Q3 2023 Investor Letter

Stenham Equity UCITS Fund

Performance Review

Fund vs. Benchmark[1]	Q3 2023	YTD 2023	Since Inception
Stenham Equity Fund (A)	**(4.8%)**	**+9.5%**	**+128.3%**
MSCI World Index	(3.8%)	+9.6%	+122.2%
Relative	(1.0%)	(0.1%)	+6.1%

Portfolio Attribution

Top Contributors – Q3 2023	Portfolio Weight	Attribution
Universal Music Group	4.7%	+0.8%
Alphabet	3.7%	+0.3%
Danaher	4.7%	+0.2%

Top Detractors – Q3 2023	Portfolio Weight	Attribution
Adyen	2.0%	(2.4%)
LVMH	5.5%	(1.0%)
ASML	4.1%	(0.8%)

Market Commentary

Investors entered Q3 with optimism that a hard landing/recession would likely be avoided, and the unprecedented period of monetary policy tightening would come to an end. However, the prospect of interest rates remaining higher for longer weighed on equity markets. The MSCI World declined 3.8% as bond yields spiked significantly. The Federal Reserve continued to remain hawkish, increasing the fed funds rate once again to a 22-year high, leaving the door open for further rate hikes. The mega-cap tech companies, now being referred to as the 'magnificent seven', weighed on markets during the quarter, but nevertheless on a year-to-date basis have been an outsized contributor to equity market performance. As shown below,

[1] *Performance as of 30 Sep 2023 is presented net of fees. 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.*

excluding these companies (Apple, Microsoft, Alphabet, Amazon, Tesla, Nvidia and Meta), the S&P 500 would essentially be flat year to date, reflecting the narrowness of the market rally this year.

S&P 500 YTD 2023 performance[1]

Portfolio Discussion

Contributors

The largest contributors to performance were Universal Music Group (UMG) and Alphabet.

In H1 2023, UMG's share price was pressured by the threat of music generative-AI flooding streaming platforms, competing with artists and labels for listening share. After actively debating the issue internally with the team and externally with multiple industry participants, we believed that the legal, distribution and adoption hurdles that music generative-AI faced were high enough for it to be unlikely to disrupt UMG in a structural way. This view informed our decision to sustain our position throughout the share price decline, contributing to performance as concerns quickly alleviated. In addition, UMG outperformed after its growth prospects were enhanced by a broad-based price increase from streaming platforms such as Spotify. Music labels like UMG capture a portion of the gross profits generated by streaming platform subscriptions and, therefore, these price increases also provide an uplift to UMG's revenue and profits.

Earlier this year, Alphabet saw its share price decline almost 20% in the space of a month as fears around the threat to Google Search from ChatGPT and Microsoft Bing escalated significantly. ChatGPT was thought to have fundamentally changed the way users search, while Microsoft Bing, after years of being relegated to an afterthought in search, was thought to have found new life following its partnership with ChatGPT owner OpenAI. Alphabet responded with a myriad of AI products, including their own ChatGPT competitor known as Bard, driving close to a 60% rally in the share price from the Feb-2023 lows. More recently, public comments from Microsoft and Apple, which utilises Google Search to power their Safari browser, further solidified Alphabet's dominant position. Apple's Senior Vice President of Services, Eddy Cue, stated "*Certainly there wasn't a valid alternative to Google at the time and there still isn't one*". The CEO of Microsoft indicated that they were willing to lose $15 billion a year, giving Apple all of the economic upside in order to be the default

[1] *Data as of 23 Sep 2023. Source: Bloomberg, Apollo Chief Economist.*

search engine for Apple's products. However, Apple refused this deal and opted to retain their agreement to keep Google as the default search engine.

With the growing pervasiveness of technology, the threat of disruption remains a risk. However, businesses that are highly entrenched within their respective ecosystems such as UMG or Alphabet, are well placed to fend off this risk provided they can continue to innovate as they have been doing thus far.

Detractors

The largest detractors to performance were Adyen and LVMH.

Adyen declined significantly following their H1 2023 trading update as profit margins were pressured by recent hiring to expand their workforce and growth slowed notably in their North America market. On the former, despite the short-term headwind to margins, we were generally encouraged by Adyen's long-term strategic approach in this regard. Many of Adyen's competitors, and technology companies more broadly, hired aggressively in 2020/21 only to be forced to pare back and make sizeable cuts across 2022/23. Meanwhile, Adyen was more measured in 2020/21, waiting on the opportunity which presented itself in 2022/23, to strengthen the business through hiring at significantly more attractive cost levels given the weakness among their competitors and the overall tech industry. The latter point on growth, however, was more concerning and the size of the deceleration was the most significant surprise as North America revenues grew 23% YoY compared to a 45% YoY growth rate just 6 months prior. Competition in this market has been a driver of this deceleration as players such as PayPal have been aggressively discounting prices to capture market share. In the short term, this headwind is likely to persist and, with limited catalysts to change the narrative, the share price may remain under pressure. However, in the long term, the current valuation in our view is pricing in an extremely draconian scenario and we believe there still remains a sizeable opportunity for Adyen to capture share in other markets outside North America, but also in different verticals such as in-store and omnichannel payments processing. This position was among the smaller holdings in the Fund going into their trading update and, at present, we have maintained our stance. We endeavour to remain objective and as we continue to conduct our work, we will update our views and portfolio positioning accordingly.

