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Equity Fund Sicav

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Dear Fellow Investor,

This is the second annual letter to owners of the Fundsmith Equity Fund Sicav ('Fund'), the Fund having converted from being a feeder fund in March 2019.

The table below shows performance figures for the last calendar year and the cumulative and annualised performance for the I class shares of the Fund compared with various benchmarks. Please note the differing start dates for the various share classes, noted below the table.

| **% Total Return** | **1st Jan to 31st Dec 20** | **Inception to 31st Dec 2020 Cumulative** | **Inception to 31st Dec 2020 Annualised** | **Sharpe ratio** | **Sortino ratio** |
|---|---|---|---|---|---|
| Fundsmith Equity Fund Sicav €[1] | +10.7 | +367.5 | +18.3 | 1.34 | 1.20 |
| MSCI World Index €[2] | +6.3 | +207.8 | +13.1 | 0.83 | 0.75 |
| Fundsmith Equity Fund Sicav CHF[1] | +10.4 | +262.6 | +15.9 | | |
| MSCI World Index CHF[2] | +6.7 | +151.2 | +11.1 | | |
| Fundsmith Equity Fund Sicav USD[1] | +21.2 | +222.9 | +16.2 | | |
| MSCI World Index USD[2] | +15.9 | +118.0 | +10.5 | | |
| Fundsmith Equity Fund Sicav GBP[1] | +17.3 | +233.2 | +19.6 | | |
| MSCI World Index GBP[2] | +12.3 | +127.3 | +13.0 | | |
| European Bonds[3] | +11.2 | +126.1 | +9.3 | | |
| Cash[4] | -0.4 | -0.8 | -0.1 | | |

[1]Class Accumulation Shares, net of fees, priced at noon CET, launch dates, Euro T: 2.11.11 CHF I: 5.4.12 USD I: 13.3.13 GBP I: 15.4.14. Prior to March 2019 performance relates to Fundsmith Equity Fund Feeder.
[2]MSCI World Index priced at close of business US time.
[3]Bloomberg/EFFAS Bond Indices Euro Govt 10 yr.
[4]3 Month € LIBOR Interest Rate
[1,3,4]Source: Bloomberg [2]Source: www.msci.com

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 and the relative performance compared to the MSCI World Index is therefore similar and shows the Fund outperformed the MSCI World Index in 2020. All of the classes have also significantly outperformed since their dates of inception.

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

| | |
|---|---|
| Paypal | +4.0% |
| IDEXX | +2.4% |
| Microsoft | +1.6% |
| Nike | +1.5% |
| Starbucks | +1.2% |

Microsoft makes its sixth appearance whilst PayPal and IDEXX are putting in an appearance for the fourth time. Someone once said that no one ever got poor by taking profits. This may be true but I doubt they got very rich by this approach either. Nike and Starbucks, which we discuss below, were both stocks which were purchased after sharp falls in March.

The bottom five were:

| | |
|---|---|
| Amadeus | -1.2% |
| Sage | -1.0% |
| Diageo | -0.6% |
| Becton-Dickinson | -0.5% |
| Philip Morris | -0.5% |

We hardly need to discuss the reasons for the poor performance of Amadeus. Airline and travel reservations have not been happy places to be in the past year, although it is worth noting nowhere near as bad as investing in actual airlines. Amadeus's share price fall in euros of -18.2% in 2020 compares with a drop of -31.8% for the Bloomberg World Airlines Index. This illustrates the virtues of Amadeus's business model in contrast to the industry it serves.

However, whilst Amadeus faces a difficult situation, we are pleased that management has spent its time and effort managing liquidity and costs in an effort to ensure that they survive these events rather than pointlessly speculating about the likely timescale and course of recovery. We believe that they should not only survive but also strengthen their competitive position.

Sage's share price remains in the doldrums as we wait to see whether the new management team can make the product fit for purpose in the age of the cloud and subscription software and compete effectively with those who can.

