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Dear Fellow Investor,

This is the seventh annual letter to owners of the Fundsmith Sustainable 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 2017 and various comparators.

% Total Return	1st Jan to 31st Dec 2024	Inception to 31st Dec 2024		Sortino Ratio[6]
		Cumulative	Annualised	
Fundsmith Sustainable Equity Fund[1]	+8.5	+98.1	+10.0	0.45
Equities[2]	+20.8	+117.3	+11.4	0.48
IA Global Sector[3]	+12.6	+78.9	+8.5	0.33
UK Bonds[4]	-2.3	-6.9	-1.0	n/a
Cash[5]	+5.1	+13.6	+1.8	n/a

The Fund is not managed with reference to any benchmark, the above comparators are provided for information purposes only.
[1] I 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] Source: Financial Express Analytics
[4] Bloomberg Series-E UK Govt 5-10 yr Bond Index, source: Bloomberg.
[5] £ Interest Rate, source: Bloomberg.
[6] Sortino Ratio is since inception to 31.12.24, 3.5% risk free rate, source: Financial Express Analytics.

The table shows the performance of the I Class Accumulation shares which rose by 8.5% in 2024 and compares with a rise of 20.8% for the MSCI World Index ('Index') in sterling with dividends reinvested. The Fund therefore underperformed this comparator in 2024.

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Outperforming the market or even making a positive return is not something you should expect from our Fund in every year or reporting period, and outperforming the market was more than usually challenging once again in 2024. Just five stocks (the 'Fab Five'?) Nvidia, Apple, Meta, Microsoft and Amazon provided 45% of the returns of the S&P 500 Index ('S&P 500') in 2024. This is similar to the concentration of returns provided by the so-called Magnificent Seven in 2023. Moreover, a single stock — Nvidia — produced over 20% of the S&P 500 returns in 2024.

Nor is this concentration of returns in a few technology companies a purely US phenomenon. In Germany 41% of the return from the DAX Index came from a single stock — SAP, the software company whose share price rose by 69% so that it is now trading on a mere 97x earnings.

Our Fund owns some but not all of these stocks and it was difficult to perform even in line with the Index unless you owned them at least in line with their index weighting. I do not intend to give a narrative of why we do not own all of them, but I will give some more detail on this point later in this letter.

In looking at individual stock contribution to performance I prefer to start with the problems. The bottom five detractors from the Fund's performance in 2024 were:

Stock	Attribution
L'Oréal	-1.8%
IDEXX	-1.2%
Zoetis	-0.7%
Novo Nordisk	-0.4%
McCormick	-0.1%

Source: State Street

L'Oréal was adversely affected by events in China where the economy is struggling under the weight of a moribund residential property sector and the associated credit problems. However, this does not alter our view that L'Oréal is fundamentally a very good business. This is not the first time that a major economy it operates in has mis-fired and we believe its management can cope.

IDEXX which makes veterinary diagnostic testing equipment and supplies is suffering from a slackening in the pace of vet visits after the scramble to adopt pets during the pandemic. As the industry leader in an area with real long-term growth prospects and a stock where we would probably struggle to buy back our position if we sold

it, we intend to continue holding IDEXX and to try to smile through the pain of underperformance.

Although Zoetis, the leading maker of veterinary pharmaceuticals, did not suffer from the same influences as IDEXX, as its drugs mainly treat chronic conditions, and it delivered double digit sales growth, it nonetheless suffered a derating.

Novo Nordisk was arguably our most surprising poor performer in 2024. It remains the market leader in weight loss drugs, which it pioneered, and the year was marked by a stream of news about other conditions which these drugs treat effectively and label expansion applications which drug regulators seem willing to approve. Yet not only did the share price fall 10% but it finished the year on a P/E ratio half that of its nearest competitor Eli Lilly.

In investment it is always better to travel hopefully than to arrive and there is certainly an arms race going on amongst drug companies to develop competitor drugs. Yet we are still dealing with a company in Novo which is the market leader and holds production and labelling advantages which should sustain that position, with revenues that are growing at 20% p.a. Moreover, we originally bought Novo because of its radical approach to drug discovery and would not rule out further developments.

