Fundsmith Equity Fund | SICAV

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Dear Fellow Investor,

The table below shows performance figures for the last calendar year and the cumulative and annualised performance of the Fundsmith Equity Fund – a sub fund of the Fundsmith Sicav ('Fund' or 'Sicav') and various comparators. Please note the differing start dates for the various share classes, noted below the table.

% Total Return	1st Jan to 31st Dec 2023	Inception to 31st Dec 2023		Sortino Ratio[5]
		Cumulative	Annualised	
Fundsmith Equity Fund EUR T Class[1]	+13.4	+464.9	+15.3	0.88
MSCI World Index EUR[2]	+19.6	+320.8	+12.5	0.64
European Bonds[3]	+10.5	+57.3	+3.8	
Cash[4]	+3.2	+1.8	+0.1	
Fundsmith Equity Fund CHF I Class[1]	+6.8	+277.0	+12.0	
MSCI World Index CHF[2]	+13.3	+198.4	+9.8	
Fundsmith Equity Fund USD I Class[1]	+17.8	+253.6	+12.4	
MSCI World Index USD[2]	+23.8	+169.1	+9.6	
Fundsmith Equity Fund GBP I Class[1]	+11.3	+290.7	+15.1	
MSCI World Index GBP[2]	+16.8	+200.9	+12.0	

[1] Accumulation Shares, net of fees, priced at 13:00 CET, launch dates, **EUR T:** 2.11.11, **CHF I**: 5.4.12, **USD I:** 13.3.13, **GBP I:** 15.4.14, source: Bloomberg. NB Prior to March 2019 performance relates to Fundsmith Equity Fund Feeder

[2] MSCI World Index priced at close of business US time, source: Bloomberg

[3] Bloomberg/EFFAS Bond Indices Euro Govt 10 yr., source: Bloomberg

[4] € Interest Rate, source: Bloomberg

[5] Sortino ratio is since inception on 2.11.11 to 31.12.23, 3.5% risk free rate, source: Financial Express Analytics

The Fund is not managed with reference to any benchmark, the above comparators are provided for information purposes only.

Given we do not hedge currency exposure, the main difference in performance between the currency share classes is the relative currency movements in the year. The relative performance compared to the MSCI World Index is therefore similar for each share class. The Fund underperformed this comparator in 2023 but a longer-term perspective may be useful and is certainly more consistent with our investment aims and strategy. Since inception, the share classes shown in the table have healthily outperformed. The T Class Accumulation shares has returned nearly 3% p.a. more than the MSCI World Index since inception and has done so with significantly less downside price volatility as shown by the Sortino Ratio of 0.88 versus 0.64 for the Index. This simply means that the Fund has returned about 38%, ((0.88÷0.64)-1)x100, more than the Index for each unit of price volatility.

Outperforming the market or even making a positive return is not something you should expect from our Fund in every year or reporting period, and outperforming the market was more than usually challenging in 2023. The performance of the Nasdaq Composite Index, which was up 43% in USD in 2023, was dominated by a few companies, the so-called Magnificent Seven — Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla — which accounted for 68% of that Index's gains. Nvidia, the designer of chips for use in AI applications, alone accounted for 11% of the 43% gain. We do not own all the Magnificent Seven and would probably not be willing to take the risk of doing so, even if all of them fitted our investment criteria.

In looking at individual stock contribution to performance I prefer to start with the problems. The bottom five detractors from the Fund's performance in 2023 were:

Stock	Attribution
Estée Lauder	-1.6%
McCormick	-0.8%
Mettler-Toledo	-0.7%
Diageo	-0.6%
Brown Forman	-0.5%

Source: Northern Trust

We sold our stake in Estée Lauder whose mishandling of the demand/supply situation in China following reopening post Covid and in the travel retail market revealed serious inadequacies in its supply chain.

McCormick has yet to return the profit margins in its food service business to the level they were before the pandemic.

Mettler-Toledo suffered from a downturn in demand for laboratory equipment post the pandemic, demand falling in China and a tighter funding market for biotech companies. However, we have no concerns about their longer-term prospects and our holding in Mettler-Toledo, in particular, is small and we may be able to use share price weakness to acquire more.

Brown-Forman and Diageo have suffered along with other drinks companies from softening in demand, especially in the Americas. Diageo's CEO, Sir Ivan Menezes, died in June just before he was scheduled to retire. In our view he was one of the unsung heroes of the corporate world.

For the year, the top five contributors to the Fund's performance were:

Stock	Attribution
Meta Platforms	+4.0%
Microsoft	+3.9%
Novo Nordisk	+3.6%
L'Oréal	+2.0%
IDEXX Laboratories	+1.5%

Source: Northern Trust

Meta Platforms' (formerly Facebook) performance makes me wonder whether I should have a fund which invests solely in the one stock in our portfolio each year for which we have received the most critical comments. Meta makes its second appearance in this list of top contributors while Microsoft appears for the eighth time having attracted strident criticism when we started buying at about $25 a share in 2011 (2023 year end price $376).

