GCQ FLAGSHIP FUND | P Class Units

MONTHLY PERFORMANCE & PORTFOLIO UPDATE

August 2024

Returns	1 Month	3 Months	6 Months	1 Year	2 Year (p.a.)	Since Inception (p.a.) (1 July 2022)
GCQ P Class (AUD)[1]	**-0.3%**	**7.7%**	**5.2%**	**25.2%**	**32.3%**	**32.1%**
MSCI World Index (AUD)	-0.8%	4.7%	6.3%	19.1%	21.4%	21.4%
Outperformance	**0.5%**	**3.0%**	**-1.1%**	**6.1%**	**10.9%**	**10.7%**

"A monopoly is an absolutely terrible thing - unless of course you own one!"

- Rupert Murdoch

The portfolio's net return for the month of August was **-0.3%**, which compares with the MSCI World Index (AUD) return of -0.8%. This brings the net return for P Class units to +82.8% since inception on 1 July 2022 (+32.1% annualised).

We exited the Fund's holding in FICO during August on valuation grounds. FICO had been a core position in the GCQ portfolio since the Fund's inception and our strongest performer, up +337% since July 2022.

We took advantage of market volatility early in the month to add to our exposure to Amazon, Alphabet and Rightmove when markets were at their lows.

September started strongly for the Fund, with Rightmove closing up +27% on the first trading day after Australia's REA Group (which is ultimately controlled by the Murdoch family) announced its interest in acquiring the leading UK property portal. When the Murdochs set their sights on an acquisition they rarely come away empty-handed.

Following this share price move, Rightmove became one of the Fund's five largest holdings. We have discussed our investment thesis in several investor updates and letters over the last year. Rightmove is a simple business sitting at the centre of a highly valuable transaction, a home sale, and has the highest margins of any company in the FTSE 100.

We built a significant position in Rightmove last year when the company sold off on market concerns that the UK's #3 real estate advertising portal would be reinvigorated under new owners.

It was no surprise to see Rightmove attract strategic interest as we believe the company's market position is virtually impregnable and the share price has been trading at irrationally low levels. Following Rightmove's strong share price performance, we have trimmed the position to take profits and keep within our discipline of investing no more than 20% of the Fund's assets in any one industry. From here, we will be watching closely with a view to maximising risk-adjusted returns for our investors.

Portfolio Overview as at 31 August 2024	Portfolio Weight
Hemnet	11%
rightmove	7%
Real estate advertising monopolies	**19%**
VISA	11%
Mastercard	7%
Global consumer payments	**18%**
MSCI	8%
S&P Global	4%
Moody's	1%
Credit rating agencies & investment index providers	**13%**
Richemont	10%
HERMÈS	2%
Super-luxury goods	**12%**
Alphabet	6%
Meta	4%
Global online advertising	**10%**
amazon.com	9%
Global cloud computing	**9%**
WD-40 Company	2%
Branded consumer goods	**2%**
Other high-quality businesses	**17%**
Total long	**99%**
Shorts	**(3%)**
Net exposure	**96%**
Cash	**4%**
TOTAL	**100%**

"Change captures our attention because it's surprising and exciting. But the behaviours that never change are history's most powerful lessons, because they preview what to expect in the future."

- Morgan Housel

INVESTING IN MARKET INDEX PROVIDERS

At GCQ, we love investing in businesses that own the intellectual property behind durable industry standards.

Industry standards are often entrenched in the processes or muscle memory of industry participants, and are typically incredibly difficult to dislodge. One example of this is the QWERTY keyboard, which was originally designed to minimise the jamming of typewriters in the 1800s, and was popularised through free typing classes by typewriter manufacturers. While QWERTY is not the most efficient layout for a modern computer or smartphone keyboard, it remains in widespread use due to its position as the industry standard.

We believe industry standards were the original beneficiaries of "network effects", before this term was popularised by the internet economy.

Several of GCQ's current and former portfolio companies, including S&P Global, Moody's, FICO and MSCI possess similar industry standard attributes.

Industry standards can make particularly attractive investments when they earn royalties on a growing asset base. For example, S&P Global and Moody's earn a high-margin royalty on rated global debt issuance; FICO earns a high-margin royalty on US consumer credit; while MSCI and the index business of S&P (which contributes ~20% of the company's earnings) earn a high-margin royalty on global equity appreciation and passive flows.

