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WS AMATI GLOBAL INNOVATION FUND

Quarterly Review

March 2024

By
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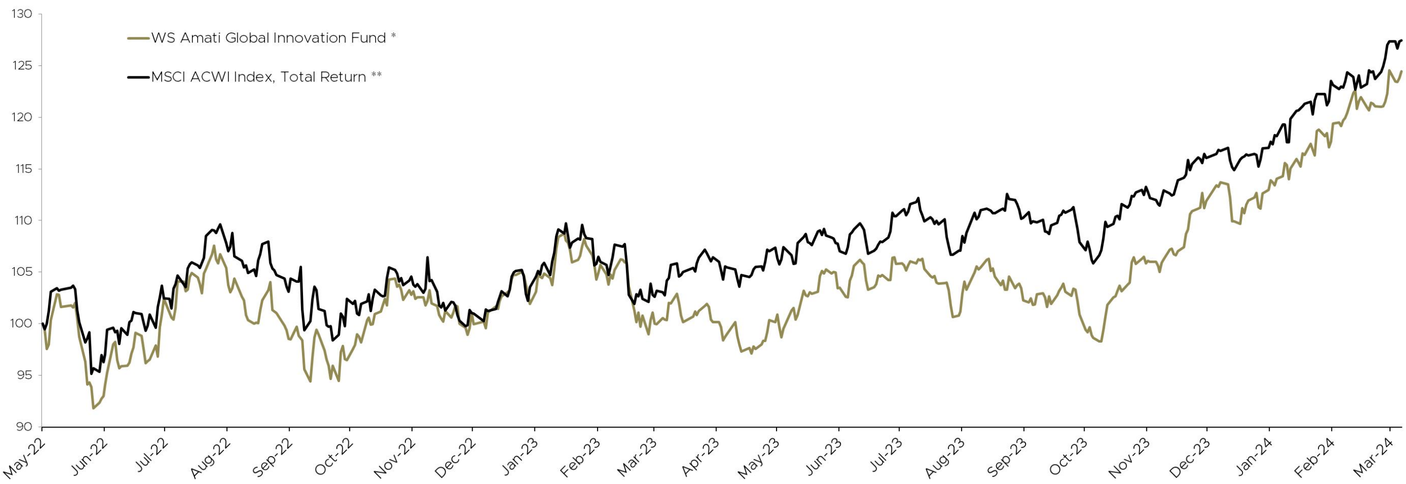
The general mood in equity markets was cautiously optimistic as we entered 2024. While recession concerns remained, the outlook was certainly brightening in economic terms with the inflationary indicators weakening and early signs that employment was holding up. As the fourth quarter, results began to materialise from mid-February and the messaging from financial and industrial companies alike reflected this mood, as did the increasingly dovish sentiments from central bankers. The potential threats from escalating conflicts, a weaker than expected Chinese recovery and an impending commercial real estate bust took a back seat as animal spirits steadily rose. For an investment portfolio such as ours, which focuses on identifiable growth from existing innovation this more positive mood tends to be helpful. The growth outlook for our investments is affected more by ‘when’ than ‘if’ and so a more optimistic capital sending environment is certainly favourable. The recent relative performance headwinds from not owning the US technology focused ‘Magnificent Seven’ remained a factor but less so than in the prior quarter. The Fund returned 9.5% for the quarter, against the MSCI All Countries World benchmark index (in GBP) of 9.1%.

Figure 1: Fund performance vs benchmark



Source: Refinitiv

Two of the fund’s biggest contributors in the first quarter can be generically referred to as semiconductor companies, but both are very different. **SK Hynix** won the top spot partly as a result of the flood of investment into generative AI. SK Hynix is a South Korean memory semiconductor powerhouse, specialising in both NAND and DRAM design and production. They are one of a small oligopoly of players in these historically very cyclical industries. The explosion in data generation, storage and consumption across most facets of life today is a strong tailwind for the business. However, we were also early in identifying the rapidly rising demand for a newer memory category known as HBM (High Bandwidth Memory) where Hynix was leading the pack. Nvidia (a prior holding in the fund) has rightly gained much of the attention around generative AI as a result of the dominance of their GPUs, but many initially overlooked the fact that these processors required a great deal of associated memory in the form of HBM. Indeed, according to Mordor Intelligence, demand is expected to grow at 25% annually over each of the next five years. The recent move in the Hynix share price reflects this knowledge gap beginning to close.

The other strongly performing semiconductor company was less well known outside of its quite specialised niche. **Impinj** is one of only two companies designing RFID chips and holds many of the process patents. Radio Frequency Identification (RFID) chips are increasingly being used to tag garments and packages across supply chains to improve tracking and inventory management. While not a new technology (it was believed to have been first used in the 1940’s by Soviet spies to eavesdrop on a US embassy) the falling costs of production have led to the technology moving into the mainstream. Companies such as Walmart, Inditex (Zara, Massimo Dutti), Decathlon and UPS are investing heavily in the technology to drive efficiency savings. The Impinj share price had suffered as a result of supply disruptions over the pandemic period and was not reflecting the coming wave of growth. While some of this is now in the price, we see a long runway ahead before RFID reaches maturity.

