Fundsmith

Assessment of Value 2021

Fundsmith
Buy good companies
Don’t overpay
Do nothing

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Introduction

The members of the Management Committee supported by the Independent Members for Value Assessment have undertaken an annual Assessment of Value provided by the Firm's funds. The process has built on the foundations of previous years.

This report is aimed at individuals who invest in Fundsmith's UK funds and their advisers.

This Assessment of Value report complements other fund documents such as the Owner's Manual and the funds' regulatory documents, including the Prospectus, Factsheets and Key Investor Information Documents ("KIIDs").

The individuals responsible for the Assessment of Value Report are:

Terry Smith – Chief Executive Officer and Chief Investment Officer

Mark Laurence – Chief Operating Officer

Paul Mainwaring – Chief Finance Officer

Jeff Randall – Independent Member

John Spencer – Independent Member

James Quaile – Independent Member

The role of the Independent Members includes providing challenge and an external perspective to the assessment of whether the funds are delivering value to investors.

Summary & conclusions

This Assessment of Value covers the Fundsmith Equity Fund ("FEF") and the Fundsmith Sustainable Equity Fund ("FSEF") for 2021. Further information about these funds can be found on the relevant websites: www.fundsmith.co.uk and www.fundsmith.green.

In carrying out the Assessment of Value exercise for our funds we consider evidence against seven pillars in accordance with the requirements of the Financial Conduct Authority, our regulator. These pillars are:

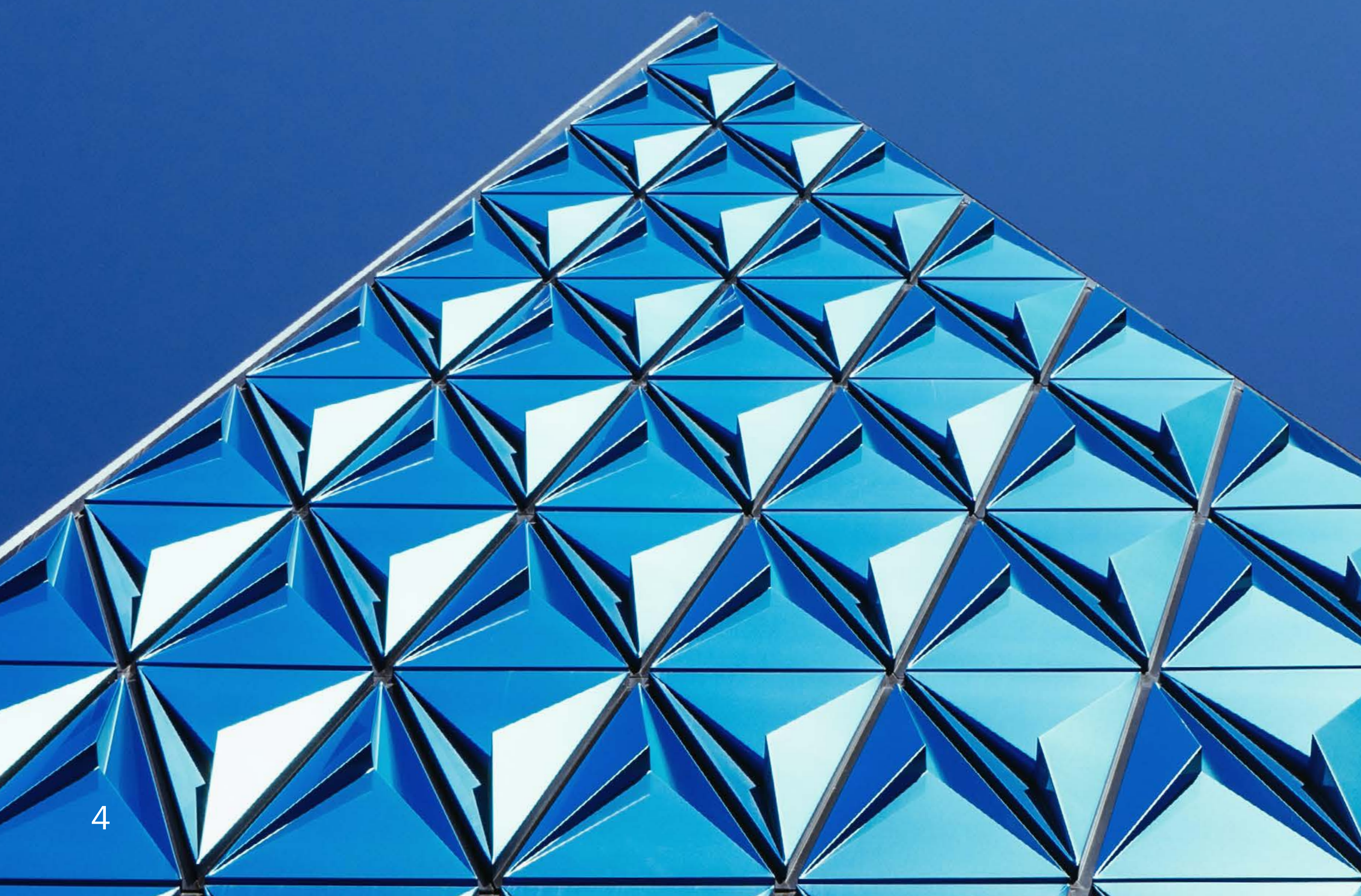
1. **Quality of service**
2. **Performance**
3. **Costs**
4. **Economies of scale**
5. **Comparable market rates**
6. **Comparable service rates**
7. **Share classes**

Overall, the Management Committee with the support of the Independent Members concluded that, in relation to both FEF and FSEF, the payments out of the funds are justified in the context of the overall value delivered to investors. This conclusion was based on consideration of each of the pillars and the evidence outlined below. The Independent Members were comfortable that the Management Committee had followed a sound process and had considered all relevant factors in the value assessment process.

