Fundsmith

Fundsmith Stewardship Report 2022

Fundsmith
Buy good companies
Don't overpay
Do nothing

Fundsmith

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Introduction

Welcome to Fundsmith's 2022 Stewardship Report. This document, following the 12 Principles for Asset Owners and Asset Managers outlined in the Financial Reporting Council's (FRC) updated UK Stewardship Code 2020 and having regard to UK rules implementing the requirements of the EU Shareholder Rights Directive 2007/36/EC (as amended), details how we allocate, manage, and oversee capital to generate value for our investors.

The FRC defines stewardship for the updated Code as:

> **"The responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society".[1]**

As a long-term, buy-and-hold investor in the companies we choose to buy, stewardship is not only part of our fiduciary duty but an essential and implicit component of our investment strategy. Fulfilling our responsibility as stewards is a key contributor to ensuring the success of our investment approach. Reflecting our dedication to this, Fundsmith was among the first cohort of applicants to gain signatory status to the Code in 2021 and has remained as a signatory since. This report explains how Fundsmith has applied the Code's Principles over the 12-month period beginning 1st January 2022 and, in doing so, gives details on how Fundsmith understands stewardship, the policies and processes used to encourage and support it, and how we performed as stewards of our investors' capital during 2022.

This report was discussed and approved at the Fundsmith LLP Management Committee meeting on 17/04/2023.

Signed, Terry Smith, CEO and CIO

[1] https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Final2.pdf

Principle 1

Signatories' purpose, investment beliefs, strategy and culture enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable benefits for the economy, environment, and society.

Purpose, culture, and values

Fundsmith was founded in 2010 as a fund management business responding to what the founding partners saw as failings in the investment industry. At the time, many of the equity funds available in the UK were consistently underperforming their benchmark, holding too many companies in their portfolios making them indistinguishable from the market as a whole, and reducing investment returns through expensive overtrading. Put simply, many equity funds were over-priced, underperforming and offered little difference from an index tracker.

Fundsmith was created to offer investors something different from the options available at the time. Through being different the founding partners aimed to offer something better, in line with Sir John Templeton's axiom that "if you want to have a better performance than the crowd, you must do things differently from the crowd". We launched our first fund, the Fundsmith Equity Fund, with the purpose of running the best fund there has ever been and to provide retail investors with the best fund they have ever owned. By "best" we mean the fund with the highest returns over the long term, adjusted for risk. Our focus on this has remained unchanged since our inception.

Our business model is derived from this desire to be better. We run funds, both open and closed ended, that invest in high-quality companies for the long term. These high-quality companies grow and compound in value over the long term, generating value for our clients and beneficiaries. Most important to the success of our business model is ensuring we are operating Fundsmith as the kind of the high-quality company we look to invest in. We apply exacting standards to potential investments to produce a portfolio of resilient businesses with excellent performance across a small number of equity funds. Minimising the cost we incur on behalf of our customers while implementing our strategy also sits at the heart of our business model. For example, we do not charge our investors entry or exit fees. Instead of the typical 'annual management charge', or 'ongoing charges figure' firms use to compare themselves, both of which fail to account for the incremental costs of trading, we consider total cost of investment ("TCI") to be a more appropriate benchmarking tool, as it recognises all the costs our investors incur whilst owning our products.

Fundsmith prioritises transparency, integrity, and conviction across all our activities as an asset management firm, including our responsibilities as stewards of our investors' capital. The firm operates with a flat management structure and minimal hierarchy, fostering a collegiate culture with strong diversity of thought. Our structure aims to remove bureaucracy and allow dynamic decision making, supported by our Management Committee. All employees have access to Fundsmith's management.

Our investment beliefs and strategies

When Fundsmith was first established in 2010, we published an 'Owner's Manual' outlining our purpose, approach to investing, and strategy. We want those investing with us to understand our investment beliefs and approach so they know exactly what we are and aren't offering. We like to compare investing to competing in the Tour De France; the overall winner of the Tour (the 'yellow jersey') never wins every stage. Similarly, we don't expect to outperform every quarter, or even year, but we do expect the companies we invest in to compound in value by more than the average company over the long term. Our Owner's Manual for the Fundsmith Equity Fund remains essentially the same as it was in 2010 and can be found on our website. Alongside the Owner's Manual, we write an annual letter for our investors, which is published on the respective fund's website. The letter details some of the key metrics we look for in the companies we have invested in and how little they have varied over time, as well as some commentary from the Portfolio Manager for the year in question. Fundsmith Equity Fund's 2022 letter is available here.

Our investment strategy is simple and builds from three basic principles: buy good companies, don't overpay, and do nothing. At Fundsmith, we believe that over the long term this approach will generate superior risk-adjusted returns compared to our peers. We believe that the most important driver of a business' returns is whether it is in fact a good business. Of the 96,000 listed equities in the world, we have identified fewer than 160 across all our fund products that qualify as being "good", according to our criteria.

The high-quality businesses we look to invest in are predictable, have defensive characteristics and invest their capital at rates of return substantially above their cost of capital. Good businesses make a high return on operating capital employed, in cash, over the long term. We are not just looking for a high rate of return, but a sustainably high rate of return, which means we invest in businesses with a significant and distinct competitive advantage. An important factor is repeat business, usually from consumers.

A company that sells many small items every day is better able to earn consistent returns over the years than a company whose business is cyclical, like a steel manufacturer, or lumpy, like a property developer. This approach rules out many businesses that do not sell directly to consumers or make goods that are not consumed at short, regular intervals. We look for businesses that typically have an advantage over the market via some form of intangible asset (brand, distribution network, technology etc.) that helps to sustain a high rate of return on the capital they employ. Further, we like businesses that can reinvest some of those returns at the same high rate. This approach comes from the belief that over the long term a company's share price will compound at about the rate of return that the underlying business invests its capital. Therefore, the key is the business's rate of return, not the share price.

There are many industries in which we don't believe a good company could ever exist. This is due to specific factors that make it impossible to generate a high return on capital employed, or through little control over pricing, as with many commodity-based industries. For example, we can confidently say that we will never invest in a mining company, an oil and gas company or a bank. Alongside this, our high-quality business screen removes some of the most environmentally and/or socially damaging industries such as airlines, energy and automotives. We avoid these as we believe their business models are unsustainable and they will struggle to generate sufficiently high returns over the long-term.

We analyse companies in the widest possible sense, considering their negative impact on the environment and society as well as any positive contributions they may have through research and development. Environmental, social and governance ("ESG") factors are becoming increasingly important to all companies and can significantly influence their long-term performance. We view damaging activity across any of these factors as boosting current profits at the expense of long-term performance. Companies with poor performance in these areas may struggle to sustain the high return on capital our companies must have. As long-term investors, we won't invest in companies that generate returns and profits unsustainably as we want to own these businesses forever. We expect the management of investee companies to act like owners of the company, prioritising capital allocation to benefit the business over the long term.

Our research process is the most important component of our investment strategy. We believe that detailed research and developing a deep understanding of a businesses before we invest is the best way to build a portfolio of companies that outperforms over the long term. When we identify a good company, we don't want to overpay if we choose to invest in its stock, but we also realise that to buy superior businesses you may need to pay a higher valuation. As Warren Buffet said, "it's far better to buy a wonderful company at a fair price than a fair company at a wonderful price". Our goal is to buy securities that will grow and compound in value over time. These securities must offer free cash flow yields that are high relative to long-term interest rates and to the investments already selected within our portfolios or the other investment candidates within our investable universe. The securities should also offer yields that are similar to, or better than, what we would get from a bond. We calculate the free cash flow of every company after tax and interest but before dividends and other distributions and after adding back any discretionary capital expenditure that is not needed to maintain the business. This avoids penalising companies for investing capital at high rates of return to grow their business, which is exactly what we want.

Finally, once we have invested in a company, we aim to do nothing. Ironically, this is the part of the process when we are most active. In doing nothing, we try only to buy and sell a company based on its fundamentals irrespective of its share price movement. This discipline means that we avoid the temptation of rebalancing our portfolios and keep trading to a minimum, reducing costs and consequently the charges for our investors.

We constantly monitor our companies after investing and continue to evaluate whether there are any changes in approach or new factors that might affect the company's long-term performance. If we identify an issue with an investee company, we follow the engagement, escalation and voting practices outlined in our report on Principles 9, 11 and 12 respectively, to promote resolutions that support the company's long-term performance.

These investment beliefs are followed and complied with across the one strategy that we operate across three investment products: Fundsmith Equity Fund (FEF), Fundsmith Sustainable Equity Fund (FSEF) and Smithson Investment Trust (SSON). The same research process is followed by each strategy, which involves defining an investable universe of good companies all of which meet our strict investment criteria. The resulting investable universe forms the basis for the respective fund portfolios.

Enabling effective stewardship

Fundsmith was set up to be a long-term shareholder in high-quality companies that will generate superior returns over the long term, adjusted for risk. We want to invest in companies that can and will sustain their operations indefinitely as, ideally, we want to hold the shares of investee companies forever. Our fundamental approach to investing means that stewardship is not a "bolt-on" concern but a crucial aspect in ensuring the success of our value proposition to clients. As our approach to investment is entirely focused on the long term, many of the day-to-day actions we take are designed to ensure we act as effective stewards of investors' capital. Our report on Principle 2 discusses how our governance is structured to support stewardship and our report on Principle 7 goes into more detail regarding the role of stewardship in our investment process.

Fundsmith's staff share the firm's investment beliefs and many of the firm's employees have significant amounts invested in the firm's products. We encourage this as we believe it aligns our incentives with those of our investors. We view this as an important aspect of good stewardship as it means we invest our client's capital as though it were our own. For many of Fundsmith's employees it is.

How have we done?

Since inception (Nov 2010–Dec 2022), our main UK Fund, the Fundsmith Equity Fund, has generated returns of 478.2% (annualised: 15.5%), compared to 256.8% (annualised: 11.0%) for the MSCI World. Not only have we outperformed the index but have done so with less risk. Since inception, the Fundsmith Equity Fund has had a Sortino ratio of 0.84 compared to the MSCI World's 0.36. The Sortino ratio is a measure of downside risk-adjusted returns, with a higher number indicating a better risk to return profile.

Fundsmith publishes a Value Assessment for both FEF and FSEF. Our Value Assessment analyses both funds across seven pillars; quality of service, performance, costs, economies of scale, comparable market rates, comparable service rates, and share classes. This report concludes that the funds provide value to our investors, and when considered alongside the strong Sortino ratio, means we are achieving our aim of delivering strong risk-adjusted returns at a reasonable cost as consistently presented to, and expected by, our investors. The assessment is available on our website.

We continually look for ways to improve our disclosure on our stewardship activities and will be using this report as an opportunity to explain how we interact with our investee companies to promote sustainable long-term returns.

Principle 2

Signatories' governance, resources, and incentives support stewardship.

An essential part of ensuring we are good stewards is establishing practices within our business that not only support but encourage stewardship. Our report on this principle addresses the way we do this; how our governance provides oversight and accountability for stewardship, how we select and work with our resources to ensure our stewardship activities are fully supported, and how we incentivise the integration of stewardship with investment decision making.

