



GLOBAL
CONCENTRATED
QUALITY

16 July 2024

Investor Letter

"Far more money has been lost by investors trying to anticipate corrections than lost in the corrections themselves."

- Peter Lynch

Dear Fellow Investor,

Over the year from 1 July 2023 to 30 June 2024 the net return for investors in P Class units of the GCQ Flagship Fund was **+25.1%**¹. This brings total returns since inception on 1 July 2022 to **+73.9%**¹.

For context, the below table outlines our returns relative to the MSCI World Index (AUD). GCQ does not seek to replicate the characteristics of this index when constructing our portfolio of high-quality companies, though it provides a reference point for the performance of a basket of global stocks.

We aim to achieve a return of 10% to 15% p.a. through the market cycle.

Returns	Since July 2023 (1 year)	Since July 2022 (2 years)
GCQ Flagship Fund (P Class) ¹	+25.1%	+73.9%
MSCI World Index (AUD) ²	+20.1%	+47.5%
Outperformance	+5.0%	+26.4%

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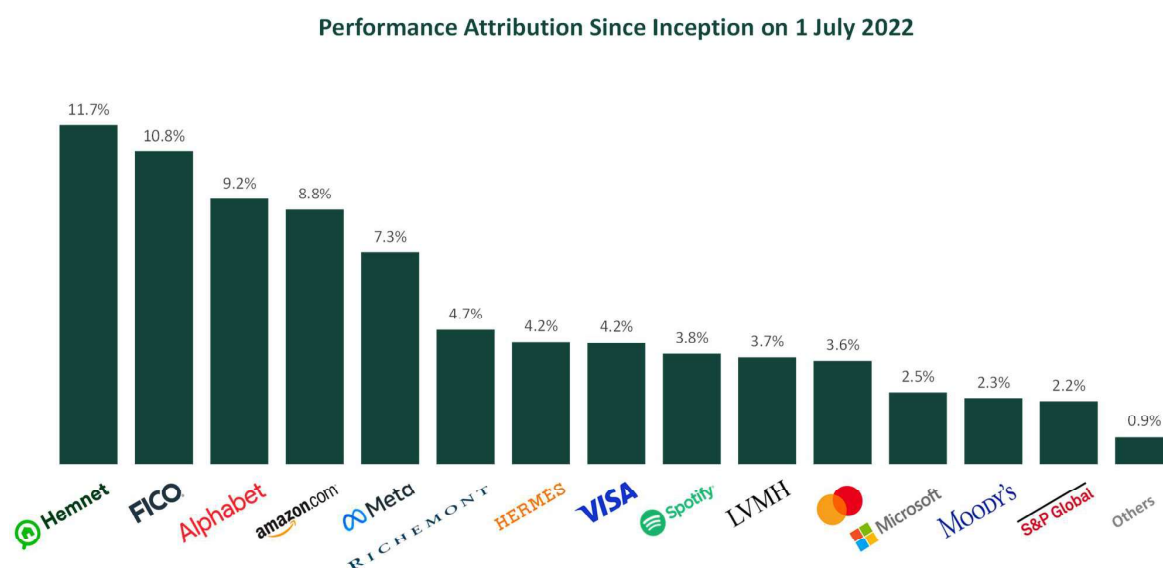
High-Quality Investment Returns

"I never buy at the bottom and I always sell too soon."

- Baron Nathan Rothschild's success formula

While we are pleased with the GCQ Flagship Fund's performance so far, we think it is important for clients to ask whether the returns generated over the past two years have been generated through a repeatable process. We ask ourselves this question when evaluating the quality of our returns internally.

Contributors to the Fund's +73.9% return since inception are depicted in the chart below. For any equity strategy, we believe that broad-based positive performance across the portfolio is indicative of a high-quality return. We have achieved this to date, with a high proportion of our portfolio companies having contributed materially to returns.



