Fundsmith
Sustainable Equity Fund | SICAV

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Dear Fellow Investor,

The table below shows the performance of the Fundsmith Sustainable Equity Fund – a sub fund of the Fundsmith SICAV ('Fund', 'FSEF' or 'Sicav') and other comparators during the first half of 2023 and since inception.

% Total Return	1st Jan to 30th June 2023	Inception to 30th June 2023	
		Cumulative	Annualised
Fundsmith Sustainable Equity Fund EUR T Class[1]	+5.5	+13.4	+5.6
MSCI World Index EUR[2]	+12.6	+25.7	+10.3
European Bonds[3]	+5.0	-30.3	-14.3
Cash[4]	+1.3	+0.8	+0.3
Fundsmith Sustainable Equity Fund CHF I Class[1]	+4.8	+1.2	+0.5
MSCI World Index CHF[2]	+12.0	+14.4	+5.9
Fundsmith Sustainable Equity Fund USD I Class[1]	+7.4	+2.5	+1.1
MSCI World Index USD[2]	+15.1	+13.0	+5.4
Fundsmith Sustainable Equity Fund GBP I Class[1]	+2.2	+13.0	+5.4
MSCI World Index GBP[2]	+8.9	+24.3	+9.8

[1] Accumulation Shares, net of fees, priced at 13:00 CET, launch date 1.3.21, source: Bloomberg.
[2] MSCI World Index priced at close of business US time, source: Bloomberg
[3] Bloomberg/EFFAS Bond Indices Euro Govt 10 yr., source: Bloomberg
[4] € Interest Rate, source: Bloomberg
The Fund is not managed with reference to any benchmark, the above comparators are provided for information purposes only.

The T Class Accumulation shares in Euros were up by 5.5% in the first six months of the year, 7.1 percentage points less than what is perhaps the most obvious comparator — the MSCI World Index (€ net). (Note we do not hedge currency exposure and so the main difference in performance between the different currency share classes is due to currency movements in the period.

These currency movements also impact the performance of the comparator, MSCI World Index.)

What did well for us in the first six months of 2023? Here are the five biggest positive contributors to performance:

Stock	Attribution
Microsoft	+1.6%
L'Oréal	+1.4%
Novo Nordisk	+1.0%
Stryker	+1.0%
Alphabet	+0.9%

Source: Northern Trust

Microsoft continued to perform well despite revenue growth slowing.

L'Oréal continues to impress with its execution, particularly in China and online, which are inextricably linked. This is in sharp contrast to Estée Lauder, of which more later.

We touched upon Novo Nordisk last year when it also appeared. It has a runaway success with its obesity drug Wegovy. The main feature of commentary on the stock this year has been about actual or potential competition-from Eli Lilly, maybe from Sanofi, Boehringer Ingelheim and Zealand Pharma, and from generic (and probably some illegal) formulations.

Such concerns often strike us as one dimensional. Did anyone really think that there will only be one drug to service an ailment (obesity) which is of such pandemic proportions that annual revenues of $54bn are estimated by 2030. It reminds me of the often breathless commentary we get about the latest fintech start-up in payment processing and the threat they pose to the incumbents such as Mastercard and Visa. The payment processing market is so large and growing so fast that there is room for several competitors and they may also help win acceptance for the product and in so doing expand the market. It is not a zero-sum game.

Nonetheless we should expect a continuing tsunami of comments on obesity drugs and Novo Nordisk in which the words competition, side effects and celebrity drug are bandied about with careless abandon like a game of buzzword bingo; and national health services and insurers are cited ad infinitum or even ad nauseum. You can often judge what should happen by the opposite of what many of them propose-as Churchill remarked in another context, they will do the right thing after having exhausted all the other possibilities.

Stryker benefited from the increase in elective surgical procedures which has resulted from the backlog caused by the pandemic.

Alphabet was our 5th best contributor despite the hullaballoo about generative artificial intelligence and how this might change online search.

The five biggest detractors from our Fund's performance during the period were:

Stock	Attribution
Waters	-1.3%
Estée Lauder	-1.0%
ADP	-0.5%
Mettler-Toledo	-0.5%
Johnson & Johnson	-0.4%

Source: Northern Trust

Waters and Mettler-Toledo have both been affected by the slowdown in laboratory expenditures post the pandemic. In neither case are we bothered by this. In fact, we hope it presents an opportunity for us to buy more.

