

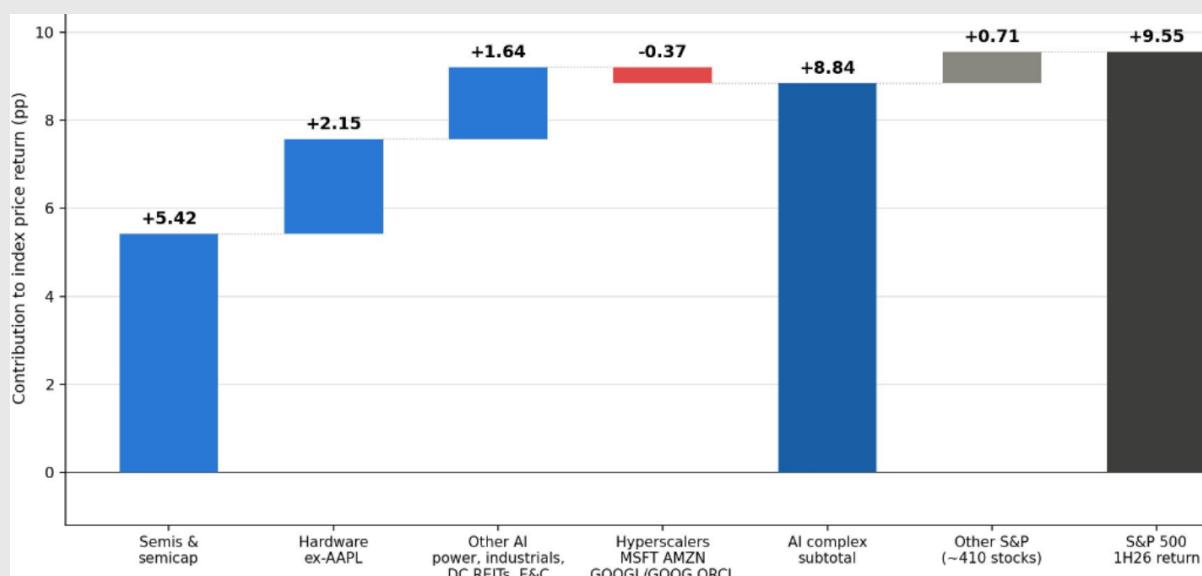
Dear Shareholder,

Game of Two Halves

Having been ahead of the market in Q1, mostly due to weakness in the software sector which we didn't own, Q2 saw extraordinary gains in another sector we don't own (semiconductors). The portfolio is up around 3.5% year-to-date, and our companies' fundamental growth and market positioning are strong.

This chart from Bernstein is illustrative of the concentration of these returns within the semiconductor sector year-to-date, and adjacent companies selling into the AI data centre build out.

Figure 1 S&P 500 H1-2026 Return Bridge¹



So why don't we own these stocks? We have owned **Micron** and **Texas Instruments** in the past, so are not against the idea that such cyclical companies can generate strong returns, but the starting point matters.

When we consider companies as potential candidates for our portfolio, we spend a huge amount of time solving for those where we believe their successful futures are both *durable* and *knowable*.

And then, of course, we pay close attention to the valuation we pay for these companies.

A comment we have heard frequently is that this is not like 1999 as the companies in question are generating exceptional earnings. This is true, and we think the dot-com analogy is indeed misplaced.

Instead, we see strong comparisons with the period which came along in the aftermath of that tech crash, which we go through in brief detail below.

¹ Bernstein

Data Mining

This is not 1999.

That bubble was characterised by profitless euphoria; this period feels very different.

We think the most useful analogy is actually the bull market which was born out of the ashes of the dot-com collapse. Namely, the Chinese capex boom and its impact on mining stocks.

China entered the World Trade Organisation at the end of 2001, a defining event of that era. In the years after, leading up to the financial crisis, China spent more than \$1tn² on capex, equivalent to \$2tn today, which is of the same order of magnitude as the AI capex boom.

As the demand for raw materials increased, mining stocks profited, and their shares soared. Companies like RIO Tinto and BHP Billiton dominated the headlines, and investors' portfolios.

Capacity was tight, and the argument was that this excess demand would continue for an indefinite period of time. At the same time, the risk that supply would increase was low, given the complexity of mining operations and the increased consolidation in that sector.³

BHP's earnings (and its share price) **grew around 10x** from 2003 to 2008 when it was still trading on a very *reasonable* sounding 8x forward PE ratio.⁴

These astounding performance figures are very similar to those seen today in semiconductor companies like **Micron**, with **earnings up roughly ten-fold and a share price to match**.

Figure 2 Data / Mining Bull Market Comparisons

	BHP	Micron
	(2003 - 2008)	(2022 - 2026)
Earnings per Share Growth	10x	10x
Share Performance	10x	10x

Stock prices discount the many different futures which can play out, and the relative weights investors prescribe to them at different points in time.

Suppliers to the data centre build out, especially semiconductor companies, are making real money today. Their earnings are multiples of their previous peaks as around half of every dollar spent on capacity is spent on chips.

