

Dear Shareholder,

Trading Business

In the first letter of the year, we discussed the underappreciated strength of **Interactive Brokers'** business model, which continued to shine through into Q3 with Interactive vying for our top contributor year to date, narrowly behind **Tesco**.

Customer accounts are growing at 30%¹ a year, ahead of management expectations and, crucially, investors' appetite for trading remains robust. Market volatility in general drives higher levels of trading, and trading is great for business.

Our Approach to Trading

Our philosophy around trading within the portfolio is rather different to the average Interactive customer.

Low turnover is a philosophy but, very much, not a target.

What that means in practice is that we will only invest in businesses where we *could* hold them for the very long term, although we are, at all times, liberated to rotate if we see greater opportunities elsewhere, from other long-term investments.

As discussed in prior letters, uncertainty is one of the few constants in the world and share prices oscillate either side of fair value, often to extraordinary degrees. This volatility is a huge advantage, not a risk as most models would have you believe. We have seen this picking up in the past year and, this quarter alone, **bought three new positions**, and **fully sold one**.

Our process relies on researching stocks for many years in advance so that, when opportune timing presents itself, we are ready to act. This should be the limit of our portfolio trading: if, and whenever, you see a meaningful opportunity to improve your portfolio's likely cash flows, you should be bold, otherwise you should remain relatively inert.

This quarter, we have been relatively bold.

¹ Source: Interactive Brokers and Latitude Investment Management

Recent Portfolio Changes

Ryanair is a business we have admired for years. From peak to trough this year the shares fell by -38% on the back of weaker short-term fare guidance.² We saw this as an opportunity to add a full position to the portfolio.

The business case may be well known to our readers but, in brief, they have by far the lowest cost structure in the incredibly competitive short-haul market in Europe. They have made decisive, counter-cyclical capital investments, buying planes at discounts when others stepped back. This has resulted in them having the lowest cost, fully owned, fleet with lower carbon emissions and longer useful life than competitors.

They have achieved this while holding average fares flat for the past ten years, growing revenues through ancillaries such as early boarding or on-board food and drinks.

The most important element of “service” for an airline is punctuality, and Ryanair consistently score top of this ranking in Europe.³

Market share has grown consistently from 5% twenty years ago to 20% today, and passenger numbers are estimated to grow a further 50% from here.⁴

Today Ryanair has a net cash balance sheet, while competitors have excessive leverage and impending capital expenditure programs to replace aged fleets. This leaves room for greater capital return over the coming years, which has already begun with a meaningful buy back this year as their 30% return on capital results in significant excess cash flow.

Airlines are clearly risky investments which, like banks, have *generally* generated poor returns for shareholders. However, like banks, there are *exceptions*, and Ryanair is one of them.

Within our broad investable universe there are seventy-two banks. Of these we believe around half a dozen are investable. The number is far lower for airlines.

Our banks holdings have been incredibly successful over the past eight years. At one point (February this year) the allocation to shares of **Goldman Sachs, Bank of America** and **JP Morgan**

² Source: Bloomberg and Latitude Investment Management

³ Source: Ryanair Investor Relations

⁴ Source Bernstein and Latitude Investment Management

reached almost 15% of our portfolio. All three have nearly doubled over the past year, taking them from “completely misunderstood” to, simply, “undervalued”.

We now maintain an 8% weight split evenly between Bank of America and JP Morgan and have sold our shares in Goldman to invest where we saw greater opportunity.

Goldman delivered a 16% annualised total return since inception, with our weighted return being higher because of trading. We expect Ryanair to deliver similar or better returns over the next eight years and beyond.

McKesson, the drug distribution business, was added into the portfolio in late 2022. This year we cut the position back following a 70% rise in the shares. Subsequently shares have fallen -15% on the back of a more accelerated generic roll out (with lower profit margins) for Humira, one of the drugs which they distribute.

We used this weakness to increase our allocation to the drug distributors by adding **Cencora**, a direct peer of McKesson, which fell similarly on the news.

One of the risks we have identified in the distribution model is the concentration of customers. Pharmacies and hospitals in the US are pretty concentrated, meaning customer churn can have an outsized impact on revenues. By reducing our exposure to McKesson and diversifying into Cencora we have marginally increased our allocation to the sector, which we continue to like for all the reasons from our initial note, while meaningfully reducing this concentration risk.

Finally, early in the quarter we reduced our **Alphabet** position substantially, by almost half, and added a position in **UnitedHealth**.

Health insurance in the US is a large, defensive growth industry and UnitedHealth is the market leader. Not only the largest, but also a business with incredibly consistent execution and the foresight to invest outside of their core business. From 2000 to 2023 they have grown their earnings at 18% per year.⁵

Much like McKesson and Cencora’s investments in technology to better service their suppliers and customers, UnitedHealth has used the cash flows generated from their core business to fund a “services” business, called Optum.

⁵ Source Bloomberg and Latitude Investment Management

This side of the business now generates 50% of profits and is growing faster than the underlying health insurance given the value created for customers through partnerships.

It's rare to see periods of share price weakness for this sector which has an incredible record of consistent delivery. However, the past year presented one such opportunity and we used this to further increase our allocation to US healthcare.

Between these three we expect around 15% EPS and cash flow growth over the next five years. They trade at an average multiple of about 17x PE, cheaper than the market by some distance, and among the most attractive within our defensive growth universe.

Down Trading

The weakest stock in our portfolio this quarter was **Dollar Tree** which fell -30% on fears of low-income consumer pressure. This is similar to when we initially invested in the stock in 2010 although, at that time, the business saw significant like-for-like growth as middle-income consumers sought deeper value.

Given specific circumstances of the current cohorts (middle-income consumers are not, yet, feeling the pinch) this benefit is delayed, although unlikely cancelled if we do see a genuine economic slowdown.

Of course, the situation is different in another way which is the store maturity. It's unlikely that the store growth of the past fifteen years will be repeated in the next, so the business is transitioning to returning cash to shareholders, including through the sale of non-core assets.

Dollar Tree is the only stock we own today which is down since launch in September 2020, having fallen 16%. The contribution to portfolio returns has been around +1% over that period, an inadequate 20% return on invested capital for a position which averaged 5% over that period.

However, this is far superior to the implied "buy and hold" contribution which would have been $5\% \times -16\% = -0.8\%$. This, again, is due to portfolio turnover, specifically three decisions in 2021, 2022 and 2023 to reduce our holding by almost half, and reinvest where we saw greater opportunities.

Conclusion

This quarter the Global Equity strategy performance was -1.5% in GBP, +4.6% in US Dollars.

We are behind the broader stock market this year, principally due to our lack of exposure to the AI arms race. Our stocks continue to perform, as we'd expect over time, broadly in line with their underlying earnings and free cash flow growth. In aggregate the businesses are performing in line with expectations from the beginning of the year, with a few exceptions performing better or worse as discussed above.

As we enter the final quarter of the year, we are optimistic about the portfolio as it stands, as well as the number of stocks on our shelf which are nearing attractive entry prices. If market volatility continues then we expect our turnover to remain slightly elevated to capture these opportunities.

Thank you as ever for your support.

A handwritten signature in black ink, appearing to read 'Freddie', with a stylized flourish at the end.

Freddie Lait