Fundsmith

Value Assessment

Fundsmith
Buy good companies
Don't overpay
Do nothing

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Fundsmith

Dear Fellow Investor,

We are now required to provide you with a value assessment each year, and we are happy to do so.

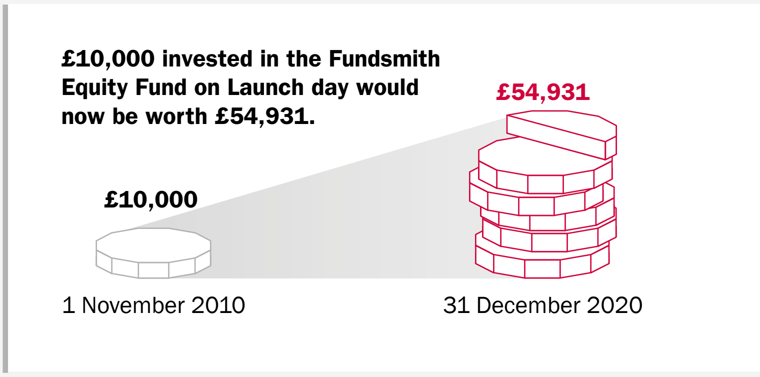
We have changed the format of the public document this year to hopefully make it more readable. The more formal part of the document is attached but this letter is to give you the summary.

Our view of value assessment is that it comes down to three questions:

- Has the fund delivered a good return adjusted for risk?
- Are the other services provided of sufficient quality?
- Are the costs you pay reasonable?

The Fundsmith Equity Fund[1] is for long term investing and so we look at performance over the long term. If you had invested £10,000 when the fund was launched on 1 November 2010, that would be worth £54,931 as at 31st December 2020. This return has been relatively consistent over that period. You should also consider relative performance in assessing the performance of a fund. Here again, our performance is strong. If you had invested in the MSCI World Index which we use as a comparator from 1 November 2010 to 31st December 2020, £10,000 would be worth £31,483, so investing in our fund delivered an additional £23,448. This relative out performance was broadly consistent throughout the life of the fund.

Importantly, the additional performance was delivered with markedly less volatility than equities generally. The Sharpe and Sortino ratios, which measure how much return you get for a unit of volatility, were 1.11% and 1.06% compared with 0.56% and 0.52% for the MSCI Index. In plain English the Fund delivered about twice as much return for each unit of volatility as the Index. This is important. It is not much good if our returns are good but so volatile that you have sleepless nights as a result.



Turning to the second question, we, at Fundsmith, have always sought to engage as directly and clearly as possible with our investors and deliver a high quality of service. We seek to engage and communicate, through our website, Annual Shareholder Meetings and publications such as the Owner's Manual and my annual letter, in a clear manner, allowing you to understand our Fund, its aims and how we are doing. We interact with you online, via the telephone and post so you can deal or ask us queries by whatever means you prefer. The COVID lockdown combined with high volumes of activity have recently put a strain on our responsiveness but we are working hard to restore acceptable customer response times. Importantly we have remained open for dealing every day throughout this COVID crisis.

So, how much have we charged for this? All of the performance figures stated are after charging our fees, so they are the amounts you would have actually received had you sold on that day as we do not charge any dealing costs. If you had been invested in the fund for the past five years[2] you would have made £13,738 in profit. For this profit, you would have paid costs of £875. In other words, of the total gains, you got to keep 94% of them. The majority of those costs are our Annual Management Charge. Over and above that, the Fund bears the costs of a number of third parties who provide services to the fund. We have worked hard to reduce these charges and we believe you are being charged competitive rates. Further, we also work hard to reduce the costs of buying and selling the investments. Partly we do this through not dealing very much (a key part of our philosophy), but we have also negotiated very competitive dealing rates. The total cost of investment for the T Class Accumulation shares was 1.06%[3] for 2020. This is a below average charge compared to our peer group despite our above average performance.

We have therefore concluded that the funds continues to offer good value. We remain confident that our investment philosophy is one that can deliver strong returns over the long term. We also continue to seek to improve our interactions with you.

As ever, we thank you for your continuing support of our funds.

