STENHAM
ASSET MANAGEMENT

Q1 2023 Investor Letter

Stenham Equity UCITS Fund

Performance Review

Fund vs. Benchmark[1]	Q1 2023	YTD 2023	Since Inception
Stenham Equity Fund (A1 Class)	**+10.0%**	**+11.1%**	**+158.4%**
MSCI World Index	+7.3%	+8.6%	+120.0%
Relative	+2.7%	+2.5%	+38.4%

Portfolio Attribution

Top Contributors – Q1 2023	Portfolio Weight	Attribution
ASML	4.2%	+1.6%
Microsoft	7.2%	+1.3%
LVMH	4.8%	+1.2%

Detractors – Q1 2023	Portfolio Weight	Attribution
Danaher	4.5%	(0.2%)
Adobe	0.0%	(0.2%)

Market Commentary

2023 began stronger than many had expected from an equity market perspective. The MSCI World returned 7.3% during Q1 and the Nasdaq Composite posted its second strongest quarter in over 10 years, recovering sharply from the decline over 2022. Reading this, one might be forgiven for thinking that the backdrop for markets was buoyant during the quarter, but Q1 also saw the collapse of Silicon Valley Bank, the second largest bank failure in US history and the largest since the Global Financial Crisis. The regional bank index, KBW Regional Banking, declined 18.6%, one of its worst quarters of relative performance against the S&P 500. Finally, we saw turmoil at Credit Suisse, which was ultimately rescued in a government-brokered deal with UBS. However, as financial conditions declined, so too did expectations for further interest rate tightening by central banks, resulting in growth segments of the market, such as technology and communications sectors,

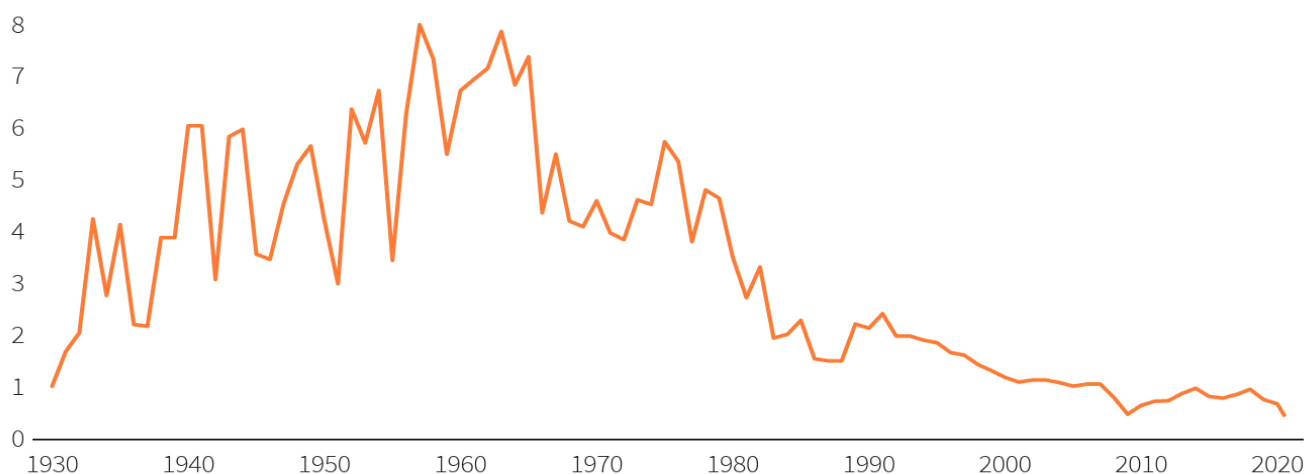
[1] *Performance as of 14 Apr 2023 is presented net of fees. Stenham Equity Fund Class A1 reactivation date 18 Nov 2020. Stenham Equity Long Only Strategy inception date 13 Apr 2012.* ***Past performance does not predict future returns.*** *Source: Stenham, Bloomberg. This is a marketing communication. Please refer to the prospectus of the UCITS and the KIID before making any final investment decisions.*

