STENHAM
ASSET MANAGEMENT

Q2 2023 Investor Letter

Stenham Equity UCITS Fund

Performance Review

Fund vs. Benchmark[1]	Q2 2023	YTD 2023	Since Inception
Stenham Equity Fund (A1)	**+4.7%**	**+15.1%**	**+167.8%**
MSCI World Index	+6.3%	+14.0%	+131.0%
Relative	(1.6%)	+1.1%	+36.8%

Portfolio Attribution

Top Contributors – Q2 2023	Portfolio Weight	Attribution
Microsoft	6.1%	+1.6%
MasterCard	9.5%	+1.3%
Ferrari	3.0%	+1.2%

Top Detractors – Q2 2023	Portfolio Weight	Attribution
Thermo Fisher Scientific	7.6%	(0.7%)
Universal Music Group	4.5%	(0.5%)
Danaher	4.6%	(0.2%)

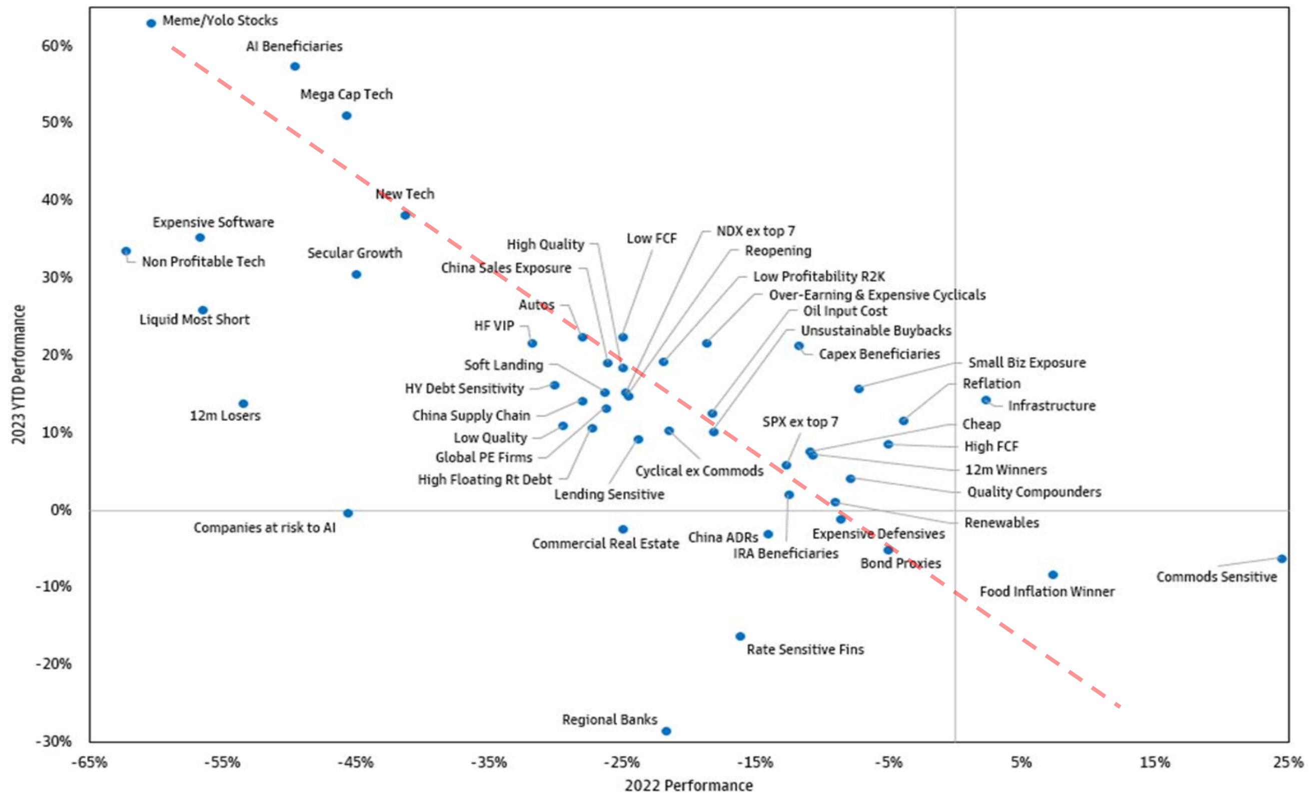
Market Commentary

In the first half of the year, markets delivered almost a mirror image of what we saw play out over 2022. As is often the case over the short term, reversion to the mean was apparent. While energy was the best performing sector last year, and the only sector in fact to deliver positive absolute returns, it has been the worst performing sector this year, underperforming the market by ~20%. Meanwhile, technology, communications and consumer sectors, the three worst performing areas of the market last year, are all meaningfully outperforming the index as the top three performing sectors for 2023 so far. In fact, the Nasdaq Composite index posted its strongest H1 performance in 40 years.

[1] *Performance as of 30 Jun 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.*

The chart below compares the performance of various equity baskets in 2022 against YTD 2023. The mean reversion (as shown by the negative correlation) is clear with, for example, the Non-Profitable Tech index and Meme/Yolo stocks which declined >60% last year and are now up >25% and >55% YTD respectively.

2022 vs 2023 YTD performance by theme[1]



