Fundsmith Equity Fund

Fundsmith Equity Fund

Short Form Report

For the year ended 31 December 2021

Fundsmith

Buy good companies
Don't overpay
Do nothing

Profile of the Fund

Investment objective and policy

The investment objective of the Fundsmith Equity Fund (the "Fund") is to achieve long term growth (over 5 years) in value.

The Fund will invest in equities on a global basis. The Fund's approach is to be a long-term investor in its chosen stocks. It will not adopt short-term trading strategies.

The Fund has stringent investment criteria which the Authorised Corporate Director (ACD) and the appointed investment manager adhere to in selecting securities for the Fund's investment portfolio. These criteria aim to ensure that the Fund invests in businesses:

- that can sustain a high return on operating capital employed;
- whose advantages are difficult to replicate;
- which do not require significant leverage to generate returns;
- with a high degree of certainty of growth from reinvestment of their cash flows at high rates of return;
- that are resilient to change, particularly technological innovation; and
- whose valuation is considered by the Fund to be attractive.

Risk profile

The Fund has no exposure to derivatives and no borrowings. Further, the investments are all in large publicly quoted companies where there is significant liquidity in the stock. The principal risk factor is the market price of the securities held by the Fund which is kept under review in the light of the Fund's objectives.

Currency risk: The Fund's portfolio is a global share portfolio and many of the investments are not denominated in Sterling. There is no currency hedging in place and the price may therefore rise or fall purely on account of exchange rate movements.

Concentration risk: The investment criteria adopted by the Fund significantly limits the number of potential investments. The Fund generally holds 20 to 30 stocks and so it is more concentrated than many other funds. This means that the performance of a single stock within the portfolio has a greater effect on the price of the shares of the Fund.

Operational risk: Failures or delays in operational processes may negatively affect the Fund. There is a risk that any company responsible for the safekeeping of the assets of the fund may fail to do so properly or may become insolvent, which could cause loss to the Fund.

Risk warning

Any stock market investment involves risk. These risk factors are contained in the full Prospectus. Investors should be aware that the price of shares and the income from them can fall as well as rise and investors may not receive back the full amount invested. Past performance is not a guide to future performance.

Risk and reward profile

◀ Lower risk
Typically lower rewards

Higher risk ▶
Typically higher rewards

1	2	3	4	5	6	7

The risk category reflects the significance of the Fund's share price fluctuations based on historical data. Historical data may not be a reliable indication of the future risk profile of the fund. The risk category of the Fund is not guaranteed and may change over time. Further, the lowest category of risk does not mean risk free.

Generally, the higher the risk category, the greater the potential for higher returns but also the higher the risk of losing money. This fund is ranked at 5 because funds of this type have experienced medium to high rises and falls in value in the past. The underlying investments are, however, in large companies with shares that are, in most cases, highly liquid.

There are a number of other risks that are not covered by the indicator above. A full description is contained in the prospectus under the heading "Risk Factors". The most material are currency risk and concentration risk which are explained above.

Performance Record

As at 31 December 2021

Change in net assets per share	Share Class T – Accumulation 31.12.21 (p)	31.12.20 (p)	31.12.19 (p)	Share Class T – Income 31.12.21 (p)	31.12.20 (p)	31.12.19 (p)
Opening net asset value per share	551.66	464.49	371.46	504.28	426.07	342.82
Return before operating charges	120.61	92.43	97.68	110.19	84.66	90.11
Operating charges	(6.32)	(5.26)	(4.65)	(5.77)	(4.82)	(4.27)
Return after operating charges	114.29	87.17	93.03	104.42	79.84	85.84
Distributions	(0.77)	(1.78)	(2.81)	(0.70)	(1.63)	(2.59)
Retained distributions on accumulation shares	0.77	1.78	2.81	–	–	–
Closing net asset value per share	665.95	551.66	464.49	608.00	504.28	426.07
After direct transaction costs of:	0.09	0.13	0.06	0.08	0.12	0.06
Performance						
Return after operating charges	20.72%	18.77%	25.04%	20.71%	18.74%	25.04%
Other information	£	£	£	£	£	£
Closing net asset value	4,654,397,369	3,565,093,281	3,092,139,869	328,111,991	270,883,618	233,484,538
Closing number of shares	698,914,699	646,250,706	665,708,093	53,965,510	53,716,790	54,799,379
Ongoing charge figure*	1.04%	1.06%	1.05%	1.04%	1.06%	1.05%
Direct transaction costs	0.01%	0.03%	0.01%	0.01%	0.03%	0.01%
Prices	(p)	(p)	(p)	(p)	(p)	(p)
Highest share price	672.16	559.05	487.25	613.68	511.48	447.54
Lowest share price	529.56	391.87	364.87	484.08	359.47	336.75

Change in net assets per share	Share Class R – Accumulation 31.12.21 (p)	31.12.20 (p)	31.12.19 (p)	Share Class R – Income 31.12.21 (p)	31.12.20 (p)	31.12.19 (p)
Opening net asset value per share	524.30	443.67	356.61	500.22	423.43	341.21
Return before operating charges	114.33	88.02	93.63	109.06	83.97	89.57
Operating charges	(8.86)	(7.39)	(6.57)	(8.42)	(7.05)	(6.28)
Return after operating charges	105.47	80.63	87.06	100.64	76.92	83.29
Distributions	–	(0.13)	(1.12)	–	(0.12)	(1.07)
Retained distributions on accumulation shares	–	0.13	1.12	–	–	–
Closing net asset value per share	629.77	524.30	443.67	600.86	500.22	423.43
After direct transaction costs of:	0.08	0.12	0.06	0.08	0.11	0.06
Performance						
Return after operating charges	20.12%	18.17%	24.41%	20.12%	18.17%	24.41%
Other information	£	£	£	£	£	£
Closing net asset value	563,850,008	434,889,985	356,739,479	30,471,679	22,730,205	19,830,762
Closing number of shares	89,532,639	82,946,393	80,406,670	5,071,350	4,543,999	4,683,340
Ongoing charge figure*	1.54%	1.56%	1.55%	1.54%	1.56%	1.55%
Direct transaction costs	0.01%	0.03%	0.01%	0.01%	0.03%	0.01%
Prices	(p)	(p)	(p)	(p)	(p)	(p)
Highest share price	635.67	531.40	466.39	606.48	506.99	445.13
Lowest share price	503.08	373.92	350.28	479.98	356.87	335.14