Yours sincerely

Terry Smith
Chief Executive & CIO

1. Please note, this report covers both the Fundsmith Equity Fund and the Fundsmith Sustainable Equity Fund. The similarity between these two funds mean that the conclusions are the same. For ease of reading, we just refer to the Fundsmith Equity Fund.

2. Five years to 31 December 2020 for the T Class in the Fundsmith Equity Fund

3. For the T Class in the Fundsmith Equity Fund

Summary & conclusion

The Executive Members of the Management Committee have followed the same process as last year with the assessment of value. The Executive Members were assisted by our three Independent Members. You might recall that the Independent Members are part of the Management Committee but their sole focus is on the value assessment process. The covering letter gives you the summary of the process and our conclusions. This Appendix covers the evidence in more detail.

This value assessment covers Fundsmith Equity Fund ("FEF") and the Fundsmith Sustainable Equity Fund ("FSEF"), collectively "the funds" for 2020. Further information about these funds can be found on the relevant websites: www.fundsmith.co.uk and www.fundsmith.green.

The evidence has been gathered under the seven pillars as set out by the Financial Conduct Authority 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**

Overall, the Executive Members of the Management Committee concluded that both FEF and FSEF did represent a good value proposition for investors. They concluded this, having discussed each of the factors and considered the evidence set out below. 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 and had considered all the relevant factors in reaching their conclusion.

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
- Running the fund

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 allowing investors or prospective investors to really understand our funds:

The Owners' Manual sets out our philosophy and approach:

- **Buy Good Companies**
- **Don't overpay**
- **Do nothing**

This philosophy, unchanged since inception, allows you to understand what we want to achieve and how we are going to do it

Within two weeks of the end of the year, we send out a detailed review of the year, how we have performed, the winners and losers of the portfolio and our thoughts on the performance

We are the only fund in the UK where direct investors can come and meet us to hear about the fund and ask questions. Our last physical meeting (February 2020) saw 1,300 attendees

Our factsheet provides information over and above monthly performance, including portfolio changes, liquidity, top holdings and portfolio breakdown

You can not only invest and redeem online, you can also get details of the value of your holding, lists of transactions, statements and tax vouchers via our website

Executing transactions and other shareholder services

We saw 195,000 investments or redemptions in the fund during 2020 across a broad range of methods:

Online dealing	36,000 trades	Available via the 'My Account section of the website with money automatically sent to your bank account if you redeem
Telephone	7,000 trades	Our offices are open 9 to 5 on business days and you can call us to trade
Post	4,000 trades	If you send in the form (and a cheque if it is an investment), we will place the deal
Fax	3,000 trades	Whilst we are less keen on this method, we will take faxes if no other method is available
EMX/Calastone	145,000 trades	For institutional investors, this is a straight forward way of placing deals

Whilst we are not perfect, our error rate was under 0.1%.

In addition, we provide direct investors the option of investing via an ISA or JISA at no additional cost. Further, we provide you with the ability to have a regular savings scheme or a regular income facility, so you can manage your investments or redemptions in an easy way.

Running the fund

The funds are run by Terry Smith, assisted by Julian Robins. Together they have over 80 years experience in financial services and are widely regarded as one of the best investment teams in the UK. They are supported by a Research team which comprises a further four people plus another five researchers who are focussed on other funds but contribute to our assessment of businesses and trends. Below are a selection of the awards that we have won recently:

Our investment style, long term investing in good companies, is all about being the part owners of businesses for the long term. This naturally leads us to focus on sustainable investing. We believe that to finish first, you must first finish. There is no point investing in a business whose business model cannot survive in the long term or where it is managed with too much focus on the short term.

As ESG (environmental, social and governance) investing has become more popular, and the regulations around this have increased, we have continued to improve our skills in this area. For the 2020 Stewardship Code, we have submitted our detailed report on how we have complied with the Principles and are looking to become signatories as and when these have been reviewed. We are signatories to the 2012 Stewardship Code and are signatories to the UN Principles for Responsible Investing. Our Responsible Investment Policy is on our website and sets out what we mean by responsible investment and how we integrate ESG factors into our investment process for all our funds.

