GCQ

GLOBAL CONCENTRATED QUALITY

18 July 2023

Investor Letter

"At one extreme of the pendulum – the darkest of times – it takes analytical ability, objectivity, resolve, even imagination, to think things will ever get better. The few people who possess those qualities can make unusual profits with low risk."

- Howard Marks

Dear Fellow Investor,

We are pleased to be sending you this semi-annual letter for the GCQ Flagship Fund.

The P (or "Platform") Class of the GCQ Flagship Fund was established on 1 July 2022 to facilitate investment in the Fund by investors who prefer to invest via a platform and with daily liquidity. Over the period from 1 January 2023 to 30 June 2023 the net return for investors in P Class units was **+35.9%**[1]. This brings total returns since inception on 1 July 2022 to **+39.0%**[1].

We believe that investment performance should be measured over the course of a business cycle, and that the period since inception is too short to make any meaningful assessment. At GCQ, we do not refer to any benchmark when selecting investments, and our concentrated portfolio differs greatly from any stock market index. However, for the purpose of putting our returns into context, the below table outlines our returns relative to the MSCI World Index (AUD).

Returns	Since January 2023	Since July 2022
GCQ Flagship Fund (P Class)[1]	**+35.9%**	**+39.0%**
MSCI World Index (AUD)	+17.7%	+22.8%
Outperformance	**+18.2%**	**+16.2%**

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[1] Net performance figures are shown after all fees and expenses and assumes reinvestment of distributions. Past performance is not an indication of future performance.

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Broad-based performance across the GCQ portfolio

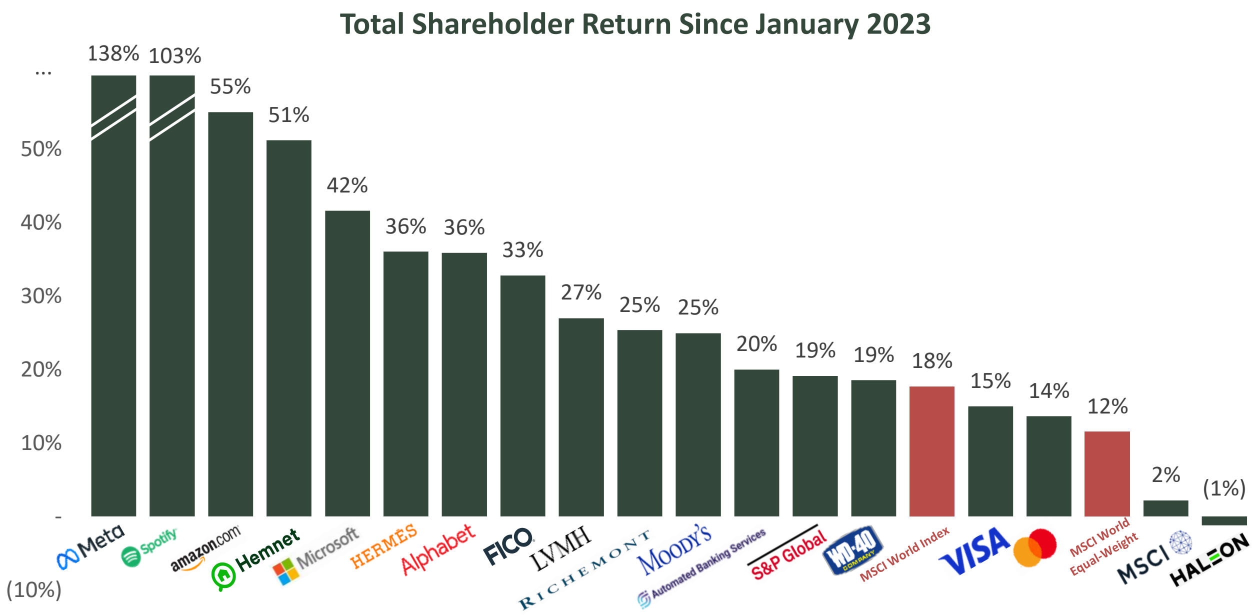
Equity markets saw a recovery in the first six months of 2023 despite continued investor anxiety about inflation, increased interest rates and a possible economic slowdown. However, this rally was driven by an unusually small number of stocks including several of the world's largest technology companies.

