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GLOBAL INVESTORS

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<u>To: Our Investors in the Chawton Global Equity Income Fund</u>

Quarter ended 31 December 2022

<u>Overview</u>

Before I go into the details of the progress made by the fund investments during the last quarter of 2022, I wanted to summarise what makes our investment approach unique.

- <u>We are conservative</u> meaning we are aiming to minimise the specific risk of the companies we invest in. This differentiates us from many active managers who are seeking immediate good performance to head performance tables and sell product. We look for companies with clear competitive advantage and therefore superiority in their industry, low operational risk through low asset intensity, steady demand and recurring revenues and low financial risk through low debt levels.

- <u>We are business analysts not stock market traders</u>. We focus on the underlying business and not the stock price and we act as owners once we have purchased. As Ben Graham wrote, the public markets must be thought of as a service which provides a price every day at which someone offers to buy your business and nothing more. It also provides the same price for you to buy more of your business. Other than this, the stock market should be ignored.

- <u>We aim to deliver a reliably superior absolute return.</u> A superior absolute return should be a return that is calibrated relative to the alternatives. The very long term returns for the UK and USA stock markets are around 6-7% real according to the Barclay's equity/gilt study. US ten-year treasuries currently offer a low risk return of 3.7%. A superior return may be thought of a risk adjusted return in excess of these over the long term. A strong well managed consumer staple delivering 5% nominal growth is capable of delivering the same.

The aim of this letter is to update you on the progress of the companies you own through being invested in this fund and to illustrate, through this, how we achieve what we are claiming we do. It also provides information on the performance of the fund with the most important figure being its compound annual growth (CAGR) since inception, which is almost 4 years now. This should be compared to the opportunity costs cited above.

Investment Performance and Activity

Performance

Chawton Global Equity Income Fund performance is shown below for the fourth quarter 2022 and preceding periods. The Fund results are net of fees and charges and are compared to the benchmark index (MSCI World GBP) and the comparator group as represented by the Investment Association Global Equity Income sector.

	Chawton Global Equity Income Fund	**MSCI World TR in GBP**	**IA Global Equity Income Sector**
Fourth Quarter 2022	4.9%	1.9%	5.5%
2022	-8.3%	-7.8%	-1.2%
2021	18.2%	22.9%	18.7%
2020	14.2%	12.3%	3.3%
2019 (from 19 May)	9.3%	8.6%	NA
Since Inception 19/05/2019 – 31/12/2022	35.2%	38.2%	29.6%
Compound Annual	8.0%	8.6%	7.0%

Source: FE fundinfo as at 31 December 2022. Total return in GBP. Past performance is not a reliable indicator of future results. The value of your investments and the income derived from it can go down as well as up and you may not get back the money you invested. * Fund launch 21 May 2019

As our fund history grows, I would recommend focusing on the compound annual return figure as the best representation of how well we are doing both absolutely and relatively. I would summarise this currently as solid, absolutely, at around 8% but we are targeting a little more.

The fund's rise of 4.9% in the fourth quarter was ahead of the benchmark which rose 1.9% but behind the Global Equity Income sector. The sector has performed relatively well this year declining -1.2% in GBP currency, compared to the fund at -8.3%. For reference, the S&P 500, in US dollars, has fallen -19.4%, its worst performance in 14 years. Performance since inception has been +35.2%, comfortably ahead of the sector's +29.6% but behind the benchmark at +38.2%. The fund did well in 2019 and very well in 2020 as COVID broke. It failed to keep up with the exuberant 2021 markets and has lost ground in the commodity driven 2022 markets.

Activity

Over the 3 months to the end of December 2022, we completed the purchase of one new position in healthcare which we discuss below. We currently own 34 stocks.

Major Purchases:

Novo Nordisk – Danish Pharmaceutical company

Major Sales:

No major sales were completed

__**Our Portfolio Companies**__

Novo Nordisk

During the fourth quarter, we completed the acquisition of a position in Novo Nordisk (Novo), the Danish listed pharmaceutical company. Whilst most pharmaceutical companies focus on a number of broad-based therapies; Novo stands out through its specialisation in one therapeutic area; diabetes. The group originates from companies founded in Denmark in 1923 set up to commercialise the newly discovered approach of managing diabetes through injecting animal insulin. This led to a rich seam of innovation and development refining and improving the approach through improved synthetic insulins and improved delivery mechanisms. It also became evident that barriers to entry are higher post loss of patents as manufacturing insulin at scale and quality, globally, is very difficult to achieve. Novo has therefore been able to both grow its business organically and build up and sustain very high returns on capital.