Novo Nordisk rose to prominence this year as a result of the wild success of its weight loss drug Wegovy (also known as Ozempic when sold for treating diabetes). However, we have owned the stock for seven years — attracted by its seemingly unusual approach to drug discovery and its ownership structure. We are not aware of another drug company whose stated aim is the eradication of the ailment from which it derives most of its revenues. The controlling stake held by the Novo Nordisk Foundation seems to guarantee a genuine long-term approach to the business. Novo is making its fourth appearance in our top five contributors — this was a successful investment long before the words 'weight loss' were uttered in relation to Novo.

L'Oréal is a long-term favourite whose handling of the China market contrasts sharply with that of Estée Lauder.

IDEXX, the supplier of veterinary diagnostic equipment, makes its sixth appearance in our table of top five contributors despite concerns about a hangover following the upsurge in pet ownership during Covid.

We continue to apply a simple three step investment strategy:

- Buy good companies
- Don't overpay
- Do nothing

I will review how we are doing against each of those in turn.

As usual we seek to give some insight into the first and most important of these — whether we own good companies — by giving you the following table which shows what Fundsmith Equity Fund would be like if instead of being a fund it was a company and accounted for the stakes which it owns in the portfolio on a 'look-through' basis, and compares this with the market, in this case the FTSE 100 and the S&P 500 Index (S&P 500). This also shows you how the portfolio has evolved over time.

	Fundsmith Equity Fund Feeder/Sicav Portfolio								S&P 500	FTSE 100
Year ended	2016	2017	2018	2019	2020	2021	2022	2023	2023	2023
ROCE	27%	28%	29%	29%	25%	28%	32%	32%	18%	17%
Gross Margin	62%	63%	65%	66%	65%	63%	63%	63%	45%	41%
Operating Margin	26%	26%	28%	27%	23%	26%	27%	29%	16%	15%
Cash Conversion	99%	102%	95%	97%	101%	96%	88%	91%	76%	85%
Interest Cover	17x	17x	17x	16x	16x	23x	20x	20x	11x	10x

Source: Fundsmith LLP/Bloomberg.
ROCE, Gross Margin, Operating Margin and Cash Conversion are the weighted mean of the underlying companies invested in by the Fundsmith Equity Fund Feeder/Sicav and mean for the FTSE 100 and S&P 500 Indices. The FTSE 100 and S&P 500 numbers exclude financial stocks. Interest Cover is median.
2016–2019 ratios are based on last reported fiscal year accounts as of 31st December and for 2020–23 are Trailing Twelve Months and as defined by Bloomberg.
Cash Conversion compares Free Cash Flow per Share with Net Income per Share.

In 2023 returns on capital and operating profit margins were higher in the portfolio companies than in the past. Gross margins were steady. Importantly all of these metrics remain significantly better than the companies in the main indices (which include our companies). Moreover, if you own shares in companies during a period of inflation it is better to own those with high returns and gross margins.

Consistently high returns on capital are one sign we look for when seeking companies to invest in. Another is a source of growth — high returns are not much use if the business is not able to grow and deploy more capital at these high rates. So how did our companies fare in that respect in 2023? The weighted average free cash flow (the cash the companies generate after paying for everything except the dividend, and our preferred measure) grew by 14% in 2023.

The only metric which continues to lag its historic performance is cash conversion — the degree to which profits are delivered in cash. Although this recovered slightly to 91% in 2023, this is still below its historical level of around 100% as a result of unusual events affecting a handful of our companies which we expect to largely unwind to their benefit in 2024.

The average year of foundation of our portfolio companies at the year-end was 1916. Collectively they are over a century old.

The second leg of our strategy is about valuation. The weighted average free cash flow ('FCF') yield (the free cash flow generated as a percentage of the market value) of the portfolio at the outset of the year was 3.1% and ended it at 3.0%. The year-end median FCF yield on the S&P 500 was 3.7%.

Our portfolio consists of companies that are fundamentally a lot better than the average of those in the S&P 500 so it is no surprise that they are valued more highly than the average S&P 500 company. In itself this does not necessarily make the stocks expensive, any more than a lowly rating makes a stock cheap. However, we expect some of this disparity in valuation to be eradicated in 2024 if, as we expect, the cash conversion of our portfolio companies improves.