Stock market indexes such as the S&P 500 or MSCI World Index form durable industry standards. The most successful indexes become the language of communicating and benchmarking market performance, and are often synonymous with the relevant stock market. The more market participants that adopt an index, the stronger and more entrenched this industry standard becomes.

History of Indexes

Many investors think of the S&P 500 Index when thinking about the U.S. equity market, and the MSCI World Index when thinking about global equity markets, but the oldest still-quoted index is the Dow Jones Industrial Average (DJIA), which was introduced in 1896.

The DJIA was created by Charles Dow, the co-founder of the Wall Street Journal, as a way for investors to gauge the health of the stock market. It originally consisted of 12 large-cap industrial stocks, but grew to a portfolio of 30 stocks in 1928. The Dow Jones index is price-weighted (as opposed to market cap-weighted) for ease of calculation by the trading floor "chalkies". This means that stocks with a higher share price (as opposed to companies with larger market capitalizations) make up larger percentages of the index. Investor interest in tracking general market conditions increased following the market crash in 1929, which saw the index lose nearly 30% of its value over two days. The DJIA gave investors an easy way to monitor movements in the overall US equity market.

In 1957, the Standard "500" (later named the S&P 500) was introduced as a superior solution. The Standard "500" was groundbreaking not only for its breadth of stocks – its 500 constituents accounted for over 90% of the total U.S. market value – but also because it was the first index to be calculated electronically based on market-capitalisation values. The new index was heralded as a superior solution for investors seeking a broader and timelier measure of the market than the Dow Jones Index. The new 500 index was published hourly, while the Dow Jones was calculated daily. As a result, the 500 quickly became the primary index used by sophisticated industry participants.

However, despite its usefulness being limited by its small constituency and price-weighted calculation, the Dow Jones Industrial Average is still quoted as a gauge of market sentiment almost 130 years later. Old habits die hard.

While S&P's index offering has been relied on as the leading measure of the US market for almost 80 years, the increasing globalisation of the investment world in more recent decades provided an opportunity for a new entrant to establish a substantial presence. MSCI seized this opportunity with the MSCI All Country World Index and MSCI World Index becoming global industry standard benchmarks.

The flagship MSCI Index products have been in use since the late 1960s. In 1965, Capital International (an asset management business) created the first set of indexes to measure the performance of stock markets outside the US. The licensing rights to Capital International's index data was purchased by Morgan Stanley in 1986, and rebranded as Morgan Stanley Capital International, using the acronym MSCI for short.

MSCI was incorporated in 1998, with Morgan Stanley owning ~97% of the outstanding shares and Capital Group International holding the remainder. In 2007, Morgan Stanley sold a minority interest in MSCI in an initial public offering (IPO). Two years later, Morgan Stanley sold down its remaining shares in a secondary sale triggered by its need for additional capital during the global financial crisis. This selldown established MSCI as a standalone company, run by CEO Henry Fernandez.

MSCI has been an outstanding long-term quality compounder. Since its IPO in 2007, MSCI's stock has compounded at +24% p.a., delivering a total return to shareholders of ~36x over this 17-year time period.

A Growing, High-Margin Royalty on Global Equity Appreciation and Passive Flows

MSCI's Index business benefits from several attractive secular growth drivers including global equity market growth, the shift from active management to passive

investing, and growing index usage throughout the investment process (primarily via custom indexes).

While MSCI is best-known for just a handful of indexes, the shift from active management to passive investing has led to customer demand for a huge number of custom-designed indexes.. MSCI now calculates over 280,000 equity indexes daily, and more than 16,000 of these are calculated in real-time.

The active to passive investing shift accelerated following the global financial crisis. It has driven assets under management (AUM) in exchange-traded funds (ETFs) linked to MSCI's equity indexes to grow from ~$300bn in 2011 to ~$1.6tn today.

There has also been a rise in customised indexes, created to support investment strategies with specific needs or constraints – e.g., socially responsibly investment strategies omitting certain sectors.

In its Index segment (close to 75% of group EBITDA), MSCI earns revenue from two primary sources, 1) subscription fees for the licensing of index data; and 2) asset-based fees – calculated based on the assets under management linked to MSCI's indexes. These two sources of revenue have grown at an +11% CAGR and +13% CAGR since 2010, respectively. It is estimated that one-third of the total fees collected by ETF issuers from investors are passed on to MSCI in the form of licensing fees.