McCormick which supplies flavourings, herbs, spices, and condiments disappointed in its slow response to the inflationary cost inputs in its ingredients and showed vulnerability to own label competition as consumers came under pressure so we sold the holding during the year.

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

Stock	Attribution
Stryker	+1.4%
ADP	+1.3%
Fortinet	+1.3%
Alphabet	+1.3%
Marriott	+1.2%

Source: State Street

Stryker is benefitting from work on the backlog of elective surgical procedures which built up during the pandemic.

ADP which makes its second appearance continues its metronomic performance. It rarely shoots the lights out in terms of performance

but then neither does it disappoint which makes it a good stock for our strategy.

Fortinet was our third best performer as demand for its cyber security products began to return to normal after the post pandemic slump (the pandemic having boosted the need for secure routers because of increased working from home).

Alphabet performed well in the light of the regulatory onslaught which it faced from various regulatory and competition authorities many of whom seem to think it should be illegal to compete effectively and after early setbacks with its AI models it seems that one early successful application of AI is in improving results for digital advertising.

Marriott is the largest hotel group in the world with the largest and widest assortment of brands and the largest membership in its loyalty programme — Bonvoy. This is a case where size does seem to bring advantages. Real estate developers which already have one Marriott brand hotel are often prone to develop another brand, where they have the capacity to do so, as they already have a working relationship and Bonvoy members find the range of brands and properties makes it easier to use their loyalty points and are more likely to book direct so saving Marriott fees from the Online Travel Agents.

We continue to apply a simple four step investment strategy:

- Buy good companies
- Sustainability screen
- 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 Sustainable Equity Fund 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 Index. This also shows you how the portfolio has evolved over time.

Year ended	Fundsmith Sustainable Equity Fund Portfolio						S&P 500	FTSE 100
	2019	2020	2021	2022	2023	2024	2024	2024
ROCE	29%	23%	28%	31%	34%	32%	16%	17%
Gross Margin	65%	61%	61%	61%	60%	60%	45%	42%
Operating Margin	26%	21%	25%	26%	29%	27%	16%	15%
Cash Conversion	99%	102%	97%	88%	93%	92%	85%	90%
Interest Cover	17x	16x	20x	19x	20x	24x	9x	9x

Source: Fundsmith LLP/Bloomberg.
ROCE (Return on Capital Employed), Gross Margin, Operating Margin and Cash Conversion are the weighted mean of the underlying companies invested in by the Fundsmith Sustainable 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.
2019 ratios are based on last reported fiscal year accounts as of 31st December and for 2020–24 are Trailing Twelve Months and as defined by Bloomberg. Cash Conversion compares Free Cash Flow per Share with Net Income per Share.

In 2024 returns on capital and operating profit margins dipped a little but gross margins were steady. Importantly all of these metrics remain significantly better than the companies in the main indices (which include our companies). Moreover, if you own shares in companies during a period of inflation it is better to own those with high returns and gross margins.

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 2024? The weighted average free cash flow (the cash the companies generate after paying for everything except the dividend, and our preferred measure) grew by 11% in 2024.

The only metric which continues to lag its historic performance is cash conversion — the degree to which profits are delivered in cash. This is still below its historic level of around 100% and declined slightly in 2024 to 92%. This was due to a sharp rise in capital expenditure at a small group of companies: Alphabet, Microsoft and Novo Nordisk. Novo is racing to build production capacity to supply enough of its weight loss drug Wegovy and finished the year spending €10 billion purchasing three manufacturing sites. The tech companies are in a race to build capacity of Artificial Intelligence ('AI') in the form of GPU chips and data centres. Whether this arms race produces adequate profits and returns for the amounts expended remains an open question to which I will return later. At least Novo is building capacity to produce a drug for which there is established demand and profitability and in which it currently has a competitive advantage.

The average year of foundation of our portfolio companies at the year-end was 1935. Collectively they are 90 years old.