We sold our stakes in Clorox and Reckitt Benckiser and purchased stakes in Nike and Starbucks during the year. Clorox and Reckitt Benckiser traded strongly due to the rush to purchase increased quantities of household cleaning products, personal cleaning products and OTC medicines. We felt that in both cases the ratings achieved did not reflect the pedestrian nature of these businesses in more normal circumstances or the issues they face which may come back into focus if or when the COVID related boost fades. Moreover, at the same time as these two stocks were enjoying an unusually good performance, two other companies which we admire saw share price falls of over 40% at the height of the panic over COVID — Nike and Starbucks. They are probably familiar to you as the world's leading sneaker and sporting apparel supplier and the leading coffee shop brand. Both are companies with high returns on capital and good growth rates — two characteristics which we seek.

In the case of Nike we felt that few companies were as well adapted to digital distribution of its products which has become de rigueur as a result of the COVID induced restrictions.

Whilst it is easy to see the challenge to the lockdowns for Starbucks's urban outlets which partly rely on seating and coffee collected on the way to the office, this is far from their only format. The sometimes spectacular queues and resulting traffic jams at Starbucks drive-through outlets both illustrate another format and testify to the continued loyalty to the brand as does the rise in loyalty club members in 2020. During this period Starbucks's main competitor in its second largest market — Luckin Coffee in China — was exposed as a fraud in yet another illustration of the rule that it is only when the tide goes out that you find out who has been swimming naked.

After the COVID lockdowns we also purchased a stake in LVMH — the world's leading designer and luxury goods business. Although we had some exposure to luxury goods through our cosmetics and drinks companies, we had no exposure to designer apparel and jewellery which LVMH brings.

As you hopefully know by now, we have 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 of those — whether we own good companies — by giving you the following table which shows what Fundsmith Equity Fund Sicav 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 Index and the S&P 500 Index ('S&P 500'). We not only show you how the portfolio compares with the major indices but also how it has evolved over time.

| | **Fundsmith Equity Fund Feeder/Sicav Portfolio** | | | | | | | | **S&P 500** | **FTSE 100** |
|---|---|---|---|---|---|---|---|---|---|---|
| **Year ended** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** | **2020** | **2020** |
| ROCE | 31% | 29% | 26% | 27% | 28% | 29% | 29% | 24% | 11% | 10% |
| Gross margin | 63% | 60% | 61% | 62% | 63% | 65% | 66% | 63% | 44% | 39% |
| Operating margin | 24% | 25% | 25% | 26% | 26% | 28% | 27% | 22% | 12% | 9% |
| Cash conversion | 108% | 102% | 98% | 99% | 102% | 95% | 97% | 101% | 94% | 95% |
| Interest cover | 16x | 15x | 16x | 17x | 17x | 17x | 16x | 16x | 6x | 6x |

Source: Fundsmith LLP/Bloomberg. ROCE, Gross Margin, Operating Profit 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. The Interest Cover numbers is median. 2013-2019 ratios are based on last reported fiscal year accounts as at 31st December and for 2020 are Trailing Twelve Months and as defined by Bloomberg. Cash Conversion compares Free Cash Flow per Share with Net Income per Share. Percentage change is not calculated if the TTM period contains a net loss.

Returns on capital and profit margins were lower in the portfolio companies in 2020. This is hardly surprising in light of events in the economy, but the scale of the falls were hardly disastrous. When people have said to us, 'You invest in non-cyclical businesses' I always reply that I have never found one. It is the degree of cyclicality in our portfolio which we seek to control through our stock selection. As a group our stocks still have excellent returns, profit margins and cash generation even in poor economic conditions. As you can see the same cannot be said for the major indices even though they have the benefit of including our good companies.

The average year of foundation of our portfolio companies at the year-end was 1922. They are just under a century old collectively.

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 2020? The weighted average free cash flow (the cash the companies generate after paying for everything except the dividend, and our preferred measure) grew by 5% in 2020.

This leads onto the question of valuation. The weighted average free cash flow ('FCF') yield (the free cash flow generated by the companies divided by their market value) of the portfolio at the outset of the year was 3.4% and ended it at 2.8%, so they became more highly rated.