Finally, how can you be sure that we are actually doing what we say on the tin? We only allow the funds to invest in companies in the Investable Universe. The Investable Universe is a list of companies that qualify as a "good company" based on our criteria. In order for a company to be added to the Investable Universe, it has to be approved by the Management Committee. We also run a series of daily, monthly and quarterly checks to ensure that the funds are being run correctly and in accordance with their investment objectives.

Concentration – making sure we remain within the concentration limits set out in the Prospectus. Our concentration limits are as follows, no single investment can be allocated to over 10% of the fund and only a limited number of investments can be over 5%. We will only invest in 20-30 stocks meaning that the portfolio will be more concentrated than many other funds, but these limits will not be exceeded.

Liquidity – making sure that the fund has sufficient cash at all times to be able to address its requirements (most importantly people who want to redeem). You should note that we have never, and would never, invest in unlisted stocks. As we give you the ability to redeem as and when you want, doing so would involve too much risk.

Risk – In the modern financial world, risk equates to volatility. We can discuss at length the rights and wrongs of this, but if we use this as a proxy, then we do consider the fund's Sharpe and Sortino ratios and these are discussed under the next pillar.

2.

Performance

Objective

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

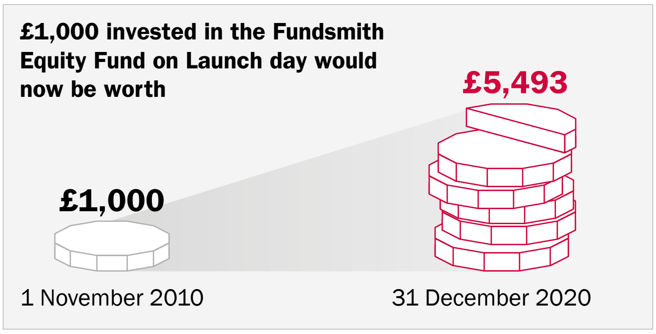
We believe that the most important measure is the absolute performance of the fund over the long term. Put simply, how much money did we make you? However, we are also aware that you, as investors, have a range of different investment choices and so, to you, relative performance is also informative. Different investors will compare performance against different choices, however, we have compared it to the MSCI Global Index. This is perhaps the best general global equities index that compares us to, essentially, global equities in their entirety.

We have looked at long-term performance as these are funds designed for the long term. Ideally, we would like you to invest for longer than five years, we have therefore looked at performance since inception.

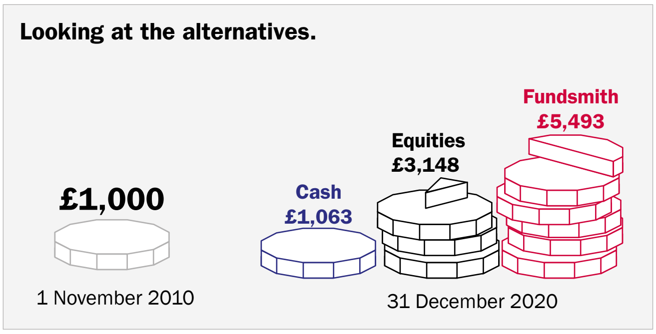
Given the similarity of FSEF's portfolio to FEF's portfolio, we have used FEF's long-term performance. The performance figures for FSEF are not materially different to that of FEF and are available on the website.

Evidence

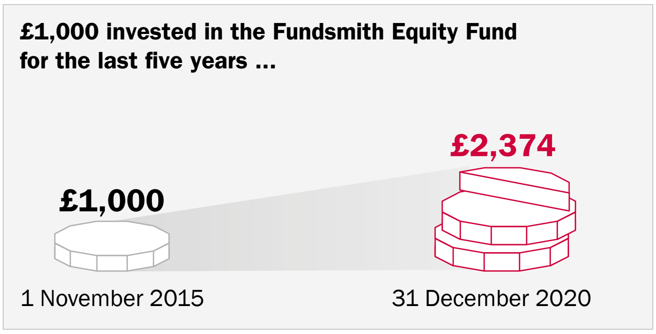
Assuming you had invested £1,000 since inception (1 November 2010) to 31 December 2020, you would have seen the following growth:



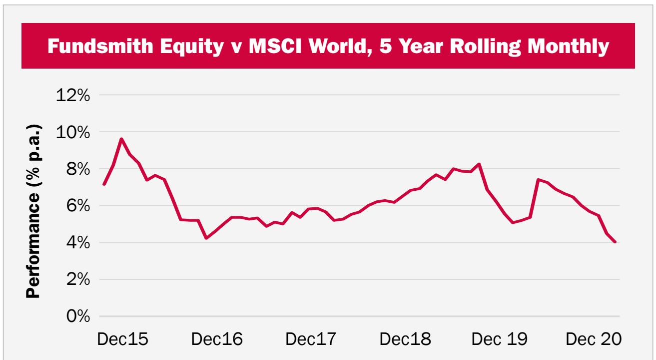
If you compare this return to other choices, you see the following:



Whilst exceptional, there are two further aspects to consider. The first is, is this performance reliant on a single exceptional period? If, you invested £1,000 in the fund for five years to December 2020, you would have seen the following:



Over time, it is reasonably stable and the performance is consistent. Further, from a relative perspective, we have, over five years, consistently outperformed the comparator index and that outperformance has also been consistent:



Source: Square Mile and FE Analytics as at 31 December 2020

Finally, have we achieved this return through taking significant risk? For this, we have looked at the Sharpe and Sortino ratios. For those of you who are not investment professionals what we say next may well seem to be gobbledegook. However, whilst the returns which our Fund provides are very important, so is the amount of risk assumed in producing those returns. These ratios attempt to measure that.

The Sharpe ratio takes the return on the Fund, subtracts a so-called risk-free return (basically the return on government bonds) to get the excess return over the risk-free rate, and divides the resulting number by the variation in that excess return (measured by its standard deviation – we warned you it was gobbledegook). The result tells you what unit of return you get for a unit of risk and our Fund has a Sharpe ratio of 1.22 since inception against 0.63 for the MSCI World Index – it is producing about twice the amount of return that the Index produces for each unit of risk.

The Sortino ratio is an adaption of the Sharpe ratio, and in our view an improvement. Whereas the Sharpe ratio estimates risk by the variability of returns, the Sortino ratio takes into account only downside variability as it is not clear why we should be concerned about upside volatility (i.e. when our Fund goes up a lot) which mostly seems to be a cause for celebration.

The result for our Fund since inception is a Sortino ratio of 1.22 but the MSCI World Index Sortino ratio is lower than its Sharpe ratio at 0.59.

The above evidence allows us to conclude that our outperformance has been consistently strong without taking undue risks.

3.

Costs

Objective

Of the seven pillars prescribed by the FCA, four of them relate to costs. As such we have considered all of these under this section. The questions that are being asked are:

- Are the costs reasonable for the fund to bear?
- Are any economies of scale passed on?
- How do the costs compare to other products from other fund managers?
- How do the costs compare to what we charge other customers?

Are the costs reasonable for the fund to bear?

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.

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.

Other costs incurred include the costs of our transfer agent, SS&C and administration costs, transaction costs, depositary and custody costs, auditor's costs and other regulatory fees.

We regularly monitor these other costs to ensure that our investors are getting a market rate and value for money. As part of this process, we have negotiated a new schedule of charges with State Street, (the Depository, Custodian and Fund Accountant) during the course of 2020. Further, we are in the process of reviewing our Transfer Agent charges.

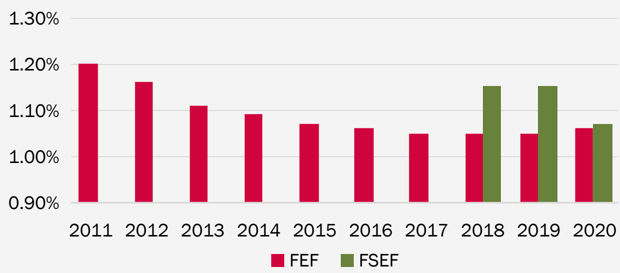
Are any economies of scale passed on?

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.

FEF and FSEF have almost identical cost structures, but because of the economies of scale, the OCF for FEF is smaller than the OCF for FSEF.

