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January 2017

Dear Fellow Investor,

This is the seventh 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 1st November 2010 compared with various benchmarks.

% Total Return	**1st Jan to 31st Dec 2016**	**Inception to 31st Dec 2016 Cumulative**	**Annualised**
Fundsmith Equity Fund[1]	+28.2	+196.6	+19.3
Equities[2]	+28.2	+110.6	+12.8
UK Bonds[3]	+6.5	+32.4	+4.7
Cash[4]	+0.6	+4.0	+0.6

[1]T Class Acc shares, net of fees, priced at noon UK time.
[3]Bloomberg/EFFAS Bond Indices UK Govt 5-10 yr.
[1,3,4]Source: Bloomberg
[2]MSCI World Index, £ net, priced at close of business US time.
[4]3 Month £ LIBOR Interest Rate.
[2]Source: www.msci.com

The table shows the performance of the T Class Accumulation shares, the most commonly held Class and one in which I am invested, which rose by +28.2% in 2016 and compares with +28.2% for the MSCI World Index in Sterling with dividends reinvested. The Fund therefore equaled the performance of this benchmark in 2016, and our Fund is still currently the No.1 performer since its inception in the Investment Association Global sector by a cumulative margin of 15% over the second best fund and 127% above the average.

However, we realise that many or indeed most of our investors do not use the MSCI World Index as the natural benchmark for their investments.

Those of you who are based in the UK and look to the FTSE 100 Index as the natural yardstick for measuring your investments and/or who hold funds which are benchmarked to the FTSE 100 Index and often hug it will have had a much worse experience than the performance of the MSCI World Index. The FTSE 100 Index was up +14.4% in 2016 and the total return including dividends reinvested was +19.2%. The Fund outperformed this by +9%.

It is a commentator's cliché that football is a game of two halves, and that was certainly true of our relative performance in 2016. At half time on 30th June our Fund (T Class Accumulation shares) was up +16.4% versus +11.0% for the MSCI World Index, aided by the sharp fall in the Pound after the Brexit result in the referendum of 23rd June as the majority of the shares in our portfolio are listed in the United States. Even though this is not an accurate reflection of the Fund's currency exposure, which really depends upon where the companies generate their revenues and profits, the fact is that the US Dollar is still the largest currency exposure we have.

So what happened in the second half of the year? We experienced what stock market commentators often describe as a sector "rotation" in which the sectors in which we are invested mostly fell out of favour and share prices of those companies underperformed, whilst other sectors which we do not own performed well, and in particular the bank sector.

This "rotation" seems to have occurred as a result of expectations about a pick-up in economic growth which focused attention on a potential recovery in the performance of cyclical stocks. This became more intense after the election (it is common to qualify this with the word "surprise" - "surprising to some" might be a better descriptor as indeed it might for Brexit) of Donald Trump as US President in early November as a result of predictions that his economic policies would stimulate more rapid growth in the US economy.

I have no way of knowing whether this "rotation" will continue but then again neither do any of the analysts or commentators who are involved in opining on the matter.

When judging this situation I think it is worth bearing in mind a number of points:

I can trace back four years of market commentary which warned that shares of the sort we invest in, our strategy and our Fund would underperform. During that time the Fund has risen in value by about 100%. The fact that you would have foregone this gain if you had followed their advice will of course be forgotten by them at the very least.

Much of the commentary is simplistic, for example, concentrating on the Consumer Staples sector as an easily identifiable set of stocks of the sort we invest in, as in a recent note by Deutsche Bank which said "the party's over" in Consumer Staples. Even if this is true, these represent only about a third of our portfolio.

The predictions of underperformance also focus on so-called "bond proxies" - stocks of companies with relatively predictable returns - which investors have supposedly turned to as a substitute for bonds as bond yields have declined to and even below zero. We are told that these bond proxies will do badly when rates rise and that they are starting to do so. As I write the US Federal Reserve has raised the Fed Funds rate by a total of 0.5% from its record low in a whole year (the first 0.25% rise was on 17th December 2015 - how time flies!). As I pointed out last year, this glacial rate of increase does not seem to justify the popular term 'hike' described in the dictionary as a sharp or unexpected increase - a description which clearly does not apply to the Fed's decision. Of course I have no idea when or by how much the Fed or any other central bank will subsequently increase interest rates. Neither I suspect do any of the commentators or analysts judging by their track record thus far, but that will not stop them making predictions and suggesting that you should make investment decisions based upon them.

