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BA Beutel Goodman U.S. Value Fund

Q4 2023 Review | December 2023

For institutional investors and professional clients only.

Investment Approach

The BA Beutel Goodman U.S. Value Fund uses bottom-up, fundamental research to invest in companies at discounts to their business value, defined as the present value of their sustainable free cash flow. The managers believe that stocks bought at a meaningful discount to business value may offer an inherent margin of safety[1] and return potential. A focus on quality companies with stable, growing businesses and strong balance sheets should mitigate the potential of permanent capital loss.

- Concentrated portfolio of highest conviction ideas—typically 25-35 holdings in a diversified portfolio.
- Minimum expected return requirement of 50% on initial investment over three years—long-term investors with a multi-year horizon.
- Process-driven sell discipline—one-third sale of stocks that exceed their upside target; secondary review for stocks that exceed their upside or downside targets.

Overview

- The portfolio outperformed the Russell 1000 Value Index over the quarter.
- At the individual security level, contributors included Qualcomm Inc., American Express Company and Gen Digital Inc.
- Detractors on an absolute-return basis included Polaris Inc., eBay Inc. and Biogen Inc.

Investment Results

The U.S. equity market closed out 2023 strongly, despite some extreme whipsaws in interest rate markets stemming from a hawkish September Federal Open Market Committee (FOMC) meeting in which Federal Reserve (Fed) Chair Jerome Powell indicated that another interest rate hike was still possible before the end of 2023. While the uncertain rate environment, as well as a shock Hamas-led attack on Israel on October 7 created significant volatility in October, markets found more positive footing in November and December following the distinct change in tone from Chair Powell and FOMC meeting notes that revealed the Fed had briefly discussed the timing of potential interest rate cuts in 2024. Against this backdrop, the Russell 1000 Value Index posted a total return of 9.50%. The Real Estate, Financials, Information Technology, Industrials and Consumer Discretionary sectors were the most significant areas of strength, all turning in double-digit returns for the quarter. Energy was the largest laggard, and the only sector with a negative return. For 2023, the Index was up 11.46%, with outsized returns coming from Communication Services (41.67%) and Information Technology (34.05%). The weakest returns came from Utilities (-7.13%) and Health Care (-5.12%).

The portfolio outperformed the Russell 1000 Value Index during the period. On a relative basis, the most significant contribution came from allocation effects, particularly a zero weighting to the underperforming Energy sector. Stock selection in Information Technology and Financials was also a significant source of relative strength. The largest detractor was stock selection in the Consumer Discretionary sector. A zero weighting to Real Estate and an underweight to Financials were also areas of relative weakness. That said, sector and regional allocations in our equity portfolios are driven purely by bottom-up, security-level considerations. As bottom-up stock pickers, we attribute our value add primarily to security selection.

Contributors to performance on an absolute-return basis included Qualcomm Inc., American Express Company and Gen Digital Inc. Qualcomm reported positive fiscal Q4/2023 earnings in November and emphasized that the extended global smartphone chip glut has started to clear. Revenue and EPS both beat expectations, and the company's Q1/2024 guidance was well above Street estimates. American Express rose in the period on solid third-quarter results, with total revenue growth of 13% and billed business growth (which drives transaction fees) of 7%. The loan book remains in great shape, with 30-day past dues flat at 1.2% (the third quarter in a row at that level, despite recession fears). Provisions continued to climb (up 58% year over year) despite seeing no signs of deterioration in credit metrics. In our view, AMEX is proving that its differentiated positioning – with its high-end consumer base in the U.S. and increasingly, in international markets – is a key

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differentiating factor for earnings growth and performance of its loan book. Gen Digital (formerly NortonLifeLock) reported positive earnings for fiscal Q2/2024 in early November, including 27% year-over-year growth in revenue and operating income growth of 41%. After weakness in the shares earlier in the year, the stable recurring operating performance and the ahead-of-plan integration of the acquisition of Avast improved investor sentiment from depressed levels.

