

# SOMERSTON CORE EQUITY STRATEGY

INVESTMENT LETTER AS AT 29 SEPTEMBER 2023

**Portfolio Objectives:** To grow capital over the medium term by investing in a concentrated portfolio of high quality companies and to outperform global equities over the economic cycle.

**Strategy:** We use a fundamental bottom-up approach to identify attractive investment opportunities. We have a 5-year investment horizon. We focus our investments in 15 to 25 high quality companies. We invest in companies that demonstrate strong governance, high profitability, low capital intensity, strong economic moats, and low business risk. We invest globally, without sector/geographic restrictions.

**Performance:** The Core Equity Strategy fell by -5.5% in the month and fell by -3.2% over the last three months. The reference index fell by -4.8% during the month and fell by -2.9% over the last three months.

## Core Equity Strategy Performance (%)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
<b>2017</b>				1.2	5.4	-0.2	0.4	-0.1	1.9	1.8	-1.8	2.1	<b>10.9</b>
<b>2018</b>	6.2	-4.6	-1.9	0.4	1.2	1.2	4.3	1.3	0.4	-8.5	2.7	-9.0	<b>-7.2</b>
<b>2019</b>	6.2	4.2	3.3	3.8	-4.0	5.7	0.6	0.8	-1.6	1.3	5.1	2.5	<b>31.1</b>
<b>2020</b>	0.9	-7.3	-14.3	12.5	5.8	2.6	4.4	5.5	-3.4	-3.8	9.7	2.9	<b>13.0</b>
<b>2021</b>	-0.6	1.7	3.3	5.0	0.2	3.4	3.1	2.2	-5.1	6.3	-1.6	2.9	<b>22.2</b>
<b>2022</b>	-8.3	-4.8	4.4	-9.4	-0.2	-8.8	10.4	-4.5	-8.6	6.6	4.7	-4.8	<b>-23.1</b>
<b>2023</b>	2.2	-3.8	5.3	1.8	-1.6	4.7	3.7	-1.1	-5.5				<b>2.9</b>

Total return since 2017: 50.5%

## Sector Allocation

Sector	% Strategy
Health Care	30.2%
Information Technology	25.8%
Consumer Staples	14.6%
Industrials	11.1%
Communication Services	8.4%
Consumer Discretionary	5.9%
Financials	5.2%

## Geographical Allocation

Region	% Strategy
North America	71.6%
Europe	28.4%

## Top Ten Equity Holdings

Name	% Fund
Alphabet Inc	8.4%
Microsoft Corp	7.6%
Thermo Fisher Scientific Inc	6.8%
Adobe Inc	6.2%
LVMH	5.9%
Assa Abloy AB-B	5.6%
UnitedHealth Group Inc	5.4%
Danaher Corp	5.3%
Estee Lauder Companies-CI A	5.2%
Mastercard Inc	5.2%
<b>Total for Top Ten</b>	<b>61.7%</b>

## Commentary

We are pleased to announce the launch of Somerston Core Equity Fund (“SCEF”). This strategy has been employed for over 10 years, and while the launch always takes longer than anyone expects, we do feel the timing is good.

While the aggregate market can be described as expensive, we are finding many of our ‘core equity’ candidates’ valuations to be fair, if not outright cheap. The table below shows our top ten holdings together with their valuation rank compared to the last ten years.

Name	Valuation
1 ALPHABET INC-CL A	31%
2 MICROSOFT CORP	75%
3 THERMO FISHER SCIENTIFIC INC	54%
4 ADOBE INC	57%
5 LVMH MOET HENNESSY LOUIS VUI	39%
6 ASSA ABLOY AB-B	1%
7 UNITEDHEALTH GROUP INC	75%
8 ESTEE LAUDER COMPANIES-CL A	44%
9 MASTERCARD INC - A	55%
10 DIAGEO PLC	8%

Only Microsoft and UnitedHealth Group are towards the top end of their 10-year range (and for good reasons), with companies such as Assa Abloy and Diageo appearing very cheap.

Assa Abloy is the global leader in access solutions. Its valuation has compressed because of concern that softening real estate markets will negatively impact the company. Yet in the most recent quarter the company announced 3% organic revenue growth and 6% acquired revenue leading to an 18% earnings per share growth at constant currency. Assa is at the leading edge of a changing technological landscape, digitalising entrance systems, allowing for efficiencies, control and monitoring. This theme has a long runway and Assa is augmenting its leadership by rolling up a highly fragmented industry. Clearly a recession will negatively impact Assa in the short term, but on most measures, Assa Abloy’s valuations are already discounting a more challenging marketplace.

While different, the story around Diageo is somewhat like Assa Abloy. Recent reports from the drinks industry show a meaningful slowdown, particularly private consumption. Indications are that inventory levels became bloated, and depletion is now well underway causing a cyclical slowdown. There is also debate whether new CEO Debra Crew, can replicate her recently deceased predecessor, Sir Ivan Menezes’, who grew the companies’ market share in the growing US Spirits market while divesting low margin business of wines and beer. Diageo’s ambition is to lift its beverage alcohol market share to 6% by 2030 from 4.7%. Over the medium term, Debra has the balance sheet strength and cash flow at her disposal, to make the required investments to fulfil this ambition.

We see similar situations with LVMH and Estee lauder which we have been accumulating into recent weakness. There are cyclical headwinds for both companies, but valuations are already reflecting that.

The Core Equity strategy aims to invest in fairly valued companies that have leading positions in growing markets; that are able to use internally generated cash for astute investment while maintaining high returns without reliance on financial leverage.

Over the last several years, we have seen all sorts of economic and market conditions. Yet, viewed through a long-term lens, core equity candidates, while not immune to these macroeconomic gyrations, take these events in their stride.

Nick Wakefield

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