

INTERNATIONAL QUALITY STRATEGY

Quarterly Investment Review

PRODUCT OVERVIEW

The GMO International Quality Strategy seeks to generate total return by investing primarily in non-U.S. equities the Focused Equity team believes to be of high quality.

The team believes that companies with established track records of historical profitability and strong fundamentals – high quality companies – are able to outgrow the average company over time and are therefore worth a premium price. The Strategy's disciplined approach uses both quantitative and fundamental techniques to assess the relative quality and valuation of non-U.S. companies and aims to exploit a long-term investment horizon while withstanding short-term volatility.

MAJOR PERFORMANCE DRIVERS

In a strong quarter for equities, the International Quality portfolio posted a positive return, but slightly behind the MSCI World ex US Index at 10.2%.

Returns were concentrated in corners of the market. Unusually, only 3 of the 25 global GICS industry groups outperformed – semiconductors, which led the pack by a country mile, tech hardware, and banks, some way behind. Energy, materials, utilities, and real estate – last quarter's leaders and less well endowed with quality business models – were relatively weak.

This quarter was business as usual for the portfolio in some ways. It performed better compared to the markets on the weaker days and weeks and delivered most, but not quite all, of the market return in a period of overall buoyancy.

The portfolio is overweight in technology, but as we have often observed, a strong market in technology stocks tends to favor the speculative tech names over the established companies that comprise the bulk of the portfolio's tech names. Despite delivering the portfolio's best stock returns via its semiconductor exposure, technology was a small detractor from the portfolio's relative performance. The allocation to software and related names that are perceived as at risk of disruption by AI was weak. The portfolio's weight here is not large at around 8%, but returns were negative in absolute terms, bringing several former market darlings such as SAP and Capgemini down to rather humble valuations.

A Little Longer-Term Perspective

While the majority of our day-to-day activity is inevitably focused on the stocks we cover, it is useful to take a step back and review progress. The last year has been a challenging relative performance period for quality investors of various hues. What has been going on? Has something changed for quality?

Returns for the International Quality portfolio have been driven primarily by the fundamentals of the portfolio. We track fundamental return as EPS growth and dividends – this quantum is within a point or two of the total return. In some sense, therefore, the portfolio is doing its job – riding on the coattails of the strong fundamentals of a portfolio of quality businesses.

If the fundamentals have been fine, why has performance lagged the broader markets? It is partly a reflection of a different opportunity set, including zero exposure to banks. It is also the market's focus this year. Despite the geopolitical ups and downs, it has been increasingly drawn to the tsunami of capital directed towards the build-out of the infrastructure of AI (the "supply layer" of AI in our parlance). 41 names out of the 1300+ constituents (or about 3%) of the MSCI World Index have generated returns in excess of 100% in U.S. dollar terms, almost all related to this capital flow and collectively accounting for more than half of the return of the index itself. The portfolio owned three of them – TSMC, Tokyo Electron, and ASML – which frankly wasn't a bad result, partially accounting for the positive performance differential between the portfolio and most of the peers we track.

While there is a scenario in which the build-out stocks are undervalued, it is a relatively aggressive one, and too many of the names doing well seem to us to have serious cyclical drivers alongside their putative secular tailwinds. With our valuation-aware investment approach, we would expect to have limited exposure to the hottest stocks in the hottest part of the market, however alluring the narrative behind them. For example, Ceres Power - a supplier of fuel cell technology that can potentially be used for data centers - trades on 58x next year's earnings. A lot needs to go right for Ceres, up 283% to its peak in May, to justify its rating. Perhaps it will, but you should not expect that to be a typical position for the Quality portfolio.

While the market's focus this year has been on the supply layer of the AI business, the market has been ferocious in its treatment of the rest of the technology sector. Software and IT services have not been shown much mercy in the context of their solid fundamental returns – the portfolio's holdings here have averaged over 20% earnings growth plus dividends since mid-2025, while their stock prices have been eviscerated. These businesses have generated strong fundamentals in the past and continue to generate strong fundamentals today, but the market has made an emphatic decision that they will not do so in the future. Like in any industry, our investment process for software is geared toward selecting businesses with competitive advantages. Our analysis suggests that their barriers to entry – based around proprietary data, systems of record, regulatory significance, etc. - will hold up just fine. If so, the shares are interestingly undervalued.

