STENHAM
ASSET MANAGEMENT

2023 Investor Letter

Stenham Equity UCITS Fund

Performance Review

Fund vs. Benchmark[1]	Q4 2023	2023	Since Inception
Stenham Equity Fund (A1)	**+11.1%**	**+21.8%**	**+183.4%**
MSCI World Index	+11.1%	+21.8%	+146.8%
Relative	0.0%	0.0%	+36.6%

Portfolio Attribution

Top Contributors – 2023	Portfolio Weight	Attribution
Microsoft	5.2%	+3.3%
Constellation Software	4.8%	+2.3%
ASML	4.8%	+2.1%

Top Detractors – 2023	Portfolio Weight	Attribution
Thermo Fisher Scientific	8.3%	(0.3%)
Adyen	3.1%	(0.2%)
Adobe	0.0%	(0.2%)

Market Commentary

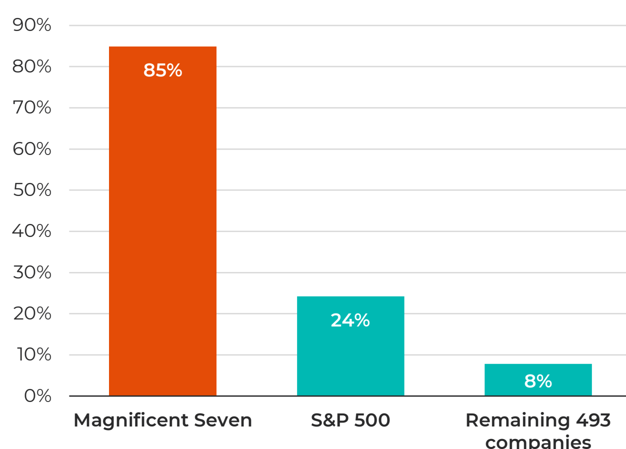
Investors entered 2023 with trepidation after 2022, which by all accounts was a year worth forgetting, as the Fed embarked on the most aggressive tightening cycle in 40 years. 2022 was the seventh worst year for the S&P 500 in nearly a century, long-term bonds had their worst performance since records began, and the long established 60/40 investment strategy had its worst year since the 1930s. An imminent recession was the consensus view heading into 2023, with many investors positioning portfolios conservatively as a result. US mutual funds sat on a record-high $240bn of cash to start the year; meanwhile, global equities logged their lowest amount of inflows in several years.

[1] *Performance as of 29 Dec 2023 is presented net of fees. Stenham Equity Fund Class A1 reactivation date 18 Nov 2020. Stenham Equity Long Only Strategy inception date 13 Apr 2012.* ***Past performance does not predict future returns.*** *Source: Stenham, Bloomberg. This is a marketing communication. Please refer to the Fund prospectus and KIID before making any final investment decisions.*

As is often the case, however, markets have a tendency to overshoot in the short term. ***"The stock market is the story of cycles and of the human behaviour that is responsible for overreactions in both directions"***.[1] Markets defied the wall of worry in 2023, overcoming concerns regarding both a recession and the tightening cycle. The narrative around a recession shifted from imminent to soft landing, and finally, to no landing at all as the consumer remained relatively resilient given the strength of the labour force. The Fed saw signs of success in the battle against inflation, giving way to them pausing interest rate hikes and markets now pricing in several cuts over 2024. This helped fuel a ~22% rally in equity markets (MSCI World) and the sharpest rise in the Nasdaq 100 Stock since 1999. As the Nasdaq performance indicates, the market was led higher by the technology sector, arguably the sector that investors were most pessimistic on heading into the year given the ~33% decline in the Nasdaq over 2022. Technology stocks were buoyed as Artificial Intelligence (AI) became the year's favourite buzzword, with the mere use of the term helping boost stock prices. While much of the euphoria around AI may go down as more hype than reality, Nvidia's FQ1 2023 print will certainly live on in earnings folklore, as the company guided to revenues more than 50% higher than the market was expecting, thanks to the demand for their semiconductors used to power AI solutions.

The other defining characteristic of the tech-led rally in equity markets over 2023 was the concentration of outperformance in a handful of the largest cap stocks known as the "Magnificent Seven" (Apple, Amazon, Alphabet, Meta, Microsoft, Nvidia and Tesla). In fact, the return for the S&P 500 would have been less than half of what it was over 2023 if we were to exclude these seven stocks from the index. To underscore their size and importance, these stocks added $4.83tn of market cap in 2023, which is larger than the current nominal GDP of every country except the US or China. Market breadth for the S&P 500 sank to its lowest level in over 20 years as the Magnificent Seven drove the overwhelming majority of performance for the index. The combination of bearish investor positioning to start the year and the concentrated market rally had ramifications for active managers during the year as the average fund in our Bloomberg peer group of over 6,000 equity funds underperformed the MSCI World, the Fund's benchmark, by close to 7%.