The second leg of our strategy is to employ a negative sector-based sustainability screen, excluding companies operating in sectors with excessive sustainability-related risk (aerospace and defence, brewers, distillers and vintners, casinos and gaming, gas and electric utilities, metals and mining, oil, gas and consumable fuels, pornography and tobacco). We then assess company sustainability in the widest sense, evaluating a business's handling of risks and opportunities and their policies and practices covering research and development, new product innovation, dividend payments, and the adequacy and productivity of capital investment.

One of the metrics we use to assess sustainability risks is RepRisk's RepRisk Index (RRI), which measures a company's current reputational risk exposure based on controversies over the last 24 months. At the end of December 2024, the weighted average RepRisk Index for our portfolio was 27.3, slightly higher than the 26.8 it was at the start of the year and lower than the MSCI World's weighted average of 33.2. This implies that on average our portfolio has a lower exposure to reputational risks relating to sustainability factors than the MSCI World.

We use the RepRisk Index scores in two ways. First, to capture any coverage relating to the companies in the Fund's investible universe we may have missed in our routine research. Second, as a proxy for the absolute negative impacts a company has, particularly on society. While environmental impacts are relatively easy to measure (e.g. greenhouse gas emissions) and therefore assess, aggregate and scrutinise both absolutely and relatively between companies, impacts on society are often qualitative and much more challenging to assess objectively. Hence, we use the RRI as a proxy for evaluating these negative impacts. Although it isn't perfect it gives us a framework to assess and compare non-quantitative impacts between the companies in our investible universe.

The rise in the portfolio's RepRisk Index over the year was partly due to increases in the RRI at Zoetis and Fortinet of 24 and 21, respectively. This was offset by Home Depot's score decreasing by 16 and the removal of McDonald's and Johnson & Johnson from the portfolio, both of which had relatively high RRIs.

Zoetis's increase was due to news in March that the European Commission had started investigating whether the company violated antitrust regulations. The Commission said it was investigating whether the company broke competition rules by preventing the launch of a competing pain medicine for dogs with osteoarthritis. In response, Zoetis said that the matter referred to an experimental compound and reminded the Competition Commission that at the

time of the acquisition, it had approved the acquisition of the competing pain treatment.

Fortinet's RRI increased this year after it released a statement in September saying that a hacker had accessed a "limited" number of customer files on a third-party cloud-based shared file drive. The breach did not result in any malicious activity. The increase in RRI was large because Fortinet usually has an RRI of 0, and this was the first negative news story since September 2021.

Home Depot's RRI fell as public criticism faded following accusations that some of the toilet paper it sold used pulp sourced from Asia Pulp and Paper last year. Asia Pulp and Paper has been linked to deforestation in Indonesia and other environmental offences.
At the end of 2024, the four companies with the highest RepRisk Index scores were:

Stock	RepRisk
Alphabet	63
Microsoft	61
Unilever	46
Procter & Gamble	42

Source: RepRisk

Alphabet and Microsoft are among the largest companies in the world and the products and services they offer are used by millions of people every day. As a result, both companies are subject to a large amount of media coverage. This inflates their RRI beyond what we would deem to be an accurate reflection of their negative impacts. Both companies were subject to antitrust scrutiny in the US and Europe in 2024 which contributed to their high RRIs.

Alphabet is under scrutiny in relation to its dominance in web search and digital advertising platforms, with the US Department of Justice (DOJ) proposing breaking up the company. The US Federal Trade Commission (FTC) launched a broad antitrust investigation into Microsoft's dominance of cloud computing and its bundling of Office products (Word, Excel, Teams etc.) and, in Europe, the European Commission charged Microsoft with antitrust violations relating to the bundling of Teams with Office 365. The Commission argued that this bundling gives teams an unfair advantage over competitors Slack and Zoom. In response, Microsoft has launched a version of Office 365 in Europe without Teams. The investigation is ongoing.

We expect the companies we invest in to manage this regulatory risk effectively and do not currently think that Microsoft or Alphabet are excessively abusing their market position. One reason that Microsoft and Alphabet have such strong positions is due to their continued

success in developing superior products and services versus their competitors.