Performance Record (continued)

As at 31 December 2021

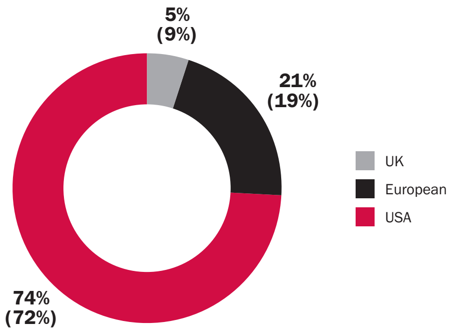
Change in net assets per share	Share Class I – Accumulation Net 31.12.21 (p)	31.12.20 (p)	31.12.19 (p)	Share Class I – Income Net 31.12.21 (p)	31.12.20 (p)	31.12.19 (p)
Opening net asset value per share	557.27	468.75	374.49	504.38	426.14	342.87
Return before operating charges	121.90	90.48	98.50	110.24	91.10	90.07
Operating charges	(5.77)	(1.96)	(4.24)	(5.21)	(10.77)	(3.82)
Return after operating charges	116.13	88.52	94.26	105.03	80.33	86.25
Distributions	(1.07)	(2.30)	(3.28)	(0.96)	(2.09)	(2.98)
Retained distributions on accumulation shares	1.07	2.30	3.28	–	–	–
Closing net asset value per share	673.40	557.27	468.75	608.45	504.38	426.14
After direct transaction costs of:	0.09	0.13	0.06	0.08	0.12	0.05
Performance						
Return after operating charges	20.84%	18.88%	25.17%	20.82%	18.85%	25.16%
Other information	£	£	£	£	£	£
Closing net asset value	16,920,191,240	13,346,652,955	10,695,659,299	6,165,167,108	5,608,167,634	4,433,567,455
Closing number of shares	2,512,662,450	2,394,992,157	2,281,756,847	1,013,262,204	1,111,892,454	1,040,390,315
Ongoing charge figure*	0.94%	0.96%	0.95%	0.94%	0.96%	0.95%
Direct transaction costs	0.01%	0.03%	0.01%	0.01%	0.03%	0.01%
Prices	(p)	(p)	(p)	(p)	(p)	(p)
Highest share price	679.68	564.72	491.51	614.13	511.82	447.65
Lowest share price	535.00	395.55	367.85	484.22	359.61	336.80

*The Ongoing Charge Figure (OCF) is the ratio of the Fund's total disclosable costs (excluding overdraft interest) to the average net assets of the Fund.

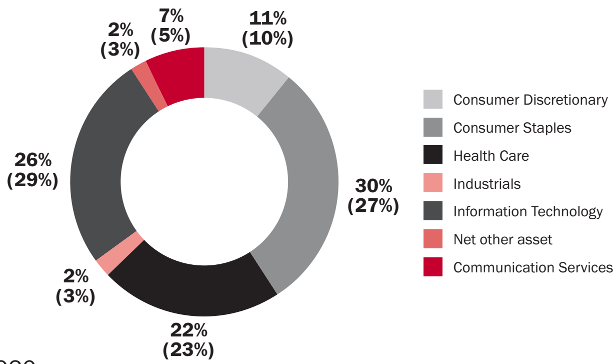
The prices in the above table are different from the published dealing prices that were available for investors on the 31 December. This is to comply with accounting rules that require us to publish the net asset value in this report based on bid prices at the close of day. The dealing prices, which are calculated at mid-day using mid prices, are used in the investment manager's review and the factsheet as the fund could only be bought or sold at those prices.

Information on the Fund

Breakdown by geography* as at 31 December 2021



Breakdown by sector as at 31 December 2021



The figures in brackets show comparative figures at 31 December 2020.

* Breakdown by geography is by country listing and not reflective of breakdown by operations.

Summary of significant changes

For the year 1 January 2021 to 31 December 2021		For the year 1 January 2020 to 31 December 2020	
Largest purchases	**Cost (£)**	**Largest purchases**	**Cost (£)**
Amazon.com	777,349,118	LVMH Moet Hennessy Louis Vuitton	701,992,055
Alphabet	624,924,621	Starbucks	414,688,371
L'Oréal	281,652,272	Nike	375,766,177
Church & Dwight	198,635,215	Church & Dwight	251,273,612
Unilever	185,939,082	L'Oréal	176,584,876
Total	**2,068,500,308**	**Total**	**1,920,305,091**
Total purchases for the year	**2,935,862,527**	**Total purchases for the year**	**2,794,996,796**
Largest sales	**Proceeds (£)**	**Largest sales**	**Proceeds (£)**
Becton Dickinson	607,163,903	Reckitt Benckiser	797,112,450
InterContinental Hotels	508,455,247	Intertek	378,327,913
Intuit	395,404,889	Clorox	261,644,252
Sage	323,015,610	PayPal	235,340,311
Intertek	135,450,945	Waters	149,858,250
Total	**1,969,490,594**	**Total**	**1,822,283,176**
Total sales for the year	**2,056,699,586**	**Total sales for the year**	**2,542,628,786**

Investment Manager's review

This report reproduces the Annual Letter that was sent to investors and published on the website in mid-January.

Dear Fellow Investor,

This is the twelfth annual letter to owners of the Fundsmith Equity Fund ('Fund').

The table below shows performance figures for the last calendar year and the cumulative and annualised performance since inception on 1 November 2010 and various comparators.