Governance

Fundsmith LLP continues to be wholly owned by its partners, all of whom are actively involved in the business on a day-to-day basis. As such, Fundsmith's ownership and governance structure is completely aligned with the long-term focus of our funds and the aim to ensure the long-term growth of the business.

Fundsmith's Management Committee is the firm's ultimate governing body and is responsible for all aspects of Fundsmith's business. The Management Committee is designed to ensure that we are being run in compliance with applicable regulatory rules, that we act in the best interests of investors in our funds, and that we are operating with an appropriate risk management framework. The Committee is ultimately responsible for setting our approach to stewardship and for ensuring that the business adheres to the stewardship principles and policies it has set itself. The Management Committee comprises both executive and independent non-executive members.

Figure 1: Fundsmith LLP management structure.

The Management Committee delegates responsibility for the development and implementation of the company's strategy and for the day-to-day management of the business to Terry Smith, Fundsmith CEO and CIO. To support Terry Smith in this, Fundsmith operates an Executive Committee as a sub-Committee of the Management Committee.

The Management Committee has also delegated certain oversight and management responsibilities to other sub-Committees. Oversight of Fundsmith's stewardship and sustainability related risks and activities are delegated to the Stewardship and Sustainability Committee. The Committee, which completed its second year of operation in 2022, reviews all relevant stewardship and sustainability related regulations and initiatives, ESG-related disclosure frameworks, the Fundsmith Sustainable Equity Fund investable universe and exclusions from it, application of our Responsible Investment Policy and engagement and proxy voting activities.

The Committee is chaired by Julian Robins, Fundsmith's Head of Research, with representatives from each portfolio management team, the Chief Compliance Officer, Head of Sustainability, and our Stewardship Analyst. The structure of this Committee was chosen to ensure that all areas of the business involved with our stewardship activities meet regularly to ensure they are aware of any changes in the company's approach and updated on key issues and best practice. The conclusions of the Stewardship Committee's meetings are reported to the Management Committee. This reflects the importance of ensuring that we are acting as good stewards of our client's capital, and our management's commitment to appropriately resourcing our stewardship activities.

Fundsmith Stewardship & Sustainability Committee	
Julian Robins	Head of Research, Founding Partner
Robert Parker	Chief Compliance Officer
Thomas Boles	Head of Sustainability
Simon Barnard	Portfolio Manager, Smithson Investment Trust
David Simpson	Stewardship Analyst

Table 1: Fundsmith Stewardship & Sustainability Committee.

Our investment beliefs are the same across the three investment products we operate (Fundsmith Equity Fund, Fundsmith Sustainable Equity Fund, and Smithson Investment Trust).

The same research process is followed by each investment strategy, which involves defining an investable universe of "good companies" that meet our strict investment criteria, as explained in Principle 1.

Each strategy we operate has an investable universe ("IU") made from companies that meet our good company criteria and operate within the respective strategy's market capitalisation range and market classification. Before adding a new company to the IU, the research team produces a comprehensive report on all aspects of the business, looking at all factors that might affect its ability to sustain a high return on capital and grow over the long term. This is then put to the strategy's portfolio management team, who then decide whether the company is worthy of IU inclusion. All IU inclusions are reviewed and approved by the Chief Investment Officer ("CIO") to ensure that the "good company" process has been followed. This ensures that we have a consistency of approach and independent review of the process. The portfolio is then created from this universe.

The Fundsmith Sustainable Equity Fund's IU is created from the companies that have been admitted to the Fundsmith Equity Fund's IU. The companies that have met FEF's criteria are subjected to additional assessments to ensure they meet our sustainable criteria. This process is discussed in more detail in Principle 7. The Stewardship and Sustainability Committee reviews the company assessments and makes recommendations to Fundsmith's CIO regarding the companies that should be included and excluded from the FSEF IU. Stewardship is also generated through the ongoing oversight and management of our investments. Our approach to this is detailed in Principles 9, 10, 11 and 12 of this report and follows the practices laid out in our Responsible Investment Policy. As part of his role as Head of Research, Julian Robins oversees the monitoring of our existing investments. He decides when, in accordance with our Responsible Investment Policy, we might need to engage, escalate, or consider divesting in a portfolio company. While Julian, as chairman of the Stewardship Committee, is accountable for our stewardship activities and processes, every member of Fundsmith's research team supports our stewardship activities and works to keep our decision making appropriately informed.

The policies we use to guide our stewardship activities are subject to an annual review by the Stewardship and Sustainability Committee in accordance with the Committee's Terms of Reference.

Resources

Stewardship is integrated at every stage of our investment process and is considered explicitly by all employees. We rely on our research department, including the Head of Research, to conduct the in-depth research and analysis of companies to identify those that can produce the long-term, sustainable growth our strategy relies on. Our research team consists of 9 analysts working across all our funds. Across the team, there is a total of over 150 years of experience, 4 CFAs, an MBA, a variety of masters' degrees and a PhD in social anthropology. The team also has a diverse range of academic backgrounds, including degrees in history and economics to French and Geography. The team has a wealth of experience across the investment industry and is focused on fulfilling our objectives as long-term investors. Their experience allows us to build our resilient portfolios of high-quality businesses and to analyse any issues that may affect our view of those companies. The experience of our analysts means we have a team that understands Fundsmith's investment process and have the skills to implement it, ensuring we fulfil our obligation to our investors and create value over the long term.

While we consider good stewardship to be a natural attribute of the entire research team, we also have a member of the team dedicated solely to stewardship activities. This extra resource helps ensure we are correctly documenting, reporting and communicating our stewardship activities to our investors. Our Stewardship Analyst has an undergraduate degree in environmental science and a postgraduate degree in global politics, he has also attained the CFA UK's Certificate in ESG Investing and Investment Management Certificate ("IMC"). He has specific responsibility for supporting the research team by keeping team members aware of ESG-related regulation and considerations, best practice and any changes in the thinking of how to approach stewardship activities.

It is also important to integrate and utilise a diverse workforce to support stewardship. In support of this, Fundsmith has committed to being an equal opportunities employer and operates under a full Diversity, Equal Opportunities, and Inclusion Policy. Our recruitment, promotion and all other selection processes are conducted based on merit against an objective set of criteria, avoiding discrimination against all protected characteristics.

We use various resources to support our analysts and their research process. We collect qualitative and quantitative information from a variety of publicly available sources such as earnings reports, sustainability reports, press releases, CDP and the Science Based Targets initiative ("SBTi"), and Bloomberg. We use Bloomberg to retrieve and calculate basic stats such as CO2 emissions, water and energy use, as well as the amount of waste generated. We also use RepRisk's RepRisk Index to assess individual company's and the portfolio's aggregated risk exposure to ESG issues, and to benchmark the Fund against our chosen index. We use RepRisk as it avoids the 'intra-industry' approach that other ratings services implement. We believe this approach allows investment in companies perceived to be 'less damaging' despite the fact they operate in highly damaging sectors.

We use these sources in combination to support qualitative decisions on the companies that can be part of FSEF's investable universe, to assess potential investments and as part of our ongoing monitoring of the companies in which we are currently invested. We do not make investment decisions based on an individual score RepRisk provides but use it alongside our fundamental research and analysis of a company.

Incentives

Fundsmith is owned and managed by its Partners. The Founding Partners do not receive variable remuneration from the Firm. They are each entitled to a pre-determined, fixed proportion of the Firm's profit, in accordance with their ownership. The Founding Partners' interests are therefore in alignment and dependent upon the long-term profitability and sustainability of Fundsmith. The portfolio managers (other than Terry Smith who is a Founding Partner and the majority owner of Fundsmith) have their remuneration structured to ensure they are similarly focussed on the long-term success of their Fund. All our funds follow the same long-term, buy-and-hold philosophy and achieve this through purchasing high-quality companies in their individual investment area. We do not set short-term targets and our portfolio managers are not rewarded with respect to the short-term performance of the funds. It is important to note again that our portfolio managers are also invested in the funds they manage. This alignment of interests with our clients is an important incentive in encouraging the sustainable growth of the businesses within each fund, and as such the sustainable

growth in value of their own and our client's investment.

Our incentive scheme for the portfolio managers (other than Terry Smith) depends on the long-term performance of the fund which they manage. As mentioned, active and effective stewardship from our portfolio managers is a key contributor to the fund's performance, and consequently, portfolio managers' remuneration. Further detail on our portfolio managers' remuneration is available as part of our annual report and accounts. We consider a range of metrics combined with qualitative judgments to analyse the effectiveness of our portfolio managers' stewardship activities. However, there are difficulties in identifying and quantifying a single, holistic measure that accurately represents the many facets of our stewardship activities and achievements over the previous 12 months. We continue to work to find better ways to measure the effectiveness of our stewardship activities. Given our investment and business strategy will only succeed if our portfolio managers encourage the long-term performance of their companies through being effective stewards, we feel stewardship is adequately addressed and incentivised.

Our Remuneration Policy is available here.

Effectiveness

As discussed in our report on Principle 1, we feel that the long-term sustainable outlook we take when investing is the key driver of stewardship at Fundsmith. Our internal governance, resources and incentives are structured around generating long-term, sustainable growth in the value of the companies in which we invest. This is the aim of all our fund products. Since Fundsmith LLP's inception in 2010, we have been successful in creating long-term value for our clients and beneficiaries, and we believe that our approach will continue to do so.

The investable universe for each of our strategies is relatively concentrated and static. Since the inception of the Fundsmith Equity Fund in 2010, we have added and removed two companies per year on average. This low turnover allows for robust oversight of the investment process and the respective strategy IUs by the Management and Stewardship committees.

However, we are aware that effective stewardship does not simply result from relying on established processes but reviewing our policies, assessing the effectiveness of our activities, and continually improving our approach. Our report on Principle 5 reviews this in more detail and explains how we typically approach the area. Even the process of producing this Report has presented opportunities to assess our approach and identify areas that we can improve upon.

Principle 3

Signatories manage conflicts of interest to put the best interest of clients & beneficiaries first.

Fundsmith is under a regulatory duty to ensure that any conflicts of interest are managed in such a way so as to put the interests of clients first.

Fundsmith's investment criteria mean our investable universe, across all our funds, totals less than 160 individual companies, significantly less than many fund managers with comparable assets under management. The result of this is a very low chance of conflicts of interest arising between Fundsmith, its Partners and employees, and the companies we invest in. Regardless, we still strive to avoid any conflicts of interest in our investment activities. Should any potential or actual conflicts of interest identified across our stewardship activities, they will be recorded in our internal Conflicts of Interest Register. Fundsmith follows the procedure detailed in our internal Conflicts of Interest Policy which outlines the steps we take to avoid, minimise and manage such potential conflicts. A summary of our Policy is available here.

Managing these potential conflicts is important. Failure to do so in the normal course of business could put us in a situation where the interests of clients and the interests of the firm are at odds with one another. Given the range of investors that invest in our products and the accompanying range of approaches to stewardship, we will not change our approach in any way under the pressure of a single investor. However, should a situation arise where the majority of our investors are of a similar mind, we are prepared to adapt our approach. We communicate our investment beliefs and approach to stewardship to potential investors in our Owner's Manual and product prospectuses to ensure all investors understand and are comfortable with our approach before investing, minimising the potential for this kind of conflict occurring. Fundsmith will always act in the best interests of the majority of the respective fund's investor base.