meaningfully outperforming value segments, such as energy and financials. This was a mirror image of what we saw play out over 2022 and investors were seemingly caught off guard by this sharp rotation, as the average fund in our Bloomberg peer index (~5,000 funds) underperformed the MSCI World during the first quarter. Data from Goldman Sachs showed an aggressive rotation by investors into sectors that outperformed over the course of 2022, as the spread between sector exposure to cyclicals such as energy, financials & materials (overweights) versus the technology sector (underweight) reached its widest level in over 10 years. It remains to be seen what interest rate environment we will find ourselves in and the subsequent impact to equity markets from a sector leadership standpoint. However, as the stark contrast of last year and the start of this year has shown, predicting and positioning for this is a difficult exercise. We have long said that while we endeavour to remain aware of the macroeconomic environment, we do not actively position the Fund in this regard. In our view, the quality and longevity of the businesses we own will ultimately prove to be the key drivers of long-term outperformance.

Portfolio Discussion

It should come as no surprise that market participants have become more short-term orientated in their investment horizons over time. As shown below, the average holding period for stocks has declined significantly, from a peak of almost 8 years in the 1950s/60s, down to just 5.5 months by 2020. Much of this can be attributed to the composition of the participants in the stock market, as quantitative/systematic trading strategies that turn over their portfolios daily have grown significantly and the rise of passive investing has only exacerbated non-fundamental trading flows as well. However, in our view, an overlooked contributor to this rise in short-termism among investors is the era of rapid change and disruption that we find ourselves in today. It can be difficult to underwrite the long-term outlook for a business when the world as we know it is changing more rapidly than ever due to the growing influence of technology. In fact, it was reported that 90% of the world's data was created in the last 2 years alone[1], a staggering statistic reflecting the pace of technological development increasing at an exponential rate.

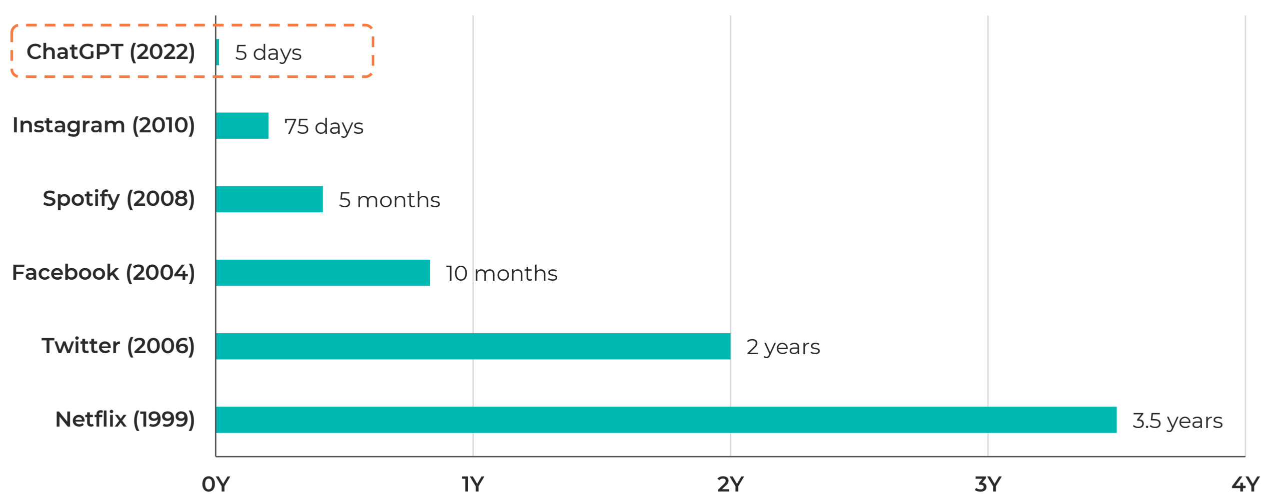
Holding period of stocks in years[2]