The primary detractors on an absolute-return basis included Polaris Inc., eBay Inc. and Biogen Inc. Amid shifting consumer sentiment, Polaris's most recent guidance indicated that EPS would come down by 6% in 2023, ahead of an even more severe decline in 2024, negatively impacting the stock. Given the strength of the franchise over the last few years, we are not surprised by the nearer-term weakness and would note that the valuation, in our view, more than discounts this weakness. We believe the long-term positioning of the business remains excellent. eBay reported Q3 results that met expectations but were overshadowed by lowered Q4 guidance as a sluggish consumer was expected to weigh on holiday sales. Although this was likely not a surprise to investors given other e-commerce players (Amazon, Etsy, etc.) reported similar guidance, the stock price declined in the quarter. The bearish narrative on eBay specifically is that e-commerce as a whole is still growing at 7% while eBay continues to lose share. While we don't take this argument lightly, in our opinion, the company is on the right path despite a current macro situation that is obscuring its solid progress. In addition, the current 10x EPS multiple does not take into account the $4 billion holding in European payments company, Adevinta. This compares to eBay's market cap of just over $20 billion. With the lock-up period now expired, eBay will likely monetize at least some of the investment and allocate the proceeds to share buybacks. When taking this into consideration, the stock trades at an attractive valuation of approximately 8.5x 2024 EPS. Biogen has a number of new product launches in the pipeline, with its new Alzheimer's medication "Leqembi" the standout. However, the market continues to be sceptical on Leqembi's gradual launch process, as well as the challenges of working with doctors and payors for this unprecedented new therapy for Alzheimer's patients.

Transactions

During the quarter, Kellogg Company (parent) spun out its cereal business into a separate entity, WK Kellogg, listed under the ticker KLG. The parent was renamed Kellanova, listed under the ticker K. Kellanova shareholders received one share of WK Kellogg for every four shares held of Kellanova stock. Following this transaction, we added to the portfolio's Kellanova position. We also added to our existing position in American Express.

Outlook

The idea of being contrarian in a frothy market driven by a group of "magnificent" stocks is unappealing, and difficult, but in our view, necessary for downside protection and for superior long-term compounding of returns. In 2023, markets minted yet another year of muted returns for Value stocks when compared to their more exciting Growth counterparts. However, it is worth considering the essence of equity investing: one dollar spent on paper towels is always equal to one dollar spent on digital advertising. This idea is at the root of value investing. Companies across all industries can be profitable, and any profitable company may constitute an attractive investment at a suitable price. At Beutel Goodman, our approach is refined further, to seek to ensure that our portfolio companies are likely to remain profitable through a wide range of scenarios.

Applying this concept to the portfolios provides some examples of success in 2023. Parker-Hannifin, for instance, returned 60% in the year. This company serves 1,000 industrial and aerospace markets representing more than 350,000 clients globally. The company has continued to break its own all-time profitability records. Meanwhile, its stock continues to trade at undemanding valuation levels, reflecting its perception as a large and complex industrial goods manufacturer. Tempur Sealy, the undisputed mattress industry leader, returned 50%, despite an initial valuation that reflected a "structural decliner" facing industry competition, limited growth and a slow replacement cycle. In the Information Technology sector, which could be considered "non-consensus Tech", NetApp returned 50% in the year as it coordinated its data-storage offerings with cloud providers. Qualcomm posted a 34% return in 2023 from a modest valuation that reflected the maturity of the global smartphone market, in line with the overall Index sector return of 34%. Similarly in the Communication Services sector, Comcast returned an impressive 28%.

Value stocks have lagged their Growth counterparts for much of 2023, and indeed for much of the last 15 years. The combination of extreme divergence of a handful of stocks compared to the broader markets, and contradictory macroeconomic signals that continue to throw curveballs at asset allocators, is setting investors up for an uncertain 2024.

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Growth companies' sizes and valuations create a statistical vulnerability. As an example, Apple stock would likely face sharp declines if investors no longer valued it with a growth premium even if its products continued to sell as they have. Valuation matters: consider that buying Apple and Nvidia stock today could make sense from a product standpoint, but this could turn out to be similar to purchasing, say, Cisco or Oracle stock in the late 1990s. These companies' products remain staples of IT infrastructure today, and their sales have grown. However, Cisco stock remains below its late 1990s levels, and it would have taken an investor 20 years to recoup losses in Oracle stock from the late 1990s. And these are companies that survived profitably, unlike, say, Yahoo or Blackberry.

The P/E ratio gap between Value and Growth in the U.S. large-cap space sits in the 86th percentile of historical observations when looking at the past ~30 years. This demands more growth runway and static industry leadership than in the past to justify, something that is not supported by our disciplined value investing process. Given the wild disparities in equity market performance outcomes in 2023 and the uncertainty facing investors in 2024, we believe investors stand to benefit from a manager that focuses on understanding the fundamental attributes of portfolio companies while aiming to protect on the downside through a focus on both business quality and valuation discounts. Rather than concentrate into one sector or theme, with expectations that each company can rapidly multiply, we seek to invest in a wide range of proven businesses where investment returns over the longer term can reconcile with current profitability. At this time, these opportunities include packaged foods, industrial products and pharmaceutical companies. We look forward to the year ahead and are confident in our portfolio companies' ability to navigate through uncertainty.

