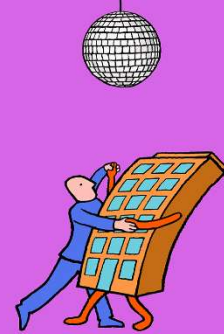


GLOBAL INNOVATION FUND

Investment Commentary

Q2 2024



Market review

The good equity returns were to be found in LargeCap during the opening half of 2024. SmallCap underperformed its larger peer by a staggering 12% over the last 6 months, while MidCap did not fare much better. This marked the worst half-year underperformance for Global SMidCap for over a quarter of a century. Unless this reverses, the asset class will deliver a record 7th consecutive year of underperformance versus LargeCap.

What was behind this dramatic divergence? Conditions in the equity markets continued to be dominated by two main themes: stickier-than-expected inflation and the ongoing domination of the large technology stocks in the US. In both the US and parts of Europe, stubborn services inflation led certain Central Banks to delay interest rate cuts. This had a negative impact on smaller companies which are more interest rate sensitive compared to their larger peers.

LargeCap technology stocks – and in particular anything “A.I.” related – performed strongly. Nvidia, which on its own is worth roughly the same as the entire Russell 2000, continued its heady triple-digit ascent (although the Magnificent Seven did begin to show some signs of bifurcation).

Towards the end of the second quarter, political upheaval weighed on most parts of the equity markets. The UK faced an election and a change of government, while in France a snap election was called by Emmanuel Macron, which raised market volatility. In the US, the election bandwagons began to roll.

Portfolio

During the quarter, the NAV of the Sterling Accumulation B Share Class increased by 3.1%, an outperformance of 6.0% versus the MSCI World SMidCap Index. Since the beginning of the year, the Fund has risen by 5%, an outperformance of 2%.

The strongest contributions during the quarter came from **TransMedics**, the provider of products and services used to transport organs for transplantation surgery, which continued to win customers and grow revenue at an impressive rate. **Nova**, the semiconductor metrology solutions provider, rose on accelerating demand and further evidence of market share gains. **Pro Medicus**, the provider of software used to view and transmit diagnostic images, continued to win market share in the US.

The weakest contributions came from **SolarEdge**, the manufacturer of power optimisers helping residential solar panels to work at maximum efficiency, which declined after the company announced a cash outflow of \$150m in Q2 and the issuing of a convertible bond. **Maytronics**, the manufacturer of robotic swimming pool cleaning robots, reduced its guidance amidst evidence of a more challenging competitive environment that caused us to exit the stock. **Stevanato**, the leading manufacturer of glass packaging solutions for pharmaceutical products, signalled to the market a longer than expected destocking cycle concentrated in its glass vials business.

Outlook

At the end of 2023 we suggested that the conditions might be ripening for the “SmallCap Effect” to emerge from its multi-year hibernation. This is yet to happen. How does this set us for the next six months?

Despite inflation remaining “higher for longer”, there were clear signs of cooling towards the end of June. On a June annualised basis core CPI in the US was below 1%, while the three-month average was only a whisker above 2%. Most reassuringly for Growth investors, such as ourselves, CPI shelter inflation (the average cost of housing in the US) plummeted to 2%. Not so long ago it was above 8%. The market reaction to this data? Futures priced in a 91% probability of a rate cut in September (up from 55%); Treasuries rallied and the yield curve

steepened; and the technology behemoths fell (Nvidia by almost 6%), while SmallCap gained.

While one month of data is too little to indicate that we are in “risk on” mode to an extent that SMidCap will catch up on this year’s underperformance anytime soon, it is another indicator that market dominance comes hand-in-hand with concentration risk. Some recent research that we found interesting was published by Bridgewater (*The life cycle of market champions*): “a consideration for investors today is that most investors’ portfolios have higher exposure than ever to the current champions [the large tech stocks]... over a third of a typical US-market-weighted portfolio is allocated to the current basket of champions, and in a world portfolio, this share ends up close to 20%—the highest in over 50 years”.

With macro data becoming more supportive of smaller company investing, it is worth ending with a point on valuation. Global SMidCap has never looked as attractive in over 20 years: the asset class is trading on near record P/E and P/Book discounts to LargeCap. On a long-term view, now may be as good a time as any for dipping a toe back into SmallCap waters.

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