Unilever and P&G, both consumer goods companies, have high RRIs due to the scale and impact of their large, complex supply chains and their direct link to the consumer. We think both these companies are managing their impacts and consequent risks effectively. For example, Unilever is continuing its efforts to limit the potential for labour abuses and illegal deforestation in its palm oil supply chain by purchasing the palm plantations it sources palm oil from. Controversies from the company's palm oil supply chain have been a significant driver of its high RRI.

At the end of 2024, the four companies with the lowest RepRisk Index scores were:

Stock	RepRisk
Waters	0
IDEXX	0
Amadeus	0
Mettler-Toledo	0

Source: RepRisk

Waters and Mettler-Toledo remain on the list from 2023 and are joined this year by veterinary testing company IDEXX and travel technology company Amadeus.

The companies held in the Fundsmith Sustainable Equity Fund continue to show their commitment to reducing their contribution to climate change. At the end of 2024, the companies responsible for 92% of the Fund's emissions had already set 1.5°C aligned emission reduction targets with the Science Based Targets initiative (SBTi), with companies responsible for a further 5% of emissions in the process of doing so. This compares to 24% of the MSCI ACWI IMI[1]. Regarding net zero, companies responsible for 67% of the Fund's emissions had a validated target and those responsible for a further 10% were committed to setting net zero targets with the SBTi.

Greenhouse gas emissions are reported across scopes 1, 2 and 3, with each representing different aspects of a company's operations. Scope 1 emissions are those generated directly by the company, for example, through fuel combustion in boilers, furnaces, and vehicles controlled or owned by the business. Scope 2 emissions are indirectly generated by the company through purchases of electricity, heat, steam, and cooling. Scope 3 emissions result from activities not owned or controlled by the company, but that the company has

[1] https://www.msci.com/documents/1296102/51038578/2024+November+MSCI+Net-Zero+Tracker.pdf/f2377c75-70cb-a14c-9c21-eb1d961d3d5e?t=1732289152071

indirect influence over, such as its supply chain. For this year's letter, we are focusing on scope 2 emissions.

The Greenhouse Gas (GHG) Protocol (the framework used to measure emissions) presents two methodologies for calculating scope 2 emissions: a "location-based" and a "market-based" approach. Location-based emissions are those that directly result from a company's grid electricity consumption. This approach uses the energy intensities, or energy mix, of the respective grids to calculate the emissions produced to generate the electricity consumed.

Market-based emissions account for this grid mix but also allow companies to apply renewable energy purchased via instruments such as Energy Attribution Certificates (EAC). These certificates are used by companies to reduce the reported quantity of non-renewable electricity consumed from the grid. As these certificates are used to replace the non-renewable electricity consumed from the grid with renewable energy, the market-based approach allows companies to reduce their scope 2 emissions accordingly.

The market-based approach has come under criticism as some believe it can give a misleading representation of a company's emissions compared to the location-based method. While this may be true, location-based emissions take no account of a company's approach to renewable energy procurement and force it to only account for the grid's energy share, which they have little to no influence over. Allowing companies to purchase and apply EACs also promotes investment in clean energy projects as corporates create a market for these certificates.

Alphabet ('Google') is a good example of this as it has seen its consumption of electricity increase considerably over the past five years to meet the growing demand for AI-based products and services and scale up its data centres that train and operate the large language models on which AI products are based. As Alphabet has reported, these energy intensive processes are the driver of the company's growing electricity demands. Between 2019 and 2023, Google's electricity consumption increased by 13 million megawatt hours (MWh), reaching a total of over 25 million MWh in 2023. For context, the average medium-sized home in the UK consumes 2,700 kilowatt hours (KWh) of electricity a year[2]. Google's consumption in 2023 was equal to the annual requirement of over 9 million homes.

