

Somerston Technology Fund (the Fund)

Investment Letter No.8 – December 2022

Portfolio Objectives: To grow capital over the medium term by investing in a concentrated portfolio of high growth companies.

Performance: The Somerston Technology Fund fell by -3.6% in the fourth quarter. Our reference index fell by -2.4%.

Performance (%)													
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2017	6.1	3.9	4.2	4.5	7.7	-1.5	5.8	3.2	-0.1	8.5	3.8	-0.8	55.1
2018	12.3	-1.4	-4.1	1.0	8.0	-0.1	0.0	8.9	-1.8	-12.3	1.3	-7.5	1.7
2019	12.0	2.9	5.6	6.3	-8.0	8.2	4.1	-3.8	-1.8	3.1	6.1	3.8	43.6
2020	6.2	-3.8	-6.6	18.2	9.6	10.0	9.1	8.5	-6.2	-0.7	9.6	5.5	73.4
2021	-0.2	1.6	-6.5	8.8	-3.6	11.6	1.0	5.7	-7.9	6.2	-1.5	-5.0	8.5
2022	-13.8	-5.5	2.2	-20.2	-6.1	-11.2	13.8	-6.9	-13.0	2.1	4.9	-10.0	-50.8

Sector Allocation	
Sector	% Portfolio
Information Technology	69.6%
Communication Services	14.6%
Consumer Discretionary	14.2%
Cash and Equivalents	1.7%

Geographical Allocation	
Country	% Portfolio
USA	81.0%
Netherlands	8.0%
Brazil	5.4%
Canada	2.0%
Singapore	1.9%
Cash and Equivalents	1.7%

Top Ten Holdings	
Name	% Portfolio
Microsoft Corp	13.0%
Apple Inc	11.9%
Nvidia Corp	10.4%
Alphabet Inc-Cl A	9.4%
Amazon.Com Inc	8.3%
Asml Holding Nv-Ny Reg Shs	5.4%
Mercadolibre Inc	5.4%
Adobe Inc	3.6%
Advanced Micro Devices	3.6%
CrowdStrike Holdings Inc - A	2.7%
Total	73.7%

This letter shows the performance of Somerson's "Technology Equity Strategy" from 31 December 2014 to 30 November 2020 then the Somerston Technology Fund from its launch on 01 December 2020.

Commentary

Technology stocks performed very poorly in 2022. The post pandemic hyper growth era moderated, and both investor expectations and valuations came back down to earth. The terrible stock prices however, mask some very good operational developments for our investments.

In the third quarter, Mercado Libre which is the 'Block' and 'Amazon' of Latin America, grew its commerce platform 32% compared to the last year, registering \$8.6 billion in gross merchandise volume in the quarter. Its fintech platform did even better with total payment volume of \$32.2 billion up 76% year over year and boasting over 40 million users. Mercado Libre attained a 11% operating margin up from 8.6% a year earlier, it is profitable on a GAAP basis and the company has produced over \$1.6 billion in free cash flow over the last twelve months. Yet its stock fell 37% in 2022.

In 2022 Snowflake, a company that provides services to generate insights from data, showed just how essential its services were, with 80% of the Fortune 500 as customers, and a net retention rate of 165%. The net retention rate shows how much more (or less) its customers are spending net of customers lost. Snowflake Net retention rates are amongst the best in its industry. Revenues grew 67% year over year in the third quarter and analysts expect 46% sales growth this year, consistent with company guidance that revenues can triple by 2026. While not GAAP profitable, operating margins are improving and in 2022, Snowflake became free cash flow positive. Snowflake stock fell 58% in 2022.

Dutch company ASML, a leader in design and manufacturing of Semiconductor machinery with a virtual monopoly in high end extreme ultraviolet (EUV) lithography machines, which makes mass production of the worlds most advanced microchips possible, had a steady year. In the third quarter net sales came to €5.8 billion, 10% higher than a year earlier. This is despite high chip inventories, sanctioning against sales to China and supply chains that remain distorted. The stock was down 27% in the year.