Our Conflicts of Interest Policy follows four steps: identification, prevention, management and disclosure. Potential conflicts of interest relevant to us may occur between our Partners, employees or any person directly or indirectly linked to Fundsmith by control (relevant persons) and a client of Fundsmith. There is also the potential of conflict between different clients. In our policy, we identify five scenarios where there is potential for conflicts of interest in our activities. These arise when the firm, or a relevant person:

- is likely to make a financial gain, or avoid a financial loss, at the expense of a client or fund;
- has an interest in the outcome of a service provided to the client or fund or of a transaction carried out on behalf of the client or fund, which is distinct from the client's or fund's interest in that outcome;
- has a financial or other incentive to favour the interest of one client or fund over the interests of another client or fund;
- carries on the same business as the client; or
- receives or will receive from a person other than the client an inducement in relation to a service provided to the client or fund, in the form of money, goods or services, that is not the standard commission or fee for that service.

Fundsmith's Management Committee, assisted by Compliance, have considered various situations arising from the day-to-day business of the Firm from which a conflict of interest may occur, given the services and activities that Fundsmith undertakes. These are documented in the Conflicts of Interest Register which is reviewed and updated annually and approved by Fundsmith's Management Committee. The potential for additional conflicts of interest will be considered each time Fundsmith takes on a new client, considers launching a new fund, develops a new investment strategy, or undertakes a new line of business.

The Conflicts of Interest Register also summarises the approach Fundsmith takes to manage and mitigate these conflicts. Where the potential for a conflict of interest has been identified, Fundsmith will seek to organise its business activities in a manner that prevents such a conflict from arising.

Where conflicts are unavoidable, Fundsmith will seek to provide measures for their mitigation and management. These management arrangements are designed to ensure that Fundsmith always acts in the best interests of its clients and puts their interests ahead of our own. Where a conflict arises between two clients, Fundsmith will seek to treat both clients fairly.

Currently, there are no conflicts of interest considered to exist at Fundsmith which we are unable to prevent or manage in such a way as to ensure the interests of our clients and beneficiaries aren't impacted. Potential conflicts may exist in relation to aspects of our business that are not material in nature, and that we believe are being effectively prevented or managed. Accordingly, these potential conflicts are not disclosed.

While executing our responsibilities as stewards of our investors' capital, conflicts of interest are most likely to occur in the execution of proxy votes. Conflicts of interest are most likely to occur here if an employee involved in the proxy voting process holds an interest or has a relationship with the company in question.

We actively manage the risk of this conflict via a variety of methods. Firstly, Fundsmith's employees are not allowed to trade in companies included in any of our funds' investable universes. We also log and monitor the outside business interests of any Fundsmith employee and their connected persons with any IU company to identify any potential conflict.

All proxy voting decisions are made by the relevant Portfolio Manager, executed by our Stewardship Analyst and monitored by Compliance. Our Stewardship Analyst checks our voting decisions' compliance with our Proxy Voting Policy (see Principle 12). Compliance also monitors the proxy voting process biennially to ensure its compliance with the Policy.

Our Management Committee has allocated responsibility separately for supervising different areas of the business, such as client relationship management, business development, portfolio management, investment research, risk management, operations, and compliance. Fundsmith ensures that the risk management function does not carry out any portfolio management or investment research tasks and is supervised and remunerated independently from those functions to further minimise any potential conflicts.

As part of Fundsmith's risk and compliance framework, the firm has a Compliance Monitoring Plan to ensure the requirements of this, and various other policies, are complied with. The compliance team are responsible for ensuring appropriate measures exist to mitigate and manage conflicts. The Management Committee is responsible for reviewing and approving these management measures. Where Fundsmith is not reasonably confident that it is able to manage conflicts to ensure that the risk of detriment to the interests of a client, fund or investors in a fund will be avoided, this will be reported to Compliance. They are responsible for taking any decisions necessary to ensure that Fundsmith acts in the best interest of the client, fund or investors in the fund.

The Management Committee reviews and updates our Conflicts of Interest Policy on an annual basis. Our legal advisors provide guidance as required in relation to our conflict management arrangements. The Conflicts of Interest Register is also reviewed on a regular basis to ensure conflicts have been properly managed throughout the period and to assess if any new conflicts have arisen.

Principle 4

Signatories identify and respond to market-wide & systemic risks to promote a well-functioning financial system.

At Fundsmith, we believe that there are more systemic and potentially market-wide risks that we cannot identify than those we can. As ex-US Secretary of Defence Donald Rumsfeld said:

> **"There are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns—the ones we don't know we don't know. And if one looks throughout the history of our country and other free countries, it is the latter category that tends to be the difficult ones".**

We take a proactive approach to risk, minimising it as much as possible while constructing our portfolios. We minimise the risks we face by investing in high-quality, defensive companies with a long-term investment horizon. These high-quality businesses are those that can make and sustain a high return on the capital they employ and reinvest these returns to support long-term growth. Picking companies with defensive characteristics helps us build portfolios that are more resilient to market-wide and systemic risks, such as changes to interest and currency rates and other macroeconomic/ geopolitical issues.

Alongside this, there are numerous industries we will never invest in as we believe it is impossible for a high-quality business of the kind we prefer to operate within them. For example, we will never invest in banks as they rely upon leverage to generate profits and, at some point, that leverage is withdrawn. We are also unlikely to ever invest in a business reliant upon commodities, such as utility companies, as they have no control over the changing price of the materials upon which they depend.

Across all our strategies, we invest in businesses that have an established track record of success. We look for companies with a dominant market share in their product/service niche or having brands and/ or patents that are challenging, if not impossible, to replicate. Our desire to invest in long-term winners is reflected in the age of the companies we invest in; the companies owned by Fundsmith Equity Fund at the end of 2022 had an average age of 100 years and a median market capitalisation of £106bn, and Fundsmith Sustainable Equity Fund an average age of 92 years and median market capitalisation of £82bn. These companies have experienced numerous economic cycles, World Wars, and technological advances and have persisted throughout. We invest in these companies with the intention to hold that investment forever.

Our long-term investment horizon means we encourage our companies to focus on long-term capital allocation to generate sustainable growth, as well as sustainable practices to ensure they are managing the risks they are facing in the day-to-day and long-term operation of their business. Our approach is fundamentally opposed to the myopic obsession held by some parts of the market. This myopia forces companies to post growth after every quarter, often pushing businesses into unsustainable short-term profit maximisation to meet these expectations. We regularly engage with companies to remind them of how little significance we put on short-term guidance or any small changes in it. This, we believe, directly contributes to a more efficient and well-functioning financial system by reminding management that not every shareholder is focused on the short term.

We spend a great deal of time researching prospective companies and want to get to know them intimately before deciding whether to invest, identifying and assessing a variety of risks. There are of course unforeseen risks that we may not have accounted for, or a company's approach to a risk may have changed during the period in which we own the stock. Our response to this is to engage with the company, aiming to understand company management's perspective of the risk and their response to it, should it be present and material. We follow our engagement, escalation, and proxy voting processes, detailed in Principles 9, 11, and 12 respectively.

There are, of course, events during the short term that impact the operations of the businesses in which we invest. While we are confident that the quality of our companies makes them resilient to this, monitoring the impact of these events is important. Over the past few years there have been a series of incredibly hard to predict events that have influenced global markets. The coronavirus pandemic in 2020 and the consequent supply chain crisis in 2021 are examples of this. Last year was no exception; Russia launched a full-scale invasion of Ukraine, inflation increased across the world and central banks started to meaningfully raise interest rates for the first time since the global financial crisis in 2008. Our response to all of these risks was the same: do nothing. We believe our approach to investing means our companies are relatively resilient to these short-term risks.

War in Ukraine

The inconsistent recognition of both physical and intellectual property rights in Russia is a geopolitical risk we were aware of and something that has long been factored into our research. First and foremost, due to doubts that the Russian courts will enforce internationally recognised property rights, we do not invest in companies domiciled in Russia. This significantly reduces our exposure to the geopolitical risk identified.

The main way we reduce this geopolitical and macro risk is by focusing on creating portfolios of globally diversified companies, not in terms of domicile but with regard to their revenue generation and risk exposure. We avoid companies generating high proportions of their profits from jurisdictions we deem to be high risk.

Inflation

Russia's invasion of Ukraine also significantly exacerbated another trend emerging from the pandemic: inflation. Strong demand from consumers emerging from lockdowns and supply chain bottlenecks caused by material and labour shortages combined with the sharp increase in commodities prices following Russia's invasion to rapidly drive-up prices for both businesses and consumers.

The companies we invest in are well placed to deal with inflation due to the nature of the industries they operate within. We look for companies which generate their revenues from a large number of everyday repeat transactions, usually from consumers. These businesses sell many small items every day rather than a few very large items less frequently. These small items are usually price inelastic, meaning producers can increase the price consumers pay for the goods without seeing a significant change in demand, making their revenue streams resilient to inflation. Further, we invest in companies with high gross margins, which means their raw material costs are lower proportion of profits and hence increase by less than companies with lower gross margins, further increasing their resilience.

Interest rates

In response to increasing inflation, central banks started programs to increase interest rates in attempt to reduce the extent to which inflation took hold. Rising interest rates increase the costs companies face when servicing the debts they hold and signal a fall in risk appetite in the global economy.

Importantly, we do not invest in companies that rely on leverage to generate a high return on the capital they employ. We have long held the belief that at some point this leverage will be withdrawn, which can put the solvency of the business at risk. Instead, we look for businesses that create high returns on capital rather than just equity. This is not to say that the companies we invest in do not use leverage as part of their business. Where our companies do use leverage, we look for business that have high interest cover and healthy balance sheets to ensure servicing the loans they do have does not impact their ability to operate when credit is more expensive.

Climate change

Despite the immediate challenges we faced in 2022, we maintained our focus on climate change and its associated risks due to their continuing relevance to us as long-term investors. Our investment approach means we are unlikely to ever invest in, or have exposure to, the industries that contribute most to climate change, such as oil & gas, mining, and utilities. However, we are still exposed to the risks and opportunities both the transition to a low-carbon economy and the physical impacts of climate change entail. Figure 3 in Principle 7 shows the concentration of greenhouse gas emissions in tonnes of CO_2e per million GBPs of total assets for different GICS sectors. We typically invest in companies that Global Industry Classification Standard (GICS) would classify as Consumer Staples, Consumer Discretionary, Health Care, and Information Technology, which, as the Figure shows, are significantly more carbon-efficient than other sectors. Due to this, our investee companies, and therefore Funds, are significantly less exposed to climate-related risk than those investing in the carbon-intense sectors such as Utilities, Materials, and Energy.

Despite our lower exposure to these risks, it is important to ensure the companies we are invested in are acting to reduce the potential impact of climate change and the chances of getting caught by negative consumer sentiment or new regulations. As part of the assessment of our companies' approaches to managing this risk we look at our companies' commitments to reducing their carbon emissions. To do this, we collect data from the Science Based Targets initiative (SBTi) and company reports to calculate our Funds' alignment with the Paris Agreement, the Business Ambition for 1.5°C, and commitments to net zero carbon emissions (covering at least their direct operations, or scope 1 & 2 emissions). Table 2 details the results of this. For comparison, 19% of listed companies in G7 indices are aligned with the Paris Agreement[2]. Using the data collected, we calculated that at least 70% of Fundsmith's assets under management ("AUM") at the end of 2022 were covered by a commitment to achieving net zero emissions by 2050 at the latest. Participants in the Net Zero Asset Manager Initiative had an average of 39% of their assets in line with a net zero commitment at the end of 2022[3].