1.

Quality of service

Approach and evidence



We have considered the various services provided to our investors, either directly or via a third party, under three headings:

- Investment management and responsible investing;
- Fund operations, including administration and depositary services; and
- Investor interaction, including relationship management, investor support and transfer agency.

In assessing the services we have considered performance, quality and enhancements made during the year.

Given the nature of the services, which are delivered by the same teams using the same systems, this assessment applies equally to both funds, except where specifically highlighted in respect of the investment management process.

Investment management

The oversight of the investment process and investment risk management for each fund was robust and overseen by an effective governance process. Fundsmith LLP is managed and overseen by a Management Committee, which has three sub-committees that oversee and challenge business areas in relation to the operation of the firm and the management of the funds.

The funds were managed in accordance with their prospectuses, with reference to their investment objectives, policies and restrictions and also having regard to wider investor communications concerning what the fund will do and will not do. There were no mandate breaches during the year and no investments were held outside of risk tolerances.

The quality of trade execution was also good.

Responsible investing

As long-term investors we recognise the importance of understanding the sustainability of the business models of the companies in which we invest and the importance this holds in the delivery of long-term investment performance for our investors. Environmental, social and governance factors, and the risks associated with them, carry the potential to impact negatively the performance of our investments and, in turn, the value provided to our investors. The firm has a stewardship team comprising two investment professionals. Oversight is exercised via the Stewardship & Sustainability Committee.

In addition to the good company screen used by Fundsmith Equity Fund, Fundsmith Sustainable Equity Fund also applies a sustainability screen, removing companies that operate in highly socially and/or environmentally damaging sectors, such as metals and mining, oil, gas and consumable fuels, tobacco and alcohol, casinos and gaming, and utilities, among others.

During the year these processes were undertaken effectively with a number of companies being excluded from consideration for the Fundsmith Sustainable Equity Fund. As part of our value assessment, we consider that two external indicators are also relevant in that they recognise how Fundsmith LLP engages with companies on behalf of investors, namely:

- Fundsmith LLP has ratings of A and above in relation to UN Principles of Responsible Investment ("UN PRI"), reflecting the integration of ESG into the firm's investment process. UN PRI is one of the world's leading proponents of responsible investing, helping investors incorporate responsible investment principles into investment decisions.
- Fundsmith LLP is a signatory to the Financial Reporting Council's UK Stewardship Code 2020, achieving signatory status as part of the initial phase in September 2021. The Stewardship Code consists of 12 principles which are designed to evidence the signatory's responsible allocation, management and oversight of capital to provide long-term value for investors, leading to sustainable benefits for the economy, the environment and society.

Fund operations

Performance and quality across all areas of fund operations remained high during 2021 and oversight activities did not identify any areas of concern. An independent benchmarking project carried out in H2 2021 confirmed that the external fund administration services and performance we receive are in line with industry norms.

Investor interaction

Investors can engage with us directly across a broad range of methods including the website and dedicated "myAccount" portal, webchat, email, phone and post. Large institutional investors may also use industry messaging services including EMX and Calastone to place deals.

We saw an increase in interactions in 2021, with approximately 3,500 calls, 1,500 emails, 1,500 letters, and 1,500 webchats received per month on average by our individual investor contact centre.

While our error rate remains relatively low at less than 0.2%, we believe we should be better. We have therefore spent considerable effort during the year to address the errors, enhance our communications with investors and generally create less friction in the servicing arrangements. This will remain an area of focus in 2022.

We saw an increase in complaints compared with the prior year. While we continue to focus on minimising complaints through improvements to service described above, we have taken comfort from our complaint handling arrangements and the extremely low level of complaints that have been referred by investors to the Financial Ombudsman Service for review.

Online services

During the year we have made significant investments to enhance our individual investor servicing, most notably launching a new investor portal "myAccount" in September 2021 to make it easier to access fund literature and deal electronically. The portal also included security upgrades, including multi-factor authentication, and made it easier for investors to provide bank account details for safer, direct, money transfers. The updated website also added technologies which enable better accessibility for investors with disabilities. At the time of writing 75% of individual investors are registered for MyAccount access.

We also launched updated and improved webchat functionality which included a chatbot to provide 24/7 responses to common questions raised by our investors, or prospective investors. This functionality puts us ahead of the vast majority of UK fund managers.

Financial guidance

During 2021 we launched a financial guidance programme for the benefit of investors with articles and webinars addressing common questions and concerns for investors. Guidance was published on the website in relation to the following topics:

- Inheritance tax of pensions, ISAs and offshore investments;
- Estate planning and gifts;
- Estate planning and inheritance tax;
- A look at withholding taxes;
- Capital gains tax

To support this service, a full-time, experienced person has been employed to ensure we continue to deliver high-quality content.

2.

Performance

Approach and evidence

We have considered the performance of each fund separately.

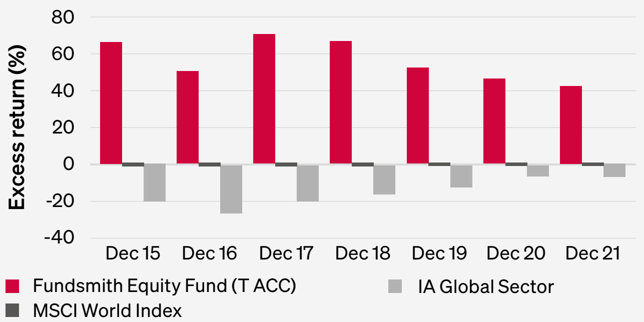
Fundsmith Equity Fund

At the inception of FEF the aim was to run the best fund you have ever owned. By best fund, we mean the one with the highest return over a long period of time, adjusted for risk.