This outcome was achieved in an equity market that has seen notably narrow performance. Since the inception of GCQ's P Class on 1 July 2022, the MSCI World Index delivered an impressive return of **+47.5%**. However, an equal-weighted version of the MSCI World Index – where the likes of Nvidia Corp carry the same heft as less consequential companies such as Swatch Group AG – delivered a return of just **+29.3%** over the same two-year period as the index return was driven by an unusually small number of stocks.



Over the past twelve months, to 30 June 2024, the MSCI World Index delivered a return of **+20.1%**. The average stock in the index achieved a more pedestrian **+9.9%** return over the same period.

In this context, we are particularly pleased that GCQ's performance has been broad-based. Our returns were not driven by an excessive exposure to a single stock or market "theme" such as Artificial Intelligence. Instead, returns were achieved by owning a portfolio diversified across approximately eight high-quality, relatively uncorrelated industries that pass through GCQ's **Industry Quality Checklist**.

Within these industries, we own high-quality businesses that pass through GCQ's strict **Business Quality Checklist**, and trade at a discount to our appraisal of fundamental value. Our checklists ensure we invest only in high-quality businesses with secular growth, pricing power, substantial and durable cash flow generation and low debt levels. We seek to sift out companies that will underperform index benchmarks over our investment time horizon, whether due to a weak industry structure, flawed business model, extreme cyclicalities or over-valuation.



Simply put, these checklists (which are discussed in greater detail in the Appendix) help us assess whether we can be highly confident that a company will be larger and more profitable in 5-, 10-, and 15- years' time; no matter what is thrown at it by potential new competitors, the global economy, or geopolitical developments.



GCQ's Approach to Risk Management

"The key to long-term profits on Wall Street is not making big killings, it's not getting killed."

- Daniel Turov

Risk management practices are closely connected with the repeatability of investment performance and should always be front of mind when a fund's performance is being considered.

All investors seek investment performance which is above average, but the level of risk appetite – and the strategies employed to manage risk – varies greatly between fund managers. For example, some fund managers are prepared to go "all-in" on an individual opportunity or theme, while others are not.

When the riskier approach works it can generate eye-catching short-term returns that give rise to enormous FOMO (Fear Of Missing Out) from investors who feel the thematic of a lifetime is passing them by. However, looking back a few years on often tells a very different story. There is no better example of this than the handful of investors who made fortunes from the subprime short in Credit Default Swaps back in 2007. A book was written and a movie was made, but none of the professional investors featured in them have gone on to achieve above-average long-term performance.

In fact, an investor who had to choose just one credit fund manager for the long term in 2006 would almost certainly have been better off choosing a capable and disciplined fund manager who was about to miss the greatest credit trade of all time – but was destined to do a little better than average in the subsequent years - than one of the handful who saw the opportunity and went all-in.

A similar argument could be made in relation to equity funds managers who timed the market to perfection through the GFC.

At GCQ, we structure our risk management processes to optimise the magnitude, quality, and repeatability of our returns over time.

In addition to our **Industry Quality Checklist** and **Business Quality Checklist** – which ensure we are invested in predictable, high-quality companies that can be valued based on cash flow and have very little debt (we are yet to find a company that has gone broke with no debt!) – we apply four key risk management disciplines:

- A strict upper limit on the percentage of our portfolio that can be invested in a single industry or business. At most, we will invest **20%** of our portfolio in a single industry, and **15%** of our portfolio in a single company.
- Diversification of our portfolio across industries that are relatively uncorrelated. For example, sales at super-luxury goods companies such as Richemont (the owner of Cartier and Van Cleef & Arpels) are uncorrelated to sales of the humble can of WD-40. Each of



these companies also has very different business drivers to real estate advertising monopolies like Hemnet.

- We avoid market timing risk by staying fully invested in a portfolio of high-quality companies. While downside volatility can be unpleasant, we believe market timing – something that many fund managers get wrong – is fraught with risk. You should expect our net exposure to be close to 100%.
- We invest in companies trading at a substantial discount to our assessment of fair value and have a strict discipline to trim or sell a position entirely when the price comes within 10% of our assessment of value. We believe owning a portfolio consisting of too many aggressively priced stocks is one of the greatest risks investors face.



GCQ Portfolio Overview as at 30 June 2024

"I just like the great businesses."