S&P 500 2023 performance[2]



Market breadth (Lower = Narrower)[3]

[1] *Seth Klarman, CEO & Portfolio Manager at Baupost Group and Author of "Margin of Safety".*
[2] *Data as of 29 Dec 2023. Weighted by market capitalisation. Source: Bloomberg, Stenham Asset Management.*
[3] *Data as of 15 Dec 2023. Percent below 52-week high, S&P 500 less Median stock. Source: Goldman Sachs Investment Research Division, Cormac Conners.*

Portfolio Discussion

Contributors

Microsoft was the top contributor to performance over 2023, and has delivered a ~26% IRR since our initial investment ~5 years ago. Microsoft was led higher by the outperformance of the technology sector, but also outperformed the sector given the above-mentioned tailwinds for large-cap companies and AI winners. As mentioned in our Q2 2023 investor letter, there is still a high degree of uncertainty around which companies are poised to be AI winners & losers at the application layer. However, at the infrastructure level, the "picks and shovels" companies should benefit from this secular trend regardless, and Microsoft's cloud computing (Azure) and enterprise software stack firmly positions the company in this category. Even among the Big 3 cloud players (Amazon, Microsoft & Alphabet), Microsoft's cloud business continues to be the leader in incremental market share gains. Microsoft Azure is expected to have gained over 200bps of market share in cloud revenues over 2023, accelerated by AI leadership and over 500bps over the past 4 years. The number of organisations using Microsoft Azure's OpenAI services grew from ~250 entering the year to ~18,000 by Q3 2023. Microsoft also launched their AI assistant for Office & Windows called Copilot, priced at a $30/month subscription, and announced that ~70% of Fortune 500 firms are trialling the service already. While the long-term outlook for Microsoft remains positive in our view, the significant outperformance has led to valuation expansion and, as such, a compression in our prospective IRR for the stock. Therefore, we have used the opportunity to reduce our position, but remain ready to capitalise on opportunities should valuation levels become attractive.

In addition, ASML was among the top contributors to performance for 2023 and has also delivered a ~26% IRR since the inception of our position ~6 years ago. ASML benefitted from the outperformance of semiconductors over the course of the year, buoyed by their critical importance in the secular demand for AI. Capital equipment companies like ASML, supplying chipmaking machinery, also benefitted as China drastically accelerated their efforts to develop their own domestic semiconductor manufacturing capabilities in light of growing trade tensions. While the long-term outlook for the business remains positive in our view, the sustainability of the China demand story is somewhat uncertain and combined with current valuation levels, has led us to reduce our position size, reallocating the proceeds to our other holding in the semis space, Applied Materials, which benefits from lower China exposure and a more attractive valuation.

Detractors

Thermo Fisher Scientific was the top detractor to performance over 2023 and has delivered ~5% since our initial investment in Q3 2022. The runoff in Covid-related sales was anticipated, and unfolded largely in line with our expectations during the period. Nevertheless, the sector encountered several unanticipated headwinds over the course of the year. Firstly, a significant portion of the consumables and instruments used in producing Covid vaccines and therapeutics were repurposed into other types of bioproduction, leading to a significant inventory build-up and subsequent destocking within bioprocessing. Secondly, biotech funding declined sharply in the higher-rate environment, prompting much more cautious spending from biopharma customers, particularly in China, and for life sciences instruments. However, recent developments indicate early signs of improvement, marked by incrementally positive management commentary and a pick-up in biotech funding. Though the next few quarters may see temporary headwinds persist, we expect improvements over 2024 as these headwinds subside and comparables ease. The structural growth drivers

behind Thermo Fisher remain robust, as demonstrated by the number of biologic drugs in development still at all-time highs, and 2023 being a record year for biologics FDA approvals. Overall, we maintain our conviction in the long-term investment thesis and have used the relative underperformance to add to our position.

In addition, Adyen was among the top detractors to performance and has delivered an ~11% IRR since the inception of our position ~4 years ago. We described, in our Q3 2023 investor letter, the drivers behind the sharp decline in Adyen's share price following their H1 2023 trading update. Since then, however, the shares have rallied over 80% from their lows to close out the year, recouping the majority of the stock's headwind to portfolio performance. The stock traded up ~38% alone on the day the company published their Q3 trading update, which saw Adyen's revenue growth accelerate far beyond the pessimistic consensus outlook going into the print. Furthermore, PayPal, whose aggressive competition in the payments processing space drove the underperformance in Adyen, saw their strategic priorities change with the start of their new CEO Alex Chriss in Q4. They highlighted a renewed focus on their more profitable digital wallet business and potentially higher pricing in their payments processing business, which would help reduce the competitive intensity against Adyen. Overall, we are encouraged by the rebound in the share price, and the stock was a top contributor in Q4 2023 as we maintained our position. That said, the position remains among the smaller holdings given the attractive long-term opportunity in payments for Adyen counterbalanced against the higher degree of competition relative to other names in the portfolio.

