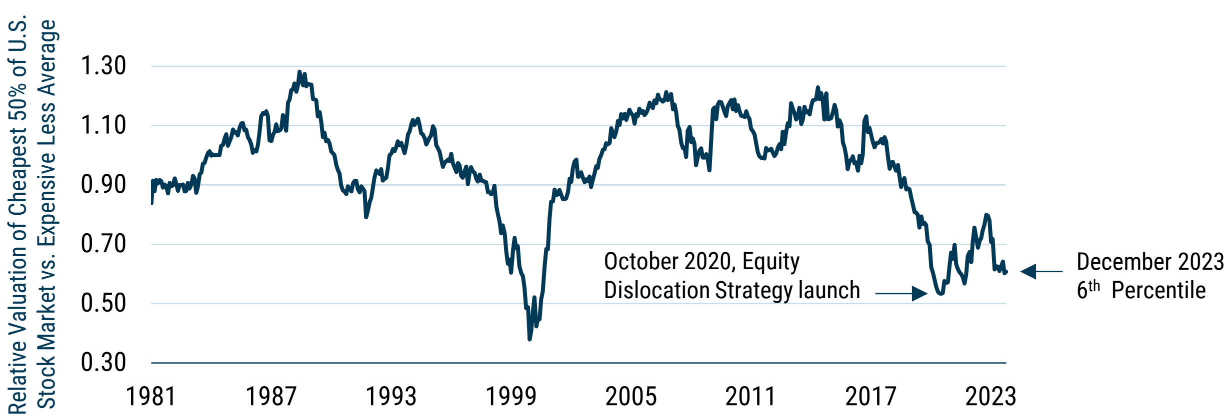
However, stock selection within banks was very strong, with the long book outperforming the short book by more than 30%. Crucially, we sidestepped the U.S. regional banking crisis as the P/FV model treated their high profitability as unsustainable and thus identified non-U.S. banks as more attractive. Indeed, the only U.S. bank held long during the year was a modest position in Citigroup.

The Remaining Opportunity

At the time of writing in early January 2024, the 20% exposure to the Equity Dislocation Strategy remains the biggest single position in the Asset Allocation team's flagship unconstrained Benchmark-Free Allocation Strategy. Quite simply, we believe that there is still a considerable amount of money to be made as the spread between value and growth closes.

We have shown the exhibit below in our last two annual letters. In 2021, the relative valuation of the cheapest 50% of the U.S. stocks over the most expensive 50% was at the 5th percentile and after a strong 2022 for value, the spread had narrowed to the 14th percentile. Growth's dominance in 2023 has reversed much of that and the spread now sits at a very attractive 7th percentile. For value to return to its median historic relative valuation, it still needs to outperform growth by another 50-60%.

EXHIBIT 3: VALUE IS STILL VERY CHEAP



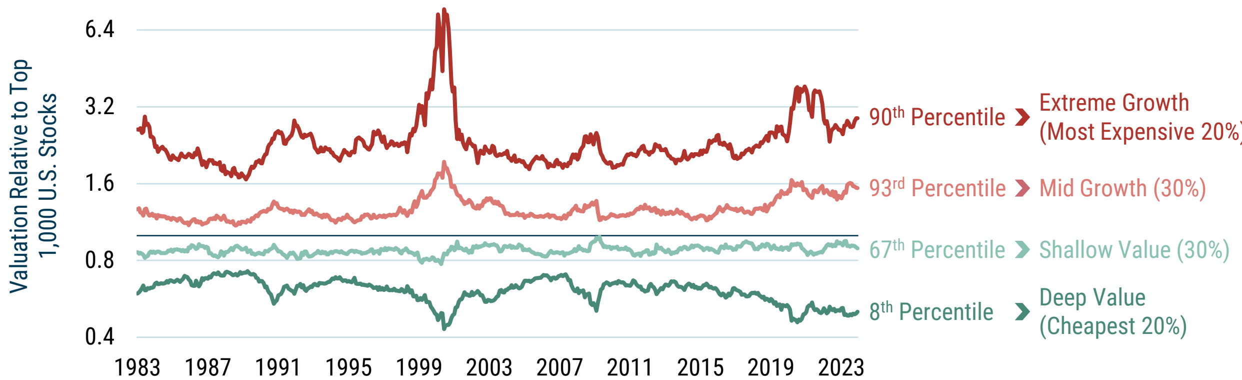
Preliminary as of 12/31/2023 | Source: GMO
Stock valuations are calculated on a blend of Price/Sales, Price/Gross Profit, Price/Book, and Price/Economic Book.

1 Net returns for individual components, such as sectors and countries, are calculated by applying the same fee rate that is used in the top level (total portfolio) net return calculation. Fees and expenses are not charged to individual investments, and net performance of individual components is provided for illustrative purposes only to meet regulatory requirements. Different calculation methodologies can result in materially different net returns for individual components. Please refer to the net performance of the (Strategy/Fund), which best represents the net performance an investor would have received if they had been invested during the periods shown.