- Charlie Munger

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

Company	Portfolio Weight
 Hemnet	12%
 rightmove	7%
Real estate advertising monopolies	19%
 VISA	8%
 Mastercard	6%
Global consumer payments	14%
 MSCI	7%
 S&P Global	4%
 MOODY'S	2%
Credit rating agencies & investment index providers	13%
 Alphabet	8%
 Meta	4%
Global online advertising	13%
 RICHMONT	11%
 HERMÈS	1%
Super-luxury goods	12%
 amazon.com	11%
Global cloud computing	11%
 FICO	6%
Local monopolies	6%
 WD-40	1%
Branded consumer goods	1%
Other high-quality businesses	11%
Total long	100%
Shorts	(3%)
Net Exposure	97%
Cash	3%
TOTAL	100%



Portfolio Update

The GCQ portfolio appreciated **+25.1%** over the past financial year.

Performance was broad-based, with particularly strong contributions from **Hemnet**, **Alphabet**, **Amazon**, and **FICO**.

Hemnet, the monopoly residential real estate advertising portal of Sweden, was our largest individual contributor to returns with its share price up **+70%** over the financial year.

Hemnet is our largest individual position today, and we believe it is still in the early innings of its monetisation journey. Today, Hemnet's Average Revenue Per Listing is only 0.1% of the average home price in Sweden, which is roughly one-third of the equivalent figure to list your home on realestate.com.au and domain.com.au in Australia. We believe adoption of more premium (i.e., expensive) listing options and price increases will close this gap over time. Profit margins, which remain approximately 15 percentage points below REA Group, are likely to materially increase as this occurs.

Hemnet continues to have substantial upside to our assessment of its fair value, though we trimmed this position earlier in the year for risk management purposes. We have subsequently had the opportunity to buy some of these shares back cheaper over the past three months. Of course, it doesn't always work out as well as this, but it is this sell discipline that we believe is incredibly important in outperforming markets over time.

Alphabet (the parent company of Google and YouTube) was our second largest contributor to returns, as its share price appreciated **+52%** over the financial year. We made Alphabet our largest position in early 2023 when the market became overly concerned about the impact of Open AI's ChatGPT on Google search. Since bottoming in January 2023, Alphabet's share price is up over **+110%**.

We believe Alphabet's commitment to "durably reengineer" its cost base over the long-term will lead to multi-year margin expansion, and we believe the stock remains undervalued today.

However, as a result of its strong performance and as Alphabet comes closer to our valuation, we have been selling stock and realising some of our gains. At 30 June Alphabet accounted for 8% of the GCQ portfolio, and was our fifth-largest position.

Amazon was our third-largest contributor to returns, with its share price up **+48%** over the financial year. Importantly Amazon's share price performance has been entirely driven by earnings growth, while its earnings multiple remains at historic lows.

Amazon is our second-largest position today, and we believe the durability of growth and margin potential of Amazon's e-commerce business remains underappreciated by the market. Further, Amazon Web Services (AWS) remains the clear market leader in the cloud infrastructure market, which remains in its early innings.

FICO's share price was up **+84%** over the financial year. FICO, which earns a high margin royalty on consumer credit in the US through sales of the FICO Score, continued to exercise its untapped pricing power. As a result, revenue from consumer credit scores sold to lenders grew **+22%** over the



last twelve months. This was achieved in an environment where mortgage origination volumes (a key driver of FICO's revenues) remain depressed, at approximately 50% of normalised levels.

In terms of share price performance, FICO has been the strongest performer in the GCQ portfolio, delivering returns of +273% since 1 July 2022. We have gradually trimmed our FICO position as the stock has continued to perform. If we had never sold a share, we would have delivered even higher absolute returns, however we believe these returns would have been lower quality given that it would result in excessive exposure to a single company. As highlighted earlier in this letter, we are proud to have achieved broad-based performance across the portfolio, which we believe is a higher-quality outcome.