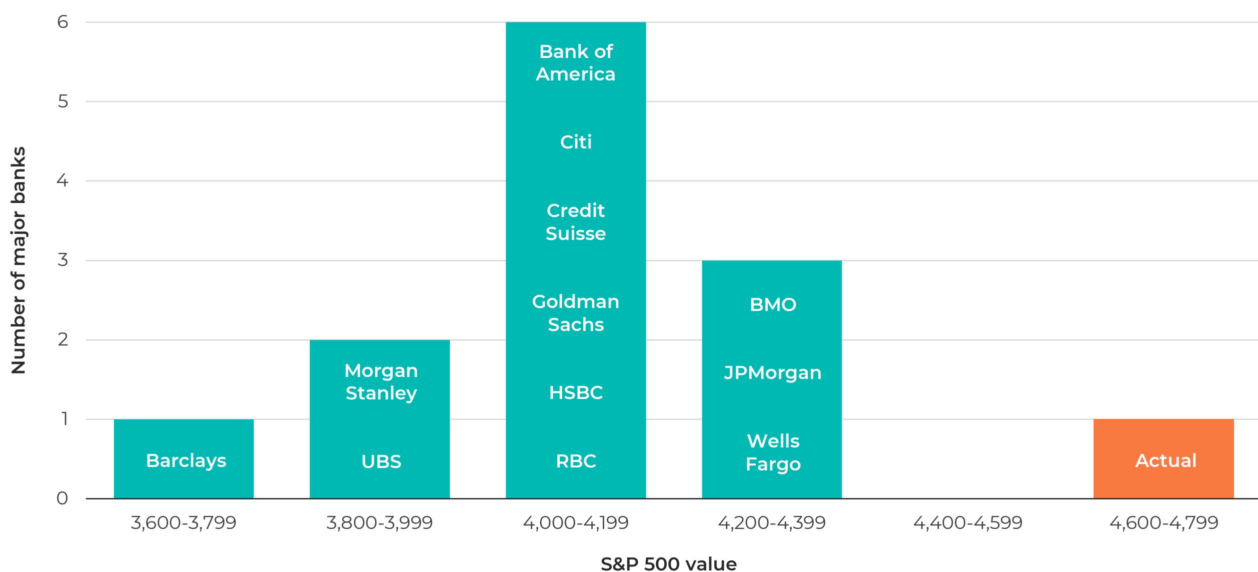
Outlook

As we look towards 2024, the debate on the direction of travel for equity markets continues. On the one hand, the Fed seems likely to begin cutting interest rates this year and the adage 'don't fight the Fed' may indeed hold true. With a record figure of over $8tn sitting in global money market assets, the outlook for inflows into equities appears positive if rates start to decline and investors shift allocations from lower yielding money market funds towards equities. Meanwhile, the private equity industry entered 2024 with record amounts of unspent investor cash ($2.59tn in cash reserves) and an unprecedented stockpile of ageing deals that firms must sell in the coming years. With huge sums of dry powder, we may see buyout activity pick up meaningfully. In addition, fiscal stimulus continues to pick up steam, with the Inflation Reduction Act, Infrastructure Investment & Jobs Act, and Chips Act among others rolling out. Finally, not forgetting what is likely to be the biggest talking point of the year for markets, the US election. 20 of the past 24 election years have seen positive returns for equity markets. While it remains to be seen whether this year conforms to the trend or not, it's reasonable to expect fiscal spending agendas, tax cuts and other economic reforms being pushed in a bid to win the election.

On the other hand, geopolitical tensions remain elevated across several parts of the world. US-China relations will undoubtedly be tested with the upcoming election and a potential Trump presidency could see this strained even further. Meanwhile the US elections will be accompanied by 63 other elections, covering over 50% of the global population. Moreover, while the Fed may cut rates in 2024, at the time of writing, the market is already pricing in six cuts over the course of the year, and so positive sentiment on monetary easing may be overextended if the Fed underdelivers. Finally, equity market valuations, most notably in the tech sector, expanded significantly over 2023. Though they remain below the peak valuations we saw in 2020, they are still firmly above average historical levels.

However, if the unfolding of market performance over 2020/21, followed by 2022 and now 2023 have taught us anything, it is that the ability to forecast the direction of travel for markets over the short term, i.e. the upcoming year, is often a futile exercise. The aforementioned points on the outlook for equities are important to consider, but trying to use them to time the market is often where missteps are made. Data over the past 30 years for the S&P 500 shows that remaining fully invested over this period would have delivered returns of ~1,170%; but missing the best 30 days in that period would have seen those returns shrink to just 159%, a fraction of the fully invested amount. ***Time in*** the market is more important than ***timing*** the market. Volatility is a recurring feature in short-term performance and 2024 will most likely be no different in that regard. While remaining invested is incredibly important, using such periods as opportunities can be even more rewarding for investors with a long-term horizon. Our investment philosophy remains fixed on the long term and we will look to add what we deem to be extraordinary businesses to our portfolio, should short-term market uncertainty provide attractive valuations.

S&P 500 2023 predictions[1]



As always, we appreciate your continued support and investment. Should you have any questions, please do not hesitate to reach out.

Kind regards,

Kevin Arenson, Chief Investment Officer & Co-Portfolio Manager
Giulio Battaglia, Chief Executive Officer
Mihir Kara, Co-Portfolio Manager
Thibault Decré, Equity Analyst

[1] *Data as of 29 Dec 2023. Source: Bloomberg, Stenham Asset Management.*

DISCLAIMER

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