

Fountainhead Partnerships

Jun 2023

Fountainhead Partnerships Fund Quarterly Letter

Participation in the stock market is not limited to the experienced, the conservative, nor even the intelligent. It is a game at which any number of people may play. And as the market level rises, the quantity of players grows rapidly, and their quality diminishes somewhat in proportion.

My experience teaches me that by far the largest losses have been sustained by investors through buying securities of inferior quality under "favorable general conditions".

– Benjamin Graham on Investors and Stocks

Fountainhead Partnerships Fund (FHPF) was up 10% (net of fees) in 1H-2023 while S&P 500 was up 16% and MSCI World was up 14%. In the last 12 months, S&P 500 is up 19.6% and MSCI world is up 16.5%, while FHPF is up 22.7%, creating 3.2% & 6.2% excess return vs the relevant benchmarks.

	1H-2023	Last 12m	Last 24m	Since Jan 2021
Fountainhead Partnerships Fund (FHPF)	10%	23%	4%	18%
iShares Core S&P 500 ETF	16%	20%	7%	23%
iShares MSCI ACWI ETF	14%	17%	-2%	10%
iShares MSCI Emerging Markets ETF	5%	1%	-25%	-20%
S&P 500 Equal Weight Index	5%	10%	-1%	17%
US 60/40 Balance	2%	2%	-9%	-2%
VanEck Semiconductor ETF - SMH	47%	45%	14%	38%
iShares US Home Construction ETF - ITB	39%	62%	22%	50%
Energy Select Sector SPDR Fund - XLE	-7%	10%	52%	111%
Financial Select Sector SPDR Fund - XLF	-3%	5%	-9%	15%

What is driving the markets? Emotions, facts or hopes!

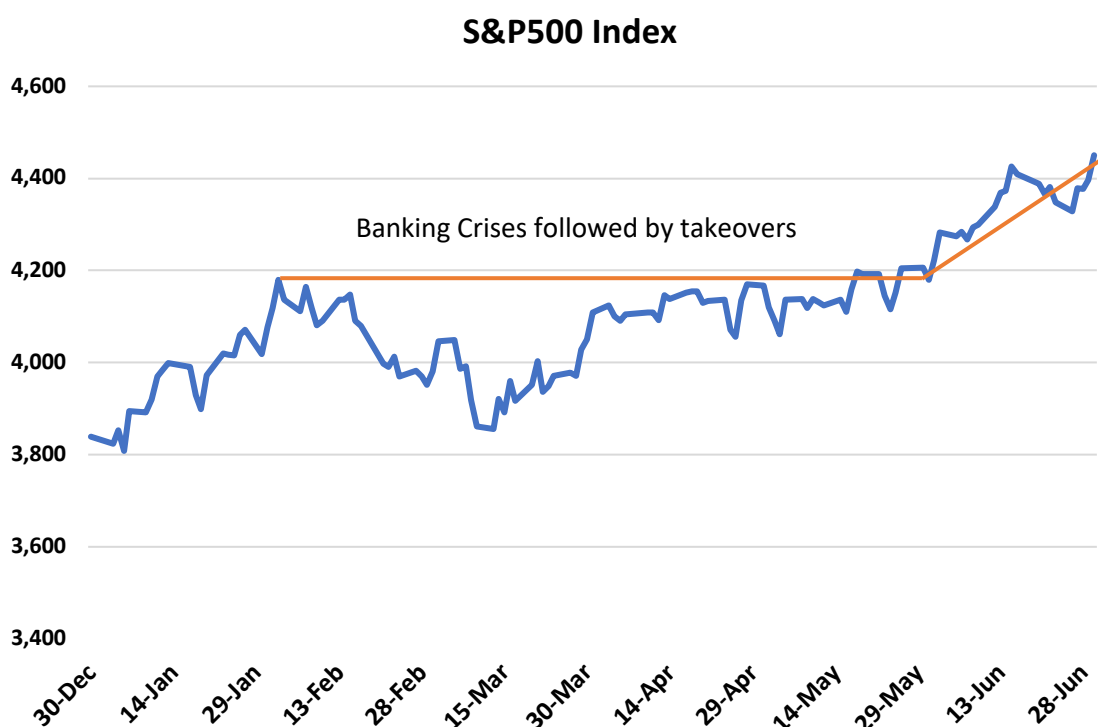
The 1H 2023 was an unusual period for the market and the economy. Investors showed contrasting emotions in each quarter. While 1st quarter was faced with the fear of recession and a banking crisis, the second quarter was celebrated by the euphoria of embracing A.I. Our Fund navigated this rather smoothly with 7% return in the first quarter and a 3% return in the emotionally charged second quarter.

