AYLETT GLOBAL EQUITY FUND
Q4 2023 COMMENTARY

FUND MANAGER COMMENTARY

HOW WE INVEST

Ultimately our goal is to preserve our clients' purchasing power in real terms. This requires patience to allow an investment case to unfold with the inevitable surprises along the way. It also requires holding firm on our investment philosophy and not being tempted into chasing short-term gains in the market.

To us, risk is not being underweight a benchmark but rather the permanent loss of capital on an investment. Our focus remains on owning good companies and making sure we don't overpay for them.

MARKET REVIEW

The MSCI ACWI capped off a strong 2023 return of 22.8% in US dollars with a strong final quarter return of 11.1%. Since the inception of the fund, the MSCI ACWI has returned 6.3% in US dollars.

A sluggish start to 2023 was overcome with AI led excitement in the markets. This led to resumed strong performance from the leading US-based technology companies, now dubbed the Magnificent Seven[1] . These stocks drove most of the market returns in 2023, with the market concentration of the S&P 500 reaching the highest level since the last technology bubble. Indeed, in 2023, a record-high 72% of stocks in the S&P 500 underperformed the index. The MSCI ACWI equal-weighted index returned 9.3% for the 2023 year for reference.

Sector-wise, it was a complete reversal of 2022, with Information Technology, Communication Services and Consumer Discretionary leading the pack after being among the weakest in the prior year. Energy, while still positive for 2023, was weaker after being the leading sector in 2022. All sectors ended the year on a positive basis, but the dispersion was wide.

FUND PERFORMANCE

While the fund didn't outperform the benchmark level in 2023, returning 8.3%, it has delivered a positive return of 5% in US dollars since its inception. Specific portfolio choices, such as not holding any Magnificent 7 stocks, being overweight in the energy sector and having a large cash balance, played a significant role in this. We are confident in our long-term strategy of prioritising consistent, positive returns for our investors, which has historically contributed to outperformance over broader market cycles.

CONTRIBUTORS

Reinet is the fund's largest holding and appears as the top contributor for a second year in a row (here's hoping for a hat-trick!). Reinet is a holding company trading at a substantial discount to net asset value. Its biggest asset is its investment in Pension Insurance Corporation, which we mentioned last year had a long runway for growth as a result of the increase in the number of defined benefit funds in a position to be bought out. In 2023, that proved to be the case, with Pension Corp executing on the opportunity and the market starting to reward them for it. Reinets' strong performance was achieved despite its investment in British American Tobacco. Notwithstanding British American Tobacco's robust and growing free cash flow generation, the share derated during the year. Challenges in the U.S. combustible market and execution missteps on the next-generation nicotine portfolio hurt investor sentiment and sent the shares to new lows.

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[1] *Apple, Microsoft, Google, Amazon, Nvidia, Meta, Tesla*

BAT is being valued like a business that will cease to exist over the next decade - an outcome we deem very unlikely. In addition to the exposure we get through our holding in Reinet, we also own BAT directly in the funds and believe the share price is well below a very conservative estimate of fair value.

Jumbo, an Athens-based retailer of everything from bath toys to ballpoint pens, experienced an outstanding year. The company demonstrated significant revenue growth in its existing stores and expanded by opening new stores in new geographies. Jumbo's retail strategy resonates well with its customers, resulting in a year of impressive results and a swift increase in its share price.

Other contributors to performance were investments in **Delfi**, **Berkshire Hathaway** and **Moneysupermarket.com**.

DETRACTORS

Despite **British American Tobacco's** robust and growing free cash flow generation, the share derated during the year. Challenges in the U.S. combustible market and execution missteps on the next-generation nicotine portfolio hurt investor sentiment and sent the shares to new lows. BAT is being valued like a business that will cease to exist over the next decade - an outcome we deem very unlikely. In addition to the exposure we get through our holding in Reinet, we also own BAT directly in the funds and believe the share price is well below a very conservative estimate of fair value.

In contrast to the good performance of BHP during the year, the **Anglo American** share price did poorly. The investor update in December was below expectations, with volume guidance being cut in many of their key commodities, most notably copper. Copper miners have been the flavour of the month, so the reduction in volumes was disappointing. While short-term volume guidance has declined, Anglo still owns a collection of world-class orebodies containing commodities the world will need for many years to come. We believe the current production issues mask a valuable underlying portfolio.