	FEF	FSEF
SBTi Commitment	77%	77%
Paris Agreement Aligned (2°C)	72%	67%
1.5°C Aligned	72%	67%
Net Zero Commitment	81%	79%

Table 2: Fundsmith Equity and Sustainable Equity Funds' involvement in carbon emission reduction schemes

We are engaging with the companies that lag the rest of the portfolio in their stated commitments. However, we have found these companies to be the ones with the lowest emissions and, therefore, the least exposed to the risks resulting from climate change. More detail regarding FEF and FSEF's environmental performance can be found as part of our annual sustainability summaries, available on our website.

We believe the way in which we construct our investable universes and portfolios helps build resilience to the risks climate change poses. Our approach to assessing the long-term sustainability of a company's returns means our research team must identify any environmental risks that could affect the company's ability to maintain high investment returns. This potential impact on investment returns is why we have always committed to not investing in the most capital intensive or environmentally damaging sectors.

[2] https://sciencebasedtargets.org/news/g7-stock-indexes-science-based-targets

[3] https://www.netzeroassetmanagers.org/nzam-update-november-2022-initial-target-disclosure/#:~:text=Almost%20two%20years%20on%20from,zero%20by%202050%20or%20sooner.

Fundsmith is a signatory to the UN Principles for Responsible Investment (UN PRI). This UN-supported network of investors works to promote sustainable investment practices through incorporating environmental, social and governance ("ESG") factors into the investment process. The initiative encourages investors and, through investor engagement, companies, to think about the longer-term impacts their capital allocation decisions have, which we believe will lead to more efficient capital markets.

We also engage with our investor base and wider community on a range of topics including the dangers of market timing, the benefits of investing with a long-term investment horizon, and other issues that influence the functioning of global markets. Our CEO and CIO regularly contributes to the investment community through various interviews and articles, discussing the misunderstandings and risks that occur within investments, and assessing ongoing market events and trends. For example, he has previously discussed the poorly understood risks associated with investing in speculative assets. We hope that by illuminating such issues we can encourage wider discussion around these risks and encourage more sustainable capital allocation and management.

During volatile periods, falling markets, or the inevitable periods of under-performance, outflows become a risk for open-ended investment funds such as ours. Ensuring we have enough liquidity to be able to return investors' cash when they want it is essential. We have long been aware of this risk and are highly unlikely to ever invest in unlisted companies within our Funds. We have also monitored and published a liquidity measure for our open-ended funds on our Factsheets since 2012. These Funds invest in companies with large market capitalisations that are typically highly liquid meaning the risk of not being able to quickly exit investments is low.

Assessing our effectiveness in identifying and responding to market-wide and systemic risks over the reporting period is challenging. Our strategies are all long-term focused; we do not focus on annual outcomes nor are they important to us. As well as this, these risks play out over a timeframe considerably longer than 12 months. For example, coronavirus continues to have substantial knock-on effects more than 3 years after the initial wave of lockdowns in the West, and climate change is not something that can be handled over the course of a year, nor can we expect our companies to respond to the risk over such a short time frame. However, we have been effective in using our stewardship activities, such as engagement and proxy voting, to ensure our investee companies are making decisions to support their long-term performance and managing their risks during the last year.

Principle 5

Signatories review their policies, assure their processes, and assess the effectiveness of their activities.

Fundsmith's governance committees, with the support of the Compliance department, review all of the Firm's policies and reports. This is done to ensure we are consistently operating in line with our investment approach and values, and complying with any regulatory requirements. We re-assess policies annually to ensure that they are appropriate and effective and that we are delivering consistency across the business, reflecting new information and continuously improving.

The principal policy that relates to our stewardship activities is our Responsible Investment Policy, which details the processes and activities used to integrate ESG into our investment process and our approach to engagement and proxy voting. The Responsible Investment Policy is controlled by Fundsmith's Stewardship and Sustainability Committee. The Committee review the Policy annually to ensure that it accurately reflects our internal processes and to ensure we are up to date with best practices.

The Stewardship and Sustainability Committee was created in 2020 and is our main point of internal assurance in relation to stewardship. The Committee was created to centralise discussions relating to our stewardship and responsible investment-related policies, processes and activities. One of the Committee's responsibilities is the ongoing assessment of current inclusions and exclusions and potential entrants to our funds' investable universes. This assessment includes reviewing companies' compliance with both the 'do no significant harm' principle and our Responsible Investment Policy. The Committee is also responsible for approving our UN Principles for Responsible Investment ("UN PRI") report and any other stewardship or sustainability related reporting, as well as reviewing engagement activity and significant votes across all funds. The Committee is chaired by the Head of Research and comprises the Chief Compliance Officer, Head of Sustainability, our Stewardship Analyst and representatives from all our funds. This means all the people involved in implementing and supporting stewardship in the investment process are present on the Committee.

The Committee also reviews any investor feedback or external reviews we receive regarding stewardship and sustainability, such as those from fund-rating agencies. We meet with such bodies regularly to update them on our approach and respond to requests for information/due diligence questionnaires throughout the year. The feedback from these meetings and assessments is taken to the Stewardship & Sustainability Committee who assess what, if any, points from the feedback we should act upon.

We also receive a level of external assurance on our integration of stewardship and ESG through our participation with the UN PRI. The PRI assess the quality of our strategy and governance, our integration of ESG in our investment process, and our active ownership. For the last reporting period, we received 4/5 for our investment and stewardship policy (median 3/5), 5/5 for our ESG incorporation in our open-ended funds (median 4/5) and 4/5 for our investment trust's ESG integration (median 4/5). We use these scores to assess where we can improve our approach for the next reporting period.

Proxy voting is a key component of our stewardship approach, allowing us to represent the interests of our investors at the meetings of investee businesses. Reflecting its importance, Fundsmith has established processes to ensure that we are properly fulfilling our responsibilities. Proxy voting is now reviewed twice-yearly by our dedicated Compliance Monitoring team, which is part of Fundsmith's Compliance function. Review frequency is assessed periodically, driven by the Compliance Risk Assessment which includes proxy voting as a risk area. Compliance Monitoring assesses whether it can be demonstrated that regulatory compliance requirements and expectations are being met and can be evidenced throughout our proxy voting process. The areas typically reviewed by Compliance Monitoring in relation to proxy voting include governance arrangements, a review of the end-to-end process from vote notification through to vote submission and conflict of interest considerations. Where enhancements have been identified, any associated actions are assigned to relevant individuals with agreed action dates. All reports on proxy voting are circulated to the Stewardship & Sustainability Committee. This new review process was introduced in 2022 and was in effect during the year.

In 2022 we also saw an opportunity to update our Responsible Investment Policy. Our Responsible Investment Policy was initially published as part of our involvement with the UN PRI initiative, but we have found it to be an effective way to communicate our approach to integrating sustainability in the investment process, how we engage with investee companies and how we approach proxy voting with our investor base. The Policy did not fully reflect the latest developments in our approach to all areas of responsible investment. Work was done to update the Policy by analysts in the Research team, reviewed by members of Compliance and approved by the Stewardship and Sustainability Committee.

We aim to report on all our stewardship activities in a fair, balanced and understandable way as a core part of our approach to stewardship. Ensuring our investors understand how we behave and act on their behalf ensures that they understand what we are doing and why we are doing it and holds us responsible for ensuring stewardship activities are carried out as our investors expect. Our stewardship-related reporting is done by analysts in the Research team who are directly involved in the investment process and implementation of our responsibilities as stewards of investors' capital. All reports are checked by Fundsmith's Compliance team before being sent to the Stewardship and Sustainability Committee for approval. The Stewardship & Sustainability Committee is in place to monitor the overall reporting process and assess the output.

We believe that internal assurance of stewardship is appropriate given our approach, size and resources, and investment strategy. However, we are keen to ensure that any decisions we make are as unbiased as possible and we continue to explore possible ways of obtaining additional forms of assurance in relation to our stewardship activities.

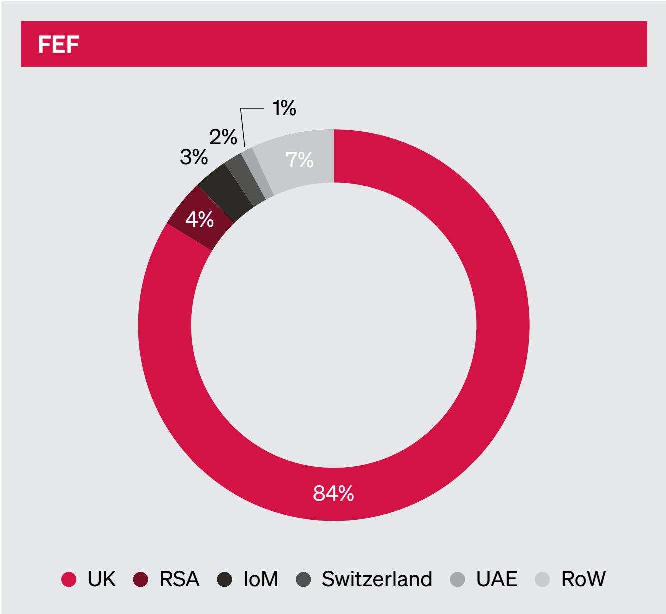
Principle 6

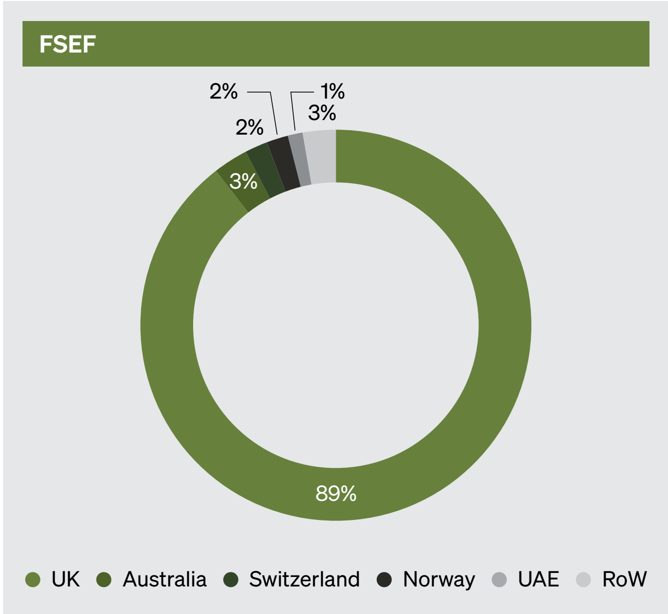
Signatories take account of client & beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

Fundsmith operates a single investment strategy across three products, all of which only invest in listed equities. As of 31 December 2022, Fundsmith LLP's total assets under management ("AUM") was £34.7bn (including segregated mandates and non-UK fund vehicles). Of this, 93% was invested in large cap developed markets and 7% in small and mid-cap developed markets. In relation to our funds, 90% of AUM was in open-ended collective investment vehicles, 3% in Delaware LPs and the remaining 7% in investment trusts, which are closed-ended investment companies listed on a stock exchange.

