GMO

YEAR-END LETTER FOR 2025

Focused Equity Team: International Quality Strategy

Dear Client,

With another year of market ebullience behind us, January seems a good time to take stock and share our thoughts on the portfolio for the years ahead.

The GMO International Quality Strategy returned 16.9% (net) in 2025, its first full calendar year.

The strategy was set up in part for investors wanting to diversify an increasingly concentrated bet on growth via U.S. market exposure. We have put your capital to work in a range of high-quality businesses, all domiciled outside of the 50 states. These businesses are leaders in their fields and in many cases, #1 players in the U.S., too.

The strategy delivered in two ways this year, but disappointed through a third lens. We will discuss each in turn.

As a diversification tool, International Quality performed as you might have hoped. When the Magnificent 7 took a tumble in the early part of the year, the strategy held up dramatically better. At one point in April, there was a 25 percentage point year-to-date return differential in International Quality's favor. And though in the end it was another good year for the U.S. tech big dogs, with the Mag 7 up more than 25%, this portfolio of exclusively international securities generated a strong absolute return that was close to that of the S&P 500.

Also reassuringly, the International Quality Strategy got the return it deserved in aggregate in 2025; the return achieved closely matched the fundamental return generated by the companies in the portfolio (as measured by growth in earnings and dividends received over the period). The strategy aims to generate strong returns by hitching a ride on the coattails of quality companies—over the long term, shareholder returns converge with fundamental returns. This year, the two converged over a single calendar year. As a result, the strategy's aggregate valuation at 2 times earnings, which we judged attractive at the start of the year, remains roughly unchanged.

What about the disappointment? You certainly could have made better returns elsewhere in international markets. The MSCI EAFE index was up 31.2% for the year. The challenge for international quality investing was evident: the best returns were found in lower-quality areas and quality investors generally struggled in a relative sense. Of the only three GICS sectors that outperformed the market, the strongest by far were financials and utilities. Both of these areas rely on leverage to juice returns, and we have traditionally not had much joy seeking competitively advantaged businesses there. The third winning sector was industrials, where the strategy does have an allocation and our selections outperformed comfortably. The best-returning holdings came from locomotion—between countries by airplane in the case of Ryanair and Safran, and between floors via elevators in the case of Kone.

The sectors where we traditionally invest—technology, healthcare, and consumer—lagged in international markets this year, and we are optimistic that there are opportunities brewing in each of these areas.

Technology

AI was front of mind for technology investors. The strategy's AI exposure is mainly via semiconductor companies (the largely U.S.-listed AI hyperscaler giants are out of scope here, and we have found Chinese AI hard to justify on quality grounds). The semis had a great year as the build-out of data centers implied continued voracious demand. We benefited from exposure to TSMC as it manufactured the AI chips used by the hyperscalers, and in turn, gained from exposure to two of TSMC's suppliers—ASML and Tokyo Electron. Both provide critical manufacturing equipment that is indispensable to producing the advanced semiconductors that underpin today's AI compute.

The strategy's remaining tech holdings come from software, and this was a different story. In thinking about the quality implications of AI, it seems there will be winners in AI applications that are yet to emerge, and the share prices of software companies around the world reflect some level of worry about who gets displaced. Picking start-ups is beyond our remit, but we do need to assess the ability of existing software companies to compete, or perhaps more importantly, deter potential new entrants. We reason that the proximity of a software company's product to critical corporate data (think: systems of record) will likely become a key determinant of AI success in the years ahead. Why? To use AI effectively, corporations need to get their data in the cloud and in the right format. This is no small task. We expect that: a) companies are unlikely to want to add further complexity by switching software providers at the same time, and b) the time scale involved (years) means that the incumbents will have plenty of time to perfect their agentic offerings.