Over time, you can see the reductions in the OCF as the funds have grown, as shown below:

Reductions in the OCF as the funds have grown



Source: Fundsmith as at 31 December 2020

As FEF has grown, the OCF has fallen as we are able to ensure that we benefit from economies of scale. Having said that, these economies have diminished since 2017, with the OCF remaining static. We continue to work with the service providers to ensure the fund benefits from any economies of scale to be had. Whilst they will not continue indefinitely, this needs to be regularly reviewed.

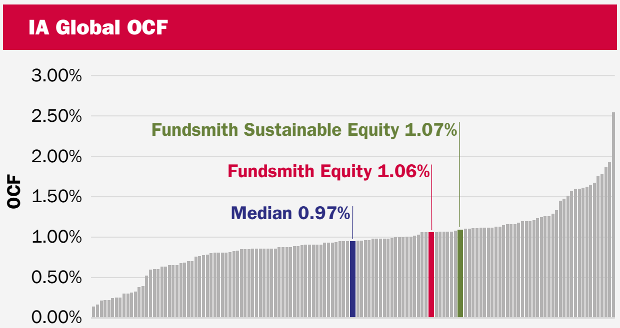
How do the costs compare to other products from other fund managers?

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 other significant costs. As a reminder, the three costs include the following:

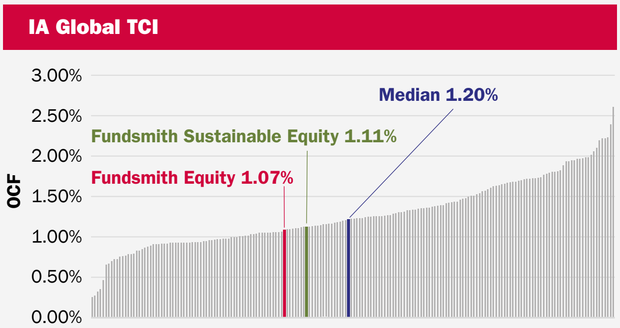
Annual Management Charge ("AMC")	The amount payable to Fundsmith for managing the fund	I Class – 0.9% T Class – 1.0% R Class – 1.5%
Ongoing Charges Figure ("OCF")	In addition to the AMC, this also includes costs payable to State Street for being the Depository, Custodian and Fund Accountant and to SS&C for being the Transfer Agent. There are also some smaller sundry items such as printing	An additional 0.06% for FEF and 0.07% for FSEF
Total Cost of Investment	This includes all costs paid by the fund. In practice, this is the OCF plus the costs of dealing shares, principally the costs payable to our broker	An additional 0.03% for FEF and 0.04% for FSEF

For FEF and FSEF, you may have seen some commentary which suggests that the funds are expensive. If you compare the OCF of both funds to the sector, as shown in the graph below, you can see that they are indeed above the average.



Source: Square Mile and FE Analytics as at 31 December 2020

If, however, you look at the TCI for our funds, you will see that they are slightly below average.



Source: Square Mile and FE Analytics as at 31 December 2019, 2020 data unavailable.

How do the costs compare to what we charge other customers?

It is not uncommon for fund managers to charge much lower fees to larger investors who are in separate or segregated accounts.