Fundsmith has a wide variety of investors in its funds, from individual retail investors to large institutional investors. Across our products, 27% of our assets under management are from retail investors, investing in our funds directly through our website or an investment platform, and the remaining 73% is from institutional investors, such as charities and pension funds.

We also have investors from a variety of locations investing in our UK listed funds. The geographic distribution of the investors in each of our strategies is shown in the graphs below.





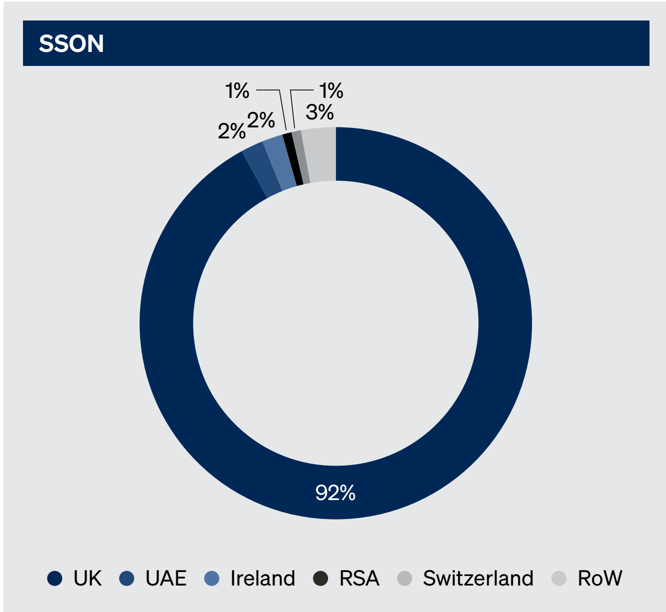


Figure 2: Fundsmith LLP UK funds' investor geographies

We make a concerted effort to clearly communicate our investment philosophy with investors prior to investment via our owner's manuals and Responsible Investment Policy. We do this to ensure they have a clear idea of the way in which we operate our funds and so they can identify whether our approach is suited to their investment and stewardship policies and preferences. We believe this is the appropriate approach given the diverse range of our investor base and, in particular, the mix between retail and institutional investors and the resources we have available as a small firm. Adapting our approach based on the preferences of a particular individual or group, risks disenfranchising our other investors and would be contrary to our aim of building a group of like-minded investors.

Most importantly, we want those who wish to invest with us to understand the long-term nature of all our strategies. Our research team spends a great deal of time identifying and researching the type of companies that we believe will provide the best long-term, risk-adjusted returns. It is important to us that investors understand why we believe the types of companies we invest in will compound in value and outperform over the long term. Providing investors with the information that supports this will enable them to have confidence in investment decisions during more volatile periods of market and fund performance. Reflecting this, our recommended holding period for investors is at least 5 years.

Unlike many other investment managers, we hold an annual shareholders' meeting ("ASM") for the Fundsmith Equity Fund and the Fundsmith Sustainable Equity Fund to which all our direct investors, retail and institutional, are invited to attend in person. The ASM has grown each year and now has over a thousand of our investors in attendance. The meeting gives those attending an opportunity to submit questions to our CIO & CEO, Terry Smith, and Head of Research, Julian Robins, with the most recent ASM seeing over 200 questions submitted. While there is only time to address a few of these during the ASM itself, we make a commitment to answer every question following the event. The ASM provides an effective format for us to collect feedback from our investors, both retail and institutional, as anyone in attendance may submit a question. This allows us to receive views from a variety of investors in an efficient manner which is particularly helpful given the smaller size of Fundsmith. It allows us to assess how successfully we are meeting our investors' needs via assessing key themes that emerge from the questions submitted. Each meeting is recorded and made available to all our investors on our website, available here.

Outside the ASM, we encourage questions from our clients and consider any issues brought to our attention in this way. All our responses to direct clients are conducted through the email address of a member of our sales team and not a generic mailbox. This gives our investors direct access to a representative at Fundsmith, usually Greville Ward (a Fundsmith Partner), to submit their questions, queries, or complaints. We also use this email address to send out any pertinent information, such as articles relating to Fundsmith or comments we have made, to all direct investors.

We have a sales and relationships team who engage with a variety of our investors, typically larger institutional investors. Analysts from the Research team frequently take part in these engagements, allowing our investors to directly engage with those involved in the investment and stewardship decision-making process. We meet with these investors regularly and respond to the requests for information and due diligence questionnaires sent throughout the year. Our meetings typically follow on from the questions sent to us, but we also frequently engage to receive feedback on various areas, and to provide updates on the performance of the fund and our various stewardship activities.

In December 2022 we sent out a customer survey to our retail investors. The purpose of the survey was to ensure we are providing a high level of service and providing value for money to our customers. We asked for feedback on the quality of our customer service and written communications, our website functionality and fund performance as well as asking investors if we provided value for money. Alongside each of these questions we also asked how Fundsmith compared to industry peers. The survey was sent to 40,000 investors and received over 2,750 responses. Fundsmith scored very highly overall and beat the peer group in every category.

Service Area	Fundsmith	Other Financial Services Firms
Call Centre Service	4.4	3.2
Making Investments	4.5	3.7
Website Functionality	4.3	3.7
Quality of Written Communications	4.5	3.4
Long Term Fund Performance	4.1	-
Value for Money	4.1	3.2

Table 3: Result of Fundsmith's investor survey response scores (out of 5)

Participants also had the opportunity to provide individual written feedback about any problems or issues they have experienced as well as any suggestions they may have, all of which have been addressed.

We also have an internal Investor Relations ("IR") team largely dedicated to answering routine investor queries and issues, escalating where necessary and reporting feedback to the sales and relationships team. Our sales and relationships and IR teams compile reports detailing the level of engagement they have with investors of all levels, including complaints, recurring issues, and suggestions for each meeting of the Management Committee.

In 2021, in response to requests from our investors and general demand for guidance on key financial topics, we started producing and publishing a series of guidance documents for our investors. During 2022 we continued publishing these guidance articles, including information editions detailing information on trusts, estate planning and Capital Gains Tax and Inheritance Tax. We also hosted a series of seminars on the topics which any of our investors may attend.

We periodically publish updates for all our products on their respective websites. These updates ensure that investors are kept informed about regarding a variety of information relevant to the respective fund. Our monthly Factsheets provide data and a short description of key activity within the fund over the previous month. All of our funds publish an annual Shareholder's Letter, written by their respective Portfolio Manager. The letters are designed to provide the fund's investors with a commentary on the performance of the respective Fund over the previous 12 months and a discussion of the year's key themes. These are all published on the fund websites. For institutional investors, there are also regular fund updates from the respective Portfolio Manager.

Despite attention turning towards the conflict in Ukraine and a tough year for ESG-focused funds particularly, we continued to work towards providing better and more useful sustainability-related information for our investors in 2022. At the beginning of the year, we significantly updated the ESG Factsheet we publish monthly for the Fundsmith Sustainable Equity Fund. We added a series of new temperature alignment metrics to assess the Fund's portfolio companies' contribution to climate change mitigation. This included portfolio Paris Alignment and net zero commitments. We also added social metrics to better evidence portfolio companies' employee diversity, including the percentage of employees who are women and percentage of executives who are women.

We also updated the proxy voting metrics included on the ESG Factsheet. Following the improvements made to our proxy voting procedures in 2021, we were able to include more information on FSEF's voting activity, including data on the number and percent of proxies voted, percent of proxies voted against management's recommendation and the percent of remuneration policies voted against.

We also published our first editions of the Fundsmith Equity Fund and Fundsmith Sustainable Equity Fund Annual Sustainability Summary in 2022, covering each funds' performance in 2021. The document details key ESG-related information for the respective fund, as well as examples of innovation within our portfolios. We have also found this Stewardship Report to be a very effective way to communicate the outcomes of our stewardship activities to investors, particularly engagement examples and proxy voting.

Overall, it is clear to us that our investors will vote with their feet, so to speak. If we are failing to account for our clients' needs and our communication with them is not living up to their expectations, we can expect those that have trusted us with their capital to move it elsewhere. As discussed in Principle 1, our priority is to run a great business; understanding and responding to the needs of those that make operating the business possible is paramount to this. Our processes used to understand and address the needs of our investors have been, and continue to be, effective.

Principle 7

Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues to fulfil their responsibilities.

As we outlined in our report on Principle 1, as long-term buy-and-hold investors, active and effective stewardship is an essential part of our investment approach. Our firm-wide Responsible Investment Policy outlines our approach in detail. It discusses how we integrate and assess ESG issues as part of the investment process for all our products and how this assessment promotes the responsible allocation of capital. It also discusses how we use engagement and proxy voting to manage and oversee the long-term performance and value of investee companies. Our Owner's Manual and other fund literature is very clear that investors should be prepared to invest for the long term, with a minimum recommended holding period of at least 5 years. We do not use service providers to assist with the integration of stewardship and investment. We do however use data provided by RepRisk to supplement our research on the reputational risks of current and potential investee companies resulting from ESG performance. RepRisk is discussed within this Principle and in Principle 8.

The success of our approach relies upon the long-term performance of the companies we invest in. Ensuring our stewardship activities are effective and our investment process appropriately considers ESG impacts, risks, and opportunities is therefore a fundamental component of our investment approach. Our priority is to invest in "good companies" and hold the stocks in these companies forever. All our investment strategies are equity based, and we adopt the same approach to the integration of stewardship for each of our funds and client portfolios. That being said, the challenges we face in integrating stewardship can vary depending on the geography and the size of the company in question. Accessing ESG data for some of the smaller companies we invest in can be difficult and necessarily changes our approach. In such cases we engage with the company both before and during the period in which we are invested to assess management's understanding of the risks they face and how they are managing them. Regardless of the size or location of the company, we aim to vote on 100% of the proxies available to us. Principle 12 gives more detail on our voting activities for 2022.

We conduct our own internal research and use sources of publicly available information to assess the companies we invest in. We regularly engage and interact with the management of those companies to ensure that they are looking to improve their businesses and succeed over the long term. The information we gain from the combination of our research and these interactions is the main way we assess whether to buy or sell a company, rather than what has happened to its share price.

We classify a company as good if it can make and sustain a high return on capital employed across the full business cycle. It is also notable that many of the companies that do the most damage to the environment and wider society do not meet this good company criteria. We will not invest in industries such as materials, energy, or utilities as we do not find them to contain businesses with sustainable business models that fit our criteria and as displayed by Figure 3, they are among the most carbon-intensive industries.

The good company screen leaves each of our funds with less than 100 individual companies in their respective investable universes, any of which we would ideally hold forever (assuming they remain good companies) but may not currently trade at an attractive valuation or form a balanced portfolio when all held at once.

We see damaging practices towards the environment and/or society as potentially resulting in the company's failure to sustain the high returns over the long term which we prioritise, damaging their growth and consequently investment potential. Therefore, understanding how the various ESG risks affect the ability to sustain a high return on capital invested is essential. Our research team identifies and assesses these issues and risks as an integrated part of our pre-investment research process and in the continual monitoring of IU companies.