During the year, we took advantage of strong share price appreciation to exit our positions in **Microsoft** and **Spotify**, both of which were trading at a narrow discount to our appraisal of fair value. We recycled capital to acquire positions in several new companies, including **VeriSign**, **Netflix**, and **Money Forward**. We remain optimistic on the outlook for these investments. In April and May 2024, we took advantage of short-term share price weakness in **MSCI**, a position we had reduced to approximately **1%** on valuation considerations, to materially increase the weight to **7%**. We believe that MSCI is one of the highest-quality businesses in the world. MSCI generates a high-margin royalty on industry-standard indices such as the MSCI World Index. Today, MSCI is our sixth-largest investment, and is trading at its cheapest valuation in many years.

The changes made over the last 12 months have seen the portfolio's exposure to the largest US-based technology companies reduce from 40% at 30 June 2023 to 26% a year later. Having exposure to these wonderful businesses served us well when they were trading on extremely attractive terms in 2022 and 2023, however we see better opportunities elsewhere as investors increasingly turn their attention to a lower interest rate environment.

Looking to the future, we will continue to seek out opportunities to buy high-quality industries and companies that are out of favour, while selling those that are more fully valued. We believe identifying these opportunities, and getting the timing roughly right, has the potential to materially enhance our returns over time.

Despite a strong year of performance, we think it's important to note that the GCQ portfolio remains attractively priced. On a weighted average basis, the portfolio is trading at only **25x** forward free cash flow. We believe this compares favourably to the S&P 500's forward earnings multiple of **20x**, given that the average company in our portfolio is higher quality, with higher growth, higher margins, higher returns on capital, and minimal debt.

We expect the portfolio's annual free cash flow generation will double over the next five years, and on this basis, we hope to achieve returns of approximately **+15% p.a.** over the next five years – even if we do not make any changes to the current portfolio.



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. At that time, we were off to a good start, having already established a distinctive GCQ culture built on a shared sense of purpose, transparency, and collaboration.

At the outset, our focus on building a successful culture was aided by the long working relationship of GCQ's founding partners and Investment Team members. As we have grown the team to ten members across investments, operations, and distribution, we have been mindful to reinforce the positive elements of this culture.

We welcomed **Yathavan (Ya) Suthaharan**, who joined as a Senior Investment Analyst in March 2024. Ya brought nine years' experience in financial markets and global equity investing. We spent more than six months getting to know Ya before inviting him to join our team, and he has quickly become an integral part of the team.

The most recent addition to the GCQ team is **Huw O'Grady**, as a Distribution Director based in Melbourne. Huw brings almost 20 years of experience managing relationships with investors and their advisers, and is well-known to GCQ having worked alongside our Head of Distribution, Stephen Higgins, in a prior role.

The decision to hire a Melbourne-based Distribution Director is consistent with our commitment to ensuring all parts of the business are fully resourced. Huw will have responsibility for managing relationships with leading wealth managers in Victoria, Western Australia, and Tasmania. A key benefit of having highly experienced distribution executives operating independently is that it enables the investment team to spend 90% of their time focused on the portfolio.

In order to accommodate our growing team, we moved to a larger office at 167 Macquarie Street from the start of July. Other than location, our key criteria in choosing an office was to ensure the full team would continue to sit in one open-plan room as this is central to the sharing of ideas and information flow. One benefit of the move is that it will allow us to recommence our intern program for university students, which we had reluctantly suspended earlier in the year due to a shortage of spare desks.

Looking forward, we have committed to three guardrails to protect the processes and culture of GCQ. These guardrails are intended to support a single focus on delivering outstanding returns for our investors over the very long term, and include commitments to:

- ***Retain the GCQ Industry and Business Quality Checklists at the heart of our investment process.*** In addition to protecting against drift in our investment style, or the emergence of complacency, we have found the checklists play a helpful role in democratising the idea generation process – our most junior analyst can suggest a company for inclusion on our watchlist and for further work, but only if it first passes through the checklist. Similarly, more senior members of the team understand their seniority counts for nothing if their ideas have not first cleared the same hurdles.