	% Total Return 1.1.21 to 31.12.21 %	Inception to 31.12.21 Cumulative %	Annualised %	Sharpe ratio[5] %	Sortino ratio[5] %
Fundsmith Equity Fund[1]	**+22.1**	**+570.7**	**+18.6**	**1.31**	**1.25**
Equities[2]	+22.9	+287.1	+12.9	0.78	0.74
UK Bonds[3]	-4.5	+40.9	+3.1	n/a	n/a
Cash[4]	+0.1	+6.4	+0.6	n/a	n/a

The Fund is not managed with reference to any benchmark, the above comparators are provided for information purposes only.
[1]T Class Accumulation shares, net of fees, priced at noon UK time, source: Bloomberg
[2]MSCI World Index, £ net, priced at US market close, source: Bloomberg
[3]Bloomberg/Barclays Bond Indices UK Gov. 5–10 year, source: Bloomberg
[4]£ Interest Rate, source: Bloomberg
[5]Sharpe & Sortino ratios are since inception to 31.12.21, 1.5% risk free rate, source: Financial Express Analytics

The table shows the performance of the T Class Accumulation shares, the most commonly held share class and one in which I am invested, which rose by +22.1% in 2021 and compares with a rise of +22.9% for the MSCI World Index in sterling with dividends reinvested. The Fund therefore marginally underperformed this comparator in 2021 but is still the best performer since its inception in November 2010 in the Investment Association Global sector with a return 357 percentage points above the sector average which has delivered just +213.9% over the same timeframe.

However, I realise that many or indeed most of our investors do not use these as natural comparators for their investments. Those of you who are based in the UK may look to the FTSE 100 Index ('FTSE 100') as the yardstick for measuring your investments and may hold funds which are benchmarked to this index and often hug it. The FTSE 100 delivered a total return of +18.4% in 2021 so our Fund outperformed this by a margin of 3.7 percentage points.

Whilst a period of underperformance against the MSCI World Index is never welcome it is nonetheless inevitable. No investment strategy will outperform in every reporting period and every type of market condition. So, as much as we may not like it, we can expect some periods of underperformance.

This is particularly so when we have a period like 2020–21 which was obviously heavily influenced by the pandemic. Our Fund outperformed the market by 6% in 2020 when the economic effects of the pandemic were at their height and most of the businesses we are invested in proved to be highly resilient. However, last year was more of a year of recovery and our companies had relatively little to recover from.

We find it difficult to outperform in particularly bullish periods where the market has a strong rise — 22.9% in 2021 — as a rising tide floats all ships, including some which might otherwise have remained stranded and that we would not wish to own.

In investment, as in life, you cannot have your cake and eat it, so it is difficult if not impossible to find companies which are resilient in a downturn but which also benefit fully from the subsequent recovery. Of course, you could try to trade out of the former and into the latter at an appropriate time but it is not what we seek to do as the vast majority of the returns which our Fund generates come from the ability of the companies we own to invest their retained earnings at a high rate of return because they own businesses with good returns and growth opportunities. In our view it would be a mistake to sell some of these good businesses

Investment Manager's review (continued)

in order to invest temporarily in companies which are much worse but which have greater recovery potential.

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

Microsoft	+3.9%
Intuit	+3.1%
Novo Nordisk	+2.3%
Estée Lauder	+2.0%
IDEXX	+1.9%

Microsoft makes its seventh appearance on this list, IDEXX its fourth, Intuit its third, Novo Nordisk and Estée Lauder their second. Someone once said that no one ever got poor by taking profits. This may be true but I doubt they got very rich by this approach either, as I've observed before. We continue to pursue a policy of trying to run our winners.

The bottom five were:

PayPal	-0.7%
Amadeus	-0.2%
Kone	-0.2%
Unilever	-0.2%
Brown-Forman	-0.1%

PayPal's performance last year was a clear exception to the benefits of running winners. The shares performed poorly amid concerns that its ambitions to construct a 'super app' to drive users to its payment systems might involve some value destruction, brought home by its apparent interest in acquiring social media operator Pinterest. We may be wrong but we would prefer if PayPal stuck to its knitting.

Amadeus is clearly still suffering from the effects of the pandemic on travel which is hardly surprising given that airline reservations are its largest business segment. However, we remain convinced that Amadeus will both survive this downturn and emerge in a stronger market position.

Kone was affected by the travails of the Chinese construction sector which represents its largest market.

Unilever seems to be labouring under the weight of a management which is obsessed with publicly displaying sustainability credentials at the expense of focusing on the fundamentals of the business. The most obvious manifestation of this is the public spat it has become embroiled in over the refusal to supply Ben & Jerry's ice cream in the West Bank. However, we think there are far more ludicrous examples which illustrate the problem. A company which feels it has to define the purpose of Hellmann's mayonnaise has in our view clearly lost the plot. The Hellmann's brand has existed since 1913 so we would guess that by now consumers have figured out its purpose (spoiler alert — salads and sandwiches). Although Unilever had by far the worst performance of our consumer staples stocks during the pandemic we continue to hold the shares because we think that its strong brands and distribution will triumph in the end.

Brown-Forman struggled under the twin impacts of the on trade shutdowns caused by the pandemic and EU tariffs on American sprits which gave us the opportunity to increase our stake. We expect both these headwinds to dissipate.

We sold our stakes in Intertek, Sage, Becton Dickinson, InterContinental Hotels and purchased stakes in Amazon and Alphabet.

As three of our sales were companies which are listed in the UK I am sure some will see this as some clue that we are selling out of the UK, or that we have some view on the prospects for the FTSE 100 versus the S&P 500 Index (S&P 500) or some other market or macro view. This is not the case. We invest in companies not indices or countries and in our view the country where a company is listed is largely irrelevant, if of course it has a well regulated stock market, and certainly does not provide a good guide to where the company generates its revenues. For example, InterContinental Hotels is listed in the UK but its largest market is the United States, hence why it reports in US dollars.

I don't intend to go into the reasoning on every sale and purchase transaction but the purchase of Amazon has attracted a lot of attention as we had previously declined to purchase its shares. Rather than give a lengthy rationale I would rather summarise it with a quote from the economist (and successful fund manager) John Maynard Keynes who said, 'When the facts change, I change my mind.' Although it could be explained by the simpler aphorism

Investment Manager's review (continued)

'Better late than never' or at least it will be if our purchase delivers the performance we expect.

