Fundsmith
Emerging Equities Trust

Fundsmith Emerging Equities Trust

May 2021 AGM

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Why Fundsmith Emerging Equities Trust (“FEET”)?

- Genesis of the Investment Trust lies in the investment opportunities inherent in emerging markets;
- Focused on attractive demographics and growing spending power of middle class consumers in developing countries;
- Higher volatility and lower liquidity in emerging markets not compatible with open-ended fund structure;
- The same approach as the Fundsmith Equity Fund.

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1. **Buy good companies**
2. Don’t overpay
3. Do nothing

1. Buy good companies – criteria and look through metrics

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Quality	High returns on operating capital employed in cash
Growth	Growth driven from reinvestment of their cash flows at high rates of return
Predictability	Make money from a large number of everyday, small-ticket, repeat, predictable transactions
Sustainability	Able to protect returns against competition

As at 31.12.20	FEET (LTM)	MSCI EM + FM (ex-financials)
Quality		
ROCE	40%	11%
Gross Margin	52%	33%
Operating Margin	18%	11%
Cash Conversion	93%	82%
Growth		
Free Cash Flow Growth	21%	8%

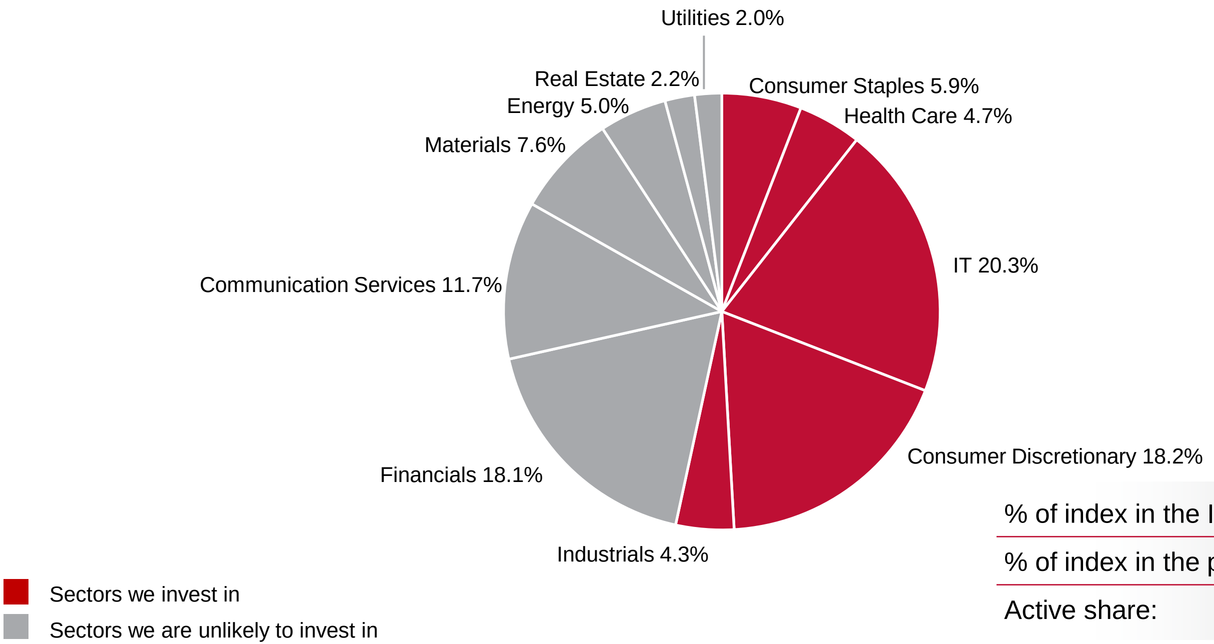
As at 31.12.20	FEF
ROCE	25%
Gross Margin	65%
Operating Margin	23%
Cash Conversion	101%
Free Cash Flow Growth	8%

Source: Bloomberg, Fundsmith. All LTM, FX-neutral weighted average data, excluding cash.

FEET and index data as at 31.12.20 and FEF data as at 31.12.20, normalised for outliers.

1. Buy good companies – sectors we favour

MSCI EM + FM sector weights



% of index in the IU:	14.2%
% of index in the portfolio:	6.3%
Active share:	93.7%

Source: www.msci.com. Data as at 31.12.20.

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1. Buy good companies
2. **Don’t overpay**
3. Do nothing

2. Don't overpay – valuation metrics

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- We look at the free cash flow yield of a company and assess it in the context of sustainability of the company's competitive advantage and longevity of growth prospects.

As at 31.12.20	FEET (LTM)	MSCI EM + FM (ex-financials)
Free Cash Flow Yield	2.5%	3.6%
Portfolio Dividend Yield	1.4%	1.8%

As at 31.12.20	FEF
Free Cash Flow Yield	2.8%
Portfolio Dividend Yield	1.4%

Source: Bloomberg, Fundsmith. All LTM, FX-neutral weighted average data, excluding cash.