Estée Lauder is the only one of the five which concerns us. It fell in response to poor figures occasioned by a build-up, and subsequent write-off, of stock accumulated in anticipation of a reopening of travel by the Chinese after the lockdown. Whilst domestic travel has returned, it seems that Chinese consumers are buying watches, handbags, and other luxury goods first which it was harder to shop for online during the lockdown. It has revealed some severe weakness in Estée Lauder's supply chain with no manufacturing capability in Asia.

We hold Estée Lauder as a complementary cosmetics company to L'Oréal, with strength in America, prestige and traditional distribution channels in contrast to L'Oréal's strengths in China, mass market and online. We await to see how the recent debacle is handled.

ADP has been affected by macroeconomic concerns about the labour market after a strong 2022.

There is nothing obvious to note about the performance of Johnson & Johnson where the spin-off of Kenvue, the consumer healthcare business, began in May.

When considering sustainability, we analyse companies in the broadest possible sense, considering their negative impact on the environment and society and 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, which makes the businesses less sustainable and may harm long-term investments.

The companies constituting the FSEF portfolio have continued to demonstrate their commitment to avoiding the worst impacts of climate change. In the 2022 HY letter, we discussed how 61% of the portfolio was aligned with the Paris Agreement's goal of limiting global warming to 2°C compared to 35% of the assets managed by signatories to the Net Zero Asset Managers' initiative. This year, the proportion of the portfolio aligned with the Paris Agreement increased to 68% compared to the Net Zero Asset Managers' initiative's 39%. Around 12% of the portfolio has already achieved net zero carbon emissions. As a proportion of the Fund's total greenhouse gas emissions, 94% is committed to, or has already set, emission reduction plans with the Science Based Targets initiative. Further, 88% of the Fund's emissions are covered by a commitment to reaching net zero emissions with an average target year of 2037. We continue to track the progress companies in the portfolio make toward their net zero goals and engage with them when necessary.

We have been assessing the reputational impact associated with the success of Novo Nordisk's obesity drug Wegovy. While the success of Wegovy is good for us as investors in the company, there is a perception that it is becoming a lifestyle drug used by the rich at the expense of those who actually need it. Numerous celebrities, including Elon Musk, have publicly discussed their success in losing weight using the drug. Demand is so strong that many physicians in the US are prescribing the diabetes drug, Ozempic, instead of Wegovy, as it is effectively the same molecule, although at a lower concentration.

In response, we met with the company to try and understand how it was managing the risk to its reputation. When we first spoke to the CEO about this last year, he was unequivocal that the company didn't want Wegovy to become a lifestyle drug despite the impact on sales. Instead, the drug would only be available from a pharmacy with a doctor's prescription rather than over-the-counter or online. This position is because the most effective way to treat obesity is using Wegovy in combination with diet and lifestyle changes, which patients are more likely to adhere to when the treatment is being supplied by a doctor.

So far, Wegovy has only been launched in the US, Norway and the company's home market of Denmark. Despite the noise on social media, the average BMI of a patient in the US is 38 (i.e. the upper end of the obese range), and they have two or three comorbidities on average (e.g. type 2 diabetes, cardiovascular disease, hypertension etc.). We were therefore reassured that the company oppose the use of Wegovy as a lifestyle drug and that the medication is getting to suitable patients, despite some media reports to the contrary. Moreover there seems little doubt that its benefit is not limited to weight loss as it can ameliorate other serious comorbidities with significant benefit for the patient and the healthcare system.

On valuation, the free cash flow ('FCF') yield on the portfolio, which had ended 2022 at 3.1%, fell to about 2.9% at the end of June 2023 through a combination of the rise in share prices and continuing disruption in the conversion of profits into cash and consequent lack of free cash flow growth. It is impossible to be definitive with half year numbers, given seasonality and the fact that it is a short period, but our portfolio is more expensive than the S&P 500 Index on this measure although the S&P contains some extreme numbers such as major oil companies and some healthcare providers apparently on FCF yields of 20% or more.

Our portfolio turnover in the first half was 6.1%. Voluntary dealing (dealing not caused by redemptions or subscriptions) cost €11,544 during the half year (0.004% or 0.4 of a basis point). The Ongoing Charges Figure for the T Class Accumulation shares was 1.11% and with the cost of all dealing added, the Total Cost of Investment was 1.12%.

We sold our stake in Adobe having highlighted our concerns about its proposed acquisition of Figma in our annual letter. The price being paid seems too high, although very little information on which to gauge this has been provided. It is possible that the deal will fail because of competition concerns, but even if it does we would be worried about what it reveals about the competitive threat to Adobe.