We continue to apply a simple three step investment strategy:

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

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

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

Returns on capital and profit margins were higher in the portfolio companies in 2021 recovering from the downturn in 2020.

As a group our stocks still have excellent returns, profit margins and cash generation even in poor economic conditions. As you can see the same cannot be said for the major indices — with the exception of their current cash conversion which I suspect is a temporary phenomenon — if you can't get the stock you need because of supply chain problems, cash tied up in working capital is likely to be low. It's also worth remembering that the index numbers have the benefit of including our good companies.

The average year of foundation of our portfolio companies at the year-end was 1926. They are just under a century old collectively.

Consistently high returns on capital are one sign we look for when seeking companies to invest in. Another is a source of growth — high returns are not much use if the business is not able to grow and deploy more capital at these high rates. So how did our companies fare in that respect in 2021? The weighted average free cash flow (the cash the companies generate after paying for everything except the dividend, and our preferred measure) grew by 20% in 2021.

This leads onto the question of valuation. The weighted average free cash flow ('FCF') yield (the free cash flow generated as a percentage of the market value) of the portfolio at the outset of the year was 2.8% and ended it at 2.7%.

The year-end median FCF yield on the S&P 500 was 3.6%. The year-end median FCF yield on the FTSE 100 was 5.4%.

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

	Fundsmith Equity Fund Portfolio								S&P 500	FTSE 100
Year ended	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2021**	**2021**
ROCE	29%	26%	27%	28%	29%	29%	25%	28%	16%	14%
Gross margin	60%	61%	62%	63%	65%	66%	65%	64%	45%	45%
Operating margin	25%	25%	26%	26%	28%	27%	23%	26%	17%	15%
Cash conversion	102%	98%	99%	102%	95%	97%	101%	95%	106%	124%
Interest cover	15x	16x	17x	17x	17x	16x	16x	23x	9x	8x

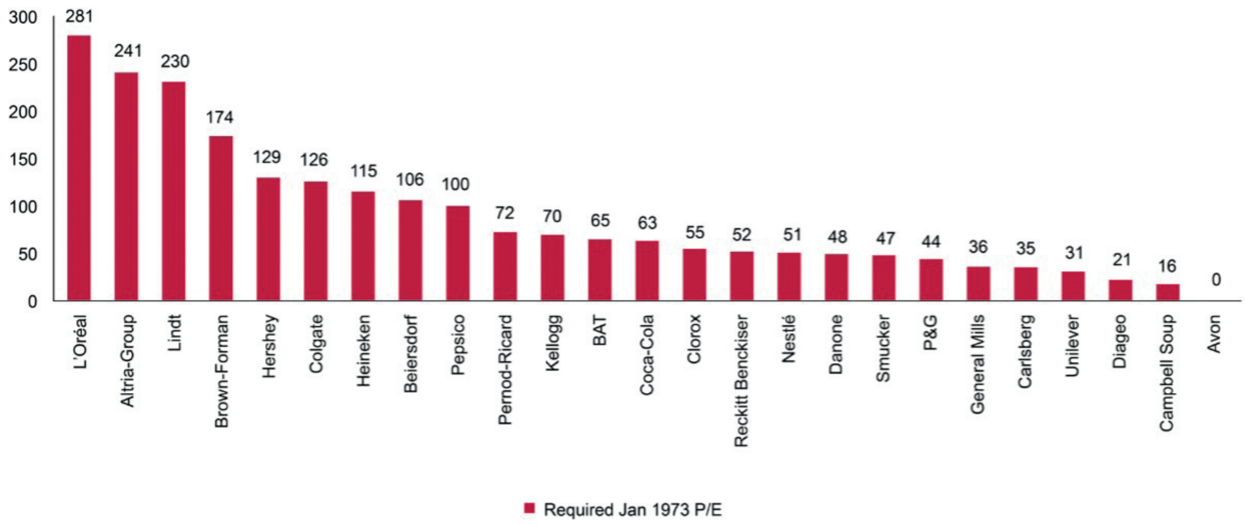
Source: Fundsmith LLP/Bloomberg.

ROCE, Gross Margin, Operating Profit Margin and Cash Conversion are the weighted mean of the underlying companies invested in by the Fundsmith Equity Fund and mean for the FTSE 100 and S&P 500 Indices. The FTSE 100 and S&P 500 numbers exclude financial stocks. Interest Cover is median. 2013-2019 ratios are based on last reported fiscal year accounts as at 31st December and for 2020-21 are Trailing Twelve Months and as defined by Bloomberg. Cash Conversion compares Free Cash Flow per Share with Net Income per Share. Percentage change is not calculated if the TTM period contains a net loss.

Investment Manager's review (continued)

The bar chart below may help to illustrate this point. It shows the 'Justified P/Es' of a number of stocks of the kind we invest in. What it shows is the Price/Earnings ratio (P/E) you could have paid for these stocks in 1973 and achieved a 7% compound annual growth rate (CAGR) over the next 46 years (to 2019), versus the 6.2% CAGR the MSCI World Index (USD) returned over the same period. In other words, you could have paid these prices for the stocks and beaten the index – something the perfect markets theorists would maintain you can't do.

Justified P/E's



Source: Ash Park Capital and Refinitiv Datastream, excludes dividends, in USD.

You could have paid a P/E of 281x for L'Oréal, 174x for Brown-Forman, 100x for PepsiCo, 44x for Procter & Gamble and a mere 31x for Unilever.

I am not suggesting we will pay those multiples but it puts the sloppy shorthand of high P/Es equating to expensive stocks into perspective.

Turning to the third leg of our strategy, which we succinctly describe as 'Do nothing', minimising portfolio turnover remains one of our objectives and this was again achieved with a portfolio turnover of 5.6% during the period. It is perhaps more helpful to know that we spent a total of just 0.009% (just under one basis point) of the Fund's average value over the year on voluntary dealing (which excludes dealing costs associated with subscriptions and redemptions as these are involuntary). We have held seven of our portfolio companies since inception in 2010.

