

QUARTERLY INVESTMENT REVIEW

Quality Trust

Performance returns (AUD)

ANNUALIZED RETURNS (QUARTER-END)	Quarter-End	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception
Quality Trust (net)	1.15	17.22	22.48	15.59	–	–	19.38
Quality Trust (gross)	1.30	17.56	23.21	16.28	–	–	20.10
MSCI World	0.29	14.17	19.80	11.11	–	–	15.18
Value Add	+0.86	+3.05	+2.69	+4.48	–	–	+4.20

MAJOR PERFORMANCE DRIVERS

The Quality portfolio's return this quarter was positive from a dollar perspective, ahead of the MSCI World index but slightly behind the S&P 500.

Market performance was again concentrated in a handful of stocks: AI chip designer Nvidia, AI improver Apple, AI user Alphabet, and AI seller Microsoft together accounted for all the of the quarter's return to the S&P 500; portfolio performance relative to the indices was determined by the allocation to growth-oriented companies.

Like you, we have read countless comparisons between today's enthusiasm for all things AI with the top of the TMT bubble in 2000. In terms of a technical description, the parallels are accurate – the narrowness of the market, the elevated cross-sectional volatility, and the concentration of capitalization in a few issues all look similar to the 2000 top. Does that mean a crash is just around the corner? We are instinctively wary of arguments of the form "the last time technical event X was observed, Y followed, and we see X today so Y is just around the corner." But these X-then-Y arguments are a form of folk memory – the investing equivalent of "don't run with scissors" – and can be a useful prompt for vigilance.

Investment returns ultimately come from three sources: earnings growth, dividends received, and changes in the earnings multiple. Our approach could be summarized as taking care of fundamentals by focusing on quality, while controlling valuation risk by seeking to avoid overreach on the earnings multiple. If we compare today's markets with the market top in 2000, we see less to fear today on both the fundamentals and the multiples.[1]

In 2000, the top 10 stocks comprised five telecoms companies, two networking beneficiaries, a software business, an oil company, and a holding company. At the June 2024 quarter end, we have five cloud tech businesses, two chip companies, a pharmaceuticals company, an oil company, and a holding company.

Inception Date: 23-Sep-20

Performance for the year of inception is less than a full calendar year. Returns shown for periods less than one year are not annualized.

Risks: Risks associated with investing in the Fund may include Market Risk - Equities, Management and Operational Risk, Focused Investment Risk, Non-U.S. Investment Risk, and Currency Risk. For a more complete discussion of these risks and others, please consult the Trusts Product Disclosure Statement. Returns shown for periods greater than one year are on an annualized basis. To obtain performance information to the most recent month-end, visit www.gmo.com.

Performance data quoted represents past performance and is not indicative of future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance data may be lower or higher than the performance data provided herein. Net returns are presented after the deduction of management fees and incentive fees if applicable. These returns include transaction costs, commissions and withholding taxes on foreign income and capital gains and include the reinvestment of dividends and other income, as applicable.

The inception date of the fund is 23 September 2020. The inception date of the performance data above is 24 September 2020, the first full day that the GMO Quality Trust was fully invested. Performance data using an inception date of 23 September 2020 would produce a different outcome and compare fund performance over a period different to that reflected in the benchmark performance. The GMO QualityTrust ARSN 643 940 872 ("the Trust") is issued by GMO Australia Limited ABN 30 071 502 639, AFS Licence No. 236 656.

QUARTERLY INVESTMENT REVIEW

MAJOR PERFORMANCE DRIVERS CONT.

In 2000, the P/E of the top 10 was 60x. Market participants were intoxicated by the ongoing communication revolution and heady fundamental returns of 22% p.a. for the group over the preceding 5 years. The valuation was simply too rich. Even if the fundamental return expectation of 19% p.a. had been delivered and stock prices held, the top 10's multiple would have still exceeded 25x by 2005. In reality, the outcome was starkly different – the fundamental return was a relatively puny 8% p.a. for the group, with earnings falling at the telecoms companies after what turned out to have been disastrous capital allocation in 3G spectrum auctions. Total returns were famously poor. Perhaps unsurprisingly, the stellar performer of the group – the only one to deliver a positive return – was the company the furthest from the TMT epicenter, Exxon.

This year's top 10 have delivered similarly impressive fundamental returns of 19% p.a. since 2019. However, the set-up is rather different to 2000 with a median P/E of 27x. This time around, if today's top 10 were to deliver on 19% fundamentals expectations and prices were to stay the same, the multiple would collapse to 12x by 2029. Implicitly, investors expect less from the mega caps now than they did in 2000. In a real sense, the stakes are lower today.

None of this is intended to be determinative and we are not making another "X-then-Y" case. We are pointing out that in an important way the stars are aligned differently this time around even if the market is superficially similar from a technical perspective. Whether today's mega caps turn out to be great or less than great investments will be a result of the evolution of their fundamentals and the consequent impact on their valuation multiples.