FEET and index data as at 31.12.20 and FEF data as at 31.12.20, normalised for outliers.

1. Buy good companies
2. Don't overpay
3. **Do nothing**

3. Do nothing - sell discipline

- Ideal holding period is forever
- Voluntarily exit a position only if:
  - Management makes bad capital allocation decisions
  - Fundamental reappraisal of investment case
  - Valuation becomes indefensible
  - Superior investment opportunity identified
- Some portfolio turnover will be involuntary, e.g. in the event of a takeover

FEET	2014	2015	2016	2017	2018	2019	2020
Value of stocks sold	£4m	£19m	£43m	£44m	£28m	£49m	£36m
Portfolio turnover ratio	n/a	67%	38%	34%	19%	27%	21%
OCF	1.7%	1.7%	1.7%	1.7%	1.5%	1.4%	1.3%
Voluntary dealing costs	0.06%	0.27%	0.52%	0.18%	0.18%	0.21%	0.14%

Source: Fundsmith 31.12.2020
OCF: Ongoing Charges Figure

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Performance

FEET performance overview

% return

	2021 to Mar	2020	2019	2018	2017	2016	2015	2014*	Since inception	Annualised
FEET NAV[1]	-4.4	+20.7	-0.5	-3.0	+21.2	+12.0	-7.0	+0.1	+40.9	+5.2
FEET Share Price[2]	-7.1	+29.1	-7.4	-9.4	+24.5	+10.5	-10.9	+7.2	+42.2	+4.2
Emerging Markets[3]	+1.3	+14.4	+13.9	-9.3	+25.3	+32.4	-10.0	+0.5	+77.3	+9.0
UK Bonds[4]	-4.0	+4.6	+3.8	+1.2	+1.4	+6.5	+1.0	+7.4	+28.7	+3.2
UK Cash[5]	+0.0	+0.3	+0.8	+0.7	+0.4	+0.5	+0.6	+0.3	+3.6	+0.5

[1] Net of fees, priced at UK market close (source: Fundsmith)

[2] At LSE close (source: Fundsmith)

[3] MSCI Emerging & Frontier Markets Index (£ Net) priced at close of business US EST (source: www.msci.com)

[4] Bloomberg/EFFAS Bond Indices UK Govt 5-10yr (source: Bloomberg)

[5] 3m £ LIBOR Interest Rate (source: Bloomberg)

* From 25.6.14.

Disclaimer: Past performance is a not a reliable indicator of future results.

Impact on relative performance

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Geographical and currency divergence relative to the index

Our bottom up approach to investing has led to the portfolio having a significant geographical difference to the underlying weightings of the MSCI index and give us a markedly different currency exposure to the index.

FEET country breakdown	Weight
India	42.9%
China (incl. Hong Kong)	16.2%
Argentina	9.0%
Brazil	4.8%
Egypt	4.7%
Vietnam	2.6%
Other Emerging Markets	11.9%
Frontier Markets	4.8%
Cash	3.1%

MSCI EM + FM country breakdown	Weight
China (incl. Hong Kong)	38.7%
South Korea	13.3%
Taiwan	12.6%
India	9.2%
Brazil	5.1%
Other Frontier + Emerging Markets	21.1%

Source: www.msci.com, FEET data as at 31.12.20. MSCI data at 31.12.20

Impact on relative performance

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Significant proportion of index performance has been led by the largest constituents in the index

TSMC, Alibaba, Tencent, Samsung and Meituan accounted for over 60% of the increase in the index in 2020.

Top 10 FEET portfolio holdings	Weight	ROCE
MercadoLibre	9.0%	NM
Foshan Haitian	8.0%	45%
Asian Paints	4.9%	30%
Info Edge	4.7%	15%
Vitasoy	4.4%	24%
Havells	3.8%	18%
Nestle India	3.7%	88%
Avenue Supermarts	3.3%	20%
Hindustan Unilever	3.3%	109%
Metropolis	3.2%	40%
Total	**48%**	
Average		**43%**

Top 10 MSCI EM constituents	Weight	ROCE
TSMC	5.8%	27%
Alibaba	5.5%	9%
Tencent	5.3%	18%
Samsung Electronics	4.5%	11%
Meituan Dianping	1.7%	8%
Naspers	1.1%	-2%
Reliance	1.0%	10%
JD.com	1.0%	8%
China Construction Bank	0.9%	5%
Ping An Insurance	0.9%	3%
Total	**28%**	
Average		**10%**

TSMC and Tencent are in the FEET portfolio

Source: MSCI weightings as at 31.12.20, LTM pre-tax operating ROCE from Bloomberg.
FEET weightings as at 31.12.20, pre-tax operating ROCE from Fundsmith.