A myriad of factors have been touted as driving the surprisingly strong start for equity markets. From Artificial Intelligence (AI) to interest rates & inflation, the short-term drivers of market performance are difficult to identify let alone predict in the future. What we can pinpoint, however, is that the majority of the move in markets this year has been driven by sentiment as opposed to fundamentals, with ~90% of YTD returns for the index explained by multiple expansion versus the remainder by earnings growth. The other notable aspect of this year's market rally has been its concentration. Over 80% of YTD performance for the index has been driven by the top 10 largest stocks. The lack of market breadth has been even more prominent in the technology sector, as the six largest tech companies (Apple, Microsoft, Alphabet, Amazon, Nvidia & Meta) accounted for over 100% of the relative outperformance of the sector compared to the broader market. The sharp reversal in sector leadership from 2022 to 2023, combined with the concentrated performance in equity markets, has resulted in a difficult environment for active managers to outperform the benchmark unless they were heavily overweight the largest cap tech stocks. The average fund in our Bloomberg peer group of over 5,000 funds has underperformed the benchmark by >100bps this year, reflecting this dynamic.

As evidenced in just the past six months alone, trying to predict these market changes with any level of certainty or repeatability is nearly impossible. Instead, our primary focus is on the quality of the businesses that we own, and seeking to construct a portfolio of these businesses in a manner that mitigates the impact of broader changes in sector or style leadership. This allows us as investors to focus on what matters, the

[1] *Data as of 30 Jun 2023. Source: Goldman Sachs.*

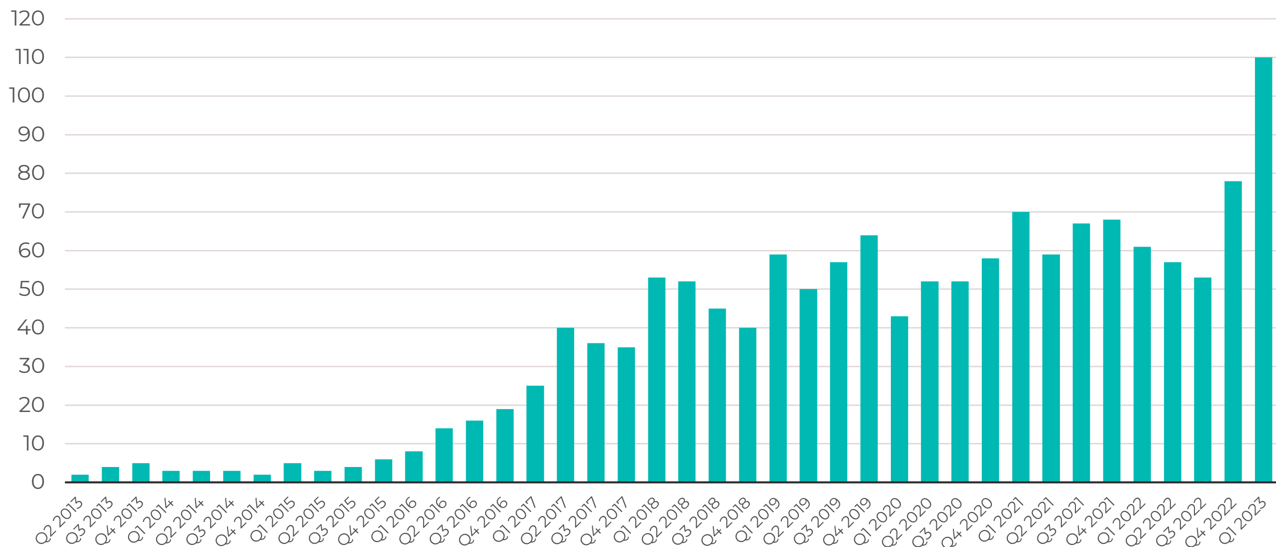
fundamentals of our portfolio companies as the key driver of long-term fund performance and outperformance against the benchmark.