[1] *Source: IBM as of 27 Jan 2023.*
[2] *Holding period measured by value of stocks divided by turnover. Source: Reuters, NYSE, Refinitiv.*

A great example of this is the recent rise of Artificial Intelligence (AI). While the origins of AI date all the way back to 1956, it was not until the advent of ChatGPT that AI suddenly seems to be becoming a household phenomenon and top of mind for almost every investor. ChatGPT set the record for the fastest app to reach 1 million users, taking just 5 days, a feat that took an internet giant like Facebook 10 months to achieve. In fact, the figure below reflects just how rapidly technological adoption has changed in the last 20 years alone. The debates on whether ChatGPT will disrupt internet search, whether AI will change our lives as we know it, or whether this is another technology fad that will fizzle out like many others we have seen before, could constitute an investor letter of its own and, quite frankly, are beyond our capabilities. But one thing is certain, the outlook for many businesses has been called into question by investors since AI became part of our daily vocabulary. It is precisely this type of disruption and technological change that is driving debate among investors, leading to shorter investment horizons as the narratives are changing faster than we can keep up.

Time to reach 1 million users[1]



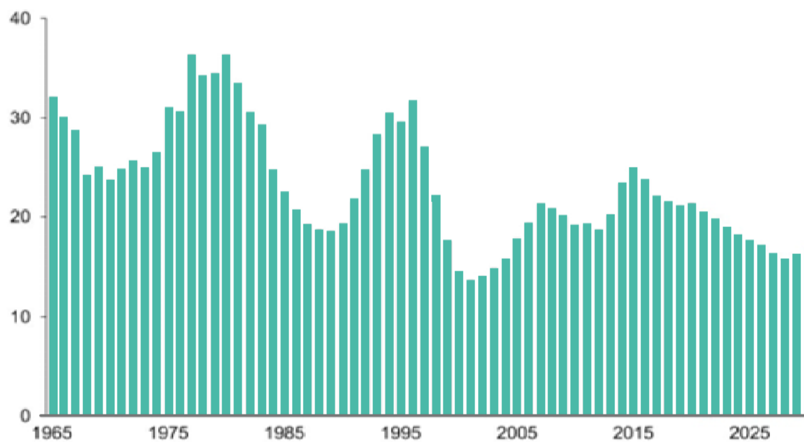
We can further hone in on the technology sector, where arguably this notion of rapid change is most relevant. Of the top 10 technology companies by market cap in the 1980s:

- only **one** of those companies is still on the list today (thankfully, one of our portfolio companies Microsoft)
- **two** have entered into bankruptcy (Eastman Kodak for example)
- another **five** peaked in market value terms over 20 years ago and have structurally declined since (Xerox & Motorola to name a couple)
- the remaining **two** were acquired by other technology businesses that have suffered a similar decline

Moving forward, given the pace of technological change has only increased since the 1980s, we think it is reasonable to assume that seismic changes in the leaders/laggards of the technology sector may take far fewer years than it has done in the past. In fact, the figure below shows that the average lifespan of a company on the S&P 500 has declined from a peak of over 35 years in the late 1970s to less than 20 years today and is expected to shrink to ~15 years later this decade. Over the past 20 years, 50% of the S&P 500 constituents have left the index. While a few of those companies were sold or merged, the majority fell out of the index due to a decline in market value. Looking forward however, at the current rate of company churn, 50% of the current constituents will be replaced in just half that time (~10 years).