During the period we added positions in Marriott & Mastercard. Marriott is in our view the leading asset light (it operates hotel brands with the real estate provided by franchisees) hotel operator, and Mastercard maintains our exposure to the payment processing sector after our exit from PayPal.

Whilst I suspect that the Fund price performance is and will remain the primary focus of our investors, we try to remain focused on what is happening with the fundamental performance of these businesses.

At this time last year, we noted that despite the generally poor share price performances, the revenue growth of our portfolio was strong, bordering on very strong at some of our companies, albeit we noted prophetically that we might well be concerned about their ability to replicate this performance over the next couple of years.

Where are we now?

The past six months have seen a slowdown in revenue growth from our technology companies, a resilient performance from our healthcare stocks and continued pressure on the profitability of our consumer businesses.

Large technology companies have in a sense become victims of their own success. Their growth over the past decade means that they are now such a large part of the economies in which they operate that they have become inevitably more cyclical. At the time of the 2008-2009 recession, Apple, Microsoft, Alphabet and Meta had combined sales of $125bn. Today, Apple generates three times that number on its own and the combined sales of these four companies are as near as makes no difference $1 trillion. As a result, the economic slowdown means that where Microsoft grew sales at 18% last year, we are looking at more like 7% this year. Meta is growing at about 8% where growth was previously well over 20%. Apple and Alphabet will almost certainly have down years in 2023 but we expect a decent bounce back in 2024.

In the healthcare sector, businesses like Stryker continue to benefit from pent-up demand after Covid which drove revenue growth in the company's most recent quarterly results of 13%, several points above its historical run rate. Others like Coloplast or IDEXX remain metronome-like in their reliability and generated revenue growth of 8% and 10% respectively. Novo Nordisk meanwhile was also an extremely reliable business growing at around 10% that has now been transformed into one growing at 25%, courtesy of its weight loss drug Wegovy.

Our consumer companies in the main continue to generate decent top line growth, albeit mostly price led. Estée Lauder was unfortunately the exception with sales down 8% in its most recent report, but we saw outstanding performances from PepsiCo which grew 14% and L'Oréal which grew 13%. However rising input costs have put pressure on margins, particularly gross margins or the difference between what it costs a company to make its products and what they can sell them for. Thus Procter & Gamble used to 'make things' for $0.50 and 'sell them' for $1.00 but now it costs $0.53 to make them. McCormick used to make things for $0.58 and sell them for $1.00, but now it makes them for $0.63. Estée Lauder used to make things for $0.20 and sell them for $1.00, now it costs $0.28 to make them. This still leaves our companies' gross margins way above those of the market average which means their bottom lines are better protected but they cannot completely offset these headwinds.

Of our stocks which don't fall into the above three sector categories, Waters 'only' grew sales at 3% where more recently we have benefited from two to three times this level of increase, and this meant that the stock had a poor first half. Sales patterns at this type of business can be lumpy and we expect better in the second half. ADP also had a forgettable first half from a stock price perspective but this was presumably a function of how well the shares did in 2022 since from a business perspective, top line growth of 10% remains bang in line with the historic run rate.

To sum up, conditions are tougher and our companies are mostly having to cope with slower revenue growth and/or higher input costs. However, that's what happens from time to time so we are mostly sanguine about it. We have a few more worries as a result but not a wholesale concern about what is happening.

Turning from company fundamentals to the macro environment, what level of interest rates will be required to tame inflation? We don't know. Will there be a recession? Of course, but we have no idea when. What will happen in Ukraine? We haven't a clue. Will China take action over Taiwan and how will the United States respond? We have no view. Even if we had we are not sure how markets would react.

Fortunately, it continues to be the case that we do not invest on the basis of our predictions about macroeconomics and geopolitics.

Whilst we await the outcome of these economic and geopolitical conundrums we will seek to continue to do what we set out to do. Which is to assemble a portfolio of high-quality companies and hold onto them so that their inherent ability to compound in value will determine how we perform over the long term.

Yours sincerely,

Terry Smith

Terry Smith
CEO
Fundsmith LLP
Distributor & Promoter to Fundsmith SICAV

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Sources: Fundsmith LLP & Bloomberg unless otherwise stated.

Data is as at 30th June 2023 unless otherwise stated.

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

Free Cash Flow Yields are based on trailing twelve month data and as at 30th June 2023 unless otherwise stated. Percentage change is not calculated if the TTM period contains a net loss.

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