After reaching record highs in the first half of the year, LVMH's post-pandemic euphoria gave way to early signs of a slowdown in the US, ultimately extending into Europe and translating into a softer-than-anticipated rebound in China. Having grown at 2-3 times its typical rate following the pandemic, the global personal luxury goods market is now mean reverting back to its structural growth profile and is doing so with a challenging macro backdrop. This has pressured LVMH's share price, which declined 25% from its highs and has erased most of its YTD gains. Following the recent decline, LVMH is trading at attractive valuation levels even on our conservative growth estimates, approaching previous downcycles and periods of elevated rates on a relative basis. As a result, while we remain watchful of the macro environment and its implications for LVMH's short-term growth prospects, we used the recent share price weakness to increase our position, as the long-term investment case remains attractive in our view.

Portfolio Company Overview

GE Aerospace and Safran, through their joint venture CFM International (CFMI), is the world's largest aircraft engine manufacturer. They serve the aerospace industry by developing, manufacturing, and servicing engines for airframers (such as Airbus and Boeing) and aircraft operators (airlines and lessors).

CFMI came to life during the 1971 Paris Air Show, when Gerhard Neumann (GE Aerospace) and René Ravaud (Safran) decided to partner on a new engine called the CFM56, and compete head-to-head with Pratt & Whitney and Rolls-Royce. More than 50 years later, attending the Paris Air Show ourselves and meeting with the two companies, as well as multiple industry participants, our conviction rose and we initiated a position in General Electric in August alongside our position in Safran, initiated in February.

There are three main quality attributes that make CFMI extraordinary in our view:

1) **Huge aftermarket opportunity:** Whenever an engine is sold, engine manufacturers have a decades-long, highly profitable, and highly recurring aftermarket opportunity selling spare parts and Maintenance, Repair & Overhaul (MRO) services. Consequently, even if every single customer stopped buying engines from CFMI tomorrow, the company would still have 20+ years of highly attractive free-cash-flow generation to capture via the aftermarket.

2) **Significant barriers to entry:** Beyond the enormous cost of development, the cost of failure is simply too high (human lives), naturally structuring the industry into an oligopoly of only three players with full-engine capabilities, trusted by regulators and customers who select only one or two engines per aircraft. China, for example, initially equipped its first homegrown aircraft (Comac C919) with a CFMI engine (LEAP) rather than its own. Aircraft engines are no easy feat.

3) **Industry dominance:** CFMI's most famous engine, the CFM56, has been sold >34k times over and has logged >1bn flight hours (or nearly 115,000 years of continuous flying), making it the most successful engine in civil aviation history. CFMI's most recent engine, the LEAP, is expected to follow on the CFM56 success story. Through CFM56 and LEAP, CFMI dominates the Airbus A320 and Boeing 737 platforms, which make up >75% of the global aircraft fleet. As a result, CFMI has secured a 70%+ market share of the global narrowbody engines market.

> *"There is still only 20% of the world's population that has ever flown".*
>
> **- Akhil Johri, Former CFO**
> United Technologies

Extraordinary quality attributes, by themselves, are not enough to pass our highly selective investment process and are sought to be coupled with attractive growth features. To that effect, global air traffic is on a secular growth trend, with >80% of the world's population having never set foot on a plane. Our research suggests that satisfying the growing demand for air travel will require nearly double the current active fleet of aircrafts over the next two decades, which will need to be equipped with engines, many of which are sold by CFMI. In addition, we believe we are currently in the golden era of aircraft engine aftermarket, which we expect to continue to unfold over 2024 and possibly 2025. The combination of continued strength in air travel, coupled with supply chain constraints delaying new aircraft deliveries, translates into higher-for-longer utilisation of the existing aircraft fleet, driving substantial volume and price growth across CFMI's aftermarket activity.

We remain watchful of the potential implications of zero-emission targets on global air traffic and aircraft retirements, taking the perspective of both passengers and regulators into consideration. The aviation industry contributes to approximately 2% of CO_2 emissions globally. Most recent engines, such as the LEAP, are 15% more fuel efficient than their predecessors, and future engines, such as the RISE, are expected to be 20% more fuel efficient than that. Beyond fuel efficiency, new propulsion methodologies, such as electricity and hydrogen, are currently under development, but will take a long time before becoming a technical reality. Finally, Sustainable Aviation Fuels (SAF) are already a technical reality but are not yet economically viable, being significantly more costly than petroleum-based fuels. Overall, we believe aircraft engine manufacturers, such as GE and Safran, are best positioned to pave the way for sustainable aviation in the future.

Conclusion

The current macroeconomic environment, alongside geopolitical tensions, have created an uncertain backdrop for markets near term. That said, we believe the resilience of our portfolio companies should allow them to weather periods of volatility. Our investment philosophy remains fixed on the long term and we will look to add to our portfolio, as we have been doing selectively should short-term market uncertainty provide attractive valuations.

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