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WS AMATI STRATEGIC INNOVATION FUND

Quarterly Review

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By
Graeme Bencke, Fund Manager

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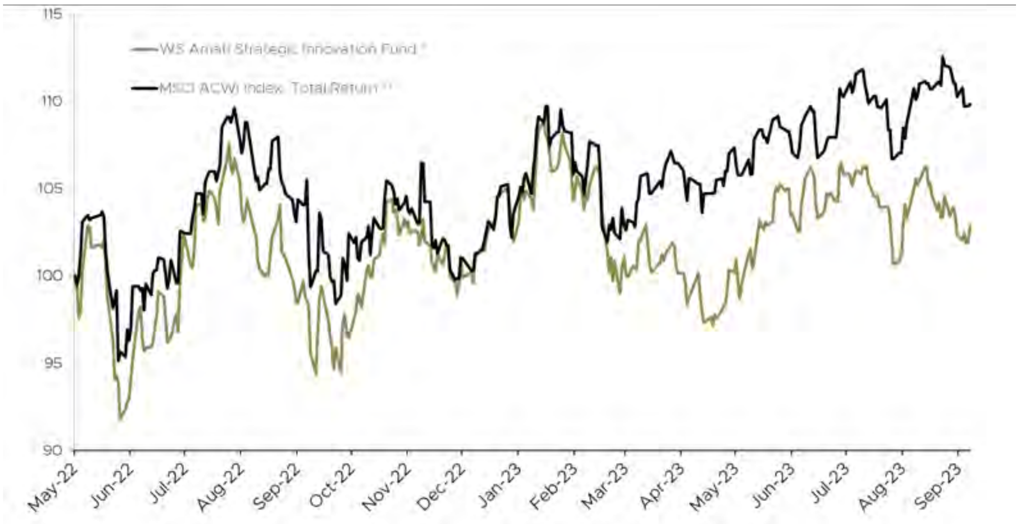
The benchmark MSCI All Countries World Index in Sterling see-sawed through the third quarter to end slightly up over the three months, largely mirroring the performance of the technology heavy US Nasdaq Index (also in Sterling terms). The US technology heavyweights nicknamed the 'Magnificent Seven', which includes companies such as Apple, Microsoft and Alphabet, set the pace for the market as they have for much of the year.

Figure 1: Perfromance v Benchmark



Source: Refinitiv

Across the index, energy stocks have been the clear winner in performance terms as oil prices push higher on the back of production cuts by the OPEC+ countries. The rising energy prices provide a clear inflationary impulse on the global economy at a point where ‘core’ inflation appears to be rolling over. This combination of factors has moved economic commentators to switch to expecting a near-term peak in interest rates only to stabilize at a higher level than previously expected. Not great news for investments that rely on a lower cost of capital to meet their return objectives.

The other subject of disappointment has been China, where the post-Covid recovery remains elusive, with softer demand, excessive financial leverage in the property market, and weak foreign direct investment weighing on growth. The government's attempts to stimulate demand have pulled down the currency against a more hawkish US, despite China's still huge trade surplus. While we do not invest directly in China, it is clearly an important market for many companies listed in the West and so remains a topic of considerable interest.

The largest contributor to performance over the period was **Fabrinet**, a contract manufacturer of optical, electro-mechanical and electronic components. The company reported a very strong set of end year results in August. Driven by demand for new AI products, the final quarter of their financial year saw record sales, profitability and cash flow. The outlook was similarly bullish and the AI driven demand has effectively offset inventory overhangs experienced by some customers. **Jacobs**, the technical professional services firm focused on infrastructure and sustainability, highlighted a record backlog, continuing revenue growth and expanding margins. Investors await more details regarding the planned spin out of the Group's 'Critical Mission Solutions' segment planned for 2024.