Diabetes comes in two forms; type 1 which is genetically inherited and manifests itself normally during childhood and type 2 which tends to occur later in life as a consequence of poor diet and obesity. The latter is far more common and commands most of the industry revenues. Novo's research led it into seeking to find treatments that reduced the risk of full type 2 diabetes developing through reducing the harmful effects of poor diet most notably through weight loss. They discovered that a peptide compound called Semaglutide could be developed into a series of drugs that had this effect and could be prescribed to patients at high risk of type 2 or in the early stages and reverse its onset. The first of these drugs was approved in 2009 and resulted in phenomenal growth for the company. Variants and improvements have led this non-insulin therapy to quickly grow to become over half of Novo's group revenues.

Novo scientists realised that the weight reducing qualities of these treatments might have a wider application in generally reducing obesity which has epidemic levels in the developed world. Their drug Ozempic, meant for these at risk of type 2, went viral in Hollywood because of its weight loss attributes. In 2021 their pioneering weight loss drug Wegovy, was approved specifically for the morbidly obese. To date the company have been unable to keep up with demand.

There are competitors in this therapeutic area notably Eli Lilly and Sanofi in insulin and Eli Lilly and Amgen in Semaglutides. However, these are smaller parts of larger groups whilst the focus and scale of Novo suggests continued success for them in what could develop into a huge market.

Novo yields 1.5% and has reduced its share count by 8.5% in the last five years.

Johnson & Johnson

During the quarter, Johnson & Johnson (J&J) announced that the board had completed the succession in leadership as Joaquin Duato was elected executive Chairman to add to his CEO role taking over from the long tenured Alex Gorsky. Duato is a 30-year insider. The transition occurred a little earlier than expected as Gorsky is only 61 but he wished to step back for personal reasons. Duato, at 59, will not likely be as long tenured but there is good internal talent to follow. The board's succession planning is robust.

J&J can trace its origins back to 1886 when it was founded to launch pioneering sterile surgical dressings. Since then, it has developed in several directions in healthcare firstly in consumer products then in drugs and medical devices. It is now one of the largest companies in the world with revenues of £94 billion and a market capitalisation of over $400 billion. It has demonstrated longevity and growth. It has also continued to deliver excellent compounding performance giving shareholders a 170% total return over the last ten years. It is one of the fund's top positions.

Pharmaceuticals, which now deliver $53 billion revenues and 65% of profits, have been a key driver of this growth as the company has managed to both launch block buster drugs and reinvest the capital generated in productive R&D to replace these and more as the patents expire. The group spends over $11 billion annually on R&D which is a greater proportion of sales than competitors.

Our research suggests the company continues to make productive use of this substantial investment. The company is a leading player in immunology and new drug Tremya is on course to be best in class treatment for psiorasis (skin disease caused by overactive immune system). Similarly, the company has a strong oncology franchise with, for example, Darzalex for multiple myeloma (cancerous white blood cells) and promising pipeline drugs including in the new CAR-T scientific area where white blood cells are genetically modified to attack cancerous cells. The common thread here is specialism in therapies related to the immune system.

Capital has also been allocated to build a medical devices division which has revenues of £27 billion and which would be the second largest in the world by revenues if a stand-alone company. Similarly, the consumer health products division, with revenues of $14 billion, would be the second largest globally. Medical Devices has been more reliant on acquisitions for growth and the substantial goodwill paid means returns on invested capital are lower than Pharma. However, we believe this has put the company in an excellent position for the impending growth acceleration in this market as populations age globally. Research by HSR[1] indicates healthcare consumption increases exponentially after the age of 50.

In 2021, the company announced that it was preparing to spin off the consumer health division which will be called Kenvue and will contain iconic brands such as Aveeno, Band-Aid, Listerine, Neutrogena, Tylenol and Zyrtec. The fund will receive its share of the new company which we will assess as a stand alone entity nearer the time of the spin.

The group has been on the receiving end of a number of legal cases in the US which is common in the sector but exaggerated for J&J as litigious attorneys eye their vast financial resources. The company is aggressive in defending these, perhaps overly so at times.

Overall, we believe the group has excellent compounding characteristics as well as being a defensive backbone dividend payer with a quarterly payment that will amount to a yield of over 3% on the current market price. This is further augmented with share repurchases which have reduced the share count by around 1% per annum over the last five years.

[1] HSR, the Lifetime Distribution of Healthcare Costs, 2004

Next plc

Well managed companies that operate in more cyclical markets such as consumer discretionary and industrials, take steps to reduce operational risk and use recessionary period to accelerate growth. Next plc, which is one of our largest holdings, retails apparel and home furnishings. It is exposed to both the general risk of economic weakness and the specific risk that its designs in any year are less popular.