There is also the question of what we might invest in as an alternative if we chose to sell the Fund's holdings in defensive so-called bond proxy stocks or if you chose to redeem your shares in our Fund. The obvious suggestion, and it is one which would have worked well in the second half of 2016, is that you should switch into cyclical stocks such as banks. Buying cyclical stocks in anticipation of a rise in interest rates does pose a fairly obvious problem - won't they perform worse than defensive stocks if the rise in rates causes an economic slowdown? There is also the fact that these stocks are in companies which over time do not create shareholder value by generating returns on capital above their cost of capital and growing by deploying more capital at such favorable returns, which is what the companies we seek to invest in accomplish. If you choose to invest in such companies then I would suggest it is not because you want to hold their shares indefinitely and allow them to compound in value but because you think you perceive an opportunity for a trade in which you buy them and then sell them for a higher price. If so I hope you have better luck with your timing in this game of Greater Fool Theory (in which you hope to buy from a seller who is less competent than you at spotting this opportunity and when the time comes you need to sell to a buyer who is similarly ill informed) than most people seem to have. As we do not profess to possess this skill, our Fund will not be attempting it.

I remain amazed (I could stop this sentence there) by the number of commentators, analysts, fund managers and investors who seem to be obsessed with trying to predict macro events on which to base their investment decisions. The fact that they are seemingly unable to predict events does not seem to stop them trying. During 2016 we had the spectacle of all the major polling organisations and the mainstream media failing to predict the outcome of the EU referendum in the UK or the US presidential election. Yet many of the same people are now busy telling us what the effect of Mr Trump's economic policies will be and how they will affect our investments.

I spend little time worrying about the macro trends and even less time trying to apply predictions about them in order to manage our portfolios. Here's a short list of possible macro factors which may affect companies and markets in the near future:

- Brexit
- China
- "Demonetisation" in India
- French presidential elections
- German elections
- Interest rates
- Korea
- President Trump
- Quantitative Easing by the European Central Bank
- Syria
- The oil price

Even if you could correctly predict how these matters would develop, and the timing of that, this would not enable you to use this as a basis of investment decisions. Markets are a so-called second-order system - to usefully employ your predictions you would not only have to make mostly correct predictions but you would also need to gauge what the markets expected to occur in order to predict how they would react. Good luck with that.

Rather like the management of some of the companies we most admire, I waste little or no time trying to guess what will happen to factors I cannot control or predict and deploy most of my time and effort on things I can control. Two of those are whether we own good companies and what valuation we pay to own their shares.

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

As at 31.12.16	**Fundsmith Equity Fund***	**FTSE 100 Index+**	**S&P 500 Index+**
ROCE	26.7%	13.5%	14.7%
Gross Margin	61.9%	40.0%	43.2%
Operating Profit Margin	25.5%	12.9%	13.9%
Cash Conversion	99.4%	81.4%	83.6%
Leverage	37.7%	48.9%	52.1%
Interest Cover	17.0x	7.9x	7.9x

Note: ROCE, Gross Margin, Operating Margin and Cash Conversion are the weighted average for the Fundsmith Equity Fund and averages for the FTSE 100 Index and S&P 500 Index. The FTSE 100 and S&P 500 numbers exclude financial stocks. The Leverage and Interest Cover numbers are medians. All data as last reported.

*Source: Fundsmith LLP   +Source: Bloomberg

The companies in our portfolio have significantly higher returns on capital and better profit margins than the average for the indices. They convert more of their profits into cash and achieve this with a much lower level of borrowing than the average company. Nor is this a one off - they have been achieving these superior results for many years. The average year of foundation of our portfolio companies at the year end was 1912.

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 2016? The weighted average free cash flow (the cash the companies generate after paying for everything except the dividend, and our preferred measure) grew by just over 11%* in 2016. We regard this as a rather good result given the generally lackluster growth which the world is experiencing and which led to earnings falling on the FTSE 100 and S&P 500 companies in the past year.

This leads onto the question of valuation. The Free Cash Flow ("FCF") yield (the free cash flow generated by the companies divided by their market value) on the portfolio at the outset of the year was 4.3%* and ended it at 4.4%* so they did not become any more highly rated. The mean FCF yield on the FTSE 100 is 4.7%+ and the median is 4.6%+. The mean FCF yield on the S&P 500 is 4.3%+ and the median 4.8%+. To try to cut through all these means and medians, our portfolio consists of companies which are fundamentally a lot better than those in the index and are valued a little more highly than the average FTSE 100 company and about the same as the average S&P 500 company, and they grew more rapidly in the past year. I would suggest that is not a bad situation for our portfolio to be in.