Turning to the third leg of our strategy, which we succinctly describe as 'Do nothing', minimising portfolio turnover remains one of our objectives and this was again achieved with a portfolio turnover of 5.4% during the period, a little higher than usual. It is perhaps more helpful to know that we spent a total of just 0.003% (just under one basis point) of the Fund's average value over the year on voluntary dealing (which excludes dealing costs associated with subscriptions and redemptions as these are involuntary). We sold our stakes in Adobe, Amazon and Estée Lauder and purchased stakes in Procter & Gamble, Marriott and Fortinet. As last year this may seem a lot of names for what is not a lot of turnover as in some cases the size of the holding sold or bought was small. We have held ten of our companies for more than 10 years, eight of which since inception in 2011.

Why is this important? It helps to minimise costs and minimising the costs of investment is a vital contribution to achieving a satisfactory outcome as an investor. Too often investors, commentators and advisers focus on, or in some cases obsess about, the Annual Management Charge ('AMC') or the Ongoing Charges Figure ('OCF'), which includes some costs over and above the AMC, which are charged to the Fund. The OCF for 2023 for the T Class Accumulation shares was 1.08% (I Class shares 0.94%). The trouble is that the OCF does not include an important element of costs — the costs of dealing. When a fund manager deals by buying or selling, the fund typically incurs the cost of commission paid to a broker, the bid-offer spread on the stocks dealt in and, in some cases, transaction taxes such as stamp duty in the UK. This can add significantly to the costs of a fund, yet it is not included in the OCF.

We provide our own version of this total cost including dealing costs, which we have termed the Total Cost of Investment (‘TCI’). For the T Class Accumulation shares in 2023 the TCI was 1.09% (I Class shares 0.95%), including all costs of dealing for flows into and out of the Fund, not just our voluntary dealing. We are pleased that our TCI is just 0.01% (1 basis point) above our OCF when transaction costs are taken into account. However, we would again caution against becoming obsessed with charges to such an extent that you lose focus on the performance of funds. It is worth pointing out that the performance of our Fund tabled at the beginning of this letter is after charging all fees which should surely be the main focus.

Last year I spent quite a lot of this letter trying to explain the background to the period of low interest rates and Quantitative Easing and how the resurgence of inflation and interest rate rises had affected company valuations, and especially those which had above average valuations.

As an illustration of this effect, consider the following. If you had invested $100 in the Vanguard Long US Government Bond Index Fund (Ticker: VBLAX, ‘Bond Fund’) in June 2020, at the trough in yields on US Treasury bonds, your total income over the next 10 years would be a mere $7 i.e. you would receive 70 cents per annum in income. You would have had to invest a lot of dollars to get an income you could live on. Had you invested in October 2023, which may represent the high point in this economic cycle for bond yields, your total income over the life of the investment will be $47.50. Quite a change.

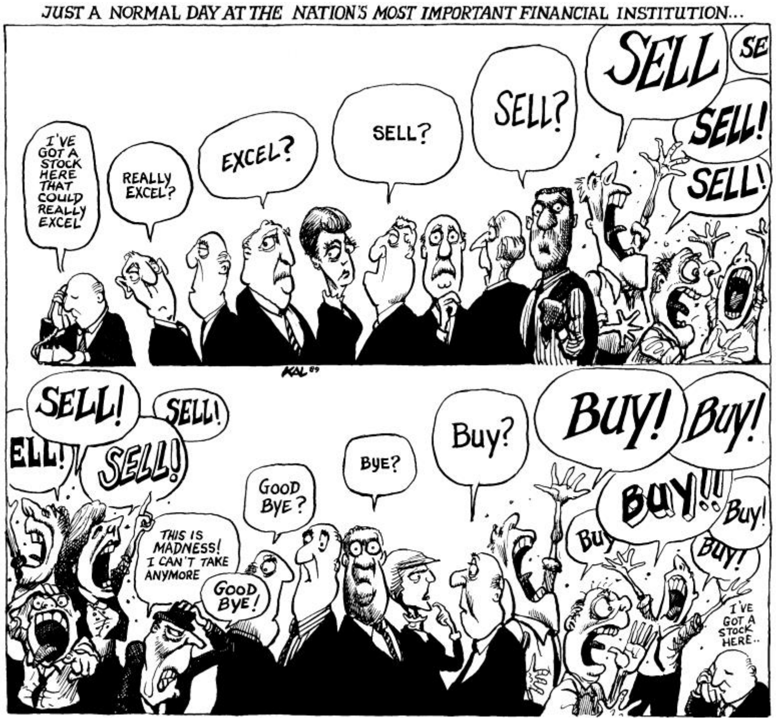
This illustrates two points.

One is that you would have lost a lot of money had you bought the Bond Fund in 2020 and had still been holding it in October 2023. The Bond Fund’s net asset value, at which it trades, declined from a peak of $17.71 in June 2020 to a low of $9.19 in October 2023, a fall of 48%. This puts the losses from investing in high quality equities over this period into perspective. Better to be in equities than long bonds when interest rates rise sharply.