Whilst this is a good thing from the viewpoint of the performance of their shares and the Fund, it makes us nervous as changes in valuation are finite and reversible, although it is hard to see the most likely source of such a reversal — a rise in interest rates — in the near future.

The year-end median FCF yield on the S&P 500 was 3.7%. The year-end median FCF yield on the FTSE 100 was 4.2%. More of our stocks are in the former index than the latter and I will not repeat the explanation which I gave in my 2017 annual letter on why I think the FTSE 100 is not an appropriate benchmark or investment proxy for our investors to use. Moreover, the valuation disparity with the FTSE 100 has been widened by the portfolio's 22% outperformance of the FTSE 100 during the year. It's hard to outperform by such a wide margin without becoming relatively more highly valued unless the portfolio's cash flows have grown at a similar differential rate. What the market seems to be rewarding is consistency of performance which has been emphasised by economic conditions in 2020.

Our portfolio consists of companies that are fundamentally a lot better than the average of those in either index and are valued much more highly than the average FTSE 100 company and higher than the average S&P 500 company. It is wise to bear in mind that despite the rather sloppy shorthand used by many commentators, highly rated does not equate to expensive any more than lowly rated equates to cheap.

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 negative portfolio turnover of -29% during the period. It is perhaps more helpful to know that we spent a total of just 0.031% (3.1 basis points) of the Fund's average value over the year on voluntary dealing (which excludes dealing costs associated with fund subscriptions and redemptions as these are involuntary). We have held twelve of our portfolio companies since inception of the Fund 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 2020 for the T Class Accumulation shares was 1.11%. 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 2020 this amounted to a TCI of 1.15%, 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 0.04% (4 basis points) 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.

Some commentators have attributed our recent outperformance to the performance of technology stocks accompanied by warnings that a 'bubble' is building in technology stocks rather like the Dotcom Bubble and that it may burst with similar ill effects. The technology heavy NASDAQ Index in euros has provided a total return of +33.2% in 2020 and the MSCI World Information Technology Index in euros delivered +32.5% so maybe they have a point.

I suspect that some of these commentators are the same ones who told you some years ago that our investment strategy was too heavily dependent on consumer staples stocks which they also viewed as over-rated. However, it's always good to start with the facts. Our Fund's sectoral exposure was as follows at the year-end:

| **Sector** | **%** |
|---|---|
| Consumer Staples | 28.0 |
| Technology | 25.5 |
| Healthcare | 22.1 |
| Consumer Discretionary | 12.7 |
| Communication Services | 4.4 |
| Industrials | 3.8 |
| Cash | 3.5 |

Technology is our second largest sectoral exposure but it is smaller than Consumer Staples and in fact if you take all our consumer stocks — discretionary and staples — together, they far outweigh our technology exposure.

Moreover, I am not sure that these sector labels are all that helpful in determining what we are really exposed to. For example, our Communication Services holding is in fact Facebook. Isn't that a technology company?

What do the following companies have in common? Amadeus, Automatic Data Processing, Facebook, Intuit, Microsoft, PayPal, Sage and Visa? They are all owned by our Fund and they are all labelled as technology companies. Yet they span airline reservation systems; payroll processing; social media, digital advertising and communications; accounting and tax software; operating systems, distributed computing (the 'cloud'), software development tools, business applications and video gaming; and payment processing. I would suggest that the secular drivers of these businesses have some distinct differences and that their prospects are not governed by a single factor — technology. This one size fits all label does not help much in evaluating them.

There are also issues with the relative valuation of some technology businesses which — like a number of businesses of the sort we seek to invest in — rely on intangibles.

The main assets of the companies we seek to invest in are often intangible. Some examples of intangible assets are brands, copyrights, patents, know-how, installed bases of equipment which require servicing and maintenance and so produce customers who are locked-in to the supplier, software systems which are critical to a business or person and so-called network effects. They are distinct from tangible assets such as real estate, machinery and equipment, and vehicles.