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

IDEXX Laboratories	+3.10%
Stryker	+2.54%
CR Bard	+2.06%
InterContinental Hotels	+1.71%
Johnson & Johnson	+1.68%

The bottom five were:

Estée Lauder	- 0.06%
Procter & Gamble	- 0.02%
Novo Nordisk	+0.07%
Colgate Palmolive	+0.23%
Imperial Brands	+0.37%

The largest contributor, IDEXX, is a company which we began buying in 2015. It is the world's largest maker of veterinary testing equipment. In contrast, we have held stakes in Stryker, InterContinental Hotels and Johnson & Johnson since inception.

Of the bottom five performers we sold our stake in Procter & Gamble in January 2016. You may note that out of the five worst contributors to our performance last year, four were consumer stocks and at least three are regularly cited as "bond proxies". It seems strange to be accused of having benefitted from the popularity of these stocks when in fact they have underperformed.

We only recently began buying stakes in Estée Lauder, the US cosmetics business and even more recently in Novo Nordisk, a Danish company, which is the world's leading supplier of insulins.

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 -15.6%* during the period. It is perhaps more helpful to know that we have held 14 of our portfolio companies since inception and we spent a total of £181,025 or just 0.003% (0.3 of a single basis point) of the Fund on voluntary dealing which excludes dealing costs associated with fund subscriptions and redemptions as these are involuntary.

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 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 2016 for the T Class Accumulation shares was 1.06%*. 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 investments for a fund, 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, Stamp Duty. 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 2016 this amounted to a TCI of 1.11%*, including all costs of dealing for flows into and out of the Fund, not just our voluntary dealing. We think that figure will prove to be low if or when other funds produce comparable numbers. However, we would caution against becoming obsessed with charges to such an extent that you lose focus on the performance of a fund. It is worth pointing out that the performance of the Fund at the beginning of this letter is after charging all fees.

As a cautionary tale about the merits of doing nothing, you may recall that in 2015 we sold our holding in Domino's Pizza since it had reached a valuation which we felt was only justifiable if its rapid rate of growth was sustainable, which we doubted was likely. In my annual letter last year I said that I "sold it with some regret and trepidation. Regret since it is undoubtedly a fine business and had been our best performing share since the inception of our Fund. Trepidation since selling shares in good companies is something we are justifiably reluctant to do." Domino's managed to prove these fears right in the most painful way as the share price rose by +45%[+] in 2016. Apart from demonstrating that I am, could we agree on "fallible" as a descriptor, I hope this illustrates why I am reluctant to agree with the commentators who suggest that you or I should sell our portfolio of great companies and invest in a portfolio of assorted junk in the hope that it will go up, the great companies share prices will go down and we can then profitably reverse the trade.

Finally, I wish you a Happy New Year and thank you for your continued support for our Fund. My colleagues and I look forward to seeing many of you at our Annual Shareholders' Meeting on 20th March and to trying to answer your questions.

Yours sincerely,

Terry Smith

Terry Smith
CEO
Fundsmith LLP

P.S. As part of the Financial Conduct Authority's (FCA) review of investor communications (Policy Statement 16/23 - Smarter Consumer Communications: Removing ineffective disclosure requirements in our Handbook) they have consulted and concluded that the half-yearly Short Form Report that we send you in March and September, for the periods ending 31st December and 30th June respectively, does not fulfill its purpose. I agree in that the format and complexity of this document was difficult to understand and I welcome the FCA's decision that we are no longer required to send you one. Not only will this save the fund the costs of physically producing and sending it to you but it will also reduce the already excess amount of paperwork that you are required to receive and that I know many of you find frustrating. For those of you that remain interested in the detail, we will continue to produce the report and post it on our website. I believe that our annual letter to shareholders, our Annual Shareholders' Meeting, the monthly factsheets on our website and the semi-annual Investment Statements, that coincide with the tax year end, are all more effective in evaluating how your investment has performed and we continually seek to improve the levels of these communications.

Disclaimer: An English language prospectus for the Fundsmith Equity Fund is available on request and via the Fundsmith website and investors should consult this document before purchasing shares in the Fund. Past performance is not necessarily a guide to future performance. The value of investments and the income from them may fall as well as rise and be affected by changes in exchange rates, and you may not get back the amount of your original investment. Fundsmith LLP does not offer investment advice or make any recommendations regarding the suitability of its product. This financial promotion is intended for UK residents only and is communicated by Fundsmith LLP which is authorised and regulated by the Financial Conduct Authority.

[*] Source: Fundsmith LLP [+] Source: Bloomberg