The other point it illustrates is that bonds have been offering an alluring alternative to equities for many investors. If Uncle Sam is willing to pay a risk-free income (and short dated bonds are as close to risk free as you can get) of close to 5%, why take the risk of investing in equities? The short answer is because equities provide a better return. For the period 1928–2023 (the earliest for which I can get reliable data), the annualised return on 10 Year US Treasury Bonds was 4.6% whereas the S&P 500 compounded at 9.8% with dividends reinvested[#]. This of course includes the Great Depression and World War Two as well as other more recent and lesser incidents like the 1987 Crash, the Dotcom meltdown, the Great Financial Crisis of 2008–09 and the Covid pandemic.

This is unsurprising. Equities benefit from a feature which no other asset class, including bonds, can provide: a portion of the profit or cash flow which belongs to the shareholders is reinvested each year by the company. This is the retained profit which is not paid out as dividends, and its investment is the source of compounding which underpins the returns of long-term investment. In my view this is the least discussed and appreciated aspect of equity investment versus all other asset classes.

So, if equities outperform bonds why are investors so keen to hold bonds at the moment? The answer of course is that whilst equities may outperform bonds over long periods of time, there is no guarantee that equities will provide this superior return in any given period, and in fact they may lose value for periods of time, as they did in 2022. Many investors do not have the appetite to invest in an asset whose price is set daily by a process which was illustrated by this wonderful cartoon:



It requires not only a grasp of investment analysis but also an iron constitution to ignore the periodic shenanigans of the stock market and reap the rewards of long-term equity investment.

I thought it would be amiss not to mention two events which marked 2023.

The first event is the rise of Artificial Intelligence, or AI, as one of the driving forces behind the rise of most of the Magnificent Seven and especially Nvidia. What to make of it? I would offer a few observations.

Firstly, AI is not quite as new as the rise in interest in AI in the stock market this year, driven by Microsoft's investment in OpenAI and the adoption of its ChatGPT large language model (actually launched in November 2022). IBM launched an AI model called Watson which beat two human champions in the US quiz show Jeopardy! in 2011. Google (now Alphabet) acquired the AI developer DeepMind in 2014.

Secondly, the stock market, in a fashion exemplified by the earlier cartoon, has decided at the outset that it can identify winners in AI in the form of Nvidia designing the chips on which the generative AI models will run and Microsoft as a provider of an AI model. If it can do so at this stage it would seem to me to be a break with tradition. Think back to some of the major technology developments of the past half century or so and the early leaders:

- Microchips: Intel
- Internet Service Providers: AOL
- Mobile Phones: Nokia
- Search Engines: Yahoo
- Smartphones: Research In Motion (Blackberry)
- Social Media: Myspace

Where are they now? Does this experience suggest that we can predict a winner in the area of AI at the outset?

Moreover, maybe there won't be a winner, either in the provision of large language models or their use. There are numerous large language models in development and deployment by the major tech companies: such as Alphabet's Gemini, Meta's Llama 2 (stands for Large Language Model) and Microsoft's ChatGPT, as well as stock market excitement about the deployment of such models by Adobe, Intuit and Fortinet amongst just the companies that we follow. There is no shortage of contenders.

The adoption of AI may lead to a situation where everyone has it, so no one has any advantage. The analogy I would offer (with acknowledgement to Warren Buffett) is a football stadium. As the game becomes exciting and the striker runs into the penalty area with the ball, the second row of spectators stands up to get a better view. This blocks the view of those in the third row who follow suit. Pretty soon all the spectators are standing but no one has a better view than before, but they are all less comfortable.

So, I think we will suspend judgement of who, if anyone, will emerge as a winner in AI.

The second event worthy of mention is the passing of Charlie Munger, Warren Buffett's long time business partner, who passed away in November at the age of 99. Apart from offering a perspective on the perennial question about my retirement, Mr Munger's demise has led to the inevitable repetition of quotations from him by commentators. However, none of the commentators has alighted upon the Charlie Munger quote which in my view encapsulates the current state of world affairs: "If you're not a little confused about what's going on, you don't understand it."

Finally, once more I wish you a happy New Year and thank you for your continued support for our Fund.

Yours sincerely,

Terry Smith

Terry Smith

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Sources: Fundsmith LLP, Bloomberg and #NYU Stern School of Business unless otherwise stated.

Data is as at 31st December 2023 unless otherwise stated.

Portfolio turnover compares the total share purchases and sales less total creations and liquidations with the average net asset value of the fund.

P/E ratios and Free Cash Flow Yields are based on trailing twelve month data and as at 31st December 2023 unless otherwise stated. Percentage change is not calculated if the TTM period contains a net loss.

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