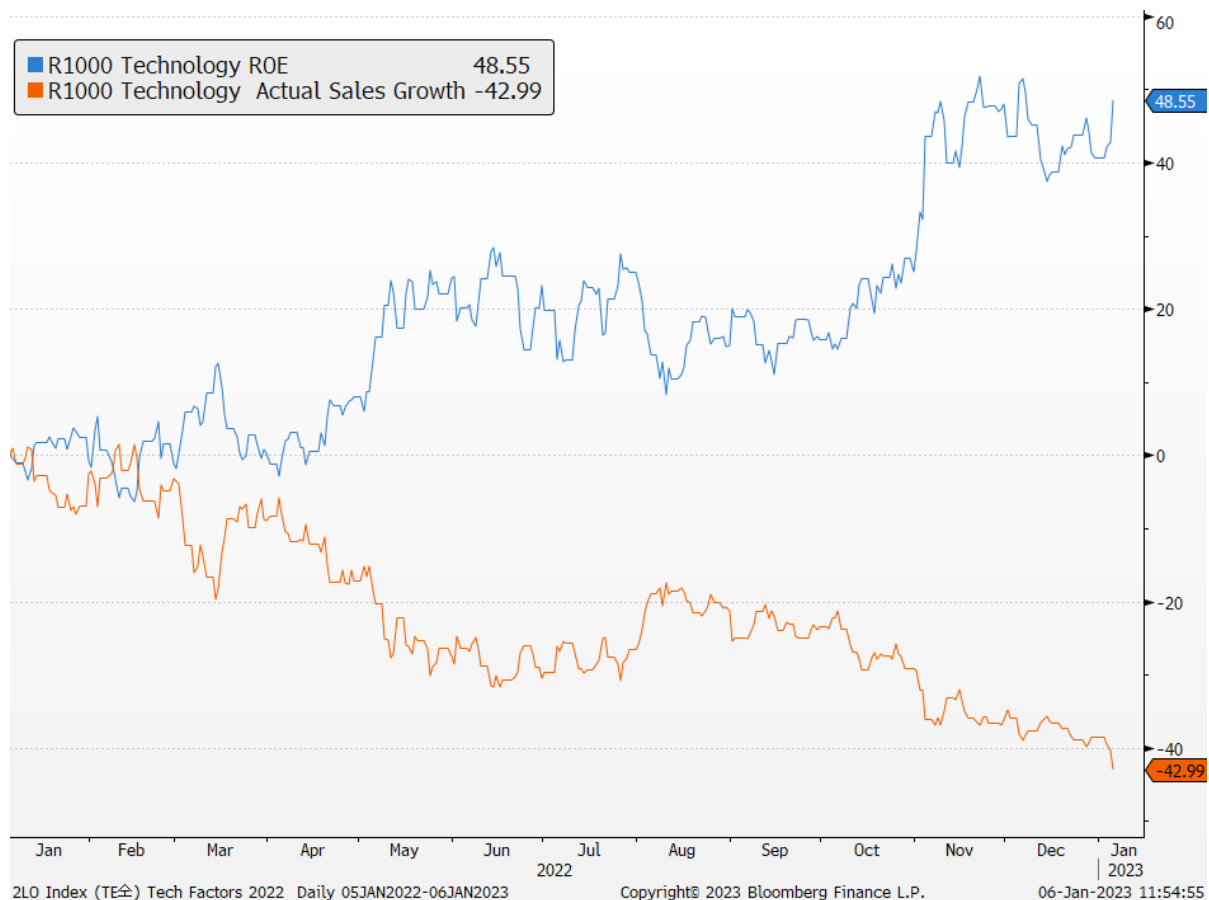
European company Adyen, which has developed an enviable fintech platform providing solutions to companies to efficiently deal with the ever-growing forms of payment that are available, grew revenue 37% year over year to €608 million and GAAP earnings grew the same. Analysts expect similar if not better growth in the years ahead. The stock fell 44%.

Some other stocks fared even worse. Block, formerly known as Square, founded by Twitter founder Jack Dorsey, fell 61% in 2022. Its consumer (Cash app) and enterprise (Square) solutions are providing efficient, holistic mobile fintech solution to millions. In the most recent quarter, Block delivered strong financial results, an impressive accomplishment under challenging economic conditions. Gross profit climbed 38% to \$1.6 billion. Cash app generated gross profit of \$774 million up 51% y/y; Square generated gross profit of \$783 million up 29% y/y. It made a GAAP loss in the year but was cash flow positive. Moreover, Block managed to increase its headcount from 5,477 to 8,521 and still grow its average revenue per employee head.