It is further worth noting that the U.S. looks distinctly odd. In the following chart, we have split the U.S. market into quintile buckets of cheap and expensive rather than the top and bottom halves. Interestingly, much of the bottom half ("shallow value") actually looks expensive, while the very cheapest stocks still look like an incredible opportunity.

EXHIBIT 4: WITHIN THE U.S., "DEEP VALUE" SEGMENT (CHEAPEST 20%) IS TRULY DISLOCATED

Valuation Groups in Top 1,000 U.S. Stocks

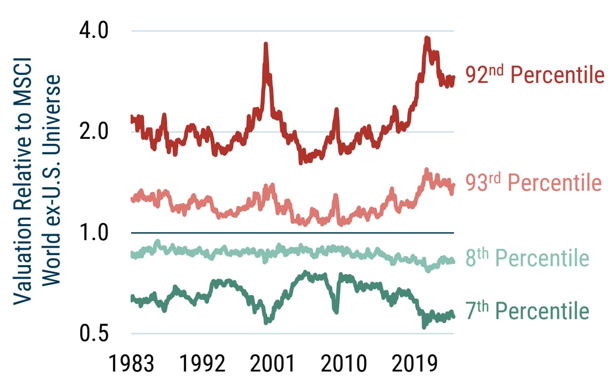


Preliminary as of 12/31/2023 | Source: GMO
Stock valuations are calculated on a blend of Price/Sales, Price/Gross Profit, Price/Book, and Price/Economic Book. Groups of value and market are weighted by square root of market cap.

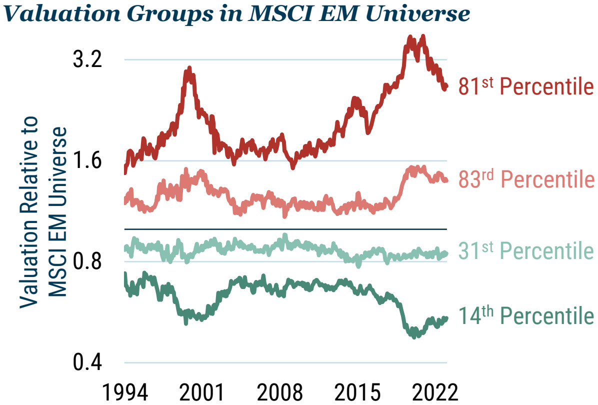
This is very encouraging for the Equity Dislocation Strategy as we tend to focus the portfolio on the more extremes of cheap and expensive. For completeness, we include below the equivalent chart for the rest of the world, where all of value looks relatively cheap.

EXHIBIT 5: DEEP VALUE IS EXTREMELY CHEAP GLOBALLY

Valuation Groups in MSCI World Ex-U.S. Universe



Valuation Groups in MSCI EM Universe



Preliminary as of 12/31/2023 | Source: GMO
Stock valuations are calculated on a blend of Price/Sales, Price/Gross Profit, Price/Book, and Price/Economic Book. Groups of value and market are weighted by square root of market cap. All groups have the same country exposure as the universe.

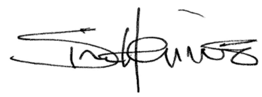
Closing Thoughts

We remain very excited about the remaining potential for the value vs. growth spread trade. Although valuations of stocks have improved markedly, we still believe that a strategy offering high expected returns without the need to be dependent on market direction deserves a place in most portfolios.

Thank you for your trust and partnership. We would be delighted to speak with you further if you have any questions. Please do not hesitate to reach out to your GMO relationship manager or a member of our Asset Allocation or Systematic Equity teams for more information.

Yours sincerely,

Ben Inker
Co-Head of Asset Allocation



Simon Harris
Head of Systematic Equity

Annualized Returns as of 12/31/2023 (Net, USD)	*Inception*	*1-Year*	*3-Year*	*5-Year*	*10-Year*	*ITD*
GMO Equity Dislocation Strategy	10/31/2020	2.09%	9.66%	N/A	N/A	10.44%
FTSE 3-Month T-Bill		5.26%	2.55%	N/A	N/A	2.13%

Final performance numbers are generally available on GMO's website five to ten business days after month end. Investors should not rely on preliminary numbers to make investment decisions.

Performance data quoted represents past performance and is not predictive of future performance.
Net returns are presented after the deduction of a model advisory fee and incentive fee 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. Fees paid by accounts within the composite may be higher or lower than the model fees used. GMO LLC claims compliance with the Global Investment Performance Standards (GIPS®). A Global Investment Performance Standards (GIPS®) Composite Report is available on GMO.com by clicking the GIPS® Composite Report link in the documents section of the strategy page. GIPS® is a registered trademark owned by CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Actual fees are disclosed in Part 2 of GMO's Form ADV and are also available in each strategy's Composite Report. The portfolio is not managed relative to a benchmark. References to an index are for informational purposes only.

Disclaimer

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