Fountainhead Partnerships

The volatility of our Fund's returns was half of that of the S&P 500 this year, and Sharpe ratio was better despite a smaller return. As market level rises, we are strictly adhering to our competence and risk tolerance, not forgetting the quote from Benjamin Graham.

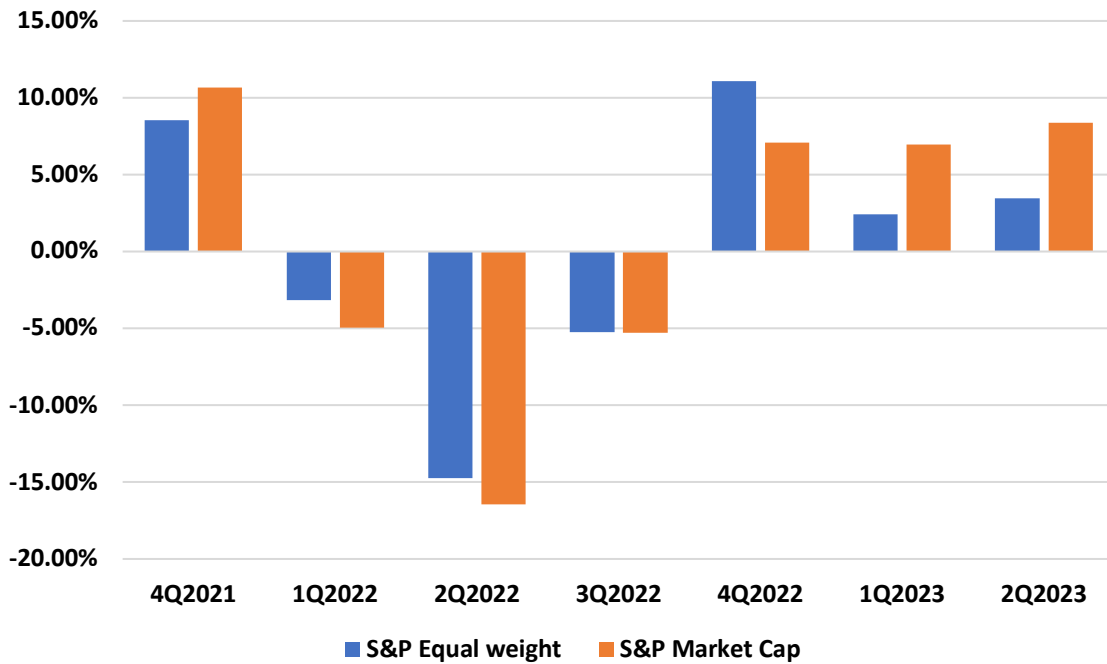
Key factors impacting the market in 1H 2023 were, 1) prolonged period of inverted yield curve/high recession probability, 2) a simmering US banking crisis, 3) sharp correction in Chinese market, 4) hopes of wider use of Generative AI applications like Chat GPT, 5) excess liquidity in the system.

S&P 500 for the most part of 1H 2023 (Feb-May) remained in a narrow range of 4000-4200. The decline of Feb-March was triggered by the banking crisis and reversed with the US Fed stepping in with another dose of liquidity injection.



June was a different story altogether. Technology stocks became the darlings, triggered by Generative AI. Ample liquidity in the system and lack of alternatives in other regions fueled the rally in the technology stocks, particularly those related to A.I. S&P 500 rallied 6.5% during the month, lifting 6M 2023 returns to above 16% (5M 2023 S&P was 9% and FHPF was 8%). This rally though was very concentrated, illustrated by only 4.5% rally (YTD) of S&P 500 Equal weighted index. We had alluded to the narrowness of market returns in our 1Q letter. That turned out to be an understatement!!!