Since inception on 1st November 2010, FEF is the No.1 performing fund in the IA Global sector of peer group funds by some considerable margin, returning 570% (based on cumulative performance of all funds in the sector 1.11.10 to 31.12.21).

The five-year rolling excess returns vs the MSCI World Index have been positive, between just over 40% and as high as 70% over all five year rolling periods since inception. The IA Global sector average has failed to produce five-year rolling returns in excess of the MSCI World Index – as reflected in the table below.

Fundsmith Equity Fund 5 year rolling excess return vs index



Data from FE fundinfo 2022

Whilst the return that FEF has provided is good, so is the amount of risk assumed in producing those returns. For this, there are various numbers we could suggest by way of evidence and, in our view, the most relevant of these is known as the Sortino Ratio.

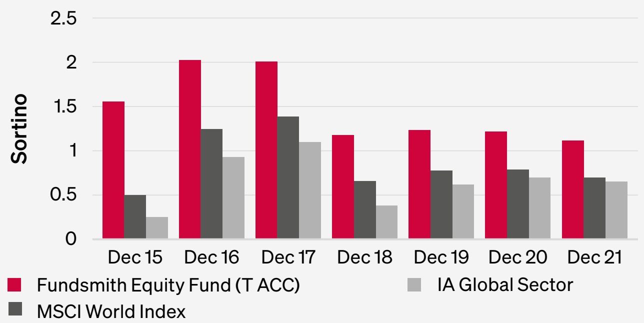
A travel analogy may be helpful here. When you book a flight, there is a level of risk associated with when the plane might arrive at its destination. However, the 'risk' that it might arrive early would not really concern you. Nor would you be concerned if someone warned you that sometimes this flight tends to arrive slightly early and sometimes really early. Early is, after all, early.

But the risk that it might arrive late is more concerning, particularly if someone told you that rather than arriving late but within acceptable parameters, this flight was sometimes 10 minutes late and sometimes 10 hours.

Investing presents similar 'risks'. However upside risk, like the plane arriving early, is not something that we are particularly concerned with nor the volatility of this upside risk. What we are concerned with however, as with the plane arriving late and also how late, is what is known in the trade as harmful volatility – in plain English, when things get bad, how bad? The calculation, for those who are interested, takes the portfolio's rate of return, subtracts the risk-free rate, and then divides this number by the standard deviation of the downside risk. The outcome, the Sortino ratio, enables investors to take funds with varying degrees of performance and varying degrees of this bad volatility and evaluate the return they're getting for the level of bad risk they are taking on.

Below we show the rolling five-year charts for the Sortino ratio relative to the MSCI World Index and the IA Global Sector. In both cases it shows FEF to have a superior Sortino ratio.

Sortino ratios



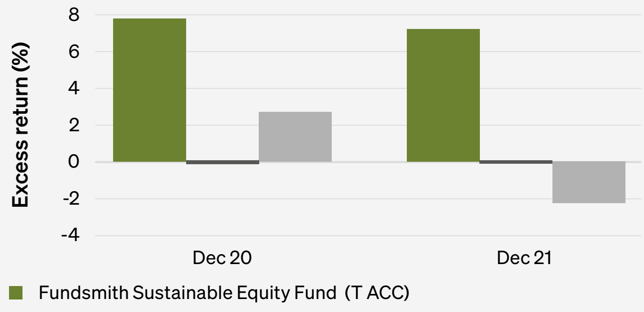
Data from FE fundinfo 2022

Fundsmith Sustainable Equity Fund

FSEF was launched on 1st November 2017. It has also performed well since inception and is just outside the top 10% of funds in the IA Global sector, returning 88% (based on cumulative performance of all funds in the sector 1.1.17 to 31.12.21).

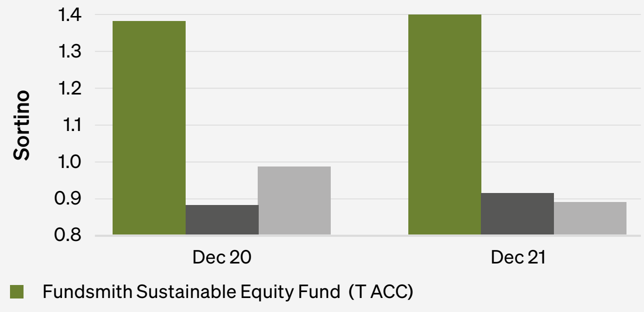
Whilst the fund is yet to reach its first 5 year rolling period of returns, below we show how it looks over a shorter two-year rolling period. Both returns and Sortino ratio are all considerably in excess of the MSCI World Index and IA Global Sector.

Fundsmith Sustainable Equity Fund 2 year rolling excess return vs index



Data from FE fundinfo 2022

Sortino ratios



Data from FE fundinfo 2022

Fund strategies

The performance of each fund has been achieved by each of them being managed in accordance with their prospectuses, specifically with reference to their investment objectives, policies and restrictions. There were no mandate breaches during the year and no investments were held outside of the firm's risk tolerances. The funds have not engaged in activities or instruments contrary to the fund strategies as consistently outlined to investors in fund literature and communications.

3.