Attractive Industry Structure with Very High Switching Costs

MSCI operates in a cozy oligopoly, alongside S&P Dow Jones Indexes and LSEG's FTSE Russell. If we look at the global index industry, the top three index providers account for ~70% of index fees, with MSCI claiming the top spot. However, the industry is not highly competitive because the MSCI World Index represents a highly differentiated proposition to the S&P 500 Index (which tracks the performance of 500 US-listed stocks) or the Russell 2000 Index (which tracks the performance of 2000 small-cap US stocks).

MSCI's long track record as an equity benchmark for global investors has contributed to its industry standard position, with its clients including 99 of the top 100 global asset managers, 90 of the top 100 global pension funds, 83 of the top 100 global banks, and 75 of the top 100 global hedge funds.

We believe MSCI has significant market power, as its customers are typically asset managers whose clients make capital allocation decisions based on the underlying benchmark tracked. A passively managed ETF would find it difficult to raise funds without the brand recognition of a well-known and trusted index, so asset managers require access to the data MSCI provides to conduct business. Meanwhile, an active manager typically requires or references a benchmark, for which MSCI charges recurring fees for licenses to use its index data. GCQ is one such customer, paying a material sum each year simply for the right to include MSCI data on the front page of our monthly updates and half-yearly investor letters.

MSCI is free to leverage its brand and unilaterally raise prices on its products, as its customers are effectively locked into its ecosystem. Price increases on recurring subscriptions are typically mid-single-digit each year.

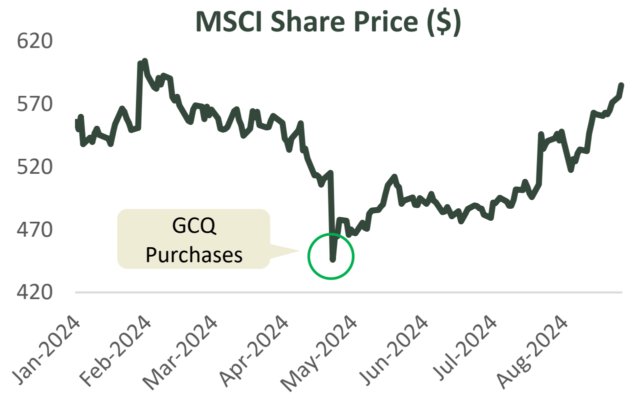
A high degree of recurring revenue, with pricing power, and very low incremental expenses leads MSCI's Index segment to generate 77% EBITDA margins, higher than any other company in the S&P 500 Index.

Further, MSCI requires almost nil incremental capital to grow, meaning each new dollar of earnings is extremely valuable, and can be returned to shareholders through a combination of dividends and share buybacks. MSCI's record of capital allocation is exceptional, having repurchased more than 30% of shares outstanding since it initiated a buyback in 2012 at an average price of $122 per share (well below the current share price of $558!)

A Rare Opportunity to Purchase a Wonderful Business

In 1Q24, a one-off blip in retention, driven by elevated cancellations following the merger between UBS and Credit Suisse, saw the stock fall -13% on the day of its earnings release. This provided a rare opportunity to meaningfully upsize our position in a wonderful business. Having previously reduced the weight on valuation grounds to 1%, we increased the position to 7% at a valuation of ~28x forward earnings, MSCI's lowest valuation in many years.

In 2Q24, MSCI delivered a strong result with revenue and EBITDA up +14% year-on-year, while the client retention rate bounced back to ~95% (up +200bps sequentially vs. 1Q24). The stock followed, up +8% on the day, and up +31% since we added to our position in April.



MSCI is an ~8% position in the GCQ Flagship Fund portfolio today, and it continues to trade at a meaningful discount to our appraisal of fair value. We are optimistic about its prospects as one of the world's great businesses; earning a high-margin royalty on the world's invested assets.

"The best business is one that is a royalty on the growth of others."

- Warren Buffett

CONTACT

KATHY WU
Chief Operating Officer
contact@gcqfunds.com
+61 (2) 7252 9124

GCQ Funds Management Pty Ltd
Level 14, 167 Macquarie Street
Sydney, NSW 2000 Australia
gcqfunds.com

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GCQ Flagship Fund's Target Market Determination is available here (https://www.eqt.com.au/corporates-and-fund-managers/fund-managers/institutional-funds/institutional). A Target Market Determination is a document which is required to be made available from 5 October 2021. It describes who this financial product is likely to be appropriate for (i.e. the target market), and any conditions around how the product can be distributed to investors. It also describes the events or circumstances where the Target Market Determination for this financial product may need to be reviewed.

[1] Net performance figures are shown after all fees and expenses and assumes reinvestment of distributions.

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