In terms of portfolio performance, while the fund outperformed the index over the first half of the year, Q2 proved more challenging than Q1 from a relative perspective. During Q2, the narrowness of the market rally, concentrated among the largest constituents of the index, continued to be a headwind. In addition, the outperformance of more speculative areas of the market, as reflected in the rally of the Goldman Sachs Non-Profitable Tech index (+14%), was also a headwind as the fund retains no exposure to these types of companies given our investment philosophy. Finally, some of the fund's non-tech holdings, such as Thermo Fisher, Danaher, Canadian Pacific & Canadian National, underperformed relative to the index, impacted both by the short-term sector rotation mentioned above as well as idiosyncratic issues. North American railroads were pressured by retail inventory destocking and declining truck rates impacting their consumer-driven segments. Life sciences suppliers were affected by bioprocessing inventory issues and weaker early-stage biotech funding. In both instances, we expect these short-term headwinds to abate, and we have used the relative share price weakness to selectively add to our positions. Moreover, the secular growth drivers underpinning our long-term thesis remain intact. North American railroads stand to benefit from the re-industrialisation and reshoring fostered by the recent US industrial policy response to geopolitical and supply-chain challenges. Life sciences suppliers are well positioned to capitalise on the ever-increasing number of biologic medicines in development, higher than at any point in history.

Portfolio Discussion

AI is unquestionably this year's favourite buzzword. The mere use of the term is now a necessary component in corporate earnings calls, helping boost stock prices and captivate markets. It is not just technology companies seeking to capitalise on this either. In fact, even the US grocery chain operator Kroger, mentioned AI eight times on their most recent earnings call. Distinguishing between AI fact and fiction to understand the implications for publicly-listed companies has been a full-time occupation for investors in recent months. Both across markets and technology, we often overstate the impacts in the short term, but underestimate the impacts over the long term. There is ample evidence for both sides of the debate on AI being either hype or reality. Hype has certainly played a part in fuelling a >300% rise in the share price of a company called C3.ai (Ticker: AI US) this year, who fortuitously changed its name from C3 IoT previously and C3 Energy before that. The company has since drawn significant short interest as the business remains unprofitable and revenue estimates have risen only ~6.5% this year compared to the share price move over the same period. We also saw Europe's largest ever seed round of financing; for an AI start-up only a month old which raised $113m despite having yet to develop a product and its first few employees starting work only days prior. However, there has certainly been some substance to AI narrative as well with Nvidia, one of the largest companies in the world, increasing their revenue guidance for the next quarter by more than 50%, from $7bn to a staggering $11bn. It is widely believed that this is the single largest revenue revision for a large cap S&P 500 company ever, thanks to the demand for their semiconductors used to power AI solutions.

Number of S&P 500 companies citing "AI" on earnings call over the past 10 years[1]