[2] https://www.ofgem.gov.uk/average-gas-and-electricity-usage

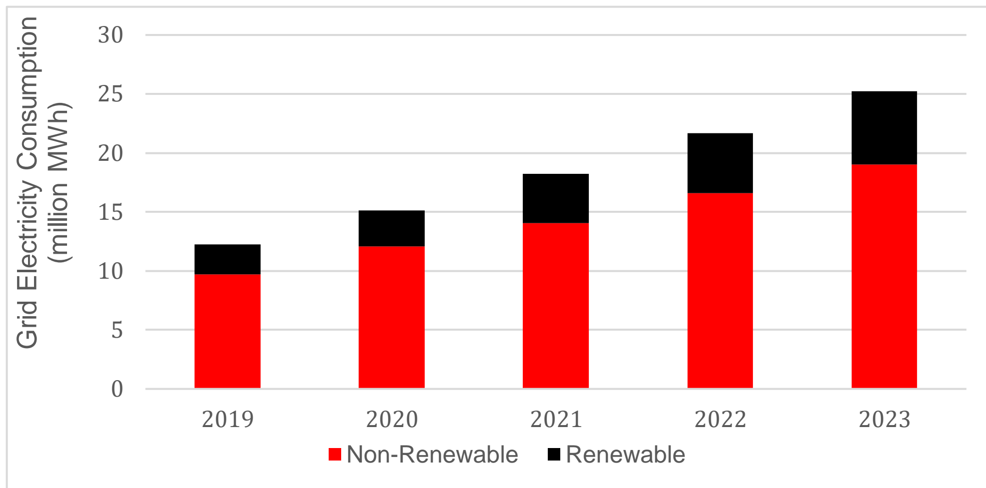


Figure 1: Google's Grid Electricity Consumption. Source: Fundsmith LLP

Google has committed to consuming 100% renewable electricity annually and, despite significant growth in its consumption, has met this commitment every year since 2017. Meeting this commitment has made Google one of the largest clean energy investors on the planet, acquiring almost 72 million MWh of renewable electricity via EACs between 2019-2023. The company purchased 19 million MWh in 2023 alone. Of course, location-based emissions do not account for these efforts and only consider the renewable electricity directly available via the grid. The proportion of renewable energy available to the company from the grid remained relatively static between 2019-2023, between 20-25% and, as a result, its location-based emissions increased at a similar rate to its electricity consumption during the period. Given that Google successfully matched 100% of the non-renewable electricity it drew from the grid with renewable energy during the 2019-2023 period, we would expect its market-based emissions to tell a very different story.

As Google removed all the non-renewable electricity consumed from the grid, using the market-based methodology ought to mean the company generated net zero emissions from electricity consumption and overall scope 2 emissions should not have experienced a significant change between 2019 and 2023. However, market-based scope 2 emissions actually increased by over 300%, reaching a total of 3.4 million metric tons CO_2e in 2023. Given the considerable efforts Google has gone to, how is this possible?

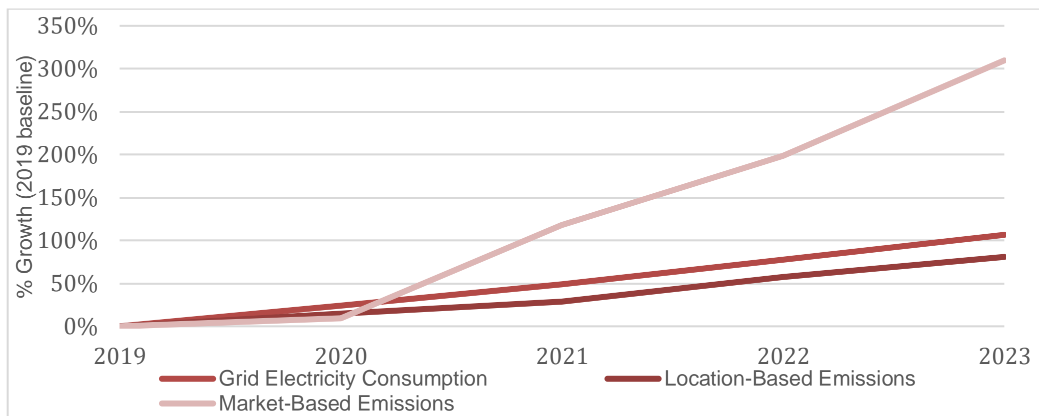


Figure 2: Growth in Google's Electricity Consumption and Emissions. Fundsmith LLP

