

SOMERSTON TECHNOLOGY FUND

INVESTMENT LETTER No.14 AS AT 30 JUNE 2024

Portfolio Objectives: To grow capital over the medium term by investing in a concentrated portfolio of high growth companies and to outperform our reference index over the economic cycle.

Strategy: We use a fundamental bottom-up approach to identify attractive investment opportunities. We have a 5-year investment horizon. We focus our investments in 20-30 high growth companies.

Performance: The Somerton Technology Fund (US Class) rose by +8.5% in the month and rose by +10.1% over the last three months. Our reference index rose by +5.7% during the month and fell by -0.1% over the last three months.

Performance (%) (US Class)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2017	6.1	3.9	4.2	4.5	7.7	-1.5	5.8	3.2	-0.1	8.5	3.8	-0.8	55.1
2018	12.3	-1.4	-4.1	1.0	8.0	-0.1	0.0	8.9	-1.8	-12.3	1.3	-7.5	1.7
2019	12.0	2.9	5.6	6.3	-8.0	8.2	4.1	-3.8	-1.8	3.1	6.1	3.8	43.6
2020	6.2	-3.8	-6.6	18.2	9.6	10.0	9.1	8.5	-6.2	-0.7	9.6	5.5	73.4
2021	-0.2	1.6	-6.5	8.8	-3.6	11.6	1.0	5.7	-7.9	6.2	-1.5	-5.0	8.5
2022	-13.8	-5.5	2.2	-20.2	-6.1	-11.2	13.8	-6.9	-13.0	2.1	4.9	-10.0	-50.8
2023	16.7	0.3	11.9	-1.1	13.2	4.6	6.5	-3.3	-6.3	-2.0	16.1	4.8	76.6
2024	6.0	7.8	0.8	-5.0	6.8	8.5							26.8

Total return since 2017: 202.7%

Geographical Allocation

Region	% Fund
North America	81.4%
South America	5.5%
Europe	5.1%
Cash and Equivalents	8.0%

Sector Allocation

Sector	% Fund
Information Technology	55.5%
Consumer Discretionary	18.2%
Communication Services	16.6%
Financials	1.7%
Cash and Equivalents	8.0%

Top Ten Holdings

Name	% Fund
Nvidia Corp	12.2%
Amazon.com Inc	9.0%
Alphabet Inc	8.7%
Microsoft Corp	8.2%
Meta Platforms Inc	8.0%
Apple Inc	5.9%
MercadoLibre Inc	5.5%
CrowdStrike Holdings Inc	3.7%
ASML Holding NV-NY Reg Shs	3.4%
Adobe Inc	2.9%
Total for Top Ten	67.4%

This factsheet shows the performance of Somerton's "Technology Equity Strategy" from 31 December 2014 to 30 November 2020 then the Somerton Technology Fund from its launch on 01 December 2020.

Commentary

Contributors and Detractors

Top contributors were Nvidia (+4.5%), Apple (+1.2%) and Arm (+1.0%). The largest detractors were Shopify (-0.5%) and Adyen (-0.7%).

Activity

During the period the fund acquired new positions in Arm and Duolingo.

Introduction

The Fund has maintained a large position in Nvidia for many years. We have often been challenged about our conviction, yet so far at least, the company has proven its doubters wrong.

At the start of 2023, we calculated that Nvidia was priced to achieve 23% annualised growth compounded over the next 10 years - an incredibly high hurdle. The investment committee were challenged by such a demanding outlook but under the present leadership team the company had positively surprised on so many occasions over the past 15 years, and knowledge that significant pipeline deliverables were due, we held that position. The company achieved that implied 10-year growth by delivering 260% sales growth in just one year – our consternation of whether Nvidia was overvalued was clearly unnecessary.

Presently, we calculate that Nvidia is priced to achieve 20% annualised growth over the next ten years. The investment committee, while challenged by this dynamic, is similarly of the view that Nvidia has a path for significant growth. We have trimmed our position, but it remains the largest position in the fund based on **1)** continued growth in datacentres, **2)** the overlooked and misunderstood importance of GPU+ Networking + Software and **3)** an attractive valuation.

Datacentre growth

This is a quote from Nvidia's CEO, Jensen Huang, at this month's annual Computex conference in Taiwan:

"The days of millions of GPU datacentres are coming. And the reason for that is very simple. Of course, we want to train much larger models. But very importantly, in the future, almost every interaction you have with the internet or with a computer will likely have a generative AI running in the cloud somewhere. And that generative AI is working with you, interacting with you, generating videos or images or text or maybe a digital human. And so you're interacting with your computer almost all the time, and there's always a generative AI connected to that. Some of it is on-prem, some of it is on your device and a lot of it could be in the cloud [...]"

And so the amount of generation we're going to do in the future is going to be extraordinary."

Jensen's comments are echoed by Broadcom and AMD. Lisa Su, AMD's CEO, is on record for believing that GPU sales will reach \$400 billion by 2027. Nvidia presently has a 95% share and using the most recent quarter, is on a run rate to generate revenues of \$90 billion from this segment. If Lisa Su is correct, and if Nvidia remain the standout leader, the growth implied by its share price is easy to justify from datacentre GPUs alone – even before we talk about the other segments of the business. Assuming a conservative 75% share of that estimate, Nvidia's growth would be over 200% from these levels.

Today, there are tens-of-thousands of GPUs in datacentres. If we look at the orders and capex plans of the datacentre operators, we have high confidence that by end of 2025, there will be hundreds-of-thousands of GPUs in datacentres, leaving still a significant runway and a few more years to get to millions of GPUs in datacentres.

The buyers of these GPU's are some of the most affluent companies the world has ever seen. Huge orders for GPUs are being planned. In a notable departure from past periods of 'new capex', these purchases are being funded, not by debt, but internally generated cash flows.