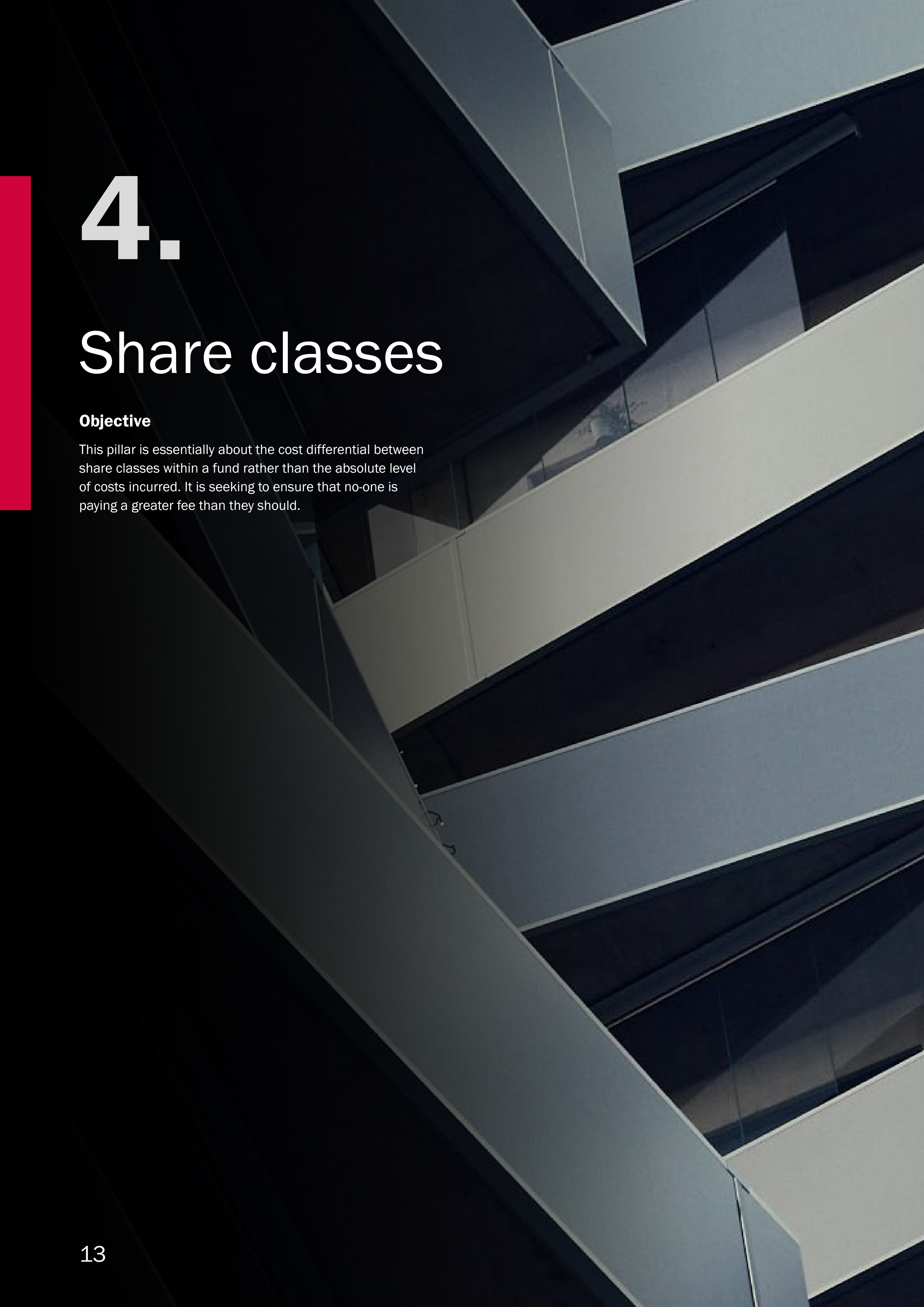
At Fundsmith, we manage a number of funds and segregated accounts. Our approach is clear and has been since inception: we will not run any fund or portfolio for a management fee under 0.9%. Therefore, if you invest over £5 million in our funds, you are paying the lowest AMC of any of our investors across the whole of our business.

4.

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. It is seeking to ensure that no-one is paying a greater fee than they should.



Evidence

We provide three different share classes in FEF and two in FSEF, which have different AMC rates, they are:

- **I Class** – 0.90% AMC - for investors of over £5 million

- **T Class** – 1.0% AMC - for investors under £5 million

- **R Class** – 1.5% AMC (FEF only) - for investors who are advised, and the method of paying the adviser is through Fundsmith rebating 0.5% from the AMC to the adviser

There is an element of fixed costs to any investor, it is important to consider whether it is appropriate to charge smaller investors a higher fee to reflect their size. Transaction (particularly banking charges), anti-money laundering checks and any communications sent to investors. In assessing whether our differential was appropriate, we looked at the 20 largest active funds in the UK and calculated the average differential. The average difference between the cheapest class and the direct retail class is 26% which compares to our 11%. From this we concluded that our fee difference is appropriate.

The R Class is, by far, our smallest class and reflects a somewhat outdated way of remunerating financial advisers. Having said that, there remain certain markets where this is normal market practice therefore we continue to retain an R Class.

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. 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 review the T Class holders to ensure none of them are holding over £5 million.

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