The first reason is Google's approach to purchasing renewable energy. The company has prioritised purchasing what are known as "bundled" Energy Attribution Certificates (EACs) rather than the alternative "unbundled" versions. These bundled EACs are usually created via Power Purchase Agreements (PPA), which are direct agreements between the consumer, in this case Google, and the energy producer. Under a PPA, Google agrees to purchase a set amount of the energy generated by a proposed renewable project ahead of its development, providing key financing that may not otherwise be available. By prioritising this approach, Google aims to bring new renewable energy to the grid. The company believes this focus on additionality will have a significantly more positive impact on generating renewable energy versus buying unbundled EACs. The unbundled versions represent renewable energy that is being generated anyway, offering no additional renewable energy generation capacity.

Google's focus on bringing new clean energy projects to the grid results in variation in the regions where it can acquire renewable power. In Europe, where developing these projects is relatively easy, the company can acquire a surplus of clean electricity. However, the company runs at a deficit in areas where development is difficult, such as the Asia Pacific region. Google's renewable energy commitment is operated globally, meaning the company manages these regional deficits and surpluses to meet its commitment. This takes us to the second issue: greenhouse gas accountancy practices.

While the GHG Protocol allows companies to use EACs to offset emissions from electricity consumption, they do not follow the same global approach as Google. Instead, the Protocol requires companies to follow regional boundaries. These boundaries mean that companies can only offset their non-renewable electricity consumption with renewable energy generated within the same region; a MWh of non-renewable electricity consumed in Japan can

only be offset with a MWh of renewable energy generated in Japan. This means the regional renewable energy surpluses generated by Google cannot be used to reduce emissions from non-renewable electricity consumption in regions where the company has a deficit. The global approach adopted by Google is, therefore, not aligned with the GHG Protocol's accounting method, which is why the company's market-based emissions have increased despite the company consuming 100% renewable electricity.

Google's experience highlights an important issue. Making knee-jerk judgments based on GHG Protocol reported emissions, as many have done, ignores the full story and the considerable progress the company is making in adding new renewable energy generation capacity, a key part of climate change mitigation.

The third leg of our strategy is about 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 2024 was 3.2% and ended it at the same level. The year-end median FCF yield on the S&P 500 was 3.7%.

Our portfolio consists of companies that are fundamentally a lot better than the average of those in the S&P 500 so it is no surprise that they are valued more highly than the average S&P 500 company. In itself this does not necessarily make the stocks expensive, any more than a lowly rating makes a stock cheap. However, we expect some of this disparity in valuation to be eradicated in 2025 if, as we expect, the cash conversion of our portfolio companies improves.

Turning to the fourth 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 -0.2% during the period. It is perhaps more helpful to know that we spent a total of just 0.003% (a third of 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 sold four companies and purchased three. As last year this may seem a lot of names for what is not a lot of turnover as in some cases the size of the holding sold or bought was small. We have held ten of the portfolio companies since inception in 2017.

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 2024 for the I Class Accumulation shares was 0.96%. 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 I Class Accumulation shares in 2024 the TCI was 0.99%, 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 0.03% (3 basis points) above our OCF when 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. 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.
We sold our stakes in McCormick, Johnson & Johnson, PepsiCo and McDonald's and purchased stakes in Greggs, Atlas Copco and Texas Instruments during the year.

We sold McCormick as we had been disappointed by the slow response which the company exhibited in its ability to pass on input cost inflation so compressing its margins, together with its exposure to own label competition which has stiffened as inflation has caused consumers to trade down.

We sold Johnson & Johnson which span out its consumer brands as Kenvue since we did not wish to remain in the business dominated by its drug pipeline, as successful as that has been in recent years, and the medical equipment business where we have a holding in Stryker which has performed better.

We sold McDonald’s and purchased Greggs. Both are in the Quick Service Restaurant (“QSR”) or fast food business. But we felt that Greggs has better growth prospects and we are able to try to seek that in smaller companies given the size of this Fund. And yes I sample the offerings of both businesses and my money literally is on the Greggs’ sausage rolls although McDonald’s has better coffee.

We sold PepsiCo as snacks are an area of consumption which is vulnerable based on the early data on the impact of weight loss drugs.