AFM costs

Approach and evidence

Administration costs and transaction costs

Each fund bears administration costs and transaction costs which are paid to third parties in connection with the operation of the fund. Each fund also bears an annual management fee which is paid to the investment manager.

Administration costs are invoiced to the fund and comprise either:

- Net Asset Value ("NAV") based costs – where the costs are determined using a basis points rate on NAV (often in a tiered structure with lower rates applying at higher NAV) on a periodic (daily or month end) basis: or
- Activity based costs – where the costs reflect a specific service being provided, and in the case of transfer agency costs are driven by the number of unitholders and the volume of interaction.

These costs are allocated to each share class according to the relative NAV of each share class. Each share class therefore bears the same percentage of NAV for administration and transaction costs.

Transaction costs are driven by the value of purchases and sales of investments in the fund.

All the costs borne by the Funds are the actual amounts charged by the third-party. Fundsmith does not include any internal costs associated with the management and oversight of service providers in the costs charged to the funds and there is no other bundling or mark up on the third-party costs that are charged to the funds.

Annual Management Charge ("AMC")

The annual management charge is determined using a basis points rate on the daily NAV for each share class.

The AMC for FEF and FSEF is 0.9% for accounts over £5m and 1.0% for accounts under £5m. The charges applicable to each fund are transparently disclosed to investors in the Prospectus and Owner's Manual of each fund and are readily available to investors. There are a number of explicit and implicit costs associated with the annual management of the funds of which by far the largest is the implicit cost of the lifetime of learning and knowledge required to be capable of delivering the best global equity fund that an investor could wish to own.

Unlike most fund managers who consider themselves to be product manufacturers who allow others to perform their distribution for them, Fundsmith has since inception sought to invest in and maintain its own full service, direct, investment platform. By embracing the latest digital e-commerce technology we offer a service that, through disintermediating third-party platform providers, allows investors to make very significant cost savings and through a direct relationship with us benefit from direct, clear and concise investor communications.

As we have noted above, significant investment has been made to improve the website's speed, security and accessibility for the benefit of investors. All costs incurred by Fundsmith in respect of its internal resources involved in the oversight of third-party service providers, the related governance arrangements and all costs incurred in connection with supporting the wider service and value for investors are funded through the AMC. There are no hidden charges or platform equivalent fees accruing to the fund, consistent with our approach towards full transparency of fees to fund investors.

Fundsmith Equity Fund

Based on the publicly available (and audited) report and accounts, the costs borne by FEF can be summarised as follows:

	2021	2020
NAV-driven administration costs	0.02%	0.04%
Activity-driven administrative costs	0.02%	0.02%
Transaction costs	0.01%	0.03%

The NAV-driven administration costs for the fund have reduced reflecting the benefit of negotiating lower rates for some services, and the benefit of the tiering of the rates, with lower rates charged as the funds increase in size.

	2021	2020
AMC – I Class	0.90%	0.90%
AMC – T Class	1.00%	1.00%
AMC – R Class	1.50%	1.50%

Since the 2010 launch of the fund, Fundsmith has made available to direct investors the T class shares at 1%. Furthermore, the R class ceased to be offered to new UK investors following the introduction of FCA's Retail Distribution Review ("RDR") rules in 2012. The industry-wide offering of an unbundled direct retail share class has only been adopted since the FCA's RDR and often at levels above 1%. There remain only a very small number of legacy (pre-2012) advised UK investors in the R Class.

Total costs borne by the Fund

The 'ongoing charges figure' ("OCF") is the sum of the administration costs and the AMC, expressed as a percentage of NAV.

The 'total cost of investment' ("TCI") is the OCF plus the transaction costs, again expressed as a percentage of NAV.

The OCF and TCI for each share class of each fund are set out in the tables below. Comparisons against our industry peers are considered further in the "Comparable Market Rates" section below.

	2021	2020
OCF – I Class	0.94%	0.96%
OCF – T Class	1.04%	1.06%
OCF – R Class	1.54%	1.56%

	2021	2020
TCI – I Class	0.96%	0.98%
TCI – T Class	1.06%	1.08%
TCI – R class	1.56%	1.58%

Fundsmith Sustainable Equity Fund

Based on the publicly available (and audited) report and accounts, the costs borne by FEF can be summarised as follows:

	2021	2020
NAV-driven administration costs	0.04%	0.06%
Activity-driven administrative costs	0.02%	(0.11)%
Transaction costs	0.03%	0.04%

The NAV-driven administration costs for the fund have reduced reflecting the benefit of negotiating lower rates for some services, and the benefit of the tiering of the rates, with lower rates charged as the funds increase in size.

The activity-driven administration costs in 2020 are a net credit to the fund reflecting the correction in that year of over-accruals of costs in previous years.

	2021	2020
AMC – I Class	0.90%	0.90%
AMC – T Class	1.00%	1.00%

Since the launch of the fund, Fundsmith has made available to direct investors the T class shares at 1%.

Total costs borne by the Fund

The 'ongoing charges figure' ("OCF") is the sum of the administration costs and the AMC, expressed as a percentage of NAV.

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The OCF and TCI for each share class of each fund are set out in the tables below. Comparisons against our industry peers are consider further in the "Comparable Market Rates" section below.

