CERNO CAPITAL

TM Cerno Global Leaders

UCITS Global Equity Portfolio (Class A)

Q4 2019

Investment Objectives

TM Cerno Global Leaders invests in global companies with sustainable competitive advantages delivering above average returns. Its target is to deliver performance in excess of MSCI World Total Return (GBP) on a 3 year rolling basis. The fund will hold 25-30 securities, equally weighted, selected according to a distinct investment thesis that accents industry structure, the sustenance of return on capital and secular growth. The fund does not invest in banks, commodity, fossil fuel or tobacco companies. The portfolio is fully invested at all times.

Fund Data

NAV/Share (Class A Acc)	£11.95
Fund Size (£mn)	70.7
Strategy Assets (£mn)	102.3*
Currency Share Class	GBP (Base)
Investment Management Charge	0.65%
Ongoing Charges Figure	0.90%**
Dealing Frequency	Daily
Legal Structure	OEIC (UCITS)
Number of Holdings	27
Active Share	97.6%
Lead Manager	James Spence
Inception Date Fund	2017
Inception Date Strategy	2014

**Includes all assets within the fund as well as other Cerno managed assets invested directly in to this strategy*

***OCF includes the Investment Management Charge*

Competition and Collaboration

Most conventional models of big business rightly emphasise the competitive interaction of companies in their market places. This is the lens through which we comprehend industry structure and its evolution in relatively open and free trading capitalist economies.

The world's favourite body of work on the subject derives from Charles Darwin's C19th Theory of Evolution and his central idea of survival of the fittest. Large company CEOs tend to believe in these concepts implicitly even if they have not read a word of Darwin's original texts.

However there lies, within the competitive arena, another more nuanced set of interactions which are collaborative. Collaboration between companies is less cited, for a number of reasons. First and foremost, it could be construed as marking some loss of agency or primacy in competition. It is suggestive of trade-offs, even if trade-offs are often highly intelligent and correct on a risk/reward basis.

Furthermore, in 21st century market places that worship dominance but revile monopolies, collaboration could sometimes be construed as collusion.

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Every global industry of consequence has a rich back-story. How did certain natural (or unnatural) advantages coalesce around the industry winners? How important did location, government or cost of critical inputs play? What was the nature of the interaction of early stage leaders and how did key discoveries emerge and were subsequently commercialised? How did key opinion formers develop their own careers. Where did they work, who did they collaborate with and who did they fall out with?

Modern CEOs – compressed as they are into reductive orthodoxy in their public statements - seldom speak of such things, even if they have dwelt on them. Large companies have no strong incentives to make honest accounts of from where they derived their historical advantages. The truth is multi-fold. Sometimes the playing field was tilted, intellectual property was purloined (even if legally) and that considerable advantages were conferred by cost advantages.

In the mid-20th Century, the US technology industry secured its leadership as a result of human and technology transfer from the US defence industry into entrepreneurial private enterprise. Prior to the invention of the world wide web, most US technology companies can be traced back to two enterprises: Bell Laboratories and Lockheed Martin. China's rising might in the later part of the 20th Century is partly derived from the deliberate low costing of energy tariffs and its emphasis on coal fired power stations: at a great cost to the wellbeing of the planet. It benefited for 25 years from the migration of the rural poor to cities: their poverty and its resultant cost advantages was itself derived from the brutal sins of Maoist economics. Japan's ascendance in Integrated Circuits and then microchips through the 1950s to 1980s was born of a hunger to rebuild economic strength in the lee of WWII but would have floundered had they not studied and copied US advances in these sectors.

These are perhaps extreme examples. A more benign account would point to the very things that marks human beings as advanced apes: our willingness to collaborate to derive mutual advantages. This urge is derived from both rational thought and emotive love, generously spiked by self-interest. The writings of Yuval Noah Harari has developed our understanding of this. When we consider the complex operations of Global Leader companies we find many examples of rational interaction, within and across sectors.

One of the most interesting examples is Microsoft, principally as it has transitioned from being a monopolist in its core business to a more open and engaging enterprise. Oracle, having not been active enough in the land-grab that is cloud services finds itself intelligently incentivised to work with Microsoft rather than exchange brick-bats, as it might have done in the past. Philips, the Dutch health care conglomerate, which once upon a time would have attempted to invent everything precisely because its scientists were so good at inventing can see the benefits of working with Samsung Electronics and Microsoft. Nestlé is consciously placing greater emphasis on the provenance and consistency of its raw materials inputs. By working with specialist industrial measurement company Waters, it can achieve better calibration and extend into personalised, bespoke nutrition which it is now doing through a division called the Nestlé Institute for Health Science. The text below expands on these examples.