If AI transforms our economic lives, and the competitive advantage of the incumbents holds, current stock prices will prove conservative. If the tens of billions of dollars that several of your portfolio companies are planning to invest in cloud capacity in coming years prove surplus to requirements, returns will of course disappoint. We have a bias to investing where we believe that valuations are reasonably aligned with potential fundamentals. We believe that Alphabet and Meta have well-proven use cases for AI and are investing in capex with their eyes wide open – they can adjust their investment plans as their businesses evolve. Microsoft probably has the best platform on the planet for exploiting AI whether through Azure demand or its own services. Your semi-conductor investments may not have Nvidia's direct exposure to AI but trade on more attractive multiples and are likely to benefit from AI demand nevertheless, alongside other aspects of secular digitalization.

Your portfolio retains a substantial allocation to growth companies and for the reasons articulated above we do not feel acute pressure to reduce the allocation today. However, the benchmark indices have indeed become increasingly concentrated in a few names and we believe that it is an advantage of benchmark agnosticism that your portfolio can retain a fairly constant level of diversification over time. As growth stock valuations are fuller today than they have been in recent years, we have looked to them as a source of funding as we maintain the overall shape of the portfolio. For example, this year we initiated a position in Thermo Fisher, a leading manufacturer of health care diagnostic equipment. This market suffered a pullback in the last few quarters as the slowdown in the venture capital segment restrained capital investment in biotech but we fully expect the secular demand for health care research to be supportive over time.

More generally we have a preference for reacting to events over crystal ball gazing as forecasting the future is more difficult than dissecting the past. In a year in which elections feature across much of the world, that preference remains. We reacted to the political ructions in France, unresolved at the time of writing, by increasing the portfolio's investment in LVMH. LVMH is a well-run global business, built to run on a longer time frame than the electoral cycle. We have not traded your portfolio in preparation for the forthcoming U.S. presidential election. The election of Donald Trump in 2016 caused sparks in the U.S. market – more cyclical businesses were boosted by the realization that a Trump administration was unlikely to dispense fiscal medicine. However, this time around Trump is more of a known quantity and a Trump victory would be less of a surprise to the markets. We remain alert for opportunities to invest in high quality businesses at attractive prices when events take their inherently unpredictable turns.

Portfolio weights as a percentage of equity for the securities mentioned: LVMH (1.6%), Thermo Fisher (1.0%), Exxon (0.0%), Alphabet (4.7%), Meta (4.0%), Nvidia (0.0%), Apple (5.0%), Microsoft (6.7%).

[1] All numbers quoted here relate to medians for the top 10. Fundamental returns are calculated as dividend income and EPS growth in the reporting currency. We proxy fundamental return expectations using dividend yield plus consensus earnings growth using IBES estimates. Price to earnings are calculated using a constant 12-month window by blending a mix of FY1 and FY2 estimates.

QUARTERLY INVESTMENT REVIEW

PRODUCT OVERVIEW

The GMO Quality Trust seeks to generate total return by investing primarily in equities the Focused Equity team believes to be of high quality.

The team believes that companies with established track records of historical profitability and strong fundamentals – high quality companies – are able to outgrow the average company over time and are therefore worth a premium price. The Trust's disciplined approach uses both quantitative and fundamental techniques to assess the relative quality and valuation of global companies and aims to exploit a long-term investment horizon while withstanding short-term volatility.

IMPORTANT INFORMATION

Benchmark(s): The MSCI World Index (MSCI Standard Index Series, net of withholding tax) is an independently maintained and widely published index comprised of global developed markets. MSCI data may not be reproduced or used for any other purpose. MSCI provides no warranties, has not prepared or approved this report, and has no liability hereunder.

The Trust accepts investments from wholesale investors only. Retail investors are not able to directly invest in the Trust but may gain exposure to the Trusts by investing with certain investor directed portfolio services, master trusts, wrap accounts or custodians ("services"). GMO Australia Limited, GMO LLC, and their affiliates, do not guarantee the performance of the Trust or the repayment of an investor's capital. This information is of a general nature only and is not advice. It does not take into account the objectives, financial situation or needs of any specific investor. The offer to invest in the Trust for wholesale investors is contained in the current information memorandum. A Product Disclosure Statement ("PDS") is also available solely for use by retail investors gaining exposure to the Trust through a service. A Target Market Determination (TMD) has also been prepared for the Trust. The information memorandum PDS and TMD can be obtained by visiting our website www.gmo.com. Investors should read the information memorandum or PDS, consider their own circumstances, and obtain their own advice before making an investment decision.

ABOUT GMO

Founded in 1977, GMO is a global asset manager committed to delivering superior performance and advice to our clients. We are privately owned, which allows us to singularly focus on our sole business – achieving outstanding long-term client investment outcomes. Offering multi-asset, equity, fixed income, and alternative strategies, we invest with a long-term, valuation-based philosophical approach.

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