Looking at equal-weighted indices tells us that the average stock in the MSCI World Index delivered shareholder returns of +12%, underperforming the index by 6%. Meanwhile, the average S&P 500 constituent underperformed by 10% – the widest margin in 34 years.

In this context, we are particularly pleased that the **+35.9%** return we have generated for GCQ's clients since January 2023 has been **broad-based** across the portfolio.

We seek to outperform by owning high-quality businesses with secular growth and pricing power, that generate substantial cash flow today, have no debt and operate within favourable industry structures. Our returns have been achieved while avoiding hyper-growth stocks in hot sectors such as artificial intelligence.

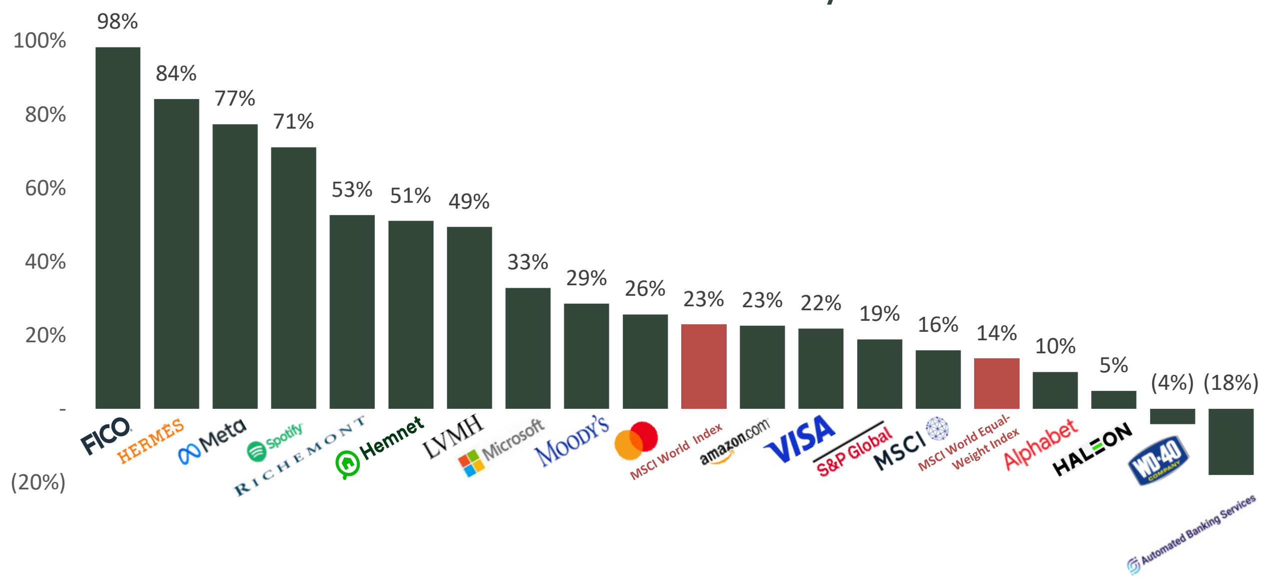
89% of the stocks in our portfolio have outperformed the average stock in the MSCI World Index since January 2023, while **78%** have outperformed the official MSCI World Index.



Note: Excludes Rightmove, which was purchased in June 2023.

78% of the stocks in our portfolio have outperformed the average stock in the MSCI World Index since July 2022, while **56%** have outperformed the official MSCI World Index.

