Fundsmith Equity Fund

Value Assessment – Public Document

Fundsmith
Buy good companies
Don't overpay
Do nothing

Introduction

As part of our role, we have always considered whether we provide value to our investors and run funds which will deliver to you the best risk-adjusted return we can. As we set out in the Owners' Manual, this is our primary focus as a business and something of which we never lose sight. The Financial Conduct Authority ("FCA") has introduced new rules designed to ensure all asset managers are acting in their investors' best interest and, as a result, delivering value. Whilst this is not, for us, anything new, the FCA has prescribed the factors to be assessed, and instructed that we produce this document to outline our approach and conclusions. This assessment does not look solely at performance of our funds, not least because the FCA has identified seven factors that it believes are relevant in assessing overall value delivered to investors.

It is for the Executive Members of the Management Committee to undertake the assessment. As part of the value assessment project, however, we have been helped by three Independent Members. In our business, the Independent Members are part of the Management Committee but their sole focus is on the value-assessment process and ensuring that we, as Executive Management, have carried out the appropriate analysis and reached reasonable conclusions. This means they are not distracted with other areas of the business and are able to devote their efforts to ensuring that we are fulfilling our obligations and offering value products to our investors.

This value assessment covers Fundsmith Equity Fund ("FEF") and the Fundsmith Sustainable Equity Fund ("FSEF"), collectively "the funds" for 2019. Further information about these funds can be found on the relevant websites: www.fundsmith.co.uk and www.fundsmith.green.

The seven factors that we will be exploring are as follows:

1. Quality of Service
2. Performance
3. Costs
4. Economies of Scale
5. Comparable Market Rates
6. Comparable Service Rates
7. Share Classes

1.

Quality of Service

Objective

When we looked at quality of service, we looked at three separate areas:

- Dissemination of information to investors and prospective investors
- Executing transactions and other shareholder services
- Oversight of the fund and its execution

Evidence

Dissemination of information to investors and prospective investors

We try to ensure that the quality and frequency of our communication with investors is above average. Our fund-specific websites are straightforward to use, promoting ease of navigation, and include all the necessary regulatory documents. We produce a monthly factsheet that provides information over and above monthly performance, including portfolio changes, liquidity, top holdings and portfolio breakdown. An annual letter for each fund is also sent out to our investors and is available on the relevant website, which covers a review of the year's performance, as well as addressing other points of interest. For FEF, which is available to retail investors, we have produced an 'Owners' Manual', which contains a readable and accessible description of the fund and our investment philosophy. We also hold an Annual Shareholder Meeting for FEF, which is an opportunity for all our investors, irrespective of the size of their investment, to engage with the Investment Manager. During the period, FSEF was an institution-only product and for this fund we produce an additional Sustainability Factsheet.

Executing transactions and other shareholder services

We try to make our funds as accessible as possible to both retail and institutional investors. As such, we offer dealing in our funds via telephone, post, fax, online, EMX or Calastone, and direct debit through a regular savings facility. Our Transfer Agent is the market leader and we work closely with it to ensure the dealing processes are as smooth and efficient as possible and investors are well supported.

Oversight of the fund and its execution

We have a significant operations team that focuses on ensuring that we execute the operation of the fund efficiently and that the fund is, at all times, run in accordance with the prospectus and applicable regulatory requirements.

Observations and Outcome

Meeting investors' expectations in terms of interacting with them on a regular basis and delivering on our investment objective is fundamental to Fundsmith's investment offering. This is achieved without compromising either on the quality of outsourced providers or on the oversight of those providers.

All aspects of quality of service were discussed and the conclusion was that we have delivered a strong quality of service. The Independent Members were comfortable with the conclusions that were drawn.

2.

Performance

Objective

Our funds' objectives are to provide long-term (over 5 years) growth in value by investing in equities on a global basis. For FSEF, we exclude certain sectors and apply further sustainability critieria. For both funds, we seek to achieve high, risk-adjusted returns.

Different investors will compare performance against different criteria, however the easiest way to measure our performance is to compare it with a relevant index. In addition, some consideration was given as to how our funds compare with other available funds, with similar investment objectives and policies. Whilst comparing our performance with other funds has less validity (many of the funds will be invested in very different ways from ours), it is an obvious comparison for investors or potential investors. We have looked at long-term performance as these are funds designed for the long term. As a minimum, we looked at five years, but also looked over the life of the fund. FSEF has not yet been live for 5 years, so our analysis for this fund was completed over the life of the fund.

In this report, given the similarity of the FSEF portfolio to FEF's portfolio, we have used FEF's long-term performance as a proxy for that of the FSEF.