Why is this important? It helps to minimise costs and minimising the costs of investment is a vital contribution to achieving a satisfactory outcome as an investor. Too often investors, commentators and advisers focus on, or in some cases obsess about, the Annual Management Charge ('AMC') or the Ongoing Charges Figure ('OCF'), which includes some costs over and above the AMC, which are charged to the Fund. The OCF for 2021 for the T Class Accumulation shares was 1.04%. The trouble is that the OCF does not include an important element of costs – the costs of dealing. When a fund manager deals by buying or selling, the fund typically incurs the cost of commission paid to a broker, the bid-offer spread on the stocks dealt in and, in some cases, transaction taxes such as stamp duty in the UK. This can add significantly to the costs of a fund, yet it is not included in the OCF.

We provide our own version of this total cost including dealing costs, which we have termed the Total Cost of Investment ('TCI'). For the T Class Accumulation shares in 2021 this amounted to a TCI of 1.05%, including all costs of dealing for flows into and out of the Fund, not just our voluntary dealing. We are pleased that our TCI is just 0.01% (1 basis point) above our OCF when

Investment Manager's review (continued)

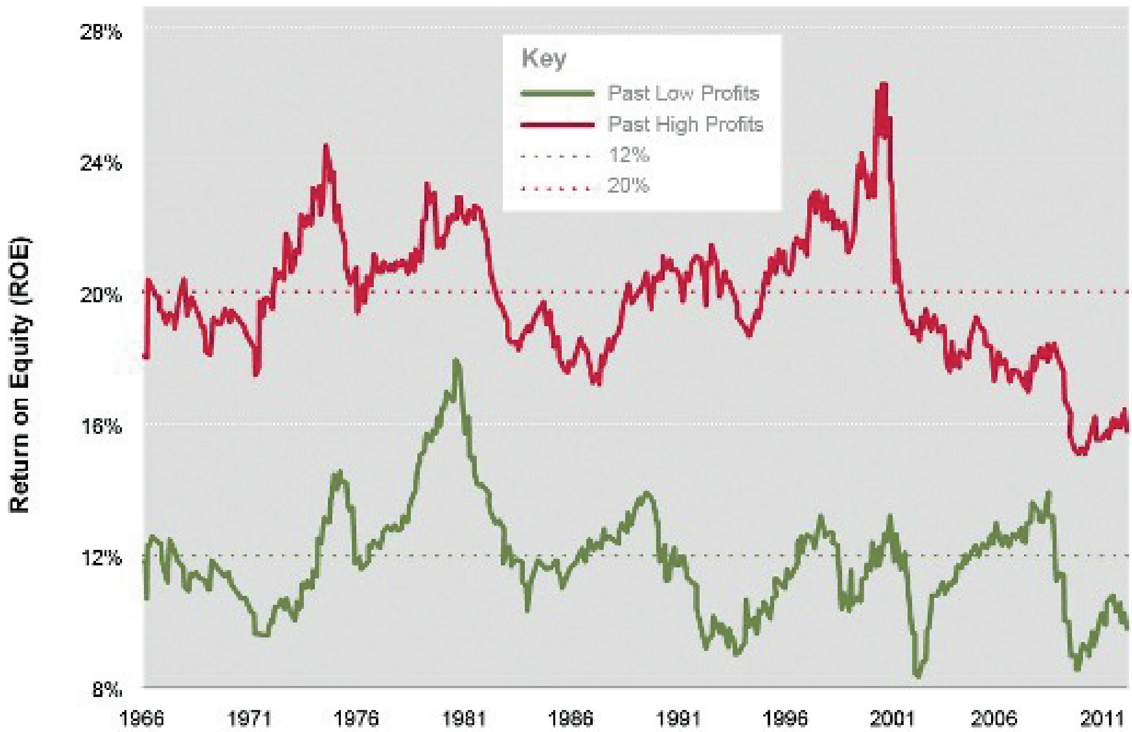
transaction costs are taken into account. However, we would again caution against becoming obsessed with charges to such an extent that you lose focus on the performance of funds. Some commentators state that an investor's primary focus should be on fees. To quote Charlie Munger (albeit in another context) this is 'Twaddle'. It is worth pointing out that the performance of our Fund tabled at the beginning of this letter is after charging all fees which should surely be the main focus.

Turning to the themes which dominated 2021, you may have heard a lot talked about the so-called 'rotation' from quality stocks of the sort we seek to own to so-called value stocks, which in many cases is simply taken as equating to lowly rated companies. Somewhat related to this there was periodic excitement over so-called reopening stocks which could be expected to benefit as and when we emerge from the pandemic — airlines and the hospitality industry, for example.

There are multiple problems with an approach which involves pursuing an investment in these stocks. Timing is obviously an issue. Another is that their share prices may already over anticipate the benefits of the so-called reopening. As Jim Chanos, the renowned short seller, observed 'The worst thing that can happen to reopening stocks is that we reopen.' It is often better to travel hopefully than to arrive.

In our view, the biggest problem with any investment in low quality businesses is that on the whole the return characteristics of businesses persist. Good sectors and businesses remain good and poor return businesses also have persistently poor returns as the charts below show:

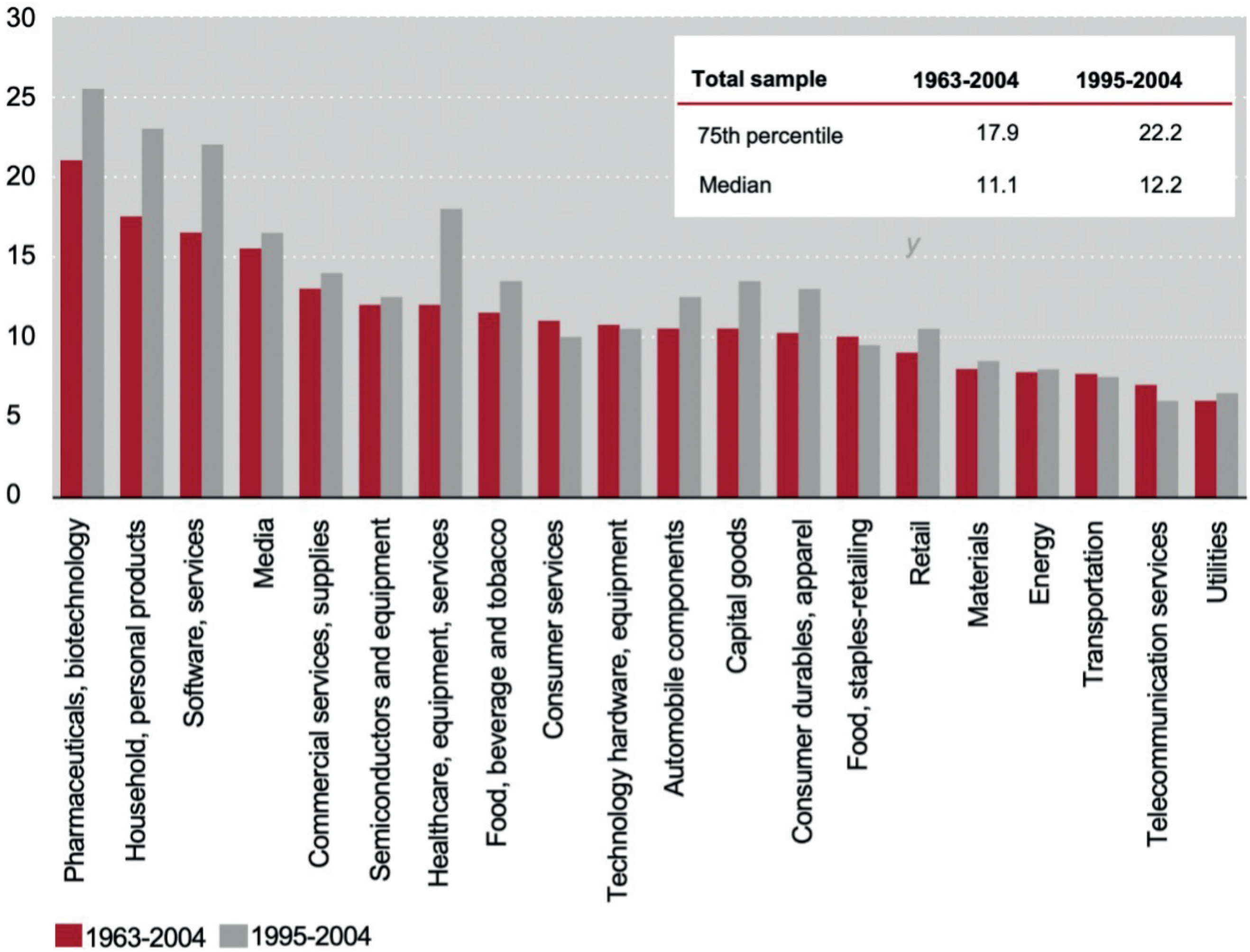
Persistence in Profitability



Source: GMO. The 1000 largest companies in the U.S. were sorted for each point in the graph into quartiles based on return on equity (ROE). Past Low Profits consists of those companies in the quartile with the lowest ROE. Past High Profits consists of those companies in the quartile with the greatest ROE.

Investment Manager’s review (continued)

Median and annual ROIC, excluding goodwill %



Source: McKinsey.

These return characteristics persist because good businesses find ways to fend off the competition — what Warren Buffett calls ‘The Moat’ — strong brands; control of distribution; high spend on product development, innovation, marketing and promotion; patents and installed bases of equipment and/or software which are troublesome to change for example.

Poor returns also persist because companies which have many competitors, no control over pricing and/or input costs, and an ability for consumers to prolong the life of the product in a downturn (like cars) cannot suddenly throw off these poor characteristics just because they are lowly rated and/or benefit from an economic recovery.

Investment Manager's review (continued)

Contrary to the mantra that every fund has to recite, past returns of companies are a good guide to future returns.

Even if you manage to identify a truly cheap value or reopening stock and time the rotation into that stock correctly so as to make a profit, this will not transform it into a good long term investment. You need to sell it at a good moment — presumably when some of your fellow ~~punters~~ investors will also be doing so because its cheapness will not transform it into a good business and in the long run it is the quality of the business that you invest in which determines your returns.

The chart below shows the excess returns — the amount by which it beats the index — of the MSCI World Quality Index (which I am taking as a surrogate for our strategy). Over the last 25 years there has never been a rolling 120 month (ten year) period when quality has not performed as well as or better than the MSCI World Index.

Source: MSCI.

I know 10 years is a long time and well beyond the time horizon of most investors, but we are long term investors and aim to capture this inevitable outperformance by good companies. If this investment time horizon is too long for you then you may be invested in the wrong fund. Moreover, if anything this chart flatters the outcome of investing in low quality, cyclical, value or recovery stocks as the index with which the quality stocks are being compared includes those quality stocks. If they were taken out of the index, the relative outperformance would be even more pronounced.

You may have heard a lot about inflation over the past year and I suspect you will continue to hear more about it in 2022.

In some respects, we needn't discuss whether or not we have inflation — German wholesale prices were up 16.6% year on year in November but were easily trumped by Spain whose producer price index (PPI) rose 33.1% in the same period. However, that eye-catching statistic is far from the whole story.

It is not difficult to see potential causes of inflation. The expansion of central bank balance sheets with Quantitative Easing after the Credit Crisis has been followed by huge monetary and fiscal stimuli put in place to counter the economic effects of the pandemic. One might reason that given the growth in the money supply has vastly outstripped the increases in production of goods and services the price of those goods and services was sure to be bid up and ipso facto inflation must follow.