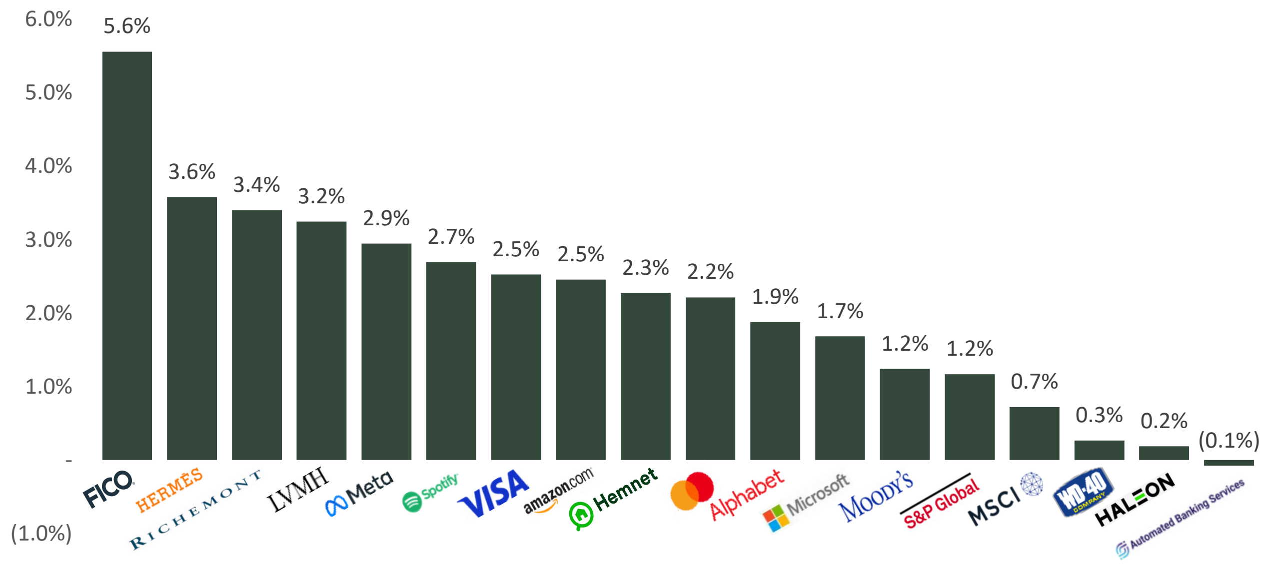
Total Shareholder Return Since July 2022



Note: Excludes Rightmove, which was purchased in June 2023.

The below chart shows a breakdown of the contributors to the **+39.0%** return we have generated for GCQ's clients since July 2022. Returns have been broad-based across the portfolio.

Attribution Since July 2022



Note: Excludes Rightmove, which was purchased in June 2023.

The GCQ investment process

Our objective is for GCQ's investment strategy to deliver high-quality investment returns over the longer term and through various economic and market cycles.

At the heart of the strategy is a portfolio of approximately 20 investments in what we believe to be some of the highest-quality listed companies in the world, trading at valuations that offer attractive future returns to shareholders.

You may recall that we place great emphasis on analysing the industry that a company operates within before progressing our work on a particular company. Central to our process for both industry and company analysis is our use of the **GCQ Quality Checklists** to ensure discipline and consistency in our approach.

Our **GCQ Industry Quality Checklist** provides a snapshot of whether an industry has a structure and growth outlook supportive of sustainably strong shareholder returns.

We then assess potential investments using the **GCQ Business Quality Checklist**. This is a separate set of 15 questions that seek to drill down on similar themes to the industry questions, but at a company level. In addition, the GCQ Business Quality Checklist includes questions around the balance sheet (we prefer to see minimal financial leverage), the capability of management, and whether corporate governance is friendly to minority shareholders.

Finally, for certain industries, we pass potential investments through **Industry-Specific Checklists**, which capture the factors that determine success *within* industries. The GCQ super-luxury goods checklist is shown below as an example.