S&P 500 Market Cap Index vs Equal weight

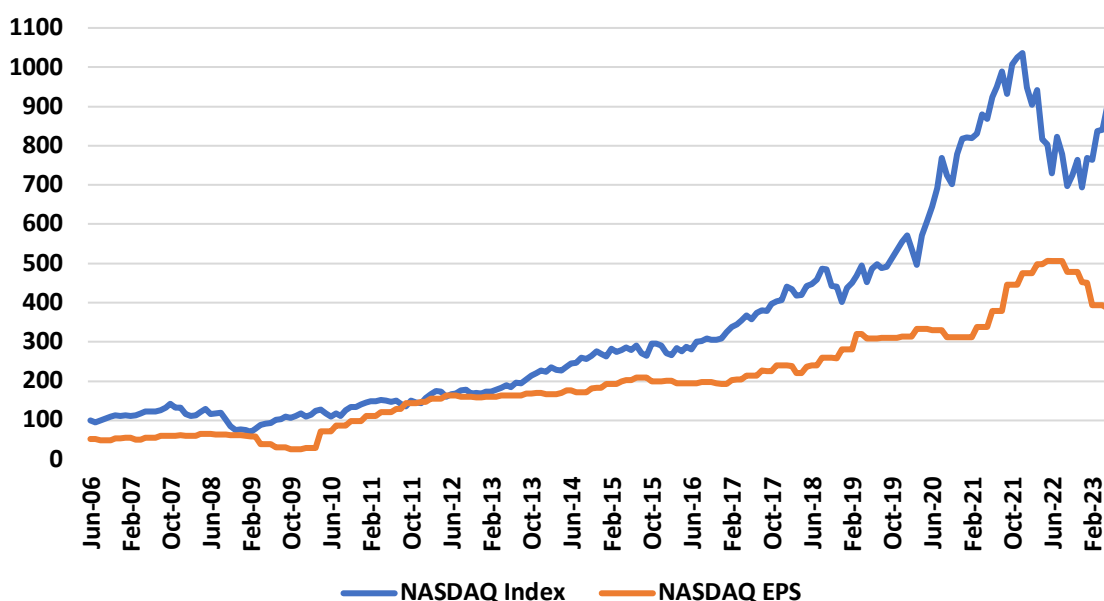


The backdrop of the current market rally can be traced back to the liquidity that the US Fed pumped in during 2020 and supplemented during the recent banking sector crisis. With some of this liquidity channeled towards a few technology stocks, their valuations have expanded to similar levels that they reached in the “bubble” of 2000. Remembering Benjamin Graham, *“as the market level rises, the quantity of players grows rapidly, and their quality diminishes somewhat in proportion”*.