Travel software leader Amadeus IT, listed in Spain, is an instructive example. To simplify, Amadeus does three things: it is the leading provider of IT to airlines, it sits between the airlines and the buyers of certain types of airline tickets, and it is modernizing reservations for some of the largest hotel chains. At first blush, it sounds like AI could upend the airline ticket distribution business as AI-driven travel planners become more important, but in our view, the company's transactional expertise makes it more likely to be a partner of AI than disintermediated by it. Amadeus's other software offerings are so core to their clients that they seem rather hard to dislodge. But like other enterprise software, Amadeus' valuation has softened and we believe that the potential return on offer is compelling.

Healthcare

Healthcare spending as a share of GDP has been rising materially for at least 50 years—not just in the U.S., but across the OECD countries for which we have good data. It might be convenient to explain that away as a rapacious industry squeezing its consumers, but the reality is less sensational, though warmer and fuzzier. Healthcare spending has risen while the prices of many consumption items have stagnated because society places a high value on healthcare, and the demand for innovative medical solutions is very real.

That may sound like a good setup, and it is, but investing in healthcare can be a messy affair with political, scientific, operational, epidemiological, and other issues frequently obscuring the bigger picture.

Most of the strategy's healthcare holdings delivered at least decent absolute returns, driven by fundamentals, and still finished the year attractively priced. The clear exception was Novo Nordisk, which had a year to forget. Novo Nordisk and Eli Lilly have slugged it out in diabetes treatment for a century or so, but more recently, the field of play moved to GLP-1 drugs for weight loss. This year, Lilly moved ahead on the next generation of injectables while Novo's shares sagged. We believe that Novo's position in GLP-1s—e.g., its oral offering—and the likelihood that competitiveness between the two companies will ebb and flow in the future comfortably underpin Novo Nordisk's current modest valuation.

Consumer

Consumer companies, especially in the traditionally more defensive consumer staples sector, are trading close to decade-low multiples. For many years, consumer staples were, ahem, staples of quality portfolios as they were able to convert relatively modest revenue growth into strong fundamental returns by virtue of their high returns on capital. They could thereby compound nicely over time, while offering a defensive return profile.

The aftereffects of the pandemic are still ricocheting through the sector. Companies like Unilever and Nestle were squeezed by rising commodity prices and underinvested in their brands to try to maintain margins, while the resulting strains on the cost of living drove increased share for the hard discounters that emphasize private-label products. More impactfully for the portfolio, drinks companies' sales accelerated during the "revenge partying" phase after lockdowns ended, only for them to be caught off guard when behavior normalized and sales began a still-ongoing contraction. Diageo is the largest and best distributed spirits company on the planet. Investors fret that the drivers of lower revenues are secular rather than cyclical in nature. Given that the stock only traded below its current multiple for a brief period in the depths of the Global Financial Crisis, we suspect that this scenario is baked into the share price. We are inclined to believe that this is more of a cyclical story and that Diageo's strengths will be better appreciated in the future, but time will tell.

We expect the strong businesses in your portfolio to continue to generate returns on your capital going forward. No doubt their share prices will lurch this way and that as they do, and we will seek to rebalance your portfolio to the areas where the combination of valuation and company quality is most compelling, endeavoring to understand what is ephemeral and what is significant.

We believe that the strategy is well-positioned for the quarters and years ahead. We expect the return stream to offer diversification versus growth-focused U.S. equities and provide exposure to several interesting areas of potential returns. If we can build a portfolio of companies deploying capital effectively, with the reassurance that their valuations are under watchful review, we hope that the GMO International Quality Strategy can continue to play a helpful role in your overall portfolio.

As ever, we thank you for the trust you have placed in us to manage your assets.

Sincerely,

Tom Hancock
Head of Focused Equity

Anthony Hene
Portfolio Manager

Ty Cobb
Portfolio Manager

Annualized Returns as of 12/31/2025 (Net, USD)	*Inception*	*1-Year*	*3-Year*	*5-Year*	*10-Year*	*ITD*
International Quality Composite	10/31/2024	16.89%	N/A	N/A	N/A	8.76%
MSCI World ex USA		31.85%	N/A	N/A	N/A	24.09%

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 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.

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