	2021	2020
OCF – I Class	0.97%	0.85%
OCF – T Class	1.07%	0.95%

	2021	2020
TCI – I Class	1.00%	0.89%
TCI – T Class	1.10%	0.99%

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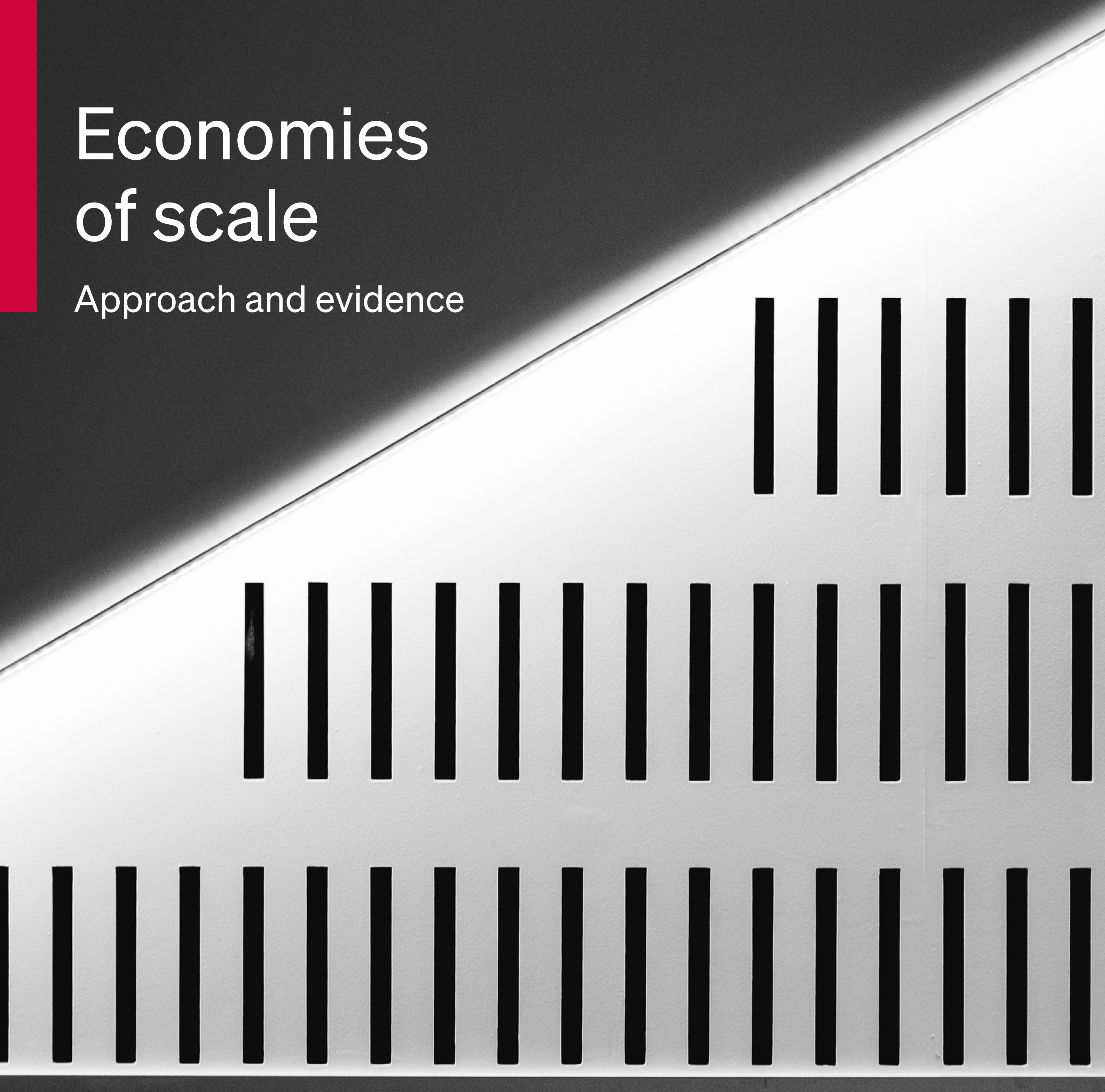
4.

Economies of scale

Approach and evidence



Administration costs and transaction costs

Economies of scale are inherent in our funds' administration costs because certain fee agreements, such as for depositary and fund administration, are on a tiered basis, with the basis points charge reducing as assets under management increase. Unlike some other firms in the industry we do not seek to profit from these costs by charging a set ad valorem fee to the fund whilst driving down the underlying charges.

Regardless of whether charges are pre-agreed to fall as assets under management rise, or a flat fee such as custody charges, Fundsmith seeks to negotiate periodically lower rates for these overall services, reflecting the scale of its activities.

During 2021, these negotiations led to further reductions in the fund administration and depositary costs that are charged to the funds in 2022 onwards and in the basis-points custody charges for fund assets.

The Firm also achieved economies of scale on behalf of the funds in negotiating a further reduction of 0.5 bps in the transaction fees charged by the outsourced dealing-services provider which will fall from 3.5 bps to 3 bps for 2022.

While the economies of scale are driven primarily by the size of the FEF AUM, FSEF has also benefitted from the same negotiated rates.

Annual management charge

The annual management charges paid by the funds are in return for the investment management services provided by the Firm. These charges are not based on the cost of providing those services, or tiered based on assets under management, but instead they reflect the value attributed to Terry Smith's lifetime of investment experience and the investment research team's expertise, led by Julian Robins, both of which we see as critical to the long-term success of the funds, and the value of the resulting long-term investment performance.

5.