Evidence

Looking at the cumulative and annualised performance figures for FEF since inception on 1 November 2010 to 31 December 2019, FEF's cumulative performance was +364.4% compared with the MSCI World Index at +180.3%. Annualised performance since inception was +18.2% for FEF and +11.9% for the MSCI World Index. These returns have been generated within an acceptable level of risk, as shown by FEF's Sharpe and Sortino ratios. We also considered discrete calendar years and monthly performance, comparing up and down months to ensure that there were no statistical anomalies. Our performance against other funds also supported the proposition that FEF had outperformed its peer group.

Observations and Outcome

It was agreed that this pillar should, by no means, be examined in isolation. However, the performance aspect of an investment and the extent to which it has achieved its investment objective is arguably the most important.

All aspects of the funds' performance were discussed and it was concluded that the funds have delivered strong performance and achieved their objectives. The Independent Members were comfortable with the conclusions that were drawn.

3.

Costs

Objective

We considered all of the costs incurred by each fund in its management and operation.

The most significant cost is the annual management charge ("AMC") which is paid to us for our services in managing the fund. The cost to the investor for our services should reflect the quality of the overall service that we provide. We believe it is important that our charges are transparent and easily comprehensible to the investor, this means that there are no hidden costs.

Other costs incurred include the costs of our Transfer Agent and administration costs, transaction costs, depositary and custody costs, auditor's costs and other regulatory fees.

Evidence

Our approach to costs is relatively simple: we charge neither performance fees, nor entry and exit fees. We considered the level of our AMC for each fund. We looked at the margins earned by Fundsmith LLP and compared those with the margins of other fund managers. Given the Partnership structure, this was not a direct comparison, but it did provide us with a point of comparison.

We also considered the Ongoing Charges Figure ("OCF"), which measures all costs incurred by a fund except for transaction costs and the Total Cost of Investment ("TCI"), which includes transaction costs of each fund.

Observations and Outcome

It was concluded that Fundsmith LLP doesn't earn excessive margins, as we continue to deliver gains to our investors in return for the charges they pay.

All aspects of costs were discussed and it was concluded that the charges and their disclosure were appropriate. The Independent Members were comfortable with the conclusions that were drawn.

4.

Economies of Scale

Objective

As our business grows and our assets under management increase, this enables us to use our size to negotiate better deals with our service providers. The resulting economies of scale mean that we are able to provide our investors with better value for their investment.

Evidence

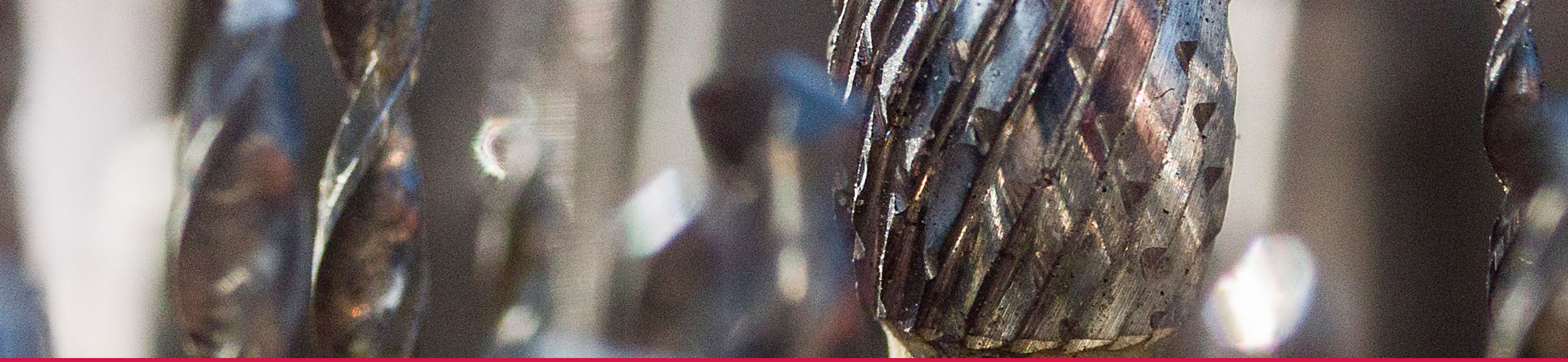
Given the fact that FSEF is still a relatively small fund, this pillar is more relevant to FEF. FSEF has an almost identical cost structure, so it can expect the same economies of scale.

As FEF has grown, the OCF has fallen as we are able to ensure that we benefit from economies of scale. For the I Class, the OCF has fallen from 1.10% in 2011 to 0.95% in 2019. Having said that, these economies have diminished since 2017, with the OCF remaining static.

