

QUALITY INVESTMENT FUND

Year Ending December 31, 2020

OVERVIEW

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

PERFORMANCE (%)

Net of Fees, USD	+17.49
Gross of Fees, USD	+18.19
MSCI World ¹	+15.90
Value Added	+2.29

Major Performance Drivers

Despite the disruption caused by the pandemic, 2020 turned out to be a respectable year for absolute returns. After the drama of the sharpest sell-off in decades and the rapid rebound, the portfolio level-pegged with the S&P 500 in 2020 while beating the MSCI World Index of global equities.

The muted relative outcome masks a year of elevated activity. Our investing preference is for a long holding period, adding to holdings in good businesses at attractive valuations, ideally where share prices have overreacted to what we judge to be a temporary cloud – i.e., a setback that is unlikely to exert an influence on the company's fundamentals after a few years have elapsed. This year served up a cloud that was dark indeed for businesses caught in the lockdowns that continue to envelop the world, and we believe it will prove temporary for many quality companies.

In the second quarter we added to existing positions in cyclically affected Consumers, Financials, and Industrials and established some new ones. In all we reallocated about 10% of your portfolio between April and June into what we now refer to as “back to normal” stocks, funded by crisis beneficiaries in Health Care (particularly Pharmaceuticals) as well as the now small weigh in classic consumer defensives. As of year-end, this back-to-normal group represents about 30% of your portfolio.

The trade out of Health Care and defensives added to relative returns for the year as these groups lagged the market in the rebound. Until the announcement of progress on vaccines in November, however, the back-to-normal part of your portfolio performed approximately in line with the broader markets, picking up some steam since. We believe that this part of your portfolio will make a more significant contribution as the pandemic dissipates, hopefully in 2021.

In hindsight, it would have been better to increase the emphasis on the Technology sector instead. Tech stocks continued to perform strongly after the virus had infected markets. Our inclination toward contrarianism, however, combined with a preference for diversification (even as the benchmark weight in the FAANGs rose inexorably), meant that we kept a lid on the allocation at around 40%. We continue to find quality business models at attractive prices in Technology. We have invested a portion of your portfolio into the makers of semi-conductors, and also the makers of

Performance data quoted represents past performance and is not indicative of future results. The investment return and principal value of an investment will fluctuate so that an investors shares, when redeemed, may be worth more or less than their original cost. Current performance data may be lower or higher than the performance data provided herein. To obtain performance information to the most recent month end, visit www.gmo.com.

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the equipment that these companies use.

We continue to believe that your portfolio offers attractive prospective returns, in a low interest rate world where signs of speculative excess have begun to crop up in various corners, from the proliferation of SPACs to the compression of credit spreads. If the broader markets do indeed sag, we would expect the portfolio to hold up a good deal better, as it has in every protracted sell-off since the portfolio's inception. But we remain as ever, squarely focused on the holdings in your portfolio, where we see solid businesses, largely underpinned by sober valuations.

¹ 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.