SOMERSTON
ASSET MANAGEMENT

# SOMERSTON TECHNOLOGY FUND

INVESTMENT LETTER No.13 AS AT 31 MARCH 2024

**Portfolio Objectives:** To grow capital over the medium term by investing in a concentrated portfolio of high growth companies and to outperform our reference index 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 30-40 high growth companies.

**Performance:** The Somerston Technology Fund (US Class) rose by +15.1% in the first quarter of 2024. Our reference index rose by +10.0%.

**Performance (%) (US Class)**

| | 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** |
| **2023** | 16.7 | 0.3 | 11.9 | -1.1 | 13.2 | 4.6 | 6.5 | -3.3 | -6.3 | -2.0 | 16.1 | 4.8 | **76.6** |
| **2024** | 6.0 | 7.8 | 0.8 | | | | | | | | | | **15.1** |

*Total return since 2017: 175.0%*

**Geographical Allocation**

| **Region** | **% Fund** |
|---|---|
| North America | 87.6% |
| Europe | 6.5% |
| South America | 5.9% |

**Sector Allocation**

| **Sector** | **% Fund** |
|---|---|
| Information Technology | 60.8% |
| Consumer Discretionary | 19.4% |
| Communication Services | 17.4% |
| Financials | 2.4% |

**Top Ten Holdings**

| **Name** | **% Fund** |
|---|---|
| Nvidia Corp | 13.5% |
| Amazon.com Inc | 9.6% |
| Microsoft Corp | 9.4% |
| Alphabet Inc | 8.6% |
| Meta Platforms Inc | 7.8% |
| MercadoLibre Inc | 5.5% |
| Apple Inc | 5.5% |
| ASML Holding NV-NY Reg Shs | 3.9% |
| Crowdstrike Holdings Inc | 3.8% |
| Salesforce Inc | 3.6% |
| **Total for Top Ten** | **71.1%** |

This factsheet 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

The Fund continued where 2023 ended, with the first quarter of 2024 rising 15.1%.

Top contributors were Nvidia (+6.9%), Meta (+1.6%) and ASML (+1.5%). The largest detractors were Apple (-0.9%) and Adobe (-0.5%).

During the period the fund acquired new a new position in Synopsys. We entirely divested from Okta, Paycom, Fiverr and Bill.com.

**Expectations**

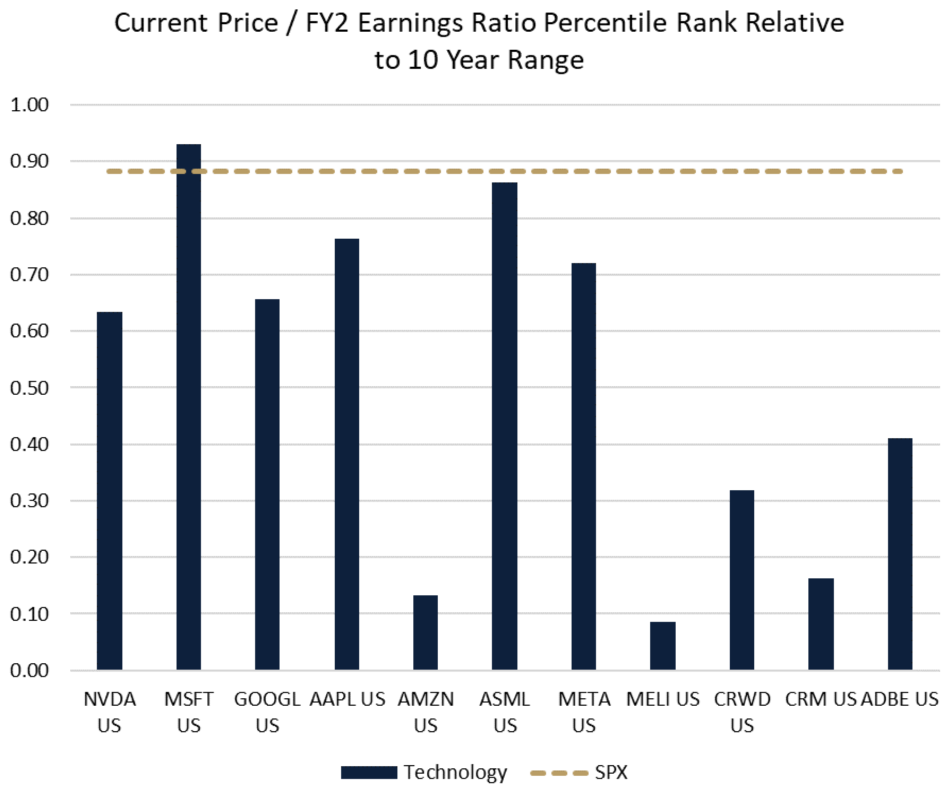
Over the short term, stock prices 'react' based on whether expectations are met, exceeded, or fall short. The price reaction is often at odds to the long-term underlying attributes and intrinsic worth of a company and eventually provide opportunities.

Corporate guidance, sell side analysts, and investors all have their part to play in moulding expectations. But companies are executing on a long- term strategy and are not well equipped to make short term forecasts. Sell side analysts try to finesse company guidance and are incentivised to be the 'most accurate'. Finally, investors value the companies based on a holistic interpretation of factors. Where companies continually beat their estimates, analysts raise their numbers at an ever-increasing rate. Attracted by the acceleration in analysts' growth forecasts, investors start to attribute higher valuation multiples. Eventually we get to the point where companies are surprised by how buoyant their markets are, sell side analysts believe the company is 'low balling' their guidance, analyst forecasts become unrealistic and investors attribute even higher valuations to reflect the acceleration.