² Federal Reserve Bank of St. Louis

³ Of course, we then had more than a decade of oversupply

⁴ Bloomberg

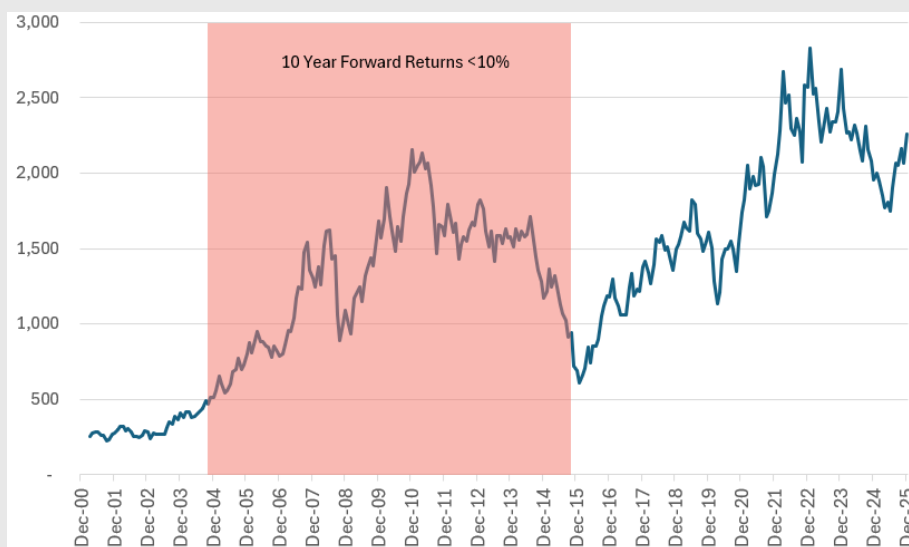
AI spending looks set to continue for a while, and the stocks do not trade on expensive multiples of *current* earnings.

Could there be a bubble in the earnings themselves, or the demand which drives them?

Going back to the mining analogy, despite strong share price moves, genuine long-term returns were very poor throughout most of the cycle.

If you bought in any time after 2004 your ten-year annualised return was below 10%, any time after 2005 and it was 0% or worse over the next decade.

Figure 3 BHP Share Price⁵ - shaded area produced weak returns



Where we are in the ultimate journey for Micron’s earnings and share price is, clearly, impossible to know, but the potential for deep and extended capital losses from here seem highly plausible.

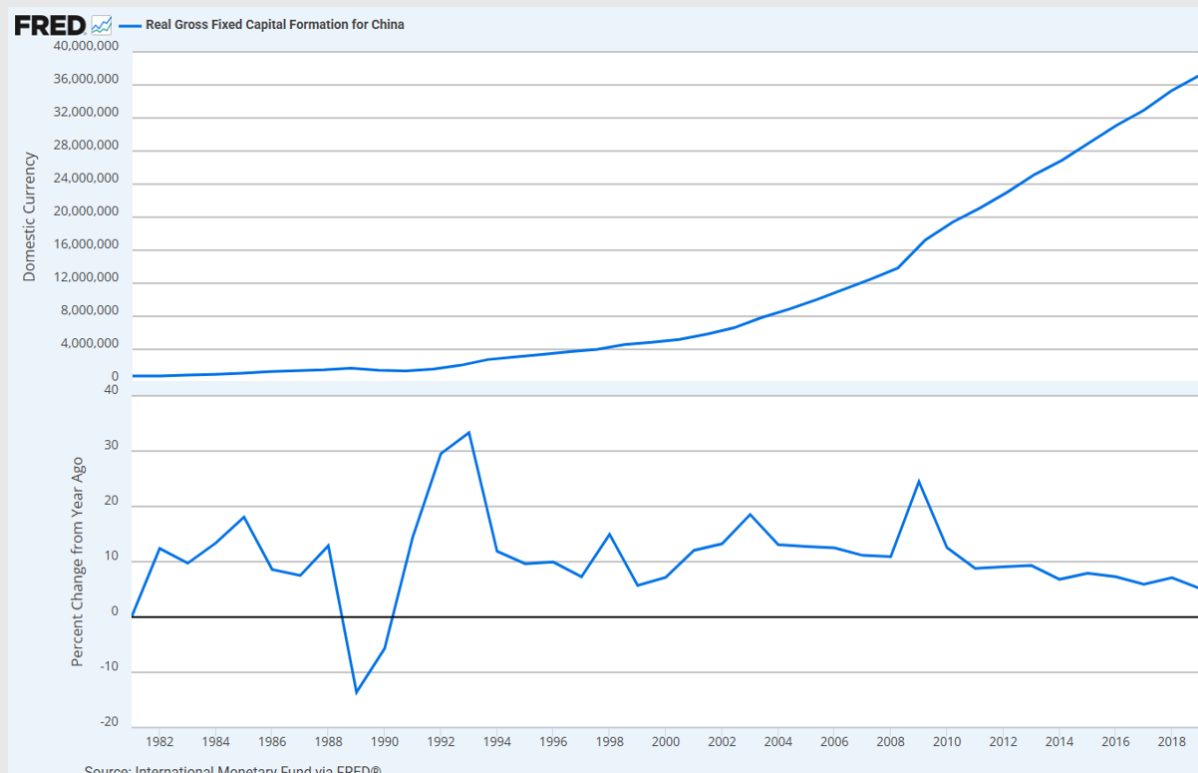
The key conclusion for us is that you don’t need to buy the top to lose money. Chasing a supercycle successfully once it’s in full swing requires short-termism and natty exit timing in order to generate sufficient returns. Neither of which we aspire to.

