SOMERSTON
ASSET MANAGEMENT

SOMERSTON TECHNOLOGY FUND

INVESTMENT LETTER No.15 AS AT 30 SEPTEMBER 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 Somerston Technology Fund (US Class) rose by +2.6% in the month and rose by +0.5% over the last three months. Our reference index rose by +4.4% during the month and rose by +3.4% 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	-5.3	3.4	2.6				**27.4**

Total return since 2017: 371.8%

Geographical Allocation

Region	**% Fund**
North America	84.3%
South America	7.3%
Europe	6.3%
Cash and Equivalents	2.1%

Sector Allocation

Sector	**% Fund**
Information Technology	55.0%
Consumer Discretionary	21.2%
Communication Services	19.4%
Financials	2.2%
Cash and Equivalents	2.1%

Top Ten Holdings

Name	**% Fund**
Meta Platforms Inc	10.6%
Nvidia Corp	9.9%
Amazon.com Inc	9.5%
Alphabet Inc	8.8%
Microsoft Corp	7.8%
MercadoLibre Inc	7.3%
Apple Inc	6.4%
ASML Holding NV-NY Reg Shs	4.1%
Adobe Inc	2.9%
Shopify Inc	2.9%
Total for Top Ten	**70.2%**

This factsheet shows the performance of Somerson's “Technology Equity Strategy” from 31 December 2016 to 30 November 2020 then the Somerston Technology Fund from its launch on 01 December 2020.

Commentary

There are four noteworthy developments for our holdings:

1. Global liquidity is once again on the rise which will underpin equity markets and circumvent the immediate valuations concerns. We invite you to read our Multi Asset Fund Letter for our thoughts on changes in global liquidity.
2. While the sequence of development for ‘AI’ applications remains uncertain, we see widespread evidence of meaningful productivity gains and investment initiatives.
3. In the wake of AI, Software as a Service (“Saas”) is unlikely to be the primary business model with merit in the future. We are seeing a significant rush by software companies to move to usage model rather than a user model.
4. The Department of Justice is busy bringing cases against many defendants, on many counts of anti-competitive/monopolistic corporate behaviour but the case DOJ vs Google 2023 (Ad Tech Monopoly) has particular interest with wide ramifications for large companies.

Central banks both in Emerging markets and Developed markets have been cutting rates. With inflation trending lower, Central banks have turned their attention from ‘inflation fighting’ to ‘saving jobs’ in the real economy.

While several commentators are sounding their doubts over the prudence of many AI investments, as long-term investors, we are not part of this group. Of course, there will be failed projects and pockets of mis-allocation of capital and while there has yet to be ‘a killer app’ driven by AI, there are thousands of problems that will be tackled by thousands of individual models, with hundreds of companies competing to be top of their field. These will take time to build, but the collective brain mass of the top companies investing in this pursuit today and the ‘killer apps’ will come. In the meantime, we have collected some quotes from large corporates that illustrate the impact AI is already having for a very broad spectrum of companies.

Walmart

“One example is that we've used generative AI to improve our product catalogue. We've used multiple large language models to accurately create or improve over 850 million pieces of data in the catalogue. Without the use of generative AI, this work would have required nearly 100x the current headcount to complete in the same amount of time.” (Q2, 2024)

UnitedHealth

“We are running now hundreds of AI use case deployments. I'd say the first wave of those are essentially allowing us to do things much more quickly, much more reliably, much more efficiently than humans can do them.” (Q2, 2024)

Alphabet

“The margin expansion in Q2 versus last year reflects our ongoing efforts to durably reengineer our cost base as well as revenue strength”. (Porat Q2, 2024)

Procter & Gamble

“One example, using data and machine learning algorithms to optimize truck scheduling to minimize idle time for drivers. We're also using digital tools to optimize fill rates and for dynamic routing and sourcing optimization. $200 million to $300 million of savings opportunity across these areas.” (Q4, 2024 earnings call)

JP Morgan Chase

"And artificial intelligence, I think that it will be very transformational. At the moment, if you guys remember, at Investor Day, I mentioned one number, that is the benefit that we see related to deployment of artificial intelligence, I said that it was last year between $1 billion to $1.5 billion. I think that this year, it's heading more towards $2 billion. And a lot of that is related to prevention of fraud. And there are all kind of benefits, but fraud is being a big beneficiary. Going forward, we think that artificial intelligence, large language models, will have, and we are doing a lot of work on this, over the medium to long-term, a big impact in improving processes and efficiencies in the operational services that we have. We have, I don't know, 100,000 and 150,000 people doing operational things, or in call centres, or things like that. Artificial intelligence will have a big impact in many domains, in the way that we manage documents, in the way that we manage voice, e-mails". (Barclays Global Financial Service Conference 2024)

Roche

"AI will revolutionize drug development. And it's not going to revolutionize drug development tomorrow, it's happening today. It's happening now. And Roche and Genentech have really been a leader in this space." (Roche Pharma Day 2024).

Our holdings in **Nvidia, ARM, AMD, Synopsys and ASML** are the obvious 'picks and shovel' investments, but **all** the portfolio's holdings are investing in artificial intelligence in a major way.

