

# QUARTERLY INVESTMENT REVIEW

## Quality Cyclical Strategy

### RETURNS (%) (LOCAL)

	Cumulative (%)		Annualized (%)				
	QTD	YTD	1 Year	3 Years	5 Years	10 Years	ITD
Net of Fees (Composite)	11.06	22.61	22.61	7.16	–	–	16.69
Gross of Fees (Composite)	11.20	23.20	23.20	7.68	–	–	17.25
MSCI ACWI	11.03	22.20	22.20	5.75	–	–	13.26
Value Added (vs. MSCI ACWI)	0.03	0.41	0.41	1.41	–	–	+3.43

### Major Performance Drivers

2023 was quite a year in the markets. The Quality Cyclical portfolio delivered robust performance as inflation subsided alongside economic concerns and investors processed positive developments on various fronts.

Returns to Technology investors were extraordinary. The NASDAQ 100 returned 54%, beating every major geographic index worldwide. Returns to investors outside of Technology were more normal (for a good year) at 15.8% for MSCI ACWI ex Tech.

Although staying ahead of changing technology is an important feature for many of the better cyclical businesses, the portfolio has a structurally lower allocation to GICS Information Technology. We have no particular beef with the large tech companies (with allocations to Alphabet and Meta), but the portfolio is largely predicated on a different type of investment. In this context, we believe that the portfolio's return, ahead of the MSCI ACWI benchmark for the year, was a decent outcome. For the quarter, the portfolio finished ahead of the MSCI ACWI benchmark.

The highest returning parts of the portfolio this year were Advertising, Travel, and Semi-Conductors. In Advertising, Meta returned a whopping 195%, recovering the majority of the ground lost during the vicious sell-off in 2022. Your travel holdings performed well across the board, with the continued European demand buoying Ryanair and Booking Holdings. We used the market's focus here to take some profits. We reestablished your portfolio's allocation to semi-conductors in 2022 as investors struggled to disentangle still excellent secular prospects from post-pandemic supply chain normalization and an inventory cycle. While memory chip specialist Micron and semi-cap equipment supplier Lam Research are perhaps through the worst and delivered strong returns over the year, the analog part of the market continues to suffer from a build-up of stock, and we established a position in Texas Instruments.

There were other positions that contributed notably to returns, coincidentally weighted toward the Spanish-speaking world. Mexican retailing and Coca-Cola bottling conglomerate FEMSA benefitted from determined execution of a simplification plan, offloading certain non-core assets with market-pleasing speed while showing operating momentum. Grupo Mexico rebounded as copper prices stabilized but was, like FEMSA, carried along by the improving purchasing power of the peso. In Europe, Inditex continues to grow well having lapped reopening benefits but continuing to reap efficiencies in terms of e-commerce and reduced store footprint gained during the lockdown period.

Inception Date: 3-Apr-20

**Risks:** Risks associated with investing in the Strategy may include Market Risk - Equities, Management and Operational Risk, Focused Investment Risk, Non-U.S. Investment Risk, and Currency Risk. 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](http://www.gmo.com).

**Performance Returns:** 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. **GMO LLC claims compliance with the Global Investment Performance Standards (GIPS®).** A Global Investment Performance Standards (GIPS®) Composite Report is available on [GMO.com](http://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 not managed relative to a benchmark. References to an index are for informational purposes only. 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%.

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## Major Performance Drivers Cont.

On the other side of the ledger, your Energy and China holdings offered weak returns. Energy prices were a little soft and so were the stocks after a powerful run the prior year. With regard to China, we have written in previous quarters how we understand in retrospect why its reopening differed from the West and came with a desire for balance sheet repair. We believe that the part of your China exposure aimed at leisure pursuits in Macao remains well positioned and added modestly to Las Vegas Sands in the last quarter. However, we reduced your exposure to large cap China Technology where our confidence in management, and in the government's support of management, has incrementally diminished.

The weakest returns, however, were found amongst your Clean Energy holdings. We believe that there are inexorable needs related to climate change that are driving revenue trends in Clean Energy. At the same time one can observe that the potential growth here attracts capital investment while sentiment to the stocks can be unstable. We have oriented your investment in Clean Energy to a handful of companies with barriers to entry. Darling Ingredients and Neste have built renewable energy businesses with locks on their supply of inputs making them tough competitors, while Green Plains has technology that potentially makes them the lowest-cost producer of various corn-derived products alongside ethanol. These positions detracted from portfolio returns while holding up better than the average Clean Energy stock (not an impressive claim). We used the negative sentiment toward Clean Energy to initiate a position in SolarEdge, one of two makers of premium invertors for solar energy generation. SolarEdge was plagued by inventory management issues in the second half. We expect these concerns to shrink in the rear-view mirror over time and hope that we acquired stock on your behalf at good prices in 2023.

As we look to the year ahead, we do not have a specific macroeconomic environment in mind. The portfolio aims to invest across a range of the best quality cyclical businesses. We believe that your portfolio companies invest productively through the cycle and generate stronger fundamental returns than the average business. They often trade at relatively undemanding prices, likely because investors are deterred by their greater-than-average cyclicalities. This greater cyclicalities can be advantageous for the portfolio in two ways. First, the companies in the portfolio are generally better able to exploit the cycle than their peers, bringing opportunities to strengthen their share or strategy when times are more challenging. Second, from a portfolio management perspective, the greater short-term volatility can bring more opportunities for rebalancing into out-of-favor areas. Over the longer-term, however, we expect the portfolio's return to be driven by superior "through the cycle" fundamentals.

Portfolio weights, as a percent of equity, for the positions mentioned were: Meta (2.6%), Ryanair (3.5%), Booking Holdings (3.7%), Micron (3.0%), Lam Research (2.5%), Texas Instruments (2.3%), FEMSA (4.1%), Inditex (3.4%), Las Vegas Sands (2.7%), Darling Ingredients (2.4%), Neste (1.7%), Green Plains (0.7%), and SolarEdge (1.4%).

## PRODUCT OVERVIEW

The GMO Quality Cyclical Strategy seeks to generate total return by investing in leading cyclical businesses. Leveraging their long-term disciplined approach to investing in high quality companies, GMO's Focused Equity team selects from a high-conviction universe of cyclical businesses that are of higher quality than their industry peers. The team believes that quality cyclical businesses are structurally underappreciated by the market and that times of elevated stress can create extraordinary opportunities in quality cyclical.

## IMPORTANT INFORMATION

**Comparator Index(es):** The MSCI ACWI (All Country World) Index (MSCI Standard Index Series, net of withholding tax) is an independently maintained and widely published index comprised of global developed and emerging 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. Please visit <https://www.gmo.com/americas/benchmark-disclaimers/> to review the complete benchmark disclaimer notice.

**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.**

## 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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