Much like a pilot completing a take-off and landing checklist, these simple questions are designed to keep us out of trouble.

Industry Quality Checklist

- ☑ Durable secular growth
- ☑ High margins
- ☑ Limited competition
- ☑ Low disruption risk
- ☑ Bargaining power with customers
- ☑ Bargaining power with suppliers
- ☑ Durable industry structure
- ☑ Predictable
- ☑ Low regulatory risk

Business Quality Checklist

- ☑ Strong organic secular growth
- ☑ Sustainable competitive advantages
- ☑ Pricing power
- ☑ High margins
- ☑ High returns on incremental invested capital
- ☑ Durable cash flows
- ☑ Predictable
- ☑ Low operational risks
- ☑ Balance sheet strength
- ☑ Capable management
- ☑ Manageable ESG risks

Industry-Specific Checklists (e.g., super-luxury goods)

- ☑ **Brand heritage**: Has the brand been around for >100 years?
- ☑ **Discounting**: Does the brand avoid discounting?
- ☑ **Distribution**: Does the brand control its distribution?
- ☑ **Category durability**: Preference for leather goods and jewellery
- ☑ **Predictability**: Is the brand immune to fashion cycles?
- ☑ **Pricing power**: Does the brand increase prices regularly?

Our team focuses its time on 15-20 industries that meet the requirements of our Industry Quality Checklist. Within these industries, there are around 200 companies we research closely, and whose performance and valuation we monitor for potential inclusion in the GCQ portfolio.

The decision to formalise the use of Quality Checklists came about when we were establishing GCQ, and our investment team looked back over our collective investment successes and failures over the decades to see if we could identify any themes.

What stood out was that, almost without exception, our mistakes were made when we were seduced by company-specific factors while paying insufficient attention to the quality of the industry in which a company operated. We might have been attracted to a compelling valuation argument, a turnaround opportunity spearheaded by a talented CEO, or an attractive quirk to a business model. It was only with the benefit of hindsight that we realised issues in the broader industry – whether the rate of industry growth or the competitive landscape – meant the investment was destined to fall short of our expectations.

Learning from these mistakes, we introduced Quality Checklists to help our team identify attractive industries where the leading companies are highly likely to deliver fundamental outperformance over a five-year period.

Coupled with rigorous valuation analysis and a commitment to only invest at an attractive price, this process is focused on sifting out the roughly 70% of companies that will underperform index benchmarks over our investment time horizon.

We do not pretend to be able to identify every company that will outperform. Instead, our focus is on investing in simple, predictable businesses with durable competitive advantages arising from some combination of network effects, scale, position as an industry standard and brand differentiation.

We are also not afraid to miss “hot” sectors in relatively young industries where the competitive landscape is rapidly changing. For this reason, we tend to avoid investing in hypergrowth stocks, and instead focus our time on high-quality industries and companies.

Portfolio Update

“The intelligent investor gets interested in big growth stocks not when they are at their most popular – but when something goes wrong.”

- Benjamin Graham

While portfolio turnover is generally low and we intend to hold our investments for many years, the investment team is constantly hunting for opportunities to upgrade the quality and attractiveness of the portfolio. Some of these changes to portfolio weights take place when we see an opportunity to take advantage of short-term market dynamics. Here, we seek to use the pendulum of the market to our advantage, buying industries and companies that are out of favour, while selling those that are more fully valued.

Buying a high-quality company that is out of favour requires both the patience to wait for attractive opportunities, and the courage to act in size when other investors are overly pessimistic. Successful investing also requires the discipline to sell positions when sentiment becomes increasingly positive, and our assessment of fair value has been reached or exceeded. We believe identifying these opportunities, and getting the timing roughly right, has the potential to materially enhance GCQ’s returns over time.