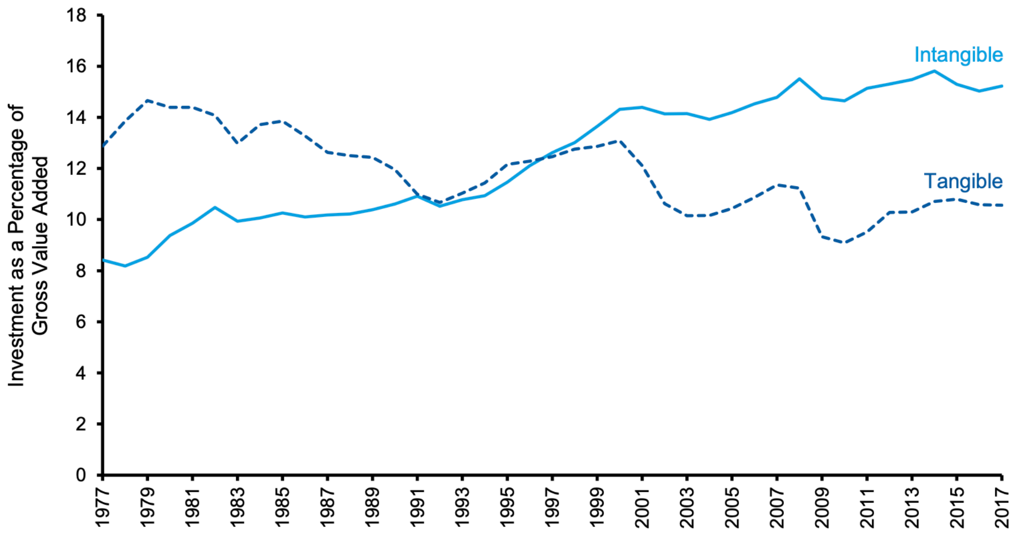
The return on intangible assets is higher as they mostly need to be funded with equity not debt and attract an appropriate return. Lenders seem to crave the often false security of lending against tangible collateral. Intangible assets can also last indefinitely if they are well maintained by advertising, marketing, innovation and product development and the duration of an asset is an important factor in figuring out its real returns.

However, there are obvious problems in comparing businesses which rely on tangible assets with those that rely mostly on intangibles. Tangible assets appear on a company's balance sheet. Cash is expended to purchase them or liabilities are assumed (debt or leases) and the assets are placed on the balance sheet. Only the depreciation charge, if any, enters the profit and loss account and there may be no impact on cash flow after the purchase. In contrast, intangible assets are mostly built through spending which goes through the profit and loss account and cash flow. Although some software development is capitalised, most is not and neither is brand development nor most research & development. Of course acquisitions skew this picture.

The net result is that for any given level of investment in assets, the profitability of a company building an intangible asset is likely to be depressed versus a company building or buying a tangible asset. This makes a mockery of the comparison of their valuations which are done by some commentators and investors who simply compare their price-to-earnings ratios ('PE').

In addition, the degree to which this needs to be taken into account in making such comparisons has been rising. The chart below shows the rise of intangible investments by US corporations:

**The Rise of Intangible Investments in the US**, 1977-2017

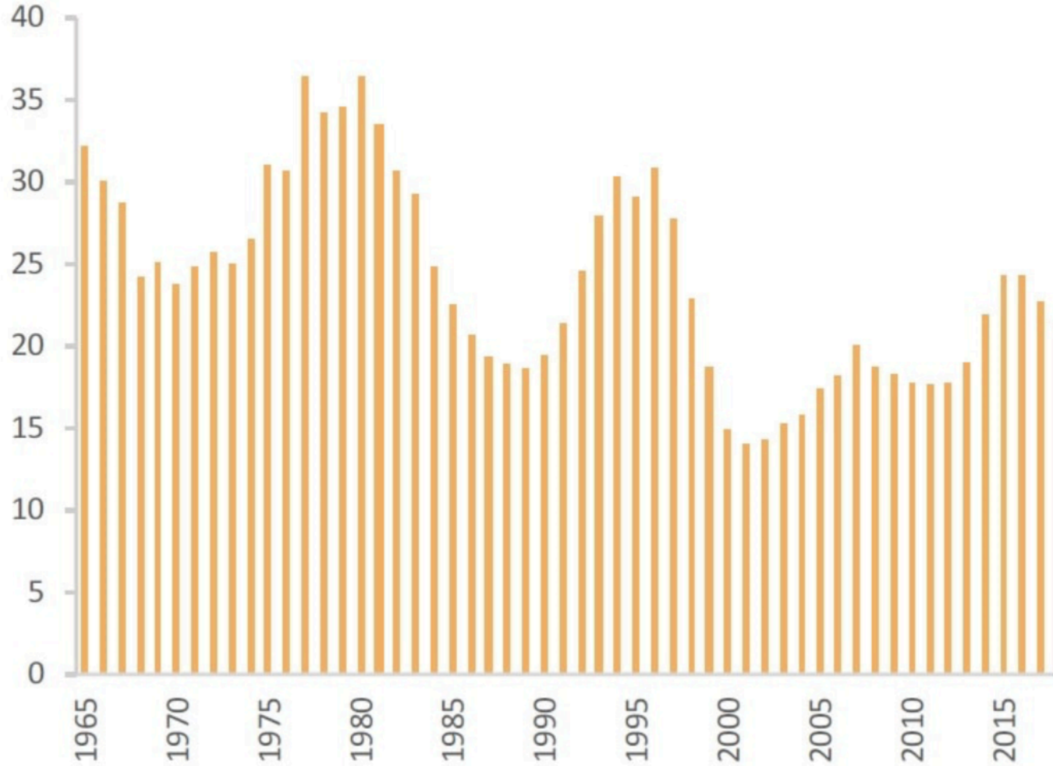



Source: Morgan Stanley (2020), Corrado and Hulten (2010)

As you can see intangible investments have been rising inexorably since the mid-1970s and overtook the proportion of investment in tangible assets in the 1990s — not coincidentally as the internet age hit full pace.

This not only makes comparisons between different types of company difficult, it also makes assertions about market valuations over time — such as the Cyclically Adjusted PE (or CAPE) difficult. A simple illustration of this is that in 1964 the average (median) tenure of a company that was in the S&P 500 was 33 years. By 2016 this had fallen to 24 years:

**Average Company Lifespan in S&P 500 Index**




Source: Innosight analysis based on public S&P 500 data sources. www.innosight.com. Years, rolling 7 year average

They are not the same companies and at least in part not even the same sort of companies.

I lived through the rise and fall of the Japanese equity market. When it reached its peak in 1989 with a PE of over 60 we were told that this was because Japanese company accounting was much more conservative than western companies. In fact, their shares were just expensive. So I am wary of explanations for why we should accept high valuations, especially if they are based upon theories about accounting. But whilst Sir John Templeton did say that the four most dangerous words in investment are 'This time it's different' (which is actually five words before anyone points this out) sometimes it really is different and if you miss such inflection points it is to the detriment of your net worth.

It is impossible for me to report on 2020 without mentioning COVID. I hope you agree that our portfolio performed well, both in terms of the share price performance and the fundamental performance of the companies, which is just as important.

It is also important to note that our operations were not impaired by the lockdowns and travel restrictions. Whilst the performance of the fund is important, it is also important that if you wish to contact us you can and are dealt with promptly and efficiently. You should be able to get any information you reasonably require which should be accurate and up to date. Perhaps most importantly, if you wish to deal — including redeeming your investment — we can execute for you. All of these vital functions continued seamlessly throughout the depths of the lockdowns. We have long been managing the dealing, operations, portfolio management and research across a number of widespread geographies, much to the amazement of some people who felt this could only be accomplished in a few London postcodes. So the need to Work From Home and an inability to travel were not major obstacles for us.

One of the mantras which has been regularly trotted out by commentators is that the events of 2020 are unprecedented. Whilst that is literally true, as Mark Twain observed, history doesn't repeat itself but it often rhymes. It is certainly true that most of us have never experienced anything like it, yet it may not be strictly true that the events of 2020 are without precedent.