Other detractors to performance include **St James Place**, **Melco International** and **Sabre Corp**.

NOTABLE ADDITIONS TO THE FUND

St. James's Place presented an attractive investment opportunity following a period of sluggish inflows and a share price drop. We initiated a position which, with hindsight, proved premature. Major adjustments to their complex fee structure further pressured the share price. However, these changes simplified the fee structure and maintained SJP's position as the leading wealth management firm with the largest UK advisory force. Despite current headwinds from the post-pandemic slowdown and cost-of-living crisis, the UK savings market remains a compelling long-term growth story. SJP's strong advisory network and simplified fee structure position them to capitalise on this structural potential when market conditions improve.

Dollar General, the dominant dollar store chain in the US, plays a crucial role in providing affordable essentials for underserved communities. Historically, it's been a high-performing, well-regarded business. However, recent market challenges and strategic missteps under the previous CEO led to a decline in performance and share price. Our analysis concluded that the core business remained fundamentally sound. Early indicators show signs of better performance, which is aided by the return of the CEO who led them to much of their initial success.

Heineken joins our portfolio as the most recognizable beer brand in the world. However, the stock faced headwinds in 2023 due to temporary challenges in key markets like Vietnam, impacted by economic slowdown and inventory issues. Our analysis indicates these are short-term hurdles unlikely to derail their long-term prospects. The company's recent focus on cost reduction, historically less emphasised compared to competitor AB Inbev, coupled with potential tailwinds from normalising commodity prices, suggests higher underlying earnings potential than currently reflected in the share price.

NOTABLE EXITS

Despite our admiration for **Booking Holdings** strengthened business model and their impressive post-pandemic recovery, we sold our position in 2023. While leisure travel, Booking's core strength, enjoyed a significant resurgence, exceeding pre-pandemic levels, this robust performance was already fully reflected in the company's valuation. We felt limited upside potential at the share price, considering the potential for travel trends to normalise and the increasingly competitive landscape.

Grupo Aeroportuario Centro Norte, a Mexican airport operator, performed tremendously post-pandemic, mirroring Booking's rebound. Passenger growth, revenue, and margins soared, prompting a significant share price revaluation. However, we exited our position due to concerns about a limited margin of safety. Airports remain a regulated asset in Mexico, a country where political leadership had previously made worrisome statements about similar industries. Our concerns proved prescient post-sale as regulatory changes were announced, leading to substantial share price declines.

Sonic Automotive, a major US auto dealer that thrived during the pandemic's supply crunch, was sold as its share price approached our fair value estimate. While the company continued to perform well, its post-pandemic normalisation wasn't fully reflected in the stock price, prompting our exit.

Our final notable sale was **Hess**, as they were acquired by Chevron in an all-stock transaction. While the acquisition premium appeared modest, Hess held a higher valuation than peers and boasted strong performance due to its Guyana discovery and resulting production. Chevron, recognising the same attractive qualities we did but with much deeper pockets than us, opted for a complete buyout. As we favoured Exxon over Chevron, we decided to sell.

OUTLOOK

Judging from the above, we had a busy 2023, and we expect 2024 to be no different. Forecasting is impossible, but we are certain that there will be continued surprises and volatility.

We should see a shift to central bank easing, which absent any recession, should provide a supportive market environment. Supply chain and commodity cost headwinds have largely ended for most businesses which should allow for margin recovery and growth. Inflation is clearly on a downtrend, even if the timeline and route to targets are likely not as smooth as most might think. The soft-landing scenario currently dominates US economic forecasts, but history reminds us that reality is often less predictable. High interest rates could continue to pose a challenge to both consumers and businesses as they need to finance these costs. We also note that geopolitical conflicts are ongoing with no end in sight, and over half the global population goes to the polls to vote for new leadership this year. It promises to be an eventful year ahead.

We remain focused on what we can control, seeking good companies that match our investment philosophy and prioritising strong business fundamentals. We see promising long-term prospects for our holdings and remain focused on the security of present cash flows and attractive pricing in an uncertain world. The fund has a healthy cash balance, ready to take advantage of any volatility in the months to come. We are grateful for the continued support of our investors.

Walter Aylett

31 December 2023