However, this omits another important element of the equation — the velocity of circulation of money. Are people more inclined to save the additional money or to spend it? The savings ratio leapt

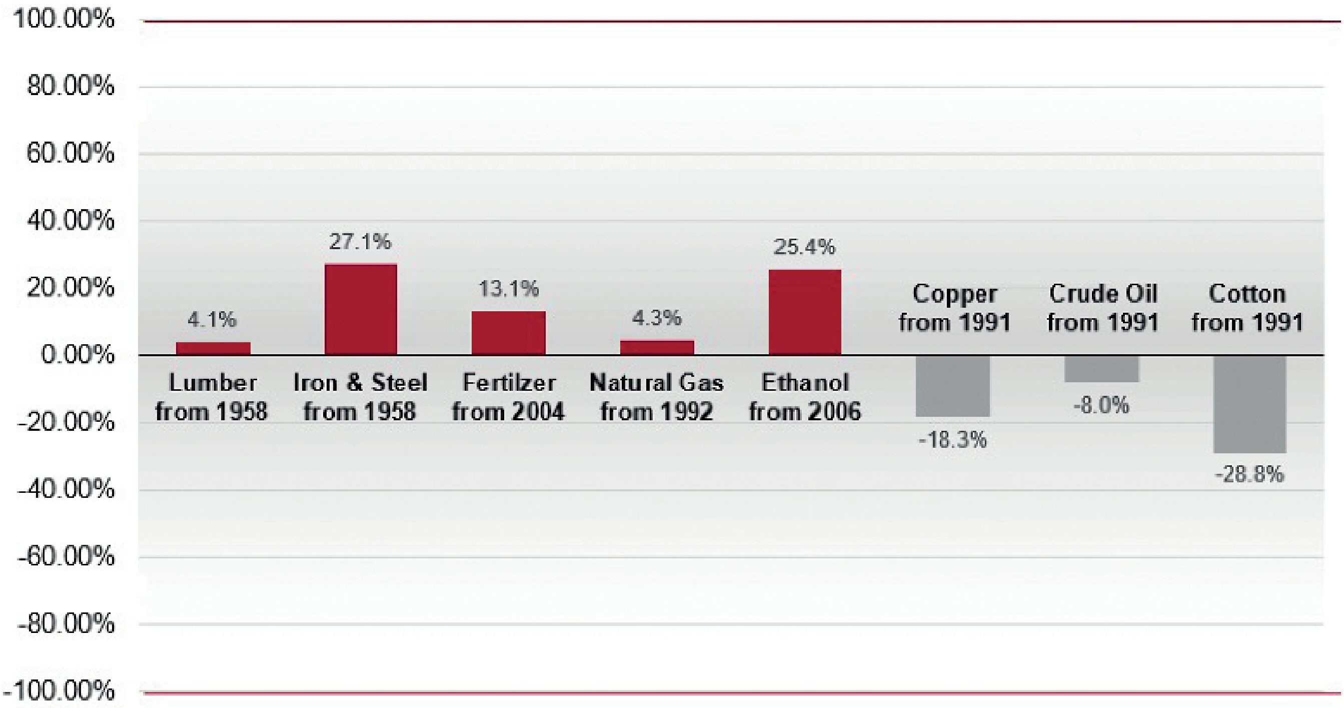
Investment Manager's review (continued)

after the Credit Crisis and again during the pandemic partly no doubt due to caution but also because there were fewer opportunities to spend, for example on travel and vacations. However, it is now on its way back to pre-crisis levels so maybe we have all the ingredients for inflation to take hold.

You might well be confused at this point (I know I am) particularly considering that the 'authorities' spent most of the decade post the Credit Crisis trying to generate inflation in order to negate the deflationary effects of the Credit Crisis and its causes. The trouble is that with inflation, as with so much else, you need to be careful what you wish for. It is a bit like trying to light a bonfire or a traditional BBQ on a damp day. If you put an accelerant like gasoline on it you can go from no fire to a loud 'Whoosh!' and find that you have also set fire to the garden fence. When inflation takes hold, it too may exceed your expectations.

In terms of how to react, if at all, there are also other factors to consider. Inflation in the cost of commodities does not necessarily equate to retail price inflation or asset inflation. The chart below attempts to correlate the price increases or decreases in a number of commodities with the Consumer Price Index over time.

Correlation of Long Term Commodity Prices With Inflation



Source: Federal Reserve Economic Research. 100% = perfect positive correlation, 0% = no correlation, -100% = perfect negative correlation.

Investment Manager's review (continued)

As you can see, there is no correlation. One of the reasons for this is that consumers do not buy commodities. They are bought by companies which make them into the goods which consumers buy. Interestingly, the eye-popping Spanish PPI rise of 33.1% in the year to November included an 88% increase in energy prices, 48% for basic metals and 16% for paper products but only 8.3% for food. Consumers don't buy basic metals.

So the initial impact of input cost inflation is not on consumer prices but on company profits. All companies are not equal in this regard. The higher a company's gross margin — the difference between its sales revenues and cost of goods sold — the better its profitability is protected from inflation.

The table below shows the impact of input cost inflation on two companies in the consumer sector — L'Oréal which we own and Campbell's Soup, which we do not own. L'Oréal has gross margins of 73% and Campbell's has 35%. A 5% rise in input cost inflation would cut L'Oréal's profits by 7% if it took no other action, whereas Campbell's profits would fall by 22%.

L'Oréal	Before	After
% of revenues		
Revenue	100%	100%
COGs	27%	28%
Gross profit	73%	72%
SG&A	55%	55%
Operating profit	18%	17%
Decline in profit		**-7%**

Campbell's	Before	After
% of revenues		
Revenue	100%	100%
COGs	65%	68%
Gross profit	35%	32%
SG&A	20%	20%
Operating profit	15%	12%
Decline in profit		**-22%**

Source: Fundsmith Research.

You will recall from the look-through table earlier that our portfolio companies have gross margins of over 60%, versus about 40% for the average company in the index. So, from a fundamental respect our companies are likely to be better able to weather inflation.

However, inflation also affects valuations. Rises in inflation and interest rates also do not affect the valuation of all companies equally. In the bond market, the longer the maturity of a bond, the more sensitive its valuation is to rate changes. A short-dated bond soon matures and the proceeds can be reinvested at whatever the new rate is. The same is not true of a 10 or 30 year bond.