When expectations are at their highest, they are vulnerable to disappointment and prospective stock returns are at their worst.

US Companies have started giving guidance below sell side analysts own forecasts. Presently, these are being brushed aside and described by both analysts and investors as 'conservative'. Yet, analysts are forecasting 25% earnings growth for the Technology Sector. This is high by any measure. However, investors are attributing credence to these forecasts and valuations have advanced. This makes stocks vulnerable. Accordingly, we have raised some cash, and trimmed holdings where investors appear to have attributed lofty expectations. We hope to deploy this cash in companies we find attractive at better valuations. In the chart below, we compare the Price/ FY2 Earnings ratio versus each company's own 10-year history. In many cases, many of our holdings are toward the lower end of their 10-year valuation range, and in the case of Microsoft and ASML, we have been reducing. Moreover, the 'quality' of many of these businesses is unrivalled, with fortress balance sheets, high returns on capital and selling essential services to millions of customers.

We do not consider we are carrying unreasonable valuation risk for long term investors.




**Outlook**

Save short term fluctuations that we may have on the horizon, the outlook for the technology sector is as exciting as ever. We described the AI advances last year akin to the invention of electricity, or more appropriately, the infrastructure to distribute electricity. Even the most ambitious people at that time could hardly have imagine the improvements to the standard of living consequent on the 'applications' and inventions that electricity enabled. Similarly, few today (ourselves included), can properly comprehend what AI compute will enable.

AI Infrastructure is being developed, and this process is still in the early innings in our view, but the more exciting aspect of AI are the future applications that AI enables. The first 'applications' remain at the embryonic stage with ideas just germinating. The AI enabled examples we have seen so far are fringe improvements to existing applications.

When Elon Musk was asked what he thought **Meta** would do with 350,000 **Nvidia** H100 chips, he responded by saying, "it is not entirely clear". Infrastructure is being rolled out at a faster rate than applications. The mistiming between infrastructure being ready but applications being slower to roll out, may pose a risk that infrastructure becomes outdated before it is even deployed. This is what happened during 1995 -2000 where a massive wave of capex was written off as obsolete as new technologies emerged that were substantially superior.

Most recently **Nvidia** rolled out its Blackwell B200 chip. The dual-die B200 GPU has 4X the AI training performance and 30X the inference performance of its predecessor. The H100 was revered as a breakthrough less than 12 months ago, yet the B200 seems to be a significant step change already.

The Security industry has been very interesting this quarter with several announcements corroborating our thesis. **Palo Alto** is the largest security company by revenue, growing over the years through acquisition. Investors were disappointed by their most recent earnings call and the stock fell 28.4%. It transpired that they lost a government contract that took down FY '24 billings guidance by $600 million. In contrast **Crowdstrike's** investors, saw the value of their holding appreciate 10.8% on the back of its earnings call and some key contract wins.

**Crowdstrike** was designed from the ground up for the modern world. Whereas **Palo Alto** sells products, **Crowdstrike** sells its platform. It operates as a global 'organism' where threats at one company in one part of the world allow for adaptations to benefit all its customers across all regions of the world. The efficacy of its strategy is evident by analysing the lifetime value of its clients. **Crowdstrike** extracts far more value over a longer period than any of the traditional peers. It has boasted AI attributes long before it was fashionable to do so. We have long backed **Crowstrike** and **Zscaler** to be the security leaders and our view is becoming more widely shared.

The US Justice Department sued **Apple** for violating antitrust laws by blocking rivals from accessing hardware and software features on its devices. The lawsuit alleges that Apple has used its power over app distribution on the iPhone to make it difficult to switch devices, has refused to support cross platform messaging apps, limited third party digital wallets and non-apple smartwatches and blocked mobile cloud streaming services.

Simultaneously, there was an EU anti-trust announcement on big Tech generally. The Probe falls under the Digital Markets Act, which is designed to tackle the dominance of so-called digital gatekeepers — the biggest online platforms — and came into effect this month. If found guilty of non-compliance, companies face fines that could amount to up to 10 per cent of global turnover.

**Apple** fell 4% on the day of these announcements. This is likely to rumble on for months/years and headline will impact the stock price. There was a good article on Bloomberg advocating **Apple'**s defence, equally there are others citing the 1998 lawsuit against **Microsoft** that arguably caused its decade long under performance.

**Apple** is a mature company that is able to use its 2 billion user base to provide services with annuity style revenues. It has a huge net cash balance of $72 billion and, with free cash flow over 100 billion it is priced with a 4% free cash yield. While growth is pedestrian, we consider the **Apple** eco system as attractive. Much of the accusations at **Apple** would potentially compromise the speed, responsiveness and security of the platform and are defensible. Other practises may well need refining. The potential return from **Apple** is not as great as elsewhere in the portfolio. It is however a high quality company and we may use it as a source of funds should prices provide the opportunity.

**Synopsys** was a new acquisition at the beginning of the quarter, **Synopsys** is a 'picks-and-shovels' play on the semiconductor industry. The US-based company develops electronic design automation (EDA) software, which is used in the entire chip design process. The company also owns and licenses semiconductor intellectual property (IP) that chip designers rely on. The combination of software sales and licensing revenue gives the company an attractive recurring revenue profile. We see several important industry trends that should support growth at **Synopsys**. These include the growing prevalence of in-house chip design leading to additional software demand, and increasingly advanced chip designs requiring greater IP spending. **Synopsys** has returned 15.5% since purchase.

**Nick Wakefield**

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