On the other side, detractors included **Autostore**, a leading provider of warehouse vertical automation infrastructure and software. Despite improving margins, the company fell after highlighting a softer order environment through the second half as industrial and retail customers delayed investment in the face of higher interest rates. However, the longer term pipeline of business remains strong and the settlement with Ocado clears a key overhang in the stock. **Mastec**, the US energy and telecoms infrastructure services company, also weighed on the quarter after missing revenue estimates for their second fiscal quarter. Added to this, Mastec reduced full year guidance on slowing customer decision making, as well as internal project delays in IEA, a recent acquisition.

There were three new additions to the fund in Q3 and two disposals. **Arista Networks** was the first of the three, added on weakness at the end of July. Arista is a pioneering provider of network equipment serving data centres and high-end enterprise networks. Their equipment leads on performance where it matters most, such as cloud data centres for the likes of Microsoft and Alphabet. We believe cloud transition still has plenty of growth ahead, and the boom in AI will accelerate it – to take full advantage of AI capabilities companies will need to migrate more of their workloads to the public cloud. Arista is the equipment vendor of choice in that setting and will benefit from the reacceleration of demand. **Danaher Corporation** was the second purchase. It has a best-in-class portfolio of bioprocessing assets, enabling development and manufacturing of next generation therapies and biologic drugs. It has proven to be a high quality business, with a deep moat, strong customer loyalty and 80% of its revenues are recurring. Danaher's bioprocessing division is complemented by a growing life science tools and diagnostics business, with similarly attractive long-term fundamentals. In the recent past the company has experienced transitory demand weakness post-Covid19, as a slowdown in China and bioprocessing de-stocking impacted the short-term outlook. This provided an excellent entry point for an otherwise highly rated company.

Most recently we acquired a position in **Intuitive Surgical**, a uniquely well positioned producer of robotic surgical equipment. The benefits of precision and control which come from trained surgeons assisted by equipment such as the Intuitive 'da Vinci' robot are increasingly evident. Intuitive leads the way in this area, with by far the widest installed base and the most highly regarded equipment. Once a surgeon is trained on a particular machine type, there is very little incentive to change and so Intuitive continues to take share as surgeons lobby for more machines of the same type when new investments are made. The revenue model includes a high proportion of repeat purchases in the form of instruments and consumables, which provides a compounding effect on sales as more machines are sold.

New purchases were funded partly from inflows and rebalancing of the portfolio, but also from the sales of our positions in **Indivior** and **Volkswagen**. In the case of Indivior we felt that the potential for a very significant, and unforecastable litigation event was increasingly likely. Despite the chances being still relatively small in our view, events such as these are impossible to entirely rule out. The possibility of permanent loss of capital therefore persuaded us to watch events from the sidelines and potentially revisit if the risk is removed.

The second divestment during the period was Volkswagen. As with Indivior we had held VW since the inception of the fund and although the investment case had played out much as we expected, the shares did not achieve our assumption of fair value. The spin-out of the Porsche AG stake progressed as planned, and provided a hefty dividend distribution, but the shares languished in the aftermath as the level of competition from Chinese OEMs increased materially. VW's strong market position in China has eroded somewhat in recent months as companies such as BYD, Xpeng and NIO have positively surprised in terms of quality and price, which has weighed on the VW share price. While we believe the valuation more than reflects the recent loss of share, we feel there are better alternatives across the fund.

The key characteristic of our investment process is identifying areas of innovation where we see significant economic value added and on companies pursuing that innovation where this value is not fully recognised by the market consensus. While we take note of macro and geopolitical risks across our research, these are not the drivers behind our investment decisions. Indeed our 3-5 year time horizon on investments is designed to remove the short term cyclical 'timing' element from our decisions in order to focus on the structural growth stemming from the innovation and change.