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MAJOR PERFORMANCE DRIVERS CONT.

Portfolio Activity

We discussed in last quarter's client letter how we added to the portfolio's software exposure in the first quarter by diversifying across additional positions. This quarter, we continued the process of diversification and taking advantage of attractive valuations by adding to Experian, SAP, Constellation Software, and Amadeus.

With the market focus so resolutely on how the AI spoils are divvied up, we are interested in tangential investment opportunities and made several purchases in businesses that we think can deploy capital well, irrespective of which way the AI wind blows. We added two new positions, one in Healthcare and one in Industrials. EssilorLuxottica is the world's leading vertically integrated eyewear company, combining iconic brands like Ray-Ban with a high-margin prescriptive lens business. Sika provides high-performance adhesives, sealants, waterproofing, and other construction materials that are critical to modern buildings and infrastructure.

We also topped up our position in pallet logistics company, Brambles. The market reacted negatively to a guidance cut driven by a perfect storm of stronger-than-expected customer demand, changes in subcontracting relationships, and tight U.S. labor availability. This occurred against a backdrop of ever-higher pallet quality demands from a customer base that is automating fast. Higher quality standards strengthen the moat for Brambles, while the issues faced this year require a reasonably quick and easy fix.

We continue to believe that your portfolio's superior fundamentals will drive returns from here. AI supply layer stocks have rocketed upwards. 2026's waves of large IPOs are very heavily AI-related. We believe that the GMO International Quality portfolio remains a compelling tool to achieve equity exposure while controlling for some of the market's baser animal instincts.

Portfolio weights as a percentage of equity for the securities mentioned are as follows: SAP (3.4%), Capgemini (0.6%), TSMC (6.3%), Tokyo Electron (2.1%), ASML (4.6%), Experian (1.7%), Constellation Software (1.5%), Amadeus (3.4%), EssilorLuxottica (0.9%), Sika (0.8%), and Brambles (2.9%).

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ANNUALIZED RETURNS (USD, %) (QUARTER-END)

	Quarter-End	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception
International Quality Strategy (net)	8.81	1.71	5.89	-	-	-	7.15
International Quality Strategy (gross)	8.97	2.01	6.53	-	-	-	7.80
MSCI World ex USA	10.22	9.19	20.99	-	-	-	22.67
Value Add	-1.41	-7.48	-15.10	-	-	-	-15.52

RISKS

Risks associated with investing in the Strategy may include: (1) Market Risk - Equities: the market price of equities may decline due to factors affecting the issuer, its industries, or the economy and equity markets generally. Declines in stock market prices generally are likely to reduce the net asset value of the Fund's shares; (2) Management and Operational Risk: the risk that GMO's investment techniques will fail to produce desired results, including annualized returns and annualized volatility; and (3) Non-U.S. Investment Risk: the market prices of many non-U.S. securities (particularly of companies tied economically to emerging countries) fluctuate more than those of U.S. securities. Many non-U.S. markets (particularly emerging markets) are less stable, smaller, less liquid, and less regulated than U.S. markets, and the cost of trading in those markets often is higher than it is in U.S. markets. This is not a complete list of risks associated with investing in the Strategy. Please contact GMO for more information.

Composite Inception Date: 31-Oct-24

Performance Returns: Performance for the year of inception is less than a full calendar year. 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 data quoted represents past performance and is not indicative of future results.** 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. 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%. **GMO LLC claims compliance with the Global Investment Performance Standards (GIPS®). A Global Investment Performance Standards (GIPS®) Composite Report is available at www.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 actively-managed, is not managed relative to a benchmark and uses an index for performance comparison purposes only and, where applicable, to compute a performance fee.

IMPORTANT INFORMATION

Comparator Index(es): The MSCI World ex-USA Index (MSCI Standard Index Series, net of withholding tax) is an independently maintained and widely published index comprised of global developed markets, excluding the United States. 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.

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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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