We bought a stake in Atlas Copco a Swedish industrial company which makes compressors, vacuum equipment, electrical and pneumatic tools and which has three characteristics which we find attractive:

- it outsources much of the manufacturing so making it capital light which enhances returns;

- it is highly decentralised with over 600 operating entities which have considerable autonomy in addressing their local market; and

- there is a controlling stake held by the Wallenberg family vehicle which should lead to good long-term decision-making since they have been in business for 151 years this year.

We bought Texas Instruments, a manufacturer of analogue and embedded microprocessors which go into a wide range of consumer and industrial devices, automobiles, and communications equipment. It is investing ahead of a probable upturn in the semiconductor cycle although it is now apparent that there is not one cycle. Demand for GPUs of the sort made by Nvidia far from being in a down cycle has been on a lunar trajectory, and there are clear differences between the cycle for regular automotive chips and chips for electric vehicles or chips for other appliances, as well as between regions. However, Texas Instruments has a long history of investing well ahead of upswings in demand and producing handsome returns from it. It is also a beneficiary of the onshoring of semiconductor manufacturing to avoid the geopolitical risks of Taiwan and China.

Last year I spent some time in this letter discussing the rise of interest in AI, as one of the driving forces behind the rise of most of the Magnificent Seven stocks and especially Nvidia. This boom/hype (you choose) continued in 2024, but some of its characteristics changed. One is that it may have become more focused. It had been seen as a driver of share prices of companies which we had previously held such as Adobe and Intuit, both of which had blotted their copybook with us by engaging in over-priced and seemingly ill-conceived acquisitions or attempted acquisitions. Both of them significantly underperformed the market in 2024 as reality seemed to dawn on investors that AI may not be of immediate and/or universal benefit and could actually be detrimental. Conversely, this has had the effect of focusing investors' attention on fewer real immediate beneficiaries of the AI boom such as Nvidia.

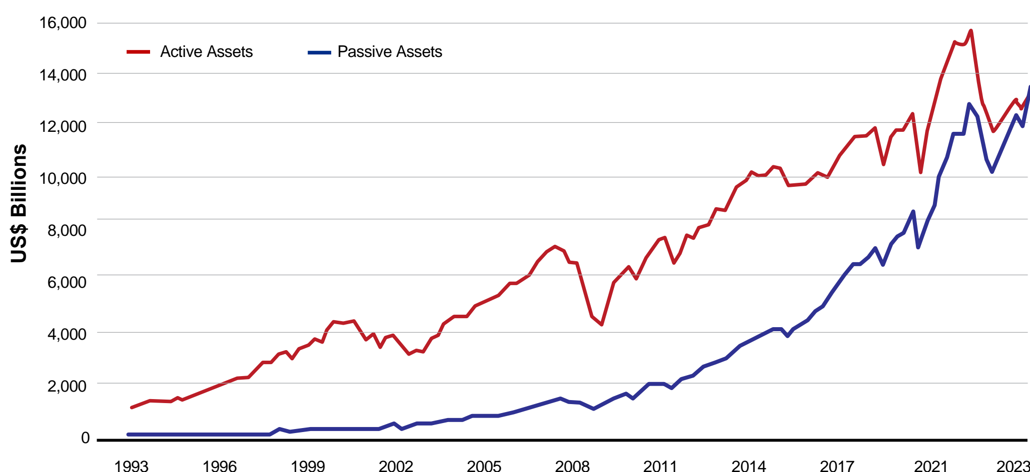
During this period commentators have frequently asked whether the AI boom is the same as the Dotcom era and therefore will have a similar ending. In response I am tempted to quote Mark Twain,

‘History doesn’t repeat itself, but it rhymes.’ Undoubtedly some of the AI enthusiasm is hype, as was the Dotcom mania, but there are a couple of key differences:

1. The leading company in the AI boom, Nvidia, is very profitable, albeit with a history of some downturns, whereas in the Dotcom boom a lot of the share price performance was driven by reference to clicks and eyeballs in the absence of any profits or even revenues. Even companies which were to rise Phoenix-like from the ashes after the Dotcom meltdown, such as Amazon, were not yet profitable; and

2. The rise of so-called passive or index funds.

The Rise of Index Funds



Source: Morningstar.