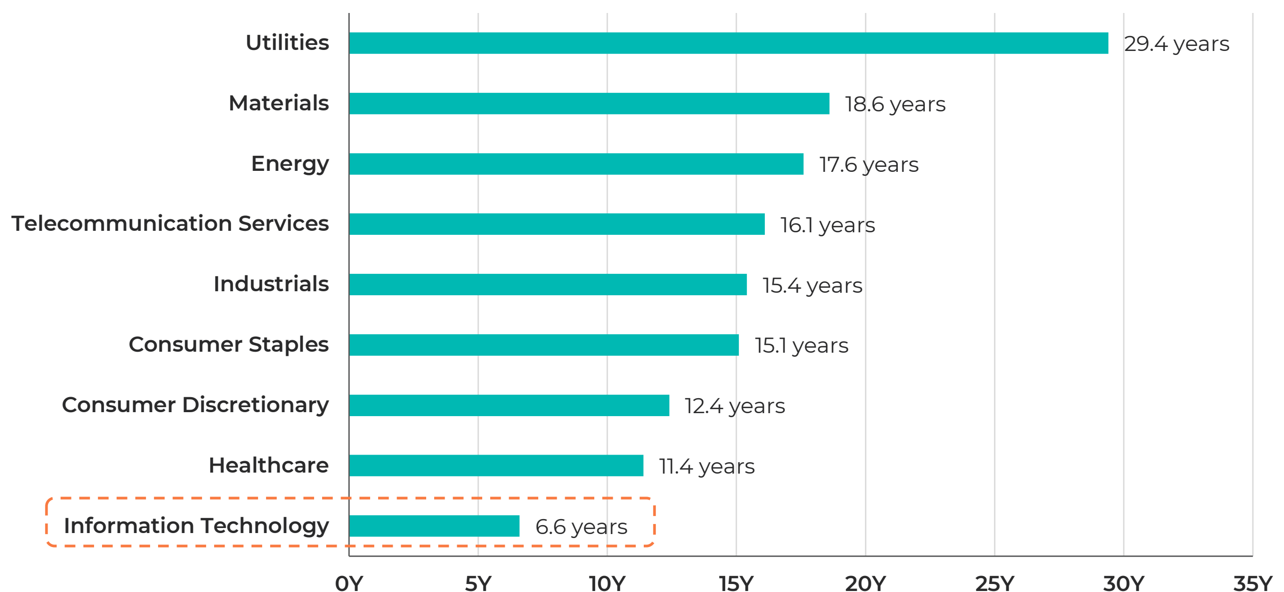
[1] *Based on company announcements via Business Insider/LinkedIn. Source: Statista.*

Average company lifespan on S&P 500 in years (rolling 7-year average)[1]



Again, the technology sector appears to be at the epicentre of this trend. When a company makes an investment in its own business, into resources or equipment for example, accountants will require the company to record a useful life for this asset on the balance sheet. Companies that expect their assets to pay off for a long time will take a more extended view than companies that have short asset lives. As shown below, the average asset life in the technology sector is 6.6 years, almost half that of the next lowest sector. All things equal, shorter asset lives suggest shorter time horizons. Executives of many technology companies cannot plan for decades in the way an industrial or utility company can because the rate of change is simply too fast.

Average asset life by sector[2]



This topic leads us to changes we have been making in our portfolio. Our intention is to be long-term shareholders of the businesses that we invest in, given our focus on identifying and subsequently concentrating our capital in what we deem to be extraordinary companies. As part of our efforts to continually evaluate and improve our process, a key reflection was this notion that those businesses operating in industries undergoing more frequent technological change generally result in shorter investment horizons.

[1] *Based on public S&P 500 data sources. Source: Innosight, Standard & Poors.*
[2] *As of 2013, based on top 1,000 non-financial firms. Source: Credit Suisse HOLT.*

Or said differently, investing in those businesses that face lower propensity for rapid technological change or disruption, lend themselves more readily to us being longer-term shareholders of them. As Jeff Bezos once remarked, *"I very frequently get the question: 'What's going to change in the next 10 years?' I almost never get the question: 'What's not going to change in the next 10 years?' And I submit to you that that second question is actually the more important of the two because you can build a business strategy around the things that are stable in time. In our retail business, we know that customers want low prices, and I know that's going to be true 10 years from now. They want fast delivery. They want vast selection. It's impossible to imagine a future 10 years from now where a customer comes up and says, 'Jeff I love Amazon; I just wish the prices were a little higher,' or 'I love Amazon; I just wish you'd deliver a little more slowly.' When you have something that you know is true, even over the long term, you can afford to put a lot of energy into it*".