MSCI USA Information Technology Price to Sales



NASDAQ Index & NASDAQ EPS - June 2006 = 100

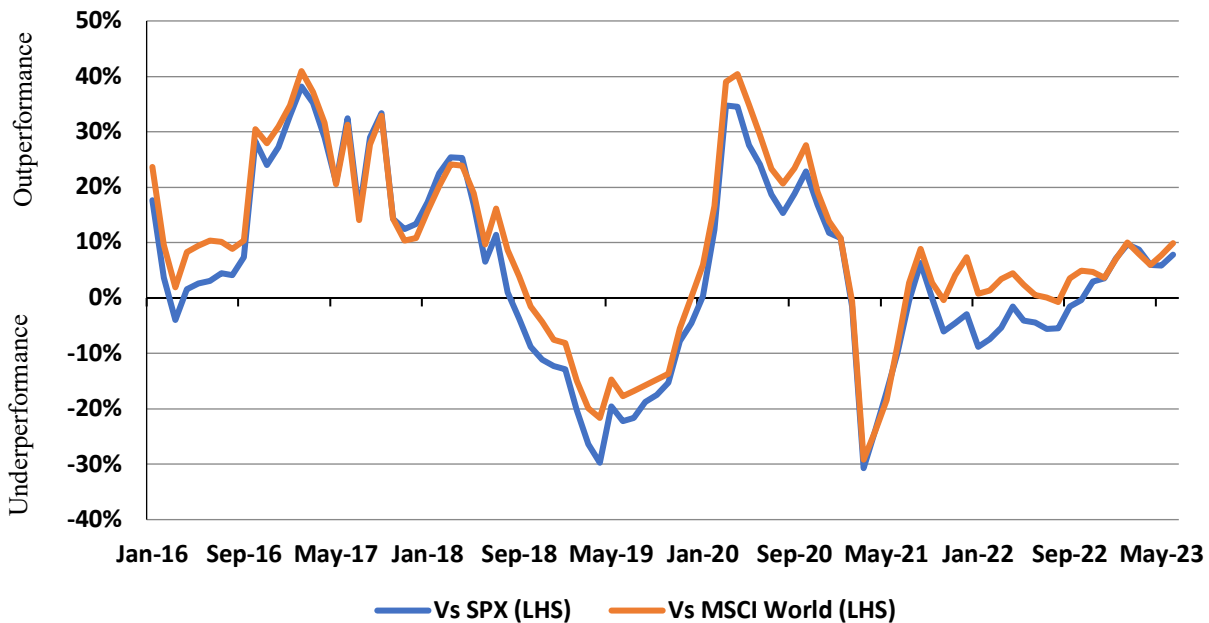


Our Process and Performance

In the first half of this year our average allocation to stocks was 72%, invested in companies that we feel comfortable with in terms of cashflow generation and their ability to withstand economic turbulence. The Fund delivered 10% return in 1H 2023, outperforming all benchmark indices on 12m basis. We think active managers' performance should be graded on at least 12 returns; although the longer the better, as compounding really does its magic over longer periods. On a 12 months' basis we have outperformed the markets more than 85% of the times and are again consecutively beating the market since Sept 2022.

We do not categorise ourselves as a value or growth manager, as our fund has consistently outperformed both the factors over most periods. Although, the brief periods in the last three years where we have underperformed the market are usually where there is a feel of market melt-up led by a very few expensive stocks. It is hard for us to beat the market in those periods without taking the undue risk of accepting higher valuations.

FHPF 12m Rolling Return vs Indexes



Our Process

When analysing the portfolio performance, we conduct a standard analysis of various parameters that influence our decision making. There are two key parameters that we consistently focus on during this analysis:

- 1) Was the performance driven by the allocation decision? E.g., if we were 100% allocated could we have delivered different result?
- 2) Why we were or were not 100% invested;
 - i. Due to valuations?
 - ii. Wrong estimation of the earnings?
 - iii. Due to lack of conviction or macroeconomic uncertainty?

The primary reason for maintaining our allocation in 1H-23 was, 1) elevated valuations of a large part of our portfolio and 2) macro-economic risks due to the hawkish US Fed tone. We could not identify any catalysts (certainly did not imagine any A.I productivity gains) to revise up the earnings of the portfolio companies or cut down the required rate of return.

Here is the table of best and worst performers of the portfolio in first half of this year:

	Absolute Return 1H2023	EPS Growth 2023	P/E 2023	Average Weight 1H2023
Top 5 Performers:				
Microsoft Corporation	42.0%	7.1%	32.28	1.9%
Alphabet Inc	37.1%	19.6%	22.37	5.3%
Brembo SpA	30.0%	3.3%	14.01	3.2%
Icon Plc	28.8%	47.7%	25.05	3.5%
Stryker Corporation	24.8%	12.4%	28.37	3.5%
Bottom 5 Performers:				
Agilent Technologies Inc	-19.6%	-2.4%	21.18	1.8%
Carl Zeiss Meditec AG	-16.0%	3.3%	23.24	2.0%
Universal Music Group	-15.3%	61.7%	16.92	3.0%
SMS Co Ltd	-14.4%	18.4%	33.9	4.3%
EUROFINS SCIENTIFIX	-13.3%	-16.4%	14.18	1.4%

Looking forward: Increasing Allocation

The euphoria around the A.I. driven stocks has created an interesting dynamic in the stock market. In order to get on to the A.I. train investors sold stocks in many good sectors of the market to buy high flying large cap stocks. This created a good opportunity for us to buy very high quality companies which we believe were unduly sold off for the love of A.I. We saw and grabbed those opportunities to increase our allocation by 12% to 88%; most in a month since Oct-2020 when we increased our exposure from 75% to 94%.

This decision is independent of the market situation. We are not forgetting Ben Graham's quote mentioned earlier; *the largest losses have been sustained by investors through buying securities of inferior quality under "favorable general conditions"*. The stocks where we have increased our exposure are trading at much cheaper valuations than they were six months ago when the market was 25% lower. Most of these stocks were significant beneficiaries of the pandemic and have been going through a slowdown in earnings, which we consider to be a temporary phase. We expect these stocks to regain their double-digit earnings growth momentum by the fourth quarter of 2023.

