QUARTERLY INVESTMENT REVIEW

Quality Strategy

RETURNS (%) (LOCAL)

	Cumulative (%)		Annualized (%)				
	QTD	*YTD*	*1 Year*	*3 Years*	*5 Years*	*10 Years*	*ITD*
Net of Fees (Composite)	8.60	8.60	-2.06	17.81	12.74	12.71	9.23
Gross of Fees (Composite)	8.77	8.77	-1.45	18.52	13.38	13.31	9.77
S&P 500	7.50	7.50	-7.73	18.62	11.19	12.24	9.07
MSCI World	7.73	7.73	-7.02	16.41	8.02	8.85	7.21
Value Added (vs. S&P 500)	1.10	1.10	5.67	-0.80	1.55	0.46	0.15
Value Added (vs. MSCI World)	0.87	0.87	4.97	1.40	4.72	3.85	2.02

Major Performance Drivers

Despite shockwaves from the collapse of Silicon Valley Bank and the subsequent fire sale of Credit Suisse in March, the impact of resurgent Growth stocks was more material - equity markets delivered positive returns this quarter with the S&P 500 and MSCI World indices up 7.50% and 7.73%, respectively. The Quality portfolio outperformed the broader markets.

There were three main drivers. First, the Quality portfolio tends to work best when investors' nerves are being tested. The malaise in the banking sector created just such a market. Although underweight in financials, your portfolio owns three credit bearing institutions: American Express, U.S. Bancorp, and Wells Fargo. Of these, American Express was relatively insulated from events. While both banks are well capitalized, U.S. Bancorp has more risk from rising deposit rates and Wells Fargo seems likely to be a beneficiary of deposit flight to the largest financial institutions. We made a modest trade out of U.S. Bancorp into Wells Fargo but believe that the shares of both banks are quite compellingly priced today. Second, the portfolio's exposure to China was helpful, particularly at the start of the year. After the country's long period under lockdown, the Chinese economy has jumped back into action, without the inflationary pressure seen elsewhere. Your portfolio has exposure to the Chinese economy via investments in multinationals, e.g., Otis, which has a significant elevator business in the country, or LVMH, which generates a substantial portion of revenues from Chinese buyers, whether at home or when travelling overseas and had an outstanding quarter in terms of revenues. Your portfolio also has some exposure to improving China-linked supply chains, most obviously through Apple, but also selling into those supply chains via the semi-conductor industry where geo-political considerations weigh on valuations. Your most direct exposure to domestic China is a smallish position in Alibaba – we believe it to be attractively priced and the reorganization in six units announced this quarter seemed a positive development.

The third driver of portfolio returns came from a single portfolio position, Meta. Last year, growth stocks suffered in the face of rising inflation and rising interest rates. We have written how we came to the conclusion that rising rates alone could not explain their poor performance, and we have had a bias to rebalancing into the Quality Growth part of the portfolio as these securities become more attractively priced. This led us to add to positions such as Salesforce, Adobe, and Alphabet, and to initiate positions in Intuitive Surgical and Amazon. However, the most impactful purchase so far has been Meta.

Inception Date: 6-Feb-04

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Major Performance Drivers Cont.

Meta has been accident-prone in recent years and when the company's announcement of heavy investments collided with a weak market in digital advertising, Meta's stock began to trade on the single-digit multiple of a dying steel mill. Our analysis suggested that the very investments weighing so heavily on the stock were likely to enhance Meta's margins in time. Much of the spending is being directed toward AI that is materially improving Meta's ad targeting (which had been compromised by changes to Apple's privacy policies). Furthermore, Meta's scale allows it to make investments that smaller peers just cannot contemplate, enhancing the company's competitive advantage in digital advertising. As a result, we purchased stock around $100 a share in November. Meta's earnings call at the start of February changed market perception. In particular, the emphasis on cost-cutting reassured investors that the company is mindful of the profit imperative on its investments and by the quarter end the stock traded above $200.

It wasn't all plain sailing, however. Your portfolio's exposure to Health Care hindered returns. Cigna, for example, had a torrid quarter – Cigna is most exposed of the managed health companies to any tightening of constraints on drug pricing and this may have weighed on returns, though we suspect an element of profit taking was also present after a strong 2022, at least compared to other equities. Fortunately, we had trimmed Health Care stocks like Cigna in the second half of 2022, funding the growth stock additions mentioned above, which was a key enabler for the portfolio's ability to outperform both in 2022 and Q1 2023.

We continue to believe that your portfolio remains a relative safe harbor in the choppy waters of equity investing. Your portfolio currently has a beta of around 0.9 and ought to offer continued protection should the storm in the banking sector develop into something more sinister.
Portfolio weights, as a percent of equity, for the positions mentioned were: American Express (1.0%), U.S. Bancorp (1.8%), Wells Fargo (2.2%), Otis (2.2%), LVMH (1.6%), Apple (4.0%), Alibaba (1.4%), Meta (3.5%), Salesforce (2.2%), Adobe (2.2%), Alphabet (3.4%), Intuitive Surgical (1.2%), Amazon (3.8%), and Cigna (0.8%).

PRODUCT OVERVIEW

The GMO Quality Strategy seeks to deliver total return by investing in equities of companies that the GMO Focused Equity team believes to be of high quality.

IMPORTANT INFORMATION

Benchmark(s): The S&P 500 Index is an independently maintained and widely published index comprised of U.S. large capitalization stocks. S&P does not guarantee the accuracy, adequacy, completeness or availability of any data or information and is not responsible for any errors or omissions from the use of such data or information. Reproduction of the data or information in any form is prohibited except with the prior written permission of S&P or its third party licensors.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 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.