INTERNATIONAL QUALITY STRATEGY

Quarterly Investment Review

ANNUALIZED RETURNS (USD, %) (QUARTER-END)

	Quarter-End	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception
International Quality Strategy (net)	-6.53	-6.53	6.30	-	-	-	2.17
International Quality Strategy (gross)	-6.39	-6.39	6.94	-	-	-	2.79
MSCI World ex USA	-0.94	-0.94	22.99	-	-	-	18.71
Value Add	-5.60	-5.60	-16.69	-	-	-	-16.54

MAJOR PERFORMANCE DRIVERS

Equity markets were weak and the International Quality portfolio lagged the broader markets for the first quarter.

We have written in these reports on many occasions about the portfolio’s bear market bias and consequent tendency to hold up better than the broader market during a sell-off. We believe that the bear market bias remains in place looking forward and therefore owe you an explanation as to why it didn’t work as expected this quarter.

Two ideas have bludgeoned their way through equity markets this year. The first is the reality of a more muscular US foreign policy stance, as evidenced by operations in Venezuela and Iran, increasing geopolitical and economic tail risk. The second is rising concern over AI’s potential to disrupt existing businesses.

Energy stocks were the stand-out beneficiaries of the first, the gyration in geopolitics, echoing the move in the oil price and beating the broader markets by an extraordinary 40 points over the quarter. The term “extraordinary” is not used lightly here; looking at quarterly global GICS sector relative returns over the last three decades, this was the biggest outperformance by any sector in any quarter. The only other data point that came close, also from the energy sector, was when Russia began its invasion of Ukraine in 2022.

Typically, we have made limited investments in the energy sector as differentiated business models with barriers to entry have been hard to find there. Although the sector inevitably has its moment in the sunshine every now and then, energy has not usually been especially impactful due to its low weight in the index. Nor has energy been a particularly reliable place to hide in the stock market. But this quarter energy was the best possible hedge for reasons that are obvious in hindsight.

Elevated energy prices have been strongly associated in the past with economic stress. Rising costs of refueling vehicles may be the most visible manifestation of this, causing inflation measures to rise and outcompeting consumer wallet share for other purchases, but energy is at the heart of the economy. Rising crude prices have knock-on effects for pricing of all forms of energy, and all economic activities rely on energy to a greater or lesser degree. Quality stocks might normally be expected to be oblique beneficiaries of rising energy costs; their higher margins imply lower input costs, buttressing them against inflation, while their greater resilience is helpful in the face of recessionary risk.

However, concerns around AI disruption, already simmering in the second half of 2025, boiled over in 2026, potentially changing the market’s normal reaction to stress. In one intense week in February, markets worried first over the impact of Claude’s Cowork product on data and workflow businesses. The next day they fretted over an AI tool’s impact on wealth management companies. Then came the potential disintermediation of advisors in large scale commercial real estate deals by agentic AI. To cap it all, a former karaoke company with an AI product shook the shares of logistics companies.

RISKS

Risks associated with investing in the Strategy may include: (1) Market Risk - Equities: the market price of equities may decline due to factors affecting the issuer, its industries, or the economy and equity markets generally. Declines in stock market prices generally are likely to reduce the net asset value of the Fund's shares; (2) Management and Operational Risk: the risk that GMO's investment techniques will fail to produce desired results, including annualized returns and annualized volatility; and (3) Non-U.S. Investment Risk: the market prices of many non-U.S. securities (particularly of companies tied economically to emerging countries) fluctuate more than those of U.S. securities. Many non-U.S. markets (particularly emerging markets) are less stable, smaller, less liquid, and less regulated than U.S. markets, and the cost of trading in those markets often is higher than it is in U.S. markets. This is not a complete list of risks associated with investing in the Strategy. Please contact GMO for more information.

Composite Inception Date: 31-Oct-24

Performance Returns: Performance for the year of inception is less than a full calendar year. 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 predictive of future performance.** Net returns are presented after the deduction of a model advisory fee and incentive fee 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. Fees paid by accounts within the composite may be higher or lower than the model fees used. Gross returns are presented gross of management fees and any incentive fees if applicable. These returns include transaction costs, commissions, withholding taxes on foreign income and capital gains and include the reinvestment of dividends and other income, as applicable. If management and incentive fees were deducted performance would be lower. For example, if, before fees, the strategy were to achieve a 10% annual rate of return above its hurdle rate each year for ten years, and an annual advisory fee of 1% and incentive fee of 20% of net returns above the hurdle rate were charged during that period, the resulting average annual net return (after the deduction of management and incentive fees) would be approximately 7.20%. **GMO LLC claims compliance with the Global Investment Performance Standards (GIPS®). A Global Investment Performance Standards (GIPS®) Composite Report is available at www.gmo.com by clicking the GIPS® Composite Report link in the documents section of the strategy page. GIPS® is a registered trademark owned by CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Actual fees are disclosed in Part 2 of GMO's Form ADV and are also available in each strategy’s Composite Report.** The portfolio is actively-managed, is not managed relative to a benchmark and uses an index for performance comparison purposes only and, where applicable, to compute a performance fee.

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MAJOR PERFORMANCE DRIVERS CONT.

Software companies have been hit hard through this. Since the middle of 2025, the Software and Services group of the MSCI World index (excluding hyperscalers) has underperformed the broader markets by 50 points in relative terms, with 20 points coming in Q1. Based on the current relative valuation of software stocks – at generational lows – the market has concluded that AI's arrival means that software stocks are no longer special businesses.