Through using its fulfilment skills developed operating its traditional catalogue business, it has successfully built a powerful eCommerce platform. It has opened this up to third party brands and is fast approaching one thousand including the likes of Nike, Ralph Lauren, Ted Baker and the White Company. Having more brands, the company both reduces the dependence on its own brands working for any particular season and provides greater diversity with the likelihood that some brands on the platform will knock the lights out with on fashion design.

The company delivered a resilient performance in the second half of 2022 despite increasing pressure on consumer's disposable income.

Lord Wolfson, the CEO, is conservative by nature and reduced financial leverage through the COVID period by selling freehold property and maximising working capital in-flows. Many competitors, with less secure finances have run into trouble with COVID increasing debt and then rapid inflation increases and consequent interest rate rises increasing debt servicing costs.

In early December, Next announced the acquisition of competitor 'Joules' for £34 million which at its height had a market capitalisation of well over £300 million. Relatively low financial risk has allowed the Next to grow, in market share terms, through both the demise of competition and this acquisition, in more difficult economic times. This will act to increase long term value.

Next yields 3.2 % and has reduced its share count by 10.7% in the last five years.

Stewardship

There have been some interesting developments at two high profile companies; Disney and Unilever, which I believe are very instructive as regards how active managers address governance and stewardship obligations.

Nelson Peltz and Terry Smith respectively have articulated the issues at these groups well. However, I would question whether long term investors in these companies have properly conducted their stewardship effectively and whether this is an inherent weakness of the hold forever and do-nothing approach.

The Achilles heel of high-quality companies with strong economic moats is poor governance practices and misaligned incentive structures. Peltz pointed out that Bob Iger, the CEO and Chairman of Disney from 2005 to 2020 clearly exerted too much power and influence over the Disney board for many years which impacted the appropriateness of incentivisation, which became excessive, the appropriateness of capital allocation and impeded proper succession planning.

Smith, a long term holder of Unilever, described how a long period of poor operational management and capital allocation persisted at the company aided by lack of proper engagement between management and shareholders.

I consider it is correct for active managers to invest in companies for long periods of time and ideally forever; however, we must also act as good stewards of our investors' capital. The FRC Stewardship code sets out a framework for analysis, engagement, escalation and collaboration with other managers to exert influence. However, if this fails to achieve change, and capital is being badly misallocated, the long-term, non-activist manager has to use their ultimate sanction; divestiture.

Peltz is now an investor in Unilever and was recently elected to the board and its remuneration committee. CEO, Alan Jope, has announced his retirement and an external appointee; Hein Schumacher, announced as his replacement. The situation is similar to Procter and Gamble five years ago when Peltz joined the board following a fierce proxy battle. We have built a full position in Unilever as we believe our interests are now properly aligned. With the reappointment of Iger, we do not think Disney has properly addressed its Governance issuers and do not hold the stock.

Conclusion

Our investment approach is differentiated through being conservative, business rather than stock market focused and targeting a reliably achievable yet superior return when compared to the stock markets over the very long term. As our track record grows, the compound annual growth rate of the fund should be used to assess our success. This is currently around 8%.

We completed the acquisition of a new position in Danish Pharmaceutical company Novo Nordisk during the quarter which has a strong franchise in the provision of insulins to treat diabetes and increasingly in drugs that prevent the onset of type 2 diabetes and stimulate weight loss.

Our other pharmaceutical company, Johnson & Johnson completed a well-planned succession process and continues to successfully invest in new drug development. It will shortly spin off its consumer health division where profits are a relatively small part of the group now.

Next, although more sensitive to economic downturns, is developing into a retail on-line platform provider for third party brands which will reduce its operational risk and increase growth potential. The company is conservatively financed which enables it to take advantage of difficult conditions to increase share; a competitor, Joules, was acquired in the quarter.

We have a robust stewardship process where we seek to engage with management and make them aware of our views. Recent governance weaknesses that were allowed to go unchallenged for long periods at Disney and Unilever resulted in poor capital allocation and poor returns for shareholders.

I hope this letter has provided greater insight into our process and progress. Please do not hesitate to contact me if you have questions or would like me to run through our associated presentation.

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As a concentrated equity portfolio of typically less than 50 stocks the fund may involve higher volatility and therefore higher risk for those with shorter term investment time horizons (under 5 years). The value of an investment and the income from it can fall as well as rise as a result of market and currency movements and you may not get back the amount originally invested. You should therefore regard your investment as long term. Details of the risk factors are included in the fund's prospectus available at www.tbaileyfs.co.uk/funds