We have been underwriting both the risk and reward to our portfolio companies in light of the emerging trends in AI. That said, narratives are changing week to week for many companies in this regard and so forecasting outcomes with a high degree of conviction remains challenging and is an ongoing iterative exercise. However, using history as a guide is often a useful approach for evaluating the investing landscape during periods of technological change. In fact, this is the same approach highlighted by Warren Buffett in an editorial for Fortune Magazine, penned in 1999 amid the sizeable growth in internet adoption which fuelled the dot-com bubble. He highlights some of the biggest technological revolutions of the century, such as those of the automotive and aviation industries for comparison. Of the 2,000+ US car manufacturers that spawned with the emergence of the automotive industry, only 3 were left still standing by the end of the 20th century. There were 300+ aircraft manufacturers during the 1940s, of which only a small number still exist. Aviation also includes airlines, an industry that has seen some of the highest rates of failure, with 129 bankruptcies in the 20-year period leading up to 1999. Jeff Bezos was also quoted in the piece saying "*When new industries become phenomenon, a lot of investors bet on the wrong companies… I noticed that decades ago, it was de rigueur to use 'Motors' in the name just as everybody uses 'dot-com' today. I thought, wow, the parallel is interesting*". It appears that we are in a similar environment with AI and it is the job of investors to parse through the noise and determine the best investment opportunities. So the question remains, how do investors go about doing this?

From our perspective, there are typically three main investment approaches when faced with periods of technological change:

1) **Pick the winners:** as evidenced above, this appears to be the highest risk approach. Akin to picking the three successful US auto manufacturers of the 2,000+ that were there at the start or picking Amazon from the ~500 tech IPOs that emerged in the lead up to the dot-com bubble. One does not need to look too far to see a similar phenomenon among the high-growth tech darlings of 2020 that rallied significantly on the prospects of digital trends catalysed by the impacts of the pandemic. Yet the ARK Innovation ETF, which was touted as a collection of such companies is now trading below its pre-pandemic highs, having more than fully reversed a >150% rally in ~2 years.

[1] *Source: FactSet.*

2) **Short the losers**: in the aforementioned examples, this would be akin to being short the horse industry with the emergence of the automobile. There have been some examples of this already, as the online education platform Chegg saw their share price decline almost 50% in a single day after warning that AI services like ChatGPT pose a risk to their business. However, as mentioned above, narratives at this early stage are changing week by week. Alphabet for example, declined almost 20% peak-to-trough in Feb 2023 alone, on fears that Google Search was at risk from AI technologies such as ChatGPT. However, the stock has since rallied ~35% as they demonstrated their own AI capabilities in response. Or the language learning application Duolingo, which was included as a top 10 constituent of Bank of America's AI at Risk stock basket, and is now up over 100% on the year as they reinforced their view that they are indeed AI beneficiaries. In fact, the top 10 constituents of the AI at Risk basket are up ~17% on average in H1 2023, outperforming the index. It seems that AI losers are just as unclear as AI winners at this early stage.

3) **Picks and shovels:** finally, we have those companies whose infrastructure are underpinning AI's emergence. The back-end or behind-the-scenes companies that are beneficiaries regardless of who the winners and losers are. The term 'picks and shovels' originates from the California Gold Rush of the mid-1800s, where ~300,000 people came to California trying their luck in finding gold in the hope of making fortunes. Only a handful of them were actually able to do so, and Samuel Brannan was one of them. He became the first millionaire of the Gold Rush, not by mining the gold, but by capitalising on the needs of miners, and selling them picks and shovels. The clearest examples of this today are semiconductor and cloud computing providers, as companies like Nvidia, Microsoft, Applied Materials and others in this space have rallied significantly this year. For long-term investors like ourselves, this strategy is the best and most sustainable approach of the three and is reflected in how our portfolio has been positioned historically, and continues to be positioned today. Pick-and-shovel businesses are present not only in our semiconductor and cloud holdings, but also in areas such as healthcare, digital infrastructure, payments, railroads & aerospace, riding the tailwinds of secular growth trends without having to take on the risk of deciphering the winners from the losers.

Conclusion

Notwithstanding short-term market fluctuations and fast-paced technological changes, we remain fully committed to our investment philosophy of concentrating our capital in what we deem to be extraordinary businesses. A distinctive feature of many of these businesses has historically been, and continues to be, their overarching position as providers of the infrastructure underpinning deep secular growth tailwinds. This position fosters greater predictability and longevity, which are highly advantageous in an environment of rapid upheavals in markets or industries, ultimately facilitating longer-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 & Co-Portfolio Manager
Giulio Battaglia, Chief Executive Officer
Mihir Kara, Co-Portfolio Manager
Thibault Decré, Equity Analyst

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