- ***Offer only one investment strategy.*** Our team works together cohesively, with the sole focus of delivering our single investment strategy. Allowing any part of the organisation to have a different focus, or a dual focus, would put this dynamic at risk – and would likely lead to worse outcomes for investors.
- ***Ensure GCQ Funds Management is always owned by the team, and only by the team.*** GCQ is currently owned by our team, with equity widely distributed. We strongly believe equity ownership helps to keep the team aligned with investors over the long term. As a result, we have committed to remain privately owned by the team, and will never introduce external shareholders.

GCQ Flagship Fund Update

We established the P Class of the GCQ Flagship Fund in July 2022 to facilitate investment in the Fund by investors who prefer to invest via a platform and with daily liquidity.

Following a detailed review process, P Class has held a “Recommended” rating³ from **Zenith Investment Partners Pty Ltd** since March 2023. More recently, in May 2024 we were delighted to receive a “Recommended” rating⁴ from **Lonsec Research Pty Ltd**.

P Class has been accepted for investment through several investment platforms including **Macquarie, Netwealth, HUB24, Praemium, PowerWrap, BT Panorama, and Mason Stevens**.

In response to growing interest in the GCQ Flagship Fund from New Zealand based investors, we are working to establish a New Zealand Portfolio Investment Entity (PIE) that will be a feeder fund into the P Class and provide superior tax outcomes for certain investors. We expect the GCQ PIE to be open to investment from 1 September 2024.



In Closing

We believe that a consistent investment process is one of the keys to long-term success in investing, with a thoughtful approach to risk management central to the investment process. Over the last year we have been pleased that our risk management processes have played their intended role in ensuring that the GCQ Flagship Fund's returns are of high-quality and likely to be repeatable over time.

We have a continuing focus on taking advantage of share price movements to refresh the portfolio with opportunities in high-quality industries and businesses, and our portfolio companies are trading at valuations well below our appraisal of fair value. Key to this has been our ongoing approach to recycling capital away from the largest US-based technology companies, which have been strong performers over the last two years, and towards high-quality companies that we expect to outperform in an environment of moderating interest rates.

As a result, 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.

We would like to thank you for the support you have shown for us by investing with GCQ. We look forward to a long-term partnership.

Yours faithfully,

GCQ Funds Management

"It's not about timing the market, but about time in the market."

- Market aphorism



Appendix: The GCQ Quality Checklists

"What we're doing is very simple, really - if we build holdings in self-evidently excellent companies, and we hold those excellent companies for long enough, we are likely to generate superior returns to the average because we own companies that are more excellent than the average."

- Nick Train

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.

We have discussed in prior letters that we place great emphasis on analysing the industry that a company operates within before progressing our work on a particular company, and the role of our **GCQ Quality Checklists** in ensuring discipline and consistency in our approach.

For the benefit of readers who are new to our investment strategy, we think it worthwhile including a discussion of the checklists in each of our six-monthly letters.

Our research process begins with the **GCQ Industry Quality Checklist**, which 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.

Any time we have made an investment mistake in the past, we have analysed the cause of the error and updated our checklists in an effort to ensure the same mistake is not made again.



Our team focuses its time on around 20 industries that meet the requirements of our Industry Quality Checklist. Within these industries, there are around 200 companies 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 central to our efforts to sift 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.

At GCQ, we are 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.



“The first principle is that you must not fool yourself and you are the easiest person to fool.”

- Richard P. Feynman

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

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³ 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, subsequently on 16 November 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.

⁴ The rating issued 05/2024 was published by Lonsec Research Pty Ltd ABN 11 151 658 561 AFSL 421 445 (Lonsec). Ratings are general advice only, and have been prepared without taking account of your objectives, financial situation or needs. Consider your personal circumstances, read the product disclosure statement and seek independent financial advice before investing. The rating is not a recommendation to purchase, sell or hold any product. Past performance information is not indicative of future performance. Ratings are subject to change without notice and Lonsec assumes no obligation to update. Lonsec uses objective criteria and receives a fee from the Fund Manager. Visit lonsec.com.au for ratings information and to access the full report. © 2024 Lonsec. All rights reserved.

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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) (<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.