Incidentally, while Chinese capex *growth* did slow in 2011 (shown in the bottom section of *Figure 4*), it still grew.

You don’t need to believe in an absence of demand in the future, slower demand growth and higher supply will do the trick.

⁵ Bloomberg

Figure 4 Chinese Real Fixed Capital Formation (CNY)⁶



With that in mind, we see the inevitable supply-side investments (such as the \$500bn investment in South Korean memory production) as likely sowing the seeds to accelerate the end of this extraordinary cycle.

Figure 5 News of Rapid Increase in Memory Capacity Investments⁷

KEY POINTS

- Shares of Samsung Electronics and SK Hynix fell on Monday after South Korea unveiled sweeping artificial intelligence and semiconductor mega-projects.
- The chip giants will build two new semiconductor fabrication plants in the country's southwest as part of a 800 trillion won (\$517.87 billion) project.
- President Lee Jae Myung announced plans to strengthen the country's leadership in the sector through large-scale investments and new manufacturing capacity

To follow a value investing discipline, you sometimes need to be willing to leave a party before the music stops.

⁶ Federal Reserve of St. Louis

⁷ CNBC

Dancing to a different tune

It feels quite strange that it's precisely those areas of the market which are traditionally known for their reliable growth, which seem the most out of favour. Healthcare, utilities and consumer stocks are trading at valuations not seen since the dot-com bubble, from which point returns were very strong.

While we maintain a diversity of exposures within our portfolio (as we always shall) our allocation to healthcare stocks has risen over the past few years; we discuss some recent changes within that allocation below.

Re-United Healthcare

At the beginning of the quarter, we significantly added to **UnitedHealth**, approximately doubling the size of the position.

We discussed UnitedHealth in detail in our [2025 Annual Report](#), where we noted that earnings had temporarily suffered due to elevated costs to deliver patient care, which were above the reimbursement rates on government Medicare and Medicaid programmes by about 2.5%.

A 2.5% deviation of the \$400bn healthcare costs paid by UnitedHealth annually created a -\$10bn adverse impact on the business, or roughly 35% of earnings.

The main levers in response are to reprice its commercial contracts and adjust the level of benefits it offers in its Medicare Advantage programme. Think of health insurance programs with free gym membership for example, which could be reduced or removed, or repriced.

As we have said many times, we do not add to underperforming positions until we have tangible evidence of operational improvement. Year-to-date, we've seen three positive developments.

The rate at which the federal government reimburses Medicare Advantage programmes was increased by +2.5% **more than the initial proposal**. While doing so, the Centers for Medicare & Medicaid Services (CMS), the government agency responsible for overseeing the industry, adopted far more conciliatory language recognising the need for 'stability and predictability' in government programmes.

The CMS also adjusted the provider quality scoring mechanism that determines the level of rebates to Managed Care companies like UnitedHealth, effectively making it easier to obtain the highest ratings, allowing the industry to generate an incremental \$18bn, restoring profitability.

Both of these developments suggest to us that the government is acutely aware that the industry is, in aggregate, loss-making and is sensitive to programme disruption ahead of mid-term elections later this year.

Finally, we had Q1 earnings where UnitedHealth's Medical Cost Ratio (the proportion of premiums spent on healthcare costs) beat by 1.6% and management commentary suggested that cost trends are running *below* their expectations for 2026. The net effect, if this sustains, is a faster recovery back towards target margins.

We added to the position at \$307, with UnitedHealth closing the quarter at \$416.

In May, **Cencora** reported earnings. The company has generated fundamental value growth (earnings per share + dividends) of 15% per year for the past five and ten years, and our research suggests this will continue. On their earnings call, the company noted a 2% miss in recent earnings estimates, while simultaneously increasing guidance for the full year by about 2%. The shares fell 20% to 12.5x PE. We added substantially to the position that day at \$250 per share.

Our most recent addition in the healthcare sector, **Royalty Pharma**, continues to deliver on its medium-term plan. As discussed in our [2025 Annual Report](#), the company earns royalties through financing a diversified collection of drugs which are already in production and has options over successful phase three results from the companies they support.

They have reported positive outcomes from a few of these trials in 2026, allowing marginal increases in our forward-looking estimates. So far this year shares are up 47% and still trade on about 11x cash flow.

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Across the portfolio as a whole, we have seen very little change, in aggregate, to our estimates for this year or beyond. We believe in the strength of these franchises, and their ability to deliver strong fundamental growth. While its clear investors have other things on their minds at present, the music in our companies will continue to play, albeit with a slightly slower tempo right now.