In late 2023 passive investment via index funds exceeded the amount of assets held in active funds for the first time. They are now more than half of Assets Under Management (‘AUM’). However, during the Dotcom boom only about 10% of AUM was in passive funds. As ever we do not always aid understanding with the labels which we sometimes use in investment. Index funds are not truly a passive strategy. There may be no fund manager taking investment decisions, but such index investing is in fact a momentum strategy.

The vast majority of index funds are market capitalisation weighted, like the indices on which they are based. The size of holdings in companies in the index fund is based upon their market value compared with the market value of the index. So when there are inflows to index funds the largest portion goes to the largest companies, and vice versa when there are outflows.

The result is that as money flows out of active funds and into index funds, as it has been doing, it drives the performance of the largest companies which are companies whose shares have already

performed well which is how they came to be the largest companies by market value.

This is a self-reinforcing feedback loop which will operate until it doesn't. For example, were there to be an economic downturn which led to a reduction in tech spending, which is now so large a proportion of overall spending that it cannot be non-cyclical, one area of vulnerability might be spending on AI as it is not currently generating much revenue. Were the largest companies then to produce disappointing results, their share prices are likely to react badly which will drag down the index performance more than that of those active managers who are underweight in these stocks. But even if some scenario like this awaits us in the future, what exactly will cause this and when it may occur is difficult or impossible to predict.

Which brings me to the subject of volatility. We don't agree that true volatility is measured by ratios such as the Sharpe or Sortino ratio which look at the volatility of fund prices or share prices, but they are widely accepted as a measure. Moreover, whilst investors should rationally focus on volatility in the fundamental value of the businesses they invest in and accept higher price volatility if this leads to higher returns, it is easier said than done. One problem is that it is difficult to remain calm and focus on the fundamental characteristics when the price volatility is sharply negative. Take a stock like Nvidia, which has been a spectacular performer for the past two years. The Nvidia share price fell by over two thirds as recently as 2021–2022. Would we or you feel comfortable owning it in such circumstances, and if not, might that share price performance cause us to make poor decisions?

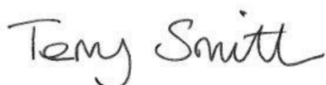
People sometimes ask us whether it is dangerous to own consumer stocks in an economic downturn. To which we reply yes, but it is not as dangerous as not being close to the consumer in those circumstances. If you think the performance of consumer companies is a worry in a downturn wait until you see what happens to their suppliers, especially the suppliers of capital equipment like factory machinery. A 5-10% downturn in sales revenues at the consumer companies can translate into a cessation of orders for some suppliers. Nvidia supplies capital goods — its latest generation GPU server sells for about $3m each — and a significant downturn in demand from its clients who do service consumers would be interesting to watch from a safe distance especially since Nvidia is currently on a P/E of 54x.

All of which brings me to a reminder of what we are seeking to achieve with the Fundsmith Sustainable Equity Fund and that is to produce a high likelihood of a satisfactory return rather than the

chance of a spectacular return which could be spectacularly good or spectacularly bad.

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

Yours sincerely,



Terry Smith
CEO
Fundsmith LLP

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Sources: Fundsmith LLP, Bloomberg and FE Analytics unless otherwise stated.

Data is as at 31st December 2024 unless otherwise stated.

Portfolio turnover is a measure of the fund's trading activity and has been calculated by taking the total share purchases and sales less total creations and liquidations divided by the average net asset value of the fund.

P/E ratios and Free Cash Flow Yields are based on trailing twelve month data and as at 31st December 2024 unless otherwise stated. Percentage change is not calculated if the TTM period contains a net loss.

The MSCI World Index is a developed world index of global equities across all sectors and, as such, is a fair comparison given the fund's investment objective and policy.

The Bloomberg Series-E UK Govt 5-10 yr Bond Index shows what you might have earnt if you had invested in UK Government Debt.

The £ Interest Rate shows what you might have earnt if you had invested in cash.

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