The financial services industry is never slow to capitalize on investors' hopes and fears, often with a cute acronym that captures the zeitgeist. Thus appeared the concept of "HALO" businesses – Heavy Assets Low Obsolescence. The idea being brokered was that at this time of technology-related uncertainty, simple businesses backed by hard assets are increasingly desirable. Instead of the more typical trade into healthcare, staples and conservative technology in the face of tougher conditions, sectors backed by hard assets excelled; in materials, real estate and utilities at the sector level, but also traditional telecoms companies and capital goods businesses.

In terms of returns, then, it was an unusual quarter in which the normal places to hide did not perform their usual role.

Should we be changing our strategy? We believe not. These hard asset businesses have not proved rich seams of high return on capital businesses with barriers to entry in the past. On the contrary: low-growth telecoms, real estate and utility companies require significant leverage to generate even acceptable returns on equity, while these hard assets have usually tracked toward the lower end of the market in terms of fundamental returns (the component of your total return generated by earnings growth and dividends paid out). It is not that hard assets are a bad thing per se, but nor are they a good thing unless accompanied by competitive advantages that protect return on capital (e.g., in the case of TSMC). Without that lens, we believe that a portfolio focused on these areas is doomed to achieve those lower fundamental returns, albeit masked by the kinds of fluctuation in valuation that we have seen this quarter.

Instead, we believe that compounding fundamental returns are more likely to be found by focusing on businesses with barriers to entry and capital discipline. After this difficult quarter, and indeed some relative weakness in the latter half of last year, there may also be valuation-related kickers available too. We note that several of our areas of focus are trading on undemanding multiples relative to recent decades.

Parts of the healthcare sector are currently trading at steep discounts. The portfolio's investments in healthcare companies across pharmaceuticals, medical devices, life sciences equipment, and diagnostics bring exposure to an area in which scientific innovation meets strong societal demand. As a result, healthcare has delivered competitive earnings growth in recent years, but you wouldn't know it looking at valuations.

Consumer staples also touched long-term low relative valuations at the end of 2025. Unilever's progress toward more focused personal care and household goods continued apace with the disposal of their remaining food business to McCormick, at what appears to be a good price. Spirits giant Diageo now has an aggressive turnaround specialist in the driving seat, and we hope for better times ahead.

Perhaps most intriguing is the opportunity signaled above in software. Investors worry about the consequences of low-cost code generation, new capabilities from generative AI, and the more nebulous threat of Artificial General Intelligence (the point at which AI can do more or less everything better, faster, and more cheaply than humans).

The value of a software business has always derived from its ability to offer value to customers relative to alternative solutions. That was true before AI and remains true today. For some software businesses, the emergence of AI has altered the attractiveness of their offering--for example, an LLM-powered chatbot may be able to do a better job of knowledge management than a traditional software package. But for software businesses with barriers to entry based on the superiority of their offering (e.g., proprietary data, robust security, mission critical importance, etc.) we suspect that the benefits of AI will be democratically distributed rather than concentrated in Silicon Valley. All companies are exploiting the benefits of lower-cost coding, just as all companies in the software space are rushing to use AI to augment their offerings. Over the next few years, the exuberant new AI app companies will have to compete head to head with the incumbents that currently serve the needs of the corporate consumers of software. We believe it is a mistake to write off the incumbents as they have some unfair advantages in their existing relationships of trust, the maturity of their understanding of their customers' needs, and their opportunities to parley their customer data head start into AI solutions. History suggests that powerful opportunities can arise when the market arrives at a firm conclusion on an issue that is steeped in uncertainty.

We believe that this is one of those situations. Over the quarter, we took steps both to accumulate and to diversify the portfolio's software allocation (by our broader definition than GICS). We initiated positions in Experian, the largest of the credit bureaus and a provider of data and software, mainly to financial institutions, and added to our existing software allocations including Constellation Software, the owner of more than a thousand applications for small businesses and public clients. All have seen their share prices dented by concerns over AI-related disintermediation. All have, we believe, barriers to entry that will equip them well in years to come.

More generally, we see a rich opportunity set, perhaps the best since the onset of the pandemic, another moment when uncertainty created the opportunity to buy shares in some world class companies at interesting prices. We believe that the portfolio's defensiveness remains in place, despite this quarter's returns, and that some of the valuations that have arisen offer the possibility of strong relative returns in future.

Portfolio weights as a percentage of equity for the securities mentioned are as follows: TSMC (5.2%), Unilever (3.4%), McCormick (0%), Diageo (2.4%), Experian (1.1%), Constellation Software (1.1%).

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PRODUCT OVERVIEW

The GMO International Quality Strategy seeks to generate total return by investing primarily in non-U.S. 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 Strategy's disciplined approach uses both quantitative and fundamental techniques to assess the relative quality and valuation of non-U.S. companies and aims to exploit a long-term investment horizon while withstanding short-term volatility.

IMPORTANT INFORMATION

Comparator Index(es): The MSCI World ex-USA Index (MSCI Standard Index Series, net of withholding tax) is an independently maintained and widely published index comprised of global developed markets, excluding the United States. 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 above information is based on a representative account in the Strategy selected because it has the fewest restrictions and best represents the implementation of the Strategy.

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