Our investments in the super-luxury goods industry provide a good case study. We built our investments in the super-luxury goods industry in 2022, when valuation multiples were compressed primarily due to concerns about extended Covid-19 lockdowns in China. While we did not know *when* China’s lockdowns would end, we knew they *would* end. The issues faced by these businesses were therefore temporary in nature, and we were being presented with the opportunity to buy into wonderful businesses at attractive prices. We invested around 15% of the portfolio in the highest-quality super-luxury companies – **Richemont**, **LVMH**, and **Hermès** – to take advantage of this situation.

Just one year on from this initial investment, the pendulum had swung a long way back, and our super-luxury company share prices were once again hitting record highs, up between 50% to 80% from their lows of 2022. By January 2023, the super-luxury companies had grown to represent 20% of GCQ’s portfolio, and with the companies closer to fully valued, we reduced these holdings substantially. Today, our combined weight in Richemont, LVMH, and Hermès is just 6%. This has been the largest change to GCQ’s portfolio in the first six months of 2023.

We have redeployed capital into opportunities that we expect to deliver stronger returns over time.

We made **Alphabet** (the parent company of Google) our single largest investment, at 12% of the portfolio, during a brief period in which investors questioned whether Google’s leading position in search would be usurped by ChatGPT. Google has been on our high-quality watchlist since its IPO twenty years ago, and we saw this as an exceptional period to buy one of the best businesses in the world at a discounted valuation. We understand Google’s business model and industry structure well, and were comfortable betting on Google’s continued dominance at an adjusted free cash flow multiple of below 10x for the core business. The market has been relatively quick to come around to our view, with Alphabet’s stock up approximately +40% from its lows recorded at the start of

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2023. We continue to think that Alphabet is attractively valued today at approximately 14x free cash flow. We discussed this opportunity in our February 2023 Portfolio Update.

We also used the capital generated from our super-luxury sales to increase our investments in **Hemnet**, **Amazon**, **Meta**, **Microsoft**, and **Haleon**.

Toward the end of the half year, we initiated a new portfolio position in **Rightmove**, the UK's leading property portal, with greater than 75% market share. Property portals operate within an incredibly high-quality industry that the GCQ team watches closely. In fact, we have been following Rightmove since the time of the company's IPO in 2006. At the time of our purchase in June 2023, Rightmove was trading at just 19x free cash flow – the cheapest it has been in a decade – despite growing revenues at a mid- to high-single digit rate and generating the highest EBIT margins of any company in the FTSE 100 Index – at GCQ, we do love monopolies! We will discuss Rightmove in more detail in an upcoming monthly portfolio update.

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GCQ Portfolio Overview as at 30 June 2023

An overview of GCQ's portfolio is shown below. With our investments still trading well below our appraisal of fair value, we think the portfolio is well positioned for the coming years.

Company	Portfolio Weight
Hemnet	10%
FICO	6%
rightmove	3%
Local monopolies	**19%**
Alphabet	12%
Meta	6%
Global online advertising	**18%**
amazon.com	11%
Microsoft	6%
Global cloud computing	**17%**
VISA	9%
	7%
Global consumer payments	**16%**
S&P Global	6%
Moody's	4%
MSCI	2%
Credit rating agencies & investment index providers	**12%**
RICHEMONT	4%
LVMH	1%
HERMÈS	1%
Super-luxury goods	**6%**
HALEON	4%
WD-40 COMPANY	2%
Branded consumer goods	**6%**
Other high-quality businesses	**6%**
Shorts	**2%**
Net Exposure	**97%**
Cash	**3%**
TOTAL	**100%**

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GCQ Team and Culture

Our introductory letter from December 2021 highlighted that maintaining a healthy team culture was one of the factors we had identified as essential to GCQ's long-term success.

We have maintained and reinforced the positive elements of our culture as GCQ has grown, and we now have a team of eight across the investment team, operations, and distribution.

We are delighted that **Weipei Luo** joined us full-time in February 2023 as an Investment Analyst after completing the final year of her Bachelor of Commerce and Advanced Studies degree at the University of Sydney. Weipei worked with us on a part-time basis during 2022 while she completed her studies.