Comparable market rates

Approach and evidence

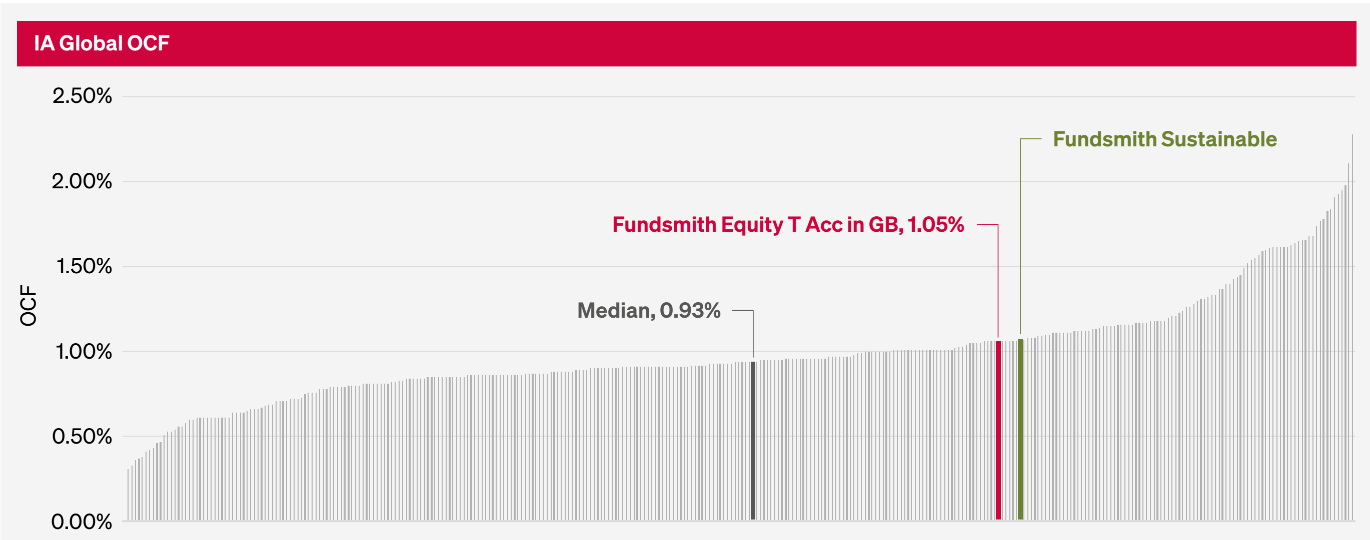
FEF and FSEF are both active global equity funds and the best available comparator for market rates is considered to be the Investment Association 'IA' Global Sector, which includes 340 similar funds.

We have used Financial Express Analytics' "Main Share Class" classification to define the universe of comparator funds. The Main Share Class is likely to be the most widely available clean share class promoted for sale. It is worth noting that there are many other different share classes for each fund and in some cases these may be bespoke for certain platforms and distributors to allow for additional fees chargeable by the platform/distributor and therefore, whilst superficially cheaper, these will not be directly comparable or widely available.

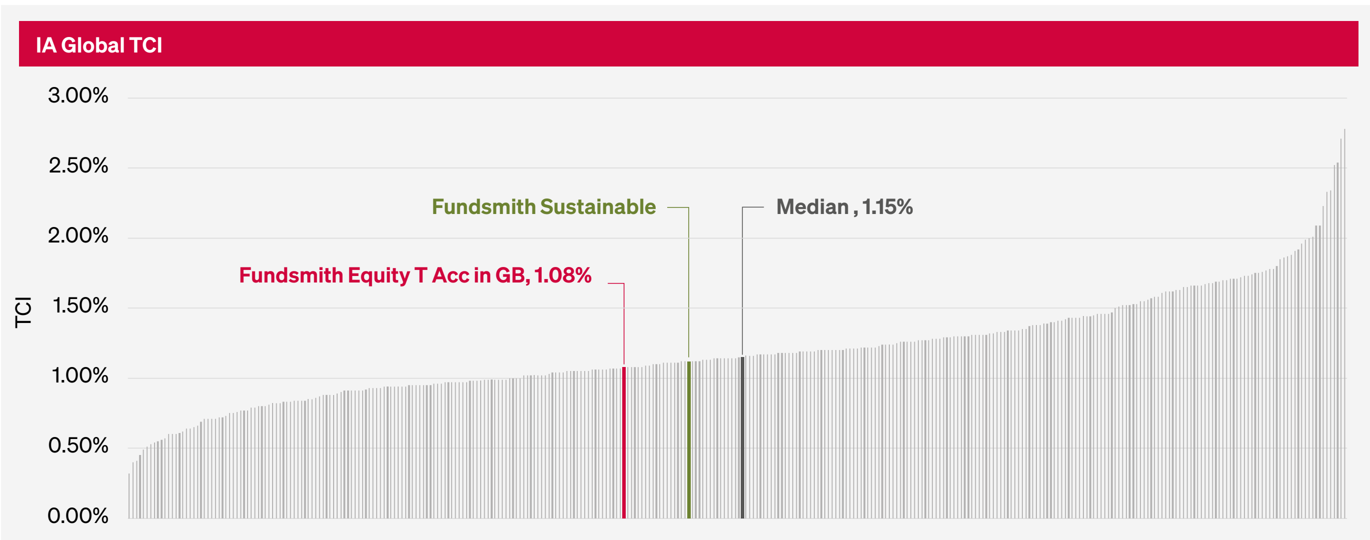
Below we show how FEF and FSEF's Ongoing Charges Figure ("OCF") and Total Cost of Investment (OCF plus transaction costs) compare with other funds in the IA Global Sector over the past reporting period. As noted above, Fundsmith does not uplift any administration costs in respect of internal services and oversight, rather it covers such expenses through the management fee. Industry practices vary and hence we consider that comparison at the aggregate level is the most appropriate.

For completeness we have shown how the T Class shares (the clean share class that is sold direct to investors) and the I Class shares (which are typically sold to investors through distributors who inevitably make additional charges on top) compare against IA Global Sector peers.