Under CEO Satya Nadella's guidance, Microsoft is both familiar and unrecognisable. After some years in the strategic wilderness under former CEO Steve Ballmer, the company has pushed hard into cloud service provision through leveraging the dense network power of its core dominance in home and office computing. Azure, its cloud infrastructure business, now accounts for one third of revenues, and by market share is second only to Amazon Web Services. The complexity of migrating commercial workloads in full to the cloud has created enhanced demand for a hybrid environment of public cloud and physical server. This has brought the legacy Windows server business into play. Microsoft is the only leading cloud provider capable of providing hybrid environments, which, in our view, are likely to become the dominant cloud paradigm.

Mr Nadella's singular vision has helped transform what could conceivably have become a directionless company. No less critical has been the shift in company culture towards a more collaborative and open stance. Microsoft was historically an active opponent of open source, seen by most independent developers as Enemy #1. Mr Nadella has emphasised user experience over short term market

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share by partnering with a number of rivals to integrate Microsoft products onto their platforms. This flies directly in the face of the jealous protectionism that was the hallmark of its past and has created a more flexible and faster growing business at the other end. Recent partnerships with Oracle and SAP demonstrates this shift.

Oracle is the dominant provider of database software globally. Microsoft is a distant second, followed by IBM. In July the two companies announced a partnership to allow customers to migrate and run mission-critical enterprise workloads across Microsoft Azure and Oracle Cloud. This allows enterprises to seamlessly connect Azure services, like Analytics, to Oracle Cloud services, like Autonomous Database. From an Oracle perspective this is a tacit admission that its failure to enter cloud infrastructure with the first wave has been costly. It is now better to share in the pie than be out in the cold. Microsoft's ecosystem now sports database offerings used by over 60% of the world's enterprises.

Microsoft Azure and Oracle Cloud working together
Source: Microsoft

Adobe is the de facto standard in content creation software through its Photoshop and Illustrator applications. It has been extending its reach from its core into marketing services through the 2018 acquisitions of Magento and Marketo. This elevates the company's offering into direct competition with the customer relationship leader, Salesforce. Finally, in March Adobe announced a new partnership with Microsoft to integrate LinkedIn with Adobe's marketing solutions. Aligning the data sources of the two software systems should enable clients to gain an edge over Salesforce users through enhanced targeting. Apart it would have been a struggle to break the grip of Salesforce. Together the firm's unique offering is more than the sum of its parts.

Microsoft's success continues to be underpinned by a singular focus on providing a 'distributed computing fabric'. Its successful execution of this goal comes down to an understanding of the need for partnerships with companies which are world-leading in their domains. Combined the ecosystem becomes mission critical. In a 2019 survey of corporate Chief Technology Officers by JPM, Microsoft was far and away the most 'critical' IT vendor, polling 31 points ahead of Amazon, up from 25pp in 2018.

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The healthcare sector is known to suffer systemic administrative inefficiencies where costs can increase much faster than incremental improvements in quality. This is an endemic problem that must be addressed as aging population and growing prevalence of chronic diseases puts increasing cost pressures on healthcare systems and individuals globally.

Healthcare companies such as Philips are responding to this by adopting digital tools and solutions, which, combined with medical hardware, can create a more integrated system for diagnosis, monitoring and treatment of patients. A few of the major trends in digitising healthcare involves tele-health for remote patient care, Augmented Reality/Virtual Reality (AR/VR) enabled devices for immersive surgery (for training and live use) and robotic surgical platforms to enhance precision and accuracy.

Philips' Connected Care division at work
Source: PRNewswire

Philips' Connected Care division created recently as part of business restructuring is dedicated to exploration of new healthcare delivery methods through data analytics, adaptive intelligence, and software via connected devices. This is a key focus of the Group's R&D effort, as they seek to improve accessibility for both patients and healthcare professionals.

They are not going about it alone, leveraging expertise from non-healthcare tech companies including Samsung Electronics and Qualcomm to co-develop connected ecosystems. The partnership will see them share technology across their respective Internet of Things (IoT) platforms, ARTIK and 2net with Philips' own HealthSuite platform. These are cloud-based digital suites that enable consumer and healthcare professionals to safely access, share, and analyses information through remote monitoring of electronic medical records (EMR) and data generated from wearables and connected medical devices in a timely fashion. Creating such a collaborative ecosystem for connected devices enables 3rd party application developers to access a wider range of informatics and ease the need to duplicate the same app for different systems, as well as allowing users to form coordinated and informed responses.

