

QUARTERLY INVESTMENT REVIEW

Usonian Japan Value Creation Strategy

RETURNS (%) (LOCAL)

	Cumulative (%)		Annualized (%)				
	QTD	YTD	1 Year	3 Years	5 Years	10 Years	ITD
Net of Fees (Composite)	6.68	21.78	21.78	2.16	–	–	7.19
Gross of Fees (Composite)	6.86	22.59	22.59	2.88	–	–	7.93
Tokyo Stock Price Index (TR)	7.97	19.58	19.58	0.71	–	–	4.69
Value Added (vs. Tokyo Stock Price Index (TR))	-1.29	2.20	2.20	1.44	–	–	+2.50

Major Performance Drivers

While the moderate 2% gain in the fourth quarter in Japanese equities (TOPIX local) failed to keep up with strong global equity returns, the rise capped an impressive year for Japanese stocks, which gained about 28% in local terms, and Usonian performance, which gained about 31% (gross) in local terms. We remain excited about the prospects for Japanese equities given the continuing pressure to reform; improvements in market dynamics resulting from those reforms; and mounting evidence that the Japanese economy is escaping deflation. On top of this, we are especially excited to skew Value and Small because Value stocks should be the primary beneficiaries of reforms and small cap stocks have fallen further behind large caps as new money flows into futures and ETFs. On the engagement side, we feel the tailwind of mounting pressure on Japanese management teams as we engage more deeply than ever with our holdings on behalf of our clients.

Japanese equities rallied in the fourth quarter, posting a total return of 2.0% for the quarter and an impressive 27.8% for the full year in local terms. Japanese equities were buoyed by expectations of better corporate management due, in part, to the continued pressure on company management and boards from regulators and investors to increase returns. Further, macro factors such as a weaker yen and increasingly sustainable inflation supported equity returns. Inflation is seen as increasingly sustainable due to higher confidence that wages will increase substantially again in 2024, leading to a positive wage-price spiral.

While the broad indices were relatively stable, the internal dynamics of Japanese equities changed considerably as the value factor underperformed the growth factor by nearly 8% in the fourth quarter, giving back half of the close to 16% outperformance accumulated year-to-date through the third quarter. This was undoubtedly linked to the significant decline in interest rates both in Japan and the U.S. during the fourth quarter as hopes of a soft landing for the U.S. economy increased and expectations for Fed rate cuts were brought forward. Size factor played a small role in relative performance this quarter with small caps underperforming the index, however the consistent underperformance of small caps during the year has summed to a significant 7.5%, outpacing the 6.2% underperformance of Growth compared to Value over the same period.

Against this backdrop, the portfolio trailed the TOPIX during the quarter. Stock selection in Health Care contributed to relative performance for the quarter, while selection in Information Technology and Materials were detractors compared to TOPIX. For the full year, the portfolio outperformed. Stock selection in Industrials was a strong contributor to relative performance, while selection in Materials was a significant detractor compared to TOPIX during the year.

We are typically satisfied if we can keep up with the index when it rallies more than 20%, given that our portfolio is extremely conservatively capitalized, meaning its equity returns benefit less from financial leverage in a strong market. While the style factor has been a tailwind for us, the size factor has been a headwind, with Value outperforming and small caps underperforming.

For a more detailed discussion on these topics, please see our complete Quarterly Letter, available from your GMO relationship manager.

Inception Date: 14-Sep-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.

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 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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PRODUCT OVERVIEW

The Strategy seeks long term capital appreciation over a full market cycle and measures its performance against the TOPIX Total Return Index (the “Index”) for performance comparison purposes. The Strategy employs a fundamental, value-oriented approach to invest in Japanese equities. Additionally, the Strategy focuses on protecting capital in down markets and strives to have lower total volatility compared to the Index.

In managing the Strategy, the Usonian Japan Equity team follows a disciplined, bottom-up approach using fundamental research to identify Japanese equities that we believe are undervalued and profitable with high quality balance sheets. The team spends considerable time developing a high level of knowledge about our companies and focusing on downside risk. Additionally, as long-term investors, we engage collaboratively with corporate management to unlock shareholder value.

IMPORTANT INFORMATION

Comparator Index(es): TOPIX (Net of dividend withholding tax) is a free-float adjusted market capitalization-weighted index that is calculated based on all the domestic common stocks listed on the TSE First Section.

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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