

# QUARTERLY INVESTMENT REVIEW

## Quality Cyclical Strategy

### Performance returns (USD)

ANNUALIZED RETURNS (QUARTER-END)	Quarter-End	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception
Quality Cyclical Strategy (net)	-3.14	3.98	10.69	3.39	–	–	15.64
Quality Cyclical Strategy (gross)	-3.02	4.23	11.23	3.89	–	–	16.19
MSCI ACWI	2.92	11.30	19.38	5.43	–	–	14.49
Value Add	-6.06	-7.32	-8.68	-2.04	–	–	+1.14

### MAJOR PERFORMANCE DRIVERS

The Quality Cyclical portfolio lagged well behind the MSCI ACWI index this quarter as market breadth narrowed to a limited number of names with exposure to AI.

Market concentration proved tough to navigate – the median stock in the MSCI ACWI index fell by -1.7%, lagging the broader market by more than 4%. Prior to the last year or so this had happened in only two calendar quarters this millennium.

About one-third of index stocks outperformed the broader markets, and a similar proportion of your portfolio did the same. However, the entirety of the index return could be accounted for by just six large AI-related names: Nvidia, Apple, Microsoft, Alphabet, Taiwan Semi, and Broadcom. Your portfolio, with its emphasis on more cyclical businesses, has limited exposure to this group via Alphabet, which was the portfolio's best performer and which made Advertising the strongest basket of exposure. The portfolio's AI adjacencies in Tech Hardware – Micron and Lam Research – delivered returns around the 10% mark while analog semiconductor manufacturer Texas Instruments performed well as activists lobby for a change in capital allocation. Booking Holdings delivered strong returns as investment in payments and other areas over the last few years have cemented the company's position in digital travel infrastructure.

At the other end of the spectrum the portfolio's allocation to Clean Energy stocks was by far the most challenged. Your holdings here bring exposure to biofuels, via Darling Ingredients, Neste, and Green Plains, and to solar, via SolarEdge and Enphase. All these holdings fell by double digits.

Enphase and SolarEdge sell into the residential and commercial (as opposed to utility scale) solar equipment markets, principally in Europe and North America. Elevated levels of inventory following the surge in distributor demand in 2022 and 2023 has left the industry with a revenue problem; the fall in SolarEdge's stock has been notable. When its channels are full of stock, there is little a company can do to boost sales without destroying margins. The most rosy take is that when inventories clear, sales will resume. We believe installation activity continues at a reasonable pace. Our instincts are to add during a downturn; we initiated a position in Enphase last quarter to diversify your solar risk but the result to date has been poor. However, we believe the chance of a rebound from the pair remains strong.

Composite Inception Date: 30-Apr-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 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%. The portfolio is not managed relative to a benchmark. References to an index are for informational purposes only.

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## MAJOR PERFORMANCE DRIVERS CONT.

The biofuels companies have distinctive exposures but shared pain from weakness in the pricing of environmental attributes in the U.S. In the run-up to the presidential election there is an understandable reluctance to be seen as stoking fuel price inflation but we expect regulatory action to normalize the supply-demand picture in due course as it has in the past. We added to Neste in the quarter – the newly appointed CEO will focus on increasing production going forward.

Other weak exposures came from Autos and China. CarMax remains constrained by falling used car sales – as the #1 company, it cannot escape industry trends – although it has performed well since quarter-end on hopes that falling prices will give the overall market a boost. The China bucket is now focussed on Macau, alongside LVMH and Otis. We may reclassify the latter two as they are driven increasingly by factors outside of China.

We established a new position in Industrials in the quarter through Knorr-Bremse, the German rail and truck braking specialist. Knorr-Bremse appears to be emerging from several years of post IPO management evolution with a clearer strategy to leverage its strong position in the century-old rail components duopoly it shares with Wabtec of the U.S.

We added to U.K. house builder Persimmon and kitchen specialist Howden Joinery. The new U.K. government has promised legislation to ease the planning logjam in the U.K. and the possibility of a generational boost to house building seems significant. Overall, the purchases were funded largely by a liquidation in Nutrien and profit taking in Micron, Alphabet, and Meta.

Diversification across your portfolio has remained approximately constant at the stock level since inception, and in terms of the exposure to different buckets of stocks, diversification has increased. The MSCI ACWI, by contrast, has seen a distinct increase in concentration, to somewhat unusual levels. How long this will persist is unknowable but we would expect a broader market to be more conducive to our style of investing. Your portfolio remains allocated to higher-quality cyclical businesses – we believe they are able to deploy their capital more productively across the cycle than the average business, and this will ultimately drive returns.

Portfolio weights for the securities mentioned: Nvidia (0.0%), Apple (0.0%), Microsoft (0.0%), Alphabet (3.0%), Taiwan Semi (0.0%), Broadcom (0.0%), Darling Ingredients (1.8%), Neste (1.5%), Green Plains (0.4%), SolarEdge, (0.4%), Enphase (0.4%), CarMax (1.9%), LVMH (2.2%), Otis (1.9%), Knorr-Bremse (0.6%), Persimmon (1.6%), Howden Joinery (0.9%), Nutrien (0.0%), Micron (3.6%).

# QUARTERLY INVESTMENT REVIEW

## 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 it believes are of higher quality than their industry peers. These quality cyclical businesses tend to be structurally underappreciated by the market, which at times of elevated stress can create attractive investment opportunities.

## 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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