The equivalent to the duration of a bond in terms of equities is the valuation multiple whether it is expressed in terms of earnings or, as we would prefer, cash flows. The higher rated a company's shares are, the more it will be affected by changes in inflation or interest rates. This is one reason why the shares of the new wave of unprofitable tech companies have performed so poorly latterly. As they are loss-making more than 100% of their expected value is in the future (there are probably other reasons like the growing realisation that you are often being invited to invest in a business plan rather than a business).

Investment Manager's review (continued)

So in brief, if inflation is seen to have taken hold rather more than some people, including the Federal Reserve Bank expects, then we are probably in for an uncomfortably bumpy ride in terms of valuations but we can be relatively sanguine in terms of the effect on the fundamental performance of our portfolio businesses which is our primary focus.

The good news is that we do not invest on the basis of our ability to forecast inflation or any other macroeconomic factor. We invest in companies not countries, indices or macroeconomic forecasts.

I would like to leave you with this thought: our Fund has prospered during the pandemic. The companies it invests in have endured much more — the Great Depression, World War II, the Great Inflation of 1965–82, the Dotcom meltdown and the Credit Crisis. They will probably survive whatever comes next and so will we if we stick to our principles and we have every intention of doing so.

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

Yours sincerely,

Terry Smith
CEO
Fundsmith LLP

Sources: Fundsmith LLP & Bloomberg unless otherwise stated.

Portfolio turnover has been calculated in accordance with the methodology laid down by the FCA. This compares the total share purchases and sales less total creations and liquidations with the average net asset value of the Fund.

PE ratios and Free Cash Flow Yields are based on trailing twelve month data and as at 31st December 2021 unless otherwise stated.

Remuneration disclosure

We are required to make this remuneration disclosure to the Funds' investors in accordance with COLL 4.5.7 (7) R in the FCA Handbook.

The financial year of Fundsmith Equity Fund (FEF) runs from 1 January to 31 December, whereas the financial year of Fundsmith LLP (Fundsmith) runs from 1 April to 31 March. The latest financial year of Fundsmith is the year to 31 March 2021 and the remuneration figures below relate to that period. The Fundsmith LLP Report and Accounts for the year to 31 March 2021 have been independently audited and filed with Companies House.

Fundsmith employed an average of 26 staff in the year, with total remuneration, excluding pension contributions, for those staff of £14,220,477 comprising fixed remuneration of £2,895,006 and variable remuneration of £11,325,471.

The profits of the Firm are shared among the Members according to their profit-sharing arrangements. Fundsmith had an average of 9 Members during the year, who shared the Firm's profit of £57,617,498.

The Members are the sole owners of Fundsmith, and the Firm's capital is derived entirely from the Members' contributions. Members are each entitled to a pre-determined, fixed proportion of the business's net profits, in accordance with their ownership of the Firm. Allocations of profits to Members are not discretionary and these amounts are due to the Members because of their investment of capital and their ownership of the business and is regarded as fixed, not variable remuneration.

The Management Committee of Fundsmith has considered carefully which of its staff fall within the definition of Remuneration Code Staff. The Management Committee has determined that for the UCITS Remuneration Code (SYSC 19E) the only Remuneration Code Staff are Members of the Firm who fall within the categories in SYSC 19E of senior management, risk takers and control staff. These individuals fall within one or more of these categories, and the Firm has chosen not to disclose the remuneration of each category to avoid double counting and on the basis of confidentiality.

The information above relates to Fundsmith LLP as a whole, is not broken down by reference to this fund or the other funds managed by Fundsmith LLP and does not show the proportion of remuneration which relates to the income Fundsmith LLP earns from the management of this fund, as this would not reflect the way Fundsmith LLP is organised.

The information does not include information relating to remuneration paid by Fundsmith Investment Services Limited, to whom Fundsmith LLP delegates certain investment management and related activities for this fund.

A description of how the remuneration and the benefits paid to Fundsmith LLP staff and Members is set out in the Remuneration Policy disclosure which is available on the website.

The Management Committee of Fundsmith LLP has reviewed the Remuneration Policy and considers that it meets all regulatory requirements and is satisfied that no irregularities occurred during the period. There have been no material changes in the Remuneration Policy applicable to UCITS Remuneration Code staff since the last Report and Accounts were published.

Further information

Reports and accounts

Each year, the Company will publish on its website (www.fundsmith.co.uk) annual and semi-annual reports discussing investment activity during the period and providing management commentary.

UK UCITS

The Company is an authorised Collective Investment Scheme constituted as a UK UCITS in accordance with the FCA rules.

Prospectus

The Fund Prospectus, an important document describing Fundsmith Equity Fund in detail, is available from the ACD, which is responsible for the management and administration of the Funds.

Also available are the Key Investor Information Document (KIID) and the Supplementary Information Document (SID).

The ACD for Fundsmith Equity Fund is Fundsmith LLP located at 33 Cavendish Square, London W1G 0PW. All documents are available on the website.

Minimum investment

The Company has three different types of share classes:

I shares, R shares and T shares.

The T share class has been used as the representative share class.

There are two types of share available in each class – Income shares or Accumulation shares.

The following table summarises the investment levels for T shares.

Minimum lump sum investment level	**£1,000**
Minimum regular sum investment level	**£100**
Minimum top-up investment amount	**£250**
Minimum holding level	**£1,000**

Publication of prices

The prices of Shares are published daily on the ACD's website at www.fundsmith.co.uk, the Daily Telegraph and in the Financial Times. Shareholders can also obtain the current price of their Shares by calling the ACD on 0330 123 1815.

Dealing Charges

There are no dealing charges on the purchase, sale or switching of shares.

Dilution Adjustment

The ACD may impose a dilution adjustment to the share price. The dilution adjustment aims to mitigate the costs to the Company of making investments (when additional cash is available following new investment into the Company) or selling investments in order to meet redemption requests.

Further information regarding the circumstances in which a dilution adjustment may be applied is set out in the Prospectus.

Fundsmith

33 Cavendish Square
London
W1G 0PW
UK

T 0330 123 1815
E enquiries@fundsmith.co.uk
W www.fundsmith.co.uk

FS0322_FEF_Results