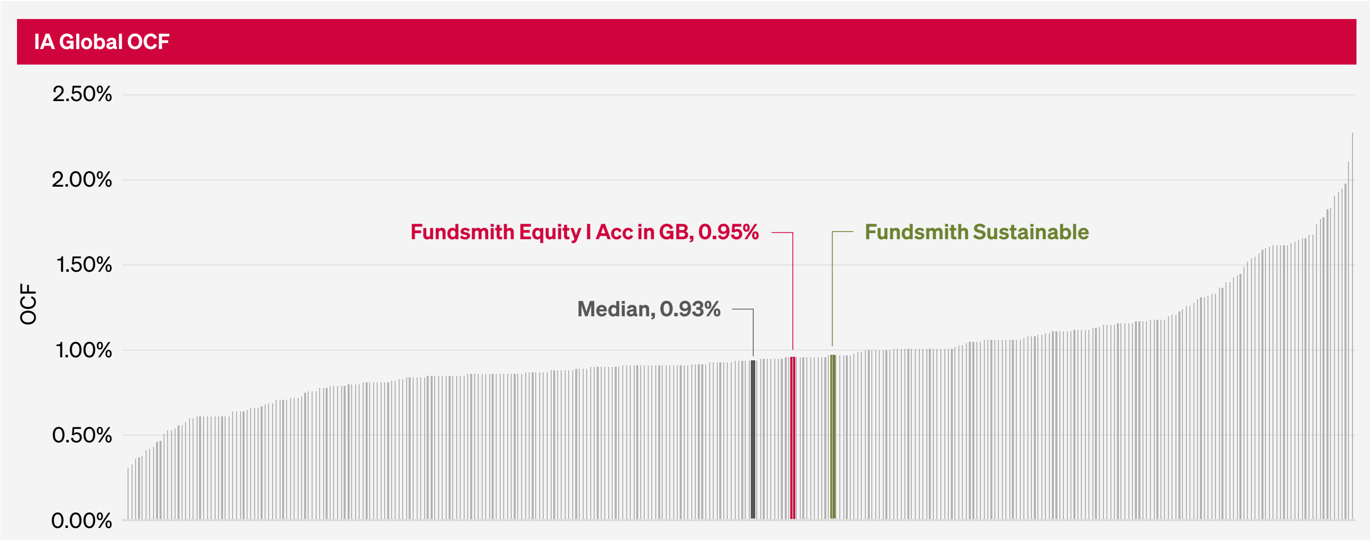
Ongoing charges figures in IA Global Sector vs T Share Class of Fundsmith Funds



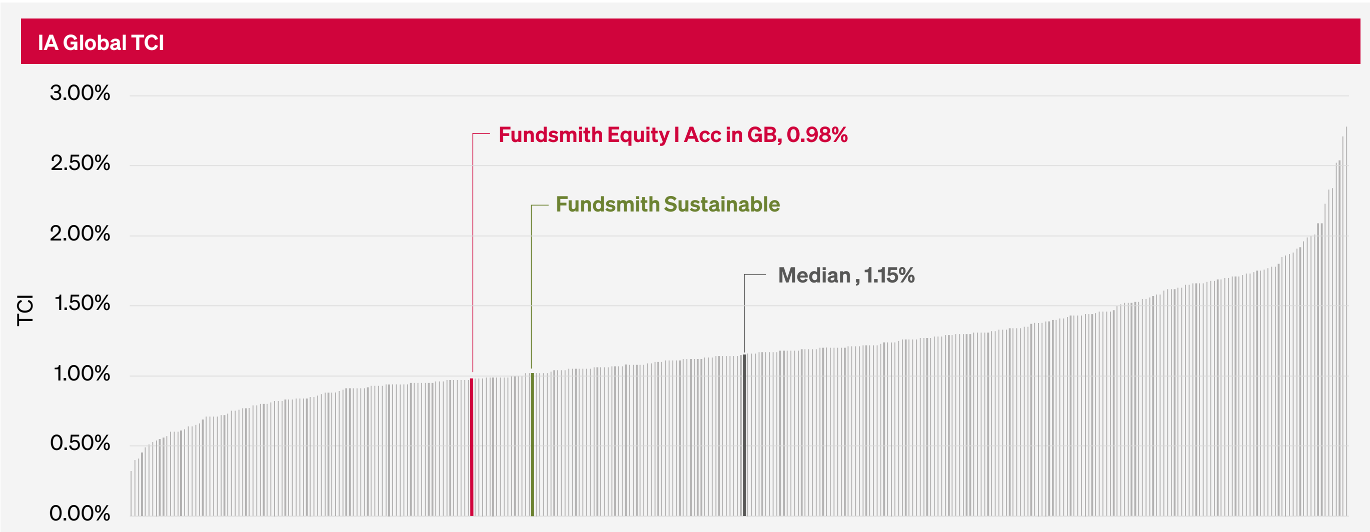
Total cost of investment figures in IA Global Sector vs T Share Class of Fundsmith Funds