The net effect of us underwriting this risk across each of our holdings has been a focus on adding to the portfolio, those businesses that have demonstrated a long history of durability and with expectations that this should continue regardless of the technological environment we find ourselves in years from now. Our North American railroads positions, namely Canadian Pacific (CP) and Canadian National (CN), are a prime example of these long-dated assets. The overwhelming majority of the North American railroad network was laid out in the second half of the 19th century. As legendary railroader Hunter Harrison used to put it: "*They ain't building any more railroads*". The same network that has been carrying much of American people's goods for the past century, will likely continue to do so over the next one, as reflected in railroads being among the very few 100-year bond issuers. Our luxury holdings, LVMH and Ferrari, also share this everlasting longevity. We believe luxury is one of the purest expressions of humans' structural need for status assertion, deeply engrained in our nature ever since we started socialising, from the emergence of our species around 300,000 years ago. Bernard Arnault, CEO of LVMH, recalls a meeting with Steve Jobs during which the celebrated tech-entrepreneur told him: "*You, you have eternity for you. Because I sell iPhones, and the iPhones, will they still be around in 25 years? But what I am sure of is that the world will continue to drink your Dom Pérignon*". In addition, we recently initiated a position in the world's largest aircraft engine manufacturer, Safran, a business whose origins date back to the early 1900s. A well-known investor once quipped about the whiskey producer Brown-Forman, that if a liquor business could survive prohibition, there was a good chance it could survive any future challenges. We think the same applies to Safran, having survived a global pandemic which halted almost all air travel across the world and is set to emerge in arguably a better position than before.

While our exposure to the technology & communications sectors has declined as a result of these changes that have taken place in the portfolio over the past 18 to 24 months, we still have valuable exposure to these sectors. We continue to own what we deem to be extraordinary technology & communications businesses as our process first and foremost is focused on the quality of the companies that we own. Within these sectors however, our preference is in owning the back-end infrastructure that underpins long-term secular trends, rather than trying to determine the technological leaders/laggards that typically see much faster change or disruption at the front end. Examples of this in our portfolio include Universal Music Group (UMG), a leading music label providing streaming platforms (e.g. Spotify, Apple Music, Amazon Music, etc.) with the evergreen content they need and hence growing secularly alongside them without stepping into their fiercely competitive arena. Or Visa/MasterCard, whose payment rails are benefitting from the growth in digital payments, irrespective of who is winning among the growing fintech competition on the front end. That said, in light of the points made earlier and all things equal, we prefer to own businesses where the rate of

technological disruption is lower and our ability to be long-term shareholders as a result is that much greater. Today, the average age of our portfolio companies is ~70 years and we hope to be able to add more extraordinary companies in the future that have stood the test of time.

Conclusion

While the sector exposures of the portfolio may have changed over the past 18-24 months, we have not deviated from the core principles of our investment framework, irrespective of the short-term outperformance of certain sectors. Our steadfast philosophy, first and foremost, is focused on the fundamentals of the companies we own, seeking to invest exclusively in what we deem to be extraordinary businesses. A defining characteristic of such businesses is their longevity, having already weathered numerous crises in the past, often there is a greater likelihood of them emerging even stronger from future challenges that may arise. In an environment in which market participants are increasingly short-term orientated and businesses are disrupted at a faster pace, we believe being lasting owners of companies with distinctive staying power puts the odds in our favour to deliver long-term outperformance.

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 & Portfolio Manager
Giulio Battaglia, Chief Executive Officer
Mihir Kara, Senior Equity Analyst
Thibault Decré, Equity Analyst

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