There have been six identifiable pandemics over the past 130 years:

| **Recent Pandemics** | **Estimated Deaths** |
|---|---|
| Russian Flu (1889–90) | 1m |
| Third Plague (1894–1922) | 12m |
| Spanish Flu (1918–19) | 50m |
| Asian Flu (1957–58) | 2–5m |
| Hong Kong Flu (1968–69) | 1–4m |
| Swine Flu (2009–10) | 0.5m |

We might be able to draw some parallels from these past pandemics as a guide for what may happen as a result of COVID.

One of the conclusions that you might draw from the economic effects of pandemics is that they do not so much cause new trends but rather they accelerate some existing trends.

The most obvious comparator — and one which people have most frequently alighted upon — is the Spanish Flu pandemic of 1918–19. The death toll of at least 50 million people caused a reduction in the workforce which may have been a factor in the subsequent widespread adoption of assembly line techniques for mass production. The assembly line was not invented as a result of the Spanish Flu pandemic — the Model T Ford was put on an assembly line in 1913 — but it accelerated its adoption.

The increase in productivity this delivered helped to fuel an economic boom as the cost of production of items such as cars and household electrical appliances were reduced as the volume of production rose so that they became affordable by the middle classes for the first time.

This helped to fuel the economic and stock market boom of the Roaring Twenties.

Might something similar happen as a result of COVID? Obviously, I do not know, and fortunately my predictive capability is not the basis of our investment strategy. However, there are some clear signs that existing trends have been accelerated by COVID. For example:

- E-commerce
- Online working from remote locations using the cloud or distributed computing
- Home cooking and food delivery
- Online schooling and medicine
- Social media and communications
- Pets — which have become more important in isolation and when their owners are at home more
- Automation and AI

The result is that many people have become more productive. Salespeople can visit many more clients if video conferencing is acceptable and at virtually no incremental cost. We receive reports of factories which we are told are operating with 50% staffing due to social distancing rules but which have more or less maintained production. I wonder what conclusion that leads to.

Of course not all businesses benefit from these developments. The airline industry, hospitality, bricks & mortar retailing and office property may all have some very difficult problems to face, just as you wouldn't have wanted to have been a saddler when Henry Ford and his competitors hit their stride.

I became increasingly bemused listening to or reading various commentators predict that the economic recovery from the COVID lockdowns would be V shaped, or shaped like a U, an L, a W, a bathtub or like the Nike swoosh (I'm not making this up). But just when I was bored of this entire meaningless alphabet soup of predictions, I came across one that I thought might be correct and help to explain what may happen. It was that the recovery may be shaped like a K. A K shaped recovery occurs when different sectors of the economy emerge from a downturn with sharply differing trajectories — like the arms of the Roman letter K.

Imagine if you had been told this time last year that there would be a pandemic and that the measures taken to contain it would so affect the world economy that US GDP would fall by 9% in the second quarter of the year and the hospitality and travel sectors would be devastated by the measures as would large segments of traditional retail activity. Considering this would you have predicted that the MSCI World Index (€) would deliver a return of 6.3%? Hopefully this illustrates the dangers of forecasting and market timing even when you know what major events will occur.

I will leave you with this thought: What are the similarities between a forecaster and a one-eyed javelin thrower? Answer: Neither is likely to be very accurate but they are typically good at keeping the attention of the audience.

Finally, may I wish you a happy New Year, a COVID free 2021 and thank you for your continued support for our Fund.

Yours sincerely,

Terry Smith

Terry Smith,
CEO
Fundsmith LLP

P.S. Please note that this fund is changing its name to the Fundsmith SICAV on 1st March 2021 and will become an umbrella fund with two sub-funds, the current Fundsmith Equity Fund and the launch of a second sub-fund, Fundsmith Sustainable Equity Fund. We will also be changing our service provider from State Street to Northern Trust on the same day, which is expected to result in some cost savings. Please visit https://www.fundsmith.co.uk/global/eu/documents and click the link at the top of the page for the full details and the documentation.

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Sources: Fundsmith LLP & Bloomberg unless otherwise stated.

Portfolio turnover has been calculated in accordance with the methodology laid down by the FCA. This 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 2020 unless otherwise stated.

Fund liquidity is based on 30% of average trailing 20 day volume.

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