Ongoing charges figures in IA Global Sector vs I Share Class of Fundsmith Funds

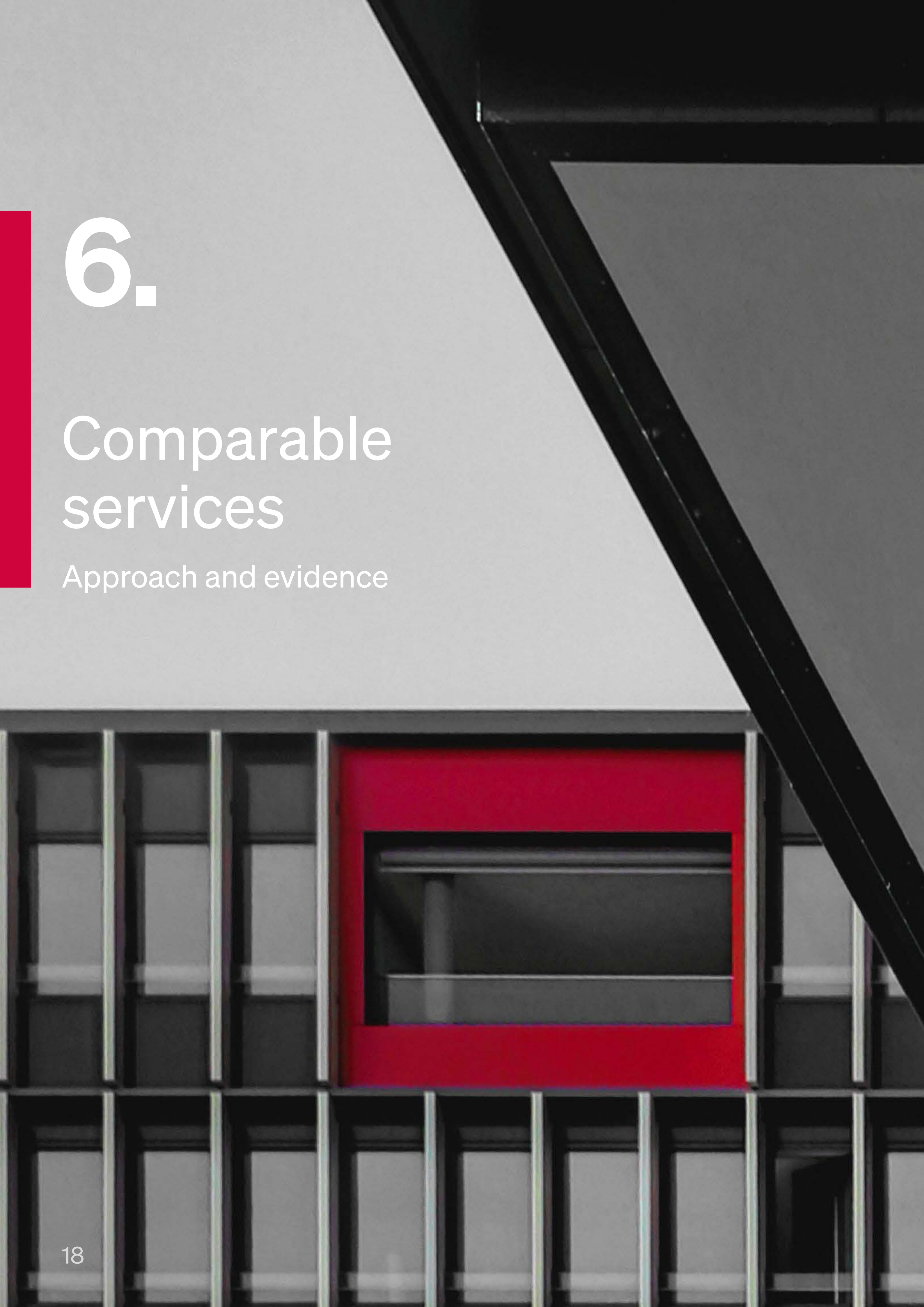


Total cost of investment figures in IA Global Sector vs I Share Class of Fundsmith Funds



Fundsmith was one of the original advocates of disclosure of transaction costs so fund buyers could properly compare all costs being incurred by fund managers and we have been voluntarily releasing the figures long before it became mandatory to do so.

As the charts above show, the TCI for FEF is only fractionally higher than the OCF but for the median fund in the sector transaction costs increased overall costs by 26%. It is a similar story for FSEF. As a result, both FEF and FSEF are cheaper when comparing TCIs than the median fund in the IA Global Sector but have both provided better long-term performance as well as a high-quality service.



6.

Comparable services

Approach and evidence

The purpose of this pillar is to highlight the relatively common practice of managing funds and segregated accounts or other pools of money at different rates.

Our position has not changed since last year's report. All of our segregated accounts, which represent highly sophisticated large investors, are at a management fee of 90bps, which is the same rate as charged by our funds' I class shares.

7.

Classes of units

Approach and evidence

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

- I Class – 90bps
- T Class – 100bps
- R Class – 150bps (FEF only)

The difference between the classes is solely around the AMC. The rationale for the difference between the classes are:

- I Class for investments over £5m;
- T Class for investments under £5m;
- R Class for where an investor is advised and the method of paying that adviser is through us rebating 50bps to the adviser. This share class has not been available to UK advised investors since the implementation of FCA's RDR rules in 2012, which required advice in relation to new business relationships to be paid on an unbundled basis. There remain only a very small number of legacy (pre-2012) advised UK investors in the R class.

We consider that the willingness of sophisticated investors to invest in our global equity strategy through segregated mandates at 90bps supports the charging structure of the FEF and FSEF I class. Furthermore we consider that our unbundled T class, which has been made available to investors since launch of each fund at 100bps remains competitive considering the services available to direct investors. We note that the offering of an unbundled direct retail share class has only been widely adopted by our competitors since the FCA's Retail Distribution Review and often at levels above 1%.

As regards the differential between the two share classes, a degree of the costs we bear are 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 are clearly higher, on a relative basis, where the investor is investing a smaller amount of money. Additionally, we also provide a number of other services to retail investors including the opportunity to invest via the website in an ISA/JISA. These services are provided at no additional cost.

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