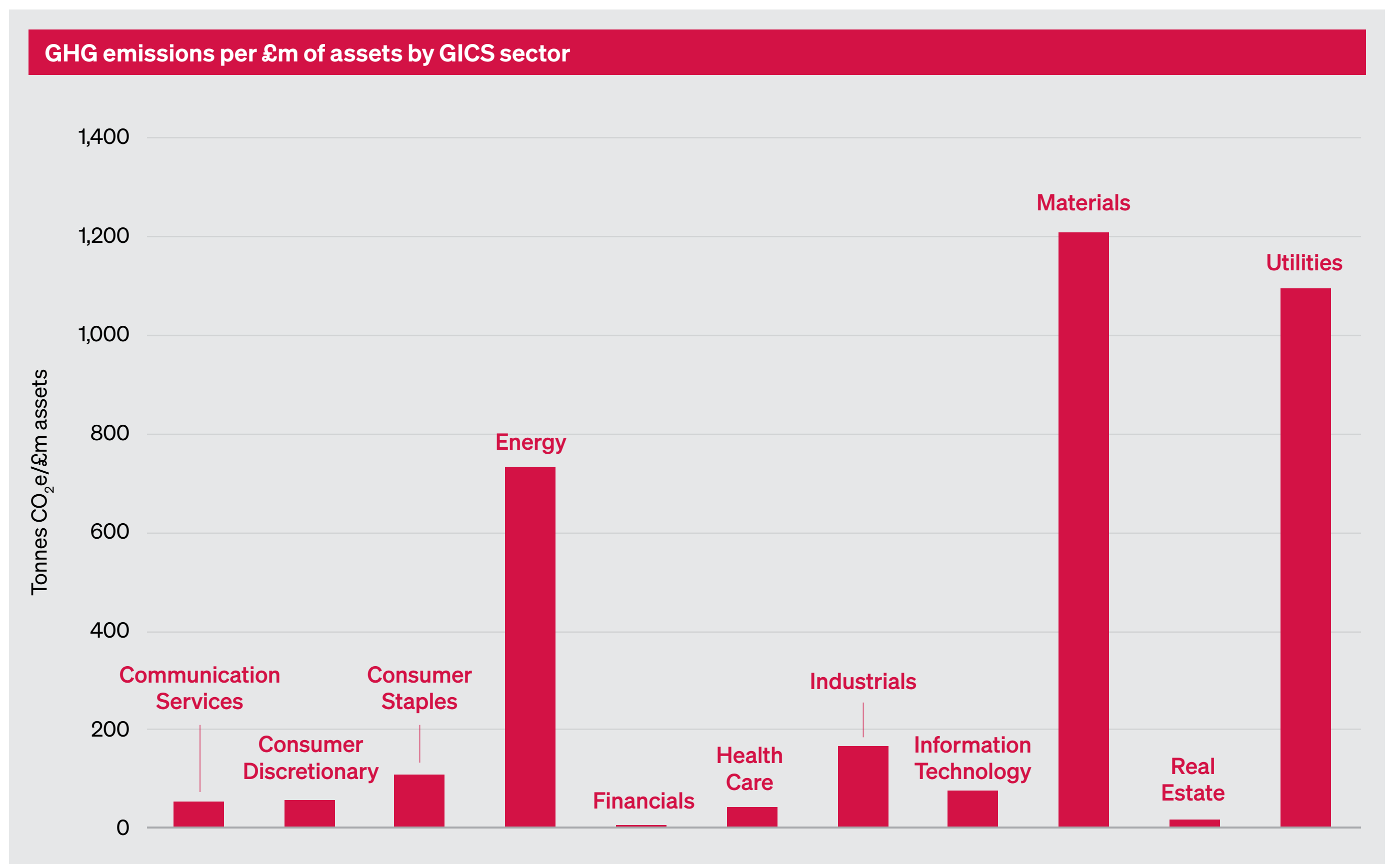


Figure 3: GHG emissions per £m of assets by GICS Sector

We consider ESG impacts in the widest possible sense, considering both the positive and negative effects that an investee company may have on the environment and/or society. We analyse and evaluate the company's environmental and social impacts, its governance policies and practice, its policies regarding dividends and executive remuneration and its methodology for assessing the adequacy of capital investments. We also look at a company's positive impacts, such as their research and development and product innovation activities, as many of the companies in the investable universes for Fundsmith's funds are constantly striving to develop their products in ways that improve their sustainability and offer a positive impact. They achieve this through improving product efficacy, inventing new solutions to problems, or reducing the negative environmental or social impacts of their existing products. Sustainability is an area which is developing and evolving, and we expect the companies in our investable universe to be aware of this and always seeking to improve.

The ESG risks we consider are varied and differ depending on the company in question. We aim to understand the risks associated with the company in a holistic sense, i.e., the risks associated with their direct activity, supply chain, the lifecycle of end products, and in the interaction with end users/customers. We also assess how effectively the company is mitigating these risks, should they be present and material.

We analyse the risks associated with the company's direct activities via various metrics. For example, we use greenhouse gas emissions to judge exposure to the transitional risks associated with the development of the low-carbon economy; high concentrations of greenhouse gas emissions increase the likelihood a company will be exposed to the fines and regulations implemented to assist in this economic transition. Greenhouse gas emissions also contribute to the wider, systemic risk of climate change and is something that we monitor closely. However, as discussed in Principle 4, our investment approach means our companies are relatively small contributors to this.

Supply chains are exposed to both environmental and social risks, which can impact the normal operation and long-term sustainability of the supply chain and, consequently, the performance of the company. To assess supply chain sustainability, we look at various factors, such as identifying the presence of potential human and/or labour rights abuses or assessing the vulnerability of the supply chain to extreme weather events.

The environmental and social risks associated with the distribution, use, and disposal of the company's products is also considered. We assess the product's impact; is it beneficial, neutral, or detrimental to society? Products that are detrimental to the environment/society are more likely to suffer from negative consumer sentiment and increased regulation over time, impacting the performance of the product and potentially the performance of the business. It is also important to include an assessment of how the company is innovating to improve the impact of their products, for example introducing so-called 'heat-not-burn' tobacco products, or reduced fat/salt/sugar food products.

We monitor and assess a company's sustainability risks and establish a view of its net negative ESG impacts using three main sources of data and information.

1. Our qualitative ESG and innovation database. We have built and continually update a database of all the qualitative information a company has provided on its own sustainability efforts from their sustainability reports, earnings calls, press releases, annual reports and/or their website. These pieces of information are tagged and categorised within approximately 140 different topic tags, under the main categories of environmental, social, governance, and innovation. These tags are updated to reflect current issues of global concern and to incorporate new factors. This allows us to look across the entire investable universe for all funds by these topics and to have a record of what a company has said/what has been said about a company regarding an issue across several years. The database currently has over 8,700 pages of information collected over the past 8 years.
2. Our quantitative ESG database. We collate data on environmental performance, diversity, corporate governance, and innovation reported by companies. We use this to provide a look-through of the respective portfolio compared to an index. Not all companies report the same numbers and even fewer use the same methodology or have them assured to the same standards. Hence, we don't rely on these numbers. We do, however, think that they still offer some insight into the relative impact of the portfolio compared to the benchmark. Environmental stats are reported per million GBPs of free cash flow. This helps us to address the trade-off between a company's investment proposition and what its net negative impacts are on the world, within our universe of good companies.

3. External reputation risk rating. We utilise an independent assessment of negative reputational risk from environmental, social and governance issues called the RepRisk Index, provided by RepRisk. RepRisk scans over 100,000 public news sources from around the world in 23 different languages every day, creating a company score based on the severity, reach and novelty of the respective issues a company is deemed to be responsible for. This service is used in two ways by Fundsmith:
   i. First, it serves as a proxy for the overall negative impact a company may have as it provides us with a way to absolutely rank companies within our investable universe. We can then adjust these rankings based on any significant positive impacts, or where we think RepRisk's score may be overstated due to its focus on the negative impacts.
   ii. Secondly, it acts as a catch-all for any negative news regarding a company that our usual news filtering services may miss.

In addition to the above, we require the companies we invest in to have well-managed policies for ethical working practices and a sustainable relationship with the environment and their stakeholders. Fundsmith integrates expectations of a company's environmental, social, governance and innovation impacts on the world into our model forecasts.

We are constantly searching for ways to improve our monitoring of ESG risks and integrate them into our investment process. As the industry moves towards a more standardised method of measuring these factors, we can start developing more consistent metrics that allow a more accurate assessment of, and comparisons between, the companies within and outside our investable universes.

Fundsmith Sustainable Equity Fund (FSEF)

Our sustainable fund, FSEF, initially follows the process outlined above but also applies hard sector exclusions and a sustainability screen over the Fundsmith Equity Fund investable universe. This means that the FSEF investable universe will always be a subset of the Fundsmith Equity Fund investable universe.

The hard sector exclusion screen is in place to prevent investment in companies described as being in the following GICS industries:

- Aerospace & Defence,
- Electric Utilities,
- Gas Utilities,
- Metals & Mining,
- Oil, Gas & Consumable Fuels, and
- Tobacco.

The Fund also excludes the following GICS sub-industries:

- Brewers, Distillers & Vintners, and
- Casinos & Gaming.

We also exclude any companies that profit from pornography. Further, we exclude companies that may not classified by MSCI as being in the industries listed above but generate a significant proportion of their profits from them. An example of this is our exclusion of Louis Vuitton Moet Hennessy (LVMH) which MSCI defines as a Textiles, Apparel and Luxury Goods company, but generates a significant proportion of its revenue from alcohol. We exclude these industries as we deem it unlikely a truly "sustainable" company could operate within them. These exclusions are detailed in the Fund's prospectus, meaning that we cannot legally invest in any companies operating in the industries/ sub-industries given above.

We then apply our sustainability screen. This screen uses the information we have collected regarding FEF IU companies' sustainability risks, net environmental and social impact on the world, awareness of these impacts, and the mitigation measures undertaken to reduce their risks/impacts. We use these factors to make a judgement on a company's overall level of sustainability. This judgement assesses whether the company's net environmental and social impact on the world is firstly, negative, secondly, excessive, and thirdly, decreasing due to concerted mitigating action by the company.

We assess environmental and social impact, both positive and negative, in the widest possible sense. The assessment of negative environmental and social impacts has an inherent subjectivity, but we attempt to make our process as objective as possible by leveraging as much information as we can in our decision-making process. We think we are well positioned to make this assessment as our investable universe is small and we know the companies inside the universe intimately. Once we have removed the companies that we find to cause an excessive amount of environmental or social harm, we are left with the FSEF investable universe.

Fundsmith Sustainable Equity Fund's additional ESG criteria means companies such as Meta (Facebook's parent company) and Philip Morris International are excluded from its investable universe, both of which are present in the Fundsmith Equity Fund's investable universe. While both companies pass our good company screen, Philip Morris International is a tobacco company so is removed by our sector exclusion screen, and Meta is excluded because our assessment concluded its net impact on society is excessively negative, and it is currently failing to mitigate these impacts.

Principle 8

Signatories monitor and hold to account managers and/or service providers.

We use very few service providers to assist our stewardship-related activities. For example, as discussed in Principle 12, we do not use any proxy voting advisory services. All our voting decisions are made independently. We use internal analysis of the vote topic and company in question to inform our decision. Service providers are only used when we feel they are necessary and offer a material improvement to the outcome of the stewardship activity than we could produce internally.