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Past performance may not be a reliable guide to future performance and investors may not get back the amount invested. All investments involve risk. The value of the investment and the income from it will vary. There is no guarantee that the initial investment will be returned.

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Performance data above relates to the BA Beutel Goodman U.S. Value Fund (the "Fund"). The BA Beutel Goodman U.S. Value Fund was launched under Brown Advisory's Irish UCITS umbrella on 30 November 2020. The performance is net of management fees and operating expenses. This communication is intended only for investment professionals and those with professional experience of investing in collective investment schemes. Those without such professional experience should not rely on it. This factsheet should not be shown or given to retail investors. Any entity responsible for forwarding this material to other parties takes responsibility for ensuring compliance with applicable financial promotion rules. Changes in exchange rates may have an adverse effect on the value price or income of the product. The difference at any one time between the sale and repurchase price of units in the Fund means that the investment should be viewed as medium to long term. This factsheet is issued in the European Union by Brown Advisory (Ireland) Limited, authorised and regulated by the Central Bank of Ireland. In the UK and other non-EU permissible jurisdictions, this factsheet is issued by Brown Advisory Limited, authorised and regulated by the Financial Conduct Authority. This is not an offer or an invitation to subscribe in the Fund and is by way of information only. Cancellation rights do not apply and UK regulatory complaints and compensation arrangements may not apply. This is not intended as investment or financial advice. Investment decisions should not be made on the basis of this factsheet. A Prospectus is available for Brown Advisory Funds plc (the "Company") as well as a Supplement for the Fund and a Key Investor Information Document ("KIID") for each share class of the Fund. The Fund's Prospectus can be obtained by calling +44020 3301 8130 or visiting https://www.brownadvisory.com/intl/ucits-legal-document-library and is available in English. The KIIDs can be obtained from https://www.brownadvisory.com/intl/kiid-library and are available in one of the official languages of each of the EU Member States into which the Fund has been notified for marketing under the Directive 2009/65/EC (the UCITS Directive). In addition, a summary of investor rights is available from https://www.brownadvisory.com/intl/ucits-legal-document-library. The summary is available in English. The Fund is currently notified for marketing into a number of EU Member States under the UCITS Directive. The Company can terminate such notifications for any share class and/or the Fund at any time using the process contained in Article 93a of the UCITS Directive. Certain share classes of the Fund will also be available for subscription in jurisdictions where the Fund may be lawfully privately placed. Please contact Brown Advisory for more information. Investors should carefully consider the investment objectives, risks, charges, and expenses of the Fund. This and other important information is contained in the Prospectus, the Supplement, and the applicable KIIDs. Read these documents carefully before you invest.

The Fund is a sub-fund of the Company, an umbrella fund with segregated liability between sub-funds. The Fund is authorised by the Central Bank of Ireland as a UCITS pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2011 as may be amended, supplemented or consolidated from time to time (the "Regulations"). The Company has appointed Brown Advisory (Ireland) Limited as its UCITS management company which is authorised by the Central Bank of Ireland pursuant to the Regulations and the Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Undertakings for Collective Investment in Transferable Securities) Regulations 2019, as amended. The investment manager of the Fund is Brown Advisory LLC. The distributor of the Fund is Brown Advisory LLC.

The Fund is a recognised collective investment scheme for the purposes of section 264 of the UK's Financial Services and Markets Act 2000.

The Fund will be available for subscription only in jurisdictions where they have been registered for distribution or may otherwise be lawfully privately placed. Only certain share classes may be registered or privately placed in some jurisdictions, please contact Brown Advisory for more information.

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The **Russell 1000® Value Index** measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The Index is completely reconstituted annually to ensure that new value-oriented equities are included and that the represented companies continue to reflect the characteristics of the Index. Russell 1000® Value Index and Russell® when related to the Russell indexes is a trademark of the London Stock Exchange Group of companies. One cannot invest directly in an index.

[1]Margin of safety is a principle of investing in which an investor only purchases securities when the market price is significantly below its intrinsic value. Even by utilizing a margin of safety strategy, an investor can still lose money.