Microsoft is reportedly looking to triple its GPU supply to 1.8 million GPUs this year to meet elevated demand for Azure, while Meta has disclosed its GPU orders with an announcement for 150,000 H100s last year and 350,000 H100s or H100-equivalents this year. Musk announced that X's 100,000 H100 cluster would be online in a few months and hinted at a possible 300,000 B200 GPU purchase.

GPU+ network+ software

Nvidia is viewed by so many as a graphics company or a chip company. But Nvidia is neither a graphics company nor a chip company. At the end of 2020, Nvidia launched the Ampere A100 chip. What was special about the A100 is that it unified training and inference on a single chip. As a multi-instance GPU, the A100 made one GPU look like seven GPUs for optimal utilization. This is key for cloud service providers, such as Amazon's AWS, Google Cloud and Microsoft Azure. The A100 was the first architecture where Nvidia was no longer simply a GPU chip company, but rather it marked the moment Nvidia became an AI systems company.

In March 2022 Nvidia launch the H100 ('H' for Hopper) and DGX H 100 server pod (essentially an entire computing rack). This was the moment investors began to understand the transition in Nvidia's business. The H100 allowed Chat GPT to launch. Prior to transformer models like the H100, labelled datasets had to be used to train neural networks. Transformer models eliminate this need by finding patterns between elements mathematically, which substantially opens what datasets can be used and how quickly.

Nvidia has already launched the Blackwell era of chips with significant improvements over the Hopper series, but it is the recent pipeline announcements over the next few years that has been mind-blowing.

Blackwell will evolve to a new Blackwell Ultra version in 2025, at least a +50% memory capacity boost over the current version. The next generation of GPU *after Blackwell* (which has not yet delivered its first shipment) was announced as Rubin. We have few details on it thus far, other than it will be available in 2026 (likely ramping up from a release in late 2025), then we will see an Ultra release in 2027 to boost the memory specs from there. Blackwell DGX AI supercomputers (DGX GB200 NVL72) will combine 36 superchips with 72 GPUs into one giant GPU. They are also adopting the same 1-year cadence in networking too. After announcing that they were doubling bandwidth this year (to 800G), their roadmap shows them doubling the port capacity in 2025, and then doubling the bandwidth again (to 1600G) in 2026. This will come as a converged switch that combines InfiniBand and enhanced Ethernet (Spectrum-X) into one network switch.

In our opinion, the last point is entirely overlooked by most analysts and **is probably the crux of the investment case for Nvidia**. NVIDIA supports two primary networking types. InfiniBand is ideal for internal networking *within* an AI supercomputer, while the more pervasive Ethernet is more for external networking *between* systems across local, wide, cloud networks, and the Internet. Think of InfiniBand as a deep and narrow network, and Ethernet as a shallow and broad one.

InfiniBand is their networking protocol ideal for AI supercomputers, which was procured from their Mellanox acquisition in 2020. Using a high-speed (400GB/s) interconnect as a networking fabric across clusters of nodes, it enables the disparate nodes to act as one big supercomputer and share a pool of unified memory across them. InfiniBand connects the AI systems, while NVLink connects the GPUs within and across those systems.

CUDA (Compute Unified Device Architecture) is their general set of accelerated computing libraries, allowing developers to compute on any NVIDIA GPU. Essentially, this is a software layer that bridges from CPU to GPU

by providing a foundation for accelerating a wide range of workloads across several scientific and data science needs.

It is Nvidia's ***combination*** of GPU + networking + Cuda software that is unique - that gives Nvidia an unassailable lead and revolutionises Nvidia from a chip company to an AI supercomputer company.

Valuation

As a mega cap company, Nvidia broke all records in the prior four quarters with sales growth of 262% and adjusted earnings growth of 461%. Over the same time frame the stock has appreciated nearly 300%. In other words, the stock price has *underperformed* its earnings growth causing the price to earnings multiple to **fall from 58 x to 38x**. I see many sceptics of Nvidia point to parallels with Cisco back in 2000. The similarities between Cisco then, and Nvidia now, stop at both companies being at the frontier of a new wave of technology. Cisco's price earnings ratio was nearly 400 x in 2000 on the back of 50% sales growth and 40% earnings growth.

If we are correct that Nvidia's growth is likely to send earnings up between 100%- 200% in the next three years, its valuation of 38 x FY1 earnings is reasonable. Especially as its revenue model evolves from licence fees from transactional fees.

Risks

Nvidia has such a lead in generative AI and has all the pieces of the puzzle, (GPU's+ Networking + software) that competition, while certain to increase, presently poses only a minor risk.

In our view, the greatest risk is the roll out of infrastructure happens far quicker pace than the roll out of applications that use that infrastructure. This may cause an 'air pocket' where many will argue that AI was a flash in the pan and its huge improvement in compute far exceeds our need. The inference will be that this capex was a capital misallocation. This argument is already starting to be sounded. Long term we are sure of the importance of AI but we too struggle to imagine the full scope of applications just as we also failed to imagine just how important 3G would be, without which it is doubtful whether Apple, Spotify, Netflix would have half the success that they have.

Antitrust and regulation will also become a feature of the investment thesis. In our view, this is more of a headline risk that causes volatility rather than a substantive issue over the next few years.

Finally, Jensen and his team have executed flawlessly over the last 20 years. To a very large part Nvidia's success is due to the people, many of whom may wish to do something different. Departures of key persons may have a greater impact than for other companies.

Summary

There are certainly areas of over valuation in the Technology sector, yet by our analysis, Nvidia's future growth path remains sufficiently compelling to justify today's valuation.

Nick Wakefield

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