We use a variety of quantitative and qualitative data to assess potential investments and monitor existing investments. Our research team does all our analysis in-house using data collected directly from company websites, publications, and via Bloomberg. Data for prospective investee companies is collected from company websites through their publications of annual reports and other public documentation. We meet management, attend conferences, and read industry publications (e.g., Pet Food Digest) to help build the profiles of the companies and industries in all our respective investment universes. We also collate data on environmental emissions, diversity, corporate governance, and innovation from data companies provide themselves. It is important to note that we don't rely on any single service provider for any part of our investment process. Data from each provider is used as part of our assessment of a company's investment proposition and is never relied on exclusively.

We check the quality/accuracy of the data by cross referencing against other freely available sources. For example, we reconcile company reported greenhouse gas emissions against those provided by the CDP, which are calculated and reported separately. Though, as CDP participation grows, more companies are using this data within their own reports. We also use our relationships with investment banks for access to company management teams and for information on companies that can sometimes be more difficult to access, particularly with smaller companies Smithson looks at. However, we place little value on any recommendations, opinions or advice that research by these institutions provides.

Every year we assess the value offered by different sell-side research providers before deciding to re-sign the contract. The Stewardship and Sustainability Committee periodically reviews the services we receive and assesses feedback from meetings we have had with providers. The Committee makes its decisions based upon the value these services add and the quality of the service provided when making their assessment.

We don't use dedicated resources for ESG data, or so-called 'sustainability ratings' for our analysis, as we have doubts about the methodology and the consistency of ratings across different providers. Our main aim when analysing a company, as mentioned throughout this report, is to assess its ability to sustain a high return on capital employed across the business cycle and its capacity to invest more capital at these high rates of return. Evaluating their ability to do this relies on an understanding of the company's net impact on the world, which is assessed through the variety of metrics we collect and analyse. Integrating the subjective assessments these sustainability ratings offer contributes nothing to our understanding of a company's ability to do this.

To help us assess these net impacts independently, we use a reputational risk score from RepRisk. We think this acts as a strong proxy for negative impacts on the world and is better suited to our approach compared to the sustainability ratings we looked at. The service analyses over 100,000 news sources a day in 23 languages, and acts as a catchall for any negative news on a company that our usual news filtering services may miss. The data we receive from RepRisk is delivered via their online 'ESG Risk' platform, from which we can download the data we need and integrate it directly into our workflow. This allows us to access the third-party sustainability-related risk proxy quickly and efficiently.

To check the validity of the information RepRisk provides, we collect and store both positive and negative media coverage of our companies in our internal daily news emails. We can then compare what we've collected to what RepRisk has considered significant. We have regular contact with RepRisk to help improve their systems and feedback any issues we have had. This contact is typically twice a year. However, if any specific issues emerge between these meetings, we have a designated customer service representative we can engage with to address them.

During 2022 we had no issues with our service providers with our needs being met throughout the year.

Principle 9

Signatories engage with issuers to maintain or enhance the value of assets.

Fundsmith's approach to engagement is available as part of our Responsible Investment Policy.

Our approach to engaging with the companies in our portfolios comes directly from our desire to be long-term shareholders in those businesses. We use engagement to encourage sustainable business decisions that will benefit the long-term performance of the company. Practically, this means we generally support changes and/or investment that promotes long-term growth and oppose the establishment of unrealistic short-term targets and activities that negatively impact the ability to sustain high returns.

The decision to engage with a company is made on a case-by-case basis and is prompted by various factors, both internal and external. We only engage with companies regarding topics relevant to their operations and when we deem the risk to be material and detrimental to long-term performance. Engaging with a company is an effective way to generate change that reduces risk, but we do not always engage with the goal of changing the company. We use engagement to reassure ourselves and to better understand the company's perception of the potential risk. Companies are often aware of the risks we identify and either have plans to, or are already, mitigating it or have deemed it immaterial. We view these engagements as equally successful as those that force change within a company. Of course, if the company is unaware or not doing enough to address the risk, engagement can then be used to generate the change needed.

One key issue we frequently engage with investee companies regarding is executive remuneration. Generally, we care how executives are paid, not how much. We would like the remuneration policies of the companies we invest in to be aligned with the sustainable, long-term growth of the business. We don't like remuneration polices that are based on the kind of short-termism discussed above. We believe an effective policy includes both a measure of growth and a measure of returns, it is no use having one without the other.

We also want to encourage companies to integrate sustainability into their business model and give due diligence to environmental, social and governance factors. As we have previously discussed, poor sustainability performance might not impact profits immediately, but it has the potential to negatively influence future growth. Sustainability factors are becoming increasingly likely to bring material financial impacts as consumer interest and regulatory pressure continues to grow.

Our approach to engagement differs slightly between our funds given the varying sizes of the businesses they invest in. As at the end of 2022, the companies in FEF and FSEF had a median market capitalisation of £106bn and £82bn respectively, while Smithson had a much smaller average at £6.4bn. Due to the size of the companies held in FEF and FSEF, our access to top-level decision-makers is limited. For example, Microsoft (held in both FEF and FSEF) had a market capitalisation of over $850bn at the end of 2022. Our total shareholding accounted to around 0.12% of the company.

However, the size of the Fundsmith Equity Fund means we are significant shareholders in some of our other investees. L'Oréal, a company we have owned since 2011, had a market capitalisation of just over $190bn at the end of 2022. At that point, we were within the company's top 5 shareholders. This position means we are more likely to be given access to the company's senior management when we request it.

Table 4 below sets out information on our direct engagements with investee companies for each of our funds throughout 2021 and 2022.

	Total no. of engagements		% of Portfolio engaged		Average no. of engagements per portfolio company	
Fund	**2021**	**2022**	**2021**	**2022**	**2021**	**2022**
FEF	61	47	72%	55%	2	1
FSEF	51	41	67%	52%	2	1
SSON	41	60	50%	71%	1	1
Total	**153**	**148**				

Table 4: Fundsmith engagements summary 2022

We recorded 148 engagements across all of our funds during 2022, meeting 53 of the 91 companies owned during the year. As was the case in 2021, the majority of our engagements were general updates regarding the company's performance, introduction to new executives, involved discussions over their long-term strategy and capital allocation plans and general risk management. Sustainability matters remained a routine topic of discussion at many of our engagements, reflecting their increasing prominence in the day-to-day operations of our businesses. We also had a significant number of engagements following Russia's invasion of Ukraine. We spoke to many of our businesses about the operational risks they faced due to the disruptions caused to supply chains, the knock-on impacts following the surges in energy costs and the disruption to any operations the company had in Russia.

As in 2021, video conferencing remained the dominant method of engaging with companies. It accounted for 68% of our meetings last year, a decrease compared to the 84% seen in 2021 but still significantly higher than the pre-pandemic 8% seen in 2019. 2022 also saw an increase in the number of in-person meetings we were able to have with businesses. We recorded a 16% increase in the number of physical meetings with person, up from 4% in 2021 to 20% in 2022.

Some examples of our engagements with companies are detailed below.

Company	Domino's Pizza Enterprises
Sector	Consumer Discretionary
Fund(s)	Smithson
Context	Environmental Risk Management
Objective	The company hired their first Chief Environment, Social and Governance Officer in 2021. We met with the company to understand how they were address the key sustainability issues that the company faced.
Activity	Met with the company's Chief of People and Investor Relations team.
Outcome	Domino's have identified two key areas with regard to the company's sustainability performance they are focusing on. The key areas are removing modern slavery from their supply chain and measuring and reducing their greenhouse gas emissions. We were satisfied with the areas the company had identified and the progress they had made to reduce the risks they posed.

Company	Unilever
Sector	Consumer Staples
Fund(s)	FEF, FSEF
Context	Greenwashing risks
Objective	Understand the company's view on the costs and benefits of the wide variety of environmental targets Unilever set in their updated sustainability plan.
Activity	Met with the company's CEO and Investor Relations team
Outcome	The CEO explained the company's positioning regarding the targets. Not only did they see them as important to generate the changes needed to protect the environment, but they would reduce the costs and risks Unilever's supply chain faced over the long term. We accepted Unilever's response and will continue to monitor the company's progress towards the targets it has set.

Company	Novo Nordisk
Sector	Health Care
Fund(s)	FEF & FSEF
Context	Remuneration
Objective	After voting against the company's remuneration policy for the first time in 2021, we engaged with them ahead of their 2022 Annual General Meeting ("AGM") to understand how the updated policy benefitted long-term performance.
Activity	Met with Novo's CEO and CFO.
Outcome	The company explained their new remuneration metrics and how they incentivised management to focus on the company's long-term, sustainable growth. We told the company we would like to see the inclusion of a returns-based metric in their policy. The company accepted our feedback. We voted against their remuneration at the 2022 AGM due to the lack of a returns-based metric. Later in the year and following this meeting, Novo consulted us during the creation of their new remuneration policy ahead of their 2023 AGM.

Company	Temenos
Sector	Information Technology
Fund(s)	Smithson
Context	Governance structure
Objective	We engaged with Temenos to address concerns we had regarding the role of the company's Executive Chairman and the CEO's lack of accountability.
Activity	We held two meetings with the company, the first with the Lead Independent Director and another with the Executive Chairman.
Outcome	The company representatives explained the structure of the company to us, outlining the role of Executive Chairman and how this interacted with the responsibilities of the CEO. We were not satisfied with the structure and communicated this with the company, highlighting that we would prefer independent oversight of executives. The company announced that the CEO was departing with the Executive Chairman stepping in as CEO until a replacement was found. The Lead Independent Director was appointed as Chairman of the Board.

Principle 10

Signatories, where necessary, participate in collaborative engagement to influence issuers.

Fundsmith is open to participating in collaborative engagements when we feel an issue is of sufficient severity and collaboration can achieve a result we could not alone. As a long-term investor, we value the relationships we build with the companies in which we invest. Our preference is to deal with companies directly and usually in private. Collaborative engagement is usually only considered when our independent engagement and escalation activities have failed to generate the change that we feel necessary.

We also find that the increasing pressure on investment managers to engage collaboratively is resulting in more engagements that potentially serve the interests of the managers over those of the underlying company. Given our long-term approach, our interests are rarely aligned with these engagements as they typically want companies to commit to short-term targets or engage in activities that provide little to no benefit to long-term performance. Collaborative engagement is only ever exercised if it offers clear benefits to the company's long-term outlook, rather than to simply tick a box to say we've done it. We prefer speaking to management and exchanging opinions and views on different issues directly. This, we believe, is more effective than any number of investors signing a generic letter sent to multiple companies.

We are a signatory to the UN Principles for Responsible Investment and continually monitor their collaborative engagement platform to identify any collaborative engagement opportunities that are aligned with concerns we may have and match our preferred approach. Should an opportunity to use collaborative engagement arise that we feel we offers meaningful value, we would participate. Fundsmith is also an active and full member of the Investment Association ("IA") and regularly participates in industry engagements and discussions.

Given the concentrated nature of our funds' portfolios, each of which hold less than 30 companies, the opportunity to take part in collaborative engagements is rare. It is rarer still given the qualities of the companies we invest in. We look for high quality companies that can make and sustain a high return of the capital they employ, allowing them to grow and compound in value over the long term. Part of our assessment of a business's ability to do this is an assessment of the risks they company face from external as well as internal factors. If a company was exposed to a risk material enough to warrant mass shareholder action, it would likely have been identified by our research and factored into our assessment of that business.