In the clinical setting, Philips is also collaborating with Microsoft to explore augmented reality (AR) features for their industry leading image-guided therapy platform for minimally invasive procedures, using Microsoft's HoloLens technology, as a concept

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device. By nature, this type of procedure reduces visibility of the patient's internal anatomy (due to small incision), surgeons must rely on real-time imaging and navigation solutions to guide their surgical tools and implants.

The AR feature brings live medical imaging and data into a 3D holographic environment that can be easily interpreted and manipulated by a surgeon, by allowing voice recognition, eye tracking and advanced gestures, giving them a more interactive way access vital informatics. This new technology hopes to improve procedure planning, enhance surgical accuracy and reduce operating times. Minimally invasive surgery is the preferred option for patients where possible, as opposed to open surgery, as it reduces post-operative pain and expedites recovery, as well as lowering the total cost of the total process.

The Global Leaders portfolio owns both manufacturers of consumer products and manufacturers of capital goods which might be purchased by the latter. One of our companies selecting another to supply goods or services provides useful insights and perhaps some confirmation of our assessment of competitive advantage.

Nestlé has long been interested in the science of nutrition. While the company is well known for its milk-based products, the Nestlé portfolio spans a much wider range of goods from Vitamin supplements to pet care.

In 2011, the company established the Nestlé Institute for Health Science (NIHS) with the objectives of creating knowledge to define and target nutrition solutions and to translate these insights into the development of nutrition solutions. This requires research which models complex interactions between diet, genetics, lifestyle and environmental factors.

To understand the impact of the nutrients we eat, scientists at the NIHS measure the status of vitamins, amino acids, fatty acids and minerals within the human system. This type of analysis was historically challenging given the need for large quantities of blood or urine sample coupled with slow testing procedures. Therefore, systematic testing of the type required by the NIHS with its objective of creating nutrient solutions was challenging.

In 2014, the NIHS and Waters Corporation announced a collaboration to develop new tests for measuring the quantity of vitamins in body fluids such as blood and urine. This combined the NIHS's expertise in nutrients and micronutrients with Waters state-of-the-art analytical technologies. By enlisting Waters Corporation, the NIHS was able to develop new methods of measuring the nutrients and micronutrients in a quick, accurate and robust way. These tests relied on mass spectrometry equipment supplied by Waters. In turn, these tests would let scientists build a comprehensive picture of a person's nutrient status which can be investigated in relation to age, health and genetic background. The goal of this work was to better define the specific nutrient needs of people with different diets and lifestyles around the globe, to measure their biological response to nutrition and ultimately meet their nutritional requirements.

Roll forward to 2018 and Nestlé has begun to offer nutritional advice in the Japanese market based on blood and test results alongside analysis of dietary habits. Most recently, Nestlé has added Persona to its stable of vitamin supplement products under the Atrium brand. Persona is a provider of personalised vitamin packages.

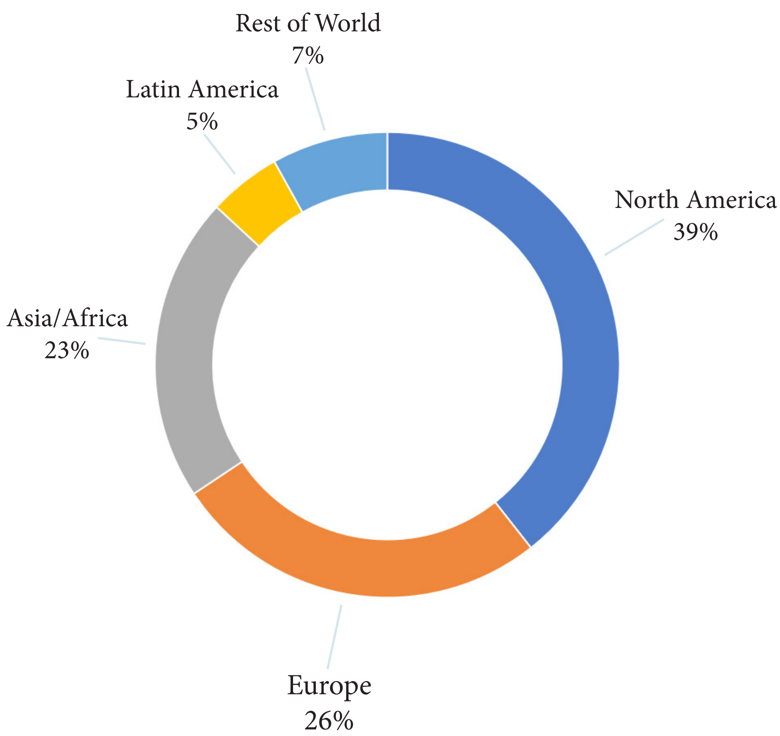
- James Spence, Fay Ren, Michael Flitton & Fergus Shaw