We are always on the lookout for high-quality investment team members, and will welcome a new Senior Investment Analyst, with almost ten years investment experience, to our team early in 2024.

We have also recently developed a structured intern program for university students nearing the completion of their undergraduate studies. Each intern will join the investment team for a period of approximately five weeks, and we hope to have around 2-3 interns each year. The first intern employed under this program started at GCQ in June 2023.

Ensuring all elements of our investment team and business operations are fully resourced as our business grows is a high priority for us. If you know anyone with the right skills and experience who may be interested in joining GCQ, please get in touch.

GCQ Flagship Fund Update

We established the P Class of the GCQ Flagship Fund to facilitate investment in the Fund by investors who prefer to invest via a platform and with daily liquidity.

Following a detailed review process, we were pleased to receive a "Recommended" rating[2] from **Zenith Investment Partners Pty Ltd ("Zenith")** in March 2023. Following receipt of the Zenith rating, the P Class has been accepted for investment through several investment platforms including **Macquarie**, **Netwealth**, **HUB24**, **Praemium**, **BT Panorama**, and **Mason Stevens**. Our Chief Operating Officer **Kathy Wu** has been instrumental in achieving this great outcome for GCQ's clients.

[2] The Zenith Investment Partners (ABN 27 103 132 672, AFS Licence 226872) ("Zenith") rating assigned to the GCQ Flagship Fund Class P on 7 March 2023 referred to in this piece is limited to "General Advice" (s766B Corporations Act 2001) for Wholesale clients only. This advice has been prepared without taking into account the objectives, financial situation or needs of any individual, including target markets of financial products, where applicable, and is subject to change at any time without prior notice. It is not a specific recommendation to purchase, sell or hold the relevant product(s). Investors should seek independent financial advice before making an investment decision and should consider the appropriateness of this advice in light of their own objectives, financial situation and needs. Investors should obtain a copy of, and consider the PDS or offer document before making any decision and refer to the full Zenith Product Assessment available on the Zenith website. Past performance is not an indication of future performance. Zenith usually charges the product issuer, fund manager or related party to conduct Product Assessments. Full details regarding Zenith's methodology, ratings definitions and regulatory compliance are available on our Product Assessments and at Fund Research Regulatory Guidelines.

We are always eager to receive feedback from our stakeholders on all elements of the business, and this includes structural elements of the Fund. For example, Zenith indicated a preference for funds to pay income distributions more frequently than annually, which alleviates potential issues involved with large distributions at 30 June.

We have taken Zenith's feedback on board and updated our fund documentation such that semi-annual distributions (if any) will now be paid within two months of the end of June and December. As previously, distributions will be reinvested in the Fund unless otherwise instructed.

Note that the nature of GCQ's investment strategy means that distributions will often be minimal. Preliminary analysis suggests that no distribution will be payable for the year to 30 June 2023.

In Closing

Despite a year of strong performance, we believe the GCQ Flagship Fund is well-positioned to compound capital at attractive rates going forward. We have taken advantage of share price movements to refresh the portfolio with opportunities in high-quality industries and businesses. Meanwhile, our portfolio companies continue to perform well, and are trading at valuations well below our appraisal of fair value.

At GCQ, we do not try to time markets. Instead, the Flagship Fund is almost always near-fully invested in a portfolio of high-quality businesses. We have found that over time, we tend to get a much better outcome by being fully invested through market cycles.

We are confident that we own a portfolio of high-quality businesses that should continue to compound intrinsic value at attractive rates over the next 3-5-years, regardless of the broader market environment.

Thank you for investing with us at GCQ. We look forward to a long-term partnership.

Yours faithfully,

GCQ Funds Management

"If the Fed Chairman were to whisper to me what his monetary policy was going to be over the next two years, it wouldn't change one thing I do."

- Warren Buffett

DISCLAIMER