Indivior, the specialty pharmaceutical business was also a stand out contributor in the fund so far this year. After a period of weakness in late 2023 the shares have rebounded strongly reflecting the longer term opportunity for their opioid addiction treatments. The stock had suffered ahead of a class action lawsuit which was resolved late in 2023 allowing potential investors to refocus on the quality of the offering and the significant treatment need, particularly in the US.

As always not all companies contribute positively every quarter and the most material of the detractors in the year to date was yet another semiconductor producer. **Infineon** is a German listed designer and producer of a range of chips and microcontrollers designed for industrial and automotive applications in the main. The company is one of a small cluster of peers which benefits as semiconductor content rises generally in many end markets, but particularly in the case of power semiconductors in automotive applications. Beyond this structural tailwind Infineon is a leader in the production of the new generation of power semis using silicon carbide. The demand for these products rises sharply as we transition to electric vehicles. The news of a recent slowdown in demand for EVs is weighing on the shares in the near term but remains something of a 'technological inevitability' in our view and we have been adding to the position on weakness.

Edenred, the French employee benefits group, continued to disappoint in Q1 after headlines suggesting possible bid-rigging in a small division in Italy led to concerns about a wider governance issue across the group. The materiality of the contracts in question is tiny but the broader concerns are difficult to refute in the short term. The company has responded as well as can be hoped given the investigation underway and we are siding with them for now. Despite looking we have found no broader suggestion of impropriety and agree that the record of the business spread over 45 countries, 2 million partner merchants and almost a million corporate clients suggests a robust system in place. Nothing is infallible though and we remain vigilant.

The third most notable detractor in the period was **Lumentum**, the US listed photonic equipment producer. The company is a global leader in the production of optical communication components and a significant beneficiary of the on-going replacement of traditional copper wires to fibre optics. Their product range also includes lasers for many other applications, from facial scanning to industrial cutting and they are considered to be a true pioneer in their markets. Recent results have been negatively impacted by a cyclical pull back in infrastructure investment in the telecoms sector overall and in particular in the US. Partly this reflects a period of digesting the prior round of investment in areas such as 5G, but also the inertia associated with the large subsidy programs available in the US. Both the IIJA and the BEAD programs provide financial assistance to telecoms companies rolling out fibre broadband around the country. However, delays in finalising payments are slowing down the process and in turn affecting suppliers like Lumentum. We do not see these issues as ultimately detracting from the opportunity for the company and remain strongly supportive.

It was an unusually busy quarter for us in trading terms with 4 new holdings and 3 divestments. We aim for a maximum of 40 holdings and for the first time since the inception of the fund we have hit this number. The first of the new additions is **MaxCyte**, a dual US and UK listed life sciences tools company exposed to a rapidly developing area within a key innovation frontier for us, cell and gene therapy. MaxCyte's electroporation technology allows for the directed transfer of biomolecules into cells, that then become therapies themselves or deliver those therapies to patients. Maxcyte's approach has leading yield and cell viability metrics, key criteria for biomanufacturing. Recently Maxcyte had a watershed moment, with the first approval of a medicine using its technology, Vertex's Casgevy Sickle Cell treatment. There are numerous others close behind, with a pipeline extending into the early 2030s. MaxCyte's technology stands apart from the peers and appears best positioned to benefit from the rising tide of investment in this area.

A rising tide is also supporting our recent purchase of Samsung Electronics, which in addition to being a clear innovation leader in a number of technology areas is also a likely to capture a wider share of the next iteration of HBM memory which we discussed earlier for SK Hynix.

Cognex, the US listed machine vision technology group was a third new addition. Machine vision is an innovation frontier we have been following since we launched the fund and is the subject of one of our early Innovation Frontier reports. Cognex is an undisputed leader in the space and set to benefit as investment across global supply chains recovers from the post-covid low. There is much discussion in the media about 're-shoring' and 'friend-shoring' of manufacturing given the growing trade rift between China and the West. This process will drive investment in automation, a key element of which is machine vision.

The final addition is a less well-known German digital service company, **Nagarro**. Like industrial automation, digital investment is at a cyclical low point but set to recover strongly over the next few years. Nagarro's strong operating model and enduring customer relationships (>85% sales growth comes from existing customers) should drive a deserved rerating in the shares.
We are firm believers in competition for places in the fund and the addition of Nagarro came at the expense of **Accenture** which we had held since inception. Accenture had provided a very reasonable 35% return but despite not yet achieving our target price, and competing to some extent with Nagarro, no longer offered the same upside potential. The two other divestments were **Trane Technologies** and **Ambarella**. In Trane's case we sold as the stock achieved our target, having returned 130% since we launched the fund less than two years ago. Ambarella was less kind to us and produced a small loss over the same period. While we continue to see a large potential opportunity for their flagship image processing chip, the market for autonomous driving is an important one for them and is likely delayed beyond our investment horizon.

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 technological change.

One of the delights of investing in innovation is the regular unearthing of new developments and addressable markets still in their infancy. These can sometimes be quite technical or complex; areas such as proteomics which is taking the progress of genomics to the next level with proteins providing a more targeted vector for treatments, and AI helping to speed up development. Robotics and automation playing an ever-larger part in industry and medicine, benefitting from progress in autonomous movement and machine learning. Even the harnessing of enzymes and microbes for health, fuel and industrial applications. Our role is to identify the companies best paced to benefit from these changes without taking undue financial or operational risk. Rather than forecasting interest rates or geopolitical outcomes we simply hold strong companies which can support their own development in markets which are already growing.

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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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