One of the areas of particular interest is the groundswell of new research and product development across the field of synthetic biology. While something of a 'catch all' term, synthetic biology refers to the burgeoning field of man-made, or at least man-altered, living materials. The associated processes are being used for producing new compounds which are impacting the pharmaceutical, textile, food, agriculture and traditional chemical industries. Many of the pioneers in this space remain well funded 'science projects' rather than truly autonomous businesses and so do not fit our investment profile. However, there are exceptions to this, and numerous companies are enabling and adopting the innovative process and are firmly within our remit. One holding in the fund is **GEA Group** which manufactures equipment for the processes associated with researching and producing biological compounds. Another, more recent inclusion is **Danaher Corporation**, again an enabler but with an even more focused repertoire of products. We believe this sector is facing a dramatic increase in demand over the coming decade, as new drugs gain approval for targeting a wide range of human ailments. As we outlined in a recent **report**, the best-selling drug of all time has been Humira, a biologic treatment for arthritis, achieving sales of more than $20bn in 2022 alone. Yet over time this may well be dwarfed by the recent breakthrough 'GLP-1' drugs for weight loss such as Wegovy and Saxenda. This fast growing area of research targets the modification of viruses as tools for creating compounds inside the body, rather than consuming chemical pills, which allows for a vast increase in the treatment potential for almost any human illness. While the realisation of this Nirvana is still a long way off, the R&D focus will only accelerate from here as each new milestone is achieved, and we continue to look for the best combinations of risk and reward across the relevant companies.

We have in the past frequently discussed the flood of development and innovation across the energy sector as alternative technologies improve in efficiency and scale, replacing traditional, carbon producing processes. One area of particular interest is nuclear energy, a subject area which has been almost a taboo for many people over the past 30 years. Long mischaracterised as toxic and dangerous, in fact this industry has an exemplary safety record of producing consistent, low lifetime cost energy for decades. As variable generation sources such as wind and solar grow in our energy mix we will continue to need reliable, zero emission base load power for which nuclear is currently the only alternative. Possibly as a result of misguided ESG initiatives in the past, there are only a small number of listed companies with significant exposure to this frontier. We are steadily reviewing those that potentially fit our profile and hope to make more investments over time. From companies using lasers to enrich uranium to others designing micro reactors for propulsion in space, there is no shortage of innovation in this sector.

Should you wish to hear the audio/video presentation from the fund manager, please click **here**.

Sales Team Contacts

Rachel Le Derf
Head of Sales & Marketing
rachel.lederf@amatiglobal.com
07979601223

Colin Thomson
Head of Intermediary Distribution
Northern England, Scotland & NI
colin.thomson@amatiglobal.com
07884026517

Jonathan Woolley
Sales Director
London, Midlands, SW England & Wales
jonathan.woolley@amatiglobal.com
07818203013

Thomas Whitfield
Sales Director
London & SE England
thomas.whitfield@amatiglobal.com
07714839155

Samantha Dalby
Sales and Insights Manager
samantha.dalby@amatiglobal.com
+44 (0) 131 503 9116

Olivia Pattison
Senior Sales Support Executive
olivia.pattison@amatiglobal.com
+44 (0) 131 503 9126

Milly Stevenson
Sales Support Executive
milly.stevenson@amatiglobal.com
+44 (0) 131 503 9125

Risk Warning

Past performance is not a reliable guide to future performance. The value of investments and the income from them may go down as well as up and you may not get back the amount originally invested. Tax rates, as well as the treatment of OEICs, could change at any time. The return on investments in overseas markets may increase or decrease as a result of exchange rate movements. There may be occasions where there is an increased risk that a position in the Fund cannot be liquidated in a timely manner at a reasonable price. In extreme circumstances this may affect the ability of the Fund to meet redemption requests upon demand. A dilution levy may be applied to the share price when the fund is expanding or contracting. Should you buy or sell in these circumstances it may have an adverse impact on the return from your investment.

This factsheet does not provide you with all the facts you need to make an informed decision about investing in the fund. Before investing you should read the Prospectus, the Key Investor Information Document (KIID) and the Supplementary Information Document (SID). The Prospectus sets out the main risks associated with the fund, the KIID shows you how costs and charges might affect your investment, and the SID details your cancellation rights. If you are in any doubt as to how to proceed you should consult an authorised financial intermediary.

Fund documentation can be requested from Waystone or Amati using the contact details above, and is available to download from our website.

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