Observations and Outcome

There was a discussion about how the OCF has changed over time. It was agreed that, whilst the economies of scale initially increase as the funds grow in size, this does not continue indefinitely. However it was important that service providers costs remain competitive and were regularly market tested.

All aspects of the economies of scale were discussed and it was concluded that, where possible, the benefits had been passed on. It was recognised that all costs should be regularly market tested. The Independent Members were comfortable with the conclusions that were drawn.



5.

Comparable Market Rates

Objective

In this section we compare our funds' charges with the charges incurred by comparable funds operated by other fund managers.

Evidence

In this section, we considered the published AMC, OCF and TCI figures for our funds and how they compared to comparable funds operated by other fund managers.

The AMC is often the 'headline' that is quoted when commentators consider costs. However, it can often miss out some other, quite significant costs. We considered all costs and how we compared with other large funds and funds in the same IA category.

Observations and Outcome

Looking first at AMC, FEF and FSEF AMC levels were higher than the average fund. When the OCF and TCI were considered, that difference reduced significantly. On the basis of TCI, both funds were only marginally above the average TCI level.

All aspects of comparable market rates were discussed and it was noted that the Fundsmith funds were, at best, average. However, set in the context of the funds' performance (particularly since performance is net of fees), this was felt to be justifiable. The Independent Members were comfortable with the conclusions that were drawn.

6.

Comparable Services

Objective

The idea behind this pillar is to highlight the practice of managing funds and segregated accounts or other pools of money with similar investment strategies but at different fee rates. The FCA has emphasised that any such pricing distinctions have to be carefully considered and justified.

Evidence

Fundsmith manages a number of funds and segregated accounts. Our approach is clear and has been since inception: we will not run any fund or portfolio for less than 0.9% per annum management fee.

Observations and Outcome

The willingness of professional investor clients for whom we manage segregated accounts to invest at this management charge provides evidence to support the conclusion that our investment proposition represents good value.

All aspects of comparable services were discussed and the conclusion was that the consistency of our approach demonstrated comparability and value. The Independent Members were comfortable with the conclusions that were drawn.

7.

Share Classes

Objective

This pillar is essentially about the cost differential between share classes within a fund rather than the absolute level of costs incurred.

Evidence

We provide three different share classes in FEF and two in FSEF, they are:

- I Class – 0.90% AMC
- T Class – 1.0% AMC
- R Class – 1.5% AMC (FEF only)

The rationale for the difference between the classes is: I Class is for investors of over £5 million; T Class is for investors under £5 million; and R Class is for investors who are advised, and the method of paying the adviser is through Fundsmith rebating 0.5% from the AMC to the adviser, in those situations where it is permissible to do this.

Observations and Outcome

We reviewed the rationale for the difference in the AMC rate between the larger and smaller investors and the costs involved in servicing the different categories of investor.

We also considered how we ensured that investors remain in the correct class, either when their investment increases to over £5 million or when they no longer need to pay trail fees to an adviser or are not allowed to pay trail fees to advisers.

It was noted that the R Class structure is no longer appropriate for most UK investors and is seen as an inferior method of investment. It was agreed that we should continue to review the justification for offering this share class.

It is not uncommon for fund management companies to charge small investors more than larger investors. This is because an element of the costs we bear is the same regardless of the size of the investment, for example, the costs of executing the transaction (particularly banking charges), anti-money laundering checks and other investor support functions. These costs as a proportion of the amount invested are clearly higher when the investment is relatively small.

In addition to bearing those costs, we also provide a number of other benefits to the smaller, individual shareholder, including the opportunity to invest via an ISA wrapper and Regular Saving and Income Facilities. These benefits are provided at no additional cost.

At least once every six months, we check to ensure that everyone in the R Class does have a current adviser who is accepting the rebate. This ensures we are not unwittingly profiting from an investor remaining incorrectly in the R Class. We also regularly review the T Class holders to ensure none of them is holding over £5 million.

The extra AMC for the T Class is charged for good reasons, both in terms of extra cost and extra benefits. The level of that charge and the cut-off point are relatively subjective and are worthy of discussion.

The R Class remains in place for the time being. It is a very small portion of FEF and we shall continue to consider whether it is appropriate.

Following these discussions, the conclusion was that the different share classes were currently appropriate and correctly monitored. The Independent Members were comfortable with the conclusions that were drawn.

8. Conclusion

Overall, the Executive Members of the Management Committee concluded that both FEF and FSEF did represent a good value proposition for investors and that the costs and charges incurred by each fund are justified in the context of the overall value delivered to investors. Having discussed each of the factors and having had the opportunity to participate in the Management Committee discussion, the Independent Members were comfortable that the Executive Members had followed a sound process to reach their conclusion.

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