Portfolio themes going forward

1 **Macro and political risk**	Reduce exposure to countries with relatively high macroeconomic and political risk, particularly in frontier markets
2 **Sector diversity**	Increase exposure to resilient growth companies in healthcare and technology sectors to ensure that the fund performs better in ‘up markets’ whilst maintaining defensive qualities
3 **Ownership and governance**	A decreased exposure to listed multinational subsidiaries and a greater emphasis on investing in businesses with more entrepreneurial and incentivised management
4 **Portfolio concentration**	Increase portfolio concentration

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Progress on portfolio themes in 2019 and 2020

	December 2018	December 2019	December 2020
1 Macro and political risk — % of portfolio in frontier markets	12%	9%	7%
2 Sector diversity — Broad sector split of the portfolio	Consumer 81% Technology 5% Healthcare 14%	Consumer 72% Technology 11% Healthcare 17%	Consumer 64% Technology 20% Healthcare 16%
3 Ownership and governance — % of portfolio in family or founder-influenced companies	53%	63%	76%
4 Portfolio concentration — Number of holdings in the portfolio	45 stocks	36 stocks	38 stocks

Source: FEET data as at 31.12.2020, 31.12.19 and 31.12.2018

Covid-19

Many of our companies have benefitted from the pandemic

- Global change in emphasis from “efficiency” of supply chains and balance sheets to “resiliency”;
- Social, economic and political change tends to have a bigger impact during and after a pandemic;
- Evidence already of significant acceleration in existing trends around (1) market consolidation, (2) formalisation of the economy and (3) digitalisation;
- Portfolio demonstrated resilience during Covid-19 given exposure to defensive sectors and high quality companies.

ESG approach

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Our long-term approach focuses on sustainability

- As long term investors ESG is an integral part of our investment approach because we are concerned about the sustainability of a company's business model;
- We approach ESG by taking into account all the factors that may impact the sustainability and longevity of returns for a business into the future. This leads to positive ESG investment outcomes;
  - Our process leads us to avoid asset-intensive, low return and cyclical businesses, automatically barring environmentally destructive industries from FEET;
  - The vast majority of the businesses we own have brand values and public perception to protect leading to positive social outcomes;
  - Governance is a material element of our evaluation of candidates for our Investible Universe. Simply put, we don't invest where we find governance structures or policies to be unsatisfactory;
- We vote on all proxies we receive ourselves and regularly engage with management on areas such as ESG, remuneration, business performance and innovation;
- Fundsmith are signatories of the UN PRI and the Trust managers sit on the Fundsmith Stewardship and Sustainability Committee.

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ESG outcomes – examples

Our long-term approach focuses on sustainability

Financial Inclusion

In Latin America, barely 50% of the population has a bank account; more than 117m users in the region now have a Mercado Pago digital account that gives them access to digital wallets and electronic payments.

Stakeholder Management

Ethical procurement practices has benefitted 63k+ farmers over the last four years, including training of 4.5k+ coconut farmers, which has led to the improvement in agricultural productivity on a sustainable basis.

Corporate Governance

High levels of management integrity and ethical business practices. Diverse board (experience, gender, skills, etc) with 60% independent board members. Segregation of roles between the position of CEO and Chairman.

Sustainable Manufacturing

Sells plant-based food and beverages. Sustainable manufacturing practices – does not use genetically modified soybeans, 99%+ recycling of soy residue, 93%+ recycling of glass bottles, big reductions in water, electricity and fuel usage, 42% female workforce.

Investment policy

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Proposed changes

	Existing	Proposed
Investment policy	‘to invest in shares issued by listed or traded companies which have the majority of their operations in, or revenue derived from, Developing Economies and which provide direct exposure to the rise of the consumer classes in those countries’	‘invest in shares issued by listed or traded companies which have the majority of their operations in, or revenue derived from, Developing Economies and which provide direct exposure to the rise of the consumer classes in those countries **or to the broader social and/or economic development of those countries’**
Number of holdings	35 to 55 stocks	25 to 40 stocks

Investment policy

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Reasons for proposed changes

- Evolutionary next step that allows the fund to benefit from changes in emerging markets such as human capital development and the growth of industries such as healthcare, services and software;

- Consistent approach with other funds within Fundsmith increasing the scope and range of investment opportunities;

- Will not lead to change in approach or compromise on the quality of companies we invest in;

- Greater portfolio concentration will ensure that we invest in companies with strongest level of conviction whilst ensuring sufficient diversification and risk management.

Conclusion

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- The aim to ‘buy good companies’, ‘not overpay’ and then ‘do nothing’ remains unchanged;
- Portfolio evolution with greater focus on businesses operating in environments conducive to sustained growth;
- Proposed investment policy will bring consistency across funds within Fundsmith and increases the scope of potential investment opportunities;
- Covid-19 has accelerated existing themes around market consolidation, formalisation and digitalisation – despite ongoing disruption the portfolio remains resilient;
- Our long-term approach focuses on sustainability.