We were not involved in any collaborative engagements in 2022 as we did not come across any appropriate opportunities.

Principle 11

Signatories, where necessary, escalate stewardship activities to influence issuers.

As discussed in our report on Principle 9, we engage with our companies with the aim of promoting their long-term performance and growth and to discuss any activities that we believe may limit their ability to sustain growth and returns over the long term.

However, engagement may not always produce the results we desire as some companies fail to act on the issues highlighted, or their response fails to address them adequately. When we find our engagement is failing to generate change, we will often escalate our activities to help the company understand our position, or to get a more comprehensive statement from the company about why they cannot/will not make the change we seek.

Our decision to escalate our stewardship activities, as with our engagement decision-making process, is done on a case-by-case basis. If our initial engagement fails to generate the changes we want, we will not automatically escalate the engagement. This decision is largely, but not exclusively, based on the scale of the impact the issue may have and the length of time before those impacts are felt, supported by our research team's knowledge of the company in question. If the severity is lower and the time frame long, we are likely to continue our engagements with the company without escalation. Conversely, if the potential impact is high and the time frame short, we will escalate our stewardship activities as necessary.

Generally, we escalate our stewardship activities by taking the issue to the company's board of directors, sending a letter to the CEO, or by exercising our right to vote against management's recommendations at its annual general meeting. Typically, we will inform management that it is our intention to vote against a proposal at the AGM so that they have an opportunity to engage with us to exchange points of view before the meeting. As discussed in our report for Principle 10, when we feel the issue is particularly significant, we may look to collaborate with other shareholders to support our cause. While we prefer to keep our dealings with companies private, in some instances we may deem it necessary to express our concerns publicly should we feel that it increases the chances of a constructive dialogue.

Should previous escalation efforts prove ineffective, or the action of the company be particularly egregious, our final escalation step is the sale of our shareholding in the company. We would likely do this because of consistently poor capital allocation by company management and no incentive structure present to encourage management to fix it. We may also sell a holding if we believe there is an issue that will seriously impact the company's ability to make and sustain a high return on capital over the long term. Reaching the point of exiting our investments is rare; most of our escalations are resolved through voting against management, on multiple occasions if necessary, and continuing our engagement with company executives.

Our approach to escalation is the same across all our strategies as we believe it is the most effective way to align management's thinking with our own, focusing on the long-term performance of the company. However, the various sizes and geographies of the companies our funds invest in means that there are some challenges in enacting this approach, particularly escalating the issue to the attention of the board or senior management as mentioned in Principle 9. Where we are larger shareholders in portfolio companies, we may find it easier to bring our concerns to the attention of senior management. However, where we are small shareholders this is considerably more difficult.

Some examples of escalating engagements with companies during the reporting period are given below.

Company	Estee Lauder
Fund(s)	FEF & FSEF
Context	Executive remuneration
Objective	Encourage the inclusion of metrics that support the long-term growth of the business.
Activity	We voted in favour of Estee Lauder's remuneration policy in 2021 despite some reservations we had resulting from changes made following the pandemic. We met with the company's Investor Relations team ahead of their 2022 AGM to discuss their updated remuneration policy.
Outcome	Our engagement started with Estee Lauder in 2021 following changes the company made to their executive remuneration policy. The company reintroduced the returns-based metrics which were removed during the COVID-impacted 2020. However, the company reintroduced the metric with a lower weighting in their bonus and long-term incentive plan compared to the pre-pandemic period. We voted in favour of the policy but communicated to the company that we would like to see the weightings return to their pre-pandemic level. In 2022 the company updated their remuneration policy but did not increase the returns-based metrics to their pre-pandemic level. We met with their Investor Relations team to discuss the policy and understand how the weightings incentivised the company's long-term growth. The engagement failed to satisfy us that the reduced weighting was as effective at promoting the long-term success of the company and we therefore decided to vote against the policy.

Company	Unilever
Sector	Consumer Staples
Fund(s)	FEF & FSEF
Context	Company acquisition
Objective	Encourage the company to focus on activities which contribute towards their long-term success.
Activity	We wrote to the company's management team to outline our concerns with the company's proposed acquisition of GSK's consumer health arm in early 2022. After receiving a response from the company, we escalated our engagement and met with the company's CEO and Chairman to discuss the potential deal and the company's wider strategy and performance.
Outcome	Our engagement with Unilever was initiated following a bid the company made for GSK's consumer health division. We felt that Unilever were significantly overpaying for the business. We wrote the company to highlight that the bid they were making overvalued the business and the returns it would generate were unsatisfactory for us as long-term shareholders. The response we received from the company did not address the issues we raised and as a result we decided to meet with the company's Chairman and CEO. Our engagement with the CEO and Chairman failed to ease our concerns about the long-term benefits of the deal and raised questions concerning management's decision making and longer-term strategy. We chose to publish an article detailing our objections to the deal as the next step in our escalation strategy. The bid was eventually aborted.

Principle 12

Signatories actively exercise their rights and responsibilities.

As long-term shareholders and part owners of our funds, we have always taken our voting rights seriously. It is key for us to vote in a way that supports the long-term, sustainable growth of our investments. We will exercise voting rights in nearly all circumstances however, in some instances we may abstain from voting when we consider it appropriate. These rights are exercised for the exclusive benefit of the relevant fund and its investors. Our full voting records for 2022 are available here.

Our approach to proxy voting is laid out in our Responsible Investment Policy and Proxy Voting Policy. We do not have a prescriptive approach to proxy voting. Rather than following a policy-based approach, our portfolio managers assess matters subject to a shareholder vote on a case-by-case basis, accounting for the specific context of the company and the topic of the vote in question. All our analysis is completed in-house and set down in writing by the relevant analyst. The final voting decision is made by the portfolio manager. We do not rely on recommendations made by proxy advisors.

When we exercise voting rights, we will do so in a manner that is consistent with the best interests of our funds, our investors and our clients. We ensure that the exercising of voting rights is consistent with the investment objectives and policies of the relevant fund. When we vote we always do so with the aim of supporting the long-term sustainable performance of the company and to subsequently create value for our clients and beneficiaries. Individual clients cannot override this approach in either our pooled or segregated accounts. We have never and will never engage in stock lending.

All our proxy votes are submitted through voting through the ProxyEdge voting platform. Our custodians input our holdings into the platform which informs us of when AGMs or EGMs are occurring, what voting rights we have, the details of each proxy and the voting deadline for each meeting.

Below we discuss our voting history for 2022, giving examples of some of our most significant votes. Significance is defined in various ways. A vote may be significant due to the size of our holding in the company or the weighting of the company in our portfolio. Equally, it may be significant if we feel that the vote can bring about substantial, positive change in the company, or that failing to vote could result in large, negative impacts to ourselves and our clients. A vote can also be significant if it varies from our typical approach to voting on a particular issue or if it results from previous engagement with the investee company regarding the issue.

We voted 100% of the 1,258 available proxies in 2022, as is our responsibility as stewards of our investors' capital. Our funds voted against 7% of the recommendations made by company management teams during 2022. We typically vote against the recommendations of company management teams as we believe that the recommendations are not in the best interests of the company's long-term growth.

	No. of shareholder meetings	No. of voteable proxies	% Voted		% Voted against management	
			2022	Since inception	2022	Since inception
FEF	28	453	100%	90%	9%	7%
FSEF	26	402	100%	100%	9%	7%
SSON	34	403	100%	99%	2%	5%
Total	**88**	**1258**	**100%**	**94%**	**7%**	**7%**

Table 5: Fundsmith 2022 proxy voting summary

Table 6 details the proportion of proxies for which we voted against management's instruction on four topics. Across all of our funds, we voted against management on 47% of the remuneration proposals presented during 2022. This includes executive remuneration policies, remuneration of the board of directors and remuneration reports. Both the Fundsmith Equity Fund and the Fundsmith Sustainable Equity Fund saw a large increase in the number of remuneration-related proxies voted against, rising from 47% and 58% in 2021 to 63% and 62% in 2022 respectively.

	Board member election	Remuneration	Shareholder proposal	Other
FEF	1%	62%	8%	4%
FSEF	1%	63%	13%	2%
SSON	0%	17%	33%	0%
Total	**1%**	**47%**	**11%**	**2%**

Table 6: % of proposals voted against management

The majority of our votes against management on remuneration related to the remuneration of executives. As we commented last year, we are increasingly seeing remuneration policies that do not do enough to align management's incentives with the long-term success of the business. Remuneration policies include metrics which management can manipulate in their favour, such as adjusted earnings. Management can adjust their company's earnings to exclude certain items, such as share-based payments, to give the illusion of earnings growth which is not there. Further, many remuneration schemes employ metrics which management have little to no control over such as total shareholder return ("TSR"), a metric based on the performance of the shares over a certain period. Management has little control over the company's share price over the periods for which they are remunerated-the last three years of stock price volatility gives evidence to this. Not only are they paid via a metric they have no control over, but they are increasingly using a 'relative' version of shareholder return, comparing themselves to a basket of companies they have absolutely no control over. We do not think this is an appropriate way to incentivise management.

After separating out the proxies that related to the remuneration of company executives, it is clear how few policies we concluded to be effective at incentivising long-term growth. Both FEF and FSEF voted against more than 90% of the executive remuneration policies presented in 2022. Hence, we now see voting in favour of a policy as far more significant than opting to vote against. Across both funds we only voted in favour of two executive compensation plans in 2022. Those were at IDEXX (held in FEF and FSEF) and Home Depot (held in FSEF only). Both companies' policies included growth and returns-based metrics which we deem as essential components of effective remuneration policies.

	No. of executive remuneration votes	Voted against
FEF	26	96% (25)
FSEF	23	91% (21)

Table 7: FEF & FSEF voting on executive remuneration

Given the influence proxy advisory firms have in the proxy voting process, we classify any vote against them as significant. Both ISS and Glass Lewis recommended that shareholders vote against the compensation policy of Halma, a company owned in Smithson's portfolio.

Over the past three years Halma have been working to increase the compensation paid to their executives, aligning it with the median of the FTSE 100 excluding financials. They have been doing this to ensure that the company remains competitive when recruiting and retaining executives. The proxy advisors concluded that the compensation increases were too large and recommended that stockholders vote against the policy. However, we thought the company's approach to the salary increases was conservative and justified. Halma is a FTSE 50 company but are basing the increased compensation on the FTSE 100 to account for their high valuation. The company is also excluding financials to offset the skew they have on the average compensation calculation. We felt the changes the company is making are important in ensuring that they recruit and retain the talent necessary to ensure their long-term performance. Therefore, we voted in favour of the policy.

We were largely aligned with management regarding board member elections last year but made significant votes against management elections at Unilever's (held in both FEF and FSEF) AGM. We made the decision to vote against the re-election of the company's Chairman, CEO and CFO. Following several meetings during the year and the engagement discussed in Principle 11, we had lost confidence in the company's strategic direction and felt that a refresh of the company's management would get the business back on the right track: prioritising the long-term sustainable growth of the business. In September, Unilever announced that the CEO intended to retire at the end of 2023.

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