	Performance vs S&P 500	Change in weight	Jan-2022	Jan-2023	Jun-2023
Increased Exposures:					
IQVIA HOLDINGS INC	-0.4%	0.9%	21.5	20.1	19.7
Universal Music Group	-13.2%	1.7%	20.7	22.2	19.3
Vivendi SA	-17.5%	1.3%	9.8	8.3	7.1
Danaher Corporation	-19.1%	1.7%	25.5	23.6	21.4
EUROFINS SCIENTIFIX	-25.0%	2.0%	21.5	15.9	14.1
New Additions:					
Seven and I	0.0%	2.0%	16.1	17.6	17.8
Reduced Exposures:					
Stryker Corporation	32.4%	-1.6%	22.0	22.5	27.1
Microsoft Corporation	31.4%	-0.1%	28.2	22.5	30.9
Alphabet Inc	22.3%	-3.2%	22.8	16.8	20.3
Cochlear Ltd	-2.6%	-2.1%	36.8	40.6	43.8

While defying the trend we have also reduced our exposure to four stocks including Microsoft and Google that have outperformed the market massively and are now trading at an expensive valuation. We also reduced our exposure to Stryker and Cochlear which also have had a very good run in the last six months. We increased our exposures to both stocks last year when they underperformed as market got worried about the delay in elective procedures after pandemic.

We added one new company to the portfolio, Seven & i Holdings. Here is a brief summary of our investment thesis.



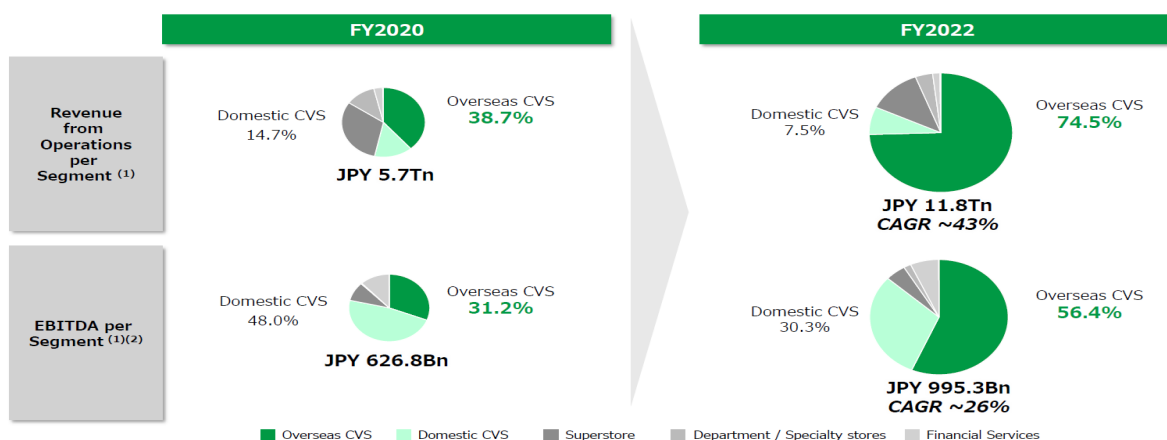
Observing global consumption trends, we have noticed the consistent strong performance of convenience stores. This can be attributed to the increasingly denser living conditions in developed economies and the shift towards smaller, more frequent shopping trips. Consequently, we have identified several companies worldwide that stand to benefit from this trend.

Due to their business structure, these companies enjoy significant market power, attractive profit margins, and the potential for expansion into emerging markets. As a result of our research, we have initiated an investment in Seven & i Holdings Co., Ltd., the Tokyo-based owner of the highly successful 7/11 franchise.

With a global network comprising 85,000 stores across 20 countries, Seven & i Holdings focuses primarily on convenience stores, although it also holds legacy assets such as superstores and specialty stores.

It is worth noting that Japanese companies have historically struggled to generate high returns on capital for investors, even with high-quality assets. Given the steps Seven & i Holdings is taking to improve the company, we believe we have made our investment at an attractive valuation.

The accompanying charts illustrate the two-year transition period, highlighting the company's increasing emphasis on global convenience stores and the superior performance of this segment compared to other businesses within the group.



In addition to expanding their store count, Seven & i Holdings is leveraging its distribution advantages and enhancing the food offerings within their stores. This strategy has proven highly successful among consumers and has been accompanied by excellent profitability. Over the past decade, food sales in global convenience stores have grown by over 10% annually, while maintaining strong group gross margins in the mid-to-high teens.

Seven & i Holdings has unveiled a medium-term management plan with financial targets that have already been upgraded, and we anticipate corporate actions through M&A in the future.

The company's forecast indicates that its earnings per share (EPS) will more than double between 2021 and 2025, and they are on track to achieve this goal. They still have excellent runway to deploy capex and have seen an improvement in ROE strongly into double digits.

Thank You.