Holding History

Company Name	Description	Holding Period*
Samsung Electronics	Dominant in semiconductor memory chips and leader in smartphones	>6 years
Nestle	Diversified global food & beverage company	>6 years
Visa	Largest global electronic payments network	>6 years
Zimmer Biomet	Leading orthopaedic care specialist	>6 years
Linde	Largest industrial gas provider in the world	>6 years
Renishaw	Engineering specialist focused on equipment for precision measurement	>5 years
Johnson & Johnson	Global healthcare company spanning pharma, medical devices, consumer	>5 years
Fedex	Leading provider of Express Delivery services in the US	>5 years
PPG	Coatings company leading in the industrial/specialty business	>5 years
Shimano	Dominant supplier of cycling componentry	>4 years
Givaudan	Leading player in the Flavours and Fragrance industry	>4 years
Novozymes	Produces enzymes which application in a wide variety of daily products	>4 years
Coloplast	Global healthcare provider focused on ostm and conrinence care	>4 years
LVMH	The largest luxury goods conglomerate and most diversified	>2 years
Rockwell Automation	Largest pure play in industrial automation and control processes	>2 years
EssilorLuxottica	Vertically integrated producer of luxury, fashion and sports eyewear	>2 years
Oracle	The largest database and enterprise software company in the world	>2 years
Ansys	Leading developer of digital simulation software for product development	>2 years
Fresenius Medical	The foremost player in dialysis care active along the entire value chain	>2 years
Waters	World leader in specialty measurements focused on the life sciences sector	>2 years
Heineken	Brewer with a strategic bias to premium beer, interests in low alcohol/craft	>2 years
Atlas Copco	Dominant producer in air compression and vacuum techniques	>2 year
TSMC	World’s largest pure-play semiconductor foundry	>1 year
ASML	Leading photolithography tools manufacturer for the semiconductor industry	<1 year
Nidec	Global top supplier of brushless DC motors for a diverse set of applications	<1 year
Microsoft	Dominant player in computing operating system and business software platform	<1 year
Philips	Healthcare technology company serving professional and consumer markets	<1 year

**Holding periods relate to the entirety of the strategy within Cerno Managed Assets*

Sales by Geography and Valuations



Global Leader companies are, by definition, global in their sales. Their domiciles are not an investment consideration and most of the companies have outgrown their home market base many decades ago.

The perceived reliability of the earnings of constituent companies and the fact that they have commanding market shares in their industries means that they will trade at a premium to wide equity market aggregates. The question is how much? The portfolio has an aggregate Return on Equity of 24% versus 17% for the World Equity Index.

We aim to rationalise margins, earnings consistency and economic value against the price paid. The fund's approach to vaulation could be described as growth at a reasonable price (GARP).

Performance

Period	**Q4 2019**	**2019**	**2018**	**Since Inception***
Performance	+3.8%	+26.3%	-5.2%	+19.5%

**The fund was launched on 1st November 2017*

Characteristics	Global Leaders*	S&P 500	MSCI World
Price/Earnings (1Y Forward, x)	23.8	18.4	16.9
Return on Equity (%)	22.0	15.1	12.2
Return on/Cost of Capital (%)	1.5	N/A	N/A
Gross Margin (%)	51.8	33.6	31.4
Operating Margin (%)	20.6	12.9	11.5
Net Debt/Equity (%)	19.5	68.3**	53.7**
Dividend Yield (%)	1.8	2.0	2.5

* This data refers to the underlying holdings
**ex financials

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Key Fund Information

Investment Objective	Returns in excess of MSCI World Equity Index (TR) on a three-year rolling basis
Sector Exclusions	Banks, Fossil Fuels, Commodities, Tobacco, Armaments
Savings Structures	Suitable for SIPPs and ISAs
Key Fund Documents	https://cernocapital.com/tm-cerno-global-leaders
Counterparties	Authorised Corporate Director: Thesis Unit Trust Management Trustee: NatWest Trustees Custodian: Northern Trust Auditor: Grant Thornton UK LLP
Contact	Tom Milnes 0207 036 4126 tom@cernocapital.com

Fund Codes

	ISIN:	SEDOL:	Bloomberg:
A Acc	GB00BF00QK62	BF00QK6	TMCGLAA LN
A Inc	GB00BF00QJ57	BF00QJ5	TMCGLAI LN

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