CrowdStrike was founded in 2011 to reinvent security for the cloud era. Realizing that the nature of cybersecurity problems had changed but the solutions had not, CrowdStrike Falcon platform was built to detect threats and stop breaches. Gartner ranked the company number 1 in terms of market share in managed detection and response. Its customers continue to spend more each year with a net retention rate of 120%, admittedly down from 132% a few years ago. In the most recent quarter, CrowdStrike grew revenues by 53% to \$580 million. It is still mildly unprofitable on a GAAP basis though cash flow positive and it has \$2.4 billion of cash on balance sheet. Its stock fell 48%.

The macroeconomic market environment drove the bifurcation between stock performance and operating achievements. Rising interest rates in the context of rich valuations changed investors' preferences. The chart below shows the performance of two long/short strategies. The blue line shows the performance of being long technology stocks in the top quintile and short stocks in the bottom quintile based on the profitability measure, return on equity. The red line is similar based on last year's sales growth. Growth was unimportant to investors during 2022, instead companies able to boast significant profitability were rewarded.

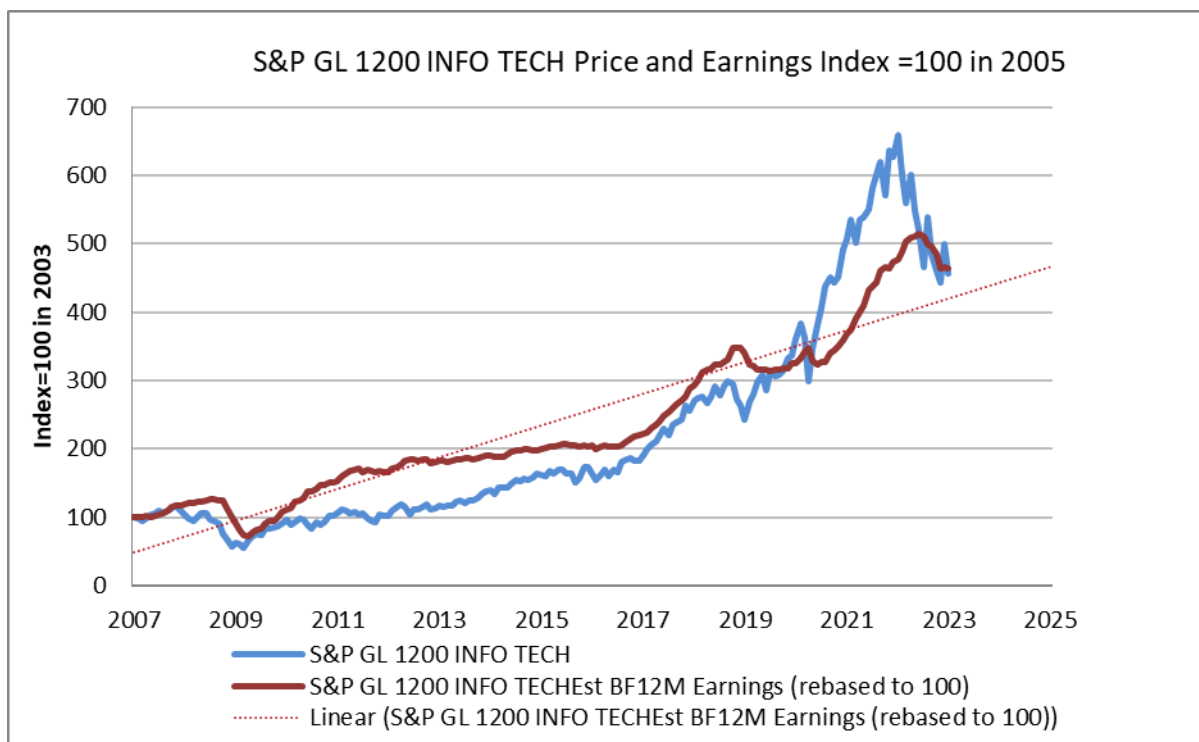
Chart 1 – During 2022, technology stocks with the best returns on equity (ROE) (blue) have outperformed stocks with highest sales growth (red)



Pleasingly, while not cheap at 19.5 x forward earnings, the Technology sector has more realistic valuations than were apparent last year.

In summary, we are content with the operating performance of our holdings. Valuations have ratcheted lower and now appear reasonable, offering better long term prospects. Investors' preference for 'Growth' attributes may not comeback in favour until interest rate hikes pause, but over the long term, we consider we own companies with tremendous long term opportunities.

Chart 2 - Price and Earnings of the Global Technology Sector – indexed to 100 in 2005.



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