Software

Having been the darling for the past decade, **software** has been an under performer in the last twelve months. There is a prevailing sentiment that AI will *disrupt* software. Yet, while there will be cases of software disruption, we consider that many software companies will be the ones that deliver the 'killer AI apps' that we have been waiting for. **Salesforce** recently unveiled their 'Agent Force' application and performed a live demonstration with New York's esteemed retailer Sachs. The demonstration was highly impressive with life like interactions, highly efficient customer service and a fully satisfied customer. **Adobe's** Firefly is yet another AI application that is in high regard, with users impressed with the leap forward in the user interface and efficiency of image creativity – all in compliance with copyright laws. **Intuit** has long used generative tools to assist users to complete their tax submissions and has delivered even greater service levels by using the latest AI tools available to them.

Yet, the software as a service model where the revenue model is on a 'fee per user' is at risk as AI causes productivity to explode and users diminish. The usage model that most will evolve to, will necessarily be more volatile, but may have better growth prospects. Investors need to be prepared for recognising value in a vastly different way from the past ten years. Software's recent compression in valuation multiples is beginning to look very attractive.

Alphabet

The Department of Justice currently has a large workload with cases against more than 45% of the market cap of the S&P 500. Of particular note, are the cases with Alphabet (Google's parent). There is a case against Alphabet regrading Google Search as the default browser on IOS in lieu of payment to Apple. We consider this case will have little impact on Alphabet but might adversely impact Apple if the court rules that c.$25 billion of annual payment from Google to Apple violates legislation. Of far greater significance in our view is the case the DOJ is bringing against Alphabet regarding Advertising Technology monopoly.

In very broad terms, there are Advertisers and Publishers. Advertiser's 'employ' Demand Side Platforms that essentially bid for online advertising space, depending on the advertisers' goals and objectives. Publishers employ Supply Side Providers to auction space on their website to the highest bidder. The Supply Side Providers and Demand Side Providers essentially 'clear' their inventories on an Ad Exchange. However, this process happens in milliseconds, curating adverts for each individual user. It is more effective to dynamically change the advert based on who is seeing it as this increases the likelihood it is clicked on.

Through acquisitions Google established a presence in most elements of the AdTech ecosystem. In mid-2000s, Google had a strong hold in the demand-side of the platform (advertisers paying for AdWords). However, Google wanted to expand the ad inventory on its network (the sell-side/AdSense). Google needed to sign up more publishers to get hold of their inventory. Initially, Google looked to launch its own Sell Side Provider, but this ultimately failed to gain traction according to the DOJ. The largest Sell Side Provider at the time was DoubleClick (c.60% of market share). It's sell-side product was called 'DoubleClick for Publishers'. Google acquired DoubleClick in 2008.

As described in the DOJ complaint (2022):

> *"The DoubleClick acquisition was a pivotal moment for Google's display advertising technology business and its strategy to dominate the ad tech stack. The deal provided Google with direct access to website publishers (and their inventory) on DoubleClick's publisher ad server and, for the first time, a significant presence on both the advertiser and publisher sides of the ad tech stack."*

It is important to recall that the acquisition was scrutinised by the Federal Trade Commission at the time, and the deal was granted permission. With a full understanding of how Google has used DoubleClick, it is evident that Google has completely tied up the Ad- tech industry.

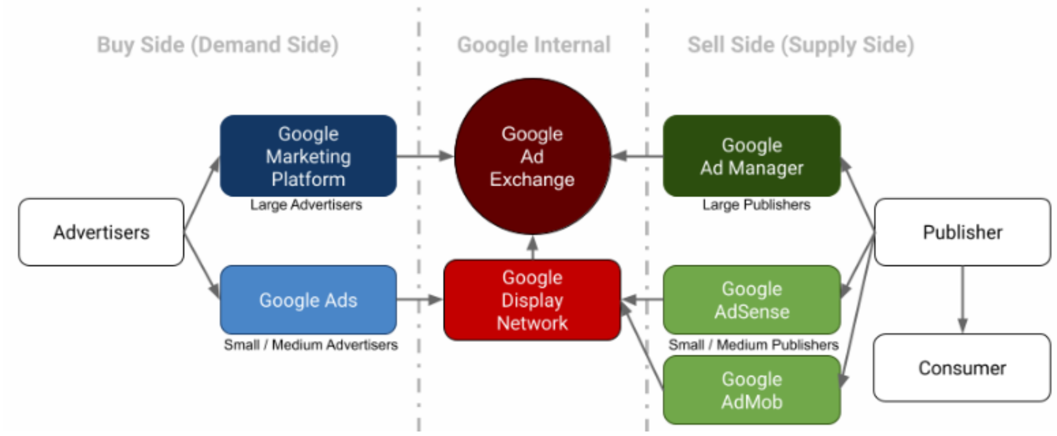

Figure: source

The Department of Justice has called for a split of Alphabet (amongst other things). It has been over 40 years since the DOJ has been successful in forcing a split of a company (the prior being AT&T). This shows that the bar for a break up is high. Clearly, Alphabet will provide a substantial battle against the motions and use as many routes to appeal as possible. The earliest we are likely to see a result is 2027.

The consequences to Alphabet's revenue and earnings are not material. This case impacts around 10% of Alphabet's revenue in total and this revenue will not disappear, rather a portion of it may need to be divested. The stock is already the cheapest of the Magnificent 7 and trading at a valuation below the overall market, at 20x FY1 earnings.

However, if this case does succeed, the actions pursuing other business models where the entire ecosystem is controlled end to end by one vendor, (such as Apple's Appstore), will gain significant momentum.

Summary

There is always plenty going on in the Technology industry. Its influence is everywhere, permeating individuals lives and corporates of all industries. Headlines cause volatility which we presently view as opportunities. Just last night Jensen Huang, Nvidia's CEO said "Blackwell is in full production," and "demand for Blackwell is insane". (CNBC).

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